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Policy for Post-Lockdown Indian Economy

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The Indian economy is during Q2 and Q3 of 2020-21, in the transition from Lockdown to Normalization. Starting around March 21, 2020 the Indian Govt imposed one of the most comprehensive lockdowns, w imposed anywhere in the world. Only essential goods and services, constituting an estimated 40% of GDP and 55% of employment were exempt from the lockdown [Virmani and Bhasin (2020)].

Lockdown and After

From mid-May Govt started lifting the lockdown gradually and by end June it was largely eliminated at the central level. The lockdown of 60% of the economy for 6 weeks in Q1 of 2020-21 was enough to reduce Q1 GDP by 25% below the GDP in Q1 of 2019-20. The GDP and IIP data confirm that the exempt sectors were the least affected by the Lockdown. The ratio of Q1 GDP in FY21 to that in FY20 from Agriculture & allied services was 1.03 and electricity, gas, water & other utilities at 0.93 (table 1). Even mixed sectors with some lockdown component like Financial, real estate & business services had a ratio of 0.93 and exempt sectors with some lockdown component like Public Administration & Other services (which include health, education, NGOs) at 0.90.

Table 1: Effect of Lockdown on GDP by sector

		GDP in Q1 FY21/FY20	Lockeddown or Exempt	mixed sectors
1	Construction	0.50	LD	
2	Trade, hotels, transport, communication,broadcasting	0.53	LD	e
3	Manufacturing	0.61	LD	
4	Mining	0.77	LD	
5	Public administration, Defence, Othr Services	0.90	E	ld
6	Electricity, gas,water & other Utilities	0.93	E	
7	Financial, real estate & professional services	0.95	E	ld
8	Agriculture & allied	1.03	E	
9	**Total GVA**	0.77		
	Note: Locked down =LD, Exempt = E			

A similar confirmation is obtained within the manufacturing sector measured by the ratio of IIP in April-May 2020 over 2019. For food products the ratio was 0.75 and 1.3, for Pharmaceutical & medicinal products were 0.46 and 1.02 and Wood & related products 0.87 & 1.4 and refined petroleum products 0.72 & 0.76(table 2). Some sectors like aeriated beverages, hygiene related chemical products and different types of packaging for essential goods, where the exemption was unclear and products like tobacco & liquor where it was initially locked-down, recovered quickly as soon as it became clear that they were part of the exemption .

	Table 2: Effect of Lockdown on IIP by industry (FY21/FY20)	Q1	April	May	June	Jn
1	Manufacture of textiles	0.25	0.05	0.27	0.46	--
2	Other transport equipment	0.23	0.00	0.16	0.50	--
3	Motor vehicles, trailers, semi-trailers	0.23	0.00	0.20	0.52	--
4	Manufacture of wearing apparel	0.41	0.04	0.60	0.60	-
5	Paper and paper products	0.45	0.24	0.50	0.60	-
6	Manufacture of electrical equipment	0.32	0.06	0.29	0.62	-
7	Fabricated metal products (-machinery, equip)	0.39	0.04	0.47	0.65	-
8	Other manufacturing	0.37	0.12	0.35	0.66	-
9	Machinery and equipment n.e.c.	0.39	0.09	0.37	0.68	-
10	Manufacture of basic metals	0.55	0.29	0.57	0.76	0
11	Manufacture of beverages	0.61	0.32	0.70	0.76	0
12	Manufacture of furniture	0.44	0.01	0.53	0.76	0
13	Computer, electronic,optical products	0.32	0.07	0.22	0.76	0
14	Leather and related products	0.41	0.01	0.45	0.78	0
15	Printing & reproduction of recorded media	0.51	0.23	0.54	0.78	0
16	Coke & refined petroleum products	0.78	0.72	0.76	0.86	+
17	Rrubber and plastics products	0.61	0.30	0.65	0.87	+
18	Other non-metallic mineral products	0.60	0.15	0.73	0.93	+
19	Manufacture of food products	1.01	0.75	1.30	0.97	++
20	Wood & products of wood,cork, straw(-furniture)	1.09	0.87	1.40	0.97	++
21	Chemicals & chemical products	0.74	0.45	0.78	0.98	++
22	Manufacture of tobacco products	0.52	0.00	0.39	1.04	++
23	Pharmaceutical, medicinal chemical, botanical products	0.95	0.46	1.02	1.35	++

This part of the economy contributing 40% to total GDP and 55% to total employment was therefore functioning normally, with demand equal to supply, and wages, employment and profits close to normal. It also had a positive saving rate as its demand for goods and services produced by the rest of the economy could not be met because of complete or partial lockdown.

The rest of the economy, constituting 60% of GDP and 45% of employment, was subject to lockdown. In terms of broad GDP sectors, this consisted of manufacturing, mining & quarrying, and construction (MMC), and large part of "Trade, Hotels and Transport", "Other services" and "Real estate, housing & business Services." The ratio of Q1 GDP in FY21 to that in FY20 from construction was 0.5, for manufacturing was 0.61 and mining was 0.77(table 1). The ratio for Trade, Hotels, transport, communication & broadcasting at 0.53, was close to the locked-down construction sector, as the non-exempt communication & broadcasting sub-sectors constituted only a small part of the overall sector and even exempt parts of the trade & transport sector serving essential commodities, was disrupted by random bureaucratic actions at the State & local level(table 2). The corresponding ratios (FY21/FY20) for average Q1 IIP for mining and manufacturing at 0.78 and 0.59 are remarkably close to the GDP ratios (table 1). We can therefore use the IIP sub aggregates to see the effect on individual industries. The lockdown was complete and comprehensive in the capital goods and consumer goods sectors, with ratio of April 2020 IIP to April 2019 IIP falling to zero (table 3).

Table 3: Effect of Lockdown on IIP by sector (FY21/FY20)

		Q1	April	May	June
1	**General**	0.64	0.42	0.66	0.83
2	Manufacturing	0.59	0.33	0.62	0.83
3	Mining	0.78	0.73	0.79	0.80
4	Electricity	0.84	0.77	0.85	0.90
5	Capital goods	0.36	0.07	0.35	0.63
6	Consumer durables	0.32	0.04	0.31	0.65
7	Intermediate goods	0.57	0.35	0.59	0.75
8	Infrastructure/construction goods	0.52	0.15	0.59	0.79
9	Primary goods	0.80	0.73	0.80	0.85
10	Consumer non-durables	0.85	0.51	0.89	1.14

The industries which completely shut down in April, were Motor vehicles & other transport equipment, tobacco products, Leather & products, Furniture, Apparel and textiles, fabricated metal products, electrical equipment, computer and electrical products and machinery and equipment. With the partial lifting of the lockdown in May, recovery was most rapid for apparel, furniture, metal products, leather products & tobacco products. In June, the worst affected capital goods and consumer goods sectors remained the worst affected, following industries worst affected(table 2); Textiles(0.46), motor vehicles(0.52) & other transport equipment(0.5), apparel(0.6), paper products(0.6), electrical equipment(0.62) and metal products (0.65).

This part of the economy contributing 60% to total GDP and 45% to total employment was therefore shut down during April 2020, with both supply and the effective demand equal to zero, there was no scope for use of *conventional fiscal policy stimulus* to raise aggregate demand[Virmani (2020)]. It would have had zero effect on demand. With lockdown, wages, employment, and profits all became zero; Every participant of this part of the economy had to use his/her accumulated savings to buy essential goods and services, resulting in negative savings rate. Those who did not have any savings to fall back on or could not get family loans to survive were completely dependent on governments, non-govt organizations and personal charity from their former employers for survival. Further, with profits zero or negative because of legally committed payments or arbitrary State govt orders, there was a possibility of wholesale bankruptcy of firms heavily indebted firms in this part of the economy.

During the lockdown, the primary requirement from government (central & state) was to ensure against starvation & extreme deprivation of workers & self-employed and mass bankruptcies, in the locked down sectors constituting 60% of GDP and 45% of employment. The latter goal was shared with the RBI which had to ensure that credit reached all those companies which were basically solvent but suffered from unprecedented liquidity problems arising from a Govt ordained lockdown of their industry or services. The problem became less acute but continued during the phased lifting of the lockdown in May and June. It has persisted thereafter, with some states, towns and districts reimposing partial lockdowns and the fears aroused among workers, firms, and consumers, by the resurgence of the pandemic. The focus of the Central & State govts, along with the RBI, therefore remained on minimizing the possibility of extreme deprivation and mass bankruptcy, during Q2 of FY21.

As State Governments lifted the lockdown at a different pace in different areas and others reimposed lockdown after lifting it, logistic chains from the producer to the final consumer as well as the logistic chains among different producers were disrupted. This has raised logistic costs, fragmented supply chains and produced pockets of excess supply and excess demand in different goods in different geographical areas; This was predicted by our EGROW foundation research paper on the economics of pandemic and the lockdown. The rise in logistic costs is reflected in the rise of the ratio of the CPI to WPI for food products during Q1 of FY21 and further to its highest level in July 2020.

Given that India is a large federal country, with powers constitutional divided between the Central government and the States, the lockdown and other restrictions have been differentially implemented creating uncertainty in the minds of the public and raising risk. One of the few available measures of uncertainty is the NSE VIX index. (Table 4) This shows a 3.5 x increase in uncertainty in March 2020 when the pandemic started in India and the Govt started imposing restrictions. It came down to 3x in April when the lockdown was announced and 2x in June when it was being lifted. By august 2020 it was down to 1.4 x its level in February 2020.

Table 4: Monthly average of daily close

Month		Average
2020.01	Jan	14.9
2020.02	Feb	15.4
2020.03	Mar	53.1
2020.04	Apr	45.0
2020.05	May	37.0
2020.06	Jun	30.2
2020.07	Jul	25.2
2020.08	Aug	21.2

Source: NSE Vix

Among the sectors which were locked down, it's important to distinguish between those which have some contagion possibilities because of close personal interaction with strangers but were more affected by the lockdown (manufacturing, mining, construction, goods transport, storage, repair services), imposed to reduce contagion, and those which are directly & heavily affected by the pandemic and fears of contagion and death. The latter has been defined in our research as "contact services" in which consumption/purchase involves contact with many other consumers/buyers. These sectors are Restaurants, Hotels, Public transport, wholesale and retail trade (except e commerce) and "Other services" such as hospitality, entertainment & tourism services. There are genuine fears with respect to these sectors which will continue for much longer.

COVID Precautions

To minimize contagion the fears connected to it and restore confidence, its essential that all governments, employers, workers, self-employed, NGOs and consumers, follow the following precautions which the science has taught us so far about the COVID19. This is the only way to a sustained normalization of the economy from the pandemic:

(1) *Hygiene* (sterilization) and frequent *Hand washing*, particularly before touching your mouth, ears or nose.

(2) Wear *Masks* in the presence of others (non-family member & infected family member). A triple (or double) layer cotton mask, covering nose and mouth, seems most appropriate for Indian weather conditions.

(3) Keep physical distance; the distance should be greater, if (a) indoors, (b) eating, drinking, or speaking directly with someone, or (c) the Other person is without a mask.

(4) Well ventilated areas, halls and rooms are safer than closed AC ones. AC halls and rooms can be made as safe as well-ventilated ones, by using Ultra-Violet purification of, or virus quality filters for, re-circulated air. Ultra-violet roof lights are being developed for cleaning room air but are not yet available.

(5) Crowded bars, indoor parties, and public bathrooms, are dangerously prone to corona virus spread. Older people & other vulnerable people should avoid.

(6) Testing, Tracing and Quarantine is a chain in which the quality depends on the weakest link. Home quarantine requires that all members of household follow the above precautions with respect to the quarantined member. Similar care is required in public quarantine facilities, clinics, and hospitals, to ensure that they do not themselves spread the corona virus instead of containing it.

Based on our analysis of the exempt and lockdown sectors, it is possible to calculate the effect of lockdown on GDP. For arithmetic simplicity, assume that lockdown was fully operational for the first one and a half month of Q1 FY21 and completely lifted during the rest of Q1. The arithmetic then shows a -25% decline (YoY) in Q1 2020-21 GDP. The actual decline was -23.5% (YoY).

Unemployment

There is extremely limited data available for the Q2 of FY21. The CMIE's monthly Unemployment rate (UR%) is useful for getting a preliminary picture of the current situation (table 4). The ratio of the unemployment rate in 2020 to that in 2019 provides useful indicator, like the IIP ratio used earlier. This ratio was 1.1 in February and 1.3 in March, indicating a 20% higher pre-pandemic unemployment rate because of the GDP growth slowdown in 2019-20 (Table 5). With the introduction of the Lockdown, this UR% ratio shot up to 3.2 in April and 3.3 in May and dropped back to 1.4 in June after lockdown started lifting. Surprisingly, it is down to 1.0 in July and August indicating a normalization of employment in Q2 of FY21(table 5).

Table 5: Unemployment Rate (%) & LFPR (%) & Ratio of UR (2020/2019)

Month	UR(%)	Ratio of UR (2020/2019)	LFPR (%)
Feb-20	7.8	1.1	
Mar-20	8.8	1.3	
Apr-20	23.5	3.2	35.6
May-20	23.5	3.3	38.2
Jun-20	11.0	1.4	40.3
Jul-20	7.4	1.0	40.7
Aug-20	8.4	1.0	40.7
2019-20	7.6	1.2	42.7

Source: CMIE & Business standard (Mahesh Vayas)

There is a caveat; however, The Labor force participation rate (LFPR) declined during the pandemic and remains 2% points above the average of 2019-20(table 5). This is consistent with the fears of contagion and of contacting pandemic when using public transport and working in a factory office or shop with many others present. CMIE data also indicates that the LFPR has declined the most among salaried employees, less among the casual labor and least among the self-employed. This is also consistent with the hypothesis that the better educated wealthier individual have the knowledge and the wealth to temporarily withdraw from the job market, while the pandemic rages. Finally the CMIE data also shows that the greatest change in LFPR is in Haryana a State bordering Delhi which has among the highest number of COVID cases, and whose modern industries and services are located in Faridabad and other towns close to Delhi.

We define post-pandemic economic normalization as attaining a level for major economic indicator like GDP, IIP or UR% equal to that prevailing in the corresponding period a year ago. The transition from Lockdown to normalization is under way in Q2 and is likely to continue in Q3 of FY21. It is critical to sustained recovery that the COVID19 precautions outlined earlier be strictly followed. During this transition period Fiscal-Monetary co-ordination is critical. Monetary policy must maintain high liquidity, low and stable real interest rates in market for all systemically significant instruments. All segments of the credit market must continue to be assured through Govt credit guarantees. Because of the fragmentation of supply chains and markets during the pandemic, conventional aggregated fiscal stimulus will not be useful and could stoke inflation in areas of excess demand, without stimulating demand in areas with excess supply. We need sector specific fiscal stimulus directed at sectors with weak demand. The govt also needs to put in place a number of structural policy reforms during the transition, which would be critical to restoring fast growth following normalization

Pre & Post COVID Trends

There are several economic trends which originated before the pandemic but have been enhanced by the pandemic. India is in a position to grab the opportunity, by joint efforts of private business, governments and NGOs. These are,

1) De-globalization of Trade, FDI and movement of people. Atma-Nirbhar Bharat and the greater acceptability of remote work are a positive.
2) High Tech decoupling between USA and China provides greater opportunity for shifting Value chains to India, given that many fortune 500 companies already have R&D centres here and there is a large supply of educated labour. However, provision of job skills need to be strengthened immediately.
3) Export supply chain diversification from China was initiated by President Trumps tariff war, but Chinas behaviour during the Pandemic has strengthened these trends.
4) Digitization has progressed much faster in the developed countries than in India. The Pandemic will accelerate the trend in India. There is an opportunity to innovate in e-governance, e-education/skilling, e-medicine/health, e-commerce and remote working.
5) Environment concerns will be heightened, and we are well placed with our Solar initiatives and start with electric vehicle policy.

6) Public health and nutrition & public health education concerns will take centre stage for some years. We can expand and deepen Swachh Bharat to overhaul the nation's sewage, solid waste collection, processing and disposal systems from end to end.

Policy Recommendations

Based on the above analysis, the polices I would recommend the following policies:

(1) Reform Textiles import duties by replacing all specific duties with a uniform ad-velorem tariff

(2) Integrate all GST rates on different textile raw materials, fibres, fabrics, and garments into a single rate, which in a broader GST simplification should be 15%. The diversity of rates on cotton and manmade/artificial fibres/fabrics has left us out of global textile supply chains and progressively lowered our ranking in textile & RMG exports.

(3) Reduce GST on commercial vehicles, consumer durables and capital goods currently at 28% to 25% and those at 18% to 15%.

(4) Integrate all subsides into a Direct Benefit/Cash transfer (DBT/DCT) system. To ensure ease of living, the DCT should delivered directly to all rural residents and migrants, on their mobile phone, with the husband and wife (one or both of who could be migrants), receiving their share separately and the share of minor children delivered to the mothers cell phone. This will ensure that the bottom 40% can be financially protected from any future disasters.

(5) To promote the acquisition of skills for moving labour from casual to regular work amend the Apprenticeship act to make it easy to impart practical job skills, without being subject to inflexible labour laws.

(6) Previously planned infrastructure and housing projects must be revived and accelerated.

(7) The announced, Strategic industry policy should be formally approved and implemented through privatization, equity, and land sale as per policy.

(8) Three agriculture related laws (APMC, ECA and Contract farming acts) have been amended to eliminate monopolies and allow competition in the markets for agriculture produce. To ensure that the smallest farmer benefits, rural roads and Bharat Net/digital connectivity should be extended to every village/habitation, and institutional environment for modern R&D and transmission of innovative practices, growth of agricultural start-ups and skilling of rural youth in modern agriculture, food processing and services.

(9) Twenty-nine central labour laws have been reduced to four labour codes. One of these was passed by parliament in 2009 and the other three have been enacted in 2020. These

should be notified and operationalised expeditiously. The SEZ law should be revised to remove remaining controls on retrenchment and other constraints on labour flexibility.

(10) Ease of doing Business can be enhanced by reducing the number of regulations, eliminating criminal penalties and facilitating digital filling/filing of simplified forms followed by randomized post audits to ensure implementation of critical regulations relating to health, safety and environment. This can be included in SEZ law amendment while the general simplification is devised.

(11) Import substitution policy should be strictly restricted to the few countries which are well known to have used asymmetric trade, FDI and technology policies (Cx), while a freer trade approach is adopted for all other countries. The supply chain resilience initiative (SCRI), Product linked incentives (PLI), and consumer goods tariffs should be on goods exported by Cx countries.

(12) Reduce the differential, higher electricity price for industry as proposed in the amendment to electricity act (2003). Set up common treatment centres for chemical plants to attract supply chains.

(13) Clean-up the legacy NPAs in the financial system, with special attention to the Public Sector Banks, while reducing government holdings below 50% and improving the system for appointment of PSB management. Experience from South Korea, Indonesia and other countries can be integrated with our own experience, to devise the best institutional mechanism for dealing with the legacy NPAs.

(14) Rationalize and simplify GST, by choosing one of the two options proposed by us, with new rates effective from April 1st, 2021. Rationalize and simplify the Direct Tax Code (DTC) as per the 255-page law proposed in August 2009. These tax reforms are essential for Atman Nirbhar Bharat as they will level the playing field for SMEs to compete with companies [given the excellent corporate tax reform (2019)].

Conclusion

The Indian economy has been set back by a series of events, resulting in a FY20 GDP growth of 4.2% and a projected FY21 growth of -5% -/+ 2.5 % with downward bias. The pessimistic view is that GDP growth will be negative or zero even in FY22. A crisis of this magnitude is a terrible thing to waste. I am an optimist; The policy approach has started to change from H2 of FY20, with the introduction of significant reform of Corporate income tax. This has been followed by a spate of major policy reform announcement during FY21, including on strategic policy framework for privatization, agriculture and labour flexibility In my view a growth take-off is possible in FY22 if we complete all the pending reforms which are already on the reform agenda, by end March 2021.

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