Fundamentals of Economics
Home Assignment-1

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Question 1:

We all know the issues of excessive debt & how it harms in the long-run. India currently has a debt of approx 75% of it' s GDP. You have been appointed as an economic advisor to the Govt of India. Pls detail why do you think this is harmful for our country & suggest any 10 measures should we adopt to reduce it?

Answer:

The COVID-19 pandemic has led to an increase in debt not only for India but for most countries around the world.

Current Debt of India:

In 2020 India's debt was around ₹147 lakh crore against last year's estimated GDP of ₹194 lakh crore . In 2021, the government borrowed another ₹12 lakh crore.

Most of the emerging economies have a government debt that is around 40% to 50% of their GDP. Compared to that our debt is around 75% to 80% of our GDP, which used to be on the higher side.

Advanced countries like the US and Japan may have even higher debt levels. But Apoorva Javadekar, assistant professor of finance at the Indian School of Business (ISB), believes that India should not compare itself to these economies because their repayment capacity is also much higher than India.

Why is a high debt harmful for the country?

- Debt-to-GDP ratio greater than 77% can negatively affect growth of a nation in the long run, according to the World Bank. Along with other measures, global investors use this ratio to make their decision about the destination country for their funds.

- Similarly, a rule of thumb was introduced by the Indian government in the form of Fiscal Responsibility and Budget Management (FRBM) Act in 2003. This act states that the government should maintain a debt-to-GDP ratio at 60% except in extreme situations.

- The composition of the debt is one of the key considerations in deciphering whether the current levels of debt are dangerous. Too much of external debt can cause considerable damage, especially in countries with limited foreign reserves who could find it hard to repay in the future.

- If the government has too much debt and it fulfils this debt by printing more money,then the value of that money goes down.

- If there are unforeseen circumstances like another pandemic or a war,the economic growth may take a hit and that is when a high debt will become a problem.

  A short-term rise in deficit to combat the pandemic is necessary. But in the medium term it is vital to reduce debt

As an Economic advisor to the government of India,I would suggest the following measures to reduce the country's debt:

1) Interest Rate Manipulation: Maintaining interest rates at low levels is another way that governments seek to stimulate the economy, generate tax revenue, and, ultimately, reduce the national debt. Lower interest rates make it easier for individuals and businesses to borrow money. In turn, those borrowers spend that money on goods and services, which creates jobs and tax revenues.

2) Instituting Spending Cuts: By instituting deep budget cuts, the nation can reduce its budget deficit.

3) Issuing Debt With Bonds: Issuing debt seems like a logical approach, but keep in mind that the government must pay interest to its creditors, and at some point, the borrowed money must be repaid. Historically, issuing debt has provided an economic boost to various countries, but in and of itself, the improved economic growth has not been particularly effective in reducing long-term government debt directly.

4) Raising Taxes: Although tax hikes are common practice, most nations face large and growing debts. It is likely that the higher debt levels are

largely due to the failure to cut spending. When cash flows increase and spending continues to rise, the increased revenues make little difference to the overall debt level.

5) Build a constituency for limited government and lower taxes:

Terminate corporate welfare and use the savings for capital gains and business tax cuts;

Reduce outdated and duplicative programs and use the savings to reduce income taxes across the board;

Privatize federal corporations by offering current public employees stock options at below-market prices;

Commercialize air traffic control duties and privatize airports, targeting the savings to airline security; and

Devolve programs to states while alleviating federal mandates and reducing federal taxes.

6) Privatize activities that could be performed better by the private sector: There is little economic justification for the government's running businesses that the private sector can run itself. Even when there is a compelling reason for government to regulate or subsidize businesses, it can do so without seizing ownership of them.

7) Terminate irrelevant programs and reform wasteful programs : Government must be made light and flexible, adaptable to the new challenges the country will face in the 21st century. Weeding out the failed and outdated bureaucracies of the past will free resources to modernize the government.

8) Terminate corporate welfare and other mistargeted programs : These programs harm the economy. Operating subsidies and loans to private businesses overtax productive sectors of the economy and redistribute that money to less productive sectors, based on the fallacy that it will somehow create jobs. Programs subsidizing start-up companies represent a misguided attempt by government to pick the market's winners and losers.

9) Consolidate duplicative and contradictory programs : Government's layering of new programs on top of old ones inherently creates duplication.

Having several agencies perform similar duties creates administrative waste and confuses program beneficiaries who must navigate each program's distinct rules and requirements.

10) Reducing public debt ratios : there is progress on attempts to monetise large poorly performing government assets accumulated in the planning period, to retire government debt or transform expenditure in more productive directions. A distinction between a temporary and a permanent rise in government expenditure is important. While deficits can finance the former, the latter requires a rise in taxation.

Question 2:

Capitalism, Socialism, Mixed economy all have their pros & cons. In your opinion, what type of economic system will suit India as of today & justify your answers with any 10 reasons for the same.

Answer:

As of today , the best suited economic suited system for India is Mixed Economy.

What is Mixed Economy?

A mixed economic system is a system that combines aspects of both capitalism and socialism. A mixed economic system protects private property and allows a level of economic freedom in the use of capital, but also allows for governments to interfere in economic activities in order to achieve social aims.

Most modern economies feature a synthesis of two or more economic systems, with economies falling at some point along a continuum. The public sector works alongside the private sector, but may compete for the same limited resources. Mixed economic systems do not block the private sector from profit-seeking, but do regulate business and may nationalize industries that provide a public good. For example, the United States is a mixed economy, as it leaves ownership of the means of production in mostly private hands but incorporates elements such as subsidies for agriculture, regulation on manufacturing, and partial or full public ownership of some industries like letter delivery and national defense. In fact, all known historical and modern economies fall somewhere on the continuum of mixed economies. Both pure socialism and pure free markets represent theoretical constructs only.

Why Mixed Economy is best suited for India?

1. In this economy both private sector and public sector function together. The heavy industries such as defence equipment, atomic energy, heavy engineering industries etc., come under the control of public sector, on the other hand, the consumer goods, small and cottage industries, agriculture, etc., are assigned to the private sector. The government helps the private sector by providing several facilities, of their development.

2. Public Sector seeks to avoid regional inequalities, provides large employment opportunities and often its price policy is guided by considerations of economic welfare rather than by profit motive. Private activities are influenced through monetary and fiscal policies to make them contribute to economic welfare of the society at large level.

3. In mixed economy the government adopts the instrument of economic planning.This is necessary for the public sector enterprises which have to work according to some plan and to acieve certain predetermined objectives.

4. The private sector cannot be left to develop in its own way.To ensure a coordinated and fast economic development the programmes of both the sector are drawn in such a way that growth in one complements the growth in other.

5. The Mixed Economic System considered to be more appropriate to remove the demerits of the capitalist and communist economic systems. Encouragement is given to free economic activities and at the same time steps are also taken to control economic activities.

6. Mixed economy also permits adequate freedom to different economic units:

(a) Consumers are free to dispose of their incomes in a manner they want, although the government does try to influence these decisions through monetary, fiscal and commercial policies.

(b) Factors of production are free to choose their own occupations although again the Government may strive to create conditions favourable for the growth of chosen occupations.

(c) Private initiative is always encouraged to find it's best possible use.

7. In mixed economic system, the state makes efforts to provide maximum welfare to workers and other citizens. The government makes provision for the employees for housing, education, minimum wages, good working conditions, etc.

8. In mixed economy, the modern technology and capital saving method is used, with the result large- scale production and profit could be possible. Reserve fund is created to meet any undesired situation in future. It produces more at the time of trade boom and utilise the reserve capital when there is recession.

9. The resources are utilised in the best possible manner in the Mixed Economic System. The Central Government makes economic planning for optimum use of the resources. Thus shortage is avoided; productive efficiency increases and cyclical fluctuations are eliminated.

10. There is healthy competition in the market. There is no cut-throat competition and adverse tactics due to government oversight. Also, there is no absolute lack of competition which is disadvantageous.