Where could customs duty go up?

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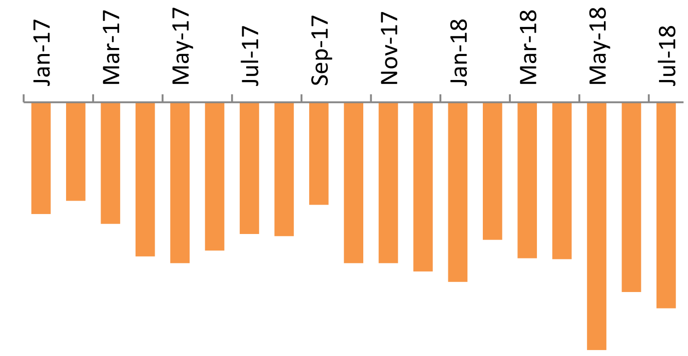
Overview

Merchandise imports, which had started to decline in December 2014, commenced increasing in October 2016 and rose sharply in FY18. The increase can be primarily attributed to rising prices of commodities rather than upturn in quantity. Total imports in FY18 stood at $465.6 bn, petroleum and gold together accounted for more than one-third of imports in FY18.

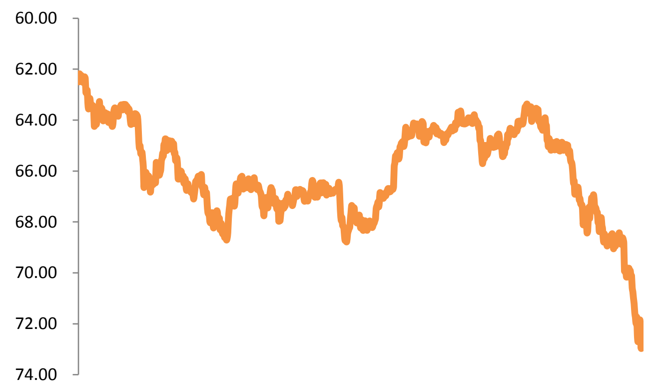
Chart 1: Widening Trade Deficit ($ mn)



Source: Ministry of Commerce

However, increasing imports, a widening trade deficit coupled with a weakening rupee has impacted the current account deficit (CAD) which has widened to 2.4% for Q1FY19.

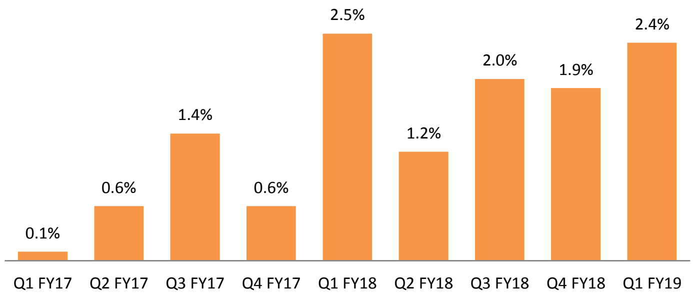
Chart 2: A weakening Rupee (inverted scale)



Source: Business Standard

Reflecting concerns over a widening CAD, the government had earlier announced five steps to increase capital inflows and strengthen the rupee. However, the government also plans to check the import of non-essential items including gold to shore up the rupee and reduce the deficit. The government is planning these steps despite the reduction in inflation as the rupee has continued to weaken and the trade deficit has widened.

Chart 3: Movement in the Current Account Deficit



Source: RBI

The purpose here is to examine which are the commodities where tariffs can be increased. The list of non-essential imports would require careful deliberation as these items should not be any raw materials or required intermediates for industry as this could increase inflation. Coal account for 4.5-5% of the total imports in the country by value. It is an important raw-material across sectors namely power, cement, steel etc. Inadequate supply of thermal coal to captive users due to supply chain issues, unavailability of high calorific-content steam and coking coal for power, cement and steel production are some of the major reasons which have led to sustained increase in import of the commodity. Given the supply chain constraints and unavailability of required quality of coal, any tariff or duty imposition on the commodity would negatively impact all the sectors mentioned earlier.

The report covers the following sectors where tariffs may be increased:

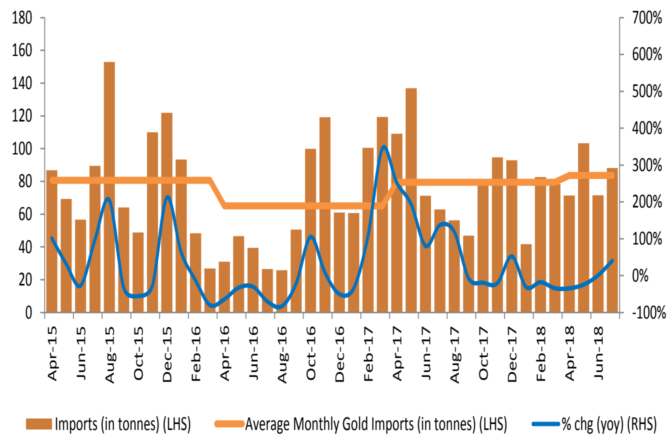
1. Gold
2. Consumer Durables
3. Iron and Steel
4. Base Metals (Copper, Aluminum, Lead and Zinc)
5. Fertilizers
6. Automobiles

The report highlights what could be expected at the industry level. The measures anticipated include an increase in customs duty. The measures suggested could have an impact on approximately 20% of the total imports and 24% of the imports excluding crude oil and crude oil products (based on FY18 imports).

Gold

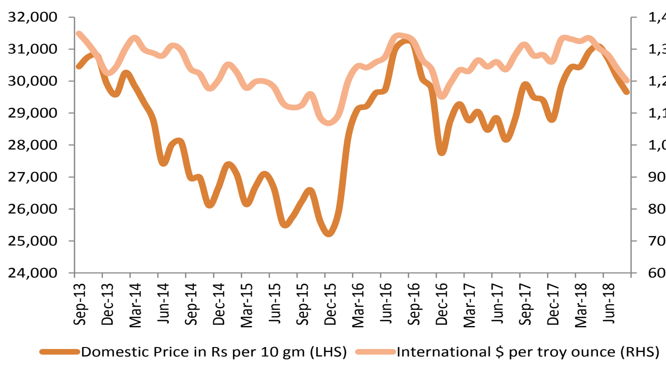
After oil, gold has the largest share of imports. In FY18, gold imports reached $33.7bn, an increase of over 20% compared with FY17. According to RBI, gold imports reached 955.2 tonnes due to an increase in domestic demand as jewellers replenished inventory amidst a turnaround in retail demand after demonetisation in the preceding year. For the first four months of FY19, gold imports fell to 334.4 tonnes compared with 380 tonnes in the preceding financial year. Lower demand and a depreciating rupee have affected the imports. However, gold demand is anticipated to increase due to an anticipated improvement in rural incomes buying power and the arrival of the primary festival season (Diwali and Dussehra) and the wedding season.

Chart 4: Monthly Gold Imports (in tonnes)



Source: CMIE

Chart 5: Average Monthly Gold Price



Source: CMIE, World Gold Council

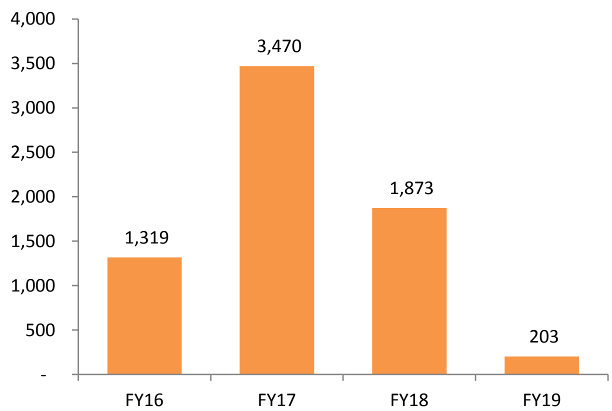
Gold imports are generally targeted when import restrictions are considered as gold is viewed as an idle asset, which does not contribute to economic growth.

Product	Current Rate	Proposed Rate
Gold	10%	12-13%

Although the import duty on gold is already high at 10%, the same could be increased to 12-13%. However, increasing the duty on gold also increases the risks of smuggling. This will however affect jewellery exports and domestic demand.

Additionally, other measures to restrict imports could also include setting up a floor / minimum price for gold imports and also incentivising the households to financialize their existing gold holdings thereby reducing the demand for physical gold.

Chart 6: Sovereign Gold Bolds (in Rs. Cr.)



Note: FY19 data till June 2018
Source: RBI

The current gold monetization scheme has not been very successful, with only a total of Rs 68.96 billion (23.5 tonnes) has been raised through the scheme since its inception until June 30, 2018 and brought into circulation, from an estimated

24,000 tonnes (Source: World Gold Council) of gold held privately. This compares unfavourably with Turkey, which has been able to bring 3-4% of private gold into circulation. To successfully implement the scheme, the government would have to incentivise banks to hold gold deposits and offer domestic consumers a higher rate of interest and a certain leeway from tax scrutiny while depositing gold in the banks

Consumer Durables

Product	Current Rate	Proposed Rate
Washing machines	7.5 - 10%	20%
Air conditioning machines	10%	20%
Refrigerators and freezers	7.5 - 10%	20%
Mobile phones	Nil – 20%	25%

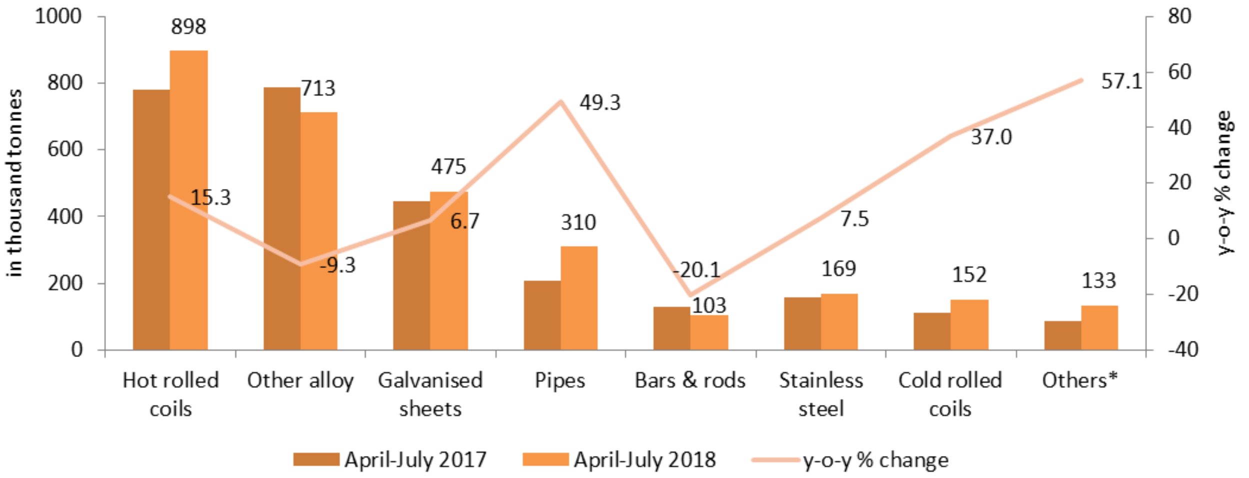
In value terms, imports of washing machines registered a growth of over 26% y-o-y during FY18, air-conditioners grew by over 22% and refrigerators witnessed a growth of over 60% on a y-o-y basis. The GST council had decreased tax rates for white goods like television (TV) sets, refrigerators and washing machines, air conditioners to 18% from the earlier 28% in July 2018. To bring the domestic industry at par with the international markets, the local players in the industry have represented to the government to increase the customs duty of various products from the current 7.5-10% to 20% to shield the domestic industry and to promote domestic manufacturing, creating jobs as well as raising incomes.

Iron and Steel

Imports of iron and steel and articles of iron or steel amounted to $14.6 billion and accounted for 3.1% of the total value of imports during FY18. This share is likely to increase in FY19 as the country has turned a net importer of steel after remaining next exporter for the past two years. Therefore, in order to restrict the growth in share of these imports, it becomes imperative to take measures at a time when the country is already witnessing a growth in imports amid a fall in exports. Imports of iron and steel and articles of iron or steel amounted to $5.8 billion for the first four months of FY19, implying a share of 3.4% of the total imports by India.

During the April-July 2018 period, steel imports rose by 9.4% y-o-y to 2.95 million tonnes, while exports on the other hand decreased by 32.5% y-o-y to 2.5 million tonnes. Thus, imports exceeded exports by 0.48 million tonnes during the period. Of the total steel quantity imported during the first four months of FY19, hot rolled coils accounted for the largest share of 30.4% and its imports increased by 15.3% y-o-y to 898 thousand tonnes. The other varieties of steel that saw a surge in their imports included pipes, cold rolled coils and others which grew in the range of 37%-57%. Among structurals, wires, railway materials and plates included in others, imports of all the varieties witnessed a y-o-y rise except for pipes.

Chart 7: Variety-wise imports of finished steel into India



Source: CMIE

**Others include structurals, wires, railway materials and plates with import quantity of structurals being the maximum and import quantity of pipe being the least*

To restrict or reduce the imports of these varieties, it is expected that the customs duty on some of the steel products such as hot rolled coils or pipes be raised. In the Union Budget 2017-18, customs duty on MgO (Magnesium Oxide) coated cold rolled steel coils used in the manufacture of CRGO (Cold Rolled Grain oriented Steel) steel was reduced to 5% from 10% and the customs duty on hot rolled coils used in the manufacture of welded tubes and pipes was decreased to 10% from 12.5%. The customs duty on imports of steel products ranges from 5% to 10%. **Thus, in order to reduce dependency on imports of certain varieties and to encourage domestic production of these varieties, we believe that the customs duty on some of the steel products could be increased to 15%.** At the same time, the government would have to ensure that this indicative duty hike does not materially impact the exports from those industries which use these imported steel products as an input for manufacturing of its goods.

The growth in imports is largely on account of higher supplies from South Korea and Japan. This is primarily on account of import duty imposed by USA on its key allies in March 2018. With this, steel imports are subject to 25% and aluminium is subject to 10% tax. The import duty is believed to have diverted exports from countries such as Japan and South Korea to India. The steel imports from South Korea surged by 27.1% to 1.06 million tonnes and that from Japan were up by 4.8% to 0.48 million tonnes on a y-o-y basis during April-July 2018. Imports from these countries accounted for more than half of the total steel imports during these initial four months of FY19. However, it is to be noted that imports from South Korea and Japan are under Free Trade Agreement (FTA) with India. This could create issues while restricting imports.

Base Metals (Copper, Aluminium, Lead and Zinc)

Product	Current Rate	Proposed Rate
Refined Copper	5%	10%
Unwrought Aluminium	7.5%	10%
Aluminium Scrap	2.5%	10%
Refined Lead	5%	10%
Unwrought Zinc	5%	10%

India's base metals (aluminium, copper, zinc and lead) imports have increased by 13% during FY19 (April-July). With a combined production capacity of 4 million, (as per the data available on Ministry of Commerce), the import duty can be increased in order to discourage imports and enable the domestic players to encourage a ramp up of production capacity and unlock its full capacity potential.

Fertilizers

Product	Current Rate	Proposed Rate
Urea	5%	10%

India has imported around 22% of its urea requirements during FY19 (April-July) and aims to eliminate urea imports completely by 2021. With the commencement of the Gorakhpur, Sindri and Barauni urea gas based plants, CARE Ratings expects an incremental increase in urea production for FY19, hence an increase in the basic custom duty could discourage further imports of urea and help pick up pace for the production. Urea manufactures are also encouraged and incentivized to produce urea beyond reassessed capacity under the New Urea Policy.

Automobiles

Product	Current Rate	Proposed Rate
Motor cars – Used cars	125%	150%
Motor cars – CBU with CIF value more than $ 40,000	100%	125%
Motor cars – CBU with CIF value less than $ 40,000	60%	85%

Imports of motor vehicles stood at a little over Rs 14 billion during FY18, a marginal drop of about 3% y-o-y during the year. However, the imports were still high in terms of value. Going forward, we expect a hike of 25% for each category of the motor car. Demand could however remain unaffected as consumption of such automobiles is a part of discretionary spending and is generally more of a status symbol rather than one based on economic value.

Conclusion

India can increase duties and put in other measures to reduce imports of non-essential items, however as it is difficult to restrict the largest contributor to the import bill i.e., oil, hence these restrictions could have a less than anticipated impact. **But, whether or not the imports of these goods would come down is a matter of conjecture.** Further trade restrictions are generally a temporary measure for reducing the current account deficit and could invite retaliatory measures from other countries.

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