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Covid 19 and Economic Challenges Ahead

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Why in News

Recently, India has rolled-out various policy measures to deal with **Covid-19**, India also has to brace for multiple impacts over an uncertain timeline that could last a year.

Key Points

- **Welfare Measures:** The government has taken various welfare measures (encompassing both food and money) to help the most vulnerable and also to partially meet the cost of retaining workers in smaller enterprises, for the next few months.
- **Test and Cost:** For the size of India's population, the quantum of tests conducted so far seems to be too few and the government should bear the entire cost for testing.
- **Compared to Developed Countries:** Emerging Market Economies (EME) like India, can hardly match what developed countries like the US, UK and Germany have announced.

These countries have basically set out to offset, through generous direct government entitlements to large sections of the population and extraordinary central bank activism, the adverse demand shock following the primary negative supply shock of the pandemic.

Challenges Ahead for India

- **Fiscal deficit:** India's national fiscal deficit is perpetually high, and it is about to get larger even without an increase in outlays.

Due to this first, revenues will decline sharply; and, secondly, state governments who are the first responders of the health emergency will be hard pressed.

- **Foreign Investment:** Foreign portfolio investment in Indian equity and bonds is about US\$ 300 billion. In March US\$ 15 billion exited. India's equity performance during March in dollar terms was low compared to other emerging market economies.
 - Over the past year, India relaxed prudential norms related to external flows management, opening up yet more the possibilities of surges and sudden stops of foreign capital.
- **Trade barrier:** India also imposed trade barriers to imports through higher custom duties.
 - It is well founded that high import barriers ultimately undermine national competitiveness and it is mostly export earnings that will have to service external liabilities.
- **Banking Sector:** Non-Performing Assets (NPAs) will spike in virtually all economies in the coming months. India's NPA ratio is over 9 percent highest, among the important economies.
 - Recent developments including that of private banks includes widely reported delays in resolution and the ad-hoc dilutions in regulations, which have not helped.
 - Neither has poor disclosure — late last year ten banks disclosed that for the previous financial year their NPAs were Rupees 26,500 crores higher than previously reported.
 - All this contributed to an increase in the banking sector's risk premium.
- **International investors:** international investors will begin to sharply distinguish between countries along the principal measure of how successfully the health challenge is being met, which will determine how quickly and durably individual economies will get back on their feet.

Way Forward

- Higher customs duties on imports must be checked, which will increase India's competitiveness and remove trade barriers.
- Issues related to the banking sector like NPAs must be dealt carefully.
- If the fiscal and monetary responses are strengthened, the likelihood of serious consequences for macroeconomic stability increases.

Source: IE