UNIT – V

Monetary policy, fiscal policy and cycles

Monetary · Fiscal · Crowding-out · Cycles

Explanatory Lecture Slides

Macro Economics · Major-6 · Semester IV

MACRO ECONOMICS

LEARNING OBJECTIVES

Topics covered in this unit

01 **State objectives and tools of monetary policy**

02 **State objectives and tools of fiscal policy**

03 **Explain crowding-out and when fiscal works**

04 **Sketch a business cycle**

05 **Place automatic stabilisers**

06 **Close the macro paper**

UNIT V · SYLLABUS MAP

How this unit is organised

01	02	03	04	05	06
Monetary policy	Fiscal policy	Crowding-out	Business cycle	Stabilisers	Assignment

Monetary policy

Objectives: price stability (now primary), growth, financial stability. Tools: repo/reverse repo, CRR, SLR, OMOs, communication, (once) credit ceilings.

- Transmission: from repo to deposit/lending rates to I and C — weak if banks are broken or if a liquidity trap.
- A 16-mark: objectives, tools, transmission, two limits.

Monetary policy

PRICE TOOL

- Repo corridor.
- OMO.

LIMIT

- Trap.
- Food shocks.
- Fiscal dominance.

Fiscal policy

T and G (and transfers) to move AD, to redistribute, to provide public goods. Discretionary v automatic. Built-in stabilisers: progressive tax, unemployment transfers (weak in India), MGNREGA as a rough rural stabiliser.

- A 16-mark twin of monetary. Always mention FRBM as the self-binding.

Fiscal policy

EXPANSIONARY

- G up / T down.
- Works with spare capacity and a not-too-steep LM.

CONSOLIDATION

- The FRBM glide — needed when debt-service eats the Budget.

Crowding-out

More G → more borrowing → r up → less private I. Complete in a classical full-employment / vertical LM world; incomplete if spare capacity or a trap (then crowding-in via profits and demand is possible).

- The 10-mark of this unit. India: public capex can crowd in logistics-dependent private I (the Gati Shakti hope).

Crowding-out

OUT	IN
• Full employment. • Closed capital market. • Steep LM.	• Spare capacity. • Complementary infra. • Depressed MEC.

Business cycles

Boom, peak, recession, trough, recovery. Features: co-movement of Y, I (more volatile), employment; prices lag. Theories: climate (Jevons, skip), monetary (Hawtrey, Hayek), Keynesian (k and v), real-business-cycle (optional), political cycle (optional).

- A 16-mark: phases + two theories + one Indian illustration (covid trough, a monsoon, a global shock).
- Hicks's super-multiplier is enough theory if you are short of time.

Business cycles

MOST VOLATILE

- Investment.
- Durables.
- Imports.

SMOOTHER

- Consumption of non-durables.
- Public salaries.

Automatic stabilisers and rules

Stabilisers damp a cycle without a new vote. Rules (FRBM, inflation target) bind the actors so animal spirits can plan. Escape clauses exist because a rule that cannot bend will break.

- The adult closing of the paper: discretion inside rules.

Automatic stabilisers and rules

STABILISER	RULE
• Progressive tax. • MGNREGA.	• 4% CPI. • FRBM ceiling. • Escape for a war or a slump.

Assignment — who does what

Tinbergen/Mundell in one line: one instrument per target, roughly. MPC owns inflation; Budget owns redistribution and public goods; they share stabilisation and must not fight (fiscal dominance).

- A last-page sentence: quote the MPC band and Art. 112, and stop.

Assignment — who does what

MPC

- Inflation first.

BUDGET

- Allocation, distribution, a share of stabilisation.

Business cycles

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- A 16-mark: phases + two theories + one Indian illustration (covid trough, a monsoon, a global shock).
- Hicks’s super-multiplier is enough theory if you are short of time.

LANDMARK AUTHORITIES

Cases a KSLU answer should name

CASE

Swiss Ribbons

(2019) 4 SCC 17

A cycle's wreckage is supposed to go through IBC, not through evergreening.

CASE

RBI v Jayantilal N. Mistry

(2016) 3 SCC 525

Monetary policy's archive is a public archive.

CASE

Minerva Mills

(1980) 3 SCC 625

A fiscal 'socialist' aim still has a rights border.

STATUTE / SECTION MAP

Provisions & materials to quote

RBI Act — MPC	Monetary policy’s statutory body and target.
FRBM Act 2003	Fiscal policy’s statutory self-restraint.
Art. 112–117	The annual fiscal instrument.
MGNREGA 2005	A rural automatic-ish stabiliser.
IBC 2016	The micro plumbing of a macro downturn.

WRITE IT IN THE HALL

10 / 16-mark frames from this unit

Q1 Explain the objectives and instruments of monetary policy in India.

Q2 What is fiscal policy? How can it be used to control a recession or inflation?

Q3 What is crowding-out? When is it complete?

Q4 Describe the phases of a business cycle. Examine any two theories.

BEFORE YOU CLOSE THE FILE

Unit recap

1. Monetary: repo + MPC band; watch transmission.
2. Fiscal: T and G, bound by FRBM, voted under Art. 112.
3. Crowding-out is a maybe, not a law — name the slope of LM.
4. Cycles: I is the volatile series; k and v are a sufficient theory.
5. Rules plus escape clauses — the adult macro of a constitutional State.