

2

COVID 19 STIMULUS AND ATMA-NIRBHAR BHARAT ABHIYAN*Alok Sheel**(RBI Chair Professor, ICRIER)*

In a televised address to the nation on May 12, the PM launched the Atma-Nirbhar (self-reliance) Bharat Abhiyan with a stimulus component of rupees 20 trillion, equivalent to 10 per cent of GDP, to tide over the current Covid-19-related crisis.

The headline number is substantial and comparable with that put together in similar circumstances by advanced economies such as the US, the UK, Japan and the European Union, where the numbers range between 10 to 20 per cent of GDP. He also proposed to leverage the crisis to make India self-reliant.

India's Atma-Nirbhar Abhiyan therefore appears to be a mix of macroeconomic stabilization and structural reform policies.

The Indian package comprises executive announcements and not legislation. It is therefore difficult to cut through duplication to determine what is part of ongoing budgeted schemes, and a reiteration of policy announcements made in the past but still to be acted upon, and what is the additionality.

Be it as it may, to compare the size of the fiscal stimulus announced with those of other major economies, we need to strip away the monetary policy component (about 45 per cent) and credit through banks and NBFCs (about 30 per cent) for MSMEs and farmers.

The actual fiscal component, including the 0.9 per cent announced earlier in March, is a maximum of 2.5 per cent of GDP, comparable with China's, although most estimates place this closer to 1.5%. The new fiscal commitment is equally divided between revenue foregone, bank recapitalization and welfare measures such as direct benefit transfers, succour for migrant labour and farmers, NREGA, health, etcetera.

By way of comparison, at least two thirds of \$ 3 trillion (14.3 per cent of GDP) mandated under four Acts in the US comprises additional funds directly from the Treasury. \$ 1.2 trillion earmarked for Corporates and small businesses is a mix of new treasury loans and credit guarantees.

The Federal Reserve is separately chipping in through monetary easing, targeted credit support and unconventional policies, based on modern monetary theories, having expanded its balance sheet by over dollars 2 trillion since March. On apple to apple basis, the US stimulus is 25% of GDP compared to India's 10%.

The Covid 19 crisis has come at a time when the Indian economy was already in trouble, with declining private investment, a troubled banking system, stressed MSMEs and high unemployment. Policy induced lockdowns have generated additional unemployment on a vast scale, including dislocation and distress of migrant labour. Both big Corporates and MSMEs have seen their revenue shrink sharply.

The Indian stimulus package comprises mostly supply-side measures that seek to inject liquidity and credit at a time when demand for both is low. Liquidity injections by the RBI were finding their way back through reverse repo, investment in treasury bonds and stock markets rather than into real investment even prior to the Covid crisis. Credit offtake was weak, and the large overhang of non-performing assets made banks reluctant to lend. The big role assigned to them in the stimulus package can only add to this stress. Bank recapitalization and sovereign guarantee for MSME loans may provide some mitigation, but the devil lies in details and implementation.

However, there is very little in the Indian package for direct income support to individuals/families, Corporates, MSMEs and for the States and local governments, that are at the forefront of dealing with the both the public health and livelihood crisis. Such support comprises almost half the US package.

The roots of the current crisis do not lie in the financial system, where providing liquidity plays a big role; nor is this a typical recession where the cost of money set by monetary authorities has a major role.

There is a sudden sharp contraction in both private and corporate incomes on account of public policy. Fiscal policy therefore needs to first do the heavy lifting, in emerging markets as in advanced economies, to get demand back on track before supply side measures can become effective.

This will no doubt elevate fiscal deficits to levels where developing countries might fear market revolt. The Modern Monetary Theory route is however open to them also. The Central bank can purchase sovereign bonds beyond what their markets can absorb to contain interest rates. This risks inflation down the line, but considering the gravity of the situation, a risk worth taking. Recent experience in Advanced Economies indicates that there are policy instruments such as Interest paid on Excess Reserves, available to lock in excess liquidity when required, and that supply shocks rather than excessive liquidity now drives consumer price inflation. The liquidity overhang is likely to be siphoned off into financial markets, and into other asset classes such as real estate and gold, rather than consumer prices that are now cushioned by heightened globalization.

The objectives of the structural reforms proposed by the PM are unclear at this stage. Is there a shift in focus from making India globally competitive in an open market economy, implicit in “Make in India”, to making India self-reliant in a closed non-market one?

The PM also talked of making India competitive in global supply chains, and the Finance Minister’s multiple television presentations talked of market friendly structural reforms. But the two objectives undercut each other. Self-reliance is reminiscent of the Nehru-Indira Gandhi era of import substitution industrialization that led to a high cost, low “Hindu” rate of growth characterized by inefficient resource allocation. A license control permit Raj and high tariff barriers were the bedrock on which this model operated.

Several post-colonial countries initially followed this model in view of the industrial success of Soviet Russia, and their earlier experience with the “imperialism of free trade”. With East Asia changing tack in the seventies, China in the eighties, and the collapse of the Soviet Union coinciding with our own BoP crisis of 1991, this model was abandoned by every country that grew rapidly including our own. Sans imperialism, free trade worked for them as they were more competitive. It makes economic and geopolitical sense for emerging markets like China and India to defend free trade and globalization at a time western countries seem disenchanted with both.

Surely, the intention is not to turn the clock back! There would be areas where the country would not be competitive, so tariff walls would need to be raised to make investment in those areas profitable, or direct subsidies given, neither of which is WTO compliant. Would the state then step in and invest in these areas? It is also difficult to see India self-reliant in areas such as POL or diamond roughs that are a major part of the economy.

This is not an argument against efficiency-oriented supply side structural reforms or self-reliance in strategic areas. It is about their appropriateness and timing. Market oriented agricultural and public sector reforms announced by the FM are in the right direction. However, they are nothing new, and are awaiting implementation. Structural reforms need fiscal support to cushion the pain, over and above the fiscal support to counteract the pain of crisis. The Covid crisis has created short-term unemployment on a massive scale. Labour reforms at this juncture will only increase the pain, making several job losses permanent and magnify the travails of migrant labour.

Painful structural reforms in the midst of crisis was the original sin of IMF structural adjustment programmes, often leading to a further decline in growth. The success of India’s IMF programme was contingent on consistently bucking fiscal deficit targets.

India remains the fastest growing major economy because it is in a demographic sweet zone and is a demand-driven economy in a demand-constrained world. The paramount objective at this point is to get back to potential growth by immediately stimulating demand. The stimulus package however has very little on this, with most of the outlays on the supply side over the medium to long-term.

Getting growth back to potential requires getting the confidence of private investors back on the one hand and expanding credit supply by cleaning up bank balance sheets that is long overdue, on the other. Investor confidence has been hit by policy unpredictability arising from demonetization, a complex GST, roll-back of tax reforms, increasing government intervention, and now the suddenness of the lockdown and micromanagement. There are added fears about the prognosis of Covid-19 for India, as the lockdown is lifted, on which Tuesday's address had little to say. More uncertainty now about the trajectory of the Indian model going forward would only frighten investors further. Policy predictability based on an unambiguous long-term blueprint that is seen to be adhered to is essential for investor confidence in a market economy.

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