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Economic Impact of COVID-19 on India and Recovery Potential

DR. DILIPKUMAR A. ODE
Assistant Professor, Department of Economics
C & S. H. Desai Arts & L. K. L. Doshi Commerce College, Balasinor (Gujarat), India
Shri Govind Guru University, Godhra, (Gujarat) India
Email - dilipode@yahoo.com

1. INTRODUCTION:

With the number of COVID-19 cases leaning dangerously more than 200,000 and the worldwide death toll crossing more than 8,000, the World Health Organization (WHO) declared the virus outbreak a pandemic in the second week of March 2020, four months after the novel virus first made headlines.

Nearly 162 countries are steadily going into lockdown, and businesses across the globe are operating in fear of an impending collapse of global financial markets. This situation, clubbed with sluggish economic growth in the previous year, especially in a developing country like India, is leading to extremely volatile market conditions. Let's understand how the coronavirus is impacting business and subsequent tax reforms in India.

With rising unemployment, interest rates, and fiscal deficit, the economy in India has seen better days. Adding fuel to this fire is the novel Coronavirus that is sending tremors down Indian trade markets dependent on China for imports.

2. Current Situation:

The first case of COVID-19 in India was reported on January 30, 2020. As of April 14, confirmed cases of COVID-19 stand at 10363. While 1035 patients have recovered, 339 have died.

Most of the cases in India are from local transmission, where people either travelled to COVID-19 infected countries, or came in contact with people who had travel history to these countries.

Government believes that the stage of community transmission of COVID-19 has, so far, been avoided by virtue of the steps taken.

The health ministry has said that as per a 'statistical rate of growth-based analysis' by the Indian Council of Medical Research (ICMR):

- Without a lockdown and containment measures, COVID-19 cases could spiral to 200,000 by April 11, and 820,000 by April 15.
- Without a lockdown but with containment measures, COVID-19 cases could spiral to 44,000 by April 11, and to 120,000 by April 15

At this time, the government is facing these immediate challenges:

- Building up the medical care facilities, even in the remote areas in the country to meet the rising number of COVID-19 cases in the event of an uncontrolled outbreak;
- Ensuring that the lockdown is implemented successfully throughout the country;
- Keeping the supply chains of essential commodities robust and to keep the 1.2 billion citizens fed; and
- Ensuring that the 450 million migrant workers rendered jobless by the lockdown and trudging on the country's highways to return to their villages are stopped in their tracks, and are housed, clothed and fed at shelters put up on the state borders.

Whilst armed with an arsenal of food grains reserve of 80 million tons and foreign exchange reserves of US$475 billion, the government is well equipped to deal with the situation. However, it is important that these resources are utilized in a prudent and effective manner to alleviate the situation.

The government has taken the following steps to prevent the spread of COVID-19 across the country:

- On March 25, the government invoked the Disaster Management Act, 2005 and imposed a 21-day nationwide lockdown to prevent the spread of COVID-19 until April 14. On April 14, Prime Minister Narendra Modi extended the nationwide lockdown until May 3. All districts, localities, and states will be closely monitored till April 20 to see how strictly lockdown guidelines have been implemented. States who do not let hotspots increase could be allowed to let some important activities resume and certain restrictions may be eased.
- All international flights are suspended, except for the ones that have been granted permission to evacuate foreign nationals. All existing visas, barring a few categories have been suspended till April 15.
- All domestic flights are suspended, except those carrying essential goods across the country.
- All bus, train, and metro services are suspended.
- State borders are sealed, inter-state movement within the country stopped.
- Camps have been set up at state borders to stop migrant workers walking back to their villages. According to the government, these camps are also providing workers with basic amenities such as shelter and food.
- Several states have identified COVID-19 hotspots, and have taken measures to seal and sanitize such high-risk zones.
- Dedicated COVID-19 quarantine sites have been set-up including hotels and railway wagons.
- 586 hospitals and 100,000 isolation beds designated exclusively for treatment and care of COVID-19 patients across the country. This number is continuously increasing with the measures being taken by the state governments and the health ministry.
- INR 1700 billion (US$24.3 billion) relief package in the form of food grains, cash transfers for the poor and vulnerable sections of the population announced to deal with the hardships caused due to the lockdown.
- INR 150 billion (US$2.14 billion) will be spent to set up isolation wards and intensive care units (ICUs), procure ventilators and personal protection equipment for medical professionals, and to train health workers to fight COVID-19.
- The finance ministry has extended several compliance deadlines under the various corporate, mercantile and taxation laws, and allowed individuals to make partial withdrawals from their provident fund accounts.
- PM-CARES fund launched to provide food and care to the poor. Donations being sought to augment resources for this fund.
- The Reserve Bank of India (RBI) has taken a number of steps to ease the stress caused by COVID-19. This includes ease in interest rates, relaxation of cash reserve ratio, and other liquidity improvement measures such as moratorium on repayment of loans by businesses and EMIs by individual borrowers.
- Aarogya Setu App has been launched by the government to disseminate information related to COVID-19 and to provide a platform for the population to reach out to the government.

Meanwhile, Asian Development Bank is working on a US$2.2 billion relief package for India to help the country combat COVID-19.

3. Economic Impact:

The Indian economy was, as it is, going through a sluggish phase ever since demonetization and GST was implemented. GDP forecast for 2019-20 was revised downwards from an optimistic seven percent to 5.4 percent. In view of this, the government had announced deep tax cuts for businesses in August 2019 to bring the economy back on track. The impact of these initiatives were seen in an uptick in the Purchase Managers Index (PMI) and Manufacturing Index for January and February 2020.

However, COVID-19 has put paid to all hopes of revival of the Economy in the near term.

- Amidst nationwide lockdown, the country’s growth is estimated to have dipped below 5 percent for FY 2019-20.
- Around 400 million workers employed in the informal economy are at risk of falling deeper into poverty during this crisis, as per a report by International Labor Organization. According to the estimates by Centre for Monitoring Indian Economy (CMIE), unemployment has risen from 8.4 percent in the week that ended on March 22 to 23.4 percent as of the week that ended on April 5.
- Bombay Stock Exchange Sensex fell from 40,363 points on February 24 to 25,981 points on March 23, it has now recovered to 31159 as on April 9. The valuations look attractive and unless another shock rattles the market, this is a good time to start making cautious and calibrated investments.

4. Sector Wise Impact:

i. **Agriculture** – The nationwide lockdown has left farmers across the country bereft of agricultural labor just before the crucial harvesting season. Farmers also worry about government procurement and their ability to sell their crops, given that many agricultural markets are still closed, despite orders from the home ministry to exempt all farming activities from the shutdown. Unless the government acts soon, farmers in India will face a bleak future leading to bankruptcies and farmer suicides. This will severely dent India's ability to revive its economy since there will be a sharp decline in consumption in the rural sectors leading to impairment of the industrial activity.

ii. **Textile** – Production halts in China and lockdown in India have had an impact. Mainly because of dependence on China for textile raw materials including synthetic yarn, synthetic fabric, buttons, zippers, and hangers. India also exports cotton yarn to China in bulk quantity, and poor demand in China has caused cotton prices to come down in India.

iii. **Apparel** – Payment of at least US$2 billion is stuck with foreign buyers because of deferment or cancellation of orders. Closure of retail stores across the country is also adding to losses.

iv. **Automotive** – The sector was already witnessing a sluggish demand for the last one year. The present situation has further aggravated the problem and compounded the situation with an acute liquidity crunch. China accounts for 27 percent of India's automotive part imports. With Wuhan being a major auto hub, the supply chain of the automotive sector has been hit significantly.

v. **Aviation** – With global travel is suspended, airlines are looking at bankruptcy. It is possible that the government might bail the aviation sector in the near future.

vi. **Hotels and restaurants** – Demand has declined substantially with owners struggling to recover the fixed costs. Pre-lockdown, hotel occupancy rates of 70 percent declined to 20 percent with restaurants losing 30 to 35 percent of their business.

vii. **Poultry** – Untrue claims regarding transmission of COVID-19 through chicken and other meat have impacted the sales and price of poultry items. Sector is facing a loss in the range of US$20 million every day.

viii. **Chemicals** – Dependence on China for active ingredients and shortage of essential chemicals amidst the lockdown has resulted in a reduced production of organic and inorganic chemicals across India.

ix. **Consumer durables** – Electronic appliances are experiencing a slowdown due to lack of demand, reduced economic activity, and supply chain dependencies with China and other impacted countries. India imports around 50 percent of its completely built units of consumer durables from China.

x. **Entertainment and sports** – Places of gathering like cinema halls and malls have been closed. Promotional and sport events are also being called off. One of the major cricketing events in the country – Indian Premier League (IPL) has been deferred for the time being – its cancellation can alone mean a loss of at least US$500 million for the organizing body.

xi. **FMCG** – After the lockdown announcement, demand for essential FMCG products spiked up owing to hoarding and panic buying by consumers. Grocery items, milk, and hygiene products have seen a surge in demand while supply chain constraints have limited the manufacturing capacities.

xii. **Pharmaceuticals** – As per Trade Promotion Council of India, the country imports around 85 percent of its total requirement of active pharmaceutical ingredients (APIs) from China. Dependencies on China have impacted manufacturing operations in India. However, demand for essential medicines and safety equipment has gone up. Government has restricted the export of certain medicines and pharma products and is monitoring the overall inventory on regular basis.

xiii. **E-commerce** – Several e-commerce players are unable to service existing orders and are not accepting new orders, even when there is a surge in demand for home delivery. However, companies are trying to service essential items on priority basis.

xiv. **IT and ITeS** – Slowdown in markets have reduced the influx of IT projects from international markets. Remote working has given rise in demand for communication tools, conference platforms, and cyber security apps, among others. These software tools are being used across sectors such as education, finance, and HR to ensure business continuity.

5. Potential Recovery:

The Investment bank, Goldman Sachs, expects a strong sequential recovery in India in the second half of the fiscal year. The Economist Intelligence Unit has forecasted the GDP growth rate for 2020-21 for India* at 2.1 percent when compared with China at 1 percent, and the US at -2.8 percent.

- S&P Global Ratings has forecasted the GDP growth rate for 2020-21 for India at 3.5 percent, China at 2.9 percent, and -1.3 percent for the US.
- Former RBI governor Raghuram Rajan says that recovery will vary from industry to industry. It can be a U shaped (slow comeback) or V shaped (sharp rapid growth) recovery curve depending on how organizations reform their work practices and the change in consumption pattern of consumers post lockdown.

India's management of the COVID-19 outbreak has been closely watched and appreciated by WHO, UN, IMF ADB and also the advanced economies like the US, UK, Italy, Germany, Spain, Japan.

The post-COVID-19 world is going to look quite different from what it has been so far. The 'advanced economies' will have to come to terms with their fragility and inability to cope and manage the outbreak. Also, investors will look for viable, lucrative, and dependable avenues of investment.

A comparison with China will show India as a better investment bet, however, India will have to demonstrate its ability to deal with the resultant economic situation in the post-COVID-19 scenario.

- Immediate and urgent steps are needed to harvest crops and secure the farmers. The government is allocating transport and other logistical support to move the crops from the fields directly to the warehouses with the help of the private sector.
- It is likely that India may run into a mild current account surplus in FY 2021 with declining oil prices. This will be a positive contributor to the macroeconomic stability of the country.
- Government needs to ensure that all the measures and stimulus packages which are doled out during the outbreak are utilized effectively. This will contribute towards minimizing the damage to the economy by reducing the impact on the fiscal deficit. Such an approach will inspire confidence in foreign investors who will, then, not hesitate to invest in the country.
- The banking and financial services sector has been in a bad shape owing to high levels of non-performing asset (NPA) accumulated over the preceding years. In the past the government has had to bail out the banks and non-banking financial companies (NBFC) in order to keep them afloat. It is likely that post-COVID-19 the banks and NBFCs will face the brunt of a surge in NPAs owing to business failures and defaults by individual borrowers due to job losses. The government will have to adopt a strategy to deal with this situation to ensure that the banking system does not collapse.
- Banks should be encouraged to support viable businesses and allow closures of the non-viable ones.
- Flexibility will have to be adopted in restructuring loan and EMI payments.
- Recapitalize viable banks and strengthen their balance sheets to make them viable and dependable. These measures were already on the cards prior to the COVID-19 outbreak.
- Government should work with banks, NBFCs, insurance companies, and large corporates for lending purposes and increasing the liquidity in the market.
- Large corporates can support the vendors in their supply chain by giving them financial support.
- Sectors directly and immediately impacted by the lockdown may face bankruptcy and closures unless the government gives relief and relaxations, allowing them to recoup their losses and recover.
- Automotive industry – As per a report by Fitch Solutions, vehicle production in India is likely to go down by a further 8.3 percent in 2020 following an estimated 13.2 percent decline in 2019. Demand will remain sluggish in medium term with postponement of purchase decision and uncertainty surrounding the demand of commercial vehicles. So, liquidity support, reduced interest rates moratorium on loans, and reduction in GST rates could be some of the measures on the cards to revive this sector quickly and generate employment. This sector may also see enhanced foreign investment particularly in auto components and parts.
- Consumer Durables – This sector is likely to pick-up sooner than automotive since consumers are likely to restart spending with smaller doses of expenditure on white and brown goods such as televisions, air conditioners, and refrigerators to name a few.
- FMCG – FMCG is already facing supply chain constraints due to the lockdown. Once things are normalized, it is expected that this sector will be the first to expand capacities. The FMCG sector could also see an increase in foreign investment in order to take advantage of the burgeoning demand in India.
- Pharmaceuticals – Supply chain management and price control are the challenges faced by this sector. R&D is likely to receive a boost. Reduction in dependence on China is to be expected for APIs. Government may mandate minimum capacity installation for certain critical drugs.

- E-Commerce – There has been surge in orders for e-commerce companies as people may prefer contactless, home deliveries. Government may encourage and facilitate e-commerce operations to minimize the risk of COVID-19. This could essentially mean employment opportunities in logistics sector with improvisations in distribution mechanisms. It may also prompt small scale players to go online.
- IT and ITeS – If Indian IT and ITeS companies are able to provide uninterrupted services to clients in the US and Europe during this time, then in the post-COVID-19 situation they will be secure and continue to flourish. However, if there is a breakdown in delivery of service at this time, then the overseas clients are likely to set up their own infrastructure to meet their demand for these services. IT companies providing software and ITeS to severely impacted sectors such as hospitality, aviation, and automotive sector are likely to see a cut in their existing business. However, due to headwinds of COVID-19 outbreak, digital is likely to see a push with adoption of cloud computing services, cyber security, process automation, remote working, and digital payment services.

COVID-19 outbreak has dealt a blow to the global economy but as the situation stands, it seems like the course of economic recovery for India will be faster than several other advanced economies. It is likely that India will come out as a viable and dependable destination for foreign investors.

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