Chapter 2: Performance of EOUs and system issues

2.1 Declining trend of EOUs

EOU scheme was primarily designed for the promotion and growth of manufacture and export of value added products. The EOU scheme allows the establishment of manufacturing units anywhere in the country with the obligation to achieve NFE. For this purpose, units are allowed duty free procurement through import or from indigenous sources.

Details of total, functional, non functional and de-bonded EOUs in last five years have been shown in Table 1 below.

Table 1: Functional, Non Functional and De-Bonded EOUs

Year	Total no of registered units	Functional Units		Nonfunctional units	Debonded units	Percentage of nonfunctional and debonded units to total units
		Number	Percentage to total units			
2009-10	3109	2279	73.30	687	143	26.70
2010-11	2802	2337	83.04	305	160	16.96
2011-12	2747	2206	80.30	336	205	19.70
2012-13	2626	2131	81.15	365	130	18.85
2013-14	2608	2095	80.33	385	128	19.67

Source: Ministry of Commerce & Industry.

As seen from the table, the total number of EOUs has gone down from 3109 in 2009-10 to 2608 in 2013-14. While the number of functional units has come down from 2279 to 2095 during the same period, the percentage of functional units to total units has declined from 83 per cent in 2010-11 to 80 per cent in 2013-14 with corresponding increase in percentage of non-functional and deboned units. There has been a gradual reduction in EOUs after the SEZ Act came into force in 2006-07. The FTP did not have any special provision to utilise the unique advantages of the 100 per cent EOU Scheme.

2.2 Performance of EOUs

The details of annual exports annual growth rate of the country and export by EOUs, their share in the country's export and annual growth rate in exports by are given in Table 2.

Table 2: Performance of EOUs

Year	Total Export (₹ in crore)	Annual growth rate of exports	Export by EOUs		
			Amount (₹ in crore)	Share in total export	Annual growth rate
FY 09	840755	28.19	176923	21.04	4.79
FY 10	845534	0.57	84135	9.95	-52.44
FY 11	1142922	35.17	76031	6.65	-9.63
FY 12	1459281	28.16	79343	5.43	4.36
FY 13	1634319	11.48	92089	5.63	16.06

Year	Total Export (₹ in crore)	Annual growth rate of exports	Export by EOUs		
			Amount (₹ in crore)	Share in total export	Annual growth rate
FY 14	1905011	16.56	82072	4.30	-10.87

Source :EXIM data and Annual Report 2013-14 of Department of Commerce.

Export by EOUs as reported by Export Promotion Council (₹ 83,700 crore, ₹ 59,824 crore, ₹ 79,343 crore and ₹ 65,927 crore) during 2009-10 to 2012-13 differ significantly from the figures furnished by DoC.

Further, audit observed that the share of EOUs in overall exports has been declining during last five years barring a marginal improvement in 2010-11. In addition the growth rate of EOU exports is not commensurate with growth rate of overall exports of the country except in 2013-14. In fact, it turned negative during 2011-12.

DC, SEEPZ Mumbai stated that the major factors responsible for poor growth of exports from EOUs were withdrawal of income tax benefit under section 10 B of Income Tax Act 1961 (with effect from 1 April 2011), decreasing profit margins on export products, more attractive schemes like SEZ where similar export benefits are available to the domestic unit without any domestic sales limitation. Similar sentiments have also been echoed by stake holders (small, medium and large EOUs). Audit observed that while exports by EOUs have been declining, during the same period, the export of SEZs has risen as shown in Table 3 below.

Table 3: Performance of SEZs

₹ in crore

Year	Exports by EOU	Exports by SEZ
2008-09	176923	99689
2009-10	84135	220711
2010-11	76031	315868
2011-12	79343	364478
2012-13	92089	476159
2013-14	82072	494077

Source: Annual Report 2013-14, Department of Commerce.

The main reasons for opting out by the EOUs from the scheme as gathered from the stakeholders are listed in Appendix 2. Important among them are unavailability of benefits of DEPB, Drawback, DFRC and Target Plus Scheme, etc., are not available, discontinuation of income-tax benefits under Section 10B of IT Act effective from assessment year April 1, 2011, (previous year 2010-11) etc. The prominent EOUs which exited from the scheme include Reliance Jamnagar, Orient Crafts Ltd, Oswal Cotton and Spinning Ltd, Vardhman Group, Ludhiana and Nahar Spinning Mills, Rajasthan.

A committee was formed under the Chairmanship of Sh. S.C.Panda, DC, NSEZ (December 2010), to review/revamp the EOU scheme. It was a study based on interviewing selected stake holders. In its report, the committee made 41 recommendations to be implemented by various agencies[4] of the Government. DoC accepted only seven of the recommendations.

The Committee had not done any impact study of its recommendations whether it be of fiscal, procedural nature or pertaining to the FTP. The revenue implication for Government and cost implication for the EOUs, was neither computed nor estimated. Neither any time line was set by the committee for implementation of its recommendations nor was any outcome measurement suggested. A comparative cost study of the unique advantages of the EOU vis-a-vis SEZ or DTA exports was not done to link the FTP/fiscals to the present scheme by the Committee, DGFT, DoC or CBEC.

Government of India had forgone significant custom and central excise revenue amounting to ₹ 32,932 crore during 2009-10 to 2013-14 on EOU/EHTP/STP scheme as detailed below.

Table 4: Duty foregone

Year	Amount of duty forgone (₹ in crore)
2009-10	8076
2010-11	8580
2011-12	4555
2012-13	5881
2013-14	5840

Though the duty forgone on the scheme remained static in FY13 and FY14 (₹ 5800 crore), the export by EOU dipped by 11 per cent in FY14 over the exports of FY13.

Audit observed that EOU scheme was different from the SEZ scheme which is formed on standard zonal model, since it specifically gives liberty to an entrepreneur to setup his manufacturing unit at any location within the national territory, commensurate to the availability of raw material, access to port, existence of hinterland facilities, availability of skilled manpower, existence of infrastructure etc. The entrepreneur in EOU invests in establishing his unit along with allied infrastructure required for exports. They are not restricted to specific geographical zones where manufacturing, regulatory and warehousing infrastructure is built in, as in case of SEZs.

Owing to their flexibility and unique position, EOU scheme flourished in 1980's, 1990's and upto mid 2000 decade had contributed to the process of structural change in the domestic industry via technological and skill spillover, economic linkages and disaggregation of the units for a positive development. However over the period, the exports from SEZs increased as against the exports from EOUs. It is substantiated by the observations in the

[4] CBDT, DoR, State Governments, DGFT and DoC.

Performance Audit (Audit Report of C&AG No. 21 of 2014 on Performance of SEZs) of the SEZs where it was observed that several EOUs and STPIs had closed and shifted base to SEZs after partial fulfillment of their growth obligations.

2.3 Analysis of the scheme

The Sh. S.C.Panda committee report was based on interviews of selected stake holders (EOUs), study of FTP and HBP, FT (D&R) Act, Customs, Central Excise and Service Tax Laws, Strategic Plan of DoC. Similarly, another report of DoC on the plan for boosting exports[5] was prepared around the same time. Audit observed that the overall functioning of the EOU's, getting permission from the custom authorities for procuring/exporting materials/services and getting sanction of claims viz. rebate, CST etc. are considered to be the major difficulties. This was on account of enhancing several export incentives for the exporters operating within DTA which finally acted as a disincentive for the exporters operating within EOU scheme. Further, it was observed that:

- The present scheme is a profit-linked incentive. No incentive was allowed on capital and revenue expenditure incurred by the unit during setting up of the unit (unlike SEZs) and further running of the unit. The unit is liable to pay Income tax on the business profits.
- EOU has to pay duty, taxes etc on import/procurement from DTA resulting in blockage of capital money of the entrepreneur. Similarly, EOUs are allowed credit of Service tax and refund CST paid on inputs which is a tedious process for the unit as well as Department.
- Multiple bodies (UAC, BoA and PRC) are approving proposals for setting up of EOU. The mechanism need to be simplified to expedite approval process.
- Usage of goods and services in EOU has not been aligned to the validity period of the LoP.
- DTA sale by EOU has not been rationalised, there are ambiguity in definition of similar goods.
- EOUs have comparative disadvantage vis-a-vis SEZ/DTA in respect of deemed export supplies as in the case of SEZ/DTA.
- EOUs have to obtain permission for job work which is time taking and adds to the cost of the EOU.

Government has fallen short by almost 33 per cent (US$ 150 billion) of its export target in 2013-14 vis-a-vis its Strategic Plan (DoC). FTP (2009-14) is being operated beyond its tenure and EOU scheme is neither able to attract

[5] Working Group Report of DoC, "Boosting India's Manufacturing Exports (2012-17).

Entrepreneurs nor contribute to the growth as envisaged while forgoing substantial duty.

DoC in their reply (January and February 2015) admitted the fact that the EOUs are de-bonding from EoU Scheme, DoC expressed it was mainly because of discontinuation of Income Tax benefit with effect from 1.4.2011. An exporter would operate in the bonded area only if he gets some extra benefits. Since duty free import of raw material, duty free import of capital goods and chapter 3 benefits are available in DTA, exporters find EOU Scheme less attractive.

Recommendation No. 1: *Ministry may initiate necessary corrective measures to arrest the decline with specific timelines and measurable outcomes so that the basic objective for export growth is achieved utilising the uniqueness of the scheme.*