REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR ENDED 31 MARCH 1988

No. 16 of 1989

UNION GOVERNMENT (CIVIL)

MINISTRY OF COMMERCE

EXPORT PROCESSING ZONES

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Prefatory Remarks

This Report of the Comptroller and Auditor General of India containing a review on the 'Export Processing Zones' has been prepared for submission to the President under Article 151 of the Constitution of India.

The findings contained in the review are those which came to the notice in the course of test audit.

Overview

This Audit Report contains a review on the "Export Processing Zones" in the country. Kandla (Gujarat) and Santacruz, Bombay (Maharashtra) zones were established in 1965 and 1972 respectively. The other four zones at Cochin (Kerala), Falta (West Bengal), Madras (Tamil Nadu) and Noida (Uttar Pradesh) were established in 1984. The export processing zones are intended to provide an internationally competitive duty-free environment for export production at low costs so that exporting firms can operate successfully in the international market. The significant Audit findings as a result of test check of records are summarised below:

Despite the numerous incentives and concessions given by the Central Government, State Governments' and other agencies, the number of units actually established fell far short of the number of approvals accorded. Even in the established zones of Kandla and Santacruz, seven plots and 32 sheds remained unallotted. In Madras and Noida zones, 77 plots and 45 sheds were not allotted.

Out of the established units in the Kandla zone, the mortality rate of units upto March 1982 and March 1988 was 30.2 and 25.4 *per cent* respectively. In the Santacruz zone, the mortality rate was 17.4 *per cent* for the period ending March 1982 which increased to 23.7 *per cent* by March 1988.

In real value terms, reckoned with reference to the value of the rupee computed with 1960 as the base year, exports from the Kandla zone declined by 13.4 *per cent* and increased by 35 *per cent* from the Santacruz zone.

Contribution from the export processing zones to total exports from the country ranged from 2 to 2.97 *per cent* during 1982-83 to 1987-88.

The net outflow of foreign exchange in hard currency from the Kandla zone during 1981-82 to 1987-88 was Rs.597.48 crores. During the same period, there was a nominal net inflow of foreign exchange in hard currency amounting to Rs. 9.56 crores in the Santacruz zone. Though the imports were mainly from countries in the General Currency Area, exports from Madras, Cochin and Falta zones were mainly to countries in the Rupee Payment Area.

During 1987-88, nine *per cent* of the working units in Kandla and Santacruz zones contributed 58 and 63 *per cent* respectively of total exports from these two zones.

The prescribed net export earnings were not achieved by 27 and 72 *per cent* of the exporting units in Kandla and Santacruz zones respectively during 1986-87. Out of the 41 units functioning for more than five years in the Santacruz zone, 31 units had not achieved the projected exports. In a few cases, the shortfall exceeded 80 *per cent.*

The prescribed value addition of 50 *per cent*, on an average, for the Santacruz zone as a whole was not achieved in any year.

There was a shortfall in the achievement of annual export targets in the Kandla zone during 1983-84 to 1987-88 except in 1984-85. The targets were not achieved during 1984-86 and 1987-88 in the Santacruz zone. None of the new zones had been able to achieve the annual export targets fixed by the Ministry.

Inadmissible duty exemption on finished goods imported by units in Kandla, Madras and Noida zones resulted in loss of revenue of Rs. 36.81 crores.

Duty amounting to Rs. 1.47 crores on unutilised imports had not been recovered from units in Kandla and Santacruz zones.

Outstanding dues on account of lease rent etc. from the units in all the zones amounted to Rs. 2.44 crores.

Substandard/rejected goods including computer accessories and peripherals valued at Rs.1.93 crores with the units in the Santacruz zone had not been disposed of.

MINISTRY OF COMMERCE

Export Processing Zones

1. Introduction

1.1 The basic concept of setting up Export Processing Zones (Zones) was to provide an internationally competitive duty free environment for export production at low costs so that exporting firms may operate successfully in the international market. The objectives to be achieved through these zones included

- increase in foreign exchange earnings;
- development of export oriented industries;
- stimulation of domestic and foreign investments; and
- creation of employment opportunities.

1.2 The first multi-product 100 per cent export processing free trade zone was established at Kandla (Gujarat) in 1965 with the three-fold objectives of export promotion, industrialisation of the underdeveloped area of Kutch and development of the Kandla port as a future alternative to the increasingly congested port of Bombay. The second export processing zone known as the Santacruz Electronics Export Processing Zone, Bombay, was approved in 1972 and commenced operation in September 1974. A building to house a gem and jewellery export complex within the premises of the Santacruz zone was added in 1987. A Committee was set up in 1981 to study the working of Santacruz and Kandla zones and to suggest, inter-alia, measures for export production. The Committee recommended establishing four to five more zones keeping in view proximity to a seaport and airport and availability of industrial and community infrastructures. In pursuance of these recommendations, an inter-Ministerial group identified seven locations against which four multi-product export processing zones were established in 1984 at Noida (Uttar Pradesh), Falta (West Bengal), Cochin (Kerala) and Madras(Tamil Nadu).

2. Organisational set up

The six zones are under the control of the Ministry of Commerce which provides funds for meeting the expenditure on administrative and infrastructural facilities within the zone. For each zone, there is a high level policy making body, known as the Authority for the zone, to review the working of the zone, to give directions, to take decisions on additional fiscal and other concessions needed to attract the right type of entrepreneurs for the industrial growth of the zone and to review the other policy issues relating to the zone. The Authority for each zone is headed by the Secretary, Ministry of Commerce and comprises representatives of various Central Government departments as well as of the State Governments concerned. A Board constituted separately for each zone and headed by an Additional Secretary, Ministry of Commerce accords single point clearance for all proposals for setting up new industrial units in the zone, including projects requiring clearance from monopolies and restrictive trade practices or foreign exchange regulation angles. While approving the proposals, the Board also lays down, in each case, the target, direction and value addition to be achieved in regard to exports. The administration of the zone is headed by a Development Commissioner. The Customs Department acts in close liaison with the Development Commissioner of the respective zone for providing bond facilities and for ensuring that goods imported duty-free are utilised in the production of goods for export.

3. Scope of Audit

The records relating to various activities undertaken in the zones towards promotion of exports were test checked in the Ministry as well as in the zones.

A draft review covering the Audit findings in respect of customs revenue aspects was furnished to the Ministry of Finance in September 1988 and its comments were received in March 1989. A draft review relating to the other activities undertaken in the zones towards promotion of exports was furnished, in November 1988, to the Ministry of Commerce who had not furnished any comments (June 1989).

This review covers the activities undertaken including the administration of duty-free imports of capital goods and raw materials in the zones. A detailed analysis was done for the period 1981-82 to 1987-88. The reply of Ministry of Finance has been taken into account.

4. Incentives and concessions to the units

Apart from providing the basic infrastructural facilities, the units established in the zones are given a number of fiscal and non-fiscal package of incentives and concessions. The more important of these are duty-free import of capital goods, raw materials and consumable spares under open general licence, exemption from central excise, grant of deemed export benefits to supplies of capital goods and raw materials made from the Domestic Tariff Area (DTA), from within the country but outside the zone, term finance at concessional rates of interest for acquiring fixed assets, reimbursement of central sales tax and corporate tax holiday for a period of five years in a block of eight years. Additionally, the State Governments of Gujarat, Maharashtra, Kerala, Tamil Nadu, Uttar Pradesh and West Bengal have extended concessions such as capital investment subsidies, exemption from local taxes, concessional power tariff etc. The non-fiscal benefits, include

(a) permission to repatriate foreign capital invested without capital appreciation in value of investments;

(b) facility for remittance of profits and dividends earned by foreign investors after payment of taxes; and

(c) facility for sale of 25 per cent of annual production in the DTA on payment of leviable duties against valid import licences.

5. Financial outlay

A total expenditure of Rs.9485.19 lakhs was incurred on the establishment of the six export processing zones till the end of March 1988 as per details given below:-

(in lakhs of rupees)

Name of the zone	Capital expenditure	Revenue expenditure	Total expenditure upto March 1989
Kandla	1196.83	361.52	1558.35
Santacruz	1727.80	722.80	2450.60
Falta	1402.37	53.24	1455.61
Madras	1291.35	87.01	1378.36
Cochin	1210.29	47.35	1257.64
Noida	1309.99	74.64	1384.63
Total	8138.63	1346.56	9485.19

6. Establishment of units

The norms broadly adopted by the Board in selecting a unit to be established in the zones are:

- economic viability;
- value added content;
- manufacturing operation involved and volume of turnover;
- marketing arrangements; and
- experience and financial background of the promoter.

The table below gives the approvals accorded and units working in the six export processing zones at the end of March 1988:-

Name of the zone	Approvals accorded	Withdrawn or cancelled after approval	Units established	Units closed down	Units working
Kandla	679	81during 1982-87	173	44	129
Santacruz	227	128	97	23	74
Falta	41	Not available	2	-	2
Madras	124	37	23	-	23
Cochin	29	2	3	-	3
Noida	73	16	15	-	15

The number of units actually established fell far short of the number of approvals accorded. A test check of records relating to 101 withdrawn/cancelled cases in Kandla and Santacruz zones revealed that in 84 cases, the entrepreneurs did not take positive steps towards establishment of the units. Further, in 17 cases, cancellation/ withdrawal was due to lack of interest on the part of collaborators, non-viability of projects, foreign exchange problems etc.

The number of units established and number of units closed down in Kandla and Santacruz zones is given in the table below:-

	No. of units established	No.of units closed down	Percentage of closed units to units established
Kandla			
March 1982	96	29	30.2
March 1985	150	41	27.3
March 1988	173	44	25.4
Santacruz			
March 1982	46	8	17.4
March 1985	72	18	25.0
March 1988	97	23	23.7

In the Kandla zone, the mortality rate of units upto March 1982 and March 1988 was 30.2 and 25.4 *per cent* respectively. In the Santacruz zone, the mortality rate was 17.4 *per cent* for the period upto March 1982 which increased to 23.7 *per cent* upto March 1988.

A test check of 21 closed units in the Santacruz zone revealed that five units were closed within two years and the remaining 16 units between two and six years of commencement of production. The reasons for closure of these units were attributed to difficulties in marketing the products and withdrawal of support by foreign collaborators. In 11 cases in the Kandla zone, the units closed down due to one or more reasons like financial and managerial problems, want of export orders, dispute among partners, labour problems and institution of custom cases.

At the end of 1987-88, the working units represented only 19 and 33 *per cent* respectively of the units approved for establishment in Kandla and Santacruz zones since inception. Thus, despite numerous incentives and concessions, a substantial number of units for which approvals were accorded could not be set up.

The Indian Council for Research on International Economic Relations was asked by the Ministry to undertake an evaluation of the Export Processing Zones in the country and make suitable recommendations to improve their performance. The terms of reference included detailed social cost benefit analysis of the Kandla and Santacruz zones, comparison of incentives available in the zones with those available in other Asian countries, analysis of the implications extending to five year tax holiday, evaluation of value-addition and single window clearance scheme and measures for improving marketing of products. The Council submitted their report in June 1986. A gist of their recommendations is given in Annexure-I. Action taken by the Ministry on the recommendations contained in the report, submitted in June 1986, was not intimated to Audit (June 1989).

7. **Delay in setting up of approved units**

The letter of approval issued by the Ministry, after clearance by the Board, for setting up a unit is valid for one year from the date of its issue within which commercial production has to commence. The approval lapses if an application for extension is not made before the expiry of the validity period.

As on 31st December 1987, there were 11 units in Kandla, 12 units in Santacruz and 17 units in Noida zones which had not started production within one year of the letter of approval. The delays were attributed to lack of interest on the part of entrepreneurs (six cases), alleged difficulties with collaborators and marketing arrangements (nine cases), delays in arranging finance (six cases) and power (seven cases), problems in arranging plant/equipment from foreign countries (five cases) and non-completion of factory buildings and other infrastructural facilities (seven cases).

For the four new zones, the Ministry had prepared an action plan for 1987-88 envisaging 15 units each to be established in Madras and Noida zones and seven and five units each in Falta and Cochin zones respecticvely. In Falta, two units and in Cochin three units were only functioning by March 1988. In Madras and Noida zones, 23 and 15 units respectively were established. The Ministry stated in April 1988 that non-achievement of targets was due to setting up of the Falta zone in a relatively backward rural area remote from the metropolis and in the case of the Cochin zone, it was due to delay in obtaining loans from financial institutions.

The decision to locate the export processing zone at Falta was taken by Government, in September 1983, with a view to developing the backward area of Falta and promoting the exports from that region. The reply of the Ministry seems to belittle the basis of selection of the export processing zones as initially conceived and indicates lack of adequate planning.

8. **Export performance of units**

The export performance of the units in Kandla and Santacruz zones during 1983-84 to 1987-88 was as under:-

Value of exports	1983-84		1984-85		1985-86		1986-87		1987-88	
	Kandla	Santacruz	Kandla	Santacruz	Kandla	Santacruz	Kandla	Santacruz	Kandla	Santacruz
No. of units with exports less than Rs. 0.5 crore	48	20	43	25	37	31	30	29	37	32
No. of units with exports between Rs. 0.5 crore and Rs. one crore	10	8	8	10	9	10	17	9	10	9
No. of units with exports between Rs. one crore and Rs. 5 crore	16	7	22	8	23	8	17	13	26	14
No. of units with exports above Rs. 5 crores	4	5	16	5	15	6	17	7	11	7

In Kandla and Santacruz zones, nine per cent of the working units accounted for a major portion of exports and a large number of units in both the zones contributed very little towards earning foreign exchange.

In the Kandla zone, during 1986-87, 17 units accounted for 74 *per cent* of total exports and 13 units did not undertake any exports. During 1987-88, 11 units contributed 57.78 *per cent* of total exports and 37 units contributed only 3.65 *per cent*. In the case of 35 units, there was a declining trend in exports during 1985-86 to 1987-88. The prescribed increase in export earnings was not achieved by 22 units constituting 27 *per cent* of the exporting units in the zone during 1986-87.

In the Santacruz zone, during 1986-87, seven units accounted for 65 *per cent* of total exports and 10 units did not undertake any exports. During 1987-88, seven units contributed 63 *per cent* of total exports and 32 units contributed only 4.5 *per cent*. During that year, 22 units exported less than 50 *per cent* of the peak value of exports achieved by them in the earlier years. The prescribed increase in the export earnings was also not achieved by 42 units constituting 72 *per cent* of the exporting units.

In the Santacruz zone, in 13 units there was a net outflow of foreign exchange of Rs. 1.43 crores upto 1986-87. In addition, there was also a net outflow of foreign exchange for Rs. 1.88 crores in 12 other units which had closed down. Four units in the Santacruz zone were performing only sub-contract work even though they were allowed to be set up for the manufacture and export of approved products for which they were allowed to import capital goods and raw materials worth Rs. 1.28 crores.

The terms and conditions under which approval for the unit was accorded by the Board specified the export projection for a period of five years. In the Santacruz zone, out of 41 units which had completed five years, 31 units had not achieved the projected exports. In 22 units, the shortfall exceeded 50 *per cent*. In 14 units, the shortfall was over 80 *per cent*. The reasons for not achieving the projected exports, as gathered from the records of the zone, were *inter alia*:

- non-availability of raw materials at competitive prices and stiff competition;
- technical and marketing collaboration problems;and
- equity participation withdrawn by foreign collaborators.

Similar information in respect of the Kandla zone was not available.

During 1987-88, Noida and Madras zones exported goods worth Rs.16.05 crores and Rs.16.42 crores against the targets of Rs.20 crores and Rs. 30 crores respectively. Exports of the other two zones viz. Cochin and Falta were Rs.3.94 crores and Rs.1.86 crores against the targets of Rs. 5 crores and Rs.10 crores respectively.

9. **Direction of imports and exports**

Imports and exports in the zones during 1981-82 to 1987-88 is given in Annexure II.

Exports from the zones represented 2 to 2.97 per cent of total exports from the country during 1982-83 to 1987-88.

During 1981-82 to 1987-88, the total imports from the General Currency Area in respect of the Kandla zone exceeded exports by Rs. 597.48 crores resulting in a net outflow of hard currency to that extent. While imports from the General Currency Area increased from Rs. 34.02 crores to Rs. 150.22 crores during 1981-82 to 1986-87, exports to the General Currency Area increased from Rs. 11.38 crores to Rs. 23.21 crores. The exports to the Rupee Payment Area increased subtantially from Rs.58.66 crores to Rs.213.06 crores during the same period. In terms of percentage, the exports to the General Currency Area from the Kandla zone declined from 16 in 1981-82 to 10 in 1986-87 of total exports.

In the Santacruz zone, during 1981-82 to 1987-88, excess of exports to the General Currency Area over imports was only Rs. 9.56 crores representing a net inflow of foreign exchange in hard currency. The decline in exports was from 90 to 80 per cent during 1981-82 to 1986-87.

Exports from Madras, Cochin and Falta zones during 1985-86 to 1987-88 were also mainly to the Rupee Payment Area though the imports were mainly from countries in the General Currency Area.

10. Export targets and achievements

The annual targets for exports fixed by the Ministry and achievements in the two zones during 1982-83 to 1987-88 were as under:

(in crores of rupees)

Name of the zone		1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
Kandla	Target	100.00	150.00	150.00	300.00	250.00	300.00
	Achievement	142.43	107.35	237.08	236.86	236.27	185.03
Santacruz	Target	35.00	70.00	110.00	110.00	100.00	120.00
	Achievement	54.37	88.62	95.83	84.49	102.36	110.17

There was shortfall in the achievement of annual export targets in Kandla zone during 1983-84 to 1987-88 except in 1984-85. Exports remained static during 1985-86 and 1986-87 and declined sharply during 1987-88. The Kandla zone Administration stated, in April 1988, that the withdrawal of orders for certain items from a particular country in the Rupee Payment Area was the reason for the decrease in the exports performance during 1983-84. Higher export earnings during 1984-85 to 1986-87, as compared to 1983-84, was stated to be artificial as a result of large scale export of various types of products of developed country origin to a particular country in the Rupee Payment Area after undertaking only minor processing operations in the zone.

In the Santacruz zone, the annual export targets were not achieved during 1984-85,1985-86 and 1987-88.

The value of rupee, with reference to 1960 as the base year, was reported to have declined from 19.92 paise in 1982-83 to 13.28 paise in 1987-88. At current prices, though the exports from Kandla and Santacruz zones increased by 29.9 and 102.6 *per cent* respectively during 1982-83 to 1987-88, in real value terms, reckoned with reference to the value of rupee computed with 1960 a he base year, the exports (Rs. 123.35 crores) declined by 13.4 *per cent* from the Kandla zone and increased (Rs. 73.45 crores) by 35 *per cent* only from the Santacruz zone during the same period.

Though it was envisaged by the Ministry that the Santacruz zone would export Rs. 50 crores of electronic items per year at the optimum level of operation expected to be reached in 1976-77, the export level of Rs. 50 crores could be reached only in 1982- 83.

The figures of exports from the Santacruz zone as well as of total exports from India of electronic items from 1981 to 1987 were as under:

Year	Total exports including Santacruz zone exports (Rs. in crores)	Exports from Santacruz zone (Rs. in crores)	Percentage of exports to total exports
1981	56.40	25.50	45
1982	83.90	48.30	58
1983	114.50	75.00	66
1984	155.00	103.50	67
1985	154.50	85.00	55
1986	240.00	100.50	42
1987	312.00	109.70	35

The contribution of the Santacruz zone to total exports increased from 45 *per cent* in 1981 to 67 *per cent* in 1984 but declined to 35 *per cent* in 1987. While the total exports almost doubled during 1984 to 1987, exports from the Santacruz zone remained more or less static. Despite the facilities and concessions extended to the units in the zone, the rate of growth of exports of units within the zone lagged far behind compared to the rate of growth of export of units outside the zone.

None of the new zones had been able to achieve the export targets fixed by the Ministry.

In the Santacruz zone, while exports to USA/Canada, during 1983-84 to 1985-86 increased from Rs. 31.02 crores to Rs. 32.11 crores, earnings in terms of US dollars decreased from 3 crores to 2.62 crores reckoned with reference to the average US dollar rate for the respective years as published in the Economic Survey of India 1988-89.

11. Value added content of exports

Value addition achieved by an export processing zone is the net inflow of foreign exchange earned for the country as a result of export and import business carried out during a particular period of time. The Santacruz zone was expected to ensure a value addition of 50 *per cent*, on an average, on its exports. The performance of the zone during the last five years, however, revealed that the value added content which was 36 *per cent* in 1982-83 declined to 31 *per cent* in 1986-87 as per details given below:-

Cumulative (in crores of rupees)

	1982-83	1983-84	1984-85	1985-86	1986-87
Total outflow	86.42	150.21	222.83	274.35	342.71
Total inflow	132.26	223.05	324.15	399.06	501.41
Net inflow	45.84	72.84	101.32	124.71	158.70
Exports	127.93	216.56	312.39	396.88	499.24
Percentage of value added	36	34	31	31	31

The Santacruz zone Administration stated, in May 1987, that the achievement could be considered reasonable considering the fact that the units in the zone faced keen competition in the international market and profit margin in electronic goods was low. The reply of the Administration is indicative of inadequacy in performance and reveals failure to monitor and to take measures to counteract the situation so as to achieve the objectives of the scheme.

Information on value added in respect of the Kandla zone was not available.

12. Employment generated

The number of operating units and employment generated during 1982-83 to 1987-88 in the two zones was as under:

Year	Kandla zone No. of working units	Kandla zone No. of employees	Santacruz zone No. of working units	Santacruz zone No.of employees
1982-83	84	6200	45	3500
1983-84	98	7000	51	6000
1984-85	109	7600	54	7500
1985-86	114	8510	59	7500
1986-87	122	8500	70	7500
1987-88	129	8250	74	8100

Employment figures declined in the Kandla zone during 1986-87 and 1987-88 despite the increase in the number of working units. In the Santacruz zone also, employment figures were stagnant during 1984-85 to 1986-87. The clarification by the Santacruz zone Administration was that though the number of units had increased, the employment had been low in the initial stages of setting up of operations by the new units. Further, certain units had also closed down during the same period.

13. Inadmissible concessions

13.1 Loss of revenue due to irregular grant of duty exemption to the units:- (i) A unit in the Madras zone was granted a letter of approval in May 1985 for the manufacture and export of sewing machine motors, knitting machines and sewing machine needles. The total value of imports and exports made by the unit upto 31st January 1987 amounted to Rs.6.69 crores and Rs.3.33 crores respectively. The unit imported finished goods in a semi-knocked down condition and exported the same with negligible value addition against the expected value addition of 54.92 *per cent*. Thus, due to non-achievement of the prescribed value addition, duty exemption amounting to Rs. 11.15 crores became inadmissible to the unit.

The Ministry of Finance stated in March 1989 that goods had not been cleared for home consumption but were exported out of India. The reply is not relevant to the issue.

(ii) Another unit in the Madras zone imported capital goods of value Rs. 9667.00. It also imported complete pharmaceutical machinery valued at Rs. 6.27 crores but declaring the same as raw materials. It also procured indigenous machinery worth Rs. 1.54 crores. Exports made between July 1986 and March 1988 were to the extent of Rs. 10.74 crores. As export consignments were despatched within a short span of time ranging from one day to two months after the dates of imports without undertaking any manufacturing activity, the duty exemption allowed on the import of finished goods to the extent of Rs. 9.04 crores was irregular.

The Ministry of Finance admitted in March 1989 that the manufacturing process was not to the extent envisaged. The matter requires further probe by the Ministry for suitable action.

(iii) Three units in the Kandla zone imported finished goods valued at Rs. 7.36 crores during 1982-83 to 1984-85 without payment of duty and re-exported the same.

The Ministry of Finance stated that bulk import had been permitted by the Zone Board and goods were re-exported after testing, labelling, packing etc.

The reply implies that no manufacturing activity had been carried out in these cases. Duty amounting to Rs. 14.73 crores was recoverable on the import of finished goods.

(iv) A unit in the Noida zone imported 20,000 pairs of footwear (complete) without payment of duty from a country in the General Currency Area by treating these as components of raw materials. The same were re-exported to countries in the Rupee Payment Area, after a few days, without carrying out any manufacturing activity, involving customs duty of Rs. 25.60 lakhs which was recoverable from the unit.

In another unit of the same importer two consignments of disc-drives (870 sets) were imported, duty-free, from the General Currency Area. These were received as 'raw materials' on 18th February 1987 and 25th March 1987 and were re-exported on 19th Feburay 1987 and 27th March 1987 respectively to a Rupee Payment Area. The duty payable on the import of 870 sets of disc-drives was Rs. 1.63 crores.

In both the cases, there was no evidence to show installation of plant and machinery in the units, before or during import/ export of these goods or use of any other imported or indigenous input for carrying out any manufacturing process.

The Ministry of Finance stated in March 1989 that import of footwear and disc-drives were allowed in the interest of export promotion. The Ministry's reply does concede the fact that there was no manufacturing activity and the grant of exemption from duty was inadmissible. In the light of the situation, the position needs to be reviewed by the Ministry.

13.2 Non-Recovery of duty on finished goods diverted to Domestic Tariff Area:- (i) A unit in the Kandla zone imported various consignments of acrylic scrap, toponal etc. in 1977. However, manufactured goods were permitted to be sold by the unit to the Domestic Tariff Area. A demand for Rs. 2.74 lakhs being the differential duty between imported raw material and diverted finished goods, was raised in 1979. Further, customs duty amounting to Rs. 0.67 lakhs was also payable by the unit in respect of the imported raw material not utilised within one year of their import. Neither of the amounts had been realised (June 1988). The Ministry of Finance stated that the department was unable to recover the outstanding amount from the unit.

(ii) Two units in the Kandla zone, cleared 17.15 tonnes of castor oil cakes to the Domestic Tariff Area during May 1984 to September 1986 on payment of duty of Rs. 10.23 lakhs after misclassifying them under item 68 of the erstwhile Central Excise Tariff. The duty payable on the goods under the correct heading 23 of the Custom Tariff worked out to Rs. 109.90 lakhs. The department issued a notice of demand for the differential duty of Rs. 99.67 lakhs in September 1986. The said demand was not confirmed (August 1988) by the adjudicating authorities.

13.3 Non-Recovery of duty on unutilised imports:- (i) A unit in the Kandla zone imported 5.26 lakh pieces of zip fasteners in 1983 without payment of duty. A case of shortage of 2,41,459 pieces of fasteners and non-utilisation of the balance quantity within, one year of their import, was booked against the importer, besides confiscation of the balance zip fasteners. The unit was directed in July 1985 to pay duty of Rs. 6.24 lakhs and a personal penalty of Rs. 20 lakhs. Even after a lapse of three years, neither the duty nor the personal penalty had been recovered (June 1988).

The Ministry of Finance stated, in March 1989, that the zone Administration filed a first information report in this case with the Gandhidham Police Station on 23rd April 1987, for impersonation and forgery. It added that the matter was under investigation and steps were being taken to recover the dues. The progress of the case has to be monitored by the Ministry.

(ii) Excisable goods brought from factories situated in the Domestic Tariff Area to the units in the Kandla zone in connection with production of goods intended solely for export, are exempt from excise duty. During 1982-83, 26 units were permitted to bring cement from the Domestic Tariff Area to Kandla zone. The department issued a show cause notice demanding Rs. 13 lakhs on the ground that cement had not been used in the exportable product but for construction activity.

The Ministry of Finance stated in March 1989 that demand-cum-show cause notices were issued in all the cases where the benefit of exemption of central excise duty for cement was extended. However, of the total amount, a sum of Rs. 11.74 lakhs was time barred. Action for confirmation of duty amounting to Rs. 1.42 lakhs which was not time barred, had been taken. As regards time barred dues, it was not known whether responsibility for administrative lapses had been fixed.

(iii) As per provision of notification dated 30th November 1979, as amended, the customs authorities should take action to recover duty on imported goods (capital as well as raw materials) and also on finished goods so manufactured or packed as have not been exported. A test check by Audit revealed that capital goods, raw materials and finished goods amounting to Rs. 1.30 crores were lying with ten closed units in the Santacruz zone.

The Ministry of Finance stated, in March 1989, that Rs. 21.98 lakhs had been recovered from two of the closed units and another unit had surrendered goods worth Rs.16.23 lakhs which had been confiscated and were being put up for disposal. Further, action in respect of taking stock of inventory of unutilised goods lying in the remaining closed and sick units in Kandla and Santacruz zones was reported as having been initiated.

14. Return on capital invested by Government in Kandla and Santacruz zones

Return on capital invested from 1981-82 to 1986-87 is shown in the following table:

	(in lakhs of rupees)									
Year	Net progressive capital expenditure		Lease rent receipt during the year		Maintenance expenditure		Net receipt		Return on capital investment (*per cent*)	
	Kandla	Santa cruz	Kandla	Santa cruz	Kandla	Santa cruz	Kandla	Santa cruz	Kandla	Santa cruz
1981-82	303.86	476.00	19.40	28.79	4.99	9.12	14.41	19.67	5	4
1982-83	396.65	480.00	39.06	34.75	15.00	16.65	24.06	18.10	6	4
1983-84	421.98	480.00	21.43	47.87	13.84	20.00	7.59	27.87	2	6
1984-85	465.07	801.00	31.86	61.35	0.54	22.00	31.32	39.35	7	5
1985-86	608.27	827.00	38.58	81.54	14.70	25.00	23.88	56.54	4	7
1986-87	684.27	827.00	31.56	106.38	30.00	40.00	1.56	66.38	-	8

The return on capital invested is reckoned as a percentage of the net annual receipts earned by the zone to the net progressive capital expenditure at the end of each financial year. Return on capital invested in the Kandla zone which was five *per cent* in 1981-82 decreased to practically nil in 1986-87. The Kandla zone Administration stated, in April 1988, that the projected return on capital at the time of establishment was not readily available with them. In the case of the Santacruz zone, the return on capital investment varied from four to eight *per cent* as compared to the envisaged return of about 12 *per cent*.

In the Kandla zone, the outstanding dues to be recovered from the units on account of arrears of lease rent amounted to Rs.45.02 lakhs at the end of March 1988. In the Santacruz zone, the dues recoverable on account of lease rent, interest on lease rent, water charges etc. amounted to Rs. 138.22 lakhs at the end of March 1988. The position of overdues in respect of the four new zones was as under:

Name of the zone	Outstanding dues as in	Amount (Rs. in lakhs)
Madras	December 1987	32.78
Noida	March 1988	24.11
Falta	December 1987	2.89
Cochin	January 1988	1.00

In the Santacruz zone, the lease rent for sheds allotted in Standard Design buildings I and II, which became due for revision from July and May 1985 respectively, had not been revised (March 1988).

15. **Non-execution of lease agreements**

In the Kandla zone, out of 160 plots and 236 sheds allotted, lease agreements had not been executed in respect of 62 plots and 173 sheds. In 13 cases, lease agreements had not been renewed after the expiry of the prescribed initial period.

No lease agreements had been executed with any of the 70 units in the Madras zone and two units in the Falta zone. In Cochin and Noida zones, lease agreements had not been executed in respect of 7 and 25 units respectively (January 1988).

It was not clear to Audit as to why lease agreements had not been executed in all the cases. No action for fixing responsibility for such lapses seems to have been taken.

16. **Non-allotment of plots and sheds**

The position of allotment of plots and sheds, as prevailing in the different zones, was as under:

In the Kandla zone, out of 222 plots, seven plots could not be allotted for want of demand (March 1988).

In the Santacruz zone, 32 out of 64 sheds in Standard Design Factory (SDF) building IV and V were lying vacant since their completion in July and May 1986 respectively. In SDF buildings I and II, sheds also remained vacant for various periods ranging upto 50 months.

In the Madras zone, out of 56 sheds of SDF constructed during October and November 1987, 24 sheds were lying vacant in December 1987. 49 plots out of 87 developed upto October 1987 were also lying vacant.

In the Noida zone, out of 32 sheds and 53 plots, 11 sheds and 25 plots were in occupation till Feburary 1988, leaving a balance of 21 sheds and 28 plots yet to be allotted.

In the Falta zone, an area of 3045.98 sq.m. out of 5000 sq.m. was lying unutilised in the two industrial sheds (December 1987).

The Cochin zone did not keep any record showing, *inter alia*, the number of plots ready for allotment to entrepreneurs and details of plot-wise area, though some plots had been allotted and others were lying vacant. Construction of two factory sheds was completed in February 1987. A total area of 2170 sq.m. was unallotted.

17. **Non-finalisation of accounts of advances paid to the constructing agencies**

The construction and maintenance works in the zones were being executed by public sector undertakings as deposit works. Advances paid and adjustments thereof in different zones are indicated below:

Kandla zone

During 1981-82 to 1986-87, the zone authorities paid advances totalling Rs. 516.82 lakhs to the Gujarat Industrial Development Corporation for executing construction and maintenance work against which the expenditure incurred by the Corporation was Rs.457.91 lakhs, leaving a balance of Rs.58.91 lakhs at the end of 1986-87. The Corporation had not furnished completion reports of the works executed till April 1988. The Kandla zone Administration stated in April 1988 that these were now being obtained from the Corporation.

Santacruz zone

During July 1984 to March 1987, advances totalling Rs. 965.93 lakhs were paid to the Maharashtra Industrial Development Corporation for construction and maintenance works. The Corporation had not furnished completion reports and the advances remained unadjusted (March 1988).

Madras zone

Advances totalling Rs.1063.65 lakhs were paid to the Small Industrial Promotion Corporation of Tamil Nadu during January 1985 to March 1987 towards construction and development works. Completion reports of the works completed and actual expenditure were awaited from the Corporation (March 1988).

Noida zone

Advances totalling Rs. 847.70 lakhs were paid during December 1984 to March 1987 to the New Okhla Industrial Development Authority towards construction and development works without finalising the terms and conditions for execution of work. Even though the works were completed by June 1987, the final accounts and refund of unspent balance, if any, were awaited from the Authority (March 1988).

Cochin zone

Advances totalling Rs.555.00 lakhs were paid to the Kerala State Construction Corporation during March 1985 to September 1987 against which an expenditure of Rs.459.64 lakhs was reported upto December 1987. The final accounts in respect of the works completed had not been submitted by the Corporation (March 1988).

Falta zone

The amounts outstanding against the National Building Construction Corporation was Rs.84.52 lakhs (March 1988) and against West Bengal Industrial Infrastructure Development Corporation was Rs. 8.49 lakhs (August 1988).

18. **Other points of interest**

18.1 **Railway siding - Kandla zone**

A railway siding in the Kandla zone (cost Rs. 10.56 lakhs) connecting the zone and the Gandhidham Railway Station to facilitate imports and exports through the Kandla port was declared open in February 1969. The siding was never used by any of the units in the Kandla zone since its inception as the units considered it more economical and convenient to transport their import/export cargo by road. Strangely enough, Kandla zone assessed, in May 1985, after sixteen years, that none of the units was likely to take advantage of the siding even in the distant future mainly due to the following reasons:

(i) The siding was connected with metre-guage line which catered to only a small segment of the hinterland confined to north of Gujarat and southern western Rajasthan.

(ii) It was more convenient, dependable and economical for the units to use road transport for movement of their inward/outward cargo.

The Kandla zone Administration, accordingly, approached the Ministry for its approval for dismantling the railway siding. This was accorded in January 1986. The Kandla zone Administration stated, in October 1986, that the action to get the railway siding dismantled had been taken up with the Railway authorities. The work of dismantling the railway siding had, however, not started till May 1988.

The Kandla zone incurred an expenditure of Rs.14.98 lakhs on the maintenance of the railway siding till March 1986.

The delay in taking a decision on dismantling of the railway siding involved avoidable recurring expenditure on its maintenance.

18.2 Blocking of funds and unfruitful expenditure in the Cochin zone

The original plan of constructing a multi-storey Standard Design Factory Building, as approved by the Cochin zone Authority in February 1985, was revised by the Authority in April 1986 and it was decided to construct only factory sheds. The Kerala State Construction Corporation, which was the constructing agency for the zone, in the meantime, had procured 582.28 tonnes of steel, valued at Rs. 37.19 lakhs, during April to November 1985, which became surplus to the requirements. The surplus steel which was returned to the zone authorities by the Corporation was yet to be disposed (June 1988).

The Corporation was also paid Rs. 2.60 lakhs towards agency commission and another sum of Rs.5 lakhs towards the preparation of plans, estimates etc. for Standard Design Factory buildings which were subsequently abandoned. Thus, apart from blocking funds to the extent of Rs.37.19 lakhs, the amount of Rs. 7.60 lakhs paid to the Corporation was rendered unfruitful.

18.3 Non-levy of vegetable oil cess in the Kandla zone

Vegetable oil cess amounting to Rs. 11.87 lakhs, at Rs.5 per quintal, leviable in terms of the Vegetable Oil Cess Act 1983, was not recovered from two units in respect of the quantity manufactured by them during January 1984 to March 1987. On this being pointed out in Audit, demand notices were issued in August 1987, but recovery had not so far been effected (June 1989).

18.4 Non-fixation of input-output ratio and non-fixation of percentage of scrap in the Santacruz zone

Custom House Standing Orders of June 1978 envisage furnishing of statement relating to utilisation of imported raw materials by the units as well as determination of the input- output ratio by the technical cell of the Custom House. There was, however, no indication that the prescribed statements were being furnished by the units. The Ministry of Finance stated, in March 1989, that as the technical cell was not in existence, the input-output ratio could not be determined. Thus the customs authorities had no means of satisfying themselves about the proper utilisation and accounting of the imported raw material. Despite Standing Orders specifically stipulating determination of input-output ratio, no follow-up action for implementing the same was taken nor was the position monitored.

18.5 Delay in the disposal of sub-standard/rejected goods in the Santacruz zone

According to the Custom House Standing Orders of June 1978, rejects/substandard finished goods can be disposed of only after their (i) mutilation and reduction to scrap within the zone under customs supervision and (ii) certification by the Department of Electronics that the scrap so obtained out of mutilation is for disposal.

A test check of the reports revealed that 2.7 crore pieces of defective metal film resistors packed in 140 cartons, 19.86 lakh pieces of dipbridge rectifiers during 1983 to 1987 and 187 items of accessories relating to computers and peripherals valued at \$15,44,693 (Rs.1.93 crores) during 1984 to 1988 had not been disposed of.

The Ministry of Finance stated in March 1989 that action was now being initiated for the disposal of rejected/substandard finished goods in five units while in respect of two other units, the matter was under consideration of the Department of Electronics.

19. **Summing up**

The review reveals, *inter alia*,

- **Despite the numerous incentives and concessions given by the Central Government, State Governments and other agencies,the number of units actually established fell far short of the number of approvals accorded. Further, the number of working units in Kandla and Santacruz zones at the end of 1987-88 represented only 19 and 33 *per cent* respectively of the units approved for establishment in these zones since inception.**
- **Out of the established units in the Kandla zone, the mortality rate of units upto March 1982 and March 1988 was 30.2 and 25.4 *per cent* respectively. In the Santacruz zone, the mortality rate was 17.4 *per cent* upto March 1982 which increased to 23.7 *per cent* upto March 1988.**
- **During 1987-88, 11 units in Kandla and seven units in Santacruz contributed 58 and 63 *per cent* respectively of total exports made by these two zones. Further, 25 units in the Santacruz zone, had a net outflow of foreign exchange of Rs. 3.31 crores upto 1986-87.**
- **In Kandla and Santacruz zones, 27 and 72 *per cent* respectively of exporting units did not achieve the prescribed net export earnings during 1986-87. In the Santacruz zone, out of41 units which had completed five years, 31 units had not achieved the projected exports. In 14 units, the shortfall exceeded 80 *per cent*.**
- **The prescribed value addition of 50 per cent on an average for the Santacruz zone, as a whole, was not achieved in any year.**
- **Exports from all the zones represented 2 to 2.97 *per cent* of total exports from the country during 1982-88.**
- **The net outflow of foreign exchange in hard currency was Rs. 597.48 crores in the Kandla zone during 1981-82 to 1987-88 as imports from countries in the General Curency Area exceeded exports to these countries. During the same period, in the Santacruz zone, there was a nominal net inflow of foreign exchange in hard currency amounting to Rs. 9.56 crores. Exports to General Currency Areas from the Kandla zone declined from 16 in 1981-82 to 10 *per cent* in 1986-87 of total exports. During the same period, in the Santacruz zone, the decline was from 90 to 80 *per cent*. During 1985-88, exports from Madras, Cochin and Falta zones were mainly directed to countries in the Rupee Payment Area though imports were mainly from countries in the General Currency Area.**
- **There was a shortfall in the achievement of annual export targets in the Kandla zone during 1983-84 and 1985-88. The targets were also not achieved in the Santacruz zone during 1984-86 and 1987-88. The envisaged target of exports of Rs. 50 crores by 1976-77 from the Santacruz zone, as a whole, could be achieved only in 1982-83. None of the new zones had been able to achieve the annual export targets fixed by the Ministry.**
- **Though exports from Kandla and Santacruz zones increased, at current prices, by 29.9 and 102.6 *per cent* respectively**

during 1982-88, in real value terms, reckoned with reference to the value of the rupee computed with 1960 as the base year, exports declined by 13.4 *per cent* from the Kandla zone and increased by 35 *per cent* from the Santacruz zone.

- Employment figures declined in the Kandla zone during 1986- 87 and 1987-88 despite the increase in the number of working units. In the Santacruz zone also employment figures were stagnant during 1984-85 to 1986-87.
- Inadmissible duty exemption on finished goods imported by units in Madras, Kandla and Noida zones resulted in loss of revenue of Rs. 36.81 crores.
- Duty recoverable from three units in the Kandla zone on diversion of finished goods to the Domestic Tariff Area, non-utilisation of imported raw material and misclassification of the items amounted to Rs. 1.03 crores.
- Duty recoverable from units in Kandla and Santacruz zones on unutilised imports amounted to Rs. 1.47 crores.
- Outstanding dues on account of lease rent etc. from the units in all the zones amounted to Rs. 2.44 crores.
- In 339 cases of plots and sheds, lease agreements had not been executed by the zone authorities.
- 84 plots and 77 sheds remained unallotted in Kandla, Santacruz, Madras and Noida zones. In Falta and Cochin zones, the number of unallotted plots and sheds could not be ascertained.
- Advances amounting to Rs. 31.25 crores paid to the agencies for construction and maintenance works in six zones had not been adjusted even though the works had been completed.
- Steel costing Rs.37.19 lakhs procured in 1985, rendered surplus due to change in design of works in the Cochin zone in April 1986, was yet to be disposed of (June 1988). Besides blocking funds, an amount of Rs. 7.60 lakhs paid to the constructing agency towards agency charges and preparation of plans etc. proved to be unfruitful.
- Vegetable oil cess amounting to Rs. 11.87 lakhs had not been recovered from two units in the Kandla zone.
- Sub-standard/rejected goods including computer accessories and peripherals valued at Rs. 1.93 crores, with the units in the Santacruz zone, had not been disposed of.

(D. S. IYER)
Director of Audit,
Commerce, Works and Miscellaneous-I

New Delhi 28 JUL 1989
The

Countersigned

T. N. Chaturvedi

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Comptroller and Auditor General of India

New Delhi 2 AUG 1989
The

ANNEXURE - I

(Refers to Paragraph 6)

Gist of the conclusions and recommendations contained in the report of the Indian Council for Reasearch on International Economic Relations.

(i) The Export Processing Zones (EPZs) should be given an explicit three fold objective of expanding net foreign exchange earnings; attract direct foreign investment and generate employment. The concept and structure of the EPZs should be formulated with the foreign investor in view.

(ii) The minimum conditions for the selection criteria for a unit to be established in the zone should be (i) generation of aggregate net foreign exchange earnings above a stipulated minimum in five years (ii) have a minimum share of foreign equity participation or collaboration and (iii) demonstration of a wage component above a stipulated level in its turn over. This should be announced as widely as possible with a comparative statement of incentives available under different export promotion schemes. The existing selection criteria which is principally based on value added component per unit of exports should be replaced.

(iii) Export Processing zone Authority (EPZA) should be formed to implement the single-window-clearance scheme and for planning, coordination and monitoring of the EPZs in the country. The functions of the 'Inspectorates' and customs operations within the zones should be taken over by the EPZA.

(iv). The incentives package as it existed, with some changes, should be put on a long term and stable footing through an adequate legislation and not changed for the next ten years.

(v) Procedures for remittance of dividends, royalties, profits should be simplified. Conditions for permitting foreign nationals to work in the zone be relaxed. They may also be permitted to transfer shares in international capital markets.

(vi) The practice of establishing percentages for scrap, wastes and rejects should be done away with and sales to the Domestic Tariff Area should be closed firmly except against valid import licences for general currency areas. Units need not seek approval from the Board for changes in product design, degree of manufacturing or processing etc. and the Transport Subsidy Scheme in Kandla should also be withdrawn.

ANNEXURE-II

(Refers to paragraph 9)

Statement showing imports and exports in the export processing zones during 1981-82 to 1987-88.

(in crores of rupees)

(A) Imports

Name of the zone	Direction of imports	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	Total
Kandla	**GCA**	34.02	91.58	67.44	141.96	141.17	150.22	103.76	730.15
	RPA	--	--	--	--	0.02	0.16	0.48	0.66
	DTA	--	--	--	--	--	--	--	--
Santacruz	**GCA**	22.83	48.76	84.36	70.43	54.59	68.94	138.68	488.59
	RPA	--	--	--	--	--	--	--	--
	DTA	1.22	1.00	1.57	3.19	1.33	1.49	NA	9.80
Madras	**GCA**	--	--	--	--	0.43	8.95	12.49	21.87
	RPA	--	--	--	--	--	--	--	--
	DTA	--	--	--	--	--	1.04	NA	1.04
Noida	**GCA**	--	--	--	--	--	0.84	8.51	9.35
	RPA	--	--	--	--	--	NA	--	NA
	DTA	--	--	--	--	--	--	NA	NA
Cochin	**GCA**	--	--	--	--	--	0.40	NA	0.40
	RPA	--	--	--	--	--	--	--	--
	DTA	--	--	--	--	--	0.36	NA	0.36
Falta	**GCA**	--	--	--	--	1.58	2.05	1.22	4.75
	RPA	--	--	--	--	--	--	--	--
	DTA	--	--	--	--	0.04	0.45	NA	0.49

(B) Exports

Name of the zone	Direction	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	Total
Kandla	**GCA**	11.38	13.89	12.98	22.57	15.50	23.21	33.14	132.67
	RPA	58.66	128.55	94.37	214.51	221.36	213.06	151.89	1082.40
	DTA	--	--	--	--	0.02	0.15	NA	0.17
Santacruz	**GCA**	26.91	46.26	85.33	89.84	73.90	81.89	94.02	498.15
	RPA	2.71	8.11	3.29	5.99	10.59	20.47	16.15	67.31
	DTA	--	--	0.01	0.06	0.14	0.38	0.38	0.97
Madras	**GCA**	--	--	--	--	--	0.17	5.40	5.57
	RPA	--	--	--	--	0.55	9.88	11.01	21.44
	DTA	--	--	--	--	--	--	--	--
Noida	**GCA**	--	--	--	--	--	5.58	8.37	13.95
	RPA	--	--	--	--	--	1.43	7.68	9.11
	DTA	--	--	--	--	--	--	--	--
Cochin	**GCA**	--	--	--	--	--	0.10	0.80	0.90
	RPA	--	--	--	--	--	0.84	3.14	3.98
	DTA	--	--	--	--	--	--	--	--
Falta	**GCA**	--	--	--	--	--	--	--	--
	RPA	--	--	--	--	2.30	3.17	1.86	7.33
	DTA	--	--	--	--	--	--	--	--

Note:- GCA General Currency Area
RPA Rupee Payment Area
DTA Domestic Tarrif Area
NA Not available

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Page No.	Column	Line	For	Read
2	2	18	March 1989	March 1988
8	2	14	Feburay 1987	February 1987
16	ANNEXURE-II (A) Imports	23 (Falta)	4.75	4.85