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The Indian economy in the post-pandemic world: Opportunities and Challenges

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Indira Gandhi Institute of Development Research, Mumbai
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Keywords: Pandemic, K-shaped recovery, Job creation, Structural challenges, Global uncertainty, Economic reforms.

JEL Code: E2, E5, E6, G2

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1. Introduction

It has been three years since the Covid-19 pandemic began spreading in India. By now the pandemic seems behind us. Even though the health shock seems over, the economic recovery from its impact has progressed at an uneven pace and in a haphazard manner. While the formal economy may have recovered from the shock the same perhaps cannot be said about the informal sector, which is also not adequately captured in the official data.

Over and above the pandemic there have been other shocks to the economic recovery in the form of severe supply chain bottlenecks triggered by the year-long land war in Europe between Russia and Ukraine, relapse of the pandemic in China and associated draconian restrictions imposed by their government on the movements of people as well as goods, and persistently high inflation in the Western economies of the US, UK and EU and consequent aggressive monetary tightening by the respective central banks. The most recent shock has manifested itself in the form of a banking sector turmoil in the US which started with the collapse of the Silicon Valley Bank in California. These global shocks have further aggravated the growth challenges facing the Indian economy even as it has been struggling to recover from the pandemic.

By some measures, large parts of the economy are back to the pre-pandemic levels of activity. However it is worthwhile to remember in this context that even before the pandemic the Indian economy was in a precarious state. There may have been structural challenges, cyclical factors as well as policy issues that may have jointly contributed to the slowing down of the economy in the run-up to the pandemic. This implies that even if the economy returns to the pre-pandemic levels, the longstanding challenges may make it difficult to achieve a high and sustainable growth rate which is essential if India wants to lift millions out of poverty, achieve a high income status and create jobs for the millions entering the workforce every year.

To add to the challenges, India is now facing a slowing global economy, a fragmented geopolitical environment, growing threat of climate change and the related uncertainties, increasing automation and its impact on the labour market, and potentially a protectionist world that is withdrawing from the uninterrupted globalisation that had created vast economic gains in the post-world war period.

In this study we first analyse what the medium term future looks like for the Indian economy in a post-pandemic world, both in the context of an uncertain global environment and also in the context of India's own structural problems. We then outline some of the structural challenges and opportunities for the Indian economy as it struggles to restore high growth in the post-pandemic period and highlight some of the factors that need urgent attention if India has to make a leap from middle to a high income country in the next few decades. The high growth will also help in increasing employment and reducing poverty.

We start by providing a brief description of how the economy was faring in the pre-pandemic period (Section 2) followed by a comprehensive analysis of how the pandemic affected various sectors of the economy and delineating the patterns of economy recovery from the shock (Section 3). We then move on to a broader discussion of the challenges and problems that might pose as obstacles in India's future growth trajectory and also throw some light on some of the important opportunities that policymakers need to be cognisant of (Section 4).

2. Pre-Pandemic economic conditions

In case of India the pandemic was even more of an acute and longer lasting shock compared to other affected countries, owing to the state the economy was in, in the pre-Covid-19 period. By the time the first Covid-19 case was reported in India, the economy had deteriorated significantly after

years of feeble performance. The pandemic compounded the existing problems of unemployment, low incomes, rural distress, malnutrition, and widespread inequality.

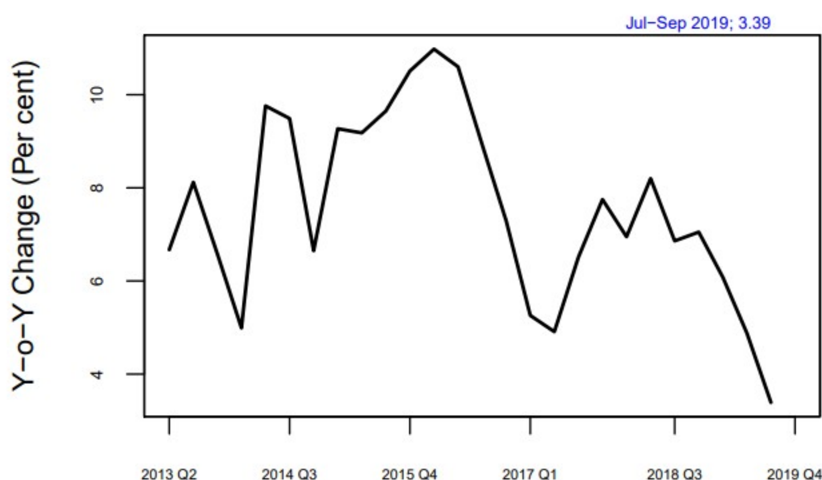
2.1 Aggregate macro conditions

As discussed in detail in Dev and Sengupta (2022a), real GDP (gross domestic product) growth rate had been on a downward trajectory since 2015-16 and by 2019-20, it had slowed down to 3.9%, the lowest level since 2002-03 (see Figure 1 for example). Unemployment reached a 45-year high increasing from 2.2% in 2011-12 to 6.1% in 2017-18.

A major driver of growth in any economy is investment by the private corporate sector. In the pre-Covid19 period, private sector investment had been declining. According to the official data, gross fixed capital formation (GFCF) as per cent of GDP declined from 34.3% in 2011-12 to 28.6% in 2019-20. In 2019-20, it grew (in real terms) only by 1.1% down from 11.2% in the previous year. Capex data from CMIE shows a similar picture of declining investment (see Figures 13a and 13b). Aggregate consumption expenditure (private and government) had also been falling, for the first time in several decades. Exports of goods and services contracted by 3.4% in 2019-20 after growing by 11.9% in the previous year; exports of goods alone contracted sharply by 6.1%.[3] In general, non-oil, non-gold exports were pretty much stagnant in the run-up to the pandemic (see Figure 4).

Some of the key macroeconomic parameters on the other hand were relatively stable with high reserves of foreign exchange and low inflation.

Figure 1: GVA growth at constant prices



Source: CMIE Economic Outlook. This graph shows non-agricultural, non-government GVA (gross value added) growth at constant prices.

2.2 Agriculture, informal sector and MSMEs

2.2.1 Agricultural sector: This sector is critical as a large number of workers and the entire country's population are dependent on it. The performance of agriculture is also key to the state of rural demand. In the pre-Covid-19 period, agricultural GDP experienced an average growth rate of 3.5% per year in the eight-year period from 2012-13 to 2019-20 with intermittent fluctuations.

[3] Data obtained from the Second Revised Estimates for 2020-21 released on February 28, 2023 by the MOSPI (Ministry of Statistics and Program Implementation). It may be noted that national accounts statistics in India especially GDP data are potentially fraught with measurement errors as detailed in multiple studies (see for example, Nagaraj et al (2020), Nagaraj and Srinivasan (2017), among others) and hence should be interpreted with caution. Wherever possible we have therefore supplemented this information with data from the private sector databases such as those published by the Centre for Monitoring Indian Economy (CMIE). All growth numbers are in constant prices (2011-12).

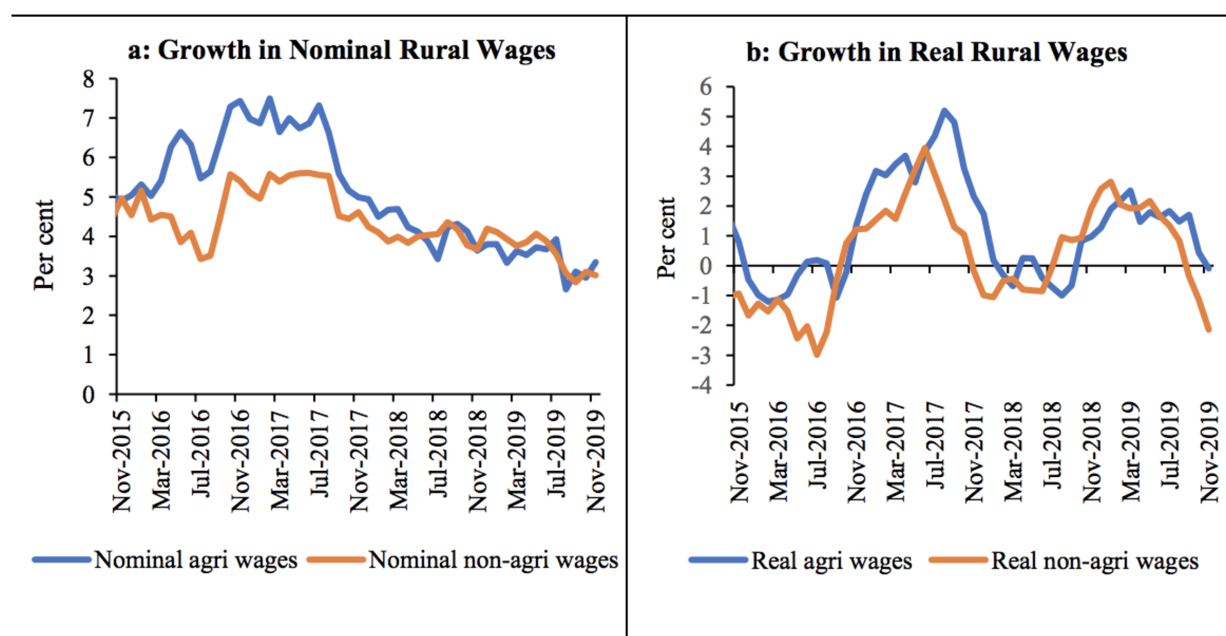
Table1: Growth Rates of GVA in Agriculture and allied Activities

Year	Growth Rates (%)
2012-13	1.5
2013-14	5.6
2014-15	-0.2
2015-16	0.6
2016-17	6.8
2017-18	6.6
2018-19	2.6
2019-20	4.3
Average growth rate during 2012-13 and 2019-20	3.48
Average growth rate during 2014-15 and 2019-20	3.45
Source: National Accounts Statistics	

However, the terms of trade moved against agriculture during 2016-17 to 2018-19 due to bumper crop and horticultural production which caused a decline in food prices. Terms of trade for agriculture improved in 2019-20 as the nominal agricultural GDP growth was 12.5% as compared to real growth of 4.3%.

Growth in rural wages was subdued in the pre-Covid-19 period, particularly for agricultural labour in both nominal and real terms, partly due to the slowdown in the construction sector (see Figure 2).

Figure 2: Growth in rural wages



Source: RBI (2020)

2.2.2 Informal sector

India has a vast informal sector, arguably the largest in the world, employing close to 90% of its working population and contributing more than 45% to its overall GDP. The share of informal employment in total employment is very high. The share, which includes agricultural workers, has declined marginally from 94% in 2004-05 to 91% in 2017-18 (see Table 2). Out of a total of 465 million workers, 422 million were informal workers in 2017-18. Even in non-farm sector (manufacturing and services), the share of informal workers was around 84% in the same year.

There are significant inequalities between informal and formal sector workers. The informal/unorganised workers do not have access to any social security benefits and also face uncertainty of work. Out of the total workers, the shares of self-employed, casual and regular workers respectively were 51.3%, 23.3%, and 23.4%. Most of the self-employed and casual employees are informal workers.

Table 2: Informal Employment: Number and Shares

	Total Employment (in millions)	Informal Employment (in millions)	% Share of Informal workers in total employment
2004-05	459.4	430.9	93.8
2011-12	474.2	436.6	92.5
2017-18	465.1	421.9	90.7

Source: Mehrotra and Parida (2019)

In the pre-Covid period, the informal sector was hit by two consecutive shocks in a short span of time, from 2016 to 2019. The first shock was Demonetisation in November 2016 when 86% of the cash in circulation in the economy became unusable overnight owing to a government decree, followed by the haphazard introduction of the Goods and Services tax in 2017.[4] With the Covid-19 outbreak, the already struggling informal sector was disproportionately affected (Ray and Subramanian, 2020).[5]

2.2.3 MSMEs

The micro, small and medium enterprises as a whole form a major chunk of manufacturing in India and play an important role in providing large scale employment. Recent annual reports on MSMEs indicate that the sector contributes around 30% of India's GDP, and based on conservative estimates, employs around 50% of industrial workers and contributes half of the overall exports. Over 98% of MSMEs can be classified as micro firms, and 94% remain unregistered with the government. Many of the micro enterprises are small, household-run businesses.

However, many aspects of government policy are at best scale neutral and do not explicitly take into consideration these enterprises. This sector also does not have access to adequate, timely and affordable institutional credit. More than 81% MSMEs are self-financed with only around 7% borrowing from formal institutions and government sources (Economic Census, 2013).

The MSMEs are present in manufacturing, trade and service sectors. Table 3 provides growth rates of industry-wise deployment of bank credit. It shows that growth of credit was either low or negative for the MSMEs. Demonetisation and GST also contributed to the poor performance of

[4] See: https://www.ideasforindia.in/topics/macroeconomics/a-macro-view-of-india-s-currency-ban.html and ideasforindia.in/topics/money-finance/a-monetary-economics-view-of-the-demonetisation.html

[5] See: https://www.ideasforindia.in/topics/macroeconomics/reviving-the-informal-sector-from-the-throes-of-demonetisation.html

MSMEs. The problems with the NBFC sector from 2018 onwards have further hampered credit allocation to this sector.

Table 3: Growth in Industry-wise Deployment of Bank Credit by Major Sectors (YoY, %)

Item	March-15	March-16	March-17	March-18	March-19	Nov-19#
Non-food Credit	8.6	9.1	8.4	8.4	12.3	7.2
Industry	5.6	2.7	-1.9	0.7	6.9	2.4
Micro & Small	9.1	-2.3	-0.5	0.9	0.7	-0.1
Medium	0.4	-7.8	-8.7	-1.1	2.6	-2.4
Large	5.3	4.2	-1.7	0.8	8.2	3.0
Textiles	-0.1	1.9	-4.6	6.9	-3.0	-6.1
Infrastructure	10.5	4.4	-6.1	-1.7	18.5	7.0

Source: Economic Survey 2019-20; # as on November 22, 2019

2.3 Formal sector

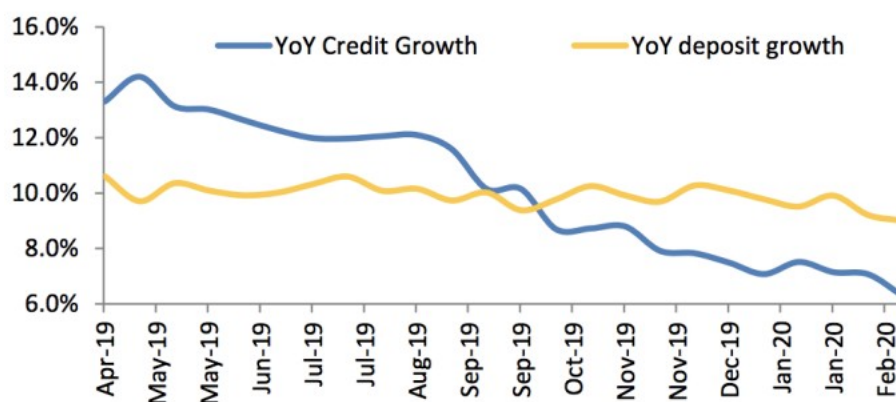
In the pre-pandemic period, one of the major problems that the Indian economy was grappling with was the Twin Balance Sheet (TBS) crisis. This manifested in the form of high levels of non-performing assets (NPAs) in the banking sector, especially in the inadequately capitalised public sector banks, and high levels of debt in large, financially stressed companies, particularly in the infrastructure sector (Sengupta and Vardhan, 2017, 2019).

The problems started from around the time of the Global Financial Crisis in 2008-09 when the world economy began slowing down and the spate of infrastructure projects that had been supported by a massive credit boom in the mid-2000s began to fail (Subramanian and Felman, 2019). The balance sheet stress in both the banking sector and the private corporate sector peaked in 2018 when gross NPAs reached a level of almost 14% of total loans. On the private corporate side, Credit Suisse reported that by early 2017, around 40% of the corporate debt monitored by it was owed by companies that had an interest coverage ratio of less than 1, meaning they did not earn enough to pay the interest obligations on their loans.

This TBS crisis triggered the introduction of the asset quality review (AQR) by RBI in 2016, which forced the banks to recognise stressed assets on their books. The banking sector’s response to this growing bad-loans crisis and to the series of steps taken by the government and the RBI to address the crisis was to avoid risks (Sengupta and Vardhan, 2020a) and curtail lending. And the private corporate sector’s response to the TBS crisis was to cut back investment spending, and start deleveraging (Vardhan, 2021).

The combination of an impaired banking sector and a cautious private corporate sector led to a drastic decline in the share of industrial credit (large firms and MSMEs) in total bank credit which fell from 44% in 2011 to 31% in 2020. In particular, credit off-take during 2019-20 was muted with non-food credit growth at 6.1% being less than half the growth of 14.4% of the previous year. This was the lowest growth rate of bank credit in nearly six decades (see Figure 3).

Figure 3: Credit and deposit growth of the banking sector (YoY)



Source: ICRA report

As the banking sector withdrew from lending, this gap in the commercial credit landscape to a large extent was filled up by non-banking finance companies (NBFCs). Between 2015-16 and 2019-20, the share of NBFCs and HFCs (housing finance companies) in institutional credit (i.e. credit from banks and non-bank financial institutions) increased from 20% to 27%, net of bank credit. This implies that some part of the shortfall in credit from the banking sector was compensated by flows of credit from NBFCs (Sengupta and Vardhan, 2022).

Almost at the peak of the NBFC credit boom, the Indian financial system received another major blow when a big NBFC named IL&FS (Infrastructure Leasing & Financial Services) defaulted on its debts in September 2018. This sent shockwaves through the banking system as well as the debt markets – the two biggest funding sources for the NBFC sector. This was followed by several other low-impact shocks in the financial sector. Bottom line is that by 2019-20, the credit landscape was in serious turmoil and credit being the engine of growth it is not surprising that all engines of growth were sputtering, particularly private investment.

Gross fixed capital formation (GFCF) growth, a measure of investment, turned negative in Q2 and Q3, 2019-20. Two key indicators of investment demand, production and imports of capital goods remained in contraction mode in January and February 2020 (RBI, 2020) before the pandemic hit India. Capacity utilisation in the manufacturing sector also declined below the long-term average in 2019-20. As shown in Figure 4, the profit margins of the firms in the private corporate sector were also stagnant in the pre-pandemic period.

3. Post-Pandemic economic conditions

3.1. Impact of Covid-19 pandemic

The Covid-19 pandemic was a huge shock that hit an arguably fragile Indian economy that was struggling on multiple aspects, as explained in the previous section, and impacted various segments of the economy. We discuss the impact and recovery from the pandemic in great detail in Dev and Sengupta (2022b) from March 2020 to February 2022.

When the pandemic began spreading in India in March 2020, the central government announced one of the largest and most stringent nationwide lockdowns in the world at the time (based on data from the Oxford COVID-19 Government Response Tracker) in order to contain the rapid spread of the contagious disease. The first wave peaked in mid-September 2020, and cases declined thereafter

till the end of the year. As the severity of the first wave of the pandemic began subsiding, many of the nationwide mobility restrictions were gradually relaxed starting June 2020.

In the summer of 2021 India was hit by a second wave of the pandemic, which peaked in May 2021, was more widespread, more severe, its geographic coverage was much greater and larger percentage of population was affected. This time around there was no nationwide lockdown; instead the lockdowns were regional and hence more scattered. Throughout the pandemic period, economic activity continued in stops and starts, depending on the heterogeneity in the geographical distribution of the Covid-19 cases as well as the extent and intensity of mobility restrictions imposed by the governments-both central and states.

Eventually the population gained herd immunity through the disease and also through mass vaccinations, but in the initial phases, at least till the second wave, uncertainty loomed large because of substantial delays in universal vaccination and threats from potential mutations of the virus. The severity of the pandemic began subsiding from September 2021 and despite a brief third wave in the Dec 2021-Jan 2022 period, by early 2022, the pandemic had mostly been brought under control in India, it had become endemic in nature and there were no further mobility restrictions. By April 2022, more than 60% of the population was fully vaccinated.

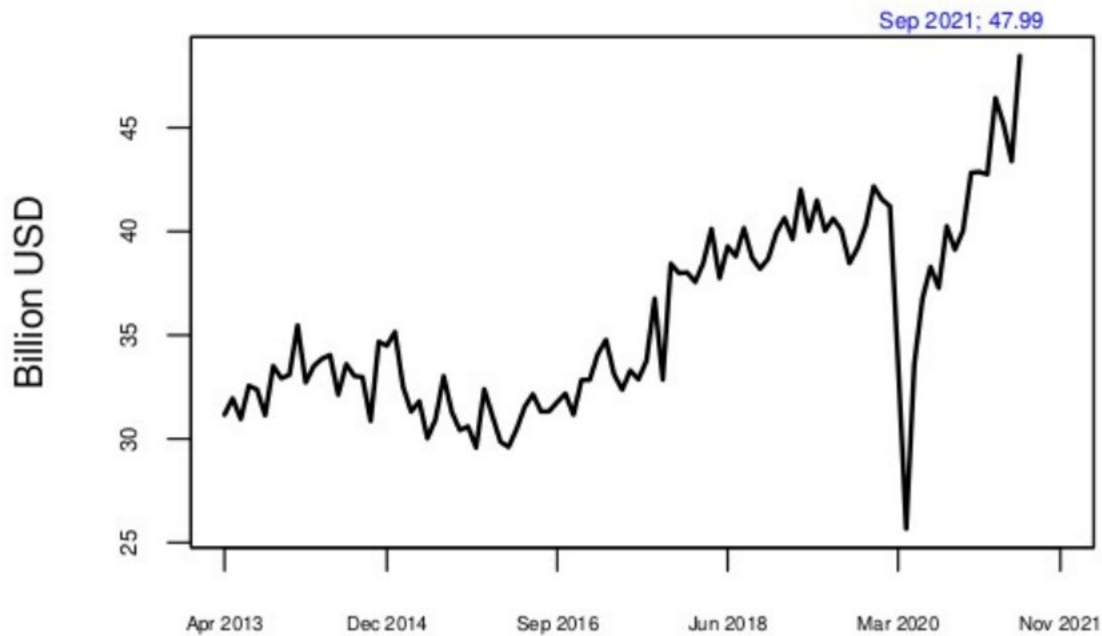
The pandemic arguably further compounded the pre-existing problems of the Indian economy especially, unemployment, depressed consumption demand, stagnating incomes, rural distress, stress in the informal sector and widespread inequality. According to official data, real GDP shrank by 5.8% in 2020-21, with the biggest contraction reported by contact-intensive sectors such as trade, transportation, hotels and restaurants i.e. primarily in the services sector. Among the components of aggregate demand, private sector consumption (in real terms) shrank on a year on year basis by 5.2%, gross fixed capital formation contracted similarly by 7.3% while exports of goods and services contracted by 9.1%. Clearly the pandemic was a severe, unprecedented shock for a slowing economy.[6]

From the middle of 2021, the economy, especially the formal sector, began recovering from this shock, primarily because of an unexpected boom in exports and also aided by the herd immunity of the population which allowed the services sector to resume activities. As the developed world came out of the pandemic and began opening up their respective economies, there was a tremendous surge in exports, especially merchandise exports, from India (see Figure 4). This contributed majorly to the recovery of the economy from the pandemic. The exports boom continued almost till the middle of 2022.

In general the formal sector seems to have fared much better than the vast informal sector, during the pandemic. While the informal sector and the MSMEs were already reeling under the previous shocks of demonetisation in 2016, the GST implementation in 2017 and the NBFC crisis in 2018, the formal sector firms who had experienced balance sheet stress during the TBS crisis, had begun cleaning up their balance sheets by the time the pandemic hit India. They had been deleveraging, new investment projects had not been taken up in a big way and also the Insolvency and Bankruptcy Code (IBC, 2016) aided the process of resolution of bad debts.

[6] Data obtained from the Second Revised Estimates for 2020-21 released on February 28, 2023 by the MOSPI.

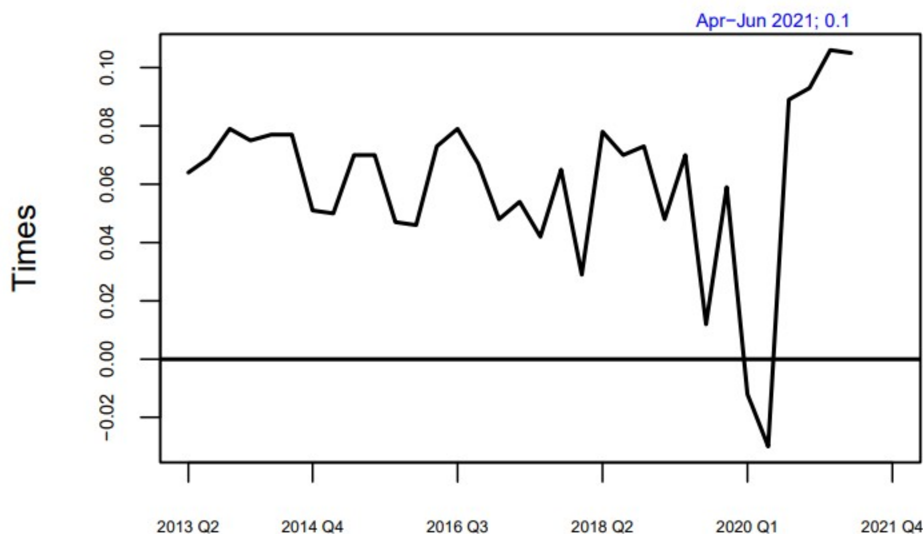
Figure 4: Non-oil, non-gold exports



Source: CMIE database

As a result, they were in a relatively better shape when the pandemic began spreading. So while the informal sector was disproportionately impacted by the pandemic not only because they were already struggling but also because they did not have the wherewithal to deal with such a big shock, it appears that the formal sector where the firms could also cut costs, gained market share at the expense of the vast majority of MSMEs when Covid-19 struck. This is demonstrated for example by the net profit margin of the listed companies which *increased* during the pandemic (see Figure 5).

Figure 5: Net profit margin of non-finance, non-oil listed companies



Source: CMIE database

Consequently, the manner in which economic recovery happened was heterogeneous and uneven led mostly by these large companies. This creates the impression that the recovery from the pandemic may have been K-shaped and the informal sector is yet to recover fully.

Real GDP grew by 9.1% in 2021-22 on a year-on-year basis fuelled by resumption of the services sector activities. Compared to 2020-21, construction grew by close to 15%, trade, hotels and transportation grew by nearly 14%, while manufacturing expanded by 11% (all in real terms).[7]

Since March 2022 the economy began facing serious headwinds from multiple quarters – an extremely volatile global environment causing unprecedented uncertainty. The land war in Europe and associated sanctions on Russia imposed by the western countries, China's zero-Covid restrictions amidst a resurgence of cases, developed countries such as the US, UK and EU nations experiencing the worst streak of inflation in four decades, forcing their respective central banks to aggressively raise interest rates – these simultaneous global shocks created widespread risk aversion, and imposed a drag on global economic growth. The IMF projected that global growth will fall from 3.4% in 2022 to 2.9% in 2023, much lower than the historical average of 3.8%. A fragmented geopolitical landscape and, persistent global macroeconomic uncertainty act as serious headwinds for the Indian economy's future growth trajectory.

By early 2023, it became clear that while large parts of the economy had gone back to pre-Covid levels of activity (interpreted as a sign of "recovery") in effect the economy had grown at barely 3-3.5% during the three years of the pandemic and recovery period i.e. from 2020-21 to 2022-23. The biggest challenge facing the Indian economy at the current juncture, therefore, is achieving a high, sustainable growth rate, and creating a sufficient number of jobs to absorb the millions of unemployed, amidst a highly volatile and uncertain global economic environment that is dealing with the repercussions of multiple adverse shocks.

And even as the world was coming to terms with certain levels of uncertainty triggered by the shocks of 2022, financial market turmoil unfolding in the US with the collapse of two mid-sized banks (Silicon Valley Bank and Signature Bank) and in the EU with the forced take over by UBS of Credit Suisse-one of the most systemically important banks at a global level, has sent renewed shockwaves across countries and, deepened fears of a financial contagion. India is unlikely to remain decoupled from the impact of this evolving crisis. In the event of more such bank failures the crisis is likely to further aggravate the headwinds for India's already weak medium-term growth prospects.

3.2 Aggregate macroeconomic conditions

3.2.1. Growth and Unemployment: Three years since the pandemic, the growth momentum of the Indian economy seems to be slowing down. The reopening of the economy in 2021, the revival of service sector activity as well as resurgence of merchandise exports helped fuel the recovery in 2021-22. However in 2022-23, additional global headwinds and, pre-existing weaknesses of the economy along with some potential scarring created by the pandemic have begun to act as a drag on growth.

Table 4 provides sector wise recovery of gross value added over the three years from FY20 to

[7] Data obtained from the First Revised Estimates for 2021-22 released on February 28, 2023 by the MOSPI.

FY23. It shows that GVA increased from Rs.132 lakh crore in FY20 to Rs.147 lakh crore in FY23 – a growth of roughly 3.7% per year. Agriculture has shown a growth rate of nearly 4% per year whereas mining recorded very low growth of less than 0.5%. Similarly, trade, hotels, transport and communications also registered a low growth rate of 1.4% per year.

Table 4: Sector wise recovery in Gross Value Added: 2022-23 over 2019-20

	2019-20 (Rs. Lakh crore)*	2022-23 (Rs. In Lakh crore)**	2022-23 over 2019-20 (Change in percent)	Average annual growth rate over three years 2019-20 to 2022-23
Agriculture, Forestry & fishing	19.94	22.21	11.38	3.8
Mining & Quarrying	3.17	3.21	1.26	0.4
Manufacturing	22.60	25.97	14.91	5.0
Electricity, gas, water supply & other utility services	3.01	3.45	14.62	4.9
Construction	10.44	12.32	18.01	6.0
Trade, hotels, transport, communication and services relating to broadcasting	26.9	28.05	4.28	1.4
Financial, real estate & professional services	28.99	33.11	14.21	4.7
Public administration, defense and other services	17.33	18.80	8.48	2.8
Aggregate Gross Value Added	132.36	147.13	11.16	3.7

*Third revised estimates
**Second advance estimates
Source: National Accounts Statistics, MOSPI

On the demand side, GDP increased from Rs.145.4 lakh crore in FY 20 to Rs.159.7 lakh crore - increase of 9.9% (see Table 5). In other words, growth rate in GDP was 3.3% per year during the three year period 2019-20 to 2022-23. Gross fixed capital formation grew at 6% while private final consumption expenditure recorded a growth rate of 4.4% during the same period. Exports and imports showed growth rates of 10% and 8% respectively. Government final consumption expenditure grew at the rate of 2.3% only.

Table 5: Components of Aggregate Demand: 2022-23 over 2019-20

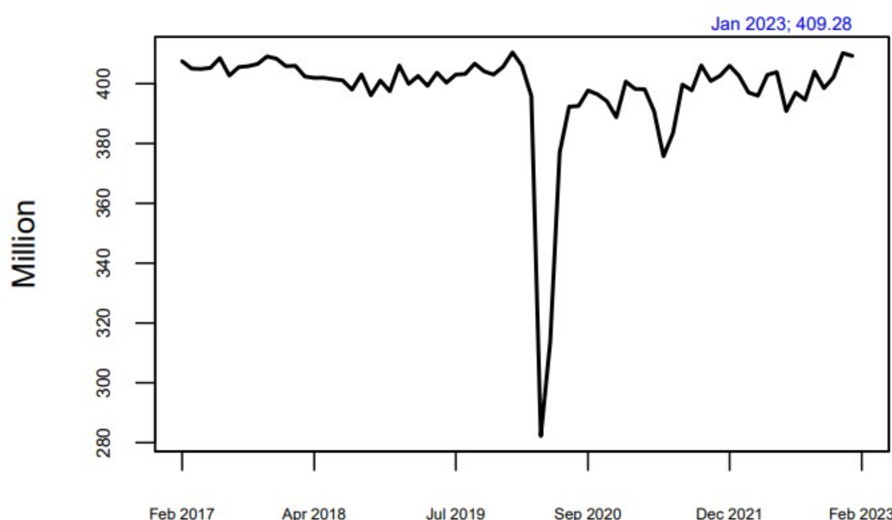
	2019-20 (Rs. Lakh crore)*	2022-23(Rs. Lakh crore)**	2022-23 over 2019-20 (change in per cent)	Average annual growth rate over three years 2019-20 to 2022-23
Private final consumer expenditure	82.56	93.42	13.15	4.4
Government final consumption Expenditure	14.92	15.95	6.9	2.3

Gross Fixed Capital Formation	45.93	54.26	18.1	6.0
Exports	28.14	36.86	30.99	10.3
Imports	33.22	41.51	25.0	8.3
Aggregate GDP	145.35	159.71	9.9	3.3
*Third revised estimates **Second advance estimates Source: National Accounts Statistics, MOSPI				

According to official statistics, in 2022-23 the Indian economy is scheduled to grow at 7% in real terms relative to 2021-22. While service sector and agriculture recovery/growth are expected to continue, manufacturing however is scheduled to grow by 0.6% as opposed to the 11.1% growth of last year.[8] In fact lacklustre performance of the manufacturing sector continues to be a serious concern for India. For the April-December period of 2022-23, the economy grew by 7.7%. Among various sectors, manufacturing grew only by 0.4% (on year on year basis) compared to 15.6% over the same period in 2021-22. Growth in construction sector, and mining also slowed down, while service sector, especially financial services exhibited relatively better performance.

Another crucial challenge facing the Indian economy now is related to job creation. Job creation has always been a major problem in India, and the pandemic has in all probability left permanent scars on the Indian labour market. A deeply worrisome piece of data in this context is the total number of persons working in the economy (across both formal and informal sectors). As estimated by the CMIE (using the Consumer Pyramids Households Survey or CPHS) this number has been roughly stagnant at 400 million since 2016. There has been no secular growth in the total employment. Once the shock of the pandemic subsided and the economy reopened, this number came back to around 400 million by early 2023 (see Figure 6).

Figure 6: Number of persons working



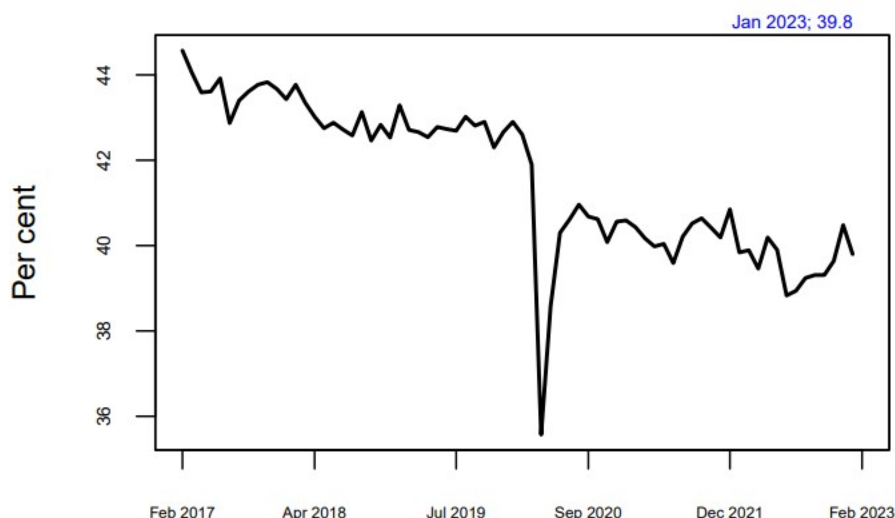
Source: CMIE CPHS database

Labour force participation rate (LFPR) was nearly 43% in the pre-pandemic quarter of October-December, 2019 and averaged 44% between March 2016 and March 2020. It recorded a sharp decline to 38.3% in the April-June quarter of 2020 during the first wave of the pandemic, and by January 2023 it had risen to merely 39.8% (see Figure 7), much below the pre-pandemic levels. In other words, the CMIE data, in general, shows that employment is yet to recover to the pre-

[8] Data obtained from the Second Advance Estimates for 2022-23 released on February 28, 2023 by the MOSPI.

pandemic level. The unemployment rate (see Table 10) looks almost similar across the two periods but given that many people left the labour force in the pandemic and post-pandemic periods, the true unemployment post-pandemic has been higher. This is clear evidence of deeper problems persisting in the economy.

Figure 7: Labour force participation rate



Source: CMIE CPHS data

Table 6: Labour Force Participation Rate and Unemployment Rate

Indicator	May-August 2019	September-December 2019	May-August 2022	September-December 2022
Labour Force Participate Rate(%)	42.85	42.71	39.17	39.51
Unemployment Rate (%)	7.46	7.52	7.43	7.47

Source: CMIE

This shows that there may have been some permanent damage from the pandemic. Moreover, given that the majority (85%) of the workers are in the informal sector and assuming the formal sector has been less affected from the overall numbers we can conclude that informal sector employment in particular is yet to recover from the pre-pandemic period.

The demand for MNREGA also provides some idea about the slow progress in employment generation in the overall economy. Table 7 shows that the average number of households employed under the MNREGA scheme in FY20 was 15.6 million; it has gone up to 18.1 million in FY23 so far, down from an average of 21.5 million in FY22. This implies that even after the pandemic has receded, enrolment under this scheme continues to be higher than the pre-pandemic level. Likewise the average number of person days generated in FY23 is higher than the pre-pandemic period.

While Table 7 shows the actual uptake of the employment under this scheme, Table 8 shows the demand for work. We find that the CAGR of average number of households as well as of persons demanding work under MNREGA is higher in FY23 compared to FY20.
Table 7: No. of Households Employed and Person Days Generated: FY20 to FY23

Months	No.of Households Employed (in millions)				No. of person days generated (in millions)			
	2019-20	2020-21	2021-22	2022-23	2019-20	2020-21	2021-22	2022-23
April	16.9	11.1	21.3	18.7	271.0	141.7	340.7	285.9
May	21.0	33.1	22.3	26.2	365.4	569.5	371.6	435.3
June	21.5	38.9	29.4	27.6	319.0	640.6	451.8	421.9
July	15.0	27.6	26.8	17.6	193.3	391.1	379.5	235.5
August	12.3	20.1	21.1	13.8	152.6	260.3	278.2	167.1
September	12.0	20.0	20.8	14.4	146.8	263.6	278.4	179.3
October	10.9	19.9	17.4	13.4	137.9	262.4	221.7	162.3
November	12.5	18.4	17.5	15.9	169.2	235.8	228.6	203.6
December	14.1	20.8	21.4	18.5	204.0	284.4	297.9	244.8
January	15.7	20.9	20.0	16.7	230.8	278.2	269.8	206.9
February	18.7	22.8	20.2	16.7	267.6	308.0	270.0	202.8
March	16.0	20.1	20.0	--	182.9	255.6	245.2	--

Source: MGNREGA, Ministry of Rural Development

Table 8: Demand for work by Households Persons under MGNREGA: FY20 to FY23

Months	Demand for work, No. of Households (in millions)				Demand for work, No. of Persons (in millions)			
	2019-20	2020-21	2021-22	2022-23	2019-20	2020-21	2021-22	2022-23
April	21.05	13.41	26.19	23.27	30.38	20.01	37.85	31.29
May	24.76	37.35	26.58	30.75	35.69	54.26	39.12	41.34
June	25.43	44.79	33.97	31.77	35.38	63.50	48.15	40.91
July	18.35	31.99	31.35	20.41	24.08	42.90	41.62	23.80
August	14.60	24.32	24.66	15.98	18.28	31.59	31.74	18.15
September	14.26	24.39	24.02	16.76	17.73	31.29	30.26	18.96
October	12.92	24.37	20.46	15.54	16.03	30.95	25.60	17.36
November	15.21	22.76	20.63	18.55	19.27	28.92	25.50	20.96
December	17.04	26.54	24.04	21.18	22.26	34.87	30.09	24.24
January	18.88	26.35	23.37	20.69	24.95	34.37	29.82	24.50
February	22.25	28.68	23.78	21.15	29.47	38.39	30.72	25.10
March	20.74	26.24	24.06	--	27.64	35.91	31.58	--

Source: MGNREGA, Ministry of Rural Development

All these point towards higher uptake of this scheme in the post-pandemic period, implying that there still aren't enough jobs in the informal sector to absorb these workers who are instead applying for the employment guarantee scheme. This in turn highlights the weak recovery of overall employment in the post-pandemic period.

Furthermore, trends in real wages reveal that rural areas are yet to recover from the stagnant/decline in real wages during the pandemic and pre-pandemic periods. Real wage growth declined sharply across all agricultural and non-agricultural operations in FY16-FY20 as compared to those of FY12-FY15 (see Table 9). Covid-19 worsened the trend of poor growth in rural farm and non-farm wages seen during FY16-20. Real wage growth was slightly above 1% in FY21 but it turned

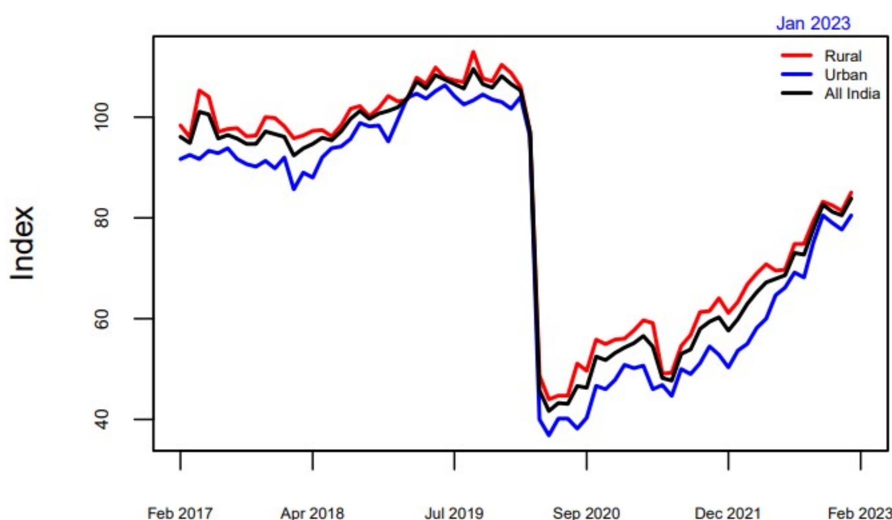
negative in FY22. In agricultural operations, real wages exhibited negative growth of 1% to 4% for different operations.

In the case of non-agricultural operations, it ranged from -0.3% to -3.2%. The Economic Survey (2023) also says nominal rural wages have increased at a steady positive rate during FY23 (till November 2022). However, the report also indicates that growth in real rural wages has been negative due to elevated inflation. It remains a matter of concern that real wages in rural areas have not recovered from low/negative growth in the pandemic and pre-pandemic period.

Table 9: Growth in Real wages for farm and non-farm activities in rural areas

Activities	FY12-FY15	FY16-FY20	FY2020-21	FY2021-22
	Real on-farm wage growth			
Sowing	10.6	1.3	0.1	-1.0
Ploughing/tilling	9.0	0.6	-0.7	-4.1
Harvesting/winnowing/ threshing	11.2	0.4	1.0	-1.3
Picking worker	6.0	1.7	1.3	-1.3
Animal husbandry worker	16.8	1.8	1.6	-2.0
	Real non-farm wage growth			
Carpenter	7.4	0.9	1.0	-3.1
Blacksmith	9.8	0.9	-0.3	-2.2
Mason	7.6	0.9	1.0	-3.2
LMV& tractor driver	10.1	0.6	0.2	-0.8
Non-farm labour	10.5	0.1	1.3	-2.6
Sweeper	14.8	0.8	1.8	-0.3
Source: Sinha and Pant (2022), India ratings and Research				

Figure 7: Index of consumer sentiment



Source: CMIE database

Data on consumer sentiment index compiled by the CMIE further underscore the possibility that recovery from the pandemic has been feeble at best (see Figure 7). Prior to the pandemic, the all

India index was roughly at 100; it dropped drastically during the lockdown of 2020 and since then, while it has been steadily going up, it still remains much below the pre-pandemic level.

3.2.2. Poverty trends

Poverty in India has been declining in the pre-pandemic period. The estimates of poverty based on the Tendulkar committee methodology shows that the number of poor came down by 137 million between 2004-05 and 2011-12 (GOI, 2009). The Rangarajan Committee also showed poverty declined between 2009-10 to 2011-12 (GOI, 2014). UNDP and Oxford multi-dimensional poverty (OPHI and University of Oxford, 2018) index shows poverty was almost halved between 2005-06 and 2015-16, climbing down to 27.5% (decline of poor by 271 million). It declined from 27.5% in 2015-16 to 16.4% in 2019-20.

Is there evidence of pro-poor growth in consumption? As Table 10 shows, the growth of per capita consumption has been higher for top deciles compared to the bottom deciles. But, the ratio between the two periods' growth is higher for bottom deciles.

Table 10: Decile-wise Growth in Per Capita Consumption (% per year, compound)

Decile	1993-94 to 2004-05		2004-05 to 2011-12	
	Rural	Urban	Rural	Urban
First Decile	0.70	0.66	2.91	2.96
Second Decile	0.49	0.54	3.00	3.28
Third Decile	0.56	0.66	3.15	3.39
Fourth Decile	0.55	0.91	3.17	3.42
Fifth Decile	0.54	1.00	3.17	3.41
Sixth Decile	0.55	1.24	3.30	3.35
Seventh Decile	0.52	1.36	3.40	3.30
Eighth Decile	0.61	1.35	3.45	3.40
Ninth Decile	0.71	1.47	3.48	3.45
Tenth Decile	1.61	2.30	3.71	4.52
Bottom Five Deciles	0.57	0.75	3.08	3.29
Top Five Deciles	0.80	1.54	3.47	3.60

Note: The growth rates are in real terms and derived from URP (universal reference period) consumption data. Source: Twelfth Five Year Plan, Planning Commission, Government of India.

We do not have official data on consumer expenditure after 2011-12. In the last one year there have been several studies on poverty using indirect methods and using CMIE, NSS and PLFS data sources. There have been extreme views on poverty trends in the post 2011-12 period. Using the 'leaked' data for 2017-18 Subramaniam (2019) shows poverty increased during 2011-12 and 2017-18. Bhalla et al (2022) present estimates of poverty and inequality for the period 2004-05 to 2020-21. According to them, the extreme poverty (ppp $ 1.9) was as low as 0.8% in the pre-pandemic year 2019.[9] Panagariya and More (2023) estimated poverty and inequality before and after Covid-19. They show that rural poverty continued to fall except in the strict lockdown quarter of April-June quarter of 2020. The rural poverty increased to 36.4% in April-June quarter 2020 from 33.50% in January-March quarter 2020. However, rural poverty continuously declined and it was 26.10% in April-June 2020-21. Urban poverty rose from 16.3% in January-March 2020 quarter to 20.20% in April-June 2020. It was around 21.50% in January-March quarter of 2020-21 but declined to 19.70% in April-June quarter of 2020-21. Another indicator for levels of living is real wages which we have discussed earlier. The growth rate of real wages between 2014-15 and 2021-22 was below 1 per cent per year across the board. The rate of growth was 0.9 per cent, 0.2 per cent and 0.3 per cent for agricultural labour, construction workers and non-agricultural labour respectively (Dreze,

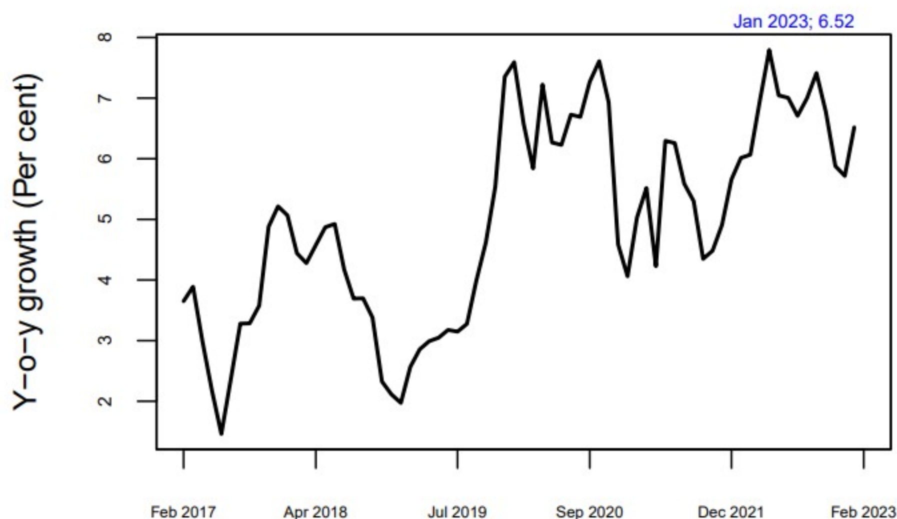
[9] Also see Roy et al (2022), Dreze and Somanchi (2023) on poverty estimates.

2023). Growth of real rural wages was 4% to 5% per annum when poverty declined faster during 2004-05 to 2011-12.

Our view is that in the post-2011-12 period, as the growth rate of GDP declined, the rate of decline in poverty must have slowed down. Policy makers must continue to follow the two-fold strategy of letting the economy grow rapidly and attacking poverty directly through poverty alleviation programmes.

3.2.3. Inflation: One problem that the Indian economy has been struggling to deal with throughout the pandemic and especially during the recovery period is inflation. The RBI has an inflation targeting mandate wherein it is supposed to maintain CPI inflation at 4% with a flexible band of +-2% around it. During the pandemic period from March 2020 to December 2021, headline CPI inflation averaged at roughly 5.8%. However between January 2022 and February 2023, the average inflation went up to 6.7%, well above the upper threshold of the RBI's tolerance band (see Figure 8).

Figure 8: Headline CPI inflation



Source: CMIE database

This was primarily due to supply chain bottlenecks triggered by the war in Europe and China's pandemic related lockdowns of 2022. WPI inflation, which is a proxy for inflation in the pipeline, also reached as high as 13%. Rising inflation in India also coincided with high and stubborn inflation in the developed economies of the US, UK and the EU.

Global food inflation also went up dramatically for many commodities due to supply chain constraints on one hand and significant increase in fiscal stimulus and injection of abundant global liquidity especially by the developed countries on the other hand which boosted aggregate demand. The FAO global food index increased significantly by 43% due to the Russia-Ukraine war in 2022. Similarly the prices of cereals and vegetal oils rose respectively by 54% and 88% in 2022. Although prices moderated in the last six months, the levels of food prices are still high at global level.

The RBI initially fell behind the curve and got delayed in responding to the rising inflation because it was arguably focusing on reviving growth as the economy was recovering from the shock of the pandemic. Subsequently it started raising the policy repo rate and tightened liquidity conditions (as reflected in the increase in the 91day T-bill rate in Figure 9). By March 2023, it has raised the repo rate by 2.5% starting from a pandemic low of 4%.

Figure 9: RBI's monetary policy

Source: CMIE database

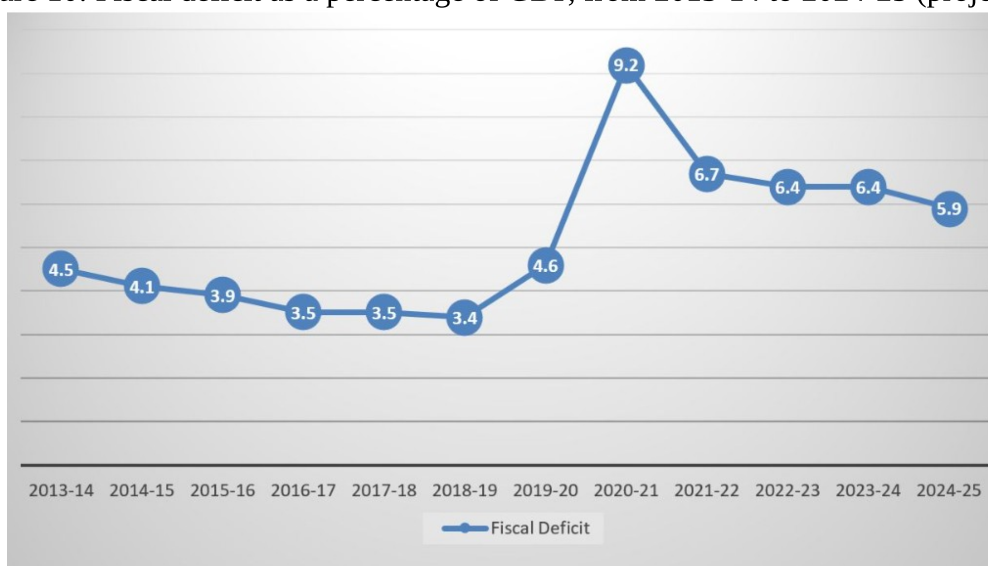
However inflation continues to hover around 6.5% and especially core inflation (non-food, non-fuel) has been highly persistent at around 6% for nearly 18 months now. This implies that inflationary pressures are deeply embedded within the system possibly because firms have been passing on the high input prices gradually given the weak demand conditions in the economy. Ironically CPI inflation is still high even though WPI inflation has significantly softened (to around 3-4%) because of the lowering of commodity prices as global supply constraints have eased up to a large extent by now. Given that the RBI's target is 4% CPI inflation, it may need to maintain a contractionary monetary policy stance for rest of this year in order to bring inflation down to the target. But this also means that monetary policy will act against growth over the medium-term.

3.2.4. Fiscal situation: On the fiscal front, as discussed in Sengupta (2023), in the pre-pandemic financial year of 2019-20, the fiscal deficit of the central government alone was more than 4.5% of GDP, much higher than the 3% medium-term target set by the Fiscal Responsibility and Budget Management (FRBM) Act. For several years the government has been struggling to spend within its means (see Figure 10).

During the pandemic period, the deficit shot up, first to 9.2% of GDP in 2020-21, and then to 6.9% in 2021-22. The consolidated central and state government deficits were as high as 13.3% and 10.2% of GDP in 2020-21 and 2021-22 respectively. Amidst slowing investment and exports, in response to the pressure to boost growth and create jobs, the government has increased its capex spending significantly in the last 3 years. Capital expenditure increased from Rs 5.93 lakh crore in 2021-22 to Rs 7.28 lakh crore (RE) in 2022-23 and to Rs. 10 lakh crore (BE) in 2023-24.

As a result of persistently high deficits, the total central and state government debt amounted to 84% of GDP in 2022-23: an uncomfortably high level compared to an average of 74% in the period from 2010-11 to 2019-20.

Figure 10: Fiscal deficit as a percentage of GDP, from 2013-14 to 2024-25 (projected)



Source: Kathuria (2023)

When the government presented the Union Budget for 2023-24, they adhered to the fiscal deficit target of 6.4% for 2022-23, and projected a fiscal deficit of 5.9% for 2023-24. While this has been widely appreciated as an attempt towards much needed fiscal consolidation, there has not been any clear and well-defined strategy that delineates how the government plans to bring fiscal deficit down to the announced target of less than 4.5% by 2025-26, which itself is on the higher side, given the FRBM target of 3%.

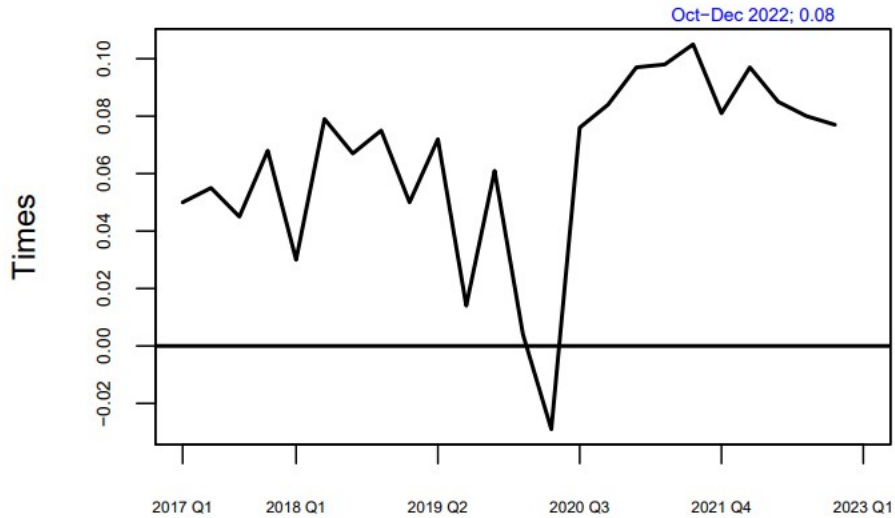
This implies that both on the monetary and fiscal aspects, the room left to manoeuvre policy in order to revive growth remains significantly limited.

3.3 Formal sector conditions

During the pandemic the large firms in the private corporate sector had benefitted by gaining market share, as explained in Section 2. In 2022, the multiple global shocks such as the Russia-Ukraine war and China’s strict lockdowns led to a renewal of supply chain bottlenecks which in turn pushed up prices of several important commodities such as crude oil, natural gas, fertilisers, wheat etc. The resultant increase in cost pressures squeezed the profit margins of the companies which began declining (see Figure 11).

Even as input prices began increasing, exports which had played a crucial role in facilitating the recovery of the economy from the pandemic stopped growing towards the later part of 2022, owing to global headwinds (see Figure 12). This too adversely impacted the performance of the corporate sector that had benefitted from the exports boom of 2021-22.

Figure 11: Net profit margin of listed, non-oil, non-financial firms



Source: CMIE database

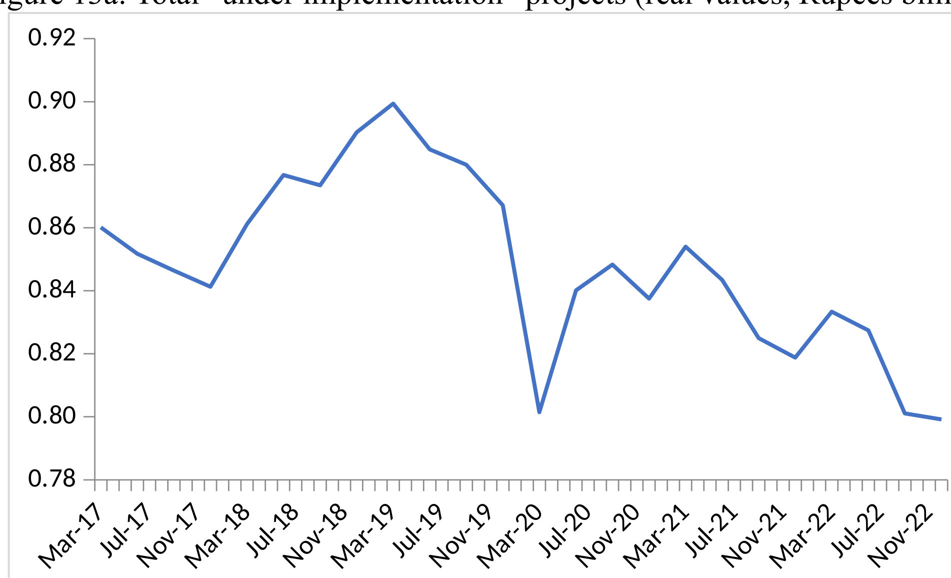
The slowdown of exports is also problematic because the other important driver of growth i.e. private sector investment has not picked up in a big way either and, the proverbial capex (capital expenditure) cycle continues to remain elusive. Figure 13a below shows the total, real value of all investment projects under implementation over the period from March 2017 to December 2022.[10] After the sharp decline in the lockdown period of 2020, projects under implementation picked up as the economy gradually reopened but started declining again roughly from March 2021 onwards. Projects under implementation act as a proxy for the general investment activity in the economy and as the figure shows, this remains sluggish.

Figure 12: Non-oil, non-gold exports

Source: CMIE database

[10] Nominal values have been converted into real by using consumer price index (CPI) of the corresponding quarter.

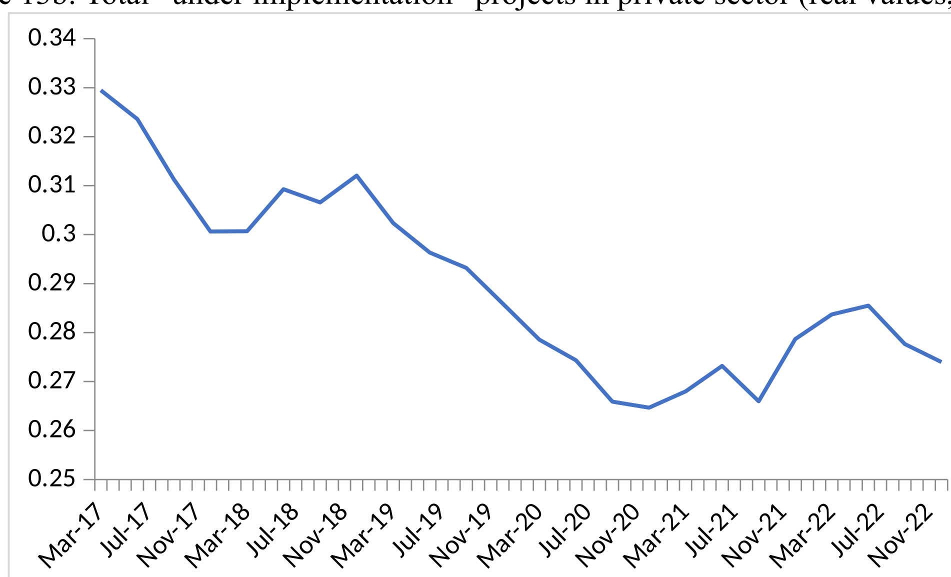
Figure 13a: Total “under implementation” projects (real values, Rupees billion)



Source: CMIE database.

Total “under implementation” projects (real terms) in the private sector (See Figure 13b) alone show a similar declining trend in recent times, after a brief uptick in 2021-22.

Figure 13b: Total “under implementation” projects in private sector (real values, Rs bn)



Source: CMIE database

Financial sector: As mentioned in the previous section, the pandemic hit the Indian economy at a time when the financial sector, and in particular the banking sector was dealing with secularly declining credit growth due to heightened risk aversion in banks as well as in large (commercial) borrowers after years of a series of balance sheet crises. The pandemic which was an unprecedented shock to the economy in general, dealt a further blow to credit growth and arguably worsened the risk aversion of the financial sector.

During the first year of the pandemic, credit growth from all sources slowed down. Bank credit growth almost halved from a CAGR of 11.3% in the previous decade to 5.6% -- the lowest in almost six decades (Sengupta and Vardhan, 2022). It recovered to 8.6% in the second year of the

pandemic. Also drastic was the decline in credit growth from NBFCs, from 25.5% to 15.1% in the first year followed by a contraction in the second year. The NBFCs were already struggling in the pre-pandemic period, as mentioned in the previous section, and the pandemic was yet another massive blow to their balance sheets. The bond market credit however grew at a steady rate of 11% during the pandemic (see Table 11).

Table 11: Growth (CAGR) of credit across sources, 2011-2022

Source	2011-2020	2020-2021	2021-2022	2011-2022
Bonds	15.5%	11.0%	11.2%	14.7%
Banks	11.3%	5.6%	8.6%	10.6%
NBFCs	25.5%	15.1%	-9.7%	20.9%
CPs	17.6%	5.8%	-3.3%	14.4%
ECB	15.6%	-3.6%	7.6%	13.0%
Total	12.9%	6.0%	8.2%	11.8%

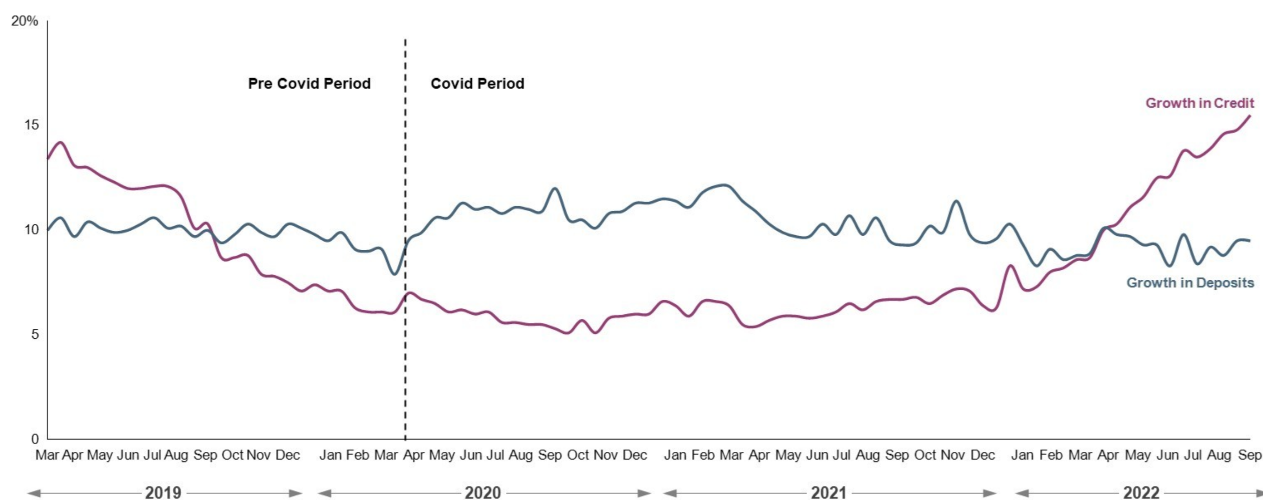
Source: Sengupta and Vardhan (2022).

By the second year of the pandemic, the health of the banking sector had improved substantially. This improvement in banks' financials primarily came about due to multiple rounds of capital infusion in public sector banks by the government, resolution of bad assets by the Insolvency and Bankruptcy Code (IBC), and also due to the decline in credit growth rate discussed earlier.

Two key indicators demonstrate the banking system's progress. Successive waves of recapitalization have given banks enough resources to write off most of their bad loans. As a result, they have been able to bring down their gross NPAs from 11% of total advances in 2017-18 to 5.9% in 2021-22. NPAs for industrial credit have been reduced even more dramatically, from 23% to 8.4%. Even after these large write-offs, most banks retain comfortable levels of capital.

This financial turnaround gave the banks the space to resume their business of extending credit. Since the pandemic period, credit growth has nearly doubled. In 2022 on average, bank credit growth was about 18% and bond market issuances were also strong. Deposit growth, on the other hand, remained muted at slightly below 10% (see Figure 14).

Figure 14: Year-on-year (YoY) credit and deposit growth of the banking sector



Source: Sengupta and Vardhan (2022)

The strong credit growth seems primarily driven by growth in unsecured consumer credit as well as home loans. Growth of credit to MSMEs remains strong on the back of the credit guarantee scheme which initiated by the government during the pandemic and extended several times since then (Dev and Sengupta, 2022b). There was also some uptick in credit demand due to capital expenditure in sectors such as renewable energy, logistics, etc. Government expenditure on infrastructure such as roads has also been creating demand for credit from EPC contractors and construction companies.

4. Opportunities and Challenges going forward

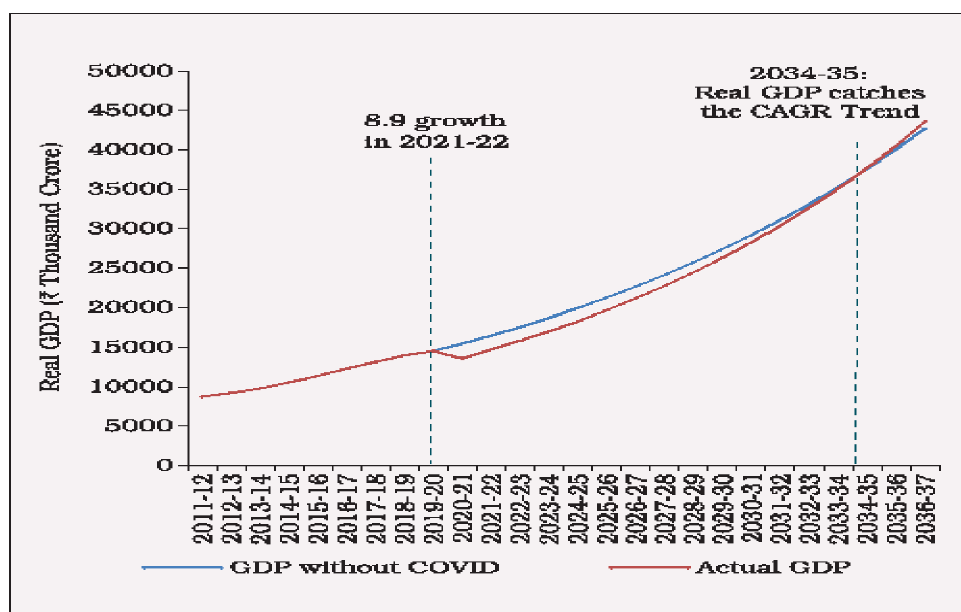
It is clear from the discussion so far that the macroeconomic fundamentals continue to be weak and now there are additional headwinds from the global economy given the renewal of uncertainty triggered by the financial market turmoil in the US.

A report of the Confederation of Indian Industry (CII) says that India's GDP can grow from the current \$3 trillion to \$5 trillion by 2026-27, to \$9 trillion by 2030 and to \$40 trillion by 2047 if its population is productively employed.

According to RBI (2022a): "*the pre-Covid trend growth rate works out to 6.6% (CAGR for FY13 to FY20) and excluding the slowdown years, it works out to 7.1% (CAGR for FY13 to FY17). Taking the actual growth rate of (-) 6.6% for FY21, 8.9% for FY22 and assuming growth rate of 7.2% for FY23, and 7.5% beyond that, India is expected to overcome Covid-19 losses by FY35. The output losses for individual years have been worked out to be Rs 19.1 lakh crore, Rs 17.1 lakh crore and Rs 16.4 lakh crore for FY21, FY22 and FY23, respectively*".

In other words it will take as many as 12 more years to overcome the loss of income due to the pandemic. Therefore, significant efforts are needed to improve growth in the medium to long term. Figure 15 depicts a medium term GDP path as projected by the RBI.

Figure 15: Medium term growth path



Source: RBI (2022a)

4.1. Short and medium term challenges

The growth rate of GDP for FY 2024 is expected to be around 7%. The RBI estimates 6.5% for FY24 while the IMF predicts 5.9% in the same year. India has to first take care of the short and medium term challenges such as high and entrenched inflation, twin deficit (current account, fiscal) and debt problems. Monetary and fiscal policies would need to be managed effectively in order to tackle these challenges in the context of growing global uncertainties. Rangarajan and Srivastava (2023) discuss the immediate growth prospects for the Indian economy. According to them, if fiscal stimulus in the form of capex continues, growth rate can come closer to that of RBI's prediction in FY24. If however revenue expenditure increases due to impending national elections, then growth is likely to be closer to 6%. A steady growth of 6% to 7% can be ensured in the medium term if fixed capital formation is raised by another 2 percentage points.

In addition to the scars left by the pandemic, what are the structural challenges that make India's growth story complicated? Against the background of two years of the pandemic, a fragmental geopolitical landscape and heightened global economic uncertainty, in this section we discuss the challenges and opportunities that the Indian economy is likely to face in the near future as well as longer term as it strives to achieve a sustained high growth rate and create new jobs. We also throw light on some of the important reforms and policy initiatives that must be implemented in order to achieve this objective.

4.2. Engines of growth

As discussed in the previous section, nearly three years after the pandemic the two main engines of growth—exports as well as private sector investment, are stuttering, similar to the immediate pre-pandemic period of 2019-20.

4.2.1. Investment: The government has also given a much needed capex push in its Union Budgets of 2022-23 and 2023-24, yet the translation of this into private investment is still not visible. Investment continues to be sluggish despite a sharp cut in corporate taxes introduced by the government in 2019. The persistent monetary policy tightening by the RBI in order to tame inflationary pressures might act as an additional drag on investment revival.

The gross fixed capital formation (GFCF) as percent of GDP increased from 27.3% in FY21 to 28.9% in FY22 and to 29.2% in FY23. It increased only marginally in FY23 as compared to 28.5% of FY20, the pre-pandemic year. For growth to increase it is imperative that the GFCF/GDP ratio goes up. What is required perhaps to unleash the animal spirits of the private sector is policy certainty, and creation of a level-playing field through government actions.

The Indian government has undertaken several structural reforms in recent times such as announcement of privatisation and asset monetisation, tax reforms (GST introduction and corporate tax rationalisation), the production linked incentive (PLI) scheme; insolvency and bankruptcy code (IBC) to improve the credit culture and resource allocation mechanism, labour reforms, and a fiscal policy focused on capex and infrastructure (RBI, 2022a). A lot more needs to be done on a sustained basis to create a conducive environment for private sector investment which in turn can create much needed jobs. Also attracting foreign companies to produce in India must be given a high priority now given that many of these companies are looking for alternatives to China and Russia. India needs to take full advantage of this opportunity.

4.2.2 Exports: The tepid economic recovery in FY22 was largely dependent on exports which grew exceptionally rapidly. However, as mentioned earlier, the growth rate of exports declined in FY23. Rising global interest rates, winding down of economic stimulus packages and consequent

slowdown in global growth will likely have a negative impact on India's trade activity going forward. Volatility in commodity prices and continued geopolitical tensions will make trade developments uncertain. If the US and Indian business cycles continue to diverge, meaning that US goes into a slow growth while Indian economy grows relatively faster, India's CAD will widen even more because exports will continue to slow down but the import bill may keep rising. The World Trade Organisation (WTO) has pegged the global trade growth at 1% for FY23, down from 3.4% amidst rising apprehensions about a global slowdown.

In recent times, services exports have picked up substantially as economies around the world have opened up fully after 2 years of the pandemic and this has been working in India's favour given that services exports are our strength. However this is likely to be a temporary development and will hit a plateau as global economy continues to slow down. Merchandise exports from India have already been contracting.

Economic theory suggests that in the face of adverse terms of trade shock, a weaker currency helps in expenditure switching towards higher exports and lower imports and hence improves the trade balance. Weaker exchange rate boosts non-oil exports and helps reduce non-oil imports by increasing the price of imports. Since the US Fed began tightening monetary policy in 2022, the US dollar has been appreciating and hence the Indian rupee has faced significant depreciation pressures. However the RBI has been intervening actively in the forex market to prevent the rupee from depreciating. It lost roughly $100 billion in 2022 in this endeavour. If the rupee fails to follow when other EM currencies are depreciating, then India's exports will lose competitiveness. Already, the rupee has appreciated significantly against other Asian currencies such as the South Korean won, the Thai baht and the Taiwanese dollar. If competitiveness is further eroded at a time when the global economic environment is turning difficult, export growth could really suffer.

In this context therefore, the RBI's attempts to prevent the rupee from depreciating, might not be the most suitable policy reaction. What is required instead is a real depreciation of the rupee; instead real effective exchange rate (REER) has been entirely flat in recent times.

From a more general and broader perspective, notwithstanding the ongoing slowdown in exports, the way international trade stands now might present a historic opportunity for India to join the club of great exporting nations. In 2022 China, the main export engine of the world had begun locking down its factories owing to a rapid resurgence of Covid-19 cases. This resulted in international firms scouting for new production locations. In fact several large corporations started operations in other Asian countries such as Vietnam etc., in order to de-risk from China. Even as China opens up now, this trend may continue as MNCs look to diversify their operations across multiple geographical locations in order to avoid over exposure to China. This is the so-called "China plus one" strategy, under which MNCs plan to build more of their new factories outside of China. Indeed geopolitical considerations will increasingly drive global commerce in the future.

On the other hand, Russia is still under tight economic sanctions imposed by the Western countries in the aftermath of its invasion of Ukraine. This implies that two large Asian countries are reducing their presence on the international trade landscape, thereby creating an unprecedented scope for India to attract international firms to produce and export from here. Moreover, geopolitical tensions between the US and China can also put India in a favourable position.

India also has a fast-growing young workforce, compared to China's shrinking and ageing labour force. The government's capex push has triggered a fair amount of infrastructure creation in the public sector. India also has world class public digital infrastructure which is facilitating innovation, productivity improvements and access to services. In a nutshell the country has tremendous potential to catch up on China whose economy is five times as big.

In order to take advantage of these opportunities, India needs a liberal, stable and consistent trade policy regime. Unfortunately government policies with respect to international trade have turned increasingly protectionist. Import tariffs have been going up since 2015. India's import tariff rates (MFN based average) increased from the lowest level of about 12% in 2008 to 15% in 2019. For the year 2018, China's import tariff rate was 9.6% compared to India's 13.5%. While 11.9% of the tariff lines had rates above 15% in 2010-11, that proportion has gone up to 25.4% in 2020-21.

As mentioned in Mitra (2023), in 2017 and 2018, India doubled its import duties on beauty aids, watches, toys, furniture, footwear, kites and candles all of which are produced in labour intensive industries taking advantage of India's vast pool of low-skilled labour but this was a clear acknowledgement of lack of competitiveness in these sectors. Import duties were also raised for electronics and communication devices and related inputs and parts which make it costlier to manufacture these items in India. There were further tariff increases in 2020 and 2021 on imports of electronics and automobile components, fabrics, agricultural products etc.
International trade today is entirely dependent on global value chains. Import duties especially on inputs hamper this process because they increase the cost of importing, thereby disrupting the production chain. Higher import duties convey to foreign firms that doing business in India is going to be costly and difficult for them.

The government has also been imposing bans and taxes on exports in order to deal with surging inflation. In 2022 they banned wheat exports, imposed an export duty on steel products at the rate of 15%, increased the export duty on iron ore from 30% to 50%, and imposed a 20% export duty on rice varieties commanding a 28-30% share of annual exports. While the government's bans and market interventions will do little to dent inflation, they are likely to damage growth by undermining exports.

India is also not part of the trade pillar of America's Indo-Pacific Economic Framework for Prosperity or the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. It also refused to join the RCEP and so far does not have any bilateral trade agreements with its principal trading partners such as the US and EU. As a result, the economy does not enjoy the full benefits of vigorous competition and the prices of some components are higher than on the global markets.

In order to compete with other peers such as Vietnam who are benefitting from the China+1 strategy perhaps more than India at the current juncture, Indian policymakers will need to make an explicit export-oriented push and signal to the world that the country is open for business. So far that has not happened but this is one of the biggest opportunities.

4.2.3 Other factors

Over and above harnessing the potential to export and reviving private sector investment, there are several other opportunities for India in the medium term to improve economic growth. A recent issue of the Economist magazine (Economist, 2022) says that as the pandemic recedes, four pillars are visible that might support growth in the next decade; (1) forging of a single national market through the GST; (2) an expansion of industry owing to the shift to renewable-energy, and a move in supply chains away from China (3) improvements in technology, IT services, and outsourcing industry; and (4) a high-tech, welfare safety-net for the hundreds of millions left behind by all this.

Moreover, India is on its way to becoming Asia's top financial technology (Fin Tech) hub with a staggering 87% Fin Tech adoption rate against the global average of 64%. The growth rate of Indian Payment systems like UPI (United Payments Interface) and Aadhar Enabled payment services (AePS) has been phenomenal. According to RBI (2022a), the long strides taken in the digital

finance arena need to be leveraged to promote growth. There are growing opportunities for new investment in areas like e-commerce, start-ups, renewables and supply chain logistics[11].

India's fast growing young workforce is another advantage which few countries enjoy in today's world. This alone can help India leapfrog to a high growth trajectory provided of course there are adequate and good quality education and skilling opportunities as well as meaningful employment options to absorb the youth.

4.2.4. Financial sector

Finance is the backbone of any economy. India being a bank dominated economy the strong credit growth revival in the post pandemic period (as discussed in the last section) is indeed a welcome news after a period of lacklustre credit growth. However, very little of this credit is going to large-scale industry or for financing investment. Lending to large industries has been stagnant in nominal terms during the last two years, implying that it has declined sharply in real terms, and there has been little lending for private sector investment. Over the last two years, bank lending to infrastructure has grown but this was fuelled mainly by public sector capex. Meanwhile, much of the lending to private industry has been in the form of working capital loans, necessitated by the increase in commodity prices, which has led to a sharp rise in the cost of holding inventories.

A big reason behind lacklustre growth of industrial credit is because private sector investment has been sluggish for nearly a decade and continues to be so now. Firms seem to have finally used up much of their spare capacity. But the fundamental problems that led to the difficulties of the past decade still have not been resolved. There is still no framework that will reduce the risk of private sector investment in infrastructure. Nor is there any reassurance for the banks that if problems do develop, they can be resolved expeditiously, since the Insolvency and Bankruptcy Code (IBC, 2016) has been plagued by delays and other problems. Now, heightened global macroeconomic uncertainty, growing geopolitical tensions and uncertain recovery prospects of the domestic economy are likely to make matters worse.

In fact in 2023, credit growth seems to be tapering off to some extent as aggregate demand in the economy has been slowing down. Additionally, the monetary contraction that is being implemented by the RBI to tackle inflation might also eventually dampen credit growth. To what extent the credit growth would decline and what impact the decline would have on economic output remains to be seen.

4.2.5 Policy levers

One of the important policy levers for boosting growth is to use the fiscal space to encourage demand. However, as already mentioned in the previous section, fiscal space in India is likely to remain limited in the foreseeable future. And if growth starts to slow down, this will make the task of fiscal consolidation even more challenging. Lowering the deficit and debt to more sustainable levels is imperative for ensuring macroeconomic stability which in turn is an important precondition for growth especially amidst growing global uncertainty.

As Table 12 shows the general government outstanding liabilities were less than 70% during the period from FY11 to FY18. But it accelerated to 89.4% in FY21. This is significantly higher than FRBM target of 60% and it is a risk for medium-term macroeconomic stability.

[11] See Srivastava (2023a) on how digital transformation will help accelerate growth.

Table 12: Fiscal Deficit and outstanding liabilities (% of GDP): Centre and States				
Year	Gross Fiscal Deficit		Outstanding Liabilities	
	Centre	States	Centre	States
2011-12	5.9	2.0	51.7	23.2
2012-13	4.9	2.0	51.0	22.6
2013-14	4.5	2.2	50.5	22.3
2014-15	4.1	2.6	50.1	22.0
2015-16	3.9	3.0	50.1	23.7
2016-17	3.5	3.5	48.4	25.1
2017-18	3.5	2.4	48.3	25.1
2018-19	3.4	2.4	48.5	25.3
2019-20	4.7	2.6	51.6	26.7
2020-21	9.2	4.2 (PA)	61.7	31.1 (PA)
2021-22	6.7 (RE)	3.5 (BE)	58.1 (RE)	29.4 (BE)
2022-23	6.4 (BE)	--	59.5 (BE)	--

PA: Provisional Accounts; RE: Revised Estimates; BE (Budget estimates)
Source: RBI (2022a), Annual Report 2021-22

At least for the next few years, fiscal policy has to follow the path of consolidation which implies that there is not much room to use this level for stimulating growth, even if aggregate demand starts to slow down. This will be a serious short to medium term challenge for Indian economy, especially given that monetary policy, the other important policy level, will need to remain focused on bringing the CPI inflation down to the RBI's target level of 4%.

The government has rightly been focusing on capital expenditure in the last three budgets. In August 2020 they also outlined an infrastructure project pipeline to be implemented over the next five years, which will serve as one of the key drivers of faster economic growth. Using the data on annual nominal growth in tax revenue, government expenditure and GDP for the period 1981-82 to 2019-20, RBI (2022a) estimates general government (centre+states) fiscal multipliers for total expenditure and its components (Table 13). The multiplier is more than one only for capital expenditure. It indicates that only capital expenditure leads to proportionately higher rise in GDP.

Table 13: Overall Fiscal Multipliers

	Impact Multiplier
Total Expenditure	0.72
Revenue Expenditure	0.79
Revenue Expenditure net of	
Payments and Subsidies	0.84
Capital Expenditure	1.32

Source: RBI (2022a)

At the same time there should be some balance between revenue and capital expenditure. Most of the expenditures on health and education are in revenue account. These expenditures on human capital should not be compromised. Fiscal consolidation must focus on raising tax revenue and as well as expenditure control. Tax/GDP ratio has to be improved by measures such as widening the tax base, removing exemptions and unproductive subsidies, further reforms in GST etc.

State Finances

Consolidation in state finances is equally important as they spend more than the centre. The state governments allocate, significant amount of funds to agriculture in their budgets. They spend 60% of the total government expenditure, 70% of education and health spending, and a larger share in public capital expenditure. Capital expenditure by States/UTs in India is more than two thirds of the total capital expenditure incurred by the general government. RBI released a report on 'State Finances: A Study of Budgets". Some of the findings of the report are the following.

1. In 2020-21, States' consolidated gross fiscal deficit (GFD) rose to 4.1 per cent of gross domestic product (GDP), from 2.6 per cent in 2019-20 (Table 14). The rise, however, was short-lived and a reversion to consolidation was done in 2021-22, as shown by the provisional accounts (PA) taking the GFD down to 2.8 per cent of GDP, as against the BE of 3.5 per cent and RE of 3.7 per cent for that year. This correction was brought about by higher than-expected growth in both tax and non-tax revenues. The revenue deficit also declined from 1.9% in FY 21 to 0.4% in FY22.

Table14: Key Deficit Indicators: 31 States and Union Territories

	2019-20	2020-21	2021-22 (PA)	2022-23 (BE)
Gross Fiscal Deficit	2.6	4.1	2.8	3.4
Revenue Deficit	0.6	1.9	0.4	0.3
Primary Deficit	0.9	2.1	1.1	1.6

PA: Provisional Accounts; BE: Budget Estimates
Source: RBI (2023)

2. Capital outlay of States showed a robust growth of 31.7 per cent in 2021-22 (PA). Strong growth in tax and non-tax revenues, coupled with advancement of payment by the Centre of tax devolution and GST compensation, provided the required fiscal space to accelerate capital expenditure. The consolidated capital outlay of the States is budgeted to grow by 38.4 per cent in 2022-23 (over 2021-22 PA). The capital outlay to GDP ratio is expected to improve from 2.3 per cent in 2021-22 (PA) to 2.9 per cent in 2022-23 (BE).

3. In 2021-22 (RE), the gross fiscal deficit was more than 4% of GSDP for 6 states: Bihar (11.4%), Assam (9.5%), Punjab (5.6%), Rajasthan (5.2%), Kerala (5.1%), Tamil Nadu (4.4%) (Table 15). Revenue deficit is also high in some of these states.

Table 15: State-wise Gross Fiscal Deficit and Revenue Deficit

States	2020-21		2021-22 (RE)		2022-23 (BE)	
	Revenue Deficit	Gross Fiscal Deficit	Revenue Deficit	Gross Fiscal Deficit	Revenue Deficit	Gross Fiscal Deficit
Andhra Pradesh	3.5	5.4	1.6	3.2	1.3	3.6

Assam	-0.4	3.3	1.0	9.5	-0.7	3.5
Bihar	1.9	5.1	5.5	11.4	-0.6	3.5
Chattisgarh	2.0	4.5	0.3	3.8	-0.2	3.3
Gujarat	1.4	2.5	0.0	1.5	0.0	1.7
Haryana	3.0	3.8	1.4	3.0	1.0	3.0
Himachal Pradesh	0.1	3.6	-0.2	4.0	2.0	5.0
Jharkhand	1.0	5.0	-0.1	3.2	-1.8	3.0
Karnataka	1.1	3.9	0.3	2.4	0.6	2.7
Kerala	3.2	5.1	3.5	5.1	2.3	3.9
Madhya Pradesh	1.9	5.1	0.5	3.7	0.3	4.0
Maharashtra	1.5	2.6	1.0	2.8	0.7	2.5
Odisha	-1.7	1.8	-3.3	0.4	-2.5	3.0
Punjab	3.2	4.2	3.6	5.6	2.0	3.7
Rajasthan	4.3	5.9	3.0	5.2	1.8	4.4
Tamil Nadu	3.4	5.2	2.7	4.4	2.2	4.1
Telangana	2.3	5.1	-0.4	3.9	-0.3	4.0
Uttar Pradesh	0.1	3.3	-1.2	4.0	-2.0	3.7
West Bengal	2.3	3.4	-2.1	3.5	1.7	3.6
All States/UTs	1.9	4.1	0.9	3.7	0.3	3.4

Source: RBI (2023)

4. States' debt to GDP ratio increased sharply at end-March 2021 to meet pandemic related expenditure. This ratio is estimated to decline slightly by end-March 2022 but is budgeted higher at 29.5 per cent by end-March 2023. At a disaggregated level, the ratio is expected to be higher than 25 per cent17 for 26 States and UTs at end-March 2023.

5. The fiscal health of States has rebounded from pandemic induced stress due to buoyant revenue collections and prudent expenditure management. Improvement in key deficit indicators has enabled States to reduce their outstanding liabilities.

6. The report cautions that a major risk for states is the likely reversion to the old pension scheme by some States. By postponing the current expenses to the future, States risk the accumulation of unfunded pension liabilities in the coming years.

7. It also indicates that all the States to continue with the current capex push, to sustain the quality of expenditure and maintain capital assets so that their longevity improves. In addition, States should also step-up capex in areas like research and development and green energy. Climate change is another area that deserves special attention in the coming years.

8. The report also suggests that state governments should set up Finance Commissions (SFC) in a regular and timely manner to decide on the assignment of taxes, fees and other revenues to local governments.

Freebies

Recently, there has been a lot of discussion on freebies given by the states.[12] To derive an estimate of freebies, RBI (2022f) collated data on major financial assistance/ cash transfers, utility subsidies, loan or fee waivers and interest free loans announced by the states in their latest budget speeches (i.e., for FY23). These estimates show that the expenditure on freebies range from 0.1-2.7% of the GSDP for different states (Table 15). The freebies as per cent of GSDP were more than 2 per cent for some of the highly indebted states such as Punjab and Andhra Pradesh (Table 16).

Table 16: Freebies Announced by the States in 2022-23

	(As a per cent of GSDP)	(As a per cent of Revenue Receipts)	(As a per cent of Own Tax Revenue)
Andhra Pradesh	2.1	14.1	30.3
Bihar	0.1	0.6	2.7
Haryana	0.1	0.6	0.9
Jharkhand	1.7	8.0	26.7
Kerala	0	0	0.1
Madhya Pradesh	1.6	10.8	28.8
Punjab*	2.7	17.8	45.4
Rajasthan	0.6	3.9	8.6
West Bengal	1.1	9.5	23.8

Note: Dhasmana, I. (2022). "Not all states are so financially weak that they can't announce freebies". Business Standard. April 2022.
Source: RBI (2022d) based on budget documents of the state governments.

The budgets may not give the entire picture of freebies as some of them happen off budget, beyond the pale of FRBM tracking (Subbarao, 2022).[13] The amount of freebies could be even higher if we take into account these extra-budgetary subsidies. Some kind of social protection measures for the poor and vulnerable groups, and informal workers are needed in any country. However, it should not be financed by increasing debt. Rangarajan (2022), suggests that overall fiscal support to such schemes should be limited to less than 10% of the total expenditure of the central government and state governments until their revenue to GDP or GSDP ratios are increased in a sustainable manner.

4.3. Structural transformation

One of the long standing challenges facing the Indian economy is structural transformation in agriculture, industry and services.

4.3.1 Reforms in Agriculture Sector: The Economic Survey (GOI, 2023) calls for the reorientation of agriculture due to challenges such as climate change, rising input costs, fragmented landholdings, suboptimal farm mechanisation, low productivity, and disguised unemployment. The Reserve Bank of India (RBI 2022b) report on currency and finance says that "the agriculture sector

[12] Singh, N.K. (2022), "Freebies are a passport to fiscal disasters", Indian Express, April 22, 2022 https://indianexpress.com/article/opinion/columns/freebies-are-a-passport-to-fiscal-disaster-7879244/;

[13] Subbarao, D (2022), "States, Freebies and the costs of fiscal profligacy", The Hindu, June 27, 2022, https://www.thehindu.com/opinion/lead/states-freebies-and-the-costs-of-fiscal-profligacy/article65573164.ece; Rangarajan, C. (2022), "Good and Bad Freebies", Indian Express, June 16, 2022.

suffers from low capital formation, declining R&D, low crop yields, inadequate crop diversity and intensity, with excessive dependence on subsidies and price support schemes."

There has been significant progress in the country's agricultural development since independence with a remarkable transformation from food scarcity to food self-sufficiency. However, the Green Revolution approach led to water logging, soil erosion, ground water depletion and unsustainability of agriculture. The policies today are still based on 'deficit' mind set of the 1960s. Also, the procurement, subsidies and water policies are biased towards rice and wheat. A change of narrative is required in Indian agriculture towards more diversified, high value production, better remunerative prices and farm incomes, marketing and trade reforms, high productivity with less inputs, less chemical and pesticide based production approaches, inclusive in terms of women and young farmers, small farmers, nutrition sensitive, and sustainable models (Dev (2023).

4.3.2. Industry and Services: In a larger context, structural transformation of the economy from agriculture towards manufacturing and services sectors can be of critical importance when it comes to generating employment opportunities. India's development trajectory so far stands out among other countries because the economy has transformed from agriculture to services bypassing the industrial route. However, there is a deep disconnect between the shares of GDP and shares of employment across sectors.

In terms of GDP, there has been structural change from agriculture to services but in terms of employment, agriculture is still the largest employer at 46% (Table 16). Moreover employment may have shifted over the years from agriculture to services to some extent but not adequately to manufacturing. Indeed, of particular concern is the inability of the Indian manufacturing sector to absorb labour. The share of manufacturing in employment was only 11% in 2019-20 (Table 17). This is problematic because getting absorbed in the services sector often requires specialised skills which the vast majority of the workforce may not possess. Therefore a widespread manufacturing push is much needed to generate millions of jobs[14].

There are two sources of productivity. One is productivity increase within sectors, and the other is shifting workers from low productivity sectors to high productivity sectors. India must focus on both sources to raise growth and employment. For the manufacturing sector, production Linked Incentive (PLI) schemes can improve performance. However, more efforts are required to improve the manufacturing sector.

Table 17: Share in Gross Value Added (GVA)and Employment 2019-20 (%)

	2019-20 share in GVA	2019-20 (%) share in employment
Agriculture and Allied Activities	15.0	45.6
Manufacturing	17.1	11.2
Construction	7.9	11.6
Industry (Secondary Sector)	29.7	23.7
Trade, Hotels and restaurants, transport, storage and communications	20.3	18.7
Financing, real estate, business services	21.9	3.1
Community, social personal services	13.1	8.9
Services (tertiary)	55.3	30.7
Non-agriculture	85.0	54.4
Total	100.0	100.0

[14] See Mitra (2023) for arguments in favour of manufacturing-fed and export-led growth.

Source: PLFS 2019-20 and National accounts Statistics		

Another view is that we should invest more in services sector as scope in manufacturing sector is limited for employment creation (Rajan and Lamba, 2023). There are indeed a lot of opportunities for India in the service sector. Brand and customer centricity are also important here (Dev, 2022). Growing startups including unicorns in manufacturing and services can also be part of this effort.

At the same time, both manufacturing and services have to be developed together. A study by Chanda (2017) deals with the interdependence between services and manufacturing sectors and argues that a vibrant service sector should be seen as an enabler for the manufacturing sector and not as a competitor to manufacturing. In its three year action plan (Niti Aayog, 2017) also indicates that India has the advantage of walking on two legs: manufacturing and services. It offers specific proposals for jumpstarting some of the key manufacturing and services sectors, including apparel, electronics, gems and jewellery, financial services, tourism and cultural industries and real estate. Among other things, it recommends the creation of a handful of Coastal Employment Zones, which may attract multinational firms in labour-intensive sectors away from China to India.

India has a major advantage of demographic dividend. However, it might soon become a liability if enough productive jobs are not created. And meaningful structural transformation is key to employment generation. According to the UN Population Statistics database, India will add another 183 million people to the working age group of 15-64 years between 2020 and 2050. Thus, a whopping 22% of the incremental global workforce over the next three decades will come from India. This further underscores the importance of creating productive employment opportunities which might however prove challenging especially now given the scarring of the pandemic.

A crucial element of this structural transformation is the role played by the MSMEs who form a major chunk of manufacturing and services in India and hence can play an important role in providing large scale employment and also reducing income, social and reduce regional disparities. Yet, many aspects of government policy are at best scale neutral and do not really favour the MSMEs. This sector does not get adequate, timely and affordable availability of institutional credit. The policies have to give a positive bias towards MSMEs so that they can be a driver for employment generation. Short and long-term initiatives are required specifically for the development of MSMEs.

4.2.3 Health and Education

Access to good health and education are essential for improving human capital. Yet India's progress on both these aspects leaves much to be desired. We also have great quality dichotomy in both these sectors. There are islands of excellence that can compete internationally in education while vast majority of them churn masses of children with poor learning achievements and unemployable graduates. One has to fix this dichotomy in heath and education.

Few years back, the Deputy Prime Minister of Singapore cautioned about school education in India. He said, "schools are the biggest crisis in India today and have been for a long time. Schools are the biggest gap between India and East Asia. And it is a crisis that cannot be justified".[15] Skill deficiency of workers is well known.

While promotion of technology and knowledge economy will add to growth, one cannot have 'demographic dividend' for growth with low human capital. Apart from enhancing productivity and boosting private investment, education and skill development will be the biggest enablers for

[15] First Lecture of Niti Aayog's 'Transforming India" initiative, August 26, 2016

achieving this dividend. In order to have structural change from agriculture to non-agriculture and from unorganised to organised, education and skill development are needed. Moreover, women's labour participation rates have been low. Raising women's human capital and participation rates need to be prioritised in order to improve economic growth.

4.3 Climate change

Climate change is now a serious challenge for India's long term growth. Reducing carbon emissions and accelerating energy transition is a challenge as well as an opportunity. In the recent COP20 meeting at Glasgow, Prime Minister Narendra Modi announced that India will aim to attain net zero emissions by 2070. Net zero, or becoming carbon neutral, means not adding to the amount of greenhouse gases in the atmosphere.

China has announced plans for carbon neutrality by 2060, while the US and EU aim to hit net zero by 2050. PM also announced that India will draw 50% of its consumed energy from renewable sources by 2030, and cut its carbon emissions by a billion tonnes by the same year. India wants commitments of developed countries on providing finance, transfer of technology and emission reductions due to historically high consumption patterns. Climate justice is another issue. Developed countries are historically responsible but rich in developing countries also have to pay for their consumption patterns.

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