BYJU'S The Learning App

Economy This Week (13th July to 26th July 2020)

Table of Contents

1. Financing the food chain (BS 15/7/20)

- The government has announced extending the free food grains distribution to the poor till November (this will entail an additional subsidy of ₹ 76000cr). This would put a fiscal burden on the government (along with the fertiliser subsidy).
- FCI had an outstanding loan of ₹ 2.54 tn from the NSSF. This has helped the government keep in check the fiscal deficit.
- In a normal year, the food subsidy on account of NFSA is around ₹ 1.8 tn. This year it is expected to rise by another ₹ 1.2 tn on account of the free food grains provision (in addition to this, the centre may have to provide for ₹ 20000 cr for decentralised procurement).
- If all of these expenditures are considered, the total food subsidy related bill will be a whopping ₹ 5.7 tn.
- This looks unlikely in the current context and the FCI may be forced to borrow further from the NSSF. Such off-budget financing will add to the economic cost of wheat and rice in FY22 (the economic cost also includes the interest paid on the borrowings, for FY21, it is estimated to be around 6%).
- Fertiliser subsidy:
    - Urea is the top fertiliser sold in India and almost 75% of the price comes from the subsidy paid by the government.
    - FY21 has already started with an unpaid subsidy of ₹ 48000 Cr. In addition to this the subsidy required for current fiscal is estimated at ₹ 80000 Cr. taking the total subsidy requirement in the current fiscal to ₹ 1.28 tn. The allocation is ₹ 71309 Cr (11% lower than the allocation in the last fiscal).
    - In addition to all of this, because of the pandemic, the Ministry of Fertilisers has been classified under the 'B' category of ministries, which means it can spend about 80% of the allocated budget.
- In light of all of this, the government must be ready to absorb a fiscal slippage to the extent of 1 to 2%. To tide over this, RBI may consider monetising the deficit.

2. Need policy clarity on import substitution (LM 14/7/20)

- The policy for import substitution should be a fine balance between the current requirements and future value creation.
- The Indian Government is looking to impose a host of tariffs on lithium-ion cells along with incentives for the domestic industry to boost its manufacturing. The lithium cells are the basic building units of the rechargeable batteries which are used in most of the electronic goods.
- The government is thinking of imposing a 10-year import duty plan that will let the manufacturers find the customers even if they manufacture them at a higher cost.
- In addition to this, the government may provide concessional credit, tax sops to these domestic manufacturers.
- Post-independence also India had imposed import substitution policy and three decades ago it was dismantled. The reason for that was the poor success of the policy. Hence we must be cautious about embarking on the same experiment.

- The experience has been that with the imposition of tariff and non-tariff barriers, companies have had less exposure from global companies. With this, they have very little incentive to keep the quality high and cost low. Even if there had been domestic competition over time, it has only led to inefficiency and costs have been pushed upwards for the users of the protected products.
- Higher costs on batteries (either because of higher import costs or higher costs because of the domestic manufacturers) will have a big impact on the sunrise sectors of the economy.
- In the case of raw materials such as rare earths, China has an advantage. Recently a JV between three state-run companies was formed - KhanijBidesh India Ltd which aims to acquire reserves of strategic minerals such as cobalt and lithium from countries such as Argentina, Chile, Bolivia, South Africa, Australia. The outcome of this will determine how quickly the domestic manufacturers can replace the imports from China.
- The details of the substitution scheme are also important. There must be provisions for the following:
    - To reduce the cost bloat, duties must be gradually reduced. This would give the domestic manufacturers sufficient time to act and increase the competition.
    - Export targets must be set to test how globally competitive the products are.

3. Managing public debt (BS 21/7/20)

- Economic disruption caused by COVID has thrown a spanner in the financials of countries. The public debts of most countries in addition to the budget deficit are expected to balloon.
- As per the IMF, the global government debt will be ballooning from 83% (2019) of global GDP to over 100% in the current fiscal.
- In the case of India, the debt as well as the fiscal deficit are expected to expand. The debt is expected to reach 87.6% as there has been a rise in the current year's borrowings. Consequently, the target to bring down the debt to 60% by 2022-23 will be pushed back by seven more years.
- The increase in public debt in the current context is understandable but the concerning matter is that it has been on the rise since 2011-12. It has risen from 67% (2011-12) to 72% (2019-20).
    - The government would have to keep aside more resources for debt servicing.
    - The debt also doesn't represent the accurate picture as the government has been providing guarantees of state borrowing which if called upon will put additional financial pressure.
- There are experts who feel that the government needs to provide a shock to the economy by monetising the debt as there is lower demand. However, this argument is fraught with risks.
    - As the lower aggregate demand has not materialised into lower inflation rates.
    - The debt was rising even before the pandemic.
- The policymakers should prepare a roadmap for large structural changes.

4. Indian inflation (LM 22/7/20)

- The government was unable to provide inflation data during the lockdown.
    - Was unable to collect the data from the market.
    - Some of the commodities were not traded.
    - Hence, it has announced the inflation data simultaneously for three months, April, May and June at 7.2%, 6.3% and 6.1% respectively.
- The declining trend has been observed as the supply constraints were eased with the easing of the lockdown.
- This inflation trajectory is a cause for worry as the initial COVID shock was on the supply side of the economy, the next wave will hit the demand side. The inflation rate has been higher than the allowed limit of 6% by the government.
- Inflation for the month of June has been higher than that of January and this trend has been seen in most of the countries. However, India is an outlier as the inflation rate in April had seen a sudden

spike compared to the month of March. India saw a sudden spike in inflation with the strike of the pandemic.

  - Lockdown was very severe which has disrupted the supply side.
  - Food articles are given higher weightage and spike in food prices will mean a higher inflation rate.
  - The rate has been retrospectively calculated so it leaves room for doubt.

- In addition to the vegetable prices, even the gold prices have added to retail inflation.
- Supply chains would be restored after the economy gets normalised.