Understanding the Investment Decline

What is the issue?

\n\n

- \n
- There is a decline in overall investment rate between 2011-12 and 2016-17 in India.
\n
- The household, and not corporate, sector is said to be responsible for the decline.
\n

\n\n

How important is investment?

\n\n

- \n
- Growth can occur with better utilisation of existing capacity or with new investment.
\n
- However, over the medium to long term, the key driver of growth is investment.
\n
- Without a high investment rate, it is difficult to sustain a high growth rate.
\n

\n\n

How has income growth been?

\n\n

- \n
- Over the last 4 years, the growth rate has been maintained at a reasonable level.
\n

\n\n

- \n
- The average growth rate of GDP has been 7.3%.
\n

- However, the declining trend is a cause of concern.
\n
- The growth rate of GDP in 2015-16 was 8.2%.
\n
- It came down to 7.1% in the following year and 6.7% for the just ended year.
\n

\n\n

How has savings been?

\n\n

\n
- The major source of funding investment is domestic savings.
\n
- The gross domestic savings rate has fallen in the last six years.
\n
- It has declined from around 34% of GDP in 2011-12 to around 30% in 2016-17.
\n
- The steepest decline in savings has been with respect to the household sector.
\n
- Within this, both financial savings and that in physical assets have declined sharply.
\n
- The private corporate sector savings have actually increased by almost 2.5 percentage points.
\n
- The savings rate of the public sector including general government shows no change.
\n

\n\n

How has the investment trend been?

\n\n

\n
- **Trend** - The investment rate also registers a disturbing decline.
\n
- In 2011-12, the gross fixed capital formation rate was around 34% of GDP.
\n
- By 2016-17, it had come down to around 28%.
\n
- Understanding the behaviour of different components of fixed capital

formation is crucial to address the declining trend.
\n

- **Components** - Investment (gross capital formation) includes three elements:
\n

\n\n

\n

i. gross fixed capital formation
\n
ii. change in stocks
\n
iii. valuables (e.g. gold)
\n

\n\n

\n

- The most important component is gross fixed capital formation.
\n
- It refers to the capital expenditures on machinery and equipment and dwellings.
\n
- The gross fixed capital formation rate fell over the period from 2011-12 to 2016-17.
\n
- However, Gross fixed capital formation stayed at a little above 7% of GDP.
\n
- Public sector including general government showed no change.
\n
- Private corporate sector investment showed in fact a rise.
\n
- Hence, the only sector that appears to have been responsible for the decline in investment is households.
\n
- Household sector’s fixed capital formation rate has shown a steep decline.
\n
- It has declined from around 15% to nearly 9% over the six-year period.
\n

\n\n

Why is the trend a cause for concern?

\n\n

\n

- **Base Year** - The base year for these indicators had been revised from 2004-05 to 2011-12.

\n

- Notably, the investment ratios according to the new series with base show a much higher rate as compared to the old series.
\n
- E.g. the gross fixed capital formation rate for 2011-12 was 31.8% according to the older series.
\n
- For the same year, it is 34.3% according to the new series.
\n
- But despite the new series, the investment rate has been declining since 2011-12.
\n
- **Cause** - The focus for the slowdown in growth has been on weak investment demand by the corporate sector.
\n
- There has been increased attention to the number of stalled projects.
\n
- This has been interpreted as a failure of the corporate sector to make investment.
\n
- But the decline in gross fixed capital formation rate has actually been caused by the household sector rather the corporate sector.
\n

\n\n

Why is the household sector a cause?

\n\n

\n

- Household sector's savings in physical assets, which is the same as investment, is normally in the form of housing.
\n
- But it is difficult to attribute the sharp decline only to the reduction in investment in housing.
\n
- Notably, the term 'households' includes not only individual households but also non-corporate business.
\n
- By definition what is not government and private corporate comes under the category of households.
\n
- Households' investment in machinery and equipment came down in 2012-13 to 2015-16 period.
\n

- Therefore, in part small businesses have suffered more and invested less.
\n
- Within the business sector, the non-corporate business seems to have borne a higher burden.
\n
- Thus, the fall in investment rate as an explanation for the slowdown in growth is reasonable.
\n
- But clearly, the corporate investment, as believed, is not the cause.
\n

\n\n

\n\n

Source: The Hindu

\n