Mains Practice Question

Q. Discuss the reasons for India's high current account deficit and suggest ways to address it. (150 words)

08 Feb, 2023   GS Paper 3 Economy

Approach

- Start your answer by introducing current account deficit.
- Discuss reasons for high current account deficit in India and suggest measures to address it.
- Conclude accordingly.

Introduction

- India, one of the fastest growing economies in the world, has been facing a persistent **high current account deficit (CAD)** in recent years. The current account, which **measures a country's transactions with the rest of the world**, reflects the balance of trade, net income, and net transfer payments.
    - In simple terms, a **high CAD indicates that the country is importing more goods and services than it is exporting** and relying on foreign capital inflows to finance the deficit.

Body

- **Reasons for India's High CAD:**
    - **Widening Trade Deficit:** India's trade deficit, the **difference between exports and imports**, has been widening in recent years due to a surge in **imports of crude oil, gold**, and other commodities.
        - The rising price of oil and other imported goods has contributed to the widening trade deficit, making it more difficult for India to balance its trade with the rest of the world.
    - **Increase in non-essential Imports:** India has been importing more capital goods, intermediate goods, and consumer goods, which have been pushing up the current account deficit.
    - **Low Exports:** India's **exports have remained sluggish due to a lack of competitiveness** in the global market and a **lack of investment in infrastructure and research and development.**
        - This has resulted in a persistent trade deficit, contributing to the high CAD.
    - **Depreciation of the Rupee:** A weaker rupee makes imports more expensive, leading to a higher current account deficit.
    - **High fiscal deficit:** The high fiscal deficit in India has led to a higher current account deficit as the government has to finance its spending by borrowing from abroad.
- **Ways to Address the High CAD:**
    - **Boosting Exports**: The government can take steps to boost exports by **investing in infrastructure, improving the business environment, and promoting innovation.**
        - This can be achieved by creating a favorable environment for investment, **reducing bureaucratic barriers, and providing incentives for exporters.**
    - **Encouraging Inward Investment:** The government can encourage inward investment by **reducing the regulatory burden and providing a stable business environment,**

by creating a favorable tax regime, improving access to finance, and reducing corruption.

- **Controlling Imports:** The government can take steps to control imports by promoting domestic production, reducing import tariffs, and encouraging the use of local goods and services.
  - By creating a favorable **environment for investment**, reducing bureaucratic barriers, and **promoting innovation.**
- **Encouraging Saving:** The government can encourage saving by promoting financial literacy, improving access to finance, and providing incentives for savings.
  - This can be achieved by creating a favorable environment for investment, reducing bureaucratic barriers, and promoting innovation.
- **Increase Energy Security:** India needs to reduce its dependence on imported energy, which will **reduce its import bill and improve its CAD.**
  - This can be achieved by increasing domestic energy production, developing alternative energy sources, and improving energy efficiency.

Conclusion

- India's high CAD is a result of a combination of factors, including a widening trade deficit, low exports etc.
- To address this challenge, the government needs to take a multi-pronged approach, including boosting exports, encouraging inward investment, controlling imports, and encouraging saving.
  - By taking these steps, India can reduce its dependence on foreign capital, improve its balance of trade, and become a more stable and sustainable economy.