It Takes Two to Tango:
Can Monetary Stimulus compensate for an Inadequate Fiscal Stimulus in India?

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Any catastrophic shock brings the role of economic stimulus to the forefront. The ongoing unprecedented Covid19 pandemic is no exception. The IMF, in its recently released *World Economic Outlook April 2020,* has projected a contraction of world output by 3 percent in 2020. Naturally, all over the world countries have resorted to monetary and fiscal stimulus so that the adverse impact on economic activity and peoples' lives become bearable. India, too, followed this route. In recent past Reserve Bank of India (RBI) has undertaken two monetary stimuli on March 27 2020 and April 17 2020, respectively. The Central Government has announced a special fiscal package of Rs 1.7 lakh crore aimed at providing a safety net.

Are these adequate, jointly and singly? Have the two arms of economic policies, viz., monetary and fiscal kept pace with each other? This note seeks to look into some of these questions and argues that in comparison with monetary stimulus, fiscal stimulus has been lagging. Apart from the adequacy of the stimulus package, we also ask the following question: can the monetary stimuli compensate for an inadequate fiscal stimulus?

Recent Monetary Policy Measures

The RBI has been quite proactive in terms of the monetary stimulus. In its Seventh Bi-monthly Monetary Policy Statement, 2019-20 of March 27, 2020 the RBI announced the following:

- Reduction of the policy repo rate by 75 basis points to 4.40 percent from 5.15 percent (accordingly, the marginal standing facility (MSF) rate was reduced to 4.65 percent from 5.40 percent).
- The LAF corridor has been widened and the reverse repo rate was reduced by 90 basis points to 4.0 percent.
- The Monetary Policy Committee (MPC) also decided to continue with the "accommodative stance as long as it is necessary to revive growth and mitigate the impact of coronavirus (COVID-19) on the economy, while ensuring that inflation remains within the target".

More recently, on April 17, 2020, the RBI announced further measures with the following objectives: (a) maintaining adequate liquidity in the system and its constituents; (b) facilitating and incentivizing bank credit flows; (c) easing financial stress, and (d) enabling the normal functioning of markets. These measures are reasonably detailed. Illustratively, for management of liquidity in the system, the RBI has taken a number of measures such as, (a) conducting targeted long-term repo operations (TLTRO 2.0) for Rs. 50,000 crore; (b) providing a special refinance facilities for Rs. 50,000 crore to three all-India financial institutions (viz., NABARD, SIDBI, and NHB) to enable them to meet sectoral credit needs; (c) discouraging banks to park funds with RBI through a reduction in the reverse repo rate by 25 basis points (from 4.0 percent to 3.75 percent; with unchanged repo and MSF rates)[2]; and (d) increasing the ways and means advances (WMA) limit of states by 60 percent over and above the level as on March 31, 2020.[3] On the regulatory front, the RBI has relaxed NPA and provisioning norms. Illustratively, 90-day NPA norm will now not apply to the moratorium granted on existing loans by banks. The Liquidity Coverage Ratio (LCR) requirement for scheduled commercial banks is going to be

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[2] On April 15, 2020 the amount absorbed under reverse repo operations was Rs. 6.9 lakh crore.

[3] This is subsequent to an earlier increase of 30 per cent on April 1 2020.

brought down from 100 percent to 80 percent with immediate effect. Loans given by NBFCs to real estate companies are to get similar benefits as provided by SCBs.

While these measures seem to be timely and appropriate, this is not to mean that all monetary arsenals have been exhausted. On the contrary, in the current situation, one can argue that perhaps a time has come to shed some of the usual conservatism associated with the *dharma* of central bankers. We have seen that in the US and the Euro area, central banks have started buying debts of different maturity and of differing ownership, extending to state governments and municipalities.[4] Has a time come when RBI starts thinking in terms of buying such debt papers? While there is yet to be any forward guidance in this front as of now, note that such an action could dramatically reduce the borrowing costs of the state governments. In a situation when the state governments are yet to receive to their full GST dues of 2019-20 from the central government, and the revenues of the state governments have collapsed, such an extension of the eligible assets by the RBI will be more than welcome by the state governments – all the more when state governments become the first line of defense in the war against Covid-19. Thus, in an unprecedented situation such as the current one, monetary policy should not only be more attuned to fiscal expansion but also needs to be bolder. Illustratively, aggregative monetary policy measures *via* tinkering the repo rate may not be much effective in the immediate run. The monetary authority needs to think of specific measures for sectors, such as pharmaceuticals, automobile, construction, tourism, viz., those have been more affected by the pandemic and the lockdown. More funding for the small, medium, and micro sector *via* increasing loans to Mudra Bank and other MSME-focused banks could also be considered.

But our difficulty with the current economic stimulus stems primarily on account of the inadequacy of fiscal policy. It is well-known that faced with any catastrophic shock, fiscal and monetary stimuli need to act in unison. Moreover, dealing with a pandemic is not necessary a downturn in a business cycle and hence is likely to be less effective than a fiscal policy. It is in this context that we will argue that fiscal measures in India have been somewhat inadequate and failed to utilize the easy money policy to its fullest extent. To begin with, let us have a look at the constituents and components of the fiscal stimulus.

Fiscal Stimulus

Admittedly, the government has a difficult job at hand. The government is facing the following four broad sets of problems.

First, in the current situation, the primary task of the government is to provide enough resources for tackling the present medical emergency. Here the emphasis should be on catering to increased demands on healthcare systems, providing the right equipment and facilities for healthcare workers and residents, spending money on developing infrastructure on screening, diagnostic tests, and preparation of adequate hospital beds. There is a possibility that a sudden spike of Corona patients may overwhelm the healthcare system and can crowd-out patients with other diseases. This is particularly important for India as health system indicators show that in terms of availability of hospital beds, India is at par only with the Least Developed Countries, and India's current health expenditure (as a percent of GDP) is even lower than average LDCs. In other indicators, India's numbers are well below the averages of developing countries and the other countries of the BRICS group (Table 1).

Second, the prolonged lockdown has halted economic activity and is threatening the livelihood of millions of workers in India. The situation is especially bad for the workers in the unorganized sectors. The government needs to create safety nets for livelihood security during the period of lockdown and

[4] As of April 27 2020, as part of its Municipal Lending Facility, the US Fed is buying up to $500 billion worth of state and local government bonds. As part of its €750 billion Pandemic Emergency Purchase Programme (PEPP), the ECB too allowed for "fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions".

eventual recovery. This can be done by providing wage subsidies, unemployment benefits, and direct cash transfers. There may also be additional requirements for providing liquidity and financing for vulnerable firms.

Third, it is now evident that the pandemic has pushed the global economy into a deep recession. Therefore, there will be a strong need for the government to bring the economy out of this slowdown. This can be done by generating enough demand and also removing the supply-side constraints in the economy. Stabilizing the financial sector and containing the systemic risk will help the economy to manage the lack of confidence in the market.

And fourth, the government may need to prepare the country for the post-Covid world. The Covid pandemic probably has made some irreversible changes in the way business, production, labour, and capital will be organized in the future. It is expected that there may also be disruptive technological changes. It will be necessary for the government to prepare a regulatory framework to ensure equitable distribution and meaningful safety nets for our workers while ensuring that the productivity gains from the new technologies are also appropriated.

Table 1. Preparedness of Health Systems of Countries

	(Per 10,000 people)			(% of GDP)
	Physicians	Nurses and midwifes	Hospital beds	Current health expenditure
	2010-2018	2010-2018	2010-2018	2016
India	*7.8*	*21*	*7*	*3.7*
Least developed countries	2.5	6	7	4.2
Developing countries	11.5	23	21	5.3
OECD Countries	28.9	80	50	12.6
World	14.9	34	28	9.8
Other BRICS countries:				
Russia	40.1	86	82	5.3
Brazil	21.5	97	22	11.8
China	17.9	23	42	5.0
South Africa	9.1	35	..	8.1

Source: UNDP Covid-19 and Human Development, available at http://hdr.undp.org/sites/default/files/preparedness_vulnerability_dashboards_12.xlsx

Given such a complex set of targets, it is quite clear that it will not be possible for only one set of policy tools to achieve these goals. For example, while the fiscal policy will be important for the first two targets, it can also play a critical role in stimulating demand in the economy (third target). Monetary policy, on the other hand, will be valuable in the third target, but it has less direct contributions in the first area. Monetary policy also plays a vital role in providing liquidity to distressed firms. Therefore, no one policy will be able to tackle all the policy objectives of the government. A sensible mix of monetary and fiscal policy will be essential.

What is the specific role of fiscal stimulus? At the risk of stating the obvious, it may be noted that a fiscal stimulus can be provided by the government mainly by a) increasing public spending in physical or human capital; b) raising money in the hands of residents by direct cash transfers, and subsidies; c) providing safety nets like job guarantee and unemployment benefits, and d) foregoing or deferring of tax receivables from a business.

There are other policies, which are a combination of fiscal, monetary, and trade policies- these can be export guarantee schemes, liquidity assistance, and credit lines through development banks.

What could have been the role of the Indian fiscal stimulus? A few key points can be flagged here.

First, even before the current crisis, it was evident that the Indian economy was passing through a period of a downswing in recent years. The IMF in its Global Economic Outlook update of January 2020 had placed India's growth projection for 2020 at 5.8 percent – a downward revision of 1.2 percentage points compared with its October 2019 projection and noted that the domestic demand in India has "slowed more sharply than expected amid stress in the nonbank financial sector and a decline in credit growth". After an initial assessment of the impact of the pandemic and the lockdown, in the more recent period, April 2020 edition of the *Global Economic Outlook*, the IMF has further downgraded Indian growth in 2020 to 1.9 percent.

Second, it is important to note that the current crisis came close to the announcements of the Union Budget on February 1 2020, which contrary to popular expectations, has not done enough in terms of pursuing a counter-cyclical fiscal policy.[5]

Third, even if the incidence of Covid-19 in India has been somewhat limited so far, in comparison with economies of similar size, there could be some lack of clarity about the reasons behind it. In particular, sceptics have pointed out that limited testing could be responsible for such a low incidence. Besides, the extended lockdown has imposed an enormous burden on the well-being of people in general and certain classes of citizens like daily wage labourers and migrant workers, in particular.

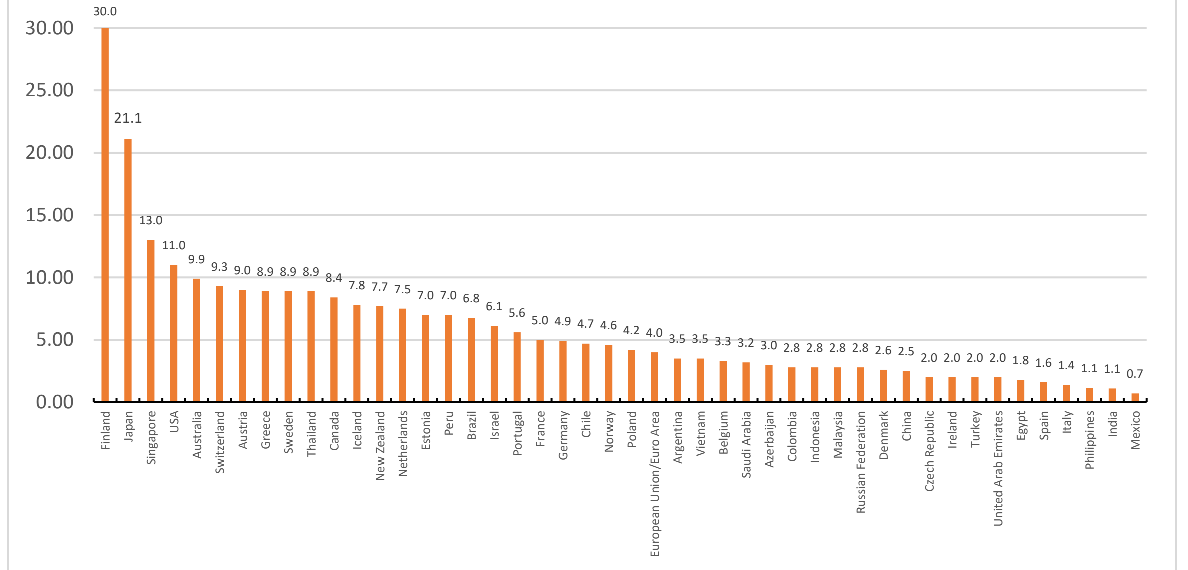
The government of India announced a fiscal package on March 26, 2020. The value of the stimulus package is around 0.8 percent of India's GDP. This package included cash transfers to low-income households, provision of food and cooking gas for the poor, insurance for the health care workers, and wage support for low wage workers. Along with this, several state governments have also announced some direct transfer measures in cash and kind. The IMF estimates the value of these transfers to be about 0.2 percent of India's GDP. The Prime Minister also announced spending of around 0.1 percent GDP on health infrastructure. Taken together, this implies that India's fiscal policy package is approximately 1.1 percent of the GDP.[6] Are these adequate? How does this compare with the rest of the world?

The IMF has compiled policy responses to the Covid crisis for most of the countries. It has measured the size of the fiscal deficit as a percentage of GDP. Figure 1 shows that India has announced one of the lowest fiscal stimuli in the world. Interestingly, the low numbers for European countries (which have been severely affected by the pandemic) are illusory in nature. For certain countries, the IMF has provided loan guarantee amounts separately. When this information is provided separately, we have not added them because credit lines and loan guarantees may not directly contribute to the fiscal cost in the current year. These will create contingent liabilities, and there is a probability that these will add to the fiscal cost in the future. These numbers are substantial. For example, in the case of Italy, loan guarantee schemes are as high as 25-50 percent of GDP.

[5] See, Pal, Parthapratim and Partha Ray (2020): "In Search of a New Theology: Fiscal Fundamentalism and Illusion in the Union Budget, 2020-21", The India Forum, available at https://www.theindiaforum.in/article/search-new-theology

[6] https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

Figure 1. Size of Fiscal Stimulus Announced by Countries in Response to COVID
(as a percentage of GDP)



Source: IMF Policy Tracker (https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19)

Reasons behind the Inadequacy of Fiscal Stimulus

Thus, give the extent of the pandemic, both in terms of cross-country comparison as well as India's own preparedness for facing any medical suggests that the fiscal stimulus was scanty. Arvind Subramanian and Devesh Kapur suggested that the government needs to spend an additional Rs. 10 trillion to fight the post-covid economic meltdown, both for disease control and for a stimulus package to support India's economy.[7] It must be acknowledged here that traditional fiscal stimulus like public expenditure in infrastructure will work once the economy is out of the lockdown phase. Still, other fiscal stimuli like targeted transfers (in cash and kind), tax relief or deferment, wage subsidies, unemployment benefits, and spending money on healthcare facilities and equipment can be extremely useful for the economy.

But why has the Central Government been following this policy of fiscal conservatism?

One possible answer can be that the government is still assessing the situation and will announce a more comprehensive set of fiscal policy measures in the near future. In the absence of any firm indication, this is at best speculative in nature.

The second answer can be that the government's budget estimates have gone awry, and there is not much room for fiscal manoeuvrings if the government wants to maintain a fiscal deficit target, which is consistent with the FRBM guidelines. As already pointed out, the Union Budget 2020-21 was overly optimistic and did not include any significant stimulus to boost domestic demand. On the other hand, revenue projections were based on unrealistic expectations. As the coronavirus attack has pushed the economy over the edge, there is simply no way that the budget numbers can be met.[8] After the Covid

[7] Devesh Kapur & Arvind Subramanian (2020): "Fiscal space: Not if but how", Business Standard, 9 April 2020, available at https://www.business-standard.com/article/opinion/fiscal-space-not-if-but-how-120040801674_1.html

[8] Latest data from Controller General of Accounts (CGA) show that total receipts (revenue and non-debt capital receipts) for 2019-20 will be well below the revised estimates for 2019-20. Till February 2020, the government has only managed to collect 74 percent of the revenue collection target. Lockdown started in March 2020 and revenue collection for this month will be meager. On top of this, the government assumed a nominal growth rate of 10 percent for 2020-21 for estimating its revenue target for the current year. Even before COVID, the Indian economy was slowing down. Now, it will be impossible to reach that target.

attack, tax and non-tax revenue collections are likely to be down by a considerable margin as the economy has come to a standstill. On the other hand, there is an urgent need for increased government expenditure. Given the growing imbalance between expected receipts and spending, the government may be acting cautiously to keep the fiscal deficit under some control.

A related reason for Central Government's fiscal restraint could be the fear of capital flight. There is a widespread belief that the Centre's fiscal deficit in 2020-21 is 3.5 percent of GDP is an underestimate. In fact, quoting a report of the Fitch rating agency, it has been reported in the popular press, "India's fiscal deficit in 2020-21 may shoot up to 6.2 percent of the GDP from 3.5 percent government estimate as a fallout of the Covid-19 economic stimulus package" (*Economic Times*, April 1 2020). Added to the states' fiscal deficit (2.6 percent of GDP in 2019-20) India's aggregate fiscal deficit could be in the neighborhood of 10 percent of GDP. Will such a fiscal situation be seen with some disdain by the global credit rating agencies? More importantly, faced with the fear of a rating downgrade, can there be capital flight from India? Is this fear constraining Indian fiscal stimulus? Answers to such questions could at best be speculative. But one thing is sure - the menace of credit downgrade has run amok in the aftermath of the global financial crisis – they should not be allowed to keep the global economy as a hostage. In retrospect, it seems that a time has come when global fora like G-20 need to give a call for responsible rating exercise by the credit rating agencies and treat the fiscal deviations in a time such as this as normal.

Where could the government get the money?

Tautologically higher revenue from taxes or borrowing can fund increased expenditure. What are the possibilities at the current juncture?

First, a tax hike at the current juncture does not seem to be on the cards. Reportedly, a proposal by a team of 50 young Indian Revenue Services (IRS) officers suggesting the government to hike income tax rates for the super-rich and imposing a Covid-relief cess of 4% for those earning above Rs. 4 lakh seemed to have troubled water. Presumably, these officers now may face disciplinary action for proposing such unsolicited tax hike call.

Second, the policymakers, can of-course, think of other traditional routes could be taking recourse to, (a) small savings, or (b) borrowing from multilateral institutions at low rates of interest.

Third, in a situation like this, printing money may be another option worth considering. Abhijit Banerjee reportedly advised to print money liberally and to transfer cash directly to those people who need it most.[9]

Forth, it goes without saying that these are abnormal times. Naturally, abnormal times may call for out of the box thinking. Our two cents is for the government to take their demand for alms to gods. Indian temple trusts are famous for their assets comprising both cash and gold. The Washington Post in an article of April 21, 2015 reported: "Wealthy Hindu temples …. are repositories for much of the $1 trillion worth of privately held gold in India — about 22,000 tons, according to an estimate from the World Gold Council. In 2011, one temple in south India was found to have more than $22 billion in gold hidden away in locked rooms rumoured to be filled with snakes".[10] In times such as these, the government could seriously consider approaching the temple trusts for funds. It is also important to note that, "Temples are places where money changes hands, frequently in questionable ways"

[9] Referring to Banerjee's presentation at a webinar organised by the Bengal chapter of FICCI on April 8, 2020, the *Telegraph* of April 9 reported, " "Forget about the macro worries. We can avoid a 1929-like situation. Go long on printing money," said the Nobel prize-winning economist who is the Ford Foundation International Professor of Economics at Massachusetts Institute of Technology."

[10] Available at https://www.washingtonpost.com/world/asia_pacific/india-wants-its-rich-temples-to-part-with-their-gold-and-help-the-economy/2015/04/21/4b7f5eda-e29c-11e4-ae0f-f8c46aa8c3a4_story.html

(Presler, 1987).[11] Gods, we think, will be happy to help people in utter distress and deprivation in an unprecedented pandemic. The current government should be able to leverage its strong ties with various religious trusts.

Concluding Observations

Thus, it is evident that a lukewarm fiscal stimulus is unable to keep pace with an otherwise conventional monetary policy exuberance. End of the day, monetary policy can only make the credit cheaper, but it cannot bring money in the hands of the daily wage labourers and migrant workers. It cannot solve the problem of health facility, logistics, or transportation, either. In an unprecedented crisis like this, fiscal stimulus has to take the lead.

And it is not clear why the government should be bothered about controlling the fiscal deficit at this point in time. Textbook suggests that emergencies like wars, disasters, and pandemics are classic cases for running large fiscal deficits. COVID is an unprecedented disaster, and in such times the government should not bind itself in best practices frameworks that are meant for normal times. Moreover, globally and in India, interest rates have become very low and probably has entered the liquidity trap zone. There are questions about the effectiveness of unconventional monetary policy in India. And especially given the kind of policy intervention required now, fiscal stimulus and fiscal spending should be the more effective policy tool.

To sum up, we believe that fiscal stimuli should be the order of the day everywhere including India, and as Krugman (2020) suggests, "There's an overwhelming case that stimulus take the form of public investment, in both physical and human capital, given low interest rates and the clear need for better infrastructure, childhood health and nutrition, and more".[12]

[11] Presler, Franklin A. (1987): *Religion under Bureaucracy: Policy and administration for Hindu temples in south India*, Cambridge: Cambridge University Press.

[12] Paul Krugman (2020): "The Case for Permanent Stimulus", available at https://www.gc.cuny.edu/CUNY_GC/media/LISCenter/pkrugman/permanent-stimulus.pdf