

**INDUSTRIALIZATION AND  
SPECIAL ECONOMIC ZONES IN INDIA:  
A CASE STUDY OF SPECIAL ECONOMIC  
ZONE IN TAMIL NADU**

*Dissertation submitted to Jawaharlal Nehru University  
in partial fulfillment of the requirements  
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**Master of Philosophy**

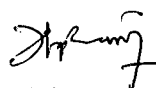
**Kalaiyaran.A**



Centre for the Study of Regional Development  
School of Social Sciences  
Jawaharlal Nehru University  
New Delhi 110067  
India  
2009


## CERTIFICATE


I, Kalaiyaran.A, certify that the dissertation titled “**Industrialization and Special Economic Zones in India: A Case Study of Special Economic Zone in Tamil Nadu**” for the degree of Master of Philosophy is my bonafide work and may be placed before the examiners for evaluation.

  
Kalaiyaran.A

Forwarded by

  
Dr. Atul Sood  
(Supervisor)

  
Prof R.K.Sharma  
(Chairperson)

  
Chairperson  
Centre for the Study of Reg. Dev.  
School of Social Sciences,  
Jawaharlal Nehru University  
New Delhi - 110 067

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## INTRODUCTION

Special Economic Zones (SEZs) as a policy of industrialization have been the subject of much heated debate which is both political and academic in its content. An SEZ, briefly put, is a geographic area intended to contain production units, carved out with the purpose of attracting investment (especially foreign investment), and to increase industrial production geared primarily towards export. There have been many forms in which industrial zones have existed, but Special Economic Zones are characterized by a particular focus on investment and exports, since these are the priorities of the Third World economies today.

The acquisition of land for the purpose of building SEZs has evoked militant and widespread resistance by people who depend on land for their livelihood. Just as the spread of SEZs has been countrywide, so has been the resistance against them. The large-scale displacement caused by SEZs, the nature and scale of resistance, and the brutal response of the state have captured the attention of academics and activists in recent years. Given the high human costs, much debate has been generated about the supposed benefits of the SEZs. The debate has, unfortunately, revolved around the question of displacement and compensation. While both are valid issues, the scope of the debate needs to be extended. The debate on SEZs must also grapple with questions of economic

rationale and feasibility. Certain arguments currently in the mainstream debate on SEZs can be mentioned here. Advocates of SEZs argue that the employment destruction caused by SEZs will be more than compensated by the employment generated. Further, it is argued that the pernicious consequences of the takeover of agricultural land will be compensated by industrial growth. The heavily criticized provisions on fiscal breaks and labour deregulation are sought to be justified in the name of attracting foreign investment. SEZs are being pushed as an effective means of expanding the industrial base and attracting foreign capital to the capital-starved Indian economy. The theoretical premise of the preceding arguments, however, does not adequately engage with the fundamental structural problems of the Indian economy.

Further, given the experience of industrial strategy in the postcolonial history of India, the relationship between the current industrial strategy and SEZs warrants a detailed and comprehensive analysis. Import substituting industrialization based on the Five Year Plans, inspired by Soviet planning, had been in practice in India till the 1980s. A certain amount of industrial growth in the initial period was followed by a period of continued stagnation accompanied by a deceleration of industrial growth. Not surprisingly, it resulted in little structural transformation. The distribution of workforce and patterns of the division of labour did not change significantly. The disproportional distribution across sectors persisted, and unlike the standards set by the experience of developed countries, there was no large scale shift of the workforce from agriculture to industry.

Indian economy in the 1980s was characterized by a narrow home market base and new internal and external contradictions. Import substitution was considered to be a failure, and it was replaced with the strategy of Export-Led Industrialization. The cornerstone of this strategy is laid in foreign investment and export promotion. In keeping with this strategy, various policy measures were adopted, particularly in the 1990s. There was a structural shift in the industrial policy measures geared towards economic reform. From the 1980s onwards the industrial sector experienced some growth, but by the 1990s, a relative stagnation had set in. Lack of infrastructure had compromised the goals of foreign investment and export promotion. Under the prevailing policy regime, it was believed that the creation of sufficient infrastructure was near to impossible. It is in this context that the importance of SEZs is to be ascertained, as they are meant to induce the creation of

requisite infrastructure through investment of private capital. SEZs therefore essentially are part and parcel of the current industrialization strategy. In both the strategies discussed above, industrial growth was driven by public investment and large scale public expenditure. Therefore, the emphasis on creation of infrastructure by private capital through SEZs needs a thorough investigation.

Ever since the SEZ Act was passed by the central government, the number of SEZs has been proliferating, and at present nearly 568 SEZs has received formal approval. The proposed area covered by these approvals is roughly 1,92,574 hectares. A set of massive incentives is being given to the Zones in the form of tax holidays and duty exemptions, in addition to land, water and electricity subsidies. The Finance Ministry has recently expressed serious doubts over the massive tax benefits that is being given to the SEZs, and has also objected to the revenue loss it will cause to the government. An estimate made by the finance ministry based on the first 70 SEZ proposals approved shows that the revenue loss in the form of tax exemptions will be more than one lakh crores. The Reserve Bank of India has also issued notifications stating that by granting loans, SEZ developers will be treated as having exposure to the commercial real estate sector. The ostensible benefits of SEZs are employment generation and infrastructure creation through increased economic activities by foreign investment. However, proper feasibility studies and cost-benefit analysis can only tell us whether it makes rational economic sense to establish SEZs at such high levels of public costs that the government exchequer has to incur in comparison to the revenue and other benefits these zones accrue.

### **Methodology and Data Sources**

This study is based on primary data collected at the SEZ of Nokia India Ltd. in Tamil Nadu, which forms the subject of my case study. Further information and data for the Nokia India Ltd SEZ was procured through RTI application filed in the district collectorate office in which it is located. The Memorandum of Understanding (MoU) signed between the government and Nokia India Ltd. was also obtained through an RTI application. Secondary data has been obtained from various government sources. Data pertaining to the number of Special Economic Zones approved “in-principal” as well as notified SEZs, and the data relating to Export Promotion Zones (EPZs) was collected



from the Ministry of Commerce. The data on the GDP and the sectoral distribution of growth was obtained from the various Statistical Abstracts of the states. Simple statistical tools such as ratios, growth rates, etc. have been used.

### **Literature Review**

I have not done a separate and extensive literature review here, since in all the three chapters, I have substantiated my arguments with the review of relevant literature. However, I have particularly made extensive use the works by Paul Baran, Prabhat Patnaik, David Harvey, Paul Sweezy, A. K. Bagchi to formulate my central arguments. The works of Karl Marx and V. I. Lenin also remain as prime motivation behind my theoretical formulations. I have used a number of published articles on SEZs, EPZs etc. to corroborate my arguments. Although much work has been done on the economic zones in India, detailed and comprehensive academic research papers on SEZs seems to be very few. For instance, while some studies focus only on the employment and growth potential of the zones, others emphasize on the land acquisition process and the related displacement and compensation issues. Nevertheless, a few studies do exist which have attempted to undertake comprehensive studies of the various facets of the economic zones. I have discussed such works in the in the following chapters in detail. It may be mentioned here that the present study will only be an exploratory attempt to examine the SEZs in India in the context of the country's postcolonial industrialization strategies.

### **Chapterization**

In the three chapters that follow, I have tried to discuss the path of industrialization pursued by postcolonial India in historical perspective, tracing back the origins of the economic zones. I have examined in some detail the specificities of Special Economic Zones in India and Asia at large, and finally undertaking a specific case study of a particular SEZ in the state of Tamil Nadu. The following is a brief overview of my arguments in the three chapters.

The first chapter locates Special Economic Zones in the history of industrial strategy in the postcolonial economy of India. The first section deals with the concept of independent

industrialization and its relevance in the postcolonial economy. The development or *mal*-development engendered by colonialism, the de-industrialization and drain of wealth, and the disarticulated development that came about as a result, is dealt with in the next section. Following this, I have discussed the emerging patterns in the international division of labor. Subsequently, the discussion moves to examine different models of planning, and evaluates the limitations and performances of the models discussed. The claim of independent industrialization is also interrogated. The failure of this strategy is evident from the dependency on foreign capital and technology. Various internal and external factors caused a virtual stagnation in industrial growth, thereby setting the stage for a new industrial strategy. The new strategy of export-led industrialization is also evaluated in this section. The theoretical premises of this export-led industrialization with a particular emphasis on foreign capital and export are also examined. I find that despite the claims and promises of both strategies, sixty years hence, a structural transformation of the economy is still a distant dream. SEZs are now being presented as the solution to the problems that the Indian economy is facing. I argue that SEZs are not a structural shift in the industrial strategy, but rather are in continuity with the strategy of export-led industrialization. I further argue that since it is nothing but an extension of the strategy of export-led industrialization, SEZs are not a new strategy in themselves, but a policy innovation within an older strategy. In fact, SEZs are crucial to the working of this export-led industrialization. The final section seeks to offer an alternative theoretical framework for understanding the current phase of industrialization and of accumulation which is being spearheaded by the policy of SEZs. Building on the work of David Harvey and other theorists, I argue that primitive accumulation of capital persists with industrial development led by finance capital in Third World countries, albeit in different forms. SEZs, I argue, can also be understood as a process of primitive accumulation.

The second chapter historically examines the emergence of Industrial Zones. The various forms in which these zones have existed and their distribution across the world is discussed here. Special emphasis is placed on the different forms in which industrial zones have existed and the corresponding industrial strategy in which they were located. This chapter argues that SEZs and EPZs essentially share certain fundamental characteristics in common. While these zones have existed in various parts of the world, they have been concentrated in Asia. An examination of the theoretical premises of EPZs

and their performance over time has been attempted here, with special reference to the Asian experience. Since the proponents of SEZs in the debates in India uphold China as an example to emulate, some attention is also devoted to analyze and evaluate the Chinese experience. In light of the Asian and Chinese experience, the origin and evolution of the zones in India is analyzed. Although the first zone in Asia was set up in India as early as 1964, the growth of zones was minimal till 2000. They proliferated only after EPZs were replaced by SEZs. The differences between the two forms of industrial zones are also briefly discussed. For instance, EPZs were led by the public sector, whereas SEZs are led by private big business and monopoly capital. Additionally, the sectoral distributions of the SEZs are skewed in favour of Information Technology and related services, encouraging real estates and speculative capital. Along with this, there is a palpable tendency for SEZs to concentrate in certain states, and within these states, in certain regions. The last section in the chapter deals with the central SEZ Act of 2005. The act lays down detailed guidelines for the entire process of setting up an SEZ, from the Incentive Structure to the operation and governance in the SEZ. The chapter is concluded with a critical evaluation of the stated objectives and provisions of the SEZ Act.

In the last chapter I intend to examine the stated objectives of SEZs and its economic rationality. A detailed cost and benefit analysis is attempted for the SEZ developed by Nokia India Ltd., located in the outskirts of Chennai. In the first section, the economic status of Tamil Nadu is briefly analyzed. On one hand, in Tamil Nadu the agriculture share in GSDP has come down below the National average, while on the other, the major workforce still remains dependent on the agriculture. The following section deals with the state's SEZ policy. Tamil Nadu is probably one of the few states that had pursued an SEZ policy even before the central SEZ Act was enacted. Similarly, the state also reposes faith in the SEZs for an industrialization drive, as has been conspicuously mentioned in the recent industrial policy of the state. The Memorandum of Understanding concluded between Nokia India Ltd. and the government of Tamil Nadu has been discussed in brief. Subsequently, taking the tax, tariff, and duty concessions as the cost to the government, a detailed cost-benefit analysis is done for overheads like land subsidy, capital subsidy, sales tax (VAT), stamp duty and corporate income tax, etc. Further, the duty forgone is also added to the costs, an expense to the public exchequer which has been severely

indicted by the Comptroller and Auditor General of India. The objective of SEZs mentioned in the SEZ policy like export promotion, net positive foreign exchange, infrastructure creation and employment generation are all taken as benefits. A detailed analysis is taken up on each benefit to show that none of the stated objectives has been realized so far. The analysis proves that export from the SEZ is far below the required level, and so is the stipulated foreign exchange earning. The company has failed to live up to its initial promises of employment generation, and of employing the people who were displaced by its SEZ. The next section deals with the relevance of cultivable land loss to the already deteriorating agricultural sector and food security. The last section focuses on the people displaced and the loss of Common Property Resources (CPR). The way in which the people dispossessed from their land and livelihood are neither absorbed in industry, are also unable to continue on the same way in agriculture, have been discussed in brief. This process corresponds in many ways with David Harvey's concept of Accumulation by Dispossession.

## CHAPTER I

### MAPPING THE TRAJECTORY OF INDUSTRIALIZATION IN INDIA

*The country that is more developed industrially only shows, to the less developed, the image of its own future.*  
– Marx, Capital, Vol. I

#### **Industrialization**

It was a broadly accepted proposition that a post-colonial economy needs an independent industrialization to overcome the centuries-old backwardness reinforced by successive colonial powers. Colonialism not only produced a certain pattern of international division of labour and a production structure to that pattern; but also produced concomitant socio and political structures congruent to that economic structure. Therefore the concept of Industrialization involves not merely a quantitative increase in industrial production but also a qualitative change in the nature of society, with the growth of new social classes and new styles of work and living as well.<sup>1</sup> The notion of independent industrialization particularly

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<sup>1</sup> Bob Sutcliffe (1972), *Studies in the Theory of Imperialism*, Longman, London. p. 174.

involves something more than this. The industrialization process should, ideally, originate and be maintained by social and economic forces within the industrializing country.

An important part of that industrialization process is the notion of markets. Though export markets may have some importance as they used to have in the industrialization of colonized countries, the domestic market now stands paramount. Thus the process of independent industrialization for a post-colonial economy has certain common features. The process cannot be considered wholly independent unless the economy concerned is contained within the borders of a wide range of industries, including economically strategic capital goods industries.

Further characteristics of independence concern the source of finance for industrialization. Economic development only happens when the surplus get in to the hands of those who will use it productively, that is, to finance industrial investment.<sup>2</sup> Generally, foreign capital can be expected to undermine economic and political independence, though essentially what is crucial in that case is control, rather than the source of funds as such. Another element in the process of independent industrialization relates to technology. Technology is a rather abstract concept; it is therefore hard to say in a concrete or precise way what constitutes technological independence. No country in modern times has been technologically isolated. And yet clearly independent technological progress has been one of the cornerstones of all the successful industrializations since the Industrial Revolution in England. The ability and opportunity to replicate, develop and adapt, or at least choose, a technology suitable to a country's resources has been a prime condition of industrialization.<sup>3</sup>

The question of technological independence is related, both casually and consequentially, to the other aspects of the social and political structure of that economy. For instance, if an economy produces goods primarily for the foreign market, it is in nearly all cases forced to use foreign techniques. Furthermore, since foreign techniques tend to be highly capital-intensive, the income they produce is concentrated in a few hands, that is to say highly

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<sup>2</sup> Paul Baran (1957), *The Political Economy of Growth*, Monthly Review Press.

<sup>3</sup> Bob Sutcliffe (1972), *Studies in the Theory of Imperialism*, Longman, London.

unequal distribution of income and asset-holding may further reinforce the tendency of using the same techniques for the goods produced and consumed at home as well. This is because the higher-income and asset-holding class has the tendency to duplicate the tastes and preferences that prevail in advanced capitalist countries.<sup>4</sup>

In short, any industrialization process is shaped and determined by the following factors: location of markets, i.e., whether an economy predominantly depends on exports or home market; nature of the market, i.e., the tastes and preferences that determines the nature and pattern of production; sources of investment capital and completeness of industrial structure; and technology. All of these factors are interrelated in a complex manner and they produce a need of a corresponding socio-political set up to initiate the process that is a need of the State intervention or what is euphemistically called the Developmental State. Particularly, when industrialization starts from a level of extreme backwardness, the role of the state becomes important. And for carrying forward a process of independent industrialization, the State must be largely independent of both local social interests opposed to industrialization as well as of foreign capital interests.

It is in this backdrop that India's industrialization experience should be seen. Although the process of independent industrialization started only in the 1950s, the date of industrialization goes back to the colonial period. The industrialization in the colonial period therefore warrants a brief analysis. It set the stage and shaped the planning in post-colonial India.

### **Industrialization in India: The Colonial Period**

India was one of the main colonies of the British Empire. The relationship between the Indian economy and the British, and its mutual interactions shaped and to an extent determined the structure and pattern of industrial development that took place in the post-colonial India. This determined the major external constraints and the direction of economic

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<sup>4</sup> P. Patnaik (1973). 'The Political Economy of Underdevelopment', *Economic and Political Weekly*, Vol. 8.

policies affecting the economic growth of this country. Thus, it warrants a brief review of the analysis of the impact of the Empire on the pre-colonial India.

All the civil wars, invasions, revolutions, conquests, famines strangely complex, rabid and destructive as the successive action in Hindustan may appear, did no go deeper than its surface. England has broken down the entire framework of Indian society, without any symptoms of reconstitution yet appearing. This loss of his old world, with no gain of a new one, imparts a particular kind of melancholy to the present misery of the Hindu and separates Hindustan, ruled by Britain, from all its ancient traditions, and from the whole of its history.<sup>5</sup>

In the above quotation Marx summarizes how the colonial British rule systematically destroyed all the fibers and foundations of Indian society and in its place brought a distorted and disarticulated development which resembles neither feudalism nor Modern capitalism that was developing in Britain. Its economic policies rather broke down the embryonic forms of indigenous industrial development and created parasitic classes and speculators for its own consolidation.

This process of destruction occurred in two phases.<sup>6</sup> First, through the so called drain of wealth, which one can argue, continued throughout the colonial period but was particularly important in the last decades of the eighteenth century, and the second phase starting after the Napoleonic wars, which involved the decline of handicrafts through factory competition. However, this phenomenon is interrelated and interdependent in some senses. For instance, while India was witnessing de-industrialization and de-urbanization, Britain was surging ahead in the industrialization and urbanization process.<sup>7</sup> And similarly, the transfer of a portion of the Indian taxation revenues to Britain entailed a continuous excess of domestic investment over domestic savings in Britain, which in turn was realized by Britain through maintaining continuous merchandise export surplus from India.

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<sup>5</sup> Karl Marx, 'British Rule in India', *Selected Works*, Vol. I, p. 313.

<sup>6</sup> P. Patnaik (1975), 'Imperialism and the Growth of Indian Capitalism', in R. Blackburn ed., *Explosion in the Subcontinent*, Penguin.

<sup>7</sup> Utsa Patniak (1994), 'India's Agricultural Development in the Light of Historical Experience', in Terry Byres ed., *The State and Development Planning in India*, Oxford University Press, New Delhi.



In order to generate this surplus, considerable monetization and commodity production was introduced producing a tendency towards differentiation among the peasantry. Cash crops were pushed displacing subsistence crops in large scale, entailing a depression of consumption of the poor peasantry. This aspect of commercialization of agriculture was in a way in response to the drive for expansion of exportable goods. Often these exportable goods took the form of primary commodities to facilitate the need of raw materials and wage goods in the expanding industrial production in Britain. In the process, urban handloom industry was more or less totally destroyed. The destruction spread to rural weavers as well. As a result of this process, it appears that Indian capital did not grow and was being pre-empted from its potential markets.<sup>8</sup>

On the other hand modern industry was introduced in the 1850s itself, of which cotton and jute textiles were the two main industries. There was only a sprinkling of other industries like sugar, paper, cement, steel and light consumer goods, some of which in fact benefited from the introduction of "discriminating protection" under the infant-industries argument in the 1930s.<sup>9</sup> For instance, the iron and steel industry was granted protection in 1924 followed by cotton textile in 1927 and sugar in 1932. However, these industries evolved not from growth of native industry, but at the cost of the destruction of much of those native industries. And also irrespective of ownership of firms, whether foreign or domestic, the machinery for these firms was imported, largely from Britain. As the development of modern industry progressed, it kept displacing more workers from traditional industry in large scale, such as the surviving spinners and handloom weavers who produced cloth for the mass consumption.

However, it is argued that the entailed loss of growth and employment due to the destruction of traditional crafts and petty production was compensated or exceeded by the surge in the modern manufacturing sector.<sup>10</sup> But certain studies contradict this argument. For instance the census data for the period 1901-1931 has shown that, even over this shorter and more recent period, the percentages of the industrial working force to the total population, the male

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<sup>8</sup> P. Patnaik (1975), *ibid.*

<sup>9</sup> P. Patnaik (1973), 'The Political Economy of Underdevelopment', *Economic and Political Weekly*, Vol. 8, No. 4/6.

<sup>10</sup> Tirthankar Roy (2000), 'De-industrialization: Alternative View', *Economic and Political Weekly*, Apr. 22-28, Vol. 35, No. 17, pp. 1442-1447.

industrial working force to the total population, and the male industrial working force to the population in the working age group between 10-59, has declined by 10 to 20 percent over the base figure of 1901.<sup>11</sup>

As far as growth of indigenous capital is concerned, there was little scope for it. Given the nature of the transition to modern industry, it seems there was a large gap between the technology embodied in the imported machines and the know-how existing in India. Indeed, even for running the machinery the mills often imported technicians from Lancashire.<sup>12</sup> Since for many products there was a limited market, and the minimum size of the firms based on imported technology was large, Indian industry did not pass through a phase dominated by a large number of small firms competing for markets. And by denying the Indians the right to foster industries by means of State patronage, and thwarting the growth of the Indian capitalist class, colonialism effectively de-industrialized the economy.

However, because of certain strategic reasons, the imperial rule made some concessions to Indian big capital. The government's contract to buy steel helped the Tatas to set up India's first steel plant. Further, the nationalization of the imperial bank gave some space for Indian big business. Indeed, Indian big business houses took over a number of foreign enterprises, for example, in jute, tea and trading. Along with this, the introduction of protection on the infant industry criterion led to notable industrial expansion which made some improvements in the industrial performance.<sup>13</sup> For instance, an estimate, though contested, shows a rise in the proportion of income generated in the sector of secondary industry from 12.7 percent to 16.9 percent, and a fall in the proportion of income generated in the primary sector from 63.6 percent to 46.0 percent between the five-year periods 1900-05 and 1942-47.<sup>14</sup>

In short, the imperial rule drained massive surplus through unequal exchange in trade, transfer of profit, interest payments on account of foreign capital. In this process of draining

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<sup>11</sup> S. Sivasubramanian (1965), *National Income of India 1900-01 to 1946-47*, quoted in A.K. Bagchi (1975).

<sup>12</sup> A.K. Bagchi (1975), 'Some Characteristics of Industrial Growth in India', *Economic and Political Weekly*, April 22, Vol. 35, No. 7.

<sup>13</sup> P. Patnaik (1973), *ibid.*

<sup>14</sup> S. Sivasubramanian (1965), *National Income of India 1900-01 to 1946-47*, quoted in A.K. Bagchi (1975).

surplus, it ruptured important linkages between and within sectors of India's economy. These were the linkages through which in the normal historical course, that is, the course taken by the original capitalist countries, capital accumulates, expands itself over and over, and transforms every sector of an economy from within. While certain internal linkages were broken, certain external ones were strengthened out of proportion. This prevented accumulation in some sectors, and diverted surplus to others for the purpose of the drain, stunting industrial growth in large sectors and exaggerating it in select ones.

### **Industrialization in India: The Post-Colonial Period**

The nature and pattern of post-colonial industrialization in India was in a way shaped and determined by the colonial legacy itself. Though there are debates in assessing the impact of colonial rule on industrialization, the arguments and experiences discussed in the earlier section shows quite conclusively that it has brought De-industrialization by replacing native industry, drained economic surplus thereby preventing accumulation of capital, made industry dependent on foreign markets keeping home market at narrow base. Even those industries that were developed were capital intensive due to the technology that was used.

As any other third world country, India also ventured into the phase of self-reliant and planned independent industrialization. Influenced by Soviet industrialization, the state was supposed to play a major role in the planning process. However, the nature of the state, and its role in industrialization process was recognized by big business groups as early as in 1938, when the National Planning Committee of the Indian National Congress was formed with such eminent spokesmen of Indian business enterprise as Seth Purushotamdas Takurdas in it. The national planning committee was followed by the so-called Bombay Plan authored by big industrialists like J. R. D. Tata and G. D. Birla, among others, in 1944, which put forward a virtual manifesto for state intervention in the industrial economy of India.<sup>15</sup> Though there were other plans floated by different eminent persons, such as the "People's Plan" by M. N. Roy and the Gandhian Plan, emphasizing more on village-based industries, it was only the Bombay Plan which became the blue print for the Five Year plans to be

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<sup>15</sup> Sanjay Baru (1988), 'State and Industrialization in a Post-Colonial Capitalist Economy: The Experience of India', *Economic and Political Weekly*, Jan. 23. Vol. 23. No. 4.

implemented later. The Bombay Plan clearly delineated the role of state in the industrialization process. Recognizing the narrow internal market base, the Plan argued the need of public investment and public expenditure to provide basic infrastructure.<sup>16</sup> But unlike developed countries, where groups of industrialists stood for agrarian revolution and land reform to create internal market, the big industrialists did not stand for it, but rather relied on the state for creating such a market.

However, the aims and objectives of the industrial policies for the Five Year plans were contained in the industrial resolutions of 1948 and 1956.<sup>17</sup> The policies were aimed at a rapid acceleration of industrial growth and increases in productivity by breaking the barriers in a predominantly agrarian economy. Four initiatives were considered crucial to realize this objective.<sup>18</sup> First, a widening and intensification of protection offered to the manufacturing sector through an across-the-board increase in tariffs and the institution of quantitative restrictions on imports. Second, a massive step up in public investment, which would not only bridge such infrastructural gaps which could hamper industrial development, but directly through purchases of commodities and indirectly through the creation of additional incomes would result in a rapid growth of the protected home market. Third, a sharp increase in the rate of savings, accompanied by measures like taxation to channelize these funds to the state, as well as through the meditation of the state financial institutions to the private sector. And finally, the introduction of a wide range of controls on capacity creation, production and prices in accordance with the strategy of industrialization adopted by the government.

Further, the introduction of Mahalanobis model which was implemented in the Second Five Year Plan emphasized the public sector and highlighted the incomparably great role of public investment. In fact, the policies contained in the above resolutions clearly outlined the role of public and private sectors. The public sectors were supposed to develop overheads and basic and heavy industries that involve large-scale high-risk capital investment. The rest was supposed to be developed by the private sector. Public investment, it was assumed, would

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<sup>16</sup> V.S.S. Shastri (1944), *ibid.*

<sup>17</sup> P. Patnaik (1979), 'Industrial Development in India since Independence', *Social Scientist*, Jun., Vol. 7, No. 11, pp. 3-19.

<sup>18</sup> C.P. Chandrasekhar (1988), 'Aspects of Growth and Structural Change in Indian Industry', *Economic and Political Weekly*, Nov., Vol. 23, No. 45/47.

play a dual role: one was to eliminate to some extent the serious gaps in the production structure, which the private sector would have been reluctant to overcome on its own and second, to provide a stimulus to private investment by extending the markets of private industrialists directly and indirectly. To ensure that private investment did not suffer from a lack of long-term funds which it might have, owing to the narrowness of the long-term capital market, a series of specialized financial institutions were set up.

However, the model also recognized certain constraints consisting of savings and the availability of foreign exchange. The model recognized that in the long period before the investments in basic industries could be used to increase the output of objects of consumption, there would be a shortage of consumer goods. This shortage, it was assumed, could be made up by production in the cottage industries.<sup>19</sup> The disproportion in the industrial sector was to be made up by the agricultural and handicraft sectors.

### **The Phase of Import Substituting Industrialization (1950s-80s)**

With the above set of assumptions and presumptions the Indian economy entered into what is known as import substituting industrialization. The import substituting process did not occur at any particular point in time. The process had many phases though the second five year plan stands out as the most important phase.<sup>20</sup> The first phase, lasting roughly up to the middle of the First Five Year Plan, witnessed the substitution in imports of such ordinary consumer goods as cotton textiles or sugar etc. While there was some development of basic goods and even of capital goods in this period, the perspective to carry on a continued and sustained growth was lacking. So the level of growth remained rather minimal. It was only after the second Five Year Plan that the momentum picked up. The period witnessed a determined thrust towards substitution in basic and capital goods industries with a view to raise the rates of growth of demand for and supply of capital goods industries.<sup>21</sup> And from the middle of the Third Five Year Plan the substitution took over the goods like luxury

<sup>19</sup> D.N. (1988), 'Political Economy of the Nehru Era', *Economic and Political Weekly*, Vol. 23, No. 45/47.

<sup>20</sup> A.K. Bagchi (1977), 'Export-Led Growth and Import-Substituting Industrialization', *Economic and Political Weekly*, Feb., Annual Number, Vol. 12, No. 6/8.

<sup>21</sup> A.K. Bagchi (1975), 'Some Characteristics of Industrial Growth in India', *Economic and Political Weekly*, Feb., Vol. 10, No. 5/7.

fabricated goods, mainly consumed by upper strata of the income class. According to an estimate, import substitution was accounted for 23 percent of the total output growth of all industries over the entire period 1950-51 to 1965-66.<sup>22</sup>

**Table 1.1**

**Rate of growth the Index of Industrial Production**

Period	Industry	Manufacturing	Mining and Quarrying	Electricity
1951-65	7.2	7.1	5.9	13.6
1966-75	4.0	3.7	3.2	9.0
1976-86	4.9	4.2	7.3	7.2

Source: C.P. Chandrasekhar (1988), *Aspects of Growth and Structural Change in Indian Industry*.

As shown in the table, the period of 1951-1965 witnessed an unprecedented spurt in industrialization as the index of industrial production registered an average growth rate of about 7.2 percent per annum for industry as a whole, a rate which was higher than anything recorded over a comparable length of time in the past. Even the manufacturing sector witnessed a growth of 7.1 percent and electricity 13.6 percent for the same period. However, the unprecedented growth came to an end within 10 years of the planning in real sense and entered a phase of secular stagnation. As the above table shows, between 1966 and 1975, the rate of growth of the index registered only 4.0 percent for the industry as whole. In fact, even if we exclude mining and quarrying and electricity from the index, the decline in growth has been steeper, manufacturing declined from 7.1 percent during 1951-65 to 3.7 percent during 1966-75 and 3.8 percent for the later period. It appears that this persistence of the

<sup>22</sup> C.P. Chandrasekhar (1988), 'Aspects of Growth and Structural Change in Indian Industry', *Economic and Political Weekly*, Nov., Vol. 23, No. 45/47.

deceleration rendered the first 15 years of post-colonial development with an exceptional interlude in an otherwise long history of stagnation that started in the colonial time.<sup>23</sup>

At the surface level, it appears that the reason for the inability of the industry to sustain its growth lies in the industrial policy itself. Some analyses suggest that two factors were responsible for bringing the high growth of the first decade followed by the unacceptable low. One argument was that the growth arising from protection had exhausted itself. The premise of this argument is that once the domestic markets have been captured by indigenous producers from foreign ones, any further growth depends on the growth of the market as a whole.<sup>24</sup> The second aspect is the role of public investment. Given the structure of the industry, it appears that if the rapid pace of expansion of industry had to be sustained, public investment had to grow at an even faster rate than before in order to balance the exhausted market protected by import substitution. For instance, capital formation in the public sector, which registered a rapid rate of increase till the mid-1960s, subsequently decelerated sharply and grew at a compound rate of just 3.2 percent per annum in the period till the late-1970s<sup>25</sup>.

**Table 1.2**

**Rate of growth the Index of Industrial Production**

Industry group	1951-55	1955-60	1960-65	1965-76
Basic Goods	4.7	12.1	10.4	6.5
Capital goods	9.8	13.1	19.6	2.6
Intermediate Goods	7.8	6.3	6.9	3.0
Consumer goods	4.8	4.4	4.9	3.4

**Source:** S. L. Shetty, *Structural Regression in the Indian Economy since the Mid-Sixties*, Table-1, pp. 186.

Given the growth in the composition of goods, these arguments are quite convincing. For example, as shown in the table above, the fact that the growth rate of basic goods increased

<sup>23</sup> C.P. Chandrasekar (1988), *ibid.*

<sup>24</sup> A.K. Bagchi (1977), *ibid.*

<sup>25</sup> Deepak Nayar (1978), 'Industrial Development in India: Some Reflections on Growth and Stagnation', *Economic and Political Weekly*, Aug., Vol. 13, No. 31/33.

from 4.7 percent to 12.1 while capital goods rose from 9.8 percent to 13.1 percent, strengthens the argument that the high growth rate was generated by the large scale of public investment. However, the debate on the deceleration and stagnation is a most contested terrain. Nonetheless, certain structural problems can be discerned, like the fact that high growth in industry witnessed in the initial period was also accompanied by the low agricultural growth. This shows that the industrialization process was predominantly led by public investment coupled with public expenditure without any structural change. Since the unequal agrarian structure was kept intact, once the market provided by public expenditure vanished, the industry could not sustain a high growth for long. However, there are certain other explanations in terms of trade in favour of agriculture. This emerges from the fact that the government set higher prices for agricultural goods against industry. Some argue that due to export pessimism, excessive control on production structure that produced inefficiency were the main reasons for the deceleration and stagnation of industrial growth.<sup>26</sup> Nonetheless, it appears that an unequal agrarian structure on the one hand and extremely concentrated monopoly capital<sup>27</sup> on the other were reasons for which the agricultural sector could not produce a sustained market for the industry. Apart from the market, technology and source of finance play a major role in any independent industrialization process.

### **Foreign Capital**

Although industrial growth was remarkably higher in the first three Five Year Plans, the fact that this growth was also accompanied by a considerable increase in the country's indebtedness makes one question the independence in the source of finance for industrialization. It is generally expected that foreign capital undermines the industrialization process in the Third World countries.<sup>28</sup> In case of India too, foreign capital kept coming in the period under review in the form of External Assistance and investments in joint ventures. However, this new foreign capital differed from the old that was prevailing in colonial times in certain aspects. The new investment was interested in the modern and technologically

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<sup>26</sup> J. Bhagwati (1998), 'The Design of Indian Development', in IMD Little, ed., *India's Economic Reforms and Development*, Oxford University Press, New Delhi.

<sup>27</sup> K. Bharatwaj (1982), 'Change and Choice in Indian Industry', *Social Scientist*, Vol. 10, No. 6

<sup>28</sup> Bob Sutcliffe (1972), *ibid.*



advanced sectors of the industry and it relied more on the participation of Indian capital which was facilitated by the emergence of Trans National Corporations. For instance, between 1948 and 1955, only collaboration agreements were approved by the government, but the number of such approvals increased on an average of nearly 400 per year for later periods. The foreign exchange crisis of 1957-58 had led to drastic import controls, including quantitative restrictions. The resulting protection, combined with large government expenditure, created extremely profitable markets in India for a whole range of commodities. To exploit this market Indian capital had to necessarily turn to foreign countries for technology. Foreign capital was attracted both by the expanding market and by the need to jump tariff barriers.

Similarly, in the name of external assistance, foreign funds kept flowing in progressively. For instance, at the end of the First Plan, total external assistance excluding grants and net of amortization stood at Rs. 196.6 crores, but by the end of the Third Plan, this figure had increased to Rs. 6199.4 crores. The Second and the Third Plan periods, which witnessed a marked tempo of industrialization were also characterized by heavy inflows of foreign aid. The gross aid inflow exclusive of grants was Rs. 2199.6 crores during the Second Plan and Rs. 4364 crores for the Third Plan.<sup>29</sup> As shown in the table the aid share was increasing progressively over the period of time.

**Table 1.3**

**Growth of Foreign Aid Relative to Other Variables (Aid flow as percentage of)**

	<b>1950-51 to 1955-56</b>	<b>1956-57 to 1960-61</b>	<b>1961-62 to 1965-66</b>	<b>1966-67 to 1969-70</b>	<b>1970-71 to 1975-76</b>
Net investment	5.9	13.0	17.2	23.6	13.2
Plan outlays	10.0	19.1	23.5	33.1	23.0
Imports	5.4	18.2	32.4	40.6	31.5
Trade Balance	33.4	48.5	84.1	132.6	185.9

Source: Prमित Chaudhury (1978), *Indian Economy: Poverty and Development*, quoted in Patnaik (1979).

<sup>29</sup> N.K. Chandra (1973). 'Western Imperialism and India Today-II', *Economic and Political Weekly*, Feb. 17, Vol. 8, No. 7.

The share of foreign aid as a proportion of net investment, of plan outlays, of imports and of trade balance increased dramatically over this decade. Amortization and interest payments on this huge accumulated debt amounted in 1966-67 to as much as 16.3 percent of India's total export earnings.<sup>30</sup>

Interestingly, the source of this Aid also shows how the economy was moving towards a particular developed economy which primarily served the interest of the later. For example, during 1958-62, India topped the list of the recipients of U.S. aid, receiving 12.3 percent of the total international aid disbursed by that country. It was placed only second to South Vietnam with 8.4 percent of the total aid dispersed in the period 1963-68, before sliding to the fourth position with 2.9 percent of the total aid dispersed in 1969-74. However, India topped in the above-mentioned two phases receiving 14.8 and 13.9 percent of the total U.S. economic aid while being placed second in the last phase with 4.9 percent of the share.<sup>31</sup>

### **Foreign Technology**

Alongside external financial dependence, technological dependence also increased during this period of planning, and with it the role of the multinationals in the Indian industrial sector also grew. The old private foreign capital, which had operated in the colonial period, worked mainly through branches in India or through managing agency houses.<sup>32</sup> The new private foreign capital which entered particularly during the Second and Third Plan years went into technologically intensive areas and produced mainly for the domestic market, which was cordoned off by high protective barriers. The mode of entry was through the Multinational Corporations and the form of its operation was through joint-ventures with Indian capital, and in a majority of cases, holding minority shares in Indian companies.

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<sup>30</sup> P. Patnaik (1979), 'Industrial Development in India since Independence', *Social Scientist*, Jun., Vol. 7, No. 11, pp. 3-19.

<sup>31</sup> Richards, Lynn (1977), 'The Context of Foreign Aid: Modern Imperialism', *Review of Radical Political Economics* (RRPE), Vol. 9, No. 4, p. 63, see Table 2 & 3.

<sup>32</sup> P. Patnaik (1988).

The actual flow of investment into India was small and the outflow on account of royalties, technical fees, dividends and capital repatriation more than matched the inflow, so that the overall balance of payments effect of private foreign investment was negative.<sup>33</sup> However, the extent of foreign control over the Indian private corporate sector was defined. For example, the ratio between the total capital employed in branches of foreign companies and the capital employed in the entire private corporate sector increased. By the end of March 1961, this ratio stood at 25.86 percent which at the end of March 1965 had climbed up to 30.57 percent.<sup>34</sup> If control was to include technological control as well, even when the proportion of shares held was low, the extent of such control in 1967-68 would have been around 40 percent of the entire private corporate sector. This foreign capital control on domestic industry not only reflects financial dependence, but also the dependence for technology.

Given the nature of distribution of income, the protective domestic market was dominated by luxury consumer goods and capital goods. Therefore the needs of the market pushed Indian capital to seek foreign collaboration in technology, among others. However, such collaborations did little to promote indigenous research. On the contrary, many of them explicitly prohibited indigenous research so that technological dependence and technological parasitism got perpetuated. Even the public sector was not spared in this regard. These sectors did not produce technology but simply used them. And this aspect is as relevant even today, as hardly any project is put up in the engineering, basic metals, chemicals and pharmaceuticals sectors without entering into foreign collaboration. Moreover these collaborations with foreign capital not only thwarts long term self-reliant growth, but also helps foreign capital to conceal outflow by transfer price<sup>35</sup>, a feature which is dominant in the operations of Multinationals. In short, this whole process of development produced a new division of labour: on the one side the MNCs dominated the technology intensive production, at times in joint venture with Indian capital, and on the other there existed a low level of standardized technology used by small capital.

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<sup>33</sup> N.K.Chandra (1973), *ibid.*

<sup>34</sup> P. Patnaik (1988), 'On the Political Economy of Economic "Liberalisation"', *Social Scientist*, Jul-Aug., Vol. 13, No. 7/8, pp. 3-17.

<sup>35</sup> N.K. Chandra (1973), *ibid.*

## Employment

Historically, Industrialization implies that the industrial (non agricultural) population grows faster than the agricultural and diverts an ever-growing part of the population from agriculture to manufacturing industry.<sup>36</sup> There was a celebrated paper by Arthur Lewis that recognized the existence of 'dual economy' in India.<sup>37</sup> Terming one sector as 'capitalist' broadly identified as industry and the other sector as 'subsistence' broadly identified as agriculture, he predicted that the 'capitalist' sector would grow and finally eliminate this dualism. Indeed Lewis pointed out that the vast under-employed labour force in agriculture was available to industry at near-subsistence wages. This would make it profitable for capitalists to expand production, and hire more workers, ploughing back their entire profits into further expansion, until the excess labour force in agriculture was fully absorbed.

However, the industrialization process had virtually negligible impact on such movement of the workforce. The vast underemployed and unemployed labour forces are still hold back in agriculture despite the growth of industry, and the dualism persisted. For instance, as shown in the table below, the ratio of the total industrial workforce taking large and small industry together, to the total workforce in 1971, was no higher than in 1901. The industrial workforce percentage in the total workforce which was at 10.74 percent in 1901, came down to 9.49 percent in 1951 due the colonial deindustrialization process, and rose only to 9.98 percent in 1971. This figure grew by a mere 0.48 percent for the entire period of planned industrialization in India.

**Table 1.4**

### Proportion of Workforce in Industry (in millions)

Year	Total Work Force	Industrial Work Force	Percentage
1901	110.712	11.879	10.74
1931	123.603	10.234	8.28
1951	139.890	13.284	9.49
1961	189.190	18.825	9.95
1971	180.373	17.990	9.98

Source: J. N. Sinha (1972), *The Indian Working Force: Its Growth and Changing Composition*, quoted in Patnaik (1979).

<sup>36</sup> Lenin, V.I., *The Development of Capitalism in Russia*, Progressive Publishers, Moscow, p. 69.

<sup>37</sup> Lewis, Arthur (1954) 'Economic Development with Unlimited Supplies of Labor', Manchester School.

And further, the period witnessed growth in unemployment. For instance, the annual compound growth rate of factory employment was 1.7 percent during the First Plan, 3.9 percent during the Second Plan and 5.7 percent during the Third Plan, which has been followed by a more or less secular stagnation. For the entire period between 1951 and 1968 the rate comes to 2.9 percent, which was just about enough to absorb the natural growth of the total employed labour force. This could not make much dent in the distribution of workforce. Further, the industrial stagnation that ensued since the mid-1960s has in fact worsened the unemployment situation. For instance, between March 1966 and March 1977, the total employment in the private and public sectors taken together in mines and factories rose from 5.195 million to 6.258 million, an average annual increase of a mere 1.7 percent which was far less than the growth of industry.<sup>38</sup>

On the other hand, in spite of the industrial upsurge for three Five Year Plans, the real wages were in virtual stagnation. In short, the nature of industrialization produced a marginal employment pattern, growing unemployment, stagnant real wages and almost complete technological parasitism. Given the distribution of income and assets, the kind of goods produced were largely capital goods and luxury consumer goods, which are generally characterized as capital intensive industries, were in a way incapable of generating substantial employment. Further, it was estimated that in India the amount of fixed investment required to generate one job in the mines and organized industry sector was as high as Rs. 39,000 during the Third Plan.<sup>39</sup> And among the Asian countries, it was observed that in many cases India and Pakistan used less labor-intensive techniques than even Japan.

In short, as any other Third World country, the Import Substituting Industrialization that was started in the post-colonial period could not be sustained in India for long. Though it had produced a decent growth rate in the initial decade, the following decades only witnessed deceleration and continuous stagnation, producing the so-called Hindu growth rate for the economy as a whole.<sup>40</sup> It brought only a marginal change in the employment pattern that existed in the colonial times, resulted into stagnant wages, growing unemployment, near-

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<sup>38</sup> P. Patnaik (1979), *ibid.*

<sup>39</sup> P. Patnaik (1979), *ibid.*

<sup>40</sup> The term coined by K.L. Krishna for the average growth rate of GDP 3.5 percent for the last three decades.

complete technological parasitism, and growing indebtedness to foreign countries. It merely perpetuated the existing unequal asset and income distribution. The explanation for this stagnation varies in accordance with the theoretical premise one takes. Therefore, each of them warrants a separate detailed analysis, though only a brief analysis of them is attempted here.

### **The Pro-Market Explanation**

The theoretical premise for the pro-market explanation of stagnation emerges from a Neo-classical perspective. It argues that before the import substitution process started, the economy had a fair degree of industrialization. For example, textiles and steel were among the many industries that had come up exclusively from market forces and with domestic investment without any infant industry protection and promotion.<sup>41</sup> The whole scheme of development produced a parasitic and inefficient public sector, export pessimism, a rent seeking class<sup>42</sup> and a license-quota system. As the economy turned inward, the absence of competition and its effects on efficiency were lost. Export pessimism, rather export bias, was mainly responsible for this technological parasitism, and if it was sufficiently countered, substantial export earning would have enabled the economy to import equipments that embodies technical change. The license and quota system only produced a rent seeking bureaucratic class. And last but not the least, the inefficient public sector crippled the efficiency of the private sector too, since the public sector enterprises supplied or rather failed to adequately and efficiently supply infrastructure inputs such as electricity and transportation over which they were granted monopoly of production.

### **Alternative Explanation**

Alternative explanations to the above formulation also vary in their different theoretical positions. However, there are certain commonalities in these explanations, which are summarized below. From their perspective, the whole strategy of industrialization was based upon the twin stimulus of protection and public investment. As the state started withdrawing

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<sup>41</sup> J. Bhagwati (2006), 'The Design of Indian Development', *India's Economic Reforms and Development*, Oxford University Press, New Delhi.

<sup>42</sup> Anne Gruger refers to bureaucratic control on quotas and license.

from public investment due to the fiscal crisis –a product of the same strategy– industrial stagnation ensued in the country. Next is the argument of the terms of trade in favour of agriculture. The reasons for this shift are variously described, but one factor pointed out in all explanations is the great bargaining strength of the surplus producing agriculturists, especially since the so-called “Green Revolution”. Another convincing explanation to the industrial stagnation emerges from the fact that the economic surplus in the hands of large farmers and large industrialists had increased as a proportion of national income since late 1960s, and this surplus was used mostly for speculative purposes rather than for production.

In short, it would not be an exaggeration to say that the experience of the import substitution-led industrialization has been characterized by the absence of a bourgeoisie and the absence of a proletariat. Because the features of that same colonial agrarian structure was intact, persistence of the distribution of workforce among sectors, technological and financial dependence, all adds up to buttresses the proposition that the Third World countries did not develop their industries under capitalist relations.<sup>43</sup> However, the early 1980s witnessed a change in the industrial policies which came to be known as export promotion strategy, though without disturbing the existing social and economic structure.

### **Export-led Industrialization**

The Indian economy, like other Third World economies which followed the import substitution-led industrialization, ended up with huge public debt and unsustainable deficits, growing regional inequality and secular stagnation of the industry, owing to a combination of internal and external factors. However, the same strategies also produced a new set of contradictions, leading to changes in the internal and external policy structure aimed at bridging the imbalance between the possibilities of domestic production and the patterns of production. The old contradictions however remained intact in the meantime. Following the experience of “Asian tigers” like South Korea, Taiwan, Hong Kong and Singapore, it was

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<sup>43</sup> Paul Baran(1957). *The Political Economy of Growth*, Monthly Review Press.

argued that export-led industrialization would solve the problem and bring the industrial sector into a sustainable growth mode.<sup>44</sup>

Before entering into the domestic factors, the recent changes in the external front warrant a brief analysis. In this, two factors emerge as relatively more significant: first, the emergence of finance capital,<sup>45</sup> and second, the concept and practice of subcontracting followed by Multinational Corporations.<sup>46</sup> The former, or the emergence of finance capital, is normally dated to the late 1970s. Till then, the private international financial system played only a limited role in recycling financial surpluses. But by the late 1970s, the system was abound with funds generated by Petro-dollars and strengthened by the financial liberalization in the developed countries.

The second significant factor is the rise of MNCs and the concurrent growth of the system of subcontracting. International subcontracting becomes all the more important for our analysis because multinational corporations played a major role in shaping export-led industrialization in the Third-World countries, and controlled their exports in the process of subcontracting. Central to the growth of Third-World exports of manufactured goods to the developed countries has been the system of international subcontracting.<sup>47</sup> In the past, export-led development concentrated on the sale of primary commodities to the developed capitalist countries. Under international subcontracting, however, it was to be based on the production and export of manufactured goods. As the import substitution started getting exhausted in the Third World countries, the above new development in the external front became a way out to attempt the revival of industrial growth with the help of foreign capital and export market. Among the domestic factors for the change in the industrial policy the following are among the most important. The home market was narrow-based, and it was expected that if the regulatory measures were dismantled, the industrial sector would automatically lead to the setting up of export-oriented industries that enjoy competitive advantage. In the process,

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<sup>44</sup> Arun Ghosh (1985), 'Industrial Policy and the Economy', *Social Scientist*, Sep., Vol. 13, No. 9, pp. 3-15.

<sup>45</sup> Patnaik (1988), *ibid.*

<sup>46</sup> Martin Landsberg (1979), 'Export-Led Industrialization in the Third World: Manufacturing Imperialism', *Review of Radical Political Economics*, Vol. 11, pp.50-63.

<sup>47</sup> The subcontracting refers to a relationship whereby, in order to cover markets in a developed country, multinationals arrange to use Third-World firms to produce entire products, components and services.



Indian industrial sector would become fully competitive with foreign industries if the necessary imports of technology were allowed. And the pent up demand generated by the earlier strategy for certain consumer goods and large amount of luxury goods would now be met by imports.

These internal and external factors symbiotically produced a set of policy measures to open up the economy to international market. However, though the strategy was initiated in the early 1980s itself, it came up for full-fledged implementation only in the 1990s.

### **Policy Measures**

Although the Indian economy was partially opened up in the 1980s itself, the corresponding policy measures took shape only in the 1990s. The aims and objectives of this policy measure can be broadly summarized as follows. First to do away with and substantially reduce controls on capacity creation, production and prices, and allow the market forces influence the investment and operational decisions of domestic and foreign capital within the domestic tariff area; second, to allow international competition and therefore international relative prices to influence the decisions of these forces; third, to reduce the presence of state agencies in production and trade, except in areas where “market” failure necessitates state intervention; and fourth, to liberalize the financial sector by reducing controls on the banking system, allowing for the proliferation of financial institutions and instruments, and permitting foreign entry into the financial sector.<sup>48</sup>

The policy measures mainly moved in three principal directions.<sup>49</sup> The first was the removal of capacity controls by de-reserving and de-licensing industries and abolishing the requirement of obtaining a license to create new capacity or substantially expand existing capacity. The second area of industrial reform related to amendment of the Monopolies and Restrictive Trade Practices Act (MRTP), so as to facilitate the expansion and diversification of large firms or firms belonging to the big business groups. Third type of liberalization in

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<sup>48</sup> Chandrasekhar, C.P. and Jayati Ghosh (2000), *The Market That Failed*, Leftword Books, New Delhi.

<sup>49</sup> Chandrasekhar, C.P. and Jayati Ghosh (2000), *ibid.*

industry involved foreign investment regulations. The first step in this direction was the grant of automatic approval for equity investment of up to 51 percent and for foreign technology agreements in identified high priority industries. Foreign Exchange Regulation Act (FERA) was modified so that companies with foreign equity exceeding 40 percent of the total investment were to be treated on par with Indian companies. The Foreign Investment Promotion Board was also established to facilitate this process.

As a result of the de-reservation of areas earlier reserved for the public sector and successive de-licensing of industries, there were only nine industries for which entry by private investors was regulated at the end of 1997-98. This meant that domestic private investors were free to invest in capacity-building and production in a wide range of industries which were previously regulated, including heavy industries, automobiles, and other important sectors. Similarly, the amendment to the MRTP Act allowed the increasing of the size of firms without any approvals, contrary to the earlier limit of Rs. 100 crore.<sup>50</sup> Further, the Act also removed the threshold limits with regard to assets for defining Monopoly and Restrictive Trade to allow the large firms to increase their size. On the external sector, the Foreign Exchange Regulation Act (FERA) was replaced with Foreign Exchange Management Act (FEMA). The net result of all these maneuvers was that interventionist barriers to the entry of domestic and foreign capital into a number of industries were substantially reduced or done away with, resulting in what has been projected as a much more competitive environment in the industrial sector.

### **Performance**

After a decade and half long secular stagnation of the economy as a whole and the industrial sector in particular, the 1980s witnessed a way out of this growth impasse. For instance, the average growth rate of GDP, which stood at 3.2 % for the period of first three decades after 1947 had finally entered a higher trajectory bordering on an average of 5.7% for the period of 1980-2004. The first period growth is termed by some as the “Socialist” growth rate while

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<sup>50</sup> Aravind Virmani (2004), ‘India’s economic growth: From Socialist Rate of Growth to Bharatiya Rate of Growth’, Working Paper No. 122, February, ICRIER, New Delhi.

terming the second as “Bharatiya” growth rate.<sup>51</sup> While the explanations for this so-called “socialist” growth have already been discussed, the latter period of growth requires a brief analysis.

**Table 1.5**

**Sectoral Growth Rate Since 1950s**

	1950-64	1965-79	1980-90	1991-2004	1980-2004
GDP Growth Rate	3.7	2.9	5.8	5.6	5.7
Industrial Growth Rate	7.4	3.8	6.5	5.8	6.1
Agricultural Growth Rate	3.1	2.3	3.9	3.0	3.4

Source: Atul Kohli (2005), *Political Economy of Growth in India, 1980-2005*.

As the table above shows, the growth indeed took momentum in the 1980s itself. The growth rate moved to the level of 5.8% for the 1980s from 2.9% for the period of 1965-79. Though the explanations are contested from different perspective, nonetheless, there is a set plausible explanation which can be enumerated as follows. First, there was a great increase in the fiscal stimulus to the economy provided by government spending. Second, there was substantial liberalization of imports, especially of capital goods and components for manufacturing. Third, and associated with both of these, was a shift to reliance on external commercial borrowing by the state to finance the increase in the consequent fiscal and current fiscal deficits. The gross fiscal deficit of the central and state governments together averaged 9.5% of the GDP at current market prices in the second half of the 1980s and touched 10.1% percent in 1990-91.<sup>52</sup> In short, like in the initial period of industrialization, the public investment and public expenditure played a more important role than the export market in pushing up the growth rate.

<sup>51</sup> Aravind Virmani (2004), *ibid*.

<sup>52</sup> C.P. Chandrasekar (2004), *ibid*.

**Table 1.6****Annual Trend Rates of Growth based on the IIP since 1950s**

Year	Total Industry Growth	Manufacturing	Mining and Querying	Electricity
1950-51 to 1964-65	7.2	7.1	5.9	13.6
1965-66 to 1974-75	4.3	2.7	9.4	3.8
1975-76 to 1984-85	4.9	4.3	6.6	7.3
1985-86 to 1994-95	6.2	6.2	4.2	8.3
1994-95 to 2003-04	5.7	6.1	2.6	5.3

Source: C. P. Chandrashekar (2004), *How is Industry Faring?*

Similarly, trend rate of growth of the index of industrial production was also rising in the 1980s after the initial years of the planning. For instance, as shown in the table above, the trend growth rate, which stood at 7.2% between the years 1950-51 to 1964-65, fell to 4.3% between 1965-66 to 1974-75, which rose up again only in the 1980s. However, the 1990s again witnessed a fall in the growth rate from 6.2% to 5.7%. In the same way, manufacturing also experienced high growth in the 1980s following a marginal rise from 6.2% for the period of 1985-86 to 1994-95 to 6.1% for the latter decade.

However, though it appears that the export-led growth in the industrial sector broke the stagnation of the late 1970s, the performance and pattern of export and terms of trade needs a separate analysis. Higher emphasis on export promotion and foreign investment led many to question this strategy on the premise that if the promotion of foreign investment and exports is the route for economic growth for a single country, it cannot be the same when many developing countries choose this path, leading only to a situation of “fallacy of composition”.

### **Employment**

The primary neo-liberal critique of the earlier import substituting industrialization was that this strategy alone was responsible for the slow rate of employment growth. It was suggested that export pessimism and an inward-looking import substitution policy had discouraged employment intensive export production and imposed capital intensive production which had low linkage effects with the rest of the economy and did not lead to more use of labour. It followed from this that opening up the economy to a more liberal policy of external trade and

foreign investment would alter that pattern. Not only would there be a higher rate of output growth, but trade would lead to production being restructured towards more labour intensive avenues, thereby generating substantial increase in employment. However, the recent experience has shown that the current strategy is in no way better than the earlier one in terms of generation of employment. In fact, there was not only a slow rate of employment growth, but it appears that in consequence of this policy a negative relationship between output and employment in certain industries has been developed.<sup>53</sup>

**Table 1.7**

**Sectoral Contribution of GDP and Workforce**

	1983-84		2004-2005	
	Share of GDP (%)	Share of Total Workforce (%)	Share of GDP (%)	Share of Total Workforce
Agriculture	37	58.5	21.1	56.5
Industry	24.4	23.9	25.9	18.7
Services	38.6	17.6	53	24.8

Source: RUPE, *Aspects of Indian Economy*, April 2008

As shown in the above table, though there was a drastic decline in the share of agriculture in the GDP, the share of the workforce marginally declined in agriculture blocking the productivity potential of the majority workforce. For instance, the share of agriculture in the GDP has come down from 37% for 1983-84 to 21.1% for 2004-2005, whereas dependence of workforce has declined marginally by 2%. Similarly, though the industry share increased by a marginal 1% for the same period, the workforce share declined by nearly 5%, showing a negative relationship between output and employment.

In general, as an economy develops it is expected that the pattern of employment would change through a process of replacing the unorganized sector in industry and services by an organized workforce. However, the overwhelming majority of India's workforce remains in the unorganized sector, trying somehow to eke out a living. Indeed, the organized sector is able to draw on the unorganized sector as a method of cost cutting. Since the 1990s, the

<sup>53</sup> C.P. Chandrasekar (2004), *ibid.*.

purchase of finished goods has risen steeply in the overall costs of Indian organized sector firms even as the share of wages has fallen. This indicates the growth of subcontracting which is common in the current phase of export-led growth in many Third World countries. Further, it appears that employers have adopted a systematic policy of replacing permanent staff with contract or temporary workers. Thus, the number of organized workers has fallen and that of unorganized/informal workers has risen within the organized sector during 1999-2005. The share of organized workers in the total workforce has fallen from an already very low 8.8 percent to 7.6 percent during this period.<sup>54</sup> So there is every reason to believe that the pattern of manufacturing growth under an open economic regime tends to be such that the responsiveness of employment growth to the growth in output produces a declining trend.

In short, though it appears that the phase of export-led industrialization has achieved a higher rate of industrial growth compared to the phase of import substitution, when other factors like employment, occupational changes and technological innovation are taken in to account, the result is far from this appearance. If the earlier import substitution strategy could not deliver an industrial transformation because of the structural problems, it is also true too for the export-led industrialization which followed it. But there is a commonality in both the strategies which presumed that industrial growth was mainly driven by public investment and public expenditure. And structural problems like highly unequal agrarian production relations and monopolistic nature of the industry continued in both cases. In fact, it was accentuated in the strategy later adopted.

### **SEZ as a New Strategy of Export-led Industrialization**

Now a new strategy of industrialization is being visualized and presented as the solution to the problems that the industrial sector is facing today. The first strategy of industrialization was projected to be that of independent industrialization, but what really took place was its total opposite. Indeed, there was a clear dependency on foreign capital and foreign technology during this phase. Owing to internal problems like a narrow base of home market and the old agrarian structure, coupled with the above-mentioned external factors, the

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<sup>54</sup>RUPE, *Aspects of India Economy*, (2008).

strategy could not be sustained for long. Subsequently, another strategy of export-led industrialization on the same socio economic structure was attempted. The emphasis of the strategy was on foreign investment and export promotion, and both were seen as the main drivers of the industrial growth. Given the experience of failure at least in terms of employment generation, yet another strategy of Special Economic Zones (SEZs) are now being presented as the way out. The SEZs are in many ways an extension of the same export promotion strategy, with the only difference being in its Enclave nature and emphasis on infrastructure, apart from foreign investment and export promotion.

Thus, it is argued that since the foreign investment is the basis for industrial growth, foreign investment will not flow into the economy as long as it lacks 'world-class' infrastructure. Since it is impossible to provide such infrastructure throughout the country in the near future, a suitable incentive mechanism is needed in order to attract private capital to develop such infrastructure first in a few pockets of the country, insulated from the environment around. However, certain questions arise on this concept of infrastructure creation, since it cannot be viewed in abstraction or in isolation. Its significance depends on the economic environment in which it operates. For instance, Paul Baran cogently says that the effect of creation of infrastructural facilities viewed in the abstract "would still remain nil or negative as long as they constitute alien bodies in a socio-economic structure into which they have been artificially injected".<sup>55</sup>

### **SEZ as a Form of Primitive Accumulation**

In the preceding sections, an attempt was made to locate SEZs in the recent state's strategy of export promotion or export-led industrialization. However, it can also be understood by employing the concept of primitive accumulation. Primitive accumulation entails in main the following aspects: separation of primary producers from land; privatization of the public sector, conversion of common property resources into marketable commodities. Each of the instances of displacement and state-led land acquisition are in a way feeding into the overall

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<sup>55</sup> Paul Baran, *The Political Economic Growth*, pp. 230-31.

process of primitive accumulation by divorcing primary producers from land, or restricting direct access to other common property resources such as forest, lakes, river, etc.

As is well known, Marx had initially brought up the concept of primitive accumulation to try to understand the historical origins of capitalism. It is generally accepted by economic historians that in pre-capitalist modes of production the primary producers, the peasants, had ownership of the means of production, most crucial among them being land. Capitalism presupposes existence of two classes of people: property-less wage laborers who have nothing but to sell wage labour, and capitalists who owns means of production and both of them are mediated by market. In order to create that class of property-less wage labourers, the primary producers, the peasants had to be separated from the means of production, i.e., land. Therefore, primitive accumulation can be defined as the process by which the producer is divorced from her/his means of production. Since, land is the primary means of production in pre-capitalist societies, the main focus of primitive accumulation was to separate peasants from the land. The so-called primitive accumulation, therefore, is nothing but the historical process of divorcing the producer from the means of production. It appears as 'primitive' because it forms the pre-history of capital, and of the mode of production corresponding to capital. This is aptly put by none other Marx himself:

The accumulation of capital presupposes surplus-value; surplus-value presupposes capitalist production; capitalist production presupposes the pre-existence of considerable masses of capital and of labour power in the hands of producers of commodities. The whole movement, therefore, seems to turn in a vicious circle, out of which we can only get by supposing a primitive accumulation (previous accumulation of Adam Smith) preceding capitalist accumulation; an accumulation not the result of the capitalist mode of production, but its starting point.<sup>56</sup>

However, the immediate question emerges as to how relevant is the concept of primitive accumulation for our time, since Marx originally defined the process as the pre-stage of capitalism. That is to say, Marx was discussing the temporal aspect, or the historical time of the process, whereas capitalism now has reached its monopoly stage.<sup>57</sup> However, in recent

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<sup>56</sup> Karl Marx, *Capital*, Vol. I ,pp 667

<sup>57</sup> V.I. Lenin, *Imperialism the Highest Stage of Capitalism*, Progressive Publishers.



literature, an attempt was made to reinterpret it.<sup>58</sup> According to this interpretation there are two distinct but interrelated form of primitive accumulation. First one stresses temporal aspect and situates the process in historical time, while the other stresses the constitutive and recurring aspect.

### **Primitive Accumulation in Historical Times**

Primitive accumulation was first described by Marx as the process by which the embryonic capitalist mode of production arose and extended itself while dissolving the feudal mode of production.<sup>59</sup> Thus, in its original form the process meant giving rise to new production relations under the capitalist mode with the creation of two classes: the wage labourers and the capitalists. In Marx own words, “As opposed to accumulation proper, what may be called primitive accumulation... is the historical basis, instead of the historical result, of specifically capitalist production.”<sup>60</sup> Thus the primitiveness of primitive accumulation is understood in a purely temporal sense and the whole process is seen as the historical phase which created the preconditions for the development of capitalism by forcing the separation of workers and means of production. Similarly the fact that the process of the accumulation also varies at space and time was registered by Marx himself. Marx states that primitive accumulation is neither a unitary nor a universally uniform process. “The expropriation of the agricultural producer, of the peasant, from the soil is the basis of the whole process. The history of this expropriation in different countries assumes different orders of succession, and at different periods. In England alone, which we take as our example, has it the classic form.”<sup>61</sup>

Further, once the concentration of means of production progresses to the extent that capitalist control of production is sufficiently consolidated, capitalism enters its competitive stage. And primitive accumulation tends to loose its centre stage and acts on the periphery, helping the capitalist class to appropriate absolute and relative surplus value from the working class.

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<sup>58</sup> De Angelis (1999), ‘Marx and Primitive Accumulation: The Continuous Character of Capital's Enclosures’, *The Commoner*, No 2.

<sup>59</sup>Deborah Fahy Bryceson (1972)

<sup>60</sup>Karl Marx, *Capital*, Vol. I

<sup>61</sup>Karl Marx, *Capital*, Vol. I, pp. 716.

### **Imperialism and Primitive Accumulation**

As the character of capital changed over time, the nature of this accumulation changed in response to that change. For instance, when capitalism moves from the stage of free competition and assumes monopoly form by the centralization of capital, primitive accumulation takes new forms. Monopoly capital not only signifies the end of competitive capitalism contained in national boundaries but also the beginning of proliferation of investments, markets and new sources of raw materials to facilitate its expanded reproduction. And the monopoly competition is being described as the process of centralization of capital in the organizational form of syndicates, cartels and trusts situated within particular national capitals. In conjunction with the force of capitalist state power, these national capitals expands their reproduction to encompass raw materials, markets and investments in areas hitherto untouched by capitalism. This phase of capitalism is known as imperialism. Lenin defines it thus:

Imperialism emerged as the development and direct continuation of the fundamental characteristics of capitalism in general. But capitalism only became capitalist imperialism at a definite and very high stage of its development, when certain of its fundamental characteristics began to change into their opposites, when the features of the epoch of transition from capitalism to a higher social and economic system had taken shape and revealed themselves in all spheres.<sup>62</sup>

At this highest stage of capitalism, primitive accumulation takes new forms, which can no longer be characterized as a process by which a new embryonic mode of production asserts itself out of the feudal mode, or for that matter, any other pre-capitalist mode. Primitive accumulation becomes the confrontation between monopoly capital and pre-capitalist modes whose productive forces and relations of production in no way approximate the conditions of existence of capital.<sup>63</sup> And the coercive force of state power becomes integral part of the accumulation process at this stage. However, the debate on the relationship between the monopoly stage of capitalism and primitive accumulation is a very intensively contested terrain. There are scholars who hold that development of capitalism is impossible at all without the primitive accumulation ignoring its historical particularity and generalizing the relationship to the operation of the capitalist mode of production as a whole. For instance,

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<sup>62</sup> Lenin, V.I, *Imperialism, the Highest Stage of Capitalism*.

<sup>63</sup> Deborah Fahy Bryceson (1972)

Rosa Luxemburg argues that capitalist simple reproduction was self-contained whereas extended reproduction was not realizable without an exogenous market. This argument emerges from the premise of under-consumption crisis.<sup>64</sup> It implies that under conditions of capitalist expansion, the necessary diversion of capital to new investments would cause the realization of surplus value on old investments to fall short as a result of the failure of the consuming power of that capitalist society. Hence it needs an exogenous market. She argues, "Historically, the accumulation of capital is a kind of metabolism between capitalist economy and those pre capitalist methods of production without which it cannot go on and which, in this light, it corrodes and assimilates."<sup>65</sup>

Therefore the search and establishment of exogenous markets leads to the process of primitive accumulation as a necessary condition of capitalist development. In addition to the exogenous market, Luxemburg argues, the system requires free access to ever fresh sources of raw materials. However, notwithstanding the above argument, imperialism is essentially historical, and the pre-capitalist modes articulate to that historical need in terms of providing market and supplying raw materials. But the form of primitive accumulation takes into account the internal as well as the external aspects of that particular pre-capitalist society.

### **Neo-Liberalism: A New Phase of Primitive Accumulation**

It has already been shown how the organic relations between capitalist expanded reproduction on the one hand and the often violent processes of dispossession on the other have shaped the history of capitalism. Though all the features of primitive accumulation that Marx mentions have remained powerfully within the recent history, the current phase of primitive accumulation differs from earlier mode on some accounts.

Since the recent phase witnessed not only dispossession of peasant populations and conversion of many formerly common resources in to private property, the current phase has actually brought everything under the market framework and witnessed the escalation and

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<sup>64</sup> Paul Sweezy, *Theory of Capitalist Development*. London.

<sup>65</sup> Luxemburg (1913), pp. 416, quoted in Bryceson (1972).

depletion of the global environmental commons like land, air and water, and proliferation of habitat degradations resulting from the wholesale commodification of nature in all its forms. The commodification of cultural forms, histories and intellectual creativity entails wholesale dispossession of which the best examples are Trade-Related Intellectual Property Rights (TRIPS) and Bio-piracy. The corporatization and privatization of hitherto public assets like public sectors and water indicate a new phase of 'enclosing commons'. The reversion of common property rights like the right to a state pension, to welfare and to national health care to the private domain has been one of the most egregious of all policies of dispossession pursued in the name of neo-liberal orthodoxy.<sup>66</sup>

The root of the current phase of accumulation in capitalism is being located in early 1970s. It is in this period that capitalism witnessed in recent history the beginning of chronic difficulty of over-accumulation, while unemployment and inflation were both surging everywhere, ushering in a global phase of 'stagflation' that lasted throughout that decade and the neo-liberal project of privatization became a response to the problem. The main substantive achievement of neo-liberalization has been to redistribute, rather than to generate, wealth and income, the main mechanisms for achieving this is being referred as "accumulation by dispossession".<sup>67</sup>

David Harvey substitutes accumulation by dispossession for the process of this accumulation. According to him, Accumulation by dispossession helps solve the over-accumulation problem and over-accumulation is a condition where surpluses of capital lie idle with no profitable outlets in sight. What accumulation by dispossession does is to release a set of assets at a very low, and in some instances, no cost. Over-accumulated capital then can seize hold of such assets and immediately turn them to profitable use. In the case of primitive accumulation as Marx described it, this entailed taking land, enclosing it and expelling a resident peasant population to create a landless proletariat, and then releasing land into the privatized mainstream of capital accumulation. However, the current process does not entail any creation of proletariat in its real sense.

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<sup>66</sup> David Harvey (2005), *The New Imperialism*, Oxford University Press, New York.

<sup>67</sup> David Harvey (2005), *ibid.*

Harvey identifies four main features of accumulation by dispossession: privatization, commodification, financialization and the management-manipulation of assets, each feeding on the other, supported by the other and gaining strength from the other. Particularly the latter two: Financialization and Manipulation of assets are being held as the prime reason for the recurring current global economic crisis. The crisis that is haunting the entire global economy today was in fact preceded by the breakdown of the global financial order built on speculation and predatory-ness.

There is another aspect of the recurring primitive accumulation based on extraction of rent on the basis of immobility and monopoly over the rarity that cannot be devalued or diluted because of immobility. In order to facilitate such rent-earning of global capital the State must actively ensure both the proprietary rights of capital over resources and also the immobility of these resources. The recent history witnessed many changes in various international laws and regulations through WTO, GATS and TRIP to ensure acquisition of property rights over land and other natural resources and sole rights to knowledge and markets. The process of acquisition of these rights is what constitutes primitive capital accumulation. So, rent extraction and primitive accumulation are two fundamental aspects of the economy in this era of neo-liberal capital.<sup>68</sup>

The process of primitive accumulation in India in the first decade of the 21<sup>st</sup> century is a process aided and facilitated by the existence of surplus labour and the administrative strategy of creating the SEZs as a most attractive destination for finance capital. These enclaves are further being made as paradise in the neo-liberal world with privileges of tax exemptions, subsidies and the most importantly the suspension of labour rights. According to an official figure, more than 21 lakh hectares of net sown area have already been lost between 1990 and 2003.<sup>69</sup> The creation SEZs would snatch more area from peasants.

Further, being in a labour-surplus economy, industry will not be able to absorb additionally displaced and dispossessed laborers through this accumulation process. Rather, it would

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<sup>68</sup> Pranab kranti basu(2007) Political Economy of Land Grab, *Economic and Political Weekly*, April 7, 2007, pp-1281-87.

<sup>69</sup> Bhaskar gosami (2008)

increase the relative surplus population –floating, latent and stagnant– depressing real wages and thereby increasing the rates of profits on each unit of invested capital. And one of the major features of the neo-liberal regime of accumulation has been the incessant ‘informalization’ of the labour process. Further growth of the relative surplus population makes the economy finely attuned to Jan Breman’s argument that “Mobilization of casual labour, hired and fired according to the needs of the moment, and transported for the duration of the job to destinations far distant from the home village, is characteristic of the capitalist regime presently dominating in South Asia.”<sup>70</sup> The State consolidates its power and becomes all the more coercive to aid and facilitate this entire process. As Anna Arent says, “Endless accumulation requires the endless accumulation of political power”, the SEZ act is a classical example of that the process of accumulation of power.

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<sup>70</sup> Jan Breman (1996), *Footloose Labour: Working in India's Informal Economy*. Cambridge University Press, pp. 23.

## CHAPTER II

### ECONOMIC ZONES: ORIGIN, PERFORMANCE, AND DISTRIBUTION

#### **Introduction**

One of the economic policies that have attracted much heated political and academic debate in the post-colonial economic history is the proposal of creating Special Economic Zones. But these zones are neither new nor a mere policy of economic reform. Nevertheless, much of the political and academic debates in the country seem to identify these Zones as a new phenomenon and equate them with the Chinese experience. In reality, Special Economic Zones are only a special case, or an extension of the better known policy of Export Processing Zones (EPZs). EPZs too are neither new nor limited to China and East Asia, as they have spread across the world. EPZs have certain basic and shared features in almost all the countries that have tried to implement them.

What is an EPZ? EPZs are “enclaves” dedicated to the promotion of export processing, isolated and insulated from the domestic economy, with relaxed and liberal state controls in import, infrastructure and in some cases, labour laws, simplified bureaucratic procedure, and a favoured treatment of foreign and often domestic investors. The international Labour Organisation defines Export Processing Zones as “industrial zones

with special incentives to attract foreign investment in which imported materials undergo some degree of processing before being exported again.”<sup>1</sup>

However, a more detailed characterization is given by Jayakantha Kumaran: According to this author, a) EPZs consist of an 'enclave' dedicated to the promotion of export processing and isolated from the domestic economy; b) Within these areas, state controls over industry are relaxed and bureaucratic procedures simplified; c) Foreign and often domestic investors in zones are given favoured treatment with respect to taxation, import controls, infrastructure and, in some cases, labour laws; d) In return, “investors are expected to process all intermediate imports within the zone and to export without adversely affecting the domestic economy.”<sup>2</sup>

Since the characterization mentioned above resemble the Indian SEZs, it is important to explore the theoretical foundation of EPZ to have a better understanding of India's SEZs. The primary rationale behind establishing the EPZs was to attract foreign Investment, encourage export promotion and employment generation. The first two were common objectives in almost all the developing countries, while the third is an outcome of these objectives. However, the relative importance of these objectives varies for each country according to the politico and economic structure of the countries concerned. But in general, the accepted opinion of the majority of policymakers is that there are too many barriers to investment in a developing economy, and these barriers are deterring foreign investors. Therefore, if the level of investment in the country is to be increased, foreign investors have to be compensated through suitable incentives and schemes.

But the next logical question that then arises is why there is such a need for foreign investment. The three most commonly cited reasons are as follows. First, it is believed that there is insufficient savings or capital within a country to invest in new projects. Secondly, as a spin off of the first, foreign investment is seen as a potential tool to increase employment in manufacturing, especially in predominantly agrarian countries. Finally, technology transfer and other forms of “learning” from foreign companies are

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<sup>1</sup> Jayantha Kumaran, Kankeshu (2003), 'Benefit-Cost Appraisal of Export Processing Zones: A Survey of the Literature', *Development Policy Review*, Blackwell Publishing, Oxford, Vol. 21:1.

<sup>2</sup> International Labour Organisation (2002), *Employment and Social Policy in Respect of Export Processing Zones*, Geneva, ILO, Document No. GB.285/ESP/5.



believed to be beneficial for domestic companies.<sup>3</sup> These positions dominated the common sense of economic policymakers across much of the developing world in late 1960s.<sup>4</sup> But this way of thinking became an important component of economic policy structure by 1980s, leading to growing competition between developing nations to attract Foreign Direct Investment (FDI).<sup>5</sup>

The second major rationale for EPZs is the encouragement to exports. Even before export orientation was seen as an inherently good policy, export promotion became important to countries in need of foreign exchange in order to import capital goods, machinery, fuels and so on. In the countries that followed the import substitution policy, it was argued that it became difficult for domestic industries to export and earn foreign exchange as high tariffs and protection for domestic industry drove up prices and reduced quality. However, it is difficult to ascertain reasons as it is the most contested terrain of debate. Nonetheless, there was clearly a need for export and foreign exchange for many developing countries for different reasons.

For some countries, particularly in the East Asia region, export promotion oriented industrial policy was the order of the day, given its strategic locations to the U.S. in international relations.<sup>6</sup> For others it was to earn foreign exchange and respond the crisis at times.<sup>7</sup> Thus the concept of 'Zones' became a primary vehicle to achieve these objectives. Some studies classify the reasons for establishing the zones as follows:<sup>8</sup> Zones as a part of an export oriented development, Zones as a crisis-response to an economy, and Zones as new arena for capital. The first type gained prominence in East Asian countries. The Zones in these economies were part of a larger economic strategy known as export oriented industrialization as an alternative to the import-substituting

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<sup>3</sup> It is accepted neoclassical proposition that developing countries are characterized by low capital stock for worker, and therefore a developing economy needs foreign capital. For further details, see Jayanthakumaran (2003).

<sup>4</sup> Gopalakrishnan (2007).

<sup>5</sup> FDI should be distinguished from foreign institutional investment, or FII. The former is investment of capital in the form of either 'greenfield' projects (i.e., new projects) or in the purchase of large amounts of shares in existing companies. The latter is portfolio investment, namely purchases of small numbers of shares on the stock market, investment in bank accounts or debt instruments and so on. FDI is generally regarded as less unstable and volatile than FII.

<sup>6</sup> P.Patnaik (2003), *The Retreat to Unfreedom*, Tulika Books, New Delhi.

<sup>7</sup> For instance, there is a view that first Zone that India established was a response to the chronic foreign exchange crisis that India was facing. For further details see Gopalakrishnan (2007).

<sup>8</sup> Gopalakrishnan (2007), 'Negative Aspects of Special Economic Zones in China', *Economic and Political Weekly*, April 28, pp.1492-94.

industrialization. This strategy aiming at industrial development, used directed credit, controlled exchange rates, sector-specific incentives and stimulated of certain types of exports. The second type, which is known as crisis response zones, was established mainly in countries that followed import substitution policy. Here, the Zones came up as a response to a failure of the overall economic strategy to generate a desired output: in the early stages, foreign exchange, in later stages exports, and finally foreign investment. There is also another view put forward as a reason for the creation of EPZs emerging from the sources of investment. Since over-accumulated capital could not find the desired outlet in the developed world, EPZs became a place for higher rate of return for that capital. These countries were facing particularly acute economic crisis resulting from a combination of high inflation along with unemployment, known as stagflation. According to this view, to counter this crisis, capitalism evolved many ways, one of which is EPZs.

Objectives of and reasons for the Zones may vary from country to country, but the cost of establishing the Zones seemed to have superseded the benefits in all the countries. Thus, the incentive structure given to these Zones needs a brief analysis. In order to attract foreign investment, taxes were exempted, tariffs were removed for many intermediated imports, other kinds of subsidies in different form were given and labour laws dismantled. There was also cut-throat competition among the developing countries to attract foreign investment, which in general led to a situation what is known as “Race to the Bottom”. The race as a rule leads to tax cuts and benefits in competition, even when such incentives exceed the socially optimal level and results in net losses to the economy. According to one study, developing countries currently lose 50 billion dollars per year due to tax exemptions.<sup>9</sup> The power that foreign investors gain over time in the countries they have invested in makes it impossible to withdraw or reduce such incentives.

Moreover, it is generally assumed that the domestic policies can influence foreign investors in deciding the location for a project. This has not been proved to be the case in reality. Multi-National Corporations (MNCs) have their own strategic decisions in global chain and such decisions do not necessarily correspond to or uphold the interest of the domestic countries. For instance, one study finds that the size of the domestic market, the rate of growth, political and macroeconomic stability, and access to raw materials – all these issues that cannot be affected by incentive policies are of least importance as policy

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<sup>9</sup> Oxfam (2000), quoted in Gopala Krishnana (2007), *ibid.*

postures when multinational investors are choosing locations.<sup>10</sup> As the United Nations Conference on Trade and Development in 2003 puts it, “It is generally accepted that location incentives are seldom the main determinant of location decisions by TNCs.”

In a similar way, policy incentives for export promotion can also be questioned. As more and more countries enter competition for a given world export market, the terms of trade becomes more unfavorable. This is what led many development economists in late 1960s to term the phenomenon as a “fallacy of composition”. They asked, if the promotion of foreign investment and exports is a route for economic growth for a single country, can it be true for all the developing countries which choose the same path.

Thus the concept of Zones and incentives given to them need a detailed analysis for different countries. The next section attempts to bring the experience of the Zones in the Asian countries in some detail, as this region had dominated and still dominates the distribution of the Zones at global level.

### **Economic Zones: Asia’s Experience**

Export Processing Zones have been in existence for a very long time, but they have experienced a massive rise over the past three decades. They gained their initial foothold in Asia with the Kandla EPZ, created in 1965, but really began to grow following the decision by Taiwan and South Korea to intensify their export-oriented strategy – partly through EPZs during the 1960s. In the 1970s a large number of countries chose to continue on the same path, establishing EPZs across the region. Studies by International Labour Organisation (ILO) now reveal that there were approximately 3000 EPZs in the world in 2002. That figure does not include the enormous numbers of industrial parks, free zones and other areas which strongly resemble EPZs, but not officially declared as such. The rise in the number of EPZs has been particularly intensive in the 1990s, as shown by the following table:

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<sup>10</sup> Shah (2005).

**Table 2.1****Export Processing Zones across the world**

Year	1975	1986	1995	1997	2002
Number of countries with EPZs	25	47	73	93	116
Number of EPZ's	79	176	500	845	3000

Source: ILO data from internal and official sources, as cited in ILO 2002.

**Table 2.2****Global Distributions of the Zones**

Geographical Area	Employment	Number of Zones
Asia (China)	36,824,231 (30,000,000)	749
Central America and Mexico	2,241,821	3300
Middle east	691,397	37
North Africa	440,397	23
Sub-Saharan Africa	440,515	64
North America	431,348	713
South America	330,000	39
Transition Economies	311,143	90
Caribbean	245,619	87
Indian ocean	226,230	3
Europe	127,509	55
Pacific	50,830	14
Total	41,934,1333	5,174

Source: Balasubramanian (2009), 'Special Economic Zones in India: The Major Issues and Challenges'.

As the number of Zones grew, the incentives structures to the Zones also underwent changes responding to the changes in domestic and international economy. A brief analysis of the performance of the Zones is crucial for understanding the current model of Zones followed in India and outside. Broadly, the performance of the variables like

foreign investment, export, foreign exchange earnings, technology transfer and forward and backward linkages, captures the efficacy of an economy, are discussed below.

**Foreign Investment:** Foreign investment has always been an important component in establishing the Zones in developing countries in general and Asian countries in particular. There are not many studies done on this aspect due to the paucity of data. Some studies have been done with the sparsely available data. Some studies, for instance, show that in 1995 the percentage of foreign-owned companies or joint ventures in EPZs in Asia varied from 100% in Malaysia to 30% in China.<sup>11</sup> In 1983, at a time when competition for FDI was less intense among developing countries, FDI as a percentage of total investment in EPZs varied in Asia from a high 90% in Malaysia (and 85% in Taiwan) to a low 16.7% in India, a significant fact. Certain countries, such as Taiwan, Malaysia, South Korea and China, have had much greater success in attracting FDI to their EPZs than other countries.<sup>12</sup> In short, as the ILO puts it, both the number of EPZs and the number of countries hosting them have expanded rapidly. At the same time, however, Zones in some of the countries have attracted no or very limited FDI.<sup>13</sup> Studying the trends of FDI in ASEAN countries we find that the relationship between the location of foreign affiliates and the location of EPZs is weak in general. This may have been the reason for limited FDI penetration into some countries.

The nature of investment in EPZs also displays certain identifiable patterns. Notwithstanding huge incentives, on the one side there was limited FDI for some countries in Asia, and on the other, the FDI which flowed in were primarily concentrated in two sectors, garments/footwear and electronics. These two sectors are generally characterized as 'footloose', for they involve light manufacturing, easy relocation and a need for cheap and relatively unskilled labour. Further, the garments industry had another reason for investing in EPZs: they attempted to take advantage of the country production quotas under the now-defunct Multi Fibre Arrangement (MFA),<sup>14</sup> an agreement on textile manufacturing. As relevant statistics show, after the MFA quotas were removed from 29 types of garments in 2002, China's share in the US market for those garments jumped

<sup>11</sup> Jayantha Kumaran (2003), *ibid*.

<sup>12</sup> Amirahamdi and Wu (1995), 'Export Processing Zones in Asia', *Asian Survey*. Vol. 35:9. September.

<sup>13</sup> UNCTAD(2002), quoted in Gopalakrishnan.(2007).

<sup>14</sup> The Multi Fibre Arrangement (MFA) was an international trade agreement to protect developed countries' garments industries from cheaper competition from the developing world. Thus it specified certain quotas for exports.

from 31% to 59% in that year alone. Glove exports from China increased by 291% while those from Guatemala, Bangladesh and Sri Lanka –three countries with textile-dominated EPZs– fell by 65%, 48% and 47% respectively. In short, the experience of the foreign investment in the Zones show the ways in which investments tends to be footloose in nature, dependent on fragile relative advantages, and tends to narrow export orientation towards particular products and industries. This brings us to the question of the kind of exports that emerge from EPZs.

**Export and Foreign Exchange:** From the point of view of the quantity of gross exports generated, EPZs in many countries have been regarded a phenomenal success. EPZs fueled a rapid growth in exports in several countries such as Sri Lanka, where the value of clothing exports climbed from 623 million dollars in 1990 to over 2.7 billion dollars in 2000, mostly through EPZs. Similarly, Malaysia emerged in 1982 as the world's largest electronics exporter, with 90% of its production in EPZs. 27 Zones in China, South Korea, Taiwan and Malaysia have notably produced large amounts of gross exports, while those in Sri Lanka and Philippines also grew rapidly.<sup>15</sup> In Malaysia and Sri Lanka, EPZ exports formed 49% and 44% of total manufactured exports in 1982 and 1990 respectively. It is thus said that EPZs have helped to change the export composition of some countries from primary commodities like unprocessed agricultural products and raw materials into manufactured exports.<sup>16</sup>

If these figures are converted in net terms, that is to say, after deducting intermediate import from produced exports, the picture is not that optimistic. According to one study, out of seven high performing Asian economies, net exports (which is the gross exports minus imports) from EPZs ranged from at most 60% for Indonesia to 16% for China of gross exports from the Zones. The average figure is around 30% in most countries. Since it is the net exports that is economically significant, such low ratios of net exports to gross exports shows the real impacts of the Zones. And, this low level of net exports also show such a lower rate of value addition in the Zones, as the value addition generally reflect the level of manufacturing and the kind of labour used in it. Some argue<sup>17</sup> that this kind of export promotion has two parallel effects; on the one hand, decreasing the countries'

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<sup>15</sup> Amirahmadi Wu (1995), *ibid.*

<sup>16</sup> Gopalakrishnan (2007), *ibid.*

<sup>17</sup> International Confederation of Free Trade Union (ICFTU) (2003).

external vulnerability by reducing their dependence on primary commodities, and, increasing their vulnerability by pushing them into an even narrower export orientation that depends on certain specific manufactured commodities on the other.

**Forward and backward linkages:** Another argument generally cited in favour of the Zones is that given the forward and backward linkages the Zones would work as a connecting link between the primary or agricultural production and the modern industry. But the linkages that the Zones developed with the rest of the economy have generally been weak and at a low level. According to the available data, the backward linkages in the form of local purchases of raw materials by the Zones are very low. This appears to be true even when the dominant industry is garments and textiles, where local raw materials are widely available. For instance, local purchases were around 5% of total purchases in Sri Lanka, while in the Philippines the figure did not exceed a paltry 10%.<sup>18</sup> Countries such as Malaysia with electronics dominated EPZs had figures even lower than this. Raw materials typically come from outside the country, often for reasons of quality and time. This is perhaps one reason why these countries registered a very low level of net export as the intermediate import replaced local raw materials, although these countries witnessed a rate of high growth in gross export.

**Technology Transfer:** It is often argued by the growth theorists<sup>19</sup> that there exist a technological gap between the developed countries and the developing world, and that in such a context, transfer of technology from the former to the latter would be an efficient mechanism to fill the divide. This can be achieved by applying several methods, including by directly training the supplier companies and training of workers and staff, or indirectly through demonstration effects and the general impact of the so-called modern management and market techniques. Such effects are of course very difficult to measure, but the little information available seems to indicate that this does not take place either.<sup>20</sup> First, for the electronics and garments industries that dominate most EPZs, there are inherent problems: garments technology is cheap and widespread, and electronics companies guard their technologies closely. Second, technology transfer is most likely to take place where new and capital-intensive technologies are being applied, and this is

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<sup>18</sup>For instance neo classical and endogenous theorists argue that FDI brings with it bundle technology and know how management skills which fill the gap that exists between developed and developing world.

<sup>19</sup> Endogenous growth theory stands on this proposition only.

<sup>20</sup> Amirahmadi Wu (1995), *ibid.*

unlikely to occur in the low-skill, labour-intensive environments of most of the EPZ factories. Research and development activities in particular normally take place in the home countries of the investors and not in the Zones. In short, although production of commodities took place in the Zones with the help of foreign capital, production of new technology certainly did not. Technology was merely copied or replicated, but was rarely developed in the Zones.

**Labour:** Another outcome of the EPZs was expected to be high level of employment generation. As the data shows, it is true that the EPZs had generated a total employment of seven million worldwide by 2002.<sup>21</sup> However, the question is whether this employment generated is really new employment or was accompanied by displacement from other sectors. For instance, industries in many countries moved to the Zones to avail the huge incentives, which resulted in only a process of migration of the workforce rather than creation of new employment opportunities.<sup>22</sup> The next logical question that can be raised is pertaining to the pattern of employment and wage structure in the economic Zones. As the data shows, the Zones had significantly higher rates of wage than outside the Zones in some countries. However, these wages were invariably much lower than the existing wage level at the home countries of the investors for the same job. In majority of the countries where Zones were set up, such as in China, Sri Lanka and the Philippines in particular, one-third of the workers received less than the stipulated minimum wage.<sup>23</sup> Further, the composition of the workforce brings out the strikingly dark side of the Zones, showing an overwhelming predominance of young women workers. As per 1995 data, 70% to 80% of the workforce in the Zones is women between the ages of 16 and 25, and in some Zones it may even reach a very high 90%. It is true that women are in a sense sequestered into the EPZ and export sectors in the emerging East Asian economies, so much so that women's share of the labour force in export-oriented manufacturing here is generally almost twice as high as their share in the labour force as a whole.<sup>24</sup> Moreover, this share has been rising over time. It might seem that the trend of feminization of employment is a trend towards liberating women from patriarchy. But it was not certainly the case. Women became targets as they were perceived as a source of cheap labour and

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<sup>21</sup> International Labour Organisation (2002), *ibid*.

<sup>22</sup> Jauch (2002).

<sup>23</sup> International Labour Organisation (2002) *ibid*.

<sup>24</sup> For instance, data provided in Seguire (2002) used in Gopalakrishnan (2007) shows this trend particularly for countries like Hong Kong, Korea, Malaysia, Singapore, Sri Lanka, Taiwan and Thailand.



regarded as a section which had a better chance of withstanding the monotonous, repetitive and exhausting nature of work without much resistance. As the International Confederation of Free Trade Unions (2003) puts it, “Women, who are considered to be disciplined, meticulous and more compliant than men, and therefore less likely to join a union, are a godsend for unscrupulous employers, who, moreover, prefer them to be young, single and without children.” Moreover, women are commonly seen as a section which can be easily subjected to disciplinary action including termination of employment if they do not comply with the Zone administration or factory management.

In short, the experience in the Zones clearly presents how difficult it is for workers to enjoy or even demand their rights. And this difficulty is compounded by certain other factors. Notwithstanding legal provisions, the state machinery within Zones normally takes a clear stand against any form of worker’s union or agitation, government inspectors are often instructed not to inspect EPZ factories, and penalties for violation of workers’ rights are rarely enforced. And this trend produces a particular labour regime, a regime in which low skill levels, high turnover, extreme insecurity and repression combine to force workers into severe conditions of exploitation, their value being in inverse proportion to their wages. There may be variations in the degree to which this occurs in various Zone or different countries, but this appears to be the general pattern across the most EPZs.

### **China’s Experience**

It is very important to have a holistic view of China’s model of developing economic Zones to understand India’s SEZ policy. Defenders as well as the critics of the Zone cite China’s model for criticism and counter criticism. For instance, a Member of Parliament argued during the debate on the passage of the Special Economic Zones Act, 2005 that China is a shining example of a country which has developed through its Special Economic Zone and various facilities given to the SEZs have attracted foreign direct investment, and these Zones have gone a long way in developing their economy.<sup>25</sup> Similarly, critics in India frequently use the Chinese policy framework for economic Zones as a benchmark for comparison. The arguments that China has only six large scale Zones and that the ownership is controlled by the state are at variance with the actual

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<sup>25</sup> Statement by M. Ramadass, Member of Parliament, Pondicherry in the Lok Sabha on May 10, 2005 quoted in Gopalakrishnan (2007).

facts. Therefore, the image presented by both the viewpoints appears incomplete at best, and in many aspects, is simply incorrect.

China has a much larger number of Zones than the six which are generally mentioned. They have by no means been an unqualified success, and they have brought about severe economic and social problems. Two specific aspects that have not been featured in the general debate on the success of the economic Zones in China are first, abuse and exploitation of labour; second, real-estate speculation and land loss. Even from the narrow perspective of the common economic indicators, Chinese Zones have not had uniformly positive results. In their initial years, when the focus was on earning foreign exchange and encouraging regional development in the traditionally backward southern coastal area, the use of Zones was meant to insulate the rest of the economy from the disruptive effects of capitalism. Yet even during this early stage, various problems dogged the Zones, such as the flood of durable goods entering through them both legally and illegally and threatening the local industry, causing foreign exchange shortages, and risking a rise in inflation.<sup>26</sup> In December 1981, the state imposed a moratorium on Zones and banned the import of 17 durable goods to stop these trends. There were also demands that the Zones should be abolished.

However, when the policy shift towards reform and “market socialism” started, the Zones also began to be portrayed in a positive light. Moreover, the Zones were regarded to be the “vanguards for market socialism” and were widely publicized as models for the Chinese economy. Yet, the successes that followed had several caveats. First, as the rest of China began to liberalise, the attractiveness of the SEZs diminished.<sup>27</sup> Investment trends proved very sensitive to regulatory changes and liberalisation elsewhere. In 1986, the realized investment in the SEZs declined by 86.5 percent in comparison to 1985. Investment patterns also varied across the SEZs, with only Shenzhen really showing any success, while throughout the 1980s Shantou hardly drew any investment. Second, the investment in SEZs was driven by capital from Hong Kong, Macao and to some extent Taiwan, so much so that 88 percent of the new ventures in the SEZs in the early 1980s were by investors from Hong Kong and Macao. By 1995, 96 percent of Shenzhen’s

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<sup>26</sup> Reardon, C. Lawrence (1996), ‘The Rise and Fall of China’s Export Processing Zones’, *Journal of Contemporary China*. Vol. 5, Issue 13, November.

<sup>27</sup> Wong (1987), ‘Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience’, Series B, *Human Geography*, Vol. 66, No. 1 (1984), pp. 1-16.

textile industry and 95 percent of its garments industry were owned by Hong Kong investors.<sup>28</sup>

Perhaps the most serious apprehension about India's SEZs emanates from the potential for real-estate speculation and loss of agricultural land. The Chinese experience in this respect is both instructive and alarming. Though land in China is a state property,<sup>29</sup> by the late 1980s efforts were made to create the legal foundations for trade in usufruct rights and leases, especially in SEZs.<sup>30</sup> Under China's Land Administration Law of 1987, use rights on land were created, and provincial governments, municipalities, and SEZs were also empowered to create their own land regulations.

In China, urban land belongs to the state and rural lands to the village commune, though families had been given individual contracts to their lands as part of the village commune reforms in the 1980s.<sup>31</sup> Only urban land use rights could be transferred to private parties, while the rural land use contracts could be transferred only to the state, which then could change it to urban land and sell development rights on it. As the Chinese state swung in favour of big business, this system made farmers' tenure insecure, especially in areas near expanding municipalities and within SEZs.

This situation simultaneously produced a speculative market in land rights with requisition by the state followed by rapid transfer through speculators. This "stir frying" had major consequences: between January 1992 and July 1993, rights over 1,27,000 hectares of land were granted to real-estate developers across China but only 46.5 percent of this land was actually developed. This large-scale transfer of land to developers was partly driven by "zone fever", namely, the rapid multiplication of Zones, as a result of continual promotion of SEZs as a model. In addition to real estate speculation, Zones also produced other problems. Ironically for an avowedly communist regime, abuse of labour is rampant in the Chinese SEZs. Seven million people out of Shenzhen's total population of 12 million are migrant workers, with almost no legal or social protection. 1992 data for the Guangdong province, home of Shenzhen, shows very high death rates among

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<sup>28</sup> Lau (2001).

<sup>29</sup> Gopal Krishnan (2007), *ibid.*

<sup>30</sup> Huang and Yang (1996), 'Export Processing Zones in Asia: A Comparative Study', *Asian Survey*, Nov., Vol. 32, No. 11, pp. 1026-1045.

<sup>31</sup> Weil (1996).

industrial workers and more than 5,00,000 child labourers, a phenomenon which had been greatly reduced in post-revolutionary China.<sup>32</sup> In 2003, at least half the firms in Shenzhen owed their employees wage arrears,<sup>33</sup> and at least one-third of the workers in the Chinese SEZs received less than minimum wage.<sup>34</sup>

All the elements of the Chinese policy that produced these consequences are present in India's policy as well. India's land market, segmented between agricultural and non-agricultural land, produces ample opportunities for speculation, a possibility greatly exacerbated –but contrary to popular perceptions– not produced by state acquisition. The frantic pace of SEZ approvals in recent years demonstrates the eagerness of the Indian government to condone land use changes, which are the real levers of speculation. This means that the Chinese SEZ experience should be read not only as a model for Third World countries like India, but also as a salutary warning.

### **India's Zones**

India's –and indeed Asia's– first Export Processing Zone was set up in Kandla, Gujarat, in 1965. It was followed by the Santa Cruz Export Processing Zone in Maharashtra which came into operation in 1973. The government set up five more Zones during the late 1980s. These were at Noida (Uttar Pradesh), Falta (West Bengal) Cochin (Kerala), Chennai (Tamil Nadu) and Visakhapatnam (Andhra Pradesh). Surat EPZ became operational in 1998. The Export-Import (EXIM) Policy of 2000 launched a new scheme of Special Economic Zones (SEZs). Under this scheme, EPZs at Kandla, Santa Cruz, Cochin and Surat were converted into SEZs. Other existing EPZs in Noida, Falta, Chennai, Vizag were also converted into SEZs by 2003. In the four decades, the EPZ programme has grown from one zone, to seven, to 53 approved SEZs under the previous policy, to the current total of more than 550 approved so far under the SEZ Act.

The long track record of the Zones presents mixed results. The performance and realized objectives are at variance. Some argue that its contribution to industrialization efforts of

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<sup>32</sup> International Confederation of Free Trade Unions (ICFTU) (2003). 'Export Processing Zones: Symbols of Exploitation and a Development Dead-End', June, ICFTU, Brussels.

<sup>33</sup> ICFTU (2003), *ibid.*

<sup>34</sup> Jayanthakumaran (2003), *ibid.*

the economy has been catalytic in promoting new production sectors, exporting new products and building up the country's image in certain products in the international markets.<sup>35</sup> For others, the EPZ policy has been another failed attempt in the country's industrialization efforts. Its export performance and investment levels have generally been dismal. And unlike other Asian countries, India's Zone policy has never been a central part of either the export or the industrialization strategy of the government. Rather, the tendency was to treat EPZs as incidental. Now for the first time in the history of economic zones in India, the SEZs today are being projected as a major path to be followed for the country's industrialization strategy.

### **Pre-Reform Period**

The first Export Processing Zone set up in Kandla of Gujarat remained as the only zone till 1973 when it was joined by the Santa Cruz EPZ (SEEPZ). In these initial years, objectives of the Zone were either unclear or not incorporated in to the country's industrialization strategy. Generally, it was viewed as a mechanism to supplement certain policy measures and worked as crisis response.<sup>36</sup> Since there was no special provision the overall policies were applied to the Zone as well. Regulations that required multiple department clearance continued, while other industry customs, regulations etc. were tight and the FDI restricted. The major concessions that were provided were tax concessions and infrastructural facilities. As expected, exports from these zones remained an insignificant part of India's overall exports up to the late 1970s and foreign investment too remained very low.<sup>37</sup> However, from 1975 to 1985, as production in the SEEPZ rose, there was a rapid growth in exports, and by 1985 the share of EPZs in India's exports had risen to 3% and 4.4% of total and manufactured exports respectively. Foreign exchange also began to rise at a higher rate.<sup>38</sup>

It was in this context that four more EPZs were set up in 1984 in areas like Noida (Uttar Pradesh), Falta (West Bengal), Cochin (Kerala), and Chennai (Tamil Nadu). This growth

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<sup>35</sup> Aggarwal (2004), 'Export Processing Zones in India: Analysis of the Export Performance', Working Paper No. 148, November, ICRIER, New Delhi.

<sup>36</sup> Gopalakrishnana (2007), *ibid.*

<sup>37</sup> Amirahmadi and Wu (1995), *ibid.*

<sup>38</sup> Aggarwal (2004), *ibid.*

of Zones reflects the underlying change in policy structure as well. This is after all the period of consolidation of the liberalization policies, both globally and at home.<sup>39</sup>

**Table 2.3**

**Employment Elasticity of Zones**

Year	Zone Development	Average Elasticity of Coefficient
1966-71	Kandla Zone was set up	1.09
1974-82	SEEPZ was set up	0.87
1987-91	Another 4 Zones were set up	0.55
1991-2000	SEZ policy initiated	0.62
2001-2006	SEZ act was enacted	0.295

Source: Calculated from Ministry of Commerce data.

After 1947, India's export was relatively more dependent on the Soviet Union and the Easter European countries. The composition of the exports was also corresponding to the requirements of these countries. Engineering goods and drugs were at the top of the export list while electronics and textiles were at the bottom. In a parallel to the experience of Sri Lanka and other countries with the Multi Fiber Agreement (MFA)<sup>40</sup>, the dependence on these countries reflects the guaranteed access to open markets. The expansion of the Zones had little effect on the share of Zones in total exports.<sup>41</sup> As the export quotas ended under the Multi Fiber Agreement for some countries, the performance of Zones also faded. Similarly, for the Indian Zones too, which had guaranteed markets in the Eastern European countries, the export started declining when the economy of these countries collapsed. The Zones then had to turn elsewhere for the market for its export and had to change the composition of the goods exported as well.

<sup>39</sup> Chandrashekhar and Ghosh (2002), *The Market That Failed*, Leftword Books, New Delhi.

<sup>40</sup> The Multi Fibre Agreement was an international agreement concluded in 1974 as measure to protect developed countries' garment industries from the developing world. It specified quotas for textiles exports from developing countries to developed world.

<sup>41</sup> Aggarwal (2004), *ibid.*

### Post-Reform Period

As the economy went through far-reaching changes in its policy structure and orientation in the early 1990s due to changes in the national and international order, the Zones also witnessed major revamping in terms of incentives and governance. In fact, the Zones were seen as a “test base” for liberalization of trade, taxation, and other policies that were then gradually applied to the rest of the economy. Yet these changes still appeared to have little effect on the performance of the Zones. During this period, exports grew on an average of 24.4 percent annually. This may seem to be a high growth rate at first glance, but was in fact considerably less than the preceding decades. Similarly, employment growth also slowed down considerably. However, the growth rate calculated for the period of 1966 to 2002 for export, value addition, and productivity (export per employee) gives us a different picture.<sup>42</sup> The Zone’s exports increased from less than Rs.1 million in 1966 to over Rs. 97727 million in 2002. Over the same period, total employment increased from 70 to around 89,000. The net foreign exchange earnings also registered an increase from Rs. 0.16 million to Rs. 43195 million, and value addition increased from 21 percent to 44 percent in this period.

The table below presents a comprehensive picture of the growth in exports, employment, imports and value addition. Three things may be observed here. First, gross EPZ exports registered an impressive growth rate over the period 1966 to 2002. Secondly, gross exports rose much faster than employment in these zones. As a result, exports per employee increased at the annual growth rate of 24 percent and a trend growth rate of 14.6 percent.

**Table 2.4**

#### **Growth rates in Export, Import and Employment (1966-2002)**

	<b>Average Annual Growth Rate</b>	<b>Trend Growth Rate</b>
Export	42.4	39.2
Import	39.9	38.8
Value addition	2.9	1.5
Employment	21.2	21.6
Exports/Employment	24.3	14.6

Source: Ministry of Commerce, quoted in Aggarwal (2004)

<sup>42</sup> Aggarwal (2004), *ibid.*

Thirdly, the growth of value addition has been declining over the same period. Average annual growth rate of value addition was as low as 2.9 percent. The trend of growth rate in value addition was 1.5 percent, implying that imports also grew approximately at the same rate as exports. The above analysis was in absolute terms, but even in relative terms there was not much of a difference. This is because the share of EPZs in total exports and manufactured exports increased from a mere 0.07 percent and 0.14 percent respectively in 1973 to 4.3 percent and 5.6 percent in 2001 respectively. In 2002, their share in total exports and manufactured exports was slightly lower at 3.8 percent and 5.2 percent respectively. This was also made possible by the overall manufactured exports which grew at a lower rate than the EPZs.

In the foreign investment front, which is one of the biggest justifications for EPZs, the picture is not impressive either. It remained uncannily constant over the decades under review. According to one study, FDI formed just 16.7 percent of investment in the EPZs in 1983, which marginally increased to 17 percent in 2000.<sup>43</sup> In short, even as the Zones multiplied and expanded, foreign investment remained constant and the proportion of FDI investment to total investment was low. A significant rise in the FDI proportion only took place after 2000. Notwithstanding the stagnancy in the growth in the above mentioned areas, there was a significant shift in the sectoral composition of EPZ industries and exports. It was a result of the collapse of the Soviet Union which brought the protected export market for engineering goods and drugs to an end. Both these sectors showed a sharp decline from 27 per cent to 5 per cent and 26 per cent to 6 per cent of EPZ exports for engineering goods and pharmaceuticals between 1990 and 2002 respectively.<sup>44</sup> The place was then taken by the electronics and manufacturing sectors, which in 2002 formed 34 per cent and 42 per cent of exports respectively. It should be noted that more than 50 per cent of the electronics exports were software and IT services.<sup>45</sup>

### **Labour in EPZs**

One of the controversial aspects in the SEZ Act is what is euphemistically called labour reform or labour flexibility. However, it is not entirely new to SEZs alone, much of which

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<sup>43</sup> Amirahmadi and Wu (1995), *ibid.*

<sup>44</sup> CII (2006), quoted in Gopalakrishnan (2007).

<sup>45</sup> Aggarwal (2004).



derived from the practices of the earlier model of EPZs. The tale of workers' rights in EPZs, as usual, is horrible. A study about workers' conditions in SEEPZ conducted in 1993 showed that the workforce mostly consisted of women younger than 25 years, which is similar to the Zone economies of any other country in the world. Employers preferred unmarried and childless women. Abuse and exploitation of workers was rife and very common. Harassment of workers once they became pregnant, frequent breaks in service to prevent workers claiming permanent or regular status, violation of minimum wages laws and such other exploitative practices prevailed in every Zone. Technically, though labour laws were applied in the Zones, their enforcement was abysmal.<sup>46</sup> In the Noida EPZ, reported violations of workers' rights included summary dismissal of workers who demanded enforcement of labour laws.<sup>47</sup> Yet another study for all the Zones confirms the perennial and pervasive violation of workers' rights.<sup>48</sup> Appointment letters, pay slips, wage-cards, are rarely given. Provisions of minimum wages laws are hardly implemented. Workers are employed on contract basis. Overtime is compulsory but overtime wages are not paid. On the other hand, wages are deducted if the workers fail to meet the high production targets fixed unilaterally by the employers. Safety equipments/apparels are not provided, as that would increase production costs and reduce the speed and output. Women are made to work in night shifts without providing proper conveyance to their residences. They are not given maternity leave. Moreover, women found to be pregnant are removed from service. Crèches are not provided. The use of toilets is controlled by issuing tokens. Sexual harassment is very common.

Though it might appear that these phenomena are universal when it comes to labour conditions, what is specific about EPZs is the restriction on the workers to organize themselves in trade unions because of the Zone status. This is because the Zones were declared as Public Utility Services, a designation under the Industrial Disputes Act of 1947, which bars strikes in such services. In short, vulnerability levels of the workers were high in the Zones. Though the pattern was not much different from other countries, there were specificities to the Indian situation.

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<sup>46</sup> Gopala Krihnan (2007).

<sup>47</sup> ICFTU (2003), *ibid*.

<sup>48</sup> The report presented at an All India EPZ/SEZ workers convention organized by the Centre for Indian Trade Union (CITU) in 2002.

### The New SEZ Policy

In 1997, the new Export and Import Policy declared on 1<sup>st</sup> April 2000 provided that a new scheme would be put in place to revamp EPZs. This was the Special Economic policy, intended to consolidate and promote EPZs in a more integrated manner than before. It also marked the beginning of a shift towards seeing EPZs and SEZs as distinct elements in India's export and industrial policy. Many of the features of the current SEZ Act were brought in through this policy, including the concepts of multi product and single product SEZs, and minimum areas for each. Private sector SEZs were also allowed for the first time. Prior to this, all Zones were being set up by the state governments. Incentives were greatly increased, and both SEZ units and developers were provided duty free imports of raw materials and capital goods.<sup>49</sup> The old EPZs were all converted to SEZs under the new policy. A number of new SEZs were also declared under this policy before the all encompassing SEZ Act was passed.

**Table 2.5**

#### Export Performance of the Zones

Year	Value Of Physical Exports From SEZs (Rs. crore)	Growth Rate
2003-2004	13,854	39%
2004-2005	18,314	32%
2005-2006	22,840	24.70%
2006-2007	34,615	52%
2007-2008	66,638	92%

Source: Calculated from Ministry of Commerce Data.

The new policy presented a combination of mixed but contradictory results. The share of foreign investment grew for the first time since the 1980s. By 2003, the proportion of FDI

<sup>49</sup> Customs notification 39/2002 Central Excise and 82/2002 customs, both dated 13.08.2002, for developers, and 52/2000 Central excise and 137/2000 Customs both dated 19.10.2000 for units, quoted in Gopala Krishnan (2007),

had risen to 24.3 percent, while the overall investment in SEZs rose from Rs. 980.7 crores in 1998 to Rs. 1700 crores in 2003, a growth of nearly 73 percent.<sup>50</sup> Notwithstanding the investment growth, employment growth was markedly low, and the workforce in SEZs grew only by 13.7 percent between 1998 and 2003. This reflects a sharp shift towards more capital intensity in SEZs.

### **Sectoral Composition of SEZ Investment**

The much expected level of investments for both foreign and private investment has not yet been materialized, and even the stated export and employment goals are not yet seen in order to proclaim the success of the Zones. The nature of investment also is as important as the level of investment. The nature of investment plays a major role in realizing the stated goals like employment generation and developing the SEZs as “manufacturing hubs”. For this, a key set of data is indeed available, one of which is the set of approvals granted so far by the Board of Approvals. Since early 2006, when the Act was passed, the Board has granted formal approvals to 568 SEZ applicants and “in principle” approved 144 others. Out of the former, 315 approvals have so far been notified.

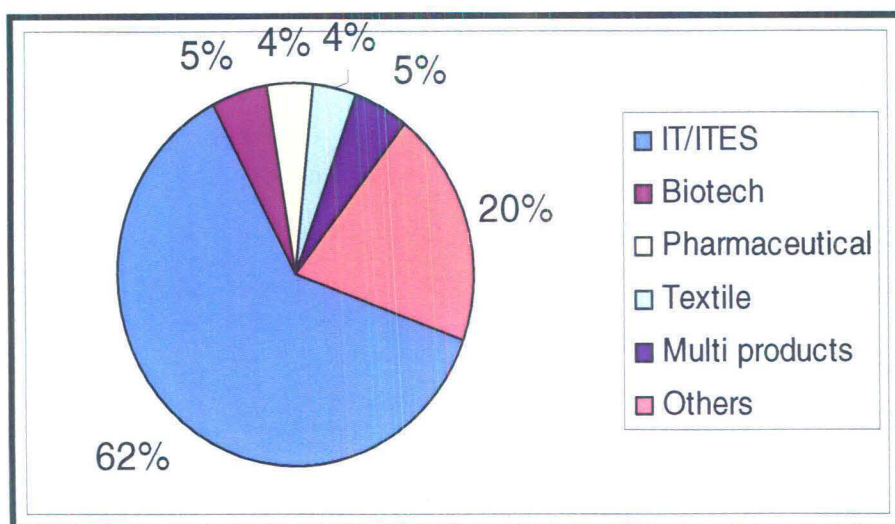
We now examine the level and nature of investment that is being attracted by then Indian SEZs by examining the list of SEZ proposals approved (both in principle and formally) so far. The sectoral break up of the approvals is as follows:

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<sup>50</sup> Aggarwal (2004).

Diagram 2.1

## Sectoral Composition of SEZ investment



Source: Calculated from Ministry of Commerce data, GOI-2008 ([www.sezinida.nic](http://www.sezinida.nic))

As shown in the above diagram, Information Technology (IT) and Information Technology Enabled Services (ITES) dominate the sectoral distribution constituting nearly 62 percent of the total approved SEZs. The next largest categories, multi-product SEZs and biotech stand at a distant second position. It appears that SEZs are in large measure becoming IT zones. The reasons for such a high demand for IT SEZs warrant a brief analysis. While the sector already enjoys a wide of range of exemptions and incentives, even then it holds a majority share in the total approvals. The tax benefits, tax holidays and other incentives that the companies in this sector are enjoying are going to end. In such a situation, shifting their companies to the SEZs might allow them an extension of tax incentives and other exemptions for another decade at the least. If this is so, then the sustainability of SEZs becomes questionable, since it strengthens the apprehension that the exemption system in the SEZs may be promoting only the shifting of existing investment rather than bringing in fresh investments. Another aspect of the IT and ITES sector is that the employment generation for a given investment is very limited because of the capital intensive structure of production. For example, for the financial year 2006-07, the sector including engineering services and Research and Development and software products accounted for 4.3 percent of the GDP, with four-fifths from exports, but accounted for just about 0.3 percent of the country's employment.

Table 2.6

## Sectoral Distribution of SEZS

Sectors	Former Approvals	In principle approvals	Notified SEZ's
Aviation/Aerospace	1	2	
IT/ITES/Electronic Hardware/Semiconductor	341	11	181
Textiles/Apparel/Wool	20	13	10
Pharma/chemicals	22	2	14
Petrochemicals & petro	4	0	1
Multi-Product	23	53	12
Building product/material	1	2	
Beach & mineral/metals	3	0	1
Bio-tech	26	1	9
Ceramic & glasses	1		
Engineering	23	10	14
Multi-Services/Services	16	11	5
Metallurgical Engineering	1		
Electronic prod/industry	3	4	3
Auto and related	3	5	1
Footwear/Leather	7	2	4
Gems and Jewellery	10	4	3
Power/alternate energy	4	1	2
FTWZ	7	8	1
Metal/Stain. Steel/Alum/Foundary	8	4	3
Food Processing	4	2	3
Non-Conventional Energy	4		1
Plasting processing		1	
Handicrafts	4	1	1
Agro	5	3	2
Port-based multi-product	7		2
Airport based multiproduct	2	1	
Writing and printing paper mills	2		1
<b>GRAND TOTAL</b>	<b>552</b>	<b>141</b>	<b>274</b>

Source: Calculated from Department of Commerce data, GOI-2008 ([www.sezinida.nic](http://www.sezinida.nic))

Further, its enormous impact on real estate is evident which remains an important aspect in the functioning of the SEZs, since it shares certain commonality with the real estate sector. In fact, it is reflected in the sectoral distribution of investment in the development

infrastructure. This distribution is even more skewed than the overall sectoral distribution of SEZs. Two types of SEZs, IT and Multi Product SEZs, form 70% of all applications by the real estate companies. More than half of the Zones applied for by real estate companies are IT SEZs. It is not difficult to understand the reasons for this trend since the primary goal of real estate developers in the creation of SEZs is to draw sufficient units to make as large a tax-free profit as possible. Moreover, the country's real estate investors are not competing to build new infrastructure for new industries, but in particular to gain access to the supplying of infrastructure to IT companies since it is an area where additional investment was not in need of a new incentive policy. In short, the sectoral distribution is more skewed and dominated by speculative and real estate business than the companies engaged in commodity production.

### **The Coming of the SEZs: Implications for Regional Development**

It was a widely-accepted proposition that the reform period witnessed considerable disparity in growth performance of the Indian states. In fact the reform accentuated this disparity for some states. However, the basic tenet of the market is that capital would move from a capital-rich region to a capital-scarce region where it might command higher returns, which led to the expectation that it would lead to some convergence following the reform. But the net result of the reform appears to have proved the contrary. By the same logic, it was expected that SEZs would be established in backward regions to develop infrastructure, thereby generating external positive economies for such regions. But as the table and map below conclusively shows, only a select few states are sharing the largest number of Zones, displaying a trend towards concentration. For example, out of the 552 formal SEZ approvals, Maharashtra accounts of the largest number (95), followed by Andhra Pradesh (94), Tamil Nadu (60), and Karnataka (48). These states account for nearly half of the total SEZs approved. Similarly, within these states too, only a certain regions absorb the majority of the Zones. For instance, in Tamil Nadu, the districts round Chennai account for one-third of the approvals. The fact that the establishment of zones would further aggravate the regional disparity was recognized by none other than the Reserve Bank of India itself. There is a tendency among states to give more tax concessions and incentives in order to woo the investors to their states, leading to process of intense competition known as the "Race to the Bottom". The states which have established functional SEZs have in general created the necessary infrastructure through

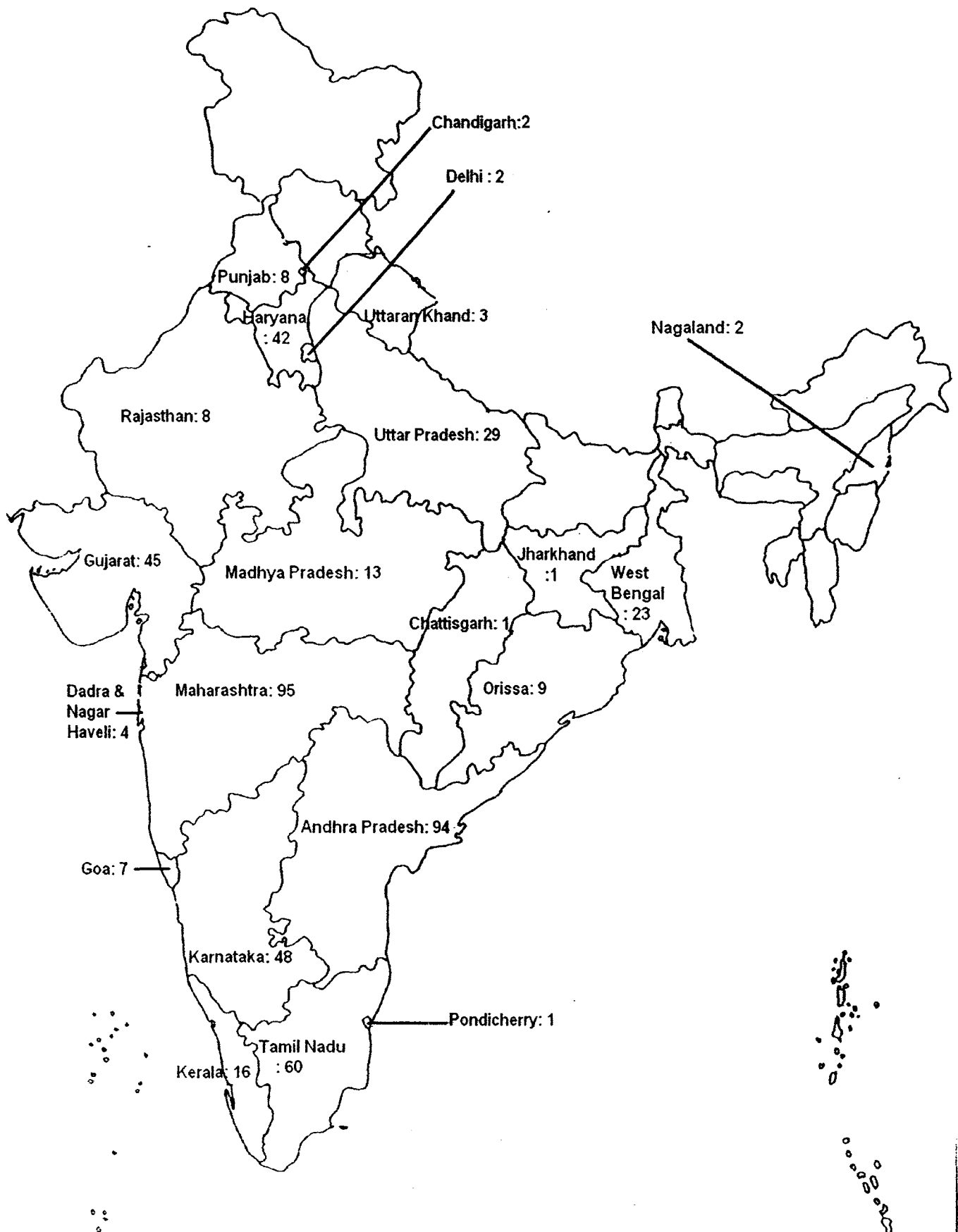
expensive public investments rather than through private investments, an aspect which requires a detailed analysis.

**Table 2.7**

**Table: State-wise Distribution of Approved SEZs in India (May 2008)**

State	Total Area in Hectares	Percentage Share of Major Sectors					
		IT/ITES	Biotech	Pharmaceuticals	Textile	Multi Products	Others
Andhra Pradesh	10,825.49	13.18	0.47	6.19	3.73	63.15	13.28
Chandigarh	58.46	100.00					
Chattisgarh	10.77	100.00					
Dadra Nagar Haveli	117.75	11.99			67.94		20.07
Delhi	386.04	19.38	17.83	31.92			30.87
Gujarat	33803.17	4.37	0.04	.17	0.32	48.70	56.40
Haryana	1,687.22	34.16	3.49		6.80	42.49	13.06
Jharhand	36.00						100.00
Karnataka	2712.21	39.72	2.70	32.04	8.60		16.94
Kerala	619.17	31.44	1.94				66.62
Madhya Pradesh	547.21	63.23				18.27	18.50
Maharashtra	11361.04	12.75	1.91	6.17	7.04	48.73	22.4
Nagaland	450.00					88.89	11.11
Orissa	1953.36	9.58				51.01	39.41
Pondicherry	346.00					100.00	
Punjab	284.07	18.33		8.33	35.67		35.67
Rajasthan	541.10	18.33			19.11		68.56
Tamil Nadu	58500.72	58.44			0.17	3.95	37.44
Uttarakhand	468.20	6.10				93.90	
Uttar Pradesh	847.67	37.50			12.23	12.23	38.04
West Bengal	521.52	80.81	1.99				17.20
<b>All India</b>	<b>126077.17</b>						

Source: Calculated from Ministry of Commerce data, GOI-2008 ([www.sezinida.nic](http://www.sezinida.nic))



**Map 2.1: State Distribution of SEZs in India**



### **The SEZ Act and its Implications**

A comprehensive Act regarding Special Economic Zones was enacted and passed by the Indian Parliament in May, 2005 which received Presidential assent on the 23<sup>rd</sup> of June, 2005. It was intended to provide a uniform framework for the creation of SEZs and other similar zones. *The act was armed with the amended rules and other legal instruments and came in to effect on 10<sup>th</sup> February, 2006.* Prior to this Act, the SEZs came up replacing the earlier EPZ regime from 1<sup>st</sup> November 2000 to 9<sup>th</sup> February 2006 under the provisions of the Foreign Trade Policy.

The importance of this Act cannot be overemphasized. It has 'supreme' power and can only be modified by an amendment in the Parliament, whereas all other policies or rules pertaining to economic zones which have so far existed can easily be modified through a notification of the central or the state government. Being unable to withstand or respond satisfactorily to the objections raised from different quarters, the central government bypassed many parliamentary procedures and did not even adequately debate its various provisions in the house.<sup>51</sup> For our analysis of this Act and related policies, we can select four basic aspects of the Act itself: the process of declaration of SEZs, the operation and regulatory mechanism inside SEZs, the provisions relating to taxes and fiscal incentives, and provisions relating to institutions of governance inside the Zones.

**Declaration of a Special Economic Zone:** How can a Zone be created and who is eligible for it? The Act provides that,

*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.*<sup>52</sup>

Anyone who wishes to establish a Zone is known as the developer. If a person or companies intend to create an SEZ, they may apply for the same either to the state government or directly to the Board of Approvals at the centre. However, in the later case the state government must be consulted and impressed upon.<sup>53</sup> If an application is forwarded to a state government, it has to send the application to the Board to Approvals

<sup>51</sup> Shankar Gopalakrishnan (2007).

<sup>52</sup> Section (3), Clause(1) of the SEZ Act, pp. 5.

<sup>53</sup> Section (4) of the SEZ Act.

after clearing it. However, a state government does not have any power to reject that proposal. This aspect gives more power to the centre to go on with its policies even if a state government does not toe that line. Thus, all applications except those of the central government have to be placed before a centralized body known as the Board of Approvals. The Board consists of the following members:<sup>54</sup> the Chairperson, who will be an Additional Secretary of the government of India or a bureaucrat of higher rank in the Ministry of Commerce, two joint secretaries or higher rank officers from the department concerned with Revenue, joint secretary or higher rank from the Ministry of Finance, upto ten officers representing Ministries of 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, a nominee of the concerned state government, Director General of Foreign Trade, a Development Commissioner (in case of applications for units in a zone), a professor of one of the Indian Institutes of Management or Indian Institute of Foreign Trade, deputy secretary or higher rank from the Department dealing with Special Economic Zones will be the Member-Secretary for the Zone.

This body evidently consists almost of the bureaucrats of the central government with the only exception of one non-official member who is a professor from an academic institution. After approving the proposal the Board is supposed to ensure that the approved proposal satisfies the minimum requirements for the various types of SEZs.

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<sup>54</sup> Section 8(2) of the SEZ Act of 2005.

Type of Special Economic Zones	Requirements
Multi Product.  Manufacture/rendering services of two or more goods/services in a sector or goods / services falling in two or more sectors	At least 1000 hectares of total area or more but not exceeding 5000 hectares, relaxation to the size for some states <sup>55</sup> particularly for north east states.  At least 35% of this area must be earmarked as a processing area <sup>56</sup> that can be relaxed to 25% by the central govt.
Single Sector for port and airport alike services	At least 100 hectares of total area, however, relaxation for some states, particularly for north east states.  At least 50% processing area.
Single Sector for IT, ITES, and Biotechnology etc.	At least 10 hectares of Contiguous area with the varying degree of built up processing area.
Free Trade and Warehousing Zone <sup>57</sup>	At least 40 hectares of contiguous area with a minimum of one lakh Sq m of built up processing area. For Multiproduct SEZ no minimum area is required, but the maximum area cannot exceed 25% of the processing area.

Apart from the above requirements, the only necessary requirement is that the concerned state government should certify whether the proposed land falls under reserved or any ecological area. After this, if the developer is in possession of the land, the Board shall then issue a former approval, and in its absence an “in principal” approval is issued. The developer is required to show that the land is contiguous and vacant and this has to be certified by the concerned state government. In sum, the only criteria and concrete requirement that the developer should have is the specified land requirements. This is

<sup>55</sup> SEZ rule 2006 was amended to relax the minimum area for certain states, particularly for North eastern and Union territories. And the Empowered Group of Ministers (EGoM) brought down the cap on the maximum size of a single SEZ from 10,000 to 5,000 hectares.

<sup>56</sup> The percentage of processing area in total area has been increased from 35% to 50% through an amendment in the rules due to the criticism of the possible speculative activities in the remaining area.

<sup>57</sup> Rule 5(2) (c) of the rules, the 40 hectares of contiguous area is required only when it is not set up as a part of a multiproduct SEZ.

enough to get an SEZ declared, notwithstanding the lofty objectives declared in the policy. Nowhere in the Act are the stated objectives like export promotion, infrastructure development and employment generation finds a mention as necessary condition for setting up SEZs.

### **Operations in SEZs**

Once the Zone is created, the central government appoints a Development Commissioner for the Zone.<sup>58</sup> The Commissioner has the status of an appointed governor or the de-facto government of the Zone with enormous powers, and his/her primary mandate is to ensure speedy development of the Special Economic Zone and promotion of exports.<sup>59</sup> The Commissioner alone has the powers to demarcate areas within an SEZ, either as processing areas for manufacturing goods or any other productive activities, and non-processing areas for any other activity. Simultaneously, s/he also has to get consent from the Board of Approvals for the operations in the SEZ which will then be eligible for subsidies and tax and duty exemptions. The procedure of setting up a unit in a Zone is completed through the following steps. The entrepreneurs, according to the Act, who wish to set up units in the SEZ, have to apply to the Development Commissioner with a copy to the developer. The application is then forwarded to the Approval Committee, which has to take certain factors into account while considering the application for setting up a unit. These factors are: the unit should have a positive net foreign exchange within the first five years,<sup>60</sup> environmental and pollution clearance from the concerned state, other sector-specific requirements for certain industries.

Based on the approval of the Committee, the Development Commissioner issues a letter of approval and authorizes the unit to undertake operations. After this, the Approval Committee and the Development Commissioner are expected to monitor the compliance of the units with the conditions specified in the approval. Notwithstanding the complex procedure for setting up a unit in the Zone and the stated objectives of the government, the only binding requirement on any unit for operating in the Zone is that it should generate a net positive foreign exchange. This condition too is applicable only for the

<sup>58</sup> Clause 11 of the SEZ act, Central Government can appoint any of its officer not below of the deputy secretary as the development commissioner of one or many of the SEZ.

<sup>59</sup> Section 12, clause (1) of the SEZ Act.

<sup>60</sup> Rule 18, clause (3) of the Rules. probably the only binding requirement for a unit in the Zone.

manufacturing or services units operating in the Zone. The developer, however, is free to use land in the non-processing area for any other non-productive purpose, from establishing an education institution to building an entertainment theatre or residential quarters, etc. All such development will also be eligible for tax and other concessions if they are part of the authorized operations.<sup>61</sup> Some argue that this particular clause in the Act, apart from some other similar provisions, would only encourage real-estate and speculative businesses than rather productive industries.<sup>62</sup>

### **Fiscal Incentives and Concessions**

Another contested area in the Act is the provision pertaining to incentives and concessions to the developer of the SEZ and units operating within it. Since an SEZ is considered to be a foreign territory within the country and the rest is deemed as Domestic Tariff Area (DTA), goods or services exchanged between these two 'areas' is considered as exports and imports. Both the developer of an SEZ and units under it are entitled to complete duty exemption on imports into and exports from the SEZ. They are also exempted from payment of central excise or duties on goods imported from the DTA which is the area outside the SEZ, payment of service tax, central sales tax and securities transaction tax.<sup>63</sup> Most of the taxes that are normally applicable in procuring goods in the economy are not applicable to SEZs.<sup>64</sup> Units enjoy a fifteen year income tax holiday, consisting of a total exemption for the first five years, 50 percent exemption for the next five years, and 50 percent on reinvested export profits for the following five years, with the condition that funds are credited to a SEZ Re-investment Reserve Account. In addition, the developer gets a 100 percent tax exemption for the initial ten years. These exemptions are also available to any contractor who is employed for setting up a factory unit. Service tax exemptions are also applicable, including any service related to an authorized operation inside an SEZ. Apart from the incentives in the form of tax and duty concession given by the central government, the state government is also mandated by the rules according to which it can exempt SEZ units and developers from all local taxes, duties and so on, including those levied by local bodies for purchases from the domestic

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<sup>61</sup> Rule 11, clause (10).

<sup>62</sup> Sridhar (2007).

<sup>63</sup> The changes in this incentive structure was brought by amending several pieces of existing legislation such as the Banking regulation act, the Income tax act, the Insurance act, and the Stamp Duties Act.

<sup>64</sup> Shankar Gopalkrishnan (2007).

tariff area.<sup>65</sup> External commercial borrowing by SEZ units up to U.S. \$500 million in a year without any maturity restriction through recognized banking channels is facilitated. In addition, electricity taxes and duties are also removed for the electric power that is being consumed within the processing area.

The above mentioned clauses in the Act have received strong criticism from all sides, including from the international financial institutions like the World Bank and the International Monetary Fund. Some argue that exemption from service tax and income tax to units composed of International Financial Service Centers and Offshore Banking facilities would become tax havens for speculative capital.<sup>66</sup> This objection is put forward even after recognizing the need of these institutions for efficient financial intermediation and credit delivery for the purpose of industrial and export promotion within the SEZs. Moreover, the Approach Paper to the Eleventh Plan has also observed that there are concerns that SEZs primarily focus on real estate, that there is a lack of level-playing ground between manufacturing units within SEZs and those in the Domestic Tariff Area outside, and that there can be large loss of revenue on account of concessions for exports of goods and services that are already been exported without such concessions. These concerns need to be addressed, and where necessary, adequate safeguards have to be put in place. An estimate made by the Finance Ministry based upon the first 70 SEZ proposals which were cleared by the Board of Approval showed a loss of total tax revenue worth Rs. 1,02,621 crores in the period of 2006-07 to 2009-10 on account of the tax incentives provided under the SEZ Act. Of this amount, direct tax itself constitutes Rs. 53,740 crores while indirect tax has a share of Rs. 48,881 crores.

### **Labour Laws**

Initial draft of the SEZ Act proposed to suspend labour laws in SEZs in their entirety. However, after facing serious criticisms from many quarters, the government reformulated the Act. The revised Act provided that the central government's powers to repeal or modify laws would not apply to any law or regulation relating to trade unions, industrial and labour disputes, welfare of labour including conditions of work, provident funds, employer's liability, workmen's compensation, invalidity and old age pensions,

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<sup>65</sup> Rule 5, clause (5) of the rules.

<sup>66</sup> Parliamentary Left dissent note given to the Parliamentary Standing Committee.

and maternity benefits applicable in any SEZ.<sup>67</sup> This new formulation in the Act was apparently intended to provide protection to the workers and against the possibility of labour laws being suspended in the SEZs. However, this protection was taken away or undermined by other legal provisions in the rules elsewhere. For instance, the rules require that the state governments declare SEZs to be public utility services, and delegate the powers of the Labour Commissioner to the Development Commissioner. Many state level policies for SEZs invoke exemption clauses in the various labour laws to ensure that the provisions of those Acts will in any case be relaxed, because the SEZ Act bars only the central government and not the state government from relaxing labour laws. These include exemptions from the Minimum Wages Act, the Contract Labour (Regulation and Abolition) Act, the Employees State Insurance Scheme, requirements for public posting of information, and so on.

Thus, one serious lacuna in the Act and the related rules is that, on the one hand the state governments are mandated to formulate SEZ policies in such a way that they grossly damage the existing system of labour rights, while on the other, the power of the Labour Commissioner is being delegated to the Development Commissioner. It has often been complained that the Development Commissioner is only interested in projecting the image of the Zone in order to attract more investment. In short, the clauses in the Act and the related rules make labour subservient to capital in an open form.

### **Governance in the Zone**

The most controversial aspect in terms of the administration of the Zone is the issue governance in the Zones and the enormous power the Development Commissioner enjoys. The SEZ Act and Rules together provide a comprehensive scheme for the governance of SEZs, which is a crucial element for the functioning of the Zones. The Development Commissioner in most states is the final authority for most clearances and on issues related to labour rights. This in large measure transfers the regulatory authority of various state bodies to the Development Commissioner. For instance, judicial and policing functions are also completely changed. No investigation, search or seizure can be carried out in an SEZ by any agency or officer without the prior permission of the

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<sup>67</sup> Section 49 of the SEZ Act.

Development Commissioner.<sup>68</sup> The only exception can be in the case of notified offences, which the central government can notify under the Act.<sup>69</sup> Even in the case of such offences, the Development Commissioner must be intimated. The Act also provides that there will be special courts set up within the SEZs for both civil and criminal matters, and these courts will be the only courts that can hear any civil dispute within an SEZ or any trial of a notified offence.<sup>70</sup> Ordinary criminal trials of non-notified offences can take place in ordinary courts, though no investigation of such crimes is possible without the authorization of the Development Commissioner. Through this process, a system of a separate judiciary is established, of which the Development Commissioner becomes the head.

Since there is no provision to have any democratically elected body of local governance in the SEZs, it has been argued that the setting up of SEZs constitute a violation of the basic character of the Indian Constitution.<sup>71</sup> It was also reaffirmed by the sixth report of the Second Administrative Reforms Commission.<sup>72</sup> The Commission categorically stated that local bodies should have full jurisdiction with regard to enforcement of local civic laws in the SEZs. This possibility was however largely negated, because apart from the provisions of the central Act, the state policies also declared that SEZs can be notified as industrial townships under the Article 243Q of the Constitution. Once it is notified under this Article, they are exempted from the provisions of Part IX of the Constitution, which mandates for elected local governments. In Maharashtra, for instance, draft of the Maharashtra Special Economic Zones Act stated that this body would have three nominees of the SEZ developer and the two of the state government. In sum, all the provisions amount to building a structure of governance where every arm of the state, from police, judiciary to local governance, are all brought under the control of the Development Commissioner. Although it appears that these provisions are made for administrative purposes, its political implications are far reaching.

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<sup>68</sup> Section 22 of the SEZ Act.

<sup>69</sup> Section 21, clause (1) of the Act.

<sup>70</sup> Section 22 of the SEZ Act.

<sup>71</sup> Jain (2008).

<sup>72</sup> Quoted in Sivaramakrishanan (2008).



## Land

The most contentious aspect in the Act is related to the provisions of land acquisition. The colonial Land Acquisition Act of 1894 has been used to acquire lands for SEZs. Land can be acquired under this Act only for public purposes, which is defined in Section 3(f) of the Land Acquisition Act, which excludes private companies. However, in many cases, irrespective of whether the developer is from the public sector or the private sector, land for SEZs has been obtained using this Act. The principle of “eminent domain” –which is the basis of Land Acquisition Act of 1894– is being used and even given priority for land acquisition over the principles in the 73<sup>rd</sup> and 74<sup>th</sup> amendments of the Constitution. The judiciary gave the verdict that once the government has acquired land<sup>73</sup> it can sell, dispose of, or transfer rights of its land at will to whomsoever it wants to, irrespective of the original intent of acquisition. After this verdict, many state governments formed their own constitutive bodies to acquire land and then sell back to private investors and developers.<sup>74</sup> In some states these constitutive bodies work as “land banks”. However, the Ministry of Commerce subsequently sent a letter to the state chief ministers, advising them to restrict acquisition of multi-crop agricultural land to 10 percent of the total area acquired for an SEZ. The rest has been left to the states, since land as well as compensation and rehabilitation policy falls within the domain of the state governments.

After this brief discussion about various aspects of the SEZ Act, we can reiterate some of its important features in a summarized form. First, the only requirement that is needed for the creation of an SEZ is the minimum land requirement specified in the act. Second, the only requirement which is binding for the SEZ developer for receiving government incentives is the positive net foreign exchange earnings by units in the SEZ. Other objectives, namely, exports, employment generation, infrastructure creation etc. are not binding on the developer. Third, the SEZ Act gives enough scope for state governments to dismantle all labour laws while it bars only the central government from doing so. Fourth, no democratic local governance institution can exist within the SEZs. All powers are granted to the Development Commissioner, who is an appointee of the government.

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<sup>73</sup> Supreme Court has given the judgment saying that land can be used as the government intends.

<sup>74</sup> For example, Tamil Nadu government formed SIDCO for small industry development, bought vast land for the same. But those lands are being redistributed to the SEZ developers.

## **CHAPTER III**

### **A CASE STUDY OF SEZ IN TAMIL NADU: AN APPRAISAL OF COSTS AND BENEFITS**

It is often said that Tamil Nadu is one of the few states that is surging ahead steadily embracing neo-liberalism in the country. The state has been following the neoliberal model in 'consistent' with the centre, adopting all the policy measures from implementing the FRBM Act to bringing down fiscal deficit as well as establishing numerous SEZs as the model for industrialization. Expectedly, these policies have also produced an unprecedented growth rate in the state economy. As shown in Table 1, the state economy has witnessed high growth rate consistently thus elevating the national economy on a higher growth plane. Except for 2002-2003, the state economy in Tamil Nadu has been growing on an average of more than 8 percent, finally settling at about 7 percent for the period of 2002-07. However, the same policies which produced higher growth have also brought higher disparity: between sectors in growth rate, among different regions, and sharpening the divide between urban and rural.

**Table 3.1: Sectoral Performance of the State Economy** (Figures in crores)

Sector	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2002-07 (AAG)
Primary	23283	19648 (-18.5)	19480 (-0.9)	22825 (17.2)	25239 (10.6)	26351 (4.4)	2.56
Secondary	37405	41515 (9.9)	44408 (7.0)	47809 (7.7)	50702 (6.1)	54208 (6.9)	7.52
Tertiary	77792	81203 (4.2)	87027 (7.2)	97141 (11.6)	104179 (7.2)	112844 (8.3)	7.7
GSDP	138480	142366 (1.8)	150915 (6.0)	167775 (11.2)	180120 (7.4)	193403 (7.4)	6.76

Source: DOES, the figures in the bracket are annual growth rate, AAG: Annual Average Growth rate.

The primary sector which holds more than 50 percent workforce had witnessed continuous negative growth for two consecutive years and finally settled at 2.56 percent average for the period 2002-07. Its share in GSDP has also come down drastically. The sector which contributed 24.79 percent of the Gross State Domestic Product in 1993-94, dropped to 18.22 percent in 2001-02, and further declined to 13.62 percent in 2006-07.

Not just agriculture, even industry witnessed decline in its share although it grew by 7 percent average for last five years. For instance, the sector which contributed to GSDP 33.69 percent in 1993-94, dropped to 31.02 percent in 2001-02 and further declined to 28.02 in 2006-07. Only the tertiary sector's contribution to GSDP, which was 41.52 percent in 1993-94 increased to 50.76 percent in 2001-02 and increased further to 58.34 percent in 2006-07.<sup>1</sup>

Notwithstanding the disparity across the sectors produced by the neo-liberal policy measures, the state government is determined to advance more aggressively on the same mode. In the recent industrial policy note, it argues that it is going to raise the

<sup>1</sup> *Annual Planning Report (2006-07)*, Tamil Nadu, Sec. 1.2.1, p. 3.

contribution to GSDP by the manufacturing sector from 21 percent to 27 percent and by 2011 make Tamil Nadu the manufacturing hub of the whole country.<sup>2</sup> Bringing more investment in automobiles and electronic and communication industries are seen as the mission to achieve that vision of “manufacturing hub”. Actually, the state has been trying to bring in more investment in Automobile sector as it calls itself the “Detroit of India”.<sup>3</sup> In fact, it has been chosen for setting up of the Global Automotive Research Centre at Oragadam near Chennai. The electronic hardware and communications industries are also portrayed as ‘Sunrise Industries’ in the state.

The state needs tremendous investment to achieve the vision of making Tamil Nadu a “manufacturing hub” and to maintain the “Detroit of India” status. And it appears that the state has invested all its hope in the Special Economic Zones to realize its dream. In fact, Tamil Nadu was one of the few states which had formulated the SEZ policy even before the centre had enacted the SEZ Act in 2005. The state’s SEZ policy contains even more tax concession and incentives than the central Act provides. Because of which, the state started attracting more foreign and domestic capitals for establishing SEZs. Now it has 44 notified SEZs, the highest among states in the country. In terms of approval, with 66 zones in hand the state stands next to Maharashtra (104) and Andhra Pradesh (99). The state has offered massive tax concessions and incentives to these zones. If competition among nations in offering incentives to attract investors leads to “Race to bottom”, it is truer for the states in India.

### **A Case Study of SEZ: Nokia India Limited**

As more and more SEZs are mushrooming in the state to avail the incentives and tax concessions, the model of SEZs needs a thorough analysis. As a case study, we have taken Nokia India Ltd. This Special Economic Zone is situated in the Suburb of the city of Chennai in Tamil Nadu and has been celebrated as one of the main cases which prove the success of Special Economic Zone policies in the country. The Nokia project has

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<sup>2</sup> *Industrial Policy* (2008), Government of Tamil Nadu.

<sup>3</sup> *Industrial Policy* (2008), *ibid.*

been praised for providing foreign investment, generating employment, building infrastructure, and for its export of mobile phones. Also probably, it was among the first major foreign investment that came specifically for the benefits offered in Special Economic Zones, by signing an agreement on 6th April 2005 with the Tamil Nadu government<sup>4</sup>. And most importantly, this project is very much in line with the current trend of neoliberal industrialization in India anchored tightly to the visions of the SEZs. Hence a study of this project would highlight, and help us evaluate, many of the important characteristics of the SEZ as a model for industrialization that has been envisioned and aggressively pushed by many states in India.

### **Costs and Benefits**

For our analysis, we will just try to quantify the costs and benefits of the Nokia project on the limited information gathered through RTI from Tamil Nadu Industry Department and the data from Nokia office and Ministry of Commerce. A few interviews with the workers and officials at SIDCO and the Zone enriched the set of information. The major tax benefits and other benefits offered to the company, in a way stands as the costs to the Government. We take the objectives enshrined in the SEZ act as the benefits of the project to the government and society at large: These are, to (i) generate additional economic activity, (ii) promote exports of goods and services, (iii) promote investment from domestic and foreign sources, (iv) create employment opportunities, and (v) develop infrastructure facilities. There are variable that are not measurable given the limited information. For instance, we are unsure about the positive net employment generation since there is no proper data available about the destruction of employment caused by the zone. Similarly there are certain costs that stand difficult to measure. None the less, for our cost analysis, we take the following: Land subsidy, Capital Subsidy, Stamp Duty, Sales Tax, Corporate Income Tax and Import duty.

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<sup>4</sup> The first Memorandum of Understanding between signed by the Tamil Nadu government and Nokia India Ltd.

**Land Acquisition:** Land acquisition process for the Zone is unique in nature because there was neither market mechanism nor any meeting of buyer and seller in any form. It was simply the state which acquired the land from farmers and handed over to the company. First land for the SEZ was allotted to Nokia from SIPCOT Industrial Park, 38 Phase III; plot A1 at Sriperumbudur on the outskirts of Chennai. This land had earlier been acquired through a government order in February 1997<sup>5</sup>. The company had no correspondence with farmers to buy the land. The land was simply allocated to the company at the rate of Rs. 8 lakhs per acre as a lease charge on 99 year leasehold tenure without any annual or monthly rent payable.<sup>6</sup> Even that minimum amount somehow got renegotiated down to Rs. 4.5 lakhs per acre in the second MoU of July 2005 for a total of Rs. 9.49 crores for 210.87 acres of land.<sup>7</sup> In fact, a report from the Comptroller and Auditor General (CAG) questioned how the entire process was done and after that the amount came down<sup>8</sup>. It also specified the actual acquisition cost for the government since some owners went to court for better compensation. The court awarded higher compensation ranging from Rs.4.20 lakh to Rs.14 lakh per acre *plus* other statutory benefits (like solatium at 30 percent of compensation amount and interest on the compensation amount from the date of acquisition of land till the date of payment). Thus according to CAG report the resulted loss stands at Rs. 7.4 crore for SIPCOT. But actual loss was even more than the CAG reported. As shown in table 2, if we just calculate the differences between the rate actually paid by the company and the rate initially agreed, it appears that the amount is more than double the amount paid by the company.

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<sup>5</sup> It was initially bought by the SIDCO, a nodal agency of the government which is virtually working as a land bank.

<sup>6</sup> The MoU, p. 5, Annexure-A.

<sup>7</sup> There was a mention of the arrival price in the MoU. And the current price of the land at the same area is Rs. 60 lakh per acre and thus the value must have been significantly higher than Rs. 8 lakh in 2005. SIPCOT, Sriperumbudur, [http://www.sipcot.com/Industrial\\_complex\\_sriper.htm](http://www.sipcot.com/Industrial_complex_sriper.htm).

<sup>8</sup> Report of the Comptroller and Auditor General (CAG) for 2007, p. 81.

**Table 3.2: Land cost and loss for the Exchequer** (Figures in crores)

	Land cost	Solatium 30%	Total land cost	Total loss
Actual Paid by company	9.49	-	9.49	
Average compensation	19.19	5.76	2.49	15.45
Maximum compensation	29.52	8.86	29.52	28.88
Agreed in MoU	16.86	5.06	21.93	12.44

Source: Calculated from the data of CAG report

In addition to that amount, if we add up the average compensation paid by the government because of the court verdict<sup>9</sup> the loss is 15.45 crore which is more than the double the amount the company paid. The court even asked the government to pay the interest rate of the compensation for the whole period. But the interest amount was not added here since the data was not available.

**Stamp Duty:** The state government has made loss not just in land acquisition alone; it also made loss in collecting the stamp duty on the land sold out to the company. In the initial agreement, the stamp duty was there, however, it was removed from the agreement through an additional agreement signed in July 2005<sup>10</sup>. The stamp duty is 4 percent of land value which is Rs. 38 lakhs if it is calculated from the official value. However, if it is calculated from the value that was supposed to be paid as per the initial agreement, it would still be higher. The difference in the land value between the amount that was supposed to be paid and the amount that was actually paid was elaborated in the earlier section. The hidden land subsidies have not stopped yet. Further, though the land was allotted to the company on lease of 99 years, if the company wishes, it is free to make a profit by subletting the land and charging a higher price. The only condition is the profit should not exceed the 50 percent of the difference of between SIPCOT's prevailing

<sup>9</sup> Madras High Court ordered the state government to hike the compensation but exact the amount is not clear. For further details see CAG Report 2007.

<sup>10</sup> MoU, July 2005.

allotment rate (in respect of the allotted land) and the value paid by the company as consideration for grant of the land, as on the date of such assignment<sup>11</sup>. Thus the company enjoys dual benefit as developer of the zones as well as an operating unit within it.

**Sales Tax (VAT):** One of the founding pillars for SEZs is export promotion. It is a theoretical base for establishing Zones in India and elsewhere. But surprisingly, the main tax incentive offered by the Tamil Nadu government was to reimburse Nokia for VAT (Valued Added Tax). VAT is only a cost to the company when it sells within India, since export products are not going to attract this tax. This indicates that already from the start the company planned to sell a significant amount of its phones in the Indian market. Normally, companies are able to recover VAT on the materials and services they buy when they sell goods or services directly to end-users. A company charges VAT on sales and deducts whatever it had paid for inputs which implies that this is a tax only on the added value. But supplies to a SEZ do not attract VAT in the first place since it is zero-rated according to the Tamil Nadu VAT Act 2006.<sup>12</sup> However, it still attracts if goods move from SEZ to DTA. This means that if Nokia had planned to sell its mobile phones within India it would have to bear the full VAT cost. But the state government offers to bear the cost of VAT on behalf of Nokia as mentioned below:

Sales from the SEZ to the DTA will be liable for VAT and Central Sales Tax. Such VAT and CST will be refunded for the residual period<sup>13</sup>. A suitable mechanism would be worked out by the state government to enable Nokia to get the refund every month without any loss of time.<sup>14</sup>

Although VAT has been implemented across India in recent years, different state governments have the right to set their own rates. For instance, it is 4 percent on mobile phones in Tamil Nadu but in West Bengal it is 12.5 percent.<sup>15</sup> There are two cases to be considered for the reimbursement of VAT/Sales Tax. The first is when Nokia sells mobile phones inside Tamil Nadu and outside. For our calculation we take 4 percent for

<sup>11</sup> Deed of Lease entered into on 19 July 2005 between Nokia and SIPCOT.

<sup>12</sup> MoU, (2005), p. 12.

<sup>13</sup> 10 years minus period for which waiver availed in the pre-VAT scenario.

<sup>14</sup> MoU, (2005), p. 12.

<sup>15</sup> An online Database on Tax related issues, <http://taxonline.net.in/STPI%20and%20SEZ/chap009.htm>



Tamil Nadu and Average VAT for the rest of India. The average was calculated as 8 percent taking the minimum 4 percent and maximum 12.5 percent for different states. As shown in the table, the amount to be reimbursed becomes very large given Nokia's position as market dominant in India.

**Table 3.3: Sales Tax loss to the exchequer** (Figures in crores)

	2006-2007	2007-2008
Total sale in Domestic Tariff Area(DTA)	4785.53	5904.53
Sale in Tamil Nadu <sup>16</sup>	287.13	354.27
Sale in the rest of india	4498.40	5550.29
Tax loss in Tamil Nadu (VAT 4%)	11.48	14.17
Tax loss in the rest of India (VAT 8%) <sup>17</sup>	359.87	444.02
Total tax loss	371.36	458.19

Total sales in DTA in 2007-08 were of Rs. 4785.53 crores, signifying that VAT of Rs. 371.36 crores would have been paid by the Tamil Nadu government to Nokia. Nokia's sales figures in Tamil Nadu are not known compared to the entire country, but if we assume it is about 6 percent as proportionate to the total population of India, Rs. 287.13 crores were the sale amount in Tamil Nadu for 2006-07. The state government must have paid to the company Rs. 11.48 crores for sales in Tamil Nadu alone. Similarly for 2007-08, the state should have paid to the company around Rs. 458.19 in total, of which Rs. 14.17 was for Tamil Nadu and Rs. 444.02 was for the rest of India.

However, the agreement has a cap on the amount the government is supposed to pay. According to the agreement, the "total avilment of such concessions shall not cumulatively exceed the investment made by Nokia in eligible fixed assets within 3 years

<sup>16</sup> The amount was calculated taking 6 percent population as the proportion to the total sales.

<sup>17</sup> The 8 percent VAT was calculated by taking average from the lowest VAT rate and Highest VAT rate in different states.

of signing of MoU".<sup>18</sup> But the cap was elevated later to the extent of additional investments from three years to five years. As per this clause, the reimbursed amount has actually exceeded the amount invested in fixed assets. Because, the company initial investment was Rs. 675 crore of which Rs. 300 crore were in fixed eligible assets. Only recently in 2008 the investment was increased by another Rs. 330 crores. In effect, the state government has itself borne the investment cost of the company.

**Capital Subsidy:** In addition to the heavy subsidies on of Land, on stamp duty and through various tax concessions, subsidy in the form of capital support was also offered to the company.<sup>19</sup> It is the state government's New Industrial Policy 2003 which offers mega projects that exceed investment of Rs. 200 crores and above would be eligible for a subsidy of Rs.100 lakhs. Since the Nokia's investment exceeds the minimum set amount, thus it is also eligible to enjoy that subsidy. The subsidies and tax concessions have not stopped yet. There are hidden forms of tax concessions such as Works Contract Tax, Lease Tax and Entry Tax that are not known, since no data is available.

**Corporate Income Tax:** Another important component of the incentive structure offered to the SEZs is Income Tax holidays. Nokia enjoys 100 percent income tax exemption on export income for SEZ units under section 10AA of the Income Tax Act for first five years, 50 per cent for next five years thereafter and 50 per cent of the ploughed back export profit for next five years. Due to paucity of the data, exact figure of net profit is not available to calculate the loss of corporate income holidays. However, an attempt is made here to calculate the amount of corporate income tax from the gross revenue. Taking a conservative ratio 3.5 percent of gross revenue per annum as the amount loss to the exchequer due to tax holidays, it becomes Rs. 229.65 crores for 2006-07 and Rs. 463.881 crores for 2007-08.<sup>20</sup> As shown in Table 4, with the same ratio, if it is calculated only for the revenue generated from domestic market, the amount will come to Rs. 413.31 crores for two years.

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<sup>18</sup> MoU (2005), p. 12.

<sup>19</sup> MoU (2005), p. 12.

<sup>20</sup> 3.5 percent income tax from gross avenue assumed an average for the manufacturing sector.

**Table 3.4: Corporate Income Tax** (Figures in crores)

	2006-07	2007-08	Total (for two years)
For Total Gross Revenue	229.65	463.88	693.53
For Gross revenue from domestic market	167.49	245.81	413.31

Source: Calculated from the data at Ministry of Commerce

**CAG Indictment for Duty Forgone:** Another cost that the government had to bear because of its neglect was the custom duty which is not paid by Nokia for the sale in Domestic Tariff Area (DTA). It was highlighted by the Comptroller and Auditor General's (CAG) audit in 2008, and it termed this as the lack of implementation even in those cases when there is a tax or duty which a company operating from a SEZ is actually supposed to pay.<sup>21</sup> Since SEZs are being termed as deemed territory outside the Customs territory of India, the supplies from SEZ to DTA shall be in the nature of imports into India and therefore, the provision relating to levy, refund, penalty, confiscation etc. would be applicable in respect to these supplies as they apply to goods imported into India<sup>22</sup>. Thus an SEZ unit should clear the goods in DTA on payment of customs duties leviable under SEZ Act. And the duty payable is equal to the duty of Customs leviable on like goods when imported into India.

Since most of Nokia's sales for last three years were not export but for the domestic market, duty on imported items should have been charged according to the customs regulations. This was pointed out by CAG report in 2008. According to the report, the company cleared mobile phones with a value of Rs. 4,855.69 crore in 2005-06 and 2006-07 in DTA at 'nil' rate of duty. And Duty of Rs. 681.38 crores (Rs. 86.7631 crore in 2005-06 and Rs. 594.6232 crore in 2006-07) foregone on the inputs used in the

<sup>21</sup> CAG Report for 2008, p. 109.

<sup>22</sup> An online Database on Tax related issues, <http://taxonline.net.in/STPI%20and%20SEZ/chap009.htm>

manufacture of these mobile phones could not be recovered in the absence of enabling provisions.

**Table 3.5: Duty forgone**

(Figures in crores)

	2006-07	2007-2008
Value of sale cleared in DTA at nil rate duty	4855.69	5904.53
Duty on the import input used on the production above value	681.38	828.56

Source: Calculated from the data of CAG Report and Ministry of Commerce, 2008

However, the CAG report provided Duty forgone only for the year of 2006; an attempt was made here to calculate the figure for 2007-2008 by taking the percentage of the amount of duty forgone to the total sales in DTA. In fact, the forgone amount has increased from Rs. 681.38 crores to Rs. 828.56. The duty loss to the exchequer for 2007-08 alone is 122 percent of the actual investment made by the company. It is not just Nokia which was indicted by CAG, even around 22 SEZ units were identified for not paying custom duty as these units had just 28 percent export from the total sale. This feature of SEZ buttresses the apprehension that the country is going to have an economy of enclaves as the industries operating in DTA would also move in to the Zones. This was in fact warned by none other than CAG itself by saying *the units under domestic tariff area (DTA) were put under disadvantageous position*, as no provision had been made to recover duty foregone on inputs procured by the SEZ units and used in the manufacture of products which were cleared at 'nil' rate of duty in DTA.<sup>23</sup>

**Summary of the Costs:** According to the details available in the agreement and the data on operations of the company for two years, the total cost of the nokia project incurred by the exchequer, and hence ultimately the tax payers of Tamil Nadu government is approximately Rs. 1259.68 crores when we add up the costs pertaining to the land

<sup>23</sup> CAG Report 2008, p. 108.

subsidy taken on the average compensation, Capital subsidy, the Tax Holidays in the form corporate income tax and sales tax (VAT) and Exemption on stamp duty. However, if we add up the duty forgone identified by CAG, the total costs would become 2769.62 crores, the amount which is 49.07 percent of the total plan outlays the government allocated for social sector for 2007-08.

**Benefits:** The Tamil Nadu government has advanced two claims regarding the benefits: employment generation and improvement in the investment climate of the state. And the SEZ Act itself has certain objectives which are in a way congruent with the state government's claims. The objectives are the following: Export promotion, generation of additional economic activity, promotion of investment, employment generation and development of infrastructure facilities.

**Export:** The basic foundation for establishing SEZs in India is Export promotion. In fact the concept of Zones evolved primarily from the foreign trade policy. Thus a brief analysis of this is needed. It is said that Nokia is one of the best SEZ export promoters. And it exports about 50 per cent of its production to about 60 countries in South East Asia, West Asia, Australia and New Zealand while the rest of the production is sold in India. However, from the use of VAT reimbursement and the huge loss on account of a failure to impose duty on domestic sales, it is already known that Nokia sells a large share of its phones within India. And therefore there is high probability that the sales made in Domestic market be counted towards export.

**Table 3.6: Export and Turnover for Nokia** (Figures in crores)

	2006-07	2007-08
Physical export	1775.96	6230.39
Deemed export(sold in DTA)	4785.53	5904.53
Not counted for NFE	-	1118.88
% of export to total turn over	27%	47%
Total turn over	6561.49	13253.8

Source: Calculated from data of Ministry of Commerce

As shown in the table, the total value for Nokia SEZ for year of 2006 is Rs. 6561.49 crores of which Rs. 1775.96 crores account for Physical Export, which is roughly 27 percent of the total for that year. For 2007, the value is 13253.8 crores accounting 47 percent for export with the tune of Rs 6230.39 crores.

However, the above figure given by the Ministry of Commerce can be questioned because a data set available at the same ministry gives the contradictory picture. For instance, the data for Exports-Imports show, that Indian exports of mobile phones jumped more than three times to the previous year in 2006-07 to Rs. 386 crore or 1.3 million phones. But during the same year, 2006-07, India imported 47 million phones to a value of Rs. 14,181 crore. Probably the problem arises due to confusion on what is the actual physical export and what is just deemed export. None the less, allowing the sales in domestic market to be treated as deemed export defeats the basic idea of export promotion.

**Net Foreign Exchange:** Another important objective of SEZ Act and supposed benefit from SEZs is Positive Net Foreign Exchange (NFE). In fact, none of objectives in the Act is binding to avail the lucrative incentive structure except positive Net Foreign Exchange. According to the Act, the NFE needs to be positive for a SEZ unit after five years of operations, in order to continue receiving central government benefits. NFE is essentially the value of export minus the value of all imported inputs and value of all payments made in foreign currency. But export can be both physical export and certain sales within India. Whether Nokia has been achieving Positive Net Foreign Exchange or not is not clear because of the fact that certain sales within India are also treated as “deemed” export. This is also counted towards the company’s export earnings.

It was not simply the fault of the company; an amended rule of SEZ Act itself has that provision<sup>24</sup>. This has allowed ‘deemed exports’ which are in effect sales within India to still count as export. The Comptroller Auditor has already realized that there is no restriction on ‘deemed exports’ being counted as actual exports. In one survey it was

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<sup>24</sup> SEZ Rule (2006), 53A-1

found that 22 SEZ units had achieved the required positive foreign exchange demand with actual export earnings only at 28 percent and the remaining 72 percent coming from domestic sales.<sup>25</sup> In addition to this malaise, the company can also inflate and deflate the figures because the whole SEZ scheme relies mainly on self-certification and does not require the Quarterly or Annual Performance Reports to be supported by any statutory documents like annual accounts, customs records, income tax returns and Bank Realization Certificates (BRC).<sup>26</sup>

In short, the SEZ had been achieving the prescribed (positive) NFE mainly through domestic sales defeating one of the basic objectives of the SEZ Act and can sell its products anywhere, in India and abroad, and still count as a Net Foreign Exchange earner. With this kind of exemption in place for mobile phones, Nokia can be anything but 100 percent foreign exchange earner if sales domestically as well as real export outside of the physical borders of India count.

**Employment Generation and Labour Condition:** The controversial issue of labour rights has been completely left out of the national SEZ Act for the states to implement it. The Tamil Nadu government had formulated SEZ policy before the SEZ Act was enacted. The policy clearly delineates the necessary changes in labour regulations,<sup>27</sup> including the declaration of SEZ as Public Utility Service to curb labour 'indiscipline' and formation of worker's trade unions. In essence the policy simply meant for SEZ developer the right to hire and fire labour at will and denying the right of the workers to strike. In addition, the state government has also concretized the form of flexibility of labour regulation in MoU signed with Nokia India Ltd. in 2005.<sup>28</sup> These policy measures gave enough scope to allow contract labour to work in the SEZs, and made it extremely tedious and difficult for workers to go on strike.

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<sup>25</sup> CAG Report for 2008, p. 105.

<sup>26</sup> CAG Report for 2008, p. 105.

<sup>27</sup> Tamil Nadu SEZ Policy (2003), section contains three subsections from Simplification labor laws and rules to declaration of public utility services.

<sup>28</sup> Memorandum of Understanding (MoU) (2005), p. 10.

In this context the question of Employment generation and pattern of employment should be analyzed. Employment generation is supposed to be one of the main benefits of the Nokia SEZ. Frequent news articles have over the years given new figures on the increasing number of people being employed and the projections for the future. Nokia initially promised a relatively modest number of employees around 1,200, but later scaled this up as the production increased to at present about 8,000 including those employed by contracting agencies of which 70 percent are reported to be women hired between age 19 and 22.<sup>29</sup> But the company recently disclosed that it has only employed 4,548 people.<sup>30</sup> If we were to properly take both possible employment generation and possible employment destruction into account, we could arrive at a figure for the net employment generated by the project. At the moment, it is not even clear that the net employment figure will be positive.

Next the nature of that employment comes at central stage. Because the number of people employed by Nokia appears to be relatively less than the promises made earlier, the quality of these jobs including working conditions and salary became extra important to determine whether really industrial employment generation has taken place. But information on actual working conditions is very limited due to the nature of the Zone as a sealed off entity, limiting the analysis mainly to what the contents of the MoUs, Tamil Nadu state laws and few interactions with the workers in the zone.

The Contract Labour (Regulation and Abolition) Act, 1970 is a central government act originally put in place to limit the use of contract labour in manufacturing. The Tamil Nadu government has weakened its provisions in favour of SEZs on a number of occasions but till date contract labour remains banned in manufacturing<sup>31</sup>. It appears that contract labour is prevalent in all non-manufacturing forms of work in the Zone and more than 3000 workers have been hired in 2008 itself. A report from the Inspectorate of

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<sup>29</sup> *Business Standard*, 'Nokia to double its workforce at SEZ', May 13, 2008.

<sup>30</sup> Labour Inspection Report, Tamil Nadu Government.

<sup>31</sup> The SEZs are allowed to use self-certification to declare they do not use contract labour according to the state SEZ policy, thus it effectively puts the actual implementation of the act in serious doubt.



Factories also confirms it.<sup>32</sup> Thus, in the Zone, it seems that the staffs were also included under contractualised labour whenever it was possible, including warehouse staff, security personnel, drivers, cleaners etc. Interestingly many of the contract labour suppliers are themselves multinationals as the following Table 7 shows.

**Table 3.7: Contract Suppliers to Nokia**

Labour Supplier	Number of Employees	Types of operations
Adecco flexi one workforce solutions ltd	250	Ware house management
Sodexo pass services India private ltd	125	Catering
G4S security services India private Ltd	175	Security
UPS SCS India private limited	100	Water house management
Maclellan integrated services private limited	110	Facilities management

Source: Inspection note of the Department of Inspectorate of Factories, Tamil Nadu government.

### **Wage Structure in the SEZ**

Another important aspect of employment is the wage structure which the company provides. For our analysis, we will take Nokia's own statement on the salary its employees receive, since there is no exact data available at government offices despite RTI filed for it.<sup>33</sup> However, the estimate mentioned in the statement of the company is in line with the interview of workers. According to the statement, the employees are paid well above the minimum wage in the zone, and the salaries vary from Rs. 5400 for experienced operators, around 70 percent higher than the minimum wage, to around Rs.

<sup>32</sup> To verify this we don't have any document, it came to be known with interaction of some officials in the SIPCOT office.

<sup>33</sup> *Business Standard*, May 13, 2008.

3400 for an apprentice which is more than three times the suggested apprentice minimum wage. The minimum wage for the electronics industry in Tamil Nadu is Rs. 108 per day which on a monthly basis of 25 working days becomes Rs. 2,700. But the question here is the employment in Zone supposed to be an organized employment, since it is a manufacturing unit. And minimum wage for electronic industry is nearly the same of the minimum wage for manual labour in the state. And the benefits of skill formation become questionable. Further, if the wage level is compared to the average global wage that the company pays for its employees in different countries which is on average Rs. 2.9 million per employee per annum.<sup>34</sup> The difference is huge and the average salary works out to be about 45 times what the workers in Chennai receive, even if the difference is discounted with the purchasing power parity (PPP) between countries, the difference is still large. In short, the claim made by the company and the state government on employment generation and decent wage level is yet to be realized. And given the amount and pattern of employment, it defeats whole idea of SEZ and questions the very way of industrialization.

### **Infrastructure**

One of the objectives of the central SEZ Act and the State's SEZ policy is the development of infrastructure facilities. The experience of Nokia gives an altogether different picture. In the agreement itself, the state government had promised to build infrastructure at public cost. Because before the land was allocated to Nokia, public money had already been invested by SIPCOT to develop certain infrastructure at the industrial park, even though this land was termed as "undeveloped land". A water supply pipeline had been laid, electrical lines had been drawn but it had to be redrawn to suit the requirements of the SEZ, and roads had been built to the site.<sup>35</sup> Costs of these activities are not known but these findings clearly shows that the infrastructure was developed at public cost.

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<sup>34</sup> The Annual Accounts 2008, Nokia group spent wages and salaries around 5615 million Euros for 1,25,829 employees.

<sup>35</sup> MoU (2005), p. 8.

In addition, it seems that the state has also subsidized certain infrastructure cost with in the zone itself. For instance, the state gave a subsidy of 50 percent of the capital cost incurred in setting up such captive power plant for the entire SEZ site and allowed to have unrestricted generation, transmission, and distribution of captive power within the SEZ, without having to pay any electricity tax or cess except for standard charges to be paid for wheeling of power.<sup>36</sup> In short, it appears in contrary to states objective of the SEZ policy of bringing in private infrastructure investment, it actually led to public investment. And the only part the company actually paid is the operating costs.

### **Implications of SEZs for Agriculture**

Tamil Nadu is probably the only state which is facing competing demands for land from the non-agricultural sector and rapid urbanization. Large chunks of prime agricultural land are being diverted for non-agricultural purpose and of which the real estate is leading. Across the state, agricultural land is shrinking and it has lost more than 10 lakhs hectares of agricultural land from 1991 to 2003.<sup>37</sup> The issue of land acquisition for setting up Special Economic Zones thus brings a serious implication for the food security and agriculture in the state. The state has 44 notified SEZs, the highest among states in the country. In terms of approval the state stands next only to Maharashtra (104) and Andhra Pradesh (99) of having 66 Zones. Due to the paucity of the data, the extent of lost cultivable agricultural land is not known, undoubtedly, given the amount of Zones and its vast size, loss of the agricultural land is certain.

The state has already been witnessing acute agrarian crisis because of dwindling growth rate of agriculture. The post reform period has been witnessing rapid decline of primary sector share in the GSDP. For instance, compared to the moderate annual compound growth rate of 5.46 of GSDP (at constant prices) during 1993-94 and 2004-05, the growth rate of agriculture and its allied activities was abysmally low at 0.42. And also there has been a steady decline in the gross cropped area throughout the period by about 25

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<sup>36</sup> MoU (2005), p. 8.

<sup>37</sup> Bhaskar Goswami (2008).

percent. The gross cropped area declines with fall in the amount of annual rainfall, but it does not increase adequately with rise in the amount of rainfall in the subsequent years. The yield has been fluctuating with a sustained increase in the latter half of the 1990s and a sustained decline since 2001. The total agricultural production has been fluctuating along with the fluctuation in yield. Further, value addition by the agricultural sector (at constant prices) was Rs.12,872 crore in 1993-94, it sharply declined to Rs.10,811 crore in 2003-04 and increased only to Rs.12,527 crore in 2004-05, which is still less than what was achieved in 1993-94. The above performance also makes it clear that in the post-reform period, the sector has been witnessing a steady decline in agricultural activity, yield and in overall agricultural production.

On one side, allowing the SEZs to mushroom with so much incentive, the State Planning Commission recommends that to get rid of the extant crisis, agricultural production has to be improved by increasing the area under cultivation with a concomitant improvement in yield out put.<sup>38</sup> It opines the increase in land under categories like cultivable waste, current and other fallows gives scope for increasing area under cultivation in the near future. Because the extent of land under fallows has increased by nearly 60 per cent from 10.43 lakh hectares to 16.86 lakhs hectares between 1993 and 2005. And both net sown area and area sown more than once have declined.

The mushrooming of the SEZs must be located at this context. And it is immanent that the sluggishness in growth and its implications for livelihood of the people are going to be further aggravated by the SEZs. In short the whole development produces a situation known as pauperization<sup>39</sup> rather than proletarianisation as the dispossessed farmers are neither able to stay in agriculture nor being absorbed in the industry.

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<sup>38</sup> Srinivasan (2007), being a member of Tamil Nadu Planning Commission, recognized the fact that the immediate need to revitalize the deteriorated agricultural sector is the net sown area must be increased with a adequate support high yield package.

<sup>39</sup> David Harvey (2006), *The New Imperialism*, Oxford University Press, New York.

## **Displacement and Livelihood**

One of the major contentious issues along with the cost of project or the revenue loss to the exchequer is the question of land and livelihood of the people displaced. The land was the main source of income for the people in this region. Around vast agricultural land was bought by SIDCO, a nodal agency, which works as virtual land bank, for the purpose of small scale industries. As mentioned earlier, this agency allotted around 210 acres to Nokia India Ltd at the subsidized rate while farmers are still waiting to get a part of the compensation package. It is not only Nokia; there are other companies that were given land at the subsidized rate. In fact, the entire area where the company is located is known as SIPCOT new industrial park. Thousands of acres are being converted into a barren land. It was assumed and promised that the people displaced would be absorbed in the factories that are coming up in this area, which is however far from the reality.

The farmers who are most affected in this region are those with marginal holdings and the landless labourers. The social composition of this group shows invariably that marginal land holders are most backward class (MBC) and landless labourers are dalits. The farmers with larger tracts of land often belong to dominant communities like the Naidus, Reddiars and Mudaliars who generally own more than 50 acres of land. The compensation these big farmers receive is large enough for them to invest in other businesses such as, transport vehicles. Hence, these farmers don't lose their livelihoods and incomes even after losing their lands. However, the displaced people for the company are predominantly marginal land holders who are now left with no alternative sources of employment. Even the company's promise, that it would hire the local people for the operation in the zone, is yet to be realized.

Another aspect of the displacement is the loss of livelihood due to the expropriation of common property resources (CPR) like lakes, village forests and lands. The common property resources provided easy access to every member of the community and used to be an integral part of the social and economic life of the people, particularly, for the landless households in the affected villages. Among the landless, a vast majority belongs to Dalit communities. Nearly one lake and two ponds were emptied and flattened in and

around the premises allotted to the company. Thus this expropriation of common property resources in a way accentuated the poverty and debt bondage of the dispossessed farmers.

Finally, given the experience, the claim that SEZs would generate more employment and bring the unemployed and underemployed in agriculture to industrial workforce is questionable. And moreover any measure of employment generation for given investment should take into account the employment loss entailed by the project. For instance, a study done on the similar, but large scale investment project of Singur shows, that for generation of one job the project entails loss of five jobs<sup>40</sup>. However, although in this case too it appears that net employment generation is negative, it requires a more thorough analysis. In short, the whole development of expropriation of common property of the resources and displacement and dispossession is classical example of the recent global phenomenon known as accumulation by dispossession.<sup>41</sup>

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<sup>40</sup> Amit Bhaduri (2007).

<sup>41</sup> David Harvey (2006). *The New Imperialism*, Oxford University Press, New York.

## CONCLUSION

SEZs today are considered to be the main driving force of industrialization in India. It was expected that the SEZs would bring in more foreign capital and induce exports, thereby working as a catalyst for employment generation. These presumptions have underlined the justification for large scale proliferation of the economic Zones in India. It therefore becomes necessary to analyze each of these aspects in detail in the light of the industrialization strategies employed in India and the experience of the Zones in other foreign countries. Though not exhaustive, the present study has tried to highlight certain important aspects related to SEZs which has not been adequately addressed by the existing literature on the subject, at the same time critically examining some of the arguments put forward in favour of the SEZ policy. The study has sought to study the debate on SEZs in the context of industrialization policies in India implemented since the Five Year Plan period.

Like any other postcolonial country of the Third World, India also sought to embark on the path of independent industrial development. Inspired by the Soviet model, the initial strategy took the form of Five Year Plans. But this strategy proved to be a failure in changing the outmoded unequal agrarian structure and backward production relations. As a result, though industry witnessed growth in the initial period, this could not be sustained

for a prolonged period. As has been argued in the first chapter, it brought only a marginal change in the employment pattern that existed in the colonial times. Moreover, this phase of industrialization resulted in stagnant wages, growing unemployment, near-complete technological parasitism, and growing indebtedness to foreign countries.

Subsequently, there was an attempt to revive the process of industrialization in the 1980s with the help of a different strategy, albeit keeping intact the existing socio-economic structure. The emphasis now was on encouraging the inflow of foreign capital and promotion of exports. Many structural changes were introduced in the industrial policy. The decade of 1990s in particular witnessed a complete change in the industrial policy structure. Though this period witnessed a revival of industrial growth, there was no corresponding growth in employment. In fact, as mentioned in the first chapter, there emerged a negative relationship between output and employment generation. The sectoral distribution of workforce among various sectors that existed in the 1950s continued to prevail in the last decades of the twentieth century as well.

Now, SEZs are being portrayed as the way out to counter the declining trend in the Indian industrial sector. Since the economy has not been able to attract sufficient foreign investment due to lack of infrastructure, it is argued, the SEZs will bridge the infrastructure gap, thereby leading to more exports and employment generation. The present study stands in contrast to the various viewpoints expressed so far in the SEZ debate in India. It has not only made an attempt to critically examine the arguments in favour of SEZs, but also questions those opponents of SEZs who perceive it as just another industrial policy which can be reformed if there is a consensus. From the discussions in the preceding chapters, it becomes evident that *SEZs is not an isolated policy, but is essentially an integral part of the current form of industrial strategy*. Hence, change in the SEZ Act requires a complete change in entire economic policy structure.

Contrary to the mainstream view that China's economic Zones have been successful, and that they are examples to emulate, our analysis has pointed out that it has been far from successful, and that the Chinese experience presents mixed results. Similarly, economic zones in other countries too have not lived up to the expectations, though some of them could be considered successful owing to their specific conditions. Nonetheless, they are not comparable to the Indian scenario and cannot therefore be generalized. This is also



because the purpose and the nature of these zones are attuned to the country's specific socio-economic context. As mentioned in the foregoing chapters, the experience of Indian Zones followed the experience of industrialization strategy which was specific to India.

The experience of Zones in general and the SEZs in particular has forced us to critically scrutinize the entire industrial strategy followed in India. As mentioned earlier, the main stated objectives of the SEZ policy are to promote exports, to attract foreign investment, and to generate employment at a fast pace. However, given the overwhelming dominance and share of real estate and IT/IT Enabled Services (ITES) in the proposed SEZs and the structural factors that have important ramifications in any industrialization strategy, none of these lofty objectives seem easily realizable. The massive tax incentives and subsidies given to the SEZs would only encourage the relocation of industries from outside to the SEZs to take advantage of its relative advantage. Similarly, there would be large scale migration or relocation of the workforce to the SEZs without any net employment generation. Exports are unlikely to grow in the absence of any substantive growth in the demand for export goods and services from India, and due to the WTO bar on export subsidies. In short, it would not be an exaggeration to say that the SEZ policy followed by the Indian government belies economic rationality, which has granted incentives that exacerbate existing economic distortions and encourage speculative activity at the expense of commodity production and development of industrialization.

Some of the above mentioned lacunas in the overall SEZ policy have been reaffirmed by our case study of the SEZ that has been developed by Nokia India Limited in Tamil Nadu. The competition among states in establishing SEZs reminds us of the proverbial "race to the bottom", where the competitive edge by any state essentially translates into who can deregulate the most, offer the cheapest and the most casualised workforce, provide the most comprehensive tax-breaks, make resources available in sufficient quantities, including land, water and electricity at throwaway prices, and so on. Indeed, Nokia was offered massive incentives by the Tamil Nadu government to outdo any other competing state in India. The subsidies and tax breaks in different forms given to the company is in fact higher than the actual investment made by it. The irony of the SEZ policy is that while the foreign investors and big domestic companies gain windfall profits through the SEZs, the people displaced by the land acquisition for these Zones are still waiting to get the meager compensation stipulated by the law. Further, the state

declared the Zones as Public Utility Services to curb even the nominal labour rights of the workers.

The supposed benefits of the Nokia SEZ were export promotion, net positive foreign exchange, infrastructure development and employment generation. However, the present analysis demonstrates that none of these have been fulfilled in reality. For instance, more than 50 percent of the goods produced in the Zone were for the domestic market, and it failed to generate the required foreign exchange. Notwithstanding the claims of employment generation, the net employment generation in this particular SEZ appears to be close to nil. Moreover, the people displaced by the Zone were supposed to be given employment. But the experience shows that more than 60 percent of the employees were 'outsiders' employed at a very low wage rate.

Infrastructure creation was the central objective of the SEZ policy, since it has been often argued that foreign investment was constrained by a lack of necessary infrastructure in the country. Since infrastructure cannot be created all over the country, infrastructure development in enclaves by private capital was seen as the best option to tackle the problem. But the experience of the case study shows that the entire infrastructure was developed through public investment and thereafter handed over to the company almost free of cost. During the earlier industrialization strategies adopted in the 1950s and 1980s, public investment and public expenditure were major drivers of industrial growth. In the present phase of industrialization through SEZs too, we find that public investment has played a pivotal role in creating infrastructure for private industries, even though one major objective of the SEZs was to develop infrastructure through private investment.

Another aspect that the case study on Nokia SEZ brings to light is the loopholes in the SEZ Act itself. Moreover, rules were regularly flouted by the company in order to earn super profits. According to the SEZ Rules, Nokia was obliged to pay import duty on its products exported to the domestic market under the DTA. This rule has however been violated by Nokia, for which it has been indicted by the Comptroller and Auditor General of India. In similar manner, many other SEZs have also faulted in paying this duty. So is the case with exports, and those goods sold in the domestic market were also shown as exports to foreign territory in order to avail tax exemptions.

The question of land and livelihood stands out as one of paramount importance. Massive land acquisition in the name of SEZs is taking place in various parts of the country at a time when agrarian crisis is engulfing the rural people at large. In the process of converting vast areas of agricultural land for industrial purpose, Common Property Resources (CPR) is also getting commodified. The phenomenon of separating land from the primary producers and converting the commons into wealth constitutes a process of primitive accumulation. The way in which SEZs are being offered with massive incentives, land is acquired for them, and Common Property Resources commodified in the process, is a classic example of primitive accumulation, but with some differences with the phenomenon originally defined by Marx. In the earlier process, the dispossessed primary producers were absorbed in the industry, whereas now they are neither able to continue with agriculture nor are being absorbed in the industry.

In short, the Import Substitution Industrialization strategy adopted in the 1950s after a brief period of remarkable industrial growth led only to a subsequent phase of stagnation and deceleration. In response to this, and also influenced by the changes in the world economy, export-led strategy was introduced. The corresponding policy changes were gradually infused into the economy, and came to its logical conclusion in what is known as the economic reforms. Foreign capital and export promotion has been the two pillars of this strategy, but without sufficient infrastructure created through public investment, it would be near to impossible to make this strategy take off, since infrastructure cannot be created at a countrywide scale, nor has private investment showed any marked interest for infrastructural development. Thus, the SEZ form of enclave development has become a perfect answer for the present industrialization strategy.

Sixty years of experience shows that the limited base of the home market is the central problem of Industrialization in India. The reasonable industrial growth achieved both in the initial phase and even in the recent phase was largely driven by public investment and public expenditures. The current strategy of export promotion to overcome the problem of limited home market needs further study. However, given the historical experience of the developed countries, without a complete restructuring of the agrarian structure to create a substantial home market, industrialization efforts in India would be a task mired by

difficulties. As Paul Baran has argued, it may perhaps not be possible under capitalist relations!

The present study has certain serious limitations. The debate on industrialization in postcolonial India is a highly contested terrain. Thus, all I have tried to do here is to map the industrialization debate since the 1950s and locate SEZs in the recent strategy of export-led growth. Similarly, the concept of economic zones and its different forms in different countries require further investigation and detailed analysis. I have also tried to understand certain commonalities among the economic zones and their relevance to SEZs in India. Further, the proposal of SEZs and its implications for sectoral distribution and regional development needs separate study. The cost and benefit analysis done for the case study is not as comprehensive as it deserves. My present attempt could only be a preliminary and exploratory one at best, while a thorough study on the socio-economic condition of the people displaced by the SEZ project would have further enriched the study. Nonetheless, this partial and incomplete attempt to theorize SEZs within a larger socio-economic framework has been an enriching experience, and I believe this study will be a precursor to more rigorous and exhaustive studies in the future.

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