LEAD

Dressing a wounded economy

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The two major tools that the government has available before it are monetary policy and fiscal actions

The impact of the coranavirus pandemic is now felt by almost every country. First, there are the health effects of the virus, and second is the economic impact of the various actions that have to be taken to combat the virus. The world is experiencing an additiona slowdown on top of the contracting tendencies already present and India is no exception The economic impact on India can be traced through four channels: external demand; domestic demand; supply disruptions, and financial market disturbances.

External, domestic demand

As the economies of the developed countries slow down (some people are even talking of recession), their demand for imports of goods will go down and this will affect our exports which are even now not doing well. In fact after six months of negative growth, it was only in January that Indian exports showed positive growth. The extent of decline will depend on how severely the other economies are affected. Not only merchandise exports but also service exports will suffer. Besides these, the IT industry, travel, transport and hotel industries will be affected. The only redeeming feature in the external sector is the fall in oil prices. India's oil import bill will come down substantially. But this will affect adversely the oil exporting countries which absorb Indian labour. Remittances may slow down.

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To ward off the spread of the coronavirus, the government has **declared a lockdown of the country**. As passengers travel less, the transportation industry, road, rail and air, is cutting down schedules, sometimes drastically. This will affect in turn several other sectors closely related to them. The laying off of non-permanent employees has already started. As people in general buy less, shops stock less, which in turn affects production. Perhaps retail units will be first to be affected and they will in turn transmit this to the production units. One is unable to make an estimate of the reduction in economic activity at this point. If the situation is not reversed soon, there can be a serious decline in the growth rate during 2020-21.

Supply disruptions can occur because of the inability to import or procure inputs. The break in supply chains can be severe. It is estimated that nearly 60% of our imports is in the category of 'intermediate goods'. Imports from countries which are affected by the virus can be a source of concern. Domestic supply chain can also be affected as the inter-State movement of goods has also slowed down.

Financial market issues

Financial markets are the ones which respond quickly and irrationally to a pandemic such as the coronavirus pandemic. The entire reaction is based on fear. The stock market in India has collapsed. The indices are at a three-year low. Foreign Portfolio Investors have shown great nervousness and the safe haven doctrine operates. In this process, the value of the rupee in terms of dollar has also fallen. The stock market decline has a wealth affect and will have an impact on the behaviour of particularly high wealth holders.

Coronavirus | Interactive map of confirmed coronavirus cases in India

How does the government deal with this sudden decline in economic activity which has come at a time when the economy is not doing well? The two major tools that are availab are monetary policy and fiscal actions.

Monetary policy in a situation like this can only act to stimulate demand by a greater pus of liquidity and credit. The policy rate has already been brought down by 135 basis points over the last several months. There is obviously scope for further reduction. But our own history as well as the experience of other countries clearly show that beyond a point, a reduction in interest rates does not work. It is the environment of the overall economy that counts. Credit may be available. But there may not be takers. You can lead a horse to water but you cannot make it drink. Any substantial reduction of policy rate can also affect savers. Interest is a double-edged sword.

The Reserve Bank of India (RBI) needs to go beyond cutting policy rate. A certain amount of regulatory forbearance is required to make the banks lend. Even commercial banks on their own will have to think in terms of modifying norms they use for inventory holding by production units. Repayments to banks can be delayed and the authorities must be willing to relax the rules. Any relaxation of rules regarding the recognition of non-performing assets has to be across the entire business sector. The authorities must be ready to tighten the rules as soon as the situation improves. This is a temporary relaxation and must be seen as such by banks and borrowers.

India coronavirus lockdown | Delivery issues add to woes for homebound

Fiscal actions have a major role to play. Once again, the ability to play a big role is constrained by the fact that the fiscal position of the government of India is already difficult. Even without the pandemic, the fiscal deficit of the Central government will turn out to be higher than that indicated in the budgets for 2019-20 and 2020-21. Revenues are likely to go down further because of the virus related slowdown in economic activity.

In this context, the ability to undertake big ticket expenditures is constrained. But there are some 'musts'. The virus has to be fought and brought down. All expenditures to test (there is some concern that the extent of testing that we are doing now is low) and to take care of patients must be incurred. Now that private hospitals are allowed to test, the cost of the people going to private hospitals must also be met by the government. The involvement of private hospitals has become necessary. It is mentioned that a test costs ₹4,500. The total cost can be substantial if the numbers to be tested run in the thousands and more. This may sound exaggerated. But we must be prepared so that we avoid the tragedy of Italy. Therefore, the first priority is to mobilise adequate resources to meet all health related expenditures which includes the supply of accessories such as masks, sanitisers and materials for tests. The challenge is not only fiscal but also organisational.

The job sector

Serious concerns have been expressed about people who have been thrown out of employment. These are mostly daily-wage earners and non-permanent/temporary employees. In fact some of the migrant labour have gone back to home States. We must appeal to the business units to keep even non-permanent workers on their rolls and provide them with a minimal income. Some relief can be thought of by the government f such business units even though this can be misused. However, in general, in the case of sectors such as hospitality and travel, the government can extend relief through deferment of payments of dues to the government.

There is also talk of providing cash transfer to individuals. There is already a programme for rural farmers with all the limitations. For a system of cash transfer to be workable, it has to be universal. At this moment when all the energies of the government are required to combat the virus, to institute a system of universal cash transfer will be a diversion of efforts. The burden on the government will depend upon the quantum of per capita cash transfer and the length of the period.

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As mentioned earlier, the government should advise all business units not to retrench workers and provide some relief to them to maintain the workers. A supplemental income scheme for all the poor can be thought of once the immediate problem is resolved. Provision of food and other essentials must be made available to the affected as is done at the time of floods or drought. States must take the initiative.

The fiscal deficit is bound to go up substantially. The higher borrowing programme will need the support of the RBI if the interest rate is to be kept low. Monetisation of deficit is inevitable. The strong injection of liquidity will store up problems for the next year. Inflation can flare up. The government needs to be mindful of this. All the same, the government must not stint and go out in a massive way to combat the virus. This is the government's first priority.

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