



**Care packages**  
State-sponsored kits of essential supplies in Kerala, which has effectively contained the pandemic but at a steep economic cost  
THULASI KAKKAT

**STATES OF MATTER**

# Behind the curve

India's post-pandemic life is riddled with unhappy economic choices



**SUKUMAR MURALIDHARAN**

In a state of economic paralysis, pundits worry that a departure from the self-inflicted rigour of the Fiscal Responsibility and Budget Management (FRBM) Act could trigger a capital flight from Indian shores. That prospect at this time strikes greater terror than the reality of the flight of migrant workers from India's cities and towns.

A week into the national lockdown enforced from March 25, the mass flight of migrant workers to their homes was described as a momentary panic induced by "fake news". A month after the Supreme Court heard those famous words from Solicitor General Tushar Mehta, successive waves of migration out of India's urban-industrial frontiers were yet to subside. Ironically, they may have gained a new momentum just when a glimmer emerged of the economy resuming a semblance of normality after a 40-day lockdown.

Early in May, at a meeting of a consortium of banks on economic revival, the Reserve Bank of India (RBI) urged a relaxation of the terms on which credit would be extended to small and medium enterprises. Bankers nodded in assent, while advancing the plea that demand had dried up and they could not conjure it up.

As the circular flow of the economy has frozen, the job of getting the wheels moving again has become a dilemma of what comes first. Does supply kick-start the circular flow or is demand a necessary precondition for resumption?

The classic remedy is the fiscal tool, for the State to tap into the national pool of savings and set the pump in motion with well-directed investments. That option seems disfavoured at this time because much of the expenditure boost would be on the revenue account. Borrowing to finance revenue expenses has never been considered good practice and, with the current precariousness of bank balance sheets, investor confidence

could take a hit.

Breaching the fiscal limits specified under the FRBM, moreover, is considered a potential red line that foreign investors in particular would dislike. Since India's capital markets are highly leveraged with short-term investments, the possibility of an abrupt withdrawal that could potentially destabilise currency parities would seem high.

The next option is to have an issue of bonds which the RBI could buy up, effectively creating volumes of extra money. Conventional wisdom holds that an excess of money fuels inflation. But that is based on the assumption that the supply response from the productive economy will not match the infusion of fresh demand. Advocates of this course of action point to the ample food stocks that lie with official procurement and distribution agencies, which should dampen any surge in prices.

Counting on this mitigating factor without looking at a number of attendant conditions may be hazardous. For instance, India experienced high food inflation through the years 2012 and 2013, despite ample stocks with the official agencies. There was a complex set of factors behind that price escalation, which proved politically costly for the Manmohan Singh government. Among the contributory factors was an excess of liquidity looking for quick speculative gains after the global financial markets collapsed in 2008. Commodity markets, not just in India but also globally, afforded one such opportunity, with detrimental consequences for living standards among the poor.

Yet there is an insistent demand from state finance ministers, for empowering state governments to float bonds that the RBI could subscribe to. When Thomas Isaac, finance minister in the Kerala government, takes a

step back from firefighting the pandemic, the future he contemplates is dire. Kerala has done exceptionally well in flattening the rising curve of infection and mitigating much of the harshness of the economic paralysis. But the costs now have to be reckoned with.

Kerala has achieved its salutary outcomes by front-loading its borrowings and budgetary expenditures. Its treasury is now empty and tiding over the rest of the year when devolution from the central pool of revenue is expected to contract would require severe austerities. As a beginning, the state government has had to dock a part of all staff salaries.

One way of neutralising a possible inflationary spiral from an infusion of new money

could be to place the burden of austerity upon those most capable of supporting it. Inflation renders a production contract very difficult to fulfil because of a constant shifting of underlying conditions. Supporting consumption demand may require a wage boost for the working population, but this would be neutralised if the owners of capital

were to seek to maintain their share of the total output by raising prices. That situation, in turn, would make an explosive price spiral inevitable.

Trust has already been deeply shaken by the abrupt shutdown of the economy and the desperate straits that the country's working poor were plunged into. Regaining this trust will not be a cost-free process.

Sustaining it would require some evidence of a fair sharing of the burden in which the iniquitous bargains struck over the last three decades will be reversed and ultimately buried.

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