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**Covid 19 and Fiscal-Monetary Policy Co-ordination:
Empirical Evidence from India**

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Abstract

Against the backdrop of covid-19 pandemic, the paper analyses the economic stimulus packages announced by the national government in the context of India and tries to identify the plausible fiscal and monetary policy co-ordination. The shrinking fiscal space due to revenue uncertainties has led to a theoretical plausibility of a re-emergence of finite monetisation of deficits in India. However, the empirical evidence confirms no direct monetisation of deficit.

Key Words: Fiscal-Monetary Policy Co-ordination, Fiscal Deficits, Monetisation, Covid 19

JEL Classification Codes: E58; E62; E63

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1. Introduction

Against the backdrop of covid19 pandemic, this paper examines the economic stimulus packages in India and analyses the plausible fiscal and monetary policy co-ordination. Globally, there is a growing concern about the tendency of segregating the monetary and fiscal policy while assessing the macroeconomic impact of deficits on economic growth outcomes. In the times of covid19 pandemic, if the path towards fiscal consolidation is through public expenditure cuts than tax buoyancy, it can adversely affect the growth recovery.

We argue in the paper that when liquidity infusion has limitations in stimulating economic recovery, high levels of deficit can be substantiated through enhancing public investment especially in health and capital infrastructure, as it is a dual crisis- a public health crisis and a macroeconomic crisis. It is not only the levels of deficit that matter, the financing of deficits is also equally significant in times of crisis. If the emergency bond financing of deficits leads to a situation where the real rate of interest exceeds real growth of economy, eventual monetization of deficits is a plausible way ahead. However, even if such a situation arises, due to the political economy considerations and the fear of inflationary pressures in the economy, a decision towards monetization of deficits could be a tough proposition. When monetary policy stance has limitations in triggering the economic growth, fiscal dominance is crucial for growth recovery. However, the availability of fiscal space has played a significant role in determining the size of economic stimulus.

Against this backdrop, the paper is organized into six sections. Section 2 provides a policy backdrop of fiscal and monetary stimulus packages announced in India. Section 3 succinctly provides an empirical review of the fiscal and monetary policy co-ordination. Section 4 deals with the fiscal rules and plausible measurements of monetization of deficits. Section 5 deals with the financing of deficits and section 6 concludes.

2.The Policy Backdrop: Fiscal and Monetary Stimulus in India to tackle covid 19

Extraordinary times require extraordinary policy responses. In India, the lockdown was announced by invoking the National Disaster Management Act, 2005. The “lockdown strategy” per se proved to be neither good nor bad to control the corona virus pandemic. Constitutionally, public health is a state subject in India. However, the Schedule 7 (entries 28 and 81) deal with inter-State migration and quarantine. The intergovernmental framework is thus crucial in dealing with the pandemic through policy co-ordination and fiscal transfers, especially when States are doing the heavy lifting to control the pandemic, despite their constrained fiscal space (Harikrishnan and Chakraborty, 2020). Ideally the fiscal decentralisation at the local level – the principle of

subsidiarity – is an effective policy mechanism to deal with the pandemic, meaning the decision making processes in crisis at a level of government closest to the people. But in India, the covid policy response through lockdown strategy has been initially announced by the Central government.

Macroeconomic uncertainty in the time of pandemic is hard to measure. The fiscal and monetary policy co-ordination is crucial to minimize such uncertainties. In the backdrop of macroeconomic uncertainty in the time of covid19 pandemic, the fiscal deficit has risen to 9.5 per cent of GDP in the Budget 2021-22. This is much above the envisioned threshold fiscal deficit to GDP ratio at 3 per cent. There is a rethinking whether adhering to numeric “ought to be” fiscal deficit to GDP at 3 per cent in the times of pandemic is growth-enhancing.

The road map was also announced in the budget 2012-22 to bring down the excess deficit of 9.5 per cent of GDP in FY 21 to 4.5 per cent by FY26. The point to be noted here is that high fiscal deficit-GDP ratio was not entirely due to new expenditure priorities to tackle the pandemic (Chakraborty, 2021). The fiscal deficit-GDP ratio has risen because of a combination of factors – the revenue uncertainties, economic stimulus-related spending, the narrowing of (denominator) GDP, along with the initiative by the Indian government to enhance budget transparency.

Budget transparency has been enhanced in the recent Budget 2021-22 by incorporating a part of off-budget borrowings into the fiscal deficit. Otherwise, the off-budget liabilities through public sector undertakings do not figure in the concept of fiscal deficit. However, Budget 2021-22 has not introduced a wider concept of deficit termed as “Public Sector Borrowing Requirement (PSBR) integrating all the borrowings incurred through public sector enterprises. The details of a major chunk of extra borrowings are kept in an Annexure in the budget documents. Only a part of such borrowings is included in the Budget 2021-22.

In India, there has not been a huge macro-fiscal stimulus package designed to provide cash transfers into the hands of people. Liquidity infusion was the major component of the economic stimulus programme in India (Harikrishnan, 2020). In the policy narrative of participation income versus basic income, Indian government has emphasised on the participation income by enhancing the allocation for employer of last resort policies for providing job guarantee. The basic income component in the economic pandemic package was limited to direct cash transfers for women and farmers. However, the magnitude of these cash transfers were insignificant due to the limitations in available fiscal space. On the monetary policy side, measures to infuse credit into the economy and lowering of policy rates were announced by the central bank in March 2020. The fiscal-monetary pandemic packages announced in India in the year 2020 is given in Table 1. In addition to these measures, the central bank of India has enhanced its liquidity infusion through several toolkits to support growth recovery

(Harikrishnan, 2020). The central bank has enhanced the targeted liquidity operations to stressed sectors. In 2021, instead of normalization procedure by roll back these announcements, the economic stimulus package has been continued by both central bank and national government.

Table 1: The Fiscal-Monetary Economic Pandemic Package in India, 2020

Components		Amount (in Crores)
Measures announced by RBI 1. Measures to infuse liquidity into the system 2. Reduced the interest rates		8,01,603
March 27th Package – including PMGKY (Prime Minister’s Garib Kalyan Yojna, scheme for betterment of the poor) 1. Welfare spending for pensioners 2. Direct cash transfers for women 3. Food security 4. Tax concessions 5. Financial security		1,92,800
	Total	9,94,03
Post May 12th Announcements		
Tranche 1 – Liquidity infusion to sectors 1.Liquidity infusion to a.Medium and Small Enterprises (MSMEs), b.Non-banking financial corporations (NBFCs), c. microfinance institutions (MFIs) and d.Power ‘distribution companies’ (DISCOM) 2.Employment Provident Fund /Tax reliefs		5,94,550
Tranche 2 – For farmers and		3,10,000

Migrants		
<ol style="list-style-type: none"> 1. Concessional credit to farmers 2. Affordable housing for migrants 3. Emergency working capital for farmers 4. Credit to street vendors – micro loans 		
Tranche 3 – Agriculture and Allied <ol style="list-style-type: none"> 1. Agriculture infrastructure and farm gate 2. fisheries 3. Animal husbandry 4. Micro food enterprises 		1,50,000
Tranche(s) 4 and 5 <ol style="list-style-type: none"> 1. Increase in allocations for employment guarantee programme 2. Funding for social and industrial infrastructure 		48,100
	Total	11,02,650
	Total Package	<u>20,97,053</u>
Extension of PMGKY (via PM’s announcement on June 30th) To extend free ration (food grains and pulses) to poor , upto November 2020		90,000

Note: These are the economic pandemic measures announced in India in early 2020. Later, several components of this economic stimulus package have been extended, for instance, through additional liquidity infusion to stressed sectors and elongation of food security, social security measures, employment guarantee allocations etc; instead of announcing additional tranches of stimulus packages. (One crore is 10 million). In Budget 2021-22, a new public health infrastructure component was announced with an allocation of Rs 64,180 crores over the next six years.

Source: Harikrishnan S (2020)

As the central bank puts it upfront, these are extraordinary times, and policies need to respond with “whatever it takes to” to deal with the pandemic. Intertemporally, the policies have been focused to systematically flatten the curve

by containing the COVID-19 pandemic through vaccination drive. However, no crisis will be followed by a quick rebound to V-shaped growth (Harikrishnan and Chakraborty, 2020). Evidence is increasingly pointing towards the situation worsening to a dual crisis — a public health crisis and a macroeconomic crisis — like never before.

The IMF highlighted that “the Great Lockdown is the worst economic disruption since Great Depression, and far worse than the global financial crisis,” and its estimates in early 2020 suggested that “*the cumulative loss to global GDP over 2020 and 2021 from the effects of the COVID19 pandemic would be around \$9 trillion, greater than the economies of Japan and Germany combined* (Gopinath, 2020).

The pandemic economics of central banks and the government was twofold. One is the focus on measures that relate to instantaneous economic firefighting measures, for instance, how to ensure liquidity infusion into the system to stabilize the market reactions. The second is the long-term policy imperatives. In India, the great lockdown was announced by the Prime Minister on March 25th, 2020. Subsequently, an economic package was announced in an iterative manner (Table 1).

To put the monetary policy stance in perspective, in India, an agreement on a “new monetary framework” was signed between the Government of India and the central bank in February 2016, by which the single objective of our monetary policy is “price stability”, based on inflation-targeting rules (Chakraborty and Harikrishnan S , 2020). This policy transition from the discretion of the RBI governor to a rule-based monetary policy has constrained the central bank to react with ease to the economic growth slowdown and other economic uncertainties. Yet another point to be considered is the central bank’s independence — “operational independence” — after the constitution of a Monetary Policy Committee (MPC) in India. The role of the RBI governor in taking crucial monetary policy decisions has been taken over by the MPC, based on their voting. As per Section 45ZL of the Reserve Bank of India Act, 1934, the RBI shall publish, on the fourteenth day after every meeting of the MPC, the minutes of the proceedings of the meeting which shall include the resolution adopted in the meeting, the vote of each MPC member, and the decisions regarding the policy rates, whether to increase, decrease, or maintain the status quo rates.

Let us unpack the COVID policy response by the central bank. On May 22, 2020, on the basis of an urgent offline meeting of the MPC — before their regular meeting — the RBI responded to the COVID pandemic by reducing the repo rate under the liquidity adjustment facility (LAF) by 40 basis points, to 4.0%, with immediate effect (reserve Bank of India, 2020, Chakraborty and Harikrishnan, 2020). This was a further reduction from the 4.40% announced in March 2020 (the repo rate is the rate at which banks borrow funds from the Reserve Bank against eligible collateral).

The reverse repo rate is the rate at which banks park their surplus funds with the RBI under the liquidity adjustment facility (LAF). The reverse repo rate under the LAF stands reduced to 3.35% from 3.75%. These rates were introduced in June 2000. Since then, the repo rate has remained the reference rate for signaling the monetary policy stance. The Cash Reserve Ratio (CRR) is cut by 100 bps. The Marginal Standing Facility (MSF) rate (overnight borrowing facility from the central bank for further liquidity) and the Bank Rate stand reduced to 4.25% from 4.65%. The MPC also decided to continue with the “accommodative stance” and their decisions are taken with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4% within a band of +/- 2 %. The recent MPC meetings held on December 8, 2021 also kept the repo rates unchanged at 4 per cent and reverse repo at 3.35 per cent. The accommodative stance is also maintained to protect growth recovery.

In addition to policy rate adjustments, the central bank has also provided liquidity infusion into the system. The Reserve Bank of India (RBI) has responded to the COVID crisis by infusing liquidity to the tune of ₹5.66 lakh crore in May 2020 (up to May 20) from ₹4.75 lakh crore in April 2020. Within the liquidity package, Rs 1,20,474 crores was injected through Open Market Operation (OMO) purchases and Rs 87,891 crore through three Targeted Long-Term Repo Operation (TLTRO) auctions and one TLTRO 2.0 auction. In order to distribute liquidity more evenly across the yield curve, the Reserve Bank conducted one “operation twist” auction involving the simultaneous sale and purchase of government securities for Rs 10,000 crore each on April 27, 2020.

In addition to infusing liquidity, the “regulatory easing” measures were announced to (i) promote credit flows to the retail sector and MSMEs and real estate developers; (ii) extend the regulatory benefits under the special liquidity facility for mutual funds (SLF-MF) SLF-MF scheme to all banks; (iv) extension of the loan moratorium and support for working capital financing until the end of August; (v) credit support to the exporters and importers; (vi) extension of the tenor of the small business refinancing facilities; and (vii) increase the state's Ways and Means Advance (WMA) by 60% (compared to 30% earlier) to monetize the deficit.

Even after bringing the rates (for borrowing) down to almost unprecedented levels, there was a huge increase in the funds parked by commercial banks in the RBI's reverse repo account — which went up from Rs 3 lakhs crores on March 27th to Rs 8.4 lakhs crores by the end of April (Harikrishnan S, 2020). With unemployment rates going through the roof, needless to say, there has been a phenomenal crash in demand. In such a scenario, focusing almost solely on liquidity measures serves only to plaster over the problem.

How this crisis will permanently shift the economic structures depends on the epidemiology of the virus and the nature and severity of the economic shocks. In

this uncertain environment, how countries emerge from the effects of the pandemic depends largely on the effectiveness of the policies they design now. Monetary policy needs to play a proactive stabilizing role in this scenario. However, the announcements so far were mainly targeted at reducing the policy rates and infusion of liquidity. Pumping money into banks and NBFCs without adequate fiscal measures to boost demand runs the risk of increasing bad loans.

As Joseph Stiglitz points out, “today’s excess liquidity may carry a high social cost (Chakraborty and Harikrishnan S , 2020). Beyond the usual fears about debt and inflation, there is also good reason to worry that the excess cash in banks will be funneled toward financial speculation.” And he warns that this could lead to a “climate of increased (economic) uncertainty” and end up “discouraging both consumption and the investment needed to drive the recovery.” This could lead us into a “liquidity trap” with a huge increase in the supply of money and not much for it by businesses and households (Stiglitz and Rasheed, 2020). The moot point is that without demand being stimulated, these policies are not enough to trigger a sustained growth recovery. The Fiscal Rules have taken the deficit financing rules as granted and deal with only numerical targets of deficits. However, excessive use of any financing mode of deficits has macroeconomic repercussions and cannot be tackled by focusing on the fiscal rules alone.

3. Fiscal-Monetary Policy Co-ordination: A Review

The significance of policy co-ordination between fiscal and monetary authorities can be traced back to ‘Unpleasant Monetary Arithmetic’ (UMA) of Sargent and Wallace (1981). The ‘Unpleasant Monetary Arithmetic’ revealed that fiscal policymaker (where fiscal authority has the ‘first mover advantage, and the monetary policy follows) dominates in the financing decision of deficits. If the bond financing of deficits becomes sooner or later unsustainable when the real rate of interest is above the real growth of the economy, the Central Bank has to monetize the deficits eventually. Under this fiscal dominance hypothesis, the attempts by the central bank to keep inflation low through inflation targeting cannot last and must ultimately give into higher inflation in the longer run. Under Unpleasant Monetary Arithmetic, inflation today or inflation tomorrow is the only plausible macro policy option (RBI, 2012).

On the contrary, the situation of central bank independence and inflation targeting with no fiscal policy dominance is referred to as ‘Unpleasant Fiscal Arithmetic’. The Unpleasant Fiscal Arithmetic thus visualizes to reverse the order of adjustment, assumed in Unpleasant Monetary Arithmetic, and to transfer the first mover advantage from fiscal agencies to the Central Bank authorities. By introducing strict fiscal policy rules, it obliges fiscal agencies to adjust to the anti-inflationary policy of the independent Central Bank and thus *Unpleasant Monetary Arithmetic* turns into *Unpleasant Fiscal Arithmetic* (Chakraborty,2015) .

A recent treatment of the fiscal-monetary policy coordination is the “fiscal theory of the price level”, (FTPL), pioneered by Leeper (1991), Sims (1994), Woodford (1994). This fiscalist literature argues that the price level is independent of

monetary policy but dependent strictly on fiscal policy; price level indeterminacy problems can be solved by having the central bank peg the nominal interest rate at a level consistent with the central bank's desired inflation rate, rather than by controlling the growth rate of the (base) money supply (Sims, 1994 and Woodford, M , 1994).

Even prior to covid19 pandemic, these theoretical debates found relevance in the macro policy transition in India from discretion to rules. The fiscal policy institutions have moved away from discretionary fiscal stance towards fiscal rules - the efficacy of fiscal authorities to keep the deficits within the numerical threshold level of deficits normalized to GDP.

Since 2016, the monetary policy authorities have begun the policy rules to 'inflation targeting' and 'central bank independence' in India (for details, Urit Patel Committee recommendations, Reserve Bank of India, 2014 and the 'new monetary framework', signed between Government of India and Reserve Bank of India in February 2015). This new dimension of the rule-based monetary policy stance in India has spurred from Taylor's rule (Taylor and Williams, 2010).

The macroeconomic policy transition from discretion to rules gives rise to one pertinent question: does monetary rule require a fiscal rule? Such monetary-fiscal linkages are treated in the literature (for instance, Sargent and Wallace, 1981) through analyzing the macroeconomic channels through which deficits affect monetary policy stanceⁱ. Unfortunately, over the years, the coordination between fiscal and monetary policy has been weakening and the policy debates have confined to just numeric values of deficits –the 'levels' of deficit to 3 percent of GDP- in attempting such linkages. Apparently there has been a widening acceptance that numeric Fiscal Rules are associated with greater fiscal discipline (Alesina and Perotti, 1995).

Blanchard (2019a and 2019b) provided a fresh perspective to these debates in his Presidential Address in the American Economic Association meetings by emphasizing the fact that high public debt is good if it can be substantiated by using it for enhancing public investment or reducing the output. When monetary policy becomes ineffective with zero bound interest rates, fiscal policy dominance is crucial for growth recovery.

4. Fiscal Rules and Monetisation of Deficits

Against the backdrop of macroeconomic uncertainty which is hard to measure, it is pertinent to discuss the appropriate concept of public deficit, and the optimal financing patterns of the deficit with special emphasis on seigniorage. The seigniorage is technically the change in reserve money in the system to GDP. This section deals with the measurement issues related to deficit; and in turn interprets data on the trends and financing patterns of public deficits in India.

To avoid the possibility of miscalculation of pre-emption of resources by the government, a correct measure of deficit is crucial. Intertemporally, there has been a transition from one concept of deficit to a series of measurements of deficit. This evolution from a single measure of deficits towards a series of *purpose-specific* deficit measures worldwide, was significant prelude to Fiscal Rules.

From the conventional approach of *single measure* of budget deficit has been replaced with a series of deficits, viz., primary deficit, fiscal deficit, monetized deficit and revenue deficit (Chakraborty 2016).

As for the coverage, the ideal concept of deficit to study the macroeconomic impact is the *Public Sector Borrowing Requirement (PSBR)*. In other words, ideally, any measurement of the deficit should consider the deficit of the public sector as a whole instead of a sectoral deficit of different public sector entities. But problem lies in covering the public sector as a whole for a comprehensive measurement of public sector deficit because there are more exhaustive lists of government entities and there are intra-public sector transactions for which data is not readily available (Chakraborty, 2016).

Apart from the above-discussed Public Sector Borrowing Requirement (PSBR), various concepts of the deficit and their use as indicators to evaluate the budgetary performance of the government are recent phenomena in India. This evolution is also a result of the paradigm shift to a series of purpose-specific deficit measures worldwide, from the conventional approach of a single measure of the budget deficit.

The generation of purpose-specific deficits has the huge relevance of facilitating the analysis of the impacts of fiscal policy stance on macroeconomic activity. However, the formulation of numerical bound and fiscal rules has shrunk the possibility of maturing such debates of macroeconomic impacts of fiscal stance, and the debates have confined to the numerical fiscal rules (Chakraborty, 2016).

Budget deficit is that part of the deficit that was covered by 91 days Treasury bills and withdrawal of cash balances with RBI. As the *budget deficit* is the borrowing from the central bank, it increases reserve money into the system and could fuel inflation and destabilize the monetary system. Thus, the emphasis was given to reduce the volume of the *budget deficit*. As RBI holds dated government securities, which also increases the volume of reserve money into the system, the *budget deficit* could only give a partial picture of the total increase in the reserve money. This is monetized deficit which is the increase of net RBI credit to the central government.

Despite the concerted policy changes undertaken by the Government of India and the Central Bank to contain the monetized deficit in India, the monetised deficit is not yet phased out in India. Though the net RBI credit to the government – the monetized deficit - has been controlled through fiscal-monetary

policy co-ordination, the net foreign exchange reserve is on the rise. Further, the shift in the financing pattern of deficits from seigniorage to bond financing which has occurred prior to the deregulation of interest rate regime in India has implications for the fiscal seigniorage.

The traditional measure of the *budget deficit* and its expanded form, the *monetised deficit*, excludes part of the resource gap of the government, which is financed through borrowing outside RBI. Thus, in recent years, the emphasis has been given to contain the *fiscal deficit*, which is the net borrowing requirement of the Government. Conventional measurement of fiscal deficit is defined as the difference between total government receipts (non-debt creating) and the total government expenditure net of repayment of previously incurred debt. In India, the gross fiscal deficit is defined as the excess of the total of revenue expenditure, capital outlay and net lending over revenue receipts and non-debt-creating capital receipts including the proceeds from disinvestment.

Along with fiscal deficit, other important deficit indicators introduced to assess the budgetary performance of the government are *primary deficit* and *revenue deficit*. In India, the primary deficit is an indicator to assess the impact of current year's discretionary fiscal action on the indebtedness of the government. Revenue deficit as a concept has received immense attention in recent years, as per the golden rule, revenue deficit (the gap between revenue receipts and revenue expenditure) needs to be phased out.

The trends in deficits in India as a percent of GDP are given in Table 2. The trends in deficits revealed that budget deficit and monetized deficit was controlled intertemporally though the latter has shown a rise in the recent years. The revenue deficit is not yet completely phased out in India. The primary deficit and fiscal deficit have moved in tandem and have shown a comparatively slight decline in the recent years, as percent of GDP. The fiscal deficit is financed through the issuance of bonds, seigniorage financing, financing through ad-hoc Treasury Bills and external financing. Over the years, Government of India resorted more to internal financing than to external financing, and market borrowing (bond financing of deficits) has emerged as the most important source of financing of fiscal deficit in India. The rationale behind the market borrowing by the Central Government was to create and widen the investor's base for government securities outside the captive market by attractive rates of interest and thereby to reduce government's dependence on monetisation of deficit.

Table 2. Levels of Deficits in India (Rs crores)

	2019-20	2020-21	2020-21	2021-22
	Actuals	Budget Estimates	Revised Estimates	Budget Estimates
Fiscal Deficit	933651	796337	1848655	1506812
	(4.6)	(3.5)	(9.5)	(6.8)
Revenue	666545	609219	1455989	1140576

Deficit	(3.3)	(2.7)	(7.5)	(5.1)
Effective Revenue Deficit	480904	402719	1225613	921464
	(2.4)	(1.8)	(6.3)	(4.1)
Primary Deficit	321581	88134	1155755	697111
	(1.6)	(0.4)	(5.9)	(3.1)

Note: Figures in parentheses denote as percentage to GDP

Source: Government of India (2021), Union Budget 2021-22 document

In India, the “golden rule” is invoked for the reduction of revenue deficit to zero or negative levels. A limit on fiscal deficits to 3-5 per cent of GDP was imposed with an emphatic rationale to avoid “crowding out” of private investment. However, many empirical evidences do not suggest ‘direct’ or ‘financial’ crowding out in the context of India (Chakraborty, 2016; Vinod, Karun and Chakraborty 2021) that deficits crowd out private corporate investment, and does not induce rise in interest rates or output gap either. What is missing in the design of numeric fiscal rules is the macroeconomic channel through which the deficits affect the output gap. It is not only the levels of deficit, but also the financing pattern of deficits that creates macroeconomic consequences. This aspect was surpassed in the debates related to Fiscal Rules and budget management policies.

5. Financing of Deficits in India

The financing pattern of deficit reveals that the gross market borrowing constitutes 68.9 per cent of total borrowings. The other sources of financing like National Small Savings Fund constitutes around 26 per cent (Table 3). In the Budget 2021-22, creating fiscal space for continuous support to ongoing series of economic stimulus packages was a matter of concern. In the regime of revenue uncertainties, the ambitious asset monetization programme announced in the Budget 2021-22 to generate revenue proceeds need a supporting regulatory framework. In the Budget 2021-22, the economic stimulus is announced not as a macroeconomic stimulus to revive the demand by providing huge cash transfers or Universal Basic Income (UBI). The concern was that if the people’s propensity of save is greater than spending in the time of pandemic, dropping “helicopter money” or “UBI” in the hands of people cannot lead to required demand stimulation. The statistics shows that the precautionary savings by the private sector is on the rise in the time of pandemic. Instead of massive cash transfers, India has designed “targeted” economic stimulus, especially to capital infrastructure and public health sector.

Table 3. Sources of Financing Fiscal Deficit in India (Rs crores)

	2019-20		2020-21		2020-21		2021-22
	Actual	% of Total	Budget Estimates	% of Total	Revised Estimates	% of Total	Budget Estimates
Debt Deficit (Net)							

Market Borrowings (G-Sec + T Bills)	624089	66.84	535870	67.29	1273788	68.9	967708
Securities against Small Savings	240000	25.71	240000	30.14	480574	26	391927
State Provident Funds	11635	1.25	18000	2.26	18000	0.97	20000
Other Receipts (Internal Debt and Public Account)	44273	4.74	50848	6.39	39129	2.12	54280
External Debt	8682	0.93	4622	0.58	54522	2.95	1514
Draw Down of Cash Balance	4971	0.53	(-)53003	(-)6.66	(-)17358	(-)0.94	71383
Grand Total	933651	100	796337	100	1848655	100	1506812

Source: Government of India (2021), Union Budget 2021-22 documents

6. Conclusion

In the context of lack of fiscal space emanating from revenue uncertainties, a relook into the fiscal rules and the financing pattern of fiscal deficit have become imminent. The lack of fiscal space can affect the expenditure requirements in the time of pandemic and in turn it would affect the sustained economic recovery. We argue to explore the monetization of deficits, with a clear excessive deficit procedure to bring the deficit to prior equilibrium in the long run. The money financing of fiscal programme is crucial to avoid prolonged fiscal austerity measures, which are detrimental for growth recovery in times of pandemic. When the monetary policy is partial in its impact on growth outcome, through liquidity infusion, it is crucial to explore the fiscal dominance. The impending decision by US Fed Reserve to increase the interest rate has put tremendous pressure on the central bank of India, an emerging economy, to increase the interest rate to avoid the capital flight. However, with growth recovery as the predominant goal, the interest rates are kept status quo. So the policy alternative is to keep the macroeconomic fundamentals strong (including the fiscal deficit-GDP ratio and inflation under control). The policy dilemma here is that if the deficit is controlled to the threshold levels of GDP through expenditure compression, economic growth suffers. However, if the real rate of interest goes greater than the real growth of economy, eventual monetization of deficits becomes inevitable. The shrinking fiscal space due to revenue uncertainties has led to a theoretical plausibility of a re-emergence of finite monetisation of deficits in India. However, the empirical evidence confirms no direct monetisation of deficit.

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