Our Views

Economic Survey 2021: Many refreshing perspectives

Earlier today, the Government of India presented its Economic Survey (ES) in the Parliament in extremely exceptional circumstances of the pandemic. As was expected it addresses several very fundamental issues and at the same time initiates a debate on some other important issues.

Fiscal Deficit

In my view, the survey indicates that the Government can stay with higher fiscal deficit to push growth. It suggests that growth leads to debt sustainability in the Indian context. On the contrary, lower debt does not necessarily lead to growth. This is because the interest rate on debt paid by the Indian government has been less than that of India's growth rate. Further, the government's spending should be counter cyclical – government should spend more when the economy is in a slow growth phase.

India's Sovereign Credit Rating (SCR)

The Survey once again, very forcefully brought out an argument that India's Sovereign Credit Rating doesn't reflect the true picture of India. Never in the history of SCRs has the fifth largest economy in the world been rated as the lowest rung of the investment grade (BBB-/Baa3). Survey puts it that while SCRs do not reflect the Indian economy's fundamentals and these noisy, opaque, and biased credit ratings damage FPI flows. SCRs methodology must be amended to reflect economies' ability and willingness to pay their debt obligations by becoming more transparent and less subjective.

Inequality and Growth

The ES deals with another very important and age-old debate between Inequality and Growth. It very persuasively argues that the relationship between inequality and socio-economic outcomes, on the one hand, and economic growth and socio-economic outcomes, on the other hand, is different in India from that observed in advanced economies. Unlike in advanced economies, in India, economic growth and inequality converge in terms of their effects on socio-economic indicators. Economic growth has a far greater impact on poverty alleviation than on inequality. Given India's stage of development, India must continue to focus on economic growth to lift the poor out of poverty by expanding the overall pie. Redistribution of wealth is only feasible in a developing economy if the size of the economic pie grows.

Regulatory framework

I am indeed glad that the Survey has brought to the fore the very important debate on over-regulation. My compliments to the Chief Economic Advisor for pointing out that the root cause of the problem of over-regulation is an approach that attempts to account for every possible outcome. Both economic theory and evidence shows that in an uncertain and complex world, it is not possible to write regulations that account for all possible outcomes. Discretion in decision-making is unavoidable in this complex world. The solution is to simplify regulations and invest in greater supervision which, implies willingness to allow some discretion which needs to be balanced with transparency and accountability.

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Innovation

Again for the first time in my recollection the Survey has talked about the need to focus on innovation. It says that India entered the top 50 innovating countries for the first time in 2020 by improving its rank from 81 in 2015 to 48 in 2020. It further says that for India to become an innovation leader, it needs greater thrust on innovation. India's aspiration must be to compete on innovation with the top ten economies. India's gross domestic expenditure on R&D is lowest amongst other largest economies. Interestingly, India's innovation ranking is much lower than expected for its level of access to equity capital. This points towards the need for India's business (private) sector to significantly ramp up investments in R&D.

Current economic and fiscal situation

The Survey suggests that in the wake of the global pandemic outbreak, the General Government (Centre plus States) is expected to register a fiscal slippage in FY 2021-21, on account of the shortfall in revenue and higher expenditure requirements. However, longer term sustainability depends crucially on reviving growth relative to the interest cost of Government debt.

On the current economic situation, the Survey makes one very important remark. It suggests that the economy is likely to grow at 11% in the next year and given an expected inflation of around 4.4% it would mean a nominal growth of 15.4% - this could be one of the fastest in the last several years.

Inflation

One interesting comment was made on inflation that apart from the short-term measures to curtail the upward price movement, we need to invest in medium to long term measures such as decentralized cold storage facilities at production centers. Consistency in important policies also warrants attention.

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