

THE GROWTH DRIVER

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

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For an economy in slowdown mode, the key to reviving the growth momentum is private investment, which is a function of the “animal spirits” of entrepreneurs. One must give credit to the Finance Ministry’s [Economic Survey](#), unveiled a day before the presentation of the [Narendra Modi](#) government’s first Union Budget in its second innings, for recognising this basic truth. Although it does not explicitly admit it, the Indian economy is, indeed, today caught in a vicious cycle of investments not happening on the ground, jobs drying up and, in turn, impacting income and consumption. This is the opposite of what happens in a virtuous cycle, where “investment, productivity growth, job creation, demand and exports feed into each other and enable animal spirits in the economy to thrive”. The Survey is right that the macroeconomic stability indicators — whether pertaining to inflation, external current account or even fiscal balances — are much better than they were five years ago and it is time to “shift gears” to enable an average annual real GDP growth of 8 per cent for India to become a \$5 trillion economy by 2024-25. But the key driver for it is investment — more specifically, private investment.

But how does one get firms to invest, which is ultimately a forward-looking activity? It basically requires the upfront costs of a project to be less than the present value of the expected rewards from the investment. The Survey has pointed out — which may not be in sync with the Reserve Bank of India’s views, at least till recently — that real rates of interest in India have increased significantly over the years and are high even on cross-country comparison. There is, therefore, need to lower the cost of capital. Further, it has argued that the country only needs a “mildly positive real rate”, which will not necessarily lead to lower savings. Savings are driven primarily by demographics and income growth: Both of these are favourable for India, given a rising proportion of its working population that will both earn more and save more.

There are other useful suggestions by the Survey that may be worth considering. The first is a redesign of tax policy, including for start-ups. High tax rates on corporate profits and notices received by new economy companies on angel funding from venture capital investors are certainly not a good idea. They need a complete review, especially in the current context where animal spirits are low. Reviving those spirits will present the biggest and most immediate challenge for the Modi government as it begins its second term.

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