Economic Policy in the Age of Covid

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With the Covid-19 shock pushing a tanking economy into recession, an unusual response from the State was expected. The government's policy response cannot but entail a sharp increase in expenditure to cope with the medical fallout and the 'sudden stop' in a wide range of economic activities that the virus attack imposes. That response had to come primarily from the Centre, which has far greater fiscal flexibility than the state governments, whose revenue receipts are under strain for multiple reasons and are subject to stringent borrowing limits.

Workers without regular employment displaced from their jobs have to be provided transfers in kind and cash to manage themselves and their families. Expenditure on testing, tracking and tracing, on protection for the medical workforce, and on ramped up isolation and treatment facilities for the infected, has to be substantial. Measures to ringfence production of essential commodities, so as to ensure that supplies are adequate and shortages do not lead to social chaos, will need some financial backing. Some industries and economic activities must be supported with transfers to ensure that they are in a position to return to business when normalcy begins to return. And the government may consider raising expenditures to spur demand and trigger a recovery after the virus attack moderates and production is restored. Overall, therefore, this is not a situation demanding just conventional 'stimulus' spending. Enhanced outlays are required for tackling a public health emergency, for providing relief to the poor and the economically vulnerable who are being devastated by the shock and the responses to it, for restoring normalcy in production and supply, and only then for stimulating a recovery.

Given this range of reasons why expenditure would have to increase in the aftermath the Coronoavirus shock, expectations are that governments in almost all countries, including India, would have to substantially step up spending. It is also true that while the State may aim to finance a part of such expenditures with private donations to institutions like the Prime Minister's National Relief Fund or the newly created 'public charitable trust' named the Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund), that can only fund a very small part of what is needed. Emergency funding of the kind that the Coronavirus shock demands cannot come directly from the private sector but must overwhelmingly come from the State. More precisely, in the Indian case, from the Centre, even if a lot of the spending would occur at the state level, because shrinking revenues, especially after the introduction of the GST regime and the onset of decelerating growth, have already strained the fiscal powers of state governments that face strict limits on their borrowing.

The Centre cannot at the moment resort to enhanced taxation to finance these expenditures, since business too is reeling under the effects of the shock. A large step up in borrowing, including borrowing from the central bank at lower than market interest rates seems to be the only sensible way to go. However, such action requires going against the fiscal conservatism propounded by the economic thinking that came to dominance in the age of finance since the 1980s. Global finance and big business have demanded adherence to the precepts of so-called 'fiscal prudence', influenced, among other factors, by the fear that debt accumulated today would encourage the government to tax tomorrow, when circumstances are more congenial for a tax heft. This conservative stance was embraced by the policy establishment in India as well and has been advocated almost with pride as the hallmark of macroeconomic policy making under the two Modi-led NDA governments. Economic leadership in the current crisis situation requires renouncing such conservatism and pushing out the State spending envelope, since otherwise the devastation wrecked by the virus-induced shock would be of much greater magnitude. Not surprisingly, some of those who preached such fiscal conservatism, in India and abroad, have now called for dropping that stance, even if temporarily, in response to the crisis.

However, a leader who was willing to experiment with the unwarranted and damaging demonetisation exercise and is willing to impose a 21-day lockdown without even the minimum preparation, as subsequent developments show, seems unwilling to make that shift. There are a number of indicators of this reticence to make the shift. The first set consists of the contents of the 1.7 lakh crore 'relief' package for the poor, the Pradhan Mantri Gharib Kalyan Yojana announced by the Finance Minister, which besides coming late, ignores a whole range of areas where new or additional spending was required. Though the package promises to reach a small amount of free food grain and pulses to the needy over the next three months, much-needed cash transfers to the vulnerable are limited to a small number and are niggardly in scale (Rs. 1,000 per individual to poor senior citizens, widows and the disabled and Rs. 500 to each woman Jan Dhan account holder). Many of the other elements of the package (such as bringing forward payment of the first instalment of Rs. 2,000 to farmers under the PM Kisan Yojana or allowing organised sector workers who are covered under the Employees Provident Fund Scheme to avail of a non-refundable advance from their own contributions) refer to funds already committed or that are not being provided by the government. Similarly, state governments have been told they can use funds from the Rs. 31,000 crore available under Building and Other Construction Workers' Welfare Fund to provide relief to workers in that sector who are badly affected, and from the District Mineral Fund for financing medical initiatives. These funds already exist, are available to the states and some had even started using them for relief.

This suggests that the Rs. 1.7 lakh crore figure as the size of the 'new' relief effort is an exaggeration. But that figure too, amounting to less than 1 per cent of GDP, is far from adequate. By way of comparison, the state of Kerala, with around 3 per cent of the country's population, which has thus far been among the most affected and has responded extremely well on all accounts, has prepared a plan to address the crisis that is expected to cost Rs. 20,000 crore. That amounts to close to 12 per cent of the national package announced by the Finance Minister. Such difference in proportion clearly indicate that significantly enhanced spending is not on the agenda of the central government.

That a fiscal effort by the Centre is not the first priority is also suggested by the decision to set up the PM-CARES fund, separate from the PM's National Relief Fund, to which, besides rich philanthropists and corporates with their social responsibility funds, ordinary Indians, including public employees are expected to contribute. While making a personal contribution in a crisis situation is to be welcomed, directing such contributions to a new institution, when others already exist, whose organisational structure and spending rules are not transparent has raised concerns about actual intent. The new fund is unlikely to garner more than a fraction of the resources required, but it would provide a plank to announce schemes that would be presented as being the result of the personal push of the Prime Minister himself, aimed at overshadowing the efforts of governments such as Kerala's. This effort at private financing appears to be aimed at making a show of national solidarity under one individual, and cannot be a serious complement to public funding that helps take much of the relief effort off-budget.

Finally, that a fiscal push is not seen as the dominant component of the crisis response is indicated by the decision of the Reserve Bank of India to make an off-cycle, emergency announcement of a monetary policy package, which includes a significant 75 basis points reduction in the policy (repo) rate, a cash reserve ratio reduction that frees liquidity and allows banks to lend more, and permission to the banks and non-bank financial companies to postpone payment of the next three equated monthly instalment (EMI) payments on a host of loans including housing, auto and durable purchase loans.

This monetary policy push is related to the conservative fiscal stance. An important component of the economic policy perspective that advocates fiscal conservatism is a stress on the role of monetary policy in macroeconomic management. When inflation is moderate and the economy is in recession or growth is slow, it is argued, central bank intervention injecting cheap liquidity at extremely low interest rates through measures like "quantitative easing" is the way to drive recovery and growth. It is this perspective that has determined policy in the developed nations during the recession years since the 2008 financial crisis, with limited or marginal impact. The real effect of this injection of cheap liquidity was an asset price bubble in financial and real estate markets which has been only partially corrected even after the Coronavirus shock. Yet, the grip of finance has meant that there has been little deviation from these unconventional monetary policies for more than a decade.

A similar emphasis on monetary policy in the current situation in India, reflected in the RBI's Covid-19 response, would also not work. If production is stalled because of the effects of the crisis and demand is falling because many are being deprived of their wages and earnings, pumping money into the system is unlikely to serve any of the government's purposes. Banks are unlikely to lend to those without the means to service such debt. At most some who need marginal support to prevent default on debt and producers who need some credit to last through the worst of the shock may be backed. But whether even they get the support promised would depend on whether the banks take up the options offered by the RBI's policy initiatives. Burdened with NPAs and expecting more loan defaults due to the crisis, they may prefer to go slow on credit provision. Attempting to outsource part of the effort to address the crisis to the banks may not yield significant results.

This raises the question as to what is holding the government and its 'decisive' leader from stepping out of this ineffective policy framework and hugely enhance spending to provide relief and mitigate the effects of the shock. The only ones who would oppose such a proactive role for the State would be those businesses, sections of finance and individuals who fear that, if the government's debt rises sharply, a part of the surpluses they earn in the near future may be tapped through taxation to finance the government's increased debt service commitments. To pre-empt such a possibility, they would prefer that the government holds back its fiscal reins and limit the scale of its crisis response. They would also support inadequate alternatives such as the PM-CARES fund that divert attention from that limited fiscal effort. Only a desire to favour these forces and/or succumb to their pressures can explain fiscal conservatism in the midst of the current crisis.

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