The contours of recovery

Centre must be forthcoming, while recognising that extraordinary situations call for extraordinary solutions. Now, reforms have to focus on specific sectors.

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The fight against the coronavirus goes on. In the meanwhile, the economic problems are multiplying. With factories closed or nearly closed, workers are without jobs and pay. Stimulus or similar efforts will show an impact only when factories resume work. Banks can provide credit only when the wheels of commerce and industry start moving. The problem of migrant workers, who may be better referred to as guest workers, can also be resolved if production of goods and services is resumed. Then their incentive to go home will be weaker. The ability to handle the problems on hand will depend, among other factors, on the growth rate in the current year 2020-21. Many analysts have recently predicted a contraction for the Indian economy. Goldman Sachs/ICRA and Nomura, in their recent assessments, have forecasted India's growth to contract by (-)5.0 per cent and (-)5.2 per cent, respectively. Even the RBI assesses that growth in the current year may be in the negative zone although it has not given a specific number. We had earlier assessed a GVA growth rate of 2.9 per cent for the current year. This was based on dividing the various sectors of the economy into four categories. These categories ranged from those minimally affected to those severely affected. It was assumed that the lockdown will last for one or one and a half months. Now it has already extended beyond two months. Under the revised set of circumstances, the expected growth rate may need to be brought down closer to 2 per cent. The World Bank has predicted growth in the range of 1.5 to 2.8 per cent. In order to relate budgetary magnitudes to GDP, we also need an idea of the magnitude of nominal GDP growth. In the current year, this is expected to be at least 4 per cent points less than the rate of growth at 10 per cent as assumed in the 2020-21 budget.

One misunderstanding about the "stimulus" must also be cleared. Any increase in government expenditure over and above the base level acts as stimulus. This is the traditional

Keynesian approach. It made no distinction between different types of expenditures. It is only later studies that made a distinction based on the size of fiscal multipliers.

The Centre has already announced an increase in gross borrowing for 2020-21 from INR 7.8 lakh crore to RS 12 lakh crore. This may lead to a fiscal deficit of about 5.7 to 5.8 per cent of GDP. This may only be enough to provide for the considerable shortfall in the budgeted tax and non-tax revenues and non-debt capital receipts, which is also being estimated by a number of analysts to be in the range of Rs 18 lakh crore, implying a shortfall of Rs 4.45 lakh crore. This shortfall is 2.08 per cent of GDP. The Centre's fiscal deficit will have to be further increased to accommodate the additional burden on the 2020-21 budget arising on account of the stimulus package.

The series of measures announced by the FM are a mix of already budgeted expenditure, additional expenditure, extension of credit facility with government guarantee for certain select sectors and a host of reform measures that are indeed welcome. Perhaps, it would have been useful if a more analytical distinction of expenditures had been given. Analytically, the overall stimulus package of Rs 20.97 lakh crore can be divided into a budgetary and a non-budgetary part. The non-budgetary part, accounting for nearly 85 per cent of the overall package, consists mainly of liquidity enhancing measures for banks and NBFCs which may facilitate the financial sector in playing a key role to kickstart the economy. The credit guarantee provided by the government under the various schemes announced recently is of central importance in this context. In fact, for certain schemes, the government has come forward to provide 100 per cent guarantee, which should quicken the pace of credit sanction and delivery by banks. Production of goods and services is inter-related in an economic system. Once production starts, different sectors will be mutually supporting since different industries and service providers are locked in an input-output system.

The budgetary part amounts only to about 15 per cent of the overall package. This can be further divided into government expenditure which was already budgeted in the 2020-21 budget and expenditures constituting genuine additionality. The latter component is only 10 per cent of the package equivalent to 1 per cent of GDP. Adding this to the enhanced level of 5.7 per cent of GDP, the Centre's fiscal deficit may be close to 6.7-7 per cent of GDP. This will maintain the level of budgeted expenditure while providing for the additional cost of the announced fiscal stimulus. In fact, the fiscal deficit will be even higher if the current year's GDP is lower than that of the previous year.

With this high fiscal deficit, the composition of government expenditure becomes critical. Some of the establishment expenditures and subsidies, especially those linked to petroleum prices like fertiliser and petroleum subsidies, may be reduced while expenditure on health-related items may be increased. The central government has announced freezing of increments of DA and dearness relief components in the case of salaries and pensions respectively. In fact, the government should be doing much more to relieve the plight of migrant workers. The pictures we see are reminiscent of Partition. Hunger needs to be fought as vigorously as the virus.

According to the National Infrastructure Pipeline, the Centre's budgetary contribution to infrastructure is estimated at 1.25 per cent of GDP on an annual basis. This is less than 18 per cent of the estimated fiscal deficit of the Centre in 2020-21, indicating a very poor quality of fiscal deficit. One dimension of expenditure restructuring should be to frontload infrastructure spending, including that on health infrastructure, thereby taking advantage of the higher multiplier effects associated with capital expenditures. Investment augmentation is also demand supporting and employment and income generating.

Support to demand will come not only from the Centre but also from the states and the public sector undertakings. States have been allowed to borrow an additional 2 per cent of their respective GSDPs subject to certain conditions. In fact, at the present juncture, these conditions are not required since the enhancement of the borrowing limit is for one time while the reforms linked to conditions are permanent in nature. In any case, states should be encouraged to support demand by going up to the full extent of the enhanced limit.

In this scenario, the combined fiscal deficit of the Centre and states alone may amount to close to 12 per cent of GDP in 2020-21. Besides, the total public sector borrowing also includes the borrowing by central and state public sector undertakings. Thus, the total Public Sector Borrowing Requirement may well exceed available sources of financing consisting of the financial savings of the household sector, savings of the public sector and net capital inflows. In this context, monetising debt has become unavoidable. The Centre must be forthcoming on these issues while recognising that extraordinary situations call for extraordinary solutions.

We must consider the shape of the next round of reforms which would pave the way for sustained growth in the post-COVID era. However, in the case of reforms, we have reached a new stage. General reforms cutting across industries and sectors have been critical in the early stages. The earlier regime of controls and permits had to be brought to a close. But now reforms have to focus on specific sectors. Applying the general principles of liberalisation to sectors such as agriculture and, more particularly, agricultural marketing, power sector, and telecom have assumed importance. Labour market reforms are needed across all the states. But labour reforms are introduced better when the economy is in the upswing. Consensus building is critical before introducing labour reforms. Land markets need to be freed up consistent with the concerns of small and marginal farmers.

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