A lot more needs to be done

While the measures over the last two days focus on some of the structural changes, the economy is now looking forward to steps that would lead to an increase in demand

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The impact of Covid-19 on the Indian economy appears to be quite devastating. Various projections suggest that GDP growth would be negative in the current financial year. Even the international financial institutions (such as the IMF) that had projected a mild positive growth, appear to now think that the growth prospects could have sharply worsened since their last forecast. All this has led to demands for larger public policy interventions to address the imminent slowdown due to the compression in both aggregate demand and aggregate supply.

Right from the beginning, the Reserve Bank of India (RBI) was proactive with its interventions through the reduction in interest rates, CRR, WMA relaxations etc., thereby increasing liquidity for markets as well as for governments (both central and state). However, such measures without demand-side policies have been ineffective as banks started parking a large part of the additional liquidity with the RBI through the reverse repo window. Hence, all along, as some of us have been arguing, there was a need for active fiscal policy intervention to stimulate demand even as monetary policy played a supportive role.

However, the fiscal policy response was largely missing and hesitant, except for the first round of stimulus measures through the Pradhan Mantri Garib Kalyan Yojana that was presented in the initial phase of the lockdown. Analysts and economists had been arguing for a quick fiscal stimulus of about 5 per cent of GDP. At last, on May 12, the Prime Minister declared that India would have a stimulus package of ₹20 trillion, which is about 10 per cent of its GDP. This was expected to be one of the largest stimulus measures, after the United States and Japan, in the world. Although it is a relief that finally there is some fiscal response, but as they say, the devil is in the detail. In the last two days, some of the details were presented by the Finance Minister; some more are expected.

It is not clear what measures the ₹20 trillion stimulus would include. Or for that matter what would be the extent of additional expenditure that is required to revive demand in the country. Apparently, it includes the monetary stimulus that the RBI has provided by way of cutting interest rates and CRR and also the first stimulus package the government provided, which together turns out to be about ₹10 trillion. As discussed earlier, banks have been returning funds to the RBI, and it is not clear if that is included as part of the stimulus. Be that as it may, the economic package, as rightly highlighted by the Prime Minister, is expected to cover the land, labour, liquidity and laws that are crucial for the "Atmanirbhar Bharat" strategy. Given that current global economic conditions are fast leaning towards deglobalisation, such a strategy could help overcome both global risks as well as those arising from the Covid-19 crisis. In that context, the measures that the FM has laid out in the last two days clearly addresses some of the concerns of the micro, small and medium enterprises (MSMEs), non-banking financial companies (NBFCs), migrant workers, farmers, and the urban poor.

For the MSMEs, the package includes emergency working capital, debt as well as equity funds. The ₹3 trillion emergency working capital support for businesses, including MSMEs, with 100 per cent government of India guarantee without any collateral is expected to help banks in providing term loans. While this would help to smoothen the credit channel of policy transmission, it may not put any additional pressure on the fiscal situation, at least in the short term. But this could affect the public debt situation as well as its servicing cost in case it pushes up the extent of stressed assets. In addition, the government also brought up liquidity support for the NBFCs/housing finance companies/micro finance institutions again with 100 per cent government of India guarantee and this may be part of the measures that the RBI has already taken through the TLTROs. What is puzzling in all this is the government's increased reliance on public sector banks that are treated differently, while it had deliberately reduced the number and size of such banks. There is hope that there would be some measures for the public sector banks in the form of recapitalisation, which would otherwise stare at more NPAs in the near future.

In the second part of the stimulus, the government has focused on migrant labourers and increased the allocation under MGNREGS, agricultural loans, extending CLSS to the urban poor. But most important is the focus on "One Nation, One Ration". While this has been in the pipeline and some states have already got into the network, efforts to bring in all the states into the network could substantially enhance welfare of the poor, especially the migrant poor. This would also be one of the major structural reforms that could improve public expenditure efficiency in the country. The extension of housing under the CLSS scheme within the PMAY-U by one more year and initiating affordable rental housing complexes should improve the quality of life in the urban and semi-urban clusters and help revive employment and industrial activities in those regions. In all, though the fiscal support in the second part is meagre, it focuses on some of the structural changes that could have a long-term impact on the economy.

While the measures that have been taken in the last two days are certainly welcome, what the economy is keenly looking forward to are measures that would lead to an increase in demand (especially in consumption) in the short run even if that means an increase in the fiscal deficit. Hopefully that would be addressed in subsequent announcements.

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