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[Economy] Current Account Deficit: How to Calculate it?

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Balance of Payment

Is made up of two components 1. Current account and 2. Capital Account.
This article, deals with Current Account only.

Current account

It is made up of three parts.

- 1. Balance of Trade
- 2. Earning from Investment
- 3.Cash Transfers

Part #1: Balance of trade

Since we are talking about India's Current account, whatever money is incoming we take it as positive (+) and whatever money is outgoing, we take it as Negative (-). For 2010-11→

Goods and Services	Worth (Million Dollars)
Export	+299284
Import	-381061
Total	-81777

- We got a negative number, therefore India has a trade "DEFICIT" of 81777 million US$ for year 2010-11. Call this figure (1)

- If we had got a positive number, we could say India had trade "SURPLUS"
- Unfortunately, we can never have "Surplus" because every-year we've to import crude oil and gold worth billions of dollar and that disturbs the whole *balance*.
- Rajiv Gandhi Equity saving scheme was an initiative of Pranab, to make Indians reduce gold-purchase and use that money to invest in capital market. But so far it seems to be heading for #EPICFAIL. Reason: Target audience doesn't have PAN cards and Demat accounts.
- Note: For the sake of simplicity, I've added + and – in front of incoming and outgoing money and did the "total". But technically it is called "net difference" between exports and imports.

Part #2: Earning on Investment

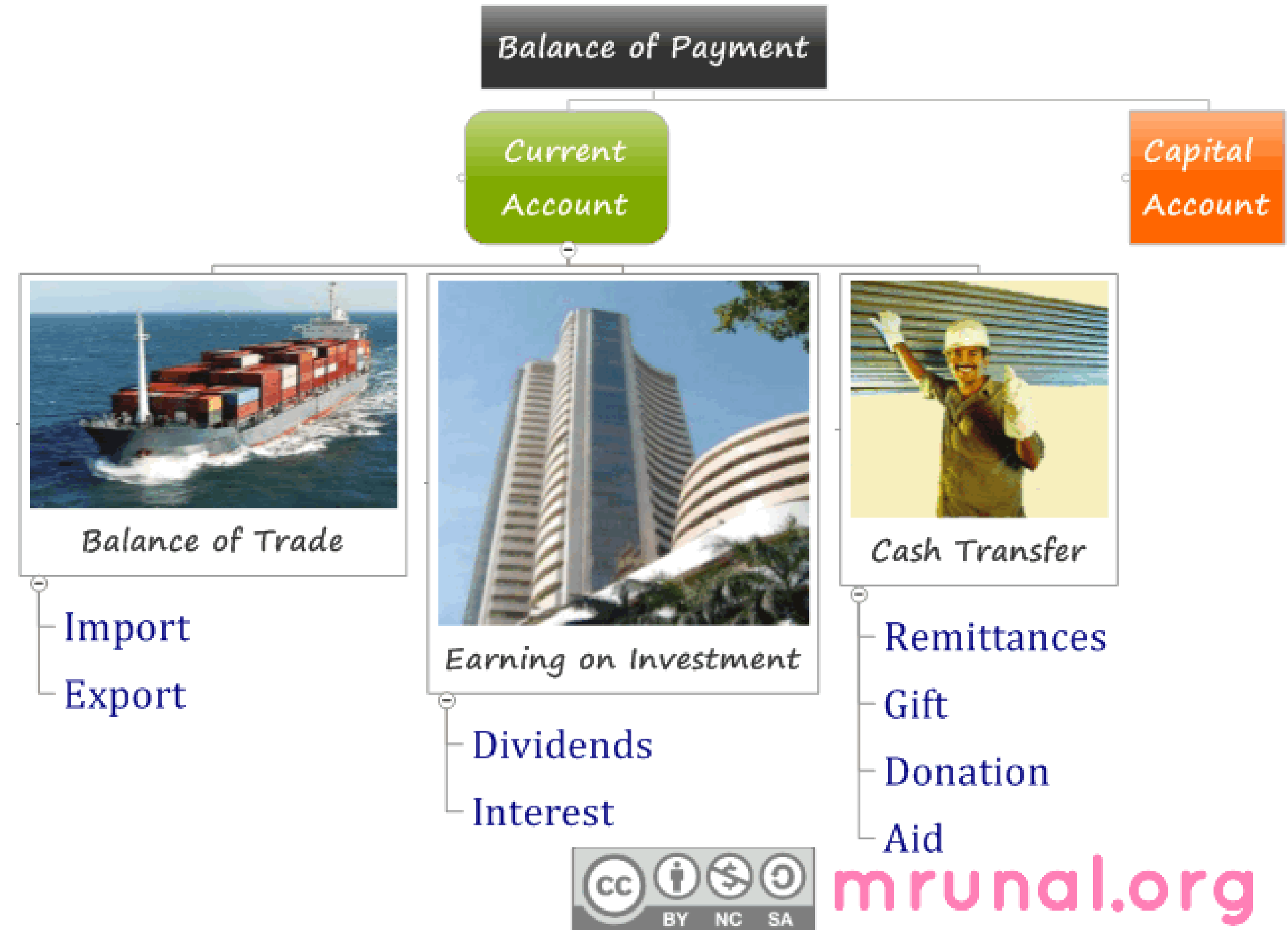
- Foreigners invest their money in India (both FDI and FII), similarly Indians invest their money abroad.
- On their investment, they earn income: interest rates / dividends etc.
- The amount of money actually invested, is put under Capital Account
- But the amount of income or interest earned on ^above investment, is put under "Current account"
- For example, An FII invests $100 on 8% Bond, therefore earns $8 in interest after one year. The $100 are classified in Capital account and $8 are classified in Current Account.
- Take the difference of incoming and outgoing Earning on Investment for 2010-11 it was -17309 Million US$…..call this figure (2)
- Question: why was it negative? Because more Foreigners invest in India compared to Indians investing abroad. (we do invest 'abroad' but in Swiss bank accounts only :P). Besides even if an Indian had invested in American or European market, he'd not have recieved much income from the investment because of the global financial crisis during that period.

Part #3: Cash Transfer

- The money transferred without exchanging any goods or services. For example an Indian worker sending money from Dubai to his family in Kerala(Remittances)
- Some American nuclear powerplant company using a charity foundation to send donations to *Jholachhap* NGOs of India, to help them finance the protests, *dharnaa pradarshan* against Russian nuclear powerplants in India = that is also one type of "service" offered by Indian NGOs but still "Donations" fall under "Cash transfers" and not under the "Goods and services"
- Again take difference of incoming and outgoing money: thankfully this number was positive for 2010-11: it was +53140 Million US$….call this figure (3)
- Why was it positive? Because so many Indian people work abroad and send money to their families, that remittance is soooo high, that it skews to balance in positive direction
- Besides there are very few foreigners working in Indian and remitting money back home. One of them was that Italian tourist-agent in Orrisa but he was kidnapped by

naxalites and went back to Italy so that is one less foreigner remitting money from India to abroad = next year the "cash-transfer" of India will look even more positive!

Current Account Deficit



Simply do the addition of figure (1), (2) and (3)

2010-11	Worth US Million $
Balance of Trade	-81777
Earning on Investment	-17309
Cash Transfer	53140
Total	-45946

Since we got a negative number, we call this Current Account Deficit (CAD): worth 45946 million US dollars.
1 billion = 100 million
10 lakh = 1 million

1 billion = 100 crores = 100 x 100 lakhs = 1000 x 10 lakh = 1000 million
1 billion = 1000 million
Hence, 1 Million = 1/1000 Billion
45946 million
= 45946 x (1/1000) billion
=45.9 billion $
Note: you'll get different number on different website and sources based on their data-sources. But 2010-11's CAD was somewhere between 45-55 billion $.
Although absolute number by itself is not important for exams. Economy is not about absolute numbers but context of those numbers.

The Invisibles

Theoretically, the CAD is calculated using above three figures: BoT + EI + CT
But in real life, many countries, including India uses a slightly modified method of CAD calculation.
Under the Current Account subheads, they classify money according to visibility of products.
Visible = import and exports of Goods (gems, petroleum, textiles etc)
Invisible involves

- Import and export of services (softwares, call centre, tourism, softwares, insurance etc.)
- Earning on investment (dividends, profits, interest etc.)
- Cash transfer (remittances, donations etc.)

^These three are classified under "invisible" because you don't see any physical goods/products moving around during the transaction.
So, take the balance (net difference) of visible
and take the balance (net difference) of invisibles.
Add them up and you get CAD.

Implications of Current Account Deficit

- As long as India continues to import to crude oil and gold, we cannot have Current account Surplus
- That means we are doomed to have current account deficit for the years to come. So Think about following questions:
- How does increase or decrease in CAD help us or harm us?
- Is CAD always bad?
- How can we reduce the Current Account Deficit?
- Ofcourse one solution is: ask the Naxalites to kidnap more and more foreign workers to decrease the outbound remittances! That'd also reduce the foreign investment coming into those naxal-affected regions = less outgoing money in "Earning from Investment" = Current Account Deficit reduced! But is it good for the overall Indian economy? Think about it!