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'Look After Unemployment and the Budget Will Look After Itself'

BY SASHI SIVRAMKRISHNA ON 12/01/2018 • LEAVE A COMMENT

The inability of the economy to generate employment opportunities for millions of Indians is developing into a serious social, economic and political issue.

Finance minister Arun Jaitley on the day of the budget in 2017. Credit: PTI

"Look after the unemployment, and the Budget will look after itself."

This was the advice of John Maynard Keynes, one of the greatest macroeconomists of the twentieth century. While many of his ideas, policy recommendations and views have slowly been phased out of popular discourse, countries continue to struggle over what may be considered as the core concern of Keynesian macroeconomics – involuntary unemployment.

India is no exception to this predicament.

The fifth budget of the present NDA government – and probably the last significant one before the 2019 general elections – will be announced in just a few days. As the day of reckoning approaches, the media has slowly begun building up tension over the challenges (https://thewire.in/211608/budget-2018-rural-distress/) of the forthcoming budget to grab attention of readers and viewers. And what better way of framing the issue than focusing on a fiscal deficit target number (https://www.ndtv.com/business/budget-2018-government-may-opt-for-wider-fiscal-deficit-target-of-3-2-in-fy19-says-dbs-1797802)?

Can the government adhere to its fiscal consolidation (http://www.livemint.com/Money/2qMLDnLcL7htbRjUC9YOZN/Budget-2018-3-key-issues-markets-are-likely-to-watch-out-fo.html) path and achieve the FRBM target of 3%? By how many tenths of a percent will it breach (http://www.livemint.com/Politics/jy58UALCuhkJ0e5XD2NcRI/Govt-breaches-fiscal-deficit-target-for-201718-in-November.html) its current target of 3.2%? With general elections not too far off and economic issues of agrarian distress, widespread unemployment and poor all round growth, how will the government balance the need for greater spending with lower than expected revenues and still move closer towards that magical number of 2.5% (http://www.livemint.com/Politics/XhpJxHhdc3l80YJjFRPajO/NK-Singh-panel-recommends-25-fiscal-deficit-target-by-FY.html) by 2023? It is the constraint of a deficit target number – peppered with plenty of numbers in lakhs of crores or trillions of rupees – that seems to bring an element of anxiety and with it, a dash of spectacle into the whole budget event and discussions that follow.

Voices are already getting louder on the dire consequences (https://economictimes.indiatimes.com/news/economy/policy/to-deal-with-fiscal-threat-fm-has-the-choice-between-short-term-gain-over-long-term-pain-or-vice-versa/articleshow/62434605.cms) of fiscal profligacy; the imminent possibility of the government raising the fiscal deficit to tackle critical economic issues. Given the euphoric response to Moody's upgrade last year, the government (http://www.livemint.com/Politics/UFiKD80bEIxJF1ztxaEzNP/Arun-Jaitley-on-Moodys-rating-upgrade-Belated-recognition.html) on its part may worry that failure to meet the target will imply conceding defeat on its economic policies and a possible downgrade in the near future. Although this overriding concern over the deficit target emanates primarily from rating agencies (https://blogs.economictimes.indiatimes.com/et-commentary/moodys-just-warned-goi-not-to-undo-fiscal-consolidation-to-boost-growth/) and neoliberal economists (http://www.moneycontrol.com/news/business/economy/hope-government-meets-fiscal-deficit-target-of-3-2-percent-arvind-panagariya-2478623.html), it is not uncommon to find this concern (https://thewire.in/124816/frbm-review-committee-overlooked-constitutional-escape-clause/) over the government's inability to meet its fiscal deficit target being highlighted in places (https://thewire.in/208682/government-set-to-breach-fiscal-deficit-target-for-fiscal-year-2017-18/) which are otherwise generally critical of neoliberalism.

The government squandered an opportunity to take the Indian economy on to a higher growth trajectory given the context of a reviving global economy, significantly lower oil prices and a huge mandate from the 2014 elections for structural change. Its inability to resolve (http://www.firstpost.com/business/bad-loans-of-indian-banks-cross-rs-800000-cr-banking-mess-explained-in-7-charts-3939999.html) the non-performing asset (NPA) issue of banks, the demonetisation of the Rs 500 and Rs 1000 notes and hasty implementation of the Goods and Services Tax (GST) has cost the economy heavily in terms of disrupting growth. The idea that somehow an economy bounces back to a high growth path after the effects of supply-side shocks dissipate is neither supported by theory nor empirical evidence. Agrarian distress, sluggish industrial growth including that of the MSME (https://economictimes.indiatimes.com/small-biz/sme-sector/all-evidence-suggest-unorganised-sector-smes-worst-hit-by-demonetisation-arun-kumar/articleshow/61542781.cms) sector and inability of the economy to generate employment opportunities for millions of Indians is developing into a serious social, economic and political issue.

Meanwhile, the slowing down of GDP growth has adversely impacted (https://timesofindia.indiatimes.com/business/india-business/govt-breaches-fiscal-deficit-target-at-nov-end/articleshow/62301138.cms) the inflow of revenues into government coffers. The budget is therefore likely to breach the deficit target of 3.2% of GDP given the level of expenditure undertaken during the year. While little can be done at this point of time to bring back the deficit to its initial target in the current fiscal year, there will be pressure on the government to ensure that the deficit does not deviate too significantly from the path of consolidation proudly announced and adhered to by it and at the same time, welcomed and endorsed by rating agencies. Abiding to fiscal consolidation will therefore be an important factor in deciding the course of action for the coming budget.

Unfortunately, fixing the deficit target at the beginning of the year is in fact a futile exercise given that the outcome is essentially non-discretionary. What the government fixes at the beginning of the year is its level of expenditure and tax rates; the actual quantum of tax collections is completed and become known only at the end of the year depending on the level of GDP. If growth is sluggish, tax collections are low so that for any given level of expenditure, the deficit widens. This is why fiscal policy is considered an automatic economic stabiliser; the deficit widens during a period of low growth and vice-versa. Now some of the reasons for low growth could be on account of, or in spite of, government policy. The global financial crisis of 2008 obviously was beyond the control of the Indian government while some reasons for the present slowdown can be attributed in strong measure to the policies followed by the present government. This is something that needs to be addressed and set right.

A new beginning

Economists tell us something else which is important in decision-making: ignore sunk costs. Whatever may have been the dire consequences of policies in the past, it is important to begin afresh, move on and implement policies that will yield better outcomes in the future. The present scenario is poor growth, low private sector investment spending, sluggish exports and high unemployment. The only way to come out of this and alleviate the situation for millions of unemployed people is increased government direct spending on job creation, in particular, on Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) – with a possible extension to urban employment too.

The questions that will be raised are obvious; where does the government get the money (http://www.livemint.com/Opinion/BM242n5faKn7XsxE68RgsO/Union-budget-Show-me-the-money.html) to spend on MNREGA? Taxpayers? And the crowding out effect? And what happens to the fiscal deficit target of 3% of GDP?

It is here that we need to dismantle the whole neoliberal economic paradigm – and there are realistic alternatives – that has seeped into popular macroeconomic discourse. This paradigm is built on four pillars; inflation targeting, independence of the central bank (https://thewire.in/105496/rbi-central-bank-autonomy/) (to set interest rates), fiscal consolidation (https://thewire.in/121017/modern-money-obsession-fiscal-consolidation/) and structural reforms (supply-side measures). Keeping the fiscal deficit low (minimum government) ensures low and stable inflation that allows the central bank to keep interest rates low thereby enabling private sector activity to propel the economy to full employment.

But will this really happen? If we continue to think so, then obviously the fiscal deficit will be the focus. With revenue growth constrained, especially with GST rates fixed, the government may resort to a cut back or at least slowdown increments in spending. In a nutshell, the government may adopt austerity measures in the present budget and try pushing on a string with supply-side structural reforms to alleviate the unemployment problem. The experience of the UK (https://www.theguardian.com/commentisfree/2017/nov/17/austerity-minorities-women-disabled), several EU (https://www.theguardian.com/business/ng-interactive/2015/apr/29/the-austerity-delusion) countries and more recently, Iran (https://www.washingtonpost.com/world/behind-irans-protests-anger-over-lost-life-savings-and-tightfisted-budgets/2018/01/06/64993a66-f23f-11e7-95e3-eff284e71c8d_story.html?utm_term=.cdd92a4abf44), Saudi Arabia (http://money.cnn.com/2018/01/09/news/economy/saudi-arabia-austerity-backlash/index.html), Argentina (https://www.telesurtv.net/english/news/Clashes-Countine-In-Argentina-Over-Austerity-Measures-20171214-0015.html) and Tunisia (http://www.dw.com/en/tunisia-anti-austerity-protests-turn-deadly/a-42079677), vividly tell us the socio-economic dangers and inhumane outcomes of austerity measures; cut back in government spending, lower GDP (government spending is a major component of GDP), low revenues, persisting fiscal deficit, lower government spending … a vicious cycle that could drive the economy in a downward spiral of higher unemployment and greater economic distress.

But dismantling the edifice of neoliberal macroeconomics only begs the question: what is a viable alternative to neoliberalism to solve the unemployment problem? The answer to me is unequivocal; modern money theory (MMT), a post-Keynesian paradigm that draws upon the work of not just Keynes himself but other important economists including Abba Lerner, Hyman Minsky and Wynne Godley. It is not possible to present MMT in a few sentences but let me at least mention some of its fundamental tenets.

First, taxes are not a source of revenues for the state. Instead, taxes drive state money (https://thewire.in/84425/taxes-really-fund-government-expenditure/) since taxes can be paid only in the tokens (money) created into existence by government spending. While the government creates money by spending, taxes destroy money thus created. Second, taxes are not "revenue" to the government. Rather it is an instrument to control inflation by draining money from the private sector. Third, even with self-imposed constraints on deficit financing, government borrowing can only happen in its own money, i.e. buyers of government bonds will have to pay for them in state money only. The system of primary dealers (PDs) ensures that government bond subscriptions never fail so that the government spending is never constrained.

Finally, fear over government debt is needless. Simple accounting tells us that public debt (liabilities) must be someone's asset – which it is – the private sector's financial asset. As P Chidambaram, former finance minister recently pointed out (http://www.newindianexpress.com/nation/2018/jan/01/scrapping-8-per-cent-taxable-bond-a-deplorable-act-says-chidambaram-1741998.html), "Government owes a duty to provide its citizens one safe and risk free instrument for savings. Taking the only instrument away is a deplorable act." But without government raising public debt – or accumulated fiscal deficits – how will the private sector get access to this risk-free asset?

These few insights reveal how MMT turns orthodox macroeconomics on its head – a modern economy does not face any financial constraint in its own fiat currency. The only constraints are real resources and until these remain unutilised, government spending is necessary to reach full employment. Of course, it would be naïve to expect a government to imbibe MMT principles without its greater acceptance in academia, think tanks and popular discourse; however, for now we can only hope that it will bite the dust, swallow its pride and let go of arbitrary fiscal deficit target numbers with increased direct spending on rural and urban employment generation, creating a virtuous cycle of growth and employment that would ultimately tame the deficit. Put simply; "look after the unemployment, and the budget will look after itself."

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