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India's Economic recovery during and post COVID-19 pandemic

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Abstract

The unanticipated spread of the coronavirus has affected the whole world and economies have been hit very severely. All economic activities around the globe has come to a halt and has posed a great challenge to all the countries to swiftly recover from this gloomy state. This article discusses the short-term policy measures and planning that would help for a sustainable recovery of the Indian Economy during and post COVID-19 pandemic.

***Keywords** : Economic Policy, COVID-19, Recovery, Expansionary, Monetary, Fiscal, Schemes, GDP, Interest Rates.*

INTRODUCTION

India went into lockdown on 25th March 2020 and currently, it is going through its unlock phases to reignite economic activities and protect its various sectors and industries. The government and the central bank have together imposed certain fiscal, monetary and social policies such as reduced interest rates, credit moratorium, Pradhan Mantri Garib Kalyan Anna Yojana (a food scheme to aid the two-third population by providing free essentials such as food grains). In May 2020 India announced an economic stimulus package worth 20 lakh crore INR, which is calculated to be approximately 10 percent of its GDP. (Source: Ministry of Statistics and Programme Implementation (MOSPI))

Recent data suggests that the Indian economy has faced a pronounced slowdown, with unemployment rates rising, and due to the prolonged lockdown the whole world has been affected and India is no exception, with government revenue and almost all economic indicators have been hit hard including the GDPof the country. Certain industries such as construction, hotels and transportation, manufacturing, finance, and real estate sectors witnessed significant plunges. In aggregate terms, households saw reduced income and wealth, and therefore consumer spending saw a sharp downfall from 21823.52 INR Billion in January 2020 to 14611.64 INR Billion in July 2020 (Source: Ministry of Statistics and Programme Implementation (MOSPI)).

In economic terms, this slowdown seems to represent the phase of a recession which is due to the falling aggregate demand, which has led to a supply shock that in turn led to the reduction in production and fall in investment spending. This article discusses the short-term policy changes that would help recover the economy sustainably. The simple Keynesian economic theory and

IS-LM model would be used to explain certain effects that could possibly be seen as post-policy enforcement.

The principles of Keynesian Economic theory explain the changes in aggregate demand by using active government policies in order to address or prevent economic downfalls like the recessions.

Keynes criticized the classical economics models and arguments that natural forces and incentives would help the economy to recover. His theories were based on the practical response to the Great Depression. According to his theory, active fiscal and monetary policies have to be implied by the government and central bank respectively to overcome recessionary pressures and fight unemployment, etc.

The IS-LM model has been chosen as it determines the short-run national income, and how various economic policies lead to a change in the income. Fiscal policies affect the IS curve and shocks in the IS curve representthe exogenous changes in the demand for goods and services. On the other hand, the monetary policy affects the LM curve, and shocks in the LM curve represent the exogenous changes in the demand for money.

Expansionary Fiscal and Monetary Policy

Increase fiscal deficit by increasing government expenditure and/or reducing taxes. The purpose of this policy is to inject money into the economy andalter people's behaviour in such a way that they save less and spend more. Consumers tend to spend more when their real income increases. In terms of the IS-LM model, this would shift the IS curve rightward (upward), which would increase Y (Income, Expenditure, Output), and increase the interest rate (i). There would be an opposite effect in Y from the Investment market, but since our IS curve is non-vertical, the net effect would lead to an increase in Y.

To correctly balance this policy an expansionary monetary policy would also be needed. Here, the LM curve would shift rightward (downward), which would increase Y (Income, Expenditure, Output) and decrease the interest rate (i). There would be an opposite effect in Y from the investment market, but since our LM curve is non-vertical, the net effect would increase Y.

Adding both the policies, Y (Income, Expenditure, Output) would increase Y, but the change in interest rate would be ambiguous. A stronger and dominating monetary policy is recommended that would lower the net interest rate as it would discourage saving and promote consumer spending. Expansionary fiscal and monetary policy would have the intended effects.

Pre pandemic, the curves IS_0 and LM_0 intersect at e_0 (Y_0 , i_0) which is the initial equilibrium. It is expected that the IS curve during the pandemic and economic slowdown would have shifted left

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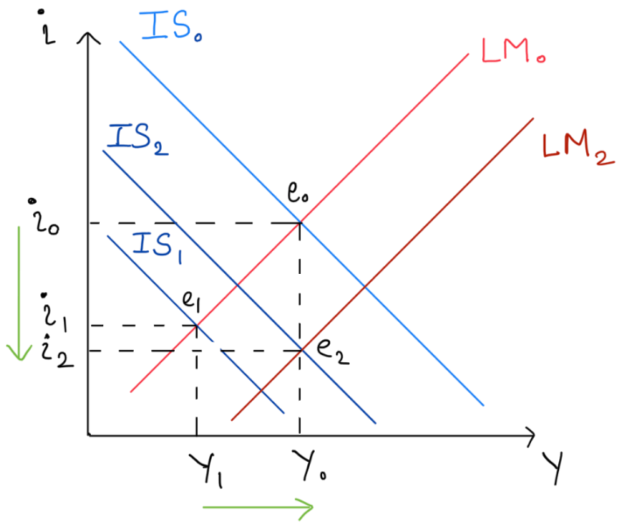
ward due to subdued aggregate demand. During the pandemic, IS_0 will shift to IS_1 and the new equilibrium will be formed at e_1 (Y_1, i_1).

Implementation of expansionary fiscal policy would increase consumer spending and the aggregate demand for goods and services that would shift IS_1 to IS_2, and expansionary monetary policy (by increasing the money supply in the economy) would shift LM_0 to LM_2.

The economy would try and return to the initial output level (Y_0), but this might not always be reached. The new equilibrium is established at or before e_2 (Y_0, i_2).



Notice, that due to the policy enforcement, the LM curve shifted more than the IS curve, as the government should employ a stronger monetary expansion than fiscal to make net interest rates fall. The new equilibrium post-policy implementation shows higher output and lowers interest rates compared to equilibrium e_1.

Insulate the Economy (Deglobalize and barriers to international imports for a fixed duration)

India would not suffer much if cross border economic activities are put at a halt, and barriers to imports are introduced. Comprising of not more than 24 percent of India's GDP, the imports could be minimised considerably. (Source: https://data.worldbank.org). India's primary imports are mineral fuel, oils, expensive stones, machinery, chemicals, etc. The import numbers had drastically reduced from January 2020 until April 2020, and increased slightly till July, with some fluctuations, but overall, imports significantly fell on average compared to the previous years. It would be economically right to circulate money within the economy and meet short term demands by self-producing certain goods. Meeting the aggregate demands internally within the economy by promoting certain activities that were previously imported would help foster growth. Further present prevailing low crude price will reduce current account deficit. Further the path of money circulation must include rural India.

Such a policy should be implemented for a fixed period in order to not destroy the traderelationships in the long-term prospects.

Reduce Interest Rates across both savings and borrowings

During times of uncertainty, households save in the present to protect themselves in case of unforeseen circumstances in the future, this is called precautionary savings. But it is very important for the households to spend as this would increase demand and increase money velocity and help the economy to grow thereafter. Hence, households have to undergo attitudinal changes in order to affect their behaviour in such a way that makes them save less and spend more.

Reduced interest rates on savings would make it less lucrative and households would rather be willing to spend. On the other hand, firms and businesses would take benefit of the lower interest rates to borrow funds in order to sustain, support their activity, and expand their production capacity. But the main underlying reason is to stimulate GDP growth by the faster circulation of money within the economy.

Let us take the simple aggregate demand function, **AD = C + I + G + (X-M),** where

AD = Aggregate Demand

C = Consumption

I = Investment

(X-M) = Net Exports

A fall in the interest rate raises consumption (C) and Investment (I). It affects the exchange rate by depreciating the domestic currency (INR) which leads to an increase in exports and a reduction in imports, thereby increasing net exports. In our case, government expenditure (G) increases when followed by an expansionary fiscal policy. When added together, aggregate demand in the economy increases, which leads to an increase in provision for production activities. To fulfil the production capacity more labourers are employed thereby reducing cyclical unemployment and the economy would start to move towards the full-employment equilibrium.

Easy Availability of credit and direct cash transfers to the poor in rural areas

Such a sharp decline in business activities and salesdue to subdued demand has affected firms of various sizes, from large scale businesses to SME and MSME, start-ups, etc. Such a pandemic was not anticipated, and businesses were not ready to withstand such a sudden shock. Cashflows of these firms have been affected significantly and the weak financials have led to the companies sacking many of their employees. In such a case, cheap and easy availability of credit would help them sustain in the current period and at least keep their businesses alive. To ensure healthy and sustainable recovery of the nation, the central bank (RBI) will have to allow for an increase in liquidity, i.e. increasing money supply (Expansionary fiscal policy) in the economy. Such can be done by:

Purchasing of securities by the RBI (Open Market Operations): Here the central bank purchases securities and injects money into the system.

Reduce the reserve requirements: As per the central bank guidelines, every bank in the nation needs to keep a certain percentage of their deposits as reserves to meet liabilities in case of emergencies. Reducing this requirement will enable banks to lend a higher percentage of their customer deposit liabilities.

Reduce the repo rate: The repo rate is the rate at which the commercial banks borrow from the central bank, which when reduced will make commercial banks charge lesser interest rates on loans, thereby making credit more affordable.

Direct cash transfers to the accounts of the poorwould help them at least to support their daily needs and basic requirements. Especially, families in rural regions, primarily depend on single source of income to support their expenses, which makes them quite vulnerable to changes in the economic climate that affect their jobs. In India, the agricultural sector employs around 58% – 60% of the total national workforce. Relief packages and support policies for farmers must be introduced to support this large proportion of the working population. The people in rural India need to be involved continuously through planned policies and programmes, so that we see development across all strata of society, and not just the privileged ones.

Temporary Raise fuel prices to earn quick revenue for the government

Considering the need for quick revenue for the government, in order to support various policies and support packages, this could be done by a temporary small rise in fuel prices, but also making sure that this step does not have a multiplied effect on the increase in transportation costs. This can be maintained by strict vigilance, and transportation costs should increase only equal to the effective increase in fuel prices, not more than that.

Otherwise, this would increase costs of necessary items, making purchases difficult for the poor and inflation. Therefore, such a step should be tested and executed in a way that does not harm the lower earning section of the economy.

Lucrative VDIS (Voluntary Disclosure of Income Scheme) type.

The VDIS (Voluntary Disclosure of Income Scheme) is a one-time, short term scheme that would give taxpayers and past tax-defaulters the chance to disclose their undisclosed income at a certain lucrative reduced tax rate. Under this scheme, the volunteering disclosers should be given immunity to come clean and convert their undisclosed income to disclosed income. This scheme would bring out a lot of money into the systemimmediately, which the government can then reallocate for development purposes and boosting economic activities.

Such a scheme was introduced in 1997, which proved to be verysuccessful. More than 475,000 people disclosed their untaxed income, which generated a revenue of INR 333.39 billion for the government.

Therefore, such a scheme would help quick increase in government revenue for reallocation purposes.

Amnesty Scheme for Loan defaulters

When a borrower stops repaying the principal amount and/or interest for more than 90 days (approx. 3 months), such advances are termed as an NPA (Non-Performing Assets). The majority of these NPAs are from advances given out by the state-owned and public sector banks. Recently, many cooperative and commercial banks have faced liquidity crisis, and high NPAs, due to which they were either declared bankrupt or merged with other banks.

A one-time amnesty scheme would give loan defaulters a onetime opportunity to pay a certain percentage of the loan amount and clear off the liability. This would help at least some money come back to the banks, even though the promised amount is not recovered. The NPAs would remain, but slightly less negative. This would not only reduce the NPA but also develop a sense of social responsibility in the borrowers to repay the maximum amount at their current capacity, instead of being a defaulter .Moratorium simultaneously may be used judiciously. This scheme should be judiciously structured with combination of some upfront payment, moratorium, restructuring of loan and amnesty.

Reduction of Income Tax and Corporate Tax

The reduction in taxes (Expansionary Fiscal Policy), gives an incentive to spend more, as the real income of the people increases. A reduction in income tax and corporate tax would benefit

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households and firms, respectively. But such a policy has to follow strict regulations such that the compliance shows expected results and not harm the lower earning, who might be affected due to reduced government revenue. To make such a policy more effective, the government would have to explore other areas of revenue generation, such as VDIS, reallocation of resources, etc.

I am confident that the present devastating pandemic situation will be over in the very near future, but it will leave the toughest ever challenges to the civilizations in the economic front. India ,as a very resilient country , will definitely be able to fix in the shortest possible time by implementing effective economic policies and planning with the support and cooperation of people of the country. India can and India will .

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