Be Mains Ready

With reference to the Economic Survey 2018-19, what do you mean by 'Virtuous Cycle' of an economy? How will the virtuous cycle help Indian economy to become a USD 5 trillion economy by 2024-25? (250 words)

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Approach

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- Define the virtuous cycle as mentioned under Economic survey 2018-19.
- Explain how this virtuous cycle will help Indian economy to become a USD 5 trillion economy by 2024-25.
- Give conclusion.

Introduction

- **Virtuous Cycle** refers to a self-propagating advantageous situation in which a successful solution leads to more of a desired result or another success which generates still more desired results or **successes in a chain.**
- According to **Economic survey 2018-19,** India's high growth requirements of 8 % real GDP growth rate to become a USD 5 trillion economy by 2024-25 can only be sustained by a **"virtuous cycle" of savings, investment and exports** catalysed and supported by a favourable demographic phase as is evident from the growth model of China and east Asian economies in recent times.
- Economic Survey makes the case for **investment as the "key driver"** that can create a self-sustaining virtuous cycle in India.

Advantages of virtuous cycle

When the economy is in a virtuous cycle, investment, productivity growth, job creation, demand and exports feed into each other and enable **animal spirits in the economy** (ways that human emotion can drive financial decision making in uncertain environments and volatile times.) to thrive.

The Economic Survey 2018-19 discusses the case of growth stories in China, Thailand, Indonesia and South Korea to highlight the issue of Gross Capital Formation – savings & investments contributing to GDP in these countries.

- Investment, especially private investment, is the “key driver” that drives demand, creates capacity, increases labour productivity, introduces new technology, allows creative destruction, and generates jobs.
- Economic Survey 2018-19 cites studies to show that **savings and growth are positively correlated** and their positive correlation is even stronger than that between growth and investment.

    Some studies argue that as investment is risky, entrepreneurs are exposed to the risk of idiosyncratic business failure that leads to the loss of the invested capital. Therefore, savings have to increase more than investment to allow for the accumulation of precautionary savings.
- When examined in the full value chain, **capital investment fosters job creation** as capital goods production, research and development, and supply chains also generate jobs. International evidence also suggests that capital and labour are complementary when high investment rate drives growth.

    The Chinese experience illustrates how a country with the highest investment rates also created the most jobs.

- **Capital investment enhances total factor productivity, which in turn enhances export performance.** Therefore, investment becomes crucial to enhancing export performance. **A strong correlation between growth in exports and GDP growth** has been seen for the high growth East Asian economies.

Conclusion

- To achieve the high real GDP growth rate over the years requires a different approach than traditional one that views job creation, demand, exports, and economic growth as separate problems.
- The new view proposed by Economic Survey 2018-19 states that these macroeconomic phenomena exhibit significant complementarities.
- **Understanding the "key driver" and enhancing the same enables simultaneous growth in each of the other macro phenomena.**
- Thus, India needs to cut real interest rates, ease labour rules, reduce capital gains tax on startup investments and encourage infant firms to grow at a sustained 8% rate to reach the GDP target of USD 5 Trillion by 2024-25. Also, **Dr Surjit Bhalla committee** recommendations needs to be studied and implemented where possible to enhance exports.