

Special Economic Zones: Influence on Corporate Social Responsibility in India

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ABSTRACT

Over the past few years, the setting up of Special Economic Zones (SEZs) in the various geographical regions of our country has been an issue which has raked up debates in the various sections of the society. The foreseen benefits of Special Economic Zones are increased Foreign Exchange Earnings and more jobs in manufacturing in a country, which desperately needs to create new employment opportunities for millions. The expected benefits when compared with the contentious issues often raise the question of the social, economic and legal viability of special economic zones.

In 2005, the government of India enacted the SEZ Act and the SEZ Rules were notified in February 2006. The objective of the policy is to promote exports, employment and investment in SEZs. The Act also provides a wide area of discretion to the State and the Central governments to regulate SEZs per their will. In order to smoothen the functioning of the SEZ the economic laws and labour laws applicable for SEZ are far more liberal as compared to other corporate bodies. Some of major contentious issues involving SEZs: massive loss of tax revenues, low compensation and rehabilitation for farmers from whom land is acquired using an unjust Land Acquisition Act, indiscriminate land use patterns within the SEZs and real-estate scams, and last but not least, significant environmental risks have made it imperative that this policy of the government must be analyzed critically in the light of the past experience. Based on above objectives this paper is an attempt to critically examine the legal issues pertaining to Special Economic Zone in India especially in corporate governance and Corporate Social Responsibility as well. This paper will help the policy maker, academics, and government for making their strategy for further development.

Keywords:(JEL classification): SEZs, Corporate Social Responsibility (CSR), Corporate Governance (CG), Labor laws

INTRODUCTION

Historical evidence demonstrates the significance of export-led growth, both in terms of experience and economic impact. In the Indian context, the concept of special economic zones (SEZs) is not new; India was among the pioneers in Asia to acknowledge the potential of Export Processing Zones (EPZs) in fostering exports. The inaugural EPZ was established in Kandla in 1965. However, the EPZ model faced challenges due to a multitude of controls and clearances, a lack of world-class infrastructure, and

an unpredictable fiscal environment. Additionally, the economic reforms initiated in the early 1990s did not yield comprehensive economic growth for India. Several factors contributed to the shortcomings of these reforms, including bureaucratic red tape, protracted administrative procedures, inflexible labor laws, subpar physical infrastructure, and the legal framework of the Indian economy. These obstacles hindered the inflow of foreign direct investments into India, which was a key objective for their establishment.

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In an effort to address these challenges and realize the desired outcomes, the Indian government made the strategic decision to revive its previous approach of establishing export-processing zones, enhancing them with investor-friendly policies. This initiative led to the development of the SEZ policy of 2000 under the provisions of the foreign trade policy, representing an evolved iteration of the EPZ policy. The primary objective was to transform SEZs into catalysts for economic growth, bolstered by top-notch infrastructure, streamlined regulatory processes, and appealing fiscal incentives, both at the national and state levels.

To instill stability within the SEZ regime, the Special Economic Zones Act was put into effect in 2005, complemented by the SEZ rules of 2006. The primary objectives outlined in the Act encompass:

1. Facilitating the generation of supplementary economic activity.
2. Encouraging the export of goods and services.
3. Fostering investments from both domestic and international sources.
4. Creating avenues for employment.
5. Advancing the development of essential infrastructure.

It is anticipated that this combined effort will result in a significant influx of investments, both foreign and domestic, into SEZs, thereby enhancing infrastructure and productive capacity. This, in turn, will stimulate additional economic activity and offer new employment prospects.

To achieve the aforementioned objectives, the SEZ policy encompasses various distinct features, including:

1. Waiver of import duties for project development.
2. Exemption from excise/VAT for the domestic procurement of capital goods for project development.
3. Freedom to develop townships within SEZs with residential areas, markets, playgrounds, clubs, and recreation centers, with no foreign ownership restrictions.
4. Income tax holidays for business income.
5. Exemption from import duties, VAT, and other taxes.

6. Permission for 10% Foreign Direct Investment (FDI) via the automatic route for all manufacturing activities.
7. Exemption from excise/VAT for the domestic procurement of capital goods for project development.
8. Streamlined procedures for swift approvals, clearances, customs processes, and dispute resolution.
9. Simplification of labor Acts with self-certification provisions.
10. Availability of both public and private banks for financial assistance to businesses.
11. In-house customs clearance facilities.
12. Access to a skilled workforce with technical expertise.
13. Full authority to provide commercial services such as water, electricity, security, restaurants, and recreational facilities within the zone.

Based on the above outline, this paper is an attempt to evaluate the SEZ policy in India vis-à-vis Corporate Governance, Corporate Social Responsibility and legal issues like Land Acquisition Act, economic laws etc. A brief discussion has also been made on the recent experience of Tata's in Singrur.

SEZ AND CORPORATE GOVERNANCE:

Corporate governance has emerged as a significant focus for businesses, as they recognize it as a fundamental requirement for attracting investments from international financial institutions. Additionally, investors seek assurance that the companies they invest in are not only effectively managed but also adhere to sound corporate governance principles. Investors view corporate governance as a vital control mechanism that guarantees the optimal utilization of human, physical, and financial resources within an enterprise. Furthermore, organizations such as GATT and WTO emphasize the importance of adhering to good governance practices.

Corporate Governance practices are a set of structural arrangements that are emerging in free market economies to align the management of companies with the interest of their shareholders and other stakeholders and society at large. Accountability,

efficiency and ethical issues are the three basic issues addressed by corporate governance.

In 1998, the OECD established a set of corporate governance principles that encompass:

1. Shareholders' rights.
2. Equitable treatment of shareholders.
3. Stakeholder involvement.
4. Disclosure and transparency.
5. Board responsibilities.

As a result, the essence of corporate governance revolves around the core principles of absolute transparency, integrity, and accountability within management. But, the recent experience of Tatas at Singrur has put a question mark on this principle of disclosure and transparency as the Calcutta High Court restrained the state government and the West Bengal Industrial Development Corporation (WBIDC) from making public the 'secret' part of the agreement they signed with Tata motors on the Singrur project. The company had taken the West Bengal government and its industrial body to the court after WBIDC posted the text of the 'general' agreement on its website on the direction of the state information commission. The commission had received a right to information plea for such disclosure.

The lawyer representing Tata Motors presented an argument in court, contending that the state information commission had breached the RTI Act of 2005 by requesting the state to disclose the agreement. According to Section 11(1) of the Act, when a third party, distinct from the RTI petitioner and the government, is involved, the consent of this third party is required for any information to be disclosed. The company's legal representative also asserted that the agreement among the three parties constituted a trade secret and should not be made publicly accessible. Essentially, the company maintained that the Nano project was a privately held commercial endeavor. In contrast, the state government had acquired land in Singrur through an outdated law, the Land Acquisition Act of 1894, which permits the state to requisition land for "public purposes".

The very objectives of the SEZ policy provide that it is for the public benefit and even the land is acquired

by the state and the central government for that very purpose. Hence no secrecy can be maintained in such situations and the public has full right of disclosure.

SEZ AND CORPORATE SOCIAL RESPONSIBILITY:

Corporate Social Responsibility (CSR) is a highly misunderstood and misinterpreted term in India. It is a common belief that by merely complying with laws and regulations the need of CSR is fulfilled. But the recent experience of Tata in Singrur and proposed SEZ in Nandigram West Bengal has shattered this belief, as here, the conflict between companies and communities over the control of land and natural resources could not be curtailed, though it was done as per the procedure prescribed by law.

The concept of corporate social responsibility provides for the accountability of organizations towards their stakeholders. The stakeholders are those who participate in some way in the activities of the organization. According to Freeman and Reed, stakeholders may be:

- Any group of the people who have a stake in the business.
- Those who are vital to the survival and success of the organization.
- Any group that is affected by the activities of the organization.

Thus, the stakeholders can be categorized into internal and external stakeholders. The internal stakeholders include shareholders, employees and management and external stakeholders are individuals and groups, who have some claim on the company and include consumers, suppliers, creditors, competitors and community.

In the above stated example of Tata, the rift between the organization and the community had gone to such an extent that the company had to finally move out of WB. The dispute was over the fertile land acquisition by Tata motors at subsidized rates (as per the Land Acquisition Act and the SEZ Act) for developing a SEZ. The compensation paid to the community at Singrur was not adequate and the land was acquired by involving state government (as provided under SEZ Act) without providing appropriate rehabilitation package to the local residents. Accordingly, under tremendous pressure and force a policy decision was taken that the

government will not acquire land for businesses anymore and companies have to directly negotiate with communities for acquisition of land.

This case gives an insight to the reality of the status of corporate social responsibility in the corporate world.

SEZ AND LEGAL IMPLICATIONS:

- a) Land Acquisition policy for SEZ: - State governments were empowered to acquire land which would be transferred to private developers to develop appropriate infrastructure for SEZs. On the other hand, the private developers are allowed the ownership rights on the land they develop for SEZs. No specific guidelines for land use of SEZs have been provided by the government and the developers at their own free will have decided to put 35 percent of land for processing units and rest to be used as non-processing zone. Apart from processing units, SEZs can have residential complexes, entertainment sections and amusement parks.

Unregulated land development policy by the private sector may lead to problems such as, developers are likely to charge high price from production units or final land users in a situation of scarcity of well-developed space. This might lead to rampant speculative activities on land discouraging both domestic and foreign companies to come to SEZs and defeating the purpose of policy. Private land developers may also choose to keep a large stretch of land unused.

According to the SEZ policy, the state government are allowed to acquire any land for SEZ and though the 1960 amendment of land acquisition Act makes the consent of farmers compulsory for any acquisition but the State government in over enthusiastic zeal ignored the above law and used 1864 draconian Land Acquisition Act of colonial period which permits acquisition without consent of owners. This has resulted into a number of disputes between farmers and the concerned State government.

Local Level Protests against Land acquisition in India

State	Location	Protest by against	Type of Land
Punjab	Barnala	Farmers against Trident	Agro Land
Punjab	Amritsar	Farmers	Fertile agro Land
Haryana	Jhajjar	Farmers	10,000 hectares of double cropped land
Mumbai	Near Mumbai	Farmers	14,000 hectares of double cropped land
Mumbai	Uttar-Goria Belt	Bt fishermen and sultpan workers	2 km metre in width and 18 Km in length
Orissa	Kashipur	Against Binas (Utkal Aluminum L.td.)	For 13 years
Orissa	Earasama near pardeep	Against South Korean MNC	Posco for 2 Years
UP	Dadri	Against Anil Ambani's Reliance Group Power plant	
Chattishgarh	Baster	Against state Govt.	
Goa	Goa	Protests by Citizens	Govt ordered cancellation of notification
WB	Singur	By local people and farmers against state govt. acquisition of land for Tatas	20 acres of fertile Agro land at a nominal price
WB	Nandigram	Local protest against the state govt's acquisition for Indonesian Salim group	Repression of protesters and killings described as worse than Jallianawalla Bag

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There has been campaign against SEZ Land Acquisition policy particularly on the question of displacement

from all strata of the society i.e. at the grassroots level, political formations and NGO's. It has been pointed that the present policy is business friendly rather than market friendly and that the land should be paid at the market rate and proper compensation package should be provided to all stakeholders. In response to these criticisms, the government of India will be bringing two amendment bills to parliament, one on land acquisition and other on rehabilitation and resettlement of displaced persons. But the sufficiency of bills with respect to sixty percent of population dependent on agriculture, needs to be understood in the broader context of food security.

- b) Financial Perspective:** One of the primary goals of the SEZ was to expedite the growth of exports. SEZs are designated as duty-free enclaves and are treated as foreign territories for trade operations, duties, and tariffs. According to this policy, units within SEZs will enjoy a 100% exemption from corporate income tax for the initial five years, a 50% exemption for the subsequent five years, and, during the final five years, 50% of the profits reinvested will be exempt from tax. To comply with the requirement of being a Net Foreign Exchange (NFE) earner, units in the zones must demonstrate a cumulative positive NFE over a five-year period from the commencement of production.

An audit scrutiny conducted by the Comptroller and Auditor General revealed that the policy had not specified the extent of foreign exchange that should be earned by a SEZ unit through actual physical exports, as opposed to deemed exports within the domestic tariff area (DTA), to meet the positive NFE provision. It is worth noting that deemed exports in the DTA do not contribute to foreign exchange earnings.

During the audit it was observed that 22 SEZ units had been achieving the prescribed "positive" NFE mainly through domestic sales and this defeats one of the objectives of the Scheme, which was to augment real exports. While an overall export of Rs. 7,149.23 crores was made by these 22 units, the actual export content was only Rs. 5,149.96 crores (72%) related to DTA earnings. Customs duty of Rs. 1,043.29

was foregone on import of goods by these units. CAG's scrutiny also revealed a failure in recovering duty foregone from units who had not achieved positive NFE. Accordingly, a duty of Rs. 106.71 crores (determined in proportion of the shortfall in achieving positive NFE) with interest of Rs. 46.17 crores was recoverable from these units.

Instances of sizeable losses to public exchequer don't merely end here as audit scrutiny also revealed that violations and non-compliances abound in SEZ units even after so many waivers and exemptions. The criticism of systemic and compliance weaknesses of India's SEZ policy in the latest CAG audit report and the impact in the revenue losses needs to enter the SEZ debate.

- c) SEZs and Employment Prospects:** One of the foreseen benefits of SEZs is creation of jobs in manufacturing in a country which desperately needs to create new employment opportunities for millions. But, the present situation does not give a positive picture as it is expected that SEZs will create 7 lakh jobs for urban skilled labour while 1.14 lakhs farm families having five member per family will be displaced along with 82 thousand farm workers.

SUGGESTIONS:

In order to derive the expected benefits from the SEZ policy and to make it both investor and market friendly it is suggested that:

- An adequate land acquisition policy needs to be worked out both in terms of the amount of the compensation payable and the type of land to be acquired.
- The policy should also provide for the specific provisions for rehabilitation of the displaced inhabitants of the acquired land.
- Financial perspective of the SEZ policy needs to be reworked in the light of the CAG's report.
- SEZ policy should be equipped with adequate corporate governance and corporate social responsibility principles and the observance of the same by the corporate bodies to be regulated.

At this juncture, the most effective course of action for the government is to revise the SEZ policy in a manner that fosters the creation of employment-intensive SEZs, while also safeguarding the nation's

finances and avoiding the discouragement of vested interests.

CONCLUSION:

This paper brings out the various contentious issues involved in developing SEZ in India. Although SEZs as concept appear to be the right solution to encourage India's manufacturing exports, the government's current approach may not be the best way to achieve the much needed push to boost India's manufacturing a during the implementation of the Act va4rious loopholes have surfaced up, like : Inadequate land acquisition policies of the government, SEZ applications generally driven by tax benefits rather than the actual requirement of creation of special economic zone, inappropriate land distribution pattern for SEZ, need for an appropriate legal framework between domestic area and SEZ., inappropriate application of the principles of Corporate Governance and Corporate Social Responsibility, inadequate policies for rehabilitation of the displaced farmers etc.

The Comptroller and Auditor General's report has also shown that SEZs are poor public policy not only socially but economically as well. Hence, in order to achieve the set objectives, the present policy of the government needs to be revamped in the light of past experience.

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