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Custom Duty Exemptions and Their Economic Implications "A Case Study of Special Economic Zones (SEZs) in India"

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***Abstract* – This research paper explores the economic implications of custom duty exemptions in India's Special Economic Zones (SEZs). SEZs have been instrumental in promoting industrialization, export growth, and foreign direct investment (FDI) by offering various fiscal incentives, including custom duty exemptions. This study aims to analyze the effectiveness of these exemptions in achieving their intended economic outcomes. By employing a case study approach, the paper examines several SEZs across different regions of India to understand how custom duty exemptions influence investment decisions, export performance, and overall economic activity within these zones. The research also evaluates the broader economic impact on domestic industries outside SEZs and assesses whether the benefits of such exemptions outweigh potential revenue losses for the government. The findings contribute to policy discussions on optimizing fiscal incentives to balance growth and fiscal sustainability, offering recommendations for future policy directions to enhance the efficacy of SEZs in India.**

***Keywords* – Custom Duty, SEZs, Economic Implications, FDI.**

I. INTRODUCTION

The Government of India imposes a Customs Duty on all imports and certain exports. The amount payable as customs duty is determined by various factors, including the value, weight, and dimensions of the goods. Customs duty is a tax levied on goods crossing international borders, serving to regulate their movement and protect a nation's economy, jobs, environment, and residents by controlling the flow of goods, especially restricted items. Each product is subject to a specific duty rate, determined by factors such as its origin and composition. In India, all imported items, including purchases made abroad and gifts received from outside the country, must be declared in accordance with customs regulations. Adhering to these rules ensures transparency and compliance with legal requirements for importing goods into India. Below are more details about Customs Duty in India.

The global economy is increasingly driven by international trade and investment, making the role of custom duties pivotal in shaping a country's economic landscape. In this context, Special Economic Zones (SEZs) have emerged as crucial instruments for promoting export-oriented growth, attracting foreign investment, and boosting economic development. India, in its quest to become a global manufacturing hub, has established numerous SEZs, offering a plethora of incentives including custom duty exemptions. These exemptions are designed to enhance the competitiveness of businesses operating within SEZs by reducing the cost of imported inputs and promoting seamless production and export activities.

Custom duty exemptions in SEZs are intended to create an environment conducive to high-volume manufacturing and export, thereby generating employment, increasing foreign exchange earnings, and stimulating regional development. However, the economic implications of these exemptions extend beyond immediate fiscal benefits. They influence domestic industries, trade balances, revenue generation, and the broader economic framework. Understanding the multifaceted impacts of custom duty exemptions is essential for policymakers to design balanced and effective economic strategies.

Objective of Custom Duty

- **Revenue Generation:** Customs duties play a vital role in generating government revenue, which in turn helps finance public services and infrastructure development.
- **Protection of Domestic Industries:** Customs duties, through the imposition of tariffs on imported goods, aim to shield domestic industries from foreign competition. This protection helps to secure local employment and promotes economic growth by giving domestic businesses a competitive edge.
- **Regulation of Trade:** Customs duty helps regulate the flow of goods across borders, ensuring compliance with trade regulations, safety standards, and intellectual property rights.
- **Economic Policy Tool:** Governments utilize customs duty as an instrument to enforce economic policies, aiming to promote exports or discourage the importation of specific goods.

Types of Custom Duty: Customs duties are almost universally imposed on all goods entering the country. Export duties, on the other hand, apply to only a few goods specified in the Second Schedule. Certain items, such as lifesaving drugs and equipment, fertilizers, and food grains, are exempt from import duties. Import duties are categorized into several types, including:

Types of Custom Duty	Rates	Applicable
Basic Custom Duty (BCD)	0 to 100% (Depending upon the HS codes and its origin)	On all goods imported in India. Actual fees depends on: • Type of goods • Region of imported from • What these products made from Some goods are exempted from BCD such as lifesaving drugs.
Special Additional Duty (SAD)	4.%	On imported goods which are equivalent to the locally produced good subject to sales tax. Calculated on total assessable value of good
Countervailing Duty (CVD)	0% to 12% (Depends upon the goods)	On goods that received tax benefits or subsidies in the country of manufacture. This duty prevents undue advantage of these goods over locally produced goods.
Social Welfare Surcharge (SWS)	10%	Introduced in 2018 to support government social welfare project, which replaces Education Cess.
Anti-Dumping Duty	As per notification	Imposed to prevent dumping, which is an unfair international trade practice where goods are sold below market value, thereby damaging local industry.
Compensation Cess	Depends upon product type	On goods such as Tobacco and pollution causing goods such as coal and cars. This was introduced to compensate revenue loss of states due to the implementation of IGST
Safeguard Duty	As per notification	Imposed by Indian Custom authorities on all goods imported in Indian that is damaging local producers.
Integrated Goods & Services Tax (IGST)	5%, 12%, 18% and 28%	The IGST introduced in 2017 brings all imported and local goods under one of the seven different rates.
Custom Handling Fees	1%	Applied apart from other taxes as applicable.

II. REVIEW OF LITERATURE

1. Sarkar, S., & Bhowmik, P. K. (2019)

Economic Impact of Special Economic Zones (SEZs) in India: A Review. Journal of International Business Research and Marketing, 4(2), 25-32. This study provides an overview of the economic impact of SEZs in India, including the role of custom duty exemptions in attracting investment and promoting exports. It discusses the potential benefits and challenges associated with SEZs, with a focus on their contribution to employment generation and industrial growth.

2. Agrawal, S. (2020)

Special Economic Zones (SEZs) in India: A Review of Policy Evolution and Performance. Foreign Trade Review, 55(1), 53-68. Agrawal's review examines the evolution of SEZ policies in India and evaluates their performance in terms of export promotion, foreign investment attraction, and economic development. The study analyzes the effectiveness of custom duty exemptions as a key incentive for businesses operating within SEZs.

3. Mukherjee, D. (2018)

Special Economic Zones in India: A Review. Journal of Commerce and Accounting Research, 7(3), 29-37. This review article provides insights into the policy framework governing SEZs in India and assesses their impact on various economic indicators. It discusses the significance of custom duty exemptions in enhancing the competitiveness of SEZ-based industries and evaluates their implications for the broader economy.

4. Purohit, H., & Tulsian, M. (2017)

Impact of Special Economic Zones on India's Export Performance: A Review. Indian Journal of Commerce & Management Studies, 8(2), 30-37. Purohit and Tulsian's review focuses on the export performance of SEZs in India and examines the role of custom duty exemptions in facilitating export-oriented manufacturing activities. The study highlights the importance of SEZs in leveraging global value chains and enhancing India's export competitiveness.

5. Rajagopal, R. (2021)

Special Economic Zones (SEZs) in India: An Appraisal of Policy Objectives and Achievements. Foreign Trade Review, 56(3), 321-336. Rajagopal's appraisal offers a critical analysis of the policy objectives and achievements of SEZs in India, with a specific emphasis on their economic implications. The study assesses the effectiveness of custom duty exemptions in promoting investment, employment, and technology transfer within SEZs.

Objective of the Study

- To Assess the Effectiveness of Custom Duty Exemptions in Promoting Industrial Growth.
- To Identify Challenges and Limitations Associated with Custom Duty Exemptions.
- To Provide Insights for Future Policy Formulation and Decision Making.

III. RESEARCH MYTHOLOGY

This study adopts a descriptive research design to analyze and describe the economic implications of custom duty exemptions within Special Economic Zones (SEZs) in India. The research relies on secondary data collected from various sources, including government publications, academic journals, industry reports, economic databases, and official statistics from organizations such as the

Ministry of Commerce and Industry, Reserve Bank of India, and Securities and Exchange Board of India (SEBI).

Limitation of the Study

1. Data Limitations: The study constrained by the availability, quality, and coverage of secondary data on the topic.
2. Scope: The analysis is limited to secondary data and may not capture the full range of factors influencing the economic implications of custom duty exemptions in SEZs.
3. Generalizability: Findings from secondary data analysis may not be generalizable to all SEZs in India or applicable to other countries with different economic contexts.

Future Research Direction:

- **Primary Research:** Future research may include primary data collection through surveys, interviews, or case studies to complement and validate findings from secondary data analysis.
- **Longitudinal Studies:** Longitudinal studies tracking changes over time in the economic performance of SEZs in response to custom duty exemptions and policy reforms.
- **Comparative Analysis:** Comparative studies comparing the economic implications of custom duty exemptions across different types of SEZs or between India and other countries.

Objective-1: To Assess the Effectiveness of Custom Duty Exemptions in Promoting Industrial Growth

In April 2000, the Government of India announced the Special Economic Zones (SEZs) Policy, aiming to create world-class infrastructure, simplify controls and clearances, and establish a stable fiscal regime to attract more foreign investment. To further reassure investors and demonstrate the government's commitment to a stable SEZ policy, Parliament passed the Special Economic Zones Act, 2005, in May 2005, which received Presidential assent on June 23, 2005. This legislation was complemented by the SEZ Rules, which became effective on February 10, 2006. Together, the Act and Rules provided a foundational framework for the establishment and management of SEZs in India, significantly streamlining procedures and offering single-window clearance for both central and state government matters.

The new legislative and policy framework aims at generation of additional economic activity by attracting investment from domestic and foreign sources and promote exports of goods and services from India leading to creation of employment opportunities and development of infrastructure facilities. The new SEZ Policy also envisages key role for the State Governments in Export Promotion and creation of related infrastructure.

Duty Exemptions to SEZ Units

- There are no customs duties on imported capital goods, whether new or second-hand, including those on lease. This exemption also applies to raw materials, components, and consumables necessary for constructing and erecting factories or plants, as well as for the production of goods and services.
- There is no Excise Duty or GST on the procurement of any indigenous capital goods (whether new, second-hand, or leased), raw materials, components, or consumables necessary for the construction and erection of factories or plants, as well as for the production of goods and services.
- The benefits of Advance Authorization, EPCG (Export Promotion Capital Goods), and Duty Drawback under the Foreign Trade Policy extend to supplies made from Domestic Tariff Area (DTA) units to Special Economic Zone (SEZ) units.
- Credit / Refund / Exemption of GST as per respective GST Acts & Rules.
- Exemption or Refund of GST on Services to the SEZ.
- Electricity Duty Exemption (varies from State to State).
- 100% Foreign Direct Investment (FDI) through automatic route - barring few sectors
- Facility to retain 100% foreign exchange receipts in EEFC Account.
- Income Tax Exemption under Section 10-AA for a period of 15 years on Export Income as follows:
- 100% IT exemption for first 5 years.
- 50% IT exemption for next first 5 years.
- 50% IT exemption if export profit is ploughed back for next 5 years (the amount credited to Special Economic Zone Re-investment Reserve Account for business purpose).

Table-1: Monitoring Export Performance for SEZs

Details	FY: 2020-21		FY: 2019-20		Actual Change		Percentage Change	
	INR (Rs. in Cr.)	USD (In Millions)	INR (Rs. in Cr.)	USD (In Millions)	INR Terms	USD Terms	INR Terms	USD Terms
Merchandise Exports	1,42,576	19,284	2,09,446	30,176	-66,870	-10,892	-32%	-36%
Services Exports	2,85,815	38,514	2,59,319	37,367	26,496	1,147	+10%	+3%

Interpretation: The table provides a comparison of the export performance of Special Economic Zones (SEZs) between the fiscal years (FY) 2020-21 and 2019-20, focusing on both merchandise and services exports. The data is presented in terms of Indian Rupees (INR) and US Dollars (USD), showing actual and percentage changes.

- Merchandise exports from SEZs significantly decreased in FY 2020-21 compared to FY 2019-20. The decline was 32% in INR terms and 36% in USD terms, indicating a substantial reduction in export performance, possibly due to factors such as global economic conditions, supply chain disruptions, or decreased demand.
- Services exports from SEZs increased in FY 2020-21 compared to FY 2019-20. There was a 10% increase in INR terms and a 3% increase in USD terms, indicating growth in this sector despite potential economic challenges. This growth could be attributed to increased demand for services such as IT, finance, and other professional services that are often less impacted by physical trade barriers.

Table-2: Monitoring Export Performance for SEZs

Details	FY: 2021-22		FY: 2020-21		Actual Change		Percentage Change	
	INR (Rs. in Cr.)	USD (In Millions)	INR (Rs. in Cr.)	USD (In Millions)	INR Terms	USD Terms	INR Terms	USD Terms
Merchandise Exports	2,68,095	36,490	1,68,272	22,802	99,823	13,688	+59%	+60%
Services Exports	3,77,394	51,464	3,26,864	44,094	50,570	7,370	+15%	+17%
Total Export	6,45,489	87,954	4,95,096	66,897	1,50,393	21,058	+30%	+31%

Interpretation: Table-2 presents the export performance monitoring data for Special Economic Zones (SEZs) over two fiscal years: 2020-21 and 2021-22. The table provides details in both Indian Rupee (INR) and United States Dollar (USD) terms. In FY 2021-22, merchandise exports from SEZs totaled INR 2,68,095 crore and USD 36,490 million, marking a significant increase from the previous fiscal year by INR 99,823 crore or 59% in INR terms and USD 13,688 million or 60% in USD terms. Similarly, services exports from SEZs in FY 2021-22 amounted to INR 3,77,394 crore and USD 51,464 million, showing a rise of INR 50,570 crore or 15% in INR terms and USD 7,370 million or 17% in USD terms compared to FY 2020-21. Consequently, the total exports from SEZs in FY 2021-22 stood at INR 6,45,489 crore and USD 87,954 million, reflecting an overall increase of INR 1,50,393 crore or 30% in INR terms and USD 21,058 million or 31% in USD terms over the preceding fiscal year. This data highlights a notable growth trajectory in both merchandise and services exports from SEZs, underscoring the positive impact of SEZ policies and trade facilitation measures in enhancing export performance.

Table-3: Export Performance of Selected SEZs in India

Name and Location of the SEZ	Exports (In INR)		
	2018-19	2019-20	2020-21
MEPZ (Chennai, Tamil Nadu)	1.866 billion	16.188 billion	43.964 billion
Cochin (Kerala)	12.492 billion	74.206 billion	194.318 billion
Noida (Uttar Pradesh)	13.587 billion	37.636 billion	65.605 billion
Kandla (Gujarat)	514 million	48.821 billion	134.359 billion
Vishakhapatnam (Andhra Pradesh)	2.728 billion	34.388 billion	99.928 billion
SEEPZ (Mumbai, Maharashtra)	2.565 billion	49.142 billion	149.664 billion
Falta (West Bengal)	207.2 million	2.179 billion	6.406 billion
Total	33.96 billion	262.56 billion	694.15 billion

Interpretation: The table presents the export performance of selected Special Economic Zones (SEZs) in India over the three consecutive years from 2018-19 to 2020-21. Notably, there is a substantial increase in export values across all SEZs during this period, indicating significant growth in their export activities. Cochin SEZ in Kerala demonstrates remarkable growth, with exports soaring from 12.492 billion INR in 2018-19 to 194.318 billion INR in 2020-21, marking a remarkable expansion in its export capabilities.

Similarly, other SEZs like Kandla in Gujarat and SEEPZ in Mumbai, Maharashtra, also display considerable growth in export values, showcasing the diversification and strengthening of India's export-oriented industries. This consistent growth trajectory across various SEZs underscores their pivotal role in driving India's export-led economic growth strategy, contributing substantially to the country's overall export performance.

Objective-2: To Identify Challenges and Limitations Associated with Custom Duty Exemptions

Custom duty exemptions, while serving as a tool to stimulate economic activity and trade, come with several challenges and limitations that need to be carefully considered:

- **Revenue Loss:** One of the primary concerns associated with custom duty exemptions is the potential loss of government revenue. When duties are exempted on certain goods, it directly reduces the revenue collected by customs authorities. This can pose challenges for fiscal sustainability and budgetary planning, especially if the exemptions are extensive or not adequately compensated through alternative revenue sources.
- **Market Distortions:** Duty exemptions can create distortions in domestic markets by altering price signals and production incentives. Industries that benefit from exemptions may gain a competitive advantage over those that do not, leading to market inefficiencies and potentially stifling competition. This can hinder the development of a level playing field and undermine the long-term competitiveness of domestic industries.
- **Administrative Complexity:** Managing and administering custom duty exemptions can be complex and resource-intensive for government agencies. Determining eligibility criteria, verifying compliance, and preventing abuse or fraud require robust administrative systems and procedures. Inadequate enforcement measures can lead to misuse of exemptions, including misclassification of goods or false claims, undermining the effectiveness of the policy.
- **Trade Negotiations and Agreements:** Unilateral duty exemptions can complicate international trade negotiations and agreements. Trading partners may perceive exemptions as discriminatory or unfair, potentially leading to trade disputes or retaliation measures. Harmonizing duty exemption policies with international trade commitments and obligations under bilateral or multilateral agreements is essential to avoid trade tensions and maintain diplomatic relations.
- **Risk of Smuggling and Illicit Trade:** Duty exemptions can inadvertently create incentives for smuggling and illicit trade activities. If price differentials between exempted and non-exempted goods are significant, there is a greater likelihood of smuggling to exploit arbitrage opportunities. This not only undermines government revenue but also poses security risks and fosters informal economic activities outside regulatory oversight.
- **Limited Targeting and Effectiveness:** Duty exemptions may not always effectively target the intended beneficiaries or achieve the desired policy objectives. Exemptions that are overly broad or indiscriminate may benefit industries or individuals that do not require support, diluting the impact on priority sectors or economic development goals. Ensuring proper targeting and periodic review of exemption schemes is crucial to maximize their effectiveness and efficiency.
- **Dependency and Rent-Seeking Behavior:** Over-reliance on custom duty exemptions as a policy instrument can lead to dependency among industries and perpetuate rent-seeking behavior. Rather than investing in productivity enhancements or innovation, businesses may focus on lobbying for continued exemptions as a means of maintaining profitability. This can create disincentives for structural reforms and hinder long-term economic competitiveness.

These challenges requires a balanced approach that considers the trade-offs between promoting economic activity and ensuring fiscal sustainability and regulatory integrity. Policymakers need to carefully assess the costs and benefits of custom duty exemptions, implement appropriate safeguards and oversight mechanisms, and complement exemptions with complementary policies to support inclusive and sustainable economic growth.

Objective-3: To Provide Insights for Future Policy Formulation and Decision Making

For future policy formulation and decision-making regarding custom duty exemptions in India, policymakers should consider the following insights:

- **Targeted Approach:** Instead of blanket exemptions, policymakers should adopt a targeted approach to custom duty exemptions, focusing on industries and sectors crucial for strategic objectives such as export promotion, import substitution, and industrial development. This targeted approach ensures that exemptions are directed towards priority areas where they can have the most significant impact on economic growth and competitiveness.
- **Alignment with Trade Agreements:** Custom duty exemptions should be designed in alignment with India's international trade agreements and commitments. Harmonizing exemption schemes with trade agreements reduces the risk of trade disputes and enhances predictability for businesses operating in the global market. Additionally, leveraging exemptions as negotiating tools in trade agreements can facilitate market access and promote exports.
- **Monitoring and Evaluation:** Establishing robust mechanisms for monitoring and evaluating the effectiveness of custom duty exemptions is essential. Regular assessments should be conducted to measure the impact of exemptions on key economic indicators such as trade balance, industrial output, employment, and government revenue. Based on these evaluations, policymakers can make informed decisions on whether to maintain, modify, or phase out exemption schemes.
- **Risk Management:** Policymakers need to mitigate the risks associated with custom duty exemptions, including revenue loss, market distortions, and trade fraud. Strengthening enforcement mechanisms, enhancing customs administration capacity, and

leveraging technology such as data analytics and risk profiling can help identify and address compliance issues effectively. Additionally, fostering transparency and accountability in the administration of exemption schemes is crucial for maintaining public trust and confidence.

- **Complementary Policies:** Custom duty exemptions should be complemented with other supportive policies to maximize their impact and effectiveness. This includes investment incentives, infrastructure development, skill development initiatives, and regulatory reforms aimed at improving the business environment and fostering innovation. By integrating custom duty exemptions into a comprehensive policy framework, policymakers can create synergies and amplify the positive effects on economic growth and development.
- **Consultation and Stakeholder Engagement:** Policymakers should actively engage with industry stakeholders, trade associations, and experts during the formulation and review of custom duty exemption policies. Consultation ensures that exemption schemes are tailored to the specific needs and challenges faced by different sectors, while also facilitating buy-in and ownership from stakeholders. Engaging with stakeholders also provides valuable insights and feedback for refining policies and addressing emerging issues.
- **Flexibility and Adaptability:** Custom duty exemption policies should be flexible and adaptable to changing economic conditions and priorities. Policymakers should regularly review and update exemption schemes in response to evolving market dynamics, technological advancements, and global trade trends. This flexibility allows policymakers to fine-tune policies to address emerging challenges and seize new opportunities for economic growth and development.

By incorporating these insights into future policy formulation and decision-making processes, India can optimize the benefits of custom duty exemptions while mitigating potential risks and challenges. A strategic and evidence-based approach to exemption policies can contribute to sustainable economic growth, enhanced competitiveness, and inclusive development.

IV. Conclusion

This research paper has provided a comprehensive analysis of the economic implications of custom duty exemptions, focusing on Special Economic Zones (SEZs) in India. Through a detailed examination of the export performance of selected SEZs over a three-year period, the study has revealed significant growth in export values, underscoring the effectiveness of custom duty exemptions in promoting industrial growth and enhancing export competitiveness. The case study highlights the pivotal role of SEZs in driving India's export-oriented industries and contributing to overall economic development. Additionally, the findings underscore the importance of policy support, such as custom duty exemptions, in fostering a conducive environment for investment, production, and export expansion within SEZs. However, while the results demonstrate positive outcomes, it's imperative to acknowledge potential challenges and areas for further improvement, such as addressing infrastructure constraints and streamlining regulatory processes within SEZs. Overall, this research contributes valuable insights into the economic implications of custom duty exemptions within SEZs and provides a basis for policymakers to optimize policy frameworks to sustain and enhance the growth trajectory of India's export-oriented industries.

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