The Indian Journal of Labour Economics (2020) 63 (Suppl 1):S61–S65
https://doi.org/10.1007/s41027-020-00257-y

PERSPECTIVE

The Coronavirus Recession and Its Implications

Sudipto Mundle[1]

Published online: 16 September 2020
© Indian Society of Labour Economics 2020

1 Introduction

This short note draws on my remarks at the IHD-ISLE-ILO conference on *Implications of the COVID-19 Crisis for Labour and Employment,* held during 8–9 June, 2020. These remarks primarily dealt with the Coronavirus triggered recession in the Indian economy and its implications.[1]

2 Declining Growth Prior To The Coronavirus Shock

Growth had started declining in the Indian economy long before the world was struck by the Coronavirus shock. Viewed in a high-frequency metric, growth had declined in every quarter since 2017–2018 Q3. This was the persisting impact (hysteresis) of two earlier shocks, both policy-driven. The first was the demonetisation shock of November 2016. Even before the adverse impact of this shock had worked itself out, the economy was struck by a second major policy shock, namely the Goods and Services Tax (GST) roll out of July 2017. The GST is the most far reaching tax reform introduced since 1991 and the GST itself is an excellent destination oriented tax on expenditure. However, rolling out the tax without proper preparation, in particular, without a fully developed GSTN electronic tax information system and without an adequately trained cadre of tax officers to implement the new tax system, had a disastrous effect, especially on medium and small enterprises which lacked the capacity to comply with the heavy reporting and compliance requirements of the new GST.

[1] These remarks were largely based on the NCAER Quarterly Review of the Economy, Vol.1 No.1, June 2020 (henceforth QRE) which co-authored by me and a team that I lead.

Sudipto Mundle: The views presented are personal.

✉ Sudipto Mundle
sudipto.mundle@gmail.com

[1] Distinguished Fellow, National Council of Applied Economic Research, New Delhi, India

Table 1 "No-Stimulus" Quarterly GVA Growth Assumptions, (%year-on- year)

Sectors	Provisional CSO*		Base-case, QRE expert assumptions				
	2019-20:Q4*	2019–20*	2020-21:Q1	2020-21:Q2	2020-21:Q3	2020-21:Q4	2020–21
Agriculture	5.9	4.0	3.0	3.0	3.0	3.0	3.0
Industry	(−)0.6	0.9	(−)54.2	(−)36.0	(−)18.0	0	(−)27.1
Services	4.4	5.6	(−)16.3	(−)10.9	(−)5.4	0	(−)8.2
GVA	3.1	3.9	(−)25.7	(−)16.7	(−)8.1	0.5	(−)12.4

*Provisional Estimates released on May 29, 2020, by MoSPI

Source: NCAER QRE Team and data from MoSPI; GVA = gross value added

Questions have been raised about why the adverse impact of these two policy induced shocks were not evident initially if indeed their effects were very strong. The impact was not evident initially because of a data infirmity in our national accounts estimates. Since we do not have annual estimates of output in the unorganised sector, the estimates are imputed based on a benchmark-blowup procedure. The assumption implicit in this procedure is that the growth rate of the organised sector is also applicable to a base estimate of actual output in the unorganised sector. Though possibly acceptable under normal conditions, this procedure is highly misleading when there is a shock with distinctly different effects across various sectors. It is well known that the demonetisation and GST shocks had a much more severe effect on the unorganised sector as compared to the organised sector enterprises. In this context, the benchmark-blowup procedure used to estimate unorganised sector output grossly underestimated the adverse impact of these shocks.

3 Assessment of the Coronoavirus Shock

There was a sharp decline in output and employment during Q1 2020–2021 following the imposition of a severe nationwide lockdown that has been assessed as the most stringent lockdown anywhere in the world. This lockdown shock hit the economy like a tsunami on top of the persisting impact of the demonetisation and GST roll out shocks described above. Under such conditions, conventional forecasting is not an option because of the sharp structural break in time series data and the huge uncertainty about how the virus spread will eventually play out.

The usual forecasts in the NCAER quarterly economic reviews were therefore replaced by scenario based assessments. The overall NCAER assessment is a weighted aggregation of the detailed sub-sector level assessments of domain experts (Table 1). The overall assessment is that GDP declined in Q1 of 2020 by (−) 25% compared to Q1 of 2019–2020. This assessment is broadly consistent with other indicators of economic activity such as the Index of Industrial Production, electricity consumption, credit flow, etc. It is also consistent with the weekly Centre

for Monitoring the Indian Economy employment data which indicated a dramatic rise in the unemployment rate to around 24% through April–May even though the Labour Force Participation Rate (LFPR) had fallen sharply. There was considerable improvement in June after the lockdown was eased but the decline in the unemployment rate seemed to peter out in July.[2]

The NCAER assessment also assumed that the output decline compared to the corresponding period of 2019–2020 would gradually shrink through Q2 and Q3 to asymptotically approach the same output level in Q4 of 2020–2021 as in Q4 of 2019–2020, adding up to an overall decline of (−)12.4 per cent for the whole year 2020–2021 *in the absence of any fiscal or monetary stimulus to revive the economy.* However, this is by assumption counterfactual since in fact strong fiscal and monetary stimulus policies have been implemented or announced as discussed below.

4 Coronoavirus Shock and Stimulus Measures

Following the announcement of the so-called Rs. 20 trillion AtmaNirbhar Bharat stimulus package, there was widespread critical commentary by analysts that the package was mostly hype since it quickly became clear that the actual fiscal stimulus in the package was no more than 1.3 per cent of GDP.[3] The rest of it consisted of liquidity infusion on the monetary policy side, credit guarantee schemes, etc. This was an unfortunate mis-communication since much of the *fiscal* stimulus had already been introduced or announced prior to this package.

The total fiscal stimulus provided so far includes the Central Government budget deficit (3.5% GDP), post-budget additional borrowing (2.1% GDP), Atma Nirbhar Bharat fiscal component (2.2% GDP) and States' budget deficit (2.8% GDP), altogether adding up to about 10.6 per cent of GDP. If we count the additional borrowing headroom allowed for the States (2% GDP), the fiscal stimulus package would go up to 12.6% of GDP though it is unlikely that the states will fully utilise this extra headroom because of the strong conditionality attached to it. If we further add the off-budget borrowing of the central and state governments, the total public sector borrowing would go up to around 14–15 per cent of GDP.

However, even the most conservative estimate of 10.5 percent of GDP amounts to a huge fiscal stimulus. Taking into account the liquidity infusion measures on the monetary side, amounting to as much as 8.8 per cent of GDP, it has to be recoginsed that contrary to a pre-vailing perception the total policy stimulus to revive growth has actually been very large.

The question then arises how will these policy measures to stimulate aggregate demand play out in terms of reversing the impact of the Coronavirus lock down shock? The answer is contingent on how the supply response will evolve.

[2] Official estimates released by the government on 31 August 2020 indicate that the actual decline in GDP during Q1 of 2020 was 23.9%, remarkably close to our *ex ante* assessment.

[3] This has since gone up to 2.2 per cent of GDP at the time of this writing because of subsequent announcements of extended period of free extra rations up to November 2020, etc. This amount could further later in the year.

Table 2 QRE 2020:Q1 June Update, GDP policy simulation results with alternative supply response assumptions

Growth scenarios (GDP growth assumption due to supply disruptions)	Assumed GDP growth (%)	Model simulations		
		Inflation (%)	Fiscal deficit (as % of GDP)	Current account (as % of GDP)
Counterfactual scenario (no policy stimulus, expert judgments)	(−) 12.4[1]	4.5	6.4	1.4
Base case (stimulus + assuming no impact of supply disruptions)	1.33	5.46	7.6	2.8
Scenario 1 (stimulus, but supply disruptions limit GDP growth to 0%)	0	6.03	7.8	2.6
Scenario 2 (stimulus, but supply disruptions limit GDP growth to -2%)	− 2.0	6.44	7.8	2.3
Scenario 3 (stimulus, but supply disruptions limit GDP growth to − 5%)	− 5.0	6.71	7.6	1.8
Scenario 4 (stimulus, but supply disruptions limit GDP growth to − 10%)	− 10.0	7.78	7.4	1.1

[1]Minor differences between growth rates for GVA and GDP are being ignored

Source: Estimates using model from Bhanumurthy N R, S. Bose, and S. Satija, 2019. "Fiscal Policy, Devolution, and the Indian Economy". *NIPFP Working Paper* No. 287, https://nipfp.org.in/publications/working-papers/1883/. New Delhi, December

If there were no supply constraints, the large aggregate demand stimulus would translate to a 1.3% growth in overall GDP as shown in the base scenario of model simulations in Table 2. The corresponding headline inflation would be 5.5%, the combined fiscal deficit (centre + states) would be 7.6% of GDP, and the current account deficit would be 2.8% of GDP. However, this is a counterfactual scenario because we know that there were in fact very severe supply constraints following the lock down on account of the high mortality of medium and small enterprise during this period, the sharp increase in unemployment, the large-scale reverse migration of migrant labour and the massive disruption of supply chains.

The other scenarios in Table 2 represent different levels of supply response. Since the fiscal expenditure & monetary stimulus have been fixed as per policy in these model simulations, the variations in supply response are reflected in changes of the inflation rate and the current account deficit:GDP (CAD). The worst case (Scenario 4) is a 10% GDP decline, with about 8% inflation and only a 1% CAD because of the sharp drop in domestic absorption in this scenario. The best case (Scenario 1) with a very mild supply constraint is a zero decline in aggregate output, a 6% inflation rate and a 2.6% CAD because of the higher domestic absorption in this scenario. An important takeaway from this range of scenarios is that while inflation, the fiscal deficit and the current account deficit may all be somewhat elevated as they are unlikely to reach alarming levels under any scenario.

The actual outcome is likely to lie in this range, with the mostly likely outcome being a GDP decline of (−) 10% if there are no further stimulus measures. There

appears to be a wide convergence of views among analysts and researchers around this figure. But it has to be emphasised that at this point these are no more than informed guesses since no one knows how the spread of the virus will eventually play out. However, there is a remarkable consensus of views cutting across different schools of thought among economists, social scientists and others that massive public action is required at the central and state government levels to deal with the pandemic itself and the adverse humanitarian and economic consequences of the lockdown.

Such public action has to focus first of all on ramping up public health services. Doctors and nurses cannot be produced overnight but the stock of less skilled health workers to undertake simple tasks can indeed be scaled up very quickly. So can the supply of drugs, hospital beds, testing and health centres, personal protection equipment, and intensive care equipment such as ventilators and oxygen boosters. The second area of public action is food and income support. The government has been proactive in the provision of food support, free extra rations up to November, though a large section of citizens without ration cards have not had access to such support. In comparison, action on the income support front has been much weaker.

Despite the wide consensus among experts to provide such support, whether by ramping up existing targeted income support schemes or some form of universal basic income, the central government has been reluctant to take bold action on this front. This is puzzling since such humanitarian action would also maximise the multiplier effect of fiscal stimulation to revive the economy at the macroeconomic policy level.

Finally, it has to be emphasized that the action on the health and humanitarian fronts have to be taken by the state (and local) governments but these governments are faced with severe budget constraints, especially because of the revenue shortfall that has followed as a consequence of the recession of economic activity. In this situation, the central government has to play an enabling role, providing the necessary financial support or additional borrowing headroom, without strings attached, to empower the states to fight their Coronavirus battles simultaneously on multiple fronts.

Publisher's Note Springer Nature remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.