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Impact of Corona Virus on Indian Economy

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Abstract
With more than 84,000 people succumbing to COVID-19 infection so far, India's death toll is the third highest in the world after the US and Brazil. Unlike the US and Brazil, India's daily increase in COVID-19 cases shows no sign of decline. Since mid-August, India has been recording the world's largest daily increases in coronavirus cases. In the second week of September, new COVID-19 cases averaged nearly 90,000 per day in India. While the world is currently witnessing the second wave of infections, India has not been able to flatten the first wave curve. Even though higher testing is critical to contain the virus outbreak, testing facilities in India have been beefed up only since mid-August. Measured on a per capita basis, India is still far behind other countries in the number of tests. Currently, the number of COVID-19 tests per million population in India stands at 42,000 — the lowest among countries with large outbreaks of the coronavirus.
Keywords: Covid, Pandemic, Economy, supply chains.

I. Introduction

India has become the world's new hotspot for the COVID-19 pandemic as infection cases have surged in recent weeks. On September 7, India overtook Brazil with 4.2 million confirmed cases to become the country with the second-highest number of confirmed cases in the world. On September 16, the total number of confirmed cases surged past five million. If the current trend continues, India may soon become the world's worst-hit country, surpassing the US.

Except for the COVID-19 case fatality rate (CFR) witnessing a decline, the rest of the indicators are strikingly worrisome in India. Experts believe that the CFR is not a meaningful metric for India as it does not capture the true level of transmission due to the low testing rate and age factor. Besides this, many deaths may go unreported in rural areas. Although the Central government insists that there is no community transmission in India, the health officials of Himachal Pradesh, Kerala and West Bengal have admitted that there is community transmission of the coronavirus in their respective states. More worrisome is that the coronavirus is fast spreading to rural and remote areas of the country that lack testing, treatment and tracing infrastructure. Since July, coronavirus cases are surging in villages and small towns. Even the remote Andaman and Nicobar Islands have reported more than 3,300 confirmed cases of COVID-19. In the absence of basic health infrastructure, containing the spread of the coronavirus is much more difficult in the rural hinterland.

Unparalleled economic blow

On March 24, 2020, Prime Minister Narendra Modi imposed a nationwide lockdown that remained in effect until May 31. Unlike other countries (such as Germany, Italy and Thailand), the lockdown in India did not help in containing the spread of the coronavirus. Infection cases kept on increasing despite India being in lockdown. The abrupt nationwide lockdown imposed across India was the biggest in the world, forcing 1.3 billion Indians to stay indoors. The lockdown restrictions were imposed without any preparation or coordination with states. It was also one of the most stringent lockdowns enforced in the world. Except for some essential services and activities, the rest of India's $2.9 trillion economy remained shuttered during the lockdown period. Economic activity came to a grinding halt in the country. The lockdown had devastating impacts on an already slowing economy and people's livelihoods as shops, eateries, factories, transport, services and business establishments were shuttered.

As per official data released by the Ministry of Statistics and Programme Implementation, the Indian economy contracted by 23.9% in the April-June quarter of this fiscal year. This is the worst decline ever recorded since India started compiling GDP statistics on a quarterly basis in 1996. India's GDP contraction was worse than any of the world's biggest economies. Except for China, most major economies witnessed GDP contraction in the April-June quarter of 2020, but India posted the steepest quarterly decline, far worse than the US (9.1%) and Italy (17.7%) — two countries severely hit by the coronavirus pandemic. We should also keep in mind that GDP calculations in India do not fully capture the economic activity in the informal sector — which accounts for more than 50% of gross value added. As informal sectors of the economy have been worst hit by the pandemic, India's GDP contraction during April-June could well be above 35% if informal sectors are taken into account.

For the Indian economy, private consumption and investment are the two biggest engines for growth. During the first quarter of 2020, private consumption — accounting for 59% of India's GDP — declined by 27%, while investments by private businesses fell by 47%. India's net exports turned positive due to sharp compression in imports. During the quarter, government spending increased by 16%, but it was not adequate to compensate for the decline suffered by other engines of growth. Except for agriculture, all the major sectors of the economy were badly hit. Significantly, labour-intensive sectors such as construction, real estate, retail trade, transport and manufacturing contracted sharply during this quarter.

No one can deny that the Indian economy was facing headwinds much before the arrival of the pandemic. India's GDP was on a downward slope much before the COVID-19 pandemic hit the country, largely due to the demonetisation exercise, and the botched-up implementation of the Goods and Services Tax (GST) that paralysed the cash-dominated informal sector and small businesses. According to a survey carried out by National Statistical Office, India's unemployment rate touched a 45-year-high of 6.1% during 2017-18. Further, the stress in India's financial sector, especially among banks and non-bank financial companies, has been increasing prior to the COVID-19 pandemic. Coupled with a humanitarian crisis and muted policy response, the COVID-19 pandemic has brutally exposed and worsened existing vulnerabilities in the Indian economy.

More woes lie ahead

There is still worse ahead. The business activity and consumption will remain subdued in the coming months due to a continued rise in virus cases across the country. Since July, several state governments have imposed localised lockdowns to curb the spread of infections. The relief packages announced by the government since March are not aiding faster recovery because the direct government spending component is modest. The bulk of relief measures consists of indirect support such as credit guarantees and liquidity infusion and have proved to be ineffective in generating higher credit growth. The credit offtake from banks will remain muted in the near term because of subdued credit demand. What's the point of massive liquidity injection when there is no demand for credit from businesses and consumers?The contraction in the Indian economy would continue into the next three quarters and a recession is inevitable. Since Independence, India has faced a recession only thrice: 1958, 1966 and 1980. Almost everyone agrees that the Indian economy is heading for its full-year contraction. Economists, rating agencies and international financial institutions have revised their forecasts and their current projections show India's GDP could contract in the range of 9% to 18% this fiscal year.

Even if the health crisis is managed by mid-2021, the economic recovery will be slow and uneven with adverse consequences on output, employment and financial stability. Both private consumption and investment demand will take a long time to recover. The discretionary spending on non-essential goods has declined drastically due to rising unemployment and worries about likely job losses in the future. In the absence of domestic demand, businesses will not undertake fresh investments, which in turn would curb employment and overall economic growth. Few indicators (e.g., power consumption, passenger vehicle sales and e-way bills) are showing signs of revival in India after the government eased lockdown restrictions, but a sharp 'V'-shaped recovery is unlikely to occur during this fiscal year. In the current scenario, it is even harder to predict when economic activity could return to pre-virus levels, largely because of the health crisis and the government's timid fiscal response. What is urgently needed is a robust fiscal stimulus by the government to spur domestic demand and to sustain investment without being over-concerned about the fiscal deficit. The primary focus of fiscal stimulus should be on the informal sectors, micro, small and medium enterprises (MSMEs), the self-employed and casual workers that have been the worst casualty of the COVID-19-induced lockdown and subsequent disruptions.

Growing stress in the banking sector

Without a doubt, the COVID-19 pandemic has amplified the existing vulnerabilities of India's banking sector, particularly of banks and non-bank finance companies (NBFCs). The NBFCs were hit by a liquidity crisis in 2018 when Infrastructure Leasing and Financial Services (IL&FS) — a major NBFC — collapsed. While the banks, particularly the public sector banks, continue to suffer from high nonperforming loans. Since April 2020, not only has credit growth of banks slowed down, but more importantly, their asset quality has also deteriorated sharply. Consequently, nonperforming loans pertaining to retail and MSME segments are on the rise. In its Financial Stability Report (July 2020), the Reserve Bank of India has estimated that under a very severe stressed scenario, the gross non-performing assets of the banking sector could rise to 14.7% by March 2021 from 8.5% in March 2020. The rise in non-performing assets would result in higher credit costs, which in turn would adversely impact banks' loss-absorbing buffers and profitability.

To provide targeted relief to bank borrowers, the K.V. Kamath committee has selected 26 sectors that will require loan restructuring and has listed the financial parameters that will be considered in the restructuring of loans affected by the COVID-19 pandemic. The committee found that 29.4% of the total banking debt was impacted by the pandemic alone while another 42.1% was already facing stress before the outbreak. In total, 72% debt of the banking sector has been impacted by the pandemic. Given the continuing rise in COVID-19 cases, some borrowers may not be able to meet the strict requirements suggested by the committee thereby contributing to higher levels of nonperforming loans in the banking sector. Make no mistake: the stress in the banking sector is widespread, not only restricted to public sector banks. Several private banks are also facing capital shortfalls in the wake of the pandemic. Even urban cooperative banks are not in good financial health due to a spike in their nonperforming loans and losses. Some small urban cooperative banks cannot meet the minimum regulatory capital requirements.

Given the weak investor interest, public sector banks may not be able to raise fresh equity from the capital markets. Therefore, the government should provide capital support to public sector banks (which constitute 70% of India's banking sector) to ward off potential solvency risks. Moody's Investors Service has estimated that public sector banks will need Rs 1.9-2.1 trillion ($25-28 billion) in external capital over the next two years to restore their loss-absorbing buffers. To ensure the flow of credit to those severely hit by the coronavirus, the government should make recapitalisation conditional upon banks' meeting priority sector lending targets for agriculture, MSMEs, social infrastructure, housing and weaker sections of society. It is high time that the Indian government also set up specialised development finance institutions (DFIs) that could offer long-term funding on concessional terms for building public health infrastructure and supporting economic development programmes.

Capital shortages: myth or reality?

India, like the rest of the world, is facing an acute "scissors effect" of decreasing tax revenues due to subdued economic activity and rising expenditure due to a higher demand for health and social protection in the wake of the COVID-19 pandemic. The tax revenues have fallen steeply since the virus outbreak. Both direct and indirect tax collections are lagging way behind targets. The same is the case with non-tax revenues. Needless to add, fiscal deficits are rising in India and elsewhere. Is there a way out? Yes. There are ways and means to raise additional financial resources to fight against the COVID-19 pandemic. One option is to seek grants and loans from bilateral development agencies and multilateral financial institutions to meet rising health and social protection expenditures. In May, the World Bank approved a fast-track $1 billion support to provide social assistance to poor households. India could also seek similar concessional loans from other development banks and IFIs to finance health and social protection programs.

A second option is to issue rupee-denominated government bonds as both Central and state governments heavily rely on this instrument to meet operational and developmental expenditures. If need be, the Central government could also issue rupee-denominated debt instruments (COVID Bonds) in offshore markets and use the proceeds to finance health and social protection measures in India. A third option is to introduce a wealth tax and impose higher taxes on the super-rich individuals. We have discussed elsewhere how substantial revenues could be raised fairly and efficiently by introducing wealth taxes on wealthy individuals to meet COVID-19-related costs. The proposal made by Indian Revenue Service Association to introduce an additional one-time COVID-19 relief cess of 4% on taxable income of over Rs 1 million is worth considering as the Central government could mobilise an additional revenue of Rs 150 billion ($2 billion) on this account.

Further, nothing stops the central government from rolling back its recent decision to reduce corporate taxes that entails huge revenue loss to the exchequer. In the same vein, the government can re-introduce the enhanced surcharge on super-rich individuals that was withdrawn under pressure from foreign investors in August 2019. Another option for the Central government is debt monetisation, under which the Reserve Bank of India would buy bonds directly from the government. Given the profound economic effects of the pandemic, many governments around the world are considering such unconventional measures. Contrary to popular perception, the Fiscal Responsibility and Budget Management Act allows the RBI to directly buy government bonds on the primary market in case of emergencies. Hence, legally speaking, India could adopt debt monetisation under the exceptional circumstances of the COVID-19 pandemic. Given the medium-term risks involved, India could pursue a debt monetisation strategy at least for the short-term with a firm exit strategy. It is equally important that debt monetisation must be strictly linked to health and social sector spending and carried out in a transparent manner. The increased level of government borrowing could raise potential debt sustainability issues, but a well-designed fiscal response will stimulate a strong recovery that will produce higher GDP growth in the near future, which in turn will reduce the debt-GDP ratio over time.

An opportunity to overhaul public health infrastructure

As economic recovery depends crucially on how quickly the health crisis is tackled, India's unequipped healthcare infrastructure needs a complete overhaul, not tinkering around the edges, to effectively respond to the COVID-19 pandemic. Leave aside coronavirus, the country's health infrastructure is grossly unequipped to deal with the most common vector-borne diseases such as malaria and dengue fever. The pandemic has exposed the vulnerability of India's public healthcare system. India's public healthcare system is one of the most underfunded in the world. India's public expenditure on health is less than 2% of its GDP. Even much before the COVID-19 pandemic, Indian public hospitals were facing an acute shortage of beds and healthcare workers. Although the private healthcare industry has boomed mostly in urban areas, affordability remains an important issue. There is an urgent need to increase public health spending in India. The financial allocations made for the public health sector under the Rs 20 trillion relief package are inadequate to meet the health challenges posed by the COVID-19 pandemic. The Central and state governments should scale up testing facilities and offer home tests free of cost.

Vaccine delivery: the next big challenge

At present, no one knows when a coronavirus vaccine will be available in India. Most health experts believe that a vaccine may be developed by the middle of 2021. Now is the appropriate time for the Central and state governments to carry out preparatory work for the production and distribution of a vaccine once it is developed and approved. They should work out partnerships with private drug companies, hospitals, public health groups, international agencies and other stakeholders to make, procure and distribute the coronavirus vaccine in India. Thanks to a homegrown generic pharma industry, India has the capacity to produce hundreds of millions of doses coronavirus vaccine. But India's real challenges lie elsewhere. Administering a vaccine to 1.3 billion people would be a challenging task because India currently lacks logistical infrastructure (such as refrigerated storage and transport facilities) to deliver coronavirus vaccines at subzero temperatures across the country, especially in rural and remote areas. Besides, India also faces a severe shortage of healthcare personnel. It could take more than a year to get every Indian vaccinated for coronavirus. The fair and equitable distribution of the vaccine is equally important. The government must bear the entire expenses of distributing vaccines for poor citizens. If need be, price controls should be introduced to make it affordable by everyone. The government should also start developing guidelines and priorities for equitable distribution of the COVID-19 vaccine.

Safeguarding livelihoods

The hastily imposed lockdown resulted in the loss of millions of jobs and triggered a mass exodus of internal migrants from urban centres to rural areas. As far as job losses are concerned, the COVID-19 pandemic has no parallel in the post-independent India. The Consumer Pyramids Household Surveys carried out by the Centre for Monitoring Indian Economy show a sharp rise in unemployment rates in the range of 8.35% to 23.52% during April-August 2020.

As a large number of micro and small enterprises have started shutting their businesses, the biggest worry is that millions of jobs could be lost permanently, which in turn, will dampen consumption and will have a knock-on effect on the whole economy. Out of work and facing an uncertain future, an estimated 10 million migrant workers returned to their native places after the imposition of lockdown. What is shocking is that neither the Central government nor state governments have data of migrant workers who lost their jobs or lives during the lockdown. Apart from setting up a Centralised database of internal migrants, the government should extend financial support to migrants who returned to their native places. Social protection programmes (including cash transfers and subsidised food) can assist them to deal with the economic shock of COVID-19. To support the livelihoods of the rural poor, the government must strengthen the rural employment scheme — the Mahatma Gandhi National Rural Employment Generation Scheme (MGNREGS) — by allocating more funds and increasing workdays guaranteed under the scheme. After the outbreak of coronavirus, the demand for MGNREGS works has increased due to disruptions in the agricultural supply-chains and the return of migrant workers to their native villages. As a result, the funds allocated for the scheme have dried up.

Along the lines of MGNREGS, India desperately needs a nationwide urban employment scheme for poor people living in urban India. Close to 90 million people in urban areas live below the poverty line. By guaranteeing hundred days of wage employment in a financial year to an urban household, such a scheme could provide livelihood security to those who are struggling to find re-employment quickly in the post-lockdown period. Another major benefit is the improvement in urban infrastructure and services. In this regard, a proposal made by Jean Drèze for a Decentralised Urban Employment and Training Scheme is worth exploring.

Spend billions to save trillion economy

There is still time for a course correction. The Indian government must act fast and boldly in developing a coherent economic recovery strategy aimed at stimulating domestic demand by raising wages of those who at the bottom of the economic pyramid besides strengthening health and social protection systems to mitigate the social and economic fallout of the COVID-19 pandemic. Given the magnitude of the health, humanitarian and economic crises stemming from COVID-19, policymakers should not shy away from higher

public spending and an expansionary fiscal policy that will boost the aggregate demand for goods and services, which in turn would restore output and create employment.
The government should commit to spending billions of dollars to better fight the health crisis and to fast-track economic recovery from the COVID-19-induced recession. Injecting billions of dollars into the economy now to save a $2.9 trillion economy is the most effective way out of this crisis.

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