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Slipping foundation

Inflation is undermining the capacity of the common man to save, says **Uttam Gupta**

A startling revelation in the quick estimates of the Central Statistical Organisation is the steep decline in investment (at 1980-81 prices) by the household sector — from Rs 23,550 crore in 1990-91 to Rs 11,083 crore in 1993-94.

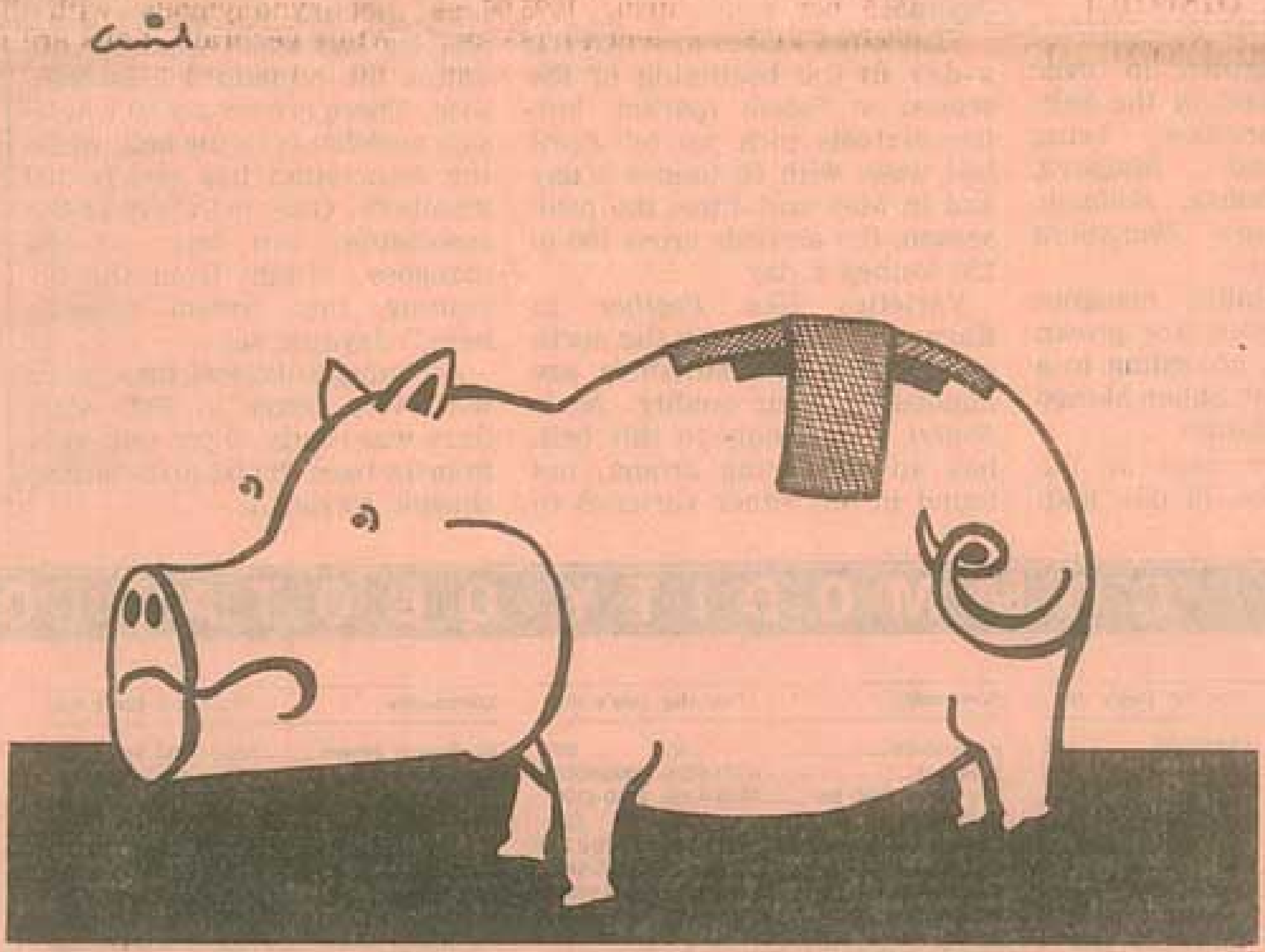
Traditionally, savings and investment by the household sector has supported India's development efforts and was largely responsible for the fairly reasonable growth performance in the 1980s of a little over 5 per cent per annum. The precipitous decline of almost 53 per cent now constitutes a serious set-back and is bound to jeopardise continued growth prospects in the future.

The investment by the corporate sector has, however, increased from Rs 12,021 crore in 1990-91 to Rs 19,891 crore during 1993-94. Though a welcome sign, it is not very reassuring for three reasons. First, the increase is far from adequate to compensate for the decline in household sector investment (public sector investment stagnated at a level of about Rs 21,850 crore during the period).

Second, even the reported increase in investment by the corporate sector is extremely unreliable as the figures are derived on the basis of a small sample of only 18 companies (out of a total of 3 lakh public limited companies) for which the CSO relies on the RBI. Thanks to liberalisation without simultaneous strengthening of the regulatory and monitoring mechanisms, a majority of companies do not report data, nor do the authorities bother to take up necessary follow-up action.

Third, critical areas like power, gas, water, etc, have still not attracted the attention of the private corporate sector on the desired scale. The situation in agriculture is even worse with investment by government, including the state governments, decreasing steeply and private investment failing to compensate for this.

The steep decline in overall savings and investment sends dangerous signals. First, the present strategy of trade and industrial liberalisation is pregnant with the possibility of leading to a huge trade deficit. During the first ten months of 1994-95, this was about $2 billion. A significant feature of the underlying trends is the much faster growth in non-oil imports. This is expected to gain momentum in the years ahead. Increase in domestic savings will be absolutely necessary to support this, or else, there is the danger of the economy slipping into recession.



Second, the process of structural adjustment and privatisation is generating a huge appetite in the private sector for funds to finance new projects and, in the public sector, for revamping and modernisation of existing plants to enable them to stay competitive. Bulk of the demand is in the infrastructural industries.

The requirements for funds in these sectors are astronomical. In power alone, for the proposed 60,000 mw additional capacity during the next ten years, this will be about Rs 180 thousand crore. The promoter, whether an Indian company or a MNC, will tend to finance only a small percentage of the total cost from internal resources or through funds brought from abroad. Bulk of the demand will have to be necessarily met either through borrowings from the domestic financial institutions or through funds raised from the capital market. This is where the critical role of the household sector comes into the picture. If its ability to save gets impaired, setting-up of the required capacity in these sectors will be rendered almost impossible.

Third, investment in agriculture is dependent substantially on the savings of the household sector; the former has virtually stagnated at about Rs 5,000 crore during the last four years or so. And, this despite good monsoon for seven consecutive years offering excellent opportunities for increasing investment to facilitate optimum yield and enhanced farm incomes. Considering that public sector investment in agriculture has been declining all along, any impairment of the capability of the households to save and invest could be suicidal, as whatever limited investment activity is taking place will also come to a grinding halt.

At a time when government is dissaving, the private sector is still dependent heavily on FIs/commercial banks for financing its investment needs and foreign investment is coming in trickles, savings by the household sector assumes critical importance. It is indeed the bloodline of the economy. And yet, various developments, including the government's policy actions, are working to the detriment of the households.

Inflation is the single most important factor undermining the capacity of the common-man even to maintain the existing savings rate. About four years ago, when the reforms started, the inflation rate was about 17 per cent. At present, it is about 11 per cent. And considering that this is on a high base, in absolute terms, the impact will be much more. Moreover, a much faster pace of increase in prices of foodgrains and other essential commodities has ensured that majority of the population ends up spending almost its entire income on current consumption.

True, the middle class, estimated at about 150 million, may offer a good savings potential, but considering their small share in the total population — about 15 per cent — it is impossible for them alone to help maintain a reasonable overall savings rate. Moreover, with emphasis on progressive import liberalisation of consumer goods, the possibility that the potential savings of this class would be available for meeting the investment needs of the economy will also diminish.

Inflation is a result of three factors: Increase in money supply owing to monetisation of the Government's budget deficit, increase in administered prices of basic inputs, utilities and services and increase in the price of foodgrains. The common denominator in all this is the inefficiencies and mismanagement in the acts of governance, running of public sector enterprises and in carrying out foodgrains procurement and distribution operations.

Increasing unemployment is another disquieting feature. While insufficient growth by itself is preventing expansion of employment opportunities, a major source of worry is the structural changes which are resulting in serious threats to small-scale industries and lower employment in agriculture and related activities. The neglect of PSEs may also lead to unwarranted closure of even some of the potentially viable units, with resultant loss of productive jobs. Inevitably, these would lead to erosion of incomes and consequently of the savings capacity of the economy.

The issue of maintaining, if not increasing, the saving/investment rate cannot be viewed in isolation. It is not merely a question of providing fiscal incentives through the budget. It must necessarily be the outcome of a holistic approach that focusses on sound macroeconomic management that generates growth impulses in a non-inflationary manner, pays adequate attention to investment in agriculture and which does not sacrifice labour-intensive industries in the name of economies of scale and technological upgradation.