Imperatives for India's Economic Recovery-Protect, Revive, Transform

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COVID-19 has dealt a serious blow to economies around the world, and India is no different. After economic activity came to a grinding halt in April, followed by a very slow May, some green shoots of recovery have been visible in June and July 20. Key macro indicators have started to inch towards last year's levels – IIP (65% of May'19), Manufacturing PMI (91% of Jun'19), Services PMI (68% of Jun'19) and GST collections (91% of Jun'19). IMF's latest forecasts project India's GDP to contract by 4.5% in FY21, along with a sharp rise in fiscal deficit to -12.1% (from -7.9% in FY19), and debt/GDP ratio to 84% (from 72% in FY19). GDP growth estimates released by leading Credit Rating Agencies and Banks range between -2% to -9%.

However, the path to recovery could be long and painful with potentially far-reaching implications. First, the impact is felt most by the most vulnerable segments of population at the bottom of the pyramid – those that were just emerging out of poverty may be pushed back in. Second, migrant labor population has chosen to return to their native states. Many are expected to stay-back to pursue occupations in rural India, creating a shortage of labor in industrial zones. Third, disruption in business activities would entail job losses, especially among MSMEs and affected sectors of the economy. Fourth, consumer sentiment, and hence demand for non-essential purchases has taken a hit across markets and income groups. Finally, new private investments from foreign and domestic private investors have reduced considerably – continuation of a trend that had formed pre-COVID.

As one looks to the future, India needs to focus on three broad imperatives to ensure a robust recovery – namely Protect, Revive and Transform

A. Protect – this is about leveraging short-term measures to provide a safety net and preserve livelihoods of the most impacted people

Alleviate misery of the most vulnerable

Support has been provided to the most vulnerable people in the form of PM Garib Kalyan Yojana – cash transfers of INR 1,500 to over 20 crore Jan Dhan accounts, free cereal and pulses through PDS for 6 months, increased daily wages under MGNREGA benefitting 13.6 crore, free gas cylinders to 8 crore families, among other measures. These measures would need to be continued in the near term, to protect the interests of our most impacted segments.

Protect employment in MSMEs

Through the Atmanirbhar Bharat package, the government has provided liquidity to MSMEs via INR 3L crore collateral-free loans benefitting 45L units, INR 20K crore subordinate debt for 2L stressed MSMEs, and INR 50K crore equity infusion. The success of this scheme in preventing job losses is contingent on timely disbursal of loans through banks, stringent monitoring to ensure execution is as per plan, and the right beneficiaries receiving the loans.

Support severely impacted sectors

Several sectors like aviation, auto, tourism, hospitality and restaurants, among others, have been severely impacted due to the lockdown and the new normal. We need to ensure the survival of these sectors through financial support in form of tax incentives, subsidies, fees waiver for fuel and electricity, among others, and private capital infusion through loans and equity till the demand for their services resumes.

B. Revive – this is about medium-term measures to boost economic activity

Accelerate public works programs

Accelerating infrastructure expenditure is a critical economic tool due to its multiplier effect on GDP, boosting demand for manufactured products and providing direct and indirect employment. To fast-track the pace of public work programs, multiple interventions are needed. First, we need to fast-track already committed projects worth INR 22L crores under the National Infrastructure Pipeline. Second, strategic projects which have been rendered unviable under PPP route, could be taken up via the EPC route. Third, the government needs to attract private investments into infrastructure projects by improving viability. This can be done through innovative PPP models like bundling multiple projects with differing returns; operational risk mitigation; financial support through subsidies, off-take agreements, tax cuts, credit guarantees, among others. To raise resources for these infrastructure projects, the government can monetize brownfield assets with stable revenue streams (e.g. ToT, InvIT) or attract concessionaires for non-core assets like wayside amenities on roads, real estate development, renewable energy production.

Jumpstart industrial activity

New corporate investment announcements in Apr-Jun'20 quarter have fallen to the lowest level in the last 16 years as per CMIE. Demand for power has fallen by 9% vs. Jun'19. This reflects a slowing down of industrial activity and business investment. To revive sectors with a short-medium recovery cycle, we can provide cheap loans backed by government guarantees. However, for sectors with long recovery cycles, capital infusion is required from the government as well as private investors. Ease of doing business can also be improved to revive activity, through measures like single window approval mechanism, simplified industrial dispute resolution framework, predictability in labor laws and wages, FTAs with consuming countries like US and UK, among others.

Mitigate labor shortages

To mitigate labor shortages in producing states, we need to provide a conducive environment for migrant laborers to return. Provision of monetary incentives, safe transport facilities, and food and job security are critical. State governments need to coordinate with units to arrange for dedicated transport corridors for laborers with all amenities. Provision of a social security net for inter-state migrant workers – providing them employment guarantee for a year, food provisions, and health insurance in the destination state is the need of the hour. During the ramp-up phase, a central marketplace may need to be created to connect un-deployed labor with vacancies. Additionally, we need adequate ramp-up testing and quarantine facilities to ensure safe resumption of work.

Boost demand and consumer confidence

Consumer sentiment in rural and urban areas is down by ~60% in Jun'20 as compared to the previous year (CMIE). BCG consumer sentiment survey showed that ~65% of low-income respondents are worried about their future income. To boost consumer confidence, we need to increase the income of individuals with all the steps outlined above. But that alone is not enough. We need to improve the safety perception of retail through robust protocols on social distancing and sanitization, community compliance with SOP, and awareness campaigns. To increase discretionary spends, we need to incentivize capital purchases in key sectors like durables, auto and real estate through tax incentives and subsidies. Further, digital retail should be promoted in smaller towns and rural areas to unlock pent-up demand.

Transform – this involves driving medium-long term structural changes which are required to unlock new growth frontiers

Drive structural reforms (labor, agri, etc.)

Through the Atmanirbhar Bharat package, structural reforms have been introduced across agriculture, coal, minerals, defense, civil aviation, atomic energy, power, health, education, among others. The agricultural marketing reform, for example, has freed farmers from APMCs and provided a level playing field to sell their produce at competitive rates, removed barriers to inter-state trade, and introduced a framework for e-trading of agriculture produce. The reforms, on paper, are a necessary condition, but not a sufficient condition. It is critical to ensure timely execution of these reforms. The government also needs to introduce additional reforms – e.g. liberalize fuel retail to promote FDI, develop financial and derivatives market for electricity, enable farmers with flexibility on choice of inputs, increase FDI cap in insurance to 74%, among others.

Accelerate digitization

Since the onset of COVID, dependence on digital has increased for education and health services, e-commerce, and payments. The government and private sector need to work in tandem to accelerate digitization across various dimensions – e.g. unified healthcare governance system, Bharat agri stack, public platform for skilling, large scale investment in data centers, private e-governance services at scale, among others. This would require substantial investment in enabling infrastructure like affordable smartphones, availability of high-quality network.

Attract foreign direct investments

India will be able to attract foreign investment in the private sector if the execution of reforms is completed on time and the country is able to digitize with speed. Further, public works programs can attract foreign investors if the project is viable.

In closing, for India to continue and accelerate the economic growth trajectory which began in 1991, and come out as a winner in the post COVID situation, the country needs to focus on six imperatives – (i) Providing a short-term safety net to the vulnerable segments, (ii) Accelerating public works programs, (iii) Boosting corporate liquidity through loans and capital, (iv) Incentivizing consumption across discretionary items, and (v) Implementing structural reforms and (vi) accelerating digitization. As we slowly emerge from this crisis, we need to prepare for a long recovery period while setting the foundation for breakthrough growth in the post-COVID world. The government has set the agenda for Atmanirbhar Bharat, however, it would be successful only with active participation from domestic and international stakeholders, along with an enabling policy environment which is conducive for a new economic revolution in India.