5 Ways For India To Fund Massive Economic Stimulus Package

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As India struggles with the Covid-19 crisis and its economic policy response, it is important to remember that unlike in many other countries, the Indian economy was performing very poorly immediately prior to the crisis. The country was undergoing a serious downturn in demand, very high levels of unemployment and a crisis in sentiment. Many questioned the viability of the growth model that had driven Indian growth for the decade prior.

These issues and problems are now multiplied manifold. India now faces both a demand shock and, potentially, a savage simultaneous supply shock in essential commodities which makes macroeconomic management an even more difficult task. The sudden stop in economic activity means that there are critical demand and income shortfalls. These will multiply in the months to come, further contracting the economy.

Dealing with Covid-19 requires three different elements which are being taken into account in many countries to different degrees: first, the protecting and ringfencing of essential services and processes; second, protecting people from the fallout of the lockdown; and third, expanding our financial and infrastructural capacities to deal with the ramifications of the crisis in the weeks and months to come.

In the Indian context, the first and second elements are fairly clear. We need to protect people's incomes at scale to the extent possible. The use of large-scale monetary transfers support workers to through the time of lockdown are essential and all governments have been attempting to arrange that. The unfortunate chaos arising from the very quick initial lockdown and the subsequent internal migration makes this a humanitarian crisis that continues to unfold. At the same time, because commodity supplies are likely to be constrained, along with fiscal transfers, inflationary concerns are real. Ensuring that food supplies continue uninterrupted, using the FCI's buffer stock, is a key macroeconomic policy measure to complement any other demand side measures.

Maintaining supply chains, making sure that financial markets are providing funds to productive uses in the real economy and other such policies are critical to complement fiscal action. In particular, the impending financial stress and potential collapse of companies should be avoided by all tools possible, since the interlinked nature of finance means that these effects will spread and cannot be reversed easily. Using the RBI as a liquidity backstop will possibly be necessary.

In terms of the third, given that we are in a global pandemic not seen in a 100 years, the previous fiscal rulebooks (already under question) should not bind. The resources for the response will have to be utilized in a decentralized manner and given to states and local authorities. At the current juncture, many states are struggling, and measures are being taken under duress. For example, Karnataka is mulling selling real estate to raise money for the Covid-19 response. Such actions will only lead to distress sales and private profiteering. Rather, there can and should be direct transfers to the states from expanding fiscal space at the Centre or through direct action from the RBI (say through a ways and means advance window). At the current juncture, we are not sure what size of response is warranted, although it is clear that existing responses have been smaller than elsewhere. Arvind Subramaniam and Devesh Kapur have suggested a stimulus in the order of 10 trillion rupees, though it is possible that this may need to be revised upwards now that the lockdown has been extended to May 3rd.

Assuming that this is the case, funding can come from a variety of sources:

First, monetary financing. Although direct monetary financing of government securities is legally prohibited, this is an option that cannot be ignored at this juncture. Even prior to the current crisis, the RBI was loading up on government securities through the open market. The concern, of course, with such a move is that it would require circumventing the law and that it would be inflationary. But this would come on the heels of a long period of credit deceleration, and, as base money increases, there is no need to expect sharp inflationary pressures in the absence of supply collapses.

Second, the extent to which government securities can be issued and bought by state banks and LIC or other corporations depends to some extent on the appetite for government securities. In the recent past, rates have trended higher, but in the face of widespread collapse, the desire for safer assets, as well as continued uncertainty about private business activity, there may be sufficient appetite. In any case, moral suasion and financial repression (keeping interest rates on debt lower) will likely be part of the mix.

Third, unspent cesses such as the education cess need to be deployed very quickly. Similarly, any unspent balances in government accounts and pending bills should be resolved very quickly.

Fourth, while ideally there should be no increase in direct taxation at the current juncture, as the economy begins to recover, a 'Covid Cess' that is placed on income earners above, say Rs 20 Lakh, could be considered.

Fifth, funds could be raised from multilateral loans and from external private market borrowing. This should be the last recourse, unless it is financed in Indian rupees.

At the same time, the infrastructural resources for tackling Covid-19 need to be expanded. Here, India's decades-old refusal to seriously tackle its public health infrastructure has come back to haunt it. It is not a surprise that a state like Kerala has done better so far in this regard, given its much more solid track record in this arena. The fact that in most of the country, there has been a two-tiered health system, one for the rich and one for the rest, means that the private health care sector has much more capacity than the squeezed public health care system. We will therefore have to use both the public and private health systems effectively. In addition to expanding and supporting the public system extensively, we will need to utilize the private sector, especially in testing. As such, private sector contracts that are required should be procured transparently, but sensibly, with quick fulfilment of payment and no additional burdens that might derail the capacity of the system to deliver on what it has been tasked to do.

Finally, while the main discussion is, appropriately about PPEs, ventilators and hospitals, this is an opportune time for India to use its indigenous pharmaceutical capacity and to loosen the grip of poorly-chosen and detrimental IP regulation. As a country, we have suffered from the inability to produce generics because of existing patent laws through the TRIPS agreement. But it is perfectly legal and sensible to issue compulsory licenses for some of the most promising treatments. Remdesivir - considered a potentially important treatment is under patent in India. By contrast, the country is the world's largest supplier of Hydroxychloroquine - another potential front-line treatment, which is available at scale precisely because it is off-patent.

The resources required for this battle can be made available. We require a great deal of cooperation, political will and organizational flexibility and creativity in the next few months to make the best use of them as we move forward.

(With inputs from Niranjan Rajadhyaksha, Amit Basole and Avinash Tripathi.)

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