Trends In Gross Domestic Savings And Gross Capital Formation In India

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Abstract
Savings and capital formation are the two prominent variables that influence an economy's growth. India's saving performance is quite impressive due to the good saving habits of Indian households, which supported the economy during the tough time of the global meltdown in 2008. The Indian economy is more resilient due to periodic reforms and can absorb shocks. This study explores the relationship between gross domestic savings and gross capital formation in India by using annual data from 1950-51 to 2021-22. The average of five-year intervals is taken to calculate sector-wise data of gross domestic savings (GDS) and gross capital formation (GCF). A correlation matrix is used to validate the relationship among the variables. Further analysing the sector-wise trend in gross domestic savings and gross capital formation, the study concluded that there is a strong relationship between gross domestic savings, gross capital formation, and gross domestic product. Household and private savings have higher contributions to GDP, and physical assets of the household sector have a higher degree of relationship with GDP concerning financial assets. In the case of gross capital formation, the household sector has a significant role throughout the period under study, especially in real estate (housing) and small-scale industries. The figures of the last decade indicate that the contribution of the public sector contracted and the role of private and household sectors dominate the economy. The household sector makes a major contribution, followed by the private and public sectors in GDS and GCF.

***Key Words** – Gross Domestic Savings (GDS); Gross Capital formation (GCF); Gross Domestic Products (GDP); Household sector; Private Sector; Public Sector.*

I. Introduction

India has emerged as the fifth largest economy in the world, with a nominal GDP estimated at \$3.937 trillion, and the third largest by purchasing power parity (PPP) estimated at \$14.59 trillion. GDP is considered a variable for India's economic growth. Savings and capital formation are the two prominent variables influencing an economy's growth (Patnaik & Pandey, 2019). Saving is that portion of income which an individual does not spend for consumption but instead keeps aside for future contingencies and investment purposes. The estimation of savings in India was performed by prominent institutions like the Reserve Bank of India (RBI), the Planning Commision, Central Statistical Organisation (CSO), and National Council of Applied Economic Research (NCAER). They prepared the estimates merely at current prices and by the type of institution, i.e., Public, Private and household sector. The household sector is broadly classified under two categories - Physical Savings and Financial Savings. Financial savings are the composition of currency, bank deposits, Life insurance funds, provident funds, pension funds, shares & debentures and mutual funds. Physical savings include investments in land, buildings and gold. The estimates of savings of the public sector are available in the government budget documents and annual reports of the enterprises. Estimates in respect of the private corporate sector are based on annual accounts of sample companies duly adjusted for full coverage based on data on the paid-up capital of all companies. Capital formation is classified into two heads: Gross Fixed Capital Formation (GFCF) and Increase

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in Stocks. GFCF of India has further classified into the following sectors: a. Construction - Building Construction & other construction and land improvement and development of plantation and orchid b. Machinery and equipment; c. Additions of all kinds of live-stocks i.e., breeding stocks, drought animals, dairy cattle and other live-stock.

The estimates of capital formation in India are prepared by the Central Statistical Organisation (CSO) in three forms: (i) by type of institution, (ii) by type of asset, and (iii) by industry of use. In the estimation of capital formation by types of institution, the Indian economy is divided into the Public, Private and Household sectors. The estimates are first prepared for the Public and Private sectors, and the residual is for the household sector. In the method of estimation by types of assets, CSO uses the commodity flow method.

The saving performance of India is quite impressive, and the household sector plays a major role in it. Nowadays, RBI is concerned over the shift of household savings from bank deposits to alternative investment avenues like mutual funds, insurance funds, and pension funds[3]. It found that with time, newer financial options were introduced in the market to encourage people to take more risks for better returns[4]. Due to the good saving habits of Indian households, they supported the economy during the tough time of the global meltdown of 2008 (Suri & Hada, 2018). The Indian economy has demonstrated multiple shocks and events like economic crisis (1991), Asian financial crisis (1997), Dot-com bubble burst (2000), Global Financial Crisis (2008), European Sovereign Debt Crisis (2010), Demonetization (2016), Goods and Services Tax (GST) (2017), COVID-19 Pandemic (2020), Russia- Ukraine war and Global Energy Crisis (2022), and Monetary Tightening by Global Central Banks (2022-23) shapes the India's economic landscape, and depict the growth trajectories and socio-economic situation of the nation. These domestic and foreign shocks since independence pushed millions of people into abject poverty and deprivation. Short-falling in rainfall and fiscal profligacy were the domestic and oil price hikes, world trade and capital flow shocks, which were the foreign shocks that affected economic growth (B.B. Bhattacharya & Sabyasachi, 2005). The Indian economy is more resilient due to periodic reforms and can absorb shocks. There is a strong relationship between gross domestic savings, gross capital formation, and gross domestic product. Furthermore, GDS and GCF have a significant influence on GDP performance. Household and private savings sectors have higher contributions to GDP, and the physical assets of the household sector have a higher degree of relationship with GDP concerning financial assets (Reddy Pujari et al., n.d..). Macroeconomic theories leave room for ambiguity regarding the causality and long-run relationship between savings and investment. The question is whether savings cause investment or investment causes savings (Kumar K, n.d.). From the classical era, savings have been considered one of the prominent growth factors and provide a cushion of security against future contingencies (Sivakumar & Marimuthu, 2023). Classical economics supports the supply-side argument and considers savings to be the primary driver of investment. Keynesian economics holds up the demand-side argument and contends that investment drives savings. Economists have conflicting views, although modern economists have a balanced perspective. This study examines the relationship between gross domestic savings and gross capital formation with gross domestic product. It also analyses the sector-wise trend in gross domestic savings and capital formation.

II.   Data Source And Research Methodology

This study explores the relationship among the household, private and public sectors of gross domestic savings and capital formation and their share in the nation's economic growth. The period covered under the study is from 1950-51 to 2021-22 using annual data collected from the Handbook of Statistics on Indian Economy published by the Reserve Bank of India, World Development Indicator and National Account Statistics (NAS) on selected variables such as gross domestic savings (GDS), gross capital formation (GCF) and gross domestic product (GDP). The average of five-year intervals is taken to calculate sector-wise data of gross domestic savings (GDS) and gross capital formation (GCF) by using Microsoft Excel. 1952-53 is considered the beginning year for GCF under the study. A pertinent time series analysis is possible since the period of annual data is long enough. Numerous graphs and tables are used to represent the trends. A correlation matrix is used to validate the relationship among the variables.

III.   Analysis And Findings: Gross Domestic Savings And Gross Capital Formation

The gross domestic savings and gross capital formation as a percentage of gross domestic product and provides the relevant information from 1950 -51 to 2021-22 (refer fig. 1). The share of domestic savings and capital formation has steadily improved over time, from a shallow base of 9.4% and 10.1% in 1950 to 30.2% and 31.4% of GDP in 2022, respectively. The highest saving ratio was 37.8% in 2007-08, and the lowest was 7.9% in
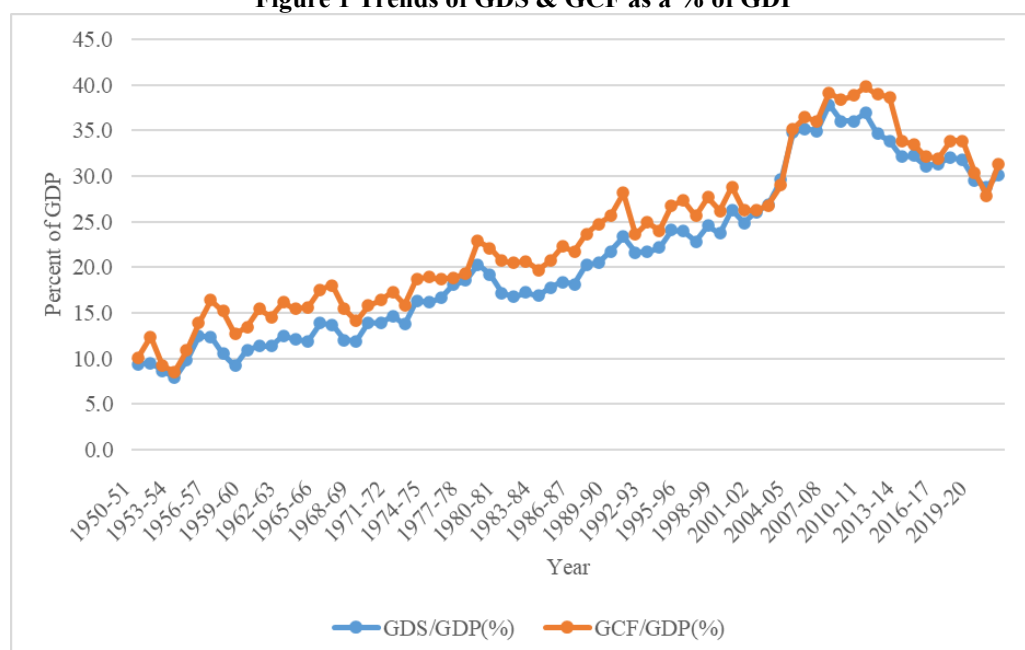
1953-54. For capital formation, 39.8% was the maximum ratio in 2010-11, and 8.5% was the minimum in 1953-54.

Figure 1 Trends of GDS & GCF as a % of GDP

Source: Compiled by author
Data Source: RBI handbook of statistics 2022-23

During the entire period, the saving ratio more or less remained lower than the investment ratio. Savings & capital formation are highly positively correlated (0.98). The share of net capital inflow accounts for 2.4% of gross capital formation. Net capital inflow from abroad is the nation's deficit on the current account in the balance of payment account, excluding official transfer payments. The first five-year plan (1951-56) was centered on the Harrod-Domer model that aimed to accelerate economic growth through raised savings and investments (Kumar Jana, n.d., 2023). However, from 1953 to 1956, savings escalated from 7.9% to 12.4%, whereas investments made a quantum leap from 8.5% to 16.4%. The good harvest in the latter two years of the plan was the primary aspect that made it successful. After that, since the inception of the Second Five-Year Plan observed a declining trend in savings and investment due to License Raj, the Mundhra Scandal of 1957 (The first big free India financial scam), and the Suez Canal crisis in 1956 (India's 70% of imports and 60% of exports moved through the Suez Canal) (Singh, 2018). India has a substantial deficit in its balance of payments. By the end of December 1957, India's foreign exchange reserve had dropped from $1.57 billion at the end of March 1956 to $626 million (Sarma, n.d..). After that, three years of annual plans were rolled out, referred to as the "Plan Holiday" from 1966-69 immediately after the war with Pakistan in 1965. The failure of the Third Five-Year Plan and the Indo-Sino War led to significant economic disruptions. In this period, India faced worsening food shortages, a sharp spike in inflation, and Indira Gandhi devaluing the Indian Rupee by a sharp down of 57%. There was a constant need to import food grains or to seek foreign aid, which posed a serious risk to Indian politics. At the same time, in 1969, 14 private banks were nationalized, which infused financial support, access to credit for priority sectors, financial inclusion and increased the accessibility of banking facilities, which helped mobilize savings from the public. After the fifth five-year plan, the Janta government proposed a rolling plan for 1978- 80[5]. The percentage of savings declined from 20.3% in 1978 to 16.8% in 1981. Due to economic uncertainties, lack of confidence in government policies, fluctuations in interest rates, rising inflation, hikes in consumer spending, and a lack of attractive investment opportunities are the prominent causes of the reduction in savings and investment. During the seventh five-year plan (1985-1990), GCF and GDS spiked from 21.7% to 28.2% and 18.2% to 23.3%, respectively. There are several reasons, but one conspicuous reason is in the 1985-86 budget, the government

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[5] Ministry of Statistics and Programme Implementation. Statistical year book India 2018. Chapter 7.
https://www.mospi.gov.in/sites/default/files/Statistical_year_book_india_chapters/ch7.pdf

lowered the rates of income tax and raised exemption limits for personal income tax[6]. After the assassination of Indira Gandhi in 1984, her son Rajiv Gandhi took over as prime minister. He was widely credited for ushering in the nation's telecom and information technology revolutions. Before 1991, India had a closed capital account, i.e., restricted capital mobility (Kholi, 2001). India's balance of payment situation had deteriorated sharply by the end of 1990. Foreign exchange reserves began to decline in September 1990. It was US$3.11 billion at the end of August 1990 to US$896 million on 16th January 1991 (Kolte & Simonetti, 2018). The 1991 economic crisis, which was the worst ever, slipped the country's GCF from 28.2% to 23.6% within a year. The country had to sell 20 tonnes of gold on the international market for $234 million for the first time to meet a foreign exchange crisis. To raise the loan for US$405 million, the Reserve Bank of India committed 46.91 tons of gold with the Bank of Japan and the Bank of England in July 1991[7]. RBI redeemed this loan and repurchased all the gold by December 1991. The Narasimha Rao-led government, with Finance Minister Manmohan Singh, launched economic reforms, including dismantling the license, Raj. The first decade of the 21st century reflected that India's capital formation and savings shot up from 26.8% to 39.8% and 26.8% to 36.9%, respectively, from 2002 to 2010. India's tenth five-year (2002-2007) plan has recorded the highest spike in gross domestic savings rate as the public sector savings turned positive in this period. India experienced strong GDP growth during this period, averaging around 7% annually. Higher growth contributed to increased savings by households and businesses (Misztal, 2011). Numerous government policies like the Golden Quadrilateral highway project, tax reforms such as the introduction of Value Added Tax (VAT) and the Fiscal Responsibility and Budget Management (FRBM) Act of 2003 helped in improving fiscal discipline, stable interest rates and moderate inflation environment attract the consumers to save more and moderate private corporate savings increased to 8.2% from 3.9% in 2001-02. Foreign Direct Investment (FDI) increased significantly from $4 billion in 2002 to over $27 billion by 2010, fueled by capital formation. Post-2010, India experienced declining saving and capital formation trends due to "policy paralysis" during 2011-2013. Several high-profile scandals, such as the 2G spectrum, Commonwealth Games scam and coal block allocation scams, shackled the Indian economy (Sen et al., 2019). India's slowdown in investment is worrisome, and many investment projects being delayed and shelved is a concerning issue[8]. Shah Commission, constituted in 2010, found evidence of enormous and large-scale multi-stage illegal mining of iron and manganese ores. As a result, the capital formation rate decreased, which made investors hesitate and reduced confidence. In the second decade of the 21st century, gross capital formation plunged from 39.8% to 27.9% in 2020. India's GDP contracted by 6.6% in the fiscal year 2020-21, reflecting the worst impact of the Covid-19 outbreak[9]. The nationwide lockdown halted economic activities and crippled the service sector. The economy rebounded in FY2021- 22, with GDP growth of 8.9% compared to 6.6% in 2020-21[10]. In 1979, Feldstein and Horioka found a significant correlation between a nation's domestic savings and investment rates (Feldstein & Horioka, 1979). The key indicator of the financial integration of a nation with the global community is the level of capital mobility. In an ideal world with perfect capital movement, there is little or no correlation between domestic savings and investment in a country. International differences in domestic savings rates led to equivalent variations in domestic investment rates (But & Morley, 2017; Feldstein & Horioka, 1979).

Sector-Wise Gross Domestic Savings

Domestic savings in India are divided into three sectors: Household Sector Savings, Private Sector Savings, and Public Sector Savings. The available data shows that the household sector has the lion's share in India's total domestic savings, followed by the private and public sectors. The household sector is further classified into two heads: Financial Savings and Physical Savings. Financial savings are the composition of currency, bank deposits, Life insurance funds, provident funds, pension funds, shares & debentures and mutual funds. At the same time, physical savings include investments in land, buildings and gold.

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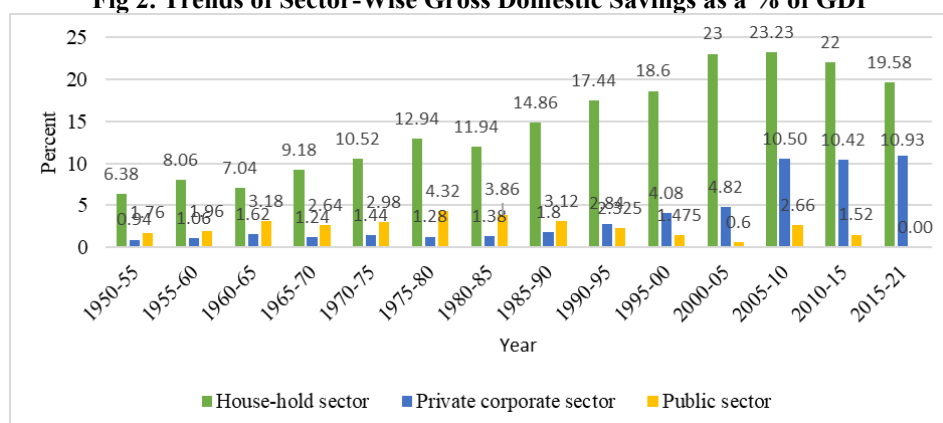[8] India's Investment Slowdown: The High Cost of Economic Policy Uncertainty. IMF Blogs. 25 March 2014.
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Fig 2. Trends of Sector-Wise Gross Domestic Savings as a % of GDP

Source: Compiled by author
Data Source: National Account Statistics (NAS).

Table 1: Summary of Gross Domestic Savings

Last Year	Previous Year	Min.	Max.	Unit	Frequency	Range
30.2 (2023)	31.2 (2022)	7.9 (1953-54)	37.8 (2007-08)	%	Annual	1950-2023

Source: Compiled by author

Figure 2 represents the sector-wise domestic savings as a percentage of GDP from 1950 to 2021 based on an average of five years. The share of the household sector was merely 6.38% of GDP in 1950-55; after that, it scurried to 19.58% of GDP in 2015-21. The maximum percentage was 23.23% of GDP in 2005-10, which was the phase of the global meltdown. When world economies were in deep crisis, India's household savings sector played the role of saviour. The contribution of the household sector is dominant, followed by the private and public sectors, respectively (K & P, 2015; M. Yadagiri & G. Srinivas, 2015). The share of the private sector was 0.94% of the GDP in 1950-51, which shot up to 10.93% in 2015-21. However, the public sector's contribution towards domestic savings has deteriorated in the last two decades. From 1950 to 2022, the public sector's contribution to domestic savings has varied from 0% to 4.32% of the GDP. The share of the public sector savings is meagre due to higher government expenditures relative to income. The public sectors operate under a fiscal deficit, leading to borrowing rather than savings (Rangarajan & Srivastava, 2004). The public sectors allocate a larger proportion of their revenue for social welfare programs, subsidies, and interest payments, leaving little room for savings. In 1951-52, public sector savings were 2.4% of GDP, the highest in the entire decade. Chin Taman Dwarakanath Deshmukh presented his first interim budget for 1951-52. He proposed an overall rise in taxes, including corporation tax and all income tax and super-tax rates, of a 5 percent surcharge (Tovar Jalles, 2022). During the early 60s, the share of the public sector improved significantly and varied between 2.8% to 3.5% of GDP. The growth rate of saving hikes in the household sector with the nationalisation of the major commercial banks and the establishment of Regional Rural Banks in 1975 boosted the savings in the non-departmental enterprises of the public sector. Public sector savings as a proportion of gross domestic product peaked at 4.7 per cent in 1976-77, declined after that, came to 0.4 per cent of GDP in 1998-99 and turned negative (-0.7) in 2000-01 (Nagaraj R, 2006) Public sector savings drifted downward after the sixth five-year plan due to defence expenditure growth, interest payment and subsidies. Public sector savings turned negative in 2000, 2001 and again in 2019 and 2020 due to several economic challenges driven by structural changes, financial shocks, and fiscal policies. In the late 1990s and early 2000s, India experienced fiscal stress due to high government expenditures, which were distinctly in subsidies, salaries, and interest payments[11]. This led to a widening fiscal deficit and pushed public sector savings into negative territory. In 2000-2001, the collapse of the dot-com bubble burst led to an impact on corporate profits, declining investment and a significant economic slowdown. After introducing the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, public sector savings showed improvement (Reddy, 2008; Seth et al.., 2020). Lower dis-savings by public authorities and improvement in non-departmental enterprises' savings generated significant savings in the public sector[12]. From 2019 to 2020,

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[11] Ministry of Finance – Economic Survey 2001-02
https://www.indiabudget.gov.in/budget_archive/es2000-01/general.htm
[12] Report of the High Level Committee on Estimation of Saving and Investment.

structural and external factors badly hit public sector savings. The global recession and COVID-19 pandemic led to substantial economic disruptions. To overcome these challenges, the government should escalate spending. Tax revenue declined due to the contraction in economic activities. Furthermore, non-performing assets (NPAs) in the public sector banks and financial stress weakened the ability of the public sector to generate positive savings. The public sector is more incompetent than the private enterprises due to bureaucratic inefficiencies, misallocation of resources, corruption and a higher public debt-to-GDP ratio (Seth et al., 2020). These are a few dominating causes of low-level public sector savings.

Table 2: Correlation matrix of sectors of GDS

	Household sector	Private Sector	Public Sector	GDS
Household sector	1			
Private Sector	0.760640969	1		
Public Sector	-0.426005522	-0.389441295	1	
GDS	0.950269943	0.898703306	-0.29420419	1

Source: Compiled by author

The following results show the relationship between gross domestic savings and its different sectors, namely, household, private, and public (refer table 2).

Household sector - The correlation of the household sector with itself is always one because of the same data. At the same time, the private sector has a positive association (0.76). This implies that the private sector performs well when the household sector does well. On the contrary, the relationship with the public sector is -0.42, a negative association. This indicates that the public sector may worsen when the household sector performs well. The relationship between GDS and households reflects a highly positive association (0.95). Consequently, GDS expands in tandem with the household sector's growth. Private Sector - A weak negative association (-0.38) between the public and private sectors suggests a slight propensity for the public sector to underperform when the private sector does well. Thus, a considerable positive correlation (0.89) exists between the private sector and GDS. i.e., the private sector expands, GDS also. Public Sector - The household and private sectors negatively correlate (-0.42) and (-0.39) with the public sector. This implies that the public sector may have difficulties when both sectors are doing well. The public sector also negatively associates (-0.29) with GDS.

GDS has a strong positive correlation with the household and private sectors, but it has a negative correlation with the public sector.

Sector-Wise Gross Capital Formation

According to Rangarajan and Dholakia's (2009) report of the high-level committee on the estimation of saving and investment, three methods are used to estimate gross capital formation (GCF). The first method is the financial side, which involves adding up savings and net capital inflow from overseas (represented as the current account balance in the balance of payments). The second method is the commodities flow method. Lastly, the expenditure method is the net acquisition of fixed assets and changes in stocks by industries. The sum of savings and net capital inflow is taken as the GCF estimate (Seth et al., 2020). Gross capital formation refers to the total of gross additions to fixed assets or fixed capital formation and increases in inventory stocks- referred to in the National Accounts Statistics (NAS) as "change in stocks" during the period of account and net acquisition of valuables. In general, there are two categories of fixed assets: construction and machinery & equipment[13]. The estimates of gross capital formation by institutions are further categorised into the Household, private corporate, and public Sectors. The expenditure method used for the estimation of the public sector and private sector is based on the analysis of budget documents and companies' annual reports. Public and private sector estimates include co-operatives by the types of assets (construction and machinery & equipment) deducted from the total estimates obtained through the commodity flow method to calculate the estimates for the household sector as a residual (Seth et al., 2020).

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https://www.mospi.gov.in/sites/default/files/publication_reports/HLC_report_25mar09.pdf.

[13]National Accounts Statistics-Sources & Methods, 2007 "Chapter 25"
https://mospi.gov.in/sites/default/files/reports_and_publication/statistical_manual/Chapter%2025.pdf

Fig 3. Trends of Sector-Wise Gross Capital Formation as a % of GDP
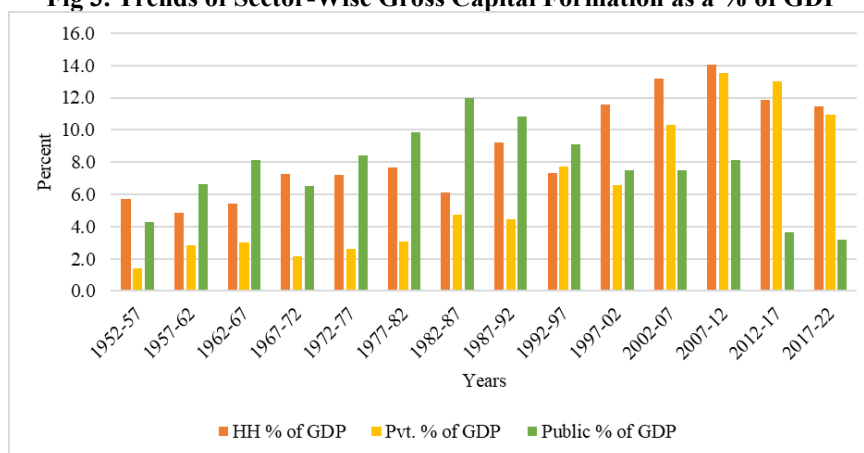
Source: Compiled by author
Data Source: Central Statistics Office (CSO).

In an emerging country, for instance, India, the pace of capital formation has a major impact on an economic growth trajectory. Domestic investment has consistently outpaced savings, while the foreign capital inflow offsets the shortfall and maintains a sustainable current account deficit. The government and private sectors are the net borrowers, whereas the household sector is a net lender as well as net saver. The amount of household sector in gross capital formation was maximum (27690.44 bn.) in 2021-22; for the private sector, the GCF was maximum (25362.17 bn.) in 2021-22, whereas in the public sector, the GCF was maximum (7027.11 bn.) in 2018-19 (refer fig. 3). After independence, the public sector dominated capital formation to shape India's economy through state-led development strategies. A major focus was on self-reliance and planned industrialisation. The public sector played a dominant role, especially through investment in infrastructure, heavy industries, and large-scale public enterprises. In the early post-independence (1950s to 1970s) era, the role of the private sector was limited, constrained by heavy regulation, state control, and a main focus on social welfare. Before the 1970s, households and the public sector dominated. Since the 1970s, the contribution of the household sector has grown steadily due to policies encouraging small-scale industries and rural development programs. The 1991 economic reforms, under the leadership of P.V. Narasimha Rao and Finance Minister Manmohan Singh, significantly shifted the composition of capital formation. The shift from state-controlled economies to a more market-oriented system by liberalisation, privatisation and globalization (LPG) policy assists in improving the role of the private sector. Information technology, telecom, manufacturing, and finance sectors drive rapid growth. After 1995, the dominance of the public sector in gross capital formation shifted towards the private sector due to inefficiencies, fiscal constraints, and a growing need for better productivity scale-down direct public investment. During the 1990s and early 2000s, there was rapid growth in the private sector, driven by information technology, telecom, manufacturing, and finance. Liberal trade and investment policies boost private investment in capital formation. Especially through public-private partnerships (PPP), the rebalancing approach was adopted by the public sector and improved the involvement of the private sector in infrastructure projects. The household sector has a significant role throughout the period, especially in real estate (housing) and small-scale industries. The figures of the last decades from 2011 indicate that the contribution of the public sector contracted and hovered around 8 – 10 per cent and the role of private and household sectors dominate the economy.

IV.   Conclusion

This study explores the detailed reasons to establish the relationship between gross domestic savings and gross capital formation concerning gross domestic product in India by using annual data from 1950-51 to 2021-22. The paper represents the trend analysis of gross domestic savings and gross capital formation with an in-depth explanation of the major upward and downward trends experienced by the Indian economy since 1950. The saving performance of India is quite impressive, and the household sector plays a major role in it. There is a strong relationship between gross domestic savings, gross capital formation, and gross domestic product. Household and private savings sectors have higher contributions to GDP. In the case of gross capital formation, the household sector has a significant role throughout the period under study, especially in real estate (housing) and small-scale industries. The statistics of the last decades from 2011 indicate that the contribution of the public sector contract and the role of private and household sectors dominate the economy. The study concluded that the household sector has a major contribution, followed by the private and public sectors in GDS & GCF. The public sector's contribution to gross domestic savings and capital formation is meagre, which should be improved.

Statements and Declarations

The authors declared that no competing financial or non–financial interests could have appeared to influence the work reported in this manuscript.

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