Revival of Economy

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While the fiscal and monetary supports that are announced to overcome the pandemic situation are substantial, the impacts of these measures depend heavily on how they are implemented. Going by the present trends, one could be optimistic that these measures should help the economy to revive, although the extent of revival could also depend on how the pandemic situation is going to evolve in the coming months.

With the world facing unprecedented shock due to Covid-19 and with sudden stop of economic activities, there are expectations that there could be a permanent loss of output. Most countries have downgraded their growth expectations in the current financial year with negative growth rates. In India as well, with the pandemic situation still evolving, the growth forecasts by all the agencies have been negative with the median forecasts at close to -10%. While there are no official forecasts, off late, the Reserve Bank of India expects the GDP to contract by 9.5% 'with risks to the downside'. Under such precarious conditions, what are the fiscal policy responses that the government has undertaken and what could be its impact on the growth contractions? This piece would briefly look into it.

As a preamble, it is important to understand, briefly though, the pre-Covid-19 situation and to what extent there was policy space to overcome the adverse impacts of the pandemic. Indeed, the GDP growth was already in a slowdown phase even in 2019-20. It has registered a growth of 4.1%, which was the lowest in over a decade. The fiscal situation was even more precarious with the Central Government invoking the escape clause in the FRBM (Amendment) Act of 2018 for two consecutive years that allows the governments to run 0.5% more fiscal deficit than specified in the Act. Accordingly, the Union Budget 2020-21 suggested a fiscal deficit of 3.8% for 2019-20 and 3.3% for 2020-21. However, the data from the Comptroller of Government

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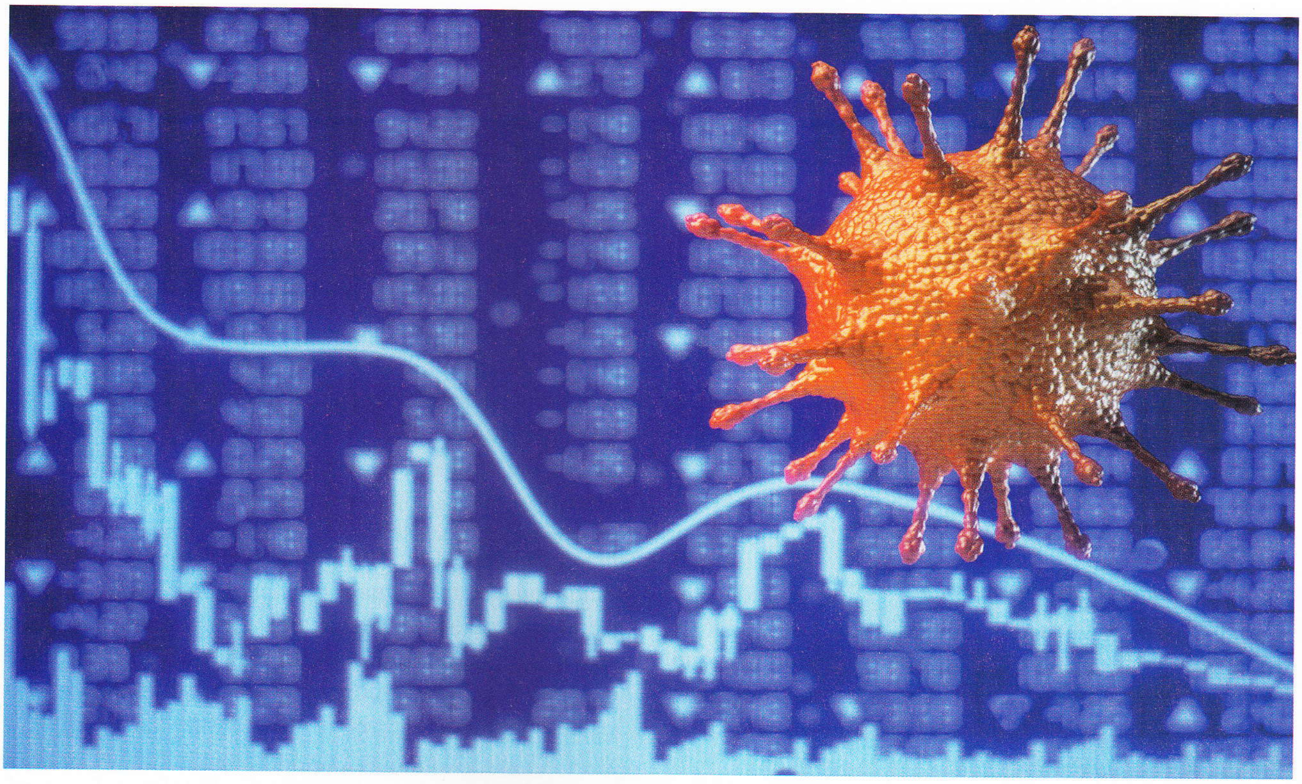


Accounts suggests that even for 2019-20, the fiscal deficit is expected to be 4.6% against the provisional estimates of 3.8%. On the part of state governments, most of the studies (including by RBI's Study of State Finances) suggest that the fiscal position at the states only deteriorated since 2015-16 despite higher (read as untied) devolution to the states. In a way, the government entered this pandemic phase with weak growth prospects and with a weak fiscal situation. In the last quarter of 2019-20, GDP growth was at 3.1% and the first quarter of 2020-21 registered the sharpest decline of -23.9%. While the pandemic by itself could not have led such sharp slowdown, it is the most stringent lockdown (although that was needed to protect the lives) that India has adopted in the first quarter which has led to sudden stop in the economic activities. With the gradual opening up of the activities (over six phases) there appears to be some green shoots noticeable since the end of September 2020. Now, the policy responses and its impact on growth is something that may be interesting to look into.

What are the actions that the largest democracy in the world has undertaken to address this pandemic and the subsequent economic slowdown? On the policy sphere, while the RBI was proactive initially to sooth the financial markets, there was hesitancy on the part of the fiscal policy clearly due to weak fiscal situation. The RBI has reduced the policy interest rates sharply and also pumped in more liquidity to the market. It has also introduced loan moratorium and other measures such as increasing Ways and Means Advances (WMA) to the State Governments, Credit Guarantee Schemes and Loan restricting Committee, among many other sectoral interventions. With the monetary policy twist, unlike in the past, there is a significant improvement in the monetary policy transmission in the recent period. Following this, the central government outlined Rs. 20 lakh crore stimulus package with accompanied large scale structural reforms as part of Aatmanirbhar Bharat Package. While there were some apprehensions about the package, that it may push India back to import substitution era that led to low level of equilibrium and low growth, the Prime Minister has clarified in his Independence Day address and also during his speech to the UN General Assembly that under the package the aim is to make India a manufacturing hub for the world. Indeed, the package talks of four Ls: land, labour, liquidity and laws, with more structural reforms in all these areas. The package also aims to help the country become self-reliant and provide support to MSMEs, the agricultural and allied sectors, migrant workers, civil aviation, defence, energy, housing and social sector that are adversely affected by the pandemic as well as lockdown.

The Prime Minister also suggested five pillars of this package and they are: Economy, Infrastructure, System, Vibrant Demography and Demand. However, what has caught the eyes was the Rs. 20 lakh crore stimulus package. The Aatmanirbhar Bharat Package includes wide-ranging interventions such as direct benefit transfer,

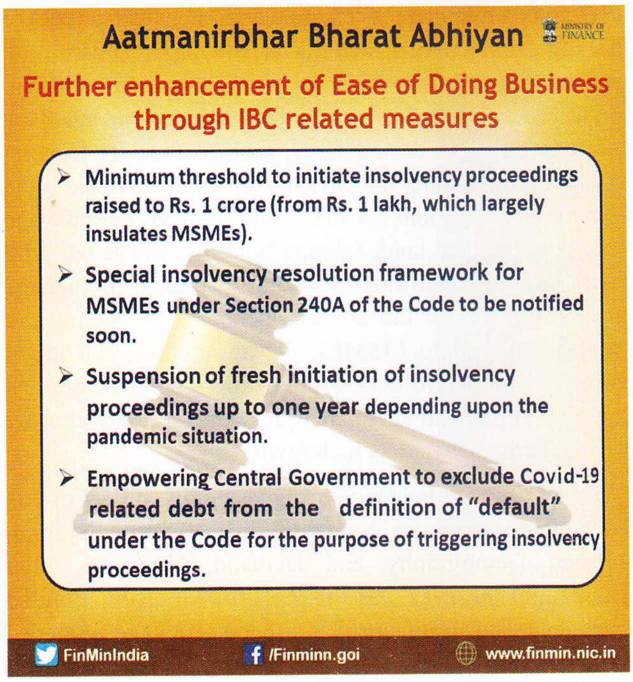
Table 1. Details of Interventions under Aatmanirbhar Bharat Package (in Rs. Crores)

PMGKY	1,70,000
RBI Liquidity Measures	8,01,603
Tranche 1 of Aatmanirbhar Package (include Collateral free automatic loans to MSMEs, Schemes for NBFCs/HFCs/MFIs)	5,94,550
Tranche 2 of the package (includes free food grain supply to migrants, interest subvention for MUDRA loans, Scheme for NABARD, KCC)	3,10,000
Tranche 3 of the package (includes Agri infra, Fisheries, Animal Husbandry, Herbal Cultivation, etc.)	1,50,000
Tranche 4 of package (Viability Gap Funding)	8,100
Tranche 5 of the package (MGNREGS)	40,000
Others	22,800
Total	20,97,053

Source: Ministry of Finance, GoI.

food security, rural jobs under MGNREGS, Credit Guarantee schemes for MSMEs and Kisan Credit Card (KCC) scheme. The package also includes the monetary stimulus provided under liquidity measures which is to the tune of Rs. 8.01 lakh crore. The extent of support in comparison with the rest of the world suggests India's intervention is wide-ranging and comparable to most of the countries except Japan and US.

Table 1 details the policy interventions that are made under the Aatmanirbhar Bharat Abhiyan. This includes a range of interventions from credit guarantee, food security, jobs, anti-poverty program (PMGKY), etc. There are few reform measures, not specified in the table as they do not have any fiscal cost. However, one of the criticisms with regard to this package is that the fiscal cost of this package is just about 1.5% of GDP as most of them include the monetary stimulus and credit guarantees. This stands against the demand for large fiscal stimulus that needs to be front-loaded in order to contain the sharp contraction in the GDP growth. However, it is important to understand that the credit guarantee to MSMEs and KCC, though do not directly affecting the fiscal deficit, it could add to the outstanding liabilities (broader concept than public debt) through contingent liabilities. In a way, while this measure does not put additional fiscal cost in the short term, this can help in reviving investments in the sectors that are hard hit not only due to pandemic and the subsequent lock-down, but also due to successive shocks such as demonetisation and GST implementation. Further, this would also help banks that are struggling with NPAs and provisioning can be done to businesses in these crucial sectors.



Against these fiscal policy measures, now there are discussions on what should be the extent of fiscal support provided to the economy in the current year. As discussed earlier, while the fiscal support under Aatmanirbhar Bharat is just about 1.5%, in our view, the fiscal support since the beginning of the current fiscal year could be larger than this and the combined (centre and states) fiscal deficit in the current financial year could be somewhere close to 12% of GDP. If one adds the public sector borrowing of about 2%, the total borrowing in the current year could be anywhere close to 14% of GDP. Here it is important to highlight that the fiscal package also needs to include the additional borrowing (of about 2.1% of GDP) that the Central Government announced even before the Aatmanirbhar Bharat package, to continue the expenditures as proposed in the Union Budget 2020-21. While this is due to the expected decline in the revenues, additional borrowing needs to be treated as fiscal support to the ailing economy. Further, in addition to this, the states are also allowed to borrow 2% more as suggested under the FRBM Act. Although there are some conditionalities, such relaxation should help some of the states to increase borrowings to compensate for the revenue losses as well as the increased demands for health care and other expenditures to balance lives and livelihoods. It may be added here that the government has already mentioned that it is open for more fiscal support and is yet to decide 'when' and 'how much' to spend. But it is also important to decide on where to spend.

What could be the impact of these policy interventions on the GDP growth in the country? This is the most crucial question among the people. There are discussions about the shape of the recovery. Whether it would be 'V' or 'U' or 'W' or any other shaped recovery is something that is important for investors. While the government feels that there could be a 'V' shaped recovery, most analysts feel that the recovery may not be that sharp. In our view, while the slowdown was sharp due to sudden lockdown, the recovery is expected to be prolonged and that depends heavily on the implementation of fiscal-monetary packages. In a way, in our view, the recovery could look like a 'smoking pipe' shape with a sharp dip in the beginning and a prolonged recovery at the later stage. Indeed, there are few green shoots already visible in the economy that suggests a gradual recovery. Indicators related to credit offtake to MSMEs, rural development expenditures (which suggest utilisation of over 80% of annual allocation), electricity demand, etc., suggest pick-up in economic activities across the sectors.

At the state level, while the expenditures due to pandemic has increased manifold, the revenues have dwindled largely due to decline in the revenues under GST. This has led to large gap between the actual and the promised 14% increase in the GST proceeds to every state government. While this could lead to some tensions between Centre and States, the pressure on the States to borrow more could be huge and this could lead to substantial jump in the public debt at the state level. Here, as many have suggested, it is important for the Centre to help the states by borrowing from the market directly so that the interest burden on the states could reduce.

Overall, in our view, while the fiscal and monetary supports that are announced are substantial, the impacts of these measures depend heavily on how they are implemented. Going by the present trends, one could be optimistic that these measures should help the economy to revive, although the extent of revival could also depend on how the pandemic situation is going to evolve in the coming months. There is also equal concern on how these measures are going to affect the inflation management. ❑