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CURRENT ACCOUNT DEFICIT: IS THIS A MAJOR PROBLEM FOR A COUNTRY LIKE INDIA

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ABSTRACT

The Objective of this term paper is to provide a concrete relationship between the Current account deficit and its Factors Affecting Indian economy. We have to carefully examine the various components of it and see its impact on the Indian economy. We'll briefly discuss What is Current Account deficit and In order to support our proposition we will look at Empirical data and see if we find any correlation when in the situation of lower Current Account Deficit the economy Performs better and on the counter with the higher Current Account Deficit economy has to go through a situation a tough spell. We'll try to look in the other developing Countries and see their trends with the Current account and try to connect the dots. We will also try and look through the phases in which developed countries has to go through and seeing is it a alarming situation for country like India which is still in its developing spell and yet to become a Developed country .Some of our studies we'll include (1) Are Current Account Deficit are persistent in other economy as well and they don't have any lasting impact on the economy. (2) Since Post-Reform did Indian Economy fared well since much of the regulation is detached. (3) As well as See if there is any Way that Government intervention helps in reducing Current Account Deficit.

INTRODUCTION

Current Account is an Obscure Economic Concept. But in Our study we have to scrutinize it carefully so that we can see the close examination of their Relationship with the economy and see how it affects it. Current Account Records transactions relating to exports and Imports of services plus unilateral transfers. Current account is a component of a balance of payments account which is a systematic record of all economic transactions between residents of a country and the rest of the world carried out in a specific period of time (financial year). Its other component is capital account. All items of flow nature are included In Balance of Current account and all items expressing changes in stocks are included in the Balance of Capital Account. Our Choice of concern here is Current account. Components of Current Account-

- Exports and Imports of goods.
- Export and Import of Services- Non-factor and factor services (called Invisible trade).
- Unilateral transfers (transfers Receipts/ Payments)
- Investment Income (Factor incomes from land, Bonds, Share abroad).

Arguments Favoring Lower Current account Deficit

For the support Of Our Proposition (1) Let's Go Back to India's Dream run period 2003-2008 since in that Period Growth has accelerated, as during 1994-1997, in both the cases "Success" has been attributed to "Economic Reforms". As the Pace of the Economic Growth is usually regarded as the

Primary indicator of the country's macroeconomic health. During the Period 2003/04-2007/08, the GDP Growth averaged an Unprecedented 8.8 Percent a year. The Previous best Five-Year period for Growth was in 1992/93- 1997/98 at a rate of 6.6 Percent a year. The reason we are discussing this is because this was the period of High growth rates in India and we can see the current account Deficit during the period and bring some correlation to it.

External Balance

Here Speaking of External Balance we are referring to Balance of payments account usually Current Account Balance is single most widely used Indicator of a nation's external balance position. In India too, the rise in the current account deficit to a record 3 percent of GDP of 1990/91. Below looking at the External Balance table, it can be seen that the situation has become a lot better during the period 2000/01-2007/08, Ranging between a high of 2.3percent of GDP in 2003/04 and low of minus 1.5 percent in 2007/08[1].

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[1] E.g. Source: RBI

Table 1: Balance of Payment Indicators

(Percent of GDP at Current Prices**)**

Year	2000	2001	2002	2003	2004	2005	2006	2007
Trade balance	-2.7	-2.4	-2.1	-2.3	-4.8	-6.4	-6.9	-7.7
Net invisibles	2.1	3.1	3.4	4.6	4.5	5.2	5.8	6.2
Current Account balance	-0.6	0.7	1.3	2.3	-0.4	-1.2	-1.1	-1.5

There is a marked rise in merchandise trade to GDP ratio from 23 percent in 2000/01 to 35 percent in 2007/08 as well as the Current account Balance shows similar Trends. The Recent trends also show the interaction of the Indian economy with the world economy. Therefore, it gives significance to our theory of a situation where the absence of stress in the Current account balance shows with the high growth rate period. Periods of High Growth can be seen with Low current account Deficit.

There is another perspective through which Current account can be seen and it is Important to see with that mirror too. Current Account is also the difference between national savings (both public and private) and Investment. A current account deficit may therefore reflect a low level of National savings relative to investment or a high rate of investment or both. Therefore, for poor developing countries and more than enough investment opportunities than they can afford to undertake because of low level of domestic savings, a current account deficit may be natural. But theoretically speaking for developing countries a deficit potentially spurs faster growth and Economic

development – although Research does not validate the truth of the statement that the country running Current account deficit grows faster, the reason can be seen with the simple argument that because of their less developed financial economic systems they cannot allocate foreign capital efficiently. Moreover, it was seen that the private capital flows from developing to developed countries. The reason must be because of their better financial economic systems. The empirical studies prove the fact that the advanced economies run a current account deficit, whereas emerging countries and developing countries often run surpluses or near surpluses. Another way to look at Current account deficit is in terms of inter-temporal trade exchanging cloth for wine today. But Looking at inter-temporal trade from another side means a country running a current account deficit is importing current consumption and exporting future consumption or importing goods today and in return, exporting goods in the future . But studies show that there is no reason why a country should not import goods today and export goods tomorrow.

Having a positive current account deficit has its own benefits like if a country is going through a crisis in shorter period of time or say some natural calamity hits it economy that depresses its ability to access its productive capacity, instead of holding the full burden of the shock immediately, the country can relax itself with the pain of shock with having a short term current account deficit as it eases the pain for them meanwhile. Conversely, research supports the proposition that countries that are subject to large economic shocks, should on average, Run current account surpluses as a form of precautionary saving. During hard times that money can be used as a way of bringing out the economy from the economic shock or natural disaster that it had been bestowed with.

Advanced economies trends can be seen with the period of High Growth Rate the Current account deficit was also quite low. We are taking here the example

[2] World Bank National Account Data, The Organization for Economic Cooperation and data their National account data files of the united states of America. In the Following year 2011 the U.S GDP was growing at a rate of 3.64 percent at the end of quarter 2011 and was running the Current account deficit of -2.74 percent that end quarter. Taking a time gap at the end of quarter four in the year 2014 the U.S economy was growing at a rate of 4.33 percent in the December quarter. Later that year the Current Account deficit shows -2.32 percent that quarter. And it Supports our study therefore with the period of High Growth rate a country should run a lower current account deficit as it also enables them to export Current consumption and receives future consumption as famously quoted Exporting current consumption and in return importing future consumption.

Now we'll look into the Indian Economic data and see If the situation says something about keeping the Current account deficit is beneficial or not. We'll look at the past trends through which the Indian economy has gone through and discuss their shocks and periods of high growth rate and their correlation with the current account deficit. For a developing country like India whose economy after post Reform is doing much Better and the economy is liberalized and integrated with the world economy.

Our point of Concern here is that is having a current account deficit is a problem for Countries and especially for an developing economy Like India We'll see this by looking at the India's growth rate and its current account deficit over the last 10 Years and see what we have so that we can conclude our argument by let see table for the growth rate and current account deficit.

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Table 2: India's Growth rate Year-by-year

(Percent per Year)

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
India's growth rate	9.6	9.3	6.7	8.6	9.3	6.2	5.4	7.5	8.0	7.1

Looking at the data we can see India showed a spurt in growth in 2007 and 2008 and some higher growth in 2011 also, later on we can see that much of the period had been of low and high change in growth in the economy. We'll now look in the same period of 2007 to 2016 Current account deficit to GDP ratio in the same period and try to see if there is any correlation we can see regarding the Current account deficit. Is it creating a hampering effect on the Indian economy? Let us present the table for now:

Table 3: India Current Account to Deficit to GDP Ratio

(Percent per year**)**

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CAD	-1.27	-2.28	-2.8	-2.81	-4.29	-4.8	-1.74	-1.31	-1.06	-0.7

***** CAD denotes Current account Deficit

We have a growth rate of 9.6 percent in the year 2007. In the following year we have a current account deficit of -1.27, one of the lowest during that period of time. So here we can see the connection between that an economy prefers a period of high growth rate with a low Current account deficit to GDP ratio. Again going further we can also look at the relative trends as well so let's go further in our analysis year 2011 was also one of the period of high growth in the economy in the recent time as well and looking at the current account deficit during the same time we had it around -4.29 as well one of the highest during that time, what would that suggest us? So again looking at data in the following year we had a GDP growth rate of 6.2 percent, one of the lowest during that period as well. We know that deficit in current account is [3] MINISTRY of Statistics and Programme implementation (MOSPI)being corrected by inflow of funds in the capital account. Seeing a higher Current account deficit lowers foreigner confidence in our economy. Having a higher current account deficit lowers our confidence in the eyes of foreigner of we repaying back their money as well. Later, during the period as well in the year 2015 we had a Current deficit of -1.058 percent as well as India's growth rate of 8.0 percent as well so it shows that having a lower Current account deficit shows boost foreign economy confidence in our economy and shows positive sign as well.

CONCLUSION

We Looked at developed economy as well as developing economy and see if there is any data that supports our proposition of having a low current account Deficit does have a positive effect on the growth rate on the economy and now coming to the conclusion of our arguments we said that most economy try to avoid a high current account deficit as we have said – A high current account deficit must be corrected by flow of funds (Via Capital account) through other account of the Balance of Payment .Economist always try and wants the economy should have a lower current account deficit as it boost foreign confidence in our economy. Persistent and high current account deficit is always a problem for every economy. A deficit of around -3% is always preferred by economists. Anything more than that is always found troublesome by the outsiders of our economy. A country like India should never hesitate to have a negative current account deficit. But a high and persistent current account deficit should always be avoided.

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