India’s Emerging Twin Deficit Problem

Why in news?

The Finance Ministry report highlights two key areas of concern for the Indian economy - the fiscal deficit and the current account deficit.

What is optimistic in the report?

- **Stagflation**- The world is looking at a distinct possibility of widespread stagflation but India is at low risk of stagflation, owing to its prudent stabilization policies.
- **Economic growth**- The economic growth outlook is likely to be affected by Russia-Ukraine conflict owing to
  - the trade disruptions
  - export bans
  - surge in global commodity prices
  - inflation
- However, in India, the economic activities sustained in the first two months of the current financial year.
- It is a good sign for India that continues to be the quickest growing economy among major countries in 2022-23.

What is the concern with the fiscal deficit?

- **Fiscal Deficit**- The fiscal deficit is essentially the amount of money that the government has to borrow in any year to fill the gap between its expenditures and revenues.
- The fiscal deficit calculations are based on two components — income and expenditure.
- As per the CGA report, fiscal deficit for 2021-22 was pegged at 6.71 % of the GDP.
- **Impact**- Higher levels of fiscal deficit imply the government eats into the pool of investible funds in the market which could have been used by the private sector for its own investment needs.
- The report states that as government revenues take a hit following cuts in excise duties on diesel and petrol, a risk to the budgeted level of gross fiscal deficit has emerged.
- **Recommendations**
  - Trim revenue expenditure (or the money government spends just to meet its daily needs)
  - Rationalize non-capex expenditure

What is the issue with current account deficit (CAD)?

- **Current account deficit-** The current account essentially refers to two specific sub-parts.
  - Import and Export of goods (Trade account)

    - Import and export of services (Invisibles account)
- If a country imports more goods than it exports, it is said to have a trade account deficit whereas it earns a surplus on exporting more services than importing.
- If the net effect of a trade account and the invisibles account is a deficit, then it is called a current account deficit or CAD.
- **Impact**- A widening CAD tends to weaken the domestic currency because a CAD implies more dollars or foreign currencies are being demanded than rupees.
- The report stated that costlier imports such as crude oil and other commodities will not only widen the CAD but also put downward pressure on the rupee.
- A weaker rupee will, in turn, make future imports costlier.
- FPI continuously pulling out money from the Indian markets due to higher interest rates in the western economies will also hurt the rupee and further increase CAD.

References

1. https://indianexpress.com/article/explained/everyday-explainers/indias-emerging-twin-deficit-problem-explained-7982895/
2. https://www.investopedia.com/terms/f/fiscaldeficit.asp#:~:text=A%20fiscal%20deficit%20is%20a,spent%20in%20excess%20of%20income.
3. https://www.economicsdiscussion.net/budget/3-types-of-budget-deficits-and-their-measures-micro-economics/753

Quick facts

Glossary

- **Inflation-** Inflation is the rate of increase of the overall price level of goods and services in an economy.
- **Stagflation-** Stagflation describes a combination of high inflation and economic stagnation as reflected by a slow growth rate and high unemployment.
- **Budgetary deficit-** It is the excess of total expenditure (both revenue and capital) over total receipts (both revenue and capital).
- **Revenue deficit-** It is excess of total revenue expenditure of the government over its total revenue receipts.

  Revenue deficit = Total revenue expenditure – Total revenue receipts

- Fiscal deficit- It is defined as excess of total budget expenditure over total budget receipts excluding borrowings during a fiscal year.

  Fiscal deficit = Total expenditure – Total receipts excluding borrowings

- **Primary Deficit-** It is defined as fiscal deficit of current year minus interest payments on previous borrowings.

Primary deficit = Fiscal deficit-Interest payments