To Save India’s Economy, Think Big, Blunt and Fast

By Pushan Dutt , INSEAD

With unemployment pushing 30 percent, the world’s fifth-largest economy needs a strong dose of fiscal and monetary intervention.

Thousands of migrant workers jostle and heave in a swarm of desperation, scrambling to board too few buses and trains to get home before a nationwide lockdown takes hold. Scenes like these, captured in major Indian cities on 24 March, have become the defining image of the coronavirus’s grip on India. Prime Minister Narendra Modi came under fire for ordering the country’s 1.4 billion people to shelter in place with only a few hours’ notice. But it is what his administration does – or doesn’t – do next that will leave a lasting imprint on the most populous democracy in the world.

India does have a number of strengths going into this crisis, as I pointed out recently at the annual **India Business Dialogue** hosted by the **INSEAD Emerging Markets Institute**. First, its **US$480 billion** foreign exchange reserves are the highest they have ever been. The external debt to GDP ratio is only 20 percent. The Reserve Bank of India (RBI), which manages the reserves, enjoys credibility and is independent of the government. Second, the country has about 11 months of imports while oil (the biggest component of imports) prices are at record lows. These two factors will ensure the rupee's stability, preventing the sort of banking shock and currency depreciation that reverberates all over South America.

But several weaknesses weigh down the Indian economy. For one thing; **growth has slowed** significantly since 2018. The vast majority of India's **micro, small and medium enterprises** (MSMEs), which account for 40 percent of the workforce and 30 percent of GDP, are unregistered and therefore difficult to help**.** And while the RBI has had a good run, the same can't be said for India's banks. Many had been under strain due to mounting bad loans even before the pandemic. COVID-19 **threatens their very survival**, and the savings of millions.

Big, blunt, fast

More than in the United States and Europe, the coronavirus has inflicted a cost of historic proportions in India, the extent of which is only just emerging. Some **122 million Indians lost their jobs in April**, pushing the unemployment rate to a record high of 27 percent. The same month in the US, by comparison, unemployment reached 14.7 percent. The Purchasing Managers' Index, a common measure of economic activity, **went into freefall from 49.3 to 5.4** in April in India.

Desperate times calls for bold measures, and quick implementation. Given India's huge numbers of migrant workers and high unemployment, as well as the massive pressure on the health sector, the government's initial response, announced on March 27, was found wanting. The US$22 billion **relief package** for the poor, worth about 1 percent of GDP, was small even compared to those of other emerging markets in Asia.

As the government grappled with the massive disruption to firms, workers and consumers, a **stimulus package** worth US$266 billion, or about 10 percent of GDP, was announced on May 11. It should be noted that the package is not a pure fiscal stimulus since it also includes monetary measures deployed by RBI, the central bank. One of the stimulus measures, a **collateral-free loan scheme** for MSMEs and other businesses, is much-needed but its outcome will hinge on the speed and effectiveness of implementation.

Also critical are measures to ensure an economy that's been put on ice can be quickly revived, and they should be blunt and fast. A good example is giving cash to workers to prevent them from going bankrupt as well as to preserve some consumer demand for when the economy reopens. While cash transfers should ideally go to the neediest, it is important to realise that such interventions are not about combating poverty.

If and when long-term objectives and short-term effectiveness diverge, the unique and severe nature of the crisis means more weight should be given to the latter. A good example is **cash transfers to women** currently managed through Jan Dhan, the national basic banking scheme. While valuable, the scheme's effectiveness is limited because only 21 percent of women have a Jan Dhan account, compared to 80 percent with any bank account. Expanding cash transfers to the poor via other channels would boost the effectiveness of the scheme even if the risk of fraud and mis-targeting might be higher. Similarly, scaling up in-kind transfers via government-run ration shops (public distribution system) would be a good policy. This is not the time to build something new.

Quickly target who you can

Unlike in advanced economies, there is no direct mechanism in India to help MSMEs and the people who work for them. In rural areas, the authorities can turn to the **Mahatma Gandhi National Rural Employment Guarantee Act** to generate employment. For businesses and employers in urban areas, the government has to prioritise the large corporations, if for no other reason than it is the only way to reach the millions of unregistered MSMEs. Help for the big players should be made conditional on continued employment of the MSMEs, and so the aid trickles down to workers employed in the informal sector.

There will certainly be trade-offs, between speed and accuracy for instance. You can give funds to people very quickly, but some of that money will be misallocated. Right now, I think we should err on the side of speed and generosity.

I'm most confident about India's monetary policy, because there is a lot that RBI can do and is doing. It can lend to insurance companies, corporates, and even non-banking financial companies. It can even create schemes to lend to small and medium enterprises, though that's risky. However, the RBI must keep an eye on long-term sustainability by extending support to banks and non-bank entities that are illiquid, not insolvent. The RBI can stop India from descending into a currency or a financial crisis.

How well India survives the economic impact of COVID-19 will depend on the trajectory of the pandemic, government measures (including health policies beyond the scope of this discussion) and their implementation -- and a massive dose of luck. Leadership is going to matter, as will institutions. India’s federal structure means that the capabilities of regional and local leaders will also be key. As Warren Buffett observed, “It’s only when the tide goes out that you learn who’s been swimming naked.” This crisis will be revelatory.

Find article at
https://knowledge.insead.edu/economics-finance/save-indias-economy-think-big-blunt-and-fast

---

About the author(s)

Pushan Dutt is a Professor of Economics and the Shell Fellow of Economic Transformation at INSEAD. He teaches in the MBA programme and the **INSEAD Leadership Programme for Senior Executives**.

About the series

Covid-19

Covid-19 is no longer a global health emergency but its impact on public health, the global economy and the future of work cannot be overstated. INSEAD's thought leaders — both faculty and their close collaborators in the practitioner and entrepreneurship communities — give their informed perspectives that could help us not just weather the crisis but emerge from it stronger than ever.