Our Views

Focus on domestic savings to reduce our dependency on foreign capital!

In the last 15 years, Foreign Direct Investment (FDI) in the country has been in the range of 1.5% to 2.5% of GDP. Since 2010, we have received over USD500 bn of FDI. Additionally, there has been very robust Foreign Portfolio Investor (FPI) flows also. While on the one hand foreign capital is important for the growth of our country, on the other it underscores our dependence on it and the associated vulnerability. Foreign capital flows are opportunistic and influenced by external circumstances, many of which are beyond our control. Last year, we have seen FPIs pull out significantly from Indian capital market, which could have impacted the market stability. At such a time, domestic investors are the ones who supported the market. So, what is the alternative to dependence on foreign capital.

Various studies suggest that for a nation to move from developing to developed category significant domestic support is required. If history is our teacher, most nations have followed this strategy. They have built an eco-system of improving domestic savings and channelizing it for nation building. According to the renowned economist John M. Keynes, domestic saving triggers a positive effect on the economic growth of any nation. The simple explanation is that the resources provided by the saving practices allow adequate investment in physical and human capital, which increases productivity levels and, therefore, total production.

Historically, America was known for its culture of value creation and was infamous for realizing every penny's worth. A similar trajectory has been followed by several other economies where domestic savings have contributed to their economic growth. As an example, China has a high savings rate supported by households which has contributed to its' economic growth and has helped fund investments and entrepreneurial activities. Japan and South Korea have long been recognized for their emphasis on saving and long-term financial planning. Japan for example, runs the largest postal, banking and insurance service under the name of Japan Postal Group which is the largest holder of personal savings in the world and channeled these savings to fund projects at a very low cost of capital.

The other nation which is very focused on the domestic saving is Singapore which has a compulsory savings system called the Central Provident Fund (CPF), this requires individuals to contribute a portion of their income towards retirement, healthcare, and housing. This system has helped foster a culture of saving and long-term financial planning among Singaporeans.

Even Middle Eastern countries, with abundance of oil wealth, maintain sovereign wealth funds to accumulate and invest surplus revenues. This has helped them in securing their economies and diversifying their sources of income beyond oil.

Taking a leaf out of these learnings, we should focus on strengthening our domestic savings and channelizing it for nation building. I have a couple of suggestions towards this, the first being to encourage our people to go back to basics - live a life of simple living and high thinking. Indians were known to live frugally and reverting back to this philosophy will leave sufficient resources for savings. We must once again target a higher Gross Domestic Savings to GDP.

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The reduction in savings from earlier levels can be attributed to growth in income levels of India's youth which is being used towards consumption, impulsive buying propelled by online discounts, and a growing culture of living life in the present. It would be important for the country to culturally connect its youth to their roots even as they grow economically. A strong emphasis on savings must be promoted to develop a community that practices simple living, avoids excessive materialism, and values self-sufficiency.

Access to low-cost savings accounts profoundly affects the amounts households save, invest, and consume. Underscoring the importance of savings for poor households, the Jandhan Yojana helped cover a significant part of the adult Indian population and has channelized Rs. ~2 lac crore into the mainstream. As a next step, products that address the specific needs and constraints of households can make financial access more powerful in mobilizing savings. Therefore, my second suggestion is to encourage people to save by introducing the right products. We need to better utilize the resources at EPFO, create sovereign wealth funds to manage nation's resources and channelize more savings in capital markets.

In conclusion, going back to our earlier enhanced domestic saving to GDP ratio of 35% on a much larger economy size of USD 3.5 trillion could provide a very good cushion against an uncertain foreign flow.

Sunil Sanghai
Founder & CEO
NovaaOne Capital Pvt. Ltd