

EXPANSIONARY POLICIES - ECONOMY

NEWS: India is currently witnessing a rare phase where both **fiscal and monetary policies are expansionary**.

- While this approach aims to revive aggregate demand in a slowing economy, it also brings the **risk of inflation, policy misalignment, and fiscal stress**.

WHAT'S IN THE NEWS?

Key Policies Adopted Recently

- **Major Allocation in Union Budget 2025–26:**
₹11.21 lakh crore has been earmarked for infrastructure, agriculture, MSMEs, and digital connectivity, indicating a strong focus on capital expenditure to drive growth and employment.
- **Income Tax Cuts Introduced:**
Aimed at boosting household consumption during a period of economic slowdown, personal income tax relief was provided to increase disposable income and stimulate demand.
- **RBI's Reduction of Repo Rate to 5.5%:**
The Reserve Bank of India cut the repo rate to lower borrowing costs and incentivize credit uptake, thereby encouraging investment and consumption.
- **Dual Mandate of RBI (Price Stability and Growth):**
 - To maintain this balance, RBI adopted rate cuts to spur borrowing and investment.
 - Retail inflation was successfully brought down to 4.6% in 2024–25, aligning with the inflation-targeting framework.
 - Liquidity support was extended to financial institutions and NBFCs to prevent credit tightening.



Issues and Challenges

- **Lack of Policy Coordination:**
Without proper synchronization between fiscal and monetary policy, simultaneous expansion could overheat the economy, leading to inflationary pressures.
- **Persistently Slow Economic Growth:**
Despite supportive policies, GDP growth remains weak, credit offtake is subdued, and unemployment levels are rising — indicating that stimulus measures have had limited transmission impact.
- **Muted Demand Response:**
Even after tax cuts, consumer spending remains low. This challenges the **Rational Expectations Theory**, which underlies inflation targeting, as people expect future taxes or inflation to offset current relief.
- **Rising Fiscal Deficit Risk:**
If economic growth fails to pick up, the government's tax revenue may fall. This could widen the fiscal deficit and force spending cuts, particularly in welfare schemes, affecting vulnerable populations.
- **Inequality and Stagnant Wages:**
While corporate profits have increased, real wages for workers have remained stagnant. This

suggests that expansionary policies are benefiting capital owners more than wage earners, exacerbating inequality.

Historical Instances of Expansionary Policies

- **The New Deal (1930s, USA):**
Introduced during the Great Depression, this policy package included massive public spending and job creation programs to revive economic activity.
- **Post-2008 Global Financial Crisis:**
Central banks, especially the US Federal Reserve, cut interest rates close to zero and launched **Quantitative Easing** to inject liquidity.
 - In India, the RBI reduced the repo rate from 9% (2008) to 4.75% (April 2009) to stimulate credit and growth.
- **Japan's Abenomics (2012–2020):**
A three-pronged approach:
 - Aggressive monetary easing by the Bank of Japan.
 - Fiscal stimulus via government spending.
 - Structural reforms to address long-term stagnation.
- **COVID-19 Economic Response (2020–2021):**
 - Countries globally rolled out large-scale fiscal packages including direct cash transfers, food aid, and loan guarantees.
 - Central banks cut interest rates and expanded asset purchases.
 - In India, the government announced the **Aatmanirbhar Bharat Abhiyan** (₹20 lakh crore package) with:
 - Historic low repo rate of 4%
 - Loan moratoriums
 - Liquidity support to NBFCs and HFCs

Benefits of Expansionary Policies in India

- **Increase in Aggregate Demand:**
Tax cuts and higher government expenditure increase disposable income and boost consumption across sectors.

- **Support to Employment Generation:**
Public infrastructure projects and MSME-focused schemes create job opportunities, especially in rural and informal sectors.
- **Promotion of Private Investment:**
Low-interest rates reduce borrowing costs, encouraging businesses to invest in capacity expansion, innovation, and recruitment.
- **Financial Market Stability:**
Liquidity infusion and credit guarantees prevent a credit crunch and ensure continued access to funds for banks and NBFCs.
- **Immediate Relief During Crises:**
Measures like cash transfers, free rations, and employment support during COVID-19 protected vulnerable sections and ensured minimum subsistence.

Way Forward

- **Enhance Policy Coordination:**
Institutionalize regular dialogue between the Ministry of Finance and the RBI to align fiscal and monetary strategies.
- **Strengthen Targeted Transfers:**
Expand Direct Benefit Transfers (DBTs), rural employment schemes, and social security nets to boost demand from the bottom up.
- **Holistic Tax Reform:**
Consider aligning direct tax cuts with rationalisation of indirect taxes (like GST) to provide comprehensive relief to both individuals and businesses.
- **Proactive Inflation Monitoring:**
As demand revives, closely track inflation trends and tighten monetary policy if demand-pull inflation becomes a risk.

Conclusion

- Expansionary policies have historically played a critical role in India's response to economic slowdowns and crises.
- Their effectiveness depends on **timely implementation, accurate targeting, and coordination between fiscal and monetary authorities.**
- While short-term stimulus is important, long-term sustainability requires **fiscal discipline, structural reforms, and inclusive growth strategies.**

Key Concepts Refresher

Fiscal Policy

- **Definition:** Government's use of taxation and public expenditure to influence economic activity.
- **Expansionary Fiscal Policy:** Increased spending or reduced taxes to stimulate demand and output.
- **Contractionary Fiscal Policy:** Reduced spending or increased taxes to control inflation and fiscal deficits.
- **Governed by:** FRBM Act (Fiscal Responsibility and Budget Management) to ensure long-term fiscal prudence.

Monetary Policy

- **Definition:** Conducted by the RBI to manage money supply, credit, and interest rates.
- **Expansionary Monetary Policy:** Lowering interest rates or purchasing government securities to inject liquidity.
- **Contractionary Monetary Policy:** Raising rates or reducing money supply to tackle inflation.

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