India's Trade Deficit as an Opportunity

For Prelims: **Trade Deficit**, **GDP**, **Foreign Portfolio Investment (FPI)**, **Capital Account**, **Current Account**, **Make in India**, **Budget Deficit**, **Balance of Payments**, **Micro, Small, and Medium Enterprises (MSMEs)**, **PM GatiShakti National Master Plan**, **National Logistics Policy (NLP)**, **Unified Logistics Interface Platform (ULIP)**, **Logistics Data Bank**, **Global Value Chain**, **Production-Linked Incentive (PLI)**, **Districts as Export Hubs**.

For Mains: Benefits and challenges associated with the trade deficit.

Source: IE

Why in News?

According to some economists, India's **trade deficit** is not a sign of **weak manufacturing** but reflects India's strength in **services** and attractiveness as an **investment destination.**

What is the State of India's Trade Deficit?

- **About:** A trade deficit occurs when a country **imports more goods and services** than it exports. It represents the amount by which the **value of imports exceeds the value of exports** over a certain period.
- **India's Trade Scenario:**
  - **Overall Trade Deficit**: Reduced from **USD 121.6 billion (FY23)** to **USD 78.1 billion (FY24)**.
  - **Services Trade:** Services exports stands at **USD 339.62 in FY24** and Services Trade Surplus stands at **USD 162.06 billion**.
    - India's share in world services exports rose from **0.5% (1993)** to **4.3% (2022)**, making India the **7th largest services exporter** globally.
  - **Merchandise Trade:** Merchandise exports stands at **USD 776 billion (FY23). Merchandise Trade Deficit** narrowed to **USD 238.3 billion (FY24)** from **USD 264.9 billion (FY23)**.
  - **Current Account Deficit (CAD)**: Reduced to **USD 23.2 billion (0.7% of GDP, FY24)** from **USD 67 billion (2% of GDP, FY23)**.
  - **Capital Account Balance:** Net inflows rose from **USD 58.9 billion (FY23)** to **USD 86.3 billion (FY24)**, driven by **foreign portfolio investment (FPI).**

Why is India's Trade Deficit not a Weakness?

- **Strength in Services:** India is a global leader in services and established a **competitive advantage** particularly **IT and pharmaceuticals** due to which it can afford to run a trade deficit in goods.
  - The export surplus in services allows India to import more goods **without destabilising** its economy.
- **Investment Destination:** When India attracts **foreign investment**, it results in a **capital**

account surplus, which is mathematically balanced by a **current account deficit.**
    - Therefore, the current account deficit is a **natural consequence** of India's strategy to attract investment.
- **Competitive Exports**: When a country runs a trade deficit, there is **downward pressure** on its **currency**, making it weaker relative to other currencies.
    - A depreciated currency makes the country's **exports cheaper and more competitive** in foreign markets, potentially boosting export activity.
- **Healthy Current Account Deficit:** India has successfully maintained a modest current account deficit of around **2% of GDP,** which is considered **sustainable.**
    - This level of deficit does **not pose an immediate risk** to the country's economic stability, as long as capital inflows match the deficit.
- **Comparative Advantage**: India's trade deficit is **not indicative of inefficiency** in manufacturing but it is based on the principle of **comparative advantage.**
    - Comparative advantage means **India exports what it is best at (services)** and imports goods where it has a **lesser advantage in production.**
- **Manufacturing Growth**: The current account deficit does not hinder the potential for greater manufacturing output.
    - **Machinery and engineering goods** imported to support **Make in India** initiative drive further **manufacturing expansion** in the Indian economy.
- **Higher Consumption Capacity:** By importing goods and services, a country can provide its citizens with a **wider range of products**, including those that may not be locally available or are more expensive to produce domestically and **raising living standards.**
- **Economic Flexibility**: When domestic production is not sufficient to meet demand, imports can fill the gap, preventing economic disruptions and ensuring that consumers and businesses have access to the goods they need.
- **Economic Integration**: Trade deficits reflect **global economic integration,** enabling access to imports that support industries and consumers.

What are the Disadvantages of Trade Deficits?

- **Loss of Economic Sovereignty**: Persistent trade deficits allow **foreign countries to buy domestic assets (opportunistic takeover),** risking loss of control over key sectors and increasing vulnerability to external influences. E.g., **Opportunistic takeover** of Indian companies.
- **Higher Unemployment**: Persistent trade deficits in an open economy may lead to domestic businesses being **unable to compete with cheaper imports**, causing job losses and economic stagnation.
- **Twin Deficits Hypothesis:** Trade deficits are often linked to **budget deficits**, as a government may **borrow to finance** its economic needs when exports are insufficient to cover imports.
- **Deindustrialization**: Persistent deficits may lead to a **decline in domestic manufacturing** and industrial sectors, as domestic industries struggle to compete with cheaper or higher-quality imports.
- **Balance of Payments Crisis**: If trade deficits are financed by borrowing, a sudden loss of confidence from foreign investors can trigger a **Balance of Payments crisis** as happened in 1991 with India**.**

What Measures are Needed for a Balanced Trade?

- **Export Credit Support:** Encouraging banks to offer **affordable and adequate export credit,** especially for **micro, small, and medium enterprises (MSMEs)** to gain **economies of scale** and in **competitiveness** in foreign markets.
- **Logistics Infrastructure:** Leveraging initiatives like the **PM GatiShakti National Master Plan** and **National Logistics Policy (NLP)** to streamline operations, reduce costs, and enhance **efficiency** in the logistics sector to support **domestic manufacturing at lower cost.**
    - NLP aims to reduce the **logistics costs to 8%** of the **GDP** by **2030 f**rom the existing **13-14%.**
- **Free Trade Agreements (FTAs):** Ensuring **FTAs** provide better terms for essential imports, enabling the country to meet **domestic demand cost-effectively.**
- **GVC Participation:** By joining **Global Value Chain (GVCs),** Indian firms can become part of

international supply chains, gaining exposure to a broader customer base and increasing export volumes.

- **Domestic Manufacturing:** Expanding the **Production-Linked Incentive (PLI)** schemes and strengthening the **Districts as Export Hubs (DEH)** initiative can boost domestic manufacturing and exports and help reduce trade deficit.
- **High Value Trade:** Increasing exports of **high-value goods and services** can reduce India's trade deficit by generating **more revenue per unit exported**.
  - E.g., companies like **Tata Motors and Mahindra Electric** can increase export of high-value **electric vehicles (EVs)**, export of renewable energy technologies such as **solar panels** etc.
- **Diversification of Export Basket:** By expanding exports into sectors like **defence equipment, aerospace, and renewable energy** (solar panels, wind turbines), India can ensure more **revenue generation** and reduce trade deficit.
- **Addressing Sanitary and Phytosanitary Barriers:** By addressing barriers like **pesticide residue limits, quarantine requirements, and animal health regulations**, India can open up new markets in **high income countries like the US** and increase its exports which can help in addressing **trade deficit.**

Drishti Mains Question:

Discuss the factors contributing to India’s trade deficit and suggest measures to address it.

UPSC Civil Services, Previous Year Question (PYQ)

Prelims

Q. With reference to Balance of Payments, which of the following constitutes/constitute the Current Account? (2014)

1. Balance of trade
2. Foreign assets
3. Balance of invisibles
4. Special Drawing Rights

Select the correct answer using the code given below:

(a) 1 only

(b) 2 and 3

(c) 1 and 3

(d) 1, 2 and 4

Ans: (c)

Q. Which of the following constitute Capital Account? (2013)

1. Foreign Loans
2. Foreign Direct Investment
3. Private Remittances
4. Portfolio Investment

Select the correct answer using the codes given below:

(a) 1, 2 and 3

(b) 1, 2 and 4

(c) 2, 3 and 4

(d) 1, 3 and 4

Ans: (b)

Mains

Q. Craze for gold in Indians has led to surge in import of gold in recent years and put pressure on balance of payments and external value of rupee. In view of this, examine the merits of Gold Monetization scheme. (2015)