Impact of Government Policy on Capital Good: With Special Reference to Make In India

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Abstract

Countries can potentially choose to import from wide varieties that are available in different sources and this choice has a bearing on their growth rates. A distinction between imported and domestically produced capital goods. Capital goods exert a significant effect on the growth rates of per capita incomes; particularly in developing countries. Almost 80 percent of capital goods production in the world is concentrated in few countries. The capital goods industry has been witnessing a downturn for the past few years. The prime objective of this research paper is to examine the impact of importing or making capital goods in the home country.

Key words: capital goods, import, export, productivity, growth rate, make in India, use in India, investment.

Introduction

Capital goods are of primary importance of growth of manufacturing in India. In recent years, production of capital goods sector has not grown fast enough to match the pace of domestic demand leading to a growing dependence on imports. Further, in a globalise world, where manufacturer are increasingly multinational, not all Indian capital goods manufacturers have been able to effectively tap the global opportunity. India’s share of global capital goods exports remains much lower than several other leading countries, despite a well developed domestic capital goods sector.

The heavy engineering and capital goods sector is often referred to as the barometer of an economy’s industrial development. However, in India the sector comes with its own challenges - it is relatively unorganized and highly fragmented. This also presents a huge opportunity for sophisticated players. Indian and international companies penetrate the Indian engineering and capital goods markets with research on macro trends and government regulations, market size & growth, key players and their market share,
demand and supply imbalances, evolving customer needs, products and pricing, and risk assessment.

ENGINEERING / CAPITAL GOOD SECTOR

The engineering sector is the largest segments in India. The sector is relatively less fragmented at the top, as the competencies required are high, while it is highly fragmented at the lower end and is dominated by smaller players. The sector is divided into two main segments - heavy and light engineering.

Capital goods

In economics, capital goods are tangible objects that are used in the production of other goods or commodities or during the providing of services. They can include things such as buildings, machinery, tools, computers and any other equipment that is used to make or do something else, which can then be sold to another party. The means of production might be owned by individuals, businesses, organizations or governments. This term also refers to any material used or consumed while other goods are being produced or services are being provided.

Investment required

Capital goods require a substantial investment on the behalf of the producer, and their purchase is usually referred to as a capital expense. These goods are important to businesses because they use these items to make functional goods for customers with valuable services. As a result, they are sometimes referred to as producer’s goods, production goods or means of production.

Capital goods vs. capital

The economic term “capital goods” should not be confused with the financial term “capital”, which simply refers to money or wealth. Production goods generally are man-made and do not include natural resources such as land or minerals. They also do not include “human capital”- labour, intellectual skills and physical skills provided by people in the production of other goods.

The Importance of Capital Goods

Aside from allowing a business to create goods or provide services for consumers, capital goods are important in other ways. In an industry where production equipment and materials are quite expensive, they can be a high barrier to entry for new companies. If a new business cannot afford to purchase the machines it needs to create a product, for example, it may not be able to compete as effectively in the market. Such a company might turn to another business to supply its products, but this
can be expensive as well. This means that, in industries where the means of production represent a large amount of a business's start up costs, the number of companies competing in the market is often relatively small.

Focus areas for capital goods

Achieving higher growth going forward would need collective efforts by both policy makers and industry directed at four key areas. The first focus area is to leverage the domestic demand effectively to drive expansion of domestic production. This would require significant coordination between the end user industry and the capital goods sector. The second focus area is building competitiveness in manufacturing to effectively compete against cheaper imports and cater to new global market. This would require harmonisation of tax, duty structures and rationalization of free trade agreements to ensure a level playing field, ensuring factor costs are globally competitive, and drive cost efficiency through creation of manufacturing clusters. The third focus area is bridging the technology divide that exists between Indian manufacturers and global competitors. Overcoming this technology would require greater incentives for R&D, investments in building the technology infrastructure, as well as promoting strategic acquisitions by Indian manufacturer to plug gaps. The fourth and last focus area is expanding the global play of the Indian capital goods sector. This requires investments in export promotion and marketing infrastructure as well as promoting strong domestic companies to become global challengers.

The acquisition of machinery and other expensive equipment often represents a significant investment for a company, so spending on such assets is often watched closely by economists. When a business is struggling, it will often put off such purchases as long as possible, since it doesn't make sense to spend money on equipment if the company isn't around to use it. Capital spending can be a sign that a manufacturer expects growth or at least a steady demand for its products, a potentially positive economic sign.

Make in India

A major new national program designed to facilitate investment. Foster innovation, enhance skill development. Project intellectual property and build best-in-class manufacturing infrastructure. There’s never been a better time to make in India.

The major objective behind this initiative is to focus upon the heavy industries and public enterprises while generating
employment, empowering secondary and tertiary sector and utilizing the human resource present in India.

The highlights and purpose of make in India include making India a manufacturing hub and economic transformation in India, eliminating laws and regulations, making bureaucratic processes easier and shorter, and make government more transparent, responsive and accountable. And a government emphasized a help site for investors’ queries about including labour laws, skill development and infrastructure.

“Make in India” and “use in India”

The capital goods industry wants the centre to focus on promoting the use of locally-made capital goods along with its drive to set up manufacturing through the “make in India” campaign.

Doing away with nil import duties on capital goods for certain specific projects, extending excise duty exemption on capital goods to nuclear power projects and extension of nil excise duty to sub-contractors are some of the key demands for budget 2015-16.

Tepid growth

Industry associations also suggest that the Comprehensive Economic Partnership Agreements (CEPA) that India has signed with countries such as Japan and South Korea should be studied closely to remove any anomalies that may have crept in, such as inverted duties.

Valued at over rs.5, 00,000 crore, the capital goods industry in India posted tepid growth in 2014, hit by the absence of fresh investments and a number of stalled projects. Major capital goods companies, both in the private sector and public sectors, have all been performing below their projects this year. Top companies in the sector include L&T, BHEL, Suzlon and Havells.

Weighed down by the government’s decision not to impose basic customs duty on the specified power projects, nuclear plants, fertiliser units and coal mining, the domestic sector wants such exemptions done away with this year.

Such duty concessions are an aberration in a tax regime and put the domestic industry at a cost disadvantage, particularly in those cases where full deemed exports benefits are not allowed, point out industry body CII in a report.

Although, the benefit of exemption in the case of mega and ultra projects has been restricted to 113 projects approved before July 19, 2012, it has still left the industry
feeling short-changed because of the sheer size of the projects.

Domestic companies want the government to extend excise exemptions for supplies to nuclear power projects and levy a 4% special additional duty of customs on all imports of capital goods, with certain exemptions.

**Excessive imports**

Our local industry has taken a beating because of excessive imports from China, especially in the power sector. The textile sector is also heavily importing capital goods. These needs to be discouraged, a government official.

The industry believes the imposition of 4% special additional duty on all capital goods imports will ensure a level-playing field for domestic manufacturers who have to pay local duties. The inverted duties structure, where the import duty on inputs is more than the finished products, is another problem facing some capital goods makers.

According to industry body FICCI, items such as pressure vessels parts of heat exchangers, parts of nuclear reactors and parts of boilers have been hit because of such inverted duties. It has been reported that duty inversion exists in certain cases under the India-Japan CEPA and the India-Korea CEPA, says an FICCI report on the inverted duty structure.

**Capital goods turn market favourites**

Engineering and capital goods companies have been market favourites in the ongoing rally, riding on the belief that the sector will benefit from rival in economic growth.

Power sector reforms, such as the e-auction process for coal blocks, the new electricity bill and the thrust on improving transmission and distribution as well as fuel linkages, have contributed largely to this sentiment. The “make in India” campaign has provided a booster shot, too. However, even as stocks have spiralled upwards, the sector is not entirely out of the woods. The BSE capital goods index now trades at a trailing 12 month PE of about 33 times much higher than the Sensex 19.5. In the first six months this fiscal, average net sales growth of engineering and capital goods companies that are part of the CNX-500 index remains flat, at best.

Adjusted profits have grown 7-10 percent overall, but several companies such as BHEL, Engineers India, Graphite India, BGR Energy, Ingersoll-Rand and Jyothi
structures continue to show a fall in profits over the corresponding period a year ago.

BHEL, for instance, still plagued by weak execution in several powers to projects due to hiccups related to environmental clearances, fuel linkages or financial issues. Many companies, such as compressor-maker Ingersoll-Rand, are still in the dark for lack of a pick-up in industrial capex spends the main growth trigger. But going by the IIP and other lead indicators, manufacturing is improving. Better demand and lower borrowing costs will encourage capex by industries over the next few quarters. Capital goods, being a late-cycle business, will then see an improvement.

What the budget can do immediately, though, is to push power sector reforms, speed up project clearances and encourage domestic power equipment makers by hiking duties on equipment imports.

**Conclusion**

India’s growing economy has offered domestic entrepreneurs and international players multiple opportunities to invest. The government of India has realised the significance of the manufacturing industry to the country’s industrial development and is taking necessary steps to increase investment in this sector. A robust manufacturing sector is essential element of the Indian growth story. Due to the overdependence of the Indian economy on the other country’s affect the financial position of the Indian economy, to overcome this problem government of India took the initiative for manufacturing the capital goods in India. Recently policy makers took the policy of “make in India” to become self reliant.

**References**


