Macroeconomic measures to revive the economy

Context:

India is in the 3rd week of lockdown and the lack of economic activity has brought the nation to a grinding halt. Several informal sector workers, marginal farmers and SMEs are taking a massive economic hit, and with a shortage of workers and resources economists unanimously believe that the economy will take months to get back on track. Though both the States and Central Government have taken adequate steps to put in place safety nets for the most marginal, the overall economic impact needs to be addressed via both short-term and long-term measures.

This brief prioritizes the sectors that will be most affected by the slump in activity due to lockdown. Then it suggests measures and policy decisions to the state and the central government to consider in once the economy opens on 15th April, albeit in a phased manner. Here the focus has been given to the Medium and Small-Scale Enterprises (MSMEs), Healthcare, Education, and suggests reforms in Trade practices to take advantage of the global recession. The primary reasons to choose these sectors were based on the number of people employed and contribution to the national GDP, with a special focus on differentiated responsibilities of state and center. These measures give a bird-eye view of world order post lockdown and help lay down the groundwork to make India better prepared to its aftershocks.

I. Reforming Trade laws and building existing capacity

PM Modi has asked all ministries to reduce dependencies on foreign supplies in this time of crisis. An aggressive pushing strategy for "Make in India" must be in place where the businesses are encouraged to locally source the raw materials for their supply chain. This has a two-fold benefit: one it mitigates the import burden and secondly its network affect the puts cash in the hands of the producers and suppliers in the lower rungs of the supply chain.

Global manufacturing has taken the biggest hit by the strict social distancing measures. This is true of not just China but smaller nations with specialized manufacturing capacities. Other than pushing for local manufacturing, India needs to make bold reforms across the value chain starting with approvals, clearances, land and labor reforms to attract investments as it emerges as an alternative manufacturing base.

1. **Improve infrastructure and logistical facilities and regulatory reforms to improve investment in manufacturing sector**

   The pandemic has exposed the vulnerabilities of international trade and global value chains (**GVCs**) involving production of different parts of a product in different countries. For example, a smartphone requires chips, accelerometers, gyroscope, camera, LCD screen, battery, and hundreds of other components, which are finally transported to one location for assembly of the final product. Though the GVCs enable companies to reduce costs and increase the scale of their operations, they render the production processes highly vulnerable – the COVID-19 attack in China and South Korea, has disrupted the supply chain for smartphones, computers, cars, medicines, and several other products.

   With several companies shifting out of China, we can take advantage of the situation. The rising demand in India, together with the multinationals' desire to diversify their production to include low-cost plants in countries other than China, could help India's manufacturing sector to grow and help in reviving the economy.

2. **Risk sharing for Cancelled Shipments**

   Due to the crash in the global supply chains export sector has been massively hit. Shipment packages worth crores have been cancelled which will massively impact MSMEs in India. To revive the confidence of exporters, the Ministry of Commerce can partially bear operational and recurring losses of these listed MSMEs registered under the merchandise export scheme for a period of 3-6 months till the ports become operational again. Additionally, to reduce the burden, GoI can initiate a single window advance cargo clearance booking system for fast-tracking shipments post lockdown.

II. Developing a framework to support the already stretched healthcare

With cases of coronavirus doubling every 96 hours, India is potentially staring at possibility of completely stretched state-run health care with no room for additional patients. However, a relatively lesser growth of the infected cases presents a breathing space for the government to build health capacity to tackle the inevitable exponential rise of the infected cases.

1. Special Tax incentives for States engaging in Rapid Testing

GoI to provide special tax incentives to States helping to set-up large scale ICMR certified or private testing centres. Additionally, to encourage private players at this time the GoI in coordination with State governments can provide tax deferrals for a period of 3-6 months for each of these testing centres, with complete exemption from dividend distribution taxes, minimum alternate tax and other State taxes.

2. Covering the cost of private treatment

Government needs to loop in the resources from the private hospitals to complement the public hospitals and establish a collaboration on efficient testing methodologies. India can use the Italian and Spanish model where the national government instructed all the private hospitals to take in all patients in need for a treatment by covering their cost and providing tax benefits to the hospitals. Alternatively, the government can also provide health loans to at a minimal interest rate to the most vulnerable households.

3. Tax Credits and Seed funding to start-ups

Even though India has a thriving start-up ecosystem, the times require more innovative ideas in health care, education, and similar essential needs. Firstly, the government needs to identify the key health challenges and then start a seed-funding campaign to spurn the new ideas and provide tax-benefits to the existing ones. This will ease the burden on the already stretched capacities of state-run organizations and will be beneficial to the long-term health of the economy.

III. MSMEs and Small businesses will be the key to revive the economy from the ground-up

India has more than 63 million micro small and medium enterprise (MSMEs) and contribute 6.1% to India's GDP and 33.4% to its manufacturing output. They are one of the most efficient machinery of Indian economy and therefore hold the key to PM Modi's target of $5 Trillion economy. However, amid lockdown their activity has come to a standstill and impacted millions of people dependent on their operations. According to GOQii survey, 26% of the businesses have recorded a slump in the revenue post lockdown. With PM Modi hinting an extension to the lockdown, the government needs to provide a safety net to its most essential cogs.

1. Cash Infusion in MSME

The GoI should try to create an MSME Stabilization Fund which can be used, in conjunction with microfinance bodies and NBFCs, to give low interest working capital to the MSMEs, keeping the effective interest rate around 5-6 percent. The tenure of the loans can be extended to 15 to 20 months, and there can be an interest moratorium for the first three months. The GoI should also encourage enterprises to locally source raw materials. This will help in maintaining the supply chain and significantly cut down on the import cost.

2. Buying stakes to avoid economic fallout:

Like Germany, Indian government needs to prioritize the sectors and then identify the high performing firms facing the brunt of the lockdown. Buying stakes in these firms will give them breathing space not just in retaining employees but also carrying out daily operations.

3. Tax deferment and loan restructuring for small businesses

All the major economies in the world have either introduced tax deferrals or suspended expiring tax payments and declarations for an average of 3 months for small scale enterprises. This will be a welcome step for the businesses and households with a healthy credit history to help them overcome the crisis.

4. Investment in Online Market Linkages:

India has 42.5 million small scale businesses, roughly employing 40% of India's workforce. Even if the economy is opened in phases it will be some time before these SMBs restore their growth trajectory as the social distancing norms will limit social activities. This provides an excellent opportunity for the State governments to invest in online infrastructure for a versatile market linkage for SMBs. Restarting the economy will require the robustness of both demand and supply side, which usually are complementary to each other. More economic activity would ensure that people have a higher purchasing power.

IV. States that are most affected by the pandemic should be prioritized

Maharashtra, Delhi, and Tamil Nadu have the highest number of cases with other states reporting increasing numbers daily. The richer states might be better equipped to deal with the crises but states like Bihar, Orissa, Uttar Pradesh and other north-eastern states can be easily overwhelmed owing either to their large population or scant health resources. Here central government needs to have a strategy in place to tackle the pandemic on multiple fronts simultaneously.

1. Alter the States devolution formula under the 15th Finance Commission

Central Government (**GoI**) should consider providing additional grants via an increased share in the divisive pool under the 15th Finance Commission devolution as an emergency/contingency fund. States to be allocated money on additional parameters such as the total number of economic enterprises operating at 100% capacity, total loss in revenue (INR), etc. Additionally, the Finance Commission can increase performance incentives for States that have been front-runners in controlling the pandemic. Strategically releasing funds based on a scientific tax formula saves the contingency funds as the cases grow in across the country.

2. Readjusting the FRBM limits for States

States who have been identified as highly contagious (active hotspots) can be provided with increased Fiscal Responsibility and Budget Management (FRBM) limits to enable them to borrow additional loans under externally aided projects (EAP). This will help the State governments seek alternate financing from multi-laterals and large-scale development agencies. This will ensure that the states proportionally receive the aid thereby leaving a window for future crises.

V. Alleviating the burden on School workers and students with loans

India currently has 34 crore students, more than the United States' population. Moreover, the educational institutes employ millions of teachers and other school workers. Since the government is hinting a phase wise opening of the lockdown, schools and colleges can be a good introduction since the children and teenagers are least likely to be affected by the virus. A strategy deployed by the German Government.

1. Opening schools as a part of staggered easing of lockdown

There are currently 1.3 million schools in India employing millions of teachers and staff workers. Since children are least affected by the outbreak, it provides an opportunity in the less-affected regions to open the schools and nurseries after the 14th April deadline. This will ease the burden on working parents and help the people employed in school to resume work. However, this step should be taken keeping in mind the number of infections.

2. Easing Student Loans

India needs to take a cue from the United States in easing the interest repayment of student loans. Due to recession in most countries, most fresh graduates are either struggling to find a job or taking a pay-cut. The government can ask the banks to either defer the interest payment or cancel them in the event of an extended lockdown.

VI. Other short-term measures

1. Redistribution of Payables and Overdues

GoI and State governments to release up to 50% of total payables and overdues to private players contracted upto FY 18-19. At present, GoI owes a massive amount of money to private contractors wherever the project is on PPP mode, with the highest number of payables is under projects tendered with NHAI, railways and shipping.

2. Tax Free Bonds to raise capital

Tax Free Bonds could help raise additional resources, apart from revisiting fiscal deficit targets and fast-tracking monetization of operating assets across the infrastructure sector to raise required resources. This will provide an added avenue for the middle class to invest in bonds as the government issued bonds are safer and give much higher interest than banks. One-time restructuring window without asset reclassification can then help businesses focus on sharp recovery.

3. Donations to COVID-19

Italian government has introduced a deductibility of donations to the COVID-19 relief for the firms who can weather the storm and can contribute to health services and essential supplies in the current state of lockdown. India can deploy similar measures.