Monetary and fiscal policy reforms of 1991

Government budget/ Fiscal budget is a forecast by a government of its expenditures and revenues for a specific period of time, usually a year, known as a financial or fiscal year, which may or may not correspond with the calendar year.
Note : The word budget is derived from the Old French bougette ("little bag").

According to Article 112 of the Indian Constitution, the Union Budget of a year, referred to as the annual financial statement (AFS), is a statement of the estimated receipts and expenditure of the government for that particular year.
The Union Budget keeps the account of the government's finances for the financial year that runs from April 1 to March 31.
The Annual Financial Statement distinguishes the expenditure on revenue account from the expenditure on other accounts, as mandated by the Constitution of India.

In the Budget, the receipts and disbursements are shown in three parts in which Government Accounts comprise
(i) the Consolidated Fund,
(ii) the Contingency Fund and
(iii) the Public Account.

The Budget Division of the Department of Economic Affairs in the finance ministry is the nodal body responsible for producing the Budget.
Monetary policy is concerned with the management of interest rates and the total supply of money in circulation. It is generally carried out by the RBI.

Economic Reforms of 1991 brought in LGP Reforms in India.
Liberalization entails the removal of governmental limitations on private individual activity.
Privatization refers to the transition of a business, industry, or service from public to private ownership and management.
Globalisation is the flow of products, services, capital, and labor across international borders.

Fiscal reforms:
The effectiveness of economic reforms depends on the achievement of fiscal stabilization. In order for the reforms to succeed, the Central Government's fiscal deficit, which had reached 8.4% in the 1990–1991 fiscal year, needed to be reduced. The below actions were performed in order to decrease the budget deficit.

- Export subsidies were abolished in 1991–1992, and fertilizer subsidies were partially restructured in 1992–1993.
- Budget assistance to loss-making public-sector units in the form of government loans to cover their losses was gradually phased out.
- Some development expenditure, such as spending on social and economic infrastructure, was reformed.

The FRBM Act is a law enacted by the Government of India in 2003 to ensure fiscal discipline – by setting targets including reduction of fiscal deficits and elimination of revenue deficit.
It is considered as one of the major legal steps taken in the direction of fiscal consolidation in India
The FRBM rules mandate **four fiscal indicators** to be projected in the medium-term fiscal policy statement. These are:
1. revenue deficit as a percentage of GDP
2. fiscal deficit as a percentage of GDP.
3. tax revenue as a percentage of GDP.
4. total outstanding liabilities as a percentage of GDP.

The FRBM Act set targets for fiscal deficit and revenue deficit.

Monetary Policy reforms
Prior to 1991 when economic reforms were initiated the basic goal of monetary policy was to neutralize the impact of large fiscal deficits of the Government. To boost public sector investment for accelerating economic growth there was large increase in Government expenditure under various Five Year plans which was financed by borrowing by the Government and deficit financing (i.e., monetatisation of budget deficit).

Both Government borrowing from the market and deficit financing leads to the increase in aggregate demand and have therefore potential for causing inflation. Therefore, to ensure adequate funds to meet the borrowing requirements of the Government the statutory liquidity ratio (SLR) of the banks was raised to the maximum limit of 38.5 per cent. That is, banks were to buy government securities to this extent.
Besides, to check inflation, cash reserve ratio (CRR) of banks was raised to a high level of 15 per cent. The high cash reserve leaves less funds with the banks to lend to the private commercial sector. In this way large expansion of credit for private sector was prevented.

After 1991 reforms
On the recommendations of Narasimhan Committee, following measures were undertaken by government since 1991: –
1. Lowering SLR and CRR
- The high SLR and CRR reduced the profits of the banks. The SLR had been reduced from 38.5% in 1991 to 25% in 1997. This has left more funds with banks for allocation to agriculture, industry, trade etc.
- The Cash Reserve Ratio (CRR) is the cash ratio of banks total deposits to be maintained with RBI. The CRR had been brought down from 15% in 1991 to 4.1% in June 2003. The purpose is to release the funds locked up with RBI.

Deregulation of Interest Rates
- The Narasimhan Committee advocated that interest rates should be allowed to be determined by market forces. Since 1992, interest rates have become much simpler and freer.
- Scheduled Commercial banks have now the freedom to set interest rates on their deposits subject to minimum floor rates and maximum ceiling rates.
- The interest rate on domestic term deposits has been decontrolled.
- The prime lending rate of SBI and other banks on general advances of over Rs. 2 lakhs has been reduced.
- The rate of Interest on bank loans above Rs. 2 lakhs has been fully decontrolled.
- The interest rates on deposits and advances of all Co-operative banks have been deregulated subject to a minimum lending rate of 13%.