# SAVINGS ESTIMATES IN INDIA
## Recent Trends and Underlying Factors

# 1

## INAUGURAL ADDRESS

Sukhamoy Chakravarty

THE theme of this seminar, *viz.*, "Savings Estimates in India: Recent Trends and Underlying Factors", is an extremely important issue in the present Indian economic situation. In fact I feel that a convincing explanation is yet to be provided for the savings behaviour in the Indian economy over the last 35 years. We have not fully understood as to why the savings rate in our economy went up significantly towards the late seventies and why it has stagnated in recent years. The present stagnation in the savings rate, coming after a period of accelerated growth, would seem to require some explanation. Prof. Krishnamurty and Dr. Sharma have been working on this problem for a considerable period of time and I hope that their paper in this seminar may throw some light on this aspect.

The issue of stagnation in the savings rate needs serious attention because a rate of growth of 6 per cent in GDP has been postulated for the Eighth Five Year Plan on the assumption that the savings rate will be raised from 21.68 per cent to 24 per cent over the period of the Eighth Plan. This implies that the policy-makers expect the average savings rate during the next quinquennium to be somewhat higher than at present, thereby reversing the downward trend or stagnation that has been noticed for the last five to six years. In other words, a certain kind of a U-turn is anticipated in the savings behaviour. While this may not be an impossible task, we have to basically understand the factors which might really lead to this kind of reversal in the savings behaviour. To postulate a marginal propensity to save of the order of around 40 per cent is a statistical exercise, but realising the same would require much better understanding of the behavioural forces which shape the outcome of the major variables like savings and consumption both in the public and private sectors of the economy.

An assumption that I have noticed in a great deal of recent discussion is that the aggregate savings rate in our economy could be increased if only the public savings could be raised. This is based on the findings that the present stagnation in the aggregate savings rate is almost exclusively attributable to the behaviour of public savings in recent years. This assumption implies that the savings rates in the public and private sectors are not related to each other, which need not, however, be true since there are many interrelationships among aggregate magnitudes like savings and income. For instance, if it is assumed that Government has been spending more than it is in a position to raise as revenues in its so-called "income account", then obviously such expenditures of the Government have some impact through various multipliers and other kinds of mechanism in the economy on the generation of private income. Supposing the Government decides to tax more or reduce the subsidies or increase the administered prices of various commodities and services, then is it reasonable to expect that, other things remaining the same, the overall rate of saving should go up because the Government or the public sector will be able to improve its savings rate? Does it also then follow that the savings behaviour of the household sector or the corporate sector will remain invariant to such policies adopted by the Government? In other words, is there something to the point that a part of the strength of the household sector savings may very well have been derived from the various policies adopted by the Government, in particular, its unwillingness to tax the agricultural sector and its unwillingness to charge full cost for the commodities and services produced and/or supplied by the public sector to different sectors or sections of the population? In my opinion, this class of questions needs careful analysis.

I feel that it is necessary to examine first the behaviour of aggregate savings in relation to gross domestic product, then analyse the interrelationships between sectoral behaviour and aggregate savings and later look into the issues connected with the behaviour of sectoral savings. In this context, the problem of financial intermediation is an important and related question, though by no means an identical question. Financial intermediation will remain an important issue even when the Government does behave better. If public investment is considered to be very important and the Government decides to step it up, then a higher rate of aggregate savings might help the Government to finance a higher level of public investment, even though the Government might be getting more indebted in the short run. However, if the rate of growth of domestic product is sufficiently high and the interest rate is suitably fixed in real terms, then the Government need not run into a debt trap, provided the underlying strength is given by the level of aggregate savings.

In this context, there is a view that if we are able to obtain more loans or aid from abroad, then it might help to raise the rate of investment. But there is also another view that this might adversely affect the domestic saving in the sense that there is a negative relationship between domestic savings and foreign savings—a theory that has been postulated by some economists.

In my opinion, we have to first clearly identify the forces underlying the rise in savings rate in our economy during the second half of the seventies and its subsequent decline and stagnation during the eighties. Such an analysis would enable us to postulate a properly structured set of policies for reversing the present stagnation in the savings rate. This does not, however, imply that the Government should not raise taxes nor am I suggesting that the Government should not re-examine its policies relating to subsidies and administered prices, all of which should help in a variety of ways. But it does not follow that aggregate savings constraint, if it were indeed a constraint, can be effectively overcome merely by adopting such policies alone. In my opinion, something deeper is involved in the present situation.

There is some evidence to believe that consumerism has now become a very major factor. Household expenditure on consumer durables has been growing faster in recent years than expenditure on other items. If we have to reckon with this increasing trend of consumerism, it is then quite possible that the household sector would now save less than it would have done in the kind of environment that existed earlier. It is, therefore, worth investigating whether the rise in consumerism has any relationship with the policies that the Government has adopted in recent years, especially in relation to taxation—both direct taxation and commodity taxation. This set of issues requires careful analysis. In my opinion it would be an over-simplified analysis to assume that the savings behaviour of the public sector is directly responsible for the present stagnation in the aggregate savings rate. It may indeed be responsible, but this cannot be established by merely analysing the different components as if they are altogether independent. These components arise from the same set of forces and there are obvious relationships of interdependence between components.

Another aspect in recent discussions which somewhat surprises me is that a great deal of interest is shown towards the private corporate sector. The rate of saving in the private corporate sector in our economy has remained almost stagnant. It might have even declined compared to the sixties. The significant slowing down in the level of private corporate savings over the past twenty years or more needs a very careful analysis and explanation. We know that in certain economies where capitalism has shown dynamism, the corporate sector does not save a large percentage of their income. But then these cannot be really considered as typical economies.

Further, a great deal of economic theory on "investment demand" functions has also been based on the behaviour of corporate profits. In the Indian context, however, we have to analyse first whether the private corporate sector is capable of getting resources from the household sector and then examine whether the existing institutional set-up really encourages the corporate sector to rely more on borrowed funds than on internal resources. Normally one would expect that there would be a tendency, in order to avoid increasing the risk, to shy away from greater degree of indebtedness than is necessary. This is based on Kalecki's theory of increasing risk, but the Indian capital market may have some special features. If that is indeed the case and the capital markets are fragmented, then the inclination on the part of the corporate sector to rely more on borrowed funds may have more to do with the Government's unwillingness to allow any private enterprise to go bankrupt. It may be that some of the Government decisions have in fact been responsible in making it more attractive for the private corporate sector to seek borrowed funds more than plan for increasing their own internal savings. If that is so, then the argument for reducing the corporate rate of taxation on the assumption that it would lead to availability of more funds for investment for the corporate sector may not indeed be justified. So this again raises a set of questions, which needs to be carefully analysed.

Then we come to the question of the so-called New Series of National Accounts with 1980-81 as the base year which, as far as I can see, differ from the Old Series basically in respect of the estimation of consumption of fixed capital. For the base year, the difference is as much as 50 per cent and so the gross savings have to be written off by about 50 per cent in order to arrive at the estimates of the net savings. In the 1930s there was a great deal of discussion on this matter, especially between Pigou and Hayek, about what is meant by maintaining capital intact. Many got tired with this debate and gave it up because nothing concrete seemed to have emerged out of it, although it was very clear that from a welfare theoretic point of view net savings was an important factor to be reckoned with. However, from the point of view of short period demand management, which became the centre of attention after Keynes, people were more concerned with gross investment and gross savings. More recently, welfare theorists are returning to consumption of fixed capital as an analytical issue to get an idea of sustainable rate of growth. Furthermore, in the context of sectoral financing, depreciation allowances form a major issue. In other words, it could be the case that in some of the sectors where in fact depreciation allowance has been shown to be low, capital stock might have been undermaintained which might lead to a bunching of investment repuirements for replacement purposes for which necessary resources might not be available. Even if the resources are available, the productive capacity will increase only marginally. The National Accounts data (New Series) pertaining to transport, communication, electricity, gas, etc., would seem to suggest that this may indeed be the important issue involved in these sectors which reflects the need for financial intermediation in a specifically directed sense. In other words, intersectoral flow of funds has to be much more carefully studied in the present context than mere aggregative analysis would permit. It seems to me that the more important lesson to be drawn from this particular set of estimates is that we may be faced with serious problems of bunching of investment for replacement purposes in coming years, merely to maintain the same rate of growth. Estimation of incremental capital output ratios based on the assumption that investment increase *per se* would really give rise to a significant additionality in growth in output may not in fact be justified in these circumstances. The information that is given in the CSO's publications does not seem to be very adequate for forming any opinion about the fresh estimates of depreciation although it is mentioned that the life table of the various types of physical assets have been taken into account for this purpose. But I am not indeed quite sure whether this has been done with the care that is needed. Although it is quite plausible that the earlier estimate of depreciation might have been an underestimate, the basis on which the new estimates have been prepared needs to be clarified.

One final point that I would like to mention is that cross-sectionally the Indian saving performance is indeed something of an exception for poor countries which are supposed to belong to the low-income category. The saving rates as per the CSO's estimates (the gross saving estimates are more or less the same in both the old and the new series) would seem to suggest that the Indian saving rate is significantly higher than those recorded in Bangladesh, Sri Lanka, Pakistan and a number of other countries, but it is certainly lower than in the case of Taiwan and South Korea. The saving rate in India is quite comparable with that achieved by Malaysia and Thailand, but these are middle income countries. The saving rate in China is significantly high, but China is a different kind of economy.

From the above analysis it is very clear that one of the necessary conditions of growth seems to have been fulfilled in the Indian case, although it is not a sufficient condition, *viz.*, that we have achieved a fairly high level of savings rate, even though people have raised some doubts in this respect. The Raj Committee itself raised questions as to whether indeed the real capital formation figures are as high as savings figures would seem to suggest. They attributed it to the differential behaviour of the sectoral price levels. Vaidynathan has also raised this question in his paper. Even so, if one goes by the normal standards of comparison, I do find that the Indian savings behaviour is an outlier compared to other most low income countries. If so, the answer will have to rely on the deeper understanding of the institutional dimensions which figure in relation to the savings determination processes. Elasticity of aggregate saving with respect to interest rate as distinguished from income elasticity is not decisively any higher in India as compared to many other countries. This could not, therefore, by itself provide an adequate explanation But there are other variables such as terms of trade between industry and agriculture, which Dr. Krishnamurty and Dr. Sharma have analysed and which might provide some light on this aspect.

Coming back to the question with which I started, if the Eighth Five Year Plan projections on growth are so critically dependent on stepping up the rate of domestic savings, then a much clearer understanding of the forces which shape the savings behaviour would appear to me to be of decisive importance. The policy instruments which are appropriate for this purpose can only be visualised after we have had a clearer comprehension of the former. Otherwise it is quite possible that a series of measures which, *ex-ante*, are intended to raise the saving rate, would work out, through mutually offsetting of decisions, to a figure which might very well be lower than what we are hoping for at this particular stage.

Finally, the assumption that savings is a constraint on growth itself seems to me to be a hypothesis requiring much clearer elucidation. In a purely supply-centric view of the growth process, this may indeed be so, but there are people like Kaldor and others who maintain the demand-centric position, in which case the causation runs not from savings to investment, but from investment to savings. In that case, higher rate of realised savings might in fact mean that the potential rate of inflation need not be as high as in comparison with situations where the savings rates were considerably lower. This leads us to the question of inflationary income redistribution and mechanism of that nature, well beyond the scope of simple neo-classical processes of adjustment. These macro-dynamic processes of adjustment, possibly neo-classical, also require, therefore, careful analysis by those who are building econometric models in order to throw light on the policy question.