DEALING WITH THE IMPACT OF GLOBAL FINANCIAL CRISIS

An Agenda For The Indian Economy

Confederation of Indian Industry

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Key Issues – In Brief

- SLOWDOWN IN DOMESTIC DEMAND; SOME SECTORS REGISTERING NEGATIVE GROWTH
- NEGATIVE GROWTH IN EXPORTS
- LACK OF ACCESS TO CREDIT FOR MSMES AND HIGH COST OF CREDIT
- DEFERRAL/ CANCELLATION OF INVESTMENTS
- STRUCTURAL IMPACT OF SUDDEN TRANSITION FROM HIGH ASSET PRICES TO LOW ASSET PRICES

Key Recommendations – In Brief

Monetary Measures:

1. Reduction in repo and reverse repo rates by 100 bps
2. Refinance Window for Commercial Vehicles Sector
3. Relaxation of provisioning norms for Commercial Vehicles and MSMEs

Fiscal Measures and Stimulus to Demand:

4. Increase Duty Drawback and Reduce Interest on Export Credit for Textiles Sector
5. Depreciation rate on Plant and Machinery to be increased to 33% for the first year
6. Deferral of Excise duty payment for sectors under stress
7. Need to give a big push to low cost housing

Stimulating Infrastructure Creation

8. Increase infrastructure spending by:
   - All sanctioned monies to be spent quickly
   - All projects awaiting approval to be fast tracked
   - Need single agency for infrastructure called National Infrastructure Facilitation and Monitoring Agency in partnership with industry
   - Government to increase direct spending on infrastructure
   - Allow infrastructure development companies (beyond IIFCL) to float tax free bonds
   - Create a National Infrastructure Stimulus Fund

Market Stabilisation and Foreign Exchange Management:

9. Create a market stabilization fund using resources from pension funds, insurance companies and public sector banks
10. Stabilise the exchange rate around the level of Rs 45/US$
11. Easing of FDI norms
12. Removal of interest rate ceiling on NRE and FCNR(B) deposits for a specified period

Supporting MSMEs:

13. Create an equity fund for SMEs with a corpus of around Rs 50,000 crores.

Imperatives of Banking Regulation:

14. Extend access to working capital beyond normal limits. This could be in the form of working capital term loans. Allow working capital cycle upto 6 months from the current 3 months under NPA classification.
15. Extend restructuring guidelines to real estate companies and retail borrowers, which have grown in size and importance, but are currently not eligible for restructuring.

Key Sectoral Recommendations

Automobiles
- Provide refinancing of vehicle loans at concessional rates of 7-9%.
- Ease Regulations of Asset financing NBFCs to enhance access to long term funds.
- Plan allocation for STUs for purchase of buses
- Relaxation of provisioning norms for commercial vehicle loans

Auto-Components
- Shore up liquidity & Reduce Interest Rates for SMEs
- Revise DEPB Rates to pre 4th November levels and Stabilise for 3 years.
- Ensure ECGC Coverage

Capital Goods
- Large investments in infrastructure sector should be announced to boost demand.

Cement
- CVD and import duty on cement imports need to be reimposed, since imports were eased up when there was a supply shortage. Now capacity has been added.
- Export of cement and clinker should be allowed from all ports.
- 55% abatement needs to be announced.
- Linkage coal supply be raised from the current level of less than 50% to more than 75% to reduce costs.

Chemicals & Petrochemicals
- Duty on Naphtha across the board to be reduced from 5% to nil.
- Steps need to be taken to cut price of Natural Gas.
- Safeguard duty on products from China, Taiwan, Korea, and Israel.
- To revisit duty draw back and DEPB norms and cover use of Natural Gas, Naphtha, Power etc as inputs in calculation of duty draw back / DEPB.

Leather sector
- Interest rate on term loans be reduced to 6% to the exporters of leather and leather manufactures (including footwear) for the next 3 years and made applicable for existing term loans.
- Increase DEPB rate.
- Service tax refund for post manufacturing services irrespective of whether they use Duty Drawback Scheme or not.

Steel
- There needs to be re introduction of the ‘revolving LCs’ shceme for SMEs.
- Installation of import monitoring mechanism to keep a watch on cheap steel imports from countries like China & CIS and application of safeguard duty.

Textiles Sector:

- Restore duty drawback to pre 1st October 2008 in view of declining exports and China having increased tax rebate on exports from 11% to 17%.
- Immediate measures for subvention on exports by additional 2%.
- Provide Subsidies to farmers to support the high MSP of cotton through Cotton Corporation of India and keep cotton prices at par with international prices.
- Reduce cross subsidy by 50%.
- 2% incentive under the Focus Market/ Focus Product Scheme to boost exports.

Introduction – The Case for Policy Interventions

The global growth outlook has steadily worsened. The NBER has confirmed that the US has been in recession since December 2007. While it was earlier thought that Asia would escape the brunt of the crisis, recent data from Asian countries have not been encouraging. With growth slowing down in China, the Chinese central bank slashed its key lending rate by 108 basis points to 5.58%, the most in 11 years. In addition, the Chinese government announced a 4 trillion yuan ($586 billion) stimulus package in housing and infrastructure through 2010.

In India, the evidence clearly points to a sharp deceleration in growth. Expectations of GDP growth in the second half of 2008-09 are significantly lower than the 7.8% achieved in the first half. Some of the recent data released include the following:

- Exports declined by 12.1% in October, the first decline in over six years; this is a sharp inflection compared to the growth of 30.9% during the first half of 2008-09
- Industrial production declined by 0.4% in October, the first decline in 15 years. The cumulative growth during April to October stands at 4.1%
- Automobile production declined by 11.6% and 5.8% in October and November respectively, and the decline has been particularly steep for commercial vehicles

Production in the automobile sector during April-November (% growth)

	Total Passenger Vehicles (PVs)	Total M&HCVs	Total LCVs	Total Commercial Vehicles	Total Three Wheelers	Total Two wheelers	Grand Total of All Categories
2007	15.0	-2.9	13.6	4.3	-6.1	-6.2	-2.9
2008	9.2	-14.6	-0.5	-7.9	2.9	7.1	6.5

Source: SIAM

- Quarterly corporate performance in sectors such as textiles and chemicals show that the impact of the slowdown has been very severe. There has been a sharp decline in profitability in the textile sector due to the increase in interest costs as well as the cost of power and fuel. Net profit margin fell to –0.2% in the September quarter from 4.3% in the previous year.

  Companies in the chemical sector saw their profit margins drop to 5.5% in September 2008 from 10.1% a year ago. The high level of growth in sales and raw material costs in the quarter ending September 2008 are indicative of the sharp price increases in this sector. With the subsequent downturn in demand and fall in commodity prices, companies are now saddled with high cost inventories.

Available data also shows a spurt in the import of chemical products, indicating the increased threat of such products being dumped in India. It will be important to verify this by getting data on the quantity of imports.

Import of chemical products (% growth, y-o-y)

	Apr-July-07	Apr-July-08
Chemicals and related products	29.7	82.3
Organic chemicals	24.6	43.7
Inorganic chemicals	38.4	79.2
Chemical material & products	3.1	50.9
Dyeing tanning & colouring materials	19.8	32.7
Fertiliser manufactured	54.0	263.9

Source: India Trade, CMIE

While these are just examples, the severity of the impact being felt across industry was not envisaged in earlier assessments. What started off in India as a result of the global deleveraging and consequent FII outflow has started to manifest itself in more ways than one. To just name a few:

- Difficulty in Short term roll over of debt;
- Steep deprecation of the Rupee;
- A severe decline in the market with no new equity issuance;
- A significant decline in ECB flows;
- Company profits taking a tremendous hit with an overall decline of almost Rs. 20,000 crores;
- Early signs of industrial recession setting in, which is much more than the initially expected simple moderation in growth; and
- The specter of huge job losses looking more real now than ever.

CII has identified five primary sources of distress:

- **Slowdown in exports**: Exports of goods and services account for about 20% of India's GDP. Although this is less than many other Asian economies, exports had been booming over the last few years and were an engine of growth. The sudden drop in external demand has now had an impact on sectors such as textiles, leather, gems and jewellery, where the SME sector is dominant. Service exports are also under pressure.

- **Lack of access and cost of credit**: Industry feels that their access to credit has declined despite all attempts by the RBI to infuse liquidity. Although RBI data continues to show strong growth in bank credit, i.e. 27% yoy growth as of November 21 compared to 23% at the same time last year, credit from banks needs to grow at an even stronger rate. This is needed to compensate for the lack of availability of funding from other sources. This includes foreign debt as well as equity, the access to both of which has been severely affected in the aftermath of the global financial crisis.

- **Slowdown in domestic demand**: The increase in inflation and interest rates in the last few years has put pressure on consumers' disposable income and hence their purchasing power. The data on Private Final Consumption expenditure (PFCE) shows that the expenditure on food and fuel account for more than 50% of PFCE. With prices rising sharply in these two categories, the ability of consumers to spend on other items has been constrained.

- **Deferral/ Cancellation of investments**: An alarming feature of the current crisis is that companies are either holding back or canceling planned investments. The reasons being poor demand outlook, non availability of credit, high cost of credit, etc. While it is quite possible that some of these decisions are prompted by exaggerated assessment of the current slowdown, this automatically acts as the starting point of a vicious cycle of degrowth, which cannot be allowed to set in.

- **Structural impact of rapid transition from high cost to a low cost economy**: The sudden drop in the prices of oil, commodities and other inputs impact the working capital position as existing stocks of raw materials, work-in-progress and finished goods all re price downwards. Consequently, businesses, with stretched cash positions delay payments, resulting in an elongation of the working capital cycle across the value chain. This leads to over-drawal of existing working capital facilities and inability to access the required additional working capital. These pressures are magnified as many companies have already committed resources to expansion plans under implementation. For these reasons and the enhanced risk perception, coupled with continuing uncertainties over interest rates and liquidity constrain banks' lending to industry. Retail customers represent the last and critical link in the chain of economic activity, linked to the businesses with which they are associated as employees, suppliers or distributors. They too are thus facing longer payment cycles and lower than expected cashflows. Earlier, transitions of this nature happened over a longer period as price corrections were more gradual. This time the rapid and dramatic correction has increased the challenge. It is therefore, critical to take pro active steps to make this transition orderly and as short as possible.

More monetary easing needed

Given this backdrop, CII recommends that the RBI continues the process of monetary easing that it began since the middle of September. Interest rates need to decline further in a situation where inflation is likely to decline to a level below 5% by March next year. This is already being reflected by bond yields which have fallen sharply with the 10-year yield at about 6.2%. This would call for an immediate reduction in the repo and reverse repo rates by at least 100 basis points.

Need for a sector focus

In addition there is a requirement for sector specific interventions, which could address the unique problems being faced by various segments of industry.

Most sectors of industry are staring at the specter of the vicious cycle of degrowth – lower investments leading to lower output, potentially resulting in corporate rationalization and job losses, which in turn would end up creating lower demand and then going on to the beginning of the cycle of lower investments.

It is imperative to stop this from happening. The economic and social cost of this would be too high to pay for India at this stage.

Just to give an example, a 20% rationalization in the auto and construction sector and a 5% rationalization in the textiles sector would immediately translate to 11 million jobs being lost! Clearly an unacceptable price to pay.

At the present moment though many large companies have a relatively safe short term liquidity position (EBIT/Interest Expenses), most SMEs are closer to the edge. Value chains being integrated as they are between large companies and SMEs, this poses a risk to the entire industrial system, needless to say creating a clear and present danger for the most vulnerable in industry, i.e. SMEs.

Need for Policy Interventions

The Government, the RBI and SEBI have acted in the last two months to infuse liquidity, cut interest costs, attract foreign exchange inflow, support the currency, create demand and boost exports.

Many of CII's recommendations have been considered favourably by the Government and Regulators in so doing. But the extent of the current crisis mandates wider as well as more focused interventions from the Government and the regulators. In the following section, a set of recommendations is listed for the consideration of the policy makers.

Recommendations

1. Monetary Measures

a. The immediate need for an interest rate reduction was met by RBI's announcements to cut repo and reverse repo rates through a series of announcements, the latest one being on 6 December 2008. This would help strengthen demand to some extent and address the credit shortage that industry is facing. However, looking at the increasing requirements of domestic liquidity, the need to stimulate demand and the downward trend in inflation, CII feels that RBI could further reduce the repo rate by another 100 bps to 5.5 percent, and commensurately slash reverse repo by another 100 bps to 4 percent.

b. The commercial vehicle sector is eligible for priority sector lending. However, unlike other sectors with priority sector status, this sector does not have a refinance window. The government and RBI could consider instituting a refinance mechanism for the commercial vehicle sector. Every Commercial Vehicle that rolls out into the market creates 6 jobs. This sector would therefore, need a special financing model to tide over the crisis. A similar refinance window is required by the MSME sector, which is currently finding it very hard to access credit.

c. There is also a requirement for relaxation of provisioning norms for the commercial vehicles and the MSME sectors, in order to support a sagging demand situation.

2. Fiscal Measures and Stimulus to Demand

d. In order to encourage textile exports, the government could consider increasing duty drawback benefits and reducing interest on export credit.

e. In order to encourage investments, the depreciation rate on plant and machinery could be increased to 33.33 percent for the first year.

f. Sectors under stress could be considered for deferral of excise duty payment. Many sectors are facing significant liquidity problems and such a deferral would go a long way in helping companies facing cash shortages.

g. There needs to be focus on low cost housing. Every State Government, in consultation with the Government of India needs to announce at least one low cost housing project. Besides providing shelter to the low-income categories, this would immediately help shore up demand in the system, since construction as a sector has huge linkages and the multiplier effect would be very positive.

3. Stimulating Infrastructure Creation

h. The government could focus on increasing infrastructure spending by;

- Ensuring that all moneys sanctioned for various government-funded projects are spent quickly, without allowing any lapses to occur. An announcement to this effect has been made but this needs close and regular monitoring.

- All infrastructure projects that are currently awaiting approval should be fast tracked and other potential PPP projects should be quickly implemented. It is critical to support the pipeline of large investments and ensure that demand is maintained. There is thus a need to identify key infrastructure projects of national importance and put them on fast track.

- While there is a lot of focus on infrastructure, there is no single agency having the responsibility of facilitating implementation of infrastructure projects in the country. As a result, several infrastructure projects suffer cost and time overruns. As per the Project Implementation Report which tracks central sector projects, out of the major 462 projects, 321 projects suffered cost over runs of 15% in the quarter Oct-Dec 2007. A National Infrastructure Facilitation & Monitoring Agency (NIFMA) may be set up in active partnership with industry, with a mandate to facilitate & monitor the implementation of infrastructure projects of national importance. As a representative of the industry, CII would be happy to be an active partner in setting up this Agency.

- The Government should take measures to increase its direct spending on infrastructure projects. Government projects including ones such as low-cost housing will act as a counter-cyclical measure and also help shore up demand for inputs like steel and cement.

- The government may also consider allowing infrastructure development companies (beyond IIFCL) to float tax-free bonds.

- A National Infrastructure Stimulus Fund needs to be created with an initial corpus of Rs 1,00,000 crores. Out of this Rs 75000 crores would be used for refinancing and interest cushioning for ongoing and fresh PPP projects. The balance Rs 25000 crores should be used for projects being carried out with government spending using existing channels like NHAI, etc. For the purpose of infusing more robustness, new projects like DMIC, Domestic Economic Zones Corporation, Rapid Transportation Corporation, etc could be created. The monies for this fund could be accessed from unspent amounts of key Government programmes, budget outlays, World Bank, ADB, etc. In addition, the IIFCL could raise finances at very low rates against sovereign guarantees from abroad. The management of the fund should be with the NIFMA.

4. Market Stabilisation and Foreign Exchange Management

i. A market stabilization fund needs to be created using resources from Pensions Funds, Insurance Companies, Participating Banks, etc. The fund would have to play a role of checking the unhealthy volatility that exists in the equity market at present. The Government can decide how the fund would be managed. However, this being a profitable venture it is not going to create any burden on the state or the Central Bank.

j. For all effects and purposes, the RBI is managing the exchange rate. Therefore, it could be possible for the RBI to bring down the Dollar – Rupee exchange rate to closer to 45, or thereabouts, which would be in the greater interest of the economy.

k. India needs to attract greater foreign exchange inflows by easing FDI norms. This becomes important in view of the increased outflow of FII funds in recent times. In this context increasing the limit of foreign holding in insurance companies from 26% to 49%, as proposed in the draft Insurance Bill becomes very important. The government could also take this opportunity to consider easing norms for FDI participation in other sectors.

l. The cap on interest rates for NRE and FCNR(B) deposits could be removed for a specified period. Banks could be given the flexibility of determining these rates. Given the current global situation, this would help attract greater foreign exchange in the form of deposits.

5. Supporting MSMEs

m. Keeping in mind the need of the SMEs a special Equity Fund could be created with an initial corpus of around Rs 50,000 crores. Contribution to the fund could come from the PSU Banks, and the management of the same could also be with the PSU Banks. The purpose of the Equity Fund would be to provide capital to SMEs through equity stake in companies upto 25 percent. This would provide SMEs with long term funding as well as meet their margin money requirements. The Equity Fund would be profitable venture and hence would not place any undue pressure on the government fisc.

6. Imperatives of Banking Regulation

q. Given the losses on existing inventories, businesses should be able to access working capital beyond the normal assessment of working capital limits. This could be in the form of working capital term loans.

r. The disruption in the business cycle has elongated the working capital cycle from 3 months to 6 months. The regulations require classification of borrower accounts as non performing if overdues exceed 90 days. This classification norm may be relaxed till the economy adjusts back to normal. Such a change would not mis represent asset quality in the banking system.

s. Retail customers represent the last and critical link in the chain of economic activity, linked to the businesses with which they are associated as employees, suppliers or distributors. They too are thus facing longer payment cycles and lower than expected cashflows.

t. It is also necessary, given the change in the structure of the economy and the composition of bank credit, to extend the restructuring guidelines to real estate companies and retail borrowers, which have grown in size and importance but are currently not eligible for restructuring.

Conclusion and Underlying Principle of Pump Priming

It needs to be noted that two-third of the Indian GDP is accounted for by domestic spending and as long as this is kept strong with additional government spending, the growth momentum of the economy can be kept on track.

It is expected that the US would end up allocating about 10% of its GDP to deal with the financial crisis. These are exceptional amounts even by the US standards. But these are exceptional situations and in view of this India should not hesitate to look at about 2% additional spend to shore up the economy.

The FRBM Act provisions for relaxation in times of exceptional need, and this period certainly qualifies as that.

Most importantly, any spending programme that is announced has to be closely monitored and progress needs to be publicly disclosed.

ANNEXURE 1

KEY SECTORAL ISSUES AND RECOMMENDATIONS

AUTOMOBILES	
Issues	**Recommendations**
- Liquidity Crunch & Working Capital - Investment Support - Demand Generation - Declining Exports	• Provide refinancing of vehicle loans at concessional rates of 7-9%. • Ease Regulations of Asset financing NBFCs to enhance access to long term funds. • Plan allocation for STUs for purchase of buses • Relaxation of provisioning norms for commercial vehicle loans

AUTO-COMPONENTS	
Issues	**Recommendations**
• Liquidity Crunch and high interest rates have slowed down demand for vehicles thus impacting domestic demand for auto-components. • Reduction by 40- 50% in exports to U.S. market, overall Exports have further deteriorated. • High volatility of exchange rates and steep depreciation. • Raw Material Prices especially Alloy Steel Prices remain higher than International Prices and Licensing Steel Imports has pushed costs higher • Imports surging especially from China (113% growth)	• Shore up liquidity & Reduce Interest Rates to 71/2% to 8% for SMEs • Revise DEPB Rates to pre 4th November level and Stabilise for 3 years, • Ensure ECGC Coverage

CAPITAL GOODS	
Issues	**Recommendations**
• Production has declined sharply due to negative order booking for all sectors except power equipment sector. • Demand Compression is expected to continue .	• Large investments in infrastructure sector should be announced to boost demand.

CEMENT	
Issues	**Recommendations**
• Export of cement and cement clinkers were banned on 11th April 2008 by the Ministry of Commerce by shifting these from "Free" to "Prohibited " category. This was done to increase availability of cement within the country. Subsequently on 27th May 2008 exports were allowed only from Gujarat ports. Now the situation has changed and therefore the status prior to 11th April 2008 should be restored.	• Cement should be shifted to “Free” category so that it can be exported from any port.
• Customs duty on cement was reduced from 12.5% to NIL with effect from 22nd January 2007 and CVD on imported cement was made NIL on 3rd April 2007 to meet the increased demand. The reduction in customs duties has resulted in increase in import of cement from Pakistan and Bangladesh.	• Impose CVD equivalent to excise on imported cement.
• Coal is the main fuel used in the manufacture of cement and coal linkage is provided to cement manufacturers. During the year 2007-08, the cement industry needed 25 million tonnes of coal but it received 14 million tonnes against linkage. For the rest of the requirement, this industry had to depend upon open market and imported coal.	• Linkage coal supply be raised from the current level of about 50% to more than 75% to reduce cost. Reduce customs duty on coal from 5% to NIL.

CHEMICALS & PETROCHEMICALS	
Issues	**Recommendations**
• During April-July 2008, imports of chemicals have increased tremendously. Production volumes have dropped to almost 50% and prices (weighted average) dropped by 40%.	• Impose Safeguard duty on products from China, Taiwan, Korea and Israel.
• Naptha is used as a feed stock by petrochemical sector and attracts customs duty of 5%. Some of the products of petrochemical sector such as styrene, ethylene dichloride and vinyl chloride attract customs duty of 2% whereas NIL customs duty is there on p-Xylene.	• Reduce customs duty on Naptha from 5% to NIL.
• Exports of chemicals affected due to reduction in Drawback rates with effect from 1st September 2008. Energy cost 40% higher than world impacting sector as this being energy intensive industry (18-20% of cost of production).	• To revisit duty draw back and DEPB norms and cover use of Natural Gas, Naphtha, Power etc as inputs in calculation of duty draw back / DEPB.

LEATHER	
Issues	**Recommendations**
• Liquidity crunch	• Interest rate on term loans be reduced to 6% to the exporters of leather and leather manufactures (including footwear) for the next 3 years and made applicable for existing term loans.
• Incentives to assist the exports.	• Increase DEPB rate. Refund service tax for post manufacturing services irrespective of whether exporter use Duty Drawback Scheme or not.

STEEL	
Issues	**Recommendations**
• Steel prices have come down by more than 40%. The domestic steel production is down by 25% due to demand contraction. • Demand slackening due to slump in the construction industry, automobile, and other areas using steels. • Steeply declining steel prices not covering the marginal cost. • Liquidity problem affecting cash flow • Threat of cheap imports from China. • Recent hike in transportation cost of raw materials (coal, coke) :	• Ensure flow of fund to the infra-structure sector so as to generate demand for steel. • Special packages for individual demand generating sectors would lift consumption and translate into fresh demand for steel. • Further relaxation in repo rate, reverse repo rate and prime lending rate by the commercial banks. • There needs to be re introduction of the ‘revolving LCs’ shceme for SMEs. • Installation of import monitoring mechanism to keep a watch on cheap steel imports from countries like China & CIS and application of safeguard duty and other regulations.

TEXTILES	
Issues	**Recommendations**
• Duty drawback: Reduced w.e.f 1st September by 30-40%	• Restore duty drawback to pre 1st September 2008 in view of declining exports and China having increased tax rebate on exports from 11% to 17%.
• Liquidity crunch: overdue interest subsidy under TUFs of Rs 2000 crores	• Expedite payment of interest subsidy.
• In China, interest rates hace been reduced to 5.5% while in India it is 13% plus.	• Immediate measures for subvention on exports by additional 2%.
• Minimum support price (MSP) on cotton creates distortion in domestic cotton prices vis-à-vis international prices.	• Provide Subsidies to Cotton Corporation of India to reduce the impact of high MSP of cotton so as keep cotton prices at par with international prices.
	• 2% incentive under the Focus Market/ Focus Product Scheme needs to be given to the Textile sector.

ANNEXURE 2

According Priority to Infrastructure to Fuel Economic Growth

The development of adequate infrastructure is a critical prerequisite for sustaining the growth momentum of the economy and to ensure inclusiveness of the growth process. The challenges in implementing projects in this sector are immense. Each segment in the physical infrastructure sector has its own specificities and has to be addressed accordingly with foresight, sensitivity, fairness and transparency for all stakeholders. Investment in infrastructure will not only support growth but has the potential to drive growth in other sectors as well.

There is likely to be a slowing down of investment in any downturn of a cycle as is being witnessed now. However, it needs to be emphasized that the component of investment that can play a counter cyclical role in this context, is infrastructure investment. Everything necessary should be done to give a boost to and create an enabling framework for these investments which are being planned for demand over the next 10-12 years.

Increase Government Spend on Infrastructure and Ensure Implementation

- **A special drive to be initiated to hasten the process of awarding contracts and commissioning new infrastructure projects**.

- **The pipeline of projects should be cleared fast**. Quick decision making on the projects pending for approval with various ministries are called for.

- While there is a lot of thrust on infrastructure, there is **no single agency available which carries the responsibility of facilitating implementation of infrastructure projects in the country**. As a result, **several infrastructure projects suffer cost and time overrun**. As per Project Implementation Report which tracks central sector projects, **out of the major 462 projects, 321 projects suffered cost over runs of 15% in the quarter Oct-Dec 2007**.

- There is thus a need to identify 20-30 infrastructure projects of national importance and put them on fast track. This would instill confidence and push demand.

- A **National Infrastructure Facilitation & Monitoring Agency (NIFMA)** may be set up in active partnership with the Industry, with a mandate to facilitate & monitor implementation of the above mentioned shortlisted 20-30 Infrastructure projects of national importance. CII would be happy to be an active partner in setting up this Agency, representing the Industry.

  The Agency should be structured on a PPP basis with a Board having equal representation from both the Industry and the Government. It should be headed by a prominent Infrastructure expert.

  The Agency should directly report to the Prime Minister on the implementation status of the various Infrastructure projects.

Address Liquidity & Interest Rate, Specially, for Infrastructure Projects

While the Government has taken quick and commendable measures to inject liquidity in the system, considering the prevailing credit crunch, a lot more needs to be done, particularly to boost infrastructure investments. Apart from liquidity crunch, the infrastructure projects are finding quite difficult to secure loans at a reasonable rate of interest. In the light of the above either they are deferring investments or slowing down on new projects.

- **First and foremost, it is important to designate India Infrastructure Finance Co Ltd. as the official nodal development financial institution (DFI) for the infrastructure sector.** IIFCL to provide refinance and give interest subsidies to all infrastructure commercial lenders.
- Pool in the funds lying unutilized for various infrastructure projects especially under the viability gap funds allocation and **make them available through India Infrastructure Finance Co Ltd. with a mandate to**
  - ❖ provide interest gap funding, to compensate banks for extending loans to infrastructure projects at a special interest rate.
  - ❖ Extend direct lending to infrastructure projects at a special interest rate.

This way the projects under implementation that have now become unviable due to increase in borrowing rates will continue to be on track.

- **Allow Infrastructure Development Companies to float tax free bonds.** This will greatly enthuse investments.

Bidding Process Revieew

An in-depth perusal of certain key provisions in the bidding process reveals some inherent weaknesses in the scheme that mitigate against the avowed objective of involving and encouraging the Indian private sector's enthusiastic participation in the country's infrastructure development.

Four broad areas which require re-examination relate to:

- Excessive weightage in the selection criteria for experience in 'Development'
- Method adopted for determining "Conflict of Interest".
- Capping of shortlisted bidders to 5.
- Issues of National Security.

Need For an Overarching Regulatory Framework for Infrastructure

There is an urgent need to put in place a guiding overarching framework for economic regulation of all infrastructure sectors ('principles for Infrastructure Regulation' or 'PIR'). It is proposed that the Principles for Infrastructure Regulation be-

- **Enshrined preferably in a Parliamentary statute to give it a robust and binding efficacy,** and
- Implemented through a mechanism which uses the existing regulatory framework, and various other institutions. (i.e. through Government Agencies, PSUs, Regulators *et al*) as its building block.

The legislation should be complementary and in addition to the other sector-specific legislations. It should extend to all infrastructure sectors which are under the legislative competence of the Union as specified in the Union and Concurrent list. The legislation may be recommendatory for sectors under the State list.

The proposed law should provide for –

- Establishment of effective, autonomous and accountable sector regulators (including existing ones), with clarity of the respective role of Government and Regulators.
- Establishing the main regulatory principles, with objectives, functions, powers and processes of the regulatory mechanism. Uniform implementation, subject to adaptation to sectoral ground realities, should minimize/ regulatory risk and secure predictability.

- Evolving a dynamic continuum of regulatory principles, which can guide regulatory processes at divergent sector and market maturities.
- Avoiding overlaps and multiplicity of authorities, processes and fora.
- Constitution of a multi-disciplinary dedicated expert **National Infrastructure Appellate Tribunal ('NIAT')** for adjudicating upon appeals arising from various sector regulators in a time-bound manner, as also exercising powers of superintendence over the regulators.

ANNEXURE 3

Dealing with the Impact of Global Financial Crisis
MSME Agenda for Indian Economy

CII Recommendations

- Earmark 15% overall priority sector lending for MSEs (Micro & Small Enterprises), as recommended by the Working Group on Micro & Small Scale Enterprises for the eleventh Five Year Plan (2007 –2012).
- MSEs should be provided with enhanced working capital support from the banks, by way of enhancement of cash credit limits and overdraft facilities, by atleast 15 percent, in each category.
- Consider higher working capital ratios with reduced margins from the industry.
- For a temporary period of 12-18 months the RBI should revise the definition of NPAs, to permit any defaults up to 180-270 days by way of over due payments.
- Government could urgently come out with possibility to offer differential rate of interest for MSMEs.
- There is a need to ensure that all moneys sanctioned for the various government-funded projects are spent quickly, without allowing any lapse to happen and in fact advancing the spends to ensure the demand in the economy is not allowed to dry up.
- There is a need for the establishment of a dedicated corpus for lending to MSMEs. The Finance Ministry and RBI could set up a Special Purpose Vehicle (SPV).
- Banks could be encouraged to provide working capital term loans for a period of 12-18 months to enable the Industry to go through this transition period.

CII Recommendations in detail

Recognising the pivotal role played by the MSMEs, Government support to MSMEs was extended since the rise of industrialization in India and the support was fine-tuned over a period of time taking into account the developments in the Indian economy. The Government policy over a period of time has been designed towards strengthening this vital sector. The enactment of the MSMED Act 2006, is a reflection of commitment & support, which the Government provides to the MSMEs.

The MSMEs too, in turn have played a pivotal role in industrialization of the economy and have contributed immensely to the growth and development of Indian economy. The MSMEs in India contribute over 45% of the India's industrial production and around 40% of the total exports. Thirteen million MSMEs in India employ over 31 million people. This sector with a total size of Rs 5,60,000 crores (US$140 billion) is the driving force for the long-term inclusive growth of the Indian economy and are also the backbone of the Indian economy.

CII is of the view that the MSMEs are particularly vulnerable to the impact of the current economic crisis. This can be attributed to four reasons:

1. MSMEs are dependent on export markets which are shrinking due to the recession in developed countries. Volatility in the currency market will further affect the risks attached to exports.
2. Competition from imports will intensify during an economic downturn. Structural competitive shifts take place which render SMEs in one economy uncompetitive with those in another in supplying global markets.
3. MSMEs are dependent on large corporates for their demand. Defaults and payment deferrals tend to increase during an economic downturn.
4. Risk aversion of banks tends to rise during such periods and MSMEs bear the brunt of banks' cautiousness in terms of lending.

These have been confirmed through a CII MSME CEO's Snap Poll, which shows a rise in delayed payments, cost of capital, reluctance to lend by banks and collateral requirements as key obstacles for MSMEs.

The monetary & the fiscal stimulus package announced by the Government of India and the Reserve Bank of India (RBI), as part of "Growth stimulus package", would definitely help the MSME sector, however given the intensity of vulnerability of this sector, CII would like to also recommend the following additional measures:

First, *earmarking 15% for MSEs (Micro & Small Enterprises) within the overall priority sector lending*, as recommended by the Working Group on Micro & Small Scale Enterprises for the eleventh Five Year Plan (2007 – 2012). The imperative need to enhance the availability of credit to the MSEs from the commercial banks and other institutional sources is well recognized and fixing a sub-target for this sector would go a long way in improving the scenario;

Second, while the RBI has taken measures to improve the liquidity position, there are apprehensions that these may not help ensuring enhanced credit availability to the MSE sector, given the high risk perception of banks towards this sector. It is, therefore, essential that the MSEs are provided enhanced working capital support from the banks, by way of *enhancement of cash credit limits and overdraft facilities, by atleast 15 percent, in each category*;

Third, Further, there is needed **to revisit the margins required for the working capital requirements**: Higher working capital ratios should be provided by the Banks, with reduced margins from the Industry.

Fourth, there is an urgent need, that **for a temporary period of 12-18 months the RBI should revise the definition of NPAs,** to permit any defaults up to 180-270 days by way of over due payments should not be treated as NPAs.

Fifth, while the RBI guidelines on debt restructuring mechanism for MSMEs, are in place, it is understood that most of the banks are not undertaking the restructuring of dues of the MSMEs, where warranted. The *RBI, needs to advise and monitor the restructuring of dues of the MSMEs*, so as to ensure that all eligible MSMEs are covered by the banks as per the guidelines;

Sixth, the Government should urgently come out with possibility to *offer differential rate of interest for MSMEs to tie over the present crisis*. In the past, to boost exports, differential rates of interest were made available. Therefore, the present situation of the MSMEs pleads consideration of a similar interest rates differential for MSMEs. In the past, to boost exports, differential rates of interest were made available. Therefore, the present situation of the SMEs pleads consideration of a similar interest rates differential for SMEs.

Seventh, there is a need to *ensure that all moneys sanctioned for the various government-funded projects are spent quickly, without allowing any lapse to happen and in fact advancing the spends to ensure the demand in the economy is not allowed to dry up*. It needs to be noted that two-third of the Indian GDP is accounted for by domestic spending and as long as this is kept strong with additional government spending, the growth momentum of the economy can be kept on track.

Eighth, there is a need for the *establishment of a dedicated corpus for lending to MSMEs*. The Finance Ministry and RBI could set up a Special Purpose Vehicle (SPV). This SPV would have to ensure that SMEs are allowed credit at close to PLR rates depending on the creditworthiness of the unit and the project.

Ninth, the high cost economy that was witnessed in the earlier part of the financial year, is now translating into a low cost economy, due to the steep fall in raw material prices. This has resulted in the Industry particularly, the SMEs sector having inventories of raw materials purchased at higher prices.

To ease the transition, the banks be encouraged to provide working capital term loans for a period of 12-18 months to enable the Industry to go through this transition period.

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