Establish fiscal council to scale up spending

There is now a body of expert analysis on economic recovery after the lockdown. In this column, I distill the key common messages and briefly expand on fiscal issues.

There seems to be consensus on the following:

1. *We should now be thinking of how we can restart activities in low infection regions with adequate precautions*. This involves more targeted lockdowns; identify pockets which have to be kept under close watch and continued lockdown, while restarting activities in other areas which can then (a) produce goods and services, (b) generate resources to help the lockdown areas. The largest employers in the organised sector can make arrangements for healthy workers to return but employers must collectively plan to open the entire supply chain. Governments should approve these plans and facilitate movement. This needs to be done before the lockdown ends.

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2. This will not help the poor and non-salaried working classes or the unorganised sector. *Income support will, therefore, be needed*. While direct transfers may help, they will not have comprehensive reach; nor can the government afford the entire burden. Non-government organisations and the private sector will have to supplement government effort. If this is not done, then there will be unintended consequences, such as we have just experienced with the movement of migrant labour. People will try anything they can to survive and that would inevitably mean widespread defiance of restrictions.

3. *Focus on businesses with good prospects of survival, rather than attempting a universal effort*. Protect the viability of such businesses selectively. This will be politically difficult but necessary.

4. *Design a comprehensive strategy on how to successfully open all transport linkages, first domestic, and then international*. This will require innovation so that such transportation can happen consistent with social distancing norms. Overcrowding, even crowding, is necessarily now a thing of the past. This will mean investments in expanding transport infrastructure and accepting that the unit cost of transport will necessarily be higher in the future; this will have to be accounted for in reworked business models. Businesses will have to get used to more frugal logistics, which means considerable decentralisation of production and distribution; the lowest cost sourcing principle that worked in a globalised world will no longer apply.

5. *Testing must be ramped up* immediately so that targeted lifting of the lockdown is possible. It should be publicly funded and is a worthwhile cause to spend money on by the plethora of relief funds that have sprung up, for these funds will not address macro-fiscal constraints.

6. *External account stability challenges exist but are manageable*. India's reserve position is comfortable. Oil prices are low. While dollar liquidity is falling, the US Fed is acting robustly, though an International Monetary Fund-led initiative is now urgently needed. But for our domestic needs, we currently have enough to finance imports and are partially protected by our relatively low engagement in global supply chains.

On the fiscal challenge, while the consensus is for relaxing the hard fiscal constraints, some worry that we do not have the luxury to do what developed countries have done. This is only partially true; we may be a poor country, but we have a large GDP and the best way to counteract the biggest threat to the fisc — a collapse in revenues — would be to step up economic activity. I do not think tax relief will play much of a role here.

I have elsewhere outlined a graded approach to the financing challenge[1]. Essentially, this involves converting stock reserves into flow resources. First, mobilise the ₹1-trillion unspent balances in different government accounts over six months. For immediate spending, open a ways and means advances (WMA) window of ₹400 billion, which can be extinguished as unspent balances are mobilised. Second, issue a Covid specific consol — a fixed income product on which interest is paid but there is no commitment to repay the principal. This is a useful instrument in a war-like situation. Successive budgets starting, say, FY23, can specify windows in which these consols will be amortised. Even with our true fiscal deficit at around 4.5 per cent of GDP, this can comfortably mobilise an equivalent amount with no immediate consequences for the debt-GDP ratio. We can then turn to nuclear options like deficit monetisation.

But before going nuclear, India will have to address the big fiscal prudence challenge, which is not captured by the fiscal deficit/GDP metric. Government spending repeatedly does not reach its targets; unspent balances are a reflection of this. This is not acceptable now. Public spending must be carefully monitored to ensure that it is demonstrably reaching the intended beneficiaries, otherwise there will be serious macroeconomic consequences— including inflation hotspots— even before monetisation is contemplated.

It is important for the government to announce a financing widow at scale using this graded approach. In my view, it should do so immediately. But that does not mean that spending is indiscriminately approved. There must be concrete spending plans, and within three months, we must have hard evidence in the public domain that such spending is being fully targeted to the purposes intended, whether income support, or working capital support, or medical procurement. To oversee this, to ramp up fiscal capacity, and to maintain national fiscal credibility, establishing a fiscal council is of the first importance.

The writer is director, National Institute of Public Finance and Policy. Views are personal

1. "Govt needs to protect national wealth and alleviate loss of national income", Indian Express, April 2, 2020