Q1

Among several factors for India's potential growth, savings rate is the most effective one. Do you agree? What are the other factors available for growth potential?

UPSC Civil Services Mains 2017 · GS III · 10 marks · Indian Economy

Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Core demand of the question

- State whether a high savings rate is the most effective factor for India's growth potential
- Give a reasoned yes, no, or partial view
- **Name other factors that also raise potential growth:** investment quality, human capital, infrastructure, institutions, and technology

Revision summary

Savings finance investment and matter for potential growth, as in the Harrod-Domar link between the savings rate and output.

India already saves a large share of GDP, mainly in households, so a higher rate is not the only or always the strongest lever.

Idle gold and land savings, or a high incremental capital-output ratio, waste the savings effort.

Other factors are investment quality, skills, infrastructure, institutions, technology and financial intermediation.

Jan Dhan, pensions, GST, Make in India and transport programmes try to put savings to work.

Introduction

Potential growth is the output an economy can sustain without overheating. In a simple **Harrod-Domar** story, a higher **savings rate** funds more investment and therefore more growth. India has long had a strong **household savings** habit. Savings are necessary. They are not, by themselves, the most effective lever once the rate is already high and the binding constraint is **how savings are used**.

Body

Savings and potential growth

- Domestic savings finance capital formation without a permanent **current-account** strain, so they matter for a large, investment-hungry economy.
- India's gross savings have often been near **30 per cent of GDP**, led by households, with corporate and public savings making up the rest.
- If savings sit in gold, cash or unproductive land, the **incremental capital-output ratio** stays high and growth does not rise with the savings rate.

- Public savings (a smaller fiscal deficit) free loanable funds for private investment; household financial savings need **banks, insurance and pensions** to reach firms.
- **So the claim is only half right:** a collapse in savings would cut potential growth, but a further rise in the rate is not the single most effective step if efficiency is weak.

Other factors for growth potential

- **Investment quality and total factor productivity:** better machines, logistics and firm organisation raise output per unit of capital more than a slightly higher savings ratio.
- **Human capital:** schooling, health and **Skill India / Pradhan Mantri Kaushal Vikas Yojana** raise labour productivity, which is India's demographic chance.
- **Infrastructure:** power, ports, roads and digital rails (**Bharatmala**, **Sagarmala**, **Digital India**) cut costs so the same savings buy more real capacity.
- **Institutions and reforms:** contract enforcement, GST (rolled out 2017), bankruptcy, and a sound **Reserve Bank** framework decide whether savings become factories or stalled projects.
- **Technology and openness:** imported know-how, **Make in India**, and export discipline raise the productivity of each rupee invested.
- **Financial deepening: Jan Dhan**, **Atal Pension Yojana**, **National Pension System**, and gold schemes try to pull physical savings into the financial system.

Judgment

- Savings remain a **necessary floor**. For India in 2017 the more effective push is to convert existing savings into **efficient, labour-using investment**, not to treat the savings rate as the only dial.

Flow diagram

Savings rate -> Investment

Investment -> Potential growth

Human capital -> Potential growth

Infrastructure -> Potential growth

Technology institutions -> Potential growth

Investment quality -> Potential growth

Conclusion

A high savings rate supports India's growth potential, but it is not the most effective factor once savings are already substantial. Potential growth rises faster when those savings meet skills, infrastructure, institutions and technology. Policy should protect household saving and, more than that, raise the productivity of investment.

Facts & figures

Harrod-Domar

Simple growth identity: the growth rate depends on the savings rate divided by the capital needed per extra unit of output.

Gross savings

India's gross domestic savings have often been around 30 per cent of GDP in the high-growth years, with households the largest source.

ICOR

Incremental capital-output ratio: how much extra capital is needed for one extra unit of output; a high ICOR wastes savings.

PMKVY

Pradhan Mantri Kaushal Vikas Yojana: flagship skill-training scheme under Skill India to raise labour productivity.

GST 2017

Goods and Services Tax, launched 1 July 2017, meant to cut tax cascading and improve the efficiency of investment across States.
