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Economic Stimulus Package: Can India Reboot the Reform and Revival Process?

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Summary

India's Finance Minister Nirmala Sitharaman has announced a spate of reforms covering a wide spectrum of the Indian economy. These include agriculture, finance and domestic industry. While many of these reforms have been long pending and are viewed as short- and medium-term strategies, implementation will be key to their success.

Introduction

India's Prime Minister Narendra Modi recently stated that the government has finalised a ₹20-trillion (S$3.75 trillion) revival package for the economy, following which Finance Minister Nirmala Sitharaman unveiled a spate of incentives. There have been five tranches of announcements, covering a large number of sectors, the last of which was made public on 17 May 2020, the day the extended lockdown was to end. The announcements have covered a large number of sectors and focused on medium- as well as long-term initiatives that can be categorised into several different boxes.

While assessing the stimulus, the basic question is whether it responds to the COVID-19 shock or is it a long-term strategy for growth? Is it an opportunity to start a set of reforms that has been under discussion for a long time or is it a medicine for survival and revival of growth?

An inkling of the thought process could come from looking at how Modi, then Bharatiya Janata Party leader in Gujarat, responded to the Kutch earthquake in 2001. He became Chief Minister soon after, enabling him to implement many of his ideas. The first initiative was to rebuild houses that had been damaged. Survival was ensured through food support and subsidies while the construction of houses provided employment. At the same time, there was focus on commercialising agriculture, providing irrigation, developing the region as a tourist hub and reviving traditional handicrafts; in short, providing employment and livelihood opportunities for the entire population. Simultaneously, there was a focus on building schools, promoting primary and secondary education, and improving healthcare. Today, Kutch is among the more prosperous regions of Gujarat.

This could be a backdrop to examine the current set of initiatives. The question is whether the economic package that has been unveiled addresses survival issues and growth concerns or is intended to restart the reform process. The last is important because several of the announcements refer to matters that have been pending for a long time. Though these have been under discussion and consideration, they are now being put out as new initiatives.

Action for Survival

There are two approaches to looking at the survival phase. For the severe shock dealt to businesses and small firms, an attempt has been made to address the immediate issues. For micro and small scale enterprises, there is a provision of collateral-free additional loan for business up to 20 per cent of outstanding debt, the creation of a fund to provide equity, creating demand by promoting purchase of local products and immediate payment of outstanding dues by state undertakings. A relief by way of support for payment of the Employee Provident Fund would also help provide liquidity. For financial companies, especially non banking finance companies (NBFCs) that are finding it hard to raise money from the debt market, the government has launched a special liquidity support as well as a partial credit guarantee scheme.

The second tranche of measures by the Finance Minister continued to address survival issues, while focusing on migrant workers, street vendors, small farmers and those who are self-employed. The most important announcement was the 'One Nation, One Ration' card scheme, wherein the ration card could be used in any state. Interestingly, this idea had been proposed during the Manmohan Singh government in 2011 but was shot down by the National Advisory Council headed by Sonia Gandhi. This has now been revived as its implementation will benefit families whose bread winner lives away from home.
Added to this is the promise of free food grain supply to all migrants for the next two months, loans to street vendors, concessional credit for small and marginal farmers, and a subsidy programme for housing (the Kutch model).

There has been an additional allocation against the Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) [employment guarantee scheme] that would provide three months wages against rural daily employment. This has been a tried and tested scheme under the Manmohan Singh government, and though criticised earlier by Modi, it has been revived with additional funding from the government.

The question is whether or not these survival relief measures are adequate to provide necessary relief. First, these policies have a low multiplier effect as they replace cash that has depleted. There is no mention of any handholding, especially for those whose livelihoods have been lost, beyond this period. Would these migrants return or stay back in their home states? If they choose the latter, then the burden of providing livelihoods falls on state governments. Some states like Uttar Pradesh and Madhya Pradesh seem to have realised this and have rolled out a number of reform measures related to labour laws and agricultural produce marketing, which should help in providing alternate livelihoods. Other states need to follow. Until then, the allocations under MNREGA should help.

Second, the devil is in the detail. For micro, small and medium enterprises, 100 per cent guaranteed loans, subordinated debt and equity infusion can provide liquidity. For vulnerable segments, higher allocation under the rural employment guarantee scheme, free food grain and additional credit for farmers are important for livelihoods. To address the credit risk challenge, as reflected in the widening chasm between the have and have-not borrowers, the special liquidity scheme and partial credit guarantee scheme for shadow banks should help. Businesses have problems other than credit, which include supply chain, labour which has gone back home, and demand revival, among others. Liquidity is just one of the parts of this system.

Third, how soon and through what mechanisms are these credits going to be made available? The free ration for migrant labour – would it be distributed as it travels or at the destination or would it be adjusted against the free food that is provided along the way? In short, the actual distribution of these announcements will determine the effectiveness in protecting survival concerns of the individuals as well as small businesses.

Agriculture Reforms to Benefit Farmers

The next set of announcements was aimed at the agricultural sector and appear to be quite promising. Agriculture has been long constrained by rigidities in marketing laws that prevent the farmer from selling his produce in private markets and across states. Reforms of the Agricultural Product Marketing Act have been on the anvil for many years but have not found traction with the states that view it as a political risk to upset the existing system which benefits middle-men and contractors.

There have been three important announcements. The first is to do away with restrictions in the categorisation of agricultural produce under the Essential Commodities Act, a pre-World War II legislation, and to deregulate most of the agricultural produce to ensure better price realisation by farmers. Following up on this would be the provision of marketing choices to the farmer, freeing him from the constraint of designated markets. Contract farming would be permitted, providing for the commercialisation of agriculture.

For this, the government has announced a large agricultural infrastructure project for farm gate as well as post-harvest management infrastructure. This, coupled with similar announcement for fisheries and dairy, could be considered path breaking – almost as important as the 1991 reforms were for industry. These would enable farmers to get better access to markets, superior technologies and indeed higher prices for their products. This would also lead to a diversification of products as well as a commercialisation of agriculture. India is producing large quantities of cereal, and with a stock of over 70 million tonnes in the warehouses of the government, there is need to urgently transform agriculture, which is still the mainstay for over 400 million people. Poverty in India is closely linked to a large number of people involved in agriculture, who contribute less than 20 per cent to the gross domestic product (GDP). For them, these measures are long pending.

The next set of announcements is medium to long term. These announcements include an easing of limits on foreign direct investment in defence manufacturing, privatisation of six more airports, opening up of more airspace and allowing private sector in commercial coal mining. These would be of considerable interest to international investors as well as private capital. There was also an announcement that the private sector would be allowed to participate in all sectors, providing for competition to the public sector.

To provide financial relief to the states, the borrowing limits were increased to five per cent of state GDP, subject to reform measures, a caveat that has already raised several states in protest.

The final set of announcements related to public health and education, especially in rural areas.

Lastly, the Finance Minister announced that debts related to COVID-19 would be excluded from defaults under the Insolvency Act, an announcement that the financial markets immediately turned their thumbs down to. Difficult to interpret and implement, this would lead to endless processes while making bank balance sheets weaker. On the other hand, the suspension of fresh initiation of insolvency proceedings for one year is expected to also provide some breathing space for cash-strapped firms and help prevent an imminent wave of bankruptcies.

Conclusion: Some Hits and Misses

So, how does one view this collection of announcements? It is clear that instead of a single comprehensive strategy to tackle survival, reduce damage and reinvigorate growth, the government has made announcements that cover a number of sectors, attempting both short-term as well as medium-term strategies. The government has tried to implement a number of ideas that have been languishing for a long time.

If the package is looked at from the point of view of providing livelihood and employment to the large number of informal workers, it is only the agricultural reform component that appears to be well-thought through. There is a lot for the states to do, and some states have already picked up the baton.

Even in the short-term, the issue remains of whether the migrants would return to their workplace or not. Would industries that depended on these migrants re-adapt? Would there be a relocation of small industries away from major towns, as states use these opportunities to try and bring in investments? The sequencing of these phases can differ but the survival phase precedes growth-revival and reforms are unlikely to help if the financial sector plumbing is not in order.

Demand stimulus is missing from these announcements but that is not a surprise as they may not deliver an anticipated bang for the buck when COVID-19 infections are still on the rise. Without an increase in demand, consumption goods sector, including automobiles and two wheelers, will find it difficult to revive.

In the next phase, a comprehensive one-time solution to deal with the bad debt situation will become necessary, as the aftermath of the pandemic is likely to result in a significant deterioration in the asset quality cycle for both banks and NBFCs. Without fixing the financial sector, medium-term growth will continue to face hurdles. One can only view these announcements as work in progress and look to the implementation of all that has been announced.

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