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Message from the Principal

The theme for the debate ***The Government should Resort to Deficit Monetisation to Prop up the Economy against the Backlash of Covid-19 Pandemic,*** so aptly chosen throws a challenge to us as to the need for a creative response to the impact of Covid-19 Pandemic and its aftermath on the Indian economy. The discussions at the debate indicate proactive and critical thinking that went into preparation for a debate of this calibre.

I would like to congratulate the faculty of the Department of Economics on this venture of penning down the ruminations of the debate ***The Government should Resort to Deficit Monetisation to Prop up the Economy against the Backlash of Covid-19 Pandemic.*** The deliberations of the debate have been reflected upon before they crystallized into this e-publication.

Compliments to the students who took on the 'new normal' as ducks to water and participated in the debate, judged by two of our former students, Devika Chirimar and Dipanjana Roy. We appreciate the faculty headed by Dr. S. Mitra, who motivated our pupils, sustained their interest and edited this e-volume till it saw the light of day.

Sr. (Dr.) Christine Coutinho
Loreto College

Content

Editorial Committee

Fiscal Recompense for the Economic Fallout of COVID-19 Pandemic in Monetary Route

Divya Sangani, 3rd Year

The Covid-19 pandemic has waged a multifarious war on the world economy. It has unleashed a situation of uncertainty and complexity which has never been witnessed by the globalized world. The World Economy has come to a staggering halt. Governments and international organizations all around the world have been trying to devise policy measures, so as to mitigate the challenges posed by this pandemic. Several countries around the world have resorted to the controversial policy measure of deficit monetization to tackle this unprecedented situation.

India has also been hit hard by this pandemic. Delving into the economic scenario we see that the government is trying to come up with several policy measures and fiscal stimuli to surmount the damage to an economy. This has burdened the public exchequer due to increased government expenditure. Government revenues in the present financial year have deeply contracted owing to the lockdown and this has raised the question of how should the government finance this monumental deficit. This has raised the much-debated issue of whether the government should adopt deficit monetization to finance government expenditure or not. Deficit monetization has always been an issue of contention with oppositions stating that this policy measure has proved to be more disastrous for the economy than the crisis for which it is deployed. Experience has shown that deficit monetization is responsible for fueling inflation. The Indian economy is suffering from a situation of falling prices, output and employment. According to the World Economic Outlook Report, inflation in emerging market economies has fallen by 1.2 percentage points, to 4.2 percent as of April 2020. A recent Reuters Poll states that India's Consumer Price Inflation has eased in June from March. Further another article from Reuters states that prices in the wholesale market have fallen for the third straight month, declining by 1.81 per cent in June, due to sharp decline in the prices of fuel and power items. Since, we are already witnessing a deflationary or near stagnant price trend, the added monetized deficit induced inflation will actually help pick up the economic growth. It has been argued that with too much money chasing too few goods and services, inflation will creep in. However, with the recent unlocking of the commercial sector, the production units have once again started churning out goods and services at a slow but gradual pace. Therefore, this argument only seems to have limited applicability. Thus, a definite amount of inflation is inevitable but the Global Economic Crisis of 2008 has shown that India though facing a bout of high inflation was successful in tackling it with credible policy instruments. Reports from various economic organizations show that India was facing demand deficiency and slowdown before the Covid-19 outbreak. This has been confirmed with the contracting government revenue for the financial year

2019 which were below the budgetary predictions. The Reserve Bank of India has already undertaken several policy measures to inject liquidity in the economy but the result has been far from satisfactory. Further, the Government policy reforms are more supply-centric, while commercial banks being risk-averse are hesitant in extending loans. So, in such a scenario deficit monetization seems to be a viable instrument. It can inject the required liquidity in the market which will propel the demand for goods and services. With deficient demand and low velocity of money the above said creation of demand will not essentially lead to an excess demand situation but only help demand to rise incrementally thus keeping inflation in check. It has also been cited that deficit monetization can pave the way for greater inequality. But this can also be tackled with the proper execution of prevailing poverty alleviation programmes with the needed modifications. It has also been observed that deficit monetization lowers investors' confidence. However, in the present situation, it is important to prioritize sustaining and assisting the existing Indian businesses which have already been hit hard by the crisis and then look at attracting further foreign investment.

Such a policy can only be implemented provided that it is monitored and controlled from time to time. Further, it is important for the government to prioritize its spending towards sectors that are productive or those which are more vulnerable. With Covid-19 still not reaching its peak in India, it is still not clear whether the government might have to increase its spending further. Therefore, in an unprecedented situation like now, monetized financing might be inevitable if not now then in the near future.

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Roadmap Towards Restoring Indian Economy against the COVID-19 Crisis: A Fiscal – cum-Monetary Perspective

Syeda Farkhanda, 3rd Year

The current global pandemic has affected the entire world economy in a myriad of ways, one of which is its adverse impact on the world economy. According to the World Economic Output (WEO) Report of June 2020, the global growth is projected at -4.9 percent which is 1.9 percentage points below the WEO Report of April 2020 and is much worse than the 2008-09 financial crisis. The pandemic has essentially brought the world economy to a grinding halt as the production, sale, and consumption of an array of goods has been disrupted. Thus, with the crisis beginning on the supply side and given the trade-off between health security and economic activism, the pandemic has led to certain unique problems. Moreover, since these problems aren't unique to a particular country, economists around the globe are working on a wide range of policy suggestions to seek a remedy. One such policy suggestion is the use of deficit monetization.

The suggestion of deficit monetization has arisen mainly due to the massive amounts of spending that governments are facing currently. According to the International Monetary Fund's World Economic Outlook report in June 2020, the steep contraction in output and the resultant fall in revenues has caused a huge surge in government debts and deficit. The report elaborates that under the baseline scenario the global public debt is estimated to exceed 101 percent of GDP in 2020-21 which is an increase of 19 percentage points from the previous year, meanwhile, the average overall fiscal deficit is estimated to rise to 14 percent of GDP in 2020, rising about 10 percentage points from last year. For advanced economies, the fiscal deficits are expected to rise to 16.5 percent of GDP and government debt to exceed 130 percent of GDP, while for emerging economies fiscal deficits are projected to rise to 10.5 percent of GDP on average in 2020 while government debt is estimated to expand to 63 percent of GDP. Since interest rates are currently low, the use of deficit monetization would allow the government to create real resources.

However, just like two sides of a coin the policy implications of deficit monetization comes with its own share of cons. Firstly, there exists the problem of inflation which could be caused by an increase in the money supply which is a consequence of deficit financing. Further, India has not had a pleasant past with the policy of deficit monetization. Historically the five-year plans in India were based on deficit financing as it was seen as a means to fund the plans, but after the seventh five-year plan, the high budget deficits along with high deficit financing consequently led to the 1991 crisis. As a result in March 1997, the government and the Reserve Bank signed an agreement to stop this deficit financing. Since unlike other sciences economics cannot conduct controlled experiments within laboratories, one of the primary sources of information is historical events and hence the true result of a particular policy can only be seen after its implementation as it often leads to unique results based on a plethora of variables. Thus, it is important to keep in mind the historical implications of the policy of deficit monetization on the Indian subcontinent.

Secondly, as pointed above the pandemic has halted the supply of various goods and services. Thus, focusing on policies aimed at only injecting demand might further aggravate inflation, as well as result in rationing and supply bottlenecks, at least in some sectors. This is crucial since demand might not consequently create its own supply as production cannot be increased at will and increasing proximity between workers might further worsen the health aspect of the population at large, which will consequently make the trade-off between the health and the economy, worse. Moreover, any shortage in domestic supply cannot be compensated by imports since international trade has also reduced dramatically. The contraction in world trade was estimated to be close to -3.5 percent (year over year) in the first quarter, according to the June 2020 World Economic Outlook Report. Thus, a two-pronged solution might be more beneficial.

It is needless to say that the pandemic has caused a huge crisis towards government finances and there might arise a situation where nations have to resort to deficit financing. In that case, it is crucial that economies ensure there are policies in place to maintain the inflation targets later, and also ensure that the supply side isn't completely ignored. Moreover, since new developments are coming up regarding the pandemic and the consequent effect on the intensity of lockdown is subject to changes, the emerging situations might call for new and improved solutions.

Thirdly, if too much money is created in too little time then prices will increase rapidly wiping out the savings of individuals. At a time when incomes of individuals have already taken a hit, and consumption at least of certain essential items cannot be curbed, individuals would want to utilize their savings towards necessities. Under these circumstances, if prices further rise it will incessantly burden the savings of those individuals. According to the International Labour Organization the global fall in the work hours from 2019:Q1 to 2020:Q4 was equivalent to the loss of 130 million jobs. This decline is further estimated to be equivalent to 305 million full-time jobs by 2020:Q2. The hit to the labour market has been especially severe for low skilled workers who do not have the option or resources to work from home. Furthermore, the ILO estimates that of the 2 billion informally employed workers worldwide, close to 80 percent have been significantly affected. In the Indian context, the incomes of a lot of people in the labour force have incurred a severe hit during this pandemic. The section of the labour force which has been hit the worst is India's massive informal sector which comprises more than 90 percent of the workforce and accounts for about 50 percent of the national product. This is specifically because workers from the unorganized sector do not enjoy any job protection or social security benefits. As a result without state support, the country might face further starvation and resultant deaths which will add on to the already increasing death toll from the virus.

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Never Say Never to Deficit Monetisation

Satakshi Chakraborti, 3rd Year

The forecast of a global recession has led many to believe that we are all onboard the same sinking ship. This complacency has led to a false notion that either everyone survives or no one does. The fatal flaw with this thought process is that the possibility of a more skewed economic power balance post-pandemic is ruled out. Just like many, India is residing in a fool's paradise. It is high time that the policymakers realise that only path-breaking economic reforms can decide whether India sinks or swims. At this point, chances of the latter seem rather bleak because little to nothing has been done to address the woes of the masses. This sorry state of the economy can be ameliorated only with reasonably unconventional economic measures seeing that there are no global benchmarks to fall back on.

This inescapable pandemic has compounded the misery of Indians, mainly, the ones who belong to the fag end of the socio-economic pyramid. India is staring at the worst recession since Independence and a potential 10% GDP loss. Seeing that this is not a cyclical slowdown but a structural one, many economists have suggested an unorthodox course of action to prop up the economy. Falling tax revenues and exceptionally high fiscal spending rates have sparked a countrywide debate over the Government's approach to deal with the fiscal deficit. The substantial risks of deficit monetisation make it a last resort according to the majority. But economists now opine that it is time to break the norm and temporarily monetise the deficit to revive the crashing economy.

Nobel laureate Prof. Abhijit Banerjee in "The Wire" interview with Karan Thapar[1] said "The State Governments are out of resources. The Federal Government, which has at least control over the resources, should be allowing them to spend more."

The significant jump in the State borrowings and the depletion of State resources shows how the Centre is being further burdened to meet the State fiscal demands. What is even more concerning is that gross borrowings have had a striking hike at the end of Fiscal Year 2020. Other alternatives to deficit monetisation like Cash Management Bills[2] and Open Market Operations[3] are rendered ineffective as they fail to bridge the gap between earnings and borrowings. At best, they contribute to an incremental increase in demand and make an underwhelming attempt to

[1] https://www.youtube.com/watch?v=4h7Zka4hIvU

[2] Cash Management Bill the short term security sold by RBI to raise money

[3] Open Market Operations is the mechanism by which RBI purchases and sells government securities in the open market to regulate money supply in the economy

resuscitate the stagnant economy. Due to the national lockdown, economic activity has become sluggish, and the money multiplier has been declining. There has been a record amount of bank withdrawals by the public, showing that they are keener on holding cash and are thrifty when it comes to expenditure. The circulation of money is thus languid, and that is very bad news for the economy already on the path of recession.

This downward trend will increase unemployment in the country. Although the Finance Minister Nirmala Sitharaman announced Rs. 6000 crore employment stimulant using CAMPA Funds[4] to create employment[5], the OECD[6] Economic Forecast Summary as of June 2020 estimates the urban unemployment rate to surge to over 25% of the labour force[7].

The Asian Development Bank forecasts the GDP growth rate in 2020 to be 4%[8]. This situation of deficient demand is further exacerbated as the Government is using supply-side measures to resolve a demand-side problem. The economic relief package relies on extending credit. But, loans take time to work; the more immediate challenge is to save life and livelihood. The unparalleled misery of the migrant workers, daily wage earners and contractual labour is being downplayed while there is no redress. Economists have vehemently supported the idea of direct cash transfers for six months consecutively to help them keep their head above water. If the purse strings are not loosened to restore the informal sector to its former health, then the formal sector will suffer a series of dire consequences.

The direct fiscal package is only 1-1.5% of GDP, only a quarter of the fiscal stimulus used in 2008. It is needless to say that more money has to be injected into the economy for giving an impetus to aggregate demand. The MSMEs are eligible for collateral-free loans, but these loans only increase their indebtedness. Instead, the Government needs to provide debt relief to these businesses. The bleeding airlines are incurring millions in losses daily. The condition of the unorganised sector is deplorable, and these people are not only losing their livelihood but also their lives. The Government understandably has a resource constraint which is why financing this exorbitant expenditure will require direct intervention by the RBI. If the debt dynamics

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[4] Compensatory Afforestation Fund Management and Planning Authority (CAMPA), under the Compensatory Afforestation Fund Act, 2016

[5] https://www.youtube.com/watch?v=G-UNA0cAT3E

[6] Organisation for Economic Co-operation and Development

[7] https://www.oecd.org/economy/india-economic-snapshot/

[8] https://www.adb.org/countries/india/economy

deteriorate any further, then the downturn will be inevitable, and the common man will bear the brunt of this aggravated economic crisis.

Under ordinary circumstances, deficit monetisation does show the Government's profligacy, but in such an anomalous economic situation, it shows prudence in decision making. In a situation of standard economic activity, the Government sells bonds to the banks and uses the money to pay for salaries, goods and services, contracts, etc. This money, deposited in the bank accounts enable the banks to extend credit and perform their economic duty. But in an unprecedented time such as this, banks are risk-averse and are not willing to buy Government bonds. Here, the RBI steps in to buy these bonds. This money helps the Government pay its regular dues and to finance the added expenditure. Here again, the money gets deposited in the banks who are now sceptical about extending loans. Through the reverse repo window, the banks earn an interest of 3.75% on this idle money. The Government also receives a lesser dividend from both the RBI and the banks because it loses out on the 6-7% bank interest rate. Some might falsely deduce that this money is free money running loose in the economy, causing inflation, while in reality, it is just the opposite. Here, base money[9] is converted to broad money[10] in an atmosphere of slow credit growth and very low economic productivity. This weak economic activity renders the inflation argument against deficit monetisation meritless.

The risk associated with this is the malfunction of the market signals due to RBI interference. The banks that now are highly liquid might end up giving loans to businesses and individuals with low creditworthiness. To avoid such problems, the Government needs to have a vividly spelt out fiscal road map with an appropriate timeline. The Fiscal Responsibility and Budget Management Act, 2003 has a clause which states that if the real GDP output is 3% points lower than the average of the last four quarters, then the Government can go for deficit monetisation. The need of the hour is to invoke this clause and save the crippling economy.

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[9] Money in circulation or held with the public, in the RBI's reserves or in the commercial bank deposits

[10] Includes base money and less liquid money like time deposits of financial institutions and banks

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Deficit Monetization: A Misstep to Boost Economy Post Pandemic of Covid-19

Udita Sen, 3rd Year

When invoking the historically raging debate of deficit monetization, the conventional theoretical wisdom of its negative impacts, that of inevitable inflationary pressures, is often addressed. Proponents of the policy conveniently assume that the inflation that does creep into the economy can be tapped in by the Central Bank, as and when the government wants to and opponents often negate this assumption. The following speech is bifurcated, thus, into two major constructives. In the first constructive, we side with the views of the proponents that the said inflation is minor and thus controllable. Even in such a scenario, there exists several negative ramifications that the policy may uncover.

Begining with loss of hard earned credibility that RBI is bound to face in the face of such a policy initiative. When the RBI agrees to monetize a deficit as big as 12 lakh crore in a developing economy like India, it subordinates its monetary policy to a mere financing strategy of the government and irrespective of whether inflation does take place, the markets suspect that the RBI has abandoned its inflation targetting regime in favour of fiscal dominance. Thereby the markets expect that in the off chance of an inflationary pressure, the RBI will not be able to factor it in and lose its operational freedom. Next, we need to shed some light on the demand forecast in the economy. India was facing a vicious cycle of deficit demand much before the Covid-19 backlash happened. Now, as we factor in the soaring unemployment rates of 23% (as of May, 2020 according to the Bureau of Labour Statistics), the all time highest in a decade, salary cuts in almost all firms and the informal sector losing their livelihoods, the demand bottleneck is only going to get worse in the times to come. So, the government's idea to give a boost to the money supply in the economy thereby regulating demand for the better, might as well backfire because of the crippling anxiety and uncertainty people are in. With no assurance of a continued, uninterrupted income for most families, an upward trend in demand is highly improbable especially in the lower income families because they are adept at surviving on bare minimums in situations of crisis. Even if we were to give in to the rosy idea of direct income transfers to especially the low income sections of the population, expecting their demands to have drastic changes will be a farfetched assumption given their instincts to save in the face of an unprecedented, unanticipated and by far uncontrollable crisis. The idea to make direct transfers to the low income families invokes the long drawn debate between unilateral transfers v/s financial inclusion. If such transfer were to be a one time activity, it will be termed as a windfall gain and it will directly find its way into savings and not permanent income thereby not giving any contribution to the consumption levels. Even if one looks beyond all these ramifications, the informal poor sections have very little control over the total levels of demand in the economy and monetizing a huge deficit to allow their demands to be hiked, the resultant change in demand would be a minor percentage of the desired levels. Further, allowing easy high powered money in the economy will allow for self-employed businesses who somehow managed to remain afloat to feed into the rosy idea of bad loans. The policy of deficit monetization is essentially a supply-side solution to a demand-side problem. Even though production will get a boost, because of the existing demand bottleneck which gets further intensified by the covid-19 backlash, the small scale businesses might fail. This problem becomes manifold keeping in mind the 20 lakh crore relief package already announced by the Central Government. On failure of repayment of such loans, they turn into NPAs and India has had to write off 65000 crore of NPAs amidst the Covid-19 pandemic, so further pressure of NPAs puts the health of the banking sector into question. Since banks are considered too big to fail, well-performing government banks would be expected to bail them out like happened in the case of Yes bank and State Bank of India. This is an intense blow to people’s confidence in the banking system of a country. Since, people in times of crisis try to remain prepared for an uncertain tomorrow, they choose to save, but with their confidence shaken in banks, they manage their funds on a micro level thus not adding to the economy substantially. What we might be looking at is a the classic problem of ‘Paradox of thrift’ whereby even though in the face of recession, people as a united front are expected to demand heavily, they end up saving at personal levels which prove to be detrimental for the economy. The above mentioned ramifications only form the first constructive where we consider minimal or no levels of inflation. The narrative further strengthens when we factor in high inflationary pressure in the economy. To give shape to that view, I shall address each section of the working population.

The apathetic stand of the ruling government and the employers towards the migrant workers, specifically small scale industry and construction workers, have led them to go on record to admit that they shall look for other employment opportunities in their respective rural villages and actively pass up their present work opportunities. Being a labour surplus economy, India cannot think of overnight automation and thereby to incentivise the workers to come back to their respective worksites, employers will inevitably have to offer higher wages. In the backdrop of high inflation, there are high chances of what is known as the wage price spiral. The existing inflation rate is that of 5.9% (as of May 2020 according to Ministry of Labour and Employment, Govt. of India) and is considered robust, for now. With higher inflations, fixed salaried workers would be hit hardest and businesses will pile up unsold inventory since people will be unwilling to purchase things beyond survival necessities. Another major ramification of salary cuts, job losses and business losses coupled with inflation is a sharp fall in income tax revenues and corporate tax revenues. Fiscal deficits are considered a positive sign for an economy if it arises out of investment spending decisions. However for India, it has happened due to a low tax revenue receipts which is highly economically unprofitable. If the government decides to monetize the whole deficit, the rates of interest are going to inevitably rise, crowding out investments. So, essentially, public investments come at the cost of private investments which heavily discourages businesses. Furthermore, deficit financing is a glaring example that the country is in a major financial pickle and is unable to be up and running. Such a situation sets in investment pessimism. Adding to the plight is the value of the Indian rupee which suffers incredible loss when the RBI allows for deficit monetization. Unlike the US dollar, the Indian rupee does not have high demand to counter the depreciative shock thus RBI is bound to sell US dollars. In the face of depreciation of the rupee, financial capital takes a flight out of the country. Investment pessimism and bearish expectations led to a fall in 66,458 crores (according to Financial Express) of FPI going out of the country in the last 2019 and 2020 before the pandemic hit. Allowing RBI to sell US dollars to shield the rupee from the fate of depreciation runs the risk of shelling out foreign exchange because RBI had to sell 902 million dollars of US currency last April, which has been the steepest fall since the 2007-8 recession. Thereby the sovereignty and freedom of the RBI is going to be put to test and questioned if the government treats it as its own purse and reduces the RBI's operational autonomy to that of a financing agent of the government.

In conclusion, for a multitude of reasons from various standpoints especially in the backdrop of Covid-19, the policy of deficit monetization would be reduced to the stunt of a hamster running in a wheel. The initial objectives will remain unmet, the agent involved will tire out and the bait of a brighter tomorrow, a better future will remain an elusive myth.

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Indian Economy vis-à-vis COVID-19 Pandemic: The Tacit Solution

Adrija Poddar, 2nd Year

It's the Keynesian revolution and the rise of demand driven macroeconomics which led to the idea of a budget deficit. The Keynesian revolution made politically feasible for governments to spend more than what they brought in. Governments could also borrow money and spend it as a part of a targeted fiscal policy. Keynes rejected the idea that the economy would eventually return to a natural state of equilibrium. He instead argued that once there is a negative external shock in an economy, for whatever reason, the fear and gloom that it brings along with itself among the different agents in an economy, becomes self-fulfilling and can lead to a sustained period of depressed economic activity and unemployment.

This corona virus pandemic has already transformed into an economic shock, impacting not only the supply chain but also the demand. In a developing economy like India, unemployment has remained a problem ever since and with the economy experiencing a series of lockdowns since March, it has done nothing but only contributed in soaring the numbers. With the employers not being able to pay salaries to their employees and workers on daily wages being retrenched, the government has to step in, in order to protect these workers and these enterprises. It has to make expenditures in the form of unemployment benefits along with the public investment and has to spend on social protection measures and health protection measures so that employees are safe at the workplace. The spending on health protection measures extends not only to these workplaces but the protection of the entire society at large. These are the two immediate spending priorities of the government - the poor and the vulnerable and the health sector. The third kind of expenditure should be directed towards providing stimulus to the aviation, hospitality and all the other sectors which have been hurt by the spread of this virus.

With the private sector becoming more and more sceptical, with the increase in NPAs leading to bank mergers, and with the sentiments of the investors being hit hard due to the continuous bank scams- as in the case of Yes Bank in the recent past and all the others which have been happening, this responsibility of drawing financial resources rests on the government. In such situation the fiscal deficit of the government is going to increase. The government in such a situation will have to resort to deficit financing either by borrowing money from the public or by printing new currency. The former even if adopted cannot cover the entire fiscal deficit that is going to accumulate in this period and in fact can soak credit from the market going against the very purpose of it. The latter today seems inevitable. Hence, the government of India has to resort to deficit monetizing as a strategy in order to prop up the economy against this COVID-19 backlash.

Monetization of fiscal deficit was in practice in India till 1997 whereby the central bank automatically monetized government deficit through the issue of ad-hoc treasury bills but with the enactment of the FRBM Act, RBI was completely barred from subscribing to the primary issuances. However, even C.Rangarajan, the former RBI governor who was a strong opponent of monetizing budget deficit admits that the central bank has to step in for monetizing government debt and buy government securities directly from the primary market.

With the RBI printing money to buy government securities, money supply in the economy will surely shoot up and can also result in an inflationary spiral. But the economy is already facing a very large demand meltdown where the people are only consuming necessities. The economists are also suggesting that deflation and not inflation is most likely in the future. Also, the transmission of base money after the RBI starts printing money into broad money by the multiplier effect will be low because of slower credit growth, thereby ensuring that the growth in M3 is far more modest than the growth in base money. Moreover, the growth in M3 translates into higher inflation via the velocity of money. But here again, the economy currently is in shutdown and is expected to recover only gradually and people being more concerned about increasing their savings and not their consumption, velocity of money is expected to remain low. Even the monetarists pointed out that the movement of price and money supply is unidirectional only when the velocity of money remains constant otherwise the correlation breaks. Also, moderate inflation is good for the economy. The wholesale price index also fell in March compared to January as the prices of food and non-food articles fell along with the fall in retail inflation. Hence, the most immediate issue that the policy-makers are likely to experience due to the pandemic is a dramatic fall in inflation and the risk of low inflation is as real as that of higher inflation and deficit monetization can ensure a backstop to this.

The second risk that deficit monetization brings along with it is external vulnerability. The argument put forward is that aggressive deficit monetization could devalue the currency, causing the foreign investors to lose confidence in the economy, but here again India's government has been able to restrict the foreign holding of its securities at 6.5 % and with the fiscal funding nearly hundred percent locally, there is a very little foreign capital vulnerability which makes it easier to embark on deficit monetizing as a strategy. In fact it may lead the economy towards recovery, leading to better corporate performances which in turn would cheer foreign investors. Also, even as India's economy faces the worst slowdown in three decades, Jio has managed to attract investors like Facebook, Silver Lake, Vista Equity, and General Atlantic increasing its equity base. Moreover, this issue of a reversal in financial flows which could take place due to a devaluation of currency has to be weighed against the outflow of money that could take place from a result in an economic crash (driving out even more investors) due to an insufficient stimulus provided by the government. What had started as a dilemma between life and livelihood is now a dilemma between lives. This economic slowdown is different from what has been experienced in the past. Those were the effects of an economic crisis but this is an economic shock caused by an unexpected health crisis which has to be tackled differently. Economy versus human life is never a moral dilemma but since it has to come to this, it is important to save the economy so that lesser human lives are lost in the future.

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The Road in Between: Fetching the Economy from the Corona Rampant

Iesha Tandon, 2nd Year

With the novel coronavirus shaking up countries all over, people are faced by a concurrent problem arising as a result of it- unemployment. With a number of sectors laying off workers and the base shifting to an online platform, the ratio of unemployed to the employed has increased. Among the issues cropping up as a result, the Indian economy which is largely dominated by labor intensive sectors, is faced with the issue of migrant workers. If newspaper articles are to be trusted, the government has taken up upon itself to provide for the livelihood of these workers by providing financial assistance through schemes like PM- KISAN, MGNREGS, Prime Minister's Matru Vandana Yojana and many more[3]. On 19th April'20, it was reported by The Economics Times that a total of Rs. 36,659 crore has been transferred to 16 crore beneficiaries using Direct Benefit Transfer (DBT) during Covid- 19 lockdown. According to National Statistical Office data, Indian economy grew at a rate of 4.2% in 2019-20, which was the lowest in the last 11 years and as reported by newspaper articles, former Finance Secretary, Subhash Garg believes that the Indian economy may contract by 10-12% in 2020-21[4]. If the financial issues seemed less, the country even faced two cyclones in less than a month on the eastern and western coast. The government sent a relief package of Rs. 1000 crore to the government of West Bengal which got badly affected due to Cyclone Amphan which hit the coast on 20th May'20. Cyclone Nisarga, which reached Mumbai on 3rd June'20, is already facing a team of rescuers and disaster management. With so many problems arising one after the other, what remains in question is definitely the uncertainty of the future which is interlinked with the financial position of the economy.

So, what comes next in question is the solution. What about it? With the continuous address of the Prime Minister to the nation, there is hope among all, coupled with dissatisfaction and confusion. The recent address presented the 'Atmanirbhar Bharat' scheme by the Prime Minister, Narendra Modi and explained by the Finance Minister, Nirmala Sitharaman. It is estimated to amount to Rs. 20 lakh crores, which, in dollar terms, is higher than the GDP of many economies of the world[5]. However, seeing the current situation and the financial crunch the economy is in, with experts saying that "India's debt- to GDP ratio is likely to rise to 76% from 70% due to wider fiscal deficit and low economic growth", is resorting to deficit monetization a good solution?

Monetized deficit is the ‘financial support’ extended by the Central Bank of the country to the government as a part of its borrowing scheme. As a result of this, there is an increase in the total money supply in the economy leading to inflation. This happens because the Central Bank purchases the government bonds and creates ‘new’ money in the process. This ‘new’ money, it is believed, leads to inflation.

In the words of former RBI Governor, Raghuram Rajan, “monetization is neither a game changer nor a catastrophe in abnormal times.” With the financial situation of India already slipping since the last few months, a strong monetary base would be needed if the government thinks of resorting to this option. Also international rating agency, Moody downgraded India’s rating from ‘BAA2’ to ‘BAA3’, which is the lowest grade for investment. Other rating agencies like, Fitch and S&P, have followed suit due to low growth of Indian economy. While the current RBI governor has denied any plans for opting for such a move, some economists believe that it is the ideal step to take at this point of time.

In fact, according to former Chief Economist of The World Bank, Kaushik Basu, the FRMB Act 2003, which ensures that the government does not overspend, should be relaxed in extreme situations, like a pandemic. To trust his words, monetization will work best when it is applied in a defined manner, so that the after-effects do not enlarge much. If it goes the other way, with inequality already being a famous discussion point, India will be faced with another issue before coming out of the ongoing problems. The current pandemic situation is acute but to shut down things and to wait for the right time to start functioning will only make the economy lag behind the others by a number of years. With the industry bearing the brunt of the pandemic and coronavirus cases on a rise, industrialist Rajiv Bajaj even said that “a badly managed hard lockdown” flattened the wrong curve- the GDP curve instead of the curve concerning the virus. However, if looking at the problems from the perspective of economic theory, the root cause of major problems boils down to low aggregate demand, which got aggravated due to the novel coronavirus attack. In the previous financial year, the Indian government tried hard to pull the ill-performing economy out of its troubles with big incentives being offered to investors and consumers. This, when faced with the present and very irrefutable issue of unemployment, will pull down demand much more. Instead of solving this demand puzzle, the economy will get more entangled in it. When viewed from this perspective, deficit monetization looks the most obvious choice, at least providing money in the hands of the people would keep the demand rolling. Production may take place- if people get money, maybe the fear that migrant workers are facing of unemployment may reduce. If a positive outlook was given by the (State & Central) government in terms of security of the workers, the reverse migration would not have taken place altogether!

To go for a move like deficit monetization or not, is something which cannot be said with certainty and is most likely being discussed in the Cabinet meeting. As reported by Odisha Sun Times, the Finance Minister has said that she is keeping options open on monetization of deficit by the RBI. A number of distinguished scholars, including Nobel Laureate Abhijit Banerjee, believe that the RBI should monetize the government's deficit 'partly' to meet the increasing expenditures, with tax revenues being affected greatly. Earlier, Keynes (1933) and Abba Lerner (1943) and ex-chairman of US Federal Reserve Ben Bernanke (2002) also believed in raising resources by various methods during the time of recession.

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Fiscal Stimuli vis-à-vis COVID-19 Pandemic and Its Monetary Outreach: Some Takeaways

Kumkum Mohata, 2nd Year

The unprecedented health and economic crisis created by the COVID-19 pandemic has forced governments around the world, both rich and poor, to loosen their purse strings to stanch a massive humanitarian crisis, further lending weight to the debate on how far governments can stretch their fiscal resources without causing debt or inflationary crisis down the line. Looking at the current economic scenario, deficit monetization is a term that is continuously capturing the minds of economic experts as a means to prop up the economy against the backlash of COVID-19 pandemic. In simple terms, deficit monetization is a process by which the RBI purchases government bonds in the primary market, in order to provide money to the government to fund its deficit. Deficit monetization is certainly not a new phenomenon. Many countries have tried it in the past since the emergence of credit money.

Deficit monetization is in fact, a very extraordinary policy instrument. Hence, while adopting a policy as such, its shortcomings need to be given adequate attention. Deficit monetization runs a grave risk of rapid inflation, crowds in investment by bringing down the interest rate. It might appear that in the event of additional government spending being bankrolled by the Central Bank, the fiscal expansion is accommodated, hence inflation risk is low. However, one argument that comes in line with Keynesian orthodoxy is that in the event of economic agents being highly apprehensive of some adverse scenario in future, the entire liquidity expansion coming through monetisation gets trapped and thereof the interest moderation effect gets obliterated or nearly so (the phenomena of liquidity trap) and this is one case where deficit monetisation can be tremendously inflationary. Moreover, in the same circumstance private investors and financier are poised with a high degree of risk aversion which is why the overall private investment stays shy in responding to interest rate movement and in some case, the private investment ends up falling paradoxically, henceforth can constitute a precondition for inflation to burgeon. Due to the looming recession brought in by the pandemic induced lock-down, many economic experts seem to overlook this phenomenon. Deficit monetization has been ill-perceived in a very narrow sense and no matter how we tinker with the specific techniques and details of this mechanism, its substance remains unchanged. -As already stated, one of the most severe threats of deficit monetizing is that it carries an inflationary pressure on

the economy." Milton Friedman's famous statement that inflation is always and everywhere a monetary phenomenon is correct. However, while rapid money growth is conceivable, without an underlying fiscal balance, it is unlikely. Thus, rapid inflation is almost always a fiscal phenomenon. " [Fischer and Easterly 1990: 38-39]. This interaction between monetary and fiscal relationships in the form of relationship between fiscal deficits and inflation forms the heart of macroeconomics, and has been the focus of extensive empirical research. If we bring it down on a theoretical plane, deficit monetization introduced in a developing economy carries dire risks. These are explained as follows. Firstly, there is an appealing argument which relies on the existence of strong expectational effects linked to perceptions about future government policy. Private agents in an economy with high fiscal deficits may at different times from different expectations about how the deficit will be eventually closed. For instance, if the government will attempt to reduce its deficit through inflation (thus eroding the real value of the debt) , current inflation , which reflects expectations of future rises in price will increase leading to an upward pressure on price. If later, the public starts believing that the government will eventually introduce an effective fiscal adjustment policy in order to lower the deficit, inflationary expectations will adjust downwards and current inflation will fall. However, we see that when a financing constraint now forces the government to finance its deficit through an inflation tax, any attempts to lower the inflation rate today, will require a higher inflation rate tomorrow. Now, the rate of money growth required will be much higher as it will have to finance not only the original primary deficit that prevailed before the initial policy change, nut also the higher interest payments due to additional debt accumulated as a result of the policy change. Secondly, we need to realize the importance of how the economic and political structure of a country establishes a relevant link between fiscal deficits and inflation. The development of financial structure and the independence of the central bank can help us understand inflation dynamics. It is a well-established fact that independent central banks serve as mitigating inflation agents. Similarly, financial markets are vital for economic development. These markets are lending agents, so they always support anti-inflationary policies and independent institutions, like autonomous and independent central bank. A policy such as monetization in this regard, simply erodes the institutional credibility of the Central Bank. When the Central Bank agrees to monetize the deficit, it is effectively agreeing to subordinate monetary policy to the financing strategy of the government. The pertinent question that we need to ask here is that what are its ramifications on an emerging market economy. It simply means that the inflation targeting regime has been abandoned in favour of fiscal dominance.
What impact will it have on public expectation of future policy action?

The public will worry that the operational freedom of the Central Bank has been diminished and it won't be able to tighten policy when inflation surges again. This means that future expectations of prices will increase and before we know, we get caught up in a high inflation trap.

Given the current economic scenario of COVID -19, deficit monetization may seem as a very viable tool to prop up the economy and revive demand. However, here the big question that we face is that, how far it will prolong. Policies such as deficit monetization form a part of the Modern Monetary Theory. Hence, these policy actions are rationalized based on the idea that this would all be very temporary, maybe only a few months. Does the present economic crisis promise a recovery possible in a few months?

The answer is certain to an individual, even if it is not explicitly answered in this essay. It now seems that lockdowns will be relaxed very gradually, which will mean a longer and a more drawn out recession. Once such a policy action is introduced, this would only mean that the government keeps falling back on the Central Bank, every now and then. Hence, for developing economies, deficit monetising clearly does not solve the problem caused by COVID-19.. It rather tends to worsen the situation even more. If we consider India in particular, we get the same dismal picture. This is due the reason that India has always been an inflation prone country and has had a history of fiscal profligacy. There was a time when automatic monetisation used to take place. There was an agreement between the government and the RBI, where when the government's reserves of the RBI, when fell below a certain threshold, automatic monetization used to take place. During the 1980's it gained momentum, leaving the monetary policy completely ineffective until reforms were introduced that abolished such ad-hoc treasury bills.

Clearly, the process of dismantling fiscal dominance has been a long drawn process and ensuring the freedom of the RBI has been hard earned. Now it seems we are willing to sacrifice this freedom so as to mitigate short term emergency needs at the cost of long term economic well-being. India's own economic performance in the past with rising fiscal deficits and also the emergence of stagflation in 1970's pushed major economies to give more autonomy to monetary policy, in order to encourage fiscal restraint. As a rising power going through transition, India's systems and frameworks for macroeconomic adjustment and control are not as robust as those of developed economies. We will still need to strengthen our independent monetary policy, but if fiscal discipline becomes too lax, the problem of local government debt goes out of control. Indian economic policy has enough room for growth and there is no need to resort to such extreme measures.

In conclusion, fiscal policy and monetary policy are two wings of macroeconomic control. It stands to reason that the work in tandem and not in a manner that one overpowers the credibility of the other. Currently, in the case of the Indian Economy, monetization would severely dismantle the optimal balance required to preserve the future needs of the Indian Economy. Our economy in recent years has been prone to various rash policy decisions, like demonetization, which have led to its slowdown. Another such policy in the name of Covid-19 relief would prove to be detrimental.

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Deficit Monetization: Unprecedented Crisis Can Lead to Unpredictable Decisions

Nikita Ladha, 2^{nd} Year

The coronavirus pandemic has led to a deep impact on the Indian economy and has caused an unprecedented collapse in the economic activities. This pandemic has affected the demand as well the supply chain of the economy. The Indian economy is already going into recession with continuous decline in output and employment. The pandemic has led to reduction in economic activities as all the sectors are impacted in some way or the other. Demand side of the economy is sluggish as people don't have enough income for spending. Due to this output is relatively low affecting the supply chain as well. This in turn leads to a low GDP in the economy.

The only way to overcome such a situation is that the government should adopt certain demand management policies in order to recover the economy. This can be done in two ways. The first is 'Direct Monetization and the second is 'Indirect Monetization'. However, there are several other ways which are generally not adopted by any economy like helicopter money (where the RBI print currency without the need for the sale of government bonds), MMT (Modern Monetary Theory).Deficit Monetization is when the central bank (RBI) prints currency and in return buys bonds issued by the central government. Whereas Indirect monetization is when the government borrows money from the market by issuing bonds in the market.In view of the current scenario, the major spending of the government can be divided into two broad heads one is expenditure in heath sector and expenditure for welfare. As it is extremely necessary for the government to increase expenditure or else there are high chances that the economy might crash. But the evident question is from where will the money come?

Several economists like Raghuram Rajan, C. Rangarajan are suggesting for direct monetization but several arguments are put forward with respect to the consequences faced by the economy because of such policy. In view of the current scenario, as government's revenue is declining continuously. Still, the government should boost their spending in the required sectors which are highly affected because of the crisis. Governments major source of revenue collection is through GST and other taxes. However, tax collection for fiscal year 2020-21 is much less than what was budgeted by the government. As government is short of revenue, government can borrow money through markets which means indirect monetization. But indirect monetization will not help in the current situation because if the government wants to raise money through issuing government bonds through open market operations, people won't buy them. People are losing their jobs, which means a fall in income, this will lead to fall in savings. As savings is declining people will be skeptical in buying bonds. In fact, FPI (foreign portfolio investors) are also withdrawing their investments from India as they do not see India as a good market to tap on. As every government needs to maintain a certain amount of debt to GDP ratio and the Indian government has already crossed that limit, it is not advisable to keep on borrowing from the market. So, borrowing from the markets won't be a good alternative to do the same.

Deficit monetisation is not a catastrophe if done in a right way. Several arguments are put forward that if the government adopts deficit monetization it will lead to adverse circumstances for the economy. Economists argue that it can lead to high or even hyperinflation and external vulnerability. In view of the pandemic, the credit market is highly affected. As commercial banks are skeptical in providing loans because of a fear of increase in non-performing assets (NPA). As there is not enough circulation of money in the market the credit multiplier does not work effectively. People are withdrawing money from the market, which means people are willing to hold money rather than spend it. This will in turn depress the money multiplier. Hence, monetisation of deficit will not be inflationary as there is not enough demand generation in the economy. In fact, it is always good for an economy to have some level of inflation in the economy. So, such a move by the central government will raise demand in the economy which will in turn lead to some amount of inflation which is good for the economy (given it does not create hyperinflation). Economists claim that deficit monetization is not a catastrophe is the government does it in limited manner and spend the sum of money is a correct way on the required sectors. However, in wake of Covid 19, adoption of deficit monetization is inevitable. Government is left with no other better alternative rather than Deficit monetization in order to recover the economy.

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Deficit Monetizing Amidst COVID-19: Bane or Boon?

Soumili Basu, 2nd Year

Deficit Monetizing or Deficit Financing, as coined by the National Planning Commission of India, refers to the "borrowings from the Central Bank against the issue of Treasury Bills and running down of accumulated cash balances." In such cases, the government transfers its securities to the RBI and borrows against them. This is followed by the RBI issuing more currency on the basis of the securities and putting them into circulation on behalf of the government. This process leads to the creation of money in the economy. Deficit Financing is necessary for situations where the government is unable to mobilize adequate resources and fails to meet fiscal deficit targets.

Deficit Financing is a necessary evil. It has been seen time and again that in the face of severe economic crisis, governments worldwide had to resort to Deficit financing. To cover the costs of the Second World War, mass deficit financing was made. The pandemic, too, has taken the shape of a World War, the exception being that the entire world has united together to fight against the deadly virus that is affecting millions.

Many economists might argue that the government should avoid using Deficit Monetization as a tool to uplift the economy unless it is an extreme situation. It is safe to say, that in the wake of Covid-19, the world is experiencing an economic crisis so bad that it deserves extreme measures such as deficit monetizing. Especially in a country like India, a labour-intensive economy, Covid-19 has terribly affected the workers as many of them have been facing the brunt of being laid off. There are many people in India who used to earn the bare minimum required to survive the day. However, they have even lost that opportunity due to the nationwide lockdown. The tourism spots which were a source of income to many have also been closed. Thus, there are thousands in India, right now, who are unemployed, homeless, and stand the potential risk of starvation. While at the same time, those who have the money to buy at least the essentials are hoarding them which has led to a great increase in demand not matched with an equal rise in supply. As a result of this, prices of essentials are increasing. They are being sold at much higher prices than usual, thus, making them further inaccessible to the ones with prevailing financial problems. Thus, the economy is moving to a state of stagflation, where there is increasing recession in the economy with a simultaneous rise in prices. This stagflation is also accompanied by the death of thousands, causing a financial as well as an emotional blow to the people of the economy. To combat such a situation, it has become absolutely essential for the government to resort to extreme means such as deficit monetizing. There is no ignoring the adverse effects of deficit financing. If the government is unable to stabilize the price level, it will increase costs, thus, putting the government in a position where it has to mobilize additional revenue through further deficit financing and this might lead to an endless spiral of rising prices and financing.

Some inflation is unavoidable but necessary. The government is required to take necessary steps to ensure that it does not result in hyperinflation. Owing to present supply problems, prices will rise anyhow. However, it is up to the government to take measures to prevent stagflation, so that not only will there be inflation but some simultaneous rise in production as well. Deficit monetizing has the potential to give rise to an endless cycle of inflation that will ultimately be harmful to the economy in the long run. However, despite considering its evils, one cannot deny that in the current scenario, it is absolutely inevitable.

The success of deficit monetizing depends upon the measures taken by the government to control inflation. Most of the disadvantages of deficit financing can be minimized if inflation can be kept within limit. If appropriate control and regulatory measures are taken to keep the financing amount in check, which in turn checks the level of inflation in the economy, then the true benefits of deficit financing, like accelerated development, can be reaped without worrying about the high inflationary pressures. Covid-19 has already induced a supply shock that is morphing into a demand shock, creating a deflationary overhang. Thus, a proper boost to the economy in the form of an injection of liquidity can stem this tide without the risk of fuelling unhealthy inflation. Also, if a proper part of the financing can be directed towards maintaining supply chains and supporting firms to reopen without the overhang of obligations such as debts, rents, etc., then it would go a long way in mitigating the risk of inflation. Certainly, this is a radical financing option but the prevailing situations ardently call for it.

The real question here is whether the government should rather sit back and have its people succumb to the economic degradation and die of starvation, which is likely to happen, or take necessary measures which may or may not have adverse consequences in the long-run. John Maynard Keynes, the noted economist, had once said, “In the long run we are all dead.”

So, the government should take whatever steps required to provide relief to its people, even if there exists a risk of there being adverse effects in the future. Immediate aid is the need of the hour, even though it brings with it the risk of a problematic financial scenario in the future.

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Deficit Monetization-An Unavoidable Helping Hand

Bhavya Agarwal, 1st Year

There is now little doubt that the Covid-19 pandemic has had, and will continue to have, deep and long-term effects on the economy. Even if, in a couple of months, the all-clear is given in terms of lockdown being lifted with the attenuation of viral spread by and by, it will take a much longer time after that for the Indian economy to get back on its feet. The crisis came when the growth in the economy was already weak. What will be needed when the time comes, are massive investments across the economy but, especially in infrastructure to provide the kick-start that the economy needs. In layman's terms, monetisation of deficit means printing more money. In other words, monetisation of deficit happens when RBI buys government securities directly from the primary market to fund government's expenses. The economic impact of the pandemic on India is likely to be around 7-8 trillion Indian rupees[1] with sectors such as trade, textiles, aviation, transport, tourism, hotels, wholesale and retail trading and Ministry of Micro, Small & Medium Enterprises (MSMEs) facing the brunt of the impact. At the same time, the financial sector, especially Non-Banking Financial Companies (NBFCs) and Micro finance Institutions (MFIs), and the real estate sector is also likely to suffer during this period due to a lack of consumer demand.

The fall in revenues and incomes will cause a substantial fall in revenue collection by the government, which in turn, will affect the fiscal deficit in the short to medium term. In the current global scenario, India will need to undertake a shift in its monetary policy towards fiscal stimulus to ensure that the economy is able to rebound from the fiscal loss suffered in the short term. The fiscal deficit going up in itself means nothing except for the question—who will subscribe to the additional borrowings? In this case, what will happen is that the RBI will have to come in and support it either through the primary market or the secondary market. Monetisation of the deficit is inevitable. Such a large increase in expenditure cannot be managed without monetisation of government debt. The health sector needs a massive boost in the funds and it is not unknown to us that there are millions to whom the hospitals are not being

1 https://www.financialexpress.com/economy/how-much-economy-will-lose-from-coronavirus-and-what-to-expect-from-economic-relief-package-2-0-by-nirmala-sitharaman/1947511

able to provide adequate medical facilities. Aviation sector also suffers a deep hit. How else are these sectors going to be brought back to their feet if it is not the RBI financing the government? The economy needs massive fiscal stimulus estimated at around 9-10% of GDP[2] .This translates into Rs 18-20 lakh crore. Budgeted borrowing in the financial year 2021 was Rs 8 lakh crore which has now been increased to Rs 12 lakh crore[3] . The market cannot support this borrowing hence, interest rates will rise sharply. The private sector and other borrowers will be denied credit. High interest rates and lack of credit due to the increased risk aversion on part of the lenders (particularly, the commercial banks) will kill the economic activity. Thus only RBI can provide such funds by printing money, in which case, the returns will be much higher than the risk.

However, there have to be restrictions and monetisation of the deficit needs to be temporary and only the important sectors are to be focused upon. But this does not tell us in any circumstance that there is no need for the financing of deficits or that other methods are enough for the economy to survive this backlash. Whatever is raised should be deployed in an infrastructural plan with health at its centrepiece. This will boost construction and create jobs. Subsidized loans should be made available but only to businesses that keep at least as many people on their payrolls as they had in February and make suppliers' invoices available on a bill-discounting platform so vendors can get paid. It's the workers, small and mid-sized enterprises that are getting hammered by large companies passing on the pain of dislocation. In some private firms, such as airlines, the government will have to infuse equity. This is the time for wartime financing wherein the normal rules don't apply. Printing money will generate demand, kickstart projects and help businesses, employees and workers. In addition to that, given the steep economic dip, risks of mishandling the monetized funds are trivial. Another point to note is the very important fact, which is neglected by most, is that the government does not get a free lunch. The RBI is paying 3.75% for the money it lends to the government (which will reduce the annual dividend the RBI pays the government commensurately), the banks get 3.75% instead of the 6% they could get by buying the government bonds directly.

[2] https://economictimes.indiatimes.com/news/economy/finance/how-printing-money-can-save-the-economy-of-a-nation/articleshow

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Moving on to a question that can be asked by many is that deficit monetization would lead to inflation and create a more unwanted situation for the economy. But what we need to understand is that these are not normal times. This is an emergency situation that the economy is facing. Instead of the banks holding government bonds paying 6% or so, they hold claims against the RBI paying 3.75% [4] . During the normal times, the banks would have continued investing or lending which would again lead to inflation. In abnormal times, because banks are risk averse and demand high yields to buy government bonds, RBI buys, say Rs 1 lakh crore of bonds directly from the govt. This money will be spent by the government as salaries or payments to companies. These come back as deposits to banks. But because banks are risk averse, this money will remain as deposits, which the banks may lend to RBI at 3.75% in the reverse repo. Because RBI is paying 3.75% every day in reverse repo, its dividend to the government will fall. Such direct financing is not inflationary per se, so long as banks are reluctant to lend further to business or consumers. However, as normal times return, the central bank will have to pay a higher rate on excess reserves or sell its government bond holdings and extinguish excess reserves, else it will risk excessive credit expansion and inflation. Even though the way government spending is financed (either directly by banks or directly by the RBI) it should not alter its inflationary consequences, the larger government spending will directly ignite demand. In abnormal times when demand is depressed and the environment is disinflationary, this should not be a central worry.

The next question that would probably arise is that deficit monetizing could devalue the currency causing foreign investors to lose confidence and pull out money, thus putting the existing fiscal financing plan at risk. Now, this is structurally not an issue for India. The government of India does not fund itself via direct external borrowings. India allows a very limited access to government securities to foreign investors – as a result total foreign holdings of domestic government securities is barely ~5% [5]. That number is far higher for most developing countries – creating an external financing cap (and dependence) on fiscal expansion. India's external account, thanks to record low oil prices, is in good shape (current account deficit should remain well within the 2% comfort zone for the year). With a fiscal deficit funded nearly 100% via local savings, there is very little foreign capital vulnerability –

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4 https://www.newindianexpress.com/business/2020/may/09/go-in-for-monetization-higher-fiscal-deficit-in-measured-way-ex-rbi-governor-raghuram-rajan

5 https://m.economictimes.com/news/economy/indicators/view-monetisation-of-deficits-fetters-are-more-in-our-mind/amp_articleshow

much easier to embark on an aggressive deficit monetization to prime up the economy. Such an exercise would likely take the economy faster towards recovery thus, leading to better corporate performance, which in turn would cheer foreign investors in equity (who are far bigger and more relevant for equity investment into India than debt).

Keeping in mind the current scenario at hand and the lack of alternatives that would bring upon an untimely doom to our economy if nothing is done about it, it becomes imperative to land the decision of monetizing the deficit. Indian businesses are starting to feel the blow and if a contingency plan of action is not initiated, such businesses are bound to succumb to the ever increasing operational costs and declining revenues which will inevitably lead to their drastic end. Thus, with such impending blows to our economy, it is imperative to consider the risks at hand and the responsibility of monetising the deficit with controlled measures and for a temporary phase. Needless to say, it is a bullet that cannot be dodged for the sake of bouncing the economy to at least the initial stage of sustainability. With the current absence of alternatives it would be worth pressing upon the fact that monetising deficit is imminent and as long as nothing else precedes it, the motion stands undefeated.

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Economic Backlash of COVID-19 Pandemic: Should Government Take up Deficit Monetisation?

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Containing the spread and reducing the economic impact of the COVID-19 pandemic will require a multipronged approach and cooperation from all parties, including substantial reductions in uncertainty levels, panic levels and disease transmission, the primary channels through which the economic impact manifests. Importantly, just like in times of war, when a country's spending on defence increases significantly, India must view the COVID-19 pandemic as a 'war' to be won and be prepared to increase public health spending significantly, but the Central Government should not forget it's bruising balance of payments during the 1991 crisis. During downturns and recessions, government deficits tend to increase because tax receipts fall. But at the same time, the availability of funds increases, because private investment falls relative to private saving. Open market operations and refinancing operations are monetary policy instruments, designed to achieve monetary policy objectives. But if the RBI agrees to monetise the deficit, it is effectively agreeing to subordinate monetary policy to the financing strategy of the government. This might not be a problem in a country where inflation is quiescent. But India is an inflation-prone country, where inflation targeting has not yet taken full hold. The repercussion of such a step will crumble the entire Indian economy which already passing through an unprecedented phase. The issue that whether government should resort to deficit monetization to prop up the economy against the backlash of Covid 19 pandemic or not, involves the labourers, the producers and the government itself.
A deficit is created when the government spending exceeds its revenue. To fill up this gap the government asks the Central Bank to purchase its bonds or issue new notes. The immediate impact of Deficit Monetisation be inflation. To understand the gravity of dire results of inflation let's consider an example of Mr. Hari, owner of a textile mill in Uttar Pradesh who has the liberty to exploit his labourers as the labour laws have been bypassed by the state government. Sakshi, a single mother works here for 12 hours earning Rs. 20 will have to cut down on her family consumption to survive the price hike caused by inflation. If Sakshi is from another state she will have to face problems in redeeming her ration benefits as India does not have proper implementation of ' One nation, One ration ' scheme. Suppose her ration card is valid and she goes to the shop. Won't the shop charge an exorbitantly high charge exploiting her vulnerability? Notwithstanding the fact this would be an unscrupulous act on the part of the fair price shop, lack of vigilance will generally call for such unfair practices in such bad times

the economy is passing through. Then what good will the Deficit Monetisation do? It will not only cause a spike in prices but also in the exploitation of the poor at the hands of the privileged. The precarious nature of informal work, as evidenced by the absence of a contract or income protection, means that their sources of livelihood may be impacted significantly by the COVID-19 pandemic, especially when countries experience lockdown. The unemployment went up to 24 percent on May 17, 2020 which clearly portraits the dire conditions of the people belonging to the lower strata of the economy. There has been a drastic rise in the job loss figures for the skilled workers, even those who were in the white-collar jobs which has only aggravated the unemployment scenario. In this appalling situation, the Government of India has taken few steps to provide short term relief to the working class people which include decrease in the Repo rate, TDS and TCS rates to inject liquidity in the market for the revival and smooth functioning of the market. The 20 lakh crore scheme presented by Nirmala Sitharaman proposed investments in MSME, agriculture and cash transfers to the migrant workers (who have been hit the hardest). This sort of fiscal stimulus can be expected to generate employment and stimulate the supply side as well as the demand side so that the economy can be stabilized. In Prime Minister's address to the nation he mentioned lockdown as the only measure to safeguard the people saying "JAAN HAI TOH JAHAN HAI" which boosted peoples' incentives to fight the deadly virus through maintaining strict norms of the lockdown, social distancing and proper hygiene. Analysis of the current situation shows that there will be a mass trade and factory diversion from China to the rest of the world. In the midst of all disruption and economic fallout there is an opportunity to build an economy which is more diversified and attractive to global services. India should work on the shattered supply chains and infrastructure to be an attractive hotspot of foreign investment after a fall in the Chinese foreign market. India has a huge population and thus a large market and an abundant labour which will serve as a strength of setting up cost efficient industries. The government has lifted up the FDI limits which will invite foreign investment and enhance the standard of living of Indians. This will create a strong fiscal base and no foreign country will be able to put economic pressure and India will attain self- sufficiency in long run. But all of this will remain a dream if the government resorts to Deficit Monetisation as the foreigners will see that the government is trying to take the cowards' way out by issuing notes.

Now let us see what can be the possible impact of Deficit Monetisation on the industrialists. The ancillary industries require huge amount of foreign investment. The industrialists of our country will face difficulty in gathering foreign capital as monetisation of deficit will result in the fall of the value of rupee in the global market. These industries will shut down due to bankruptcy and other locomotive, railways and ship-building industries will also face huge losses due to this and the government will be further pressurized. Moreover, such industries with zero foreign investment won't be able to compete in the global market and will make huge losses. In order to survive they will cheat the GST laws and the government itself will go bankrupt as it's revenue will drastically fall in a situation of increasing spending. The World Bank won't provide a bail out to India as a loan provided should be repaid. Even if it does, it will impose heavy bets. Greece in 2014 went bankrupt and today one- fourth of Greece's property is owned by China, it lost it's right to use euro. India definitely does not want to become another Greece. As a famous quote says, 'The tough time passes but only the tough ones survive'. India should keep on working on its self-reliance policy and should not resort to Deficit Monetisation which will come as a long term disaster in the disguise of a short term relief.

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