



Don't worry about the deficit

To tackle the fallout of pandemic, government must spend, provide safety nets

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AS INDIA reels from a new wave of COVID-19, concerns are being raised about the premature halt to its economic recovery. After an estimated contraction of -8 per cent in FY21, the IMF raised its growth forecast for the Indian economy in FY22 from 11.5 per cent to 12.5 per cent in its latest World Economic Outlook Report.

"The upgrade in the forecast was because of the evidence we were getting from high-frequency indicators in the past two months in terms of the normalization of economic activity," said Gita Gopinath, chief economist at IMF. As India battles to contain the surge in COVID-19 cases, several states have already imposed severe restrictions at the local level. The services sector has been hit the most as a consequence of these lockdowns and it would be difficult for India to deliver on this optimistic growth projection.

Against this background, what role can fiscal policy play support the economy? This question becomes important as the monetary policy is already accommodative and may not have enough room to further boost the economy. The RBI has reduced the benchmark repo rate by 115 basis points since 2020. With headline as well as core inflation inching up in recent months, the RBI may not be in a position to further cut the policy rate.

But does the government have enough fiscal space to provide stimulus to the economy? Remember, as per the latest Union Budget, the

fiscal deficit is estimated to moderate from 9.5 per cent of GDP in FY21 to 6.8 per cent of GDP in FY22. This expected decline in fiscal deficit is not on account of lower fiscal spending but because of expectations of sharper revenue growth. The revenue receipts are estimated to grow by 15 per cent and fiscal spending by 1 per cent this financial year. With the debt to GDP ratio already more than 90 per cent, additional fiscal expansion will not be an easy choice for the government.

However, extraordinary times call for extraordinary measures and the government will have to find ways to create fiscal space. This has become especially important as the economy is yet to shrug off the impact of the previous lockdown. With the total suspension of economic activity after the imposition of the lockdown, the unemployment rate reached unprecedented levels as per CMIE. The unemployment rate increased by nearly 14.8 percentage points, rising to 23.5 per cent in Apr 2020. The unemployment rate fell in later months after the lockdown measures were eased and economic activities gathered momentum. However, the normalisation of the unemployment rate in such exceptional times can be misleading as it could partly be a consequence of a fall in the labour force participation rate.

Under these difficult circumstances, immediate measures must aim at providing the requisite social safety net to the poor and the vul-

nerable. The central government has already announced it will distribute an additional five kg of grain to the 800 million beneficiaries of the National Food Security Act, which is welcome. However, given the unprecedented uncertainty brought about by this COVID wave, the ration support under the PDS should be raised further.

Lockdown measures may remain in place for longer than initially intended and we may see a spike in unemployment rates. The government should also consider transferring cash to the bank accounts of the poor, just as it did last time, to compensate the poor for the loss of income. This becomes important as MGNREGA – the "employer of last resort" policy of the government – may not provide the safety cushion that it is indeed to as long as lockdown measures remain in place.

The current crisis has exposed the faultlines that cripple our health system. Given the nature of the pandemic, the best stimulus perhaps would be to provide free vaccinations to the population as the benefits of faster and wider vaccine coverage more than outweighs its monetary cost. Immunisation is a public good. As we get over this crisis, the government must increase its outlay on physical and human health infrastructure.

How can this additional fiscal cost be financed? Part of this additional cost may be financed by reducing non-essential government expenditures and use it for

COVID-related expenditure. However, this may not be enough to cover all the expenses and the government may need to resort to additional borrowings from the market than budgeted earlier. The government should not be deterred by a worsening fiscal deficit in the short run as the additional growth that it generates may make debt consolidation easier when things normalise. As emphasised by Union Finance Minister Nirmala Sitharaman, we "do not fear deficits" in the time of the pandemic.

Given that a timely deficit may not have adverse macroeconomic consequences, surviving this pandemic first by enhancing the required spending is crucial. The RBI may allow inflation above the upper bound of 6 per cent only in the short run. Chances are that the RBI may increase the interest rates the moment we realise that inflationary expectations are not just transitory. The plausible rise in interest rates may also be crucial to prevent capital outflows, given the global "economic outlook" when the US economy adopts an easy monetary policy combined with a huge fiscal stimulus to catalyse the convergence of its economic growth to pre-pandemic levels.

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