India in Trade Deficit with Top Trading Partners

For Prelims: Trade deficit, free trade agreement, export-oriented sectors, external debt, inflation, Merchandise Exports from India Scheme (MEIS) , Sagarmala project , Foreign Direct Investment (FDI)

For Mains: Current Status of India's Trade Deficit, Key Impacts of the Trade Deficit on the Indian Economy, Possible Measures to control the Trade Deficit.

Source: TH

Why in News?

Recent official data shows that India has a trade deficit with **9 out of its top 10 trading partners**, including China, Russia, Singapore, and South Korea in 2023-24.

- A trade deficit occurs when the **value of a country's imports exceeds the value of its exports,** with imports and exports referring both to physical goods and services.

What is the Current Status of India's Trade Deficit?

- **India's total trade deficit in the last fiscal narrowed** to USD 238.3 billion as against USD 264.9 billion in FY 2021-22.
    - Trade deficit with China, Russia, S Korea, and Hong Kong increased in the last fiscal compared to 2022-23, while the trade gap with the UAE, Saudi Arabia, Russia, Indonesia, and Iraq narrowed.
- China has emerged as India's largest trading partner with $118.4 billion of two-way commerce in 2023-24, surpassing the US.
    - However, the US was the top trading partner of India during 2021-22 and 2022-23.
- India had a trade surplus of $36.74 billion with the US in 2023-24, and also with the UK, Belgium, Italy, France, and Bangladesh.
- India has a free trade agreement with four of its top trading partners - Singapore, the UAE, Korea and Indonesia (as part of the Asian bloc).

What are the Reasons Behind India's Trade Deficit?

- **Reliance on Energy Imports:**
    - India imports more than 85% of its crude oil needs which makes the Indian economy **vulnerable to the fluctuations** in global oil prices, significantly impacting the trade deficit.
- **Dependence on Key Inputs:**
    - Some Indian industries, like **pharmaceuticals, semiconductors** etc. heavily rely on imported raw materials and intermediates. This increases the import value and contributes to the deficit.
    - For instance, the pharmaceutical sector heavily imports **Active Pharmaceutical Ingredients (APIs)** from China.

- **Lower Exports of Manufactured Goods:**
  - The volume of exported manufactured goods from India, often **falls short of imports** due to factors like **lower manufacturing capabilitie**s and **lower competitiveness** in the global market compared to nations like China and the US.

What are the Key Impacts of the Trade Deficit on the Indian Economy?

- **Benefits:**
  - A trade deficit is **not essentially bad** if a country is importing raw materials or intermediary products as it would **boost manufacturing and exports.**
  - A short term benefit of the trade deficit is that higher imports ensure **availability of a wider variety of goods and services** to citizens which offer greater choices and further improve living standards.
  - The trade deficit also results in **currency depreciation** resulting in benefits like **preference of Indian exports** due to more competitive prices.
  - In some cases, a trade deficit can encourage domestic businesses to **invest in innovation and improve efficiency** to **compete with imported goods**. This can lead to **job creation in** export-oriented sectors like packaging, shipping, logistics etc.
- **Challenges:**
  - Over-reliance on imports **can stifle domestic innovation and production** in certain sectors, limiting the availability of domestically produced goods.
  - A large trade deficit, particularly in **sectors with significant import penetration**, can **lead to job losses** in the industries related to that particular sector.
    - For example, the **imports of textiles products** from Bangladesh, at cheaper rates, have caused some industries to shut off, resulting in job losses.
  - A persistent trade deficit can put downward pressure on the rupee's value, potentially **weakening the domestic currency.** This can make **imports even more expensive.**
  - Lower exports can lead to **decreased government revenue from export duties.** This can **impact the government's ability** to fund social programs and infrastructure development.
  - To finance a trade deficit, India might need to borrow from foreign sources, **increasing** external debt and **interest payments.**
    - This further depletes forex reserves, and signals economic instability to investors, leading to reduced foreign investment.

What Measures can be taken to Control the Trade Deficit?

- **Trade Agreements:** Negotiating and implementing FTAs with key partners **can reduce tariffs** and other barriers to Indian exports, making them more competitive in foreign markets.
  - **Example**: The India-UAE CEPA aims to reduce tariffs on over 80% of bilateral trade, potentially boosting exports of Indian textiles, pharmaceuticals, and agricultural products.
- **Improving Export Infrastructure:** Investing in infrastructure development, such as **modernising ports, roads, and** logistics networks can streamline the export process and reduce transportation costs.
- **Import Substitution:** The government shall encourage the use of **domestic substitutes for imported products** through public procurement policies and campaigns promoting locally made goods.
  - **Example:** Promoting the **use of domestically produced steel in government infrastructure projects** can reduce reliance on imported steel and boost the domestic steel industry.
- **Rationalise Imports**: Analysing import data can help identify **non-essential or luxury goods** that could be substituted with domestically produced alternatives.
  - **Example**: The government should discourage the import of certain electronic items through **higher tariffs,** encouraging consumers to choose domestically produced options.
- **Skilling the Workforce**: Investing in skill development programs can create a workforce with the expertise needed for modern industries, enhancing domestic production capabilities and reducing reliance on imports.
- **Managing Currency and Debt Levels Effectively**: The RBI should manage the rupee's exchange rate effectively, aiming for a balance that promotes exports without causing excessive

depreciation.
  - The government should focus on **fiscal consolidation** to reduce its debt burden, creating a more stable economic environment for domestic industries to flourish.

Conclusion

It's important to note that there's no one-size-fits-all solution, and the effectiveness of these measures depends on various factors like the specific trade partner, the nature of imports and exports, and the global economic climate. The Indian government needs to carefully assess the situation and implement a combination of these strategies to effectively address the trade deficit and promote sustainable economic growth.

Drishti Mains Question:

Q. Highlighting India's current trade deficit status with most of its major trading partners, discuss its impacts on the Indian economy. Also,suggest measures to bring down India’s trade deficit.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims:

Q. Consider the following countries: (2018)

1. Australia
2. Canada
3. China
4. India
5. Japan
6. USA

Which of the above are among the ‘free-trade partners’ of ASEAN?

(a) 1, 2, 4 and 5

(b) 3, 4, 5 and 6

(c) 1, 3, 4 and 5

(d) 2, 3, 4 and 6

Ans: (c)

Q. Which of the following best describes the term ‘import cover’, sometimes seen in the news? (2016)

(a) It is the ratio of value of imports to the Gross Domestic Product of a country.

(b) It is the total value of imports of a country in a year.

(c) It is the ratio between the value of exports and that of imports between two countries.

(d) It is the number of months of imports that could be paid for by a country’s international reserves.

Ans: (d)

Mains

Q. Normally countries shift from agriculture to industry and then later to services, but India shifted directly from agriculture to services. What are the reasons for the huge growth of services vis-a-vis the industry in the country? Can India become a developed country without a strong industrial base? (**2014)**