Policy Responses to COVID-19

What is the issue?

- There is a looming threat of global recession and impending domestic demand destruction due to COVID-19 health emergency.
- Faced with significant uncertainty over the depth and duration of the negative shock, policymaking should be extremely quick and innovative.

How the policy focus should be?

- Due to COVID-19 spread, the policy focus has been to avert the health emergency otherwise; the economic emergency would be inevitable.
- But, looking ahead, it is important to keep a fiscal and monetary policy template ready to reduce any implementation delays.

What principles could be a framework to guide policy?

- Minimising hysteresis - Supporting easy reversibility.
- Subsidiarity - Supporting local action by official and civil society.
- Sustainability - Retaining the ability to provide a graded response to ensure political and economic confidence.

Why the FRBM Act needs to be suspended?

- The government has already utilised the elbow room offered by the FRBM Act under exceptional circumstances in FY20 and FY21 budgets.
- This leaves limited conventional fiscal space for any stimulus.
- But there could be a case for temporarily suspending the FRBM Act, as was done during the global financial crisis of 2008.
- Given the recent trends, the FRBM Act-mandated maximum target of a fiscal deficit of 3.8% of GDP might have already been breached for FY20.
- As growth concerns outweigh worries about future macro-stability risks now, any fiscal stimulus should not be deterred by FRBM considerations.
- The fiscal package should be proactive, quickly implementable, sizeable, targeted and reversible.

What are some spending ideas?

- **Earmarking** an enhanced budget for healthcare would definitely be the top priority.
- **Income support** to people whose livelihood has been impacted (these will primarily include daily wage earners).
- **Direct cash transfer** to this group is ideal, but might suffer from proper identification challenges.
- **Packages for deeply affected sectors** like travel, tourism and MSMEs could have three components - temporary postponement of taxes, cheaper loans, and explicit financial grants.
- **Frontloading public spending** to counter balance the near-term headwinds.
- The government can **suspend capital gains tax** temporarily to incentivise flows back into the equity market in the short term.

How a fiscal package could be funded?

- **Windfall from oil prices** - The government should be optimising the windfall from the sharp drop in oil prices.
- The central and state governments should not raise the taxes on petroleum products disproportionately, so that the benefits could be passed on to the consumers.
- Moreover, there should be further fiscal gains from lower kerosene and LPG subsidy.

- **Health emergency bond** - The government could consider issuing a tax-free health emergency bond to tap more resources.
- In a volatile equity market environment, these bonds could receive good response.
- **Direct RBI monetisation of deficit** - This is allowed by the FRBM Act under special circumstances including the "national calamity".
- This could be met through a combination of direct monetisation and OMO support to check interest rates from rising.

What would be the monetary response?

- Central bankers are trying to counter the two channels of transmission of the virus shock,
    1. Financial stability risk arising out of large market dislocations,
    2. Growth risk from estimated disruption in economic activity.
- **Adequate buffers** need to be created, so that the turmoil in equity market/macro economy does not spread to credit markets.

- RBI has been infusing both dollar, and rupee **liquidity** to ensure that the financial systems do not freeze up.
- On top of it, there is scope for an immediate 25-50 bps **rate cut** as a first step to support growth.
- RBI may indirectly intervene in the corporate bond, CP market as the credit spreads have widened quite substantially.
- It might provide **regulatory forbearance** for retail customers, and certain specific sectors.

Source: The Indian Express, Financial Express.