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Corrective Macroeconomic Measures in India: The Strategy During a Pandemic-Driven Recession and Beyond

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Abstract

The effectiveness of fiscal and monetary policy measures used during recessions in India is examined in this paper. In the past few recessions preceding COVID-19, more or less similar policy tools were used to rectify the economy as undertaken during normal periods, were found to be ineffective. In the presence of supply constraint Keynesian equilibrium situation during the COVID-19 recession period implemented policy tools did not yield fruitful results. Although the economy revived out of an independent demand and supply constraint situation in the post-COVID scenario, it entered the trap of dependent demand and supply constraints due to trust deficits of economic agents, which in turn resulted in high inflation and unemployment. As a retaliatory measure, restricted monetary policy undertaken by the government to control inflation may lead to further recession. 'Debt monetization' may help to restore trust among the economic agents which may be instrumental to bring the economy back on track.

Key Words: Pandemic, Fiscal policy, monetary policy, economic recession, fiscal profligacy, equilibrium

Introduction

The outbreak of COVID-19 created a fear of economic uncertainty and loss of human life throughout the globe[i]. Stringent preventive measures like "social distancing" and "economic lockdown" were undertaken by countries to restrict the spread of the virus. These measures in turn created an independent demand and supply constraint situation, which led to an economic recession during 2019–21 in major parts of the globe. Similar measures in the Indian subcontinent led to a supply bottleneck when the country was already struggling with a typical Keynesian demand-constrained equilibrium situation[ii]. A sudden rise in temporary unemployment and uncertain economic conditions gave rise to an increase in demand constraints. Besides this, the measures made the demand and supply constraints independent of one another. In other words, neither the increase in demand in response to supply (Keynesian theory) nor the increase in supply to demand (Say's Law) occurs. It was unusual and unanticipated that the economy would face such a situation. This scenario appears to be a "*supply-constrained Keynesian equilibrium*" (Dasgupta and Rajeev 2020).

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To overcome recession, a range of fiscal and monetary tools, along with protective health measures, were undertaken by countries across the globe. The response to economic measures was mostly invisible during the lockdown. In some parts of the world, a combination of expansionary fiscal policy and restrained monetary policy was used to maintain consumer purchasing power and producer trust. Consumer purchasing power induces the producer to restart production as soon as demand and supply constraints become dependent. In such a situation, the producer anticipates the rise in demand, looking at the extent of fiscal tools implemented during COVID 19.

The fiscal and monetary policy tools used before lockdown in India were found ineffective in addressing the economic situation arising due to COVID 19. The Indian government came out with a restrictive monetary and fiscal policy in the name of *"Atmanirbhar Bharat Abhiyan"* (ABA) (Chakraborty and Thomas 2020). It left the economy to market forces with little state intervention until the arrival of a dependent demand and supply constraint situation in the economy, which is largely a "wait and watch policy." In other words, the ABA 20 trillion dollar package failed to stimulate demand because the actual fiscal cost was less than one percent of Indian GDP.

The intervention through monetary policy, which forms only contingent liabilities, has little scope to boost the supply. The fiscal policy tools used under ABA are restricted to the poorer section of the population only (Kasilwal 2020). These policy measures were maintained until demand and supply constraints became intertwined. As a result, the unemployment rate reached its highest level in four decades, and the rate of inflation reached its highest level in a decade, indicating a slow response and a flaw in the selection of economic measures to address the situation (Nilsen 2022).The only way out in such a situation is to finance demand-inducing stimulus policy measures within a Keynesian framework. In such a situation, debt monetization will be an appropriate tool to finance fiscal policy in a relatively weak economy. Albeit it was recommended by a group of experts to fund a sizable portion of stimulus packages through debt monetization, the Indian government was reluctant because of its bitter experience of fiscal profligacy in the past (Kar and Naidu, 2020). With this background, the objective of the study is to re-examine the effectiveness of fiscal and monetary policy tools used by different governments across the globe, including India, to bring the economy back during different recessions from 1980–81 to 2020–21 using an appropriate set of indicators[iii].

Although recessions occur due to either demand or supply constraints, or the interdependence or independence of both constraints[iv],there is a small body of literature relating to policy tools used to revive the economy during independent demand and supply constraints (Shomali and Giblin 2010; Pandey et al. 2018)[v]. During the aforementioned situation, a policy that maintains consumer confidence and producer trust may be beneficial for a quick revival after demand constraints and supply constraints became dependent.

The paper begins with a comprehensive review of fiscal and monetary tools prescribed by different schools of thought to revive the economy from recessions in Section I, followed by an analysis of policy measures undertaken by the Indian government during different recessions before COVID 19 in Section II of the paper. Section III examines the policy measures undertaken during the post-COVID situation in India. Finally, conclusions and policy suggestions are discussed in Section IV.

Section - 1

A Brief Review of Mechanisms

Acceleration of economic growth is possible through maintaining 'full employment levels of income and output'. Different Mechanisms have been prescribed by different schools of thought since the Classical to maintain full employment levels of income and output (Hudea, 2015).An auto-corrective market mechanism was advocated by the Classical to maintain full employment level of equilibrium. This line of advocacy was quite acceptable till the Great Depression of 1930s[vi]. During the recessions before the Great Depression of 1930s, at a higher level of unemployment, labourers were offered lower wages which had widened the profit margin. Realization of larger profit, accrued through lowering the wage rate, induced higher investment and employment. However, during the Great Depression, this mechanism did not ensure continuity in boosting investment infinitely with the pressure of trade unions[vii]. The idea of 'wage flexibility', as conceived by the Classical functions in a restricted domain up to a certain wage level. Keynesians were well aware about wage rigidity that wage level cannot reduce after a certain point due to the presence and active functioning of the trade union (Harvey 2016). Logically, it is also quite impossible to reduce the wage infinitely. The Keynesian argued that investment is 'the factor' to maintain full employment level in the economy. Although the Classical were of the same view to some extent, differences are observed on the sources of investment. When Classical assumes that private investment is the only mechanism to maintain full employment, Keynes and Keynesians advocates for 'Public Investment' to maintain full employment at the time of synchronization of private investment. Keynes's prescription of 'public investment' was a recommendation on what the classical were silent about[viii]. The 'private investment' in the presence of wage flexibility mechanism enhances the income of the higher-income group population. In contrast, public investment along with private investment helps to boost the income of all sections of the population specifically lower- and middle-income groups. Since the MPC of the lower- and middle-income group is higher than that of the high-income group population, Keynesians presumed that the injection of public investment along with private investment will generate adequate effective demand in the economy. The United State of America (USA) and the United Kingdom (UK) benefited from the Keynesian prescription during 1930s, when there was a demand constraint situation. Industrialization, excess capacity in the consumption goods industry, elastic supply of working capital (Rao 1952), animal spirit behavior of human beings in decision-making (Begg 1982) and almost stationary population growth[ix] are few important assumptions of Keynesian mechanism necessary to maintain full employment.

During the late 1960s and 1970s, violations of certain Keynesian assumptions led to an economic recession in Organization for Economic Co-operation and Development (OECD) countries. When the economies of OECD countries, as well as the United States and the United Kingdom, deviated from the full-employment equilibrium path in the late 1960s and early 1970s,Because of the relatively high population growth rate and the rational behaviour of economic agents, public investment could not ensure economic stability[x]. The new classical school argued that wage flexibility mechanisms have the potential to bring the full-employment level of equilibrium back without state intervention in the presence of rational behaviour by economic agents. Wage cuts in OECD countries during the 1960s allowed for the filling of the unemployment gap from the available involuntarily unemployed labour force, in contrast to Keynesian theory. The employed workers did not resist a wage cut, as apprehended by Keynes, in the presence of a large, involuntarily unemployed army of labourers. Firms began to recognize (with the development of rational behavior) the possibility of increasing profit by lowering wage rates (Hoover 1988).Government investment through fiscal and monetary policy cannot ensure full employment when all economic agents behave rationally. When the economic agents realise that their income has increased in equal proportion to the rise in prices of goods and services through fiscal and monetary policy, they will not raise their demand. Keynesians are of the view that increasing employment leads to an increase in the level of output and a further increase in the rate of inflation. However, as per the new-classical firms, firms keep the level of output constant when they realize that the increase in profits is due to rises in both inflation and the wage rate. Elsewhere, it is mentioned that fiscal policy is effective, not monetary policy, in the presence of “complete price flexibility”, “rational public expectation,” and “white noise economic shocks” (Galbac 2015).

The global economy entered a new phase of disequilibrium during the 1980s due to the increasing acceptability of the idea of the prevalence of imperfectly competitive market conditions. The wage flexibility mechanism as propagated by the new-classical school failed to ensure equilibrium because of the following new lower ceiling argument. New Keynesians argued that wages could not decline further below a certain level. The decline in wages: (i) affects the incentive to work and the quality of the labour force negatively; (ii) increases the possibility of withdrawal of the labour force from the job market; and (iii) involves a high transaction cost for new recruitment. The new Keynesians suggested government intervention through counter-cyclical monetary[xi] and/or fiscal policy in order to restore equilibrium.

The corrective mechanisms prescribed by new-Keynesian schools were found effective before the economic slowdown of 2009. During the 2009 economic slowdown, involuntary unemployment increased due to economic agents’ “pessimistic expectations,” rather than the failure of wage cuts, as the New Classical School argued[xii]. Pessimistic expectations of economic agents frequently contract effective demand, reducing demand for labour and thus increasing unemployment. Demand for labour is determined by aggregate demand in the goods market and not by the wage rate. However, the nominal wage (money wage), which is determined in the labour market, influences the general price level, inflation, and income distribution. Money wages are central to the Post Keynesian School’s argument for determining inflation[xiii]. Since money wages determine inflation, the post-Keynesian school suggested price and income policies as the appropriate tools to control inflation. Fiscal, monetary, and income policies were three well-accepted tools used to revive the economy[xiv]. The post-Keynesian mechanism failed to tackle the economic situation arising due to COVID-19 after March 2020.

Historically, the reasons for the economic slowdown were classified as supply and demand constraints. The classical approach advocates for the rectification of the supply constraint through an automatic market mechanism. In contrast, demand constraints are addressed through Keynesian fiscal and monetary policy. Monetary policy is less effective in stimulating growth at a very low rate of interest offered against investment in the financial market because speculative demand for money exhausts the total supply of money. It works at very high interest rates because the total supply of money is used as the transaction demand for money or purposes. In between the two rates of interest mentioned above, the relative strength of the money supply and investment determines the effectiveness of the fiscal and monetary policy. The New Keynesian School proposes counter-cyclical monetary and fiscal policy to address the interconnected demand and supply constraints. However, the present “supply constraint Keynesian equilibrium” (Dasgupta and Rajeev 2020) is a unique situation where both demand and supply are independent. No appropriate mechanism has been prescribed in the literature so far to rectify the disequilibrium that evolved due to disjoint demand and supply constraints.

Section - 2

Policy Measures under Pre-COVID-19 Recession

Economic recession often occurs with varying degrees across the globe (Crafts and Fearon 2010; Kose*et al.* 2020) (Table 1) either due to demand constraint or supply constraint or both as stated earlier. In this section, policy initiatives undertaken in India are reviewed during times of supply constraints, demand constraints, and the interdependence of demand and supply constraints. Although the tools of fiscal and monetary policies were found effective in cases of demand constraint in achieving growth rates during normal time (1981–82, 1983–85, 1988–90, 1992–94, 1995–98, 1999–2002, 2003–08, 2014–15, 2016–17, and 2017–18), the same set of tools was not successful during an economic recession resulting from supply constraints, demand constraints, and the interdependence of both[xv] (Chakraborty and Harikrishnan 2022; Mundle and Sahu 2021). The ineffectiveness of the above policies during the periods of drought (1982–83, 1985–88, 2002–03, 2009–10, and 2010–11) except for 2009–10 is attributed to the interdependence of demand and supply constraints (Tables 1, 2, and 3).

The fiscal imbalance caused by a decline in revenue generation, an increase in transfer payments, and a 3.1% decrease in crude oil production as a result of agitation in Assam and a weak decision-making process at the Center are to blame for the recession caused by the presence of demand constraints in 1990-1991[xvi]. Further, the lack of desired quantities of oil imports widens the recession, resulting in inflation. Fiscal policy (expenditure containment, tax rationalization, tax compliance, tax effort, and promotion of saving and investment) used to control inflation could not be found effective. The direct tax relief and efficient management of public distribution no doubt raised the level of demand in the economy to some extent. The level of demand was not sufficient to stimulate investment and raise output. The rise in the statutory liquidity ratio (SLR) from 38 to 38.5% and selective credit controls against bank advances for stock of price-sensitive essential commodities under the monetary policy could not control the excessive money supply.

With the prevalence of demand constraints in the economy during 2012–14, the growth rate reduced significantly due to domestic structural constraints, inflationary pressure, and the global economic slowdown. In a similar manner, the targeted economic growth could not also be achieved during the 1991–92 recession resulting from global market uncertainty. The reduction of growth rates during the above periods indicates the failure of the tools of fiscal and monetary policies used. Application of more or less similar tools during both normal and economic slowdown periods without exploring suitable alternative tools is responsible for the failure of policy measures.

Table 1: Economic Downturn across Globe

Down-turn	Cause	Socio-econo-mic Condition	Severity (UN)	Suffering Countries	Remedial Mea-sures	Re-marks
GD 1930s (1929-39)	Stock Market, Banking, and International trade crisis (Sofya 2008) fiscal and monetary policy (Crafts and Fearson 2010)	Less than 20%GTO (Kose *et al* 2020), The habit of people to be rich, Neglect of agriculture, more weightage to industry, less proportionate growth of wage than productivity, high tariffs, and concentration of capital on few hands due to the heavy weightage of the automobiles industry, the opening of bank without federal or state restriction, installments credit in USA. Individual to collective bargaining, pro-union legislation. (Sofya 2008; Crafts and Fear son 2010), protection of industry from trade union (Ohanian 2009) DC	25% in USA	(USA, UK, Germany, Italy, Norway, South Africa, Poland, Australia) North America, central and eastern European Countries (Albers and Ubele 2015)	SCMM, limited government intervention with the voluntary co-operation of business and labor, trade barriers, the public charge on immigrants, government expenditures through public programs in 1931	SCMM failed,
ER 1973-75 or 1970s	Sharp rise in oil prices due to the Iranian revolution	50% GTO (Kose*et al* 2020) DC (Dasgupta and Rajeev 2020)	9% in USA	Western world	MP and FP	MP and FP failed
ER 2007-09	Asset inflation, easy access to credit, and increase in installment debts(Shomali and Giblin 2010)	Less than 55% GTO (Kose *et al* 2020) DC ((Dasgupta and Rajeev 2020))	10% in USA		Expansionary MP and FP	MP and FP succee-ded
ER2020-21	COVID-19	400% GFO(Kose*et al* 2020) DC and SC ((Dasgupta and Rajeev 2020))	14.7% in USA	Whole world	Expansionary MP and life induced FP	

Note: GD = Great Depression, ER = Economic Recession, SCMM = Self -corrective Market Mechanism, MP = Monetary Policy, FP = Fiscal Policy, DC = Demand Constraint, SC = Supply Constraint, UN = Unemployment, GTO = Global Trade Openness and GFO =Global Financial Openness

Source : Available literature.

Table 2: Tools of Fiscal and Monetary Policy Used in India (1980-81 to 2020-21)

Period	Fiscal Policy	Monetary Policy	Objective
1980-81 to 1984-85	PIT, CT, food subsidy, RLEGP and NREP, Infrastructural Investment, de-licensing of 25 priorities industries, (compulsory deposit scheme for income taxpayers, surtax, the surcharge on PIT payable by all class of companies, tax holiday and incentives for long-term saving, special paper bond, 1981)	CRR (1981 to 1985), SLR (1981 to 1983; 1984-85), FCR (1983-85), soft loan (1983-85), Interest rate on advances (1983-85), Borrowing from commercial bank and discretionary finance, MR, season credit policy and enlargement of financial structure during 1981 to 1983, ECRF during 1983-84 and export credit refinance, discretionary power to commercial bank in releasing sanctioned working capital , liberalization of flow of credit and exemption from selective credit control in 1984-85	EG (RG in 1981-82,)
1985-86 to 1989-90	MVAT, CED concessions for small-scale units, Investment Deposit Account Scheme, and PIT concessions to exporters in 1986-87, the surcharge on PIT, CT, wealth tax and custom duty, domestic airfares and upper-class railway fares and external assistance initiatives in 1987-88, concessions to agricultural and agro-based activities, investment allowance and duty reliefs to selected industries and incentives for export production in 1988-89	CRR, SLR and MR (1985-90), FCNA (1985-87; 1988-89), Lending rate for borrowers (1985-89), ECRF (1985-87; 1989-90), call money (1988-90) FCR, freedom to commercial bank to fix rate of interest on deposit of maturities of less than one year within a ceiling limit of 8 percent, rate of interest for maturities of 91 days, and persuasion in 1985-86, differential interest rate structure in 1986-87, deposit interest rate, discretionary credit policy, instructions regarding coordination among banks and sick financial institutions, conversion of short term to long term loans, reschedule investment credit and relaxation from interest and penalties in 1987-88, Treasury bills, relaxation/imposition from RBI authorization for term loans, extension of maximum period of repayment and reduction of margins of housing loan in 1988-89, interest rate on refinance under 182 days refinance facility, minimum lock in period for long term fund, restriction on refinance of non-food credit, incremental non-food credit deposit ratio, warning for violating the stipulation and level of credit ceiling in 1989-90	EG and Equity
1990-91 to 1994-95	custom duty in 1990-91, concessional import duty, Capital expenditures	CRR (1990-92; 1993-95), SLR (1990-91; 1993-94), FCNA (1992-93;1994-95),MR (1990-93) ECRF1(1990-92), incremental non-food credit deposit ratio, charge on unutilized portion of credit limit of large	FD and EG

Period	Fiscal Policy	Monetary Policy	Objective
		size borrowers and debt relief in 1990-91, Bank rate, interest on short term deposit, advances of all categories and export credit and imposition of ceiling on withdrawal of big borrowers in 1991-92, lending rate for advances in 1992-93, interest rates on deposit and loans and minimum lending rate in 1993-94, adhoc treasury bills, reduction of price on rice, abolition of duty on sugar, reduction of import duty in 1994-95	
1995-96 to 1999-2000	PIT (1996-2000), CT (1996-2000), CED (1996-97; 1998-99), MVAT, Monthly budgeting of departments, expenditure cut on staff cars, electricity, telephone bills and official entertainments, complete ban on purchase of new vehicles and conferences in hotels, closer of several offices abroad, 25% cut in foreign travels budget, impounding additional DA for officers drawing a monthly salary of 3500 rupees and above, tax relief to small scale industry, agriculture and environmental protection and MAT in 1996-97; increase in tax-free reimbursement on medical expenses, tax deductions on educational institutions, hospitals, incentives on house building, tax holiday to industry set up in backward areas, commercial production of minerals and telecommunication sector, reduction and exemption of import tariffs, interest payment and subsidy in 1998-99	CRR(1995-2000), SLR (1996-98) ceiling on borrowing from RBI through ad hoc treasury bill, open market operation, reduction of import duty, reduction on import restriction on manufactured consumer goods and reduction in custom and excise duties in 1995-96, call money rate in 1996-97, ways and means advances, and Bank rate in 1997-98, Bank rate and repo rate in 1998-99, repos and lending against the collateral of Government of India Securities, cheque writing facility, interest rate swaps and forward rate agreements, two-tier bond, FCNA, interest rate surcharge on import finance and the minimum rate of interest on overdue of the export bill in 1999-2000.	FD
2000-01 to 2004-05	Rationalization of Taxation, VAT, containment of social and economic revenue account expenditure and borrowing, securities transaction tax in 2004, tax on all cash withdrawal, PIT in 2003-04, central VAT, service tax, defense expenditures, Interest Payment, subsidies, tax holiday benefits for small-scale industries and industrial units set up in industrially backward states and district in 2001, permission to set up industry	Liquidity Adjustment Facility, licensing to commercial bank for capital market, credit delivery system focusing small scale industry, and renewed efforts to reduce non-performing assets of commercial banks, permission to sound bank and well managed non-banking financial companies to the insurance business, new banks in the private sector, certificate of deposits, commercial papers, supervision of banks and their subsidiaries and government shareholding in a nationalized bank in 2000-01,	FD

Period	Fiscal Policy	Monetary Policy	Objective
2005-06 to 2009-10	Custom duty (2005-07; 2009-10), CED (2005-07; 2009-10), rectifying anomalies like inverted duty structure, tax exemptions, voluntary tax compliance, VAT, outcome budget and FRBMA in 2005-06, tax on donations, direct tax exemptions, service tax, interest rate, subsidy, accrual accounting in government, and performance audit in 2006-07, FRBMA, ceiling on guarantee, consolidated sinking fund, guarantee reduction fund, VAT by states, outcome budget, non-plan expenditure, restriction on fresh recruitment and creation of new post, administrative reform, review of functioning of state public sector undertaking and contributory pension scheme for newly recruited staff in 2007-08, import duty on tradable goods whose prices showed unprecedented increase, tax relief and increased expenditure on public project, plan and non-plan expenditure in 2008-09, MTFRP, setting up an expert group to advice on pricing on petroleum products, people's participation in public sector undertaking and structural changes in direct taxes and harmonized GST and development of infrastructure in 2009-10	Bank rate (2005-06; 2008-09), CRR (2005-10) and RRR (2005-09), RR (2006-09), ceiling on interest rate on non-resident rupee deposit and export credit on foreign currency, standard advances for personal loan, capital market exposures, residential housing beyond 20 lakhs and commercial real estate loans, risk weight on exposure of commercial real estate, permission to primary dealers to diversify their activities in 2006-07, ceiling on interest rate on non-resident rupee deposit and export credit on foreign currency, the average cut off yield on 182 Treasury Bills, overseas investment limit, prepayment of external commercial borrowing, ceiling rate of interest payable by non-banking financial corporations and risk weight on residential housing loans to individuals in 2007-08, SLR in 2009-10	FD and EG
2010-11 to 2014-15	FRBMA and MAT (2011-13); PIT (2011-13; 2014-15) CED, custom duty and increase of service tax base and its exemption (2010-15) fiscal concession to agriculture, food processing, energy and infrastructure, simplification of procedure on small scale industries, containing non-plan and raising plan expenditures and debt reduction in 2010-11, the surcharge on CT in 2011-12, restriction on subsidies, modernization of business process of tax administration and subsidies in 2012-13, Investment allowance, tax holiday, tax concession on foreign dividend and roll back provision in advanced pricing agreement scheme in 2014-15	RRR (2010-13; 2014-15), CRR (2010-12; 2013-15), OMO and market stabilization scheme in 2010-11, RR (2011-13; 2014-15), Marginal standing facility rate, daily marginal standing facility borrowing, weekly auction of cash management bill and SLR in 2013-14, and SLR in 2014-15	FD and EG

Period	Fiscal Policy	Monetary Policy	Objective
2015-16 to 2019-20	GST (2016-20); MTFRP (2016-17; 2018-19); CT (2017-18; 2019-20); PIT (2017-19) Integration of railway budget with the union budget, advancement of the date of union budget to 1st February, elimination of plan and non-plan expenditure classification in 2016-17, custom duty, addressing concerns and facilitating measures, exemption, and rate in digital payment, the exemption provided to prime minister relief fund, chief minister and lieutenant governor relief fund, tax exemption to a foreign company on the sale of leftover stock of crude oil and initiatives on investment management on CPSES in 2017-18, initial public offer, offer for sale, buyback and exchange-traded fund for collection of disinvestment and increase in the state share in the divisible pool in 2018-19.	RRR, marginal standing facility rate, and withdrawal of the legal tender status of specified bank notes in 2016-17, RR and OMO in 2018-19, RR in 2019-20	EG
2020-21	PIT, food subsidy, collateral-free automatic loans to MSME, Employment Provident Fund support for business and workers, financing for agricultural projects, scheme for the formalization of Micro Food Enterprises, funding for fishermen, animal husbandry development fund, promotion of herbal cultivation, beekeeping initiatives and vegetables, free food grain supply to migrants	OMO, CRR, RR, special liquidity scheme, partial credit guarantee scheme, and liquidity injection by REC and PFC for power distribution companies in 2020-21	EG through increasing demand

Note: PIT = Personal Income Tax, CT = Corporation Tax, RLEGP = Rural Labour Employment Guarantee Programme, NREP = National Rural Employment Programme, CRR = Cash Reserve Ratio, SLR = Statutory Liquidity Ratio, EG = Economic Growth, FD = Fiscal Discipline, FCNA = Interest rate on Foreign Currency Non- resident Account scheme, MR = Margin Requirements on Consumer Credit, FCR = Food Credit Refinance, ECRF = Export Credit Refinance Facility, MVAT = Modified Value Added Tax, VAT = Value Added Tax RG = Revenue Generation, MSME = Minor, Small and Medium Enterprises, GST = Goods and Service Tax, MAT = Minimum Alternate Tax, FRBMA = Fiscal Responsibility Budget Management Act, MTFRP Medium Term Fiscal Restructuring Programme, OMO = Open Market Operation; CED = Central Excise Duty, RRR = Reverse Repo Rate, RR = Repo Rate

Source: Government of India (2020): Indian Economic Surveys from 1980-81 to 2019-20 and International Monetary Fund (2020): "World Economic Outlook".

Table 3: State of Indian Economy from 1981-82 to 2020-21 (in Per cent)

Year	Growth rate of GDP	Saving	Domestic Capital	Inflation	Situation
1981-82	6	18.6	18.9	2.4	Normal
1982-83	3.1	18.3	19.2	7.3	Drought
1983-84	7.7	17.6	18.8	8.2	Normal
1984-85	4.3	18.8	19.6	7.6	Normal
1985-86	4.5	19.5	20.6	3.8	Drought in several areas
1986-87	4.3	18.9	21.1	5.3	Poor monsoon
1987-88	3.8	20.6	21.5	10.7	Drought
1988-89	10.5	20.9	21.6	5.7	Normal
1989-90	6.7	22	22.4	9.1	Normal
1990-91	5.6	23.1	22.9	12.1	Political uncertainties, fiscal imbalance due gulf crisis, BoP crisis
1991-92	1.3	22	22	10.8	Fiscal crisis due BoP crisis and high inflation
1992-93	5.1	21.8	22.4	7	Normal
1993-94	5.9	22.5	21.4	10.8	Normal
1994-95	7.3	24.8	21.9	10.4	Normal
1995-96	7.3	25.1	24.4	4.4	Normal
1996-97	7.8	23.2	22.8	5.4	Normal
1997-98	4.8	23.1	21.7	4.5	Normal
1998-99	6.5	21.5	21.5	5.3	Unfavourable global economy
1999-00	6.1	24.9	21.8	6.5	Normal
2000-01	4.4	23.5	22	5.5	Normal
2001-02	5.8	23.6	23	1.6	Normal
2002-03	4	26.5	25.3	6.5	Drought
2003-04	8.5	29.8	27.6	5.5	Normal
2004-05	7.5	31.7	32.1	6.5	Normal
2005-06	9.5	34.2	35.5	4.4	Normal
2006-07	9.7	35.7	36.9	5.4	Normal
2007-08	9.3	36.8	38.1	4.7	Normal
2008-09	6.7	32	34.3	8.1	Global crisis and freezing of developed financial market
2009-10	8.6	33.7	36.5	3.8	Drought
2010-11	8.9	34	36.8	9.6	Drought
2011-12	6.7	33.9	38.2	8.1	Global Uncertainty
2012-13	5.1	31.8	36.6	7.4	Global crisis, domestic structural constraint and inflationary pressure
2013-14	6.9	30.6	32.3	6	Global crisis, domestic structural constraint and inflationary pressure
2014-15	7.5	33.1	34.4	1.2	Normal
2015-16	8	31.1	32.1	-3.7	global headwinds and a truant monsoon
2016-17	8.2	30.3	30.9	1.7	Normal
2017-18	7.2	30.5	32.3	3	Normal
2018-19	6.8		10	4.3	Global uncertainty
2019-2020	5			2.6	Global uncertainty
2020-21	1.9				Pandemic

Source : Same as Table 2.

Section - 3

Policy Measures during and Post-COVID-19 Period

The recession during 2019–21, unlike a few earlier recessions, is the outcome of a contagious health problem. Stringent measures are undertaken to restrict the spread of the COVID outbreak led to a situation of independent demand and supply constraints. The Indian economy derailed from the growth path during this period (Dasgupta and Rajeev 2020). To combat the situation, direct government fiscal intervention (Mukhopadhyay 2021), a multi-pronged approach combining wider fiscal and monetary policy (Furnaro and Wolf 2020; Dua, 2020; Moharir, 2022; Goyal, 2022), and a policy that fights inflation, unemployment, inequality in the distribution of income and wealth, and ecological imbalance (Skidelsky 2020) are prescribed. Under the "*Atmanirbhar Bharat Abhiyan*," the Indian government implemented a minimum-life-support fiscal policy as well as a credit-induced monetary policy. These policy measures were far from the experts' idea and merely a slight modification of the ongoing fiscal and monetary tools (Table 2). These measures are criticized as being inappropriate to boost the economy in such a situation (Chakraborty and Thomas 2020; Pal and Ray 2022).

The minimum life support fiscal policy was an extension of the ongoing public distribution programme (free rations) along with minimum cash transfers to poor households for a limited period of time. Intervention through the public distribution system with free food grains to poor households along with a set amount of cash transfers is nothing more than populist policy disguised as fiscal tools. This restricted fiscal policy intervention has zero growth-stimulating effect. Like many developed countries, India was in need of a wider fiscal intervention in a Keynesian frame that could have the capacity to restore confidence among producers and consumers during COVID. Instead of opting for a liberal and wider fiscal policy measure, the present government adopted a wait-and-watch policy and left the economy in the hands of the market for response. Even though entrepreneurs grasped the opportunities offered by the government through credit-induced monetary policy at a lower rate of interest, they did not invest in the absence of demand and hoarded their money. Dasgupta and Rajeev 2020 also observed that the expansion of money supply through monetary policy during such situations leads to a liquidity trap.

Fiscal stimulus packages (federal transfers to states for infrastructure building, tax rebates, temporary income tax cuts, cash for clunkers, and financial aid for first-time homebuyers) could not stimulate growth during the Financial Crisis and Great Recession of 2007–2009 (Taylor 2018). As observed by Rangarajan, monetary policy may not be an appropriate instrument for economic growth in such a situation (Rangarajan 2020).The failure of the tools of fiscal and monetary policy to stimulate growth in selected countries during and after COVID-19 is also reflected in the growth rates of those countries (Tables 4 and 5).

Minimum-guaranteed cash transfers to poor and middle-income households might have increased trust among economic agents. With the opening of economic activities, even if the policy prescription [particularly monetary policy (Patra and Bhattachayya 2022)] recovered the economy to some extent, the larger output loss due to lack of private consumption and investment (Mukhopadhyay 2021; Sheel 2022; Gupta 2022) and the further reduction of government expenditures in the Union budget2021–222 (Mundle and Sahu 2021) resulted in the presence of dependent demand and supply constraints (Mundle 2020) and the budget 2021-22 (Mundle and Sahu 2021) resulted in the presence of dependent demand and supply constraints (Mundle 2020). This could not allow the policy measures to revive the economy as per expectation (Economic and Political Weekly 2022).

Instead, it resulted in high inflation (Mundle 2022). As a retaliatory measure, the government used restricted monetary policy by increasing the lending rate of interest in the post-COVID period. It may lead to a further recession in the economy. The increase in inflation is due to a lack of output relative to demand as a result of a trust deficit among economic agents. In order to raise the level of demand, trust restoration among economic agents should be of prime importance. The fact that poor and middle-income households contribute a significant (97%) portion of the GST shows that these groups account for a large portion of the economy's demand (Indian Express 2023). In order to increase trust among the economic agents for a continuous rise in demand, which would put pressure on raising the level of investment, the government should incur a large volume of investment on cottage and small-scale industries, roads, solar energy, and irrigation to boost agriculture, provide tax exemption on basic needs, and increase the tax exemption slab of income tax. As a result, the income of low- and middle-income households would rise, increasing demand to a greater extent. It is also argued that government expenditures should be made to finance small and medium enterprises and help vulnerable sections of society. The voluminous investment package is to be financed through state debt monetization. The state faces huge fiscal constraints. The central government has a lack of credibility and debt management issues (Kasliwal 2020). Further regulation of consumer credit, directives to shift credit from less productive to more productive uses, fixation of maximum limits and lending for certain purposes, publicity, and moral suasion should be pursued under monetary policy. In other words, growth-oriented fiscal policy as well as counter-cyclical monetary and income policy may aid in economic recovery.

Table 4: Tools of Fiscal and Monetary Policy in Selected Countries during COVID-19

Country	Fiscal Measures	Monetary Measures	Remarks
Australia	Payroll tax relief for businesses, discount utility bills, cash payments to vulnerable households, health spending, construction, infrastructure packages, and green investment, Asset-backed securities to small banks and non-bank financial institutions, loan guarantees between the Commonwealth government and participating banks, Job Trainer Skills package, Job Maker program, loss carry-backs and personal income tax cut, national vaccination, aged-care and disability, women, retirement flagship Job Keeper and wage subsidy program, tax reliefs for low and middle income earners	Policy rate cuts, yield curve targets, term funding facilities, government bond purchases, longer-term repos, broadening the range of eligible collateral for open market operations, swap line, allowing banks to utilize some of their large buffers, the regulatory concession for six months, Dividend payment restrictions and Insolvency relief measures for businesses	Financial support to business, low and middle income household and banks,

Country	Fiscal Measures	Monetary Measures	Remarks
China	Epidemic prevention and control, production of medical equipment, accelerated disbursement of unemployment insurance and insurance to migrant workers, tax relief, social security contributions and additional public investment.	Liquidity injection via open market operations, re-lending and re-discounting facilities for manufacturers of medical supplies and daily necessities, MSME and agricultural sector, RRR cuts for MSME, reducing interest on excess reserves, expanding banks' credit line to private firms and MSEs, financial relief to affected households, corporates and regions	Financial support to low income household
USA	Investing in public health, time-bound assistance to families, communities and businesses, unemployment benefits; student loan payment relief; deferring collections of employee social security payroll taxes; identifying options to help renters and homeowners avoid evictions and foreclosures; forgivable Small Business Administration loans, help small businesses; establishment of hospitals; expansion of virus testing; one-time tax rebates to individuals; food safety net for the most vulnerable; prevent corporate bankruptcy providing loans, guarantees, and backstopping Federal Reserve 13(3) program; 2 weeks paid sick leave; 3 months emergency leave for infected; food assistance; transfers to states for unemployment insurance. Expansion of Small Business Administration loan subsidies.	Reduced Federal funds rate, cost of discount window lending and cost of swap lines; Purchase of Treasury and agency securities; Expanded overnight and term repos; broadened U.S. dollar swap lines; temporary repo facility for foreign and international monetary authorities. Commercial Paper Funding Facility; Primary Dealer Credit Facility; Money Market Mutual Fund Liquidity Facility; Primary Market Corporate Credit Facility; Secondary Market Corporate Credit Facility; Term Asset-Backed Securities Loan Facility; Paycheck Protection Program Liquidity Facility; Main Street Lending Program; and Municipal Liquidity Facility; mortgage forbearance for 12 months, suspending foreclosure sales and evictions of borrowers for 60 days, and offering loan modification options.	
USSR	compensation for frontline medical staff, health and safety inspectors; sick leave, leave pay to individuals under quarantine; unemployment benefit ; lumpsum benefit for 3 months to children up to 3 years of age; one-time lumpsum benefit to children within 3-16 years; lumpsum benefit to each child of families whose parent lost job up to 6 months and schoolchildren and children in one-parent families; interest rate subsidies for SMEs and important enterprises; tax deferrals for most affected companies; deferrals on social contributions for SMEs in affected sectors for 6 months; tax holiday on all taxes excluding VAT and	Reduction of key rate by 200 bps, preemptive sale of FX reserves and FX sales; increasing the limit on FX swap operations, temporary introduction of long-term refinancing instrument; Forbearance on provisioning for restructured corporate and SME loans to all sectors; extension of deadline for full provisioning of restructured corporate loans; refinancing facility to support SME lending; reduction of interest rate on CBR refinancing loans; permission to bank to value securities and foreign exchange operations; reduction of the Deposit Insurance Fund contribution; measures to protect retail borrowers suffering from	Financial support to business and low income household

Country	Fiscal Measures	Monetary Measures	Remarks
	social contributions for SMEs, sole proprietors and NGOs providing social services; refunding of tax for 2019 of registered self-employed and partial refund on 2020 taxes; reduction of eligibility age to register as self-employed; partial refund on the social contributions of sole proprietors; deferrals on rent payments to all levels of government, zero rent to the federal government for three months for SMEs in affected sectors; grants for SMEs in affected industries for two months, subsidized and forgivable loans for enterprises in affected industries; subsidies to enterprises in selected affected industries; zero import duties for pharmaceuticals and medical supplies and equipment; grants to firms hiring people who lost jobs in 2020; guaranteed loans to SMEs and affected industries; subsidies to airlines, airports, automakers, and others; state-owned bank, airlines and development institution re-capitalization and expanded eligibility for subsidized mortgage lending.	pandemic; deferrals of loan payments up to six months for affected citizens and SMEs; restructuring loans to affected retail borrowers and SME; Measures to support retail and mortgage lending; provision of services of non-bank financial institutions and remote customer services; measures in the field of AML/ CFT and currency control; new credit risk assessment methods and lower risk weights in mortgage lending freed about Rub 300 bn; reduction of risk buffers for unsecured loans and cancels risk buffers for consumer loans; lifting the cap on banks' fees for online retailers	
UK	Increasing payment to vulnerable section, property tax holiday, direct grants to small and most affected firms, compensation of sick pay leave and additional funding for National Health Service, public service and charities, postponement of value added and income tax for a temporary period, trade credit insurance, minimum financial support to protect job, cash transfer to poor and business having shutdown, payment to support job	Reduction of bank rate, expansion of central banks holing of government bonds and non-financial corporation bond, incentives for lending real economy, additional liquidity to government, loan guarantee schemes, contingent term repo facility, reduction of counter cyclical buffer rate and maintaining systematic risk buffer rate	Support business and increase social safety

Source: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

Table 5: Growth rate of Selected Countries (in %)

Country	Q4-2019	Q1-2020	Q2-2020	Q3-2020	Q4-2020	Q1-2021
Australia	0.4	-0.3	-7.0	3.5	3.2	1.8
China	1.2	-8.7	10.0	2.8	3.0	0.4
USA	0.5	-1.3	-8.9	7.5	1.1	1.5
UK	0	-2.8	-19.5	16.9	1.3	-1.6
USSR	-0.5	0.7	-2.6	0.7	-0.2	0.0
India	0.6	0.8	-25.9	23.1	9.3	2.1

Note: The growth rate relates to percentage change from previous quarter.
Source: https://stats.oecd.org/index.aspx?queryid=350

Section - 4

Conclusions and Policy Suggestions

Disequilibrium is a stylized fact. Different schools of thought have prescribed different mechanisms at various points of time to rectify the disequilibrium and expedite economic growth. The domain of prescription is dominated by classical and Keynesian economists. The other schools of thought are mostly extensions of either the former or the latter. Disequilibrium occurs to varying degrees due to either demand or supply constraints or both. However, disequilibrium arises due to independent demand and supply constraints that are usually unusual, as seen during the COVID-19 period. In such a situation, none of the measures found were responsive. When some developed countries used a more expansive fiscal policy in conjunction with monetary measures to keep demand high and signal producers to produce, India used a more restrictive fiscal policy and credit-based monetary policy. These measures were helpful in protecting lives but failed to create a demand-inducing stimulus in the economy. However, it would have been preferable if the government could have used a liberal fiscal policy tool, such as progressive cash transfers to all segments of society, in addition to monetary tools. The developed countries realised the importance of the Keynesian method of intervention and could place a signal of adequate demand on the market. India missed this opportunity to gather trust among economic agents by not being able to (i) create a sense of confidence among the consumer to spend fearlessly and (ii) get the producer ready to respond to the demand soon after the removal of independent demand and supply constraints. The producer makes production decisions based on market signals or by speculating on market demand based on recent fiscal policy interventions. During the post-COVID situation, the economy is encountering high unemployment and inflation due to a lack of investment and output. Increasing the repo rate by the Reserve Bank of India (on February 8, 2023, by 25 basis points to 6.5 percent) in such a situation to fight against inflation and projecting a GDP growth of 6.4%, assuming the mechanism will work with the appreciation in the value of money, looks more theoretical than realistic.

In such a situation, economic growth is more guided by (i) the confidence of producers in market demand, (ii) policy interventions of the government, and (iii) the investment capacity of the producers. There is a lack of demand-inducing stimulus mechanisms during COVID. The investment capacity of the producer has deteriorated due to the lockdown of economic activity and the occurrence of global market uncertainty. Producers could not speculate or trust the increase in demand at the right time. Consumers will be hesitant to spend freely in the absence of demand-inducing fiscal policy and in anticipation of another economic shock in the near future, as rational expectations predict. Similarly, a rational producer will read the market demand on the basis of unemployment and the policies initiated during COVID. As a result, the production process becomes slow and may create temporary inflation in the economy. In such a condition, the use of monetary policy instruments to control inflation is not rational or may even be counterproductive. Furthermore, India's Finance Minister stated that the economy has already recovered from the COVID, contradicting the immediate monetary policy measure. With the recovery of the economy, the growth rate has increased, resulting in an increase in demand. But the increase in present demand is an outcome of forced consumption resulting from saving and hoarding, which may continue for a temporary period of time. Income tax reductions are announced in budget 202-24 in order to sustain increased demand over time. However, this tool has less of an incentive effect on the demand of the salaried and entrepreneurial classes. The small proportion of savings may not be converted into demand due to people's lack of confidence in the stability of the economy and in the existence of the state based on their previous experiences. The implementation of the seventh pay commission, the re-introduction of the old pension, government investment in social and economic infrastructure, and an increase in the amount of social security schemes through debt monetization may be helpful to increase demand.

Endnotes

i ‘CO’ stands for corona, ‘VI’ for virus, and ‘D’ for disease. The disease was formally referred to as ‘2019 novel corona virus’ or ‘2019-n CoV’. The COVID-19 virus is a new virus linked to the same family of viruses as Severe Acute Respiratory Syndrome (SARS) and some types of common cold.

ii Before COVID-19 led lockdown, the Indian economy faced a supply-side problem largely on account of ‘Demonetization’ implemented in 2016, ‘Goods and Service Taxes’ brought in 2017 and slowdown in credit growth (Sengupta and Vardhan, 2020). A demand constrained economy is one where the rise in demand increases the level of income, output and employment in the economy without increasing the price level while the reverse of it is the supply constrained economy (Patnaik 2020).

iii The indicator consists of growth rate of Gross Domestic Product, investment and saving, wholesale price index, State of economy and tools of fiscal and monetary policy used over time.

iv Demand constraint occurs due to unemployment, unutilized capacity of plants and raw materials. It is often observed in capitalism. The shortage of labour, equipment and raw materials leads to supply constraint which is encountered in socialism. The mixed economy faces both supply and demand constraints (Patnaik 2020).

v Shomali and Giblin (2010) comparing the severity, causes and policy reactions between 1930s great depression and 2007-09 recession found different steps taken by government to revive the economy although the causes of both recessions are more or less same (asset inflation and excesses in the housing market). The economy came out of trap with interventions of Keynes during 1930s depression. The rational expectation framework helped the economy to revive from recession during 2007-09. Pandey *et al* 2018 observed that unfavourable monsoon and failure of fiscal and monetary policy are the reasons behind recessions during 1950 to 1990-91 and 1991-92 to 2017 respectively. The slowdown in corporate performance, credit off take and subdued export led to deceleration since 2012.

vi The classical theory believes in full employment equilibrium in an economy based on ‘*Laissez fair*’ perfectly competitive market condition because unemployment relates to frictional and seasonal unemployment only. If such type of unemployment exists, it can be eradicated by lowering wage and interest rate. The flexibility in wage rate brings full employment in the labour market which in turn leads to optimum output in goods market. It is because saving and investment being function of rate of interest, flexibility in interest rate automatically converts saving into investment in zero time gaps resulting equality of income and expenditures. The inter-linkage of goods and labour market brings about combination of aggregate demand and perfectly inelastic supply, which is full employment level of output.

vii A number of industrial unions were formed during 1930 like United Automobiles Workers and United Mines Worker, which came together in the Congress of Industrial Union along with American Federation of Labour and dominated orgnized labour in United States.

viii The Classical school speaks about government intervention, but it is restricted to extent help for the smooth functioning of the market mechanism. However, Keynes view of government intervention is intervention in the form of public investment through fiscal policy which enables income to equalize with expenditures when investment falls short of saving in bringing full employment level of income and output in goods market. According to Keynes, saving is directly related to income and investment is inversely related to rate of interest. When income increases, consumption increases less than proportionate change in income. In other words, saving increases at an increasing rate with the rise in income. In order to equalize investment with the increased saving to attain equilibrium, government investment is required. Further at a very low rate of interest, income is increased to a greater extent with the rise in government investment. The change in supply of money can bring about full employment at a very high rate of interest when total money supply is devoted to transaction demand for money to equate income with expenditures. However, the rise in money supply can not increase income at low rate of interest because the whole increased money supply is kept by public at cash in hand.

ix Keynes assumed short run and existing skill, quantity of labour, quality and quantity of equipment, technique of production, degree of competition, taste and habits of consumer, social structure and more or less closed economy as given to preserve capitalism.

x The economic conditions changed over past 40 years from capital saving to capital using with a fast growth rate of population. What were taken as given by Keynes became variable over time. The economic problems became growth, dynamics and inflation instead of stagnation.

xi A counter cyclical monetary policy is one which stabilizes both inflation and output around a set target.

xii The different schools of thought from the Classical to New-Keynesian mostly emphasized “wage” as the main determinant of equilibrium. However, the expectation of economic agent is the main factor determining equilibrium as argued by the Post-Keynesians.

xiii The Post-Keynesian school rejects the automatic market mechanism of new-classical and price and wage stick-ness of new Keynesian since wage cut reduces consumption and hence aggregate demand contracting the level of income and output. As per Post-Keynesian school effective demand which is determined by entrepreneur’s expectation of future demand, can fully utilize the resources in operating at its full potential in short and long run. Extending beyond full employment to the theories of income distribution, growth and stability, they argue that endogenous bank lending determines the supply of money not the central bank. Inflation is the result of conflict over the distribution of available income and output not of excess demand. It is a social phenomenon, not a monetary phenomenon. Inflation or stagflation can not be controlled through monetary and fiscal policy. It is the income policy that works effectively, equitably and adequately. Fiscal and monetary policy instruments contracting the level of economic activity, reduces the amount of income and output available for distribution thereby heightening the social conflict underlying the inflationary process.

xiv Fiscal, monetary and income polices are injected to generate income sufficient to make demand equality with supply to maintain full employment output through investment in productive activities in an economy where there is demand constraint and both demand and supply are interlinked to each other.

xv Abnormal situations arise due to either natural or external factor or both where natural factors may be drought or pandemic. Fiscal and monetary policies were successful during 2009-10 due to favorable agriculture and industrial performance even if there was drought (Sahoo and Bishoni 2022) and global market uncertainty during 2008-09.

xvi The proportion of expenditures on capital formation has declined from 40% to 32.7% while that of transfer payments from central government to states and union territories have increased from 30.7% to 42.7% during 1980-81 to 1990-91 (Government of India 1990-91).

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