Suggestions
for Augmenting
Manufacturing and Exports

Submitted to

National Manufacturing Competitiveness Council

(NMCC)

From

Federation of Indian Micro and Small & Medium Enterprises (FISME)

B-4/161, Safdarjung Enclave, New Delhi-110029

info@fisme.org.in

http://www.fisme.org.in

FISME's Suggestions For

Augmenting Manufacturing and Exports

Background

- Manufacturing has been relatively a new phenomenon in independent India. The entrepreneurs entering into manufacturing peaked in 80s and the momentum continued till early 90s[1]. Several factors contributed to the boom in early 80s but two were most prominent: captive, growing Indian demand and liberal funding *(through State Financial corporations which may have paid a price for the liberalism, but they eventually created for India a large pool of small manufacturing enterprises).*
- However, since late 90s, there has been a definite shift away from manufacturing. Indian markets opened up *(Quantitative Restrictions abolished and Import duties came down drastically)* and funding for enterprise creation dried up *(most SFCs went belly-up and net bank credit to SSI sector came down from 15% in 1998 to hardly 6% in 2005-06).* Changed economic dispensation coupled with stifled infrastructure led to large scale sickness. With no legal exit route in place, large number of entrepreneurs have had to face persecution, jail terms and relocation with enormous social cost.
- With new avenues opening up in services sector where it was possible to bypass infrastructural bottlenecks and regulatory rigidities, bulk of entrepreneurs considered manufacturing not worth the trouble. Indian economic grew without commensurate job growth. The sobering fact has been that growth of services create far less jobs and tend to include more elite work force leaving bulk of rural India.

Current Context

- The period since 2003 has been of surging growth fuelled by internal consumption. 'The setting has been provided by population demographics and the trigger by low interest rates generated a boom through competitive retail finance market hitherto not witnessed in India chiefly in two segments: housing

[1] See 3rd SSI Census (2001-02). Of total registered SSI units in 2001-02, around only 7% came up during 1957-79; 5% during 80-84; 12.8% during 85-90; 27.8% during 91-96; 21% during 97-98; 19.6% during 99-2000. Growth tapered thereafter.

and consumer durables. If you take the cement and primary iron products out, almost every single product and service used in the construction and finishing of dwelling has a small sector stamp. Out of top 200 SSI products in terms of gross output (3rd SSI Census), growth of 40 product categories are directly fuelled by housing alone such as paints, bricks/ tiles, building hardware, all form of wood articles, cement and concrete products, plastics, electrical products and accessories, home furnishing etc. Then take services: plumbing, painting, electrical wiring, architectural services , interior decoration, steel fabrication, carpentry and so on.[2]'

- The tide has turned in current fiscal year though. Rise in interest rates, appreciation of rupee and sobering of consumer demand have the combined pairing impact on SME growth. Rise in interest rates have retarded the housing sector; rupee rise has blunted exports and high inflation has reduced consumer demand. Though it will take at least 12-18 months for the combined impact of these factors on industrial production to become fully apparent, some early disturbing signs are already on horizon. Industrial output is down to 9.7 percent between April and October compared with 10.1 percent in the same period. Though Exports during April-October rose by 20.9 per cent in dollar terms to $85.58 billion (Rs. 3,47,793.90 crore), export performance of most of SME intensive sectors show alarming signs of deceleration. During the period Textile exports fell by 22 per cent, handicrafts by 66 per cent, leather by 9 per cent and marine products almost by 20 per cent[3].

Augmenting manufacturing and exports growth

1. Premise of FISME's suggestions

- FISME has been of opinion that though the demographics and low interest rates created a boom in the short term- which was later killed prematurely by trying to reign in inflation by monetary measures alone, India still lacks the critical building blocks to sustain manufacturing and exports growth in long term amidst global competition.
- That the demographics will fuel growth is certain, what remains an open question is whether the domestic demand would be satiated by Indian manufacturing thus

[2] Plumbers, Carpenters and Growth' by Anil Bhardwaj in Indian Express (11th April 1007) on how rise in interest rates would kill economic growth.
[3] FISME's Memorandum for Union Budget 2008-09

distributing the gains equitably and sustainably. To unleash Indian entrepreneurship, on one hand we need to address the structural and institutional weaknesses in the system and on another we will have to equip and prod entrepreneurs for bracing global competition unabashedly.

- We believe that manufacturing capabilities and exportability are inter related and mutually reinforcing. Sustainable competitiveness cannot be achieved only by provisioning of short term measures such as currency manipulation or hedging or SWAPs. In medium and long term, competitiveness could only be ensured by increasing productivity and reducing transaction costs in economy.

2. Specific Suggestions for Manufacturing

There are some key exogenous and endogenous factors that stifle manufacturing growth and limit exportability. Most of measures suggested by FISME aim at medium and short term gains.

i. **Improve access to competitively priced and adequate finance**

a. Restore interest rates to levels of 2005-06.
b. Induce massive competition in Financial sector opening it up to foreign banks and lifting restrictions unilaterally
c. Establish independent Regulatory Authority for Banks and FIs *(on lines of Telecom)* to induce competition and improve service quality and let RBI concentrate management of larger macro-economic issues
d. Regulate the Rating Companies for better service codes, their rating models and pricing. Do not let monopolies build in this domain.
e. Do away with new barriers as third party rating under Basel-II *(see how EU has smartly classified its entire SME segment under retail)*
f. Remove policy impediments for new financial instruments such as ‘Factoring’ to take off
g. Build new age institutional mechanisms for SMEs to raise *equity (e.g. SME exchange on lines of South Africa, Brazil, China among others)* and facilitate Private Equity Funds in SME segment
h. Restore Credit Linked Capital Subsidy Scheme (CLCSS) for Technological upgradation of SMEs

ii. **Improve access to economically priced and adequate Electricity**

a. Support collective SME initiatives for distribution of electricity in geographical concentrations, industrial areas and clusters
b. Remove policy impediments in open access particularly levy of subsidy element on collective initiatives
c. Accord top priority on providing electricity to manufacturing units *(as has already been done in a few states)*

iii. **Improve Industrial infrastructure**

a. Step-up building of hard infrastructure. Neither the current outlay and nor the institutional and operational mechanisms are commensurate to address huge existing gaps
b. Urgently renew focus on creation of industrial areas with basic infrastructure – an area now languishing for over 15 years because of lack of attention *(Creation of SEZs will not improve SMEs' plight)*
c. Cede the administrative and tax collection powers to associations to maintain the Industrial Areas in PPP mode *(there are already successful models in India)*

iv. **Seamless movement of goods across states**

a. Establish unified Regulatory Agency to ensure seamless movement of goods across states.
b. Railways monopoly on freight movement needs to be broken. Un-bundle Railways *(like Power sector)* along operational lines into three separate independent operational companies: Railway stations, tracks and services of carrying goods and passengers *(on lines of UK).* Tracks and stations should be available for universal use on fee basis. Let private companies start carrying the export cargo first.

v. **Education and Skilled workforce**

[SMEs are suffering from acute skill shortages. Most ITIs have become redundant. The recent ITI upgradation programme is not SME need sensitive and is likely to have only marginal impact.]

a. Fund ‘district-wise skill deficiency mapping’ exercise and invite private parties to train people, develop skills, get them third party rated and pay fee based on success. *(there are already successful initiatives at a few places particularly in Gujarat)*
b. Fund Audio-visual and print aids for skill enhancement *(on lines of US)* and also dedicate one DD channel for continuous skill development coupling it with distance education.
c. Fund massive skill identification and grading programme for those not having any formal education but possessing requisite skills *(on lines of recent UNDP sponsored programme for leather craftsmen in Agra wherein 62,000 skilled craftsmen were identified and graded on skill level and ID cards issued to 47000 of them).*

vi. Labour Laws

[Many states follow a flawed mechanism of determining Minimum Wages based on sectors in which a worker is employed. Therefore, a worker in Engineering sector is entitled to a different rate than the one in food processing sector.]

Nationally let there be a consensus on three issues:

a. Base minimum wages on rational criteria and not sectorally or specific to industry *(unlike the current situation in many states where a worker in Engineering sector is entitled to a different rate than the one in food processing sector)*
b. Allow Contract labour *(as already in many states)*
c. Provide an option to SMEs for using market based mechanism for ESI and PF and after having contributed let them be freed from keeping records and unnecessary formalities. (*ESI in particular is one of the most useless scheme where huge contribution goes waste in dilapidated ESI infrastructure that nobody uses.)*

vii. Taxes

[Area based exemptions create huge disparities with in India. The current dispensation rewards inefficient companies and punish efficient ones. SMEs suffer most in such conditions.]

a. Suspend area based exemptions (e,g. in Himachal and Uttrakhand) forthwith
b. Stay on course for GST by 2010
c. Remove tax barriers like Entry Tax and Octroi which are the biggest barriers in making India one market

viii. Bankruptcy and Insolvency Codes

a. Put in place the modern bankruptcy and insolvency codes reflecting the needs of ruthless competitive markets and uncertainties in globalization so that while entrepreneurs are encouraged to take risk, lenders are confident of quick disposal of cases and repossession of assets after failure. *(Remember what Thomas Freidman states in Lexus and Live Tree on critical policy the countries would need in globalization, "…the bankruptcy laws and courts that actually encourage people who fail in business venture to declare bankruptcy and try again, perhaps fail again , declare bankruptcy and then try again before succeeding and creating the next amazon.com')*

ix. Benchmarking of best manufacturing practices

a. Fund benchmarking of best manufacturing practices (within India) in top 20 SME segments having dominance in exports *(a cue could be taken from recent World Bank study[4] on Competitiveness in India)*

x. Stamp Duties

[High stamp duties on transfer of property and on commercial transactions such as on financial instruments create huge cascading effect.]

a. Harmonize the Stamp Duties across states and drastically reduce them

---

[4] 'Unleashing India's Innovation: Toward Sustainable and Inclusive Growth' Mark A. Dutz, Editor World Bank 2007

xi. Productivity: Cutting waste

a. Having identified gaps in processes through benchmarking studies, provide financial support to SMEs to encourage use of expert services to cut waste

b. Fund technological upgradation in plants & machinery suppliers for top 20 SME dominated export impacting embedded services

xii. Informal to formal

a. Fund comprehensive study to map reasons for informality in India to identify areas of reforms in regulatory and taxation regime

b. Special fiscal and tax incentives to encourage vertical growth and building of scale

xiii. **SME Audit of Laws**

a. Constitute a mechanism whereby all laws and bills go through mandatory 'SME Audit' *(on lines of US and EU)* pre-empting negative fall out of existing and emerging regulations

3. Suggestions for Exports

i. **Comprehensive Programme for Internationalization of SMEs**

a. Fund a comprehensive long term SME export support programme to increase SME participation in exports from current levels of <u>0.5%</u> of registered SMEs to 5% in next 10 years leveraging export promotion schemes of center and states with cluster development programmes. *[FISME is ready to provide a detailed blue print for this ambitious initiative based on global best practices]*

ii. Indian Missions: Hub of Commercial Services

a. Let Indian Missions adopt the Commercial Service Model *(of US Department of* Commerce delivered through US Embassies; of UK and Australia.) to provide value added services to exporters

b. Put in place a mechanism for regular briefing of our senior mission officials by Industry Associations

c. Facilitate ‘Export Incubation’ – boucket of support services through Embassies so that exporting companies could establish their presence in major markets

iii. Bad debt recovery/ payment defaults

a. Break the monopoly of Export Credit Guarantee Corporation (ECGC) services of which most SMEs find loathsome and hugely inefficient. Allowing large banks, insurance and private companies to develop innovative instruments to hedge payment defaults for SMEs
b. Fund/ facilitate development a mechanism through which SMEs could take services of recovery agents in importing countries in case of defaults.

iv. Provide Representation to SME bodies

a. Provide due representation to SMEs in Prime Minister’s Economic Council, Board of Trade and other Trade related decision making bodies in Ministry of Commerce for better appreciation of their needs in policy decisions *(none of SME bodies are represented in these committees).*