Impact Factor (SJIF): 6.092 E-ISSN: 2583-1615

International Journal of Research in Academic World

Received: 25/April/2023 IJRAW: 2023; 2(5):67-70 Accepted: 23/May/2023

Impact of Merchandise Trade on Current Account Deficit in India

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Abstract

Although the World economy is continuing to expand at a good pace, the persistence of large fiscal and external imbalances clouds the international economic outlook. No country remains untouched by the international economic events. A country's balance of payment (BOP) is a detailed accounting of all economic transactions that took place within a specific time period between its citizens and others across the world. Balance of payment includes currents account and capital account. Current account deficit is a result of current account imbalance. CAD occurs when a country's total imports of goods, services and transfers are greater than countries total exports of goods, services and transfers. The balance of trade takes into account only the merchandise items and neglects services exports and capital flow. Imports have always been greater than exports. Thus it was found that imports of India are consistently higher from exports and it results as a negative trade deficit on regular basis. The main cause of the current account deficit is a trade deficit. The economy, stock markets, and investments are impacted by CAD. The trade deficit must be closed by making a more concerted effort to increase exports and control imports through the thoughtful removal of unnecessary or interchangeable goods.

Keywords: Balance of payment, trade deficit, exports, imports, current account balance

Introduction

Although the World economy is continuing to expand at a good pace, the persistence of large fiscal and external imbalances clouds the international economic outlook. No country remains untouched by the international economic events. In his work (Gerber, J. 2014) [1] suggest that One measure of the importance of international trade in a nation's economy is the sum of exports and imports divided by the GDP especially it is the value of all final goods and services produced inside a nation during some period usually one year. As a developing and a moderate trade partner of the world India as a country have a history of accelerated inflation, instability of exchange rates and interest rates fluctuations which had enormous impact on external trade relations.

A country's balance of payment (BOP) is a detailed accounting of all economic transactions that took place within a specific time period between its citizens and others across the world. It includes all of a country's current exporting and importing of goods and services, as well as financial operations including buying and selling foreign assets, making direct and indirect international investments, borrowing from and lending to other countries. Balance of payment includes currents account and capital account. The current account of balance of payment deals with transfers of current goods and services and unilateral transfers such as gifts or donations. The current account consists of two major items namely:

a) Merchandise exports and imports, and
b) Invisible exports and imports.

The capital account of the balance of payments is a record of all transactions which alter the external assets and/or liabilities of a country. Capital account includes three major items namely:

a) Foreign Investment
b) Loans and
c) Banking capital.

Balance of payment condition may have current account deficit or capital account deficit.

Although any type of disequilibrium is generally considered undesirable for a country, yet deficits are supposed to cause more harm than surplus can in the long-run. However, without the exact composition of the balance of payments one cannot and should not call deficits always bad. In contemporary international economics a number of concepts of balance in the balance of payments and deficits and surpluses are in use. For example, we have merchandise balance, current account balance, capital account balance, basic balance, balance on regular transactions, etc. Each of these matches selected credits with selected debits and give different result about deficit and surpluses in the BOP. Current account deficit is a result of current account imbalance. CAD occurs when a country's total imports of goods, services and transfers are greater than countries total exports of goods, services and transfers. This situation makes a country a net debter to the rest of the world. Current account deficit is not necessarily a bad thing for certain countries. It could be a positive for growth for some time whereas sometime it may be a negative sign, indicating countries credit risk. Developing countries may run a current account deficit situation in the short term to increase the local productivity and exports in the future. But in the long run this is not a desirable situation for the domestic economy. In his study (Ghose, Ajit K, 2013) [2] described that in 1991 India experienced a severe balance-of-payments problem. Numerous studies had been conducted following the economic unrest of 1991. In his study (Kumar, Nagesh, 2013) [3] discussed that the reforms pursued since 1991 have deepened global integration of the Indian economy in terms of a rising share of trade and an even more dramatic transformation of services trade as well as the emergence of the country as one of the most attractive destinations for and important source of FDI flows. In a Study Bhattacharya, M., & Bhattacharya, N. S. (2011) [4] observed that whether the volume of merchandise trade and FDI inflows influences economic growth. They concluded that India's capacity to progress will depend to a certain extent on the country's performance in attracting foreign capital. It was also found that dynamism of merchandise trade will accelerate economic growth in the country. The external sector received a significant boost from India's economic reforms and structural adjustments, which resulted in a current account surplus from 2001–2002 to 2003–04. Early 1990s peak tariff rates were 150%; by 2007, they were under 10%.

Status of Merchandise Trade

The most commonly used concept is merchandise balance or balance of trade. This is defined as the difference between the value of merchandise exports and the value of merchandise imports. If the value of merchandise exports and value of merchandise imports are equal to each other, then we say that there is balance in the balance of trade. If the value of merchandise exports exceeds the value of merchandise imports we say that there is balance of trade surplus. If the value of merchandise imports exceeds the value of merchandise exports, we say that there is balance of trade deficit.

The balance of trade takes into account only the merchandise items and neglects services exports and capital flow. The concept was very useful in the times of the mercantilists when services transactions constituted very less portion of the current account. It is not very useful today when services transactions have assumed very significant role and tend to neutralize balance of payment surplus or deficits. Deficits or surpluses in the balance of trade today cannot be called good or bad unless we have information about other accounts. For example if import of capital goods is causing the trade deficit it may not be regarded as undesirable and similarly trade surplus created by export of raw materials and primary goods may not be called desirable. Moreover, today if a country has surplus in its merchandise balance, its overall balance of payment may be in deficit and vice-versa. India has very low share in world trade and its development needs are becoming higher. In his study (Razmi,A.,2005) [5] estimated that India is a sizable developing nation with a low trade to gross domestic product ratio and is the subject of the balance-of-payments-constrained growth (BPCG) model application.

India's ranking was at twenty eight in merchandise export with a one per cent share in world export in 2006. India ranked at seventeenth place in merchandise imports with 1.4 per cent share in 2006. World trade data suggest that in 2017 India was at twentieth place in merchandise export while at eighth place in export of services. India stood at eleventh place in merchandise import and at 10^{th} position in services import. Taming imports is not desirable while exports can be easily hurdled in sluggish world trade. In his article (Rajagopalan, R. 2020) [6] studied the Indo-Pacific strategy of India, which grew out of its former "Look East" and "Act East" strategies. This policy is considerably more concerned with strategic issues than it is with commerce or connectivity. So a close look on current account is always needed. India's Foreign Trade:

In recent decades, India has emerged as a significant exporter, which has helped the Indian economy soar to new heights. The quantity of goods exported from India has increased dramatically, and the market is currently more expansive than ever. India is largely responsible for importing specific items into several overseas markets. The major exports from India include sugarcane, automobiles, jewellery, pharmaceuticals, and petroleum products. (Dr.P.Ragu, 2017) [7] study determines correlation between India's current account balance (trade) with India's external debt, its components and selected foreign exchange rates. Foreign exchange rates include US dollar and pound. The study found that India has experienced heavy imports since independence. Imports have always been greater than exports. It can be observed in the following table:

India's Foreign Trade

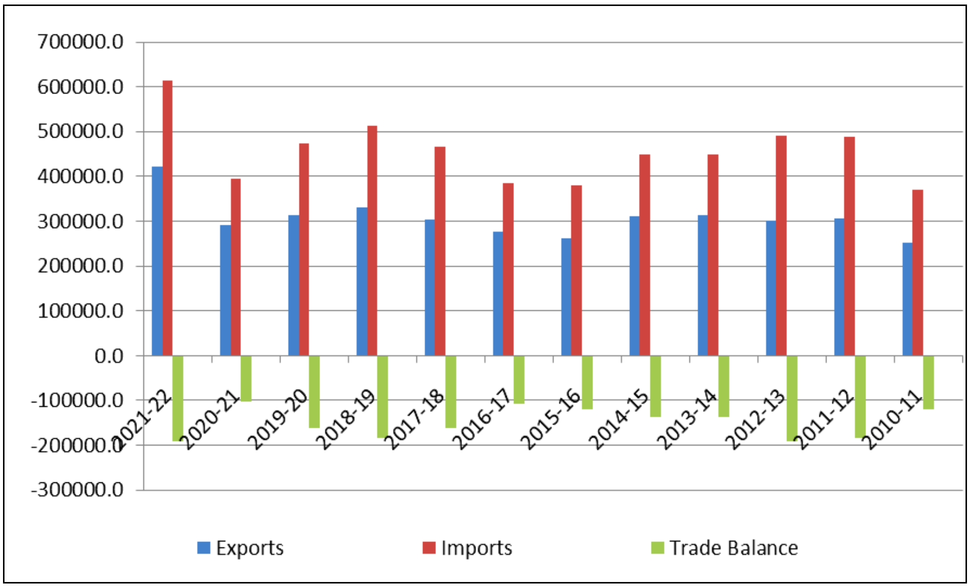
Table 1: India's foreign trade (US $ Million)

Year	Exports	Imports	Trade Balance
2021-22	422004.4	613052.1	-191047.7
2020-21	291808.5	394435.9	-102627.4
2019-20	313361.0	474709.3	-161348.2
2018-19	330078.1	514078.4	-184000.3
2017-18	303526.2	465581.0	-162054.8
2016-17	275852.4	384357.0	-108504.6
2015-16	262291.1	381007.8	-118716.7
2014-15	310352.0	448033.4	-137681.4
2013-14	314415.7	450213.6	-135797.9
2012-13	300400.6	490736.6	-190336.1
2011-12	305963.9	489319.5	-183355.7
2010-11	251136.2	369769.1	-118632.9

Source: Handbook of Statistics on Indian the Economy 2022, RBI.

The analysis of foreign trade data suggest that export of India increased from 251136.2 US million $ in 2010-11 to 422004.4 US $ million in 2021-22. While imports of India increased from 369769.1 US million $ in 2010-11 to 613052.1 US $ million in 2021-22. The trade deficit was much higher as 190336.1 US $ million in 2012-13.This scenario made a very negative impact on current account balance. In 2013 the foreign exchange rate of Indian currency was effected negatively. Thus it was found that imports of India are consistently higher from exports and it results as a negative trade deficit on regular basis.

India's Foreign Trade



Graph 1: India's Foreign Trade (US $ Million)

India's Current Account and Trade Balance

The main cause of the current account deficit is a trade deficit. The economy, stock markets, and investments are impacted by CAD. A lower CAD can boost investor confidence and increase the currency's attractiveness to foreign investors. The study by (Hassan, M. S., Wajid, A., & Kalim, R., 2017) [8] demonstrates a long-term association between India's trade imbalance and its contributing elements. The results show that a real effective exchange rate depreciation reduces the trade deficit significantly. India's trade imbalance considerably decreases as economic growth increases. It was found that by focusing on India's real effective exchange rate, per capita income, and money supply, the trade imbalance might be reduced.

India's Current Account and Trade Balance

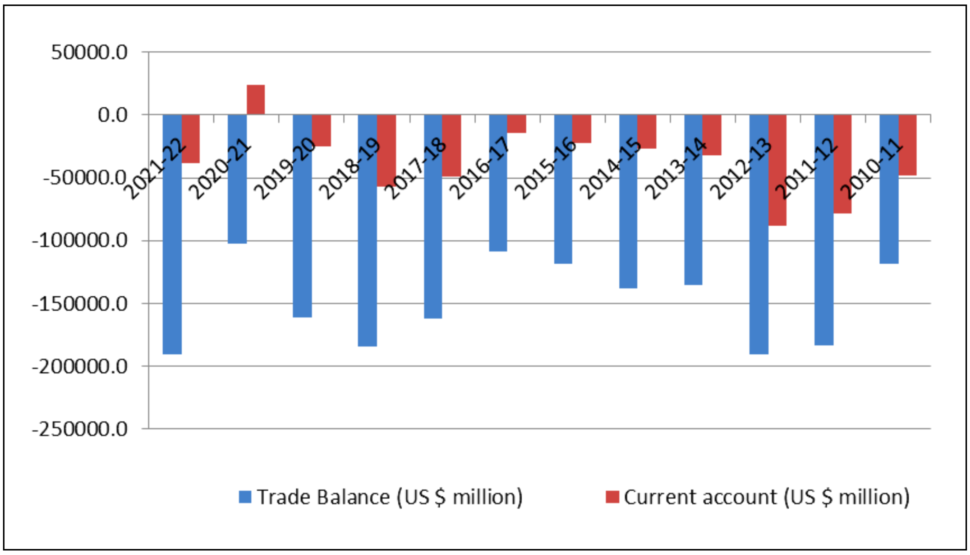
Table 2: India's current account and trade balance (US $ Million)

Year	Trade Balance	Current account
2021-22	-191047.7	-38766
2020-21	-102627.4	23912
2019-20	-161348.2	-24656
2018-19	-184000.3	-57256
2017-18	-162054.8	-48717
2016-17	-108504.6	-14417
2015-16	-118716.7	-22151
2014-15	-137681.4	-26859
2013-14	-135797.9	-32296
2012-13	-190336.1	-88163
2011-12	-183355.7	-78155
2010-11	-118632.9	-48053

Source: Handbook of Statistics on Indian the Economy 2022, RBI.

The Trade balance and current account data of recent decade suggest that trade deficit has a big impact on current account deficit. In 2011-12 the trade deficit was 183355.7 US $ million and the current account deficit was 78155 US $ million. In 2021-22 the trade deficit was 191047.7 US $ million and the current account deficit was 38766 US $ million. Thus it can be seen that the trade deficit was nearly same but current account deficit become much lesser.

India's Current Account and Trade Balance



Graph 2: Trade Balance and Current Account

Conclusion and Suggestions

This research article titled "Impact of merchandise trade on current account deficit in India" aims to evaluate the economic impact of the current account deficit on India from a variety of perspectives. From 2011 until 2022, trends and the makeup of India's imports and exports were examined. A number of variables, including high oil costs, an increase in the importation of capital goods, and a fall in exports, have contributed to India's current account deficit. Policymakers and economists continue to be concerned about the current account deficit because it can make the economy more susceptible to external shocks and changes in the state of the global economy. The Indian government and central bank have implemented a number of steps to alleviate the current account deficit, including tightening the budget and the money supply to lower inflation and foster economic growth as well as increasing exports and lowering imports. The trade deficit must be closed by making a more concerted effort to increase exports and control imports through the thoughtful removal of unnecessary or interchangeable goods. It is unrealistic to anticipate a net decrease in imports during an economic expansion. The amount of outstanding debt has inevitably risen as a result of ongoing current account deficits. Correction of the current budget imbalance is necessary for a strategy to guarantee a sustainable balance of payments. A smaller current account deficit translates into a smaller economy-wide disparity.

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