Rising Fiscal Deficit - Causes

What is the issue?

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- The government's fiscal deficit touched 114.8% of the full-year estimates at the end of November. Click here to know more.
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- It is essential that the government wake up to other causes beyond the oil import impact.
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What is the current trade scenario?

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- India's external account has once again emerged as a source of concern.
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- Notably, the current account deficit has widened to reach 2.4% of GDP over April-June 2018.
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- This increase was driven entirely by the trade deficit, which grew rapidly in 2017-18.
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- **Exports** - Since 2014, exports have been mostly stagnant (after a period of healthy increases before then).
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- But, total imports came down and then increased sharply in 2017-18.
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- This was reflected in the total merchandise trade deficit.
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- Trade deficit declined for several years from the large deficit observed in 2013-14, and only rose sharply once again in 2017-18.
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- Over the period April-November 2018, the trade deficit is once again said to have widened.
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How was the oil price impact?

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- It is true that India benefited hugely from the global decline in oil prices in the first 4 years of current government's tenure.
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- Evidently, the overall oil price scenario -
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i. reduced the pressure on the balance of trade
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ii. contributed to lower rates of domestic inflation
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iii. provided windfall gains to the public coffers
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- Notably, the government did not pass on most of the oil price decline to consumers but instead raised tax rates.
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- However, with India being net importer of oil, global oil prices have been suggested as the significant driver of the total trade deficit.
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- Periods of rising global oil prices have therefore been associated with higher total imports and vice versa.
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- So naturally, the external deficit is assumed to be driven by factors outside domestic policy control.

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Is oil price the only factor for trade deficit?

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- India is both an exporter and an importer of petroleum products.
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- Also, there is growing involvement of domestic oil refinery and distribution corporations (particularly the private ones).
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- Quite often, increased oil exports reflect the choices domestic oil companies make - to produce for the domestic market or to export.
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- These, in turn, are related to the local prices and duties, therefore driven by domestic policy.
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- The oil trade balance thus indicates that the oil deficit can increase even in periods of relatively low global oil prices (as in 2016-17).
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- This is because of the choices made by Indian oil corporations, especially the private players like Reliance.
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- So the impact of oil prices on balance of trade is not quite simple and is not driven only by external factors as it is believed to be.
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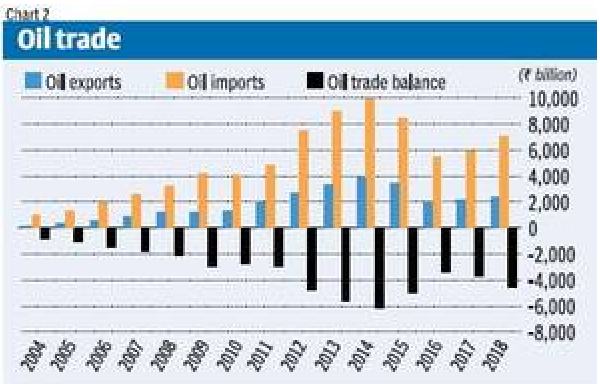

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What are the other factors?

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- Non-oil imports have typically been high and rising rapidly.
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- Even in the mid-2000s, non-oil trade was largely in balance and then began to show only relatively small deficits from 2006 onwards.
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- After 2008, such deficits grew rapidly, as imports kept growing much faster than exports.
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- Resultantly, the non-oil merchandise trade deficit peaked in 2012-13, ironically a time when global oil prices were also not that low.
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- They came down the following year, but then rose once more, as non-oil imports kept expanding rapidly.
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- It is to be noted that this increase was driven by increasing import volumes, as the prices for many of India's imports also remained low.
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- Low prices indicate that the potential of imports to displace domestic production has been much greater.
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- Increased imports of various final goods have added to the woes of many small-scale producers in agriculture and industry.
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- In all, even in the period of rise in oil prices in 2017-18, the non-oil trade deficit was even larger than the oil trade deficit.
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What does it imply?

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- High global oil prices are only one of the many reasons why India should be concerned about the rising external trade deficit.
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- The more significant causes lie elsewhere, and some are domestic.
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- The government should take note of this, and address the developments in non-oil imports too.
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Source: Business Line

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