

1. Critically examine the impact of external debt on India's economy. How can India manage its foreign borrowings efficiently?

External debt refers to the total amount of money that a country owes to foreign entities. External debt can be a double-edged sword for a developing economy like India. While it can provide much-needed capital for development, it also carries potential risks if not managed prudently. As of September 2024, India's external debt was \$711.8 billion, which is 19.4% of the country's GDP. This is a 4.3% increase from June 2024.

Positive Impacts:

- **Financing Development:** External debt can supplement domestic resources, allowing India to invest in crucial sectors like infrastructure, education, and healthcare. This can stimulate economic growth and improve living standards.
- **Access to Global Capital:** It provides access to a larger pool of funds at potentially lower interest rates than domestic borrowings, especially for long-term projects.
- **Technology Transfer:** Borrowing from international institutions or through FDI can facilitate the transfer of technology and expertise, boosting innovation and productivity.
- **Enhanced Creditworthiness:** Servicing external debt responsibly can enhance a country's creditworthiness, making it easier to attract future investments.

Negative Impacts:

- **Debt Burden:** Excessive external debt can lead to a heavy debt servicing burden, with a significant portion of export earnings being used to repay principal and interest. This can strain public finances and limit spending on essential services.
- **Vulnerability to External Shocks:** A large external debt makes the economy vulnerable to external shocks like currency fluctuations, changes in global interest rates, and commodity price volatility. These shocks can disrupt economic growth and lead to financial instability.
- **Currency Risk:** If the debt is denominated in a foreign currency, depreciation of the domestic currency can increase the cost of servicing the debt, further burdening the economy.
- **Conditionalities:** Loans from multilateral institutions may come with conditionalities that can limit a country's policy space and force it to adopt policies that may not be in its best interests.
- **Debt Trap:** In the worst-case scenario, if a country is unable to service its debt, it can fall into a debt trap, where it has to borrow more just to repay existing debt, leading to a vicious cycle of indebtedness.

Managing Foreign Borrowings Efficiently:

- **India can adopt several strategies to manage its foreign borrowings effectively:**
- **Prudent Borrowing:** Borrow only when necessary and for productive investments that generate returns to service the debt. Avoid taking on excessive debt for consumption or unproductive spending.
- **Diversifying Sources of Borrowing:** Reduce reliance on any single source of borrowing. Explore different options like multilateral agencies, bilateral agreements, and international capital markets to diversify risk.
- **Maintaining a Healthy Debt-to-GDP Ratio:** Keep the external debt-to-GDP ratio at a sustainable level. This indicates the country's ability to service its debt without jeopardizing its economic growth.
- **Managing Currency Risk:** Minimize exposure to currency fluctuations by borrowing in a mix of currencies or using hedging instruments to mitigate currency risk.
- **Strengthening Export Competitiveness:** Enhance export competitiveness to increase export earnings, which can be used to service external debt more easily.
- **Promoting Domestic Resource Mobilization:** Focus on increasing domestic savings and investment to reduce reliance on external borrowing.
- **Effective Debt Management:** Establish a robust debt management framework with clear guidelines for borrowing, monitoring debt levels, and ensuring transparency in debt transactions.

- **Sound Macroeconomic Policies:** Pursue sound macroeconomic policies that promote economic growth, price stability, and fiscal discipline. This creates a favorable environment for managing external debt.

By carefully considering the potential risks and adopting proactive strategies, India can utilize external debt as a tool for development while safeguarding its economic stability. It's crucial to strike a balance between utilizing external resources and maintaining a sustainable debt burden to ensure long-term economic prosperity.

2. Discuss the challenges in increasing India's tax-to-GDP ratio. Suggest measures to improve tax compliance and efficiency.

India's tax-to-GDP ratio, a key indicator of the government's ability to mobilize resources, has remained stubbornly low compared to other developing and developed nations. This presents a significant challenge in funding public services, infrastructure development, and social welfare programs.

Challenges in Increasing India's Tax-to-GDP Ratio:

1. Large Informal Sector: A substantial portion of India's economy is characterized by informal activities, often cash-based and undocumented. This makes it difficult to track income and enforce tax compliance.

- According to the National Statistical Office (NSO), the informal sector contributed about 24% to India's GDP in 2019-20.

2. Narrow Tax Base: A small percentage of the population actually files income tax returns. This is due to factors like low per capita income, exemptions for agricultural income, and a large number of people working in the unorganized sector.

- In the assessment year 2022-23, only about 8.16 crore individuals filed income tax returns out of a population of over 1.4 billion.
- **Tax Evasion and Avoidance:** Tax evasion, where individuals and businesses deliberately underreport income or engage in illegal activities to avoid paying taxes, is a significant problem.
- Tax avoidance, using legal loopholes to minimize tax liability, also contributes to lower collection. Benami Transactions (Prohibition) Act, 1988: Aims to curb black money and tax evasion by prohibiting benami transactions.

3. Complex Tax Laws: India's tax laws have been criticized for being complex and cumbersome, making it difficult for taxpayers to understand and comply. This can lead to unintentional errors and also create opportunities for tax evasion.

4. Inefficient Tax Administration: The tax administration system faces challenges like corruption, slow adoption of technology, and inadequate training of tax officials, hindering efficient tax collection.

5. Low Tax Morale: Tax morale, the willingness of citizens to pay taxes, is relatively low. This can be attributed to factors like lack of trust in the government, perception of corruption, and a feeling that taxes are not being used effectively.

6. Exemptions and Incentives: Various tax exemptions and incentives provided to specific sectors or industries, while sometimes necessary, can erode the tax base and contribute to a lower tax-to-GDP ratio.

Measures to Improve Tax Compliance and Efficiency:

1. Expanding the Tax Base:

- **Formalizing the Economy:** Encourage formalization through promoting digital transactions, simplifying business registration, and strengthening labour laws.
- **Increasing Awareness:** Conduct campaigns to educate citizens about the importance of paying taxes and the benefits of compliance.
- **Improving Taxpayer Services:** Make filing returns and paying taxes easier through online platforms, simplified forms, and assistance centres.

2. Strengthening Tax Administration:

- **Technology Upgradation:** Invest in technology for improved tax collection, tracking, and analysis. Use data analytics to identify potential tax evaders and improve compliance.
- **Capacity Building:** Train tax officials to enhance their skills in tax laws, investigation, and technology usage.
- **Reducing Corruption:** Implement measures to curb corruption in the tax administration system through increased transparency, digitization, and stronger accountability.
- **Project Insight:** An initiative by the Income Tax Department to use data analytics for better tax compliance and detection of tax evasion.

3. Simplifying Tax Laws:

- **Rationalizing Tax Structure:** Simplify tax laws by reducing the number of tax slabs, eliminating unnecessary exemptions, and making the system easier to understand.
- **Reducing Compliance Burden:** Streamline tax procedures and reduce the burden on taxpayers, especially small businesses.
- **Goods and Services Tax (GST) Act:** Introduced in 2017 to simplify indirect taxes and improve tax compliance.

4. Improving Tax Compliance:

- **Strengthening Enforcement:** Take strict action against tax evaders and increase penalties for non-compliance.
- **Promoting Voluntary Compliance:** Offer incentives for voluntary compliance, such as rewards for timely filing and tax benefits for honest taxpayers.
- **Leveraging Technology:** Use technology to track financial transactions and identify potential tax evaders.

5. Building Tax Morale:

- **Increasing Transparency:** Ensure transparency in the use of tax revenue and communicate effectively with citizens about how their taxes are being used.
- **Improving Governance:** Enhance governance and reduce corruption to increase public trust and encourage tax compliance.
- **Income Tax Act, 1961:** Governs direct taxes and has been amended periodically to improve compliance and efficiency.

By implementing these measures and leveraging technology, India can gradually increase its tax-to-GDP ratio, enabling the government to mobilize more resources for development and public services.