Business Standard

# Why India's SEZ regime is headed for its biggest overhaul since 2005

*Industry and policy experts say the original framework helped exports but struggled to deliver the manufacturing transformation once envisioned*

Akshita Singh | New Delhi

The government is reviewing the SEZ regime as it seeks to align export hubs with today's manufacturing goals, domestic market needs and global supply chains. (Representative image from file)

India is preparing the most extensive overhaul of its Special Economic Zone (SEZ) framework since the SEZ Act came into force in 2005, as policymakers seek to revive a model that was once at the centre of the country's export strategy.

The proposed reforms, often referred to as SEZ 2.0, come at a time when India's manufacturing ambitions, global trade realities and investment priorities look very different from two decades ago.

The changes under discussion include easier access to the domestic market, more flexible operational rules, changes to net foreign exchange requirements and closer integration with global value chains.

But why is India revisiting a policy that once played a central role in attracting investment and boosting exports?

### The promise of the 2005 model

The SEZ Act was introduced to address long-standing problems that had constrained India's export sector, including cumbersome approvals, weak infrastructure and policy uncertainty. According to Nilanjan Banik, professor at Mahindra University, the SEZ framework was designed to create hassle-free export environments backed by single-window clearances and better infrastructure. The aim was to improve export competitiveness while attracting domestic and foreign investment.

The policy initially delivered results. SEZs emerged as major export hubs, particularly for information technology, pharmaceuticals, engineering and electronics. They attracted private investment, generated employment and helped create dedicated industrial ecosystems. Mahendra Chouhan, president of IMC Chamber of Commerce and Industry, said the SEZ programme contributed to exports, investment and job creation, while developing quality infrastructure across several sectors.

However, he added that manufacturing expansion fell short of expectations and many approved zones remained underutilised.

**ALSO READ: Govt plans wide-ranging reforms to modernise SEZ regime, spur investments**

### What changed?

Industry experts and policy observers point to several developments that gradually weakened the original SEZ value proposition.

For Arpita Mukherjee, professor at the Indian Council for Research on International Economic Relations (Icrier), the challenges went beyond WTO disputes and tax changes.
"In the original model, there were multiple issues starting from the land size to the incentives structure," she said.

Mukherjee said non-fiscal incentives remained limited, while fiscal incentives linked to net foreign exchange earnings later came under scrutiny because export-linked subsidies faced restrictions under World Trade Organization (WTO) rules.
She also pointed to operational issues within the framework. According to her, too many SEZs were approved without adequately assessing the performance of applicants. Businesses also

faced difficulties in obtaining state-level clearances, while overlapping regulations added to compliance burdens.

Another issue emerged around domestic sales. Mukherjee noted that if a company with an export surplus sold goods in the domestic tariff area, customs duties applied, even as similar products could enter India under free trade agreements at lower or zero duty rates.

**The changing tax structure**

Ashoo Gupta, partner at Shardul Amarchand Mangaldas & Co, said the original framework offered a strong package of tax incentives, including income-tax exemptions, relief from Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT), along with customs benefits.

However, the withdrawal of DDT and MAT exemptions, followed by the expiry of key income-tax benefits for developers and new units, reduced the attractiveness of the scheme for many investors.

"The withdrawal of tax incentives was one of the most significant factors that undermined the competitiveness of SEZs as an investment destination," Gupta said.

Gulzar Didwania, partner at Deloitte India, said the phased withdrawal of tax benefits gradually shifted investment decisions away from tax considerations and towards factors such as infrastructure, supply chains and export orientation.

**The rise of MOOWR**

At the same time, manufacturers gained access to an alternative framework through the Manufacture and Other Operations in Warehouse Regulations (MOOWR).

The scheme allows businesses to defer customs duties on imported inputs and capital goods, operate from locations of their choice and serve both domestic and export markets without positive net foreign exchange obligations.

According to Banik, MOOWR offers 100 per cent duty deferment with no interest liability and allows companies to sell into the domestic market with greater flexibility, making it attractive for many manufacturers.

Gupta said MOOWR provides advantages such as location flexibility, fewer compliance requirements and unrestricted domestic sales. Didwania noted that it particularly appeals to businesses serving both domestic and export markets.

Mukherjee said the overlap between Free Trade Warehousing Zones under the SEZ framework and MOOWR created competing policy structures.

"There are too many overlapping policies," she said.

Most experts do not view the two frameworks as direct substitutes. Instead, they argue that MOOWR and SEZs serve different business models. While MOOWR functions primarily as a customs facilitation mechanism, SEZs continue to offer dedicated infrastructure and integrated industrial ecosystems.

## A different manufacturing strategy

When the SEZ Act was introduced, exports sat at the centre of India's industrial strategy. Today, policymakers are simultaneously pursuing export growth, domestic manufacturing, supply-chain resilience and strategic sector development through programmes such as Production Linked Incentive (PLI) schemes.

Chouhan said SEZs can no longer function as standalone islands and must be aligned with initiatives such as Make in India, PLI schemes and industrial corridors. He argued that future zones should function as manufacturing-led growth engines integrated with global value chains.

Mukherjee said changing global trade conditions have also altered the way governments think about incentives.

"With changing global trade dynamics, incentives have to be linked not only to employment creation but to quality job creation," she said.

She added that labour standards and working conditions have become increasingly important in key export markets such as the US, UK and European Union. According to her, future incentive structures should also be linked to environmental sustainability, labour sustainability and quality improvements.

## Why SEZ 2.0 now?

The current reform exercise seeks to address many of the concerns that have emerged over the past decade.

Industry groups have pushed for easier domestic sales, simpler compliance requirements, greater operational flexibility and better integration with domestic supply chains. Businesses have also sought faster approvals, digitised procedures and greater policy certainty.

The Union Budget for 2026-27 introduced a one-time measure which allows eligible manufacturing units in SEZs to sell goods in the domestic tariff area at concessional customs duty rates linked to export performance.

According to Gupta, the measure addresses one of the longest-standing complaints from manufacturers by providing greater access to the domestic market.

Didwania said the proposed reforms move away from rigid export-centric conditions and recognise changing global supply-chain patterns. Businesses, he said, are particularly looking for simpler movement of goods between SEZs and domestic markets, reduced compliance costs and greater certainty around job work and contract manufacturing.

Mukherjee said easier domestic sales and WTO-compliant incentives are necessary to address some of the core challenges facing SEZs.
She also argued that policymakers need to rethink how incentives are designed. According to her, goods and services should not be treated identically because goods subsidies face WTO disciplines while services subsidies do not face similar restrictions.

"Most countries are subsidising services," she said.
Mukherjee added that future reforms should place greater emphasis on non-fiscal incentives, ease of doing business, regulatory coordination and experimentation with different reform models inside SEZs.

**Will the reforms be enough?**

Experts broadly agree that reform is necessary, but differ on what success should look like.
Chouhan said SEZ 2.0 should move beyond the traditional export-enclave model and become a platform serving both domestic and international markets. In his view, success should be measured not only by exports but also by investment, technology transfer, domestic value addition and employment.

Gupta argued that the next phase requires a permanent legislative framework that provides certainty on domestic market access, resolves tax-related friction and creates incentives that comply with WTO rules. He also stressed the need for better logistics, infrastructure and connectivity.
For Mukherjee, the next phase should focus on reducing overlapping regulations, improving coordination between the Centre and states, and turning SEZs into testing grounds for new reforms.

"GST is an excellent example of how Centre and states can work together," she said.

The challenge for policymakers is no longer simply reviving an export promotion scheme. It is redesigning SEZs for an economy where manufacturing, services, sustainability standards and global value chains all matter alongside exports. That shift explains why India is rewriting its SEZ framework two decades after the 2005 law.

First Published: Jul 06 2026 | 12:22 PM IST

Page URL :https://www.business-standard.com/industry/news/india-sez-regime-biggest-overhaul-2005-exports-manufacturing-126070600353_1.html