

Budget 2022: Is there really a need for fiscal consolidation?

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The [Union Budget](#) for 2022-23 will be announced next week. Apart from the possible sectoral allocations and tax concessions expected, a key point that is already being discussed and will continue to be discussed fervently over the next few days will be the estimated fiscal deficit. A nuanced reading of the view of economists and experts reveals that calls for 'fiscal discipline' have been replaced by a gentler term, 'fiscal consolidation'.

This implicitly suggests that the government had rightly responded to the economic crisis triggered by the COVID-19 pandemic by relaxing its adherence to the 3 percent of GDP deficit norm with a larger deficit, although it is now time to become more cautious about the deficit. 'Consolidation' is however a vague term: does it mean not increasing the deficit from its present level, reducing it gradually or reducing it all the way back to 3 percent of GDP?

For all its pretensions of being a science with complex mathematical models, when it comes to actual policy, economists craftily use undefined terms. For almost three decades beginning in the 1980s we were told that fiscal policy was ineffective and that an economy would automatically and efficiently adjust to shocks. The government was to take a backseat and state interventions, if at all needed, should be through monetary policy conducted by an independent central bank. All that went for a toss when the US economy was hit by the global financial crisis (GFC) in 2008.

Aggressive fiscal policies were again resorted to in 2020 when the COVID-19 pandemic spread across the world. Even the European Union had to concede that austerity policies pursued in the aftermath of the 2008 GFC were untenable in 2020 and fiscal deficits were necessary to rescue their collapsing economies and their citizens from hardship. Expansionary fiscal policies undertaken by governments supported by their central banks saved the world from a situation that could have been far worse than the Great Depression of the 1930s.

Rather than appreciating the positive role played by fiscal policy, economists are once again attempting to script a return to a world where the governments recede into the background and market forces dominate. Sustained fiscal deficits, it is argued, would lead to a wage-price spiral and consequently inflation that would distort an optimal allocation of resources that markets would otherwise achieve. In fact, the rise in inflation rates in major economies like the US is being blamed on the fiscal deficit which had come close to 15 percent in 2020 and in 2021. Paranoia over spiralling inflation and even hyperinflation is being circulated, rather than answering a question that economists

would otherwise always begin their argument against spending and deficits: from where does the government get the money to spend?

India too witnessed a steep rise in the general fiscal deficit during the pandemic years, crossing 10 percent of GDP. This intervention, although some consider insufficient, unequivocally helped the return to pre-pandemic GDP levels and can perhaps put the economy back on a strong growth trajectory.

Even as inflation concerns remain, its underlying cause remains debatable: supply-side disruptions, profit-inflation, and global energy prices could be stronger drivers of inflation rather than the general level of effective demand in the economy. Several other concerns remain over factors that may inhibit a return to robust growth: a K-shaped recovery, consumer confidence remaining subdued and way below pre-pandemic levels, sluggish growth in key sectors of the economy including several service sector industries like hotels and tourism, the struggling MSME and informal sectors, and most importantly the persistent high rates of unemployment, particularly urban unemployment.

With these critical challenges ahead, the crucial point is that the government must continue to play a key role through fiscal policy in ensuring a return to normalcy in specific spheres of the economy. Reliance on interest rates or monetary policy to stimulate market forces to solve these concerns over a reasonable period of time will be inadequate. Rather than raising the bogey of deficits through terms like fiscal discipline or consolidation, it is time that economists emphasize the positive role that fiscal policy has played in alleviating crises and the role that it can continue to play in doing so, especially after the most acute effects of a crisis have passed.

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