Covid-19 & India's Fiscal Challenge

Why in news?

Fiscal stimulus is needed to mitigate the economic effects of the Covid-19.

What are some forecasts?

- The immediate future appears dire for large emerging markets like India.
- The International Monetary Fund (IMF) slashed India's growth forecast for 2020 from 5.8% to 1.9%.
- The World Bank estimated that India would grow 1.5% to 2.8% in 2020-2021, the lowest since the start of 1991 economic reforms.

What are the monetary stimulus efforts taken?

- Given the severity of the crisis, the Reserve Bank of India (RBI) has responded proactively to **ease liquidity concerns**.
- However, this credit easing policy is yet to be transmitted to many firms.
- The RBI has granted **regulatory forbearance** relating to asset classification to support economic activity.

What are the fiscal stimulus efforts taken?

- In contrast to monetary stimulus, the Indian government's fiscal stimulus efforts are inadequate.
- India's fiscal stimulus is **less than 1% of its GDP** (Rs. 1.7 trillion).
- This stimulus is trivial compared to the magnitude of stimulus injections undertaken by many East Asian countries like Malaysia (16.2%).

Will the relief packages help India?

- The Asian Development Bank and the World Bank will offer relief packages to India worth $1.5 billion and $1 billion respectively.
- These packages would **only be supplementary** to the larger fiscal stimulus package that India may need to roll out.
- However, with a government debt of around 72% of GDP, India's fiscal room to opt for a massive stimulus appears much more limited.
- Any aggressive stimulus spending will result in a surge in India's gross public debt and will negatively influence its credit ratings.

Does India have an effective financing option?

- To finance its additional stimulus, foreign investment in government securities should be encouraged to seek capital flows.
- Given the heightened risk aversion and short-term capital outflows from India, it is unclear how much the recently liberalised norms will help.
- India has foreign exchange (FX) reserves of around $476 billion.
- Given the likely pressure on its balance of payments moving forward, utilising FX reserves does not seem to be viable at the moment.
- A radical financing option would be to monetise the deficits by allowing the RBI to print money to buy the government bonds as long as inflation remains under check.
- But India has worked hard to move away from such fiscal stimulus moves that led to macroeconomic instability.

What could be done?

- It is important to do whatever it takes to moderate the meltdown, offer disaster relief and eventually kick-start the economy.
- However, if there is no proper governance of any massive fiscal spending, even a very well-intentioned policy may end up doing harm.
- India needs to be concerned as it possesses the least state capacity to make tough decisions to return to a trajectory of fiscal credibility.
- India should start **re-prioritising expenditures** towards greater spending on health and social safety nets for low-income households.

Source: The Hindu

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