

EXECUTIVE SUMMARY

Background

A Special Economic Zone is a geographical region within a Nation-State in which a distinct legal frame work provides for more liberal economic policies and governance arrangements than prevail in the country at large. The geographical areas thus notified under the SEZ Act, were declared to be outside the normal customs territory of India.

To establish a new regulatory framework, Government of India announced a comprehensive SEZ policy in April 2000 as a part of the EXIM Policy, which was followed by a dedicated SEZs Act in February 2006. This Act aimed to promote economic growth and development in the form of greater economic activity, promotion of exports, investments and creation of employment and infrastructure. The objectives were to be achieved through incentivizing the SEZ activities in the form of income tax holidays, various exemptions from several indirect taxes and other benefits. For success of this Act, DoC, DoR, CBEC, CBDT, State Governments, Banks etc were required to act in tandem.

Post enactment of the Act, the country had witnessed several protests resisting land acquisition initiatives for SEZs, pointing towards a need for their social evaluation in addition to the defined objectives. Though a number of deficiencies in administering indirect taxes were brought out in the Report No. 6 of 2008 of the C&AG of India, besides several audit findings in the subsequent years, on inadmissible concessions given to SEZs; a comprehensive performance assessment of SEZs was impending. Considering the magnitude of exemptions¹ availed by SEZs, it was imperative to assess their performance vis-a-vis the duty forgone.

The objective of this performance audit was to assess the adequacy of regulatory framework, policy implementation, operational issues and internal controls of SEZs. An attempt was also made to study the social and economic benefits of SEZs in India.

¹ ₹ 1.76 lakh crore, according to 83rd Report of Parliamentary Standing Committee on Commerce on Functioning of SEZs, June 2007.

Our audit conducted between November 2013 and January 2014 involved review of records maintained by a functionaries (BoA², DC, SEZ Authorities, SEZ units), located throughout the country, under the Ministry of Commerce and Industry (DoC, DGFT), and units under the Department of Customs, Central Excise & Income Tax. We had also obtained information from various Ministries/Departments/PSUs of State Governments/Public sector Banks. Stakeholder's feedback were obtained from Development Commissioners, Developers, SEZ units, Exporters, Trade and Industry associations through questionnaires administered for this purpose.

Audit observed that there was a requirement of multiplicity of approvals for SEZs with just 38.78 percent of them becoming operational after their notification. 52 per cent of the land allotted remained idle even though the approval dated back to 2006. There was a decline in the activity in the manufacturing sector in the SEZs. Land acquired for public purposes were subsequently diverted (up to 100% in some cases) after de-notification. Seventeen States were not on board in implementing the SEZ Act with matching State level legislations, which rendered the single window system not very effective. Developers and units holders were almost left un-monitored, in the absence of an internal audit set-up. This posed a huge risk for the revenue administration.

(i) Performance of SEZs and socio economic impact

Though the objective of the SEZ is employment generation, investment, exports and economic growth, however, the trends of the national databases on economic growth of the country, trade, infrastructure, investment, employment etc do not indicate any significant impact of the functioning of the SEZs on the economic growth.

Outcome budget of Department of Commerce indicated that the capital outlay of SEZs for development of the infrastructure is funded under Assistance to States for Developing Export Infrastructure and Allied Activities (ASIDE) Scheme from 1 April 2002. An outlay of ₹ 3793 crore was provided under ASIDE scheme during the 11th Five Year Plan (2007-12). ₹ 2050 crore was spent in the 10th Plan period and ₹ 3046 crore (upto 1 Jan 2013) was spent during the 11th Five Year Plan under the scheme. However, the same has not been included to indicate the outlay or domestic investment of SEZs.

² Board of Approval is a 19 member body in the MoC&I responsible for scrutiny and approval of applications received throughout the country for establishing SEZs.

Generation of employment opportunities, encouraging investment (both private and foreign) and increasing India's share in global exports are the three important objectives of the SEZ Act. Performance of sampled SEZs (152) in the country indicated certain non performance in employment (ranging from 65.95% to 96.58%), investment (ranging from 23.98% to 74.92 %), and export (ranging from 46.16 to 93.81%). The achievements of SEZs in the country are contributed by a few SEZs located in some developed States, which were mostly established prior to enactment of the SEZ Act.

(ii) Growth pattern of SEZs

Among all the States of India, Andhra Pradesh boasted of operating maximum number (36) of SEZs in the country followed by Tamil Nadu, Karnataka, and Maharashtra. Over a period of time, the growth curve of SEZs had indicated preference for urban agglomeration by industry, undermining the objective of promoting balanced regional development. Another significant trend in the SEZ growth has been the preponderance of IT/ITES industry. 56.64 per cent of the country's SEZs cater to IT/ITES sector and only 9.6 per cent were catering to the multi product manufacturing sector.

(iii) Land allotment and utilization

Land appeared to be the most crucial and attractive component of the scheme. Out of 45635.63 ha of land notified in the country for SEZ purposes, operations commenced in only 28488.49 ha (62.42 %) of land. In addition, we noted a trend wherein developers approached the government for allotment/purchase of vast areas of land in the name of SEZ. However, only a fraction of the land so acquired was notified for SEZ and later de-notification was also resorted to within a few years to benefit from price appreciation. In terms of area of land, out of 39245.56 ha of land notified in the six States³, 5402.22 ha (14%) of land was de-notified and diverted for commercial purposes in several cases. Many tracts of these lands were acquired invoking the 'public purpose' clause. Thus land acquired was not serving the objectives of the SEZ Act.

In four States (Andhra Pradesh, Karnataka, Maharashtra and West Bengal), 11 developers/units had raised ₹ 6309.53 crore of loan through mortgaging SEZ lands. Out of which, three developers/units had utilized the loan amount (₹ 2211.48 crore i. e 35 per cent of ₹ 6309.53 crore) for the purposes other than the development of SEZ, as there was no economic activity in the SEZs concerned.

³Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Odisha and West Bengal

(iv) Tax Administration

SEZs in India had availed tax concessions to the tune of ₹ 83104.76 crore (IT-₹ 55158; Indirect taxes-₹ 27946.76 crore) between 2006-07 and 2012-13. Our review of the tax assessments indicated several instances of extending in-eligible exemptions/deductions to the tune of ₹ 1,150.06 crore (Income tax ₹ 4.39; Indirect Taxes ₹ 1,145.67 crore) and systemic weaknesses in Direct and Indirect tax administration to the tune of ₹ 27,130.98 crore.

(v) Monitoring and Control

A feedback response of Developers, Units within SEZs, the Development Commissioners, Exporters, Trade and Industry, was elicited on various issues concerning functioning of SEZs in the country. These responses mainly point towards, among others, a need for revamping single window clearance system efficient tax administration and review of the decision to introduce DDT and MAT.

The DCs, Developers and Units have largely stated in their feedback that, monitoring was adequate. However, audit is of the opinion that monitoring framework requires strengthening. The inadequacies in the performance appraisal system of SEZs, compounded by lack of Internal Audit, facilitated developers to misrepresent facts to the tune of ₹ 1150.06 crore which remained undetected as there was no mechanism to cross verify the data given in the periodical reports with the original records. Further, there was no system to monitor the exemptions given on account of Service Tax, Stamp Duty etc. Consequently, a reliable estimate of the magnitude of the total tax concessions provided could not be made.

DoC does not have any IS Strategic plan for Database Management System of the SEZs in the country because the entire database management system project, its maintenance and the strategic management control have been outsourced to NSDL. Thus, a critical IS system is not internally monitored nor has any committee been formed to adequately monitor the system as required in a typical IS organisation. Approval of an important stakeholder in DoR was also not taken with regard to the revenue administration function of the system.

In view of the complete outsourcing of the project and its maintenance activities, the strategic control of Service Level Agreements review, source code review and performance audit of the IT infrastructure and the application needs to be mandatorily with the Government. Accordingly, separate and specific SLAs are required to be reviewed and correspondingly aligned.