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The 'right way' towards a $5-trillion economy

With focus on capex and R&D, Budget 2021 has given a push to the domestic market, which holds the key to India's growth

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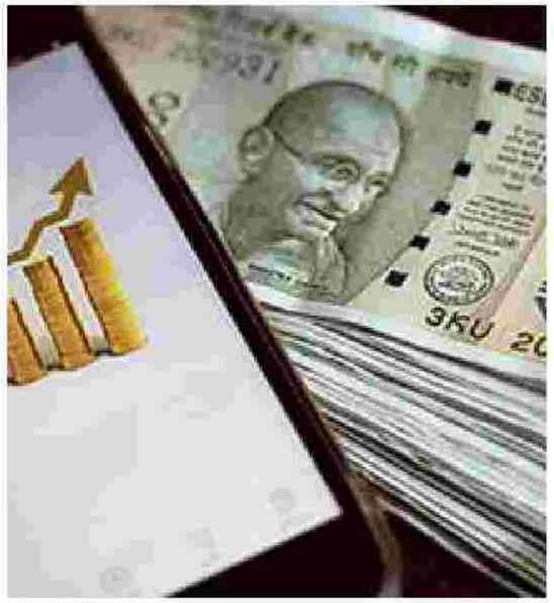
Presented promisingly at the tail-end of the pandemic and at the beginning of the inoculation drive, Budget 2021-22 lived up to the expectation of being an exercise to push growth. Not only does it have the levers to take forward the economy to its pre-pandemic growth path but the clarity as well on the distribution of these levers between the public and private sectors.

It further looks to build capacity now to sustain high growth later with an inclusive strategy. So, is the Budget a harbinger for the economy to grow to $5 trillion by 2025?

India can take two different paths to becoming a $5-trillion economy by the target date. One is the accounting way that shows the target to be achievable with a high growth of nominal GDP, comprising a large inflationary component, and a strong currency. Intuitively, this can happen when a sustained deluge of capital inflows partly appreciates the rupee and partly augments the forex reserves.

Increase in reserves injects liquidity that, in the absence of sterilisation, fuels inflation in the economy. The final outcome includes a huge build-up of reserves, an overvalued currency, high inflation and, most disconcertingly, low growth and employment. It is doubtful whether even this weak outcome can endure as inflation-targeting central bank stamps out high inflation and capital inflows become wary of high inflation/low growth economies.

The other path to reaching the target is the real way that the Budget elaborates under the pillar of physical and financial capital, and infrastructure. A strong infrastructure push driven by the public sector increases the investment rate in the economy. The multiplier then comes into play raising income and consumption levels. Higher consumption, in turn, induces private investment through the investment accelerator. The induced private investment further amplifies the income and consumption levels as the multiplier once again comes into play.



Multiplier effect Budget gives impetus

The Budget thus pushes a capex stimulus that brings in a multiplier-accelerator interface to set in motion an investment-income-consumption spiral in the economy. This 'real way' increases the growth of real GDP, creates job opportunities and keeps inflation low and stable to raise the standard of living. It also accommodates an appreciated currency by increasing export competitiveness through productivity gains. The pillars of reinvigorating human capital and innovation and R&D in the Budget include strategies to increase total factor productivity in the economy.

Slow recovery

In the next two-three years, high real GDP growth rates will be a rarity in most of the economies as they slowly recover from the impact of the pandemic. The IMF also, in its January 2021 update of the World Economic Outlook, has only marginally raised the projected growth of world output in 2021 and beyond. With world incomes growing slowly, the export stimulus to India's GDP growth will take some time to go into overdrive.

Clearly, the domestic market holds the key to India's growth in the next few years with enhanced local manufacturing gradually substituting for goods and services supplied from abroad. In this regard, the Productivity Linked Incentive Scheme will herald a new chapter of Make in India to boost domestic production. As domestic manufacturing moves up the global technology frontiers, productivity gains will ensure that output is competitive enough to penetrate world markets.

At 6.8 per cent of GDP, the budgeted fiscal deficit will fund a large capital outlay to take the economy forward, the real way. A moderate fiscal consolidation plan allowing the glide path of fiscal deficit to reach 4.5 per cent in 2026 portends large capex in the next few years as well. High real GDP growth rates are on the anvil to quickly make the economy a $5 trillion one although the timing of attaining it is uncertain. With growth set to happen the real way, a $5 trillion-economy should be seen as an idea to pursue for all-round development of the country and not a numbered target monitored in an accounting way.

The writer is Adviser, DEA. Views are personal