

The phasing of three categories of expenditures by Gol is important to avoid catastrophe

Devil, Us, the Deep Blue Sea



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Policymakers do face a dilemma while dealing with the economic impact of the coronavirus, even though they may not want to acknowledge it openly. The current chorus of opinions advocates that Gol should launch massive expenditure expansion programmes. There is no doubt that at a time like this, the government must attack and deal with the virus, whatever it takes to do this. This reminds us of an old saying that the fundamental principle of war finance is that nothing should be decided on the principle of finance.

On what kind of expenditures that Gol must undertake, there is a plethora of advice. Added up, it amounts to a sizeable increase in expenditure. Should the government—and more particularly the Reserve Bank of India (RBI)—worry? What is disconcerting is not the proposed increase in fiscal deficit, but how it will be financed. In fact, there will be no takers in the market for the additional loans, particularly at lower rates of interest. Therefore, the only way to finance it is for RBI to pick up the loans either in the primary or secondary market.

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The 'escape clause' in the amended Fiscal Responsibility and Budget Management (FRBM) Act enables RBI to enter the primary market in times of national emergencies. Thus, what one is talking about is monetisation of debt. The extraordinary increase in liquidity resulting from the support to the banking system and government can result in ballooning of reserve money initially, and later, in money supply depending on the money multiplier.

With non-agricultural production stagnating, at some point, there will be an explosive increase in prices. Inflation can become a real danger. This is a lesson we can draw from our own post-2008-09 global financial crisis experience. Therein lies the dilemma. Should we worry about what might happen on the price front? On a war finance basis, we should not.

But can we completely ignore the inflationary consequences? Is inflation a certainty? The probability is very high. It may come with a lag. A bad monsoon will make the situation worse.

Credit Where It's Due

On the provision of liquidity to the business sector through the banking system, there are two concerns. The liquidity-enhancing measures announced by RBI are imaginative and innovative. But banks need to use these facilities with caution. Credit must be given where it is needed and justified. Otherwise, we will have a different problem to face later.

Second, the present stagnation in industrial production and services is greatly influenced by the Covid-19 mi-



On the crossroads

gitation lockdown. Mere provision of credit will not help. If the lockdown is extended beyond mid-April, the industrial and service sectors will suffer greatly. No amount of credit will help. Thus, from a healthcare point of view, Gol must think of alternatives other than the lockdown.

The required government expenditures can be classified into three categories: (1) healthcare expenditures, (2) relief to people directly affected, such as daily wagers and migrant labour, and (3) expenditure to stimulate demand and revive affected sectors. Gol must immediately address the first two categories.

The first set of expenditures is paramount. There is some concern among experts on the extent of testing that is being done currently. Many experts feel that the magnitude of testing must increase multifold times. The first priority is to mobilise adequate resources to meet all health-related expenditures, including supply of accessories like ventilators, masks, sanitisers and material inputs for tests. The challenge here is not only fiscal but also organisational.

The second set of expenditures tries to take care of people who have been directly affected by the lockdown. The announcement made by finance minister Nirmala Sitharaman earlier last

month directly addressed it. Here again, there is a feeling that problems of people thrown out of employment have not been adequately addressed. It is a heart-rending sight to see migrants walking all the way to their home states from their places of work. More needs to be done on this front.

Spend When You Must

The third category of expenditures can wait until we have had some success in combating the virus. Once the lockdown is lifted, and when business units are ready to expand their activities, additional liquidity from RBI as well as some supportive expenditure by Gol can help. The phasing of expenditures by the government, thus, becomes important.

There is the dilemma of having to choose between the devil and the deep blue sea. This is not 'fiscal fundamentalism'. We are thinking of upwards of 6% of GDP as fiscal deficit. We may end up with more than double of the mandated level. We should be conscious of the inflationary impact. We can, however, soften the impact of the choices by appropriate phasing.

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