Nokia SEZ: Public Price of Success

MADHUMITA DUTTA

The government claims that the special economic zones will bring in investment, increase exports and economic activity, and create employment. The Nokia Telecom SEZ near Chennai is often held up as a stellar success of such claims. A closer look at the figures indicates that Nokia's investment is almost entirely paid for by public subsidy, much of the production is sold domestically, employment generation is below projections and workers are short-changed.

This article is based on the report, *The Public Price of Success* co-authored by me. I acknowledge Patrik Oskarsson for his comments on this article.

Madhumita Dutta (*madhu.dutta@gmail.com*) is a Chennai-based member of Citizens' Research Collective on SEZs.

Since 2006, when the Special Economic Zone (SEZ) Act came into force, the number of operating zones has increased from only a handful to 315 with an additional 253 receiving preliminary approval. According to a recent press release by the Ministry of Commerce and Industry, 2.53 lakh employment opportunities have been generated in them. Further "physical export" has increased from Rs 66,638 crore in 2007-08 to Rs 90,416 crore in 2008-09. With Rs 10,385 crore of "physical export" between 2006 and 2009, investments of Rs 2,225.47 crore (of which foreign direct investment (FDI) is Rs 834 crore) and 14,859 workers provided direct employment, the Nokia Telecom SEZ in Chennai, Tamil Nadu is usually placed on top of the list of SEZ "success stories" mentioned. According to the ministry "these figures establish beyond doubt that the response to the SEZ policy has been overwhelming and the scheme has been able to achieve the envisaged objectives".[1]

The above numbers used to justify the success of the SEZ policy are presented as self-evident. But given the wide-ranging exemptions from most taxes in the national SEZ Act it is not obvious to see business gains as being equal to public benefits. Moreover, little is known about the actual employment conditions. With the help of the Right to Information Act it is now possible to shed the secrecy surrounding investment deals and take account of what the Nokia deal actually means for the economy of Tamil Nadu, and as one of the important claimed success stories of SEZs.[2]

A memorandum of understanding (MOU) was signed between the Tamil Nadu government and Nokia for the establishment of a SEZ on 6 April 2005.[3] It was at the time known from newspaper reports that other states had also been interested in attracting Nokia. One Tamil Nadu official was quoted as saying

> it was a tough contest involving Maharashtra, Haryana and Tamil Nadu. Because of the swift responses from Chennai and the special package that was offered, Nokia opted to settle for Tamil Nadu.[4]

The MOU in addition to all the benefits of the national SEZ policy offers extra tax incentives, control over the labour force, and land at a concessional rate.[5]

VAT Reimbursement

Since SEZs are ostensibly meant for export promotion, it is fairly surprising that the main tax incentive offered by the Tamil Nadu government was to reimburse Nokia for valued added tax (VAT). VAT is only a cost to the company when it sells within India since export products are not going to attract this tax. This clearly indicates that, right from the start, the company planned to sell a significant share of its phones in the Indian market.

The MOU states:

> Sales from the SEZ to the DTA will be liable for VAT and CST. Such VAT and CST will be refunded to Nokia by the State Government in terms of the mutually agreed mechanism for the residual period (10 years minus period for which waiver availed in the pre-VAT scenario).

There are two cases to be considered for VAT/CST. The first is when Nokia sells mobile phones within Tamil Nadu. The Tamil Nadu government will, in this case, receive the VAT money from the vendor of the phone and reimburse it to Nokia. This results in a loss of income for the state. The second case of reimbursement concerns sales by Nokia in a state other than Tamil Nadu. Here the phones will attract central sales tax (CST) which will be collected by the respective state government from the vendors, but it is the Tamil Nadu government which reimburses Nokia for the payment of this tax. This reimbursement becomes a cost for the government to be paid in competition with other expenditures like education and health.

If 4% VAT/3% CST (CST was 3% for the fiscal years 2007-08, which is used in the example here) is to be reimbursed, the sum would quickly become very large given Nokia's position as market dominant in India. Sales in 2007-08 were Rs 3,578 crore, meaning Rs 107 crore would have been paid by the Tamil Nadu government to Nokia (excluding the share of sales in

Tamil Nadu which are not known).[6] But since the exact figures are not known, the cap on the amount the government will pay Nokia as mentioned in the MOU can be a better way to approximate the reimbursement:

> Total availment of such concessions shall not cumulatively exceed the investment made by Nokia in eligible fixed assets within 3 years of signing of MOU. The cap can be enhanced to the extent of additional investments made by Nokia within 5 years of signing the MOU.[7]

In 2005 Nokia had promised to invest Rs 675 crore (then $ 150 million) of which Rs 300 crore were in fixed eligible assets.[8] An added investment in 2008 of Rs 338 crore ($75 million) is assumed to be eligible for additional VAT concessions.[9] With this, the sum of Rs 638 crore becomes the maximum reimbursement for the company. In effect, it means that the Tamil Nadu government has offered Nokia to pay for its investments via the VAT/CST reimbursement and allow sales in the world's fastest growing mobile phone market, while the tax incentives have prevented the state from recovering the expenses. Is this a case of attracting investors by paying for their investments?

Land Deal

Land was allotted to Nokia from SIPCOT[11] Industrial Park at Sriperumbudur on the outskirts of Chennai. SIPCOT had acquired this land earlier through a government order in February 1997.[12] In the original MOU Nokia was supposed to pay Rs 8 lakh per acre as a lease charge on 99-year leasehold tenure but somehow the sum got renegotiated down to Rs 4.5 lakh per acre in the second MOU for a total of Rs 9,48,91,500 for 210.87 acres (85 hectares) of land.[13] A report from the Comptroller and Auditor General specified how the actual acquisition cost for the government had been between Rs 4 and Rs 14 lakh per acre, plus an additional 30% to the previous landowners who went to court for better compensation. The result was a loss of Rs 7.4 crore for SIPCOT and thus the Tamil Nadu government.[14]

Apart from the lower land price, the second MOU also removed the need for Nokia to pay stamp duty on the land which was earlier set to 4% of land value or Rs 38 lakh. Written by hand in the lease deed is the added statement regarding the lease rent for Nokia:

> The Lessee shall have to pay the annual lease rent of Re 1 per year for 98 years and Rs 2 for the 99th year and the same has been paid in advance in consideration of occasion of the lease deed.

While the state makes loss by leasing the land to Nokia at a lower cost, it gives the company the possibility to make profit by subletting the land and charging a higher price if it so desires.[15] At the time when Nokia got control over the 210 acres of land for setting up the SEZ, public money had already been invested by SIPCOT to develop infrastructure at the industrial park.

Table 1: Additional Incentives

Incentive	Conditions
Works contract tax	Not known
Lease tax	Not known
Entry tax	Not known
Capital subsidy for mega projects	Rs 100 lakh plus 150% if located on land belonging to the state government
Electricity tax	For the first five years of commercial production
Infrastructure	A water supply pipeline had been laid, electrical lines had been drawn, and roads had been built to the site by SIPCOT
Failure to charge duty on goods sold within India	Duty of Rs 681.38 crore (Rs 86.76 crore in 2005-06 and Rs 594.62 crore in 2006-07) foregone on the inputs

Sources[10]

Employment: Whose Benefit?

Information on actual working conditions is very limited due to the nature of the zone as a sealed off entity. The available documents do however point to a number of troubling aspects with the working conditions. Nokia initially promised direct employment for 1,200 workers but later, as the production increased, scaled this up to 8,000, including those employed by contracting agencies. Out of this number, 70% are reported to be women between age 19 and 22.[16] An inspection report from the deputy chief inspector of factories, in July 2008, showed the company employed 4,548 people, or significantly lower than the number of workers reported in the press.[17]

The Contract Labour (Regulation and Abolition) Act, 1970 is a central government act originally put in place to limit the use of contract labour in manufacturing. The Tamil Nadu government has weakened its provisions in favour of companies on a number of occasions but to date such labour remains banned in manufacturing. Contract labour has been found to be prevalent in all non-manufacturing forms of work in the Nokia SEZ, with 2,893 contract labourers hired in 2008 according to an inspection report from the inspectorate of factories. Thus, in the Nokia SEZ, it seems like staff has come to be contract labour with very low job security whenever possible including warehouse staff, security personnel, drivers, cleaners, etc.[18]

The issue of controlling strikes in SEZs have been dealt with in many states by declaring zone operations as public utilities. This has been done for all SEZs in states like Andhra Pradesh, Maharashtra and Karnataka. In Tamil Nadu public utility status is not part of official policy but instead hidden in the specific MOU. In the MOU signed on 6 April 2005 the TN government promised that:

> [t]he State shall declare the SEZ Site to be a 'Public Utility' to curb labour indiscipline.[19]

The text does not offer any explanation on why there is an a priori need to "curb labour".

Another measure of "success", in terms of employment generation, is to see if this multinational provides a decent salary. But even in this case Nokia seems to have failed. As per Nokia's own admission "employees are paid well above the minimum wage.... Salaries vary from Rs 5,400 for experienced operators, around 70% higher than the minimum wage, to around Rs 3,400 for apprentices." If this is compared with what Nokia pays to its employees globally, which is Euro 44,624 per annum, or Rs 29 lakh, in wages and salaries per employee during 2008,[20] it works out to be 45 times what the workers in Sriperumbudur plant receive. Even adjusted to the different purchasing power of India compared to Finland, the global average employee has a salary 10 times[21] that of the Indian workers indicating that there is an enormous gap between the different employees of the global Nokia family.

Conclusions

The public costs for the Nokia SEZ are of two kinds; the first is the direct expenditure by the Tamil Nadu government, among other things in creating infrastructure and reimbursing Nokia's VAT payments; the second is the loss of income if normal taxes would have been applied. Of the known direct costs for the public the VAT reimbursements dominate. Together with the subsidised land the Tamil Nadu government is estimated to have paid Nokia Rs 645.4 crore.

The main objectives of SEZs according to the national SEZ Act are to (i) generate additional economic activity, (ii) promote exports of goods and services, (iii) promote investment from domestic and foreign sources, (iv) create employment opportunities, and (v) develop infrastructure facilities. Our findings indicate that the Nokia zone, like other SEZs, are mainly for the Indian market, and there are loopholes in existing laws which allow domestic sales of mobile phones to count towards export (objective ii). The Nokia SEZ and other electronics manufacturing has lead to investments in Chennai to set up the plants (objective iii). But every rupee invested in fixed assets by Nokia is paid back by the Tamil Nadu government via its offer to reimburse VAT leaving only the operational costs to be covered by the company. In effect the government is paying for the company's infrastructure investment and we have every reason to believe this type of agreement is standard for Tamil Nadu (to achieve objectives ii and iii the state government paid for objective v). The relatively poor pay of the workers and unmet employment protections make the employment creation argument weak (objective iv).

In sum, for the benefits given to Nokia, very little reciprocity exist in benefits for India. We can only congratulate Nokia on getting an amazing host of concessions and freebies to enter what is now the world's fastest growing market for mobile phones. Its profitability is certain to be significant although actual data on the mobile phone business is not available. But to think that the success of a private company based in Finland has anything to do with the development of India seems very far-fetched. Put in a different way, of what use is increased economic activity (objective i), if the benefits of this activity only goes to one company? This clearly reiterates the fundamental flaws in the SEZ policy and legislation. It demonstrates that the success of a SEZ comes at an enormous public price.

NOTES

1 PIB Press Release, 21 May 2009, "Special Economic Zones" – Backgrounder. http://pib.nic.in/release/release.asp?relid=48806 (accessed 1 June 2009).

2 An added factor, which has not attracted much attention, is the possibility for a large company like Nokia to get concessions both as a SEZ developer on the creation of infrastructure, and the benefits of a SEZ unit during operations. Developer benefits mean no customs on imported construction and no service tax on services performed in the SEZ including construction related ones. Unit benefits include income tax, service tax and excise tax exemptions. In the case of the Nokia SEZ it was additionally possible to extend the developer benefits to all the companies within the zone by registering a special society, the "Nokia Telecom SEZ Society", under the Tamil Nadu Registered Societies Act. This allowed all the units to become co-developers with Nokia and get the infrastructure incentives.

3 A second MoU which contains amendments of certain sections of the original MoU was signed between the parties the same year on 18 July.

4 *The Hindu* (8 April 2005), "A Breakthrough for Tamil Nadu in Hardware Segment" http://www.hindu.com/2005/04/08/stories/2005040806090100.htm (accessed 21 April 2009).

5 The MoU also indicates that other units in the SEZ would get the same benefits assuming at least investment of Rs 300 crore.

6 The VAT rate for mobile phones is 4% in most states but, for example, in West Bengal it is 12.5% making the exact amount of the reimbursement somewhat different from the example provided here.

7 This cap, strangely, seems to apply only to the local sales tax reimbursement and not VAT as stated in both the 6 April and 18 July MoUs. It therefore remains unknown whether there is at all a cap on the VAT reimbursements or not.

8 *The Financial Express* (7 April 2005), "Chennai to Host Nokia Plant", http://www.financialexpress.com/news/chennai-to-host-nokia-plant/129642/0 (accessed on 1 June 2009).

9 CNBC-TV18 Moneycontrol (7 December 2007), Nokia India to Invest $75 mn to expand Chennai Plant, http://www.moneycontrol.com/india/news/business/nokia-india-to-invest-75-mn-to-expand-chennai-plant/17/15/316244 (accessed 1 June 2009).

10 P 12 of the Schedule of MoU, 6 April 2005, Government of Tamil Nadu, 2003, "Tamil Nadu New Industrial Policy 2003". http://www.tn.gov.in/misc/indpolicy2003.pdf (accessed 20 March 2009).

Government of India, Comptroller and Auditor General of India, 2008. Performance Audit, Indirect Taxes – Report No 6 of 2008. New Delhi http://cag.gov.in/html/reports/indir_taxes/2008_6_PA/section_3.pdf. Lease deed between SIPCOT and Nokia signed 19 July 2005.

11 SIPCOT is the State Industries Promotion Corporation of Tamil Nadu, a state government entity.

12 Deed of Lease entered into on 19 July 2005 between Nokia and SIPCOT.

13 How either of these prices was arrived at is not known since the price mentioned on SIPCOT's website, at present, is Rs 60 lakh per acre. It must have been significantly higher than Rs 8 lakh in 2005. SIPCOT Sriperumbudur, http://www.sipcot.com/Industrial_complex_sriper.htm (accessed 21 April 2009).

14 Government of India, Comptroller and Auditor General of India, 2007. *Audit Report (Commercial), Tamil Nadu for the Year 2006-2007*, New Delhi. http://cag.gov.in/html/cag_reports/tn/rep_2007/com_chap_4.pdf

15 Annexure to July MoU.

16 2008, "Nokia to Double Its Workforce at SEZ", *Business Standard*, 13 May, http://www.business-standard.com/india/news/nokia-to-double-its-workforce-at-sez/37393/on (accessed 22 May 2009).

2008, "Dream Factories", *India Today*, 10 June. http://www.intoday.in/index.php?id=2534&option=com_content&task=view&sectionid=7&secid=37 (accessed 22 May 2009).

17 According to TN government labour department's "Labour Inspection report form 2A" dated 30 July 2008.

18 Department of Inspectorate of Factories, Registration certificate regarding contract labour 30-07-08.

19 P 10 of MoU signed 6 April 2005.

20 Numbers taken from the Nokia Annual Accounts 2008. Based on Euro 5,615 million spent on wages and salaries in 2008 and 1,25,829 people employed by the Nokia Group at the end of 2008. http://media.corporate-ir.net/media_files/irol/10/107224/reports/Nokia_in_2008.pdf

21 India PPP dollar rate was Rs 14.67/$ in 2005 when the real exchange rate was Rs 44.10/$. For Finland the corresponding rates were Euro 0.98/$ PPP with real exchange rate being Euro 0.80/$. This gives a PPP-adjusted Nokia Chennai wage of $4,417 per year and an average Nokia global wage of $45,535 per year. The global wage is 10.3 times higher. World Bank (2008) *2005 International Comparison Program Global Results: Summary Table,* http://siteresources.worldbank.org/ICPINT/Resources/icp-final-tables.pdf (accessed 30 April 2009).