

1. "There is a need to align fiscal expansion or contraction with credit contraction and expansion respectively." Critically analyze the statement and suggest the suitable amendments needed in the laws to achieve this. (250 Words)

**Answer:**

India being a developing economy is expected to have a fiscal deficit to maintain the growth prospects however the Fiscal Responsibility and Budget Management (FRBM) Act insists on a blanket 3 per cent arithmetical limit on fiscal deficit.

Finance Minister in his budget speech said that there is a need to align fiscal expansion or contraction with credit contraction and expansion respectively. Thus it recognises the inverse correlation between fiscal deficit (fiscal expansion) and bank credit (monetary expansion).

**What is inverse correlation between fiscal deficit and bank credit?**

If credit growth falls, fiscal deficit may need to rise and if credit rises, fiscal deficit ought to fall – to ensure adequate money supply to the economy.

The logic of correlation between credit expansion and fiscal deficit has five sequential limbs:

- Money is the blood of economic growth.
- Most money that fuels the economy is created by banks, not by government.
- Banks and financial institutions fund business and others, and it is that credit money which drives the economy.
- If, for whatever reason including lack of business confidence, the bank credit to the economy does not adequately grow, like it did not in the last few years, economic growth will suffer for want of adequate money.
- That is when the Budget needs to step in, to pump money into the economy by incurring deficit (spending more than the income), and, for the purpose, borrow the money lying with banks or even by printing more money, if that is needed. This ensures that growth does not decelerate for want of enough money circulating in the economy.

The FRBM law has ignored the fourth and fifth limbs of the logic and fixed the 3% fiscal deficit as inviolable. If the government spends more than its income, then deficit arises, which it has to finance by borrowing money created by banks. The FRBM Act says it cannot borrow more than 3% of GDP - even if banks do have money, even if the private sector does not take it, and even if the economy needs it for growth. The money may lie idle in banks, and yet the law will not allow the government to borrow.

However, it is unanimously agreed that money is critical for economic growth. Without adequate money, GDP growth will suffer.

From 2012-13 to now, i.e. 2015-16, the Indian economy seems to have been experiencing-shrinking money expansion and credit demand shrinking even faster.

**Way ahead**

It's time to align the monetary and fiscal economies. If bank credit growth falls, fiscal deficit may need to go up. If bank credit growth rises, fiscal deficit should reduce. The FRBM Act need

to be amended to have a range of fiscal deficit instead of a fixed value so that economic growth can be maintained by targeting a suitable fiscal deficit & also adhering to it. This is of much importance in global slowdown & credit agencies monitoring the India's financial consolidation.

## PRACTICE QUESTIONS

### **Answer the following Questions**

1. Withdrawing from Iran nuclear deal by US is a serious mistake and has many possible ramifications for India. Analyse. (250 words)
2. Examine the performance of National Forest Policy 1988. Discuss whether the draft forest policy will address the issues faced by forest sector in India? (250 words)