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## Special Economic Zones: Gain or drain?

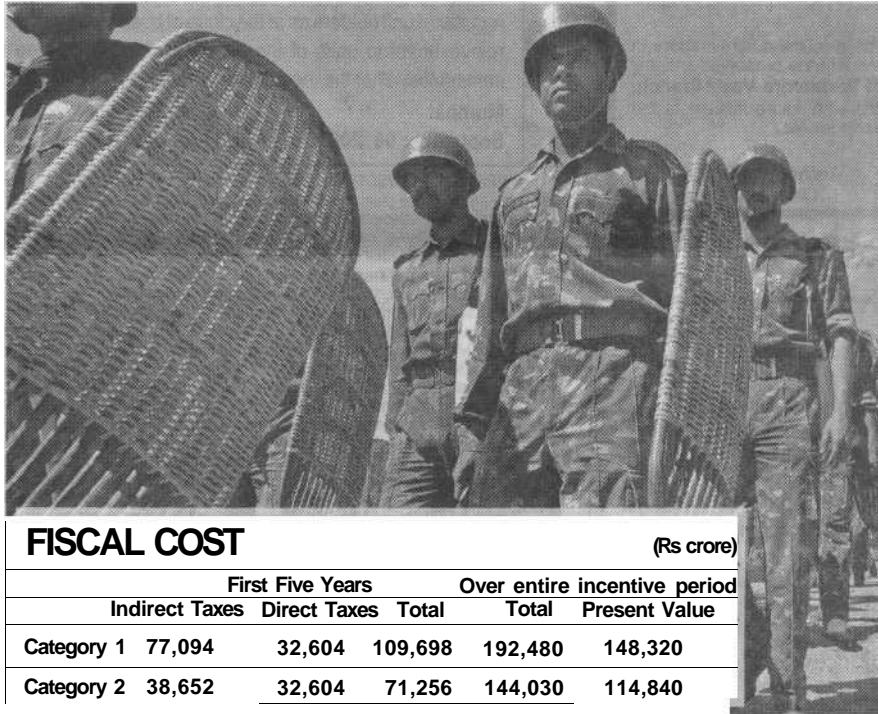
R Kavita Rao

**W**ith the report by ICRIER on the economic impact of SEZs having been submitted to the ministry of finance, the debate on the possible impact of this policy on the economy has resurfaced. In the interest of an informed debate, here is an alternative set of numbers.

Two important principles need to be mentioned upfront, before discussing numbers. First, the fiscal impact is contingent on whether the investment is incremental over and above the existing levels of investment or whether it is just a realignment. If the investment would not have occurred in the absence of the policy, there can be no revenue loss attributed to the policy. Revenue loss arises only if the investment is a re-alignment of normal investment levels in the country. If Rs 300,000 crore is the total investment expected in SEZs — as reported in the "Factsheet on SEZ" put out on the SEZIndia website (<http://sezindia.nic.in>) — it would be useful to compare this figure with the total investment in the country and the contribution of the corporate sector. In 2006-07, Gross Fixed Capital Formation (GFCF) was Rs 12,16,000 crore, of which if the corporate sector accounts for 40 per cent, its investment would be Rs 4,80,000 crore. If the investment in SEZs is to be realised over a long time period, there is no issue of concern, since on the one hand, small increments to investment are always feasible, and on the other, the policy is not likely to make a splash of an impact on the economy!

For the policy to be significantly effective, the investment should be upfront, say, spread over two years. The additional Rs 1,50,000 crore of investment implied would mean a step-up in GFCF by over 3 per cent of GDP in the first year itself. In a single year, this would be feasible, if the bulk of the investment is in the form of FDI. The profile of SEZs does not indicate a predominant FDI component. Domestic investment by the corporate sector expand-

The present value of the fiscal cost of SEZs is thrice the infrastructure generated, and there is little to suggest this will result in a net addition to overall investment in the country, says R Kavita Rao



	FISCAL COST					(Rs crore)
	First Five Years			Over entire incentive period		
	Indirect Taxes	Direct Taxes	Total	Total	Present Value	
Category 1	77,094	32,604	109,698	192,480	148,320	
Category 2	38,652	32,604	71,256	144,030	114,840	

Members of a special police force march in formation near Nandigram on March 16, 2007, following the deaths of at least 14 people who were killed when police clashed with villagers protesting the acquisition of their land for industry

ing by over 25 percent in a year over and above normal growth seems unlikely, suggesting that the policy results in some fiscal costs. Following from the above, if the investment is not additional investment, employment generated too cannot be counted as a net gain either.

Second, since the losses are sought to be measured against some gains to the economy, the picture being painted depends on what are considered "gains". Clearly, one cannot measure the losses against the expansion in economic activity, since by

definition, taxes can take away only a part of the total income generated, for any economic activity. No economic activity would be viable if taxes exceed the income generated. An alternative benchmark would be to assess the impact on the constraints facing the domestic producers. One of the major gains expected from SEZs is the augmentation of infrastructure. It would be interesting to assess the revenue foregone against this benchmark.

The data on the website of the ministry of commerce on proposal-wise information on area and proposed in-

