

## **The Poverty of Economic Conservatism\***

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In terms of economic policy, the Modi government must be perhaps the most conservative in the world. During the entire period of the pandemic when millions of people lost their incomes and livelihood support, most governments around the world provided universal cash transfers to the people, but not the Modi government. True, many other third world countries too did not provide such universal cash transfers, but their hands were tied; they had contracted heavy external debt and were enjoined to austerity by agencies like the IMF that helped them roll over their debt. But India was under no such external pressure to pursue austerity and avoid making transfers to the working people; the Modi government's niggardliness towards the people was entirely its own decision, born out of a blind faith in policy conservatism. And the bankruptcy of such conservatism is now visible to all.

Government expenditure is kept restricted in order to control the fiscal deficit so that inflation remains low; but despite government expenditure being restricted, wholesale inflation in May was 12.94 per cent and retail inflation was 6.30 per cent, and even the fiscal deficit as per cent of GDP was soaring. The economy is supposed to revive on the back of the massive tax concessions handed out to the corporate sector, once the lockdown is lifted; but the growth rate of the index of industrial production was 3.1 per cent in May, decelerating from 4.3 per cent in April (and this is not because of any base effect). Likewise, conservative economic policies are supposed to please globalised finance, attract financial inflows, and keep up the exchange rate; but the rupee has been under considerable pressure of late. Thus, conservative economic policies are producing the very opposite results to what they are supposed to produce. And now the capitalists themselves are getting tired of it. The very class in whose interests conservative policies are meant to be pursued is now openly opposing these policies.

T V Narendran, a Tata executive who is the current chairman of the Confederation of Indian Industry, has presented a proposal on behalf of the CII suggesting a fiscal stimulus of Rs 3 lakh crores, including a provision for cash transfers. This means that the proposal for cash transfers is now being made across the spectrum, not just by economists, opposition political parties, and civil society organisations, but even by the capitalists' body itself. Not that they are all making identical suggestions; but they are all recognising what is apparent to everybody other than to the Modi government, namely that the real problem of the economy today arises from a shortage of purchasing power in the hands of the people, which can be rectified by providing cash transfers. Contrast this with the absurd claim of the government economists that handing purchasing power to the people would be of no use, because it would not lead to any larger expenditure on consumption by them!

Equally striking is the fact that Uday Kotak, the owner of Kotak Mahindra Bank, has asked not just for an enlargement of the fiscal deficit but for printing money to finance it, which is utterly unthinkable for conservative economists. Contrast this position with the government's position, stated in an affidavit to the Supreme Court, where the government says that it has no money to make ex gratia payments to those who have died of Covid-19. If we go by the union government's own figures and

even update them, then the total number of those who have died because of Covid-19 would not exceed 4 lakhs. At the rate of Rs 4 lakh per person, the total compensation would come to Rs 16,000 crores. The fact that a government which spends Rs 20,000 crores for a grandiose, unnecessary, and utterly vandalistic project like the Central Vista project, has no money for providing help to Covid victims, speaks volumes about its ethical priorities. But the relevant point here is that even a banker, Uday Kotak, sees nothing wrong with the government's printing money; the government's claim that it has no money to make ex gratia payments in other words would not convince even the capitalists.

It is not that the capitalists have suddenly developed a fondness for the people; it is just that they are hard-headed and realistic enough to see that a revival of the economy requires cash transfers to the people.

The poverty of the conservative economics espoused by Modi lies precisely here: it believes that a revival of the economy requires not an increase in purchasing power in the hands of the people but a reduction in it. Its reasoning runs as follows: a recovery requires either no increase in government expenditure or an increase in such expenditure devoted mainly to infrastructure investment; since the fiscal deficit must be controlled and taxing capitalists is out (on the contrary they have to be incentivised), any increase in government expenditure must be financed at the expense of the workers. And this is best done through raising indirect taxes.

The obvious error in this thinking is that if government expenditure increases by taxing workers, then since workers more or less consume what they earn, there is very little net increase in aggregate demand: the increase in demand generated by government expenditure is offset by the decrease in demand caused by the reduced consumption of the workers. There can be no revival of the economy under these conditions.

Besides, since the workers are being squeezed through indirect taxes, there is a rise in prices. Because of this tax-push inflation, even to maintain its old level of real expenditure, the government has to increase its nominal expenditure, as do the capitalists (only the workers cannot raise their nominal expenditure which is precisely how they get squeezed). Hence, the government has to get additional indirect tax revenue that is larger than (and a multiple of) the additional expenditure it had proposed to make at the original prices, which means larger inflation than had originally appeared necessary. The economy therefore gets zero stimulus for expansion even while experiencing significant inflation.

This is exactly what is happening in the Indian economy. Government expenditure is scarcely stimulating the economy; but the mode of its financing, through indirect taxes on petro-products above all, which has pushed up petrol prices even above Rs 100 per litre in large parts of India, has unleashed inflation, which essentially hurts the poor. If the government continues chasing the will-o'-the-wisp of seeking to revive the economy by squeezing workers through indirect taxes, then the inflationary process will continue; but it would achieve no economic revival.

Contrast this with an alternative policy. Suppose the government spends a certain amount, say Rs100, as transfers to the poor. Since the poor more or less consume what they earn, all of it would be spent by them buying goods and services. Assuming

for simplicity that the capitalists do not consume anything out of their incomes at the margin, and that their share in output is half, the total demand generated in the economy through the various rounds of expenditure, through the multiplier, will be Rs 200. This will also generate Rs 200 of additional output of goods and services, without any increase in prices (since unutilised capacity existed in the economy). By our assumption that the share of profits is half, Rs 100 of this extra output will be the extra profits which, again by our assumption, will be saved.

Now, if the government taxes away this extra Rs 100 of profits, then (i) there will be no increase in the fiscal deficit; (ii) there will be no increase in private wealth compared to the initial situation (since extra savings which constitute addition to wealth would have been taxed away), and hence no worsening of wealth distribution; (iii) there will be an improvement in the condition of the workers, both because of the initial transfer and because of larger employment; and (iv) there will be no inflation because of this expansion programme.

Thus in contrast to the conservative economic policy which unleashed inflation while worsening the state of the workers, and all to no purpose by way of economic recovery, the alternative economic policy that makes transfers to workers by taxing capitalists, achieves a recovery without causing any inflation. And since the tax on capitalists only takes away the extra profits coming their way, they too would be no worse off than in the initial situation. The absurdity of conservative economic policy is now becoming clear, even to capitalists, though not to the Modi government.

\* This article was originally published in the [Peoples Democracy](#) on June 27, 2021.