The Macro-Economic Impact

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Short-term

Agriculture: The main concern for the agricultural sector is to maintain the supply chain for fruits and vegetables. How will wholesale markets in particular operate without large numbers of buyers and sellers being present?

Industry

Production in all three kinds of enterprises will be affected but will show up differently. For all types of enterprises including MSMEs the question is what are their liabilities?

Borrowings: Letting them go bankrupt will have a further devastating effect on their creditors particularly the banks. It thus might be better to postpone their debt servicing. This is something that will have to be dealt with in the context of the current regime on reporting on NPAs and their effects on bank lending.

Wages: Since there will be limited demand and production they could reduce this liability by sacking workers. This, however, should be avoided as apart from its social consequences it will make the revival of the economy more difficult. As and when the economy recovers the firms will have to hire new workers and train them a time consuming process. It would be best if firms can be persuaded to retain them. Some European countries do this by paying a portion of the wages of the workers, say 50 to 75 percent. Of course, not all of this is a cost to the government as then the government need not pay unemployment benefits. It should be investigated how some such scheme can be shaped to take account of Indian realities.

Financial costs

The recession will reduce revenues from both direct taxes, personal and corporation and indirect taxes, GST. To the extent that the level of economic activity is maintained the social expenditures will be offset by higher tax collections. An important question is by how much the deficit may be increased to tackle the fall in economic activity. Most developed countries are planning to spend between five and ten per cent of GDP to support livelihoods of individuals and to support companies. The US initially thought that an expenditure of about $1 trillion will suffice, but the bill cleared by the Congress has doubled the expenditure to about $2 trillion which would be about 10 percent of GDP. The recognition of the gravity of the situation can be gauged from the consensus about the increased expenditures against the strong opposition to President Obama's much smaller stimulus package of $ 787 millions for 2008-09.

Medium-term

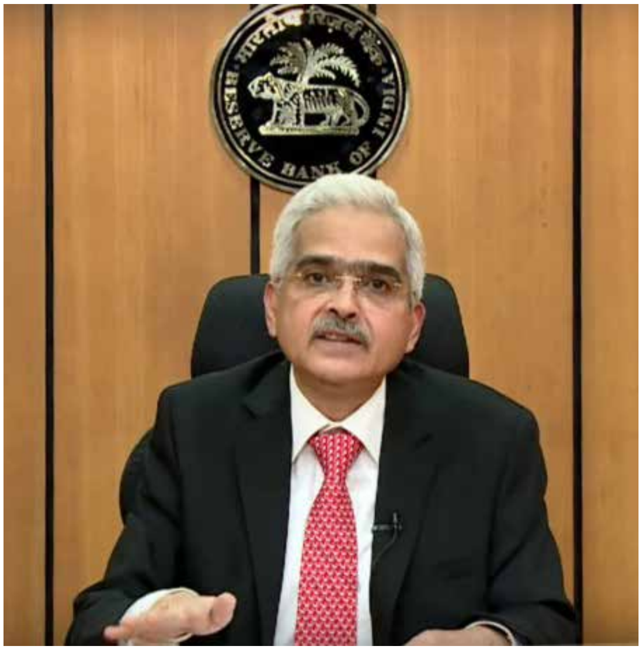
Agriculture: Problem will arise when the harvest is ready. Will there be enough workers for the harvesting, an issue especially important for larger farmers? Also, how will the sale and storage of the harvest be organized? Also how should the input supply chain be maintained when the next sowing season arrives?

Industry and employment: Existing safety net schemes such as the PDS, MNREGA, and various pension schemes need to be strengthened to minimise the adverse welfare effects of the fall in economic activity and the subsequent fall in employment. For those losing jobs what is needed is to provide them with income. To meet the needs of these workers including daily wagers the PDS system needs to be expanded.

Financial sector: The higher tax collections will persist in a longer run as the recovery in economic activity will be faster the lesser the disruption in the production system. In the Indian context the multiplier effect of government expenditures is likely to be larger as the income supplements will largely go to poorer sections of the population who have a higher propensity to consume. An increase in the deficit of about 3 to 6 percent may be sufficient in the Indian case. Of course, one will have to be flexible as further support may be needed.

Injection of such a large demand when the production system is declining will risk a rise in the rate of inflation. This can be checked by two sorts of action:

Strengthening of the PDS system and maybe extension of the system to newer essential commodities. The other would be larger imports. Planning for the larger imports will have to start soon so that they are available when demand outstrips domestic supply. Fortunately the reserves seem to be large enough to absorb the higher imports. The effect on the current account and balance of payments deficits needs to be estimated. The deficits would increase not only because of higher imports but also lower exports as world demand falls and our production capacities are adversely hit. It might be necessary to make provision for higher borrowings now rather than after the deficit has increased.



Role of the Reserve Bank: In these uncertain times monetary policy should be used not for the purposes of inflation targeting but to ensure sufficient liquidity. However, in addition, there is the need to strengthen its supervisory function to ensure that financial institutions do not indulge in unsustainable practices.

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