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A WAR-LIKE STATE AND A BOND TO THE RESCUE

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

As India's ominous COVID-19 curve stretches further, urgent attention needs to be paid to an economy that is teetering on the edge. Several economists, former Finance Ministers and central bank Governors have made the clarion call for a large stimulus to pull the economy back from the brink. There are a few who seem to believe that there are ways and means to provide this stimulus without breaking the bank as it were. As we spend more time in a national lockdown or quasi-lockdown situation, I believe that austerity measures and reallocations notwithstanding, we will definitely need to go beyond current revenue receipts to fund the complete stimulus.

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In the Budget before the pandemic, India projected a deficit of 7.96-lakh crore. However, even then there were concerns around off balance sheet borrowings of 1% of GDP and an overly excessive target of 2.1 lakh crore through disinvestments. The financial deficit number is set to grow by a wide margin due to revenue shrinkage from the coming depression that will most certainly be accompanied by a lack of appetite for disinvestment.

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In addition to the expenditure that was planned, the government has to spend anywhere between 5-lakh crore and 6-lakh crore as stimulus. The Finance Ministry is sanguine about this fact as was clear in a press conference held by the Economic Affairs Secretary on March 31, 2020, where he said that the government will not exceed the borrowing limits indicated in the Budget. The insipid stimulus provided by the government so far and recent announcements by the Reserve Bank of India (RBI) only serve to highlight how out of touch with reality they are. All the RBI's schemes are contingent on the availability of risk capital, the market for which has completely collapsed. The two have tried several times over the last year to nudge banks into lending to below investment grade micro, small and medium enterprises, but have come up short each time. Furthermore, while the 60% increase in ways and means limits for States is a welcome move, many States have already asked for double the limits due to the shortages in indirect taxation collections from Goods and Services Tax, fuel and liquor. The government and the central bank need to understand that half measures will do more harm than good. It will only lull us into a false sense of security, much like a lockdown without adequate testing.

Politicians and epidemiologists across the world have used the word "war" to describe the situation the world is currently in. As we wage a united war against this virus, it would be interesting for us to look at war-time methods of raising financing. One such method that has been used as early as the First World War is the Consol Bond. In 2014, the British government, a century after the start of the First World War, paid out 10% of the total outstanding Consol bond debt. The bonds, which paid out an interest of 5%, were issued in 1917 as the government sought to raise more money to finance the ongoing cost of the First World War. Citizens were asked to invest with the advertising messaging: "If you cannot fight, you can help your country by investing all you can in 5 per cent Exchequer Bonds. Unlike the soldier, the investor runs no risk."

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One cannot help but wonder how successful a Consol Bond issue would be for the Indian government if the Prime Minister had made a similar call to every citizen of our country to invest in them instead of making donations to PM-CARES, or the Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund. After all, most of the Consol bonds in the United Kingdom are owned by small investors, with over 70% holding less than £1,000. Furthermore, unlike PM-CARES, the proceeds of the bonds could be used for everything — from Personal Protective Equipment for doctors to a stimulus for small and medium-sized enterprises.

There is no denying the fact that the traditional option of monetising the deficit by having the central bank buy government bonds is one worth pursuing. However, given an as yet hesitant (to raise debt) Prime Minister's penchant for making citizens active participants to his missions, he might view a Consol Bond as a more compelling alternative. Furthermore, with the fall of real estate and given the lack of safe havens outside of gold, the bond would offer a dual benefit as a risk free investment for retail investors. When instrumented, it would be issued by the central government on a perpetual basis with a right to call it back when it seems fit. An attractive coupon rate for the bond or tax rebates could also be an incentive for investors. The government can consider a phased redemption of these bonds after the economy is put back on a path of high growth — a process that might take that much longer for every day we extend this lockdown.

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