FISME's response to two stimulus packages

1. The index of industrial production (IIP) registered a negative growth of 0.4 per cent during October 2008 with the manufacturing sector registering a negative growth of 1.2 per cent - first time in the last 13 years. Exports have also registered a negative growth for the two recent consecutive months, October-November 2008, for the first time since February 2002. These two facts are sufficient to bring home the point that industrial activities have been hit severely.

2. The crisis had two major impacts:

   a. Impact on demand:
   Global recession – exports severely affected; slow down of buying in sectors like auto, customer durables, housing, real estate etc driven by adequate liquidity and low cost of finance; Capex stopped/suspended in Pvt. based infra and capital assets

   b. Financial crunch:
   Banks- specially foreign/private, becoming risk averse; Liquidity crunch at banks due to demand of corporates to substitute their commercial papers/existing overseas funding etc. (though improved during last one month); drying of NBFC resources and delaying of payment of bills of MSMEs by Corporates to generate cash flows

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3. To address these issues, government of India came put with two packages, impact of which is being tabulated below:

	Initiative for MSMEs	**Comments**
	First Package	
1	▪ General: RBI steps to ease liquidity	▪ Liquidity increased but with banks; not reflected in enhanced lending
2	▪ Interest rate cut 0.5% for Small and 1% Micro by PSU banks	▪ No clear guidelines; no time frame set; little impact at ground
3	▪ PS banks agree to enhance working capital limit by 20%, payable in one year with six month moratorium	▪ Impact yet to be experienced at ground
4	▪ Credit Guarantee limit enhanced to Rs. 1 cr with guarantee cover of 50%	▪ Marginal impact
5	▪ Refinance facility to SIDBI upto Rs. 7000 cr	▪ Positive step but impact will be spread over a long time
	Second package	
6	General: ▪ Package focuses on infrastructure, housing; NBFCs ▪ RBI initiatives: reduction in Repo, reverse repo and CRR	▪ Might kick-start lending for housing; capital provisioning for NBFC is good ▪ RBI initiatives create conditions for banks to lend

7	▪ Monitoring mechanism by State level bankers committee; formation of cell to receive complaints	▪ Positive impact unlikely
8	▪ Enhanced coverage for credit guarantee up to Rs 5 lac	▪ Marginal impact;

4. Areas that have remained unaddressed:

The crisis situation between Sept ~Dec 2008 created pain for large number of SMEs because of sudden reversal of prevailing conditions magnitude of which swept many SMEs of their feet. No body could have envisaged these conditions least of them SMEs. Question was whether government was willing to do something to ease pain of transition. The grudge is that nothing has been done in the so called stimulus to ease that pain. To illustrate the point:

a. SME suppliers to auto companies as well as to large corporates accumulated their unpaid receivables choking their working capital
b. SMEs who went for expansion keeping in view of the market growth, suddenly found them defaulting on repayments to banks as market conditions suddenly changed
c. SMEs that contracted raw material at prevailing high in Sept, found the value of their material at half of the price. Many are on verge of defaults. (enclosing the case)
d. Similarly, SMEs that signed contracts for forex derivatives to mitigate their risk on foreign currencies discovered that their liabilities within three months have mounted to such an extent that could wipe them out of business.

5. New dangerous trends of protectionism which will make MSMEs uncompetitive:

There are efforts by a few large corporate houses to seek protection for their duties by either higher import duties or through anti-dumping duties or non-tariff barriers or combination of all of these. Protectionist pleas for raising import duties on building blocks of manufacturing like on metals and plastics should be strongly resisted. Acceding to such demands would lead to 'Reverse Tariff Escalation' and instances of Inverted Tariffs across manufacturing chain and specially hurt SMEs. With greater integration of Indian economy with China and ASEAN, inverted tariff would render a large number of SME product categories uncompetitive.

Two glaring examples of these trends are being quoted below:

Item	Recent Protectionist Intervention	Impact on competitiveness
Mandatory requirement for BIS standard for import of steel import items (Non-tariff barrier)	Gazette Notification No. S.O. 2173 (E) dated 9th Sept 2008, stipulating mandatory BIS Certification for Import, manufacture, Storage, Sale etc of steel items including for Electrical Industry:	▪ Rise on Input cost for user small industry ▪ Even raw material not manufactured in India are not spared ▪ Very high disparity between intl. and domestic prices
Polyester Filament Yarn (Non-tariff barrier)	Put to Restricted List on Nov.24, 2008; was freely importable from last 30 years.	▪ High input cost for a large number of weaver/ knitting industries

6. What is needed:

a. Special contra cyclical measures are required on NPA norms and clear guidelines on NPA norms needs to be issued;

b. A moratorium on repayment of installments for units who are affected and special dispensation for SMEs affected by sudden reversals

c. Immediate steps for ensuring timely payments from large corporate buyers to small companies. The most important proposal pending with Ministry of MSME and Ministry of Finance in this regard is that the following provision in Section 43-B of the Income Tax Act:

   " (g) any sum payable by the assessee to a micro and small unit as defined under MSMED Act and outstanding for more than thirty days."

d. Making the coverage of Credit Guarantee cover mandatory on loans upto Rs. 25 lac. Premium of the guarantee could be born for first year.

e. To push banks for lending further reduction in reverse repo rate and also reduction in G-Sec 10 year benchmark yield by at least 200 basis point

f. To augment demand for MSME products, immediate decision on 20~25% target of public procurement for all central government and central PSUs. The mater is pending for a long time

g. Exports: Big push is needed for exposing SMEs to exports. Currently 0.5% of SMEs are engaged in exports and yet contribute to about 50% of our exports. There is critical need to look beyond Export Promotion Councils (EPCs) and leverage resources of private organizations and associations focusing SMEs.

h. While there is case for kick-starting regulatory reforms in number of areas which impede manufacturing, one immediate step could start the process of turning the tide in favour of manufacturing and also in its modernization. Income Tax rates on labour intensive MSMEs may be fixed at 50% of normal rate. This will help in capital formation and growth of this sector as has happened in IT sector.