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THE YEAR OF COVID – WE LOOK BACK AT THE FUTURE

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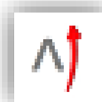

"WHO has been assessing this outbreak around the clock, and we are deeply concerned, both by the alarming levels of spread and severity and by the alarming levels of inaction. We have therefore made the assessment that COVID-19 can be characterized as a pandemic." – Director General, WHO, March 2020

With these few words, WHO made clear that the way we lived was going to change imminently — and it did.

It has been a year since the start of the COVID-19 pandemic, which has changed the ways in which each of us relates to the world. We look back at how India fared in the last 12 months and how the next 12 moths may have in store for all of us.

For us, more than a public health crisis, it has been a year of economic crisis manifested most severely in the labour market.

Experts feared that India would suffer heavily, economically, and otherwise. Tried and tested methodology predicted almost 300 mn infections by the middle of 2020. On the face of it, India was battered by the world's 3rd highest number of infections, we spent time under the severest of lockdowns and in turn faced one of the sharpest contractions anywhere in the world. In the first and second waves, more than 13 million have contracted the virus and more than 165,000 have perished. But India's story is also that of surprise. We have witnessed one of the lowest death rates amongst large countries and given the precarious health infrastructure have done remarkably well in controlling the gigantic wave of infection.

However, India's economy has taken a massive hit. A return to growth is expected this year. However, if experience from previous shocks is any indication, there will be lasting damage. We are in the middle of a once-in-a-lifetime disruption to all facets of life – social, political, and economic.

In the face of the pandemic the structure of the economy, especially that of the labour market typified the extreme vulnerability of India's workers. We look back at 2020-21 and the pandemics impact on the economy.

A. Labour Market – serious repercussions

Casual Labour hit hardest

1. 75% of employment was concentrated in casual and distress driven micro – entrepreneurship. With less than 10% of workers in India under social security or job contract, an overwhelming number of these ~ 400 mn workers were critically exposed.

Greatest labour market shock

2. This was possibly the greatest contemporary labour market shock. This was expected as Covid affected all sectors with both demand and supply effect. Moreover, a significant effect was on salaried employees, many of whom either faced a cut or were forced out of the labour market.

Unemployment rate with shocks

Source: CMIE

Women affected harder

3. Typically, at times of economic contraction, male employment is hit harder than women, in case of covid women were hit harder with higher unemployment rates @ 21.2% than for men at 20%. Women unemployment were higher still in MP, West Bengal, Karnataka, Gujarat, and Jharkhand.

High Case load states worse affected

4. Expectedly effects varied between net migrant donor states versus net migrant recipient states. Labour supply constraints outweighed contraction in high case load states.

Move towards distress driven self-employment

5. Lock down impacted daily wage earners and primary occupations viz., street vendors, auto and taxi drivers disproportionately. Notably even salaried jobs in formal employment were affected. There was a shift towards distress driven self-employment made evident from the fact that employee PF accounts closure saw a drastic increase of 8% between April 2020 – Jan 2021.

Manufacturing and Services hit hardest

6. States with high concentration of manufacturing – Gujarat, Maharashtra, Haryana etc. and services – Telengana, Karnataka, Rajasthan, Himachal, Uttarakhand, and Tamil Nadu witnessed larger scale unemployment that other states. Mining, manufacturing, electricity, consumer durables, hospitality, etc. were affected severely. In locations with comparatively higher concentration of service jobs, the unemployment rate was over 15%

Surge sectors saved the day

7. Finally, some surge sectors viz., grocery, banks, gas stations ATMs etc. arrested the further decline in employment numbers.

B. The Rest of the economy – A long way to recovery

"The way global economy is panning out, it is an educated guess that the long-term economic damage from the pandemic will be twice as severe in emerging markets than in wealthy countries." – Oxford Economics

Pre-Pandemic Slowdown

- ✓ The economic impact has been largely disruptive. India's growth in the Q4of the fiscal year 2020 went down to 3.1% according to the Ministry of Statistics. Notably India had also been witnessing a pre-pandemic slowdown, and according to the World Bank, the current pandemic has "magnified pre-existing risks to India's economic outlook".

Impact of Pandemic

- ✓ The World Bank and rating agencies had initially revised India's growth for FY2021 with the lowest figures India has seen in 30 years since India opened. The contraction was not uniform, rather it differed according to various parameters such as state and sector. The Ministry of Statistics released the GDP figures for Q1 FY21, showing a contraction of 24% as compared to Q-o-Q before. Since then, there has been a steady move upwards but reaching the pre-covid days still seem to be distant. As a matter of fact, all types of recession, long or short leads to output loss.

Inadequate Fiscal Measures

> ***"The relief measures adopted by India were not only much smaller in scale, but also centred on easing supply-side constraints and providing liquidity support rather than aggregate demand support."***
>
> ***UNCTAD***

- ✓ To mitigate some of the adverse effects and to stimulate growth and demand in the economy, time to time the Government announced a variety of measures to tackle the situation, from food security and extra funds for healthcare and for the states, to sector related fiscal incentives and tax deadline extensions. Early during the pandemic, economic relief measures for the poor totaling over US$24 billion were announced followed by Reserve Bank of India measures which made available US$52 billion to the country's financial system. On 12 October and 12 November, the government announced two more economic stimulus package, bringing the total economic stimulus to ₹29.87 lakh crore (US$420 billion) — 15% of national GDP.
- ✓ Most of these measures have been supply focused whereas, fall in aggregate demand has not been adequately addressed. Moreover, the actual distribution of such

Impact on credit and funding of new businesses including Private Equity Funding

- ✓ As an effect of the strictest lockdown, loss of jobs and uncertain outlook, aggregate demand fell drastically over the last year. As a corollary new credit offtake as well as funding for new businesses suffered. While large corporate houses viz., Reliance et al were able to quickly shed excess leverage and become leaner, start ups and MSME units have continuously faced a lack of demand for their products on one hand and drying up of sources of credit from formal financing channels.

Effect on Fiscal Prudence

- ✓ India's FRBM measures aimed at maintaining Fiscal Deficit at 3.5% of GDP. Pre pandemic, Fiscal Deficit was under pressure due to inadequate growth of government receipts. The pandemic has hit our fiscal prudence even harder. Government's stimulus measures have created a situation of burgeoning government spending without adequate revenues being received by the government. While GST etc. receipts have picked up significantly in recent times, the overall fiscal numbers look grim. Unlike developed economies with long history of economic prosperity, we do not have unlimited resources to keep on providing Fiscal Stimuli. The Fiscal Deficit is already set to touch almost 9% if government receipts do not further grow at anticipated levels. It is a reminder to the government that demand boosting measures need to be implemented immediately.

A Silver Lining

- ✓ Amid all this gloom, agriculture, e commerce, FMCG, stood out as outliers and provided a silver lining. Agriculture grew at a modest 2% throughout FY 2020 to provide much needed succour to the returning migrants. Government's push at providing Direct Benefit Transfers (DBT) to farmers, migrant labour, women in the informal sector to tide over their immediate needs.

C. The Future – Our View

What does India's path to Post Pandemic Recovery look like?

India and the world are seeing the light at the end of the tunnel. With vaccination efforts on the upswing, unless there is a serious outbreak again (a distinct possibility), there is a good chance that the worst is behind us. India has a chance to pause and take a serious look at its current trajectory. Government officials routinely talk about India's V-shaped economic recovery. India's quarterly GDP growth plummeted by ~24% in the April-June quarter relative to the previous quarter. In the following quarter, Q-o-Q growth shot up by ~22%. On a chart, it looks like a **'V'.** Sadly, that is not the whole story. Data published as part of the OECD Economic Outlook, Interim Report March 2021 forecasts that the real GDP value of India's economy for the fourth Q4 2021 will be 7.8% lower than the OECD's pre-pandemic prediction.

So, the talk of a "V" shaped recovery is currently premature. An analysis of economic vulnerabilities by Oxford Economics, a global forecasting consultancy, finds that long-term economic scarring in India could be among the deepest in the world. Limited fiscal support for the recovery, structural rigidities, imbalances in the financial sector and other reasons will cause the economy to take longer to reach its pre-pandemic trajectory. However, our government is now taking some further concrete measures to bring back a semblance of growth.

A Silver Lining Once More – A Good Budget with Targeted Demand Boosting Measures

The budget for the fiscal year from April 2021 to March 2022 points to a shift towards demand-side stimulus, with an uptick in public investment (particularly in physical infrastructure) for the coming fiscal year.

In order to maintain momentum and to create a conducive environment for revival, we suggest 5 tested principles that may be implemented.

We must focus on these 5 priority areas if we wish to move forward on a path to faster recovery.

1. Prioritise Public / Government Investment in physical and Social infrastructure

Currently, it is futile to expect that private investment will come forth. Therefore, public investment is necessary to crowd in private investment. India has a lack of infrastructure facilities that has been often cited as one of the major reasons behind the failure of industry, particularly manufacturing, to take off and reach a desired level. Infrastructure has also been a key issue in the inability to attract sizeable amount of FDI. This crisis time may have created an opportunity to bridge that long-standing gap. Aggressive public investment on infrastructure for the next 2 fiscals can help the efforts to revive the economy.

2. Provide input tax relief to certain key sectors

During difficult times, the usual appeal is for corporate tax concessions. It will not work this time. The most important point to note is that there was already existing distress in Indian industrial production. The pandemic amplified it. So, one possible way through this recessionary trend in industry is to provide input tax concessions. It is quite comprehensible that we may not be in any position to provide input subsidies to all sectors. The process may start with the top 5 manufacturing in terms of weightage – metals, oil, chemicals, processed food, and automobile. Once some of the initial beneficiary sectors revive themselves, those can be taken out and replaced by others – machinery & equipment, textiles, electrical equipment being the prominent among those.

This can be an effective supply-side augmentation in addition to the demand inducing measures like DBT and urban employment guarantee. In totality then it can revive a good part of the investment demand.

3. Direct Benefit Transfers to be augmented and continued

Demand augmenting measures must be implemented. It would not be imprudent to say that more DBT is needed – covering more people. Typically, DBT provides income support and prevent wealth disruptions that are necessary to deal with this extraordinary situation. The pandemic has hit not only the poor, but also a sizeable section of the workers who do not have any kind of social security. While it is true that identifying affected population is a difficult task, it will not be impossible, either, using Aadhaar and a coordinated effort between central and state governments. A temporary income support for 12 months through DBT can further augment consumption and aggregate demand in the economy.

In any recession, money must be directly pumped into the system to boost immediate consumption and investment. Boosting immediate economic activities by investing public capital enhances the purchasing power in the economy, that purchasing power then is spent on consumption, that consumption boosts demand and instantly productions are augmented to meet that extra demand which creates more purchasing power in the economy. This cycle goes into the upper spiral and takes the economy out of recession. That is how investment multiplier works in any economy. Monetary interventions usually have little immediate effect on the economy.

4. Suspend FRBM for the near future and monetise our central Fiscal Deficit

Currently the growth concerns clearly outweigh worries about future macro stability risks. At this juncture, quick decision making, and timely implementation of those decisions are the most important factors to get the economy back to the road of revival. To provide fiscal push to the economy, suspending FRBM for two years should be the initial step to finance any fiscal revival attempt. Latest estimates show that India has already breached the fiscal deficit target in 2019-20. It is currently estimated at 4.6 percent of GDP, well above the mandated target of 3.8 percent of GDP. Therefore, it does not make any sense to not undertake a stimulus programme because of FRBM.

For monetizing our deficit, an attempt can be made to tap Foreign debt markets where interest rates are below "0" in real terms; NRIs can also be offered COVID bonds at floating rates – with the assumption that rates will be at lower level for some time. In the domestic market, however, there is a larger possibility of mobilisation of finance because many large funds, institutions, and high net worth individuals, may opt for an assured return (Government guaranteed) COVID bond – even at a relatively lower rate of interest. We need INR 9-10 lacs crores of funds for fiscal stimulus. An attempt to mobilise INR 2 lacs crores each in these three categories of overseas debt market and COVID bonds is a plausible option. The remaining INR 3 lacs crores can be monetised – borrowed from the RBI at a fixed rate lower than the repo rate (ideally around 3.5 %) and with longer duration.

5. Expand Employment Guarantee Scheme to Urban Areas

After the migrant workers' crisis during the lockdown, the focus is now on reverse migration. There is a short and long term reverse migration taking place. There are already reports of workers returning from their homes, where they could not find gainful employment. Incidentally, since MGNREGA has been used by ~ 86 million people (H! 2020-21). This is the highest-ever utilisation of the scheme and the rural ecosystem of employment is under massive stress.

It is of paramount importance that cyclical short-term migrants are absorbed into the urban employment set. But the absorption may not be an easy task when jobs are generally disappearing. Expansion of employment guarantee scheme in urban area is thus necessary to stabilise the economy. Apart from boosting purchasing power and thereby consumption demand, this scheme has the potential to raise and stabilise urban wages. This can also create a stable national labour market by regularising inter-state migration that can continuously balance surplus and shortage in different labour markets.

While it is our view that these 5 measures both at the central and state levels may be implemented, we are acutely aware that India could take a significant amount of time to get back to its pre-Covid growth path and wipe out the economic damage caused by the lockdown. We are hopeful that if these measures are implemented immediately, the economy which is under rebound after hitting the nadir, may witness a faster than expected return to its pre – covid trajectory.