THE OBSERVER
OF BUSINESS AND POLITICS
MONDAY MARCH 18, 1996

Fast lane catastrophe

The policy on joint ventures for manufacture of cars is seriously flawed, says **Uttam Gupta**

IN a note recently submitted to the cabinet, the commerce ministry has proposed major changes in policy with regard to CKD/SKD imports by car joint ventures. Amongst others, this seeks to modify a decision taken in November, 1995 by which imports up to 65 per cent of the CIF value of a complete car should be treated as parts and components and the balance 35 per cent as CKD/SKD kit. The commerce ministry is now proposing to reduce this cut off point to 35 per cent.

At the outset, it is important to note that JVs do not manufacture cars in India. They are merely assembling operations. In other words, they are importing the complete car. Under the existing policy, import of the complete car is prohibited. However, since the JVs have been allowed to do this, there is need to lend credibility. This is possible only if you do not call it a complete car. The policy makers preferred the surrogate CKD/SKD to distinguish it from import of a complete car.

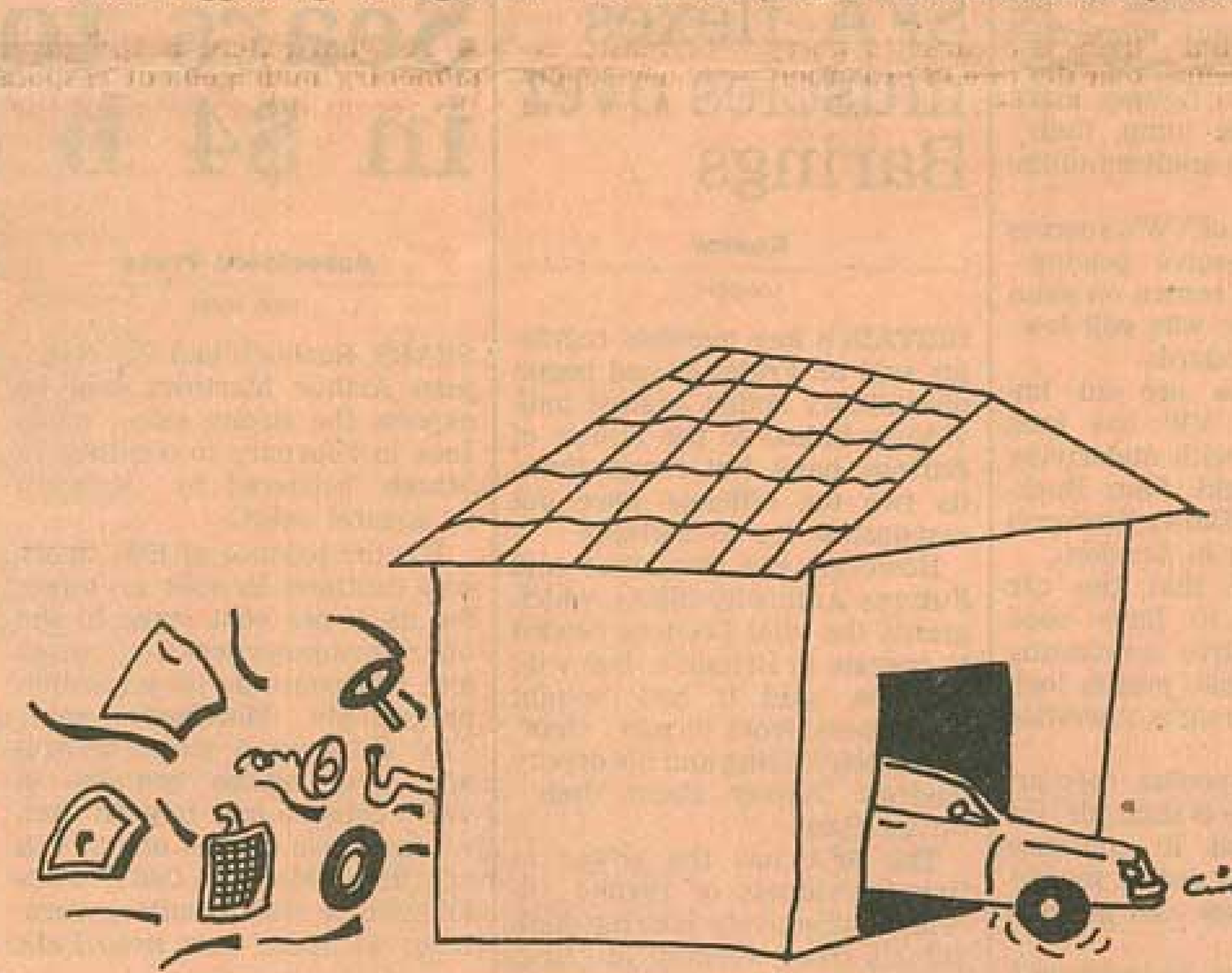
Allowing the JVs to import the complete car by itself, was not considered good enough to lure the MNCs to the Indian market. So, the government felt the need to give them yet another sop by way of concessional duty. To achieve that, the value of the car is bifurcated into two components — a part that can be treated as spare parts and components entitled to a lower rate of duty, and the balance as the CKD/SKD kit which would attract a higher rate. Whereas, the rate applicable to the former is 35 per cent, in respect of the latter, it is 110 per cent, including 50 per cent as the basic duty and 60 per cent as the countervailing duty (CVD).

With this duty structure, i.e. 35 per cent on spares/components and 110 per cent on CKD/SKD and taking 65 per cent as the cut off point (under the existing policy), the JV will land up paying an effective duty of only 61.25 per cent (35 × 0.65 + 110 × 0.35). This is against a duty of 110 per cent if the entire import is treated as CKD/SKD.

The JV gets a further bonanza as under the MODVAT scheme it can claim reimbursement for CVD. This means that its duty liability CKD/SKD import is only 50 per cent. This, in turn, would require the JV to pay an effective duty of only 40.25 per cent (35 × 0.65 + 50 × 0.35).

In short, the policy makers have not only permitted import of cars in contravention of the thrust of the policy on import of consumer durables, they have even resorted to purely hypothetical and arbitrary classification to reduce the effective duty applicable to import of cars to a low of about 40 per cent. The amendment suggested by the commerce ministry will require the JV to pay a marginally higher duty of 44.75 per cent (35 × 0.35 + 50 × 0.65).

While suggesting changes in the policy, the commerce ministry has opined that it is worried about the worsening trade balance, declining foreign exchange reserves and increasing pressure on the rupee. How come the ministry has suddenly become wiser? These problems were already confronting us in November 1995.



During the first six months of 1995-96, the trade deficit was much worse than in the corresponding period of 1994-95. FIIs were coming in trickles and inflow of funds through the GDR route had dried up. And, above all, the pressure on the rupee was building up in August 1995, when in a matter of just one month it slid to Rs 34 to a dollar. That implementation of car JVs would lead to unprecedented foreign exchange outgo is also a fact on which the ministry cannot plead ignorance. Will the amendment suggested by the ministry help in addressing its concerns? The proposal is tantamount to a small increase in the effective rate of duty payable on imports. Is that, by itself, sufficient to deter the JVs from going ahead with their plans or reduce the extent of their imports? The answer is 'No'.

Considering that the JVs are serving predominantly the elite segment who have no constraint of purchasing power and there is hardly any competition (each JV has successfully found a slot for itself), consequential increase in the cost of the car can be easily loaded on to the price without any resistance.

The recent steep depreciation of the rupee has led to substantial increase in the cost of imported CKD/SKD. No JV has, however, said that it will withdraw or scale down operations or reduce import content. When the rupee depreciation could not deter them, how can a small increase in the effective rate of customs duty? Consequently, the pressure on foreign exchange arising from CKD/SKD imports is unlikely to reduce.

In its package, the commerce ministry has also mooted foreign exchange neutrality. Having allowed the JVs to import the complete car, how can you achieve foreign exchange neutrality unless there is commensurate export commitment?

MNCs are coming to sell cars in India only and not to export. While they may undertake some exports, the bulk will be sold here only.

The ministry's proposal reportedly talks of achieving higher levels of indigenisation. Is it workable? We have seen the fate of the Phased Manufacturing Programme (PMP). It failed miserably and had to be abolished. Even in a case like Maruti, where the government is very much a part of the management, full indigenisation is still not in sight.

How can the government force it in private JVs especially when it does not even have a clear and workable criteria of measuring the extent of indigenisation? In any case, we have nothing credible by way of effective monitoring and follow up action. So, even if you tie them down to a clearly laid down criteria and an indigenisation schedule, this would remain only on paper.

The policy on car JVs is seriously flawed. It is contrary to our national economic interest. Needless to say, it has been formulated to help MNCs and cater to the interests of a small section of the Indian population.

The most serious drawback of the existing policy is the heavy drain on foreign exchange that it entails. Second, JV operations would lead to proliferation of the number of cars on the roads. The third drawback relates to the impact on the SSI/ancillary units and employment. Following the onslaught of the JVs, the existing models are being gradually eased out. Not only there is no further growth in these segments, even replacement demand is being met from new models. That will seriously jeopardise the prospects of existing SSIs.

The existing policy on JVs should go lock stock and barrel. The government should evolve a fresh policy that seeks to regulate the number of cars on the Indian roads, ensures net foreign exchange earnings and has a positive effect on growth of SSI/ancillary units.

The policy should provide for setting up of a fullscale manufacturing plant in India with substantial export commitment. The government should also insist on high indigenous content in investment.