THE HINDU

llout of COVID-19

vth and a tighter fiscal

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India slid into the pandemic crisis in the backdrop of economic downslide; fiscal stimulus has to be structured

The impact of COVID-19 will be debilitating for the global as well as the Indian economies. Various institutions have assessed India's growth prospects for 2020-21 ranging from 0.8% (Fitch) to 4.0% (Asian Development Bank). This wide range indicates the extent of has projected India's growth at 1.9%, China's at 1.2%, and the global growth at (-) 3.0%. The actual growth outcome for India would depend on: the speed at which the economy is opened up; the time it takes to contain the spread of virus, and, the government's policy support.

Growth prospects

India slid into the novel coronavirus crisis on the back of a persistent economic downslide. There was a sustained fall in the saving and investment rates with unutilised capacity in the industrial sector. In 2019-20, there was a contraction in the Centre's gross tax revenues in the first 11 months during April 2019 to February 2020, at (-) 0.8%. These trends continue to beset the Indian economy in this crisis.

We examine the growth prospects for 2020-21 from the output side, making reference to real gross value added (GVA). In 2019-20, which would serve as the base year, India may show GVA growth of about 4.4%, well below the Central Statistics Office's second advance estimate of 4.9%, as the fourth quarter number is likely to be revised downwards on account of the adverse impact of the virus on economic activities. The IMF's GDP growth estimate for 2019-20 is at 4.2%.

GVA is divided into eight broad sectors. Although all sectors have been disrupted, some may be affected less than the others. We divide the output sectors in four groups.

In group A, we consider two sectors that have suffered only limited disruption — namely agriculture and allied sectors, and public administration, defence and other services. In the case of agriculture, *rabi* crop is currently being harvested and a good monsoon is predicted later in the year. Despite some labour shortage issues, this sector may show near-normal performance. The public and defence services have been nearly fully active, with the health services at the forefront of the the COVID-19 fight. For the group A sectors, it may be possible to achieve 90% of the 2019-20 growth performance.

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Differential impact of the novel coranavirus on Gross Value Added in 2020-21

Group	Sector	Share 2019-20 (MAE)	Average growth (2017-18, 18-19, 19-20 MAE)	2019-20 MAE	Targeted growth (2020-21)	Contribution to growth (% points)
A	Agriculture, forestry & fishing	14.4	4.0	3.1	2.8	0.40
B	Mining & quarrying	2.6	0.6	2.2	1.1	0.03
C	Manufacturing	17.4	4.4	0.3	1.8	0.31
B	Electricity, gas, water supply & other utility services	2.3	8.0	4.1	2.1	0.05
B	Construction	7.8	4.7	2.4	1.2	0.09
D	Trade, hotels, transport, communication, etc.	19.6	7.0	5.1	1.5	0.30
B	Financial, real estate & professional services	22.3	6.3	6.8	3.4	0.76
A	Public Administration, defence and other services	13.6	9.3	8.2	7.4	1.00
	GVA at Basic Price	100.0	5.9	4.4	2.94	2.94

MAE refers to modified advance estimates that are derived by adjusting downwards, CSO advance estimates dated February 28, 2020

Next, we consider the group that is likely to suffer maximum disruption (Group D). This includes, trade, hotels, restaurants, travel and tourism under the broad group of "Trade, Hotels, Transport, Storage and Communications". This sector may be able to show 30% of 2019-20 growth performance. Group B comprises four sectors which may suffer average disruption showing 50% of 2019-20 growth performance. These sectors are mining and quarrying, electricity, gas, water supply and other utility services, construction, and financial, real estate and professional services. In the last group (Group C), we place manufacturing which has suffered significant growth erosion in 2019-20. It is feasible to stimulate this sector by supporting demand.

In this case, we apply a 40% performance factor, not on the 2019-20 growth which is an outlier, but on the average growth of the preceding three years. Considering these four groups together, a GVA growth of 2.9% is estimated for 2020-21. Realising this requires strong policy support, particularly for the manufacturing sector which has a weight of 17.4%. It is also based on the assumption that the Indian economy may move on to positive growth after the first quarter. In the first quarter, GVA growth will be negative.

Calibrating policy support

Monetary policy initiatives undertaken so far include a reduction in the repo rate to 4.4%, the reverse repo rate to 3.75%, and cash reserve ratio to 3%. The Reserve Bank of India has also opened several special financing facilities. These actions will have a positive impact on output only after the lockdown is lifted. These measures need to be supplemented by an appropriate fiscal stimulus. Although industry has been clamouring for a large fiscal stimulus, cash-constrained central and State governments have taken expenditure reducing measures by announcing a freezing of enhancements of dearness allowance and crore for the States, together amounting to 6.0% of GDP.

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There is also a talk of substantially reducing non-salary defence expenditure. With lower petroleum prices, fertilizer and petroleum subsidies may be reduced. These expenditure cuts are contemplated to keep the fiscal deficit under some control.

On fiscal deficit

Fiscal stimulus can be of three types: relief expenditure for protecting the poor and the marginalised; (b) demand-supporting expenditure for increasing personal disposable incomes or government's purchases of goods and services, including expanded health-care expenditure imposed by the novel coronavirus, and, bailouts for industry and financial institutions. The Centre had earlier announced a relief package of ₹1.7-lakh crore of which the additionality was only ₹65,000 crore, since it included a frontloading of the budgeted expenditures. The Centre's budgeted fiscal deficit of 3.5% of GDP may have to be enhanced substantially to make up for the shortfall in budgeted revenues; account for a lower than projected nominal GDP for 2020-21, and provide for a stimulus. Thus, the Centre's fiscal deficit may increase to 6.0% of GDP. Expenditure on construction of hospitals, roads and other infrastructure and purchase of health-related equipment and medicines require prioritisation. These expenditures will have high multiplier effects. Similar initiatives may be undertaken by the State governments which may also enhance their combined fiscal deficit to about 4.0% of GDP to account for 3.0% of GDP under their respective Fiscal Responsibility Legislation/Law and to provide for the shortfall in their revenues and some stimulus.

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Financing of the fiscal deficit poses a major challenge this year. On the demand side, the Central (6.0%) and State governments (4.0%) and Central and State public sector undertakings (3.5%) together present a total public sector borrowing requirement (PSBR) of 13.5% of GDP.

Against this, the total available resources may at best be 9.5% of GDP consisting of excess saving of the private sector at 7.0%, public sector saving of 1.5%, and net capital inflow of 1.0% of GDP3. The gap of 4.0% points of GDP may result in increased cost of borrowing for the Central and State governments. This gap may be bridged by enhancing net capital inflows including borrowing from abroad and by monetising some part of the Centre's deficit. Monetisation of debt can at best be a one-time effort. This cannot become a general practice.

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