

Impact of National Income on Saving and Capital Formation in India

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Abstract - The study of national income estimate provides a vivid picture of the entire economy of a country. It enables to know the economic condition of the nation, per capita income and the standard of the people. National income includes the aggregates income of all the people in a country over a period of one year. The study analyses the growth of national income and thereby per capita income. It also examines the impact of national income on savings and investment. The growth of national income and per capita income has been estimated over a period of past sixty years of planned economic development of India.

Keywords: National income, per capita income, net domestic product, saving, investment, and capital formation.

I. INTRODUCTION

National income estimates provide a vivid picture of nature and magnitude of the entire economy, and the contribution of various sectors of a country. It indicates the direction of change in the economy of a country. The study of national income of India signifies in many aspects. Firstly, it enables to know the useful information about the economic condition of the nation and it gives the per capita income of the people which reveals the per capita income and standard of living of the people. Secondly, national income estimate shows the trends in the economic development of the country. Thirdly, it is vital important in connection with the economic and development planning. It is an indicator of wealth and economic welfare. Fourthly, it reveals the fact that it is the source from which all factors of production receive their rewards. Lastly, national income and per capita income figures help to assess the taxable capacity of the people. It also signifies an important part in determining the level of employment, saving and investment of a country.

The National Income Committee¹ observed that national income estimate measures the volume of commodities and services turned out during a given in a period country. In the words of the committee, a correct estimate of the national income and its distribution are essential to enable the state to frame their budgets and economic policy on proper proportion, direction, place and times. National income estimates compiled by several countries enable comparative studies being made of the progress of production of wealth, saving, investment, and shift in emphasis upon the sector of the economy². It has a positive impact on savings of the people and capital formation. In this context the estimate signifies to study the growth of national income over the

period of past 60 years of planned economic development. The study also examines the impact of national income on savings and investment.

A. Concept of National Income

National income includes the aggregate income of all the people in a country over a period of one year. It also adds the income awarded in different factors of production such as, rent, wages, interest and profit over a period of time. Dr. V.K.R.V.Rao³ has defined national income as “a money value of the flow of commodities and services, excluding imports becoming available for sale within the period, the value being reckoned at current prices minus the following items of (1) the money value of any diminution in stock that may have taken place during the period. (2) the money value of the flow of goods and services used up in the course of production.(3) the money value of the flow of goods and services used to maintain the existing capital equipment intact (4) receipt of the state from indirect taxation (5) favourable balance of trade including transaction in the treasure (6) net income in the country’s foreign indebtedness or the net increase in the holding of balances and securities abroad whether by individuals or the government of the country.” In view of Prof.Marshall, “the labour and capital of the country acting on its natural resources, produce annually a certain net aggregate of commodities, materials including services of all kinds are national income.”

II.LITERATURE REVIEW

Mahinder Chaudry, D. and Hoselitz, B.F. (1965)⁴ have made a study on National and State income of India. The study has analysed a general survey of state-wise income and national income of India. It has found that there is a differences in the growth of state income. It varies from state to state. The reasonable difference variation ranges from 7 per cent to 9 per cent. As a result of variations in income, the share of saving would vary from state to state. V.K.R.V. Rao (1980)⁵ has conducted a study on savings, capital formation and national income. The objective of the study is to see how far savings and capital formation have increased during the three decades of planning and to examine the effects of these increases on growth of national income. The study concludes that savings and capital

formation have had a positive influence of increase in national income.

Barry P. Bosworth, (1982)⁶ has studied capital formation and economic policy. He concludes that increased saving can not depend on increased domestic capital formation. The failure of fiscal and monetary policy leads to a deterioration rather than an improved investment incentives. It is extremely difficult to develop an effective program to raise capital formation when national income is low. Bakare, A.S. (2011)⁷ made a study based on Harrod Domar Model, The study has found that there is a significant relationship between capital formation and national income and thereby economic growth. It also concludes that savings play a fundamental role in determining capital formation and economic growth of a country. Robin Varghese (2011)⁸ has observed that the allocations of national income totals reflects per capita income, savings and investment. The building up of national capital depends on the most productive use of saving and increase in current savings. The raising of output in agriculture and industry should have a higher priority in allocation of saving.

III. OBJECTIVES

The study has been carried out with certain objectives.

1. To examine the growth of national income of India.
2. To analyse the contribution of net domestic product to the national income .
3. To estimate the target and actual growth of national income during Five Year Plans.
4. To study the impact of national income on savings and capital formation.

IV. SOURCES OF DATA

The study has been analysed by using secondary data. The secondary source of data are collected from census of India, Economic Survey of India and various published books. The collected relevant data have showed the growth of national income and per capita income of India. To measure the trends in the growth of national income, the simple statistical tool namely percentage and index number have been used.

V. DATA ANALYSIS AND DISCUSSION

A study of national income and per capita income in India is important to assess the impact of five year plans. The increase in national income at current prices reflects the influence of increase in the production of real goods and services. During the 60 years of post independence period of planned economic development, national income and per capita income have registered an increasing trend steadily. The growth of net national income at constant prices is an indicator of total productive effort and the rate of growth of goods and services of the country. At the same time, the growth of per capita income at constant prices is also an index of the range in the standard of living of the people. Both are reflecting in the process of economic development.

Table I Shows the growth of national income and per capita income of India. In 1950-51 the per capita income was Rs.264 crores and Rs.1852 crores in 1980-1981 while it was Rs.54151 in 2010-2011. It is also noted that national income has also increased from Rs.9144 crores in 1950-1951 to Rs.118252 crores in 1980-81 and Rs.67935963 in 2010-2011. All these evidences reveal that both per capita and national income have grown in the Indian economy.

TABLE I TREND IN NATIONAL AND PER CAPITA INCOME, AND SAVING AND CAPITAL FORMATION.

Year	National Income (Rs)	Per capita Income (Rs)	Gross domestic saving	Percentage of saving to N1	Gross domestic capital formation	Percentage of capital formation to National Income
1950-1951	9144	264	989	10.8	1133	12.4
1960-1961	15206	373	2079	13.7	2618	17.2
1970-1971	38973	740	6821	17.5	7297	18.7
1980-1981	118252	1852	26590	22.5	27003	22.8
1990-1991	456280	5621	134408	29.5	146018	32.0
2000-2001	1702454	17295	515545	30.3	525078	30.8
2010-2011	67935963	54151	26511933	3.9	2882413	0.4

Source: Economic Survey 2012-2013, A9 <http://indiabudget.nic.in>
Central Statistical Organisation, Govt. of India, National Accounting Statistics (2010-2011)

Saving and investment are brought about by the mechanism of income. The Central Statistical Organisation of India⁹ defines saving as the excess of current income over current expenditure and is the balancing item on the income and outlay accounts of producing enterprises, and households, government administration and other final consumers. Domestic saving consists of household, private corporate and public sector saving. It involves financial saving and physical assets. Saving is defined as the excess of current receipts over current expenditure.

Capital formation is most important which determines the rate of growth of economy. The volume of capital formation is determined by the rate of growth of saving of a country. Rate of interest is also a determining factor of saving. Table 1 shows the percentage of saving to national income during 1950-1951 to 2010-2011. During this period, domestic saving has risen steadily. In 1950-1951 the gross domestic saving was Rs.989 crores which had increased to Rs.26590 crores in 1980-1981 and Rs.2651933 crores in 2010-2011. The rate of growth of saving has reflected due to the growth of national income. The percentage of saving to the national income was 10.8 per cent in 1950-1951 which increased to 30.3 per cent in 2000-2001. It is noted that in 2010-2011 it has come down to only 3.9 per cent. The principal cause for "this decline is accounted by a reduction in private savings, primarily house hold savings in financial assets, and somewhat by a reduction in corporate savings".¹⁰ Nevertheless, the share of public sector in gross domestic saving was very low. It was

accounted 5.2 per cent. Thus, the growth of national income has a positive impact on the saving of a country.

The concept of capital formation refers to investment. If saving of a country exceeds investment, it means that the country reduces its expenditure on goods and services over a period of time. It hoards more and spends less. On the other hand, if investment exceeds saving, the country increases its expenditure on goods and services. The present study estimates the rate of domestic capital formation as a percentage of gross domestic products. The rate of growth of national income has a positive influence of capital formation thereby investment. Table 1 reveals the gross domestic capital formation and percentage of capital formation to increase in national income.

In the year 1950-1951, the gross domestic capital formation was Rs. 1133 crores. It increased to Rs.27003 crores in 1980-1981, and Rs.2882413 crores in 2010-2011. Similarly, the percentage of capital formation to national income has increased from 12.4 per cent in 1950-1951 to 22.8 per cent in 1980-1981 and further to 30.8 per cent in 2000-2001. In the year 2010-2011, the percentage to the national income was only 4.2 per cent. There was a reduction in the investment rate in 2010-2011, both in the public and private sectors. The reduction in corporate investment could be attributed to global factors as well as to domestic factors namely increased cost of borrowing and raise in interest rates.¹¹

TABLE II SHARE OF NET DOMESTIC PRODUCT TO NATIONAL INCOME.

Sector	At 1980-1981 Prices				At 1999-2000 prices		At 2004-05 Prices
	1950-51	1960-61	1970-71	1980-81	1990-91	2000-01	2010-11
Primary Sector	57.2	53.3	46.5	40.0	32.7	26.5	15.1
Secondary Sector	16.3	18.6	22.3	24.2	28.0	22.7	24.9
Tertiary Sector	26.5	28.1	31.2	35.2	39.3	50.8	60.0
NDP at factors cost	100	100	100	100	100	100	100

Source : Government of India, National Income Statistics 1989, 1998, 2009, and Statistical year Book, 2012, Table 3.6

Table II reveals the contribution of primary, secondary and tertiary sectors to net domestic products. The constituents of primary sector are agriculture, forestry and logging, and fishing. During the past 60 years, the share of the primary sector in the net domestic product had varied from 57.2 per cent in 1950-1951 to 15.1 per cent in 2010-2011. Thus, the share of the primary sector in net domestic product has declined over the years.

The constituents of secondary sector are mining and quarrying, manufacturing, electricity, gas, water supply and construction. During the post independence period, the contribution of secondary sector in net domestic product has

increased from 16.3 per cent in 1950-1951 to 24.9 per cent in 2010-2011. During this period, a continuous increase has been observed except during the year 2000-2001.

The tertiary sector consists of trade, transport and communication, financing, insurance, banking, mining, community, social and personal administration, public administration, and defence. Since 1950-1951, the net domestic product of tertiary sector has increased steadily from 26.5 per cent in 1950-1951 to 60 per cent in 2010-2011. Thus, the overall progress in secondary and tertiary sector has increased the share in net domestic product and thereby growth in the national income.

TABLE III GROWTH PERFORMANCE IN THE FIVE YEAR PLANS (PERCENTAGE)

Sl.No.	Five Year Plan	Targeted growth	Actual
1.	First plan :1951-1956	2.1	4.2
2.	Second plan:1956-1961	4.5	4.2
3.	Third Plan :1961-1966	5.6	2.6
4.	Fourth Plan :1969-1974	5.7	3.2
5.	Fifth Plan :1974-1980	4.4	4.9
6.	Sixth Plan :1980-1985	5.2	5.4
7.	Seventh Plan:1985-1990	5.0	5.5
8.	Eighth Plan :1992-1997	5.6	6.7
9.	Nineth Plan :1997-2002	6.5	5.5
10.	Tenth Plan :2002-2007	8.0	7.5
11.	Eleventh Plan:2007-2012	9.0	7.8

Source: (i)Government of India Planning Commission Eleventh Five Year Plan 2007-2012, New Delhi, 2008, vol.1, Table 2.1, P.25
(ii)Government of India, Economic Survey, 2011-2012, NewDelhi, 2012, Appendix Table 1.2, P.A4.

Table III highlights the growth performance of national income during five year plans. During the period of first five year plan, the growth target was 2.1 per cent while the actual growth was 4.2 per cent. There was cent per cent increase in the national income in the first five year plans. The actual growth of national income during the period of 1951-1956 was 4.2 per cent and it increased to 7.8 per cent during 2007-2012. It is noted that during the last six decades, national income has raised steadily except during the third and ninth plan periods.

The national income had increased at a rate of 4.2 per cent per annum as against the target of 2.1 per cent per annum in the first plan period. In the second plan the target was fixed at the rate of 4.5 per cent per annum. But the rate of increase in the national income was 4.2 per cent only. There was a gap of 0.3 per cent in between the target and actual growth. The Third plan had contemplated about 5.6 per cent increase in the national income per annum. The average increase realized was only 2.6 per cent per annum. In the fourth plan also the growth rate was declining at the rate of 2.5 per cent per annum.

It is clear from the evidence that during the First, Fifth, Sixth, Seventh and Eight Plan almost all major sectors registered satisfactory growth rates. However, the annual grow rate was disappointing during the Second, Third, Fourth, Nineth, Tenth and Eleventh Five year Plans.

VI.FINDINGS

The following findings are drawn from the study.

1. The increase in the national income is an indicator of the change in the standard of living of the people. During the period of 1950-1951 to 2010-2011, there was an increase in the per capita income and national income. In this period, per capita income had increased from Rs.264 to Rs.5451.
2. The study has revealed that during the period of five year plans, the actual growth of national income had increased tremendously, except during the third and fourth plans. It is noted that among all the plans, the eleventh five year plan achieved the highest growth rate in the national income.
3. It is found that during the past sixty years, the contribution of agricultural sector in the net domestic product has gradually declined. The share of forestry in the domestic product has also fallen.
4. The share of industrial sector in the net domestic product has increased consistently. The net output of the registered manufacturing units has not only increased substantially over the years, but their contribution to the net domestic product also steadily rose. As far as the employment potentials of unorganized manufacturing sector is concerned, it has received a great attention and importance in the Indian economy.
5. Indian's domestic saving has risen considerably during the past sixty years of planned economic development. The financial saving of household, private corporate and public sector has increased considerably. The ratio of gross saving in the household sector to the gross domestic product has recorded considerable increase over the past five decades of economic planning.
6. The rate of capital formation to the national income has risen considerably from 1950-1951 to 2010-2011

in India due to the massive investment in public and private enterprises.

VII. CONCLUSION

The study concludes that the growth of per capita income of the people has a positive impact on savings and investment. Employment generation enhances the per capita income of the people. It could be achieved if the natural as well as human resources would be used properly in order to increase per capita income and thereby national income. It helps to achieve economic development through savings and investment in a developing country like India.

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