Article

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Covid-19 and Indian Growth Trajectory

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Abstract

About the last one year, more than 180 nations are in the same line of threat by the disastrous pandemic of Corona Virus Disease 2019 or the COVID-19. The impact and shocks created by this on the polity, society and economy in the global level is highly overwhelming. There is high unprecedented collapse in the global supply chains. It is therefore much care is required for economic intervention in this area. It is the same fruit of globalisation which makes the issue worse and in this modern globalised world, cross-country linkages were the major route of these supply chains. Looking much into the developing economy of India, what are the major problems and impact of the pandemic on the economy briefly elucidates as even in 2008, amidst the problem of demand shock, employment was more or less affected in the country. But now it comes to stagnation in real effect. Moreover, this issue is also a reverberation of supply shock with a simultaneous presence of subdued demand and production slowdown. That is the overall growth of the economy is grinding to a halt. It is very important to analyse the economic impact of COVID-19 on the actual and expected growth rate in Indian economy to understand how much and to what extent the pandemic worsened the existing situation of economic slowdown in the country. The need of this anomalous analysis is to be done in order to find an answer to the much debated political and economic policies of the present government in power, so it could be more a political question which is of clear righteousness. In this paper we would look more on the pragmatic need of the policy reforms to trim down the negative effect of the pandemic on the economy and to bring back the equilibrium which is clearly being traumatized. The paper also tries to explain the implication of the policy changes not only in a micro level rather concentrating on a macroeconomic perspective. It would be clear throughout the analysis that an unblemished and sturdy expansionary policy is crucial for macroeconomic management and need to be coherently co-ordinated with monetary and exchange rate policy for boundless impact.

Keywords: *Economic slowdown, Recession, Economic Growth, Fiscal Policy, Covid-19.*

Introduction

In this country of more than a billion people, having 7th largest economy with a GDP growth of only 6.2% where the domestic consumption is one of the main drivers of growth but unemployment is

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rising and people's purchasing power has taken a hit. The third quarter of 2019 is witnessing a silent but devastating slowdown of Indian economy especially slowdown in auto-industry, declining GDP growth, and reduced consumer spending. Car sales are declining, private investment is slowing down and the banking sector is in a crisis. At the same time government is visualising a 5 trillion economy. In between this dichotomy the question is that whether the current economy is sustainable or not? Deceptive act of Demonetisation and Ineffectual implementation of GST along with the current pandemic Covid-19 altogether worsens the situation. The longevity and intensity are the two major depressing factors of the current economic slowdown. The economy is witnessed with issues of both finance constraint as well as demand constraint. Given the both constraints and the availability as well as effectiveness of policy responses, it is more conclusive that easing up of the demand constraint should be the prime policy to be in action to counter the financial fragility and this unprecedented slowdown.

Current situation of the economy

Recent economic data indicates that there is slowdown in Indian economy i.e., the GDP grow at 5 % in the first quarter of financial year 2020. By the end of the second quarter the growth continued to witness a sharp decline and almost the economy is clearly into an economic recession. On one side investment measured in the Gross Fixed Capital Formation (GFCF) showed a decline trend and other side the gross saving reduced from 34.3 % in 2011 to 28.8% in 2018.moreover the rural wage rate, exports also get reduced. The inflation rate has reduced from 10.03 per cent in FY13 to 3.41 per cent in FY19. Low inflation rate depicts weakening of demand that would discourage fresh investments and job creation. Falling capacity utilization, along with excess liquidity presence in commercial banks and piling up of stock of food grains on one side and rural distress & wage suppression together uncover the slowdown as a demand side issue. In general, we can say that the slowdown is a *demand side* problem. The GDP growth rate has been declining continuously declining due to ineffective demand within the people. The reduction in the aggregate demand leads to increased inventory that in turn reduced or stopped production of new goods. It results in unemployment and low level of income. Ultimately affects the living standards of the people with a low per-capita income.

One of the major reasons for slowdown of economy is a psychological factor of *crisis of confidence* among consumers and investors. For the past few years, informal sector is faced up with lack of demand now it turned out to formal sector also. Banks wouldn't give credit unless the investors are not willing to borrow. Since the measures taken by the government are basically supply side it's the time to look more on this serious issue from a demand-oriented approach by implementing ways to increase the effective demand of the people as well as by ensuring safety and certainty in spending the money in the economy.

About the last one year, more than 180 nations are in the same line of threat by the disastrous pandemic of Corona Virus Disease 2019 or the COVID-19. The impact and shocks created by this on the polity, society and economy in the global level is highly overwhelming. There is high unprecedented collapse in the global supply chains. It is therefore much care is required for economic intervention in this area. It is the same fruit of globalisation which makes the issue worse and in this modern globalised world, cross-country linkages were the major route of these supply chains. WTO through its press release announced that the global trade is expected to fall by between 13% to 32% in the current year due to this disastrous pandemic. It is very essential to understand the interaction between the pandemic and its effect on the economy as the questions of how, when, and in what way the problems which would be created by this can be solved in a quick spell of time. This is also the time when the IMF claimed that since the Great Depression of 1930's, the world economy as a whole is going through a sharply negative downturn in its growth rate. In other words, we can say that the global economy is grinding to a halt. In a narrow sense we can approximate that the beginning of the 2020 started witnessing a particular divide of the time globally, which can be roughly defined as a pre-corona and a post-corona period.

In the western world, the policies are mainly concentrated on the areas to limit the collapse of aggregate demand, providing liquidity to business and economic transfers to people losing jobs. It shows that even the problem has been identified, there were not much emphasize on the broken supply chains. Clearly speaking one of the main issues is the problem of institutional failures which includes weakening of technocratic, autonomous civil service and general underinvestment in state machineries. It is the domestic institutions are failing and therefore high need of fundamental changes as reforms not as revolution is obligatory for the time being. Once China shuts down the supplies, the Indian pharmaceuticals, automobiles, and especially mobile phone industries were mostly affected. Other sectors which were seriously affected includes real estate, banking, agriculture and manufacturing industries. Growth and survival of several industries have been severely impacted. In agriculture sector, the issue is more because of the critical time period as these are the months when the crops are ready to be harvested. Apart from this, the absence of labour force and transportation issues will have serious repercussions.

In banking, the problem may mainly arise out of bad loans and existing NPA's [2]. But as far as known, the RBI's three-month moratorium policy can relax the impact to some extent. 52% of the CEO's of top Indian companies already commented about a massive job loss in the upcoming days after this disastrous COVID-19, that is there was already high unemployment rate (a 45-year high) before the outbreak of the pandemic and now it is again increasing without any control in the rate. An economy like of India, already a victim of high level of educated as well as frictional unemployment couldn't be much optimistic in the upcoming time being as the economic disruptions resulted after the pandemic can lead the issue more challenging. It is because we had already witnessed a sharp loss of job amounting to 3.3 million even in the so-called capitalist economy of United States.

Growth Strategy and Policy Implication

Economic policy making is central to the growth and sustainment of any nation. The policy effectiveness is based on the righteous implementation of a well-designed plan of action which altogether binds and establish the macroeconomic stability. It is very important to analyse the economic impact of COVID-19 on the actual and expected growth rate in Indian economy to understand how much and to what extent the pandemic worsened the existing situation of economic slowdown in the country. The need of this anomalous analysis is to be done in order to find an answer to the much debated political and economic policies of the present government in power, so it could be more a political question which is of clear righteousness. If we consider the above said situation from a microeconomic perspective, there is a similar need of analysis as same as the well-known 'Hicksian- Slutskian'[3] approach to split out the pre-corona and post-corona impact on the total downturn effect in the Indian economy. Looking much into the developing economy of India, what are the major problems and impact of the pandemic on the economy briefly elucidates as even in 2008, amidst the problem of demand shock, employment was more or less affected in the country. But now it comes to a stagnation in real effect. Moreover, this issue is also a reverberation of supply shock with a simultaneous presence of subdued demand and production slowdown.

[2] NPA means Non-Performing Assets.

[3] Economists, Eugen Slutsky and John Hicks developed independent approaches to split the total price effect on demand into income and substitution effect with the introduction of compensating and equivalent variation in budget. Here I used this just to show the need of splitting the real impact of economic slowdown in the Indian economy before and after COVID19.

Once it comes to the developing economies, there is a high necessity for the central assistance by international institutions intervention by proper allocation of resources and coordination apart from the side of the fiscal and monetary authorities of the countries. Government and policymakers started cutting down the interest rates as a measure to stabilise economies which were impacted. This is also a time when the supreme financial institution in the country, RBI refused to publish the growth projection, creating the situation more worrisome. Whereas the credit rating agencies like Moody's predicted a rate of 2.5% and Goldman Sachs estimated it to 1.6%. There is higher need of greater coordination better social safety, better regulation along with high priority in social distancing at least for this shorter span of time. Considering Indian economy and thinking of the viability of a direct cash transfer at this time can be a fruitful measure in the short run but wouldn't be a better idea to follow for a longer period. More care is required to stabilise the supply chain problems. It would be also a virtuous policy to initiate bailout packages for bankrupted sectors. Looking at what can be a good monetary policy is that the central banks should be ready to provide abundant liquidity to both banks and NBFC's, with more attention to MSME's. It is more significant because once after the pandemic the utmost problem that the economy is going to witness is that of liquidity crunch[4]. It is also highly significant and alarming time as there should be given considerable stress to the much devastating issues of climate changes in the economy and society as a whole. Since the problem is a twin sided (both demand and supply) one, the policy and revival strategy are to be necessarily shaped in such a way so that at least for the time being there could be hope for improvement from this unprecedented situation. The economic policy followed by the right wing National Democratic Alliance (NDA) government has always thought of beyond the political economy of Communism-Capitalism, and necessarily stressing more on Free-Market economy. As this issue is mainly a reverberation of supply shock with a simultaneous presence of subdued demand and production slowdown, that even persisted before the outbreak of the pandemic. The policies of the fiscal authority even then to solve the above-mentioned demand side problem was criticised for its superfluous spotlight on supply side measures. Even when compared to some other developed countries, it is somewhat positive that Indian economy could be better than other economies. Even the nation's biggest import of crude oil won't be affected negatively in immediate future as the oil prices by now had decreased to a great extent due to the external shock of reduction in demand and in quick supply chain breakages but how the economy as a whole take a decisive stand determines the positive impact.

While looking into the so-called comprehensive fiscal stimulus package announced by the Government of India, which is about 10% of the nation's GDP seems to be more futuristic in nature rather than to concentrate on the present situations in a more realistic way. The packages announced by most of the countries including India mainly concentrated on two aspects of policy framework. That is one through the fiscal impulses and the second one is through liquidity provisions. When it comes to the reality in order to solve the problem there is a balanced need of the two dogmas. The package gave more stress to liquidity provisions when compared to the fiscal stimulus that is required to make the engine of the vehicle functioning. That is for the 'V' shaped recovery[5], there is a need of at least 5% of fiscal impulses whereas it is estimated between 2 to 2.5% only in the package announced. It clearly shows us that still the policies are mostly formulated fundamentally on supply side keeping demand side untouched or slightly envisaged. Even though there were a lot number of policies, allocations, provisions and reforms measures announced, the effective result of these measures is still uncertain as most of them are only liquidity creating measures which would help in cash and credit transferring but would be more beneficial in long-run as now a larger section is facing the problem of deficiency of demand. There arises

[4] During a liquidity crunch, businesses and consumers are charged high interest rates on loans which are more difficult to obtain. Also known as liquidity crisis and credit crunch.

[5] A V-shaped recovery is characterized by a sharp economic decline followed by a quick and sustained recovery. A V-shaped recovery is different from an L-shaped recovery, in which the economy stays in a slump for a prolonged period of time.

the need of fiscal stimulus policy which could necessarily raise the aggregate demand in the economy more directly than a liquidity diffusion strategy. This is also not the time for any government to think more on keeping the fiscal deficit under control as doing so would create the situation more into a worse picture. A direct benefit transfer of a minimum of 3000 to 5000 per households and provisions for raising the supply levels of food grains and necessity items through the PDS, strengthening of NFSA etc. are the measures to be taken immediately. Deficit financing with the aid from the monetary authority is also vital as the demand pressure is inflating.

It is not clear that what is the real financial pressure that put forward the government to privatise the Defence Manufacturing sector and Space Science Facilities, which forms the pride and prosperity of the nation. The policies such as technology-driven education, additional Rs 40,000 crore allocation for MGNREGA, additional access to institutional credit for marginalized and small farmers, Inter-state trade facilitation in agriculture marketing etc. are some of the steps which would receive unconditional support from the citizens of the country. But the real question is the existence and survival of those who are completely and ruthlessly affected by the pandemic.

Conclusion

The role of government expenditure multiplier is fundamental in such an economic slowdown or in a recession. It is true as this would escalate the employment, output and income level. By tax cut means, there would be indirect injection of income into the economy or a way to prevent the leakages from the economy thereby increasing the disposable income and it would necessarily boost consumption demand back to track in a demand constrained economy. Still there exist a tension created by the increased savings and imports which are leakages from the domestic economy. Altogether the policy would work in a way such that the Gross Domestic Product (GDP) increases and unemployment in the economy starts diminishing. It is clearly witnessed that both revenues as well as the Tax to GDP ratio decreases during any economic slowdown or downturn. A lower interest rate is commendable for lower interest expenditure for government and it could spur the investment and consequently a higher GDP growth. Similarly, lower foreign interest rates result in capital inflow and in turn lead to more liquidity enabled growth.

Here comes the question of Sustainability and Financeability of such a fiscal adjustment. Financing the deficit could be done practically through any of the following methods such as borrowing from abroad or in- foreign currency, borrowing from central bank, borrowing from domestic commercial banks or even from domestic non-banking sector. The initial method of financing would cause an exchange rate appreciation and also affect the value of external debt in domestic currency but the sustainability of the debt is a limiting factor for the same whereas the second method result in same as creation of high-powered money by fuelling inflation in an economy. The latter two sources end up on with crowding out the private sector by increasing interest rates in the economy. In a recession, the policy treatment is therefore to be the government who initiates and stimulates the economy by expanding its spending and/or by lowering the tax rates prevailing in the economy. The spending should be directed in such a way that it generates a larger fiscal multiplier, as the larger the multiplier, the greater the policy effectiveness in stabilizing the economy. Moreover, a larger multiplier entails in a lower level of leakages (imports and savings) and lower the crowding out or the monetary conditions would be more accommodative. Since 2016-17, the monetary policy was focused on inflation. combined fiscal deficit of the centre and the state was high. And government committed to lowering its fiscal deficit, it left little room for government to increase its spending to boost the economy.

In simple words, the answer to those who still doubts, what is wrong with the policies taken till now could at least understand the basic sense put forward by the economist Keynes as ‘In the long run we are all dead’. There lies the paradox that emerge from this as what is the need of a policy which couldn’t answer the present crisis rather looking into an uncertain future ahead? In the middle of all the above said glitches and challenges ahead we can hopefully expect that Indian economy could come out with a proper synthesis of a robust fiscal and resilient monetary support penetrating to the lower levels of the society resulting in multiplier growth results.

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