Monetary and Fiscal Policy of India

The Monetary and Credit Policy is the policy statement, traditionally announced twice a year, through which the Reserve Bank of India seeks to ensure price stability for the economy.

These factors include - money supply, interest rates and the inflation. In banking and economic terms money supply is referred to as M3 - which indicates the level (stock) of legal currency in the economy.

Besides, the RBI also announces norms for the banking and financial sector and the institutions which are governed by it.

How is the Monetary Policy different from the Fiscal Policy?

- The Monetary Policy regulates the supply of money and the cost and availability of credit in the economy. It deals with both the lending and borrowing rates of interest for commercial banks.
- The Monetary Policy aims to maintain price stability, full employment and economic growth.
- The Monetary Policy is different from Fiscal Policy as the former brings about a change in the economy by changing money supply and interest rate, whereas fiscal policy is a broader tool with the government.
- The Fiscal Policy can be used to overcome recession and control inflation. It may be defined as a deliberate change in government revenue and expenditure to influence the level of national output and prices.

What are the objectives of the Monetary Policy?

The objectives are to maintain price stability and ensure adequate flow of credit to the productive sectors of the economy. Stability for the national currency (after looking at prevailing economic conditions), growth in employment and income are also looked into. The monetary policy affects the real sector through long and variable periods while the financial markets are also impacted through short-term implications.

INSTRUMENTS OF MONETARY POLICY

- Bank Rate of Interest
- 2. Cash Reserve Ratio
- 3. Statutory Liquidity Ratio
- 4. Open market Operations
- 5. Margin Requirements
- 6. Deficit Financing
- 7. Issue of New Currency, 8. Credit Control
Inflation

Inflation is a rise in the general level of prices of goods and services in an economy over a period of time. When the price level rises, each unit of currency buys fewer goods and services. A chief measure of price inflation is the inflation rate. When Prices rise the Value of Money falls.

- CREEPING INFLATION (0%-3%)
- 2. WALKING INFLATION (3% - 7%)
- 3. RUNNING INFLATION (10% - 20 %)
- 4. HYPER INFLATION (20% and abv)

Inflation can have positive and negative effects on an economy. Negative effects of inflation include loss in stability in the real value of money and other monetary items over time; uncertainty about future inflation may discourage investment and saving, and high inflation may lead to shortages of goods if consumers begin hoarding out of concern that prices will increase in the future. Positive effects include a mitigation of economic recessions, and debt relief by reducing the real level of debt.

Deficit Financing

- It means printing of new currency notes by Reserve Bank of India. If more new notes are printed it will increase the supply of money thereby increasing demand and prices.
- Thus during Inflation, RBI will stop printing new currency notes thereby controlling inflation.
- During Inflation the RBI will issue new currency notes replacing many old notes.
- This will reduce the supply of money in the economy.

Fiscal Policy

Fiscal policy refers to the government’s choices regarding the overall level of government purchases or taxes. Fiscal policy influences saving, investment, and growth in the long run. In the short run, fiscal policy primarily affects the aggregate demand. It refers to the Revenue and Expenditure policy of the Govt. which is generally used to cure recession and maintain economic stability in the country.

Instruments

- Reduction of Govt. Expenditure
- 2. Increase in Taxation
- 3. Imposition of new Taxes
- 4. Wage Control
• 5. Rationing
• 6. Public Debt
• 7. Increase in savings
• 8. Maintaining Surplus Budget

Other measures

• Increase in Imports of Raw materials
• 2. Decrease in Exports
• 3. Increase in Productivity
• 4. Provision of Subsidies
• 5. Use of Latest Technology
• 6. Rational Industrial Policy
Liberalization, Privatization and Globalization
in India (LPG)

The economy of India had undergone significant policy shifts in the beginning of the 1990s. This new model of economic reforms is commonly known as the LPG or Liberalisation, Privatisation and Globalisation model. The primary objective of this model was to make the economy of India the fastest developing economy in the globe with capabilities that help it match up with the biggest economies of the world.

The chain of reforms that took place with regards to business, manufacturing, and financial services industries targeted at lifting the economy of the country to a more proficient level. These economic reforms had influenced the overall economic growth of the country in a significant manner.

Liberalisation
Liberalisation refers to the slackening of government regulations. The economic liberalisation in India denotes the continuing financial reforms which began since July 24, 1991.

Privatisation and Globalisation
Privatisation refers to the participation of private entities in businesses and services and transfer of ownership from the public sector (or government) to the private sector as well. Globalisation stands for the consolidation of the various economies of the world.

LPG and the Economic Reform Policy of India
Following its freedom on August 15, 1947, the Republic of India stuck to socialistic economic strategies. In the 1980s, Rajiv Gandhi, the then Prime Minister of India, started a number of economic restructuring measures. In 1991, the country experienced a balance of payments dilemma following the Gulf War and the downfall of the erstwhile Soviet Union. The country had to make a deposit of 47 tons of gold to the Bank of England and 20 tons to the Union Bank of Switzerland. This was necessary under a recovery pact with the IMF or International Monetary Fund. Furthermore, the International Monetary Fund necessitated India to assume a sequence of systematic economic reorganisations. Consequently, the then Prime Minister of the country, P V Narasimha Rao initiated groundbreaking economic reforms. However, the Committee formed by Narasimha Rao did not put into operation a number of reforms which the International Monetary Fund looked for.

Dr Manmohan Singh, the present Prime Minister of India, was then the Finance Minister of the Government of India. He assisted. Narasimha Rao and played a key role in implementing these reform policies.

Narasimha Rao Committee's Recommendations
The recommendations of the Narasimha Rao Committee were as follows:

- Bringing in the Security Regulations (Modified) and the SEBI Act of 1992 which rendered the legitimate power to the Securities Exchange Board of India to record and control all the mediators in the capital market.

- Doing away with the Controller of Capital matters in 1992 that determined the rates and number of stocks that companies were supposed to issue in the market.
• Launching of the National Stock Exchange in 1994 in the form of a computerised share buying and selling system which acted as a tool to influence the restructuring of the other stock exchanges in the country. By the year 1996, the National Stock Exchange surfaced as the biggest stock exchange in India.

• In 1992, the equity markets of the country were made available for investment through overseas corporate investors. The companies were allowed to raise funds from overseas markets through issuance of GDRs or Global Depository Receipts.

• Promoting FDI (Foreign Direct Investment) by means of raising the highest cap on the contribution of international capital in business ventures or partnerships to 51 per cent from 40 per cent. In high priority industries, 100 per cent international equity was allowed.

• Cutting down duties from a mean level of 85 per cent to 25 per cent, and withdrawing quantitative regulations. The rupee or the official Indian currency was turned into an exchangeable currency on trading account.

• Reorganisation of the methods for sanction of FDI in 35 sectors. The boundaries for international investment and involvement were demarcated.

The outcome of these reorganisations can be estimated by the fact that the overall amount of overseas investment (comprising portfolio investment, FDI, and investment collected from overseas equity capital markets) rose to $5.3 billion in 1995-1996 in the country) from a microscopic US $132 million in 1991-1992. Narasimha Rao started industrial guideline changes with the production zones. He did away with the License Raj, leaving just 18 sectors which required licensing. Control on industries was moderated.

Highlights of the LPG Policy
Given below are the salient highlights of the Liberalisation, Privatisation and Globalisation Policy in India:

• Foreign Technology Agreements
• Foreign Investment
• MRTP Act, 1969 (Amended)
  • Industrial Licensing
  • Deregulation
  • Beginning of privatisation
  • Opportunities for overseas trade
  • Steps to regulate inflation
  • Tax reforms
  • Abolition of License -Permit Raj