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COVID-19 and Macroeconomic Uncertainty: Fiscal and Monetary Policy Response

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COVID-19 and Macroeconomic Uncertainty: Fiscal and Monetary Policy Response

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Abstract

The macroeconomic uncertainty created by COVID-19 is hard to measure. The situation demands simultaneous policy intervention in terms of public health infrastructure and livelihood. Along with the global community, India too has announced its initial dose of fiscal and monetary policy responses. However, more fiscal–monetary policy coordination is required to scale up the policy response to the emerging crisis. Innovative sources of financing the deficit, including money financing of fiscal programmes, a variant of "helicopter money," need to be explored.

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Macroeconomic uncertainty is hard to measure. The COVID-19 pandemic has created an uncertainty worse than a war in many respects. In fact, many have termed it as World War III. This uncertainty has come as a double whammy for the Indian economy, which was continuously slowing down for a couple of years "structurally" with no evidence of a V-shaped or U-shaped revival.

The nation is now facing a humanitarian crisis. We face a humungous task of saving the "lives" and "livelihood" of people. Rightly, we have given priority to saving lives by taking extreme steps of "social distancing" to flatten the curve. The complete lock down of 21 days in India is aimed at this. As we do this, livelihoods are at peril, and it has triggered an exodus of migrant workers. Unless we minimise the effects of the simultaneous economic disruptions, it will turn into an unimaginable economic pandemic too. Measuring these macroeconomic uncertainties and designing a "COVID-19 policy response" package is a daunting task.

Governments around the world have resorted to unprecedented monetary and fiscal policy measures to limit the adverse impact of COVID-19, both the unparalleled public health crisis and the macroeconomic crisis. The International Monetary Fund (IMF) has launched a policy tracker to help member countries to be informed about the experience of others in fighting the pandemic and the discretionary policies taken to help them combat the pandemic more effectively (IMF 2020). The IMF policy tracker was launched on 24 March 2020. In India, the fiscal–monetary policy response to COVID-19 has come after this. Unlike many countries, including Singapore and South Korea, India has opted for a complete lockdown rather than aggressive testing, likelihood plotting of route maps and scaling up public health infrastructure and services. A complete lockdown means a complete disruption of supply chains, which was already affected by shutdowns in other countries. Now, this has become a supply shock of inconceivable magnitude for an economy, which was reeling under a severe demand shock for a significant amount of time.

Given the gravity of the issue at hand, this is the time the government has to forget about the magnitude of debts and deficits. Identifying the fiscal space is paramount to preventing the pandemic. Breaching the fiscal rules (Fiscal Responsibility and Budget Management [FRBM] Act, 2003) by altering the threshold levels of 3% fiscal deficit to gross domestic product (GDP) is the need of the hour. It is not only the levels of deficits but also a relook into the financing patterns of deficit that is impending here. A huge pressure is mounting from economists to implore the Reserve Bank of India (RBI) to go for an exceptional seigniorage financing of deficits to face this macroeconomic uncertainty. A National Institute of Public Finance and Policy working paper on "Fiscal Seigniorage" explains the ways in which an optimal level of seigniorage can be arrived at, without exploding into high levels of inflation (Chakraborty 2015). The "money financing of fiscal programme" (MFFP) is a variant of helicopter money (Buiter 2014; Bernanke 2016; Aggarwal and Chakraborty 2019).

A new e-book titled *Economics in the Time of COVID-19* edited by *Vox* editor-in-chief Richard Baldwin and Beatrice Weder di Mauro, president of the Centre for Economic Policy

Research (CEPR), has analysed the mechanisms of economic contagion and what governments can do about it (Baldwin and di Mauro 2020). A National Bureau of Economic Research paper (2020) has modelled the macroeconomics of the epidemic and revealed that the reduction in consumption and work exacerbate the size of recession caused by the epidemic (Eichenbaum et al 2020). The European Central Bank (ECB) at the onset of the COVID-19 pandemic has waived its restriction on the amount of bonds it can buy from each member state in its Pandemic Emergency Purchase Programme (PEPP). Countries are puzzled about the ways to finance post-COVID-19 macroeconomic stabilisation and economic recovery programme for growth.

Fiscal Policy Response

In India, 36 hours into the lockdown, Finance Minister Nirmala Sitharaman announced a fiscal package that is claimed to be worth `1.7 lakh crore, constituting around 5% of the total public spending and around 1% of the GDP. It is aimed at guaranteeing access to food and cash for the poor and vulnerable sections. But, a closer examination of the package raises doubts about the quantum of relief involved. One important component of the package is the free provision of an equal amount of eligible quantity of cereals and pulses for three months. This step is expected to benefit about two-thirds of the population so as to ensure food security during these hard times. But, the cost for the union is negligible given the fact that the Food Corporation of India godowns are overflowing with stock.

Frontloading of the PM-KISAN transfer by about four months is another element of the package. Although it will benefit about eight crore households, it does not involve any additional expenditure. In fact, it involves an expenditure of Rs.17,500 crore out of the budgeted Rs.75,000 crore in Union Budget 2020–21. Similarly, the announced revision in wages for all the states under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) cannot be counted as a pandemic-related announcement or relief, although the quantum of revision is more this year. The MGNREGA wages were revised for the FY 2019 too, in March 2018, and wages increased by an amount equal to or greater than Rs.10 for six states and by an amount equal to or greater than Rs.5 for 17 states (MGNREGA–1, 2018; MGNREGA–2, 2019) Moreover, the realisation of the announced gain of Rs.2,000 per worker per year would happen over a period of one long year and assumes that the project can resume soon. There was a drastic reduction in the allocation of MGNREGA by Rs.9,501 crore from the 2019 revised estimates. In the scenario of a total lockdown, we do not know when this project could resume.

Ex gratia payments to women account holders of Pradhan Mantri Jan Dhan Yojana (PMJDY), poor widows, senior citizens and physically challenged persons are expected to provide much needed relief for the beneficiaries. This is a recognition of the statistically invisible care economy. It is also claimed that transfer under PMJDY will benefit about 20 crore families and the latter will benefit about three crore individuals (Table 1).

Table 1: COVID-19 Fiscal Package 2020 in India: An Illustrative Mapping with Demand for Grants (Rs. Cr)

Sl.No	Scheme/ Programme ./ Beneficiary	Ministry/ Dept./ Act	2018 Actual	2019 Budget	2019 Revised	2020 Budget	Relief Package – Illustrative Estimate (Crores)	Comments
1	PM Jan DhanYojana (cash transfers to savings account of women)	Ministry of Finance -Dept. of Financial Services	0	0.01	0	0.01	30600	
2	Ujjwala (clean fuel to low income households - LPG subsidy)	Petroleum and Natural Gas	3200	2724	3724	1118	13000	
3	Cash transfers to Senior Citizens, Widows & Physically Handicapped	-	-	-	-	-	3000	
4	Food subsidy	Consumer Affairs, Food and Public Distribution	101327	184220	108688	115569	NA	Cost of three months off-take of Cereals and Pulses
5	PM-KISAN (income support transfer to farmers)	Agriculture and Farmers' Welfare	1241	75000	54370	75000	17500	Only front-loading of expenditure
6	NREGA (employment guarantee scheme)	Rural Development	61815	60000	71001	61500	NA	No Additional Expenditure now
7	Self Help Group - Loans						NA	Banks expected to lend more
8	Employer's Provident Fund (EPF)	EPF regulation to be amended to allow higher non-refundable withdrawal					NA	No Expenditure
9	Organised Sector-PF 24% of salary	Govt. will pay 24% of salary to EPF for next 3 months, of those with salary less than 15K working in establishments with less than 100 employees					NA	Involves Expenditure
10	Health Insurance	Insurance cover of 50 Lakh for govt. health workers fighting Covid19.					NA	Involves Expenditure for paying premium

11	Construction workers	Building and Construction Workers Welfare Act	31000	31000	(max if States spend whole)
12	District Mineral Fund (DMF)	National Mineral Policy/Act	35925	35925	(max if States spend whole)
		Total		1,70, 000 (including the missing values)	

Source: *Finance Minister's announcement and Budget Documents of Various Years; NA = Breakup not Available in Covid19 Relief Package Announcement*

However the percentage of women in the 15–64 age group who have PMJDY accounts is abysmally low, at 47%. Integrating gender budgeting in energy infrastructure— providing free liquid petroleum gas cylinders for Pradhan Mantri Ujjwala Yojana beneficiaries for next three months should also be welcomed. These three components are expected to cost the union government about Rs. 46,000 crore.

An interesting fact about the package is that about 40% of the announced amount is on account of Building and Construction Workers Welfare Fund and District Mineral Fund (DMF). According to the finance minister, the former is a corpus of about Rs.31,000 crore with about 3.5 crore registered workers. Similarly, the DMF has about Rs. 35,000 crore, which is directed to be used for augmenting the funds for fighting the COVID-19 pandemic. However, as the DMF is based on the mining royalty regime, an urgent policy response is required to scrutinise the royalty rates and base across states. These two programmes— cess and DMF— are designed within the framework of cooperative federalism between the centre and the states. There are ambiguities regarding the centre–state financial relations in arriving at a COVID-19 mitigation strategy and the stimulus package. The COVID-19 policy response in terms of intergovernmental fiscal transfers to the states from the Fifteenth Finance Commission is also awaited.

The raising of the limit of collateral free lending to self-help groups (SHGs) is expected to benefit about seven crore households. However, this does not entail any additional burden on the union government. The government paying the employer's and employee's share to Employees' Provident Fund (EPF) for those workers with monthly salary less than Rs. 15,000 in establishments which employ less than 100 workers is a positive step. But, it is not a huge commitment and will not benefit them immediately although it grants the workers succour for the time being and hope in the medium term.

The finance minister has also announced an insurance scheme for health workers fighting COVID-19 in government hospitals and health care centres. This involves an

insurance coverage for about 22 lakh health workers to the tune of Rs. 50 lakh per worker. Although this is a welcome step, lack of coverage for the majority who work in the private sector is a cause for concern. Moreover, the government should consider making additional payment to the health workers who are toiling day and night, risking their lives. The incentive for them should not be limited to risk coverage alone.

The states and union territories, which are fighting the pandemic on the front line, have been demanding relief from the union. A transfer of Rs. 17,287 crore by the union to the states on 3 April, one day after the video conference of the Prime Minister with the chief ministers is a temporary relief for some states, although it falls short of their demand. Out of this, Rs. 6,195 crore is on account of revenue deficit grant on the recommendations of the Fifteenth Finance Commission and is available to 14 states. The rest is under the State Disaster Response Mitigation Fund.

In the time of a pandemic, fiscal policy will have a bigger role to play compared to monetary policy. Probably, the government is assessing the situation and waiting before announcing bigger packages. The government's response in this time of crisis can go a long way in building trust, which is crucial in building a vibrant economy and a strong nation.

Monetary Policy Response

Central banks across the world are responding to the Covid-19 pandemic. That the RBI advanced the meeting of the Monetary Policy Committee (MPC) by one week is in itself a sign that it is proactive in the emergency. Through its decision and the announcements made on 27 March, the RBI has succeeded in sending the signal that it is aware of the gravity of the impending crisis, and that it will do "whatever it takes" to overcome the pandemic-induced crisis (RBI 2020). The announced monetary policy has paid attention to ensuring liquidity, reducing cost of loans, encouraging transmission and regulatory easing.

Reduction of the cash reserve ratio (CRR—the average daily balance that banks are required to maintain with the RBI— by 100 basis points (bps) to 3% will infuse liquidity to the tune of Rs. 1.37 lakh crore into the banking system (Table 2). Similarly, Targeted Long-term Repo Operations (TLTRO) that allows banks to keep funds borrowed at repo rate for a longer period of time at the current rate of three-year tenor will add another Rs. 1 lakh crore. Accommodation under marginal standing facility (MSF) allows scheduled banks to borrow additional amounts, over and above liquidity adjustment facility (LAF) at a punitive interest rate, which has been raised to 3% of the statutory liquidity ratio (SLR) portfolio from the earlier 2%. This can infuse a liquidity of Rs. 1.37 lakh crore. Although MSF is not used by banks on a regular basis, these three steps together can infuse a liquidity of Rs. 3.74 lakh crore.

The LAF involves overnight and term repo auctions. It helps banks to tide over daily liquidity mismatches, mainly to maintain the CRR. If banks are short of funds, they can borrow at the repo rate. If they have excess funds, they can park the funds at reverse repo rate. Under LAF, repo rate has been reduced by 75 bps, taking it to 4.4%. The reverse repo rate has been reduced by 90 bps to 4%. Given the inflation target of 4%, this brings our real

interest rate close to zero.

Table 2: COVID-19 Monetary Policy RESPONSE in India, 2020

Policy Response	Policy Change	Effect / Impact
Policy Rate	Repo rate reduced to 4.4 by .75 bps Reverse Repo rate reduced by .9 bps	With inflation target at 4, India is close to a zero interest rate.
Liquidity	1. Cash Reserve Ratio (CRR) cut by 100 bps to 3 2. Targeted Long Term Repo Operations (TLTRO) of 3 years tenor 3. Marginal Standing Facility (MSF) increased to 3% of Statutory Liquidity Ratio (SLR)	Infusion of 3.74 Lakh Crore liquidity
Widening of Monetary Policy Rate Corridor	The corridor raised to 0.65 from 0.5	Makes it less attractive for banks to park funds with RBI, nudging them to lend more.
Regulatory Easing	1. Moratorium on term loans & working capital loans for 3 months 2. Implementation of NSFR deferred by 6 months 3. Deferment of last tranche of capital conservation buffer	Eases the balance sheet of banks while regulatory forbearance provides relief to borrowers.
Review of the limits of monetisation	Reviewed the limits of Ways and Means Advances to State Governments and Union Territories by 30%	To increase fiscal space of subnational governments through alternative models of "financing" the deficits.

Source: *RBI (2020), Seventh Monetary Policy Statement of RBI and related documents, 2020.*

The RBI has also used a trick to encourage transmission of these rate cuts by widening the monetary policy rate corridor. It is determined by the reverse repo and MSF rates. The difference between these two rates, which was 50 bps is increased to 65 bps. With a reverse repo rate of 4%, it has become less attractive for banks to park their funds with the RBI. This is expected to nudge banks to lend more.

As expected, regulatory forbearance also has been announced in the monetary policy. A moratorium on term loans and working capital loans for three months is expected to provide relief to the borrowers. Similarly, deferment of implementation of the net stable

funding ratio and last tranche of capital conservation buffer are expected to provide relief to the banking sector.

The RBI also has done its bit to help the states and union territories. The central bank had already constituted an advisory committee to review the limit ways and means advance (WMA) limits for state governments and union territories. Pending its final recommendations, the RBI, through an announcement on 1 April, has raised the WMA limits for states and union territories by 30% to help them tide over the situation. However, as the calendar for market borrowing for the first quarter of the new fiscal shows, the yield curves in the bond market are likely to face an upward pressure. During this period, union government will borrow Rs. 3 lakh crore, and all state governments together are expected to borrow about Rs. 1.27 lakh crore.

Overall, it seems that government and the RBI are adopting a wait and watch policy. But, even if the pandemic is tamed in the next couple of months, the hardship it is going to cause for the vulnerable is going to be unimaginable. Some have even said that more people will die of hunger than the pandemic unless the government wakes up to the situation and addresses the issue on a war footing.

Conclusion

The macroeconomic uncertainty created by COVID-19 is hard to measure. The situation requires simultaneous policy interventions in terms of public health infrastructure, livelihood and humanitarian issues emanating from the interstate migration crisis. Although India has announced iteratively the policy measures, more fiscal–monetary policy coordination is required to scale up the policy responses to "whatever it takes" to respond to this crisis. Innovative sources of financing the deficit, including "money financing of fiscal programme"—a variant of helicopter money—can be a solution. Breaching the FRBM by raising the threshold deficit– GDP ratio from 3% is significant, with a clear "excessive deficit procedure road map" as the post-COVID-19 exit strategy. The government as the employer of last resort with effective rise in the existing wages could be an effective component of this policy.

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