Union Budget 2021-22: Increase the fiscal deficit*

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The union budget for the year 2021-22 would be placed in the parliament on the 1st February in India. This budget would be placed in a context of extreme demand depression following the Covid-19 induced lockdown. The economy needs to be given a massive demand boost for faster recovery. The fiscal stimulus should be the main instrument to give the economy a big demand-side push. The centre must enhance its own expenditure and also it should enable the state governments to do an expenditure expansion by increasing the central transfers to the states. The expenditures must be pro-poor in nature, for more effectiveness of the government expenditure multiplier and also for humanitarian reasons. However, the tax and non-tax revenues are expected to be lower as a result of reduction in income and profit and purchasing power of people following the lockdown. Therefore, the government expenditures can be enhanced only by incurring larger fiscal deficit.

The main three objections about increasing the fiscal deficit are inflation, crowding-out and concerns about the sustainability of the public debt. The possibility of a demand-pull inflation under a severely demand constrained situation is absurd. Cost-push inflation may take place due to the higher tax rates (say, on petroleum) and lower subsidies as well. So, lower indirect tax rates and higher subsidies may actually reduce the inflation, ofcourse at the cost of higher fiscal deficit. The possibility of crowding-out of private investment under a demand constrained situation is unrealistic. The interest rate is primarily policy-determined. In fact, there would be an increase in the private investment if the profitability increases through higher demand and higher purchasing power of people. That can happen only through the fiscal stimulus in the current situation. Since, the government borrowing is primarily domestic in nature in India, there is no question of increase in foreign indebtedness because of higher fiscal deficit. As far as the domestic debt is concerned, there is no question of its unsustainability as long as people have faith on the currency notes issued by the same government which issues the government securities.

If the aggregate demand in the economy recovers at a faster rate by a sufficiently large fiscal stimulus, the future investment, growth, level of employment would be higher and as a result of that, the fiscal deficit as a proportion of GDP would automatically come down through increased revenue receipts and GDP growth. The debt to GDP ratio is also bound to come down in the near future. Therefore, an expansionary fiscal policy today would help in reducing fiscal deficit and debt to GDP ratio in future. Moreover, the priority now is expenditure expansion rather than thinking about the fiscal deficit today under this unprecedented challenging situation. The Keynesian demand management policy, which was formulated following the great depression during the inter-War period should be followed now for the revival. The international rating agencies would not downgrade India only because of the higher fiscal deficit to GDP ratio but, they may also downgrade us because of the lower growth, higher inflation, lower profitability, higher unemployment and instability. Moreover, we need to prioritise our domestic interest over the interest of the foreign investors.

As far as the financing of the fiscal deficit is concerned, the government can always borrow from the commercial banks and other lending institutions as much as they are willing to invest in the government securities. The rest of the money can be borrowed from the central bank (RBI), this process is popularly called monetisation. As on 22nd January 2021, the RBI is sitting over a foreign exchange reserve of more than 585 billion dollars or more than Rs.42 lakh crore or more than 21% of the Indian GDP of 2019-20. This reserve was Rs.35 lakh crore or 470 billion dollars before the lockdown. Therefore, there has been an increase of this idle asset by around 3.5% of GDP (of 2019-20) during the lockdown period. Hence, the RBI is absolutely in a comfortable position to lend money to the government to finance its fiscal deficit.

The expenditures in health, education, employment generation, poverty reduction etc. helps the poorer section of population more than the richer section. Since, the consumption propensity is higher for the poorer section, if their purchasing power increases, the fiscal multiplier or the effectiveness of the government expenditure in boosting the aggregate demand, growth and employment increases. Therefore, the composition of government expenditure and tax cuts (if required) should be done in pro-poor manner for faster revival. When the private investment is not increasing at the aggregate level despite the credit-push through Atmanirbhar Bharat Abhiyan package of the central government, the profitability can be improved only by boosting the aggregate demand through enhancing the purchasing power of common people in the country. The possibility of export-led growth is bleak because the pandemic has affected our export destinations, too. So, fiscal stimulus is the only way out. Let us increase the monetised deficit in order to increase the government expenditure substantially on the face of lower revenue receipts. This is definitely not the time for fiscal conservatism. Let us set our priorities right.

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