Prelims and Mains focus: about the declining savings rate in India and its causes

Context: India has been witnessing a slowdown in consumption as well as savings for a while now, raising questions over the growth of real income in the economy.

Why are savings so important?

- People can use their money for either consumption or savings. Savings are an important tool to help people smoothen out consumption. That is, they can use the savings for a rainy day. However, savings are also important for the overall economy, as they help in financing investments—whether they are public or private.

- Therefore, higher savings would ideally reduce the cost of borrowing for private investments. Reduction in government savings, deleveraging by companies and slower growth of household savings are driving the fall in the savings rate.

What has been the trend in savings rate?

India is not alone when it comes to a declining savings rate. Brazil, China and South Africa too witnessed a substantial decline in gross savings as a percentage of gross domestic product (GDP) since 2011. The decline came amid the slowest growth in world trade. In India, the savings rate as a percentage of GDP has declined by nearly 5% between 2011 and 2018.

Why cut exemptions amid falling savings?

- A complicated tax structure creates inefficiency in income allocation.
Savings exemptions aim to promote certain instruments when one could use better financial instruments to save. For now, the government has left the option open for individuals to choose the existing system or to opt for the lower tax regime.

- Besides, incentivizing savings through tax breaks is not the best approach to encourage savings. The impact of the proposed taxation system, however, has to be evaluated.

**Why is India’s savings rate going down?**

- The fact that income has grown over the last couple of years (albeit at a slower rate) makes it difficult to identify the reason for this fall. Even consumption growth has slowed down, which should ideally translate to higher savings.

- One reason could be the **shift towards services consumption** such as health and education, which have become **costlier**. A bigger concern is the **rise in household debt**. **Easy availability of no-cost EMI’s on durables** could be a big reason.