Capital Goods: Indian Regulatory & Policy Environment

The government has maintained focus on the development of engineering and capital goods sector as a part of its industrial strategy for more than six decades. Over the last three decades, substantial reforms have been undertaken for the industry, including de-licensing of all industrial segments in the sector and opening up the sector to 100% FDI under automatic route. Further, there is no restriction on the payment to foreign collaborator for technology transfer, royalty etc. The government freely allows the imports and exports under the sector.

As a part of liberalisation, the import duties on capital goods in India have been considerably reduced over the last two decades, which has in turn negatively affected the domestic industry. The customs duty on various industrial segments has been reduced to zero/ 5%/ 7.5%. The project imports for Oil & Gas, Power, Specified Goods for Road Projects, etc. attract zero duty and this has rendered the domestic players uncompetitive, as they are faced with several other taxes such as Excise duty, CST/ VAT, Octroi, etc. Moreover, for certain industries like electrical machinery there is a case of inverted duty structure, wherein the import duties on raw materials like copper, rubber components, etc. are higher than the import duties on finished capital goods. As such, the domestic private manufacturers are rendered uncompetitive against the imports not only amongst the industrial consumers but also with respect to government procurements. Additionally, government tenders often puts the domestic private players at a disadvantage as there is a preference for PSEs.

Another liberalisation move by the government has been the signing of various Regional and bilateral free trade agreements with other countries. During recent years a number of FTAs/PTAs have been signed with foreign countries whereby the import duty on various capital goods has been gradually reduced to zero. This places domestic producers at a disadvantage due to high input costs (the import duty on raw material/ parts is not zero) coupled with high interest rates. For instance, the Indian companies have lost out market share to Korean companies post India’s Free trade agreement with Korea.

Another issue with import policy of the government has been the imports of second hand machinery. The old machinery can be imported in India without any restriction of age, resulting into huge import of second hand machinery into India. This puts the Capital Goods industry at a major disadvantage.