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## **Is It Really Time For India to Shift Away From the Fiscal Deficit Debate?**

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Last week, NITI Aayog vice-chairman Rajiv Kumar [is reported to have stated](#) that he is more concerned about the rising trade deficit than the falling rupee. The remedy suggested by him is “more exports”. He warns that under the current circumstances, tightening fiscal and monetary policy at the same time would be asking for trouble.

That raises some legitimate questions. Is Kumar preparing the ground for a major fiscal onslaught to lift the economy up when the Reserve Bank of India’s two recent interest hikes (June and August) in quick succession appear to be not to the liking of the government?

And is he laying out a possible excuse for the likely fiscal blowout against the backdrop of assembly elections in five states before the end of 2018 and the May 2019 parliamentary elections?

### **Trade deficit and the falling rupee**

The reasons behind India’s trade gap (payments for imports of goods exceeding receipts from exports of goods) due to the falling value of the domestic currency are clear. The rupee’s depreciation would raise the landed prices of imports. If imports are quoted in dollars, especially petroleum crude, the import bill goes up. India imports nearly 75% of total oil requirements (half of the country’s imports).

Though India’s exports would become cheaper and more attractive to foreigners as the rupee falls in value, in the short run, production of exports cannot be stepped up to take advantage of the depreciation.

Secondly, India's exports are not as diversified as China's. The latest statistics show that the trade deficit in July 2018 is the highest in five years: \$18 billion. International agencies, including Nomura, report that besides the rising high oil prices (with Brent crude futures at \$72.67 a barrel this week), the slowdown in global growth would affect demand for India's exports.

With the festival season around the corner, India's gold imports would rise. As [The Wire has reported and analysed](#), India's electronics imports are on the rise – there was an increase of 11.9% this July, compared to 6.7% in the last crisis year (2013).

The current account deficit (CAD) or the net of inflows and outflows of foreign exchange would deteriorate to reach 2.8% of GDP in 2018-19 from 1.9% in 2017-18. The CAD is estimated in value terms at \$48.7 billion in 2017-18, which is more than \$14.4 billion (0.6% of GDP) in 2016-17. The basic balance (current account plus net flows of FDI) in the light of heavy pullout of hot money by portfolio investors is likely to be negative.

The International Monetary Fund approves of RBI's efforts towards stopping the fall in the rupee by using the reserves of \$426 billion. The two-way nature of exchange management, namely purchasing foreign exchange when the rupee is overvalued in 2017 to contain rupee appreciation and selling foreign exchange for arresting further decline in rupee in the last few weeks, is appropriate. The interventions in currency markets are no longer frowned upon.

The IMF is concerned with the falling rupee. If the fall in the rupee is not stopped, the CAD would increase. That would further exercise pressure on the rupee and the currency would further depreciate regardless of outflow of hot moneys.

The NITI Aayog's thinking, therefore, is at odds with conventional wisdom.

### **Twin deficits**

Rajiv Kumar [also says](#) that we should not focus on “fiscal deficit number, as large economies like USA, China and European Union do not give much importance to fiscal deficit”.

The world's advanced economies, after the 2008 global recession, resorted to buying bad debts of banks under the name of quantitative easing for pumping in money to get out of the economic rut. The near zero interest rate in the US and negative rates of interest in Eurozone and Japan did not work. Finding themselves caught in the liquidity trap, they switched onto a traditional Keynesian remedy of public expenditure.

India is not an advanced economy. Here, conventional theory applies: fiscal and trade deficits are twins. If an open economy spends more (aggregate demand exceeds aggregate supply), the excess demand spills over into external sector, leading to a trade deficit.

The RBI did the right thing as its mandated goal is domestic price stability. It raised the interest rate to 6.50% on August 1. By doing so, it maintained its credibility. Besides this, it intervened in

the currency markets for arresting the fall. The Turkish lira's 40% fall against the dollar on August 16 strengthened the dollar, further depressing all currencies, including the rupee.

The central bank has done its job, having raised the policy interest rate and intervened in the currency market towards stabilising the exchange rate.

Now, it is the government's turn. It should do what is expected of it: maintain fiscal stability.

There are differences how this is calculated as indicated in IMF's staff report after its usual, [annual mission to India under Article IV of the IMF Charter](#): If state governments' fiscal deficits are added to central government deficit, the nation's actual deficit for 2017-18 is 7% of GDP.

If we go by government's definition though, it is only 3.5%. In 2018-19, the IMF's estimate is 6.6% of GDP, whereas the budget estimate is only 3.3%. Differences in definitions aside, there is only one message. That is loud and clear. India cannot afford any fiscal indiscipline. The NITI Aayog's vice-chairman's advice that "we must shift debate out of fiscal deficit" seems to be out of step.

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