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Post COVID-19 Indian Economy: A Roadmap for Revival

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Summary

The COVID-19 pandemic has stunted global economic growth. It may well lead to a contraction in the Indian economy in the current year. The government is pondering on a roadmap to rejuvenate growth and restore avenues for livelihood to millions who have lost their jobs. The revival package needs to focus on certain key sectors which will ensure maximum output in the short run. This will require large government spending which may shoot up the fiscal deficit. Nevertheless, it is recommended that the government focuses on five critical sectors and, in the process, move past fiscal deficit targets for the present.

Introduction

At the turn of the year, the Indian government and watchers of the Indian economy were crossing swords over what the first full budget post the general election should have contained and the measures needed for the country to become a US$5 trillion (S$6.9 trillion) economy by 2024. Much was being made by the government of its budget presented on 1 February 2020 regarding inter alia the proposed new optional personal income tax system for those who forgo exemptions, doubled divestment target for the next fiscal at ₹2.1-lakh crore (S$42.9 billion), five new 'Smart Cities' to be set up via the public-private partnership model and 100 more airports to be set up by 2024 to support the *Udey Desh ka Aam Nagrik* (Let the common citizen of the country fly) scheme. All this was to be part of a multi-billion dollar farm, infrastructure and healthcare package to revive growth in the country, with the budget aiming to boost the income and purchasing power of the people. All that talk is now history. Never before have discussions on the budget been pushed, so soon and so far, out of public memory. All this is the result of 1.5 grammes of a virus which has infected three million people worldwide[1] and brought the global economy to its knees – with the Indian economy expected to contract five per cent. The government and the Reserve Bank of India (RBI) are also not ruling out lower economic output during the entire financial year — which will be a first in over four decades.

Whatever be the alphabet the shape of which the recovery curve will take, it has become essential to lay out a roadmap to regenerate rapid growth. So many lives and livelihoods are at stake, so the preparation and implementation will have to be swift. In proposing a roadmap, it is apposite to issue a disclaimer right at the outset that the focus on healthcare and COVID-19 containment policies cannot be relaxed since no economic recovery can be expected unless the virus is contained. Since that is an obvious given, we will leave the health-related issues out of the purview of this paper.

[1] Nidhi Patel, "Corona Virus weight in grams & attograms", *25hournews*. https://25hournews.com/news/corona-virus-weight-in-grams-attograms-1850.

Expecting economic recovery only through market forces will be a futile thought as the damage to the economy is far beyond what monetary and other liquidity infusing policies can achieve. On the other hand, this is a watershed opportunity for the government to rebalance the economy, inject large tranches of government funds and have deep reforms piggy back on these measures. The solution lies only in large government spending. In doing so, while the long-term results can surely be kept sight of, the big push in the form of increased government spending will yield results in the short term. The government has introduced multiple reform policies such as labour reforms, agriculture market reforms and land acquisition/purchase policies for the private sector, amongst others. The momentum on such reforms and others in the pipeline will have to be continued as these will buttress the various initiatives of the government. However, the need of the hour is to revive growth, provide livelihood and avenues for enhanced disposable income in people's hands, generate demand and provide enhanced bank credit, thereby facilitating manufacturing, construction and services. These measures will ensure the start of a virtuous cycle of investment, production, supply and growth.

Investment-led Stimulus Package

It is learnt that the key economic advisors to the government have proposed an investment-led stimulus to help revive the economy.[2] The proposed enhanced spending on infrastructure, along with an upgradation of urban facilities, is being projected as this is expected to create durable assets and jobs, and generate demand for cement and steel. A key theme, including in the finance ministry's assessment, is to channelise resources in areas which provide quick results. While the ₹102 lakh crore (S$2 trillion)[3] National Infrastructure Pipeline will provide the much-needed impetus to productive asset creation, some of the projects are seen to be long gestation and may take years to implement.

The topmost priority that the government will have to focus on in this revival package is a major push for infrastructure development. Disentangling stalled projects in the road, railway, power and real estate sectors should be given priority in the context of the immediate employment generation propensity that they provide. At the same time, agricultural production is poised for substantial increase. This will enable a jump in rural incomes and, hence, demand for goods. To ensure credit off-take, banks will have to take a calibrated approach towards risk awareness while advancing funds to entrepreneurs and services. Thus, if the government is able to identify about five major areas such as infrastructure, banking, agriculture, real estate and micro, small and medium enterprises (MSME) for revival through a tight timeline based monitoring, the other sectors could easily be hand-held towards rapid growth.

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2 Surojit Gupta & Sidartha, "Spend big on for revival: Advisers to PM", *The Times Of India*, 17 July 2020. https://m.timesofindia.com/business/india-business/spend-big-on-infra-for-revival-advisers-to-pm/amp_articleshow/77008825.cms.

3 "National Infrastructure Pipeline (NIP): Things to know", *Times of India*, 31 December 2019. https://timesofindia.indiatimes.com/business/india-business/national-infrastructure-pipeline-nip-things-to-know/articleshow/73046161.cms.

Investment in Infrastructure – Critical for Growth

The RBI Governor, Shaktikanta Das, has acknowledged the impetus that can be given to rapid economic growth by large scale infrastructure projects and the need for government-led alternative sources of funding. He stated, "As in the case of the golden quadrilateral, a big push to certain targeted mega infrastructure projects can reignite the economy. This could begin in the form of a north-south and east-west expressway, together with high-speed rail corridors, both of which would generate large forward and backward linkages for several other sectors of the economy and regions around the rail/road networks."[4] He went on to add, "On financing options for infrastructure, we are just recovering from the consequences of excessive exposure of banks to infrastructure projects. Non-performing assets relating to infrastructure lending by banks have remained at elevated levels. There is clearly a need for diversifying financing options."[5] It is in this context that alternate sources need to be explored with the government giving the initial push.

While discussing the need to provide an impetus to infrastructure spending, it is important to recognise that India, a country, which has been providing support and skilled manpower to many developed countries, is itself inadequately prepared for a post-pandemic digital infrastructure requirement. The Indian citizenry had taken a major leap forward in switching to electronic payments and using debit/credit cards in the aftermath of demonetisation in November 2016. The government has done well in encouraging the opening of Jan Dhan accounts as these will not only ensure transactions through normal banking channels, but also lead to a redistribution of wealth and plug leakages. Consumers have been induced to gravitate towards digital platforms faster than in recent years, while also ensuring better tax to GDP ratio. Another critical benefit will be improvement in the ease of doing business which has seen sluggish improvement thereby inhibiting foreign direct investment.

A similar exigency has arisen with the onset of the COVID-19 pandemic. There has been a substantial shift towards virtual classrooms and on-line teaching with its footprints in rural areas too. It is a recognised fact that meeting India's mammoth primary education requirements through physical approaches will not be able to cover the rural populace and, hence, the need for virtual classrooms. Schools and higher educational institutions have switched to digital platforms but the lack of resources among the service providers and dominance of some players may come in the way of competition and, hence, rapid growth. State governments have adopted digital platforms to keep track of labour employment/unemployment, along with the migration from states. This is also a good beginning but more players from the private sector in this sphere will provide the right impetus to facilitate growth post the pandemic. It is in the field of exports that fast growing and efficient digital infrastructure will be able to provide the maximum push.

Media reports indicate that conservative sources in government have cautioned against increased public spending as it will inflate the fiscal deficit leading to downgrades by rating agencies. However, the present situation demands bold innovative decisions. Maybe

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[4] Anup Roy, "Not just banks, find other ways to finance infra, RBI guv tells India Inc", *Business Standard*, 28 July 2020. https://www.business-standard.com/article/finance/not-just-banks-find-other-ways-to-finance-infra-rbi-guv-tells-india-inc-120072701100_1.html.

[5] Ibid.

downgrades will happen but enhanced growth will help regain the ratings. On the flip side, not enhancing public spending will create recessionary trends which may still lead to downgrades. A study conducted by the State Bank of India[6] (SBI) has recommended direct monetisation as a plausible way of funding the centre's deficit at lower rates without increasing inflation or adversely affecting debt sustainability. Under this, the government can raise funds directly from the RBI via issuance of 'COVID perpetual bonds' or such instruments. The report by SBI's economics department notes that India's debt to gross domestic product (GDP) ratio has risen substantially over the years, and contraction in growth this year could raise questions over debt sustainability. The projected contraction in GDP will push up the debt to GDP ratio by at least four per cent. The study, thus, concludes that "growth rather than continued fiscal conservatism is the only mantra" to get back on track.

The study takes recourse to a provision in the Fiscal Responsibility and Budget Management Act which provides for the government to resort to the direct monetisation of deficit in certain exceptional circumstances. The current COVID-19 pandemic is certainly one such contingency. The report argues that bringing growth back is more important to debt sustainability, compared to fears of rating downgrades resulting just from higher deficit levels. Thus, on a balance of consideration, the government should not be deterred by fiscal deficit targets, given the unprecedented crisis since the need of the hour is to revive growth. While the private sector may possess the funds, they are risk averse towards making large investment in these uncertain times. It is only with the demonstration effect that government spending will have on employment, thereby generating demand, that the private sector will be encouraged to invest.

Financial Sector Reforms Crucial to Revival

The financial sector in any country is the heart and soul for regenerating any economic activity. The Indian banking sector, with a preponderance of public sector banks (PSBs), continues to carry a huge amount of stressed assets on their balance sheets. The non-performing asset levels are very high, capital adequacy precarious, and they lack the appetite to take credit risks. Despite a large number of steps that have been announced by the government, starting with the 'Indradhanush project',[7] nothing much has come out of the proposals barring consolidation of some banks, the benefits of which are yet to emerge and the recapitalisation by government of PSBs, which is yet to transit into to higher capital adequacy and thus greater lending. The RBI seems to have brought out a discussion paper on 'Governance in Commercial Banks' which is expected to tilt favour in terms of board-level decision making. However, with 70 per cent of the banking sector being owned by the government, unless the quality of the directors at the board level improves and the management at the higher level becomes more professional, any number of discussion

[6] Mayur Shetty, "Deficit monetisation can keep interest rates down: SBI report", *Times of India*, 20 July 2020. https://timesofindia.indiatimes.com/business/india-business/deficit-monetisation-can-keep-interest-rates-down-sbi-report/articleshow/77060906.cms.

[7] To resolve the issues faced by the public sector banks (PSBs), the government launched a 7-pronged plan called 'Mission Indradhanush' in 2015. This mission aims to revamp the functioning of PSBs in order to enable them to compete with private sector banks. It seeks to revive economic growth by means of reduction of political interference in the functioning of PSBs and improving credit.

papers will not produce path-breaking results which indeed are the need of the hour. The financial sector has to be the fulcrum of the economic revival plan and that is where the greatest inadequacies lie.

It has to be recognised that the impact of COVID-19 will result in an increase in bad loans. The real position will be known only when the period of moratorium is over and those who had availed of the moratorium are required to pay their dues to banks. Studies indicate that the amount of loans under moratorium vary from 31 per cent to 65 per cent in PSBs.[8] In relative terms, the bad loan situation improved last financial year. Overall bad loans of commercial banks were 8.3 per cent of advances at the end of March 2020 against 9.1 per cent a year earlier. However, post COVID-19, if the bad loan position worsens, it will necessitate a further infusion of capital. This will put added financial pressure on the government as the amount required will be in addition to the ₹3.08 lakh crore (S$62 billion) it has infused over the last five years.

This government inherited a rather fragile banking set-up in 2014. It has made bold announcements to usher in reforms. However, none of these have been followed up by any reform steps in areas where the inadequacies lie. Top-level executives continue to be appointed by the government and, quite often, merit or professionalism among the appointees is conspicuous by their absence. The directors on the boards of the PSBs have had no connect with any banking activity, chief executive officers await announcements from the finance ministry and are conspicuous by the lack of dynamism to boost banking activity.

The financial sector today is very risk-averse when lending and parts of it are dealing with reputational damage when it comes to mobilising savings. Governance reforms, which were flagged by the P J Nayak Committee[9] and accepted by the government, still lie in cold storage. Creating a professionally managed holding company to which the government would transition its stakes, allowing bank boards to drive banking activity, posting professionally competent executives even from the open market, enabling a distressed asset resolution machinery within the bank, drawing down government stake to may be 35 per cent to enable raising capital from the market, and most of all, ensuring that executives are insured from unnecessary harassment by investigative agencies, are some of the age-old measures crying for adoption. If the credit enhancing process has to be kick-started, these measures will have to be introduced post haste.

Boost to Agriculture and Small Industries

The agriculture sector seems to be poised to grow at its fastest pace, in the decade gone by. Rainfall has been bountiful. Sowing has shown a 45-per cent increase (it was 40.3 million hectares till July last year as compared to 58 million hectares for the same period in the

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8 'With trillions in moratorium, billions can be in NPAs', *Business Standard*, 6 July 2020.

9 The P J Nayak Committee was set up by the Reserve Bank of India to review corporate governance in public sector banks and suggest reforms. The Committee gave its report in May 2014. It was chaired by P J Nayak, the former Chief Executive Officer and Chairman of Axis Bank.

current year).[10] Early sowing will help agriculturalists take three crops, thereby putting enhanced disposable income in the hands of the rural population. With reforms in agricultural marketing, providing legal backing to contract farming and higher minimum support prices for grains, oilseeds and pulses, the agrarian economy will certainly give the much desired boost to the rest of the country's economic development. In pulses alone, the overall *kharif* (monsoon crop) sowing is higher by 21 per cent which is expected to result in an increase in output by 20 per cent. Considering the fact that last year's pulses output was short of domestic requirement by about 15 per cent, this may well be the first year when the domestic production of pulses will match demand. There has been a large-scale migration of people from the cities to villages. The government has provided for a higher outlay on the Mahatma Gandhi National Rural Employment Guarantee Act 2005 (MNREGA). This will serve to further bolster rural incomes. All that the government needs to do is ensure timely availability of inputs, timely purchase under minimum support price, unfettered marketing channels and adequate availability of credit. It is widely believed that a four per cent increase in agricultural output translates into a one per cent increase in GDP. If this is true, agriculture could well provided that much needed impetus to economic growth in the immediate post COVID-19 era.

In terms of its capability to generate employment and provide an export push, the potential in the MSME sector is huge. The government has realised this factor and, hence, provided a substantial boost to the sector in its stimulus package. The space likely to have been lost by China in the global markets offers an opportunity to India. A study conducted by the SBI[11] indicates that India can think long term and build relations with global markets to reap the benefits of its comparative advantage. Whilst India may not have a revealed comparative advantage in the capital goods sector, there is a bigger opportunity in the consumer goods sector. India's biggest advantage and concentration (17.3 per cent) is in the textile and clothing sector, wherein Indian products still enjoy a competitive advantage, compared to a concentration of 12.3 per cent in the food product sector where New Delhi does not have any competitive advantage. Vietnam seems to have gained in the present trade war against China; it is reported that a fair number of Chinese companies may have set up shop there.

The three key parameters identified for the success of small businesses are financial stability, availability of skilled labour in the MSME clusters and market competitiveness of their products to achieve import substitution as well as export growth. Government assistance should be forthcoming for design, manufacture and creating a favourable sales environment for products which the customers need. The assistance should help them connect to a demand-led environment, wherein business strategy and processes are aligned to the changing market dynamics through a market-oriented strategy. In this context, India needs to adopt a two-pronged strategy: firstly, capitalise on its supply of labour, concentrate on labour reforms, ensure a direct push to the MSMEs through financing and tax benefits as well as creating multiple manufacturing clusters across the country; and secondly, manoeuvre the geopolitical space to play its cards right and give a heads up to

[10] Saikat Das and Gayatri Nayak, "Farm sector sect to grow at super speed after a generous monsoon and return of migrants", *The Economic Times*, 19 July 2020. https://economictimes.indiatimes.com/news/.economy/agriculture/farm-sector-set-to-grow-at-super-speed-after-a-generous-monsoon-and-return-of-migrants/articleshow/77026442.cms.

[11] SBI Ecowrap.

Indian products. If early action is taken on these issues, India may well be poised to create a sizeable niche for itself in the global markets.

Real Estate to be a Game Changer

The real estate sector is another major employer of skilled and unskilled labour. It has been the source of livelihood to a very large section of migrant labour. However, with about 1,600 projects of varying sizes and 458,000 dwelling units being held up due to different reasons, the demand for labour, steel, cement, wood and such other ancillary products has been at an all-time low. Real estate developers, consumers and investors have been facing the burden of unsold inventories and incomplete construction projects. Facilities such as the National Housing Board raising liquidity for housing finance companies, relaxation of external commercial borrowings and approval of a ₹25,000-crore (S$5.17 billion) alternate fund have helped. There is an urgent need to approach the challenge of liquidity suffered by the sector, especially after the cash crisis of the non-banking finance companies. Liquidity will improve sentiment in the market with a regular supply of ready to move-in homes. The challenge before the government is to take a series of bold steps. It is rather strange that despite the potential that this sector has to offer, the initiatives by the government to revive it have been tardy. There is need to provide a one-time restructuring scheme to outstanding loans in this sector. Unless assistance from the government of the kind listed below and some haircut is taken by the lending institutions, this sector will not be able to revive.

One way to help the sector with credit at cheaper rates is to provide an industry status to the real estate market. Enhanced liquidity with some moratorium on outstanding credit will provide the much-needed relief to the sector. Certain state governments like Karnataka have taken the initiative to introduce land reforms and make land purchase and land use change, more streamlined and hassle free. This is indeed a very welcome change as land acquisition could take anything up to three years, which would render any project unviable. Developers have to approach multiple government offices for project approval. They need to be provided with a single-window clearance facility to ensure faster project implementation. Developers have to also contend with multiple rates of taxes thereby complicating project preparation and documentation. These multiple rates of taxation need to be transitioned to a single standard goods and services tax rate. Such minimal steps will certainly improve buyer and developer sentiment and also help in unclogging vast amounts of money in stressed accounts. Most importantly, as is the need of the hour it will create employment, generate demand for items such as cement and steel, thereby providing disposal income in the hands of workers

All these measures require a huge quantum of state funding. While sources of increased revenue are being explored by the government and disinvestment has been identified as a major source of non-tax revenue, it is intriguing that even in the best of times, the annual targets of disinvestment have never been met. As per statistics maintained by the public sector unit of the Bombay Stock Exchange, as against a target of ₹922,725 crore (S$193 billion) set by government from 1991-92, only ₹485,605 crore (S$103.4 billion) has been achieved, which is only 53 per cent.[12] In 2020-21, a target of ₹210,000 crore (S$31.3 billion)

[12] BSEPSU. http://bsepsu.com.

has been set. Last year, the target of ₹1.05 crore (S$20.7 billion) was revised downward to ₹90,000 crore ($19.3 billion) and again to ₹65,000 crore (S$12.4 billion) and yet the achievement was only ₹49,828 crore (S$9.7 billion) when the lockdown was ordered only on 22 March 2020. It defies imagination that despite sundry high power committees being set up to undertake divestment, enterprises such as IDBI Bank (the disinvestment of which was announced in 2015) and Air India still remain with the government.

The government has recently indicated that certain the PSBs may also be in the pipeline for disinvestment. This is a good decision as Indian banking suffers from scale and quality issues. Certain small banks really perform no role and, due to the lack of capital, can hardly upgrade their technology platforms. They also serve to be a drain on government resources to maintain their capital adequacy. This is an area where some alacrity will have to be injected into the system if non-tax resources have to be bolstered.

While asset monetisation and speedy disinvestment can help reduce the gap and boost spending, the need to focus on higher expenditure as the way out of the current economic situation will have to be the mainstay of the revival process. The pandemic is here to stay and does not appear to be leaving in a hurry. It will not be enough for the government to boost spending. The spending will have to reflect the nation's priorities. Well directed public spending, especially towards labour employing projects which provide outputs in the short run, is the need of the hour. It is not being argued that fiscal deficit targets be thrown to the winds but in terms of the priorities before the government, lives and livelihoods should take preponderance over any such consideration. Increased economic activity and the revival of employment generation projects will boost economic growth which will ensure rating upgrades. The recommendation is, thus, to conceptualise a policy which is tailored to suit the current requirement.

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