

DEPRECIATION RESERVES AND THEIR ECONOMIC CONSEQUENCES

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THE excess of depreciation reserves over the replacement needs is a constituent of the national income that eludes even the fastidious grip of the national income accountant. For an individual firm depreciation reserves are not an income. But for a growing economy as has been demonstrated by Domar E.D.,¹ a portion of it is in the nature of income which can be used either for consumption or investment purposes. The greater the rate of growth, the higher proportion of depreciation reserves is in the nature of income.

In an economy where the total stock of fixed capital is constant over time, the depreciation allowed every year will be just sufficient to meet the requirements of replacing the yearly worn out fixed capital.² But where the amount of fixed capital is growing, the amount on which the depreciation is chargeable will be more than the constant amount of fixed capital that would go with a non-changing economy requiring the current rate of replacement. Consequently, there will be collected more amount in depreciation fund than will be required in current replacement, leaving a surplus to be utilised by the nation in the way it thought fit.

In the following, after recapitulating Domar's demonstration, we have given a method for calculating this surplus under the system of depreciation accounting prevalent in India, and then have considered in brief, its effects on the growth of an economy; and the distortions it may impose on the growth of a centrally planned economy, if this source is not taken into account.

¹ Domar, E.D., 'Depreciation, Replacement, and Growth', *The Economic Journal*, Vol. 63 (March 1963), pp. 1-32. Also reprinted in *Essays in the Theory of Economic Growth* by Domar E.D., (Oxford University Press, New York, 1957), pp. 154-194. See also Mathur P.N., 'A note on Planning in India', *Indian Economic Journal*, April 1957, pp. 402-3 where its effects on capital output ratios are examined.

² In this paper the discussion is throughout conducted as if the prices were constant over time. We have abstracted from the problems of financing replacement in inflationary or deflationary periods. For them individual tools have to be devised according to the nature of each situation. Refer Mathur, P.N., 'Depreciation in National Income Accounts' in *Papers on National Income*, Vol. 1. V.K.R.V. Rao *et al* (ed.).