Policy Lessons for India from Argentina

Why in news?

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- The Argentinian currency has hit a record low against the US dollar raising concerns on the economy of the country.
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- India which has relevance with global economic changes needs to acquire policy lessons from the Argentina.
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What are the economic tensions in Argentina?

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- Argentina is a small economy which is much dependant on Dollar economy with lack of economic fundamentals.
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- The country is now in danger of defaults in terms of its external borrowings with numerous episodes of current-account instability.
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- Prospect of higher interest rates in the United States has pushed Argentina to the brink of another crisis.
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- Due to this Argentina will not be able to control inflation, reduce the fiscal deficit and keep the growth revival going all at the same time.
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What is the relevance of global economic conditions for India?

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- When global conditions are positive, the Indian macro-fundamentals appear strong.
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- A global low-interest rate regime would aid fund flows into the Indian economy and finance the Current Account Deficit (CAD)
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- Low crude oil prices will keep the trade deficit under control as well as moderated inflation and the fiscal deficit.
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- Since the recent global interest rates and crude oil prices are high due to global economic condition India might face the scenario of external borrowing and might become default if measures are not taken.
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What are the concerns for Indian economy?

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- The new global macroeconomic headwinds will expose the basic inadequacy of the Indian economy on the external account.
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- The combination of returning inflation and the government’s loosening of its self-imposed fiscal consolidation targets proves this scenario.
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- As of now India is not in any danger of default, and has indeed been remarkably responsible in terms of its external borrowing.
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- But India faces a danger of losing control of its macroeconomic policy because of a past unwillingness to undertake structural reform.
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- India has more foreign exchange reserves than it needs during such crisis, but even so an episode of capital flight will drain reserves and stress the rupee.
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- If this happens Reserve Bank of India will not be able to manage the rupee, preserve foreign exchange reserves, and operate an independent monetary policy.
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What policy lessons India needs to learn from Argentina?

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- India to stabilize its external account and to restore the ability to conduct

macroeconomic policy needs microeconomic reforms that make Indian products competitive.
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- It will cause a reduction in imports as well as an increase in exports, allowing India to survive the sort of adverse conditions which already claimed Argentina as a victim.
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- India does not need to approach an Argentina-style crisis to discover the negative effects on its domestic economy of a failure to address underlying external weaknesses.
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- But Argentina is an important reminder to India that structural weaknesses on the external account are always capable of reducing the set of policies available to decision makers.
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Source: Business Standard

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