CHAPTER XI

CONCLUSIONS AND OBSERVATIONS

To-day, there is almost a universal agreement that the role of capital formation in industrialisation has a major role to play in the underdeveloped countries such as India. It is a familiar fact that the great gap in per capita income that divides the developed and underdeveloped countries at the present time is broadly paralleled by a similar disparity in the structure of their economies; the former are diversified and largely industrial economies, while in the latter, production is confined predominantly to agricultural sector. Consequently, the Indian economy remained static by and large till the country achieved independence. India took to planning from April, 1951. It made it an essential element in its policy for economic development that efforts be made to raise the rate of investment as swiftly as possible. Capital formation, from the point of view of industrialisation is what co-ordination and control
are to political development. Also, the problem of raising the level of industrial investment obviously merges into the larger issue of the level of total investment. Indeed if new capital is not formed, irrespective of the form of political set-up, either stagnation or retrogression of the national income must follow.

India, with its population of 54.8 crores, faces the crucial problem of disguised unemployment on an extensive scale which is essentially different from that of developed nations. The spectacle of an 'unlimited supply of labour' at current real wage rate which are also subsistence wages, is not uncommon in India. The extent of disguised unemployment is estimated to be about 20% to 30% of the agricultural working force. This form of unemployment is essentially different from that of developed nations. The problem caused is not due to the lack of effective demand but is the result of the scarcity of the real capital. If this man-power is gainfully employed, it would result in increasing the output and national income. The situation calls for an accelerated rate of investment towards capital formation.

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In 1950, India presented a woeful lack of total income, output and savings. Due to predominantly agrarian economy with low productivity and the rising trend of population, the country's economy remained stagnant during Thirties and Forties. The rate of gross domestic capital formation as percentage of gross domestic product between 1950-1955 was only 8% which was even lower than the rate of capital formation in Burma, Ceylon, UAR and Israel.2 There was little attempt in India towards industrialisation. Consequently, the number of domestic capital goods industries was negligible at the start of five year plans in India. After laying the foundation of planning in India during the First Plan, a stronger dose of investment in heavy and basic industries was given in the Second Plan period followed subsequently in the Third Plan and in the Fourth Five Year Plan as well. It can further be noted that the intention of the planners is to maximise employment and capital formation on the one hand and increase consumption on the other in order to raise the standards of living. Superficially the objectives of increased consumption and increased investment appear to be contradictory in terms. But it is not so as in the

2. See for details, TABLE 7, Chapter IV, p.135.
face of rising incomes, a certain amount of austerity, especially in the use of luxury articles, would provide funds for investments. Thus Keynesian economics in the context of its relationship between total income and consumption has a limited application in India and in other underdeveloped countries because these countries cannot afford the luxury of mass-consumption as advocated by Keynes. Further, Keynes makes liquidity preference the villain in his diagnosis of the stagnation of an underdeveloped economy. Giving the instance of India, which is incidentally only one in General Theory, he says:

"The history of India at all times has provided an example of a country impoverished by a preference for liquidity amounting to so strong a passion that even an enormous and chronic influx of the precious metals has been insufficient to bring down the rate of interest to a level which was compatible with the growth of real wealth."  

This view has been correctly contended by A.K. Das-Gupta who says that the levelling down of the structure of interest rates would not have any significant effect upon employment and output. The trouble in India had been not of money supply subsequent to the influx of precious metals as it was that the influx of precious

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metals did not result into imports of capital goods. The main problem of promoting investments, therefore, remains so that stock of capital goods in the country might increase. Any country, in which available capital falls short to absorb labour force at the productivity level corresponding to the prevailing technology and is not adequate to exploit natural resources, has to be characterised as underdeveloped. Hence the real solution of the problem in India lies in increased savings as against Keynesian policy of increased consumption.

India stands in need of a rapid economic growth and overall development of the various components of the economy. In that case, capital formation remains one important aspect of growth and the different interpretations of capital from classical period to the modern age are of practical as well as intellectual interest.

In spite of the fact that the importance of capital formation was great, precise data relevant to the subject were not available in India till the year 1950-51. With the advent of planning in India, significant attempts have been made by the Central Statistical Organisation, the Reserve Bank of India and the National Council of Applied Economic Research, to bring forth the statistics of savings and investments in the country. In addition to this, the
CSO has been publishing data of national income every year. The CSO's estimates of gross fixed capital formation and change-in-stocks are more comprehensive, although they involve a time-lag, due to their time-consuming processing system. Data provided by the CSO have been used for detailed analytical purposes. The trends in the distribution of domestic capital formation, however, show the shifts in the economy from agriculture towards industrialisation. It also points out the need to increase the rate of capital formation in the economy for purposes of quicker growth without endangering economic stability.

Again, the need for a correct assessment of the economy and subsequently, a right policy to be adopted becomes of utmost importance. Problems of low income, unequal distribution of wealth among people and different regions in the country, inadequacy of saving and capital, are a stumbling block in the way to the prosperity of a country. One is apt to get confused to find oneself faced with a large number of divergent investment decisions in the economy. Firstly, those policies apparently seem to be diametrically opposed, as some of them favour balanced growth and others prefer unbalanced growth. India, with its scanty resources and numerous problems, was forced to an unbalanced growth in the beginning of the process of
planning. But ultimately India has to adopt those methods which would lead to a balanced growth in the economy. It is important to create the growth potentiality so that the country may move in forward direction. Secondly, in view of the shortage of capital, an equilibrium has to be brought about by decreasing the ratio of capital to output through such investment planning which is less capital-intensive. There is a snag in the whole concept of capital-output ratio which determines the quantum of investment needed for the warranted rate of economic growth. Some hold that there is a constancy of capital-output over a period of time which is a questionable proposition. First, it does not explain the gradual transformation that undergoes in this ratio from time to time within the plan period, as new technology is used progressively and as external economies become available. The need, therefore, is to take investment decisions in a flexible manner suitable to the exigencies of the country's economy.

Despite the fact that the First Plan was successful in an overall manner, because of unusually good harvest during the years 1953-55, it did not raise the level of investment to the extent to which it would have.
The net rate of investment during the First Plan came to about 7% of the national income. Indeed it was observed that the possible increase in capital formation was partly nullified by a rise in the level of consumption standards. Improvement in living standards is not in itself bad but it should not be at the cost of the investment as then it would fall short to absorb the new entrants to the labour market. Unfortunately, it turned out to be a situation that the backlog of unemployment that was 5.3 million at the commencement of the Second Plan rose to 8 million at its end. The situation assumed still bigger dimensions when it was estimated that the employment opportunities would have to be provided to 35 million people during the period 1966-71 and to another 30 million persons during the period 1971-76, thus bringing the total of the unemployed persons to 65 million. As the agricultural sector is already over-crowded, it can be expected that an increase in investment in the industrial sector would enhance the capacity of the economy to absorb a large number of people. A part of this population belong to rural areas, suffering from disguised unemployment. Not much attention in the beginning appears to have been

5. See for details, TABLE 4, Chapter V, p.185.
given to this part of the crucial problem to mobilise enough redundant labour for capital works. Attempts at integrated planning appear to have been made after laying the foundation of planning in the First Five Year Plan to be followed in an increasingly large measure in the subsequent Five Year Plans in India with its ultimate objective for a balanced economy.

Another equally important matter is the general belief that higher the volume of investment, the greater could be the rate of economic growth. This would be possible if an optimum utilisation of the capital projects is made possible which in turn would lead to higher productivity, which is very important from the point of view of income-growth determining consumption, saving and investment, output and employment in the economy. However, the utilisation of idle capacity by working double or triple shifts even, can increase the production only to some extent. The long-term growth of the economy will depend on the rate of increase of capital formation. Hence the balanced view is that an all-out effort should be made to increase investment carefully in high priority channels, so that the rate of interest would not be a heavy burden in calculations of cost. Hence investments should be made in a way that
the returns are not only greater than inputs, but also leave after consumption, a substantial amount of savings for capital formation. One finds oneself in a dilemma when investments in basic and heavy industries have to be accorded top-priority, as they have a definite agglomerative and self-reinforcing quality. In that case, it is only after the lapse of a period that the economy will have achieved the self-generating stage, as much investments involve time to materialise for obvious reasons. Thus modern economic growth is the application of the industrial system and scientific knowledge to the system of production. All this demands capital formation which is sine-qua-non for peace, progress and prosperity.

A country of the size and population of India can depend upon international aid only temporarily if that does not tantamount to political dictates of the rulers abroad. Due to recent political developments and the unhelpful attitude of the USA, the chances of aid on official basis cannot be depended upon. Moreover, foreign aid involves debt rescheduling and debt repayments. Alternatively, the country must take immediate important measures like import substitution, increasing exports and encouraging foreign private capital. Further, it is a
well acknowledged fact that on the eve of independence, not only the national income and per capita national product had been low in India, the growth of domestic savings was also negligible. Hence the economy was in a state of stagnation. People were caught in a sense of urgency to augment domestic savings for investments. Several specialised financial institutions came into being to serve as 'catalysts of investment'. In spite of these efforts and the professions of the government, it is found that the increase in the rate of domestic savings has been quite nominal between 1950-51 and 1968-69, which varies between 5.5% to 10.4%. On the other hand, investments had exceeded savings varying at the rate of 5.6% to 13.3% of the national income during the same period. Hence the mobilisation of resources from external sources became necessary. One could have assumed an automatic increase of savings with the increase in income subsequent to the rise of investment so as to reduce dependence on foreign aid. The failure of savings ratio to rise over long period with the increase in income can, however, be explained in terms of the demonstration effect of Prof. Duesenberry which is opposed to Keynes' view that the increase in aggregate income per capita is usually followed by increase in the proportion of savings. In India the marginal savings rate did not

7. See for details TABLE 5, Chapter V, p.186.
8. See for details TABLE 4, Chapter V, p.185.
appreciably increase with increase in income. These gaps between savings and investments became discernible from the Second Plan period in which hardly one-fifth of the total plan outlay had to come through taxation and market borrowings, while the rest of the resources were external aid and inflationary. The trend also continued during subsequent plans. Saving, thus, can depend on hard work and parsimony in expenditure. Wise spending is as necessary as more earning. Conspicuous consumption patterns of richer nations must not be followed by the people in India as a matter of course. Similarly, 'conspicuous production' by way of expenditures in palatial buildings and production of prestige articles must be avoided, at least in the beginning of the development effort. There is a considerable scope to reduce expenditures incurred on ceremonial purposes in connection with marriage and death and also by discouraging accumulation of gold in different forms. It should be noted that the curbing of consumption required to step up the rate of growth to any desired level does not have to continue indefinitely. Once the economy is adjusted to the new rate of growth, consumption will benefit along with investment. Again, taxation should be judiciously devised in the country so that it may neither go against the genuine feelings of the masses, nor may tax
the industrialists and the foreign investors in a way that it may discourage capital formation in the country and might kill the goose that lays the golden eggs. There appears a scope for the diversification of taxation structure in the country. There are increasing number of persons who feel that the agricultural sector provides the most attractive and possible source of mobilisation of resources as their economic conditions are much better than many persons in the urban areas especially due to green revolution in the recent times.

However, the fact remains that India needs to tighten its belt and learn lessons from countries like Japan and the USSR which have accumulated capital even in economic isolation. Japanese are the most forbearing consumers in the world with 20% of personal disposable income being saved. Naturally their economy has been activated more by investment than by demand. Placed as India is in a tight financial position, it needs repetition for the countrymen to remember what a willing nation with a knack in hard work can accomplish in a short period. It has been observed in regard to Japanese economy that "In 1963, Japan showed the lowest rate of personal consumption (53%) and public sector purchase (10%) and the highest rates of fixed capital formation (32%) and inventory building among individual countries."  

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It is thus possible to widen the savings margin and step up the rate of capital formation in India by lowering the level of consumption as in Russia and Japan. Its impact on the economy will be felt quite soon. The Planning Commission while working out a developmental model for the Indian economy observed that the sequence of economic growth would gain rhythm if the capital formation could rise by 'somewhat less than two-thirds but by more than a quarter of the additions to national output in each successive period.' It implies that for self-sustaining economic growth, capital formation should rise by a rate within the range of 25% to 66% of the additions to gross product. All leakages from capital accumulation must be plugged. In short, the gap between saving and investment could be filled in either by deficit financing, inflation and other monetary measures at the home front, or by means of foreign assistance to meet especially the problem of the shortages of foreign exchange due to continuous adverse balance of payments in the country. Thus, at least for a short period, foreign resources are required while keeping in mind the investment gap approach and the balance-of-payments approach. In the long-run the policy of self-reliance

must be pursued, in which mutual dependence on one another is not ruled out. Barring a few exceptions, foreign private investment in the country should neither hamper the technological advancement and know-how of the country nor the country should suffer in terms of employment and exploitation of natural resources etc. All necessary measures should be taken to stabilise prices in the economy along with other monetary measures so that the widening gap of balance of payments may be reduced. This requires the capacity of the country to produce and provide goods to the foreign countries so as to be able to import the capital goods from them.

Another important question is the manner in which investments in the country are channelised so that the output can be maximised in accordance with the moods and aspirations of the people. The public sector has been regarded as the pace-setter in investment, especially for the strategic sectors of the Indian economy vide Government of India's Industrial Policy Resolutions of 1948 and 1956. In the beginning of the Second Plan, India committed herself to the establishment of 'socialistic pattern of society' and

13. See for details, Appendices A and B.
accordingly, resolved to instal most of the industries in the public sector. Nevertheless, the private sector also plays an important role in country’s economy. Necessarily, therefore, the industrial policy has to be pragmatic and flexible to suit the changing conditions in the country.

The need of infrastrutures and social overhead capital is widely regarded as an essential prerequisite to general economic development. Hence the role of government capital formation typically rises in the early decades of development. The policy of the government also determines the investment plan of the public sector which appears to be gathering momentum in the foreseeable future. In the long run, industrialisation would depend on the increasing production of electricity, iron and steel, heavy machinery, heavy chemicals, coal and heavy industrials. The development of these industries would increase capacity for capital formation. The aim of the establishment of heavy industries is to make India independent of foreign imports of producers goods so that the accumulation of capital would not be hampered. Besides this, it would also lay a firm capital base for a high rate of income-growth at home. The development of the heavy machine building industries must have a top-priority as they facilitate a much quicker
rate of industrialisation after four or five years. It is only by developing basic industries that a secure foundation for capital formation can be laid and the country can be made more and more independent of imports of vitally needed plant and equipments. The major effort in the development of basic capital goods industries must come from the public sector so that it may occupy the 'commanding heights' of the Indian economy to be in accordance with the aspirations of the people pledging for a socialistic pattern of society. It can be noted that there is a large scope for the maximum utilisation of idle capacities. A huge amount of money has already been incurred in the public sector and if adequate returns are available, those surpluses can play a major role in financing the various projects. It is clear that these public sector enterprises should adopt a price policy that may promote surplus and thus help economic growth.

But the main weak points in the development of these industries are their being both capital-intensive and employment-light. Alternatively, it has been suggested that a larger proportion of investment in consumption goods is preferable to concentration on the capital goods industries

because the former yields substantially higher investment as well as substantially higher consumption at all points of time. It also produces a much larger volume of employment. Small-scale and house-hold industries including agriculture for which an adequate market and employment potentialities in the country exist must be nourished through the private sector. Most of the large scale and small scale industries have been working under the private sector subject to the overall control and supervision of the government. Indeed, the state and central governments have also started feeling a great need of helping the small scale industries so as to absorb unemployed persons in larger numbers. They can help to reinvigorate the economy to a large extent as almost 91.5% of factories are covered in this sector with a fixed capital of 8.1% only as against large scale industries covering only 2.8% of factories but possessing 84.6% of fixed capital. The significance and the scope of encouraging small scale industries with the central and state governments aid becomes quite obvious especially when the intentions of the government and of the people for the dispersal of industries, equal distribution of income etc.,

15. See for details, TABLE 1, Chapter VIII, p.322.
are already well-known. That will also augment the resources for employment and would generate income to facilitate capital formation in the country for economic development.

Lastly, the economic development of under-developed economies requires to develop power, transport and communications, etc., for bringing about a balanced development of the country as also to endow it with the capacity for self-propelling and accelerated growth. They involve heavy investment, but at the same time, do have a promise of all-round expansion of the economy, which would also accelerate the process of capital formation. It is to be acknowledged that India has built up the basic infrastructure in the last two decades of its planning. Its commercial services have been admirably revolutionised and much better organised to keep pace with the changing needs of the country. The latest measure of the nationalisation of fourteen major banks, if properly worked upon, will work as a shot in the arm and will produce better results in financing industries, especially the small-scale industries and the public sector.

India has been advancing ahead economically in the last two decades. It has occupied a privileged position in the overall economic development as compared to other developing economies. Much remains to be done still. Its rate of growth is much less than the warranted rate of
economic growth and the per capita income is much less than that of many developing countries even. Despite limitations in the wake of Indo-Pak-Bangla Desh problems a determined effort is being made in the country to accelerate the rate of economic growth by progressively increased domestic resources. Although the Fourth Plan envisages a growth rate at 5.5% per annum, it are subject to modifications due to abnormal circumstances that the country faces these days. In spite of this the need to quicken the pace of economic development in the country is of utmost significance. In that endeavour, it shall be important not only to increase the agricultural productivity but also to accelerate the pace of industrial development in the country during 1970's. In that the role of capital formation assumes vital importance which requires a sense of commitment, caution and proper planning.

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