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IMPACT OF SPECIAL ECONOMIC ZONES ON EMPLOYMENT, FOREIGN DIRECT INVESTMENT AND EXPORT

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Abstract

A Special Economic Zone is a geographical region that has economic laws more liberal than a country's typical economic laws. Usually the goal is flourishment in foreign investment. In other words, SEZs are specifically delineated enclaves treated as foreign territory for the purpose of industrial, service and trade operations, with relaxation in customs duties and a more liberal regime in respect of other levies, foreign investments and other transactions. These regions exists in many countries of the World and China perhaps the oldest to give reality to this concept. Although they exist in several countries, their attributes vary. Typically they are regions designated for economic development oriented toward inward FDI and exports fostered by special policy incentives.

Keywords: Special Economic Zone, Foreign Direct Investment, Export Promotion Zone.

Introduction

Special Economic Zone (SEZ) refers to a totally commercial area specially established for the promotion of foreign trade. A Special Economic Zone is a geographical region that has economic laws more liberal than a country's typical economic laws. Usually the goal is flourishment in foreign investment. In other words, SEZs are specifically delineated enclaves treated as foreign territory for the purpose of industrial, service and trade operations, with relaxation in customs duties and a more liberal regime in respect of other levies, foreign investments and other transactions. These regions exists in many countries of the World and China perhaps the oldest to give reality to this concept. Although they exist in several countries, their attributes vary. Typically they are regions designated for economic development oriented toward inward FDI and exports fostered by special policy incentives. The SEZs in India are the outcome of the present government's industrial policy which emphasizes deregulation of Indian industry and to allow the industries to flexibly respond to the market forces. All undertaking

other than the small scale industrial undertakings engaged in the manufacture of items reserved for manufacture in the small scale sector are required to obtain in industrial license and undertake an export obligation of 50 percent of the annual production. This condition of licensing is however, not applicable to those undertakings operating under 100 percent Export Orientated Undertakings Scheme, the Export Processing Zone (EPZ) or the Special Economic Zone Schemes.

The SEZs are the new nomenclature of modified earlier Export Promotion Zones or EPZs. The first EPZ in India was set up in 1965 Kandala, Gujarat. They were created as privileged zones with facilities of liberal tax and labour laws. They were to attract the foreign investors to import materials for use and export of manufactured commodities. In this way jobs would be created and export got enhanced. The main difference an EPZ and a SEZ is that the former is just an industrial enclave but the latter is an integrated township with fully developed infrastructure.

Objectives of the Study

1. To study the employment generation of southern states like Kerala, Karnataka, and Andhra Pradesh compared with Tamil Nadu.
2. To study the Foreign Direct Investment performance of some selected countries SEZs with India and Indian States.
3. To study the export performance of some selected countries SEZs with India and Indian States.
4. To study the empirical analysis of the impact of SEZs on Employment, FDI and Exports.

Methodology

The researcher estimates the equation of the form

$Y_{it}=\alpha+\beta X_1+\beta X_2+\beta X_3+\beta X_4+\beta X_5+\beta X_6+Ui$-----(1)

where i represent the state and t represents the time for the dependent variable (i.e. , FDI inflow), y and the explanatory variables (x); α is the parameter specific to each state and does not vary over time. The following variables in linear form are considered

$LFDI_{i,t}=\alpha i+\beta_1 LPGSDP_{i,t}+\beta_2 PELEC_{i,t}+\beta_3 HDENSITY_{i,t}+\beta_4 URBANDENSITY_{i,t}+\beta_5 NEARPORT_{i,t}+\beta_6 SEZpolicy_{i,t}+Uit$----------(2)

Where, $\beta_{1\ to}\ \beta_6$ are the parameters to be estimated. Our key variable is SEZ policy which is captured as a dummy which takes the value one from the year when a state implements SEZ policy and zero before that. If coefficient of β_6 is positive, this would imply that SEZ policy has worked and has induced FDI in the state. Alternatively, to see the robustness of the results, we also use number of Operational SEZs in the state and hypothesize that a state having more number of operational SEZ would be able to attract more FDI. With respect to other variables, LPGSDP is the log of Per-capita GSDP (at constant Prices), which is used as a measure of size of the market. Higher the GSDP per capita, higher is the market potential. As SEZs are established primarily to attract investment and are export oriented, the size of the domestic market may not be very relevant. However, as we are looking factor influencing total FDI in a state, the market size captured by GSDP per capita becomes relevant. We thus include this variable in the model.

Scope of the Study

The number of special economic zones (SEZs) globally continues to expand SEZs account for an increasing share of international trade flows and employ growing number of workers world-wide. In the global economy, EPZs are viewed as an important second best policy instrument to promote industrialization, employment and regional development. However, costs and benefits of SEZs have generated an intense debate, touching on almost every possible aspect of SEZs. Therefore whether SEZs are beneficial for development remains a subject of controversy. The present study has focused on human development effects of SEZs. This is a relatively under researched theme. Although labour standards, labour relations and employment effects have been the most ironical and controversial elements of SEZs, a comprehensive analysis on these aspects is scarce in the Indian contest and will contribute to a better understanding of the employment and human dimensions in SEZs. Zones are popular instruments in developing countries for pursuing export-led growth strategies. Developing countries have built zones as models for selective policy applications and for easier integration into the world economy. India is not an exception. However, the recent special economic zones (SEZs) that have come up following the SEZ

Act of 2005 have created several controversies. These include concerns over accentuation of economic divides and industrial relocation.

Direct employment created by SEZs projecting a total of 2.14 million. Of this, 61 percent is in IT/ITES and another 15 percent is in existing strengths with a further 21 percent in multiproduct SEZ, amounting to 97 percent. It is interesting to note that the 1.25 million direct employment proposed to be created by the IT/TIES SEZs alone exceeds the current employment in that sector. Further, 85 percent of this proposed employment is in the five states, with 40 percent in Andhra Pradesh alone, of which two-thirds is from IT/ITES SEZs of this indirect employment too, 68 percent is generated by IT/ITES, another 12 percent is in existing strengths and 17 percent in multi-product SEZ, again amounting to 97 percent. The five states account for three-fourths of the indirect employment generated but in this instance, if one replaces Tamil Nadu by Punjab, the share of the top five States jumps to an amazing 92 percent. This is because 17 percent of the total indirect employment, i.e., half a million jobs are generated by one IT/ITES SEZ, Quark City, in Mohali, Punjab Even so, it is not the top job generator, which is another IT/ITES SEZ, viz. Sanghi in Andhra Pradesh which proposes to create 600,000 jobs. Of the approximately two million indirect jobs to be created by the IT/ITES SEZs over one half, i.e., 1.1 million jobs were in just two SEZs.

In India, all the eight Central government controlled EPZs situated in Kandla, Surat, Santa Cruz, Cochin, Chennai, Noida, Falta and Visakhapatnam have been converted as SEZs. In addition, sever new SEZs (Manikanchan-West Bengal, Jaipur, Indore, Salt Lake Electronic City-Kolkota and Mahindra City-IT-Hardware-Electroninics-Chennai, Mahindra-Apparel and Fashion-Chennai, Jodhapur-Rajastan) have become operational in 2004-05 (Government of India 2007). Exports from SEZs in India grew by 16.40 percent from 2000-01 to 2004-05. In same period, total exports from India grew by 12 percent (www.sezindia.nic.in). This clearly signifies the importance of SEZs in India. Exports from the SEZs during 2005-06 have registered a growth of 25 percent in rupee terms over the previous year and 52 percent in 2006-07 over the previous years.

LFPR, WPR and UR based on Usual Principal Status (UPS), 2015-16

Factor	Rural			Urban			Total		
	M	F	P	M	F	P	M	F	P
LFPR	77.3	26.7	53.0	69.1	16.2	43.5	75.0	23.7	50.3
WPR	74.1	24.6	50.4	66.8	14.3	41.4	72.1	21.7	47.8
UR	4.2	7.8	5.1	3.3	12.1	4.9	4.0	8.7	5.0

Source: Report on 5th Annual EUS, 2015-16

As per EUS Surveys, employment growth has been sluggish. Further, States that show low unemployment rates also generally rank high in the share of manufacturing. While States compete to seek investment offering incentives, linking incentives to the number of jobs created, sustained efforts need to be considered as a tool to increase employment. There is a clear shift in employment to secondary and tertiary sectors from the primary sector. The growth in employment by category reflects increase in both causal labour and contract workers. This has adverse implications on the level of wages, stability of employment, social security of employees owing to the 'temporary' nature of employment. It also indicates preference by employers away from regular/formal employment to circumvent labour laws.

The SEZ Act came into place in 2005, a tremendous growth in exports has been observed. Moreover, SEZ in India has also made a remarkable progress in terms of export promotion between the periods 2005-06 and 2010-11. During 2001-2010, it has shown a 121 per cent growth over the previous year. The same is still continuing as shown in the above table. Despite all this growth, as per the Report of the Comptroller and Auditor General of India Report, the actual exports are far behind.

State wise FDI inflows during 2001 to 2014

States	Avg. FDI	%	Total
Maharashtra	4854	40.60	67954
Delhi	2801	23.43	39215
Tamil Nadu	1128	9.44	15792
Karnataka	1072	8.97	15014
Gujarat	829	6.94	11607
Andhra Pradesh	634	5.31	8881
West Bengal	207	1.73	2901
Rajasthan	89	0.74	1241
MP Chattisgarh	81	0.67	1130
Kerala	77	0.64	1074
Haryana	76	0.64	1063
Goa	49	0.41	684
UP (Uttaranchal	31	0.26	434

Odisha	18	0.15	250
North Eastern States	5	0.04	73
Bihar Jharkhand	4	0.03	55

Source: Compiled from FDI inflow data from indiastat

As can be seen from the table, States with seaport have not only had higher urban density, higher per capita GSDP, but also higher highway density. The number of operational SEZs is found to be positively correlated to the per capital income, availability of electricity, urbanization, SEZ policy and nearness to the port but negatively correlated to highway density. This is not surprising as given the purpose of setting up of SEZs which is meant for exports, they not only require larger parcel of land at a particular location, but also would be away from urban centers but nearer to a port. The equation (2) has been estimated in three different ways 1) pooled model (keeping α constant i.e. ignoring the state specific or temporal effects); 2) fixed effects and 3) random effects. As the states are heterogeneous, random effects and fixed effects models control for the state specific effects, and the suitability of these models is tested using the Hausman specification test. We tested for the presence of time effects in the fixed effects model and found them to be not significant and hence the results are not reported here. The estimated results are given in Table 5 Column 2 represents the results where the state-level differences are not considered. Though, the researcher do not see any evidence of heteroscedasticity from the Cook-Weisberg test, the researcher report robust standard errors after correcting for heteroskedasticity. Columns 3 and 4 give the result for fixed effects and random effects estimation. The F statistics (5.76 with probability of >0) indicates that the state level differences are important.

To check the suitability of fixed effects vis-à-vis the random effects, a Hausman test is carried out. As the test statistics (9.37) is lesser than the critical value, the null of Random effect being more efficient is accepted. The additional test of Cook-Weisberg test for random effect. The test statistics of 59.84 (probability of 0.00) validates that random effect model is efficient in the present case. The Wooldridge test with value 16.471 (probability of 0.00) indicates the presence of autocorrelation in the sample. Column 5 reports the results of the model corrected for panel specific autocorrelation. Since the model given in Column 5 is our preferred model to discuss the results only.

The results validate that SEZ policy has a direct influence on the FDI inflows in a state. The results indicate that a state which has formulated SEZ policy will be able to attract additional 3.21 million US $ (=exp (β_6)) FDI; vis-a-vis a state, which has not formulated the policy. Besides the policy formulation, other factors influencing FDI inflows are the market size and urbanization. A state having a sea port is also able to attract more FDI. Surprisingly, electricity generation in a state has no bearing on FDI inflow. One possibility could be that it is not the electricity generation as such; rather it is electricity availability that would influence FDI inflow. It doesn't have data to account for electricity availability; as a result, the researcher could include only energy generation variable only. Surprisingly, the research found that highway density has a negative influence on FDI inflow. One probable reason is that extent of road infrastructure is not merely reflected by highways, even a simple tar road may add up to the infrastructure. For lack of data on all kinds of roads in a particular state for all the years, the researcher could not include the variable.

It was seen from the above table that the explanatory variables included in the model for employment, FDI and export reveal greater variation in the impact of special economic zone. In the case of employment, the R^2 value indicates that 78 percent variation in the employment associated with variables included in the model. All the six independent variables had a positive impact on special economic zones. The inputs namely generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities, development of infrastructure facilities and maintenance of sovereignty and integrity of India, the security of the State and friendly relations with foreign state were statistically significant and they were positively related to the dependent variable. Capital flow was found to be the most influential variable and it had a greater influence on creating more employment opportunities. It indicates that one percent increase in this variable in 0.3349 percent increase in employment. The other important

determinants of employment opportunities observed were human capital. An additional percentage of these variables could generate more employment opportunities by 0.2968 and 0.1922 percent respectively. The regression co-efficient of additional economic activity and maintenance of sovereignty were found to be non-significant. The F-value shows that the regression model fitted is statistically significant at one percent level. In the case of FDI, all the six explanatory variables are jointly responsible for 77.45 percent of impact of inviting FDI. The variables namely, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities, and development of infrastructure facilities were statistically significant at 5 percent level. It means that one percent increase in these variables could increase the FDI by 0.2518, 0.1824, 0.1426 and 0.4334 percent respectively. Development of infrastructure facility variable and it had a greater influence on FDI. The variables namely, additional economic activity and maintenance of sovereignty of the State had a positive influence but insignificant impact on FDI. The F-value shows that regression model fitted is statistically significant at one percent level.

In the export category, R^2 indicates that 76.22 percent variations in the dependent variables were explained by all the explanatory variables included in the model. The variables generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities and development of infrastructure facilities were statistically significant at 5 percent level and they were positively related to attract more export promotion. It means that an additional percentage of these variables could increase export by 0.2963, 0.1622, 0.1125 and 0.3968 percent respectively. Promotion of exports of goods and services had a greater influence on SEZ followed by development infrastructure facilities in the study areas. As per F-value given in the above table, the regression model fitted was found to be significant at one percent level. Thus, it was inferred from the analysis that among the significant variables, generation of employment opportunities and attracting FDI are found to be more important influencing factors by the SEZs rather than promoting exports.

Conclusion

At the national level, export is statistically significant in all the specifications. However, the instrumental variable estimate of trade's impact on income is higher than the OLS estimates. Thus, it is possible that although these countries liberalized their trade policies through SEZs, they did not adopt other growth-enhancing policies, such as better governance and property rights protection. This will lead to a negative correlation between exports and the errors terms in an OLS regression and thus to downward bias in the OLS estimate of export's effects. In contrasts to the national results, the regional results suggest a positive correlation between exports and the errors terms in an OLS regression which biases the OLS estimate of export's effects upwards. It is likely that liberalized regions are likely to adopt other growth-enhancing policies, such as infrastructure development. It seems that such regional policies which enhance regional growth are not growth enhancing at the national level. Therefore, a possible policy implication would be that among other policies. Therefore, India would have to ensure better governance and property rights regimes to enhance growth at both the regional and the national levels.

Further, this paper also contributes to a better understanding of the relationship between SEZs, openness and growth estimate of the percentage increase in regional economic growth was 0.51 for every 1 percentage increase in regional exports. For India, data constraints restrict the data analysis to only those regions with EPZs. In these regions, economic growth is very export inelastic. The number of operational units in each EPZ is not statistically significant in all specifications. The increase in number of operational units in each EPZ has very limited impact on regional growth. The key objective of economic development is to maximize the positive human development and poverty impacts. SEZs have the potential to enhance human capabilities. But for this potential to be realised, the government must devise strategies to strengthen the opportunities that are likely to emerge, protect interests of the SEZ workers, and forge linkages between SEZs and the domestic economy.

The establishment of SEZs has undoubtedly helped to increase the volume of

international trade. Further, a large amount of foreign investment has found its way not only into the export trade, but also into infrastructure construction and commerce. Foreign companies have been encouraged to establish their presence in the territories and the export industry has grown. Advanced foreign technology has been brought in with the inflow of foreign investment. All these factors have contributed to the growth of the Indian economy. The enactment of the SEZ Act and its implementation should enable the Government of India to fulfil its agenda of economic reforms as the multiplier effect on the economic activities triggered by SEZ materializes. The challenge now is whether India through its SEZs can leverage its cost advantage and huge knowledge base and break the hold of China in manufacturing by making India the preferred destination for doing business.

Thus it can be concluded that the government needs to enact legislation, create of focused administrative infrastructure to govern SEZs, offer highly attractive incentives and locate zones in the best possible locations. Overall investment Climate (infrastructure, governance) in a country matters in the success of its SEZs in terms of competitiveness. Generally, it is argued that the SEZ concept is attractive because it is much easier the resolve the problems of infrastructure and governance on a limited geographical area than it is to resolve them countrywide. These zones cannot be insulted from the broader institutional and economic context of the country and be treated as an economy within the economy. These zones are a part of the economy and require economy within the economy. These zones are a part of the economy and require overall improvement in the investment climate to ensure success in the long run. They should not, therefore, be viewed as an alternative to the overall development model. This is perhaps the reason why SEZs failed to fulfill the role of engines of industrialization in most countries on a sustainable basis.

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