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Recovery, Resilience, and Adaptation: India From 2020 to 2030

Rajesh Bansal, Anirudh Burman, Rudra Chaudhuri, Tarunima Prabhakar, Srinath Raghavan, and Suyash Rai

CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

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Summary

The coronavirus pandemic has exacerbated existing geoeconomic, geopolitical, and strategic fault lines. Albeit widespread, the coronavirus has impacted countries differently, which are differentially equipped to deal with its consequences. While developed economies can afford to prioritize surviving the pandemic and getting back to pre-pandemic living standards, emerging economies like India must treat recovery as a necessary opportunity to remedy the long-standing problems with their economies. If left untreated, these problems could precipitate into other crises and might keep India from capitalizing on opportunities that lie outside its borders.

The following text is a framing note. It is not a research paper in the conventional sense. We present Carnegie India's view on the challenges that India faces at this critical moment in world affairs, and outline a framework for India to tide over the current crisis (recovery), invest in institutions and structures for the future (resilience), and thrive in the following decade in a world that is unlikely to resemble the previous ten years (adaptation).

To address the deeply entrenched issues in its economy, India must prioritize:

- strengthening its laws and institutions that govern bankruptcy resolutions of firms;

- developing a suitable medium-term fiscal strategy, thereby building resilience in fiscal management and adaptation in the coming years;

- reviving private investments by improving state-capital relations and easing binding constraints on productivity; and

- increasing procedural transparency and effective grievance redressal mechanisms to ensure greater support for and adoption of digital transformation.

To deal with challenges across the short, medium, and long term, India's domestic economy needs to be tied to its external engagements. In the post-pandemic world, ensuring external stability will be essential to building resilience at home. Our key recommendations are predicated upon a world of shifting integrated geoeconomic, geopolitical, and strategic balances. Given the right policies, this may serve as an opportunity for India. We recommend that India:

- Balance its lopsided economic relationship with China and recalibrate its engagement with other Asian states. Playing a stronger role in developing South Asia and having a clearly defined Indo-Pacific strategy will help India safeguard its interests.

- Consider emerging as a viable alternative for firms relocating from China. Given shifting trade relations, India could position itself as a strong alternative. In addition to building capability, India will have to balance its image of being economically self-sufficient yet keen on building trade relations.

- Invest and strengthen its digital infrastructure. To meet the demands of a world reliant on technology, India must make hard-nosed decisions to build digital capability. Without building domestic capability, India loses the opportunity to play a pivotal role in key transnational projects.

- Undertake a strategic reorientation of existing assets to create more usable military assets.

Deep economic transformation is essential if India is to make the most of the opportunities that lie outside its borders. In turn, the emphasis on long-term economic growth and stability will provide India greater leverage in exploring new geostrategic opportunities, including in such frontier areas as global technology standards. Importantly, it will also provide the country with the means to invest in the urgently needed strategic transformation of its military. In our research-led journey, we shall continue to engage with and consult the government, the private sector, and other experts on a range of issues across three broad interrelated areas: political economy, technology, and foreign policy.

Introduction

The coronavirus pandemic is a transnational and international crisis—both in its origins and in its unfolding consequences. While its global effects are still indeterminate, some broad contours of the post-pandemic world are increasingly evident. The state is back. Borders between and within nations are more restrictive than before.[1] National and nationalist sentiments have grown sharper. Protectionism and populist politics have gained more traction.[2] International institutions are struggling to mediate the global response to the pandemic. No one country or group of countries can claim international leadership. With the rails coming off the Sino-American relationship, great power rivalry has, for the first time since 1989, become a defining feature of global politics.

This conjuncture has exposed all states to internal and external vulnerabilities. Adapting to an unsettled future will require recasting national priorities and reimagining models of governance. In this context, the manner in which India manages its internal and external challenges within its constitutional democratic framework will have significant implications for the emerging world order.

And yet, the challenges stemming from this pandemic are greater in India than in many other countries. An economic slowdown that predates the pandemic is overlaid with the pandemic's fallout.[3] Essentially, India faces a compounded crisis.

The pandemic has deepened existing fault lines in the Indian economy. Moreover, India will now have to deal with unpredictable changes in trade, investments, private consumption, and government expenditure. Fiscal policy will need to grapple with the extent and limits of the state's ability to raise and deploy resources. Monetary policy will need to be much more adaptive, and will need to find new ways to be effective in these precarious times. India will also need nimble trade policies that respond to fast changing trends in global commerce.

In short, the Indian economy's recovery poses very different challenges from that of developed economies. Governments in developed countries are focused on tiding over this period. Emergency fiscal efforts and stimulus packages in those countries are designed to provide a measure of stability to their pandemic-hit economies. Their main aim is to restore the conditions that existed before the pandemic struck. India, however, needs to recover from the effects of the compounded economic crisis and return to the path of sustained high growth. Tiding over is not an option.

Indeed, India needs much more than recovery. It must also build long-term resilience to be able to adapt to a less certain future. Achieving a high degree of policy elasticity is a monumental task. But recovery will amount to little unless long-standing structural constraints are addressed concurrently.

Deep economic transformation is also essential if India is to make the most of the opportunities that lie outside its borders—whether it is by encouraging the diversion of supply chains to India or ensuring that the country retains its centrality in the strategic development of South Asia. None of these goals can be realized in full measure unless the compounded economic crisis is arrested. In the post-pandemic world, the imperative to ensure external stability must be seen as part of an attempt to build resilience at home. In turn, the emphasis on long-term economic growth and stability will provide India greater leverage in exploring new geostrategic opportunities, including in such frontier areas as global technology standards. Importantly, it will also provide the country with the means to invest in the urgently needed strategic transformation of its military.

To unpick India's knotty internal and external policy challenges, Carnegie India has set out to research and propose specific measures for achieving recovery, resilience, and adaptation. The focus is not on how India can survive the pandemic in the short term, but on how the country can thrive in the decade ahead.

Our commitment is to consult the government, the private sector, experts, and others on a range of issues across three broad interrelated areas: political economy, technology, and foreign policy. We will do so with a view to uncovering the theory of change in these domains as well as answering some crucial questions pertaining to India's recovery from the pandemic. Ultimately, we intend to provide a road map for navigating the emerging realities of an indeterminate future.

This paper introduces the challenges Carnegie India collectively seeks to address. It provides a "house view" of how we assess the current situation, and our analysis of what it portends for the future. The paper also sets out the interrelated pieces of analysis that we will publish over the coming year.

The overarching framework offered here is based in part on a series of interviews, conducted soon after the pandemic struck, with leading industrialists, technologists, policymakers, investors, entrepreneurs, international bankers, and other experts. In these interviews, our aim was to capture the principal challenges for India as it went into a nationwide lockdown in late March 2020. These insights were invaluable in helping us obtain a bird's-eye view of the myriad problems that now confront India, and home in on the critical underlying challenges. We provide an independent assessment of these challenges and of the need for thinking about recovery, resilience, and adaptation in a single framework.

In this paper, we first outline the primary challenges that India faces in dealing with its compounded economic crisis. We lay out the structural problems that predate the pandemic, as well as those triggered by the coronavirus. We examine the extent to which the pandemic has exacerbated earlier challenges, even as it has thrown up fresh ones.

The paper then analyses the key geopolitical, geoeconomic, and strategic challenges with which India will need to wrestle. These external dimensions of the problem are inextricably intertwined with the internal ones. They will require new approaches to building resilience and adapting to a fast-changing world, even as they complicate India's ability to deal with the compounded economic crisis. At the same time, the compounded crisis imposes constraints on India's pursuit of security and stability. Either relying on extant methods of maximizing strategic autonomy or reverting to older models of economic self-reliance is unlikely to help. In fact, the latter approach might deprive India of the opportunities thrown up by the pandemic, especially in the areas of supply chains and technology.

The Compounded Crisis

The Indian economy's current predicament stems from two crises: the shock of the coronavirus pandemic and the slowdown in economic growth and investment that predated the pandemic. India's challenge is, therefore, to ensure economic recovery by taking measures to address the causes of and mitigate the effects of both these crises, so that the economy can recover, build resilience, and adapt to the changing realities.

A Persistent Crisis of Growth

In the 1990s and 2000s, India had an impressive growth run for a democratic country. While economic growth slowed down in some years due to exogenous shocks—the Asian financial crisis in 1997, a major drought in 2000, and the global financial crisis in 2008—each time the country made a speedy recovery.

After the crisis in 2008, the economy recovered quickly, and growth in investments and economic output was robust for two years. It seemed that the Indian economy had become resilient. It saw a sharp slowdown beginning in 2012, but showed some recovery between 2014 and 2017 (this paper refers to financial years by their end years), suggesting that India had returned to a norm of high growth. But the economy has slowed down significantly since then, with gross domestic product (GDP) growing by 8.3 percent in 2017 to only 4.6 percent in the first three quarters of fiscal year 2020—that is, between April and December 2019.[4] Growth was obviously low in the fourth quarter as well, but this might have been due at least in part to the pandemic.

To understand the slowdown, it is important to look more closely at the last decade. It is true that growth seemed to have recovered between 2014 and 2017, but in fact, this had little to do with a renewed dynamism or continued structural transformation of the Indian economy. Rather, the recovery had a lot to do with a fall in the trade deficit (import of gold declined; import of certain engineering goods declined due to slowing economic activity; and the import bill for some commodities, such as metals and crude oil, shrank because of falling international prices[5]), an increase in real-value addition due to drops in input prices,[6] and a recovery in consumption fueled by low crude oil prices, off-budget fiscal stimulus, and expansion of credit from nonbanking financial firms.[7]

Indeed, the drama of growth decelerating in 2012 and 2013, recovering between 2014 and 2017, and slowing down again from 2018, is not visible in India's performance on investments and exports. Barring a few good quarters, the growth in investments and exports has mostly remained low since 2013. New announcements of private investments have been falling steadily, and, as a percentage of the GDP, they were the lowest in 2020 since at least 1996.[8] India's share in world trade has only improved marginally in these years. In both commercial services and merchandise trade, the improvement in India's share has been much slower than it was during the previous decade, rising from 1.65 percent in 2011 to 1.72 percent in 2019 for merchandise trade, and from 3.15 percent to 3.52 percent for commercial services.[9]

The underlying causes for this crisis of growth are much debated, with a variety of plausible explanations vying for legitimacy.

According to one argument, the lack of reforms in factor markets, and governance failures, have made it difficult for the economy to grow.[10] Indeed, the relative lag in reforming factor markets and some products markets, such as agriculture, has been a long-running theme in India's political economy, with the slow pace of reforms often being blamed for the economy's failure to show continued dynamism. This argument was made even in the context of the 2012–2013 slowdown, with some suggesting that India would need to implement major reforms in the coming years to be able to achieve and sustain high growth.[11] In some ways, other explanations for the growth slowdown—such as that structural barriers prevent the Indian economy from serving the demands of many consumers,[12] or that India hasn't sufficiently focused on boosting exports[13]—relate to this problem, of supply-side constraints limiting the efficiency of the economy. In order for the economy to produce things at a competitive price—whether for the domestic or the international market—it is important to improve productivity, and a key reason that this has not happened is the lack of reforms in certain areas.

Others have argued that the slowdown has been prolonged by the failure to resolve balance-sheet stress in a timely and efficacious manner.[14] According to this view, the delays in resolving the weaknesses of banking and infrastructure balance sheets led to a slowdown in investment and exports earlier, and now that the sources of the temporary consumption boom have weakened, India faces a crisis of balance sheets in four sectors: banking, infrastructure, real estate, and nonbanking financial firms.[15] In essence, this argument points to weaknesses in institutional mechanisms, and to a lack of political will to address the problem. When firms with stressed balance sheets confront a crisis like the pandemic, many go bankrupt. Until 2016, India did not have the proper legal architecture to resolve the bankruptcies of nonfinancial firms. Although a law addressing those bankruptcies was enacted that year,[16] and a mechanism has since been built for resolving failed nonfinancial firms, the system has limited capacity. Amendments to the law, which bar certain categories of persons from participating in resolution, have further limited the efficacy of the mechanism. Meanwhile, the government has wavered in taking decisive action toward building a mechanism for resolving failed financial firms.

Yet others have pointed out that in the last decade, state-capital relations have demonstrably worsened. There are now a dramatically greater number of disputes between state and private firms and individuals on tax matters—as a percentage of gross direct tax revenues, direct taxes under dispute increased from 18 percent in 2010 to 62 percent in 2013, and have remained above 60 percent for each year since then.[17] There is also evidence to suggest that the government loses in a vast majority of these disputes.[18] Further, certain policy choices, such as the compliance-heavy design of the Goods and Services Tax (GST), reflect low trust between the government and private firms. In addition, laws have been amended to weaken the checks and balances over enforcement authorities' powers to take disruptive actions, such as searches and seizures.

Finally, while some have placed the blame broadly on uncertainty in the policy environment, others have argued that the slowdown can be explained by a combination of factors. Specifically, they point to the centralization of power, and the resultant slowdown in decisionmaking inside the government; poor policy decisions, such as demonetization; poorly implemented policies, such as the GST; excessively tight monetary policy (before the government's approach became more accommodating); and the crisis in the financial sector.[19]

These arguments, all of which are based on facts, capture different aspects of the story of India's slowdown. The lack of reforms in some markets and institutions may be creating binding constraints on growth. It is also likely that the slow resolution of the balance-sheet crisis has dampened investments—after all, firms with stressed balance sheets may go bankrupt. While steps have been taken to resolve these crises, the increase in the scale of the problem may have outpaced these efforts. Further, the efforts to repair the balance sheets were hampered by a lack of political will. The slowdown in investments is also linked to the worsening of state-capital relations—the lack of trust between the state and private firms makes it difficult for the latter to believe that their problems will be solved.

By the end of 2019, the economic slowdown had become quite severe. This was underscored by five facts:

1. Almost every engine of the economy was sputtering—consumption growth had been slow for four quarters, and capital formation had been shrinking for two quarters.

2. The slowdown had persisted despite fiscal and monetary policy efforts to boost growth. Since 2018, the growth in government-financed consumption has far outpaced overall economic growth. In the three quarters between April and December 2019, the growth in government-financed consumption was 11.2 percent, while overall GDP grew at 4.6 percent. The central bank had loosened its monetary policy stance since early 2019, to, partially, address the fall in consumption.

3. The slowdown was sharp and across sectors: between April and December 2019, both industry and services registered their lowest growth rates since the beginning of the decade.

4. Growth slowed down in 2019 despite a fall in the trade deficit.

5. There was considerable uncertainty about the real depth of the balance-sheet crisis. Its severity became apparent when Yes Bank, a major private bank that had reported adequate capital until December 2019, nearly failed suddenly in early March 2020.

So, for almost a decade, India has been in a growth crisis, which had only deepened lately, and there was much uncertainty in the economy well before the coronavirus came along.

The Shock of the Pandemic

The first-order economic effects of the pandemic arise from the restrictions imposed by governments, and the voluntary responses to the public health crisis. These effects depend on how long the pandemic will last and the extent to which people will be able to participate in economic activities while taking due precautions. The second- and third-order effects of the pandemic remain uncertain. There may be as yet unpredictable changes in trade, technology use, capital-labor relations, investments, consumption, and government expenditure.

The long pause in economic activity due to the lockdown was predictably tough for the economy. The unemployment rate soared from 8.4 percent in the week just before the lockdown to 27.1 percent in the middle of the lockdown.[20] As expected, most other indicators also dipped. Soon after the lockdown was eased, economic activity bounced back. A variety of indicators—such as electricity generation and consumption, production and sale of vehicles, steel production and consumption, and the purchasing managers' index—registered an upturn.[21] Yet most indicators remained well below the levels seen in the corresponding period of the previous year. Unemployment almost came back to its prelockdown level. Most of the increase in unemployment during the lockdown was in the category of "small traders and wage laborers"—once the lockdown was lifted, they got back to work, but perhaps with lower earnings. However, the number of salaried employees has fallen precipitously—from 86.5 million in February to 65 million in August—suggesting that the formal sector jobs have been badly hit by the crisis.[22] Any recovery that is being seen in the period immediately after the lockdown is likely to be exaggerated, owing to the pent-up demand created by the lockdown.

At the time of writing, most economic activities are permitted by the government, but are confronted with varying levels of friction. Labor markets are unsettled. Credit markets are marred by uncertainty, which has impacted the transmission of monetary interventions. For much of this crisis, banks have played it safe, choosing to park funds with the central bank rather than lending them out. To varying degrees, product and service markets are facing supply constraints and demand slowdown. Overall, the prognosis for the economy this year is bad. Most analysts expect a sharp decline in the GDP,[23] only differing by a few percentage points in their estimates of the expected depth of the decline.

India entered this crisis with key sources of resilience already under stress, owing to which the impact of the pandemic is likely to be worse.

First, due to the ongoing slowdown, the government had already deployed the usual instruments of macroeconomic policy. In January 2020, the government invoked the escape clause of the fiscal responsibility law to create additional fiscal space in financial years 2020 and 2021.[24] The Reserve Bank of India (RBI) had been cutting interest rates to boost growth since early 2019.[25] In the wake of the pandemic, the government and central bank have announced certain measures to support the economy. The package of interventions includes additional government spending, credit guarantees (or contingent liabilities), monetary easing, and leveraged fiscal interventions (funds with only seed capital provided by the government).[26] Additional expenditure has so far been very small, most of it focused on relief for those badly hit by the crisis.

India does not have the fiscal capacity to support much of the economy. India's fiscal capacity in terms of tax-to-GDP ratio is not comparable with that of developed countries, and the government's receipts have been hit by the crisis. Unless fiscal expansion is for expenditure that produces a high multiplier in the economy, there is a real risk of a debt crisis down the road. Such a multiplier effect can only be obtained by capital expenditure. But institutional weaknesses impede the successful implementation of capital expenditure projects. Further, monetary policy also suffers from problems of slow and weak transmission, limiting its efficacy in a crisis.

Second, many financial and real economy firms were already distressed due to the economic slowdown. Efforts were underway to repair the balance sheets of banks, and the insolvency and bankruptcy code was being used to resolve the bankruptcies of firms. Had the precrisis balance sheets of firms been better, they would have been more resilient to this shock. Although the approach so far has been to rely on a moratorium on bankruptcy resolutions and loan repayments to give firms some breathing space, this is likely to become infeasible, as the banks and other creditors cannot absorb the delays in receipts indefinitely. Delaying the recognition of problems could worsen them.

Third, institutional bandwidth to deal with the crisis is limited, and already constrained. The bankruptcy resolution mechanism is relatively new, its capacity is low, and it is already engaged in resolving the failures of firms in recent years. Regulatory authorities in the financial sector are caught up with balance-sheet crises in banks and nonbanking financial companies. Government institutions such as financial regulators and bankruptcy tribunals may also face capacity constraints in dealing with the challenges arising from this crisis.

While it is difficult to predict all the ways in which this crisis will affect the Indian economy, certain pathways of impact can already be discerned.

First, the balance-sheet crisis will deepen—that is, the insolvencies will become more severe, leading to more liabilities holders in firms losing their claims. It will also widen—that is, it will spread to more sectors, especially those hit by the crisis. The manner in which these crises are resolved will determine how efficiently the factors of production will be used, which will have an impact on the overall economic recovery.

Second, while effectiveness of fiscal policy will be crucial for India's recovery from this crisis, and for building resilience for the future, managing risks to macroeconomic stability will be difficult. The impact on fiscal receipts, and the uncertainties around them, as well as the rising demands for more expenditure, will make fiscal management challenging and avoiding a debt sustainability crisis difficult. Monetary policy responses will be constrained by a lack of information and problems of transmission.

Third, the uncertainties of this crisis and the worsening balance-sheet crisis may further dampen private investments. Investments are linked to problems of exports and consumption, as productivity-enhancing investments can be crucial for export competitiveness and for making products more affordable. Thus, the revival of investments, although very difficult to achieve, will be crucial for recovery and building long-term resilience.

India's response to this crisis should, therefore, differ from that of countries that do not have similar background conditions. Governments and central banks in developed countries are rightly focusing on supporting their economies to tide through this period, so that the shock to the standard of living can be minimized in the short run, and the precrisis standard of living can be restored in the medium term. Recovery for India, however, means getting back on the path of high growth.

Despite the many challenges it presents, the current crisis provides a rare opportunity for reforms in India. There is an impulse for change in areas in which change has routinely been considered politically unviable. This includes factor market reforms in agriculture, land, labor, and capital. Initiatives of the union government and several state governments have opened the aperture for reform. It is essential, however, to ensure that the reforms take into account long-standing problems with the Indian economy. Patchwork solutions to tide over the next year or two will do little for India's extended economic growth. Rather, reforms should ease the binding constraints to investment and growth.

There is an opportunity now to seize the future, as long as the government thinks carefully and systematically about tomorrow, even as it seeks to tackle the problems of the present. These long-term objectives have been discussed and debated for several years. In many ways, there is nothing novel about the specific issues that we have outlined. Rather, we seek to make a case for an integrated approach that addresses the needs of 2020 as much as it considers the potential requirements of 2030.

An Integrated Approach

An integrated analysis of the problems in the Indian economy reveals the need for India to not just make an immediate economic recovery but get back on the path of sustained high growth. To do this, the country needs to focus on issues with clear short-, medium-, and long-term outcomes. Three key objectives must motivate policy measures for recovery, resilience, and adaptation.

The first must be to maintain and enhance India's economic resilience. India has built certain institutions and implemented certain policies that can contribute to the pursuit of prosperity by building resilience in the economy. These include: a modern bankruptcy resolution law, a framework for monetary policy, a fiscal responsibility law, and reforms in banking supervision to identify bad debts. These need to be strengthened.

Recovery efforts should not harm policies and institutions that undermine the medium-term resilience of the economy. For example, after the last economic slowdown, banking supervision by the RBI delayed acknowledging bad debts in banks. These debts kept piling up and were eventually recognized only in 2015. This delay prevented timely corrective action. Similarly, the recent move to suspend the bankruptcy law and a loan moratorium for an extended period will hide and delay the resolution of existing problems. While such moves can, for short periods of time, enable firms to adapt to changes, if they are extended for a long time, they hide the scale of the problem, and so make the crisis worse. The crisis response should maintain the integrity of these institutional sources of resilience and build more resilience in the economy.

The second objective must be to ease the binding constraints to economic growth. The crisis has brought a sense of urgency to India's reforms agenda. There are reform opportunities in the financial sector, land market, labor market, contract enforcement, and in the infrastructure and construction sectors. Equally important is the need to reform institutions, such as the Revenue Department, Enforcement Directorate, and financial sector regulators. These institutional reforms are essential to mending state-capital relations.

The third objective must be to develop better adaptation strategies. Recovery and resilience will have to go hand in hand with adaptation to changing global realities. Whether it is in trade policy or technology adoption, this crisis is already leading to significant changes in the global economic order. In some ways, these changes may create opportunities for India, while they may also present new risks and threats. Devising better adaptation strategies will require careful mapping and projection of the changes happening in the global economy and identifying suitable policy responses to them in view of India's capabilities and constraints.

Priorities for Recovery, Resilience, and Adaptation

Three overriding objectives ought to shape and drive policy measures for recovery: rescuing India from the immediate crisis, building resilience, and encouraging adaptation. These dimensions will need to be considered in an integrated manner. This means that in pursuing these objectives, India will need to focus on a set of strategic and tactical issues.

Resolution of Failed Firms

One such issue is the efficient and orderly resolution of failed firms. As discussed earlier, the crisis is already precipitating bankruptcies of financial and nonfinancial firms. Given existing fiscal constraints, it is unlikely that support from the government will make more than a dent on the scale of firm failures. So, in the coming years, the government will have to make difficult choices regarding the survival of financial and nonfinancial firms. Postponing the recognition of this problem and delaying its resolution could make things worse. Managing the bankruptcies well will not only aid in a quick recovery but also build institutional capabilities that will enhance the resilience and adaptability of the Indian economy. Efficient resolution can ensure that factors of production do not stay locked in firms that have failed.

This requires efforts on two fronts. First, existing laws and institutions that govern bankruptcy resolutions of nonfinancial firms need to be strengthened, so that they can manage the rising cases of firm failures. The mechanism for resolving bankruptcies of nonfinancial firms and certain categories of financial firms will have to handle a much greater volume of cases in the coming months and years. So, to begin with, bankruptcy regulation must be tweaked to discourage excessive litigation and to innovate mechanisms that provide for quicker resolutions. In addition to this, capacity in the National Company Law Tribunal must be augmented rapidly.

Second, a mechanism needs to be built for resolving the failures of financial firms. In this regard, India is far behind most G20 countries. As the failures of Infrastructure Leasing & Financial Services Limited (IL&FS) and Yes Bank show, India presently lacks a sound framework for the resolution of financial firms. So, the only feasible solution for such large financial firms turns out to be direct or indirect government control or recapitalization. Instead, the government must act immediately to build a suitable legal framework under which bankruptcies of financial firms such as banks and insurance companies can be resolved.

Fiscal Management

Since fiscal management has been challenging for a few years and is likely to be even more difficult due to the crisis, it is important that the government carefully consider its approach to the problem.[27] The approach will have to be anchored in a suitable medium-term strategy. The existing medium-term framework has lost its relevance due to the crisis—fiscal projections are no longer relevant, and even the basis for projections will change because of the crisis. Developing a suitable medium-term fiscal strategy will require assessing fiscal responsibility in the medium term, imagining plausible scenarios for receipts, estimating the optimal allocation of expenditure, and improving center-state fiscal relations. Such a medium-term approach should help build resilience in fiscal management and enable flexibility for adaptation in the coming years.

Relatedly, the crisis makes it essential for the government to redefine its expenditure and asset ownership. This will be crucial for recovery, as the private sector may not be able to do the heavy lifting in the short term. Government expenditure on public goods will make the economy more resilient. The government needs to redefine its fiscal role in the economy by shifting deployment of fiscal resources closer to where they are most required. This requires a close and clinical analysis of those patterns of government expenditure that traditionally limit efficiency. Further, the government could monetize its assets to deploy more resources for new capital expenditure projects. These include operational infrastructure assets and stakes in public sector enterprises where the government need not continue to have an operational role. As discussed earlier, well-planned and properly implemented capital expenditure can have a high fiscal multiplier. But this requires political will. In 2016, the government had announced that it would restart the privatization of public sector firms, but to date not a single transaction has happened.[28]

Private Investments

Private investments have an impact on the productivity and competitiveness of the economy. Reviving them is, therefore, a priority. Investment and entrepreneurship are functions of the cost of capital and the return on investment. The cost of capital, in turn, depends on the financial intermediation in the domestic economy and its linkages with global finance. The return on investment depends on the existence of opportunities to deploy capital profitably, and then the ability to appropriate those returns. For the Indian economy to revive investments, three kinds of policy and institutional reforms are required.

First, the government should improve state-capital relations in order to reduce the hostility and uncertainty that has come to mark these relations in recent years. Among other things, improving these relations will require improving governance and legal processes for taxation and regulation. It is essential to improve the rule of law and accountability in these functions so that the agencies responsible for them think carefully about their interventions. These can be achieved if political will exists.

Second, the government should implement productivity-enhancing reforms. Indian laws place significant constraints on firms' abilities to acquire and allocate factors of production. This hampers their resilience to economic shocks, and results in the destruction of value. Instead, the government's focus should be on easing the binding constraints to investment and growth. This will require a variety of interventions: among others, the removal of constraints on land-use in both rural and urban areas; improvement in the experience of migration and urbanization; and the removal of labor-law compliances that do not protect health and physical safety. Further, reforms that reduce the cost of capital for firms in India can also help revive investments. Reduction of the cost of capital can, in turn, be achieved with financial sector reforms, coupled with reforms of government debt and capital flows. These could include the development of bond markets, banking reforms, reduction of financial repression, and further opening of international capital flows. The reforms will require a variety of measures, including legislative amendments, regulatory changes, and institutional reorganization.

Third, the government should give an impetus to the infrastructure and construction sectors. However, in India, these sectors face many impediments relating to procurement, project management, regulation, and financing. Since 2012, the stock of infrastructure projects under implementation has been steadily falling, and since 2017, there has been a sharp decline in new project announcements in infrastructure sectors.[29]

Overcoming these impediments will be key to building the capacity to implement capital expenditure projects, whether they are funded by the government or private capital.

If they are even partially successful, the objectives and reforms mentioned above can have an important effect on growing and strengthening India's domestic economic capabilities and institutional architecture. Further, such capabilities can be multiplied if India is able to devise and implement a comprehensive digital strategy.

Digital Strategy

While the digitization of economic as well as public services was a policy focus for India prior to the pandemic, the rapid adoption of digital technology for continuous service delivery during the pandemic has accelerated the transformation. The pandemic forced a behavior change toward using digital platforms for professional and personal, as well as public, transactions. This behavior change will have long-term implications—prior inertia or suspicion about the digital as an untested territory is now overshadowed by its demonstrated utility during the crisis. This will pave the way for easier adoption of future, noncritical, online services.

In the response phase of the pandemic, India is relying on existing digital infrastructure, such as the Unified Payments Interface (UPI), for disbursing additional welfare benefits and providing fiscal support for economic recovery. The UPI is an application that enables domestic payments. It is an interoperable technological platform that is used across India's growing digital payments businesses.[30] With the contact tracing app Aarogya Setu, India also demonstrated its ability and willingness to deploy de-novo digital systems in crisis response. India should build on these trends and transition important services from physical to digital, while also investing in digital-first services.

Notwithstanding the material difference between brick-and-mortar structures and digital platforms, the conceptual relations through which citizens and local and national governments engage (such as tax collection, welfare disbursal, and grievance redressal) remain unchanged. This means that citizens as well as public administration officials need to be able to trust the newer mechanisms and digital infrastructures through which these relationships are executed. So, even as India invests in building its digital infrastructure, it must also invest in building public trust in that infrastructure. In the absence of this trust, people might withdraw from accessing public services. They might also shy away from participating in digitally mediated collective responses expected during pandemics or against newer cybersecurity threats.

Apart from focusing on the integrity and security of digital platforms, India must also focus on the mechanisms through which these platforms are built. Procedural transparency and effective grievance redressal mechanisms will ensure greater support and adoption of the digital transformation.

Even as India explores public-private partnerships in building out this digital infrastructure, it must recognize that the implications of newer cybersecurity threats for the public and private sector are different. For example, public administrative offices, unlike private companies, might not find it financially or politically expedient to pay ransomware demands.[31] India must be selective and thoughtful in the specific technical and outreach practices it adopts from the private sector in the design of public service platforms. It must also invest in digital literacy for its citizens so that individuals are able to discern legitimate applications from illegitimate ones and can be effective responders when collective action is needed.

Further, the effects of the overriding objectives mentioned above can be multiplied if India is able to find a degree of external stability in, what is and what will be, an even less-certain world.

External Stability

It has long been a central objective of Indian foreign policy to leverage the external environment to foster an internal transformation. In the post-pandemic world, ensuring external stability will be essential to building resilience at home. The external challenges fall broadly into three categories: geoeconomic, geopolitical, and strategic. In thinking about recovery, resilience, and adaptation to changing realities, Indian leaders will need to be mindful of the interconnections between these dimensions. Further, to adapt to a post-pandemic world, India's external engagements will need to be more firmly tied to its domestic economic needs.

The external choices that India makes will determine the extent to which it can recover from the immediate effects of the current crisis, build resilience for the future, and adapt to emerging global realities. Then again, these choices will also be made in an international context that seems directionless. The United States has limited appetite for the burdens of global leadership, while its accelerating rivalry with China makes even transactional management of international affairs more difficult. International institutions, from the International Monetary Fund and the Asian Development Bank to the World Health Organization, have struggled to provide leadership in their domains. This is the new fragmented reality of the post-pandemic world.

The pandemic is a product of globalization, but it also poses serious challenges to the current model of globalization. India was among the prime beneficiaries of the wave of globalization that crested after the Cold War and receded after the global financial crisis of 2008; and now it is facing its most serious challenge yet. It is important, however, to disaggregate this picture and consider which aspects of globalization are impacted to what extent, and what that implies for India.

Geoeconomics

In crafting its global economic strategy for a post-pandemic world, India needs to consider its position across three broad areas.

Trade

Consider the question of trade. The World Trade Organization–centered model of global trade has been under considerable stress for over a decade. During this period, regional trade blocs and groupings have been discussed and some completed, such as the Trans-Pacific Partnership, the Trans-Atlantic Trade and Investment Partnership, and the Regional Comprehensive Economic Partnership. U.S.-China trade relations, which formed a central axis of this global trading system, were already under strain before the coronavirus struck.[32] In the wake of the pandemic, there has been an increased drive toward diversification of manufacturing supply chains in Asia—not only away from China but more broadly as well.[33]

India has never been an integral part of these supply chains, except in certain niches. So in some ways, this crisis is an opportunity. As governments in Australia, the United Kingdom, the United States, and parts of Europe reconsider their economic ties with China, India could emerge as an alternate location for manufacturing and related services. Of course, there is no reason to assume that India will automatically be regarded as an attractive destination for companies looking to relocate their operations from China and reorient their supply chains. Not only are all the traditional problems of investing in India intact, including the lack of urgently needed reforms in land, labor, and capital discussed earlier, but the government has also now made an avowed move toward "self-sufficiency," however loosely defined the term may be.[34]

This protectionist impulse is continuous with India's decision to pull out of the Regional Comprehensive Economic Partnership after years of negotiations, on the grounds that Indian domestic producers would wilt in the face of competition.[35] There is a cognitive dissonance in believing on the one hand that India should be an attractive destination for investment, and acting on the other hand on the assumption that India should be a relatively closed economy. India needs to strike a new balance between its domestic imperatives and external engagement.

Migration

Another aspect of globalization that will see considerable change is migration. Here, too, some trends were already in evidence before the pandemic. The issue of H1B visas for Indian workers has been a sore point with the United States for the past four years.[36] The recent decision to suspend new visas altogether lends an edge to this issue.[37] Moreover, as the American economy grapples with the consequences of the pandemic, there will be increasing pressure on Indian companies using Indian workers in the United States to create jobs for Americans. Although technology might allow some of these services to be performed offshore, the mobility of even high-skilled Indian workers will face more restrictions.

India also needs to think hard about Indian workers in the Middle East. Many of them have been brought back to India, and their ability to return and resume work after the pandemic is an open question. It is also a critical one, since remittances from these workers are an important source of economic support for their families. The World Bank estimates a 23 percent decline in remittances into India in 2020, from $83 billion in 2019 to $64 billion.[38] This will truncate 0.7 percent of the GDP. More importantly, it will have a significant impact subnationally, among the five or six Indian states that have traditionally received the majority of inward remittances.[39]

Data

Apart from the restrictions on the cross-border movement of people and capital, the future of data, too, hangs in the balance. India is the world's largest open data market. There are close to 600 million Indians who use 4G data.[40] It is estimated that by 2024, a billion Indians will have access to smartphones.[41] In short, India offers scale that is accessible—unlike China. It is the reason big tech firms, from Facebook to Amazon, are investing in India, and intensifying their partnerships with

Indian conglomerates.[42] India can be a net beneficiary of the United States' technological and economic disengagement from China. But making the best of the U.S.-China disjuncture will require hard-nosed decisions about how India treats data. Data is not a natural resource. India will have to think carefully about how it approaches different categories of data, whether it is personal, nonpersonal, or financial.

India ought to leverage its distinctive position and play a more active role in setting global standards on the cross-border movement of data. It should work with like-minded states in the G20, and elsewhere, to shape a stable international environment, keeping Indian interests in mind. This is an emerging terrain in international politics, and India can take a leading role on it. But to do so, India will need to strike the right balance between localization and internationalization.

Additionally, India has long invested in digital infrastructure. In 2009, the Indian government established Aadhaar, a unique digital identification scheme. At present, more than 1.2 billion Indians have an Aadhaar number.[43] In 2016, the government initiated the Unified Payments Interface, or UPI.[44] There is no reason why this safe, tried, and well-tested infrastructure cannot be exported across India's borders. From Asia to Africa, India's UPI could serve as the standard for the future. To capitalize on these innovations, the government and the Indian private sector need to work much more closely together with third countries. Lines of credit will need to be offered to companies that are willing to invest in frontier markets. They will require the trust of the government and its unfailing support. These are, after all, strategic endeavors that can firmly establish India's footprint in and across the Global South.

Of course, in pursuing these goals, digital safety will be paramount. In this new era of health surveillance and digital service delivery, mobile phones will not only be the means of access to critical services but will enable authenticated access to them. As a network of connected individuals rapidly emerges, securing the underlying technical infrastructure will not be sufficient to ensure the resilience of the overall system. The service delivery mechanism can also be undermined by deceiving and confusing the citizen or end user. This could be through knockoffs of legitimate government apps and large-scale scams that collect privileged private information. Cybersecurity risks are introduced not only through network breaches but through individual device hacks.

Moving services to individually held, connected access points, such as mobile phones, widens the ambit of technical exploitation from network security to also include platform abuse.[45] Mobile phones used by defense personnel for personal use are as much a vulnerability as the communication network between defense stations. The Chinese app ban in the summer of 2020 reflects the challenge of enacting cybersecurity responses at the level of individually held mobile devices[46]—the response to a foreseeable national risk will no longer only be centralized. It will involve collective and possibly voluntary action by individuals.

The geoeconomic challenges highlighted above are not insurmountable. Unlike other popular investment destinations, such as Vietnam and Thailand, India offers a large consumption market. A sizable portion of goods—from computer chips to mobile phones—that are produced in India can be consumed in India. At the same time, it is crucial to realize that this is a competitive arena, one in which India has in the past missed opportunities. The bet on India's market size and demographic dividend might attract financing for India's vibrant start-ups and for its promising digital future, but this in itself will not make India globally competitive. That will depend on how carefully the government can weigh the advantages of selective internationalism against the populist impulse for protectionism. These decisions will also directly affect India's ability to carve out a space for itself in times of rapidly changing geopolitics.

Geopolitics

The geopolitical fallout of the pandemic is increasingly clear. The rivalry between the United States and China is no longer confined to maritime Asia-Pacific or trade imbalances, but has become a wider strategic, economic, and technological competition.[47] For long, New Delhi sought to maximize its strategic autonomy between the United States and China. Maintaining better relations with both the United States and China than they had with each other provided India with adequate room to maneuver. But Chinese military transgressions in the summer of 2020 on multiple sections along the Line of Actual Control (LAC)[48]— which divides Indian and Chinese held territories—have put a squeeze on such an approach.

The standoff on the border, which led to the death of twenty Indian soldiers and a number of Chinese casualties,[49] has challenged the comfortable assumptions that underpinned India's approach to China for the past three decades. Restoring the status quo ante along the LAC is likely to be a long process.[50] But it is unlikely to restore the political conditions that existed prior to the outbreak of hostilities. For the moment, Chinese assertiveness appears to have led to a recalibration within India—whether or not this will last is yet to be seen. What is needed is a whole-of-government reassessment of the manner and method in which India approaches China, including along the 3,488-kilometer-long LAC.

India must also move decisively to recalibrate its lopsided economic relationship with China. To be sure, the flow of Chinese products and finance has a business logic of its own. These cannot be stanched without incurring economic pain at a time when the Indian economy is slowing down.[51] Yet, alongside the domestic reforms discussed earlier, it is imperative that India cut down its dependencies on China in crucial sectors such as pharmaceuticals and critical infrastructure, while leveraging access to the Indian market for its broader political objective of a balanced relationship with China.

India's choices vis-à-vis China are further complicated by Beijing's inroads into neighboring South Asian countries.[52] Since at least 2013, when the Belt and Road Initiative was formally introduced by President Xi Jinping, Chinese capital and infrastructural expertise have gained a presence in Bangladesh, the Maldives, Nepal, Sri Lanka, and of course, Pakistan.

While some states, like Sri Lanka, have challenged the terms of agreements with Chinese firms, the fact that China's influence across South Asia is growing is without doubt. The effect of China's growing authority is more obvious in some countries, such as Nepal,[53] than in others. The support provided by India to most South Asian states following the outbreak of the pandemic is of crucial importance and helps reaffirm India's commitment to the safety and security of South Asia. Yet, India will need to do more to clearly and effectively demonstrate its commitment to South Asia's development. This will only be possible if India is, and as importantly, is seen to be, an alluring economic hub in the region. The need for a secure neighborhood will have to be balanced against domestic economic interests and imperatives.

The challenge posed by China also calls for a renewed engagement, both economic and strategic, with the wider Asian region. Here, India's creditworthiness will depend on its ability to invest further in the relationship with Japan and the United States; give additional and wider economic meaning to the quadrilateral security arrangement between itself, Australia, Japan, and the United States; and focus on a clearly defined and better resourced Indo-Pacific strategy.

India will now have to think hard about these choices. Previously, there was a sense that a democratic and economically open India, which was experiencing high growth and was increasing its military power, was a desirable partner—even if it was reluctant to be drawn into anything smacking of an alliance. But the current crisis calls into question these fundamental assumptions. An economically faltering and inward-looking India is unlikely to be an attractive partner for these countries. An India that is relatively open to foreign capital and cross-border economic alliances, and has less stringent market barriers, would be much better positioned to meet the exigencies of geopolitics. Economic buoyancy is equally important for India's strategic effectiveness, and to its ability to deter and deny its enemies the space and opportunity to challenge its territorial integrity.

Strategic Transformation

The combination of the compounded economic crisis and the standoff along the LAC underscores the larger fiscal-military challenge that confronts India. One foreseeable consequence of the pandemic is a greater pressure on India's defense budgets owing to a drop in government revenues.[54] Even to keep up the current levels of military expenditure, defense spending will have to rise as a proportion of GDP. This is bound to be challenging against the backdrop of urgent competing demands for spending on public infrastructure and welfare. Any reduction in defense allocation will inevitably reduce the allocation for capital acquisition—which, since the rollout of the one-rank-one-pension policy, has already been diminishing relative to pay and pensions.[55] Such a diminution could pose serious challenges, both to India's current model of armed forces, as well as to its plans for modernization.

The problem India confronts is the following. As challenges along the border with China and Pakistan continue, the imperative to rely on manpower to deal with border encroachments will be strong. But this will force India to continue with a manpower-intensive model that requires higher personnel costs, reducing the funds available for military modernization, especially of the navy, crimping India's ability to operate in the Indo-Pacific.

Over the past decade and a half, the Indian military has been tasked with preparing for a two-front war.[56] But military modernization has not kept pace with this ambition.[57] This is partly owing to the military's inability to think harder about its continued investment in deep strike capabilities against Pakistan—capabilities that, in the context of nuclear weapons, may not be usable for the purposes envisaged. Meanwhile, India's attempts to raise a mountain strike corps in the eastern theater have foundered on the rock of inadequate finances.[58] In the post-pandemic fiscal context, rather than cling to outdated scenarios, it is imperative to rationalize the allocation of forces (qualitative as well as quantitative) between the two fronts and train them for the real contingencies that lie ahead.

The only real way out of the strategic bind is to move toward a radically different model of military manpower, and to undertake a strategic reorientation of existing assets to create more usable military assets. This would mean a force structure that has a smaller long-service core with a larger short-service component—the opposite of what exists today. A reorientation along these lines will, over time, ease the crushing burden of pensions and free up more resources for capital acquisition. It will also ensure that India has a leaner and younger force. As with the exercise of rationalizing resources and deployment between the western and eastern fronts, such a radical overhaul will rub up against entrenched organizational and political interests. However, at least in terms of its institutional architecture, the Indian higher defense establishment is now better positioned to make these pivotal choices.

Such a strategic transformation will not only make India's military power more effective in ensuring a stable external environment but will also make the country a congenial strategic partner for other Asian states. Further, it will increase the potential for platform interoperability with countries like Australia, Japan, the United States, and others, and afford India the opportunity to play a more ambitious role in the Indo-Pacific.

Looking Ahead

At Carnegie India, our endeavor is to analyze and assess how exactly India can recover from the current crisis, become more resilient, and also remain capable of adaptation in an indeterminate future. This paper outlines the challenges as we see them. It is partially shaped by the interviews that we conducted with practitioners, industrialists, venture capitalists, manufacturers, and others. We began this process soon after India went into a nationwide lockdown at the end of March 2020. Our aim now is to develop our early observations into long-form research products. In these selected areas of work—specifically, political economy, technology and foreign policy—our objective is to offer deeply researched road maps of how India can tide over the current crisis (recovery), invest in institutions and structures for the future (resilience), and thrive in the following decade in a world that is unlikely to resemble the previous ten years (adaptation).

In this journey, we shall continue to engage with and consult the government, the private sector, and other experts and practitioners from different walks of life. Our research-led outcomes will mainly comprise long-form papers, published over the next two years. In sum, our mantra is finding the intellectual and practical ways and means for India's recovery, resilience, and adaptation from 2020 to 2030.

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