Recovery takes more than reforms

In any serious attempt at economic recovery, the focus must be on food supply and not money supply

PULAPRE BALAKRISHNAN

The most recent growth estimates of the National Statistical Office show that after a steep contraction in the first quarter of last year, growth accelerated steadily afterwards. This would have assured a recovery had we not experienced the second wave of the pandemic that came with the current financial year. Overlapping State-level lockdowns that started in April have now lasted for almost as long the nationwide lockdown of 2020, and there is no gainsaying their impact on the economy. Output may well have contracted in the beginning of this year. So, though recovery will eventually come, it could be W-shaped rather than V-shaped.

Meaning of reforms

When the issue of economic recovery was raised in public, a minister asserted that the economy will recover due to the reforms planned or already implemented by the government. We do not know what the government has in mind but we should be sceptical of the claim that reforms can make a difference at this stage. Since 1991, the term 'reforms' has been used to mean both policy changes that remove restrictions on private sector activity in certain areas and those that increase profits in existing lines of production. Recent examples of these are allowing greater private sector participation in defence as part of the Atmanirbhar Bharat Abhiyaan launched in 2020 and the significant lowering of corporate tax in 2019, respectively. However, more reforms may be ineffective in spurring recovery. Presently for the private sector, entry into a new area or undertaking investment in an existing activity may not appear profitable given their expectation of the state of the economy in the near future, upon which their revenue will depend.

We may assume that the private sector is fully aware of the following history. In February, believing that the peak of the epidemic had been crossed, the government reverted to its principal macroeconomic pre-occupation, namely fiscal consolidation or the paring down of the fiscal deficit. Accordingly, it raised its budgeted expenditure by less than 1% in the last Budget. The onset of the second wave of COVID-19 in April has thrown the economic policy calculations of the government out of gear. Back in February it was already known that the economy had contracted in 2020-21. To keep public expenditure virtually unchanged under such circumstances had been heroic enough then, but now, with a possible further contraction of the economy, to continue with the frigid fiscal stance would be disastrous. Though we do not know how output has fared so far this financial year, data from the Centre for Monitoring Indian Economy show that unemployment has risen in May, indicating slack demand for output. With this knowledge, the private sector is unlikely to respond with alacrity to liberalising reforms.

Public spending is the key

Right now, raising public spending is the only game in town left to the policymaker serious about bringing on a recovery. If we are to have it, though, we should accept a higher than budgeted deficit. A debate involving economists and central bankers has been set off on whether the government should now 'print money'. This is the wrong way to approach the problem. It puts the cart before the horse. It is also alarmist. The objective is to revive the economy, public spending is the instrument and the funding must be found. It need not involve money creation. India's public debt is low by comparison with the OECD countries, and debt financing remains an option. Even if money financing is adopted, it need not cause accelerating inflation as some predict. Experience in India suggests otherwise. However, studies do show that any economic expansion would be inflationary if the production of food does not respond adequately. How the expansion is financed is less relevant for inflation at least in the near term. In any serious attempt at economic recovery, the focus must be on the food supply and not the money supply.

Pulapre Balakrishnan teaches economics at Ashoka University, Sonipat, Haryana