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Capital industry in doldrums

The neophyte's faith in the panacea of free trade is going to seal the fate of the domestic industry, says Uttam Gupta

A major victim of import liberalisation has been capital goods industry. Commencing 1991-92, its growth rate has been negative for almost three consecutive years. The industry on an average is operating at just about 50 per cent capacity utilisation. The order book position of some of the engineering giants like the BHEL has been reduced to practically nil.

According to the Confederation of Indian Industries (CII), a whopping Rs 15,000 crore has already been invested in the capital goods industry. Over the years, this has contributed about Rs 6000 crore towards export earnings and Rs 3500 by way of various taxes and duties. In addition, the industry employs about two lakh people. All this may be seriously jeopardised unless drastic corrective measures are undertaken.

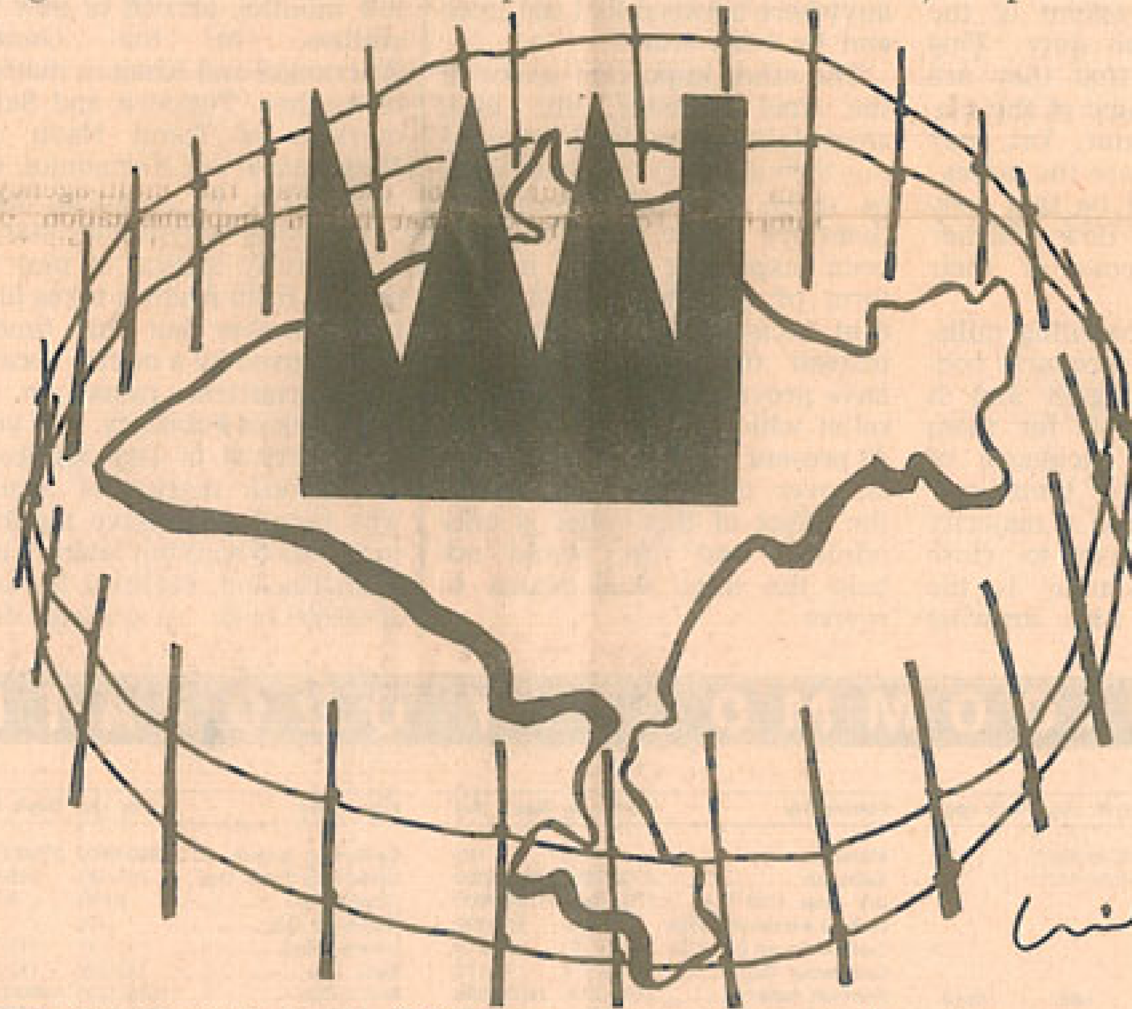
Prior to 1991-92, imports of capital goods were either on the negative list or attracted high import duties. Suddenly reversing gears, the government has now freed imports and lowered customs duty drastically. From an already low 35 per cent the budget for 1994-95 has further reduced the customs duty on project imports and general capital goods to 25 per cent. Import of power projects attract even lower rate of 20 per cent, while fertiliser project imports are completely exempt.

The MNCs produce the said items much cheaper than we do. What is more, they are capable of dumping the product into our market at prices much below their cost of production. The world-wide industrial recession which is unlikely to be over soon, is a further impetus driving the MNCs to penetrate huge markets like ours irrespective of cost considerations.

Our problem is that we are mindlessly pursuing the goal of free trade between nations, which unfortunately is never fair. The developed countries indulge in unfair trade practices both in our as well as their own markets. The US textile and steel industry is heavily protected. The European Union (EU) has a system of reference prices and, in the event of CIF cost of imported products being lower than the reference price, compensatory taxes are levied.

Regardless of these cold realities, the new policy dispensation puts the domestic capital goods industry at a serious disadvantage in terms of duties. Although the budget for 1994-95 has claimed substantial relief, the customs duty on imported steel and major non-ferrous metals continues to be 50 per cent as against 25 per cent duty on project imports and even lower for other categories. The budget seeks to offset excise duty on domestic capital goods through a countervailing duty on imports. But, that may not deter imports as importers of capital goods can claim benefit of MODVAT in respect of the countervailing duty paid by them.

Besides, some of the specifically designed schemes like the Export Promotion Capital Goods (EPCG) accentuate the disadvantages of the domestic industry by facilitating import of certain capital goods at zero duty. The domestic industry gets further handicapped because of high interest rate, administered prices/tariff on coal and power.



Another factor that tilt the balance in favour of the foreign suppliers is the availability of credit either from the governments in the country of origin or multilateral institutions supportive of them. During 1991-92, orders for about 3900 MW of power generation capacity went to the foreign companies primarily on the strength of the bilateral loans. In contrast, BHEL got orders of just about 60 MW. Of the total capacity contemplated for addition during the eighth plan period, almost 25 per cent is being targetted to come through imports on the basis of bilateral and multilateral loans.

For several years the industry grew up in a highly protected regime. That itself was a big blunder as market was assured irrespective of the cost and quality considerations. Much worse was the opportunity this gave to the bureaucracy and the political leadership to meddle in a whole range of decisions affecting the running of these enterprises.

Now, despite being fully conscious of these weaknesses, the pendulum is being swung to the other extreme by declaring open season for the MNCs to trample our own industries. The official buzzword is competition with the logical corollary that any industry which cannot compete has no business to exist. This approach will only spell disaster for the country. Besides the liquidation of our own capital goods industry, this would even be detrimental to user industries who may currently be getting imports at cheaper cost. Once the domestic competition has been eliminated, foreign suppliers are bound to exploit the situation and increase prices to exorbitant levels.

Coordinated action on several vital fronts is the need of the hour. First, any contemplated plan to further lower the duty on imported capital goods should be kept on hold to prevent aggravation of the miseries.

Second, a level playing field has to be generated to facilitate competition with foreign suppliers on equal footing. The CII has recommended an import duty of up to 5 per cent on raw materials, 5-15 per cent on components. A reasonable view has to be taken on this and an appropriate rationalised duty structure put in place immediately.

The interest rate should be reduced to just about half of the prevailing rate as the industry in the developed countries gets finance at no more than 7 per cent.

Suppliers' credit is a major limitation with the domestic industry. The US Export Import Bank is known for working hand in glove with the companies scouting for prospective buyers abroad. We need to match this by making the Consortium of Banks and FIs to support the indigenous suppliers of plant and machinery. The banks are currently flush with funds. There is also reduced demand from a section of the industry which has been successfully collecting funds from the investing public even for their working capital needs.

Third, there is an urgent need to strengthen our anti-dumping machinery. Simplification of the procedures and reduction of the time limit between the date of registration of the complaint and action recommended by the designated authority are called for to ensure speedy redressal from the injury caused by the dumping.

Fourth, special efforts are required in respect of the PSUs which may not be able to compete even after the level playing field is given to them. This is because while the industries in the private sector have been liberalised, the public sector is yet to be liberated from controls.

The key issues that need attention are professionalisation and autonomy of the managements, their stability and complete elimination of back-seat driving. Professionally managed and fully autonomous boards may not also be able to improve things unless the balance sheets of the PSUs are freed from the huge burden of past loans, high and penal interest. These structural changes are a must if the domestic capital industry is to confidently face upto the emerging global competition.