Table 2: Savings and Investment Rates

(Percent to GDP)

Item	1950-65	1965-81	1981-90	1990-91	1991-97	1997-2003	2003-08	2008-12	2012-13
Savings									
1. Household Sector	7.0	10.8	13.3	18.5	16.5	21.0	23.2	23.7	21.9
(a) Household - Financial	2.1	3.9	6.6	8.5	9.7	10.0	11.2	9.8	7.1
(b) Household - Physical	4.9	6.9	6.7	10.1	6.8	11.0	12.0	13.9	14.8
2. Private Corporate Sector	1.2	1.4	1.7	2.6	3.6	3.9	7.2	7.8	7.1
3. Public Sector	2.6	3.9	3.7	1.8	2.2	-0.3	2.9	1.2	1.2
(a) Public Authorities	2.3	2.9	1.1	-1.1	-0.7	-3.6	-1.1	-1.7	-1.6
(b) Non-departmental Commercial Enterprises	0.3	1.0	2.6	2.9	2.9	3.3	4.0	3.0	2.8
4. Gross Domestic Savings	10.8	16.1	18.7	22.9	22.3	24.5	33.3	32.7	30.1
Investment									
1. Gross Capital Formation	12.9	17.1	22.5	24.9	23.2	24.9	33.4	36.2	34.7
(a) Public Sector	5.6	7.9	11.3	10.6	9.1	7.2	7.8	8.7	8.1
(b) Private Corporate Sector	2.4	2.3	4.5	4.3	7.3	6.3	12.5	11.6	9.2
(c) Household Sector	4.9	6.9	6.7	10.1	6.8	11.0	12.0	13.9	14.8
2. Valuables						0.4	1.1	2.0	2.6
3. Errors & omissions	-0.5	-0.3	-2.0	1.1	0.2	0.0	0.3	-0.5	0.1
4. Total Investment	12.3	16.8	20.5	26.0	23.5	24.9	33.6	35.7	34.8
Saving-Investment Gap									
Overall	-1.5	-0.7	-1.8	-3.1	-1.2	-0.4	-0.4	-3.0	-4.7
Public Sector	-2.9	-4.0	-7.7	-8.8	-7.0	-7.5	-4.9	-7.5	-7.0

Source: Central Statistical Organization, Government of India; Reserve Bank of India.

3 Second, the quality of the fiscal stimulus, which focused on tax cuts and increased revenue expenditure (particularly in subsidies) while keeping capital outlays stagnant, added to demand pressures, which were then mirrored in high inflation. That the growth recovery in 2008-12 was on steroids is reflected in the very large unprecedented growth in the rate of government consumption (see Table 1). The withdrawal of the fiscal stimulus has also been hesitant and slow. There was an attempt to keep up public investment in roads and power through a step-up in public-private partnerships (PPPs) along with the fiscal stimulus in 2008-10, but then a steep decline took place after that, thereby contributing to the growth slowdown, particularly in manufacturing and in key infrastructure sectors.

Third, the delayed and incomplete withdrawal of the fiscal stimulus led to crowding out of the private sector, which might have also hampered private corporate investment. 4 The extraordinary growth in gross fixed capital formation observed in 2003-08 almost halved in 2008-12. Simultaneously, the high nominal interest rate environment in an environment of subdued growth also impacted corporate profitability and investment. The availability of domestic resources for the private corporate sector was squeezed from all sides.

account the government's announced medium-term fiscal plans. They are also conditioned on the expected practice of sound macroeconomic and financial policies. The growth and investment relationship draws upon historical productivity estimates reflected in incremental capital output ratios, supported by estimates on total factor productivity that has been achieved in recent years. Implications of the investment and growth projections for balance of payments – both current and capital accounts – and the overall external sector sustainability are also factored in, while also imposing a cap on the recourse to sustainable foreign savings. The projections are the preferred point estimates, picked following consultations with a broad range of stakeholders in government and in the private sector (NTDPC, 2014). 5

6 The projections aim to provide a consistent macroeconomic framework and their implications for returning Indian annual GDP growth to around 7 per cent in the near future and then ascending to 8-9 per cent in the following quinquennial periods from 2017-2032. The results then provide some assessment of the feasibility of achieving such a growth objective, should the return to such a growth path be seen to be within the realms of reality? Another way of interpreting these projections is to see the results as implications of achieving such a high growth path: what they imply for the evolution of key macroeconomic variables.

7 This scenario entails the gross domestic capital formation (GDCF) rate to increase from about 35 per cent in 2012-13 to around 39 per cent during 2017-22 and further to 43 per cent by the 5-year period 2027-32. The corresponding rates of domestic savings would be about 36 per cent during 2017-22, rising to 41 per cent during 2027-32. These projections envisage an increase in all the three major components of savings – household, private corporate and public savings (Table 3).

8 While the projections may seem ambitious, they appear to be reasonable and achievable, given that the domestic savings rate and the investment rate had reached as high as 37 and 38 per cent, respectively, in 2007-08. The fact that Indian savings and investment rates have exhibited a secular uptrend since independence, although interspersed with some short periods of stagnation, also provides comfort in the likelihood of reaching the projected savings and investment rates. Of course, these projections are contingent on the pursuit of sound and stable macroeconomic and financial policies and continuing structural reforms, as elaborated in the rest of the paper. In this scenario, the absorption of external savings has been kept at around 2.5 per cent of GDP throughout the period, which is judged to be consistent with a sustainable CAD. We draw out the implications of this on the trajectory of balance of payments, capital flows, and desired foreign exchange reserves.

What do the projections imply for overall efficiency of the economy? One crude measure of productivity is the incremental capital output ratio (ICOR). International experience suggests that the best ICORs achieved for any sustained period fall in the region of about 3.5 to 3.6. Indian ICORs have ranged between about 3.5 and 4.5 for much of the past three decades (Chart 1**Chart 1**). Our projections embedded in the desired growth paths of GDP and GDCF imply an ICOR of about 4.2 over the next couple of decades. We are therefore assuming a relatively high level of efficiency in resource use, but which is consistent with Indian historical achievements and also other recent evidence on productivity. For example, according to estimates in RBI (2014), the trend rate of growth in total factor productivity (TFP) of the overall economy increased from 1.1 percent per annum during the 1980s and 1990s to 2.3 percent during the 2000s (2000-01 to 2008-09), led by manufacturing without a very major restoration of manufacturing growth in India to annual growth rates approaching a sustainable 10 per cent. Even with such an optimistic manufacturing growth scenario, the share of manufacturing in Indian GDP would not exceed 15 per cent, while agriculture can be expected to fall below 10 per cent, in 20 years. Whereas such a high rate of manufacturing growth was indeed achieved during 2005-08, it has since tapered off and collapsed to almost zero during 2012-14. The achievement of the kind of growth projected here is thus critically dependent on the revival of competitive Indian manufacturing in a sustained fashion over the next couple of decades.

Financing Growth

Domestic Savings

1 We first examine how the investments projected could be financed. We begin by assessing the way different constituents of savings can be expected to behave: household savings, private corporate sector savings and public sector savings. Household savings have been the bedrock of domestic savings in India, exhibiting a steady increase over the years. 2 They reached about 21 per cent of GDP during 1997-2003 and ascended further to just under 24 per cent during 2008-12. We have therefore projected a slow increase to about 28 per cent by 2027-32. From the point of view of financing of investment by the public and private sectors, it is the household financial savings that are important. Net household financial savings increased from about 6-7 per cent of GDP during the 1980s to about 10 per cent in the 1990s, stabilizing at this level thereafter. It is only in the very recent years that they have again fallen to around 7 per cent, as savings appear to have been directed to gold. In the near future, we expect financial savings to be restored to the earlier 10 per cent level, as inflation subsides, monetary conditions stabilize and households begin to obtain positive real interest rates on their deposits and other financial savings. Financial savings are then projected to 3 increase gradually to around 13 per cent by 2027-32. This would appear reasonable with increased financial depth and inclusion in the economy as income increases at the kind of pace projected. We would, in particular, expect increasing shares of savings going into contractual saving such as insurance, provident and pension funds. This tendency should get accentuated as urbanization gathers pace and people have to insure themselves for their retirement. The unfolding demographic structure is also conducive to savings.

A distinguishing feature of the golden era of growth (2003-08) was the dramatic increase in private corporate savings from 3.9 per cent of GDP during 1997-2003 to about 7.8 per cent during 2008-12. It was the buoyant profitability of that period and high corporate investment levels that induced the private corporate sector to keep such high levels of retained earnings – or we could reverse the causation: It was the high levels of profitability that allowed high retained earnings that helped greatly in financing high levels of corporate investment. Restoration of private corporate investment will critically need enhancement of profitability so that private corporate savings again reach their earlier level of 7.5 per cent of GDP within the next 3-4 years. We have then projected them to increase to 9.5 per cent by 2027-32.

It is necessary to restore confidence in future Indian growth for corporate investment to increase again in the next couple of years. This brings us to the desired trajectory of public sector savings, which consist of two broad categories: public authorities and non-