A PLAN FOR ECONOMIC RECOVERY

22 April 2020
A Plan for Economic Recovery

Every crisis is an opportunity. While this may be a cliché, the COVID-19 crisis does indeed provide India with an opportunity to reshape the industrial landscape. Given the extent of the damage to the economy from the disruption to business, a medium-term plan for recovery is the need of the hour. Unlike in 1991, India does not face a balance of payments crisis. Instead, the country requires to overcome challenges such as non-availability of long-term funds and high cost of doing business. This requires simultaneous reform across both real and financial sectors. The paper is an attempt to set out some suggestions for actions to be taken in the short and medium-term.

In addition to the immediate stimulus which is required urgently to overcome the deep distress in the economy, a medium-term plan is needed to be implemented over two years. This would include not only immediate restructuring requirements to support the economy from the damages inflicted by coronavirus but also prepare for a more competitive economic landscape over the next decade. The first part of the paper sets out the different elements of the economic damage. In the second part, we discuss some suggestions for the short-term stimulus and the medium-term plan.

A. Economic Costs

A.1. Lockdown Impact on Economy

Economic activity has slowed down significantly across most sectors. In the manufacturing sector, only food processing, pharmaceuticals and medical equipment are operational, while construction and mining activities have halted completely. Within services, majority of trade, transportation and hospitality remains closed, while financial, IT and government services remain partially operational. The table below indicates the sectors which are completely shut down and those that are partially shut down and some where no impact is expected.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Severe (0%-25%)</th>
<th>Significant (25%-50%)</th>
<th>Partial (50%-75%)</th>
<th>No Impact (100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Agriculture</td>
<td></td>
<td></td>
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<tr>
<td>2. Industry</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Mining</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>2.2 Manufacturing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2.2.1 Food Products
2.2.2 Textile & Apparel
2.2.3 Metals
2.2.4 Machinery
2.2.5 Petroleum & Others
2.3 Electricity, Gas, Water

3. Construction

4. Services
4.1 Trade, Repairs, Hotels & Restaurants
4.2 Transport
4.3 Communication & Broadcasting, Storage
4.4 Financial Services
4.5 Real Estate & Professional Services
4.6 Other Services
   (including Health, Education etc)
4.7 Public admin. & defence

5. Total

Source: CII Research Estimates

A.2. Growth Scenarios

Based on the estimated impact across different sectors, we have estimated GDP growth under three different scenarios:

**Table 2: Growth Scenarios**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Illustration</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Optimistic Scenario</td>
<td>Economic activity picks-up slowly post lockdown period and resumes to full capacity shortly thereafter.</td>
</tr>
<tr>
<td>B. Base Scenario</td>
<td>Pick-up in economic activity is constrained by restrictions on free movement of goods and people even in post lockdown period</td>
</tr>
<tr>
<td>C. Downside Risk Scenario</td>
<td>COVID-19 outbreak extends and spreads further, leading to prolonged restrictions in existing hotspots while ‘new’ hotspots get identified.</td>
</tr>
</tbody>
</table>

In the base scenario, we expect that economic activity will resume post the lockdown period but will take time to reach normal capacity levels, as restrictions on people and goods will continue in the identified hot-spot regions even beyond the lockdown phase.
This will lead to disruption in supply chains, slow pick-up in investment activity, labour shortages in the short-run and muted consumption demand on account of reduced household income. The optimistic scenario assumes that economic activity will start recovering as soon as the lockdown is removed and will get back to normal in a phased manner within a short span of time.

The downside risk scenario assumes that the restrictions on free movement of people and goods in hot-spot regions gets extended well beyond the lockdown phase as the COVID-19 outbreak extends and lingers on for longer. Further, new regions are identified as ‘hot-spots’ leading to increase in number of hot-spot regions. In this scenario, consumption demand will contract sharply, the investment activities will crash, and the government will be forced to increase fiscal spending to sustain the economy and to prevent any humanitarian crisis.

Based on these scenarios and the estimated impact on different sectors of the economy, we expect GDP growth to lie between -0.9 and 1.5 per cent for FY2021.

In the base case, GDP growth is estimated at a negligible level of 0.6 per cent while in the optimistic scenario it is projected at 1.5 per cent. In the downside risk scenario, where the pandemic outbreak gets prolonged, thereby restricting full restoration of economic activity for an extended period, the GDP growth for FY2021 could possibly contract by as much as -0.9 per cent.

**Chart 1: GDP Growth Projections: 2020-21**

<table>
<thead>
<tr>
<th>Consumption</th>
<th>Investment</th>
<th>Government Expenditure</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-20</td>
<td>2020-21</td>
<td>Optimistic</td>
<td>2020-21 Base</td>
</tr>
<tr>
<td>5.3</td>
<td>-0.4</td>
<td>-0.6</td>
<td>-2.5</td>
</tr>
<tr>
<td>-0.7</td>
<td>0.2</td>
<td>-1.6</td>
<td>-3.7</td>
</tr>
<tr>
<td>2.8</td>
<td>16.6</td>
<td>18.3</td>
<td>20.1</td>
</tr>
<tr>
<td>5.0</td>
<td>1.5</td>
<td>0.6</td>
<td>-0.9</td>
</tr>
</tbody>
</table>

Source: CII Research Estimates
A.3 Loss of Jobs and productivity

The Indian workforce has many people employed informally – estimated at a minimum of 60 per cent. They could be casual labour employed in the formal or informal sectors or self-employed in various professions. According to the last labour survey for 2017-18, out of a total of around 480 million workers, 250 million were self-employed while 109 million were casual labour.

Table 3. Estimated Workforce by Type of Employment (in million)

<table>
<thead>
<tr>
<th>Type of Employment</th>
<th>Total Population</th>
<th>Total Labour Force (All Ages)</th>
<th>Population Unemployed (All Ages)</th>
<th>Population Employed (All Ages)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self - Employed</td>
<td>250</td>
<td>109</td>
<td>119</td>
<td></td>
</tr>
<tr>
<td>Casual Labour</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage/ Salaried</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: PLFS 2017-18 and CII Research Estimates

The sectors which generate most of the employment, including both manufacturing and services, are all currently under lockdown. According to a CII report on employment generation, the ten largest sectors by employment are: building, construction and real estate; beauty and wellness; retail; transportation, logistics and warehousing; tourism, hospitality and travel; electronics and IT hardware; handloom and handicrafts; textile and clothing; food processing; auto and components.

Many of these sectors are dependent on informal workforce to a large extent. In the construction sector, which is considered the largest non-agricultural sector by employment, the share of casual labour was 83.7% as per the latest labour force survey for 2017-18.

The lockdown has forced several million casual labourers to either move to over 22,000 relief camps being run by central and state government agencies or back to their hometowns and villages. Their jobs and livelihoods are at risk as most of them neither have any formal contracts with their employer nor are covered under any kind of social security schemes of the government. Being at the bottom of the population pyramid, they are likely to have little to no savings to tide over this lockdown phase.

What is not as visible as the other losses is the loss in productivity that is taking place. This could be due to a combination of the following reasons: a) disruption in the
manufacturing process b) work from home in services while possible but limits team collaboration c) reduced availability of labour after the restart and many other reasons. As a result, it will take some time before businesses can be expected to perform at their pre-lockdown level of productivity.

B. Recovery from the Downturn

B.1 Fiscal stimulus required

According to one view, as India already has a high level of government debt (with a general government debt-GDP ratio of 68.1 per cent), a further increase in fiscal spending is hard to afford and will surely lead to a rating downgrade. Yet, a comparison with major G-20 countries shows that India’s debt level is not that high (Chart 2). Further, the stimulus so far provided by the Finance Ministry is small compared to many of the other countries that are fighting the COVID crisis (Table 4).

**Chart 2: General government debt for select countries (% GDP, 2018)**

![Chart showing general government debt for select countries](source: IMF)

**Table 4: Fiscal stimulus provided by different countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>US$ bn</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>2,208</td>
<td>9.1</td>
</tr>
<tr>
<td>Japan</td>
<td>179</td>
<td>3.5</td>
</tr>
<tr>
<td>Germany</td>
<td>167</td>
<td>4.5</td>
</tr>
<tr>
<td>China</td>
<td>159</td>
<td>1.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>145</td>
<td>5.5</td>
</tr>
<tr>
<td>Italy</td>
<td>60</td>
<td>3.0</td>
</tr>
</tbody>
</table>
This still allows the government to provide a sharp but temporary stimulus that can be withdrawn once the economy is back on track. Without such a step, the budget will continue to bleed for several years, as the revenue shortfall continues. At this stage, the government must do whatever it takes to tide over the crisis. The RBI will be required to provide support through secondary market purchases of government bonds, especially for state governments.

Some of the elements of the fiscal cost will include the following:

- The cost on additional health infrastructure such as hospital beds, medical equipment and drugs required to treat the surge in patients (Centre and States).
- Transfers to the poor who have lost their jobs and livelihoods will be necessary, as a consumption booster (Centre and States).
- Support to businesses who are facing distress and are unable to repay their loans and make statutory payments. They need government support, both general as well as sector specific ones in stressed sectors such as aviation, retail, tourism and hospitality (Centre).

We expect the Central government’s spending (not including the spending on health) to be a little over Rs 6 lakh crore (or 3 per cent of GDP). Further details of the suggested interventions are given in the table below.

### Table 5: Fiscal Interventions required immediately

<table>
<thead>
<tr>
<th>Cash Transfer to Poor</th>
<th>Support to enterprises</th>
<th>Pre-empting bank failures</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Additional support to the lowest strata and the informal sector</td>
<td>• Wage and interest support</td>
<td>• It is possible that the pain in the real sector would soon manifest in terms of non-performing loans for banks.</td>
</tr>
</tbody>
</table>
| Provide cash transfer, amounting to INR 2 lakh crore to JAM account holders  
(In addition to 1.7 Lakh crore stimulus already announced) | Banks should provide additional working capital limits, equivalent to April – June wage bill of the borrowers, backed by a Government guarantee, at 4-5% interest.  
A similar carve out could be provided for the April – June | • For banks to increase their lending in this environment of risk aversion, they should be assured of a government backstop either in terms of recapitalisation or government guarantee on loans. |

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<table>
<thead>
<tr>
<th>France</th>
<th>50</th>
<th>2.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>23</td>
<td>1.7</td>
</tr>
<tr>
<td>India</td>
<td>22</td>
<td>0.8</td>
</tr>
</tbody>
</table>

Source: National sources, CII Research
| The cash transfers should be done in tranches to maintain the demand level. | interest obligations of the stressed sectors |

While RBI has taken action to provide surplus liquidity to banks, the transmission to companies is proving to be difficult, due to extreme risk aversion among banks and other lenders in the current situation. To overcome this bottleneck, CII suggests a two-pronged strategy:

- The creation of a fund or SPV with corpus of Rs 1.5 lakh crore which will subscribe to NCDs/Bonds of Corporates rated A and above. The fund can be seeded by the Government contributing a corpus of Rs 10,000-20,000 crore, with further investments from banks to the tune of Rs 70,000-80,000 crore and balance Rs 50,000-60,000 crore brought in by financial institutions such as LIC, PFC, EPF, NIIF, IIFCL et al. This will limit Government exposure while providing adequate liquidity to industry.

- A credit protection scheme for MSMEs whereby 75-80% of the loan should be guaranteed by RBI, i.e. if the borrower defaults, RBI should buy the loan and repay the bank up to 75-80% of the loan, so the risk to the lender is limited. SIDBI could provide the guarantee for loans to industry and trade while NABARD could provide the guarantee for loans to agro-processing sectors.

**B.2 Medium-term plan**

While the short-term stimulus is urgently required to repair the economic damage, it may not be adequate to prepare the economy for a sustained recovery. A medium-term plan is required to build a more competitive economy with better opportunities for trade and investment. The plan needs two elements: structural reforms for competitiveness and a financing plan. Given below are brief ideas on what is required.

**B.2.a Structural reforms**

CII has made many recommendations for economic reforms, most recently at the beginning of the present government’s term. Structural reforms are now urgently required for reducing the cost of doing business. They would also renew confidence in the economy and support the recovery in the medium-term. Broadly, they fall in the following five buckets.
- The cost of transportation and logistics needs to be lowered through better quality infrastructure. The National Infrastructure Plan has laid out the details. Serious implementation is now required.

- Commercial power tariffs remain high in India, further affecting industry’s competitiveness. Further, the state power distribution companies are running at huge losses. Taking forward the reform / privatization of the Discoms is necessary.

- The cost of credit remains high and credit availability is constrained. Reform of the banking sector including reduction of government stake in public sector banks is required to improve governance and address their NPA problem. The availability of long-term funds must be stepped up by strengthening institutions such as IIFCL and NIIF.

- The high level of regulatory permissions required for businesses affects the Ease of doing business. This includes the difficulty in getting access to reasonably priced land for industry. Reforms by State governments are especially important in this area.

- Complicated taxation structure, especially in indirect taxes. There are too many tax rates, both import tariffs and GST, which makes the system irrational and open to evasion. A three-tier tax structure with raw materials and intermediate goods being taxed at a lower rate than final products must be implemented. In addition, the GST structure can be simplified in the form of one registration and bringing down the GST rates to at best three, including zero. The currently exempted products such as petroleum products, natural gas, alcohol, electricity should be included under the GST ambit.

- Labour market reforms are required to enhance labour market flexibility and provide incentives to small companies to increase their scale and employment. Threshold limits under labour laws such as Industrial Dispute Act, Contract Labour Act and Factories Act limit the size of enterprises and good quality employment in the country.

**B.2.b Macro stability**

For the medium-term, it is important to return to macro-stability. A roadmap for fiscal consolidation should be drawn up and any sign of inflation should be nipped in the bud. In case of food inflation, supply side management can be useful in holding prices instead of monetary tightening.
Although there is little or no likelihood of a balance of payments problem in the current situation, there may be a surge in imports as the economy recovers. The RBI’s substantial foreign exchange reserves provide comfort that such a situation can be managed. The accompanying structural reforms should be aimed at reviving the prospects for India’s exports.

While the immediate budgetary spending should be made to save lives and protect businesses, measures should be taken to maintain financial stability in the medium term. Most importantly, financial contagion must be avoided by protecting the health of the financial institutions.

Overall, a combined programme of short-term spending and medium-term reforms are necessary for a sustained economic recovery. Such a plan will revive India’s prospects and help narrow future fiscal deficits.
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