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Financial Lessons to be learnt from the Pandemic

What is the issue?

The pandemic has turned the fiscal balance upside down, but the good news is that some structural changes might develop from the experience.

What is the impact of Covid-19 on Indian economy?

- The Indian economy was facing headwinds much before the arrival of the second wave.
- Coupled with the humanitarian crisis and silent treatment of the government, the Covid-19 has exposed and worsened existing inequalities in the Indian economy.
- **GDP**- India's GDP shrank 7.3% in 2020-21 which was the worst performance of the Indian economy in any year since independence.
- **Tourism sector**- The tourism sector contributes nearly 7% to India's annual GDP.
- The restrictions due to the second wave have crippled the tourism sector, which was already struggling to recover from the initial loss suffered by the businesses in 2020.
- **Aviation and Travel sector**- Aviation and other sector establishments faced a massive struggle during the pandemic.
- **Automobile sector**- The automobile sector remained under pressure in the near term due to the covid-19 situation in India.
- **Real Estate and Construction sector**- The real estate and construction activities faced a disruption as a large number of migrant workers have left the urban areas.
- **Fiscal Deficit**- India's fiscal deficit for 2020-21 zoomed to 9.5% of GDP as against 3.5% projected earlier.
- **Lockdowns and restrictions**- The lockdowns and restrictions that have been imposed in the past have impacted the economic recovery timeliness.
- Rising inequality and strained household balance sheets have constrained the recovery.

What are the key learnings from the pandemic?

- The Reserve Bank's latest report on State finances for 2020-21 reveals some key learnings.
- **Bolster local government**- There is a need to bolster the finances and political robustness of the urban local bodies and panchayati raj institutions which have done much of the heavy-lifting in managing the pandemic.
- The RBI's qualitative survey observes that their inability to meet the budgetary target of expenditure on public services in 2020-21 at the time of pandemic reflects their fiscal constraints arising out of revenue shortfalls and limited opportunities for market borrowings.
- The RBI study reveals that 22% of the municipal bodies surveyed reported a revenue loss of more than 50% in the second wave, while 11% reported an expenditure spurt of over 50% affecting their capacity to maintain infrastructure.
- Their ability to raise funds through property taxes and user charges needs to be improved.
- There must be greater fiscal transparency, revitalising the municipal bond market and boosting infrastructure finance and green finance.
- **Fiscal deficit-** The States' fiscal deficit to GDP ratio of 4.7 % in 2020-21 is expected to come down to 3.7 % in 2021-22 driven by a growth in revenue receipts of States.
- There must be a clear recognition that the fiscal deficit to GDP ratio need not be a number, but one that may be revised within a band as endorsed by the Fifteenth Finance Commission.
- An incentive-based approach to managing the fisc, such as allowing fiscal space for Discom reforms, is the way forward.
- If we have to move towards sustained economic growth, the states and the centre need to work towards a cooperative strategy through their cooperative federalism scheme to increase the vaccination drive.

References

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