Capital Goods: Regulatory & Policy Benchmarking

The capital goods industry has witnessed increased competition in the present scenario of high globalisation. Western countries like Germany and Italy have been leaders in this technology oriented sector for a long time but over the last few decades, China has emerged as a strong competitor on the back of its low manufacturing costs and supportive government policies. The capital goods sector in India has not succeeded in building competitiveness primarily due to structural disadvantages, inadequate support mechanism and firm level inefficiencies. A comparative assessment of Indian capital goods sector vis-à-vis that of competing countries has been done hereunder to facilitate formulation of suitable policies and strategies for improving competitiveness of Indian players in the global market.

Privatisation of capital goods sector in major countries has improved competitiveness

The capital goods industry in India is largely dominated by public sector enterprises, which has to a large extent affected the development of this sector. In terms of overall output as well, PSEs dominate the market and even though their market share has dipped over the last decade, they command a large market share due to preferential purchase policies of the government. India can take a cue from China, which too was largely dominated by SOEs until late 1970s but the economic reforms during 1980s and 1990s that included privatisation drive and labour reforms has improved the industrial performance, efficiency and overall competitiveness of the sector and today, China is one of the leading global suppliers of capital goods.

Another disadvantage for the Indian capital goods sector emanating from the industry structure is that the sector includes a wide range of products but lacks depth due to low demand sophistication of Indian market, which in turn leads to low competitiveness of its products in the global market. On the other hand, major advanced countries generally do not produce entire range of products rather focus on select segments where they are most competitive.

Strong government focus imminent for development of capital goods sector

China has maintained a strong focus on development of capital goods sector and its government has constantly supported the industry by providing policy impetus as well as implementing expedient measures with respect to taxation, subsidies and financial support during the times of economic crisis.

Better investment climate in competing countries gives them a competitive edge

Leading countries in capital goods manufacturing have maintained a healthy investment climate that has helped them in attracting substantial foreign capital required for effective development of the capital intensive industries. China has been amongst the most favoured nations for investments on account of low labour costs, large domestic market, preferential policies for foreign investments, export promotion policies and stable political climate. Germany's investment climate is also highly lucrative for manufacturing businesses, owing to the various incentives offered by the government, existence of sound and secure legal framework, open and transparent markets, strong infrastructure, reliable logistics, internationally competitive tax conditions and financial support from the government.

In contrast, India has not been able to attract huge FDI despite liberal investment policies and low labour costs, primarily due to poor physical infrastructure that affects the supply chain and hence adds to the

costs. According to industry estimates, infrastructure inadequacies translate into 5 per cent cost disadvantage for Indian capital goods manufacturers vis-à-vis foreign manufacturers.

State subsidies and incentives have played a key role in sector's development

Industry players in China enjoy various subsidies and incentives such as cash grants, interest subsidies, debt forgiveness, extension of non-performing loans, energy subsidies, land subsidies, etc. Moreover, the Chinese government has often negotiated technology transfer from foreign enterprises in exchange for providing access to government projects.

Similarly, in Italy various subsidies are being provided under the National incentives plan to the eligible enterprises including Capital grants, operating grants, interest rate subsidies, tax credits, equity participation and guarantees.

In India, the benefit of interest subsidies available to many sectors is not available to the capital goods sector, rendering them uncompetitive against their counterparts in other countries which are heavily subsidised. The cost burden is further aggravated by the high incidence of direct and indirect taxes. According to industry estimates, the cost disadvantage to Indian capital goods manufacturers due to indirect taxes is estimated at nearly 24%.

Additionally, India allows second hand imports of capital goods at concessional rates for various sectors, which has deterred the growth of domestic capital goods industry. Consequently, the capital goods industry is losing its competitiveness to the cheap imports.

Besides lack of subsidies, the Indian capital goods industry also does not receive adequate export incentives due to which its export competitiveness is low. For instance, export promotion schemes of the government are not easily available for project exports and interest rate subvention provided earlier to the capital goods sector has been discontinued. Lack of export incentives lowers the competitiveness of the industry, which already suffers from high export transaction costs.