5. To Print More Money, or Not to

Prelims Syllabus: Economy

Mains Syllabus: GS-II Government Policies and Interventions for Development in Various Sectors and Issues Arising out of their Design and Implementation.

Why in News?

- Reserve Bank of India (RBI) has been trying to boost the liquidity in the financial system. It has bought government bonds from the financial system and left it with money amid COVID 19.

Need for Government to Borrow:

- Under normal circumstances, just because the economy has stalled and the government will not be getting its revenues, the government fiscal deficit is expected to shoot up to around 15% of GDP when the permissible limit is only 6%.
- Also, if the government was to provide some kind of a bailout or relief package, it would have to borrow a huge amount. The fiscal deficit will go through the roof.
- Moreover, for the government to borrow the money, the market should have it as savings. Data show that savings of domestic households are barely enough to fund the government's existing borrowing needs. So there isn't enough money in the market for the government to borrow.

Direct Monetisation of Deficit:

- In this, government deals with the RBI directly and asks it to print new currency.
- In lieu of printing this cash, which is a liability for the RBI, it gets government bonds, which are an asset for the RBI since such bonds carry the government's promise to pay back the designated sum at a specified date.
- This is different from the indirect monetising that RBI does when it conducts the so-called Open Market Operations (OMOs) and/ or purchases bonds in the secondary market.

Has India ever Done this in the Past?

- Yes, until 1997, the RBI "automatically" monetised the government's deficit. However, direct monetisation of government deficit has its downsides. In 1994 then RBI Governor decided to end this facility by 1997.

Main Problems with Direct Monetisation of Government Deficit:

- Government expenditure using this new money boosts incomes and raises private demand in the economy. Thus, it fuels inflation. A little increase in inflation is healthy as it encourages business activity. But if the government doesn't stop in time, it creates high inflation.
- Since inflation is revealed with a lag, it is often too late before governments realise they have over-borrowed. Higher inflation and higher government debt provide grounds for macroeconomic instability.
- While no ideal level of debt is set in stone, most economists believe developing economies like India should not have debt higher than 80%-90% of the GDP. At present, it is around 70% of GDP in India.
- The other argument against direct monetising is that governments are considered inefficient and corrupt in their spending choices — for example, whom to bail out and to what Extent.