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E: ISSN NO.: 2349-980X **Shrinkhla Ek Shodhparak Vaicharik Patrika**

Game Makers: A Comparative Analysis of Fiscal versus Monetary Policies in The Pre Reform and Post Reform Era in Indian

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Abstract

This paper aims to draw a comparison between the fiscal and monetary policies set in the pre(1948-91) and post reform era(since 1991) in India. Pre-reform era witnessedanti - inflationary monetary policies. After reforms Cash Reserve Ratio(CRR) and Statutory Liquid Ratio(SLR) were reduced,Self Help Groups(SHG) became important, monetary policies were separated from fiscalpolicies which in thepre-reformer a included high and complex tax structure and in the post reform phase witnessed a reduction and abolition of multiple taxes, tariffs, introduction of VAT, and fertilizer subsidies to accelerate growth with price stability.

Keywords: Monetary, Fiscal, Bank, Tax, Policy, Economic, Government, Growth, Reform, Rate

Introduction

Fiscal policies of the government not only uses taxation and government expenditures as it's levers but it also partly determines the nature and course of monetary policies of the central bank which in turn uses the supply of money and the repo rate as its triggers. This study examines and assesses the difference between fiscal policy measures in the pre and post reform era and monetary policy measures in the pre and post reform era. Earlier, several papers have been written on fiscal policy measures and monetary policy measures in India but none of these papers have compared the fiscal and monetary policies set in the pre and post reform era. Here, in our paper, I will mainly highlight the key differences between the policy measures (both fiscal and monetary) and compare their impacts on the developing economy of India.

Pre-reform

In the pre-reform era, monetary policies were mainly anti-inflationary. In the First Plan (1951-56), the policy was mainly confined to allocation of resources. During the Second Plan period (1956-61), bank rate was raised further. In the Third Plan (1961-66) and Annual Plans (1966-69), the RBI adopted a credit policy of restraint. It raised the bank rate even further; Credit Authorisation Scheme, a system of differential interest rates (DIR) were introduced; SLR was raised followed by the nationalisation of major commercial banks. The Fourth Plan (1969-74) witnessed the adoption of restrictive credit control measures, stipulation of Net Liquidity Ratio (NLR), further enhancing of SLR to 30% and NLR to37%. The Fifth Plan (1974-79) mainly targeted inflation. In Sixth Plan (1980-85), efforts have been continuously directed towards containing the inflationary pressures with an increase in SLR.

Post-reform

In contrast to the pre-reform era, the post-reform era witnessed considerable reductions in CRR and SLR; increased focus on SHG**;** the RBI signed an agreement with the government to separate the Monetary policy from the fiscal policy and interest rate structure was changed to the market oriented or liberal rate of interest. The banking sector got more autonomy and operational flexibility. More freedom to banks for methods of assessing working funds and other functioning empowered and assured market orientation.

In the pre-reform era, fiscal policy measures in this period included wealth and expenditure tax; high personal & marginal Income tax rates encouraging tax evasion; numerous excise duties besides sales tax and high import tariff .Deficit financing was used as a means to cover the

gap between ambitious investment plans and the low levels of savings in an underdeveloped economy. All capital independence expenditures were treated as developmental and all expenditure on civil works were treated as non-developmental. These policy measures turned out to be inefficient and growth was anaemic. India experienced a huge economic crisis (Gulf Crisis of 1990) with a steep rise in import bill of crude oil, followed by deterioration in the exchange rate of the rupee. This called for changes policy measures for a quick recovery of the Indian economy.

In the post reform era, personal and corporate income tax rates; import tariffs and fertilizer subsidy were reduced and wealth tax was abolished. Service tax and progressive reduction in peak rate of customs duty on non-agricultural products were introduced. VAT was introduced on 1st April, 2005 and many other policy reforms have taken place in this era. The FRBMA Act (Fiscal Responsibility and Budget Management Act) was introduced in 2003 to strengthen the economy's fiscal discipline .Another major fiscal reform includes the introduction of Goods and Service Tax (GST) on 1st July, 2017. GST is the one indirect tax for the entire economy, replacing the other indirect taxes. Economic reforms since 1991 have placed India on a higher growth trajectory as compared to the pre-reform era.

Aim of the Study

The main objectives of my dissertation are to explore the various fiscal and monetary reforms undertaken in the pre-reform and the post-reform era; identify the impacts of the policies undertaken; compare the fiscal and monetary policies undertaken in the pre-reform and the post-reform era.

Literature of Literature

Goyal, Ashima.2011.History of Monetary Policy in India since Independence. This paper explores the fiscal and monetary policies from 1950s to 2010. It helps to understand the impacts of the policies undertaken in the pre and post reform period drawing a comparison and inferring that policy was sometimes exceedingly tight when the common understanding was of a large monetary overhang. Fiscal dominance made policy procyclical. The three factors that cause a loss of monetary autonomy—governments, markets and openness—are moderating each other. Markets moderate fiscal profligacy and global crises moderate markets and openness. Greater current congruence between ideas and structure is improving institutions and contributing to India's better performance.

Khilar, Priya, Ruchi.2017. Review of Monetary Policy of India since Independence. This paper carries clear ideas regarding the monetary policy and its background during the pre and post reform eras. It states that Indian Monetary Policy has seen many structural changes since independence. During early 1990s, the major monetary policy measures were Cash Reserve Ratio (CRR) and Statutory Liquid Ratio (SLR). In case of India, it has been observed that the increase in inflationary pressure is mainly due to the money demanded by the central government to meet the budgetary deficit of the country.

Ahluwalia, Montek S.: India's Economic Reforms An Appraisal. This work explores the various economic reforms undertaken in the pre and post reform eras. Ahluwalia states that India's economic reforms began in 1991 when a newly elected Congress government, facing an exceptionally severe balance-of-payments crisis, embarked on a programme of short-term stabilization combined with a longer-term programme of comprehensive structural reforms. Rethinking on economic policy had begun earlier in the mid-1980s by which time the limitations of a development strategy based on import substitution, public sector dominance, and pervasive government control over the private sector had become evident. But the policy response at the time was limited to liberalizing particular aspects of the control system without changing the system itself in any fundamental way. The reforms initiated in 1991 were different precisely because they recognized the need for a system change, involving liberalization of government controls, a larger role for the private sector, and greater integration with the world economy.

Reddy,Y.V.2008. Fiscal Policy and Economic Reforms.This paper explains various fiscal and other economic reforms in India in the pre and post-reform eras. It states that broadly, during the first 30 years of independence, between 1950 and 1980, the fiscal deficits of both the central and the state governments were not excessive. This was a period of revenue surplus in general. However, automatic monetisation of government deficit by the RBI, which started as an exception during the mid-1950s, became a regular practice thereafter. Simultaneously, there was also a distinct shift in the management of the financial sector with the nationalisation of major commercial banks in 1969 and 1980. These two developments had a significant bearing on the relationship between the monetary authority (RBI) and the fiscal authority (Government). A significant deterioration in the fiscal situation in the 1980s is characterised by large and automatic monetisation of government deficits.

Methodology

Research Question

Comparison of the fiscal and monetary policies undertaken in the pre and post reform era.

Type of research

Both qualitative and quantitative (i.e mixed method or triangulation).

Research design

Explanatory, exploratory, descriptive, empirical and involves textual reading.

Methods of data collection

Qualitative and quantitative involving secondary data from various resources.

Methods of data analysis

Qualitative and quantitative (i.e. mixed method or triangulation) involving textual reading and content analysis along with statistical means and diagrammatic representations.

Inference

Monetary policy was very accommodating in the good times while it was too tight in bad times. Fiscal policy was preferred to monetary policy in order

to pave a path for development, i.e. there existed fiscal dominance which at times pushed the monetary policy to be too tight or too loose.

Analysis and Findings

Background of Monetary Policy

In 1930s the great depression influenced the economic and political perspectives. Need for strong governmental support on the ground of developmental and preventive intervention was agreed upon, so that the private sector can maintain a smooth flow of earnings and employment to generate a more or less stable consumption which would help to avoid long run fluctuations and to maintain an undisrupted flow of investments.By maintaining a stable macroeconomic environment, economic policy can thus contribute to economic growth and welfare. But what needs to be stabilized and how? Moreover, to what extent are cyclical fluctuations "acceptable"? What is a "feasible" degree of stabilization? And what are "effective" stabilization tools? These questions have long been debated by economists and the answers provided have changed considerably over time. Friedman's view on stabilization policy was grounded in the firm belief that the economic system is eventually self-stabilizing whereas available knowledge about the economic system is too limited for effectively addressing short-run fluctuations. Even if one would subscribe to Friedman's"Eventually self-stabilizing economy".

Monetary and Fiscal Policy in India

Fiscal policy helps to maintain economic stability by pushing up aggregate demand income of the private sector during depressions and by controlling the same during booms. An important stabilizing function of fiscal policy operates through the so-called "automatic fiscal stabilizers". These work through the impact of economic fluctuations on the government budget and do not require any short-term decisions by policy makers. Monetary policy in a developing country plays an important role in increasing the growth rate of the economy by influencing the cost and availability of credit, by controlling inflation and maintaining equilibrium the balance of payments.Let us now look at the various impacts of these policies in the pre and post reform era (since 1991).

Effect on Different Sectors

The share of agriculture in total income dropped from 55 % (1950-51) to 30%(pre reform) and 15% (2010); whereas population growth rate was not slowing down. As a result there was a rise in inequality, but a fall in Poverty level and a rise in literacy due to growth and development, still leaving a huge mass.below poverty line and minimum education implying a much needed broadening of work force.

Growth and Inflation

India witnessed a strong money market in the 50s.with a market determined interest rate which eventually came under the controls of planning programmes. With an emphasis on public sectors with capital in demand, gathering resources for such investment and increasing the dependence on formal financial system.

After a good initial start with the 1st and 2nd five-year plans, the system was unable to raise growth rates or moderate the supply-side shocks the economy was subject to. Table 1 shows decadal average inflation rates were dominated by primary goods and fuel (FPLL) inflation. Liberalization, and the effect of competition from abroad, reduced primary good and manufacturing inflation in 2000s, but the severe international food and oil price shocks pushed it up in the last years of the decade (Chart 1).

Table: 1

Average Annual Inflation

Base 1982=100	WPI (All Commodities)	WPI (Primary Goods)	WPI (Food Articles)	WPI (Non-Food Articles)	WPI (FPLL)	WPI (Manufacturing)	CPI (IW)
1953-54 to 1959-60	2.47		2.94		2.3	1.62	
1960-61 to 1969-70	6.34		7.43		5.03	4.92	
1970-71 to 1979-80	8.97	8.95	7.23	8.56	12.15	9.03	9.32
1980-81 to 1989-90	7.97	7.76	8.57	7.69	9.21	7.86	8.48
1990-91 to 1999-00	8.12	9.37	10.24	8.31	10.56	7.13	8.73
2000-01 to 2009-10	5.27	5.68	5.27	5.64	8.05	4.34	6.75

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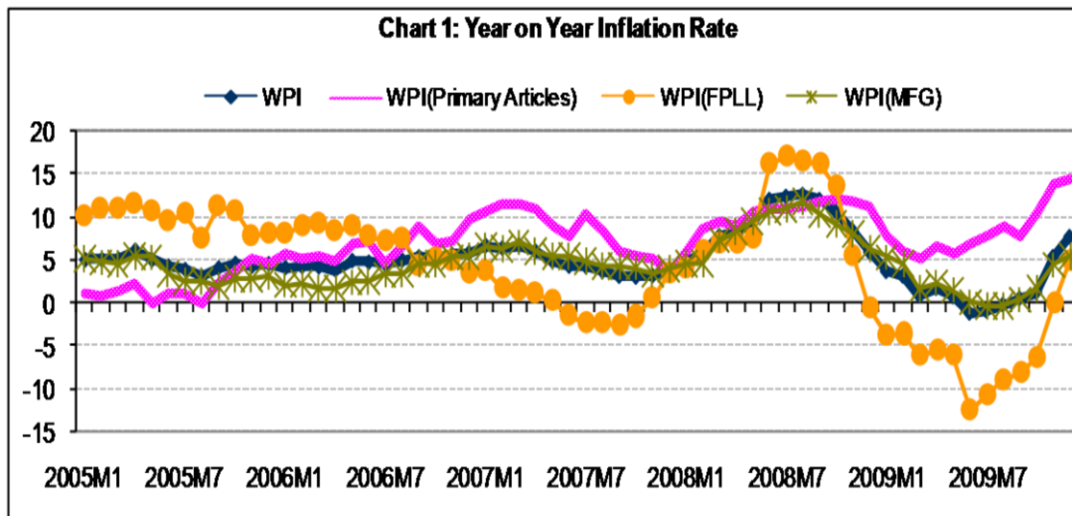
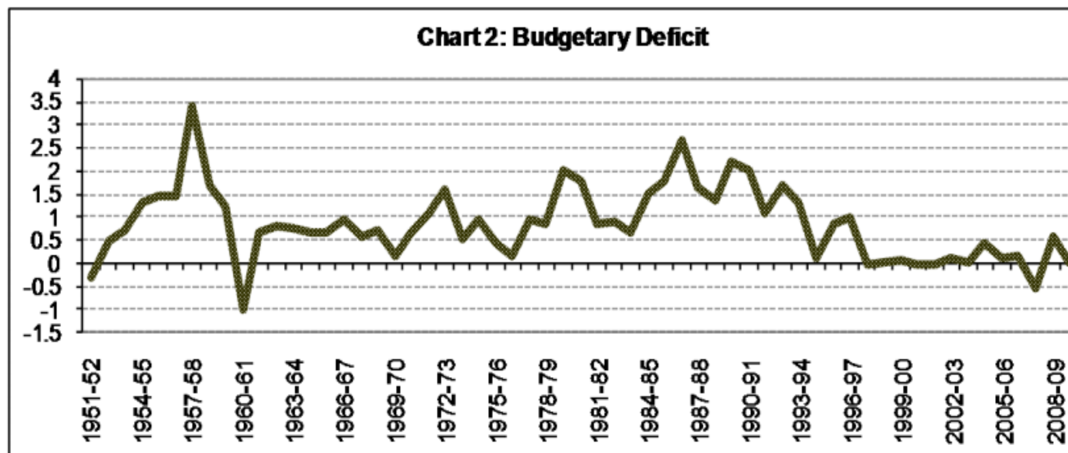




***Source**: RBI and CSO*

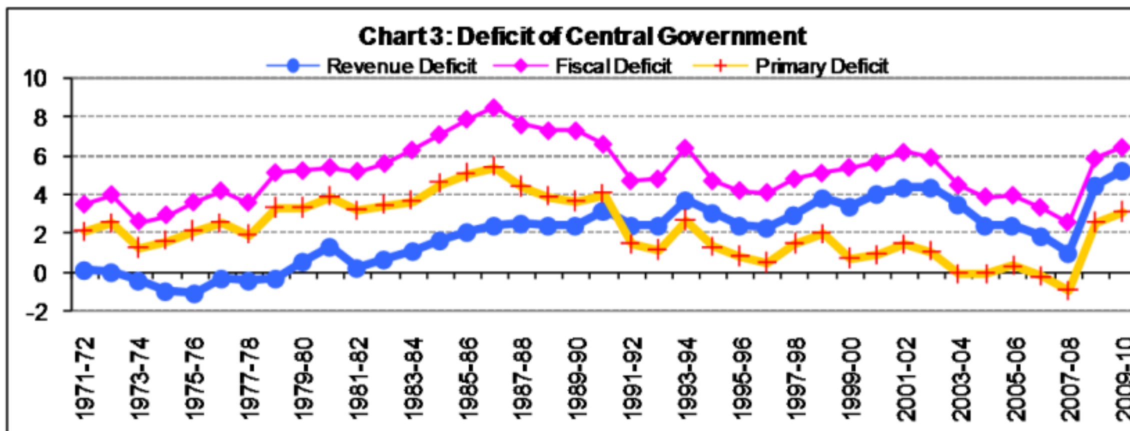
The second 5-year plan with its mammoth plans and a sluggish resources pushed the government for deficit financing (Chart 2). In this phase RBI lost its absolute autonomy, and was primarilyas signed to become to pull up resources for Government expenditure. Apart from expanding rural credit, controlling inflation became a prime target for RBI. With tight money supply, selective credit controls were introduced for credit rationing. This phase(70s) witnessed a serious and penetrating financial engagements specially the process of nationalisation and expansion of branches led to a notable rise in the savings (GDS) GDP ratio. The post-reform period with increasing growth helped the rate of growth of GDS to surpass the rate of growth of capital formation (GDCF) and consumption (PFCE). India has a healthy combination of savings to finance investment and consumption to create demand. But the savings are poorly intermediated through the financial sector, and even in 2010 less than half the population had a bank account.

Politics

A majoritarian democratic regime, such as India's, has abias towards targeted transfers at the expense of public goods,compared to a regime based on proportional voting. Political fragmentation, after the first twenty years of independence when the Congress party provided a stable government, made matters worse. As the Congress lost dominance and intense multiparty competition set in, populist schemes multiplied. With multiple competing parties, swing votes become critical for winning in a first-past-the-post system. After the oil shocks of the seventies, several user charges for public goods were kept fixed, although costs were rising. Subsidies, transfers and distortions increased while

Current and future provision of public goods suffered. By the 1980s, populist Central Sponsored Schemes (CS) became away for the central government to directly reach the masses. New schemes were announced every year, although targeting was poor and waste and corruption proliferated. Since state elections were separated from those at the Centrein 1971, frequent elections kept this pressure upcontinually and harmed longer-term development. The first reaction of new caste-based parties to the acquisition of power was consumption transfers to their support groups, especially as belief in avibrant future was missing since the development policies ofthe past had not delivered growth. Oncein power they were concerned with "loot" inorder to buy votes and legislators in the

future. Institutions of governance were undermined. In the South where the caste-based movement was older, progressive reform, emphasizing education and capacity building, was achieved .The objective of providing government services at affordable prices led to cross-subsidization bothin the provision of specific products and across government functions. Low price caps for many public goods led to systematic incentives to lower quality and investment. Thus falling efficiency and rising costs compounded the problem of low user charges emerged due to increasing costs and shrinking efficiency which hindered the process of expected deflation as a result of technical and organisational advancement. The cross-subsidization was not sufficient to cover costs. The choices made amounted to protecting the poor through current transfers, rather than building their assets and human capital, when it was the latter that was the sustainable option.



Governmentfinances

As these effects cumulated, the revenue deficit became positive. That is, government consumption exceeded its income. Chart 3, shows that the firstyear the revenue deficit became positive was 1980-81 and there was never a surplus on current account after that. This is the amount the government needs to borrowto finance its own consumption. The government's borrowing in any year to finance current and capital expend iturenet of taxand non-tax revenue is it sfiscal deficit. The primary deficit is the fiscal deficit minus interest payments. Since this is net of the burden of servicing debts dueto past borrowing it is a measure ofcurrent borrowing, and of fresh addition to government debt. This, along with interest payments, adds to government debt. Chart 3 shows the fiscal and primary deficits began to fall after the reforms. The primary deficit even became briefly negative, but given the burden of interest payments on past debt, the revenue deficit could not fall until interest ratesfell and tax buoyancy was established in 2003. All three deficits shot up again with the fiscal stimulus after the global financial crisis.

In the early years the only deficit concept used was that of budget deficit (Chart2). This was the change in outstanding treasury bills (Tbills), Government deposits and other cash balances with the RBI. The budget deficit under estimated the monetary impact of the deficits inceit did not include RBI holdings of dated Government securities (Gsecs). The RBI largely held the treasury bills. To the extentthey were held by banks the irmonetary impact was reduced. RBI credit to the government gives the correct monetary impact of fiscal operations. After1996, when automatic monetization of the deficit was reduced, and government funding by banks in creased, the budget deficit falls (Chart 2).

As fund constraints appeared, it waseasiest to postpone investment plans. This strategycontinued in thepost-reform period. Table: 2 shows the trend reduction in capital expenditure compared to revenue expenditure, and the sharp fall in capital expenditurein the post reform period. This allowed some improvement in thefiscal and primarydeficit that was speciallymarked after 2000 (Table: 3), aperiod of tax buoyancyfromreform and highergrowth. Fiscalresponsibilitylegislation also contributed, but was overturned bytheglobal crisis. The revenue deficit, however, remained high as well-entrenched populist expenditures became difficult to cut.There was an argument that some expenditures essential to build human capacitywere classified as current not capital expenditure. The government accumulated debt both sinceit was borrowing for consumption, itwas earningverylow returns onits investments, and its expenditures were not successful for alongtime in improving growth and taxes. Expenditures onceimplemented set in self-sustainingdynamics partlybycreatinginterest groups or constituencies theyfavoured.

In the more recent period, as growth creates more opportunities for the people, delivery and governance have begun to matter for electoral performance. Even as monetary policy got some degrees of freedom from fiscal and legislative improvements, large inflows after reforms created new constraints.

Table 2

Center's Fiscal Position
(As a percentage of GDP at Current Market Price)

	Revenue Receipt	Tax Revenue	Non Tax Revenue	Total Expenditure	Revenue Expenditure	Capital Expenditure
1950-51 to 1959-60	-	4.5	-	7.14	3.75	3.39
1960-61 to 1969-70	-	6.7	-	12.32	5.87	6.46
1970-71 to 1979-80	1067	8.69	2.2	14.62	8.62	6
1980-81 to 1989-90	12.56	9.96	2.7	17.84	11.68	6.16
1990-91 to 1999-00	12.21	9.19	2.93	15.7	12.28	3.41
2000-01 to 2009-10	12.9	10.01	2.99	15.4	12.97	2.49

Table 3

Deficit of Central Government (Averages) (As a Percentage of GDP at Current Market Price)

	Revenue deficit	Fiscal deficit	Primary Deficit
1970-71 to 1979-80	-0.12	3.9	2.4
1980-81 to 1989-90	1.9	6.8	4.1
1990-91 to 1999-00	3.1	5.1	1.6
2000-01 to 2009-10	3.34	4.8	0.8

Source: RBI and CSO

Conclusion

Fiscal and monetary policies have always played a key role in the development of an economy. Similarly, the policies undertaken in India from time to time have affected its economy in a number of ways. Our study suggests that the monetary policy were sometimes exceedingly tight. In focusing on financing the Government, rather than on domestic cycles, policy was procyclical—too accommodative in good times and tight in bad times. Fiscal dominance pushed monetary policy to be too tight or too loose to compensate. An intellectual climate that encouraged government intervention favoured the dominance of fiscal policy. These ideas became embedded in institutions and created path dependence—it was difficult to break out on a new path. The balance of payments crisis and the change in intellectual ideas provided the opportunity. However, there came a change in the policies which brought down the volatility of rates of interest .In the mid-nineties, there were unhealthy government finances, sharp peaks in policy and market rates that hurt growth. India's fiscal policy in the phase of planned development commencing from the 1950s to economic liberalisation in 1991 was largely characterised by a strategy of using the tax system to transfer private resources to the massive investments in the public sector industries and also achieve greater income equality. The result was high maximum marginal income tax rates and the consequent tendency of tax evasion. The public sector investments and social expenditures were also not efficient. However, the path of debt-induced growth that was pursued partly contributed to the balance of payments crisis of 1991.Following the crisis of 1991, tax reforms focussed on lowering of rates and broadening of the tax base. Measures undertaken to accelerate growth included, excise duty cuts, fiscal support to selected export industries and ramping up public expenditure. Recent policy documents like the 12th Plan Approach Paper and the government's Fiscal Policy Strategy Statement of 2011-12 appear to indicate that the fiscal consolidation mind-set is fairly well institutionalized in the country's policy establishment (Planning Commission, 2011; Ministry of Finance, 2011). In the future, it appears that the government would focus on tax reforms and better targeting of social expenditures to achieve fiscal consolidation while maintaining the process of inclusive growth.

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