



NATIONAL APEX CHAMBER

Baba Kalyani Report on SEZs: An Analysis

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Executive Summary

Ministry of Commerce and Industry constituted a committee headed by Mr Baba Kalyani, chairman & MD, Bharat Forge limited in June 2018 to study the existing Special Economic Zone (SEZ) of India and prepare a policy framework to adopt strategic policy measures which helps India to capitalize on global growth opportunities while developing its own highly competitive manufacturing and service base. The Baba Kalyani committee has proposed to rename SEZs in India as 3Es- Employment and Economic Enclave, with the objective of moving from island of exports to catalyst of economic and employment growth. The 3Es aims to bring together all categories of investors that enable economic activity or job creation and investment targeted towards leveraging domestic demand.

The committee has recommended moving away from exports to more integrated hub for employment and economic activities supported by quality infrastructure and ease of doing business. For this it has been recommended to use initiatives for creation of manufacturing ecosystem and to be delinked from export performances. The quantum of initiatives should be based on investment committed, job creation, promoting women in job, value addition, technology differentiation, trade potential and priority industry. It has been recommended to shift from trade competitiveness to manufacturing competitiveness. The committee has recommended allowing domestic supplies in Rupee/ payments to be made in rupee when enclaves deal with areas outside the zone and move away from incentive linkages from exports so that the condition of Net Foreign Exchange (NFE) is not required.

The other recommendations are the review of requirements of manufacturing and services separately. As the enablers for manufacturing and services sectors are different, the committee has recommended separate development frameworks, including different operational rules and procedures. The committee has recommended that similar nature industries/sectors could be allowed in certain sector focussed enclaves to promote higher demand.

Key Highlights of the Report

- Framework shift from export growth to broad-based Employment and Economic Growth (Employment and Economic Enclaves-3Es).
- Formulation of separate rules and procedures for manufacturing and service SEZs.



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- Shift from supply driven to demand driven approach for 3Es development to improve efficiency of investment-based on certain industries, current level of existing inventory in the region.
- Enabling framework for Ease of Doing Business (EoDB) in 3Es in sync with State EoDB initiatives. One integrated online portal for new investments, operational requirements and exits related matters.
- Enhance competitiveness by enabling ecosystem development by funding high speed multi modal connectivity, business services and utility infrastructure. Critical to provide support to create high quality infrastructure either within or linked to the zones eg. High Speed Rail, Express roadways, Passenger/Cargo airports, shipping ports, warehouses etc.
- Promote integrated industrial and urban development- walk to work zones, States and center to coordinate on the frame work development to bring linkages between all initiatives.
- Procedural relaxations for developers and tenants to improve operational and exit issues.
- Extension of Sunset Clause and retaining tax or duty benefits.
- Broad-banding definition of services/allowing multiple services to come together.
- Additional enablers and procedural relaxations.
- Unified regulator for IFSC.
- Utilizing Multi Services SEZ IFSC for all the inbound and out bound investment of the country.
- Incentives for availing services from IFSC SEZ by domestic institutions.
- Extension of benefit under services Export incentives scheme.
- Allowing alternate sectors to invest in sector specific SEZs/ 3Es.
- Flexibility of long term lease for developers and tenants.
- Facility of sub-contracting for customers outside 3Es/SEZs without any restriction or cap at any level.
- Specified domestic supplies supporting 'Make in India' to be considered in NFE computation.
- Export duty should not be levied on goods supplied to developers and used in manufacture of goods exported.
- Flexibility in usage of NPA by developers and sale space to investors/ units.
- Infrastructure status to improve access to finance and enable long term borrowing.
- Promote MSME participation in 3Es and enable manufacturing enabling service players to locate in 3E.
- Dispute resolution through arbitration and commercial courts.



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Introduction of SEZ Policy

The government has set a target of creating 100 million jobs and achieve a 25% of the GDP from manufacturing sector by 2022 and increase the manufacturing value to USD 1.2 trillion by 2025 and at the same time compile the policy with the relevant WTO regulations.

Recognizing the need to promote exports to propel GDP growth of the country, the government of India announced special economic zone policy in 2000 as a part of the EXIM policy and the act was passed in parliament by 2005. The main features of the policy included tax holidays, exemption from import duties and single window clearances. While companies in services sector has been able to get benefit through SEZ policy, manufacturing sector has been unable to replicate the similar export led growth due to the following reasons:

- Complexity in undertaking domestic and international business for manufacturing
- Uncertainty in government policies, specifically tax
- Multiple regulatory stakeholders need not necessary aligned all the times
- Some provisions of SEZ law not operationalized, though enacted to be single legislation for development of SEZs
- Procedural delays and infrastructural bottlenecks

In view of these challenges and lessons learnt from past experiences and from other countries, Ministry of Commerce and Industry constituted a committee headed by Mr Baba Kalyani, chairman & MD, Bharat Forge limited in June 2018 to study the existing Special Economic Zone (SEZ) of India and prepare a policy framework to adopt strategic policy measures which helps India to capitalize on global growth opportunities while developing its own highly competitive manufacturing and service base. The committee submitted its report in December 2018.

The Objectives of the Baba Kalyani Committee:

- Evaluate, implement and suggest SEZ policy measures from the year 2000 to cater the needs of exporters in present economic scenario with WTO compatible
- Suggest course correction for encouraging manufacturing sector and maximizing utilization of vacant land in SEZs
- Make comparative analysis of the SEZ scheme in India and worldwide and suggest changes in the SEZ policy based on the international experience
- Dovetail the SEZ policy with other schemes



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Recommendations by Baba Kalyani Committee

The key recommendations of the Committee based on the above mentioned objectives and the inputs from various industry stakeholders can be categorised into the following matrix:

Fiscal intervention regarding institutional and regulatory alignment	Non-fiscal interventions regarding institutional and regulatory alignment
Fiscal intervention regarding infrastructural inputs	Non-fiscal interventions regarding infrastructural inputs

The committee has proposed to rename SEZs in India as 3Es- Employment and Economic Enclave, with the objective of moving from island of exports to catalyst of economic and employment growth. The 3Es aims to bring together all categories of investors that enable economic activity or job creation and investment targeted towards leveraging domestic demand.

Another key highlight of the recommendations was the review of requirements of manufacturing and services separately. As the enablers for manufacturing and services sectors are different, the committee has recommended separate development frameworks, including different operational rules and procedures. Further, the committee has recommended that similar nature industries/sectors could be allowed in certain sector focussed enclaves to promote higher demand.

Therefore, the recommendations of the committee has been categorised into 4 categories as follows:

- Overall strategic recommendations for both manufacturing and service sector
- Recommendations for manufacturing sector
- Recommendations for service sector
- Recommendations and Common Policy Framework



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1. Employment and Economic Enclaves: Strategic Recommendations for both Manufacturing and Service Sector

The exports focus of SEZs impacts the utilisation of units and limits their ability to be flexible in managing demand between domestic or export market. The committee has recommended to move away from exports to more integrated hub for employment and economic activities supported by quality infrastructure and ease of doing business. For this it has been recommended to use initiatives for creation of manufacturing ecosystem and to be delinked from export performances. The quantum of initiatives should be based on investment committed, job creation, promoting women in job, value addition, technology differentiation, trade potential and priority industry.

Another focus area is to promote demand driven approach instead of supply driven and leverage existing inventory of land parcels in various government initiatives. For achieving this, the committee has recommended the tightening of approval processes for new enclaves based on minimum development obligations, time bound investments and operationalization of business with finite number of extensions to deadlines.

Enabling framework for ease of doing business in 3Es has been given prime importance by the committee including one integrated online portal for new investment, operational issues management and exits/de-notification for developers and tenants. For achieving this, the committee has recommended that the approval process can be automated and integrated with other ministries and department at the center and state. Further the committee has suggested that the entry and exit process should be streamlined and brought under single integrated authority, larger role of development commissioner in facilitating approval processes, formalising de-notification process for enclaves and delink its present mandatory usage for SEZs purpose only. Promote integrated industrial and urban development- walk to work zones, States and center to coordinate on the frame work development to bring linkages between all initiatives and procedural relaxations for developers and tenants to improve operational and exit issues.

It has been recommended to give infrastructure status to improve access to improved financing options as this status would allow these sectors to be entitled to a number of benefits and concessions and give access to improved foreign finance through external commercial borrowing.

Further, the committee has recommended to allow payments to be made in rupee when enclaves deal with areas outside the zone.



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2. Employment and Economic Enclave for Manufacturing Sector

The Baba Kalyani committee has suggested to shift from trade competitiveness to manufacturing competitiveness. In order to create manufacturing ecosystem, the committee has recommended that the government should increase the competitiveness of the 3Es by enabling link infrastructure by funding high speed multi modal connectivity, business services and utility infrastructure. The link infrastructure is critical for the boost of industrial activity as they form the vital part of industrial area development.

Further, to improve utilisation of units in the processing areas, flexibility to be considered to enable 3E units to support sub-contracting outside 3Es and to operationalize it, reversal of duty or tax benefit on input used for manufacturing can be considered.

According to the committee, the recent amendments to the rules, certain exclusions were made in the categories that are considered for Net Foreign Exchange (NFE) computation, on 19 September 2018, in the categories that area considered for NFE computation, for instance supply of goods to any project import of which is permitted at zero (0) % of duty provided international competitive bidding procedure is followed. Similarly, supply of goods of DTA against payment of foreign exchange either through EEFC (Exchange Earner's Foreign Currency) account of DTA customer or payment received from overseas entity is removed. These exclusions are adversely impacting the Make in India initiative including projects of national importance, such as defence projects. Therefore, status quo prior to 19 September 2018 should be retained, however, the benefits can be restricted to goods manufactured by the units.

The committee has further suggested that to remove the issue of limited export demand, possibility must be explore the possibility of allowing alternate sectors to operate in a sector focussed 3Es, so that the sector specific 3Es could be multi-sector to some extent.

The current practice of 30 years lease is unattractive for investors and therefore they opt for alternative options or destinations with more generous terms. Thus, flexibility of lease period for units and developers should be provided that will enable taking a long term view on the project and enable financing for their development.



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3. Employment and Economic Enclaves for Services Sector

The committee has recommended continuing with present SEZ policy dispensation framework for services and broad-banding with strategic focus on some services. The committee has recommended that existing tax or duty benefits should be retained, sunset clause to be extended and for identified “sunrise” service benefits in tax laws to be considered in line with those extended for IFSC (International Financial Service Centre).

Broad- Branding of the definition of services or allowing multiple services to come together is required and for this it has been suggested that a list of services from a strategic and growth perspective could be developed through detailed studies involving relevant stakeholders, to analyze current regulatory and procedural bottlenecks restricting growth of the identified services and develop enabling framework and to categorize the services and allow multiservice SEZ.

Further, the committee has recommended to consider incentive to identify strategic industries on same lines as in manufacturing. Provide procedural relaxation that include simplification of processes, ease in day to day operations.

The requirement of receipt in foreign exchange for services provided in DTA should be dispensed with and should be brought at par with treatment given to clearance of goods to the DTA specially since such services are no longer counted towards NFE. As all IFSC units are licensed by financial services regulatory to carry out permissible activities, it is proposed that requirement of Net foreign Exchange under the existing regulations should be exempted for IFSC units in the proposed framework. For instance a Re- insurer operating from IFSC receives premium in foreign currency, however in case of the global claim, would be required to pay in foreign currency and thereby it may not be able to achieve positive NFE earning.

4. Employment and Economic Conclave: Common Policy Framework

The key recommendation common to manufacturing and services from a policy framework perspective are:

- Enable development or urban amenities within the enclaves and SPVs to manage them, the regulations and institutional framework for enabling development and the state and centre can cooperate in enabling delivery of the approach.



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- Provide for a swift resolution of disputes through arbitration mode or through commercial courts over other dispute redressal mechanism.
- Encourage better usage and development of the NPA, the dual-usage norms for the NPA should be flexible and review of the local development regulations in deciding the area mix for NPA.
- Reimbursement- based mechanism for developers to incentivize utilization of assets in NPA by business in PA. The committee recommends to upfront exemptions, and specific methodology may be evaluated for incentivizing the service provided to users in the PA.
- To promote MSME investments in 3Es by linking with MSME schemes of Government of India. The Government should enable development of competitive supply chains within enclaves and the current government schemes for MSMEs to be made available in SEZs and also specific initiatives for MSMEs therefore these enclaves could offer central government schemes for MSMEs cluster development and offer utility charges at lower rate than to large investors.
- Units within the enclaves to be provided with competitive utilities tariff to ensure they are not paying rates higher than available through other means.
- “Servicification” in proposed enclaves- fund support development of essential services in 3ES to be provided by MOCI, to enable service units in manufacturing to be allowed in manufacturing 3Es and to support can be given to compensate for logistics service costs, labour transport costs, labour mining costs, advertising and marketing costs.

5. Transition of Existing SEZs to 3Es Framework

Further, on transition to new framework, the committee suggested that the policy framework should have a transitional clause ensuring the following to enable a seamless transition:

- Status quo on duty or tax benefits already availed including export benefits
- No additional conditions on existing operations
- No penal consequences including recovery proceedings on such transitions
- Existing SEZ units to migrate to 3E framework and for establishment of new business or expansion of operations in 3Es
- Pending litigations or disputes to be dealt under the old regime.
