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INVESTING IN THE INDIAN SPECIAL ECONOMIC ZONES
A BACKGROUND PAPER

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EXECUTIVE SUMMARY

The Institute of South Asian Studies (ISAS) Background Paper describes the evolution and salient features of the Special Economic Zones (SEZ) Act (2005). It notes that substantial benefits accrue to these zones in the form of tax concessions, customs facilitation and policy stability. In return for these benefits, the Act stipulates that commercial units within an SEZ be net foreign exchange earners during a block of five years, beginning from the first year of commercial operations. This means that commercial units within an SEZ should earn US$1 over and above domestic sales during a five-year commercial period.

The paper throws light on the definitional issues and regulatory concerns of the developers and commercial units operating within an SEZ. First, there are no clear benchmarks for successful implementation in the Act for developers. This grey area in the Act should redound to the advantage of a Singapore investor because the Ministry of Commerce and Industry (MOCI) will look at these issues on a case-by-case basis. The benchmarks need to be stated in the developer's plan to be approved by the Board of Approval located within MOCI. Profits to be made on the real estate side could be allowed if MOCI is convinced that enough is being done to develop the processing area and for attracting export oriented units.

The regulatory checks on successful project implementation of commercial units within an SEZ are unlikely to increase transactions costs if the units are net foreign exchange earners.

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The paper argues that the Act has made partial progress towards evolving a procedure for single window clearance of SEZ projects. Issues such as labour regulations; skill shortages; land acquisition; environmental clearance; power availability; a developer's powers with respect to town planning; transport linkages; access to finance; corruption; and the overall propensity to approve foreign direct investments will have a state-level component. In most of these cases, state-level SEZ Acts will determine the extent to which state-level policies are synergised with central policies. In addition, the central government's Ministry of Environment and Forests (MOEF) will need an Environmental Impact Assessment after the Board clears a project.

Political relations between the centre and the states need a detailed analysis. Factors such as state governments with a short tenure as opposed to those with stable tenure, conflict ridden centre-state political relations and intra-state party politics need to be analysed carefully.

The ISAS paper analyses the state-level factors that could affect the general competitive potential of an SEZ in five Indian states, which look attractive from the point of view of a Singapore investment. An industry specific analysis of these factors requires a more detailed and separate analysis. Table II reports that Haryana is the best governed state, followed by Maharashtra, Andhra Pradesh, Gujarat and Tamil Nadu. More detailed state-level analysis reveals some caveats that would need to be added before making a decision in favour of a particular state.

Indian and Chinese SEZs could work very differently. The tax incentives in China are for foreign investment rather than for exports. In India, the special tax incentives are for exports rather than for foreign investment. Labour regulations could be easier to deal with in China. The architecture of Chinese SEZs is more locally driven compared with the Indian experiment. India enjoys better financial infrastructure and a skilled English speaking work force. Infrastructure bottlenecks are becoming less onerous for Indian manufacturing.

There are two reasons for optimism about the success of a Singapore-led SEZ in India. First, MOCI and the central government are keen to promote such a project. Many regulatory ambiguities in the Act would enjoy the sympathetic understanding of the central government. Second, there is keenness for investment among the Indian states, which would facilitate the single window clearance and tax concessions.

The Act and the regulations should not unravel as a consequence of the debates taking place within the Empowered Group of Ministers. Investors would require policy certainty for implementing a successful SEZ project in India.[1]

[1] This paper reflects the architecture and policy concerns in relation to the SEZ Act as of March 28, 2006. The policy ambiguities of more recent vintage are reported in the conclusion (Section 23.1).

I INTRODUCTION

1 Contents

1. 1 Terms of Reference

The ISAS' background paper on the SEZs aims to address the following issues:

- The concept of SEZ in India and the various forms it could take;
- The Indian government's policy towards SEZs, at the Central and State level;
- The laws, regulations and incentives governing SEZ developers and tenant firms;
- The differences in SEZ policies of the different Indian states of interest, for example, Gujarat, Andhra Pradesh, Tamil Nadu, Maharashtra and Haryana;
- Factors for site selection and propose possible sites where SEZ could be developed; and
- What Singapore companies are already doing in India, viz. SEZ development?

1.2 Organisation of the Paper

- Section 2 deals with the research methodology adopted in this paper.
- Sections 3, 4 and 5 define an SEZ, discuss its background and problems, and take note of the salient institutional features of an Indian SEZ.
- Sections 6 and 7 detail the main provisions of the SEZ Act of 2005, which are a significant gain for investors.

- ❖ Sections 8 and 9 discuss the issues that need to be addressed in the Central Act.
- ❖ Sections 10, 11, 12, 13, 14, 15 and 16 discuss issues where state-level governance will matter. These include areas such as land acquisition; labour issues; taxation; pollution clearances; town planning; access to physical, financial and human infrastructure; and, state politics. State-level variation in governance and SEZ legislation is noted for the states of Maharashtra, Tamil Nadu, Andhra Pradesh, Gujarat, and Haryana.
- ❖ Sections 17 – 21 analyse the location advantage of each of our five states.
- ❖ Section 22 briefly compares India with China.
- ❖ Sections 23 and 24 summarise the possibilities and challenges facing a Singapore investment in Indian SEZs.

2 Research Methodology

2.1 <u>Field-work Support</u>

The ISAS Team was in touch with the Singapore High Commission and briefed the High Commission on all the interviews. The High Commission aided the field-work. The Chief Mentor of the Confederation of Indian Industries, Mr. Tarun Das, took a personal interest in the field-work. India’s Commerce Secretary, Mr. S N Menon took time off his busy schedule to orient the ISAS team about his Ministry’s expectations about investments in the Indian SEZs. Subsequently, MOCI and persons mentioned in Appendix I have updated the ISAS Team on developments that concern this paper.

2.2 Interviews

The ISAS Team obtained interviews within a short span of time. The team interviewed developers, held discussions with consulting firms that had been approached by developers and MOCI, and discussed matters with two officials in stationed in Tamil Nadu and Andhra Pradesh. The team was able to meet Commerce Secretary, Mr. S N Menon, Joint Secretary, Dr. Rahul Khullar, and Deputy Secretary, Mr. Rajgopal Sharma. MOCI shared a publication titled, *Frequently Answered Questions on Special Economic Zones* (March 2006), which can be procured by the Singapore High Commission, New Delhi, from Dr. Rahul Khullar. This publication, which will be called *FAQ* March 2006, in this paper, gives greater clarity to the Regulations notified in February 2006, and has been distributed to the Development Commissioners.

2.3 State-Selection

2.3.1 Criteria for Selection: This selection was based on a combination of factors such as, an assessment of the level of enthusiasm about SEZ investments in these states, a reading of governance indicators, and, a reading of the state-level Acts and policies in conjunction with the Central Act. The ISAS team decided to focus on the states of Maharashtra, Gujarat, Tamil Nadu, Andhra Pradesh and Haryana.

2.3.2 The State Acts: Maharashtra, Haryana and Gujarat have legislations that pursue guidance on the best practices recommended by the Centre. Andhra Pradesh has a state SEZ Act, which is awaiting clearance at the

Central level. Tamil Nadu's Act deviates a little from the Centre's design.

2.3.3 Statistical Source: The statistics are largely drawn from one source: World Bank, *India: Investment Climate Assessment 2004* (Washington: Finance and Private Sector Development Unit – South Asia Region, November 2004). This was a survey for 1855 firms, covering 12 states and 40 cities. It is referred to as the World Bank Study (2004) in the text.

II WHAT IS A SPECIAL ECONOMIC ZONE?

3 Key Definitions

3.1 Special Economic Zone

3.1.1 Definition: An SEZ in India is treated as being separate from the "domestic tariff area" (DTA) for the purposes of trade related operations only. Developers and commercial units would enjoy tax concessions, lower commercial start-up costs, and superior financial and physical infrastructure. The commercial entities have to be net foreign exchange earners in order to avail these benefits. Goods and services entering an SEZ from the domestic tariff area or the rest of the world are able to enjoy duty free entry into an SEZ [*SEZ Act 2005, Chapter I Sections 2a and 2i, and SEZ Notification February 2006 Chapter III Section 17(2)(1)*].

3.1.2 Types of SEZs: The size of an SEZ can vary from 10 hectares to 1,000 hectares depending on what the SEZ is meant for. A multi-product SEZ will cover an area of at least 1000 hectares. Sector specific SEZs for electronics hardware, software, bio-technology, non-conventional energy, and gems and jewellery, needed to cover a minimum area of 10 hectares. In certain states like Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttaranchal, Sikkim, Jammu and Kashmir, Goa, or in a Union territory, the coverage area conditions are less stringent (*FAQ March 2006, Question 2; SEZ Notification February 2006, Chapter 2 and Section 2*).

3.2 Developer

3.2.1 Definition: A developer wishing to set up an SEZ can be an individual resident in India or abroad; a Hindu undivided family; a cooperative society; a company; a firm; a proprietary concern; an association of persons, a local authority; or, a state government. The Central Government will not be setting up any new SEZs. The developer will take the lead in building the commercial and residential infrastructure in the entire area of an SEZ. 100% foreign direct investment is permitted with the approval of the Board of Approval. *(FAQ, March 2006, Question 1; and, Question 26; SEZ Act 2005, Chapter I Section 2g and 2f)*.

3.2.2 Co-Developer: The developer can bring in a co-developer with the permission of the Board of Approval. The co-developer, like the developer can have up to 100% ownership in its commercial enterprise within the SEZ and will get the same benefits as the developer, once it is approved by the Board. There is no requirement of 26% equity threshold of a developer in a co-developers enterprise (*FAQ March 2006, Question 21; SEZ Notification February 2006, Chapter II, Section 4*). The developer will lease land to the co-developer. However, if the co-developer does not wish to shoulder all the risks, it can request the developer to have 26% stake in the co-developer's business. In that case, the co-developer will not enjoy any tax benefits.

3.2.3 Contractor: A developer can employ a contractor without the approval of the Board. All the duty benefits will apply to the contractor. Responsibility for the proper utilization of goods lies with the developer *(FAQ March 2006, Question 12)*.

3.2.4 Special Purpose Vehicle: If firms "A", "B" and "C" wish to form an entity called a special purpose vehicle, then the special purpose vehicle will become the developer and will need to obtain the approval of the Board *[SEZ Notification February 2006, chapter II Section 4(4)]*.

3.3 Commercial Unit

3.3.1 Definition: A commercial unit within an SEZ is a commercial entity that will make use of the infrastructure created by the developer, avail tax benefits, easier clearance parameters and customs facilitation, in order to be a net foreign exchange earner within a five year period (*SEZ Act 2005, Chapter I, 2j and 2l*). A net foreign exchange earner is a commercial unit that earns US$ 1 greater from exports than what it sells within the domestic tax area, within a block of five years from the first year of commercial operation. Developers are expected to attract commercial units within an SEZ.

3.3.2 The Net Foreign Exchange (NFE) Requirement: MOCI is keen to ensure that firms do not wilfully violate the NFE requirement. This is the reason why a unit's Letter of Approval is valid for a period of five years, even though its lease period could be longer *[SEZ Notification February 2006, Chapter III, section 19(2)]*. The Letter of Approval for a Unit could be co-terminus with the lease period so long as the unit is a net foreign exchange earner within every block of five years of the lease period. In case the NFE requirement within a block of five years is not met, then the unit's Letter of Approval will be withdrawn, and, it may have to pay back the benefits it enjoyed and face penal action under the provisions of the Foreign Trade (Development and Regulation) Act, 1992 *(SEZ Notification February 2006, Chapter IV, Section 25)*. The Unit will get an opportunity to explain the reasons, which came in the way of its fulfilling the NFE requirement. MOCI reported that such an incident has not occurred so far.

4 Processing and Non-Processing Areas

An SEZ developer needs to build 25% of the total SEZ area as a "processing area" critical for carrying out the commercial activities in a large multi-product SEZ (at least 1,000 hectares of land). The rest 75% of the area will be the "non-processing area", which will be meant for residential and other activities within an SEZ. Smaller sector specific SEZs in areas such as information technology, gems and jewellery (10 hectares) have a processing area requirement of 50% of the total area (built up area 100,000 sq meters for IT and Free Trade Warehousing Zones). There are different specifications for backward states and for a multi-sector services SEZ [*SEZ Notification February 2006, Chapter 2, and Section 5(2); FAQ March 2006, Question 2*].

4 Evolution of SEZ Policy

4.1 History

The SEZ Act was passed in 2005 to address earlier policy failures associated with attracting investment in the export processing zones in India. The Indian experiment with Export Processing Zones (EPZs) began in the mid 1960s. Efforts to liberalise them gained momentum only after 2000. Despite these efforts, India had failed to secure substantial foreign direct investment in its EPZs. In 2003, the ratio of foreign direct investment to total investment in Indian EPZs was less than 25%, as compared to a figure of over 80% in similar zones in Bangladesh and Sri Lanka in the same year.

4.2 Problems

4.2.1 No Policy Stability: Between 2000 and 2005, the Government of India’s policy commitment towards SEZs had to be renewed on a yearly basis through the announcements of the Foreign Trade Policy of India.

4.2.2 Tax Benefits: There was need for greater tax benefits, even though these had improved over the years.

4.2.3 State-Level Issues: State-level governance issues, which could not be resolved by the Centre, were hindering investment.

4.2.4 Need for Legislation: The absence of legislation on SEZs was a major hindrance to investment because investors needed policy stability and better tax benefits in order to calculate the costs and benefits of a significant investment. Even though the Ministry of Finance (MOF) was worried about the revenue forgone due to tax privileges given to SEZs, MOCI was keen to demonstrate a successful experiment in public private partnership, aided by tax benefits.

4.3 Development of SEZs

Though MOCI's website lists 14 functional and 61 approved SEZs in India, only two private SEZs are poised for take off at the moment. MOCI and State Governments are flooded with requests for SEZ applications. Many of these applications and approvals are in the Information Technology (IT) sector where India has a competitive advantage. Others are inspired by profits in the real estate business in India.

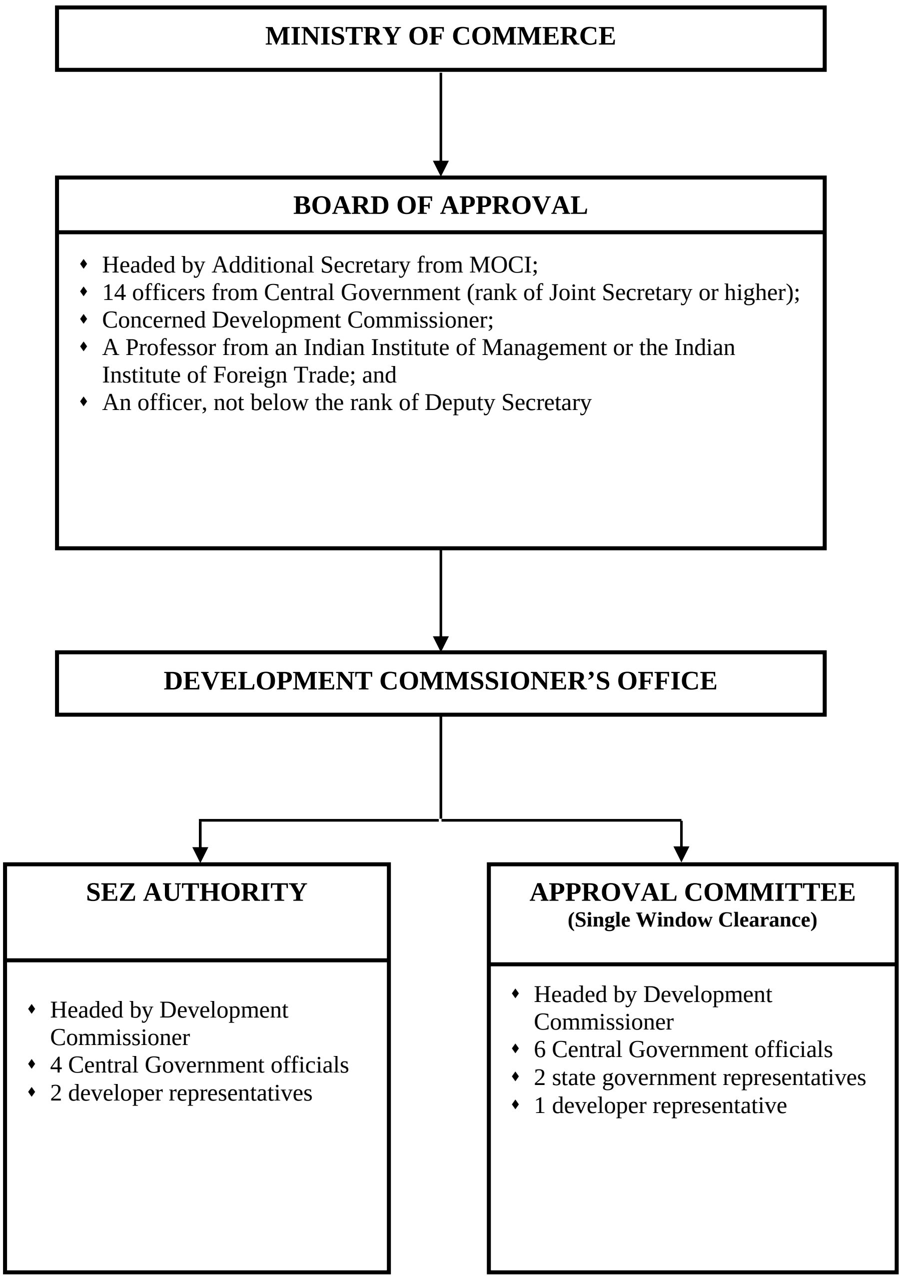
4.4 Two Significant Cases

There are two large multi-product SEZ projects that MOCI considers progress towards private participation in the building of India's infrastructure and competitiveness. These are the Maha Mumbai and the Navi Mumbai SEZs being developed by Reliance Industries Limited in partnership with Seaking Infrastructure Limited, which may get consolidated into the Maharashtra Integrated SEZ. The second is the one close to Chennai being developed by Mahindra World City.

5 Salient Institutional Features of an Indian SEZ

Figure I describes the broad institutional structure provided by the SEZ Act 2005.

Figure I



5.1 Board of Approval

5.1.1 Powers and Composition: The Board of Approval housed within MOCI evaluates the proposals of the developers interested in setting up an SEZ. It has wide ranging powers of delegation, approval and jurisdiction over the Development Commissioner. The Board has 18 members headed by an Additional Secretary from MOCI. Fourteen of the officers hold the rank of a Joint Secretary or higher in the Central Government. They represent the ministries of Commerce and Industry; Science and Technology; Small Scale, Agro-based and Rural Industries; Home Affairs; Defence; Environment and Forests; Law, Overseas Indian Affairs; and, Urban Development. In addition, there will be the concerned Development Commissioner, a Professor from an Indian Institute of Management or the Indian Institute of Foreign Trade, and, an officer not below the rank of Deputy Secretary dealing with SEZs (*Chapter III of the SEZ Act*).

5.1.2 Possible Problem: The Board has been able to handle problems of inter-ministerial coordination quite efficiently. The first meeting of the Board took place on 17 March 2006 when 150 out of 177 proposals were cleared and 27 were deferred. 70 of these are likely to be notified by 31 March 2006.

5.2 Development Commissioner

5.2.1 The Office: Each SEZ will have a Development Commissioner who will be appointed by the Central Government (MOCI). The Officer will hold a position not below the rank of a Deputy Secretary to the Government of India. The Office of the Development Commissioner will be assisted by other officers of the Central Government.

5.2.2 Duties: First, The Development Commissioner's Office, which will be in close proximity to the SEZ will guide and monitor the progress of the Development Commissioner and Commercial Units within an SEZ. Second, the Development Commissioner is supposed to facilitate the single window clearance facility and coordinate issues between the Centre and the concerned State Government (*The SEZ Act 2005, Chapter IV*).

5.3 Single Window Clearance and Approval Committee

5.3.1 Duties and Composition: A single window clearance mechanism has been operationalised to speed up the state level regulatory clearances required for investment. It is to be headed by the Development Commissioner. This facility involves an Approval Committee comprising 9 members; six of whom belong to the Central Government, two are from the concerned state government, and one is a representative of the developer (*The SEZ Act 2005, Chapter V*).

5.3.2 Efficacy: The efficacy of the single window clearance mechanism will depend on the extent to which the states would be willing to delegate their powers to the Office of the Development Commissioner.

5.4 SEZ Authority

5.4.1 Duties and Composition: An SEZ Authority is to be headed by the Development Commissioner and will be responsible for governing an SEZ. It is to be formed within 6 months of the date of Commencement of the Act. The Authority will comprise of four officers of the Central Government and two nominees of the Developer (*The SEZ Act 2005, Chapter 6*).

5.4.2 Efficacy: The efficacy of an SEZ Authority will depend on the extent to which the concerned state government is willing to cede powers to the Development Commissioner.

II IMPORTANT PROVISIONS OF THE SEZ ACT 2005

6 Tax Benefits

Tax benefit for developers and commercial units that are net foreign exchange earners is the most substantial achievement of the SEZ Act. These benefits are detailed in Chapter 6 of the SEZ Act on 2005. They include:

6.1 100% Tax Exemption for Developers

The 100% income tax exemption to the developer for a block of 10 years within a 15 year period is a major benefit. This provision has been made because the developer needs to make a substantial investment in the early stages of the business.

6.2 15 year tax exemption for Commercial Units

These tax concessions include 100 % income tax exemption in the first 5 years, 50 % tax exemption in the next five years, and, a 50 % tax exemption on the export profits ploughed back between the 11^{th} and 15^{th} year.

6.3 Benefits for Off-Shore Banking Units (OBU)

The major benefit for OBUs is the 100% income tax exemption for the first five years and 50% for the next five years under 80LA of the Income Tax Act *(Second Schedule to the SEZ Act)*.

6.3.1 Bad News: Section 10 (23 G) was introduced to the Income Tax Act of 1961 in 1996. It gave exemption to any infrastructure capital fund or company on income earned by way of dividends, interest on long-term debt (greater than 5 years) or long-term capital gains, in projects involving industrial parks, SEZs and a variety of activities involving infrastructure development. The union budget of 2006 has removed this benefit. This move is being opposed by ICICI Bank and HDFC Bank, which view it as being a negative signal to infrastructure development in India. Other special exemptions for OBUs are being resisted by the Reserve Bank of India.

6.4 Capital Gains Tax

There is exemption from the Dividend Distribution Tax, the Minimum Alternate Tax (MAT) and capital gains tax on transfer of assets in case of shift of an industrial undertaking from an urban area to a SEZ.

6.5 Indirect Taxes

The central indirect taxes like the sales tax and the service tax will not be levied. There will be no customs duty on goods and services coming in from the DTA or other countries into the SEZ's commercial units. Each state will decide the extent to which they would give exemptions on state-level taxes.

6.6 Application of Customs Duty

Custom duty will be imposed on goods moving from the SEZ to the DTA. The view of MOCI is that this will discourage domestic sellers from applying for SEZ status.

7 Policy Stability

The SEZ Act goes beyond just tax benefits. It lends greater policy stability to taxation and other issues than was possible though the yearly announcements of the Foreign Trade Policy.

7.1 Modification to the Income Tax Act

Modifications have been made to the Income Tax Act of 1961. Income Tax provisions within an SEZ cannot be amended through a Finance Bill. The entire SEZ Act will have to be amended for making changes in the income tax provisions. This will ensure policy stability.

7.2 Amendments

Certain Acts in the Third Schedule of the Indian Constitution like the Insurance Act of 1938 and the Banking Act of 1949 have been amended. This would help in the evolution of a superior financial architecture within SEZs.

7.3 Procedure for Future Modification

Acts within the First Schedule of the Indian Constitution can be modified via an established procedure if they conflict with the SEZ Act.

7.4 Customs Facilitation

Self certification procedures have increased the efficiency of customs clearance.

III UNRESOLVED CENTRAL GOVERNMENT ISSUES

8 The Functions of the Development Commissioner

Two problems related to the functions of the Development Commissioner have not been resolved definitively in the SEZ Act of 2005.

8.1 Extent of Central Direction

Table I below shows that majority of the investment related governance issues are either largely or partially governed by the states. The Centre can only recommend the best practices to the states on important subjects such as land rights, labour regulations, taxation, local transport, water supply, and pollution clearance.

Table I
Significance of State-Level Governance

Issue	Central Government Regulation	State Government Regulation
Labour Regulations	•	•
Land		•
Pollution	•	•
Water supply		•
Power	•	•
Taxation Policy and administration	•	•
Local Transport (road, minor ports,)		•

8.2 <u>Role of the Development Commissioner</u>

The role of a Development Commissioner in a particular state will depend on the extent to which states are willing to cede their powers to the Development Commissioner, who represents the Central Government within an SEZ. Off the 7 investment-related issues mentioned in Table I, 4 are governed jointly by the Centre and the state governments. The remaining three are largely or exclusively governed by the state governments. The powers of the Development Commissioner in respect of facilitating a single window clearance will be determined by the extent to which the states are willing to cede their powers to the Development Commissioner in their state-level SEZ legislations. The paper discusses state-level variation in granting powers to the Development Commissioner in Sections 10, 11, 12 and 13.

9 Concerns of the Developers and the Units

9.1 Developer Issue 1: Criteria for Successful Project Implementation

Developers will be given an initial license for three years, which can be renewed by the Board of Approval of MOCI for a period of another two years (*SEZ Notification 2006, Chapter 2, section 6*), depending on the progress made by the developer. It is not clear what the Board would consider a successful project implementation by the developer. Lack of clear markers can increase transaction costs at the time of renewal.

9.1.1 Explanatory Note: While developers and consultants are worried about the lack of clear benchmarks that would constitute successful implementation within a three year period, there is scope for some flexibility in this area. MOCI's position is that the benchmarks set by the developer, which will be approved by the Board of Approval, will constitute the standards for evaluation. These benchmarks will differ on a case to case basis.

9.2 Developer Issue 2: Requirements in the Processing and Non-Processing Areas

There are no guidelines in the Procedures about what would constitute successful implementation for developers. Can developers build their real estate business first, make some money, and then focus on developing the 25% of the processing area earmarked for commercial operations? This is an area that needs clarification.

9.2.1 Explanatory Note: First, this issue will be resolved in the developer's plan approved by the Board of Approval and will be viewed on a case by case basis. MOCI would be looking for genuine commitment towards building the processing area and supportive activities in return for benefits on the real estate development side.

9.3 Developer Issue 3: Lease Period in Non-Processing Areas

The Procedures notified in February 2006 do not mention what the lease period for the residential parts of the non-processing zone will be. The developers need to have a better understanding of what the minimum lease period for the non-processing zone will be. They are expecting leases of about 30 years for the processing area because the Procedures grant them a period no less than 20 years (*SEZ Notification 2006, Chapter 2, and section 7*). They would need longer term leases of about 99 years for the residential areas for commercial viability.

9.3.1 Explanatory Note: This is an issue that will need to be settled with the state government when a Singapore developer negotiates with the state government on land acquisition issues. The minimum lease period requirement is 20 years for the entire zone. MOCI will welcome developers who have secured a longer lease period.

9.4 Commercial Unit Issue I – Extension of Letter of Approval

The Letter of Approval for commercial units within an SEZ could be extended after a year of operations for a period of one to two years, depending on whether the Development Commissioner is convinced that two-thirds of the project implementation has occurred (*Chapter 3 of the SEZ Notification 2006, especially sections 19.1 – 19.7 suggest that*). Developers are unhappy with the stipulation of only a year's guarantee to commercial units within an SEZ, as this may affect their chances of luring commercial units to areas developed by them. Second, the commitment to monitor and renew all the Letters of Approval within a year may be too onerous a task for the Development Commissioner's Office, given its size and diverse regulatory functions.

9.4.1 Explanatory Note: Most consultants think that a unit will get five years to prove their net foreign exchange earning capability. These stipulations are to ensure that units get on with commercial activities as fast as possible. In other words, these regulatory procedures are unlikely to pose much of a burden on the units.

9.5 Commercial Unit Issue II: License Renewal in the Commercial Phase: A commercial unit's license needs to be renewed after five years of commercial activity *(Chapter 3, section 19.6 of the SEZ Notification February 2006*). This stipulation can pose problems. One can understand that units need to comply with certain norms, barring which licenses would be withdrawn. What seems unreasonable is the need to renew licenses every five years, which can increase transactions costs. Moreover, what is the value of a five-year approval when the lease period for units will be greater then 20 years?

9.5.1 Explanatory Note: This regulation reflects MOCI's urge to review the net foreign exchange earning capacity of a unit after a five-year period. A net foreign exchange positive unit for a block of five years is unlikely to face any difficulty in getting its renewals till the end of its lease period. The emphasis on exports could be one reason why auto companies like BMW may not wish to come into the Mahindra WorldCity SEZ close to Chennai because they may not like to set up separate lines of production for exports and the domestic market. The auto component manufacturers, who are exporting, have found a place within the same SEZ.

IV STATE-LEVEL ISSUES AND LOCATION ADVANTAGE

10 State-Level Legislative Variation on SEZs

The approaches of the states of Gujarat, Maharashtra, Tamil Nadu, Andhra Pradesh and Haryana towards the SEZ Act are worth noting. The analysis in this section is based on a reading of the Central Act (2005), the SEZ Notification (2006), and the Haryana State SEZ Act; the policies of the Governments of Maharashtra, Tamil Nadu, Andhra Pradesh and Gujarat posted on the SEZ website; and, interviews in Delhi, Chennai and Hyderabad.

10.1 Maharashtra, Gujarat and Haryana

The approaches of the Government's of Maharashtra, Gujarat and Haryana are relatively more in tune with the best practices suggested by the Central Act than those of Andhra Pradesh and Tamil Nadu. They have delegated substantial powers to the Development Commissioner and have a liberal policy on taxation.

10.1.1 State-Taxes: All the three states have a relatively liberal policy on the exemption of state-level taxes, as suggested by the Centre. This includes stamp duty and registration fee exemptions for the transfer of immovable property in these states [SEZ Notification 2006, Chapter 2, Section 5 (a)].

10.1.2 Power, Water and Sanitation: Maharashtra, Gujarat and Haryana have a liberal policy on the taxation and governance of power generation, distribution and wheeling, and, the provision of water and sanitation. The states with a liberal policy on power sector tariffs for SEZs were also ranked as the better governed states in the World Bank Study (2004). The best governed state among the five was Gujarat, followed by Maharashtra, Haryana, Andhra Pradesh and Tamil Nadu.

10.1.3 Powers of the Development: Commissioner: Gujarat and Haryana have given wide powers to the Development Commissioner and the developer with respect to town planning and governance. The Maharashtra SEZ Act goes a step further. In Maharashtra, the Industrial Township Authority, and the Special Planning Authority concerned with land use, will be largely administered by the developer.

10.2 Environmental Clearance

Environment is the one area where MOEF will not consider the Board's approval equivalent to a Central level clearance (except for IT SEZs). Environmental concerns need to be addressed both at the level of the Centre's MOEF (Environmental Impact Assessment) and the state's Pollution Control Board. Central clearance can take up to 180 days, despite a Joint Secretary of MOEF sitting on the Board of Approval. Environmental clearances are maze of rent-seeking activity at the Central and state levels in India *(FAQ, March 2006, Question 8)*.

10.2.1 Jawaharlal Nehru Pharma City Experiment: The Jawaharlal Nehru Pharma City in Andhra Pradesh has devised a model wherein MOEF has given a blanket exemption to all units within the Pharma City. This model is worth studying in detail and could be emulated in the setting up of an SEZ.

10.3 Tamil Nadu

The state of Tamil Nadu has the highest propensity to keep the powers with the State Government. An investor in Tamil Nadu will have to work as much with the Industrial Guidance and Export Promotion Bureau of the State as with the Development Commissioner. The good news for investors in Tamil Nadu is that the AIADMK Government is bullish about investments and would like to take the credit for it.

V LAND ACQUISITION

11 The Issue

The issue of land acquisition is governed largely by the concerned state government. Acquiring contiguous land could pose the toughest bottleneck for constructing a 2500 acre multi-product SEZ in India.

11.1 General Issues

Land acquisition confronts problems such as unclear ownership, inflexible zoning and high stamp duties. States often subsidize water and electricity because it is politically difficult to charge optimal user fees. They compensate themselves by charging high stamp duty at the time of a land transaction. High stamp duty on land generates a burgeoning black market in land acquisition. According to a McKinsey Survey, land market distortions account for about 1.3% of lost GDP growth in India per year.

11.2 Displacement Issues

Land acquisition on a large scale could be a trickier issue because there are no clear models about dealing with the issue of displacement of poor people. Most developers seek the help of state governments for land acquisition. The Union Government can also help in this project. The method used to acquire land for the National Highways project needs to be studied carefully.

11.3 Examples of Displacement Conflict

Four examples of displacement conflicts are mentioned below. They need to be studied in some detail for discerning a viable strategy for acquiring contiguous land.

11.3.1 Kalinga Nagar (Orissa): The Tata's are finding it difficult to persuade the tribal people to leave the land they had acquired in Kalinga Nagar in Orissa from the State Government. The Tata's had purchased this land for building a steel plant from the Industry Development Corporation of Orissa 10 years ago. The violent reaction of the tribal people led to the killing of 12 tribal people and one policeman. Displacement of tribal people would require greater sensitivity to their needs as the Government of India recognizes their particular needs.

11.3.2 The Mahindra World City Project in Rajasthan: The Mahindra's faced problems in acquiring land from farmers for their SEZ in Rajasthan, despite the blessings of Chief Minister Vasundhara Raje. The problem had to be solved socially by transforming media opinion, as well as politically, by convincing the opposers within the ruling Bharatiya Janata Party.

11.3.3 Kakinada Port (Orissa): Acquiring land for the Kakinada Port in Andhra Pradesh turned out to be a tricky problem. The Andhra Pradesh Government found a solution by locating the oil refinery in the

Theodangi Mandal, which was a little distant from the Kakinada Mandal.

11.3.4 NOIDA (Uttar Pradesh): There have been problems related to land acquisition in the greater NOIDA area of the national capital region.

11.4 State-wide Variation

According to the World Bank Study (2004), land acquisition was the easiest in Haryana, followed by Andhra Pradesh, Maharashtra, Gujarat and Tamil Nadu.

VI LABOUR ISSUES

12 The Legislative Issue

Labour is an issue in the Concurrent List of the Indian constitution, which implies that the unionized work force is protected by 23 Central Government legislations and at least seven to ten Acts in each state.

12.1 The Development Commissioner and the Labour Commissioner

The SEZ Notification urges the state government to give the Development Commissioner the powers of a Labour Commissioner (SEZ Notification 2006, Chapter 2, Section 5 e). This means that a representative of MOCI would deal with labour issues rather than the state's Labour Commissioner, unless the state willingly delegated this power. Second, the states were urged to treat activity within an SEZ as a public utility service, which means that strikers have to notify a strike before indulging in strike activity.

12.2 No Direction in the SEZ Act

The Central Government could not give a firm direction to the states on reducing the rigidities in the labour market owing to the power of the Left parties within the ruling United Progressive Alliance coalition. Union activity is protected within SEZs and there is no guarantee that states would delegate the powers of the Labour Commissioner to the Development Commissioner.

12.3 Dealing with Labour

Indian companies have found ways of dealing with labour laws by using contract labour. Foreign companies that play by the rule book often find it tough to retrench workers. Unionized labour in India, which is less than 10% of the work force, enjoys unreasonable wages and benefits at the cost of the unorganized sector. The unorganized sector is exploited in a labour abundant country. The World Bank (2004) study on manufacturing competitiveness found that 30% of the firms interviewed would employ fewer people if they were free to choose. Most of the respondents felt that this was due to labour laws (30%), while others thought that this was due to trade union pressure (17%) and pressure from the Government (13%).

13 State-Level Variation on Labour Policy

It is safe to conjecture that industrial relations would be affected by past history and state-level legislation rather than the Central Act. States have adopted more than one approach in their legislations on labour laws concerning SEZs. Maharashtra, Gujarat, Haryana and Andhra Pradesh have more favourable labour laws compared with Tamil Nadu.

13.1 Maharashtra

In Maharashtra, the powers of the Labour Commissioner and the Director of Health and Safety have been given to the Development Commissioner. The Maharashtra Public Service Act will not apply to an SEZ, which implies that there will be no reservations for scheduled castes and scheduled tribes within an SEZ in Maharashtra. The State will allow only one trade union, that too with a membership greater than 300 people. The minimum number of people required to form a trade union outside a Maharashtra SEZ is seven.

13.2 Gujarat

Gujarat has given the powers of the state's Labour Commissioner to the Development Commissioner. Gujarat has also designated commercial operations within an SEZ as a public utility service.

13.3 Haryana

Haryana has given the Development Commissioner the powers of a Labour Commissioner and the Chief Inspector of Factories.

13.4 Andhra Pradesh

The Andhra Pradesh Government has an SEZ Act pending approval with the Central Government, which gives the power of the Labour Commissioner to the Development Commissioner.

13.5 Tamil Nadu

Tamil Nadu is the least willing among the five central states to cede powers to the Centre. The Tamil Nadu Government has given the powers of a Labour Inspector to the Development Commissioner. These powers are less significant than the powers of the Labour Commissioner.

13.6 Labour Laws and Industrial Relations

Is there a relationship between more flexible labour laws and the past history of industrial relations within a state? The World Bank Study reported (November 2004) that labour regulations were the least problematic for manufacturing industries in Andhra Pradesh followed by Gujarat, Maharashtra, Haryana and Tamil Nadu (See Table II). This data seems consistent with the legislative story where we find that Andhra Pradesh, Gujarat, Maharashtra and Haryana have given labour related powers to the Development Commissioner whereas Tamil Nadu has not.

VII POLITICAL ISSUES

14 The Politics of Investment

The impact of state politics and centre-state relations on foreign investment needs exploration. We suggest the need to pursue three propositions.

14.1 If Opposition Party in the State is a Part of the Ruling Coalition

Our interviews suggest that if the opposition party in a state holds an important portfolio in the Centre, then they may try to discourage investment in the state till they come to power. The DMK Party of Tamil Nadu, which has representation in the Centre, may be playing such role with respect to the ruling AIADMK party in the same state. The forthcoming Tamil Nadu elections will be important.

14.2 A Stable Tenure

A Chief Minister with a stable tenure may be able to do more for an investor than one who is facing an election. This could be one reason why the Board has deferred decisions about West Bengal, Tamil Nadu and Kerala, the three states facing elections within a short time frame.

14.3 Ruling Party in the State is Opposition Party in the Centre

One needs to explore whether an opposition government in an investor friendly state faces problems from the ruling party in the Centre. Could this be a reason why there is little action on SEZs in Gujarat?

VIII ANALYSING LOCATION ADVANTAGE

15 Summarising Factors Affecting the Choice of Location

15.1 Factors Considered: Critical variables concerning competitiveness such as labour issues and skill shortages; land acquisition problems; transport linkages; regulation and corruption; foreign investment approval rates; customs facilitation; power availability; financial infrastructure; and, autonomy to the developer on town planning, were considered in our ranking of the five states Haryana, Maharashtra, Andhra Pradesh, Gujarat and Tamil Nadu.

15.2.1 <u>Sector Specific Factors Not Considered:</u> The study did not point to sector specific factors that would privilege one state's competitive advantage over other states. That would require a more detailed industry level analysis.

15.2.2 <u>The Petrochemicals Initiative:</u> The Task Force on Petroleum, Chemicals, and Petrochemicals Investment Regions, being coordinated by the Prime Minister's Office, reflects the Government of India's urge to promote exports and energy security. This initiative involves the Planning Commission, the Ministry of Petroleum and Natural Gas, the Department of Chemicals and Petrochemicals, and MOF.

MOCI's role in this initiative is relatively peripheral. There is little indication yet of a clear policy in this area. It is being considered whether a part of an investment region could be turned into an SEZ.

The Petrochemicals Initiative could aid a Government to Government project implementation like the Indian and Malaysian cooperation in the highways project. In the highways initiative, the Malaysian Government helped to secure the projects and then decided which companies would implement them.

TABLE II
Investment Related Governance Indicators

	A	B	C	D	E	F	G	H	I	J	K
	Customs	**Labour**	**Power**	**Town Plan**	**Land**	**Transport**	**Finance**	**Reg/ Corrupt**	**Skill Shortage**	**FDI Approval**	**Average Rank**
Haryana	5	4	3	2	1	1	1	1	1	5	2.4
Maharashtra	3	3	2	1	4	4	3	3	2	1	2.6
Andhra Pradesh	1	1	4	4	2	2	4	2	3	4	2.7
Gujarat	4	2	1	2	3	3	2	4	4	3	2.8
Tamil Nadu	2	5	5	5	5	5	5	5	5	2	4.4

Source: World Bank, *India: Investment Climate Assessment 2004* (Washington: Finance and Private Sector Development Unit – South Asia Region, November 2004), chapter 3. The figures are based on a survey of 1855 firms conducted over 12 states and 40 cities.
D was derived from a reading of State SEZ Acts and policy.
J has been taken from S Narayn, *Growth Opportunities in Indian States: Issues of Governance and Economic Development*, (Singapore: Institute of South Asian Studies and Marshal Cavendish, 2005), p. 42.

Variables:
1. A = The variable Customs meant days to clear customs for imports.
2. B = The variable Labour was operationalised as: reported overstaffing rates.
3. C = The variable Power was operationalised as: respondents identifying power supply as a "major to severe" bottleneck.
4. D = The variable Town Plan reflected the extent to which the developer and the Development Commissioner had a say over planning and land use. We did this ranking on the basis of state policy.
5. E = The variable Land was operationalised as: % of respondents identifying access to land as a bottleneck to growth.
6. F = The variable Transport was operationalised as: respondents identifying transport as a "major to severe bottleneck" to growth.
7. G = The variable Finance was operationalised as: respondents identifying external finance as a bottleneck to growth.
8. H = The variable Reg/Corrupt was operationalised as: the % of respondents regulation and corruption as a major or severe obstacle to growth.
9. I = The Skill Shortages was operationalised as: % of respondents identifying skill shortages as a growth bottleneck.
10. J = These values are FDI approvals from August 1991 to May 2002. These figures were taken from Narayan (2006).

15.3 Transport Linkages

Transport related problems in our five states were the least in Haryana followed by Andhra Pradesh, Gujarat, Maharashtra and Tamil Nadu.

15.4 Access to External Finance

We were surprised to find that the World Bank had ranked Haryana above Maharashtra in terms of the ease with which external finance could be obtained. The state rankings for our five states on this parameter were: Haryana, Maharashtra, Gujarat, Andhra Pradesh and Tamil Nadu.

15.5 Customs Clearance

Firms in Andhra Pradesh cleared customs faster than any other state, followed by Tamil Nadu, Maharashtra, Gujarat and Haryana. The SEZ Act and self certification procedures have further facilitated customs clearance.

15.6 Regulation and Corruption

The World Bank found that regulatory and corruption related obstacles were the least in Haryana, followed by Andhra Pradesh, Maharashtra, Gujarat and Tamil Nadu.

15.7 Skill Shortage

Skill shortage was the least in Haryana, followed by Maharashtra, Andhra Pradesh, Gujarat and Tamil Nadu.

15.8 Variables Discussed Above

The variables “labour” (section 13, especially 13.6), “Power” (section 10.1.2), “Town Plan” (10.1.3), and “Land” (section 11, especially 11.4) in Table II have been discussed in previous sections.

15.9 Overall Governance Rank

The lowest governance rank implies the best governed state on the 10 parameters discussed in Table 2. Our rankings suggest that Haryana was the best governed state (2.4), followed by Maharashtra (2.6), Andhra Pradesh (2.7), Gujarat (2.8) and Tamil Nadu (4.4).

16 Haryana

16.1 Governance Rank and State Legislation

Haryana has an investor friendly Act, which has been posted on the State Government website. No other State Act was to be found either on the State Government's website or MOCI's website. Table II gives it the best governance rank (2.4).

16.1.2 Land Acquisition: The Government of Haryana has been most successful among the states considered in this study in obtaining land for investors Table II.

16.2 SEZ Activity

There is vigorous SEZ Activity in the state with Reliance Industries having expressed a major interest in a large SEZ. The State Government has made available a large amount of land to Reliance Industries in the Bahadurgarh area for a multi-product SEZ. Manesar is being earmarked for non-polluting light engineering industry and Bawal near Rewadi for more polluting industry. It is not surprising that SEZ investors are active in Haryana. Haryana is ideal for SEZ activity that does not require a port facility.

16.3 Geographical Proximity and Airport Connectivity:

The state of Haryana is adjacent to the International Airport in Delhi, which is a five hour flight from Singapore. The airport in New Delhi has the second highest number of weekly flights (25) from Singapore, after Chennai.

16.4 Singapore's Concern

Singapore investors may be discouraged from opting for Haryana owing to its distance from a sea port.

17 Maharashtra

17.1 Governance Rank

Maharashtra is an investor friendly state. Table II suggests that it is the second best governed state after Haryana.

17.2 State Act

Maharashtra has an investment friendly state Act that tries to make progress on labour issues and gives substantial governance powers to the developer.

17.3 Port Development

Singapore can contribute to port development in Maharashtra.

17.4 Possibility of Offshore Banking Unit and International Financial Services Centre

Given Mumbai's history as India's financial centre, Offshore Banking Units and an International Financial Services Centre are likely to develop in this location. This is an area where India-Singapore synergies facilitated by CECA can be explored.

17.5 FDI Approvals

Table II suggests that Maharashtra has had the highest number of foreign investment approvals between 1991 and 2002.

17.6 Proximity and Airport Connectivity

Mumbai is five and a half hours away from Singapore by air. It has 19 direct flights to Mumbai per week. Chennai and Delhi enjoy better connectivity than Mumbai.

18 Andhra Pradesh

18.1 Governance Rank

Andhra Pradesh has the third best governance rank (2.7) after Haryana and Maharashtra. This achievement reflects Chief Minister Chandra Babu Naidu's bold agenda of improving governance in the state, aided by the World Bank. Naidu proposed a SMART (simple, moral, accountable, responsive and transparent) government, initiated e-governance initiatives like e-sewa, and, initiated the Computer-aided Administration of Registrations Department (CARD). The present Chief Minister Mr. Y S Rajashekhar Reddy has not reversed these policies.

18.2 The State Act

The Andhra Pradesh State Act is more liberal than the Tamil Nadu State Act on issues like the powers of the Development Commissioner but is more conservative than the Acts in Gujarat, Haryana and Maharashtra.

18.3 Pollution Clearances

AP’s experiment with pollution control is useful from the perspective of reducing delays. The Pharma City case needs further study as a way of reducing regulatory bottlenecks.

18.4 Port Development

Ports in AP need development, which can be facilitated by Singapore. Kakinada and Vishakhapatnam could be further developed. There is demand for port facilities in AP and the rest of India. The Central Government wishes to encourage port development in India.

18.5 Proximity and Airport Connectivity

The geographical proximity of Andhra Pradesh to Singapore should work to the advantage of a Singapore investor. The travel time by air is about four hours. The flight connectivity between Hyderabad and Singapore at eleven direct flights in a week compares favourably with Ahmedabad in Gujarat, which has only three direct flights.

18.6 State Politics

AP has a Congress Chief Minister who desires investment. The synergy between the Congress Party in the Centre and the Congress Party in Andhra Pradesh could be helpful in luring investments to the state. Could it be that the recent Fab City investment worth US$ 2 billion was aided by the fact that AP has a Congress Chief Minister in power?

18.7 FDI Cases

AP was ranked 4th out of our five states on FDI approvals. AP is bullish about changing this situation.

20.6.1 SEM India: The SEM India investment worth $ 2 billion in the electronics hardware area was won by AP after competition between AP, Tamil Nadu and Karnataka. AP was able to provide 1200 acres of land and water resources with greater ease than its competitors. The Industry Minister Dr. Geetha Reddy has suggested that the Fab City could become an SEZ. Jurong and Servana are to prepare the master plan for the Fab City.

19 Gujarat

19.1 Good Legislation and Governance

The Gujarat State Act is an investor friendly legislation that seeks to empower the Development Commissioner and promotes the liberal policies of the Central Government. The indicators in Table II suggest that Gujarat is a reasonably well governed state, with a 4th rank after Haryana, Maharashtra and Andhra Pradesh.

19.2 Low Level of SEZ Activity

Past SEZ activity had met with little success. The proposed SEZ activities were in areas such as port development, petrochemicals, chemicals, and gems and jewellery.

19.3 Port Development

Port development is a possibility in this state.

19.4 Geographical Proximity and Airport Connectivity

It takes five and a half hours to reach Ahmedabad from Singapore and Singapore Airlines has three direct flights to Ahmedabad.

20 Tamil Nadu

20.1 Governance

Table II suggests that Tamil Nadu was the least well governed state of the five states discussed above. It fared the worst on 8 of the 10 variables in Table II.

20.2 State Legislation

The Tamil Nadu State Act tries to keep most of the governance powers with itself. Its State Act is the least synergised with the central legislation among all the five states discussed in the paper.

20.3 DMK versus AIADMK Conflicts

Conflicts between the two major parties in Tamil Nadu need to be studied carefully. When AIADMK is in power, the DMK accuses it of selling the state to multinationals. But the DMK works to attract investment when in power. To give one example, the DMK opposed the deal struck by AIADMK with Mahindra and Ford in 1995. But the DMK Party accepted the next major project proposed by Hyundai when it came to power. The impact of DMK – AIADMK conflicts over SEZ investments need to be studied carefully.

20.4 FDI Success

Tamil Nadu had the second highest number of foreign investment approvals between 1991 and 2002 after Maharashtra. The state government has been bullish about foreign investors and has been providing excellent investment packages since the mid-1990s. Their major victory was the establishment of a joint venture between Mahindra and Ford in 1995. Their second success was the investment deal with Hyundai Motor Company in 1996. This was followed by a deal with French Glass maker St. Gobain.

20.5 Paradox of Poor Governance and FDI Success

How does one explain poor governance, weak legislation and success in foreign investments? It could be that the investment climate for the big investor preferred by the Government of Tamil Nadu is quite different from what the sample of 1855 firms interviewed by the World Bank suggests. Second, the state government may wish to work with a weak Act because it wishes to take the credit for attracting investment on its own terms rather than depend on Central design.

20.6 Ports

Tamil Nadu has the advantage of port facilities. It is also geographically close to Singapore.

20.7 Geographical Proximity and Excellent Airport Connectivity

There are 28 direct flights from Singapore to Chennai per week. The travel time is approximately three and a half hours. Chennai is better connected to Singapore by air than any other city in India.

21 Singapore-India Synergies

21.1 A Singapore Initiative

MOCI and the business chambers would be willing to arouse enthusiasm among state governments and possible Indian partners for such an investment. Singapore could initiate an SEZ in collaboration with an Indian partner, given the regulatory plusses and minuses of each state and their respective business potential.

21.1.1 Example A significant SEZ project under implementation is the one by Mahindra World City close to Chennai. Ascendas has made a contribution towards the construction of this SEZ.

22 The India-China Comparison

How do Indian SEZs differ from the Chinese SEZs? These are important considerations before approaching India as a business location because Singapore has more experience in dealing with China than India.

22.1 Taxation

The Chinese SEZs offer tax incentives for foreign investment rather than for exports. India offers special incentives for exports rather than for foreign investment.

22.2 Labour

The Chinese have labour regulations, which are not enforced strictly. Labour regulations in India pose challenges for most businesses except those that have learnt to exploit surplus contract labour that is not protected by legislation.

22.3 Extent of Local Level Governance

The Chinese experiment was driven more by the needs of the local governments and less by Central direction. As the Chinese experiment succeeded, more areas wished the same privileges as the coastal SEZs. In the Indian story, it is still to be determined whether local level governance will be more important than central level governance. We expect variation among the Indian states and a relatively greater degree of central control than China. Central level governance in India's telecom sector has produced a favourable commercial environment.

22.4 Other Comparisons

According to the World Bank study of November 2004, Chinese businesses have a shorter start up time and faced a better infrastructure scenario. On the positive side, India had a more developed financial infrastructure and fewer tax and regulatory inspections. Despite regressive labour laws, overstaffing in

Indian manufacturing industry was coming down. Dependence on captive generation was also becoming less.

IX IN SUM

23 Challenges and Possibilities

The ISAS Background Paper has attempted to point out the progress that the SEZ Act makes for export oriented investment in India. Most of the progress lies in the areas of taxation, stability of India's foreign trade policy, and customs facilitation.

23.1 New Challenges

Table III highlights some of the challenges relating to policy uncertainties that have cropped up after February 2006:-

TABLE III
Policy Uncertainties

Issues	Policy Instability	Concerns
1. SEZ Size 1.1. IT SEZ	• Has the requirement for the built up area changed from 100,000 sq. meters (*SEZ Notification February 2006)* to 1 million square feet up in Tier I cities? Also, is there a requirement for a built up area of 500,000 square feet and 250,000 sq. feet for Tier II and Tier III cities respectively? • Will there be no total area requirement beyond the built-up area? • Will there be an employment requirement for IT SEZs? Will such a requirement be mandatory or just a guiding principle?	Many of these concerns arise out of debates within the Empowered Group Of Ministers in May 2006. MOF is keen on a larger area requirement, whereas MOCI and parent ministries often push for the optimal commercial area requirement.
1.2 Bio-Tech SEZs, Non-Conventional Energy SEZs and Gems & Jewellery SEZs	• Will the 10 hectare total area requirement be reduced to 6 hectares? • Will there be a 400,000 sq. meter built up area requirement? • Will there be an employment requirement for bio-tech, non-conventional energy and gems & jewellery SEZs?	-same as above-
2. Multi-Product SEZ 2.1 Processing Area 2.2 Employment	• Has the processing area requirement changed from 25 percent (*SEZ Notification February 2006)* to 50 percent of the total SEZ area? • Will there be an employment requirement in Multi-Product SEZs?	Is MOF trying to undo MOCI's design described in the Notification of February 2006?
3. **Tax Issues** 3.1 Minimum Alternate Tax (MAT) 3.2 Direct Taxes	• Will the MAT benefit cease to exist (*Section 6.4)? Or* will MAT benefit be restricted to export profits only? • Is the GoI reviewing 162 items that had been exempted from direct taxation?	Is the MOF trying to take away the hard earned tax benefits of the SEZ Act 2005, especially the amendments to Section 10(A) of the Income Tax Act?
4. Definition of Exports	• Will the definition of exports need to adhere to the Export Services Rules, 2005 and the Taxation of Service Rules, 2006?	

23.1.1 Issues: Table III summarises the debates between MOCI, MOF and the parent ministries over issues such as coverage area, tax benefits, and employment requirements. These debates were deliberated among the Empowered Group of Ministers dealing with the SEZ issue.

23.1.2 Inter-Ministerial Conflict of Interest: The MOF is keen to increase the coverage area requirements and lower the tax benefits. MOCI and parent ministries such as the Ministry of Science and Technology (for sectors like Biotechnology and Non-conventional SEZs) are keen that entrepreneurship takes off in these SEZs.

23.1.3 Need for Policy Stability: The benefit of the SEZ Act of 2005 in relation to previous SEZ policy is a higher level of policy and regulatory certainty. Debates within the Empowered Group of Ministers should not unravel the architecture and provisions of the Central Act.

23.2 Policy Ambiguities in the SEZ Architecture

23.2.1 Policy Ambiguities at the Central Level: A number of regulatory issues related to monitoring the investments of developers and units need to be addressed at the Central level. The paper has suggested ways to approach these grey areas and the flexibility of MOCI in these areas. However, it appears that inter-ministerial turf wars are exacerbating the policy uncertainties.

23.2.2 State-level Ambiguities: States would either need to synergise their legislations consistent with the good practices suggested by the Central Act or provide good governance at the state level. It would help the large investor if the Centre could facilitate state-level synergies in relation to the Central Act.

23.3 Infrastructure Support: A large investor would be concerned about the provision of public goods such as railways, roads, airports and ports connecting the SEZ with the domestic tariff area and the rest of the world. The central and the state governments would need to play a vital role to ensure that SEZs succeed. India could learn from the Chinese experience in this respect.

24 Reasons for Optimism

24.1 Central Government's Willingness

The ambiguities that remain could be resolved by the political will of the Central Government. The Singapore Government could work with MOCI to facilitate a successful Singapore promoted SEZ in India. MOCI was of the opinion that once Singapore expressed a wish favouring a multi-product SEZ, the ambiguities could be worked out. It was keen to work with Singapore in order to make a success of its SEZ policy. It needed to showcase a success story within the next year or two.

24.2 Willingness of the States

Investor friendly states like Maharashtra, Tamil Nadu, Andhra Pradesh, Haryana and Gujarat are keen to invite investment in SEZs located in their states. The support of the various Indian states interested in an investment would be critical for the success of a SEZ project. MOCI would encourage such an initiative.

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