Perhaps India's Greatest Challenge in Recent Times[1]

Economically speaking, India is faced today with perhaps its greatest emergency since independence. The global financial crisis in 2008-09 was a massive demand shock, but our workers could still go to work, our firms were coming off years of strong growth, our financial system was largely sound, and our government finances were healthy. None of this is true today as we fight the coronavirus pandemic. Yet there is also no reason to despair. With the right resolve and priorities, and drawing on India's many sources of strength, it can beat this virus back, and even set the stage for a much more hopeful tomorrow.

The immediate priority, of course, is to suppress the spread of the pandemic through widespread testing, rigorous quarantines, and social distancing. The 21 day lockdown is a first step, which buys India time to improve its preparedness. The government is drawing on our courageous medical personnel and looking to all possible resources – public, private, defense, retired –for the fight, but it has to ramp up the pace manifold. It will have to test significantly more to reduce the fog of uncertainty on where the hot spots are, and it will have to keep some personnel and resources mobile so that they can be rushed to areas where shortages are acute.

We should now plan for what happens after the lockdown, if the virus is not defeated. It will be hard to lock down the country entirely for much longer periods, so we should also be thinking of how we can restart certain activities in certain low-infection regions with adequate precautions. Restarting requires better data on infection levels, as well as measures to protect workers returning to work, such as temperature checks of workers (though this will not catch asymptomatic carriers), uncrowded transport, personal protection equipment, adequate distancing at work, as well as measures to identify and contain new infections. Healthy youth, lodged with appropriate distancing in hostels near the work place, may be ideal workers for restarting. Of course, only a handful of employers will initially be able to ensure adequate worker safety, but they may be the largest employers. Since manufacturers need to activate their entire supply chain to produce, they should be encouraged to plan on how the entire chain will reopen. The administrative structure to approve these plans and facilitate movement for those approved should be effective and quick – it needs to be thought through now.

In the meantime, India obviously needs to ensure that the poor and non-salaried lower middle class who are prevented from working for longer periods can survive. Direct transfers to households may reach most but not all, as a number of commentators have pointed out. Furthermore, the quantum of transfers seems inadequate to see a household through a month. The state and center have to come together to figure out quickly some combination of public and NGO provision (of food, healthcare, and sometimes shelter), private participation (voluntary moratoria on debt payments and a community-enforced ban on evictions during the next few months), and direct benefit transfers that will allow needy households to see through the next few months. We have already seen one consequence of not doing so – the movement of migrant labor. Another will be people defying the lockdown to get back to work if they cannot survive otherwise.

Our limited fiscal resources are certainly a worry. However, spending on the needy at this time is a high priority use of resources, the right thing to do as a humane nation, as well as a contributor to the fight against the virus. This does not mean that we can ignore our budgetary constraints, especially given that

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our revenues will also be severely affected this year. Unlike the United States or Europe, which can spend 10 percent more of GDP without fear of a ratings downgrade, we already entered this crisis with a huge fiscal deficit, and will have to spend yet more. A ratings downgrade coupled with a loss of investor confidence could lead to a plummeting exchange rate and a dramatic increase in long term interest rates in this environment, and substantial losses for our financial institutions. So we have to prioritize, cutting back or delaying less important expenditures, while refocusing on immediate needs. At the same time, to reassure investors, the government could express its commitment to return to fiscal rectitude, backing up its intent by accepting the setting up of an independent fiscal council and setting a medium term debt target, as suggested by the NK Singh committee.

Many small and medium enterprises (SME), already weakened over the last few years, may not have the resources to survive. Not all can, or should, be saved given our limited fiscal resources. Some are tiny household operations, which will be supported by the direct benefit transfers to households. We need to think of innovative ways in which bigger viable ones, especially those that have considerable human and physical capital embedded in them, can be helped. SIDBI can make the terms of its credit guarantee of bank loans to SMEs even more favorable, but banks are unlikely to want to take on much more credit risk at this point. The government could accept responsibility for the first loss in incremental bank loans made to an SME, up to the quantum of income taxes paid by the SME in the past year. This recognizes the likely future contribution of the SME to the government exchequer, and rewards it with easier access to funds today. Of course, this helps the SME only if the lending bank is prohibited from directing the SME to use the guaranteed loan to repay the bank's past loans.

Large firms can also be a way to channel funds to their smaller suppliers. They usually can raise money in bond markets and pass it on. Unfortunately, corporate bond markets are not very receptive to issues today. Banks, insurance companies, and bond mutual funds should be encouraged to buy new investment grade bond issuances, and their way eased by the RBI agreeing to lend against their high quality bond portfolios through repo transactions. The RBI Act will have to be changed to enable the RBI to undertake these transactions, and it will have to apply suitable haircuts to these portfolios to minimize its credit risk, but it will be a much needed support to corporate borrowing. The government should also require each of its agencies and PSUs, including at the state level, to pay their bills immediately, so that private firms get valuable liquidity.

Finally, the difficulties in the household and corporate sectors will no doubt be reflected in the financial sector. The RBI has flooded the banking system with liquidity, but perhaps it needs to go beyond, for instance lending against high quality collateral to well-managed NBFCs. However, more liquidity will not help absorb loan losses. NPAs will mount, including in retail loans as unemployment rises. The RBI should consider imposing a moratorium on financial institution dividend payments so that they build capital reserves. Some institutions may nevertheless need more capital, and the regulator should be planning for that.

There is much to do. The government should call on people with proven expertise and capabilities, of whom there are so many in India, to help it manage its response. It may even want to reach across the political aisle to draw in members of the opposition who have had experience in previous times of great stress like the global financial crisis. If, however, the government insists on driving everything from the PMO, with the same overworked people, it will do too little, too late.

Once the government has the response under control – and hopefully India's hot temperatures and humidity will weaken the virus transmission -- it has to rebuild hope. The economic outlook even before coronavirus had been weakening steadily, and the socio-political environment was deteriorating. Few would be enthusiastic about simply returning to that situation. It is said that India reforms only in crisis. Hopefully, this otherwise unmitigated tragedy will help us see how weakened we have become as a society, and will focus our politics on the critical economic and healthcare reforms we sorely need.