How to pay for the stimulus
Pulapre Balakrishnan

https://www.thehindu.com/opinion/op-ed/how-to-pay-for-the-stimulus/article32279610.ece

The Hindu
August 6, 2020

Former Prime Minister Dr. Manmohan Singh and his Congress Party colleague Mr. Praveen Chakravarty have in these pages written of the appropriate policy response to the currently depressed state of the economy. Given Dr. Singh's deep understanding of the subject, this is in the nature of invaluable counsel. Unlike the dispensation in power, he and his colleague are for government intervention to revive the economy. They present greater public spending as the *sine qua non* of such a revival, and they are absolutely correct in this diagnosis. They also present the options available and rank them, in the sense of recommending the order in which they ought to be considered for use.

Greater public spending will increase the fiscal deficit and this expansion has to be financed. Theoretically it can be financed by higher taxes. However, when the economy is in a recession this is usually not in the reckoning even though the balanced-budget multiplier is one, i.e., output expands by exactly the same amount as the increase in government spending. So what are the options? They are issuing debt to the public and borrowing from the Reserve Bank, termed 'money financing' as it increases the money supply. Dr. Singh and Mr. Chakravarty plump for increased debt. While they do not rule out of court money financing they suggest that it may be imprudent to do so. Instead, they recommend borrowing from the multi-lateral international agencies, namely the World Bank and the IMF. However, it is not clear that this is a superior strategy.

The media has recently reported some economists responding to the suggestion of money financing with the Friedmanesque quip "there ain't no free lunch". But it may be mentioned that there is no free lunch in the case of debt-financing either. Not only have the moneys to be repaid, they will have to be paid back in hard currency. This would involve India having to earn hard currency by stepping up exports. If a stimulus of approximately 10 percent of the GDP is envisaged, with exports at 25 percent of the GDP. it would imply stepping up exports by close to fifty percent. This would be a herculean task under present circumstances. Indian exports had been faring poorly since 2014. Since then there has been the shock to global output and trade due to COVID-19.

Three more issues are relevant when considering borrowing from the World Bank and the IMF. First, there is the issue of conditionalities. There is no reason to oppose conditionalities on principle but it is not obvious what conditionalities will come along with the loan. Secondly, a loan is bound to take some time to be negotiated, taxing the energies of a government that ought to be engaged in the day to day battle with the coronavirus. Third, external debt is a truly national which arguably government bonds held by the country's private sector is not.

When money financing is proposed it elicits a negative response from some quarters with something akin to a taboo being invoked against the idea. But invoking taboo is not serious economics which would require that a good reason be given for opposing the use of money financing to expand public spending at present. Dr. Singh and Mr. Chakravarty speak of "high intangible and institutional costs" associated with it but do not expand on this. The standard economic argument against money financing is that it is inflationary. However, whether a fiscal expansion is inflationary or not is related more to the state of the economy than the medium of its financing. When resources are unemployed, output may be expected to expand without inflation. As COVID-19 has shocked output downwards unemployed resources must now exist. There is no reasoned case for denying ourselves the option of money financing to take us back to pre-COVID-19 levels of output and employment.

Pulapre Balakrishnan is Professor of Economics, Ashoka University, Sonipat