India, post-Covid-19: Reviving Growth, 2021-2025

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Introduction

The Indian economy was caught in one of its worst ever slowdown phases even before the Covid-19 pandemic inflicted a massive disruption. GDP growth, which was 8.3% in 2016-17, had come down to 4% by 2019-20. The pandemic's disruption, more so, because India imposed one of the most stringent lockdowns in the world in the initial phase of the pandemic, led to an unprecedented GDP contraction of 7.3% in 2020-21.

Even as the economy was on a path of gradual sequential recovery – quarterly growth rates in 2020-21 were -24.4%, -7.4%, 0.5% and 1.6%, respectively – the second wave of Covid-19 infections; far more severe than the first wave, battered the economy once again in the first quarter of the current fiscal year. The impact of two quick disruptions on an economy, which was already losing momentum in a big way, is bound to leave long-term scars. The extent of economic healing and the time taken to achieve this will critically depend on the kind of policy intervention not just in the short-term but also the medium term.

This paper looks at the prospects of India's post-pandemic economic recovery in the medium term and attempts to highlight possible headwinds and tailwinds to future growth. The discussion is divided into four sections. Section I will summarise the broad stylised facts around India's economic growth. Section II will try and contextualise the post-pandemic economic situation beyond headline growth numbers. Section III examines the post-pandemic economic policy response. Section IV will build on the discussion in Sections I-III along with possible political economy and external economic drivers to lay out possible economic scenarios.

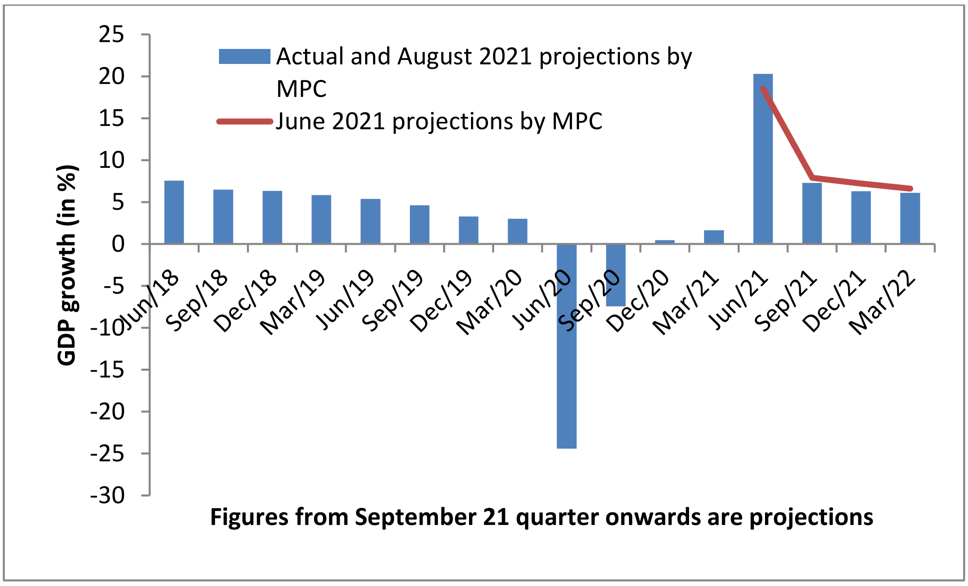
Section I: Stylised facts on GDP growth

a. Will India's GDP reach pre-pandemic levels in 2021-22?

As per provisional estimates released in May 2021, India's GDP suffered its highest ever contraction of 7.3% in 2020-21. The latest forecast (August 2021) by the RBI's Monetary Policy Committee (MPC) expects a GDP growth of 9.5% in 2021-22. If this projection materialises, the 2021-22 GDP will be 1.6% more than the pre-pandemic (2019-20) level.

While the next RBI forecast will come in the month of October, GDP numbers for the first quarter (Aril-June 2021; henceforth Q1-22) of the current fiscal year have created grounds for scepticism about the Indian economy regaining pre-pandemic levels in 2021-22. This is because Q1-22 GDP growth of 20.1% missed the MPC's projection of 21.3%. Interestingly, the MPC had made an upward revision in its Q1-22 GDP growth forecast and brought down the projections for the remaining three quarters for the fiscal year between its June and August meetings.

Chart 1: GDP growth rates, actual and projected



Source: CMIE and RBI

MPC's August 2021 revision in GDP projections suggested that it expected a lower than expected damage from the second wave of the Covid-19 pandemic in Q1-22 but saw demand side headwinds to growth in the next three quarters. Q1-22 numbers missing the MPC's projections means that even if the projections for next three quarters hold, 2021-22 GDP growth will be 25 basis points – one basis point is one hundredth of a percentage point – lower than the RBI's current annual growth projection of 9.5%. It remains to be seen whether the MPC retains its growth projections in its October meeting.

b. Sector-wise impact of the pandemic

As is to be expected, the pandemic's economic disruption did not have a uniform impact on different sectors of the economy. While agriculture was the only sector which managed to avoid a contraction in 2020-21, service sector activity suffered a bigger adverse impact than industry, largely a result of the contact intensive nature of the former. The asymmetry in sector-wise impact of the pandemic became even more pronounced after the second wave, which can be seen from the fact that service sector output in Q1-22 has a much bigger deficit from pre-pandemic levels of output (Q1-20). The implications of this asymmetry in the pandemic's economic impact will be discussed in detail in the next section.

Chart 2A: Annual growth in Gross Value Added in 2020-21

Sector	Annual growth (in %)
Total GVA	**-6.2**
Agriculture, forestry and fishing	**3.6**
Industry	**-7.0**
Mining and quarrying	**-8.5**
Manufacturing	**-7.2**
Electricity, gas, water supply and other utility services	**1.9**
Construction	**-8.6**
Services	**-8.4**
Trade, hotels, transport, communication and broadcasting services	**-18.2**
Financial services, real estate and professional services	**-1.5**
Public administration, defence and other services	**-4.6**

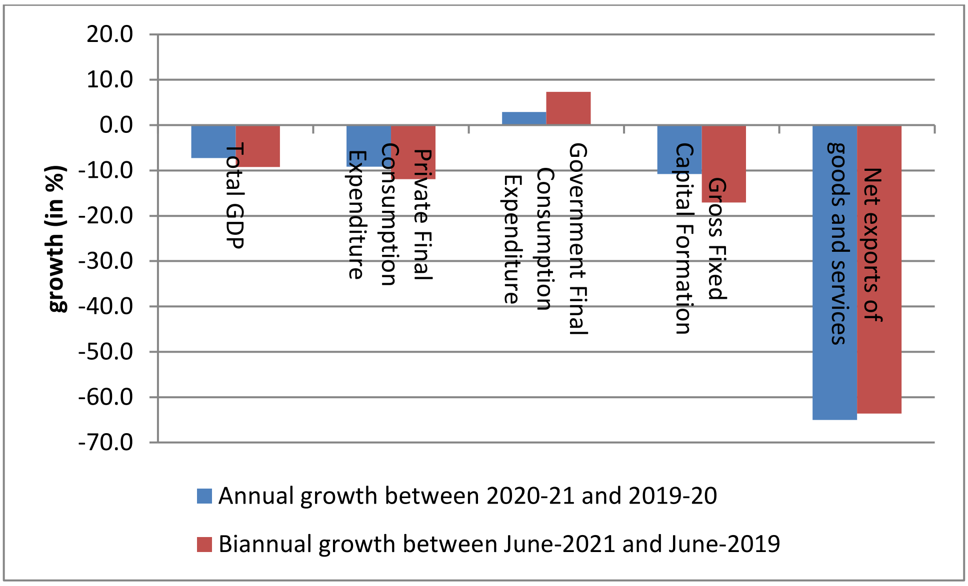
Chart 2B: Biannual growth in Gross Value Added in June 2021

Sector	Biannual growth (in %)
Total	-7.8
Agriculture, forestry and fishing	8.2
Industry	-6.2
Mining and quarrying	-1.8
Manufacturing	-4.2
Electricity, gas, water supply and other utility services	3.0
Construction	-14.9
Services	-12.5
Trade, hotels, transport, communication and broadcasting services	-30.2
Financial services, real estate and professional services	-1.5
Public administration, defence and other services	-5.0

Source: CMIE

On the expenditure side, private consumption has suffered the biggest hit because of the pandemic. This is likely a result of both mobility restrictions preventing consumption, especially of contact intensive services as well as destruction of demand because of squeeze on mass incomes. A weakness in consumption demand is bound to generate headwinds for capital spending, as businesses are sitting with idle capacity. It is noteworthy that stimulus from the government spending route was muted in the first phase of the pandemic. While exports are looking up, largely on account of a strong economic revival in advanced economies, their net impact on GDP is likely to be muted because of a resumption of imports even as global commodity prices have risen.

See Chart 3: GDP growth after pandemic



Source: CMIE

c. A simple recovery to pre-pandemic levels is not good enough

While the question of the economic activity surpassing pre-pandemic levels is important on the psychological front, it can hardly be a yardstick to evaluate India's medium term economic prospects. Two reasons can be given to support this argument. One, long-term economic damage from the pandemic can damage the growth potential of the economy, resulting in lower growth rates once the base effect dissipates. Jayanth R Varma, an external member of the MPC flagged this threat in the June 2021 meeting of the MPC.

"The economic recovery that was visible in the early months of 2021 was arrested by the second wave of the pandemic which has been catastrophic in terms of lives lost. But the economic impact appears to have been less severe, and high frequency indicators provide some reason to hope that the economic recovery will resume soon as the second wave now appears to be well past its peak. However, ever since the onset of the pandemic, nowcasts and forecasts of economic growth have not been highly reliable. Moreover, there is a fear that the health shock is inducing high levels of precautionary savings that could depress demand for several quarters to come", Varma said.[1]

Secondly, it needs to be remembered that economy had been losing growth momentum ever before the pandemic, and unless this is reversed on a sustained basis through suitable policy intervention, income levels and living standards would end up being much worse than what they would have been had the slowdown and pandemic not happened. This matters a lot when it comes to the medium-term increase in India's per-capita income levels or even GDP. For example, in June 2019, Prime Minister Narendra Modi had set a target of making India a $ 5tillion economy by 2024.[2] Latest projections from the IMF's World Economic Outlook (WEO) database show that India's GDP will not cross $ 5 trillion even in 2026-27, when it expected to be $4.53 trillion. To be sure, there is good reason to believe that even these IMF projections will turn out to be overestimates.

An analysis by Centre for Monitoring Indian Economy (CMIE) looked at growth projections for the Indian economy by the RBI, IMF, WB and professional growth forecasters and found that they seem to display an optimism bias, compared to the CMIE's own projections. "It is important that the inherent optimism bias of the RBI, multilateral agencies and professional growth forecasters who predominantly belong to the financial markets is recognized by investors and enterprises to avoid possible mis-allocation of resources", the analysis said.[3]

[1] Taken from Minutes of the Monetary Policy Committee Meeting, June 2 to 4, 2021 available at https://bit.ly/3yOLobn

[2] See https://bit.ly/2Yl2n8x

[3] An optimism bias in forecasts, Manasi Swamy, CMIE published on August 12, 2021 available at https://bit.ly/3DDjpyN

Chart 4: Optimism bias in growth projections for India

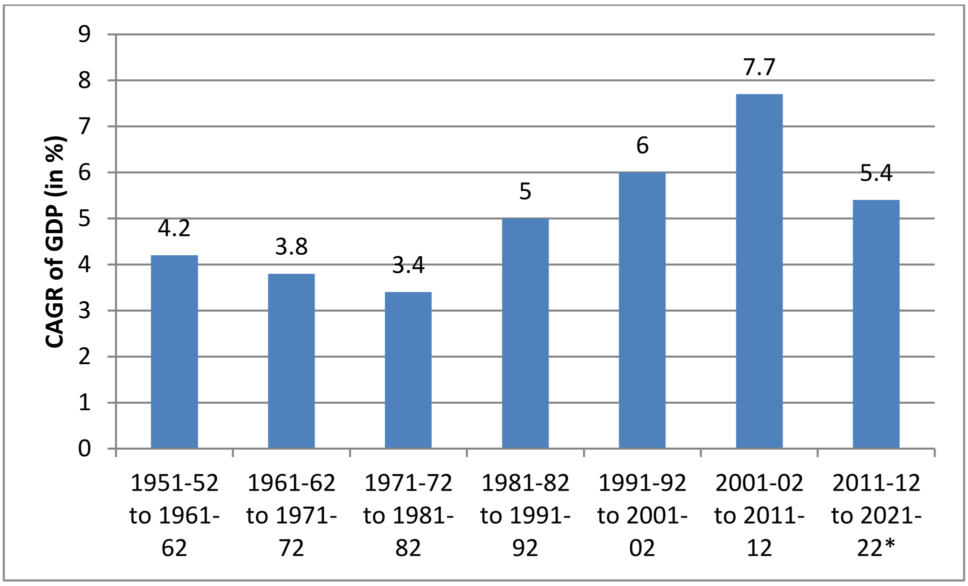
Month of forecast	Forecaster	2017-18	2018-19	2019-20	2020-21	2021-22
April	CMIE	6.9	6.9	7	0.1	9.2
	SPF	7.4	7.3	7.3	5.5	11
	RBI	7.4	7.4	7.2		10.5
	WB	7.2	7.3	7.5	1.9	10.1
	IMF	7.2	7.4	7.3	1.9	12.5
June	CMIE	7.2	7	6.8	-6	7.2
	SPF	7.4	7.4	7.2	-1.5	9.8
	RBI	7.3	7.4	7		9.5
	WB	7.2	7.3	7.5	-3.2	8.3
	IMF	7.2	7.4	7.3	-4.5	12.5
August	CMIE	7.2	7	6.8	-6	7.2
	SPF	7.4	7.4	6.9	-5.8	9.2
	RBI	7.3	7.4	6.9		9.5
	WB	7.2	7.3	7.5	-3.2	8.3
	IMF	7.2	7.3	7	-4.5	9.5
Actual	CSO	6.8	6.5	4	-7.3	

Source: CMIE

A long-term comparison of India's GDP growth rate, assuming the RBI's projection of 9.5% GDP growth in 2021-22 holds, shows that growth performance in the current decade (ending 2021-22) has been underwhelming when compared to the rest of the reform-period.[4]

[4] 1991 is taken as the beginning of economic reforms in India in most commentaries.

Chart 5: Decade-wise CAGR of GDP in India



Source: CMIE, 2011-12 to 2021-22 calculation assumes a 9.5% GDP growth (RBI's projection) for 2021-22

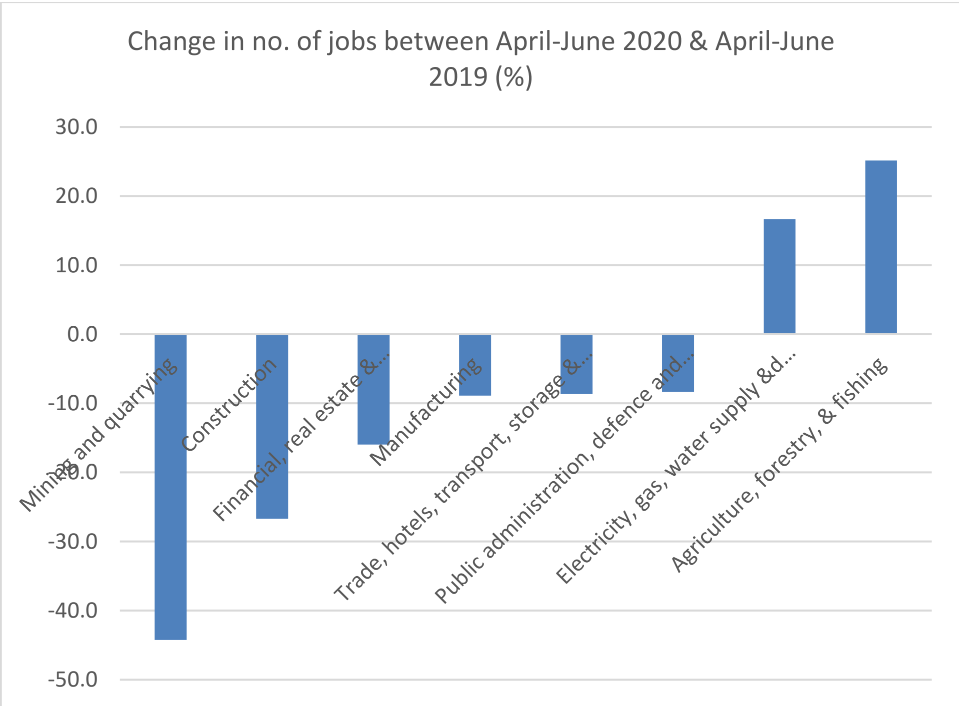
Section II: Looking at the pandemic's damage beyond GDP numbers

Economic disruption from the Covid-19 pandemic did not affect all stakeholders in the economy in the same fashion. By now, there is adequate evidence to argue that the economic 'have-nots' – labour in the labour-capital binary and informal sector in the formal-informal binary – have suffered more because of the pandemic. Part of the reason for this is the nature of economic disruption which affected contact intensive services more than others. But this is not the only factor behind the pandemic's regressive impact.

a. **Pandemic's shock to labour markets**

While large parts of the white-collar workforce could manage to carry on its economic activities through remote means, most of the blue-collar workforce, especially in contact-intensive services did not have this luxury. This means that the latter group suffered a bigger shock to its incomes than the former. As economic activity and incomes dried up, a large part of the blue-collar non-farm workforce moved back to agriculture, triggering an unprecedented retrograde structural transformation – an increase in employment share of agriculture – in the Indian economy. Statistics from the latest Periodic Labour Force Survey (PLFS), the official source of employment statistics in India, show this trend clearly. Because the PLFS surveys follow a July-June calendar, the 2019-20 PLFS includes the period when the Indian economy was under a lockdown, which began on 25 March, 2020. Given the fact that agriculture's income share is significantly less than its employment share in the economy, a shift in employment from non-agriculture to agriculture signifies a worsening of income levels.

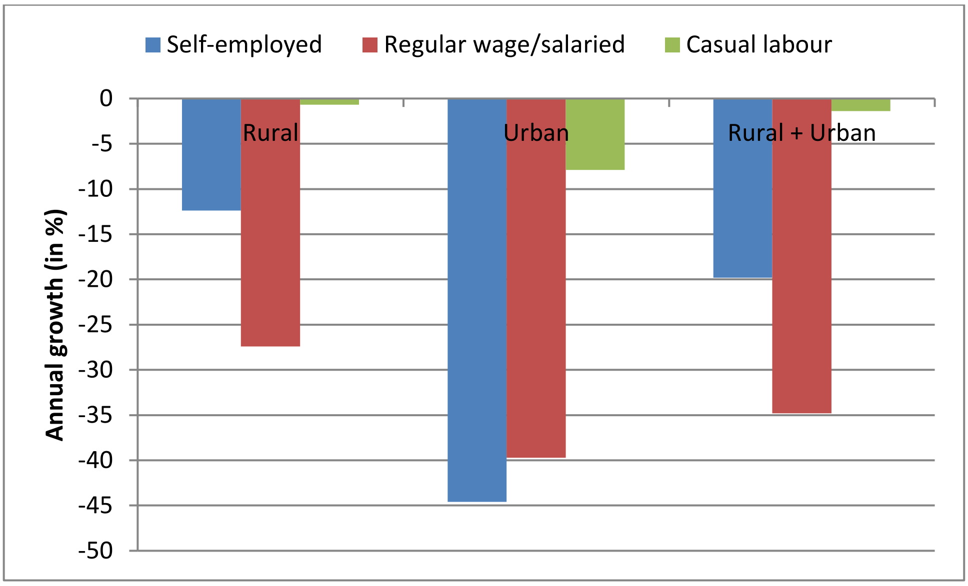
Chart 6: Estimated change in sector-wise employment in India between April-June 2020 and April-June 2019



Source: Hindustan Times analysis of unit-level PLFS data taken from https://bit.ly/3kYjvbW

This precarious transformation in India's labour market is hidden by a reduction in headline unemployment rate between 2018-19 and 2019-20. Even those who managed to retain their jobs in the non-farm sector had to face underemployment (fall in hours worked) and wage-squeeze. Also, a methodological flaw in the manner in which the PLFS calculates wages, might have led to an underestimation of wage squeeze during the pandemic.[5]

Chart 7: Change in average numbers of hours worked per week between April-June 2020 and April-June 2019



Source: Hindustan Times analysis of unit-level PLFS data taken from https://bit.ly/3kYjvbW

While the PLFS numbers are slightly dated, evidence from other high-frequency indicators such as RBI's Consumer Confidence Surveys (CCS), Purchasing Managers' Indices (PMI) for manufacturing and services and average rural wages underline the continuing weakness in employment and labour incomes.

For example, net current perception on employment in the July 2021 round of the CCS was -68.2, significantly worse compared to the already low value of -30.5 in the March 2021 round. Net current perception is the difference in the share of respondents who reported an improvement and worsening on a given indicator compared to last year. The CCS is conducted in 13 major Indian cities and therefore designed to capture consumer sentiment in the non-farm economy.

[5] See https://bit.ly/3kPGqpF for a detailed discussion

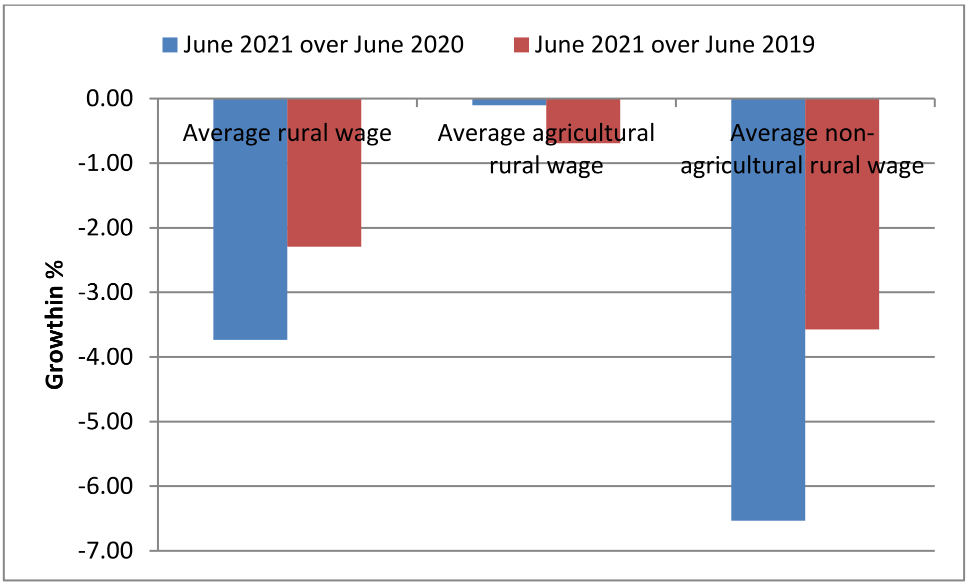
PMI manufacturing has been above the psychological threshold of 50 in all months except one (June 2021) since August 2020. A PMI value above 50 signifies expansion in economic activity compared to previous month. PMI services, as expected, have had a more troubled recovery. They only crossed 50 in the month of October 2020 and went below this critical level once again in May 2021.There was a sharp revival in PMI services in the month of August, with the index reaching 56.7. However, the fine print of PMI numbers points towards jobless growth in the post-pandemic recovery, as the surveys recorded a continuous fall in employment in the post-pandemic period until June 2021. The welcome change of an increase in manufacturing employment in July after sixteen months was reversed once again in August, as growth lost momentum on demand side concerns.[6] Even the strong service sector recovery in August was accompanied by a shedding of workers, with companies reporting sufficient workers to meet demand needs.[7]

Latest monthly data on inflation adjusted rural wages (June 2021) shows that not only were they lower than pre-pandemic levels (June 2019) but also less than their last year levels. A comparison of agricultural and non-agricultural rural wages shows that it is the latter which has a larger deficit vis-a-vis last year and pre-pandemic levels. This, in a way, suggests that distress migration driven glut in rural non-farm labour markets; as reflected in the PLFS data, might be continuing. Given the importance of rural-urban migration in India's unskilled labour market, rural wages are often a useful indicator of the bargaining power of unskilled labour in India. Also, the post-pandemic decline in rural wages has come on the back of a prolonged weakness.

[6] "Uncertainty regarding growth prospects, spare capacity and efforts to keep a lid on expenses led to a hiring freeze in August, following the first upturn in employment for 16 months in July", Pollyanna De Lima, Economics Associate Director at IHS Markit, said. Taken from https://bit.ly/3DIicGx

[7] "Despite signalling upbeat growth projections, service providers again lowered headcounts in August. However, the rate of job shedding was marginal and the weakest since January. Several firms indicated having sufficient workers to meet demand needs", an IHS Markit press release said. Taken from https://bit.ly/3h2qcse

Chart 8: Real rural wages in the post-pandemic period



Source: CMIE, CPI-rural has been used to deflate nominal wages

b. Bigger impact on informal sector, smaller firms and consumer demand

One of the biggest failures of economic reforms in India has been the persistence of employment-income imbalance in economy. This asymmetry is most pronounced in the farm versus non-farm binary. Agriculture's share in GVA is just around 15%, but it continues to employ more than 40% of the workforce. This does not mean that the non-farm economy does not have its own problems of employment-income asymmetry.

In fact, this imbalance operates at two levels in the non-farm economy. First is the usual employment-income share imbalance. This is largely the result of a second layer of complexity in the Indian economy, namely, the presence of informal sector workforce in very large numbers in some sectors. Indeed, the Indian economy displays a remarkable degree of dualism in many sectors. For example, the service sector comprises of high value services such as in finance and information technology based activities on the one hand and labour intensive low value services such as petty trade activities and hotel and restaurants. The extent of income-employment imbalance and the role of informal employment is summarised in the following chart. To be sure, services are not the only activity which employs informal sector workers in a large number. Construction, the biggest source of non-farm employment growth in India in the post-reform period, also offers very low incomes and poor working conditions.

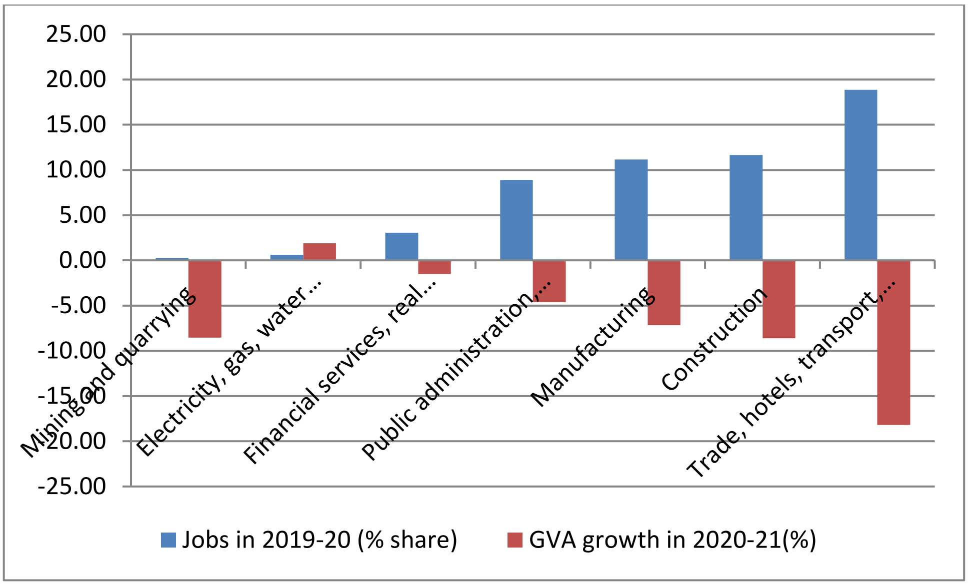
See Chart 9: Sector-wise Income and employment share

Sector	% of labour force in		Share in GVA in 2019-20
	Organised sector	Unorganised sector	
Agriculture	0.2	42.3	14.8
Mining & Quarrying	0.3	0.1	2.4
Manufacturing	4.4	7.7	17.1
Electricity, Gas & Water supply	0.4	0.2	2.3
Construction	2.5	9.6	7.8
Trade, Hotel & Restaurants	1.3	11.3	20.3
Transport, Storage & Communication	1.8	4.1	22.0
Finance, Business, Real Estate	1.9	1.5	
Health, Education, Public Admin	5.9	4.6	13.3
Total	18.7	81.3	100.0

Source: HSBC Securities and Capital Markets Research and CMIE

The pandemic's sector-wise impact, when read with respective employment shares, suggests that it is the most labour intensive sectors which have suffered the biggest damage, while the ones where labour incomes are higher have done much better. This trend entails a worsening of already serious inequality between various segments of the labour market in India. While, agriculture, which is the largest employer in India, escaped contraction, per worker earnings are expected to have come down here as well, thanks to a reverse migration of non-farm workers to the farm sector.

See Chart 10: Non-farm sectors with larger employment share suffered more during the pandemic

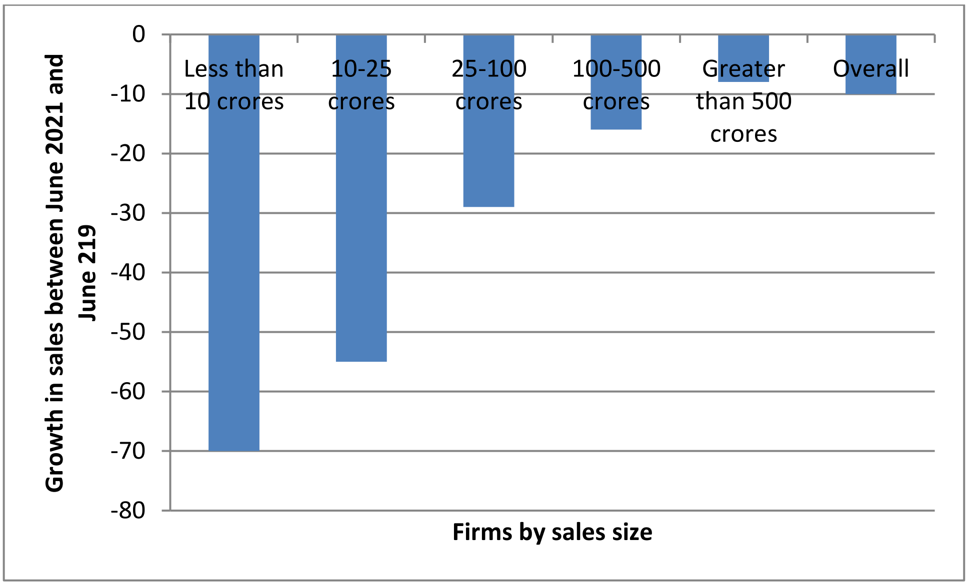


Source: CMIE and PLFS

The pandemic has also exacerbated the big-capital versus small capital fault line in the economy. This is best seen in corporate results for both 2020-21 and the Q1-22, which shows that larger companies have had a faster recovery, both in terms of sales and profits. To be sure, the profit growth story is also a result of firms cutting costs, including on wages, during the pandemic and an exogenous boost from reduction in corporation tax rates by the union government in September 2019.[8]

[8] In September 2019, the Government of India slashed corporate tax rates for domestic manufacturers from 30% to 22%, while for new manufacturing companies; the rate was reduced from 25% to 15% provided they do not claim any exemptions.

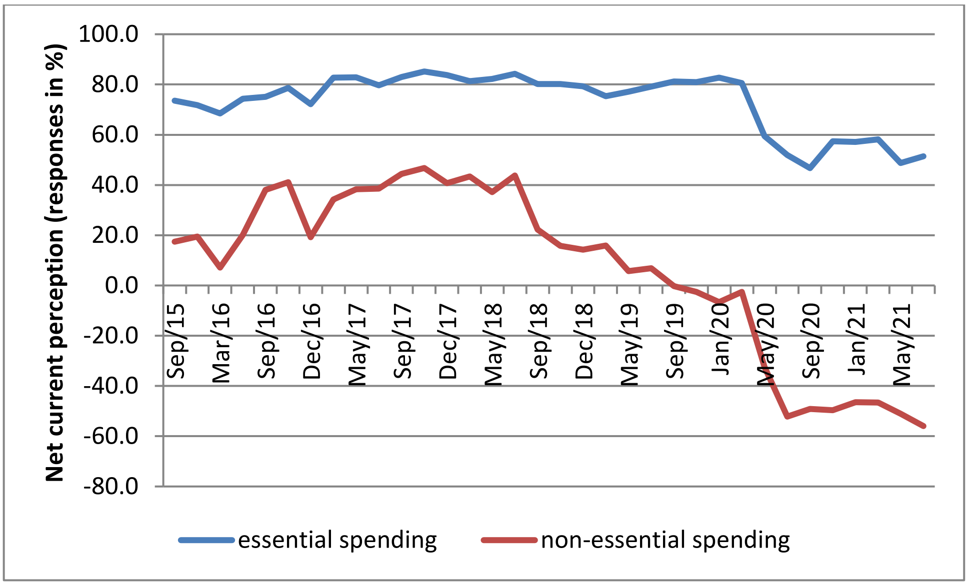
See Chart 11: corporate performance summary by firm-size



Source: Hindustan Times analysis of CMIE Prowess Database taken from https://bit.ly/2X1aqGE

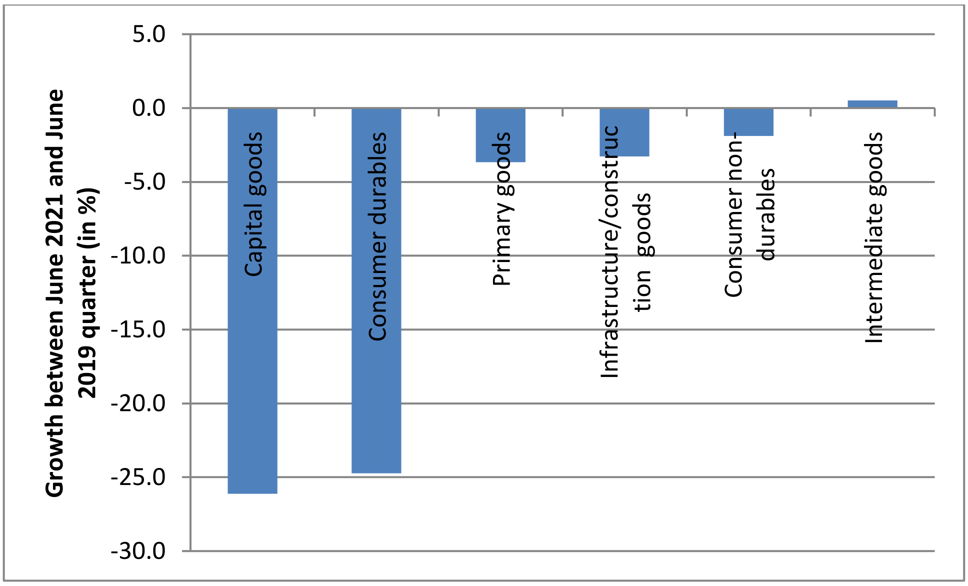
The preceding discussion makes it clear that the pandemic's adverse impact has been more severe on low-income households and businesses compared to their more well-off counterparts. This entails larger headwinds for consumption demand as the marginal propensity to consume – consumption for every additional unit of income – is known to fall as incomes rise. This trend can be seen in high frequency indicators of consumer sentiment as well production data. Consumer sentiment, especially regarding non-essential spending showed very little revival even in the July 2021 round, by which time the second wave of Covid-19 infections had come down. Index of Industrial Production (IIP) data corroborates this finding, given the fact that consumer non-durables and capital goods had the biggest deficits vis-a-vis pre-pandemic levels of production.

Chart 12: Rise in prices of essentials seem to be squeezing discretionary demand



Source: Consumer Confidence Survey, RBI

Chart 13: Category-wise growth in Index of Industrial Production between June 2021 and June 2019 quarter



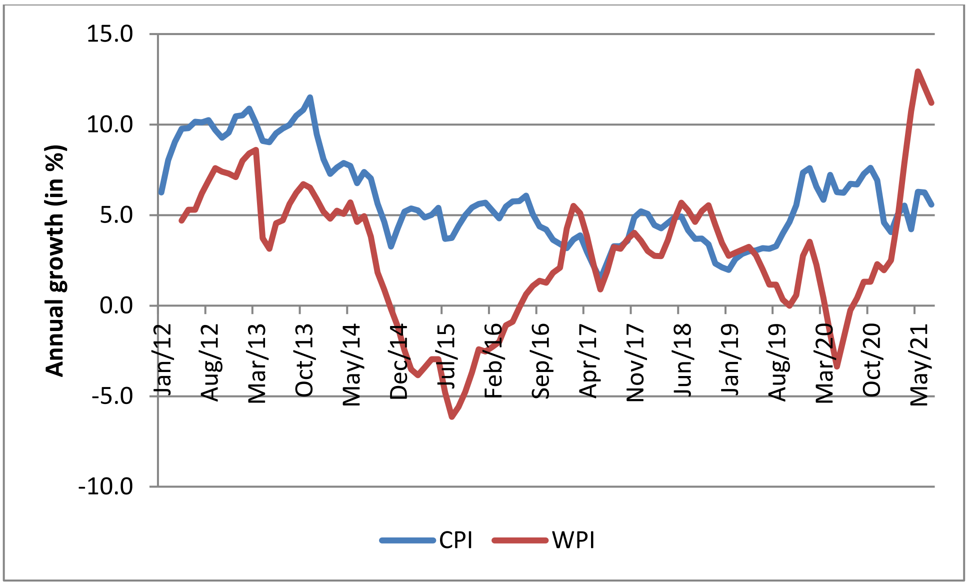
Source: CMIE

c. Inflation, with an adverse terms-of-trade shock to rural demand

Economic disruption associated with the pandemic had two kinds of effects on inflation. In the initial phase of the pandemic, prices came down, as economic activity and derived demand for most commodities took a hit. The demand-side headwinds to inflation were expected to turn into supply-side tailwinds once demand picked up and value chains struggled to come back to normal. What has complicated matters on this front is the differential impact the pandemic has had on various parts of the world, and their importance for global value chains. For example, world over, automobile and electronics manufacturers are facing a supply-crunch of microprocessors, thanks to the pandemic's disruption in the south-east Asian region. This has led to a spike in prices of automobiles across the globe. Then there is the case of crude petroleum, whose prices crashed in a big way in the early phase of the pandemic, but have risen significantly thereafter, in fact higher than what they were before the onset of the pandemic. To be sure, this is also a result of a deliberate cut in production by OPEC countries, a global cartel of important petroleum producers. International commodity prices are also being driven by tailwinds from the very high levels of fiscal stimulus which has been given in advanced countries, which has given a boost to both domestic and export demand there.

For countries like India, this is a development with mixed consequences. On the one hand, there is the prospect of a boost to export demand and therefore growth. But as the inflation curve races ahead of its growth counterpart (as discussed in Section I) is still lagging, economic policy, especially its monetary arm, will have to deal with the dilemma of prioritising economic recovery at the risk of high inflation. India's benchmark inflation rate, measured by the Consumer Price Index (CPI), has stayed above the RBI's target of 4% for last 23 months ending July 2021. In 13 out of these 23 months CPU has stayed above the upper band of RBI's tolerance limit of 6%. Wholesale price index (WPI), which is a proxy for producer prices – CPI is designed to capture the consumption basket for the average Indian household – has been growing in double digits for the past four months. The current trend in both retail and wholesale inflation is quite high by past standards.[9]

See Chart 14: Annual growth in CPI and WPI



Source: CMIE

Experts differ on their prognosis for the future trajectory of inflation. Even though the MPC has made an upward revision to its inflation forecasts, the RBI continues to insist that the current phase is transient and driven by supply side disruptions.[10] Other economists have been arguing that that the problem might not dissipate anytime soon and could even become worse.[11]

Another additional complication on the inflation front in India is the fact that it is particularly high for some sensitive commodities, such as edible oil and petroleum products. The latter phenomenon is largely policy driven, a fact which will be discussed in detail in the next section. The skewed nature of

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[9] Current CPI and WPI series begin from January 2011 and April 2011. India has had much higher bursts of inflation in the past.

[10] In its August meeting, the RBI the inflation projection for the current fiscal year to 5.7%, an increase of 60 basis points compared to the projection in its June meeting. “The approach to inflation is not a cold turkey method, where you slam the economy until it goes limp,” RBI deputy governor Michael Patra said. “It is important to bring that down over time and not immediately.”

[11] “We think there are some good reasons why RBI should begin to plan a gradual exit (from loose monetary policy). Inflation has been higher than 4% for 21 months and is likely to remain so over the foreseeable future. And monetary policy has its limits in driving growth. It is a countercyclical tool and can help close the output gap, but not drive potential growth,” Pranjul Bhandari, chief India economist at HSBC Securities and Capital Markets, said in a note dated August 6,2021

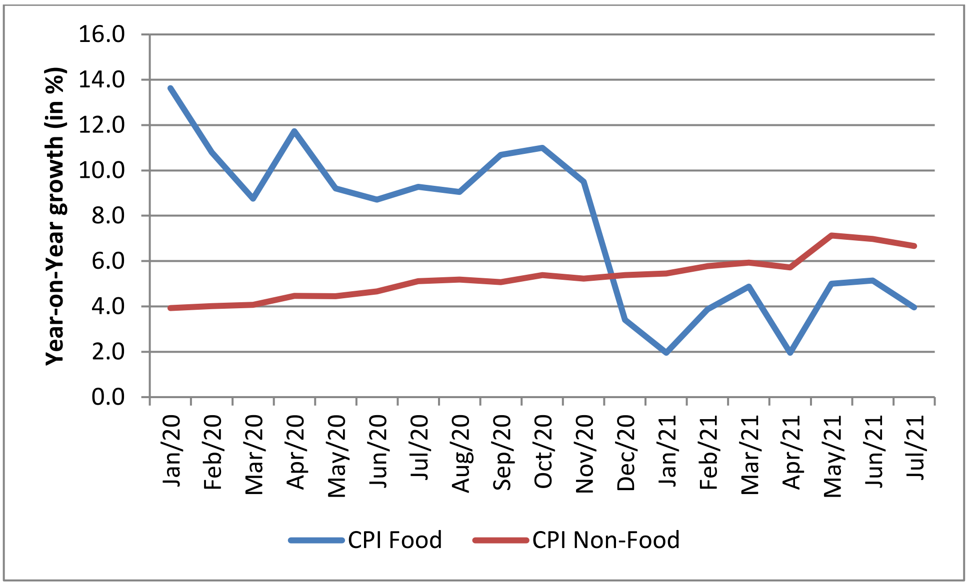
inflation in essentials is expected to have put a particularly severe squeeze on budgets of small households and thereby dent their purchasing power for other commodities. This trend can be seen from the RBI's latest CCS round, where households reported an increase in spending on essential commodities but a decline on non-essential heads, which largely capture discretionary demand.

One of the most important effects of inflation in India is the terms-of-trade (relative prices) balance between agriculture and non-agriculture sectors.[12] While official statistics on the inter-sector terms-of-trade are dated, inflation in food and non-food items is a short-term good indicator of this variable. A comparison of these trends shows that non-food inflation has been surging ahead of food prices, which is bound to put pressure on farm incomes.

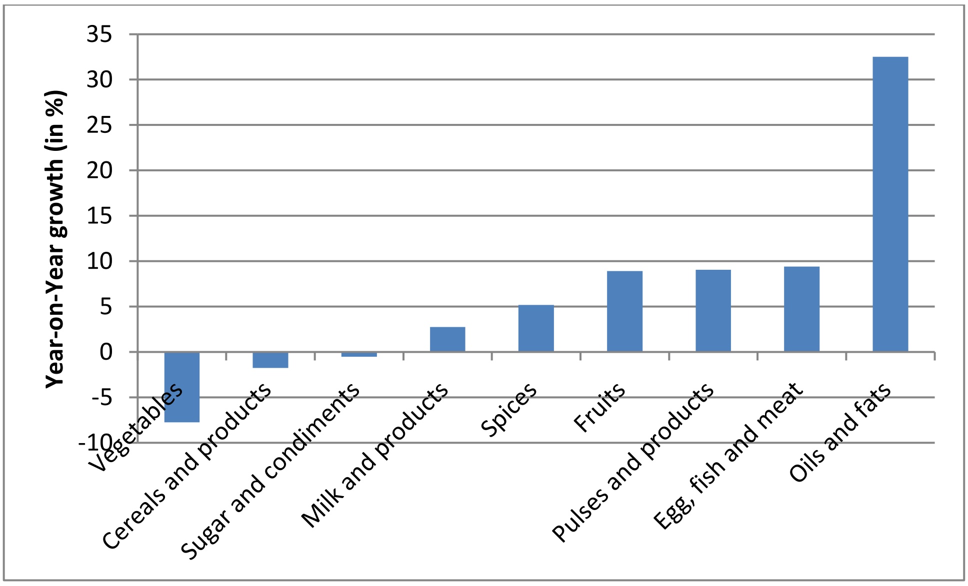
The actual situation is likely to be worse compared to what the headline food and non-food inflation numbers suggest because of two reasons. Rise in prices of important agricultural inputs such as diesel (for irrigation) and fertilizers has been particularly high. The headline food inflation number is itself skewed by rise in prices of select commodities such as edible oil and pulses, which have large import content in India. Prices of cereal and vegetables, which account for more than half of the total value of agricultural production in India, have actually been falling in the recent past. An adverse movement in terms-of-trade for agriculture does not bode well for future prospects of rural demand.

[12] Terms of Trade and Class Relations: An Essay in Political Economy (1977) by Ashok Mitra has among the most insightful discussions on this issue

See Chart 15: food and non-food inflation



See Chart 16: inflation within food category



Source: CMIE

Section III: India's policy-response to the pandemic

India's policy response to the pandemic's economic disruption has relied more on monetary rather than fiscal policy support, the balance of fiscal federalism has been shifted more towards the centre and the present government's pro-formal sector reform agenda has received a boost. Each of these factors is worth examining in detail.

a. Fiscal policy turns pro-cyclical, centralised and even inflationary

That India offered a relatively weaker stimulus fiscal stimulus in the wake of the pandemic, at least when compared to other major economies, was evident in the early phase of the pandemic itself.[13]

What weakened the fiscal boost even further was the fact that even though nominal GDP suffered a contraction of 3% in 2020-21, gross tax revenue of the centre actually went up from Rs 20.1 trillion to Rs 20.24 trillion between 2019-20 and 2020-21.

This otherwise counter-intuitive feat was achieved by a large hike in taxes on petroleum products. Initially its effect was more in terms of holding back benefits from consumers who did not benefit from a sharp fall in crude petroleum prices in the international market. However, the taxes were not rolled back even when international prices started rising and this has resulted in petrol-diesel prices reaching an all-time high in the country, much higher than what they were when crude oil prices were significantly higher than what they are today. Contrary to what is often argued by a section of commentators in India, it is the non-rich which shoulder the biggest burden of petrol-diesel prices.[14] While the government has been maintaining it is unable to bring down petroleum taxes because of an inherited burden of oil bond payments from its predecessor, facts do not support such an argument.[15]

This means that both the tax and inflation burden from the additional petroleum taxes are essentially regressive in nature. A regressive shift in India's tax burden, in fact, goes beyond the issue of higher taxes on petroleum products. The pandemic has given a further boost to the worrying trend of a growing weight of indirect taxes in the overall tax basket. Indirect taxes, unlike

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[13] On May 12, 2020 Prime Minister Narendra Modi announced an economic package of Rs 20 trillion ($263 billion) for the economy, which amounted to roughly 10% of India's GDP. However, an analysis by Pranjul Bhandari from HSBC Securities and Capital Markets looked at the details of the package and found that the actual fiscal component of it was just 1% of the economy. Another research note by Bhandari (Where India differs from the world: Implications for 2021) dated December 11, 2020 found that India's fiscal stimulus was just 2.2% of its GDP, among the lowest in the region.

[14] See https://bit.ly/3h0vcNR for a detailed discussion

[15] See https://bit.ly/3kUWKFJ for a detailed discussion

their direct tax counterpart, put an equal burden across class and therefore regressive in nature.[16]

Another perverse trend on the fiscal policy front has been the growing tilt towards centralisation of revenues. To be sure, this trend has been in making even before the pandemic arrived, best seen in the growing reliance of the centre on use of special cess and duties in collecting taxes. Constitutional provisions which govern India's fiscal federalism framework do not include taxes collected through the cess route in the divisible pool of the centre. It is this pool which has to be shared with the states as per the formula given by a Finance Commission, which is reconstituted every five years. The 14th Finance Commission had earmarked the share of states at 42% of the centre's taxes. The 15th Finance Commission has by and large retained this number at 41%.

A simple comparison of the actual share of centre's revenue shared to the states shows that this promise was never realised in practice. Most of the additional revenue levied by the centre on petroleum products during the pandemic was in the form of additional duties not meant to be shared with the states. As a result, even though the centre's gross tax revenue increased between 2019-20 and 2020-21, the amount handed out to states actually came down by 10%, from Rs 6.5 trillion to Rs 5.9 trillion. A similar trend can also be seen in the latest numbers for the current fiscal year.[17]

A squeeze on resources available to the states matters because they spend a bigger amount than the centre even in normal times, and have done most of the heavy lifting during the pandemic. The fiscal room for the states has suffered an additional squeeze because of complications around the Goods and Services Tax (GST). The GST, which was India's biggest indirect tax reform since independence, required state governments to almost give up

[16] See https://bit.ly/3jF9P6w for a detailed discussion

[17] According the latest available numbers from the Controller General of Accounts (CGA) the cumulative tax devolution to states between April-July 2021 was Rs 1.65 trillion compared to Rs 1.76 trillion in the same period last year. Centre's gross tax revenue increased from Rs 3.8 trillion to Rs 6.9 trillion between April-July 2020 and April-July 2021.

their fiscal autonomy for the purpose of evolving a pan-India indirect tax.[18] The reluctance of states to part with their fiscal autonomy was among the biggest reasons GST's roll-out was stalled for many years despite an in-principle agreement. The agreement finally happened when the centre agreed to offer guaranteed 14% growth in revenue to the states for the first five years of the implementation of GST. In order to fund this commitment, there was a provision of a separate compensation cess under the GST.

This means that the centre's commitment on the GST front was much beyond the usual Finance Commission mandate. It was not enough for the centre to share a fixed proportion of its ex-post tax revenue. Rather, its commitments were fixed based on the ex-ante path of states getting guaranteed growth in their revenues. The promise was always fraught with risk, and it became even more difficult to implement once the pandemic erupted. The centre reported a shortfall of Rs 2.35 trillion in the GST compensation cess in 2020-21. After a lot of controversies and deliberations, the GST Council – it is the apex body comprising of representation from central and state governments for all matters related to the GST – agreed on the states meeting their revenue shortfall by borrowing through the RBI. The repayment for these loans will be done by extending the period of the GST compensation cess, which will add to the already existing indirect tax tilt in India's tax burden.

b. Beginning of the end of a long phase of monetary policy easing?

The RBI had been easing monetary policy, at least in terms of interest rates, even before the pandemic struck. The policy rate had been reduced seven times between February 2019 and April 2020, a cumulative reduction of 2.5 percentage points from 6.75% to 4.25%. The stance of monetary policy is also accommodative at the moment. Reducing interest rates has not been the only route of monetary policy support during the pandemic. The RBI has been injecting significant amount of surplus liquidity in the system, and played a key

[18] Prior to GST states could levy state level Value Added Tax and Service Tax on economic transactions, while the centre had freedom in terms of levying union excise duties and service tax. GST has subsumed almost all taxes except those on petroleum products, sale of alcoholic beverages and property transactions.

role in implementing the various credit relief packages which were actually announced by the centre but had to be implemented by the banking system.

While the monetary easing might not have had any significant impact on economic, even credit growth, it is expected to have played a role in preventing destruction of productive capacity in the economy by maintaining flow of funds and postponing loan repayments through moratoriums for businesses during the lockdown.

RBI's latest financial stability report suggests that unlike the growth hit from the pandemic, the share of non-performing assets in the banking system have not increased significantly, at least, as of now.[19] An even more important achievement of the RBI has been to ensure that the most vital functions of the banking system were not disrupted by the pandemic even when things were at their worst.

Future tailwinds to growth from monetary policy might lose momentum going forward due to two reasons. As inflation continues to test India's inflation-targeting framework, the RBI is expected to begin a rollback of its easy money policy, first via an end to liquidity injection to be followed up with rate hikes next year. While the RBI continues to insist that monetary policy will continue to prioritise growth over inflation, analysts expect a normalisation of monetary policy sooner rather than later. That, businesses expect a rollback of easy money going forward and believe that lending costs have already bottomed out, was apparent in the response of expect cost of finance in the latest round of business surveys conducted by the RBI.

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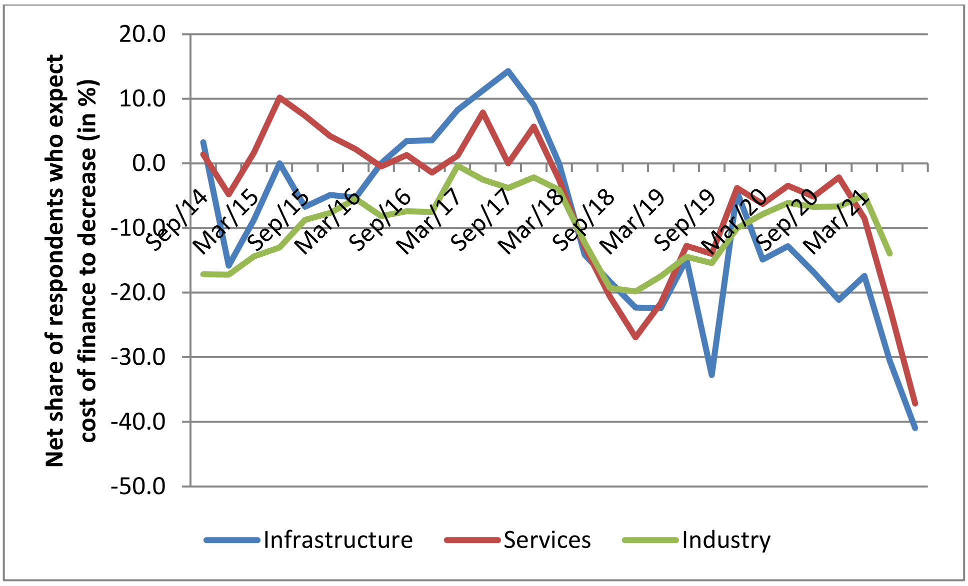
[19] The gross NPA ratio for the banking sector could rise to 9.8% by March 2022 under a baseline, as compared with 7.48% in March 2021. The baseline scenario used in the current stress tests in one where GDP growth for FY22 is at 9.5%. In January, the RBI had said the gross NPA ratio of banks could rise to 13.5% by Sept. 30, 2021 under the then assumed baseline scenario of 0% GDP growth in the second half of FY21. Read more at https://bit.ly/2X4hxPa

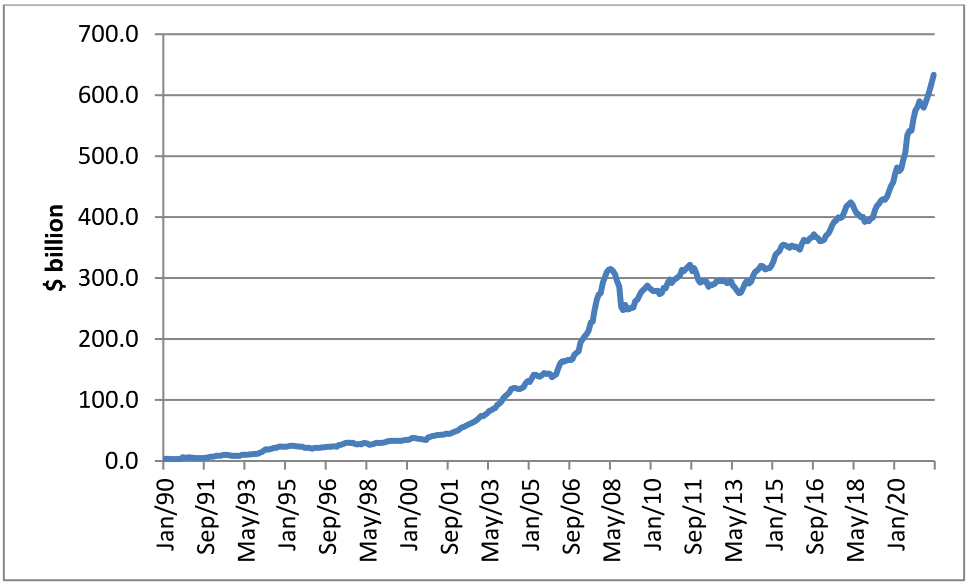
See Chart 17: Expectations about cost of finance



Source: RBI

Another factor worth taking note of is the role played by the effects of international monetary easing, primarily a result of near zero interest rates in the advanced countries under the leadership of the US Federal Reserve. This has had a favourable impact on costs of non-bank borrowing, especially in bond markets. Monetary easing in advanced economies had also played an important role in attracting foreign capital in Indian capital market. This has led to twin benefits of a large foreign currency reserve; which provides a cushion to macroeconomic stability and a boom in stock markets, which has translated into a positive wealth effect for a small but economically significant section of the population. The actual economic impact of an eventual rollback in monetary easing, both domestic and international, remains to be seen. While there is a broad consensus that this might not be a repeat of the situation which played out during the 'taper-tantrum' of 2013, they are unlikely to be insignificant.

See Chart 18: India's foreign currency reserves



Source: CMIE

c. **The medium term policy vision: monetisation and formalisation to boost investment, infrastructure and animal spirits**

The policy response of the Narendra Modi government to the pandemic, both in its immediate aftermath and the medium term economic recovery strategy, can be summarised as a two-pronged one.

The government's immediate relief was just enough to make sure that there was no large-scale humanitarian tragedy because of the lockdown's economic shock. This was done via provision of free food grains to almost 800 million people in addition to other minimal welfare benefits such as transfer of Rs 500 and cooking gas cylinders to poor households. The government also put in extra money in the Mahatma Gandhi National Rural Employment Guarantee Scheme, a counter-cyclical programme which offers 100 days of guaranteed employment offering unskilled labour wages in rural areas. However, is has been more than clear that the fiscal support under such programmes has been directed towards managing destitution rather than providing a Keynesian type demand boost through the fiscal multiplier.

This is in keeping with the government's pre-pandemic economic philosophy which has always seen the solution to India's growth predicament via supply side lens, especially in the infrastructure sector. This belief is accompanied by the fact that it is the private and not public sector which has to take the lead in India's infrastructural development. The evidence of such thinking can be clearly seen in important pre-pandemic initiatives by the government such as the ambitious National Infrastructure Pipeline worth Rs 100 trillion to be completed till 2024-25 and very little concomitant provisioning in the government's own budget for these activities. The recently announced National Monetisation Pipeline (NMP) also tries to achieve the same objective in a roundabout way. By offering brown field assets to the private sector on lease, the government is hoping to boost both public and private capital spending – the former through proceeds from such leasing out and the latter through private commitments to take up similar spending – which it believes will rejuvenate the overall growth prospects of the economy. To be sure, the NMP is only one of the many policy initiatives to achieve this objective. The latest Union Budget has adopted an ambitious disinvestment target, notwithstanding the fact that they have not been realised in the past. The government has also announced the creation of a long-term development finance institution, which it believes to cater to the credit requirements of such infrastructure projects.

See Chart 19: Projected and actual disinvestment targets under the Modi government

As a logical corollary to its belief in the possibility of a big-ticket private investment driven growth revival, the current regime is also invested in the idea of promoting greater formalisation of the currently informal sector/petty production dominated parts of the economy. The argument given in support of such a policy orientation is two-fold: boost to future incomes by unlocking the economies of scale and an enhancement of government's own spending abilities as formalisation brings in more revenues. While this has been the dominant philosophy behind policies such as demonetisation, what many believe was a hurried roll-out of the GST, the pandemic period was utilised to make a concerted push for facilitating the entry of big capital in Indian agriculture. In May, 2021 the union government brought in three key ordinances, which were later passed as laws, undoing regulations in sale, purchase and storage of food items and leasing of land.[20] The legislations continue to face large-scale protests from farmer organisations in India, especially in the regions which enjoy large scale government procurement. To be sure, their actual political impact will only be known in the next round of state election cycle in early 2022, when Punjab and Uttar Pradesh will go to polls.

In addition to opening up space for formal sector activity, both directly and indirectly through factors market reforms such as in labour markets, and allowing private capital to use existing public assets rather than go through the (often treacherous) process of building them afresh, the government also seems to be toying with some sort of an ad-hoc industrial policy framework in the form of the Production Linked Incentive (PLI) scheme which offers many benefits including on taxes to entrepreneurs setting up manufacturing activity in certain sectors.[21] Because the PLI incentives are tied to production, demand constraint can be a limiting factor here.

It is through these policies that the government believes that new investment and income opportunities will be created and India's economic growth will rejuvenate itself.

Section IV: Imaging the future: Keynesian pessimism versus Say's optimism

[20] We have discussed the issue of latest agricultural reforms by the government in detail in Indian Agriculture Needs a Holistic Policy Framework, Not Pro-Market Reforms (Biswajit Dhar and Roshan Kishore), Economic and Political weekly, April 17 2021

[21] The PLI scheme offers incentives on incremental sales to both foreign and domestic companies manufacturing in India. It was started with three sectors in March 2020, but more sectors have been added subsequently.

What are the medium-term growth prospects of the Indian economy? Will the government's vision of boosting economic growth via a government facilitated private investment boom materialise in reality? Or have the pandemic and the economic slowdown which preceded it left long-term scars on India's growth potential? There are two ways to answer this question.

The first approach can apply quantitative methods to project future scenarios via various kinds of models. Even if one is agonistic to the relative merits and demerits of such quantitative methods – as was discussed earlier, many institutional and private forecasters seem to have erred on the side of over-optimism while projecting India's growth performance – there is a more fundamental problem at hand. This problem is the growing inadequacies in India's statistical system, which is the building block of any such quantitative exercise. India's latest GDP statistics have courted a lot of criticism around methodological issues, including from a former Chief Economic Advisor of the current government. Then there is the issue of absence of crucial statistical information, such as the absence of a Consumption Expenditure Survey (CES) after 2011-12. The CES is used extensively in designing important statistical indicators such as the CPI and GDP series. It is also the only credible source of extent of inter-personal inequality and poverty numbers in the country. While some of the problems of the statistical system are systemic in nature and predate the current regime[22], others, such as the government withholding the results of 2017-18 CES, seem to be driven by partisan political considerations.[23]

The other way to look at this question is to apply the quintessential question of whether India's current economic predicament is driven by supply-side or demand side factors. As has been explained above, the government's policy response in the pandemic's aftermath is based on the premise of growth challenges being a result of supply-side constraints. While even the

[22] For a detailed discussion, see https://bit.ly/2WPVSdi

[23] In November 2019, leaked findings from the CES 2017-18 were published in the media, suggesting an unprecedented fall in average consumption in four decades. This was followed by the government scrapping the report itself. See https://bit.ly/3tbjlBq for details

supporters of such policies will agree that they will create short-term pain – imagine government employees losing jobs after disinvestment or small traders losing business as big capital expands its footprint in a sector – the larger argument revolves around the expected benefits of the process of a Schumpeterian creative destruction in the economy. Two arguments cane be given why the possibility of such gains materialising in the future are far from certain.

Firstly, the compulsions of politics and political finance are likely to create intermittent disruptions, even contamination of what are sold are pro-market reforms, which will unleash the forces of creative destruction. The government's repeated interventions in the food market, even after the passage of the three farm laws, to try and bring down prices of important food items such as edible oils and onions, is a very good example of the first kind of limiting factor.

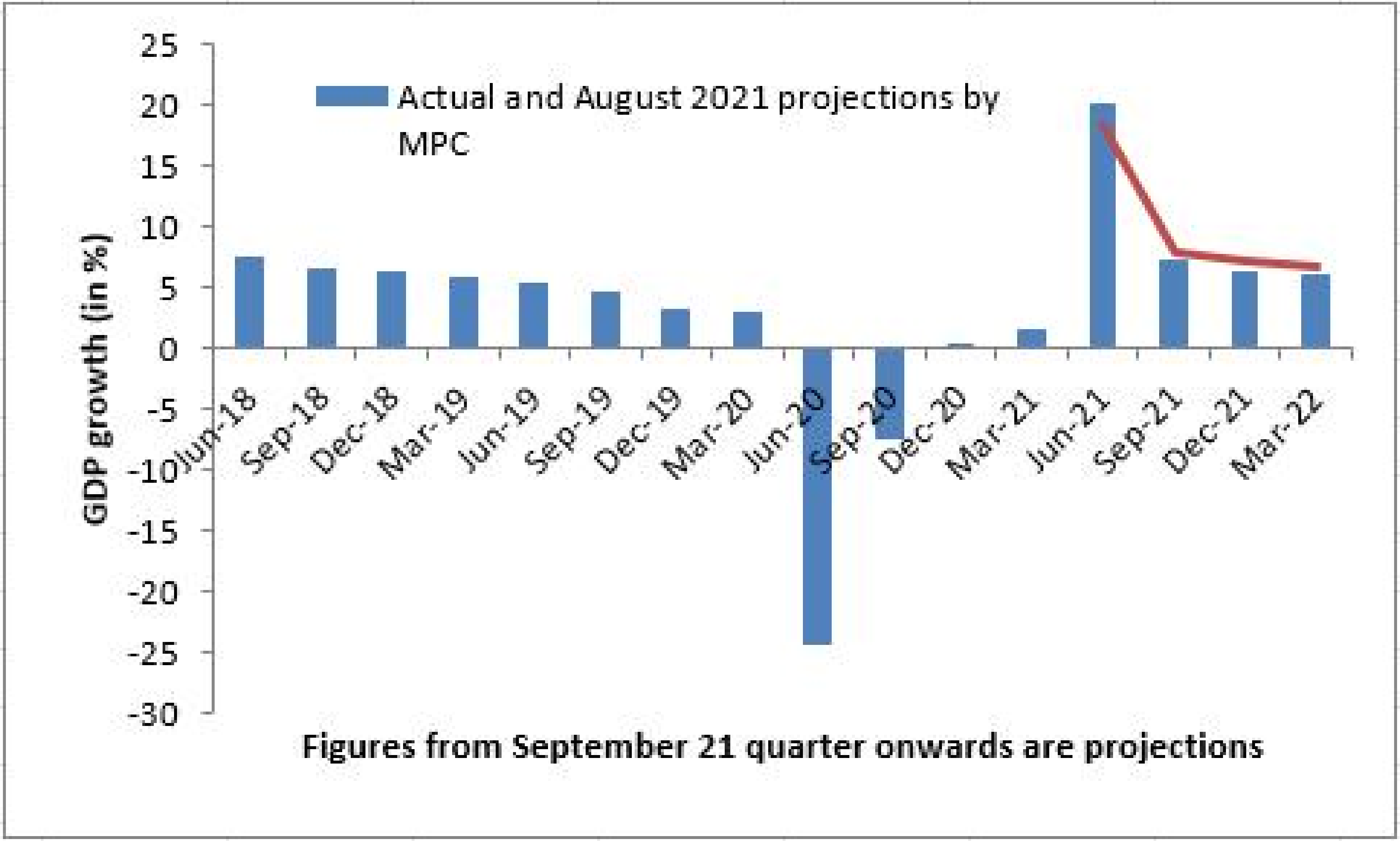
Various commentators have been flagging the possibility of an increase in monopoly power in key sectors of the Indian economy, with speculations around the policy regime favouring a few business groups.[24] Whether or not there is wrongdoing[25] in such matters is beyond the point, but a decline in degree of competition or privatisation of sectors with significant externalities and economies of scale, is bound to encourage monopolistic practices eventually. This can lead to a danger of systemic boost to inflation as prices of such utilities rise. The Railways which offer a very cheap mode of transport to India's blue-collar workforce is a good example to think of. There is also the risk of irrational exuberance – the NMP document itself terms the Rs 6 trillion in expected proceeds as "indicative high-level estimate" – in valuing future gains from such projects, which if it happens, can leave a bad debt hangover for the financial system, which will ultimately lead to a drain on fiscal capacity.

[24] See https://bloom.bg/3zPwXF7 for example

[25] Changes in India's political finance rules under the present regime, such as the Electoral Bond scheme, have granted a legal cover to opacity in donations to political parties. Donations to the BJP, both from electoral bonds and otherwise, are far ahead of what other parties get in India today.

Because the government's post-pandemic response has no direct consumption boosting elements, it is in a way, a very narrow bet on infrastructure driven capital spending. Investment activity outside this sector is likely to remain subdued unless consumption demand revives itself, which by the government's own logic will depend on the success of the infrastructure pipeline kind of initiatives. The only other potential tailwind to growth will be an export driven boom, which also played an important role in sustaining India's best ever boom phase in the first decade of the century, before the headwinds from global financial crisis of 2008 spoiled the party. The irony is, even the government's own policy documents believe that India's export growth potential lies in harnessing its comparative advantage in labour intensive industries.[26] The task of exploiting the potential of this sector could have been addressed better by a synergy of income support policies accompanied with a more holistic industrial policy which tried to promote medium-sized firms rather than tilt the scales further in favour of big capital.

[26] See https://bit.ly/3n88hUS for a discussion on this

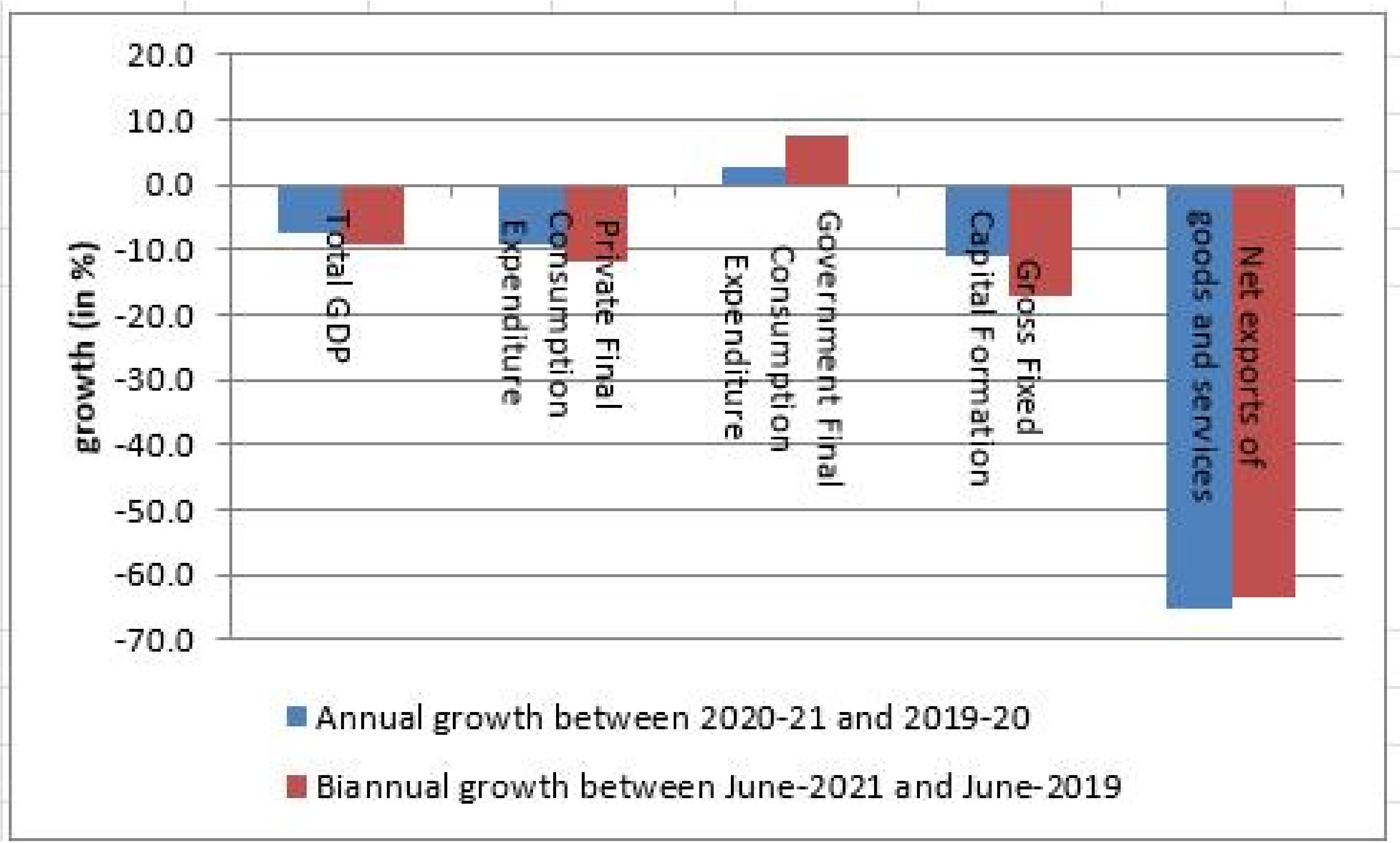


25
20
15
10
5
0
-5
-10
-15
-20
-25
-30
GDP growth (in %)
Actual and August 2021 projections by MPC
Jun-18
Sep-18
Dec-18
Mar-19
Jun-19
Sep-19
Dec-19
Mar-20
Jun-20
Sep-20
Dec-20
Mar-21
Jun-21
Sep-21
Dec-21
Mar-22
Figures from September 21 quarter onwards are projections

Gross Value Added at Constant Basic Prices: By Economic Activity: Base Year 2011-12						
Rs. Million : 1961-62 to 2020-21						
-	2019-20	2020-21	**Sector**	**Annual growth (in %)**		
Total GVA	132,714,708.20	124,534,298.00	**Total GVA**	**-6.2**	Trade, hotels, transport, communication and broadcasting services	-18.2
Agriculture, forestry and fishing	19,685,710.00	20,400,790.00	**Agriculture, forestry and fishing**	**3.6**	Construction	-8.6
Industry	39,276,059.00	36,543,620.00	**Industry**	**-7.0**	Mining and quarrying	-8.5
Mining and quarrying	3,221,160.00	2,946,440.00	**Mining and quarrying**	**-8.5**	Services	-8.4
Manufacturing	22,694,240.00	21,070,680.00	**Manufacturing**	**-7.2**	Manufacturing	-7.2
Electricity, gas, water supply and other utility services	3,005,319.00	3,062,540.00	**Electricity, gas, water supply and other utility services**	**1.9**	Industry	-7.0
Construction	10,355,340.00	9,463,960.00	**Construction**	**-8.6**	Total GVA	-6.2
Services	73,752,930.00	67,589,890.00	**Services**	**-8.4**	Public administration, defence and other services	-4.6
Trade, hotels, transport, communication and broadcasting services	26,997,970.00	22,083,880.00	**Trade, hotels, transport, communication and broadcasting services**	**-18.2**	Financial services, real estate and professional services	-1.5
Financial services, real estate and professional services	29,165,090.00	28,728,150.00	**Financial services, real estate and professional services**	**-1.5**	Electricity, gas, water supply and other utility services	1.9
Public administration, defence and other services	17,589,870.00	16,777,860.00	**Public administration, defence and other services**	**-4.6**	Agriculture, forestry and fishing	3.6

Gross Value Added at Constant Basic Prices: By Economic Activity: Base Year 2011-12		
Rs. Million : June 2011 to June 2021		
-	Jun-19	Jun-21
Total	33,052,730.00	30,475,160.00
Agriculture, forestry and fishing	4,493,900.00	4,862,920.00
Industry	9,901,830.00	9,285,630.00
Mining and quarrying	829,140.00	814,440.00
Manufacturing	5,675,160.00	5,438,210.00
Electricity, gas, water supply and other utility services	796,540.00	820,420.00
Construction	2,600,990.00	2,212,560.00
Services	18,657,000.00	16,326,590.00
Trade, hotels, transport, communication and broadcasting services	6,643,110.00	4,635,250.00
Financial services, real estate and professional services	8,022,410.00	7,899,290.00
Public administration, defence and other services	3,991,480.00	3,792,050.00

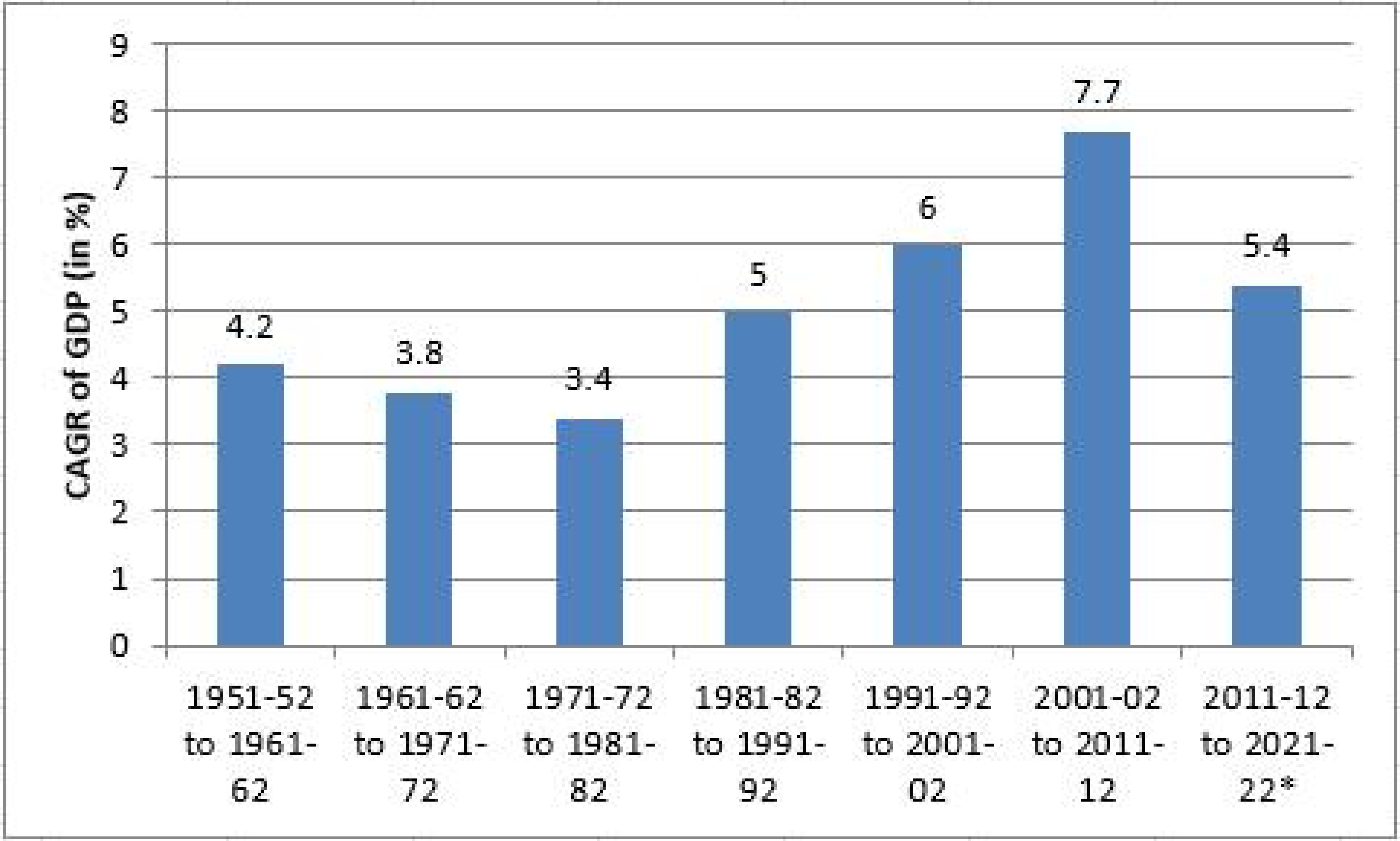
Gross Value Added at Constant Basic Prices: By Economic Activity: Base Year 2011-12	
Rs. Million : June 2011 to June 2021	
Sector	**Biannual growth (in %)**
Total	**-7.8**
Agriculture, forestry and fishing	**8.2**
Industry	**-6.2**
Mining and quarrying	**-1.8**
Manufacturing	**-4.2**
Electricity, gas, water supply and other utility services	**3.0**
Construction	**-14.9**
Services	**-12.5**
Trade, hotels, transport, communication and broadcasting services	**-30.2**
Financial services, real estate and professional services	**-1.5**
Public administration, defence and other services	**-5.0**



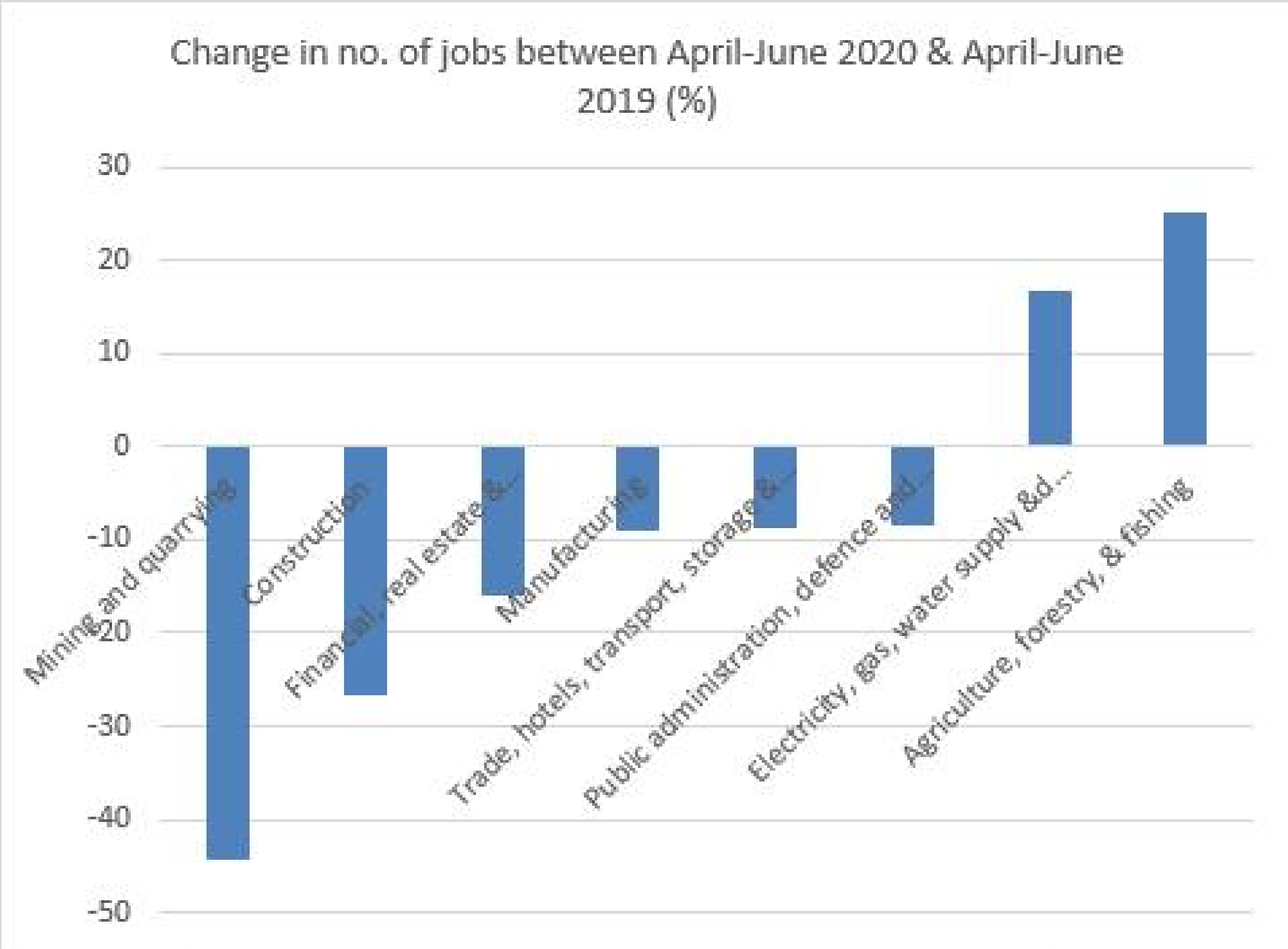
20.0
10.0
0.0
-10.0
-20.0
-30.0
-40.0
-50.0
-60.0
-70.0
growth (in %)
Total GDP
Private Final Consumption Expenditure
Government Final Consumption Expenditure
Gross Fixed Capital Formation
Net exports of goods and services
Annual growth between 2020-21 and 2019-20
Biannual growth between June-2021 and June-2019

Real GDP Growth Forecast (%)

Month of forecast	Forecaster	2017-18	2018-19	2019-20	2020-21	2021-22
April	CMIE	6.9	6.9	7	0.1	9.2
	SPF	7.4	7.3	7.3	5.5	11
	RBI	7.4	7.4	7.2		10.5
	WB	7.2	7.3	7.5	1.9	10.1
	IMF	7.2	7.4	7.3	1.9	12.5
June	CMIE	7.2	7	6.8	-6	7.2
	SPF	7.4	7.4	7.2	-1.5	9.8
	RBI	7.3	7.4	7		9.5
	WB	7.2	7.3	7.5	-3.2	8.3
	IMF	7.2	7.4	7.3	-4.5	12.5
August	CMIE	7.2	7	6.8	-6	7.2
	SPF	7.4	7.4	6.9	-5.8	9.2
	RBI	7.3	7.4	6.9		9.5
	WB	7.2	7.3	7.5	-3.2	8.3
	IMF	7.2	7.3	7	-4.5	9.5
Actual	CSO	6.8	6.5	4	-7.3	

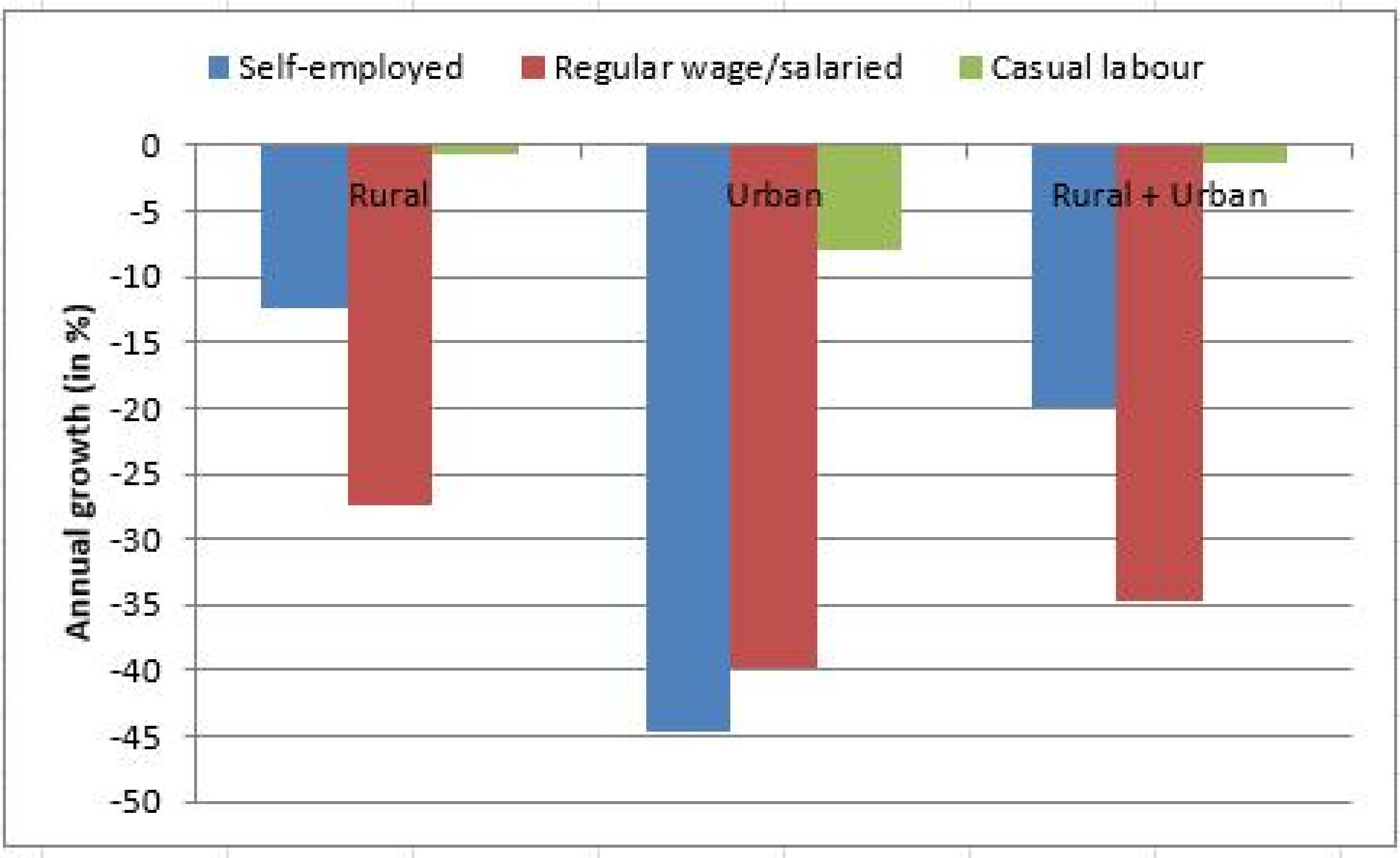


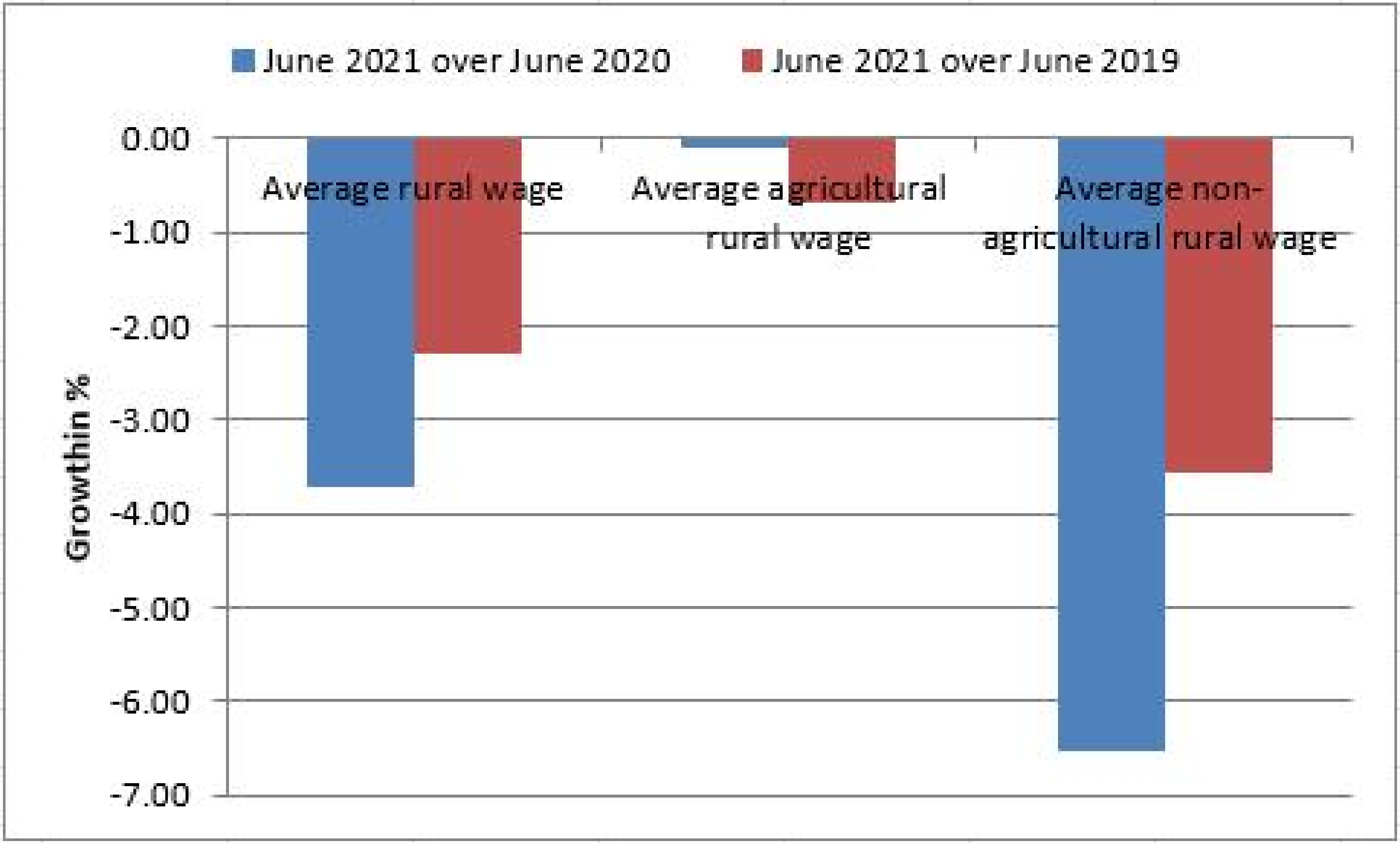
CAGR of GDP (in %)
9
8
7
6
5
4
3
2
1
0
4.2
3.8
3.4
5
6
7.7
5.4
1951-52 to 1961-62
1961-62 to 1971-72
1971-72 to 1981-82
1981-82 to 1991-92
1991-92 to 2001-02
2001-02 to 2011-12
2011-12 to 2021-22*



Source: Unit-level PLFS 2018-19, 2019-20

Note: Data for current weekly status (based on status in last 7 days)

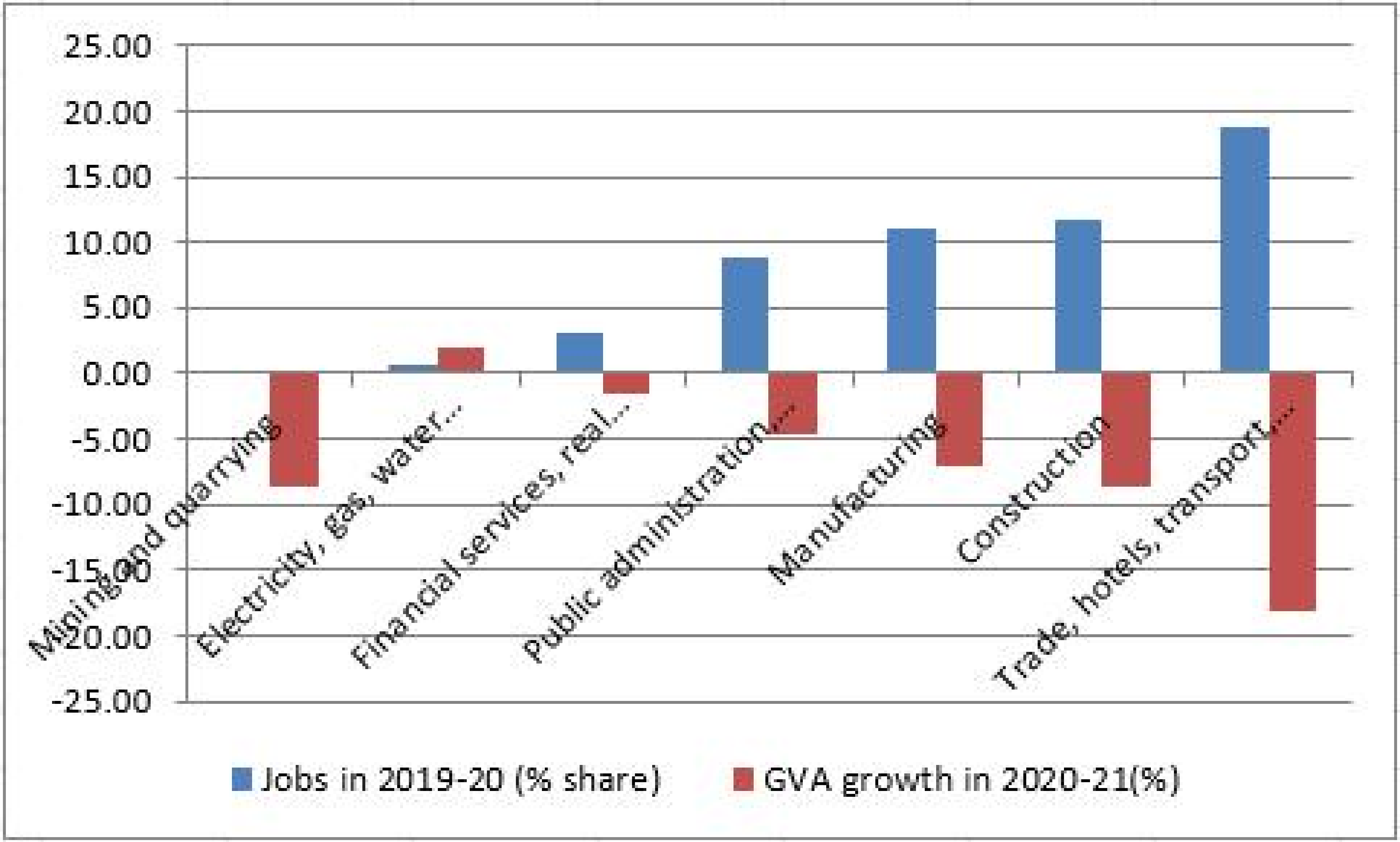

Self-employed
Regular wage/salaried
Casual labour
0
-5
-10
-15
-20
-25
-30
-35
-40
-45
-50
Annual growth (in %)
Rural
Urban
Rural + Urban

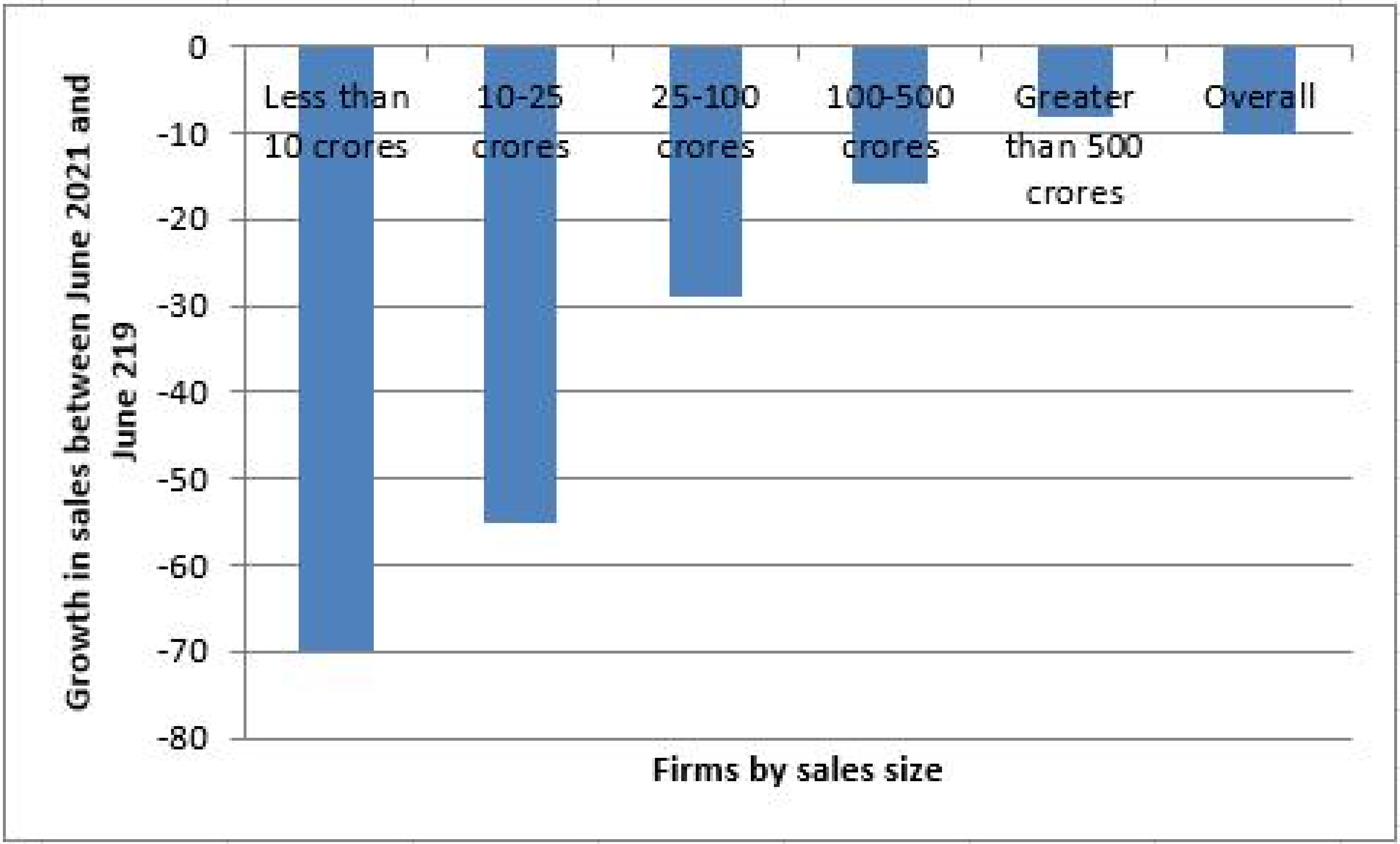


June 2021 over June 2020
June 2021 over June 2019
0.00
-1.00
-2.00
-3.00
-4.00
-5.00
-6.00
-7.00
Growthin %
Average rural wage
Average agricultural rural wage
Average non-agricultural rural wage

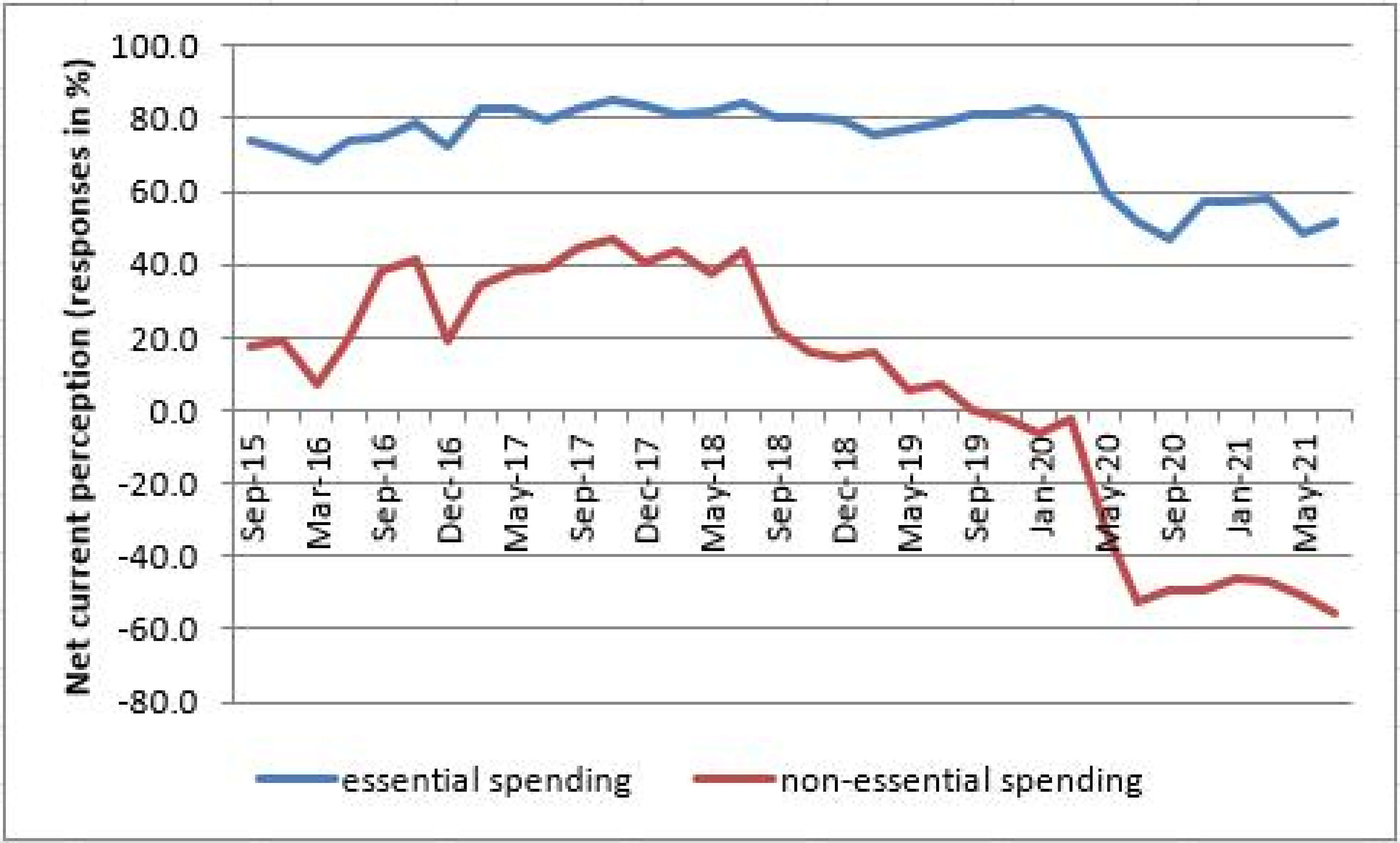
Sector	% of labour force in		Share in GVA in 2019-20
	Organised sector	Unorganised sector	
Agriculture	0.2	42.3	14.8
Mining & Quarrying	0.3	0.1	2.4
Manufacturing	4.4	7.7	17.1
Electricity, Gas & Water supply	0.4	0.2	2.3
Construction	2.5	9.6	7.8
Trade, Hotel & Restaurants	1.3	11.3	20.3
Transport, Storage & Communication	1.8	4.1	22.0
Finance, Business, Real Estate	1.9	1.5	
Health, Education, Public Admin	5.9	4.6	13.3
Total	18.7	81.3	100.0

-	2019-20	
Total GVA	132,714,708.20	
Agriculture, forestry and fishing	19,685,710.00	14.8
Industry	39,276,059.00	29.6
Mining and quarrying	3,221,160.00	2.4
Manufacturing	22,694,240.00	17.1
Electricity, gas, water supply and other utility services	3,005,319.00	2.3
Construction	10,355,340.00	7.8
Services	73,752,930.00	55.6
Trade, hotels, transport, communication and broadcasting services	26,997,970.00	20.3
Financial services, real estate and professional services	29,165,090.00	22.0
Public administration, defence and other services	17,589,870.00	13.3

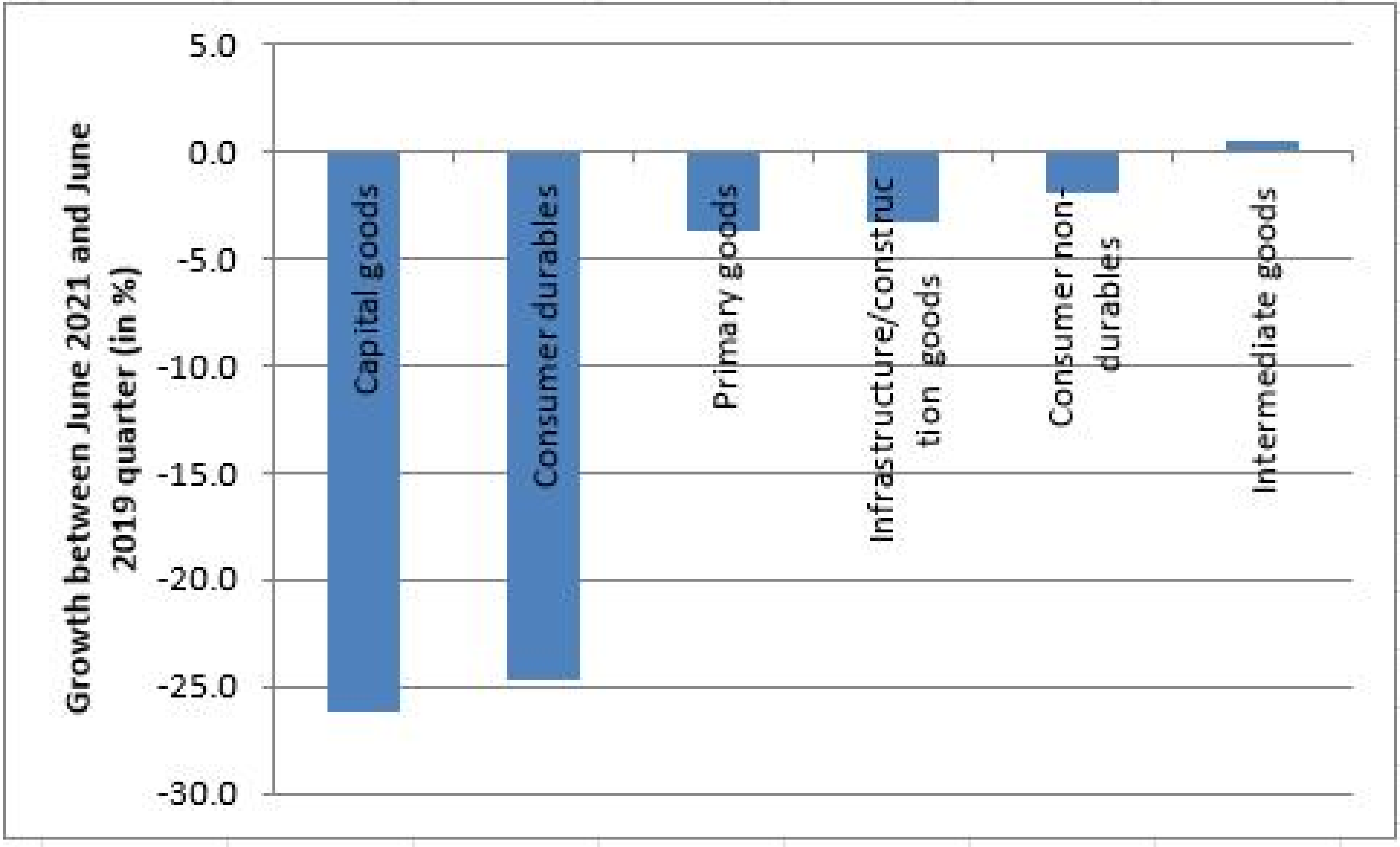

25.00
20.00
15.00
10.00
5.00
0.00
-5.00
-10.00
-15.00
-20.00
-25.00
Mining and quarrying
Electricity, gas, water...
Financial services, real...
Public administration...
Manufacturing
Construction
Trade, hotels, transport...
Jobs in 2019-20 (% share)
GVA growth in 2020-21(%)



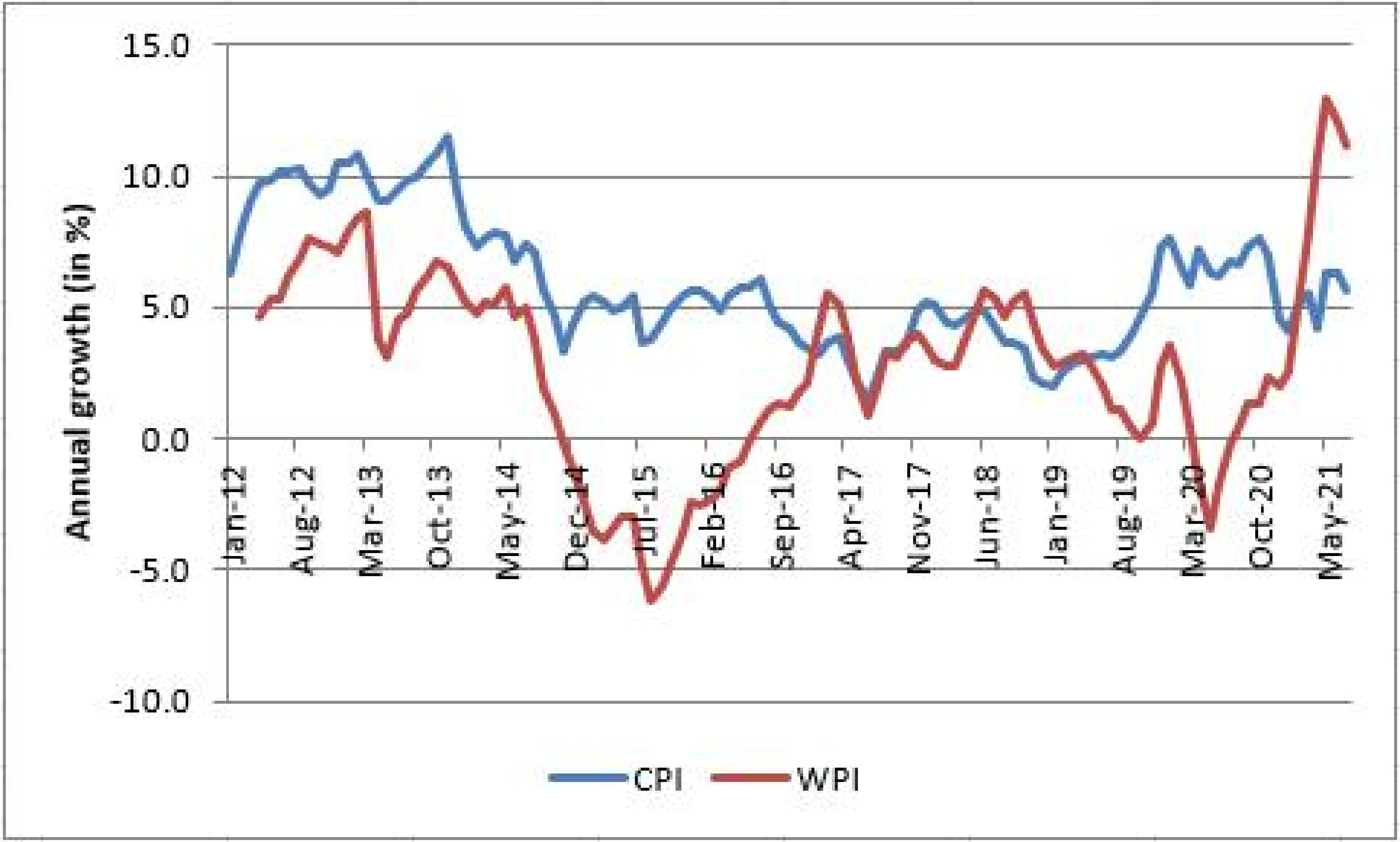
0
-10
-20
-30
-40
-50
-60
-70
-80
Less than 10 crores
10-25 crores
25-100 crores
100-500 crores
Greater than 500 crores
Overall
Growth in sales between June 2021 and June 219
Firms by sales size



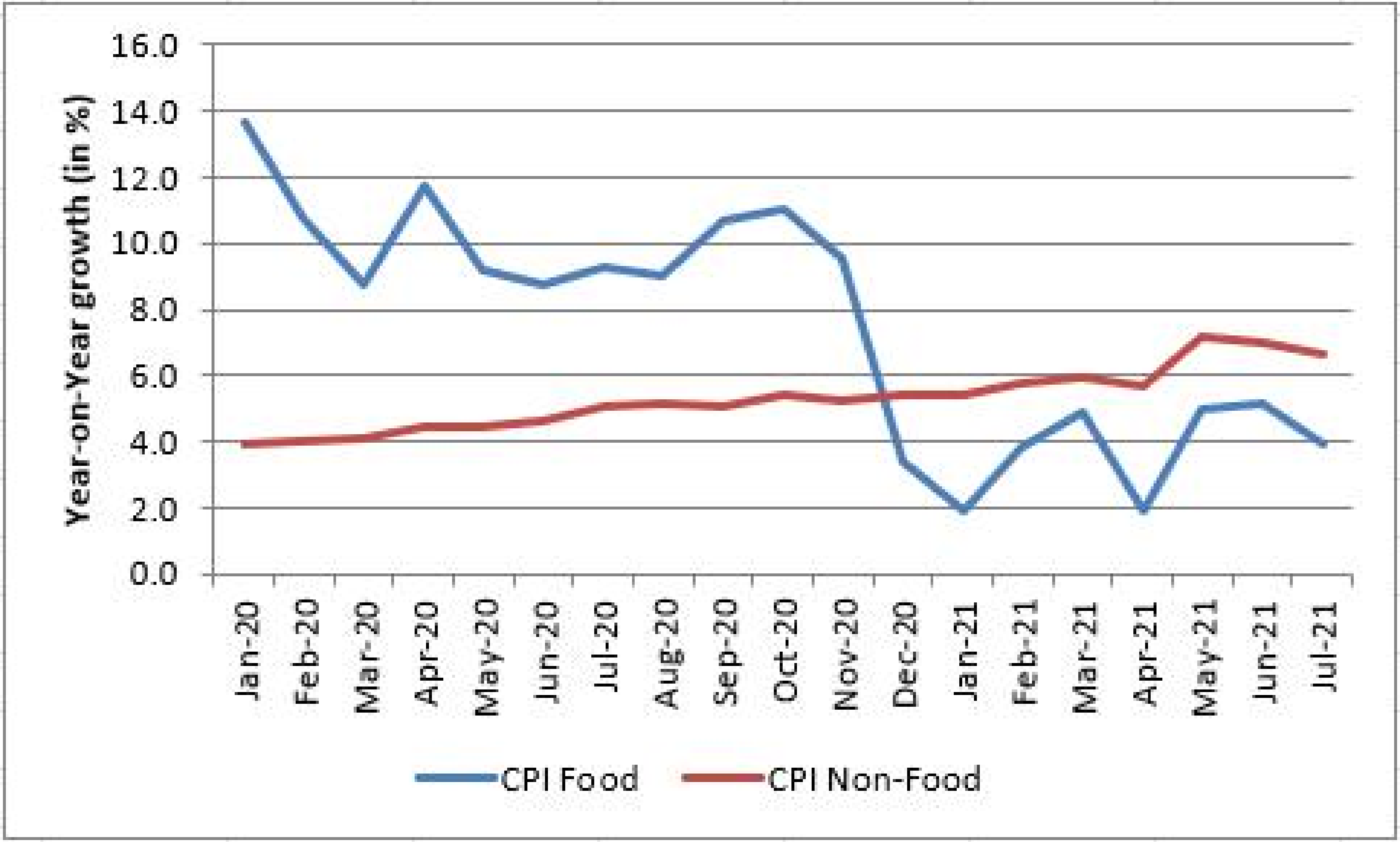
Net current perception (responses in %)
100.0
80.0
60.0
40.0
20.0
0.0
-20.0
-40.0
-60.0
-80.0
Sep-15
Mar-16
Sep-16
Dec-16
May-17
Sep-17
Dec-17
May-18
Sep-18
Dec-18
May-19
Sep-19
Jan-20
May-20
Sep-20
Jan-21
May-21
essential spending
non-essential spending



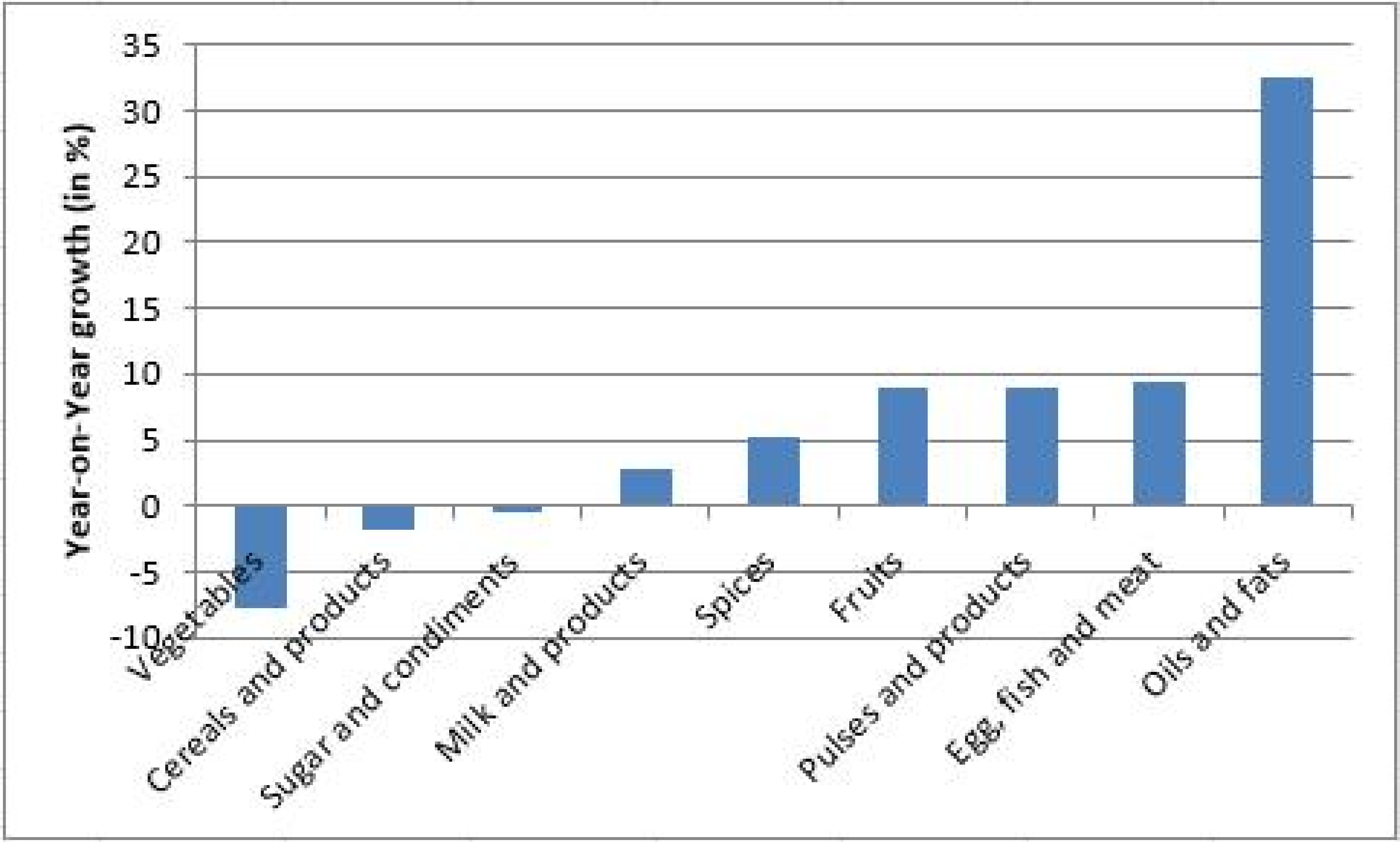
Growth between June 2021 and June 2019 quarter (in %)
5.0
0.0
-5.0
-10.0
-15.0
-20.0
-25.0
-30.0
Capital goods
Consumer durables
Primary goods
Infrastructure/construction goods
Consumer non-durables
Intermediate goods



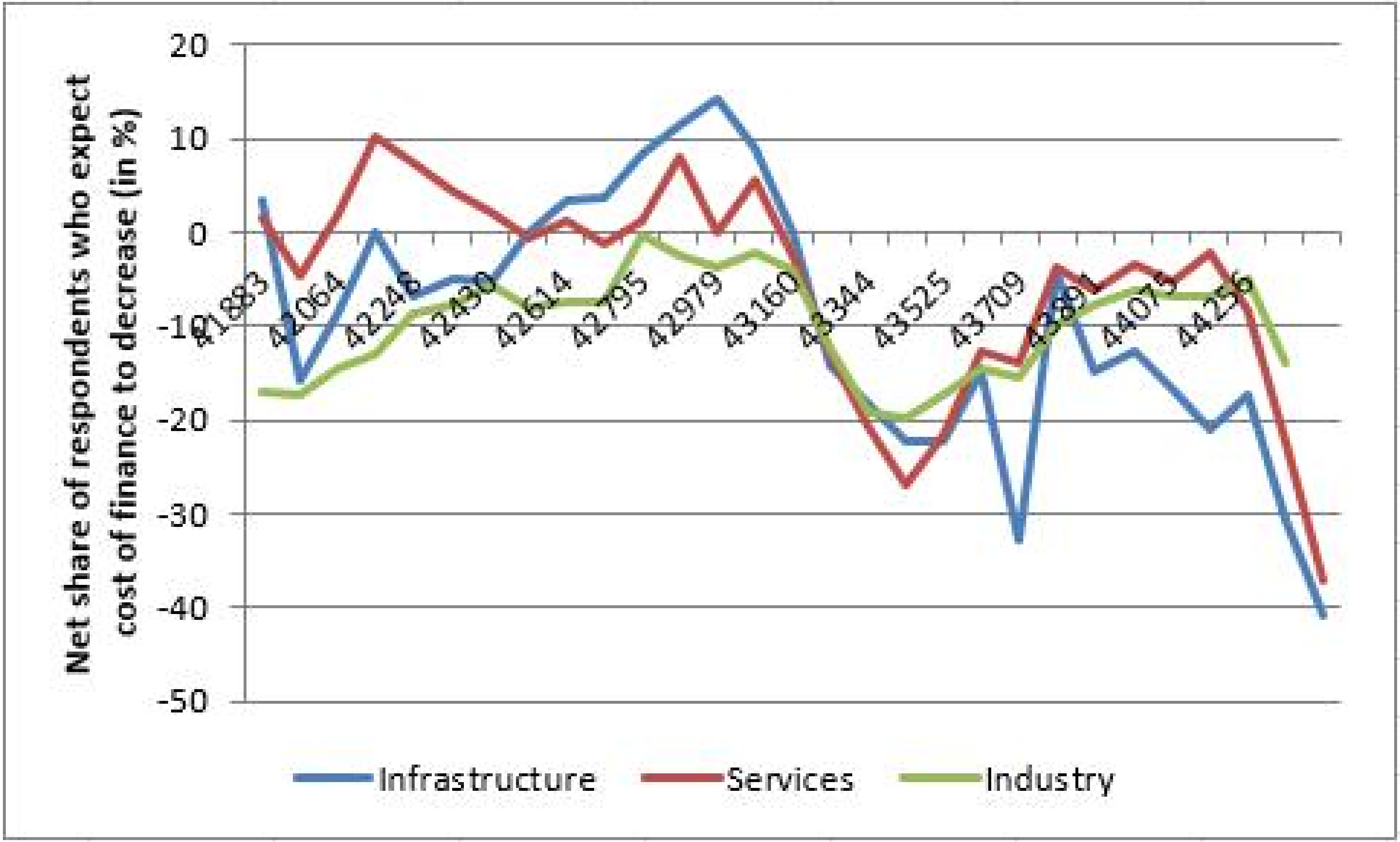
15.0
10.0
5.0
0.0
-5.0
-10.0
Annual growth (in %)
Jan-12
Aug-12
Mar-13
Oct-13
May-14
Dec-14
Jul-15
Feb-16
Sep-16
Apr-17
Nov-17
Jun-18
Jan-19
Aug-19
Mar-20
Oct-20
May-21
CPI
WPI



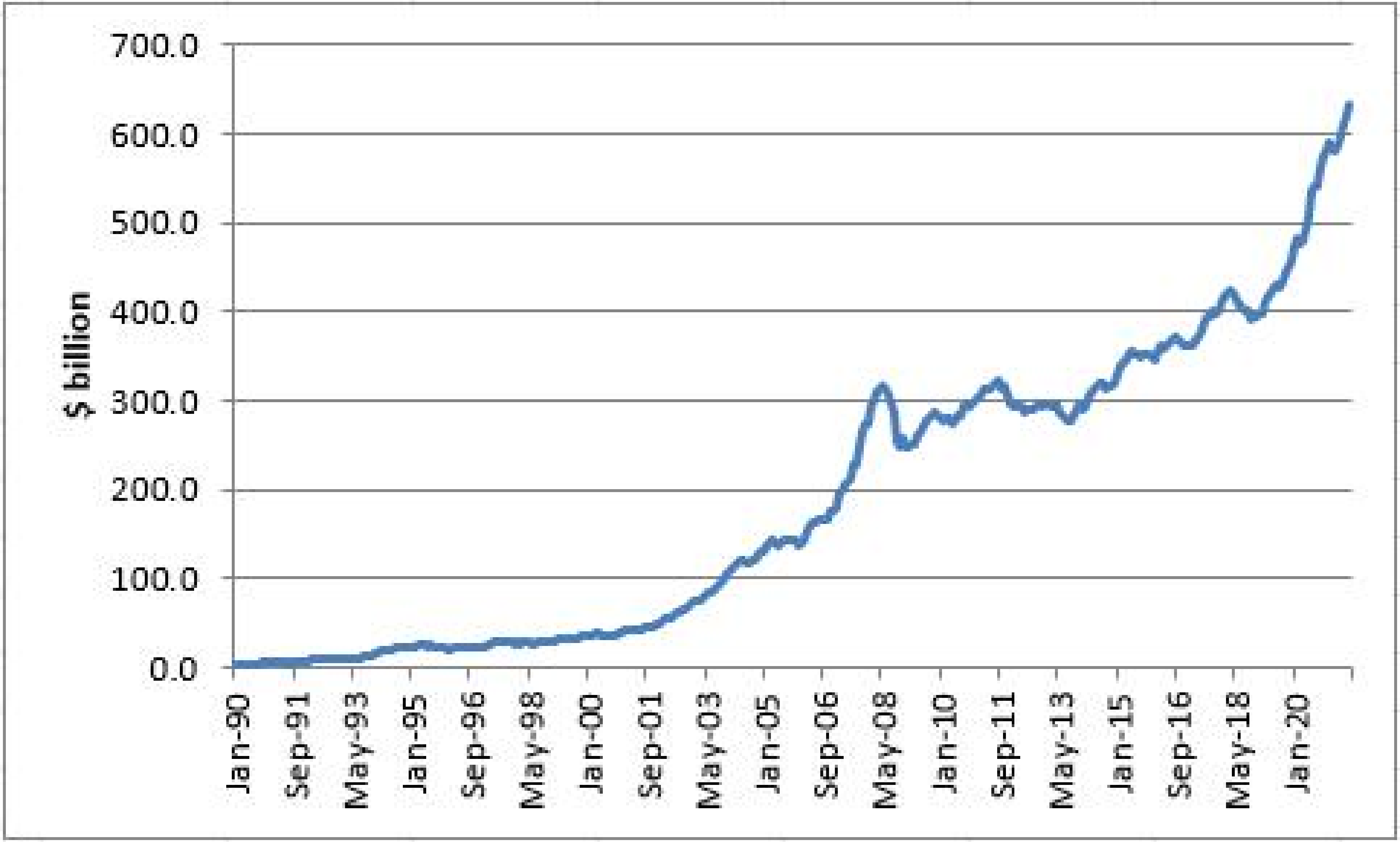
16.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Year-on-Year growth (in %)
Jan-20
Feb-20
Mar-20
Apr-20
May-20
Jun-20
Jul-20
Aug-20
Sep-20
Oct-20
Nov-20
Dec-20
Jan-21
Feb-21
Mar-21
Apr-21
May-21
Jun-21
Jul-21
CPI Food
CPI Non-Food



Year-on-Year growth (in %)
35
30
25
20
15
10
5
0
-5
-10
Vegetables
Cereals and products
Sugar and condiments
Milk and products
Spices
Fruits
Pulses and products
Egg, fish and meat
Oils and fats



20
10
0
-10
-20
-30
-40
-50
41883
42064
42248
42430
42614
42795
42979
43160
43344
43525
43709
43891
44075
44256
Net share of respondents who expect cost of finance to decrease (in %)
Infrastructure
Services
Industry



700.0
600.0
500.0
400.0
300.0
200.0
100.0
0.0
$ billion
Jan-90
Sep-91
May-93
Jan-95
Sep-96
May-98
Jan-00
Sep-01
May-03
Jan-05
Sep-06
May-08
Jan-10
Sep-11
May-13
Jan-15
Sep-16
May-18
Jan-20