PROSPECTS FOR SAVING AND GROWTH[1]

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At the outset, I would like to express my gratitude to the organisers for giving me this opportunity to be with you. Though I belong to Andhra Pradesh, I had known Mr. Doshi personally since we interacted professionally. In fact, a few days before his unfortunate trip to Davos in January 1994, we were together for a couple of days in Hyderabad in a Retreat for Secretaries to Government of India and Chief Secretaries of States. Mr. Doshi displayed in his participation in the deliberations, a deep understanding of developmental issues, especially in the area of industry, and a very friendly, and warm temperament. It is that memory, apart from the persuasive skills of the respected Principal who made me accept this invitation.

I owe an apology to the organisers and many of you for changing the schedule from 9th to 16th December. Though I had agreed to send the script of my address for 9th, I was advised by the organisers to have the pleasure of meeting you all. I am thankful to them for the courtesy shown to me.

Since we know that Mr. Doshi devoted a large part of his life to the issues of development, we decided that it would be appropriate to speak on Prospects for Saving and Growth-naturally in our own economy, on the eve of the Ninth Five Year Plan.

I would like to start with an account of the performance of our economy in terms of saving and growth in the Plan era and more particularly in the post-reform period. We would also see how our performance compares with some other developing countries. We could then move on to a detailed assessment of the prospects for household, corporate and public sector saving which together constitute domestic saving, typically financing over ninety per cent of our investment. An assessment of foreign saving is also necessary, both for completing the picture about investment and for its significances to our growth. This should help us in identifying critical issues in determining growth scenarios. In particular, I would like to flag what may be termed as "new realities" that should be noted by policy-makers in planning for an appropriate level as well as composition of saving

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and linking them with growth-scenarios. I hope to conclude by mentioning, what I consider as the most critical factor that would make or mar our optimistic projections.

Let me, at the outset, note that there are methodological problems in estimating savings, especially in respect of households and corporates. Public sector saving is essentially based on government accounts and balance sheets of public enterprises but we need to also include local governments' financial positions. While the methodological issues are being looked into by an official committee under the Chairmanship of Professor Raja Chehlliah, I would make some use of the data that we have inured to focus on the logic of assessing prospects for saving and growth.

Saving Performance

What has been our performance in terms of saving?

First, gross domestic saving as a percentage of Gross Domestic Product (GDP) at current market prices doubled from 10.3 per cent in the First Plan to 20.6 per cent in the Seventh Plan. This helped the gross domestic investment rate to rise from 10.7 per cent to 23.1 per cent between the First and the Seventh Plan. In the Eighth Plan, the saving rate is 22.3 per cent during the first three years with 24.4. per cent in 1994-95.

Second, though there has been a long-run rising trend, the saving rate witnessed a large year-to-year fluctuation. During the 1950s, the saving rate varied between the peak of 13.9 per cent to a low of 8.2 per cent, the range of variation was 15.3 per cent and 12.2 per cent during the 1960s, 23.2 per cent and 15.4 per cent during 1970s and 22.2 per cent and 18.2 per cent during the 1980s. During the first half of the 1990s, the degree of variation declined somewhat. The peak saving rate of 24.4 per cent in 1994-95 was more than 3 percentage points higher than the low of 21.2 per cent in 1992-93.

Third, the household saving has been the mainstay of our domestic saving performance. As a percentage of GDP, household saving grew from 8.4 per cent in 1960-61 to 19.8 percent in 1990-91 and the average for Eighth Plan so far is 17.70 per cent. Household saving contributed 66 per cent of total gross saving in 1960-61, which increased to 84 per cent in 1990-91 but declined to 79 per cent in the Eighth Plan so far.

Fourth, saving in the financial assets showed an impressive growth from 2.8 per cent of GDP in 1960-61 to 11.1 per cent in 1994-95, which increased its share in the total household saving from 33.5 per cent to 58.9 per cent during this period.

Fifth, the share of private corporate sector in total saving, which fluctuated widely during the 1960s and 1970s, showed smart recovery in the 1990s : its share declined from 13.4 per cent in 1960-61 to 7.9 per cent in 1980-81, but recovered to 11.8 per cent in 1990-91, and moved impressively up to 15.6 per cent in 1994-95. In terms of percentage to GDP, private corporate saving which remained almost stagnant at 1.7 per cent between 1960-61 and 1980-81, increased by over on percentage point to 2.8 per cent in 1990-91 and by a further percentage point to reach 3.8 [per cent by 1994-95.

Sixth, perhaps the most disquieting aspect of the saving behaviour in the Indian economy is the trend erosion of public sector saving over the years. Public sector saving rate which averaged 2.7 per cent in 1960s, 3.7 per cent in 1970s and 3.0 per cent in 1980s, declined sharply to1.3 per cent in the first half of 1990s. The deterioration in the public sector saving performance partly stemmed from the emergence of negative saving of the Government administration since 1984-85 and the increasing magnitudes of dis-saving since then. The negative saving of the Government administration which amounted to 1.43 per cent of GDP during 1985-86 to 1989-90 increased to 2.6 per cent in the first half of 1990s.

Seventh, the non-departmental and departmental public enterprises, however, showed some improvement in their saving performance, with a saving rate of about 4 per cent of GDP during the first half of 1990s.

Eighth, foreign saving has played a relatively minor role in financing domestic investment in India. In fact, except for late fifties and sixties, during most of the period, foreign saving accounted for less than ten per cent of our investment. Foreign saving as a percentage of GDP averaged 1.5 per cent during the Sixth Plan and 2.5 per cent during the Seventh Plan. It declined to 1.0 per cent in the first four years of the Eighth Plan and this is far less than the target of 1.6 per cent envisaged in the Plan. In the eighth Plan, there is a distinct shift from debt flows to non-debt flows and from short-term maturity debt to longer maturity debt. The proportion of private capital flow increased as compared to official flows. The access of private sector to foreign saving has also increased.

There has been a lively debate on the effect of reform measures undertaken recently, on the domestic saving. The data available for the three years of the post-

reform period would not give a firm basis for reaching any definitive conclusions on this issue. For, the limited number of observations is limited and the period exhibits perverse effects of the initial shock introduced by policy regime shift. Nonetheless, one could draw some important features of our saving-investment performance in the post-reform era i.e. from 1992-93.

First, the average gross saving rate of 22.3 per cent during 1992-93 to 1994-95 does not seem to be promising against the backdrop of the average saving rate of 23.2 per cent during 1990-91 and 1991-92 and 20.6 per cent during the Seventh Plan. Excluding 1994-95, when the saving rate shot up to the historical peak of 24.4. per cent, the average saving rate would drop to a little over 21 per cent in the post-reform period.

Secondly, for quite sometime, the household saving rate has been hovering in the range of 17 to 20 per cent, with the peak rate occurring at 19.8 per cent in 1990-91. In the post-reform period, and starting with 199-93, the average saving rate seems to be plateauing off around 18 to 19 per cent.

Thirdly, financially saving of the household sector during the period 1992-93 to 1994-95 averaged 10.1 per cent of GDP compared to 9.4 per cent during 1990-91 and 1991-92 and 7.6 per cent during the Seventh Plan. Therefore, much of what could be expected as improvement in household saving rate, would have to come in the form of financial assets, and the specific policy initiatives to promote saving in these assets.

Fourthly, the saving rate of the private corporate sector averaged 3.4 per cent during 1992-93 to 1994-95, which is about 70 per cent higher than the ratio of 2 per cent during the Seventh Plan.

Fifthly, the negative saving of the government administrative department increased from 1.43 per cent in the Seventh Plan to 2.7 per cent during the period 1992-93 to 1994-95. This, of course, is a reflection of the rising magnitude of revenue deficit in the general government budget, which was 3.3 per cent of GDP for center alone during this period. However, the saving of public enterprises sector showed a distinct improvement, accounting for 3.95 per cent in the post-reform era compared to 3.78 per cent and 2.43 per cent in the Seventh and Sixth Plans, respectively.

Sixthly, the aggregate investment rate in 1960s was 15.6 per cent, and in 1970s it was 19.1 per cent. It was in the 1980s that this rate went up to an average of 22 per cent, and as a result, the GDP growth rate also edged up to the range of

5.5 to 6.0 per cent. The eighth Plan envisaged an aggregate investment rate of about 23.2. per cent, and in the first three years our performance in fractionally higher than planned. Our rate of growth is close to what we planned so far- around 5.5 per cent. The incremental capital output ratio is virtually stagnant at a little over four, in the Sixth, S3venth and Eighth Plans.

Briefly stated, our rate of growth is determined by investment, given a somewhat constant Incremental Capital-Output Ratio (ICOR); and prospects for growth will improve only if the domestic saving rate, which is a predominant portion of the investment rate, is raised and efficiency improved.

Some Comparisons

It would be useful to attempt a comparison of our saving and investment performance with some of the fast growing Asian Economies. I will list some for enabling one to obtain policy insights.

(a) The domestic saving rate in the Indian economy is far below as compared with that of the East Asian economies such as Indonesia, Malaysia, Thailand, Singapore, China and Korea.

The newly industrialized economies and most of the countries in South-East Asia exhibit domestic saving rates of over one-third of GDP, among the highest in the world. While the average saving rate in Indonesia, Malaysia, Thailand and Korea was between 35-38 per cent during 1991-95, that of China and Singapore ranged between 40-48 per cent. An exception has been the Philippines where the saving rate fell from 24 per cent in 1995 for several reasons including the political turmoil in the 1980s and a series of natural disasters.

(b) High domestic saving rates, which have recently been supplemented by large inflows of external capital are major factors in the economic success of many of the Asian economies. However, despite the recent increase in external capital inflows, domestic saving continues to finance about 90 per cent of investment.

(c) A notable feature of the high saving performance of the East Asian economies is the high rate of saving by the government sector in these economies. For instance, in Malaysia, government saving showed a drastic improvement from 1.4 per cent of GDP in 1985 to 5.7 per cent of 1993 and constituted around 16 per cent of gross domestic saving rate in the economy.

(d) In contrast to the South-East Asian economies, our South Asian neighbors have very low domestic saving rate, ranging between 8.0-15.0 per cent of GDP in 1995. In contrast, investment in these countries ranged between 15.5-26.3 per cent, reflecting their heavy dependence on external assistance to meet their investment needs.

(e) The achievement of high rates of growth in South-East Asian economies is mainly explained by the faster rate of capital accumulation. The incremental capital output ratios, implied from the Gross Domestic Investment and real GDP growth rates in respect of Indonesia (5.17), Thailand (5.04), Singapore (5.07) and Korea (5.44) during 1991-95, were higher than that in India. China with an average ICOR of about 3.6 during the period 1991-95, however showed higher rate of productivity gains than some of the East Asian economies ad India. Nevertheless, on the productivity front, the achievement of the Indian economy in the recent period is comparable with the East Asian economies and other developing countries. This reflects the idea that the constraints to growth of the Indian economy stems mainly from the slow rate of increase in capital stock. The constraint would be greatly eased if there is a simultaneous improvement in productivity.

Household Saving

There are a number of factors that influence the household saving. It would be useful to recall each of the factors and their relevance to our conditions on judgmental basis and to focus on those factors that are amenable to policy measures.

First, the growth in income is an important factor in determining the saving rate. This appears to be equally true in India, particularly on the basis of trends in the recent past.

Secondly, income distribution has an impact on the saving rate. Redistribution policy may temporarily dampen the saving rate. But the secondary or dynamic effects of such redistribution on efficiency could be different, though this may not be easily amendable to quantifications. There could, therefore, be a conflict between policies to bring about immediate improvements in saving and policies towards redistribution. Further, it is often argued that globalisation results in consumerism which in turn reduces saving rate. This impressionistic observation is, however, not supported by empirical evidence.

Thirdly, macro-economic stability in general and inflation in particular is known to have an impact on saving. There are controversies as to the exact nature of the relationship between the two. However, the rate of inflation beyond a point or volatility in prices does have a negative impact on saving.

Fourthly, the efficiency of financial intermediation has a strong relationship with the saving rate. In particular, financial saving is promoted by ensuring an adequate return relative to other physical and other forms of s saving. It is necessary to ensure that savers perceive that there is not erosion in the real value of their saving: this will to an extent be taken care of if the interest rate regime is not artificially repressed. Some studies have shown that in India there is a positive relationship between interest rate and financial saving. There are, however, some who argue that interest rate has no impact on saving; more important there are a few who argues that a large increase in interest rate might even adversely affect saving, since a target income can be obtained with a lower level of saving. Empirical evidence is not clear on the direction of the impact, but in our case a reasonable return on saving seems to enhance the financial saving.

Fifthly, it is also argued in some quarters that rapid improvement in government saving dampens the household saving. Empirical evidence in general and available findings in India do not indicate such an inverse relationship.

Sixthly, it is noticed that higher the proportion of working population to the total population, greater is the saving rate. On this count we must be aiming for larger employment opportunities which are likely to enhance the saving rate.

Seventhly, there are strong social influences such as the role of extended family and the societal values placed on the saving rate in terms of inter-generational obligations. In this regard we continue to have a strong bias in favour of saving.

Eighthly, availability of insurance and tax benefits are also known to have a positive effect on saving. Studies have shown that tax benefits have contributed substantially to the increase in financial saving.

Finally, a factor generally contributing to higher saving rate relates to what may be termed as contractual saving, mainly PF and other contributions. There is substantial scope for increasing contractual savings in our country. This could be an important instrument for improving long term financial saving. Such savings, being of long-term tenor, are critical to finance our infrastructural needs now.

In brief, therefore, it is clear that the level of saving rate and the improvement in saving rate depend on a number of socio-economic and other related matters. In the short and medium term, however, it is the policy related aspect that determines household saving. Assuming a continued output growth of 6-7 per cent, and an inflation rate of about 6 per cent, coupled with improvements in the financial intermediation, it is reasonable to expect the household saving rate to improve further. However, supplementary initiatives in terms of policy instruments providing for tax incentives and improvements in contractual saving may be required to ensure that the household saving rates is around 19 to 20 per cent.

Private Corporate Saving

The growth of private corporate saving is determined as much by macro-environment as by micro-conditions at the firm-level. There are a few factors relevant to us in making an assessment of prospects.

First, the growth of corporate sector as a whole, which in our case has been accelerating in the post-reform period.

Second, the growth of corporate income which had seen large increases for a while was followed by some deceleration. However, competitive pressures, apart from infrastructural bottlenecks, could result in thinner margins for corporate, unless compensated by efficiency.

Third, the tax treatment has a strong influence on incentives to plough back profits. In fact, improvements in corporate saving in the recent past, could be attributed at least in part, to a more favorable tax regime.

Finally, macro-economic stability and policy-stance especially in regard to interest rates and exchange rates would influence a corporate's decision to invest and to plough back profits. In terms of prospects a favorable macro-economic environment should help corporate saving to increase substantially from the average rate of 3.4 per cent in the Eighth Plan so far - which is itself a great improvement over the Seventh Plan average of 2 per cent. Hence the corporate saving could be in the range of 4.0 to 4.5 per cent of GDP in the next Plan period.

Public Saving

Public sector saving will have an important bearing on the total saving performance of the country, and the success in this regard would depend on strong fiscal management. The contribution of public sector saving has to be analysed at

the center, state and local government levels and in terms of government sector and public enterprise sector.

In regard to government administration, the tax-GDP ratio of the centre had come down an average of 11.2 per cent in late eighties to 10.2 per cent during the last five years. This is partly explicable by the fact that the adjustment process required substantial reduction in customs duty. Since much progress has already been made in this area, it should be possible to expect an upward movement in this ratio. Coupled with efforts to extend the tax base and inculcating basic compliance culture, it should be possible to target a ratio that was achieved in late eighties at 11.2 per cent. With a healthy growth in GDP, it should be possible to achieve a higher ratio of 11.5 per cent. However, in regard to state governments, their tax-GDP ratio has been 5.7 per cent and considering the inelastic nature of their resource base it may be unrealistic to expect any substantial improvement in this ratio and at best 6 per cent could be hoped for.

The critical part of the fiscal management relates to expenditure. In the Central Government, the non-discretionary expenditures, particularly interest payments, account for the single largest item. More important, the debt already incurred is in the overhang and interest rates have already been set on these debts. Hence, the scope for reduction in expenditure on this account is limited and is governed by the incremental cost of additional borrowings. The cost of such fresh borrowings would critically depend on inflation, particularly the inflationary expectations as well as the extent of fiscal deficit. Similarly, the wage bill in the government is essentially a committed expenditure except at the increment. The direct and indirect subsidies would appear to be a major area of discretionary expenditure. However, there has been a substantial under-funding of maintenance in the past, necessitating adequate provisions in future to avoid erosion of the value of the capital assets both at the central and state levels.

As regards state governments, it will be difficult to envisage substantial reduction in expenditure if adequate emphasis has to be given on education and health. In fact, most of the expenditure on these heads are in terms of wages and hence in the nature of non-discretionary expenditure. The cost recovery, particularly in the area of water will be critical to finances of the state. Overall, however, the functioning of the state governments is closely linked to the delivery of services and improvement in efficiency is more important than reduction in expenditure. Indeed,

since the state governments provide most of the public goods, including law and order, it would be in appropriate to suggest reductions in this expenditure.

In respect of public enterprises, their contribution during the ninth Plan may be enhanced if efficiency improves and market orientation is assured. At the same time, dividends from the equities held by the Government in the central public enterprises would be reduced to the extent privatization has occurred. Incidentally, there may be a need to have a higher dividend than in the past to maintain their attractiveness in the capital market.

As regards, state public enterprises, the critical factors relate to user fee or cost recovery, particularly in regard to Electricity Boards and Transport Undertakings which together have about two-third of the investment and employment instate public enterprises. Unless there is a dramatic change, their contribution to saving would continue to be negative.

To assess the prospect, it would be necessary to know that the public sector saving assumed for the Eighth Plan was 2 per cent of GDP while the realization so far is 1.3 per cent. Hence it is reasonable to assume that the public sector saving would be in the range of 2-2.4 per cent.

Foreign Saving

The level of foreign saving will depend as much on our own policy environment as on the global developments. In assessing the prospects, three factors are important.

First, the current account deficit should be such that it can be financed by normal capital flows. Since the share of foreign trade is relatively small, we should be cautious in setting the level of the sustainable current account-GDP ratio.

Second, the flow of foreign saving would be enhanced if the economic fundamentals are regarded as good. Since domestic saving forms part of such fundamentals it being at a comfortable level would be of help. Foreign saving thus would not be a substitute but a supplement.

Third, the overall creditability and sustainability of macroeconomic policies matter a great deal for a sustained flow of foreign saving. The policy and regulatory environment needed for attracting large foreign saving should also take into account the time needed to prepare the local institutions and industry to compete and collaborate. No doubt, this is a transitional phenomenon, which may affect the early part of the Ninth Plan.

It may, therefore, be realistic to assume foreign saving in the range of 2.0 to 2.4 per cent of GDP as against the Eighth Plan target of 1.6 per cent (and actual being far less due to adjustment programme).

Scenarios

From the analysis, it is very clear that, under the most optimistic scenario the saving would be 20 per cent in respect of households; 4.5 per cent in regard to corporate sector; 2.4 per cent in respect of public sector and 2.4 per cent in respect of foreign saving. This would give a saving rate of 29.3 per cent. Assuming that ICOR would be four, we could aim for a growth of 7.3 per cent. However, under not so optimistic scenario, the growth rate would be lower. Assuming the ICOR to be 4 per cent, a 6.5 per cent growth would be possible even if the overall investment rate is 26 per cent. This is the minimum that one needs to aim at. As Dr. Rangarajan, Governor, Reserve Bank of India has mentioned in Calcutta, "Over the medium term to maintain the growth rate of 6.5 per cent or even better, we need to address two major constraints. One is with respect to saving and the other with respect to infrastructure facilities. Given the need to contain the current account deficit at around 2 per cent of GDP, a high growth rate can be sustained only if the domestic saving rate goes up. Among the components of saving, the one that would particularly need attention will be public sector saving."

New Realities

In making any assessment of saving and growth, it is necessary to recognise the general reform ambience in which the economy is placed.

First, there are constraints on the freedom of action in the context of the globalisation of Indian economy.

Secondly, reform implies larger role for the government in social sector and perhaps infrastructure, and in both, the role of the states would be larger than that of the Centre. These should be reflected in investment needs and expenditure projections.

Thirdly, more than direct investment in public sector, the role of policy preconditions and procedures for achieving faster growth with stabilisation needs to be recognised.

Fourthly, the importance of price stability in the context of globalisation and possible adverse implications for inflationary expectation and the interest rates

should be appreciated. Price stability is critical not only as an 'anti-poverty measure' but also for maintaining a competitive level of real exchange rate in the economy, since our trade-partners are moving towards low inflation targets. It is also necessary for sustaining the desired rate of growth.

Fifthly, the analysts of our economy would look at both the quantitative and qualitative dimensions of fiscal reform. Reducing fiscal deficit by constraining capital expenditures could harm the growth process, particularly in the transition towards effective private sector participation. Also, reducing fiscal deficit by constraining provision of public goods, especially education and health, would be similarly counter-productive. In effect, hard choices have to be made between subsidy for power and primary education as also between subsidy for water and primary health.

When we speak of growth scenarios, there is a justifiable concern for poverty issues. Here, we may recall what Professor Suresh Tendulkar has recently said: "In the Indian context, however, competitive populism practiced by all political parties would end up providing short-term palliatives against poverty at the cost of the long-term cure i.e., rapid growth, because the mostly non-poor, politically vocal and influential organised sector workers have been successfully evading the pains of stabilisation and structural adjustment. Obviously, a slow-down in the rate of economic growth is the inevitable consequence, with adverse impact on the long-term cure for poverty." Perhaps Professor Tendulkar is suggesting that policy makers have to tackle what has been described as "the tyranny of ten per cent," i.e. of the proportion of work force in the organised sector.

The Critical Issue

The prospects are bright if we can ensure sound macro-economic policies coupled with effective institutional as well as regulatory measures operating at the micro-level. There is also need to ensure quick responses to global developments as well as market realities within the country.

In the Ninth Plan period, the rewards of sound macro-economic management appear to be high. More important, the penalty for inappropriate or delayed policy responses and ineffective instruments could be severe.