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Have cars, will ride

Planning for unrestrained growth in supply of cars is unsustainable, says **Uttam Gupta**

AFTER the initial hiccups, almost all the joint venture proposals involving foreign multinationals in the automobile sector are beginning to take shape. The JVs involve import of car kits in completely knocked down (CKD) or semi-knocked down (SKD) conditions. The activities in India will thus be restricted only to assembling operations, marketing and selling.

Quite clearly, the JVs do not envisage setting up of manufacturing facilities in India. Growing desire amongst the elite for models with foreign stamp, the Indian market has obviously become the darling of multinationals.

True, India global provides lucrative business. But, there could be other options to exploit the market here viz directly exporting the car made at the existing production centres of MNCs abroad or setting up a manufacturing plant in India. Why should the multinationals then have to settle for the assembling route involving imports of CKD/SKD kits? The reasons are not difficult to seek.

The first option is just not available as import of cars is prohibited, being an item on the negative list. What about setting up of a manufacturing plant in India? The multinationals perceive dangers in this approach. First, starting from the scratch here will tantamount to duplication of the manufacturing facilities that are already existing in their respective home lands/production centres. The latter are capable of serving markets world wide and will remain unutilised/underutilised in case in MNCs decide to undertake fresh investment in emerging centres of demand like India.

Even from the view point of the cost of the car, it is much more attractive to source supplies of various sub-units (engine or the chasis) from the existing depreciated plants rather than producing them fresh in a new manufacturing facility which is bound to be high cost (due to much higher investment and resultant cost of servicing it).

The only flip side in this arrangement may be the cost push effect of import duties on CKD/SKD imports. The impact of this, however, has been substantially reduced by the Indian policy makers agreeing for an effective duty of only 50 per cent (total duty of 110 per cent minus 60 per cent towards CVD in respect of which the JVs can claim reimbursement under the MODVAT).

A factor deterring MNCs from setting up a manufacturing plant in India is that the demand boom is transitory. This is because of the increasing infrastructural bottlenecks, specifically inadequate network of roads, parking problems and above all, the environmental effects. Already, these problems are becoming unmanageable and it will not be long before these assume catastrophic dimensions.

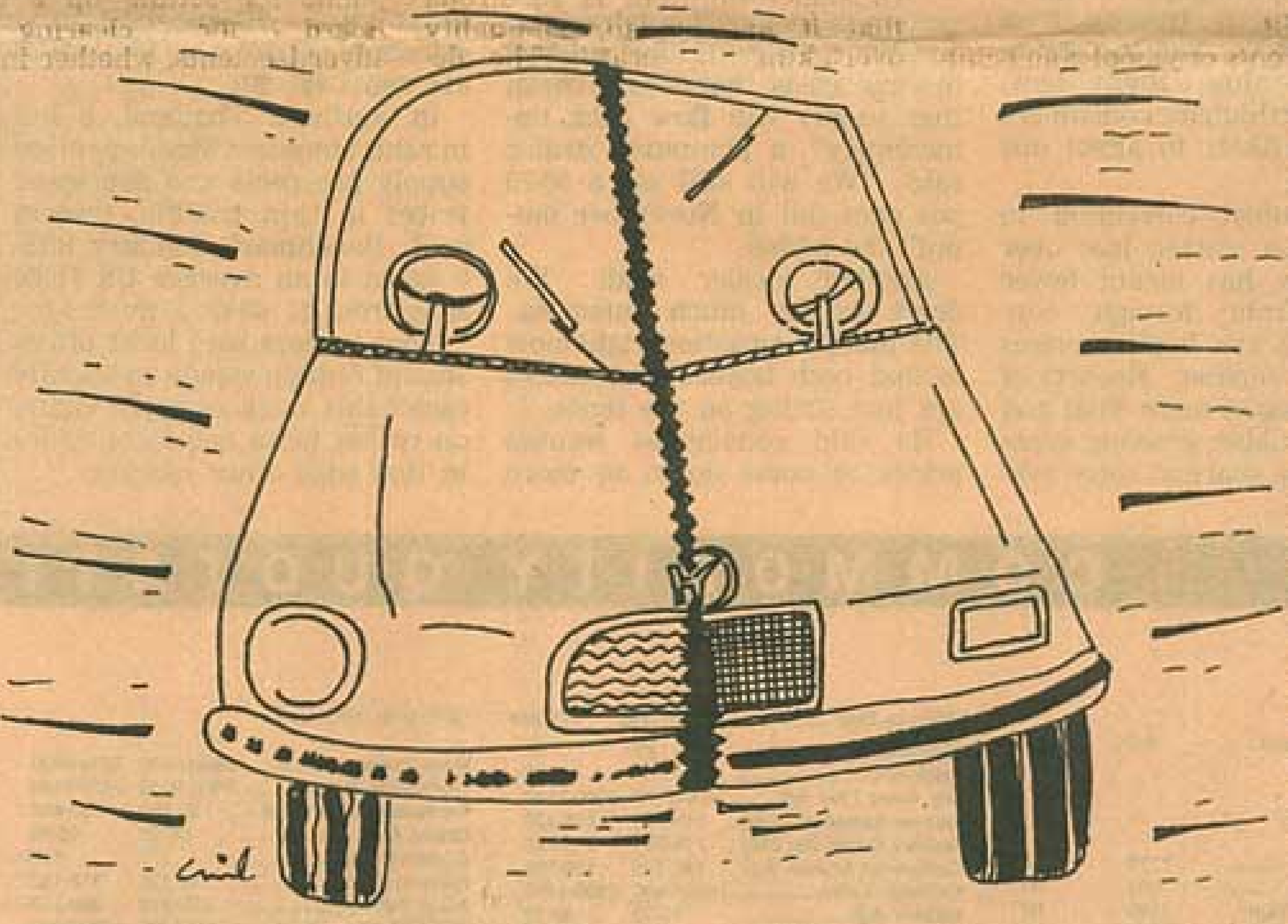
The rapid growth in the vehicle population (thanks to mushrooming of JVs) will bring this stage sooner than later. At this stage, the government which at present is not quite sensitive to these issues, may even be forced to prohibit further addition to the vehicle population.

The possibility of major breakdown and resultant disruptions is also not ruled out as the existing network of roads is in bad shape and there is criminal neglect of maintenance. This would mean longer time for both passengers and goods traffic on the roads, in turn, affecting industrial/economic activity. Increasing pollution will be an additional penalty.

The operation of JVs alone would involve a foreign exchange outgo of about Rs 7,000 crore. They will contribute very little by way of export earnings as the JVs are primarily meant to tap the domestic market.

We are in a free market exchange rate regime which does not differentiate between the sources of demand for foreign exchange. In fact, in an overall shortage situation, those who can afford to pay a better price, have a greater chance of having access to dollars.

Quite clearly, the JVs have a distinct edge in this respect. Which means, the essential sectors — already affected adversely due to recent steep depreciation of the rupee and insufficient availability of foreign exchange — will be squeezed harder. Which, in turn, will undermine overall growth and add to inflation.



Promoters of JVs argue that these will contribute to the development of small scale and ancillary industries for supply of auto parts and components. How far that happens, only time will tell. What is certain is that introduction of a whole range of new models is bound to result in displacement of the existing models/designs as also a closure of SSI/ancillary units catering to the latter.

While allowing the JVs, the government seems to be concerned only about the indigenisation aspect ignoring more vital concerns. Even in this limited respect, it has adopted the MOU approach for making them do what we expect. Whether or not the government has evolved a foolproof mechanism to measure the extent of indigenisation and enforce it remains a big question mark?

The issue is not just one of allowing MNCs through the CKD/SKD route visa-vis setting up manufacturing facilities along with transfer of R&D or allowing them to directly export cars to the Indian market. Irrespective of the route chosen, the fundamental question is whether, we should at all plan for growth in supply of cars on an unlimited scale. The answer is categorical 'No'. An explosion in the number of cars on the roads is unsustainable, given the limitation of infrastructure and inherent environmental problems.

The broader considerations of infrastructure, environment and scarcity of foreign exchange should set the contours of the policy in this regard. The policy should aim at controlling the growth of cars on the roads. This will call for management of both the demand and supply.

On the demand side, fiscal measures (raising excise duty etc) alone may not be of much help. In the past, despite increase in prices, demand has continued to grow rapidly. However, alternative modes of transport like chartered buses/luxury coaches can address the needs of a large section of the middle class. If the supply of former is adequate and assures comfortable journey, the latter are less likely to opt for owning a car. Besides, you save on road space, accommodate more traffic and time spent on roads is less.

On the supply side, car manufacturing including the JVs, should be permitted only when the promoter undertakes a "predominant" export obligation. Entry through the CKD/SKD route should be completely banned. This will ensure that only serious parties come in with long-term commitment and that their number is limited. Fewer car makers is also in the best interest of small scale and ancillary units.

To ensure that they do not exploit their monopoly position, the government should permit import of cars, while maintaining import duty at reasonably high rates. This will also satisfy the elite who can procure/choice. The foreign exchange outgo on this account will be miniscule when compared to the huge outflows under the present dispensation.