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SPECIAL ECONOMIC ZONES IN INDIA: RECENT DEVELOPMENTS AND FUTURE PROSPECTS

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EXECUTIVE SUMMARY

This paper describes the evolution of Indian Special Economic Zones (SEZs) in 2007 and substantially updates ISAS Working Paper No. 12 dated 30 March 2006. Indian SEZs are industrial townships with commercial units, which enjoy tax concessions for export oriented production of goods and services. The central government wanted to woo domestic and international investors towards export oriented production inspired by the success of Chinese SEZs. The tax concessions for developers and commercial units in the SEZ Act (2005) have played a vital role in attracting export oriented foreign investment in areas such as hardware, apparel and shoes, which would have normally headed for other Asian destinations in the absence of these benefits.

The SEZ Act 2007 sought to reduce regulatory hazards by creating the Office of the Development Commissioner – which was supposed to sort out regulatory issues such as environment, power, water and labor clearances via an administrative single window. This window was supposed to reduce the transactions costs of an investor. In the absence of this single window, investors needed to knock the doors of numerous state- and central-level ministries and officials for investment approvals.

The single window in the Development Commissioner's Office has not materialised even in the aggressively investment hungry states like Tamil Nadu and Andhra Pradesh. However, the industry departments in these states provide strategic guidance to the investor. This aids a preferred investor in clearing numerous regulatory bottlenecks before making a successful investment.

It is important for an investor to figure out how vital its prospective investment is from the perspective of a particular state. The measure of attractiveness of an investor would depend on how big it is in terms of global operations, and its contribution to exports, employment generation and technology diffusion. If an investor is a global brand, with the ability to attract other brands, the better governed investment hungry state governments will work hard to win their confidence. State governments in Tamil Nadu, Andhra Pradesh, Gujarat, Maharashtra and Haryana realise that attracting one big player would create a positive sentiment for other investors as well.

Second, investment attractiveness would depend on the sectors that a state is interested in. For example, the government of Andhra Pradesh's push towards labor intensive textile manufacturing led to a very favorable textile policy at the state-level, which gave it an edge over other states that wished to attract SEZ investment in export oriented production of textiles and apparel.

Last but not least, an investor's attractiveness would depend on a state government's investment successes in the past. Successful states that have created a good industrial ecology in a particular sector may be willing to give fewer concessions than those that are trying to establish themselves as investment destinations.

Land acquisition for SEZs became a serious problem because state governments could legally acquire land without seeking consent of the local people. This had led to protests in a number of SEZ locations in India, where people refused to give up their residence and traditional sources of livelihood easily. Violence at a place called Nandigram in the state of West Bengal was a major setback for the development of SEZs in the rest of the country.

The Ministry of Commerce and Industry (MOCI) dealt with this problem by stressing that 100 percent consent of the local people was essential. It also stressed the need to keep SEZs out of fertile agricultural land, and to keep human displacement at a minimum level. These criteria would be invoked while judging the viability of an SEZ project by the Board of Approval headed by the Commerce Secretary.

The good news is that some SEZ developers have shown the way by providing generous relief and rehabilitation packages in poor areas where people's lives have improved as result of SEZ activity. These developers have worked with the people over a period of time to win their consent.

In other places, state governments have taken consent seriously and major clashes between the investors and local people have been averted. These governments are of the opinion that realising the goal of 100 percent consent of the local people may be a difficult condition for most investors to fulfill. States needed to play a vital role in acquiring land for investors.

A successful SEZ investment in India would benefit by noting the following investment related issues:

a) relief and rehabilitation of the displaced people is a serious issue;

b) investors need to attract the attention of state governments, and the investors and the concerned state governments must discover synergies, which they find mutually worth pursuing;

c) investors should stay out of partisan politics because ruling parties frequently lose power in India; and

d) it helps if the concerned state has ministers in central ministries who can help clear infrastructure projects such as roads, ports, airports and rail connections favorable to investors in that state.

TERMS OF REFERENCE

This paper updates ISAS Working Paper No. 12 titled *Investing in India's Special Economic Zones*, dated 30 March 2006. It focuses attention on recent investment related regulatory issues with respect to India's SEZs. These zones enjoy tax concessions, in return for which, commercial units within these zones are supposed to export 51 percent of their output. The issues highlighted in the earlier paper, which continued to be significant for successful investment in SEZs were:

a) Land acquisition and rehabilitation;

b) Investor-government relations; and

c) The single window clearance for investors.

RESEARCH METHODOLOGY

Field-Work Support

This study was based on interviews in New Delhi, Gurgaon, Jaipur, Hyderabad and Chennai with the persons acknowledged above. The views of civil servants, investors, consultants and representatives of industry organisations were sought for updating the earlier work on SEZs. Visits to operational SEZs in the neighbourhood of Hyderabad and Chennai helped to gain first hand knowledge of SEZs in evolution.

Published Sources

The paper relied on published material such as the *Economic and Political Weekly*, *The Industrial Economist* (Observer Research Foundation), World Bank publications, news sources and papers commissioned by MOCI – Government of India, Ministry of Rural Development – Government of India, the Department of Industry – Government of Andhra Pradesh, the Industrial Guidance Bureau – Government of Tamil Nadu, Department for International Development (UK), the Indian Institute of Management (Ahmedabad), and the Department of Commerce's SEZ web site. Data on land acquisition was supplied by investors.

State-Level Focus

It was decided that the study will focus more attention on Andhra Pradesh and Tamil Nadu. These two states had the highest number of notified SEZs [Andhra Pradesh (46) and Tamil Nadu (24)] as of 30 November 2007. Moreover, the two states scored high marks in terms of attracting quality export-oriented foreign investments. Tamil Nadu is a hot foreign investment destination with Nokia, Ford, Hyundai, Foxconn and Motorola having made substantial investments in the state. Andhra Pradesh has succeeded in luring investment in areas such as textiles, leather, gems and jewelry, information technology, pharmaceuticals and biotechnology. These states have attracted the attention of Singapore investors such as Ascendas.

LAND ACQUISITION

Poor Regulatory Framework

The regulatory framework for acquiring land under the Land Acquisition Act (LAA, 1894) is ill suited for serving a rapidly growing economy. The Act allows the government to acquire land for public purpose. Public purpose was defined for an age when the government used to carry out many development activities, which are in the domain of the private sector today.

<u>The Problem</u>
An SEZ is a case of public-private partnership in building townships, which will be run and administered largely by the private sector for generating export oriented and profit-making activities. At a time when displacement, relief and rehabilitation issues were not clearly resolved for government projects such as dams, roads and bridges, SEZs posed a serious challenge to the regulatory framework governing the acquisition of land:

a) Could such activities be defined as ones where compulsory land acquisition by government was appropriate?

b) What should be the appropriate remuneration for those who are evicted from their places of residence and livelihood?

Violence in Nandigram

It was the protests and political violence in Nandigram in West Bengal (150 kilometers from Kolkata) in January and March 2007, which posed a substantial threat to the success of SEZs in India.[2] The Communist Party of India – Marxist (CPIM) government in West Bengal was working with an Indonesian foreign investor, the Salim group, to set up a petrochemical SEZ in Nandigarm. Local people were infuriated by the use of force to evict people from their places of residence and agricultural livelihood. Political forces to the extreme left such as the Maoists and the more moderate Trinamool Congress helped to organise a social movement under the banner of the Bhoomi Ucched Pratirodh Committee (BUPC or the Committee to Prevent Land Eviction) to prevent the setting up of the SEZ.

The Congress Party, which faced criticism on a variety of development issues from its coalition ally (CPIM), did not lose this opportunity to project this lapse in the CPIM's commitment to the rural poor. The situation in Nandigram continued to be tense till central forces were deployed to ease the situation. Land acquisition in Nandigram may have been affected by the power of absentee landlords whose interests coincided with the political opposition groups in the area. Land acquisition and SEZs earned a bad name after these incidents, and the central government needed to recalibrate its policies on land acquisition. Chief Minister Buddhadeb Bhattaacharya has reassured the people of Nandigram in late December 2007 that there will be no SEZ in Nandigram and that the violence caused due to land acquisition is deeply regretted.

Janadesh 2007

Janadesh 2007, the long march of the 25,000 landless and tribal people from Gwalior in Madhya Pradesh to New Delhi in October 2007, has raised the issue of land reforms and access to common property resources, especially among the tribal and disadvantaged people. It has led to the setting up of the National Land Reforms Council with the Prime Minister as Chairman. Inequitable distribution of land and natural resources and attention to marginalised sections as part of relief and rehabilitation policy has gained attention as a result of this non-violent struggle initiated by a Gandhian non-governmental organisation called Ekta Parishad (Council of Unity).

Political Opposition

Political opposition to the Indian SEZs arose from opposition parties but the ruling parties wanted SEZs to succeed. The Congress Party, in opposition in the states of Orissa and Karnataka, opposed SEZs, and so did the opposition Bharatiya Janata Party (BJP) in the centre. The trade union wing of the BJP – the Bharataiya Mazdoor Sangh also opposed SEZs. At the level of the central government, the Ministry of Finance and the Reserve Bank of India maintained their skepticism about the possible of contribution of SEZs to employment and infrastructure generation at the expense of the revenue foregone. The political opposition to

[2] Other locations such as Kalinganagar (Orissa), Kakinada (Andhra Pradesh) and Nandagudi in Karnataka also witnessed protests. It was Nandigram that brought the issue of land acquisition to national attention.

SEZs in the aftermath of violence in Nandigram produced a freeze on "in principle" SEZ approvals between January and May 2007.[3]

The Parliament's Recommendation

The Parliamentary Standing Committee on SEZs, headed by the national level opposition BJP leader Murli Manohar Joshi, in its recommendations to the Vice President Bhairon Singh Shekhawat sought a freeze on SEZs. It suggested:

a) That the maximum size of a multi-product SEZ should be 5,000 hectares of fallow land or 2,000 hectares of one crop land. There should be no SEZs on multi-crop land.
b) That land should be taken on lease from farmers and farmers should be paid periodic rentals.

c) That the state government should set the benchmark price for land and farmers should be paid a price higher than that price.

d) It was urged that the processing area in an SEZ should be raised from 35 percent of the total area to 50 percent of the same.[4]

e) The committee noted the lack of representation from the Ministry of Agriculture in the implementation of SEZs.

Political Support

The political support for SEZs came from the Department of Commerce, the Prime Minister's Office and the Chief Ministers of Andhra Pradesh and Tamil Nadu, who had succeeded in attracting substantial investment to their states. Investors had betted on these zones in the hope that SEZs would provide policy stability. Investments would not be forthcoming if investors were not clear about the policy framework within which investments needed to succeed. Neither the Department of Commerce nor the Prime Minister's Office saw SEZs as a zero sum game between the interests of industrialists and the common man whose livelihood and aspirations needed to be protected. The crisis in Nandigram had alerted these two institutions to the obsolete regulatory framework (LAA of 1894) which did not leave the common citizen with appropriate avenues to pursue their interests. An Empowered Group of Ministers headed by Mr Pranab Mukherjee was to arbitrate these issues between the supporters and opponents of SEZs. The critical factor favouring SEZs was the success of Andhra Pradesh and Tamil Nadu in attracting employment generating investments:

a) In February 2007, Chief Minister Karunanidhi of Tamil Nadu and Chief Minister Y. S. Rajasekhar Reddy of Andhra Pradesh wrote strongly-worded letters to the Prime Minister and the head of the Empowered Group of Ministers on SEZs, respectively. The Chief Minster of Andhra Pradesh argued that the state was larger than West Bengal and Tamil Nadu and only 30 percent of its land was cultivable. SEZs were a good option for employment generation.

3 "In principal" approvals for SEZs are accorded by the Department of Commerce for new and viable projects that have not secured the land. "Formal approvals" are accorded after the applicant is in possession of the land required for an SEZ. In the last stage, SEZs are notified after receipt of land details and verification reports from the Development Commissioners of the SEZs.

4 The processing area is that part of the SEZ where manufacturing and productive activities occur. The rest of the SEZ is called the non-processing area.

b) Tamil Nadu was in the process of converting Sriperumbudur into the hardware hub of the world with quality investments from companies like Nokia, Foxconn, Motorola and Ericsson. India's booming telecommunications revolution in the GSM cellular sector had inspired the hardware manufacturers of GSM mobile phones to set up operations in Tamil Nadu. In addition, Samsung, Dell and Flextronics were also investing in hardware manufacturing in this area. The Nokia investment in Sriperumbudur was an iconic one for the State Industries Promotion Council of Tamil Nadu (SIPCOT) because land prices in the area rose from Rs.100,000[5] per acre in 2005 to Rs.20,000,000 in 2007 the Sriperumbudur area. SIPCOT, as an industrial promoter and a land bank, became commercially viable after the success of SEZ investment in the state.

c) Sri Lanka's Brandix Apparel and MAS holdings were ready to begin export oriented operations for high end exports to rich country markets from Andhra Pradesh. The paper will describe below how the policies of the government of Andhra Pradesh promoted export oriented investments in textiles.

d) Apache Shoes in Nellore district of Andhra Pradesh, a manufacturer of shoes for Adidas, was prepared to invest Rs.5 billion in Andhra Pradesh with an employment potential of 25,000 workers. Apache was employing about 4,500 workers in December 2007, a figure that is likely go up to 10,000 workers by 2008. The SEZ has transformed economic activity in Tada, a town with more than 100,000 inhabitants (Business Standard, 10 December 2007, p. 1). Apache's operations in China employed about 19,000 workers.

e) Hyderabad Gems SEZ Limited employed 1200 people, a figure that could go up to 30,000. Trainees were being paid Rs.1,000 and were learning the trade faster than the counterparts in China working for the same parent company – Gitanjali Gems.

f) Foreign investment in areas such textiles, shoes and hardware with employment potential was evidence that SEZ policy was succeeding in India. Without the special tax benefits accorded to SEZs, these investments would have found a place in countries such as China, Vietnam and Malaysia. Promising industrial clusters were also developing around Pune.

g) Taiwanese and Singaporean investors (Ascendas) were looking for policy stability in order to invest in India.

Policy Response

It took till the end of May 2007 to resolve some of the regulatory issues. The Ministry of Rural Development began working on a Relief and Rehabilitation policy, which had been discussed within the Cabinet.[6] A new bill had been introduced in the Parliament, which could lead to an amendment of the LAA, 1894. Given the investment and employment opportunities that lay ahead, the SEZ policy moved faster than government legislation.

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5 S$1 = Rs. 27.2 on 30.12.07.

6 The Indian Cabinet is a group of influential ministers who make important decisions for the country.

a) It was decided by MOCI that the processing or manufacturing area within an SEZ would be 50 percent of the total SEZ area rather than 35 percent of the same, as was the case before.

b) The Board of Approval headed by the Commerce Secretary was looking for 100 percent consent from the local people before approving SEZs. This provision was to ensure that another Nandigram type violent protest would not be repeated as a consequence of forced land acquisition by invoking the LAA of 1894.

c) The Relief and Rehabilitation Policy (2007), enunciated by the Ministry of Rural Development, discouraged investors from acquiring land that were fertile. Displacement was to be kept at a minimum. Social impact assessments based on rigorous surveys of the area and public hearings were proposed. Alternative locations for habitation, especially for the tribal people, were proposed. Land acquired for one purpose should not be used for other purposes. It was discussed within the cabinet that the government may be allowed to acquire 30 percent of the total land required by developers, especially in order to acquire contiguous land, which may be tough for private players on their own.

Dilemmas for Investors

Investors would like the state governments to acquire land for them. The problem they face is that land prices shoot up as more land is acquired. A typical investor mentioned that a person who had budgeted land price escalation from Rs.200,000 per acre to Rs.2,500,000 per acre, might find it tough to pay Rs.20,000,000 per acre. The paradox of developing land was that the more a developer developed the land, the more expensive it became to obtain additional acres of land. Those who could hold on to land for a long time would benefit from sky rocketing land prices. This could render the cost of setting up SEZs beyond the reach of a typical investor. Moreover, this might lead to a situation where pockets of habitation could not be acquired. Most developers were keen that governments step in to acquire the land.

Dilemmas for Investment Friendly States

How do investment-friendly states acquire land? According to one authentic account, the state obtains consent of 85 percent of the people in the area of the concerned SEZ. During this process, the concerned government buys dry land, works out a reasonable market price, and, urges the probable investor to provide jobs to people in the area. Public hearings are held to satisfy up to 85 percent of the people about the reasonableness of the deal. After ensuring that the vast majority of the residents are satisfied, the state invokes public purpose to acquire land as per the LAA of 1894. Off the 15 percent who do not acquiesce, some do not take the matter to court because of the cost and effort involved in litigation. The state government is prepared to face the court for those who did not give up, and would respect the court’s decision. The concerned official mentioned that the involvement of the state in acquisition was critical, and that any policy that limits the state to acquiring up to 30 percent of the SEZ land, will make it tough for investors. In other words, they claim that there is no uniform solution to the problem of land acquisition and rehabilitation, as suggested by the Relief and Rehabilitation policy of the Ministry of Rural Development.

The Sri City SEZ (Andhra Pradesh) Land Acquisition

The Sri City SEZ, in southeastern Nellore district of Andhra Pradesh, is 65 kilometers from Chennai port (Tamil Nadu), 45 kilometres from Ennore Port (Tamil Nadu) and 65 kilometres from Krishnapatnam port (Andhra Pradesh). Land acquisition in Sri City by the developers is considered a model by MOCI. The process of developer driven relief and rehabilitation was quite sophisticated. The developers were sons of the soil with rural backgrounds who had been successful in India and abroad. The person who was overseeing the acquisition activity was an ex-bureau chief of the Times of India in Hyderabad, with extensive knowledge of local, social, economic and political conditions. The following social, economic, political and administrative conditions helped in acquiring 2,700 acres of land in the first phase.

a) People in the Sri City area were largely poor and uneducated. There were no English medium schools till class X. Forty-one percent of the population had primary school education and merely 29 percent had passed high school. 68 percent of the people were marginal farmers (1.4 acres), 20 percent were small farmers (3.8 acres), five percent were medium farmers (6.5 acres), and big farmers (8.9 acres) and landlords (18.1 acres) together comprised about seven percent of the population. Non farm labour engaged about 19 percent of the population. Casual work wages and wages in towns were higher than agriculture wages in the area. Over 98 percent people did not own a refrigerator and 66 per cent did not own even a bicycle. The average annual income per household was a paltry Rs.36,000.

b) The economic condition of declining agriculture and poverty aided land acquisition. Whereas a mango garden would typically earn Rs.12,000 per acre every year, a cash compensation of Rs.490,000 per acre, deposited in a bank would yield an income of Rs.45,000 per annum. Absentee landlords of the mango orchards faced pilferage and monitoring problems. The plight of the marginal farmers who lacked storage facilities and the ability to invest in their land was much worse.

c) The presence of industry in nearby places in Tamil Nadu (Tada, Sriperumbudur, Sathyavedu, etc.) convinced the local population that industry had more to offer than land. Moreover, farm work would employ people between 90 and 120 days in a year whereas employment in industry was continuous through the year.

d) The social package offered by the Sri City developers was generous. A Sri City Human Resource Academy was set up to train people for the SEZ in advance of commercial activities. These involved activities such as plumbing, masonry, electrical work, driving, software, tailoring and embroidery. Assured jobs after training in the academy became an attractive proposition for the local people. Youth from the local area who were being trained at the academy became a resource for winning trust for the SEZ developers. Social infrastructure such as power, water, sewage facilities, schools, temple, hospital, shopping area and theater were provided for. Moreover, the habitation areas in the village were not acquired. People in these areas would benefit as the land price in this area would rise as a consequence of development in the SEZ.[7] Each family was assured one job without any recommendation and a village coordinator looked after the overall progress in relief and rehabilitation.

e) Land was purchased at prices above the market rate. Dry land that went anywhere between Rs.32,000 and Rs.72,000 per acre were purchased for Rs.250,000 per acre. One crop wet land was purchased for Rs.310,000 per acre. In addition, there was a compensation of about Rs.80,000 to Rs.100,000 for each well and Rs.6000 for each

[7] Another similar strategy of land acquisition worked well in Rajasthan where a quarter of the developed land acquired from a farmer, was given back to the farmer after it had been developed.

mango tree. The average cost per acre of land acquisition was Rs.335,000. The administrator of the district (Collector) disbursed the entire amount within a period of six months. The Andhra Pradesh Industrial Infrastructure Corporation Limited helped in acquiring land without titles.

f) Social entrepreneurship created a positive sum between the entrepreneurs and the inhabitants in the Sri City area and consent was achieved within a period of one and half years. No police action was involved. In order to ensure success, it would be important make sure that people invested their wealth for long term gains rather than short term consumption. According to some reports, 50 percent to 60 percent of the amount earned was invested in neighbouring land and the living conditions of people had improved.

<u>Positive Outlook on Land Acquisition</u>
Emboldened by successes in land acquisition such as the Sri City experience, the Commerce Secretary announced at the India Economic Summit organised by the World Economic Forum on 3 December 2007 that the 5,000 hectare cap on SEZ size may be removed when the relief and rehabilitation policy and the amendments to the LAA, 1894 have met Parliamentary approval. Such an increase in size would benefit large projects such as the 10,000 hectare site of Reliance Industries in Jhajjar (Haryana), the 8,000 hectare DLF project in Gurgaon (Haryana), and a 10,000 hectare project of Gujarat Positra Port Infrastructure Limited in near Panvel in Maharashtra where Reliance has a stake. Moreover, foreign investors like Ascendas, interested in large multi-product SEZs, would also benefit from such policy. Infrastructure like airports and ports that could aid activity in multi-product SEZs will require land in excess of 5,000 hectares. MOCI feels that, with good planning, SEZs will not consume agricultural land for two reasons. First, the total land requirement for SEZs is 0.07 percent of India's land area and a mere 0.13 percent of agricultural land. Second, if SEZ policy emphasises the development of dry land for SEZ use rather than wet land, this too will ensure complementarity rather competition between industry and agriculture.

OTHER FACTORS AFFECTING SEZ INVESTMENT

Synergies between Investor and State Government

Investment is a relationship based on trust and the mutual fulfillment of interests. Investment-friendly states realise that as they succeed in attracting more and better quality investments, they can also demand a higher price from investors. For example, the government of Tamil Nadu may have worked very hard to attract the Ford Motor Company but once Ford had set up its plant and infrastructure, it might have been easier to attract Hyundai. The same could be said about Nokia's investment in Tamil Nadu. Once Nokia had made a success of the hardware SEZ in Sriperumbudur, Flextronics, Ericsson, Dell, Motorola, Foxconn, et al, may have been easier to convince.

<u>Attracting the Blue Whale</u>
An investment-friendly state government like Tamil Nadu or Andhra Pradesh goes all out to convince an iconic investor (the blue whale) like Nokia or Foxconn, with the knowledge that if they can pass a tough investment review process with the big ticket investors, it will become easy to attract more players. Big investors conduct a serious investment review process and the state government has to satisfy the investor with infrastructure facilities such as roads, ports, airports, railways, power, water, sanitation, and high quality of human

resource. The review process involves two or three independent consultant evaluations. Only when the big investor gets concurrence from all the consultants does it bet on a new location. Investors attract the attention of a state depending on the size of commercial operations, brand name, the magnitude of investment and employment potential, and the ability of the investor to contribute to the commercial ecology of the neighborhood. It is imperative for the investor to realise its attractiveness potential in terms of whether or not it is being perceived as an iconic investor or the "blue whale".

Building Personal Trust

States have investment promotion officers who go beyond the call of duty to earn investor goodwill. There are fascinating accounts of how governments helped arrange international schools for the children of key officials of an investing firm, and, how officers belonging to investing firms who forgot their passports and travel documents were secured by government officials at times well beyond office hours.

Sectoral Compatibility

Andhra Pradesh's textile policy yielded good results in being able to attract investors such as Brandix Apparel and MAS Holdings – Sri Lankan companies in the high end lingerie market in the West, which service brands such as Victoria's Secrets. Textiles have traditionally been the strength of the Tirupur area in Tamil Nadu. Andhra Pradesh realised that the cotton growing region within the state did not enjoy any value addition from manufacturing. This was remedied by the Government's Textile and Apparel Promotion Policy, 2005 - 2010. The end of Multi-Fiber Agreement quotas on 31 December 2004 and the initiation of multilateral trade in textiles under the governance of World Trade Organization was viewed as an opportunity. The aim was to employ 1.5 million people, mostly women and the literate unemployed in the handloom, textile and apparel sectors and raise exports from US$0.08 billion to US$5 billion. Andhra Pradesh competed with states like Gujarat, Tamil Nadu and Punjab to make it an attractive investment destination.

The government of Andhra Pradesh provided a number of incentives within in its explicit policy statements in order to attract investments. The policy encouraged investors to work with consultants such as Infrastructure Leasing and Financial Services Limited (IL&FS) by providing special incentives for this purpose. Water and power were made accessible at cheaper rates compared with neighboring Tamil Nadu. Power in Andhra Pradesh was available at Rs.2.75 per unit when the same was priced at Rs.6 per unit in neighboring Tamil Nadu. Units were exempt from zoning regulations, which had involved the administrative costs of converting agricultural zones into industrial ones. There was 100 percent reimbursement for stamp duty on land procured for setting up textile units. Textile and Apparel Parks were treated as public utility services under the Essential Services Maintenance Act for ensuring labor discipline and productivity. There were special incentives for projects employing greater than 2,500 people with an investment higher than Rs.1 billion. There were special exemptions from corporate tax and urban land ceiling regulations for textile SEZs. There was to be a one time grant of Rs.1000 per worker for spinning units, and garmenting and weaving units enjoyed an incentive of Rs.5,000 per worker for costs incurred towards training workers. Easy clearances on regulatory matters such as pollution, water, and electricity were made available via a single window located within the state government. Provision was made for health care, fire station, bank, police station, and other human and social infrastructure that could be made available via a special purpose vehicle.

The incentives given in the Textile and Apparel Policy (2005-2010) of the government of Andhra Pradesh made it possible for the state to attract investments that could well have gone to some other state. The actual package of benefits enjoyed by Brandix and MAS Holdings revealed that once a state has a pro-active policy; it is willing to show flexibility beyond the policy stipulation, in order to compete with other states. IL&FS as consultants played the critical consulting role. Investors should be looking for such policy announcements in order to judge whether they will be adequately wooed by a state in a particular sector.

States within the Indian union have competing and complementary interests in different sectors. Investors need to know which states are promoting a particular sector. For example, Andhra Pradesh could be competing with Gujarat, Tamil Nadu and Punjab in textiles. It could be competing with Gujarat for attracting petrochemical and oil refining investments. If Andhra Pradesh is a relatively new habitat for textiles and petrochemicals investments, it might work harder to wean investors to the state in these sectors.

Anchor Tenant in a Multi-Product SEZ

An anchor tenant is a large commercial unit within a multi-product SEZ, which assures the economic viability of the SEZ from the early stages of its inception. The Kakinada SEZ is a large multi-product SEZ with port facilities. This SEZ is being developed by attracting an anchor tenant – the Oil and Natural Gas Commission Limited (ONGC), which is a profitable Indian public sector company and one of Asia’s leading companies in oil and gas exploration and production. ONGC holds 46 percent of the shares in Kakinada SEZ Private Limited, which is a special purpose vehicle. Fifty-one percent of the shares are held privately, and the remaining three percent are held by the government of Andhra Pradesh. ONGC’s investment of Rs.220 billion in a refinery that would utilise 30 percent to 40 percent of SEZ land will help the SEZ become commercially viable in the long run. This unit will also help attract other commercial units to the SEZ. This is a business model that involves a large commercially viable public sector entity plus government holding up to 49 percent of the shares, with the remaining 51 percent rest with private players.

Centre-State Issues

There are matters that state governments need to resolve with the central government in order to promote investments. Cordial relations between the ruling party in the centre and the party governing a particular state is always helpful. For example, Andhra Pradesh SEZ investments would benefit by better rail and air connectivity between Vishakapatnam and Hyderabad, matters that need central government clearance. Differences between the ruling Congress Party in the state of Maharashtra and the Nationalist Congress Party’s Civil Aviation Minister Praful Patel in the central government could have led to delays in the US$600 million Boeing investment in the Muti-modal International Hub Airport in Nagpur. The Maharashtra Airport Development Corporation was concerned that it did not enjoy the support of the Airports Authority of India regulated by the central government. This facility was being created to service aircrafts in India. It helps if the central Minister has a special interest in the affairs of a state or belongs to the party ruling in a state. The fact that Tamil Nadu’s ruling DMK party has a Minister of Surface Transport in the united Progressive Alliance coalition government in the centre helps the state construct roads to service its investors.

Investor's Political Leanings

It helps if investors refrain from supporting political parties in a partisan way. The approaches of India's two leading entrepreneurs – Mukesh and Anil Ambani – are a study in contrast. Mukesh Ambani did not join any political party and established cordial relations with the ruling Congress Party after it came to power in 2004. This contributed to the approval of his Navi Mumbai SEZ in Maharashtra in October 2007.

His brother Anil Ambani of the Anil Dhirubhai Ambani Group, on the other hand, became a member of parliament with the support of the ruling Samajwadi Party in Uttar Pradesh (UP) in 2004. As long as the Samajwadi Party was in power in UP, his SEZ project in Noida (UP) was being supported by the Mulayam Singh Yadav government. The defeat of the Samajwadi Party and the victory of the Bahujan Samaj Party in May 2007 meant that this project now met with vehement opposition from Chief Minister Mayavati. The SEZ project was turned down by the Mayavati government on the grounds that land for the 2,500 acre SEZ project had not been acquired in an appropriate manner. Investors need to be aware that governments lose power quite frequently in India and an investor must project itself as being not so close to one government so as to be viewed as an adversary by another government.

Demand for Civil Servants in Private Sector SEZ Jobs

SEZs have created a demand for civil servants in the private sector because of regulatory uncertainties. The single window clearance on regulatory issues is not working as envisaged in the SEZ Act (2005). This window was supposed to be housed within the Office of the Development Commissioner – an official of the MOCI. Most regulatory areas are within the jurisdiction of state governments and even investment promoting states like Tamil Nadu, Andhra Pradesh, Maharashtra and Gujarat are facilitating regulatory clearance within their state-level industrial guidance bureaus rather than by ceding regulatory powers to the Office of the Development Commissioner of an SEZ. This has resulted in a situation where private sector SEZ developers are recruiting middle to senior level government servants with attractive pay packages, so that they can help the investor sort out regulatory issues. Regulatory clearances require an understanding of the way the government works at the centre and state levels, and contacts within the government.

IN SUM

Challenges for Indian SEZs

This paper has described the challenges faced by those interested in investing in India's SEZs:

<u>Regulation of Land</u>
The manner in which land acquisition was regulated by the government (Land Acquisition Act of 1894) created complex problems when the government used the same provision to acquire land for creating profitable public-private partnerships geared towards export oriented manufacturing. Could the government invoke public purpose to acquire land for SEZs in the same manner as it had in earlier times for acquiring land for public utilities like roads, dams and public sector industrial units? The SEZ Act (2005) was silent on this issue.

Single Window Clearance

The SEZ Act tried wresting regulatory powers with an official of the central government's MOCI, the Development Commissioner. These powers such as regulatory clearances for land, labour, power, water and pollution constitutionally belonged largely with the concerned state government. The Central Act could only persuade the states to wrest these powers with the centre in the interests of speedy investment in the state. This paper demonstrates that even the most investment-friendly states were unwilling to give up their regulatory powers and cede them to the central government.

Overcoming the Challenges

Tax Benefits

Foreign direct investment occurred in Indian SEZs and in new areas such as hardware, textiles, and shoes, because of the combination of tax benefits provided for in the SEZ Act (2005) along with the pro-active approach of states like Tamil Nadu and Andhra Pradesh. SEZ benefits along with a new textile policy brought foreign investment in high-end apparel to Andhra Pradesh that did not exist before. MOCI was able to resist pressures from the Ministry of Finance to reduce the tax concession. The success of Indian SEZs rendered the tax concession argument arguments made by MOCI quite compelling.

Local Level Solutions to Land Acquisition

The problem of land acquisition could be solved locally in many places by winning the consent of the people. Even though there is no clear legislation around what would constitute fair and equitable acquisition, MOCI stressed three things when matters came to a head after the violence in Nandigram:

a) The MOCI stressed the need to obtain 100 percent consent of the people living in the local area. This meant that the relief and rehabilitation package would have to be generous, if private players were to use the benefits accorded by the SEZ Act and the State governments. The Sri City success story described above reveals how consensual land acquisition was possible in the context of a generous relief package coupled with social entrepreneurship. However, some state governments are of the view that they should be actively involved with creating the consent and acquiring land as this work will not be easy for investors.

b) Emphasis was laid on utilising dry or non agricultural land. This meant that industrialisation was likely to increase living standards in areas where agriculture was inhibited by poor climatic and soil conditions.

c) Displacement of people was to be kept to the minimum level.

State Government-Investor Synergies

Investment was aided by the pro-active nature of certain states willing to push export oriented investments in certain sectors rather than the success of the single window clearance in the Development Commissioner's office. Industrial bureaus of states governments brought out good investment packages in conjunction with SEZ benefits. This helped them attract big investors to their states. They worked hard to woo good investments, with the hope that if one major player gets convinced, it will be easy to convince others. States like Tamil Nadu and Andhra Pradesh succeeded in attracting investors who would have otherwise found a place in countries like China, Vietnam and Malaysia.

Investor Strategies

Given the aforementioned parameters affecting the success of SEZ investments in India, a typical investor needed to be concerned about the following issues:

a) The investor needed to understand its attractiveness given the needs of a particular state government in India. A state with high profile investments will yield fewer benefits than one, which is still trying to win big investors to the state.

b) Land acquisition must be preceded by a generous rehabilitation package. The people of the area must be convinced that what they are getting in return for giving up their agricultural land and traditional livelihoods will improve their economic and social conditions.

c) Investors should avoid becoming part of partisan politics in the state.

d) Large SEZs could gain by getting the government and some anchor investor involved in the equity of the special purpose vehicle running the SEZ, as in the case of the Kakinada SEZ described above. This helps build stakes between the government, the developer, and commercial units within the SEZ.

e) Local governments will be able to serve investors better in areas such as roads, ports, airports and railways – if the state and the central governments are working together rather than in opposition to each other's interest in a particular state.

Reasons for Optimism

Regulatory bottlenecks notwithstanding, there are reasons for optimism that Indian SEZs are poised for consolidation and growth. India has been able to attract foreign investment in areas such as hardware, shoes and apparel manufacturing, which would have earlier gone to other Asian countries. This constitutes the real success of India's SEZ policy. Investors need to figure out the niceties of the Indian investment climate and if perceived as being attractive, the concerned state governments in India will go a long way to remove the regulatory obstacles to investment.

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