Revival Of Consumption Demand In The Indian Economy: Cash Dole-out Is Not The Solution

With economic activities grinding to a halt due to the pandemic, COVID-19 has dealt a double whammy to a large section of the Indian population.

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International Economic Bodies Have Predicted Faster Recovery For Indian Economy: Ashwani Awasthi, RICS SBE

The Indian economy is fast settling to a 'New Normal' with Unlock 2.0 effective July 1, 2020, relaxing the night curfew timings, provision of additional domestic flights and trains, and more activities being permitted in a calibrated manner outside of containment zones. The Government has progressively moved from – 'जान हैं तो जहान हैं' (only if I am alive and healthy, I can conquer the world) to 'जान भी जहान भी' (I have to be both healthy and live a long life of prosperity and success). With the pandemic having negatively impacted countries globally, the International Monetary Fund (IMF) in its revised projections of June 2020 has predicted that the Indian economy will contract 4.5% in FY21 as against the optimistic forecast announced of 1.9% growth in April 2020.

The reason being cited for the revised downward forecast has been the pandemic led severe nationwide extended lockdown leading to supply chain disruptions, massive job losses with unemployment numbers in India rising to 27.1% (as per CMIE) in May 2020 resulting in loss of income, lower consumption demand and weaker consumer sentiment.

Interestingly, CMIE data shows that with Unlock 1.0 happening, unemployment numbers ending July 7, 2020, was at 9.19%, nearer to pre-COVID levels. Also, a better than normal monsoon will have a positive impact on the agricultural sector which is forecasted to improve by 3.0% approximately and the services sector is expected to increase by 4.4%. These two sectors contribute more than 70% of the overall GDP of the country. Also, the demand in the FMCG sector is returning to pre-COVID levels and the rural market is almost intact as per the recent Nielsen survey reports.

In response to the economy being halted abruptly in its track of economic growth (with the lockdown announced on March 25, 2020) and with a viewpoint of being able to provide a kick-start to the economy on June 8, 2020 (with Unlock 1.0 happening), the call by the Prime Minister, Narendra Modi was for the citizens to aim for being 'आत्मनिर्भर', i.e. self-reliant and 'Vocal for Local'.

Some of the policy announcements to provide the much-needed boost to the Indian economy have been:

The Government of India has already announced a stimulus package to the tune of Rs. 20 lakh crores (equivalent to 10% of the country's GDP). Some term the stimulus provided by the Government as being tepid compared to other emerging economies and far lesser than those announced by advanced economies while others view it as a reformative fiscal package. We would agree with the latter ie the stimulus package is a reformative one which will have a far-reaching impact in the medium to long term.

The first stimulus was announced by the Union Finance Minister, Nirmala Sitharaman on March 26, 2020, which included free food grains for three months for 80 crore of India's poorest section (extended in the second stimulus for another three months), one-time transfer of Rs 2000 to 7 crore farmers, Rs 500 transferred to 20.05 crore women Jan Dhan account holders for three months to be able to deal with the COVID pandemic.

So while on the one hand, it was a case of free food grains/money transferred to the poorer section of society, on the other hand, one needs to bear in mind that the Government has sourced the food grains and thereby started the demand cycle of growth. This was followed by measures being announced by the Reserve Bank of India (RBI) to infuse liquidity in the financial circular flow. Subsequently, the Finance Minister announced a five-part stimulus package between May 13 and May 17, 2020, and pronounced other far-reaching policy reforms for the economy such as the amount to be paid under MGNREGA being increased to Rs 202 per day from Rs 182; an additional allocation of Rs 40,000 crore for this scheme (this is in addition to the Budgetary provision). This will again enable extra income in the hands of people thereby fuelling up consumption levels in the economy.

For the Indian farmers there have been sweeping policy changes made leading to critics stating that liberalization for the Indian Industry happened in 1991 but for the Indian farmer, liberalization has just set in via three ordinances: 1. Amendment to the Agricultural Produce Marketing Committees Act which enables farmers to sell their produce outside the mandis giving them the benefit of 'my crop, my right'; 2. Essential Commodities Act, 1955, focusing on lifting the restrictions on commodities such as cereals, pulses, onions, etc; 3. Farmers (Empowerment and Protection) Agreement on Price Assurance and Farm Services Ordinance, which provides a charter for farmers to engage in contract farming with large food multinational companies leading to a scenario of 'One India, One Agricultural Market'. The advantage for farmers now being able to access markets directly (without the intervention of the middlemen and thereby, breaking the monopoly of APMCs) will help them gain the benefits of higher prices for their produce. This would lead to increased income in the hands of these farmers which in turn will result in increased demand for products and services. Also, with the infrastructure of cold chain and refrigerated transportation being encouraged to be built by the Government, the farmers will be in a position to command better prices in the medium to long term.

To top it further, on June 30, 2020, the Prime Minister, Narendra Modi announced that under the Pradhan Mantri Garib Kalyan Ann Yojna, 80 crore people would be receiving 5 kg free ration and 1 kg dal per month till November end, 2020. Under the aegis of 'One Nation, One Ration Card' the benefits of this scheme would be derived by the lower economic strata including the migrant workers and their families.

Are these measures adequate?

With economic activities grinding to a halt due to the pandemic, COVID-19 has dealt a double whammy to a large section of the Indian population. It has resulted in the loss of cash and income especially for people at the bottom of the pyramid and to further worsen the situation migrant workers have also lost access to food and shelter. Critics state that the policy measures announced by the Government are largely supply-side measures (such as FDI limit in defence manufacturing increased to 74%; Rs. 3 lakh crore to be given as collateral-free automatic loan to MSMEs, etc) and are inadequate.

As per critics, it is demand-side measures which are needed to be able to provide the requisite boost and reverse the contractionary momentum of the Indian economy. As stated earlier, the Government has worked on this front too, by allocating Rs. 50,000 crore for implementation of public infrastructure works across six States and 116 districts being earmarked for the migrant workers returning home; Government bearing the Employee Provident Fund (EPF) contribution for three months of those earning up to Rs.15,000/- per month, reducing EPF contribution from 12% to 10% for three months for those in a higher income bracket thus leading to more cash available in the hands of the individual to spend, etc. Thus, once the economy gets a kick-start due to the above demand increasing measures, it will have a multiplier effect on the entire economy. It should also be contemplated that prior to the Covid19 pandemic the Indian economy was already facing a demand constraint.

Thus, in such a scenario, giving out cash handouts to the poorest section of society is not the answer to the revival of consumption demand. Proponents of demand-side measures claim that providing more cash handouts will increase private consumption demand in the economy. This will restart the circular flow of goods and services, and consumption and production will gain momentum. However, in place of giving hard cash and thereby starting the demand cycle, by providing food grains the Government is boosting demand on behalf of this section of society which in turn will kick-start the revival of the economy.

Points to ponder on…

Cash dole-out will lead to additional government expenditure and with revenue collections plummeting due to lower tax collections during the Lockdown, it will exert pressure on an already rising fiscal deficit number of the Indian economy. The Government will have little option but to ask RBI to monetise a part of the fiscal deficit.

Is monetising of fiscal deficit the need of the hour?

The concept of monetisation of fiscal deficit was abandoned two decades ago with big-ticket reforms enabling the citizens to partake of single-digit inflation since then. With the Fiscal Responsibility and Budget Management Act 2003 (FRBM) in place, the focus of this Act was to bar RBI from participating in primary issuance of Government Securities since April 1, 2006. There is an escape clause which states that RBI can subscribe to the primary issue of Central Government securities in case the fiscal deficit target is exceeded on "grounds of national security, the act of war, national calamity, the collapse of agriculture severely affecting farm output and incomes, structural reforms in the economy with unanticipated fiscal implications, the decline in real output growth of a quarter, by at least three per cent points below its average of the previous four quarters". The permissible deviation in the Act is to an extent of 0.5%. However, this escape clause has already been invoked by the Government on February 1, 2020, prior to the Covid19 pandemic. To further add to the already existing woes in the economy, monetisation of fiscal deficit will also lead to increased money supply resulting in inflationary pressures.

A contrarian view is that increased Government expenditure can be netted out by increased direct taxes. But, one should bear in mind that increased taxes will lead to lesser income in the hands of taxpayers thereby once again negatively impacting consumption levels. It will lead to a situation of a trade-off between consumption levels increasing for essential items if cash dole-outs are given as against increased discretionary spending by the taxpayers. The Government, in this case, would need to choose between which of the two is the lesser devil?

Another fact that needs to be looked at and considered is that the full-blown impact of the pandemic has not been experienced by the economy. With Unlock happening in phases, people contracting the virus are increasing by leaps and bounds. With increased fiscal deficit already having put the Government in a corner, is this the right time for the cash handout to be given or should the Government wait and watch for some time.

Rather, as the stimulus package has already permitted delayed tax payments, if the economy does not revive fast enough, one would also need to consider if the Government would need to cut tax rates, including GST and put more money in the hands of people.

So, are cash handouts needed or should the Government use the limited fiscal space to be able to facilitate schemes such as Garib Kalyan Rozgaar Abhiyan and expedite implementation of public infrastructure works and those related to augmentation of livelihood opportunities? In lieu of cash dole-out, giving of free ration coupled with the Ayushman Bharat Scheme (free health coverage) and the Pradhan Mantri Awas Yojna (housing for all) is an adequate measure to help this section of population sustain and survive.

On the other hand, by providing food grains the Government is boosting demand on behalf of this section of society which in turn will kick-start the revival of the economy. This will also ensure that the limited fiscal space is available for the Government to invest in infrastructure projects which in turn will generate employment for the lower-income strata and enable them to sustain their livelihood. Concomitantly, shouldn't one appreciate the fact that the Government has kept the burden on taxpayers at a minimum?

The million-dollar question now is: Keeping the available limited fiscal space in mind, should the Government give out cash dole-outs to people at the bottom of the pyramid or use it for implementation of public infrastructure works and those related to augmentation of livelihood opportunities is a better solution?

If the economy is not able to reverse the contractionary trend fast enough, shouldn't the Government cut tax rates and increase money in the hands of people leading to increased consumption of essentials and propelling discretionary spending thereby giving the necessary boost to consumer durables and electronics, automobiles, apparel, luxury products etc

In the post-COVID-19 scenario, with productive activity in the economy coming to a standstill both demand and supply-side measures implemented hand in hand are the need of the hour.

Thus, the Government has rightly strategized for a mixed bag of stimulus to stabilise and refuel India's economic growth track and also adequately provided for the lesser strata of society, ie free food grains, free healthcare facilities and housing for all.

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