Navgujarat Commerce College

Affiliated to Gujarat University

NAVGUJARAT COMMERCE COLLEGE GANDHINAGAR

Reading Material:

Economics of Government Finance
B. Com. Sem - III

(For internal use and reading purpose only)

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Syllabus

S. Y. B. COM. SEMESTER - III
CC - 201 ECONOMICS OF GOVERNMENT FINANCE

Unit : 1: INTRODUCTION TO PUBLIC FINANCE
Economic systems - concepts - Capitalism, Socialism and Mixed Economy - characteristics. Public and Private Finances: meaning, difference and similarities. Indian Federal Finance: concepts of three layers of government. Market failure and role of government. Characteristics of public and private goods, merits goods. Government budget, its importance. Various concepts of deficit: revenue deficit, budgetary deficit, fiscal deficit, primary deficit, their uses and effects.

Unit : 2 :TAXATION
Direct and indirect taxes : meaning and its characteristics - concepts of progressive, proportional and regressive taxes. Present Indian tax structure: its characteristics and defects. Role of taxation in economic development. Meaning of tax avoidance and tax evasion.

UNIT: 3: INCOME AND PUBLIC EXPENDITURE
Sources of income of local government, state government and central government. Public expenditure: purpose, importance and causes of increase in public expenditure. Meaning of Fiscal Responsibility and Budget Management Act (FRBM Act). Privatization and disinvestment : concept and importance.

UNIT: 4: PUBLIC DEBT
Public debt - meaning and types of public debt. Economic effects of public debt. Difference between taxation and debt. Burden of public debt - Learner's and Buchanan's view point.

References :
1) Public finance in Theory & Practice : R.A. Musgrave & P.G. Musgrave
2) Introduction to Public Finance : Carl C. Plehn
3) The Theory & Working of Union Finance in India: Bhargava R. N.
4) D.M.Mithani : Money, Banking, International trade and Public finance
5) Public Finance : H.L. Bhatia
6) Public Finance : B.P.Tyagi
7) Public Finance : R.C. Agrawal
8) Modern Public Finance : Jha R.
9) Intermediate Public Economics : Jean Hindriks & gareth D. Myles
10) Public Finance : S.K. Singh
11) Public Finance : M. Maria John Kennedy

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Unit: 1 Introduction to Public Finance

Q-1 Discuss the meaning and features of capitalist economy or capitalism. (6 Marks – 2013, 2015)

Introduction:

Capitalism is an economic system in which each individual in his capacity as a consumer, producer, and resource owner is engaged in economic activity with a large measure of economic freedom. Under capitalism resources are owned privately and there is no government intervention in economic decision making of consumers and producers.

Meaning of Capitalism

Following are some of the definitions of Capitalism:

According to W. N. Lucas, "The capitalism is that kind of organisation which is natural and man-made. The capital ownership is private, and the purpose of economic activity is profit. It is also called as dashing system."

In the words of John Stvachi, "Capitalism is a system where farms, factories and mines etc. is owned by private people. The main factor which run the entire system is not love but profit."

From the above definitions we can say that in capitalism resources are owned privately and are used to earn profit. It is a system where freedom of choice about how to use these resources is there.

Features of Capitalism

Following are the main features of a capitalist economy;

(1) **Private Property:** Capitalism thrives (flourish, succeed, prosper) on the institution of private property. It means that the owner of a firm or factory or mine may use it in any manner he likes. He may sell it, or lease it or use it at will. Government's role is confined to the protection of the institution of private property through laws.

(2) **Profit Motive:** The main motive behind the working of the capitalist system is the profit. The decisions of businessmen, farmers, producers, including that of wage-earners are based on the profit motive. The profit motive is synonymous with the desire for personal gain. It is this motive which guides the decision making of entrepreneurs regarding how to use their resources.

(3) **Price Mechanism or Market Mechanism:** Under capitalism, the price mechanism operates automatically without any direction and control by the central authorities. It is the profit motive which determines production. Producers take decision about how much to supply in the market based on prices. Based on the same prices consumers also decide what to purchase and how much to purchase. It is the consumers' choices which determine what to produce, how much to produce, and how to produce. Thus in capitalism market mechanism works on the basis of forces of demand and supply.

(4) **Role of Government:** During the 19th century, the role of government was confined to the maintenance of law and order, protection from external aggression, and provision for educational and public health facilities. This policy of laissez-faire—of non-intervention in economic affairs by the Government—has been abandoned in capitalist economies. Now government, through its monetary and fiscal measures, try to maintain aggregate demand. It tries to control the situations of inflation and deflation in an economy and thus tries to maintain balance.

(5) **Consumers' Supremacy:** Under capitalism, 'the consumer is the king.' It means freedom of choice by consumers. The consumers are free to buy any number of goods they want. Producers try to produce variety of goods to meet the tastes and preferences of consumers.

(6) **Freedom of Enterprise:** Freedom of enterprise means that there is free choice of occupation for an entrepreneur, a capitalist, and a labourer. But this freedom is subject to their ability and training, legal restrictions, and existing market conditions. Subject to these

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limitations, an entrepreneur is free to set up any industry, a capitalist can invest his capital in any industry or trade he likes, and a person is free to choose any occupation he prefers. It is on account of the presence of this important feature of freedom of enterprise that a capitalist economy is also called a free enterprise economy.

(7) Competition: Competition is one of the most important features of a capitalist economy. It implies the existence of large number of buyers and sellers in the market who are motivated by self-interest but cannot influence market decisions by their individual actions. It is competition among buyers and sellers that determines the production, consumption and distribution of goods and services.

Q-2 Discuss the meaning and features of socialism.

Introduction:

Under socialism the decisions as to how much to produce, which methods of production to employ and for whom to produce are taken by the planning authority. That is why a socialist economy is also called a planned economy. Such economies are China, Cuba, Vietnam, and North Korea.

Meaning:

A socialist economy is an economic organisation in which the means of production are owned and regulated by the government. The production and distribution of goods and factors of production are done by the government under the direction of the planning commission.

According to H. D. Dickenson, "Socialism is such type of system where the ownership of the factors are with society and its organisation is done by public representatives and unions. The fruits are of the entire society."

Features of Socialism

Following are the main characteristics of a socialist country:

(1) Public / Collective Ownership: A socialist economy is characterised by public ownership of the means of production and distribution. There is collective ownership whereby all mines, farms, factories, financial institutions, distributing agencies (internal and external trade, shops, stores, etc.), means of transport and communications, etc. are owned, controlled, and regulated by government departments and state corporations. A small private sector also exists in the form of small business units which are carried on in the villages by local artisans for local consumption.

(2) Central Planning: A socialist economy is centrally planned which functions under the direction of a central planning authority. It lays down the various objectives and targets to be achieved during the plan period. Central economic planning means "the making of major economic decisions—what and how much is to be produced, how, when and where it is to be produced, and to whom it is to be allocated—by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole."

The central planning authority organises and utilises the economic resources by deliberate direction and control of the economy for the purpose of achieving definite objectives and targets laid down in the plan during a specified period of time.

(3) Definite Objectives: A socialist economy operates within definite socio-economic objectives. These objectives "may concern aggregate demand, full employment, satisfaction of communal demand, allocation of factors of production, distribution of the national income, the amount of capital accumulation, economic development…and so forth." For achieving the various objectives laid down in the plan, priorities and bold targets are fixed covering all aspects of the economy.

(4) Freedom of Consumption: Under socialism, consumers' sovereignty implies that production in state- owned industries is generally governed by the preferences of

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consumers, and the available commodities are distributed to the consumers at fixed prices through the state-run department stores. Consumers' sovereignty under socialism is confined to the choice of socially useful commodities.

(5) **Equality of Income Distribution:** In a socialist economy, there is great equality of income distribution as compared with a free market economy. The elimination of private ownership in the means of production, private capital accumulation, and profit motive under socialism prevent the amassing of large wealth in the hands of a few rich persons. The unearned incomes in the form of rent, interest and profit go to the state which utilises them in providing free education, public health facilities, and social security to the masses.

(6) **Planning and the Pricing Process:** The pricing process under socialism does not operate freely but works under the control and regulation of the central planning authority. There are administered prices which are fixed by the central planning authority. There are also the market prices at which consumer goods are sold. There are also the accountings prices on the basis of which the managers decide about the production of consumer goods and investment goods, and also about the choice of production methods.

(7) **Absence of competition:** In the socialistic pattern, the ownership is of the government and that is why competition is not necessary. The sector has to produce only on the basis of the targets decided by the government. In order to achieve the urgency of targets the competition is observed but in the nature of the bureaucracy it is not successful. This leads to state monopoly.

(8) **Maximum Social Advantage:** In socialism resources are owned by the society and are utilized for the benefit of the whole society. The state distributes the sources among such various uses that they think will serve the social ends. The state determines the commodities to be produced and the technique of production. This is done on the basis of certain arbitrary standards taking into consideration the use and proper allocation f goods and services for maximum social advantage.

(9) **There is no exploitation:** Under socialism, since state is the employer, there is no exploitation of workers. The state applies the two fold principle for wages. One is the quantity and quality of work done. He, who produces more, gets a higher wage, and vice versa. The second basis is the needs of the worker. For example, a minimum wage rate is fixed which must be adequate to provide the basic requirements of the workers.

Conclusion:

Socialism is an economic system where government controls the resources and decides about how to use the resources and what to produce and for whom to produce. Under socialism a government aims at maximum welfare of its citizens.

Q-3 Explain meaning and features of Mixed Economy. (6 Marks – 2012)

Introduction:

The developing countries like India have adopted mixed economy to accelerate the pace of economic development. Even the developed countries like UK, USA, etc. have also adopted 'Mixed Capitalist System'.

Meaning:

According to Prof. Samuelson, "Mixed economy is that economy in which both public and private sectors cooperate."

According to Murad, "Mixed economy is that economy in which both government and private individuals exercise economic control."

From the above definitions we can say that a mixed economy is a golden mixture of capitalism and socialism. Under this system there is freedom of economic activities and government

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interferences for the social welfare. Hence it is a blend of both the economies. The concept of mixed economy is of recent origin.

Features:

Following are the main features of a mixed economy:

1) **Co-existence of Private and Public Sector:** Under this system there is co-existence of public and private sectors. In public sector, industries like defense, power, energy, basic industries etc., are set up. On the other hand, in private sector all the consumer goods industries, agriculture, small-scale industries are developed. The government encourages both the sectors to develop simultaneously.
2) **Personal Freedom:** Under mixed economy, there is full freedom of choice of occupation, although consumers do not get complete liberty but at the same time government can regulate prices in public interest through public distribution system.
3) **Private Property is allowed:** In mixed economy, private property is allowed. However, here it must be remembered that there must be equal distribution of wealth and income. It must be ensured that the profit and property may not concentrate in a few pockets.
4) **Economic Planning:** In a mixed economy, government always tries to promote economic development of the country. For this purpose, economic planning is adopted. Thus, economic planning is very essential under this system.
5) **Price Mechanism and Controlled Price:** Under this system, price mechanism and regulated price operate simultaneously. In consumer goods industries price mechanism is generally followed. However, at the time of big shortages or during national emergencies prices are controlled and public distribution system has to be made effective.
6) **Profit Motive and Social Welfare:** In mixed economy system, there are both profit motive like capitalism and social welfare as in socialist economy. Government companies aim at increasing public welfare while objective of private firms is profit maximization.
7) **Check on Economic Inequalities:** In this system, government takes several measures to reduce the gap between rich and poor through progressive taxation on income and wealth. The subsidies are given to the poor people and also job opportunities are provided to them. Other steps like concessions, old age pension, free medical facilities and free education are also provided to improve the standard of poor people. Hence, all these help to reduce economic inequalities.
8) **Control of Monopoly Power:** Under this system, government takes huge initiatives to control monopoly practices among the private entrepreneurs through effective legislative measures. Besides, government can also take over these services in the public interest.

Conclusion:

A mixed economy is a golden mean between a capitalist economy and a socialist economy. It is an economic system where the price mechanism and economic planning are used side by side. There is mixture of private and public ownership of the means of production and distribution. Some decisions are taken by households and firms and some by the planning authority. All developing countries like India are mixed economies.

Q-4 Differentiate between capitalism and mixed economy. (6 Marks: 2014) and socialism

Introduction:

Capitalism, Socialism and Mixed economy are economic systems for running a country. All the three have their advantages and disadvantages. Here we have tried to differentiate between the three.

Difference between Capitalism, Socialism and Mixed economy:

Following points show the difference between different economic systems:

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Sr.	Point of Difference	Capitalism	Socialism	Mixed Economy
1	**Basic goals**	Under capitalism the basic objective is maximizing profit.	Socialism aims at increasing welfare of people.	In mixed economy government aims at increasing welfare while private enterprise focus on maximizing profit.
2	**Price determination**	Price is determined by the market forces of demand and supply.	Price is determined by government.	Price of some products are determined by government and for other products it is determined by market forces.
3	**Control over market**	Private enterprises have complete control over market. Least government interference.	Government controls the market.	Private enterprise have some control of market but more of government interference is there.
4	**Attitude of workers.**	Workers' pay is directly related with their effort so they are efficient in their work.	Since government takes responsibility of workers they try to work as less as possible.	Efficiency in private sector is high but government employees are not interested in working hard.
5	**Choices in the market.**	Consumers have wide variety of goods available to choose from.	Only the goods considered necessary by government are produced so no choice is available.	Choice is available to consumers due to competition among private entrepreneurs.
6	**Social freedoms.**	Freedom of speech, press, assembly, job choice, election etc. are available.	Strict government control and no such freedom is granted to citizens.	Freedoms are provided but some restrictions are imposed by the government.
7	**Ownership of wealth**	Private ownership of wealth is allowed.	Government owns all the resources no private property rights.	Some wealth is owned by government but for other property private property right is given.
8	**Competition**	There is tough competition in market.	Absence of competition in market.	There is competition in market. Government companies also compete with private companies in market.

Conclusion:
All the three economic systems are different from each other but mixed economy shares the characteristics of both capitalism as well as socialism.

Q-5 What does Federal Finance System mean? Discuss the problems of Federal Finance. (6 Marks: 2013, 2015)

Introduction:
The essence of the federal form of government is that each government (Central, Union Territories and State governments) and local-self government is independent of each other with constitutionally demarcated (separate) functions. What is needed is that each government should have independent sources of revenue and should have command over resources to meet its needs.

Meaning:
Federal Financial System is a system of government in which there is division of powers and functions between federal government and several regional governments.

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According to Dr. R. N. Bhargava, **"federal finance refers to the finance of the federal as well as of the state governments and the relationship between the two."**

Thus we can say that Federal Finance refers to the system of assigning the source of revenue to the Central as well as State Governments for the efficient discharge of their respective functions i.e. clear-cut division is made regarding the allocation of resources of revenue between the central and state authorities.

Problems of Federal Finance:
A federal financial system faces following problems:

1. **Responsibility of collecting tax:** Under federal financial system, responsibility of collecting taxes lies with both central as well as state governments. One problem may arise is regarding which taxes are to be collected by the state and which are to be collected by the centre.
2. **Distribution of tax between state and centre:** One of the problems that is faced is regarding determining share of state government from the taxes collected by central government from the particular state.
3. **Dependence of states on centre:** The portion of state governments in collected taxes is very less so in order to carry out its responsibility state governments have to depend on grants received from central government. Many a times state governments ask for more grant than they need and the extra money is misused by the states.
4. **Basis of giving grant:** If central government provides grants on the basis of predetermined percentage of tax collected from the state than developed states will get more money while the backward states will receive less money. This distribution is not going to help the backward states bring about much development.
5. **Insufficient grants:** The responsibility of state governments are more while the grants and share in taxation is less so budgets of state government are in deficit. In order to fulfill this deficit, state governments have to take loans from the central government.

Conclusion:
Federal financial system means a layered system. In India the federal financial system includes central government, state government and local self-governments. The main problems that are faced in a federal system relates to distribution and utilization of tax income and grants.

Q-6 Compare public finance with private finance. (6 Marks, 2014) OR Give the meaning of public and private finance and differentiate between them (6 Marks – 2012)

Introduction:
Public finance deals with the money-raising and money-spending actions of government. Private finance means the financial problems and policies of an individual economic unit.

Meaning of Public Finance:
According to B. S. Bastable, "Public finance deals with the expenditure and income of public authorities of the state, and their mutual relation as also with the financial administration and control."
In order to maintain justice, law, order, equality and social welfare of people, government has to spend money. They have to generate income also. So the actions of government related with income and expenditure of income for protection and welfare is public finance.

Meaning of Private Finance:
Private finance is the study of revenue, expenditure, borrowing and financial administration of individuals or private companies. The objective of private finance is to fulfill the requirements of individuals, individual firms and companies is based on the principle of rationality.

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Similarities between Public and Private Finance:

Following are some of the points which show similarity in both public and private finance:

1. **Objectives:** Both public and private finance aim at maximization of satisfaction. Public finance focuses on maximizing individual want while public finance focuses on maximizing social satisfaction.
2. **Rationality:** Under both public finance as well as private finance the decisions regarding allocation and utilization of resources are based on rational thinking.
3. **Problem of choice:** The resources available with government as well as individuals and businesses are scarce and have alternative uses. Thus, both government and individuals are faced with problem of choice to decide how to utilize their resources.
4. **Debt:** In case expenditure of any of them exceeds income, both have to resort to loans.
5. **Budget:** In order to manage their scarce resources both public finance and private finance includes preparation of budget.

Differences between Public and Private Finance:

Following table shows the dissimilarities between public finance and private finance.

Sr.	Point of Difference	Public Finance	Private Finance
1	**Objective**	Public welfare,	Personal satisfaction, profit maximisation
2	**Expectation of return**	Government spend money without expecting any return.	Individuals spend money for the satisfaction of their wants.
3	**Compulsion**	Contribution to public finance in the form is compulsory in nature.	Spending money by an individual on any good is voluntary.
4	**Planning income – expenditure**	Government decides what it desires to spend and then plan to generate required resources.	Individuals try to adjust their expenditures to their income.
5	**Limit of resources**	Resources available with government are wider.	An individual has access to limited amount of resources.
6	**Present – future**	Public finance is concerned with the needs of present time as well as future times.	Private finance concerns with the needs of present time only.
7	**Budget**	In public finance deficit budget is considered good.	In private finance balanced or surplus budget is considered good.
8	**Effect of expenditure**	Government can remove inflation, unemployment, depression etc. through its expenditure policy. So government expenditure policy affects the society.	An individual expenditure policy does not impact the society as a whole.
9	**Basis of expenditure**	Expenditures are based on maximum social welfare.	Expenditures are affected by taste, preference, social status, customs etc.
10	**Secrecy**	Government budget is open public document and is available to all.	Secrecy in private finance is possible.
11	**Delay in expenditure**	Government cannot afford to delay vital expenditure like defense, famine relief etc.	Individuals can afford to delay his expenditure.

Conclusion:

Both public and private finance have some similarities but they are also different from each other in many areas. Public finance is necessity for development and welfare of society while private finance focuses only on individual welfare.

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Q-7 Discuss the meaning and functions of an economic system. (4 Marks, 2013)

Introduction:

Scarcity of resources forces individuals as well as nations to choose how to allocate their resources for efficient utilization. An economic system helps in creating maximum welfare using the limited resources.

Meaning:

An economic system is a system of production, resource allocation, exchange, and distribution of goods and services in a society or a given geographic area.

According to Loucks, "An economic system consists of those institutions in which a given people, a nation, or a group of nations, has chosen or accepted as the means through which their resources are utilized for the satisfaction of human wants."

Functions of an economic system:

Following are the main functions performed by an economic system:

Traditional Functions of Every Economic System

The traditional functions of every economic system include the following:

- **What to produce and what not to produce:** In deciding on what goods to produce, an economic system also decides in what not to produce. For example, if the system wants to provide roads and recreational facilities, it may have problems since it may lack enough resources to do so at the same time. It will be necessary that it chooses between the two. It may for instance have to choose roads. An economic system can consider a wide variety of goods than the other which is poorly endowed.
- **What method to use:** Economic systems also function to decide on the particular technique to be used in production. Here, the economic system decides what method of factor combination to be employed in order to maximize the use of the scarce resources, by minimizing cost and increasing productivity. The decision may involve whether to employ labor-intensive or capital-intensive methods of production.
- **For whom to produce:** Another problem the economic system is faced with is for whom to produce. To get maximum use from the scarce resources, the commodity must be produced in an area where it would be demanded and where costs will be minimized. The production unit may be sited near the source of raw material or the market center depending on the nature of the product.

Non-Traditional Functions of Every Economic System

- **Enduring economic growth:** Economic systems must ensure economic growth. Owing to scarcity of resources, the society must know whether its capacity to produce goods and services is expanding or decreasing. Some major ways to promote economic growth include ensuring adequate rate of growth of per capita income, improvement in technology through the adoption of superior techniques of production, and better and more extensive education and training of the labor force and others.
- **Ensuring full employment:** Society must also ensure full employment. It is the task of economic systems to ensure that resources are not idle or unemployed, since resources are scarce. In the market economy, full employment is achieved by stimulating demand.

Conclusion:

Economic systems are the means by which countries and governments distribute resources and trade goods and services. They are used to control the five factors of production, including: labor, capital, entrepreneurs, physical resources and information resources to decide about resource allocation and achieving growth and increasing employment.

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Q-8 Explain various characteristics of an economic system.

Introduction:

An economic system is a system of production, resource allocation, exchange, and distribution of goods and services in a society or a given geographic area.

Characteristics of an economic system:

Following are the main characteristics of an economic system:

1. ***A Group of People:*** An economy has a population base. It deals with human beings. An economic system always implies a group of people who are living in a particular territory. It enquires how a given people are engaged in the organisation of production for the satisfaction of their wants. 'Participants' constitute a major element of an economic system.
2. ***Scarcity of Resources***: An economic system irrespective of its form exists due to the fundamental fact that there is a scarcity of economic resources, through which goods and services can be produced. So optimal allocation of resources constitute the central core of any economic system. Effective organisation of production is a common and general problem. Different economies tackle this problem in different economic ways.
3. ***Organisation of the Process of Consumption:*** Mere production is not enough. In any society production is aimed at the satisfaction of material wants. This aim may be the satisfaction of present wants or the satisfaction of future wants of the society. This necessitates a pricing process or economic calculation. Under capitalism this is done in an automatic manner through the operation of the price mechanism. But in a socialist economy economic calculation poses a problem.
4. ***Institutions:*** An economic system consists of an assemblage of economic institutions. An institution simply means a way of doing something or a way of managing something. Depending on the diverse human interest there are different types of institutions, such as religious, social, legal, political, economic, etc. But an economic system is concerned with the economic institutions only.
5. ***Flexibility :*** The economic systems are not static but dynamic. They go on changing from time to time. Economic systems being man-made are subject to alteration. An economic system is composed of certain economic institutions. These institutions are created, destroyed, replaced, moulded and remoulded by the members of a society in different capacities. When these institutions change or are modified in a certain way we label them under capitalism. When they change other direction, they constitute socialism or a mixed economy.
6. ***Ownership of wealth:*** In different economic systems ownership of wealth is different. In capitalism ownership of resources is private while in socialism resources are owned and managed by government.
7. ***Reward of Economic Activity:*** It is necessary to know that which economic activity can be done by a person himself and how to use the reward received through that activity. Under capitalism the reward obtained is profit. Whereas in socialism, more importance is given to welfare of society instead of profit.
8. ***Uniformity in diversity:*** The aim of each economic system is to make efficient use of scarce resources and increase in the welfare of people. The method operated by each system is likely to be different but their ultimate goal is very clear. E.g. in capitalism by private sector, in socialism by the public sector and in the mixed economy through mixture of private and public sector.

Conclusion:

Even though different types of economic systems hold different philosophies regarding how to run the country, all the economic systems have many things in common. They all have scarce resources, they are all flexible, group of people, uniformity etc.

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Q-9 Write a short note on (a) Balanced budget, (b) Surplus budget, (c) Deficit budget (4 Marks; 2013,2015)

Introduction:

Budget means a financial statement showing future income and expenditure. Generally government prepares budget before commencement of a financial year. The budget can be either balanced, surplus or deficit budget. All of them are discussed as below:

1. **Balance budget** – A government budget is said to be balanced when its estimated revenues and anticipated expenditure are equal. i.e. government receipts and government expenditure. The government must exercise financial discipline and should keep its expenditure within the available income. The concept of a balanced budget has been advocated by classical economists like Adam smith. A balanced budget was considered by them as neutral in its effects on the working of the economy and hence they are regarded it as the best. However, modern economists believe that the policy of balance budget may not always be suitable for the economy. For instance during the period of depression, when economic activities are at low level, resulting in unemployment. The government may come to the rescue of the people. It can borrow money and spend it on public works. This will increase employment and total demand for goods and services and encourage investment.
2. **Surplus budget** – when estimated government receipts are more than the estimated government expenditure it is termed as surplus budget. When the government spends less than the receipts the budget becomes surplus that is.

   Estimated government receipts > anticipated government expenditure.

   A surplus budget is used either to reduce government public debt or increase its savings.

   A surplus budget may prove useful during the period of inflation. In periods of inflation, although there is greater employment there is also a tendency for prices to rise rapidly.

   This has to be checked particularly in the interest of those who have more or less fixed income. This inflationary gap can be corrected by lowering the level of effective demand in the economy. It can be corrected by increasing taxes. This would increase the revenue of the government but reduce the purchasing power of the people. As a result, the aggregate demand will fall. This inflation gap can be corrected by lowering the level of public expenditure.

   The surplus budget should not be used in a situation other than the inflationary gap as it may lead to unemployment and low levels of output as an economy.
3. **Deficit budget** – when estimate government receipts are less than the government expenditure. In modern economies, most of the budget are of this nature. That is

   Estimate government receipts < anticipated government expenditure.

   A deficit budget increases the liability of the government or decreases its reserves. A deficit budget may prove useful during the period of depression, economics activities are at a low level. It results in unemployment, business loss and even bankruptcy and inflation etc. the government can borrow money and increase the expenditure on public works through deficit financing. This will increase employment and total effective demand for the goods and also the services which would then encourage investment. Thus, a deficit budget is useful for removing depression and unemployment.

Conclusion:

Any country in the world is aiming to avoid deficit budget although the surplus budget is difficult for a country to achieve and that is the reason countries strive for a balanced budget in order to avoid inflation, unemployment, loss or another consequence.

Q-10 Write a short note on (1) Private goods (2) Public goods and (3) Merit goods (4 Marks; 2013,2014, 2015)

1. **Public Goods:** Pure public good is defined as a good that one person's consumption of the goods does not reduce the amount available to other; that is, the consumption of a public good is non-rival. For example roads, gardens, bridges, government hospitals etc.

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According to Prof. Samuelson, "Public goods are those goods, where one individual's consumption of the goods does not reduce the consumption of other individuals. Public goods involves with total supply as the form of equality not as the form of summation."

Characteristics of public goods:

- Public goods are indivisible: No one can be excluded from the benefits of these goods. For example defense service is indivisible. An individual cannot ask to be left unprotected by defense arrangements of a government or refuse the benefit of a reduction in air pollution or that of street light.
- Public goods or services have to be financed through compulsory contributions by the members of the society.
- Public good's consumption by one individual does not reduce the consumption of other individuals.
- Public good's production and financing cannot be left to market mechanism.
- Public goods are provided based on preference of society not on individual preference.
- Public goods are available for consumption to all members of society equally.
- Consumption of public goods is non-rival. It also suggests joint consumption.

2. **Private Goods:** Private goods have been defined as, "Private goods yield utility only to the person consuming the goods, it is denied to others." For example benefits from consumption of coffee will be available to only the person drinking the coffee.

Private goods are priced in the market and only those may be allowed the use of it that pays its price. Thus, those who do not agree to pay or those who cannot pay the price are excluded from the consumption of private goods. This means that principle of exclusion is applicable to private goods.

According to Samuelson, "Private goods are equal to the summation of the supplies available to all persons.

Characteristics of Private Goods:

- Benefits of private goods accrue only to the one paying the price for the good.
- Private goods are subject to the exclusion principle.
- Private goods can be produced and purchased through market mechanism.
- Whether to purchase or not to purchase a private good depends on decision of consumer.
- Individual preferences are much important in production of private goods.
- If total expenditure is more than total income for private goods, the producer can close down the production.
- If there is an error in taking decision regarding private goods, it will affect a few consumers.

3. **Merit Goods:** Human wants are main spring of economic activity. Form the point of view of resource use, wants can be classified into private and public wants. Public wants are satisfied through budget and goods that go to satisfy these wants are called public goods.

In 1959 R. A. Musgrave developed the concept of merit goods. Merit goods are those goods that are in nature of private goods as their consumption may not be non-rival. Yet they may not be provided by the market to the extent the community may want them to be created. Education and health services are good examples of merit goods.

Merit goods may be provided in a free market – but in insufficient quantities. Merit goods usually have positive externalities.

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Why does the government provide merit goods and services?

- To encourage consumption so that positive externalities of merit goods can be achieved for example free inoculation (vaccine, injection) against infectious diseases.
- On grounds of equity – because the government believes that consumption should not be based solely on the grounds of ability to pay for a good or service.

Difference between public goods and merit goods:

Following table shows the difference between public goods and merit goods:

Merit Goods	Public Goods
• Provided by both public & private sector	• Normally funded and provided by the government
• Positive marginal cost of supplying to extra users	• Collective consumption – provide to one and you provide to all
• Limited in supply – potentially high opportunity cost	• Largely unconstrained in supply
• Rival – consumption by one reduces availability to others	• Non-rival in consumption
• Excludable e.g. private health care and education	• Non-excludable – giving rise to the free rider problem
• Rejectable by those unwilling to pay for the good or service	• Non-rejectable – usually funded by general taxes

Q-11 Explain the meaning of (1) Revenue deficit (2) Budget deficit (3) Fiscal deficit and (4) Primary deficit. (4 Marks; 2013, 2015)

1. **Revenue Deficit:**

   Revenue deficit is excess of total revenue expenditure of the government over its total revenue receipts. It is related to only revenue expenditure and revenue receipts of the government. Alternatively, the shortfall of total revenue receipts compared to total revenue expenditure is defined as revenue deficit.

   Revenue deficit signifies that government's own earning is insufficient to meet normal functioning of government departments and provision of services. Revenue deficit results in borrowing. Simply put, when government spends more than what it collects by way of revenue, it incurs revenue deficit. Mind, revenue deficit includes only such transactions which affect current income and expenditure of the government. Put in symbols:

   Revenue deficit = Total Revenue expenditure – Total Revenue receipts

2. **Budget Deficit:**

   Budget deficit is the overall type of deficit. It means the excess of total expenditure over total revenues. Budget deficit includes both capital and the revenue items mentioned in the receipts and expenditure.

   The term 'deficit financing' is used for filling this deficit only. The Budgetary deficit is financed either by borrowings, taxation, or printing money.But Governments have largely relied on borrowings for financing the budget deficit, hence, giving rise of Government Debt.

   Budget Deficit = Total Expenditure – Total Revenue

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As a result of this development, the significance of Budget deficit has been lost in the realm of public finance and hence it is not reported in the Budget documents by the Government of India.

3. **Fiscal Deficit:**
Fiscal deficit is defined as excess of total budget expenditure over total budget receipts excluding borrowings during a fiscal year. In simple words, it is amount of borrowing the government has to resort to meet its expenses. A large deficit means a large amount of borrowing. Fiscal deficit is a measure of how much the government needs to borrow from the market to meet its expenditure when its resources are inadequate.
Fiscal deficit = Total expenditure – Total receipts excluding borrowings
= Borrowing
Fiscal deficit shows the borrowing requirements of the government during the budget year. Greater fiscal deficit implies greater borrowing by the government. The extent of fiscal deficit indicates the amount of expenditure for which the government has to borrow money.

4. **Primary Deficit:**
Primary deficit is defined as fiscal deficit of current year minus interest payments on previous borrowings. In other words whereas fiscal deficit indicates borrowing requirement inclusive of interest payment, primary deficit indicates borrowing requirement exclusive of interest payment (i.e., amount of loan).
We have seen that borrowing requirement of the government includes not only accumulated debt, but also interest payment on debt. If we deduct 'interest payment on debt' from borrowing, the balance is called primary deficit.
It shows how much government borrowing is going to meet expenses other than Interest payments. Thus, zero primary deficits means that government has to resort to borrowing only to make interest payments. To know the amount of borrowing on account of current expenditure over revenue, we need to calculate primary deficit. Thus, primary deficit is equal to fiscal deficit less interest payments.
Primary deficit = Fiscal deficit – Interest payments

Q-12 Distinguish between surplus budget and deficit budget. (4 Marks – 2012, 2014)
Introduction:
A budget is a financial document, which forecast the future income and expenses, further it illustrates the ways in which income is going to be received, and how that received income is going to be shared or allocated among the expenses that are to be incurred.

When income exceeds planned expenditure the excess amount is called budget surplus. On the other hand the amount by which future spending of an individual, a company, or a government exceeds its income over a future period of time is called budget deficit.

Difference between Surplus budget and Deficit budget
Following points show the difference between the two types of budget:

- A deficit budget situation means that the expenses of a government has exceeded the tax income during that period, whereas a surplus budget scenario means that the tax income of a government exceeds its expenses.
- In general, budget deficit is very common, while budget surplus occurs rarely.
- During periods when budget surplus occurs tax reduction may be granted, but which is not available during budget deficit periods.
- Interest rate on and treasuries and securities will be high during the period of budget surplus, which is not common during budget deficit period.
- Spending of a government will be high when there is a budget surplus, where as saving, cost cuttings, and borrowing will be high when there is a budget deficit.

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Conclusion:

In developing countries mostly the budgets prepared are deficit budgets. In order to give boost to economic development deficit budget is prepared. Surplus budget occurs when government spends less than its income. It occurs rarely and in developed nations.

Q-13 Discuss reasons of failure of market mechanism. (4 Marks, 2014)

Introduction:

In the real world, there is non-attainment of Pareto optimality (***Pareto efficiency**, or **Pareto optimality**, is a state of allocation of resources in which it is impossible to make any one individual better off without making at least one individual worse off)* due to a number of constraints in the working of perfect competition. An important cause of environmental degradation is market failure. It means poor functioning of markets for environmental goods and services. It reflects failure of government policy in removing market distortions created by price controls and subsidies.

Reasons for market failure

Following are some of the reasons due to which market mechanism fails:

1. **Incomplete markets:** Markets for certain things are incomplete or missing under perfect competition. The absence of markets for such things as public goods and common property resources is a cause of market failure. There is no way to equate their social and private benefits and costs either in the present or in the future because their markets are incomplete or missing.
2. **Indivisibilities:** The Pareto optimality is based on the assumption of complete divisibility of products and factors used in consumption and production. In reality, goods and factors are not infinitely divisible. Rather, they are indivisible. The problem of divisibility arises in the production of those goods and services that are used jointly by more than one person.

   An important example is of road in a locality. It is used by a number of persons in the locality. But the problem is how to share the costs of repairs and maintenance of the road. In fact, very few persons will be interested in its maintenance. Thus marginal social costs and marginal social benefits will diverge from each other and Pareto optimality will not be achieved.

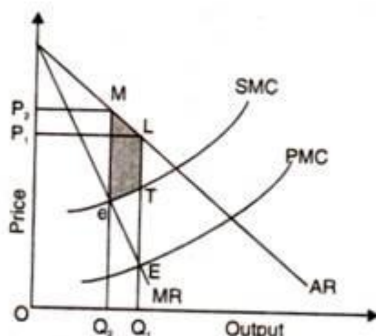

FIGURE 18.1 : (IMPERFECT MARKETS)

3. **Common Property Resources:** Another cause of market failure is a common property resource. Common ownership when coupled with open access, would also lead to wasteful exploitation in which a user ignores the effects of his action on others. Open access to the commonly owned resources is a crucial ingredient of waste and inefficiency.

   Its most common example is fish in a lake. Anyone can catch and eat it but no one has an exclusive property right over it. It means that a common property resource is non-excludable (anyone can use it) and non-rivalrous (no one has an exclusive right over it). The lake is a common property for all fishermen. The fisherman who catches more fish imposes a negative externality on other fishermen so that the lake is overexploited. This is called the tragedy of the commons which leads to the elimination of social gains due to the overuse of common property. Thus when property rights are common, indefinite or non-existent, social costs will be more than private costs and there will not be Pareto Optimality.

4. **Imperfect Markets:** Pareto efficiency increases under perfect competition. But it declines under market distortions or imperfections. Let us consider a case of monopoly. Initially, monopoly equilibrium is at point E where the private marginal cost curve, PMC, cuts the marginal revenue curve, MR, from below.

   The monopolist produces OQ_1 output at OP_1 price. But the production process generates smoke in the air. Therefore, the pollution board levies a tax equal to TE on the monopoly firm.

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The imposition of a pollution tax is, in fact, a fixed cost to the monopoly firm. Now the social marginal cost curve cuts the marginal revenue curve at point e.

The monopolist increases the price of his product from OP_1 to OP_2 and restricts output to OQ_2 and thereby reduces consumers' surplus to Q_2 MLQ_1 (= OQ_1 LP_1 – OQ_2 MP_2). In fact, Q_2 MLQ_1 is the social cost of OQ_2 output. But the net loss to society is Q_2 MLQ_1 – TE= eMLT, the shaded area in the figure.

5. **Asymmetric Information:** Pareto optimality assumes that producers and consumers have perfect information regarding market behaviour. But according to Joseph Stiglitz, "In the real world, there is asymmetric (incomplete) information due to ignorance and uncertainty on the part of buyers and sellers. Thus they are unable to equate social and private benefits and costs."

Suppose a producer introduces a new antipollution device in the market. But it is very difficult for him to predict the current demand of his product. On the other hand, consumers may be ignorant about quality and utility of this anti-pollution device. In some cases, information about market behaviour in the future may be available but that may be insufficient or incomplete. Thus market asymmetries, fail to allocate efficiently.

6. **Externalities:** The presence of externalities in consumption and production also lead to market failure. Externalities are market imperfections where the market offers no price for service or disservice. These externalities lead to misallocation of resources. Externalities can be positive or negative.

Positive Externalities of Production:

According to Pigou, when some firm renders a benefit or cost of a service to other firms without appropriating to itself all the benefits or costs of his service, it is an external economy of production. External economies of production accrue to one or more firms in the form of reduced average costs as a result of the activities of another firm.

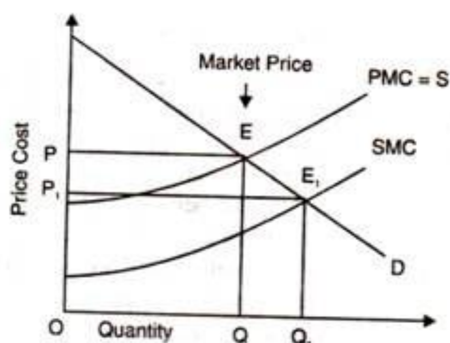

FIGURE. 18.2 : (POSITIVE EXTERNALITIES OF PRODUCTION)

Whenever external economies exist, social marginal benefit will exceed private marginal benefit and private marginal cost will exceed social marginal cost.

This is illustrated in Figure 18.2 where PMC is the private marginal cost curve or supply curve of firms. The demand curve D intersects the PMC curve at point E and determines the competitive market price OP and output OQ.

SMC is the social marginal cost curve which intersects the demand curve D at point E_1 and determines the social optimum output level OQ_1 at price OP_1. Since for every unit of output between OQ and OQ_1 social marginal cost (OP_1) is less than the competitive market price OP, its production involves a net social gain equal to QQ_1.

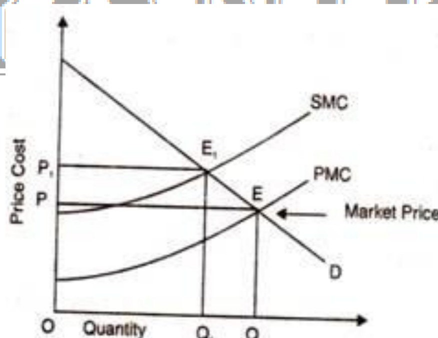

FIGURE 18.3 : (NEGATIVE EXTERNALITIES OF PRODUCTION)

Negative Externalities of Production:

When the production of a commodity or service by a firm affects adversely other firms in the industry, social marginal cost is higher than social marginal benefit. Suppose, a factory situated in a residential area emits smoke which affects adversely health and household articles of the residents.

In this case, the factory benefits at the expense of residents who have to incur extra expenses to keep themselves healthy and their households clean. These are social marginal costs because of harmful externalities which are higher than private marginal cost and also

social marginal benefit.
This is illustrated in Fig. 18.3 where the PMC curve which intersects the D curve at point E and determines the competitive price OP and output OQ. But the socially optimum output is OQ_1 and price is OP_1, as determined by the intersection of SMC and D curve at point E_1.
Thus the firms are producing Q_1 Q more than the social optimal output OQ_1. In this case, for every unit between Q_1 and Q, social marginal cost (SMC) is more than the competitive market price OP. Thus its production involves a social loss i.e.. $OQ – OQ_1 – QQ_1$.

7. Public Goods: Another cause of market failure is the existence of public goods. A public good is one whose consumption or use by one individual does not reduce the amount available for others. An example of a public good is water which is available to one person and is also available to others without any additional cost. Its consumption is always joint and equal.

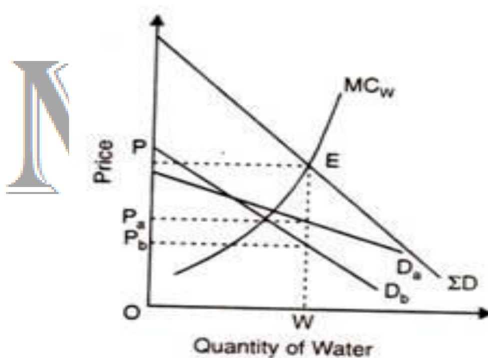

FIGURE 18.5

It is non-excludable if it can be consumed by anyone. It is non-rivalrous if no one has an exclusive rights over its consumption. Its benefits can be provided to an additional consumer at zero marginal cost. Thus public goods are both non-excludable and non- rivalrous. Moreover, environmental quality is generally considered as a public good and when it is valued at market price, it leads to market failure.
Suppose potable water is supplied by the municipal corporation. There are two individuals A and B who use it. Both consume the same quantity of water. But they differ in how much they are willing to pay for any given quantity.
This is illustrated in Figure 18.5. where D_a and D_b are the demand curves of two individuals A and B respectively. Therefore, demand prices are OP_a and OP_b corresponding to a given quantity OW of water. The curve ΣD is the vertical summation of D_a and D_b curves.

The equilibrium for a public good exists where the sum of the individual prices equal marginal cost. Therefore,

$$\mathbf{OP = OP_a + OP_b = MC_W}$$

But each consumer is being charged a different price. This is a case of price discrimination because price OP_a is greater than price OP_b for the same quantity of water OW. Hence there is market failure.

8. Public Bads: There are also public bads in which one person experiencing some disutility does not diminish the disutility of another, such as air and water pollution. Public goods and public bads cannot be handled by the institution of private property. K.E. Boulding has explained public bads with the following example: “If someone drives his car into my living room and pollutes it, I can sue him for damages. This is a private bad. But if someone congests the roads or pollutes the air, however, there is not much I can do about it as an individual. This is public bad.”

Conclusion:
Market failure is a necessary but not a sufficient condition for intervention. To be truly worthwhile, a government intervention must outperform the market or improve its functions. Second, the benefits from such intervention must exceed the costs of planning, implementation, and enforcement, as well as any indirect and unintended costs of distortions introduced to other sectors of the economy by such intervention.

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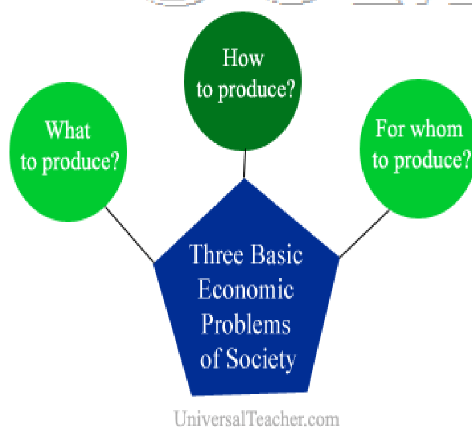
Q-14 Distinguish between fiscal deficit and revenue deficit.
Following table summarizes the differences between fiscal deficit and revenue deficit:

Basis	Fiscal deficit	Revenue deficit
Meaning	It is the difference between total revenue and total expenditure of the government (excluding borrowings).	It results when revenue receipts are less than the revenue expenditure.
Indicator	It is an indicator of the total borowings needed by the government.	It indicates the dependency on loans in near future.
Arises	It arises due to hike in capital expenditure.	It arises when the government's actual net receipts are lower than the projected receipts.

Q-15 What are the basic problems of the society? (4 Marks – 2012)
Introduction:
All modern economies have certain fundamental or basic economic problems to deal with. In every single economy, including the so-called "affluent society", resources are limited. As a result, decisions regarding the resource use have to be made together by individuals, by business corporations, and by society. It is the social choice and community preferences which give substance to the question of macro-economic decisions.

Three Basic Economic Problems of Society
Following figure shows the 3 fundamental economic problems faced by all societies worldwide.



What to produce ?
Each and every economy must determine what products and services, and what volume of each, to produce. In some way, these kinds of decisions should be coordinated in every society. In a few, the government decides. In others, consumers and producers decisions act together to find out what the society's scarce resources will be utilized for. In a market economy, this 'what to produce?' choice is made mainly by buyers, acting in their own interests to fulfill their needs. Their demands are fulfilled by organizations looking for profits. For instance, if cellphones are in demand it will pay businesses to produce and sell these. Government authorities also perform some part in making 'what?' decisions. For example, a law demanding all ladies to wear a helmet generates demand for helmets, and profit-seeking businesses will produce them.

How to produce?
How to produce question is related with selection of appropriate technique of production. Two types of production techniques are available. 1) Labour intensive technology where use of labour and tools is more and machines are generally not used and 2) Capital intensive technology where machines are used more and as less labour as possible. In a country like India where cheap labour is readily available labour intensive technology will prove to be helpful while in developed country where technology is easily available and there is shortage of labours, capital intensive technology is suggested.

For whom to produce?
This **basic economic question** is focused on who receives what share of the products and services which the economy produces. The portion of production which each person and family

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can consume is determined by their income. Income is distributed in line with the value of resources we have to sell. As an example, a top cricket player will earn far more income than a professor. A top cricket player has a resource to sell for which many people will pay a high price. Professors are not so rare, and few people pay for their services. The 'for whom' decision can even be dependent upon skills shortages, in which case organizations will provide higher incomes to attract workers with rare skills. In the same way, high wages may be required to attract employees to rural locations.

Conclusion:
The economic problem is at times referred to as the basic, central or fundamental economic problem. It is one of the crucial economic theories in the functioning of any economy in this world. Due to scarcity, choices have to be made by consumers, businesses and governments.

Q-16 Discuss the meaning and importance of government budget. (4 Marks – 2012)
Introduction:
In order to run an economy smoothly every government has to incur expenses and has to collect income from citizens to finance these expenditures. Before commencement of a financial year government presents an estimate about future income and expenditure. This is called government budget.

Meaning of Government budget:
A government budget is a government document presenting the government's proposed revenues and spending for a financial year that is often passed by the legislature, approved by the chief executive or president and presented by the Finance Minister to the nation.

Importance of government budget
Following points show importance of government budget for any country:

1. **Reallocation of Resources:** Through the budgetary policy, Government aims to reallocate resources in accordance with the economic (profit maximisation) and social (public welfare) priorities of the country. Government can influence allocation of resources through subsidies and by producing certain goods and services.
2. **Helps in reducing inequalities in income and wealth:** Economic inequality is an inherent part of every economic system. Government aims to reduce such inequalities of income and wealth, through its budgetary policy. Government aims to influence distribution of income by imposing taxes on the rich and spending more on the welfare of the poor. It will reduce income of the rich and raise standard of living of the poor, thus reducing inequalities in the distribution of income.
3. **Economic Stability:** Government budget is used to prevent business fluctuations of inflation or deflation to achieve the objective of economic stability. The government aims to control the different phases of business fluctuations through its budgetary policy. Policies of surplus budget during inflation and deficit budget during deflation helps to maintain stability of prices in the economy.
4. Management of Public Enterprises: There are large numbers of public sector industries (specially natural monopolies), which are established and managed for social welfare of the public. Budget is prepared with the objective of making various provisions for managing such enterprises and providing those financial help.
5. Economic Growth: The growth rate of a country depends on rate of saving and investment. For this purpose, budgetary policy aims to mobilize sufficient resources for investment in the public sector. Therefore the government makes various provisions in the budget to raise overall rate of savings and investments in the economy.
6. Reducing regional disparities: The government budget aims to reduce regional disparities through its taxation and expenditure policy for encouraging setting up of production unins in economically backward regions.

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Conclusion:

A government budget is an annual financial statement showing item wise estimates of expected revenue and anticipated expenditure during a fiscal year. The government plans expenditure according to its objectives and then tries to raise resources to meet the proposed expenditure.

Multiple Choice Questions:

1. In which economic system, ownership of capital resources is private and economic decisions are take n with maximum benefit?
(A) Capitalism (B) Socialism (C) Mixed economy (D) Gandhian economy

2. In which economic system, customers are the king of the market?
(A) Socialism (B) Capitalism (C) Mixed economy (D) Equalism

3. In which economic system, ownership of production resources of the state and economic decisions are taken with the social welfare objective.
(A) Capitalism (B) Socialism (C) Mixed economy (D) Equalism

4. Which sector is more important in mixed economy?
(A) Private (B) Public (C) Cooperative (D) Private and public

5. Study of which economic activity means public finance?
(A) State (B) Person (C) Family (D) Firm

6. In which finance, objective is social welfare?
(A) Private (B) Public (C) Cooperative (D) None of them

7. On which principle is private finance based?
(A) Market (B) Government (C) Budget (D) Cooperatives

8. Which of the following countries has unitary finance system?
(A) India (B) USA (C) France (D) Canada

9. Which of the following country has the federal finance system?
(A) India (B) France (C) Britain (D) China

10. Who has the right to collect custom duties in India?
(A) State government (B) Central government (C) Municipality (D) Joint

11. Who appoints the finance commission in India?
(A) Prime minister (B) President (C) Governor (D) Finance minister

12. The finance commission is appointed every _____________ in India?
(A) Two (B) Three (C) Five (D) Seven

13. The 74th constitution amendment act of 1992 gave important place to __________.
(A) Central (B) State (C) Local self government (D) All of the three

14. Which one is the base unit of local self government?
(A) Gram Panchayat (B) Taluka Panchayat Samities (C) Zila Development Samities (D) State Development Parishad

15. Government has to play important role to satisfy _________ wants.
(A) Individual (B) Collective (C) Private (D) Religious

16. In which commodity, contribution is compulsory in production?
(A) Individual (B) Collective (C) Cooperation (D) None of these

17. Which wants decided b the group and imposes on individual group?
(A) Private (B) Social (C) Welfare (D) Public

18. Which budget is also known as programming budget?
(A) Deficit budget (B) Surplus budget (C) Balanced budget (D) Performance budget

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19. In which budget, past income-expenditure factors are not considered but is based on current year's situations?

(A) Balanced budget (B) Performance budget (C) Deficit budget (D) Zero-base budget

20. The deduction of interest-payments from fiscal deficit is considered as _________ deficit.

(A) Revenue (B) Capital (C) Primary (D) Budgetary

21. In which year revenue deficit was minimum percent of GDP in last ten years of India?

(A) 2002-03 (B) 2005-06 (C) 2007-08 (D) 2010-11

22. How many percent of GDP fiscal deficit was estimated in Indian central budget?

(A) 1.8% (B) 5.1% (C) 5.9% (D) 4.6%

23. Which deficit is important economically?

(A) Primary (B) Budgetary (C) Fiscal (D) Revenue

24. Which finance aims at social welfare?

(A) Private (B) Public (C) Co-operative (D) None of these

Answers:

1. Capitalism 2. Capitalism 3. Socialism 4. Private and Public 5. State 6. Public 7. Market 8. France 9. India 10. Central government 11. President 12. Five 13. Local self government 14. Gram Panchayats 15. Collective 16. Collective 17. Welfare 18. Performance budget 19. Zero-base budget 20. Primary 21. 2007-08 22. 5.1% 23. Fiscal 24. Public.

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Unit: 2 Taxation

Q-1 Explain the meanings of direct tax and indirect tax and discuss merits and demerits of any one of them. (6 Marks-2013; 4 Marks – 2012, 2014, 2015)

Introduction:

Government of any country has to carry out public expenditure for the protection and welfare of society. Taxes are the main sources of income for government out of which they finance their public expenditure. Taxes can be direct or indirect.

Direct Tax:

A direct tax is one, which is paid by a person on whom it is legally imposed and the burden of which cannot be shifted to any other person. The person from whom it is collected cannot shift its burden to anybody else.

The impact i.e. the initial burden and its incidence i.e. the ultimate burden of direct tax is on the same person. For e.g. Income tax, wealth tax, property tax, estate duties, capital gain tax, corporate / company tax, etc. are all direct taxes.

Definition:

According to Dr. Dalton, "A direct tax is really paid by the person on whom it is legally imposed, a direct tax is one which cannot be shifted or passed on. Disregarding incidence of taxation indirect taxes are those levied on the sale or purchase on any goods or services other than personal services and all other taxes are direct."

Advantages / Merits of Direct Taxes:

Following are the important advantages or merits of Direct Taxes :-

1. **Equity:** There is social justice in the allocation of tax burden in case of direct taxes as they are based on the principle of ability to pay. Persons in a similar economic situation are taxed at the same rate. Persons with different economic standing are taxed at a different rate. Hence, there is both horizontal and vertical equity under direct taxation. Progressive direct taxation can reduce income inequalities and bring about adequate social & economic justice. For example, in the Indian Budget of 2015, individual with an income of up to Rs. 2,50,000 are exempted from payment of income tax.
2. **Certainty:** As far as direct taxes are concerned, the tax payer is certain as to how much he is expected to pay, as the tax rates are decided in advance. The Government can also estimate the tax revenue from direct taxes with a fair accuracy. Accordingly, the Government can make adjustments in its income and expenditure.
3. **Relatively Elastic:** The direct taxes are relatively elastic. With an increase in income and wealth of individuals and companies, the yield from direct taxes will also increase. Elasticity also implies that the government's revenue can be increased by raising the rates of taxation. An increase in tax rates would increase the tax revenue.
4. **Creates Public Consciousness:** They have educative value. In the case of direct taxes, the taxpayers are made to feel directly the burden of taxes and hence take keen interest in how public funds are spent. The taxpayers are likely to be more aware about their rights and responsibilities as citizens of the state.
5. **Economical:** Direct taxes are generally economical to collect. For instances, in the case of personal income tax, the tax can be deducted at source from the income or salaries of the individuals. Therefore, the government does not have to spend much in tax collection as far as personal income tax is concerned. However, in the case of indirect taxes, the government has to set up an elaborate machinery to collect taxes.
6. **Anti-inflationary:** The direct taxes can help to control inflation. During inflationary periods, the government may increase the tax rate. With an increase in tax rate, the consumption demand may decline, which in turn may reduce inflation.

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Disadvantages / Demerits of Direct Taxes ↓

Though direct taxes possess above mentioned merits, the economist have criticised them on the following grounds :-

1. **Tax Evasion:** In India, there is good amount of tax evasion. The tax evasion is due to High tax rates, Documentation and formalities, Poor and corrupt tax administration. It is easier for the businessmen to evade direct taxes. They invariable suppress correct information about their incomes by manipulating their accounts and evade tax on it. In less developed countries like India, due to high rate of progressive tax evasion & avoidance are extensive and led to rise in black money.
2. **Arbitrary Rates:** The direct taxes tend to be arbitrary. Critics point out that there cannot be any objective basis for determining tax rates of direct taxes. Also, the exemption limits in the case of personal income tax, wealth tax, etc., are determined in an arbitrary manner. A precise degree of progression in taxation is also difficult to achieve. Therefore direct taxes may not always fulfill the canon of equity.
3. **Inconvenient:** Direct taxes are inconvenient in the sense that they involve several procedures and formalities in filing of returns. For most people payment of direct tax is not only inconvenient, it is psychological painful also. When people are required to pay a sizeable part of their income as a tax to the state, they feel very much hurt and their propensity to evade tax remains high. Further everyone who is required to pay a direct tax has to furnish appropriate evidence in support of the statement of his income & wealth & for this he has to maintain his accounts in proper form. Direct tax is considered inconvenient by some people because they have to make few lump sum payments to the governments, whereas their income receipts are distributed over the whole year.
4. **Narrow Coverage:** In India, there is a narrow coverage of direct taxes. It is estimated that only three percent of the population pay personal income tax. Due to low coverage, the government does not get enough funds for public expenditure. Estate duty & wealth tax are equally narrow based and thus revenue proceeds from these taxes are invariably small.
5. **Affects Capital Formation:** The direct taxes can affect savings and investment. Due to taxes, the net income of the people gets reduced. This in turn reduces savings. Reduction in savings results in low investment. The low investment affects capital formation in the country.
6. **Effect on Willingness and Ability to Work:** Highly progressive direct taxes reduce people's ability and willingness to work and save. This in turn may have a negative impact on investment and productive capacity in the economy. If tax burden is high, people's consumption level gets adversely affected and this has an impact on their ability to work and save. High taxes also discourage people from working harder in order to earn and save more.
7. **Sectoral Imbalance:** In India, there is Sectoral imbalance as far as direct taxes are concerned. Certain sectors like the corporate sector is heavily taxed, whereas, the agriculture sector is 100% tax free. Even the large rich farmers are exempted from payment of personal income tax.

Conclusion – Direct Tax:

Under direct tax burden of tax cannot be shifted. The disadvantage of direct taxation are mainly due to administrative difficulties and inefficiencies. The extent of direct taxation should depend on the economic state of the country. A rich country has greater scope for direct taxation than a poor country. However direct taxation is an important aspect of the modern financial system.

Indirect Taxes:

An indirect tax is one in which the burden can be shifted to others. The tax payer is not the tax bearer. The impact and incidence of indirect taxes are on different persons. An indirect tax is levied on and collected from a person who manages to pass it on to some other person or persons on whom the real burden of tax falls. For e.g. commodity taxes or sales tax, excise duty, custom duties, etc. are indirect taxes.

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Over the years the share of indirect tax has declined in India due to reduction in the rates of indirect taxes.

Definition:
According to Dr. Dalton, "An indirect tax is imposed on one person, but paid partly or wholly by another, owing to a consequential change in terms of some contract or bargain between them. Thus an indirect tax is conceived as one which can be shifted or passed on."

Advantages / Merits of Indirect Taxes ↓
The merits of indirect taxes are briefly explained as follows:-

1. **Convenient:** Indirect taxes are imposed on production, sale and movements of goods and services. These are imposed on manufacturers, sellers and traders, but their burden may be shifted to consumers of goods and services who are the final taxpayers. Such taxes, in the form of higher prices, are paid only on purchase of a commodity or the enjoyment of a service. So taxpayers do not feel the burden of these taxes. Besides, money burden of indirect taxes is not completely felt since the tax amount is actually hidden in the price of the commodity bought. They are also convenient because generally they are paid in small amounts and at intervals and are not in one lump sum. They are convenient from the point of view of the government also, since the tax amount is collected generally as a lump sum from manufacturers or traders.
2. **Difficult to evade:** Indirect taxes have in built safeguards against tax evasion. The indirect taxes are paid by customers, and the sellers have to collect it and remit it to the Government. In the case of many products, the selling price is inclusive of indirect taxes. Therefore, the customer has no option to evade the indirect taxes.
3. **Wide Coverage:** Unlike direct taxes, the indirect taxes have a wide coverage. Majority of the products or services are subject to indirect taxes. The consumers or users of such products and services have to pay them.
4. **Elastic:** Some of the indirect taxes are elastic in nature. When government feels it necessary to increase its revenues, it increases these taxes. In times of prosperity indirect taxes produce huge revenues to the government.
5. **Universality:** Indirect taxes are paid by all classes of people and so they are broad based. Poor people may be out of the net of the income tax, but they pay indirect taxes while buying goods.
6. **Influence on Pattern of Production:** By imposing taxes on certain commodities or sectors, the government can achieve better allocation of resources. For e.g. By Imposing taxes on luxury goods and making them more expensive, government can divert resources from these sectors to sector producing necessary goods.
7. **May not affect motivation to work and save:** The indirect taxes may not affect the motivation to work and to save. Since, most of the indirect taxes are not progressive in nature, individuals may not mind to pay them. In other words, indirect taxes are generally regressive in nature. Therefore, individuals would not be demotivated to work and to save, which may increase investment.
8. **Social Welfare:** The indirect taxes promote social welfare. The amount collected by way of taxes is utilized by the government for social welfare activities, including education, health and family welfare. Secondly, very high taxes are imposed on the consumption of harmful products such as alcoholic products, tobacco products, and such other products. So it is not only to check their consumption but also enables the state to collect substantial revenue in this manner.
9. **Flexibility and Buoyancy (good spirit, enthusiasm):** The indirect taxes are more flexible and buoyant. Flexibility is the ability of the tax system to generate proportionately higher tax revenue with a change in tax base, and buoyancy is a wider concept, as it involves the ability

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of the tax system to generate proportionately higher tax revenue with a change in tax base, as well as tax rates.

Disadvantages / Demerits of Indirect Taxes

Although indirect taxes have become quite popular in both developed & Under developed countries alike, they suffer from various demerits, of which the following are important.

1. **High Cost of Collection:** Indirect tax fails to satisfy the principle of economy. The government has to set up elaborate machinery to administer indirect taxes. Therefore, cost of tax collection per unit of revenue raised is generally higher in the case of most of the indirect taxes.
2. **Increase income inequalities:** Generally, the indirect taxes are regressive in nature. The rich and the poor have to pay the same rate of indirect taxes on certain commodities of mass consumption. This may further increase income disparities among the rich and the poor.
3. **Affects Consumption:** Indirect taxes affects consumption of certain products. For instance, a high rate of duty on certain products such as consumer durables may restrict the use of such products. Consumers belonging to the middle class group may delay their purchases, or they may not buy at all. The reduction in consumption affects the investment and production activities, which in turn hampers economic growth.
4. **Lack of Social Consciousness:** Indirect taxes do not create any social consciousness as the taxpayers do not feel the burden of the taxes they pay.
5. **Uncertainty:** Indirect taxes are often rather uncertain. Taxes on commodities with elastic demand are particularly uncertain, since quantity demanded will greatly affect as prices go up due to the imposition of tax. In fact a higher rate of tax on a particular commodity may not bring in more revenue.
6. **Inflationary:** The indirect taxes are inflationary in nature. The tax charged on goods and services increase their prices. Therefore, to reduce inflationary pressure, the government may reduce the tax rates, especially, on essential items.
7. **Possibility of tax evasion:** There is a possibility of evasion of indirect taxes as some customers may not pay indirect taxes with the support of sellers. For instance, individuals may purchase items without a bill, and therefore, may not pay Sales tax or VAT (Value Added Tax), or may obtain the services without a bill, and therefore, may evade the service tax.

Conclusion:

Elaborate analysis of merits and demerits of direct and indirect taxes makes it clear that whereas the direct taxes are generally progressive, and the nature of most indirect taxes is regressive. The scope of raising revenue through direct taxation is however limited and there is no escape from indirect taxation in spite of attendant problems. There is common agreement amongst economists that direct & indirect taxes are complementary and therefore in any rational tax structure both types of taxes must find a place.

Q-2 Show the defects of Indian tax structure and give suggestions to correct them. (6 Marks – 2013, 2015; 4 Marks – 2014) OR State main shortcomings of Indian tax structure (4 Marks – 2012)

Introduction:

Tax, is the payment we make to the Government, for a good/service. It is this money that Govt uses for all the functions it is expected to do. Military, Infrastructure - Economic and social, basic amenities, welfare etc.

Defects of Indian tax structure:

Present tax structure of Indian government is not pleasing as it does not fulfill the basic cannons of taxation. The steps have been taken for improvement of taxation system during planning

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period but still our tax structure suffers with many defects. Following points discuss major defects in India tax structure.

1. **Low share of taxation:** The amount of tax revenue resulting out of the total national income is very low as compared to other countries. Indian tax structure is very insignificant compared to other countries such as Britain, Germany, America etc. In America share of tax revenue in national income is 29%, it is 33% in Britain and in Germany it is 35% while the same rate in India is mere 18%.
2. **Complex structure:** A provoking feature of the Indian tax system is its complexity. Both direct and indirect tax laws are highly complex. Government of India imposes new and new taxes over the period of time, many taxes are removes after some time. Government also gives tax benefits under many provisions. This leads to tax evasion and tax avoidance. Also because of its complexity, tax payers have to use services of experts for filing taxes and have to pay for it.
3. **Laziness in collecting taxes:** The majority of states have tries less in levying taxes compared to central government during planning period. State governments depend on grants and loans through central government rather than use taxes. Most of the states have deficit budget because of their laziness.
4. **Dominance of indirect taxes:** The share of indirect taxes in developed countries is less than 20%, while in India, central revenue receipts from indirect taxes was in the ratio of 74%:24%, in 1994-95. After implementing new economic policy, the rate of indirect taxes has been reduced up to 43% in 2012. However, It is well known that indirect taxes are more burdensome to the poor than the wealthy.
5. **Tax-evasion and Tax avoidance:** The Indian tax structure is highly complex. This provides enough scope for avoiding and evading taxes. According to an estimation, tax evasion has resulted in black money about rupees 80,000 crore. This vicious circle of tax evasion breeds into a growth of black money and inflation.
6. **Exempted agricultural income:** According to Indian constitution, central government levies taxes on non-agricultural sector and state government levies taxes on agricultural sector. Central government imposed high tax rate on income, while state government does not impose tax on agricultural income. The share of agriculture sector was 15% in GDP in 2012. However, it has nominal 1 to 2% share in total tax revenue receipts.
7. **Regressive structure:** Another defect of tax system in India is that it is regressive in nature. They are more burdensome to poor people. In this manner, it is not based upon the principles of equity and social justice.
8. **Less than ability to pay:** According to Clarke, the maximum ability to pay tax can be 25% of national income of any country. While it is less in India yet. According economic survey of 2011-12, central taxation and GDP ratio is 10.5% which will be about 16% in 2016.
9. **Frequent changes in taxes:** Government of India changes taxes frequently. It affects adversely on savings and investment. It creates difficulties for producers, traders and investors to take decisions for long period of time.
10. **Limited scope:** In developed countries like Britain, Germany, America etc. the base of taxation is broad while it is very narrow in India. This burden falls on small portion of population while majority of the people are not covered. For example, excessive emphasis on indirect taxes has resulted in the glaring imbalance of nearly 100% of citizens affected by indirect taxes but hardly 1% of the population coming under the purview of direct taxation, while in Britain it touch more than 31% population.

Conclusion:
Over the period of time Indian government has tried to change the taxation and try to make it more efficient and idle. But still it suffers with many defects. There is still need of radical improvements in Indian tax structure.

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Q-3 Differentiate between Direct and Indirect taxes.

Comparison Chart

BASIS OF COMPARISON	DIRECT TAX	INDIRECT TAX
Meaning	Direct tax is referred to as the tax, which is paid by the person to the government to whom it is levied and charged on the income and wealth of persons.	Indirect Tax is referred to as the tax, which is paid by the taxpayer to the government indirectly, charged on goods and services.
Burden	The person on whom it is levied bears its burden.	The burden of tax can be shifted to another person.
Types	Wealth Tax, Income Tax, Property Tax, Corporate Tax, Import and Export Duties.	Central Sales tax, VAT (Value Added Tax), Service Tax, STT (Security Transaction Tax), Excise Duty, Custom Duty.
Evasion	Tax evasion is possible.	Tax evasion is hardly possible because it is included in the price of goods and services.
Inflation	Direct tax helps in reducing inflation.	Indirect taxes promotes inflation.
Levied on	Persons, i.e. Individual, HUF (Hindu Undivided Family), Company, Firm etc.	Consumers of goods and services.
Nature	Progressive	Regressive

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Q-4 Discuss the meaning and characteristics of direct taxes. (6 Marks, 2014)

Introduction:

A direct tax is one, which is paid by a person on whom it is legally imposed and the burden of which cannot be shifted to any other person. The person from whom it is collected cannot shift its burden to anybody else.

The impact i.e. the initial burden and its incidence i.e. the ultimate burden of direct tax is on the same person. For e.g. Income tax, wealth tax, property tax, estate duties, capital gain tax, corporate / company tax, etc. are all direct taxes.

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Definition:

According to Dr. Dalton, "A direct tax is really paid by the person on whom it is legally imposed, a direct tax is one which cannot be shifted or passed on. Disregarding incidence of taxation indirect taxes are those levied on the sale or purchase on any goods or services other than personal services and all other taxes are direct."

Characteristics of Direct Taxes:

Following are the main characteristics of direct taxes:

1. **Based on tax payer's ability:** Direct taxes are closely related to ability-to-pay. Poor people are exempted from paying tax while wealthy people are taxed at higher rate.
2. **Cannot be shifted:** Under direct taxation, the impact of taxes and incidence of taxes rest with same person. That means the burden of direct taxes cannot be shifted to others.
3. **Less errors:** Tax rates for direct taxes are generally fixed and follow a definite base for charging taxes. So these taxes are easy to calculate and chances of error are less.
4. **Equity and justice:** Direct taxes follow the cannon of equity and justice because they are progressive in nature. It means more tax will be levied from rich people. It is based on equity because people with same income will be charged same rate of tax.
5. **Reduce disparity:** Government collects more taxes from rich people and spends the tax income for welfare of poor people. Thus, government tries to reduce the gap between rich and poor.
6. **Elastic:** Direct taxes are elastic in nature. This means that when income of people increases, tax income of government will increase. On the other hand if people's income decrease, tax income of government will also decrease.
7. **Civic consciousness:** Since tax payers consciously pay the direct taxes, they know that the money spend by government includes tax payment done by him. Thus he will be interested in knowing how the tax money is used by the government.
8. **Social Welfare:** Direct taxes help in creating social welfare as it is collected mostly from rich people and used for welfare of poor people. Also this tax has less adverse effects on productivity.

Conclusion:
Direct taxes help in reducing income inequality in fair and just manner. It is also elastic, easy to calculate and leads to social welfare. One of the important feature of direct taxes is that its burden cannot be shifted to others.

Q-5 Write a note on 'Role of taxation in economic development.' (6 Marks- 2012, 2014; 4 Marks- 2013, 2015)

Introduction:
Tax is a contribution exacted (collected) by the state. It is a non penal but compulsory and unrequited (nothing will be provided in return) transfer of resources from the private to the public sector, levied on the basis of predetermined criteria.

Role of taxation in economic development
For economic development of a country, tax can be used as an important tool in the following manner:

1. **Optimum allocation of available resources:** Tax is the most important source of public revenue. The imposition of tax leads to diversion of resources from the taxed to the non-taxed sector. The revenue is allocated on various productive sectors in the country with a view to increasing the overall growth of the country. Tax revenues may be used to encourage development activities in the less developments areas of the country where normal investors are not willing to invest.
2. **Raising government revenue:** In modern times, the aim of public finance is not merely to raise sufficient financial resources for meeting administrative expense, for maintenance of law and order and to protect the country from foreign aggression. Now the main object is to ensure the social welfare. The increase in the collection of tax increases the government revenue. It is safer for the government to avoid borrowings by increasing tax revenue.
3. **Encouraging savings and investment:** Since developing countries has mixed economy, care has also to be taken to promote capital formation and investment both in the private and public sectors. Taxation policy is to be directed to raising the ratio of savings to national income.

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4. **Reduction of inequalities in income and wealth:** Through reducing inequalities in income and wealth by using an efficient tax system, government can encourage people to save and invest in productive sectors.
5. **Acceleration of Economic Growth:** Tax policy may be used to handle critical economic situation like depression and inflation. In depression, tax is set to increase the consumption and reduce the savings to increase the aggregate demand and vice verse. Thus the tax policy may be used to strengthen incentives to savings and investment.
6. **Price Stability:** In underdeveloped countries, there is another role to maintain price stability to ensure growth with stability.
7. **Control mechanism:** Tax policy is also used as a control mechanism to check inflation, consumption of liquor and luxury goods and to protect the local poor industries from the uneven competition. Taxation is the only effective weapon by which private consumption can be curbed and thus resources transferred to the state. Thus the economy can ensure sustainable development.
8. **Balanced regional development:** Government gives specific relief from taxation to backward areas. The government of India has declared 48 districts as backward area, and has given relaxations of taxes for development of these areas. Therefore, some backward areas have been developed.
9. **Generate employment:** Tax policy has to play an important role to control unemployment, for this, government promote the generation of employment opportunities. Thus, government gives relaxation to labour-intensive industries and imposes taxes on capital-intensive industries.

Conclusion:

The classical economists were of the view that the only objective of taxation was to raise government revenue. But with the changes in circumstances and ideologies, the aim of taxes has also changed. These days apart from the object of raising the public revenue, taxes are levied to affect consumption, production and distribution with a view to ensuring the social welfare through the economic development of a country.

Q-6 Classification of taxation on the basis of tax impact and incident of tax. (6 Marks – 2012, 2015)

Introduction:

Taxes are the government's way of earning an income which can then be used for various projects that the government needs to indulge in to help boost the country's economy or its people. Taxes in India are decided on by the central and state governments with local governments, such as municipalities, also deciding on smaller taxes that can be levied within their jurisdiction. It must, however, be remembered that the government cannot impose any tax that it wishes to. All the taxes imposed by the government must be laws.

Tax impact:

The term impact is used to express the immediate result of or original imposition of the tax. The impact of a tax is on the person on whom it is imposed first. Thus, the person who is liable to pay the tax to the government bears its impact.

Tax incidence:

The term incidence refers to the location of the ultimate or the direct money burden of the tax as such. It signifies the settlement of the tax burden on the ultimate tax payer. It is the ultimate result of shifting. Hence, the incidence of a tax is upon that person who cannot shift the burden any further, so he has to himself bear the direct money burden of the tax.

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Relation between tax impact and tax incidence:

1. Impact refers to the initial burden of the tax, while incidence refers to the ultimate burden of the tax.
2. Impact is at the point of imposition, incidence occurs at the point of settlement.
3. The impact of a tax falls upon the person from whom the tax is collected and the incidence rests on the person who pays it eventually. For example, suppose a tax — excise duty — is imposed on soap. Its impact is on the producers, in the first instance, as they are liable to pay it to the government. But, the producers may succeed in collecting it from the consumers by raising the price of soap by the amount of tax. In that case, consumers eventually pay the tax and so the incidence falls upon them.
4. Impact may be shifted but incidence cannot. For, incidence is the end of the shifting process. Sometimes, however, when no shifting is possible, as in the case of income tax or such other direct taxes, the impact coincides with incidence on the same person.

Types of taxes based on impact and incidence:

Based on impact of tax and incidence of tax, taxes can be divided into two types. 1) Tax where impact and incidence are on the same person. It means the tax which cannot be shifted. It is called **direct tax** and 2) Where impact is on one and he shifts incidence on the other. So the tax which can be shifted. It is called **indirect tax**.

Tax which cannot be shifted or direct tax:

The tax where impact and incidence of tax are on the same person are called the taxes on which burden cannot be shifted. They are also referred to as direct tax. Following are the taxes which are included under direct tax:

1. **Income Tax:** This is one of the most well-known and least understood taxes. It is the tax that is levied on your earning in a financial year. There are many facets to income tax, such as the tax slabs, taxable income, tax deducted at source (TDS), reduction of taxable income, etc. The tax is applicable to both individuals and companies. For individuals, the tax that they have to pay depends on which tax bracket they fall in. This bracket or slab determines the tax to be paid based on the annual income of the assessee and ranges from no tax to 30% tax for the high income groups.
2. **Capital Gains Tax:** This is a tax that is payable whenever you receive a sizable amount of money. It could be from an investment or from the sale of a property. It is usually of two types, short term capital gains from investments held for less than 36 months and long term capital gains from investments held for longer than 36 months. The tax applicable for each is also very different since the tax on short term gains is calculated based in the income bracket that you fall in and the tax on long term gains is 20%. The interesting thing about this tax is that the gain doesn't always have to be in the form of money. It could also be an exchange in kind in which case the value of the exchange will be considered for taxation.
3. **Securities Transaction Tax:** It's no secret that if you know how to trade properly on the stock market, and trade in securities, you stand to make a substantial amount of money. This too is a source of income but it has its own tax which is known as the Securities Transaction Tax . How this tax is levied is by adding the tax to the price of the share. This means that every time you buy or sell shares, you pay this tax. All securities traded on the Indian stock exchange have this tax attached to them.
4. **Perquisite Tax:** Perquisites are all the perks or privileges that employers may extend to employees. These privileges may include a house provided by the company or a car for your use, given to you by the company. These perks are not just limited to big compensation like cars and houses, they can even include things like compensation for fuel or phone bills. How this tax is levied is by figuring out how that perk has been acquired by the company or used by the employee. In the case of cars, it may be so that a car provided by the company and used for both personal and official purposes is eligible for tax whereas a car used only for official purposes is not.

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5. **Corporate Tax:** Corporate tax is the income tax that is paid by companies from the revenue they earn. This tax also comes with a slab of its own that decides how much tax the company has to pay. For example a domestic company, which has a revenue of less than Rs. 1 crore per annum, won't have to pay this tax but one that has a revenue of more than Rs. 1 crore per annum will have to pay this tax. It is also referred to as a surcharge and is different for different revenue brackets.
6. **Wealth Tax:** The wealth tax, governed by the Wealth Tax Act, allows the government to impose a tax on the net wealth of a person, an HUF or a company. This tax is set to be abolished in 2016 but until then the tax levied on the net wealth is about 1% of the wealth that exceeds Rs. 30 lakhs. There are exceptions to this tax which are organisations that don't have to pay wealth tax. These organisations could be trusts, partnership firms, social clubs, political parties, etc.

Tax which can be shifted or indirect tax:
The tax where it is possible to shift the burden of paying taxes is known as indirect tax. Here the impact of tax is on one person say producer which he shifts on to the consumers so here incidence is on consumer. Following is the discussion regarding indirect taxes:

1. **Sales Tax:** As the name suggests, sales tax is a tax that is levied on the sale of a product. This product can be something that was produced in India or imported and can even cover services rendered. This tax is levied on the seller of the product who then transfers it onto the person who buys said product with the sales tax added to the price of the product. The limitation of this tax is that it can be levied only once for a particular product, which means that if the product is sold a second time, sales tax cannot be applied to it.
2. **Service Tax:** Like sales tax is added to the price of goods sold in India, so is service tax added to services provided in India. In the reading of the budget 2015, it was announced that the service tax will be raised from 12.36% to 14%. It is not applicable on goods but on companies that provide services and is collected every month or once every quarter based on how the services are provided. An important thing to remember is that since the service at a restaurant is a combination of the food, the waiter and the premises themselves, it is difficult to pin point what qualifies for service tax. To remove any ambiguity, in this regard, it has been announced that the service tax in restaurants will be levied only on 40% of the total bill.
3. **Value Added Tax:** The value added tax is a tax that is levied at the discretion of the state government and not all states implemented it when it was first announced. The tax is levied on various goods sold in the state and the amount of the tax is decided by the state itself. For example in Gujrat the government split all the good into various categories called schedules. There are 3 schedules and each schedule has its own VAT percentage. For Schedule 3 the VAT is 1%, for schedule 2 the VAT is 5% and so on. Goods that have not been classified into any category have a VAT of 15%. VAT will soon be replaced by GST (Goods and Service Tax)
4. **Custom duty & Octroi:** When you purchase anything that needs to be imported from another country, a charge is applied on it and that is the customs duty. It applies to all the products that come in via land, sea or air. Even if you bring in products bought in another country to India, a customs duty can be levied on it. The purpose of the customs duty is to ensure that all the goods entering the country are taxed and paid for. Just as customs duty ensures that goods for other countries are taxed, octroi is meant to ensure that goods crossing state borders within India are taxed appropriately. It is levied by the state government and functions in much the same way as customs duty does.
5. **Excise Duty:** This is a tax that is levied on all the goods manufactured or produced in India. It is different from customs duty because it is applicable only on things produced in India and is also known as the Central Value Added Tax or CENVAT. This tax is collected by the government from the manufacturer of the goods. It can also be collected from those

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entities that receive manufactured goods and employ people to transport the goods from the manufacturer to themselves.

Conclusion:
Based on impact and incidence of tax we can say that there are two types of taxes. One in which burden of paying tax cannot be shifted which is known as direct tax and other where burden of paying tax can be shifted which is known as indirect taxes.

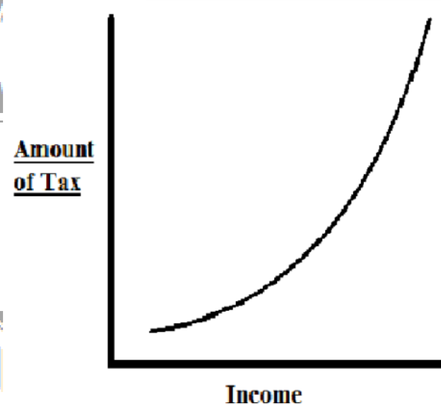
Q-7 Explain various types of taxes on the basis of rate of tax. OR write a short note on (1) Progressive tax (4 Marks – 2012), (2) Proportional tax and (3) Regressive tax. (4 Marks – 2013, 2014, 2015)

Introduction:
Tax systems fall into three main categories within the tax code: progressive, proportional and regressive taxes. Following is the discussion of the three types taxes.

Progressive Tax:
Taxes in which the rate of tax increases are called progressive taxes. Thus, in a progressive tax, the amount of tax paid will increase at a higher rate than the increase in tax base or income, for the taxation amount is the product of multiplying the base by the rate and both these increase in a progressive tax. Thus, a progressive tax extracts an increasing proportion of rising income. The progressive rate of taxation is illustrated in following Table.

Schedule of Progressive Tax Rates

Tax Base (Y) (Rs.)	Progressive	
	Tax Rate (R) (Per cent)	Amount of Tax (T) (Rs.)
1,000	10	100
2,000	15	300
3,000	25	750



Relative Merits of Progressive Taxes:

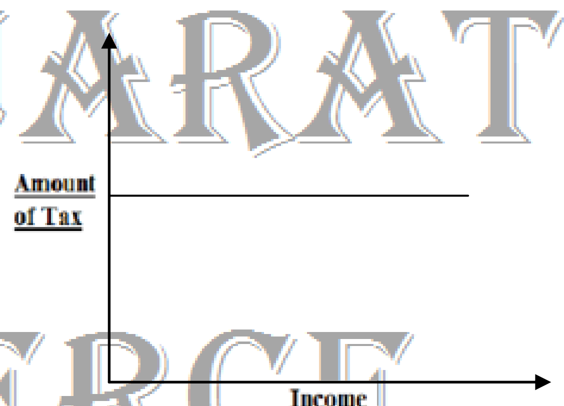
1. A proportional tax is inequitable, as it falls relatively heavily on poor incomes. A progressive tax is more equitable, as a larger part is taxed on higher incomes it is justifiable just as the law of diminishing marginal utility operates in the case of money. Hence, the disutility of paying a high tax by rich is not as much as that of poor in paying even a low tax. Therefore, the rich should be taxed at a higher rate than the poor.
2. Progressive taxes may be justified on the ground that higher incomes contain surpluses, which have cent per cent capacity to bear taxes. Thus, progressive taxation fully complies with the principle of capacity to bear or ability to pay the tax.
3. Progressive taxes are more economical, as the cost of collection does not rise when the rate of tax increases.
4. Progressive taxation has greater revenue productivity than proportional taxation.
5. The progressive tax system also complies with the canon of elasticity. For, a rise in income is automatically taxed at a higher rate under the system so that revenue increases with economic expansion.
6. Progressive taxes are an engine of social improvement. The strong should assist the weak and the rich should aid the poor. This social morale is well sustained by progressive taxation.

7. Progressive taxation can lead to a better distribution of income and wealth, hence, an increase in general welfare of the community. According to Kaldor, the desire to reduce economic inequalities can be regarded as a justification for adopting a highly progressive tax system.

Proportional Tax:
Taxes in which the rate of tax remains constant, though the tax base changes, are called proportional taxes. Here, the tax base may be income, money value of property, wealth, or goods etc. Income is, however, regarded as the main tax base, because it is the determinant of taxable capacity of a person.
In a proportional tax system, thus, taxes vary in direct proportion to the change in income. If income is doubled, the tax amount is also doubled. This has been illustrated in the table below.
Thus, a proportional tax extracts a constant proportion of rising income.

Schedule of Proportional Tax Rates

Tax Base (Y) (Rs.)	Proportional	
	Tax Rate (R) (Per cent)	Amount of Tax (T) (Rs.)
1,000	10	100
2,000	10	200
3,000	10	300



Relative Merits of Proportional Taxes:
1. Proportional taxation leaves the tax payer in the same relative economic status.
2. Proportional taxation is simple to calculate and to administer. Since it is uniformly levied, it is very convenient to estimate.
3. Proportional taxation in not as repugnant to tax payers as progressive taxation.
4. The effect on willingness to work hard and save is not adverse in the case of proportional taxes.

Regressive Tax:
When the rate of tax decreases as the tax base increases, the taxes are called regressive taxes. This has been illustrated in the schedule below.

Schedule of Regressive Tax Rates

Tax Base (Y) (Rs.)	Regressive	
	Tax Rate (R) (Per cent)	Amount of Tax (T) (Rs.)
1,000	10	100
2,000	8	160
3,000	6	180
4,000	5	200

It must be noted that in regressive taxation, though the total amount of tax increases on a higher income in the absolute sense, in the relative sense, the tax rate declines on a higher income. As such, relatively a heavier burden (sacrifice involved) falls upon the poor than on the rich. Generally, taxes on necessaries are regressive as they take away a greater percentage of lower incomes as compared to higher incomes.
Thus, regressive taxation is unjust and inequitable. It does not comply with the canon of equity. It tends to accentuate inequalities of income in the community.

Conclusion:

Now the question may arise: of the above stated categories of rate structure, which is the best? The answer should be: We have to select that tax system which will distribute the tax burden most equitably. Regressive taxation is, of course, not accepted by any economist on the ground of equity. But, there has been a heated controversy regarding proportional and progressive taxation.

Q-8 Explain main objectives of tax policy in India. (4 Marks, 2013)

Introduction:

A tax is a compulsory contribution of a person or entity to the state as per the rules. The tax payer does not receive direct and or special benefit in return. It is spent by the government for the common interest and benefit of the people.

Objectives of tax policy in India:

The main objectives of tax are as follows:

1. **Raise More Revenue:** The fundamental objective of taxation is to finance government expenditure. The government requires carrying out various development and welfare activities in the country. For this, it needs a huge amount of funds. The government collects funds by imposing taxes. So, raising more and more revenues has been an important objective of tax.
2. **Prevent Concentration Of Wealth In A Few Hands:** Tax is imposed on persons according to their income level. High earners are imposed on high tax through progressive tax system. This prevents wealth being concentrated in a few hands of the rich. So, narrowing the gap between rich and poor is another objective of tax.
3. **Redistribute Wealth For Common Good:** Tax collected by the government is expended for carrying out various welfare activities. In this way, the wealth of the rich is redistributed to the whole community.
4. **Boost Up The Economy:** Tax serves as an instrument for promoting economic growth, stability and efficiency. The government controls or expands the economic activities of the country by providing various concessions, rebates and other facilities. The effective tax system can boost up the economy. Similarly, taxes can correct for externalities and other forms of market failure (such as monopoly). Import taxes may control imports and therefore help the country's international balance of payments and protect industries from overseas competition.
5. **Reduce Unemployment:** The government can reduce the unemployment problem in the country by promoting various employment generating activities. Industries established in remote parts or industries providing more employment are given more facilities. As a result, the unemployment problem can be reduced to a great extent through liberal tax policy.
6. **Remove Regional Disparities:** Regional disparity has been a chronic problem to the developing countries. Tax is one of the ways through which regional disparities can be minimized. The government provides tax exemptions or concessions for industries established or activities carried out in backward areas. This will help increase economic activities in those areas and ultimately regional disparity reduces to minimum.

Conclusion:

Tax is permanent instrument for collecting revenues. It is a major source of revenue in the developed world and has been appearing as an important source of revenue in the developing world as well. It has been an instrument of social and economic policy for the government.

Q-9 Discuss the meaning of tax evasion and tax avoidance and differentiate between them. (4 Marks – 2012, 2013, 2015)

Introduction:

Every assessee wants to escape from paying taxes, which encourages them to use various means to avoid such payment. Tax Avoidance and Tax Evasion are two techniques which are used by

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many people to reduce their tax liability. They do so by taking expert advice. **Tax Avoidance** is completely lawful while **Tax Evasion** is considered as a crime in the whole world.

Tax Avoidance:
An arrangement made to beat the intent of the law by taking unfair advantage of the shortcomings in the tax rules is known as Tax Avoidance. It refers to finding out new methods or tools to avoid the payment of taxes which are within the limits of the law.
This can be done by adjusting the accounts in a manner that it will not violate any tax rules as well as the tax incurrence will also be minimized. Formerly tax avoidance is considered as lawful, but now it comes to the category of crime in some special cases.
The only purpose of tax avoidance is to postpone or shift or eliminate the tax liability. This can be done investing in government schemes and offers like the tax credit, tax privileges, deductions, exemptions, etc., which will result in the reduction in the tax liability without making any offense or breach of law.

Tax Evasion:
An illegal act, made to escape from paying taxes is known as Tax Evasion. Such illegal practices can be deliberate concealment of income, manipulation in accounts, disclosure of unreal expenses for deductions, showing personal expenditure as business expenses, overstatement of tax credit or exemptions suppression of profits and capital gains, etc. This will result in the disclosure of income which is not the actual income earned by the entity.
Tax Evasion is a criminal activity for which the assessee is subject to punishment under the law. It involves acts like:

- Deliberate misrepresentation of material facts.
- Hiding relevant documents.
- Not maintaining complete records of all the transactions.
- Making false statements.

Comparison between Tax Evasion and Tax Avoidance:
Following table shows the comparison between tax evasion and tax avoidance over various points:

Basis for Comparison	Tax Avoidance	Tax Evasion
Meaning	Minimization of tax liability, by taking such means which do not violate the tax rules, is Tax Avoidance.	Reducing tax liability by using illegal ways is known as Tax Evasion.
Concept	Taking unfair advantage of the shortcomings in the tax laws.	Deliberate manipulations in accounts resulting in fraud.
Which type of means used?	Use of Justified means	Use of such means that are forbidden by law
Happened when	Before the occurrence of tax liability.	After tax liability arises.
Type of act	Legal	Criminal
Consequences	Deferment of tax liability	Penalty or imprisonment

Conclusion:
Tax Avoidance and Tax Evasion both are meant to reduce the tax liability ultimately but what makes the difference is that the former is justified in the eyes of the law as it does not make any offense or breaks any law. However, it is biased as the honest tax payers are not fools, but they can also make arrangements for postponing unnecessary tax. If we talk about the latter, it is completely unjustified because it is a fraudulent activity, because it involves the acts which are forbidden by the law and hence it is punishable.

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Multi Choice Questions:

1. Whose payment is compulsory of the following?
(A) Services (B) Commodity (C) Tax (D) Debt

2. In which tax, the burden cannot be shifted to other person?
(A) Indirect taxes (B) Direct taxes (C) Proportional tax (D) Regressive tax

3. Tax is levied, according to tax payer's ability to pay, under ___________ tax.
(A) Direct tax (B) Indirect tax (C) Proportional tax (D) Progressive tax

4. Which is one of the characteristics of indirect tax from the following?
(A) Reduce inequality of income (B) Consider ability to pay (C) Does not consider ability to pay (D) Tax shifting is impossible

5. To shift, monetary burden of tax to other person is called ____________.
(A) Tax avoidance (B) Tax evasion (C) Tax shifting (D) Incidence of tax

6. Indirect tax is known as ________________.
(A) Tax on honesty (B) Tax on production (C) Reduce income inequality tax (D) Ability to pay tax

7. Which tax reduces income inequality from the following?
(A) Progressive (B) Proportional (C) Regressive (D) Indirect

8. Under regressive tax, tax rate _________________ with increase in income.
(A) Increases (B) Decreases (C) Proportional (D) zero

9. In which tax, tax rate multiplier increases?
(A) Progressive (B) Proportional (C) Regressive (D) None of them

10. Tax on income is called ________________.
(A) Indirect tax (B) Direct tax (C) Proportional tax (D) Progressive tax

11. Currently the exemption limit is on income up to Rs. _______________.
(A) 2,00,000 (B) 2,50,000 (C) 3,00,000 (D) 3,50,000

12. Which tax revenue receipt is distributed between central and states?
(A) Excise duties (B) Corporation tax (C) Custom duties (D) Service tax

13. Which taxation revenue receipts are highest in Indian central indirect taxes?
(A) Custom (B) Excise duties (C) Service tax (D) Other tax

14. In which taxation State Government receive highest revenue receipts?
(A) VAT (B) Land Revenue (C) Tax on agriculture income (D) Stamp and registration

15. The share of indirect taxes has been reducing since _____________ in India.
(A) 1981 (B) 1991 (C) 2001 (D) 2011

16. The share of indirect taxes in 2011-12 was ____________ in India.
(A) 43% (B) 16% (C) 37% (D) 57%

17. Economic survey of 2011-12, central taxation and GDP ratio is _________________.
(A) 6% (B) 10.5% (C) 13% (D) 17%

18. In India, per capita burden is _____________ as compared to per capita income.
(A) Proportional (B) Higher (C) Lower (D) Indefinite

19. Which activity is illegal from the following?
(A) Debt (B) Tax avoidance (C) Tax evasion (D) Loan

20. A tax is levied at 10% on the first Rs. 20,000 of income, 15% on the next Rs. 30,000 income and 20% on the next Rs. 40,000 would be:
(A) Progressive (B) Regressive (C) Proportional (D) None

Answers: 1. Tax 2. Direct taxes 3. Progressive tax 4. Does not consider ability to pay 5. Incidence of tax 6. Tax on production 7. Progressive 8. Decreases 9. Progressive 10. Direct tax 11. 2,50,000 12. Excise duties 13. Excise duties 14. VAT 15. 1991 16. 57% 17. 10.5% 18. Higher 19. Tax-evasion 20. Progressive.

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Unit: 3 Public Income and Expenditure

Q-1 Explain the meaning and objectives/ aims of public expenditure. (6 Marks- 2013, 2015)

Introduction:

Public Expenditure refers to Government Expenditure. It is incurred by Central and State Governments. The Public Expenditure is incurred on various activities for the welfare of the people and also for the economic development, especially in developing countries. In other words The Expenditure incurred by Public authorities like Central, State and local governments to satisfy the collective social wants of the people is known as public expenditure**.**

Objectives/ Aims or Purpose of public expenditure:

Government spends money in an economy keeping in mind the following objectives:

1. **Reallocation of Resources:** Government uses its revenue to reallocate resources. Many a times due to imperfections in market, they fail and government has to intervene in the market. In order to save many producers and employment government has to give subsidies. Production of certain goods like liquor may harm the society, which society and in turn government has to bear, many services where if private sector is allowed to operate either they will make more profit or will not provide better services. In order to fulfill these responsibilities government needs revenue.
2. **Redistribution of income:** Disparities in the income distribution prevails in any economy. Because of such disparities poor class of people may have to suffer so in order to increase welfare of weaker section of people government incurs public expenditure. Government, through taxes, collects revenue from rich class of people and spends the same amount to provide goods, education, health care etc. facilities to poor either free or at very cheap rate.
3. **Controlling market fluctuations:** Through government expenditure, a government can control economic activities. Inflation and deflation both are harmful to proper development of an economy. Government uses public expenditure to control inflation and deflation. In case there is inflation in market, government decreases public expenditure, controlling demand in market. On the other hand whenever there is deflation, government increases public expenditure, which increases effective demand and economy gets out of depression.
4. **To run commercial activities:** Services like transport services which are natural monopolies are most well be provided by government. The cost of rendering such services should be covered by taxes like vehicle taxes. This would reduce some real cost to the society such as the inconvenience caused to the public when these services are supplied by private monopolies. Also water, gas, electricity etc. may be more beneficially provided by the government than private firms. Moreover government may also invest in projects which are highly favourable from social point of view. Public expenditure is also needed to help farmers by providing them cheap loans and subsidy.
5. **Public expenditure and economic life:** Public expenditure can affect the economic life of a country in various ways. i.e. it can be re-established to develop the level of production and distribution and to maintain economic stability. It can enhance the level of production by granting loans for the development of agriculture and industries. It can also make provisions for technical knowledge, means of transport and communication, power etc. to encourage production. Through public expenditure government manufactures essential commodities and capital goods and compete with private enterprises. Thus, public expenditure is used as a tool of government economic policy to improve production, distribution and to maintain economic stability.

Conclusion:

With the help of public expenditure government aims at bringing about equality, reallocation of resources, helping poor section of society, provide commercial services, control the market etc. for increasing social welfare of citizens of the country.

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Q-2 Discuss the sources of revenue for the state governments in India. (6 Marks-2013, 2015; 4 Marks 2014)

Introduction:

India follows Federal Financial system so power and functions of government are shared between Central government, State government and Local self governments. Each of the government has to perform specific duties. In order to justify their duties, they need to have some source of income.

Source of revenue for State Government:

State government gets its income mainly from two sources i.e. tax revenue and non-tax revenue. Discussion of both the types of revenue is as follows:

Tax revenue:

Tax income constitutes major portion of revenue of government. Tax revenue of state government can be classified into two categories. 1) State's own revenue 2) Share in central government's tax revenue.

State governments are given powers to impose and collect taxes. It can collect 1) Land revenue 2) Taxes on sale and purchase of goods except newspaper 3) Taxes on agricultural income 4) Taxes on land and building 5) Succession and estate duties on agricultural land 6) Excise on alcoholic liquors and narcotics 7) Taxes on entry of goods into local area 8) Taxes on mineral rights subject to any limitations imposed by parliament 9) Taxes on consumption and sale of electricity 10) Taxes on vehicles, animals, boats 11) Stamp duties except those on financial documents 12) Taxes on goods and passengers carried by inland waterways 13) Taxes on luxuries including entertainments, betting and gambling 14) Toll tax 15) Taxes on profession and trade 16) Capitation tax etc.

In 2010-11 budget, the tax revenue of the states is placed at Rs. 6,27,148 crores, of which revenue from state's own tax would be Rs. 4,18,151 crores.

1. **Income tax collected by states:** The state government receive revenue from taxes on income in two ways. 1. Agriculture income tax and 2. Profession tax. These taxes are imposed and collected by the state government in which agricultural income yields only Rs. 20 crores to 22 crores. On the other hand professional tax yielded around Rs. 3000 crores in 2007-08 budget.
2. **Taxes on property and Property transactions:** Another main source of state revenue is taxes on property and property transactions. It consists of the sources of land revenue, stamp and registration, and tax on urban immovable property.
    a. **Land revenue:** Land revenue was the most important source revenue of states in 1951-52 in India. The basis of land revenue and the rates of land revenue differ from state to state. The basis of assessment of land revenue is net assess of land or value of the produce or gross produce. The rate of land revenue also varies from state to state.
    b. **Stamps and Registration:** In recent times, stamps and registration on transfer of property occupy very important position. The collections from stamps and registration have been gradually increasing. The amount expected to be collected was about Rs. 36,860 crores in 2007-08.
3. **Sales tax on commodities and services:** Like the union government, the state governments too have found commodity taxes as the best source of revenue. General sales tax, state excise duties, motor vehicle tax, electricity duty, entertainment tax are the examples of commodity taxes.
4. **States share in central excise duties:** central government has right to impose taxes on excise duties. But according to finance commission, state get share in central excise

duties. In modern times, central excise duties become the second most important source of income to the states after sales tax.

Non-Tax Revenue:
There are two forms of non-tax revenue of the states. 1) Grant-in-aid from the central government and 2) other non-tax revenue.

1. **Grants-in-aid from the central government:** states get grants from the centre in two forms
   a. **Statutory grants:** Certain functions and resources have been assigned to the states in the Indian constitution. Some states receive less resource of revenue incomes as compared to the expenditure on the responsibilities of development and welfare. Therefore, these states get grant-in-aid as per the provision of finance commission to fill up the non-plan deficit.
   b. **Discretionary grants:** This type of grants is received to the states on the recommendations of planning commission. The states receive grants in the context of natural calamities from the centre.
2. **Other non-tax revenue:** States also get non-tax revenue in the following forms:
   a. **Through loan:** The states are powered to raise loan in the market but they also borrow from the centre. If such types of loans are received by country's people or country's currency then it is called internal loan and if it is received by foreign countries or in foreign exchange, it is called external loan. For instance, loan through World Bank.
   b. **Income of State's Property:** State also gets income through properties. States give these properties on rent and receive income.
   c. **Services provided by State Governments:** Some services are provided by the state government to the people and states get income as reward of these services. For example, electricity, roads, water etc.
   d. **Profits of public enterprises:** Some important industries are operated by the state government. If these industries earn profit, it becomes an income of the state government.
   e. **Others:** Sometimes states get income through specific taxes. Some area's people get benefits from states' economic development schemes. Hence, states charge specific tax to those persons who get benefited to it.

Conclusion:
State governments receive income from tax and non-tax revenue. Tax revenue includes direct and indirect taxes while non-tax revenue includes grants, loans and other sources of income.

Q-3 Discuss the sources of revenue for the central government of India. (6 Marks – 2012 , 2014)

Introduction:
For increasing social welfare government generates revenue from various sources. Over and above social welfare, central government has to shoulder many other responsibilities like defense, balanced regional development, maintaining integrity of nation etc. For all these purpose government needs revenue from various sources.

Sources of revenue for Central Government:
Central government earns income from the following sources A) Tax Revenue B) Non-tax revenue and C) Capital Receipts.

Tax Revenue:
Taxes collected by central government are of three types viz. taxes on income and expenditure, taxes on property or capital assets, taxes on goods and services.

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1. **Taxes on Income and Expenditure:** In India, central government imposes two types of income taxes i.e. personal income tax and corporation tax.
    a. **Personal income tax:** Personal income tax is levied on individuals by the central government. It is based on the cannon of ability to pay. People with low income are exempted from paying income tax. The exemption limit and tax slabs keeps on changing. Currently on income up to 2,50,000 there is no income tax, income between 2,50,000 to 5,00,000 tax rate is 10%, income between 5,00,000 to 10,00,000 tax rate is 20% and on income more than 10,00,000 income tax rate is 30%. The volume of revenue collected from person income tax amounted to Rs. 1,95,786 crores in 2012-13 budget.
    b. **Corporation tax:** Corporation tax stands first in tax revenue of centre. It is a tax on the net income of the companies. The central government imposes a tax on the profits of the large and small companies known as the corporation tax. The rates of corporation tax are dissimilar for the domestic companies and for foreign companies. Many companies, even some large companies with vast profits managed to escape the corporate tax by taking advantage of using the provisions of exemptions, deductions, incentives, differential rate of depreciation etc. so in 1996-97 P. Chidambarm imposed Minimum Alternate Tax (MAT). Government collected Rs. 3,73,227 crore rupees as revenue in 2012-13 budget.
2. **Taxes on property or capital assets:** Central government imposes tax on wealth, inheritance of wealth and gifts. These taxes fall on rich and they help to reduce inequality of income and wealth in country. however, these taxes never became significant due to inefficient implementation and extensive evasion. Following are some of the taxes that are collected on property:
    a. **Wealth tax:** You can understand from the name that wealth tax is levied to wealth. But interesting thing is that wealth tax is not levied to all the assets of the person but only on idle asset of the person. The assets which are not utilized to generate revenue are covered here. It is imposed on accumulated wealth or property of every individual, Hindu Undivided Family and closely held companies. Rs. 30 lakh is the exemption limit on wealth tax. Assets over and above Rs. 30 lakh will be taxes at 1%.
    b. **Estate duty and gift tax:** Estate duty is imposed on the estate of an individual which is inherited by heirs. The duty imposed and collected by the central government but the proceeds are passed on to the states. Estate duty is a tax on the total market value of a person's assets (cash and non-cash) at death. It does not matter if the person has a will or not, the assets are still subject to estate duty. Estate duty has been removed from 15th February, 2008.
    Gift tax in India is regulated by the Gift Tax Act which was constituted on April 1, 1958. As per the Gift Act 1958, all gifts in excess of Rs. 25,000, in the form of cash, draft, check or others, received from one who doesn't have blood relations with the recipient, were taxable. However, with effect from October 1, 1998, gift tax got demolished and all the gifts made on or after the date were free from tax. But in 2004, the act was again revived partially. A new provision was introduced in the Income Tax Act 1961 under section 56 (2). According to it, the gifts received by any individual or Hindu Undivided Family (HUF) in excess of Rs.50,000 in a year would be taxable.
3. **Taxes on Goods and Services:** Taxes on goods and services are the most important source of revenue of the central government. Central excise duties, custom duties and service taxes are important taxes of the central government. It includes the following:
    a. **Custom duties:** These are duties or taxes imposed on commodities imported into India and those goods exported from India. Import duties have been comparatively very productive. There has been considerable increase in revenue from custom duties because of heavy imports of iron and steel, chemicals, drug and medicines, fertilizers, petroleum products etc. Custom duties were more important than excise

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duties in the beginning of planning period. But in the last few years, the government of India has gradually reduced and rationalized import duties. Thus, it got 4th rank in total tax revenue of the centre. However, in 2012-13 budget, the central government hoped to collect Rs. 1,86,694 crores from custom duties.

b. **Central excise duties:** After independence, the government considered the need for additional revenue for purposes of economic development. These duties are levied by the centre on commodities which are produced within a country. But commodities on which state government impose excise duties for example, liquor and drugs are exempted from central excise duties. Excise duties rank 3rd in total tax revenue and 1st rank in centre's indirect taxes. Gross revenue from central excise duties was about Rs 70 crores in 1950-51. The budget estimates for 2012-13 anticipated gross excise tax collection at Rs. 1,94,350 crores.

c. **Service tax:** Till 1995-96, the government of India had imposed taxes only on commodities leaving out services. Central Finance Ministry realized that if commodities could be taxed on their production and sale-services too could be taxed. In the last few decades, the services component in GDP was enhancing rapidly. This tax is one of the fastest growing taxes for the central government. For example, a yield from service tax was Rs. 2,610 crores in 2001-02 and was expected to be Rs. 1,24,000 crores in 2012-13.

Non-Tax Revenue:

Besides taxes on income, property and commodities, central government get revenue from other sources also. Which are called non-tax revenue. This non-tax revenue include receipts from fiscal services, interest receipts, dividend and profits of government enterprise, general services, etc.

In 1950-51, non-tax revenue of the centre was Rs. 49 crores, it has increased in the last few years and was expected to be Rs. 1,64,613 crores in 2012-13 budget. Interest receipts consists of interest on loans to states and union territories, interest payable by railways, and postal services and other interest receipts such as loans to public enterprises etc. Profits and dividends related to profits of RBI, profits of nationalized banks, LIC, public enterprises etc.

Fiscal services deals with revenue received by the central government from 1) currency, coinage and mint 2) other fiscal services deals with the India Security Press, Nasik, Hydrabad etc. and 3) general services comprise of social community services, economic services and grants-in-aid and contributions.

Capital Receipts:

The budget in India is divided into two parts 1) Revenue budget and 2) Capital budget. The capital receipts of the central government consists of the following incomes:

1. Net recoveries of loan and advances made previously to the state government, union territories, and public sector undertakings.
2. Net market loans i.e. gross borrowings from the market less repayment of public debt.
3. Net small savings collection.
4. Other capital receipts such as provident funds, special deposits etc.
5. Foreign aid.

Capital receipts consist of that revenue, which government has to pay in future. Loan is the main source of centre's capital receipts. It includes internal and external loan. For instance, centre hoped to receive Rs. 5,55,240 crores from capital receipts in which Rs. 4,79,000 crores was expected from market loans in 2012-13 budget.

Conclusion:

With the growth of national income and per capita income, the sources of revenue available to the central government are also enhancing. There has been increase in tax receipts due to new taxes and altered tax rates.

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Q-4 Discuss the meaning and importance of public expenditure. (6 Marks, 2014)

Introduction:

Underdeveloped and developing countries are eager to develop their economies rapidly. For this the governments need to spend a lot of money. The private sector is unable to find and invest large amount which will give profit only in long run. Hence, economic development has to depend mostly on public expenditure. The expenditure done by government for social welfare is known as public expenditure.

Importance of Public Expenditure:

Following points discuss importance of public expenditure:

1. **Growth and Development of country's economy:** Development of a nation depends on development of infrastructure, development of its human resources, availability of health and educational services, advancement in science, development of agriculture and industries etc. In order to manage these developments government has to spend huge amount of funds.
2. **Balanced regional development:** Every economy wants to develop each regions equally but some of the regions develop on their own but for other regions to develop government expenditure is necessary. Governments give more attention in developing backward areas. This task needs huge amounts of which dependence has to be on public expenditure.
3. **Importance in economic stability:** Public expenditure is very important to bring economic stability. With the help of public expenditure government can control economic fluctuations like inflation and deflation.
4. **Importance in social welfare:** Social environment in a country is deeply affected by public spending. In recent years, with increase in its scope, public expenditure is very important in the realization of general social welfare. Undertaking of social expenses like hospitals, colleges, schools and technical institutions too are important. Money for these things cannot come out of private resources.
5. **Growth in production:** Public expenditure enhances production by developing productive efficiency of workers, by supplying economic and social overheads, by providing direct aid in the form of loans, grants, and subsidies and technical advice and by investment in public enterprise. In addition, increasing the level of production, public expenditure may influence the pattern of production or composition of output.
6. **Economic overheads:** Economic development is not good in underdeveloped countries owing to the lack of the required infrastructure. Economic overheads like the road and railways, irrigation, roads, power plants etc. are very important for accelerating economic development. All these expenses are part of public expenditure.

Conclusion:

Public expenditure plays an important role in economic development of a country. It is pre-requisite to generate and maintain conditions necessary for economic growth. It must create environment for investment and provide intensives for savings. Public expenditure makes the essential environment for the expansion of private enterprise and initiatives.

Q-5 Explain reasons for the growth of public expenditure in India. (6 Marks – 2012; 4 Marks- 2013, 2015)

Introduction:

Public expenditure means the expenditure done by the government for social welfare. In a developing economy like India public expenditure plays an important role. As an economy develops public expenditure also increases.

Reasons for growth of public expenditure:

Following are the main reasons for increase in India's public expenditure over time.

1. **Population Growth:** During the past 50 years of planning, the population of India has increased from 36.1 crore in 1950-51, it has crossed over 102 crore in 2001 and currently

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(2016) the population is around 125 crores. The growth in population requires massive investment in health and education, law and social order, etc. A young population requires increasing expenditure on education & youth services, whereas the aging population requires transfer payments like old age pension, social security & health facilities.

2. **Defence Expenditure:** There has been enormous increase in defence expenditure in India during planning period. According to Economic Survey 2006-07 the defence expenditure of central government was Rs.10,874 crores in 1990-91 which has increased significantly to Rs.51,542 crores in 2006-07. The defence expenditure has increase tremendously due to modernisation of defence equipment used by army, navy and airforce. India cannot postpone modernisation in defence especially when its neighbouring countries are buying the latest defence equipments from developed countries of the world.
3. **Increase in National Income:** The increase in national income also resulted in more income to the government by way of tax revenue and other income. As a result of which the government Expenditure also increased because under the circumstances, the Government is not only expected to expand its traditional activities but it also undertakes new activities.
4. **Government Subsidies:** The Government of India has been providing subsidies on a number of items such as food, fertilizers, interest to priority sector, exports, education, etc. Because of the massive amounts of subsidies, the public expenditure has increased. According to Economic Survey 2006-07 the expenditure on subsidies by central government in 1990-91 was Rs.9581 crores which has increased significantly to Rs.44,792 crores in 2005-06.
5. **Debt Servicing:** The internal debt as well as external debt is on the increase. The government has been borrowing heavily both from the domestic market and from foreign sources, to meet its expenditure. As a result of which, the government has to make huge amounts of money towards interest payments. The interest payment of the central government has increased from 21,500 crore in 1990-91 to Rs.1,39,823 crores in 2006-07.
6. **Expansion of Administrative Machinery:** There has been an increase in the administrative machinery in the country with the rapid growth of population and also economic development. Heavy expenditure is to be incurred on administrative machinery in respect of police, tax administration, administration of public sector enterprises, etc.
7. **Development Projects:** The government has been undertaking various development projects such as irrigation, iron and steel, heavy machinery, power, telecommunications, etc. The development projects require lot of capital and revenue expenditure.
8. **Urbanisation:** There has been an increase in urbanization. In 1950-51 about 17% of the population was urban based. Now the urban population has increased to about 28%. There are more than 23 cities above one million population. The increase in urbanization requires heavy expenditure on law and order, education, civil amenities like drinking water housing, electricity, etc.
9. **Industrialisation:** Setting up key and basic industries requires a huge capital and profit may arise only in the long run. It is the government which starts such industries in a planned economy. India needs a strong network of infrastructure including transport, communication, power, fuel, etc. The public sector has created a strong infrastructure as a support base for our industrial sector by investing huge capital. The government has not only improved the rail, air and sea transport but has also expanded them manifold.
10. **Economic Incentives:** Economic incentives such as subsidies, cheap credit, tax concession, cheap electricity, etc. given by the Government to the agriculturists and industrialists have caused monetary burden on the Government whereas recoveries in respect of both economic and social services have been insignificant.
11. **Increase in grant in aid to state and union territories:** There has been tremendous increase in grant in aid to state and union territories during planning period. According to Tata Statistical Outline 2004-2005 the Grant in aid to states and Union Territories was Rs.3982 crores in 1990-91 which has increased to Rs.15,669 crores in 2003-2004. The

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grant in aid to states and union territories has increased significantly both for developmental purposes like construction of roads, railways, etc. and for non-developmental purposes like police administration, tackling terrorism and naxalite activities, etc.

12. **Education:** Education not only contributes to mental development of man but also raises productivity. Moreover mass education is necessary condition for the success of democracy. The state has made attempts to create various types of educational facilities. In order to meet growing demand for skilled labours. Government has also set up specialised institutes for medical & technical education which involves heavy expenditure.

Conclusion:

There is a tremendous rise in total public expenditure in India during the period 1961-2007 without adequate increase in revenues. This has resulted in huge deficit in budget in India. Hence there is a need to manage public expenditure in India to control and reduce fiscal deficit during future period of time.

Q-6 Discuss merits and demerits of disinvestment and privatisation of Public Enterprises. (4 Marks- 2012, 2013, 2014, 2015)

Introduction:

Privatisation means transfer of ownership of an industrial unit from public to private owner. This can happen in industrial as well as in services sector also. If government entrusts ownership of a public sector industrial unit to private individual or a firm it is called privatisation. Privatisation can be done in two ways which are called privatisation and disinvestment.

Privatisation:

The years before 1991 were not considered good for Indian economy, we failed to developed the way Russia did using socialistic ideology. In 1991 we faced foreign exchange crisis, there was shortage of essential food grains and inflation was rampant in Indian economy. In order to get out of this situation we went to IMF and World Bank for loans who put forward the condition that we have to implement economic reforms. As a result India implemented Liberalisation, Privatisation and Globalisation.

Privatisation means transfer of ownership of a public company from public/ government to private people or institutions. Government sells its shares in the company to a private company and also transfers management of the company to that private entity.

Objectives of privatisation:

For what purpose privatisation is taken in India?

- The main objective of privatisation is to improve the work efficiency of the public sector units and hence make them profitable.
- The second objective of privatisation of public sector units is to be free from the burden of loan and interest.
- The third objective of privatisation is to raise monetary resources for the economy.

Merits of privatisation in India:

Following points show the benefits that occurred to India due to privatisation:

1. **Improved efficiency:** The main argument for privatisation is that private companies have a profit incentive to cut costs and be more efficient. If you work for a government run industry, managers do not usually share in any profits. However, a private firm is interested in making profit and so it is more likely to cut costs and be efficient. Since privatisation, companies such as BT, and British Airways have shown degrees of improved efficiency and higher profitability.
2. **Lack of political interference:** It is argued governments make poor economic managers. They are motivated by political pressures rather than sound economic and business sense.

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For example a state enterprise may employ surplus workers which is inefficient. The government may be reluctant to get rid of the workers because of the negative publicity involved in job losses. Therefore, state owned enterprises often employ too many workers increasing inefficiency.

3. **Short Term view:** A government many think only in terms of the next election. Therefore, they may be unwilling to invest in infrastructure improvements which will benefit the firm in the long term because they are more concerned about projects that give a benefit before the election.
4. **Shareholders:** It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient then the firm could be subject to a takeover. A state owned firm doesn't have this pressure and so it is easier for them to be inefficient.
5. **Increased competition:** Often privatisation of state owned monopolies occurs alongside deregulation – i.e. policies to allow more firms to enter the industry and increase the competitiveness of the market. It is this increase in competition that can be the greatest spur to improvements in efficiency. For example, there is now more competition in telecoms and distribution of gas and electricity.
6. **Government will raise revenue from the sale:** Selling state owned assets to the private sector raised significant sums for the UK government in the 1980s. However, this is a one off benefit. It also means we lose out on future dividends from the profits of public companies.

Disadvantages of privatisation

Following points show disadvantages of privatisation:

1. **Natural monopoly:** A natural monopoly occurs when the most efficient number of firms in an industry is one. For example tap water has very significant fixed costs, therefore there is no scope for having competition amongst several firms. Therefore, in this case, privatisation would just create a private monopoly which might seek to set higher prices which exploit consumers. Therefore it is better to have a public monopoly rather than a private monopoly which can exploit the consumer.
2. **Public interest:** There are many industries which perform an important public service, e.g health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry. For example, in the case of health care, it is feared privatising health care would mean a greater priority is given to profit rather than patient care. Also, in an industry like health care, arguably we don't need a profit motive to improve standards. When doctors treat patients they are unlikely to try harder if they get a bonus.
3. **Government loses out on potential dividends**.: Many of the privatised companies in the UK are quite profitable. This means the government misses out on their dividends, instead going to wealthy shareholders.
4. **Problem of regulating private monopolies**.: Privatisation creates private monopolies, such as the water companies and rail companies. These need regulating to prevent abuse of monopoly power. Therefore, there is still need for government regulation, similar to under state ownership.
5. **Fragmentation of industries:** In the UK, rail privatisation led to breaking up the rail network into infrastructure and train operating companies. This led to areas where it was unclear who had responsibility. For example, the Hatfield rail crash was blamed on no one taking responsibility for safety. Different rail companies has increased the complexity of rail tickets.
6. **Short-termism of firms.:** As well as the government being motivated by short term pressures, this is something private firms may do as well. To please shareholders they may seek to increase short term profits and avoid investing in long term projects. For example,

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the UK is suffering from a lack of investment in new energy sources; the privatised companies are trying to make use of existing plants rather than invest in new ones.

Disinvestment:

An important aspect of present industrial policy of the Government is that it should not operate commercial enterprises. With that end in view the Government has decided to disinvest the public enterprises.

Disinvestment means the dilution of stake of the Government in a public enterprise. This can be done in two ways. When the Government sells a part of its equity of a public enterprise less than 50 per cent of its total stock, it is called merely disinvestment and in this case control and management of the business enterprise remains in the hands of Government.

On the other hand, when disinvestment or sale of its equity capital by the Government exceeds 50 per cent so that the majority ownership and therefore control and management of the enterprise are transferred to private enterprise, it results in privatisation.

Objectives (importance) of Disinvestment

The ministry of disinvestment outlined the following as the primary objectives:

1. **Appropriate use of public resources:** Releasing the large amount of public resources locked up in non-strategic PSEs for development in areas that are much greater on the social priority, such as basic health, family welfare, primary education and social and economic infrastructure.
2. **Reduce public debt:** By selling its stake in PSEs government can reduce the public debt of government.
3. **Transferring risk:** transferring the public risk to the private sector wherever the private sector is willing and able to step in.
4. **For the best use of efficient man-power:** Realizing other tangible and intangible resources such as, large manpower currently locked up in managing public sector enterprises, and their time and energy, for development in high priority social sector that are short of such resources.
5. **Control deficit:** Revenue deficit and fiscal deficits are the serious problems in Indian budget. Deficit finance can be controlled if money can be created by disinvestment of public sector.
6. **Productivity and profitability:** Under public sector, freedom for decision-making by the managing directors was extremely limited. In this case if opportunities are given to private sector with the entry and capital investment, it will increase productivity and profitability.

Limitations of Disinvestment:

Following points show limitations of disinvestment in India:

1) **Poor performance of Disinvestment plans:** In all the years, realisations from disinvestment were much less than the targets. The main reasons for this poor performance were as follows:
   - **a)** The government earned out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. Thus it failed to realise not only the best value but also the other objectives of the disinvestment programme.
   - **b)** The government launched the disinvestment program without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much needed linkage between the public enterprises on the one hand and the capital market on the other.
   - **c)** The government did not adopt suitable methods to oversee the disinvestment of public sector shareholding.

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d) The Department of Public Enterprise and the Finance Ministry adopted techniques and methods which resulted in far lower realisation than justified.

On account of all these reasons, there was considerable ―under-pricing of public enterprises shares resulting in considerable loss to the government.

2) **Insufficient competition:** Competition was not generated to secure best price as at the final stage, financial bids were submitted by only one party in case of MFIL, CMC, PPL and two parties in case of BALCO, HTL, VSNL, HZL, while in case of IPCL, Expression of Interest by three) international bidders was rejected without assigning any reason.
3) **The shareholders agreement:** It was entered on terms adverse to government, as the strategic partner has been given right to purchase balance equity of privatised PSUs, in what is known as, call and put option. In case of HZL (Hindustan Zinc Limited), the strategic partner used this option to purchase 79.9 million shares at Rs. 40.51 per share when the market price was hovering around Rs, 119.10, giving it a windfall profit. Another company, BALCO has exercised its call option and remitted a sum of Rs. 1,098 crore by cheque to the government, based on some kind of ad hoc valuation of shares. The market value of the shares was several times higher.
4) **Post-clearing adjustment clause:** In the sale of four unlisted companies, MFIL, BALCO, HTL and PPL, an open-ended agreement has been entered, under which the government is required to pay the strategic partner any claims resulting from depletion of current assets of the company, between the date of the last audited balance sheet and the date of purchase of the shares. All the four companies have filed heavy claims against the government and in case of MFIL, the government has already paid Rs. 12.64 crore to the new management. In the case of PPL, while the government realised Rs. 151.70 crore through the sale, the buyers have lodged a claim of Rs. 151.55 crore under this clause.
5) **Undervaluation of assets:** It implies substantial losses for the government and therefore for the tax-paying citizens of the country. There is a basic problem with all privatization of public assets, which means that they tend to be associated ultimately with losses to the State exchequer rather than gains.
6) **Concentration of economic power:** The disinvestment of public enterprises is also opposed on the ground that it will lead to the concentration of economic power in a few private hands. This economic power can be used to exploit the consumers on the one hand and workers on the other. Further, greater concentration of economic power in private hands will also lead to increase in inequalities of income and wealth. Thus, disinvestment and privatisation is a negation of the objective of promoting equality.
7) **Sick units:** Disinvestment is also opposed on the ground that it is no solution for loss-making sick public sector undertakings. In fact, it is pointed out that about 50 per cent of loss-making public enterprises, especially in the field of textiles, are those sick units which were taken over by the Government from the private sector to protect the jobs and interests of the workers.
8) **Misuse of the revenue:** The revenue generated from disinvestment should have been used for investment and development purpose instead government used it for offsetting fiscal deficit.

Conclusion:

As a part of reforms government initiated privatisation and disinvestment of public sector enterprises with the objective of making them profitable, raising money, getting out of burden of debt. But in reality both privatisation and disinvestment did not helped the economy much. Private companies were only interested in purchasing profit making companies. On the other hand government had to devalue its assets in order to disinvest them.

Q-7 Write a note on 'FRBM Act' in India. (4 Marks- 2012, 2013, 2014, 2015)

Introduction:

In order to bring fiscal discipline and to implement a prudent fiscal policy the government introduced the Fiscal Responsibility and Budget Management Bill 2000. The bill became an Act

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in August, 2003. The FRBM Act 2003 was further amended. The FRBM Act 2003 (as amended) became effective from 5th July 2004.

Objectives of the Act:

The main objectives of this Bill /Act are

1) To reduce fiscal deficit.
2) To generate revenue surplus.
3) To adopt prudent debt management.

Features of FRBM Bill:

1. **Revenue Deficit:** The revenue deficit should be reduced to an amount equivalent to 0.5% or more of GDP every year, beginning with in the financial year according to FRBM Rules 2004. Further FRBM Act, 2003 states that appropriate measures should be taken to eliminate revenue deficit by March, 2009, and thereafter build a adequate revenue surplus.
2. **Fiscal Deficit:** The fiscal deficit should be reduced to 0.3% or more of the GDP every year, beginning with the financial year 2004-05. The fiscal deficit should be brought down to 3% of GDP by March 2009.
3. **Government Guarantees:** The Central Government should not provide guarantees in excess of 0.5% of GDP in any financial year, beginning with 2004-05. (For Eg. Guarantees for loans borrowed by State Governments, Public Corporations etc.)
4. **Additional Liabilities:** The FRBM Rules 2004 states that the Central Government should not assume additional liabilities in excess of 9% of GDP for financial year 2004-05 and progressive reduction of this limit by at least one percentage point of GDP in each subsequent year.
5. **Relaxation In Deficit Reduction Targets:** The FRBM Act states that the revenue and fiscal deficit may exceed the targets specified in Rules only on grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify.
6. **RBI's Subscription To Government Securities:** The RBI should not subscribe to primary issues of Central Government securities from the year 2006-07.
7. **Transparency In Budgetary Process:** The FRBM Act and Rules States that the Central Government should take suitable measures to ensure greater transparency in fiscal operations. The Government is also required to submit statements of receivables and guarantees and a statement of assets, at the time of presenting the annual financial statement latest by Budget 2006-07.
8. **Quarterly Reviews:** The FRBM Act states that the Finance Minister to make a quarterly review of trends in receipts and expenditure in relation to budget and place the outcome of such reviews before both the Houses of Parliament.
9. **Projection Of Fiscal Indicators:** The FRBM Rules 2004 states that the Central Government should specify four fiscal indicators. These are
   a) Fiscal deficit as a percentage of GDP.
   b) Revenue deficit as a percentage of GDP.
   c) Tax revenue as a percentage of GDP.
   d) Total outstanding liabilities as percentage of GDP.
10. **Financial Statements:** The Central Government should place in each financial year before houses of Parliament three statements:-
    a) Medium Term Fiscal Policy Statement.
    b) Fiscal policy strategy statement.
    c) Macro-economic Framework statement along with Annual Financial Statement and Demands for grants.

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11. **RBI Borrowings:** The FRBM Act States that the Central Government shall not borrow from RBI except by way of advances to meet temporary excess of cash disbursements over cash receipts.

Conclusion:

The FRBM Act 2003 is a land mark legislative measure which can play an important role in introducing fiscal discipline in future period of time.

Q-8 Write a note on planned expenditure and non-planned expenditure. (4 Marks- 2013, 2015)

Introduction:

All the expenditures that are incurred on the public exchequer of the country are kept in two categories viz. Plan and Non Plan. The expenditures which are done by the Government of India in the name of Planning are Plan expenditures. All other expenses are Non-plan expenditures.

Plan Expenditure:

Any expenditure that is incurred on programmes which are detailed under the current (Five Year) Plan of the centre or centre's advances to state for their plans is called plan expenditure. Provision of such expenditure in the budget is called Plan Expenditure.

Expressed alternatively, "plan expenditure is that public expenditure which represents current development and investment outlays (expenditure) that arise due to proposals in the current plan." Such expenditure is incurred on financing the Central plan relating to different sectors of the economy.

Items of plan expenditure are:

(i) Expenditure on electricity generation, (ii) irrigation and rural developments, (iii) construction of roads, bridges, canals and (iv) science, technology, environment, etc. It includes both revenue expenditure and capital expenditure. Again, the assistance given by the Central Government for the plans of States and Union Territories (UTs) is also a part of plan expenditure. Plan expenditure is further sub-classified into Revenue Expenditure and Capital Expenditure which along with their components are shown in the preceding chart.

Non-Plan Expenditure:

This refers to the estimated expenditure provided in the budget for spending during the year on routine functioning of the government. Non- Plan expenditure is all expenditure other than plan expenditure of the govt. Such expenditure is a must for every country, planning or no planning.

For instance, no government can escape from its basic function of protecting the lives and properties of the people and protecting the country from foreign invasions. For this, the government has to spend on police, Judiciary, military, etc. Similarly, the government has to incur expenditure on normal running of government departments and on providing economic and social services.

Conclusion:

The expenditures which are done by the Government of India in the name of Planning are Plan expenditures. All other expenses are Non-plan expenditures. Generally (not always), the plan expenditure produces some tangible assets related to economic development. This is not a rule, but this is one reason that plan expenditures are also called Developmental expenditures.

Q-9 Write a note on sources of income of local government.

Introduction:

India follows Federal financial system where our economy is managed by central government, state government and local self-governments. Local government is an integral part of the national government and it is close to citizens. In modern period, self government plays a vital role for providing essential services.

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Types of self government:

Self governments can be of two types

1. **Urban local government:** It consists of Municipal councils, Municipal corporations, Town area committee and Notified Areas.
2. **Rural local government:** It includes Gram Panchayat, Taluka Panchayat and Zila Panchayat.

Both of the self governments are assigned duty of providing basic facilities like road, water, electricity, health and education services etc. In order to provide these services, local self governments need to have sufficient revenue. Which comes from different sources.

Sources of finance for local government

Following are the main sources of income for the local self government:

1. **Tax revenue:** There are three main types of taxes that can be collected by local governments 1) Taxes on individuals 2) Indirect taxes on consumption and production and 3) Taxes on real estate such as taxes on land and buildings.

   Main taxes levied by municipalities are taxes on property, taxes on goods and personal taxes. Local self government receive income through taxes which are imposed on services such as water, road, electricity, transportation, health, sanitation etc. Over and above they collect taxes on lands and buildings, taxes on entry of goods into area of local authority, taxes on vehicles, taxes on animals and boats, taxes on profession, trade and taxes on advertisement other than advertisement in newspaper.
2. **Non-Tax Revenue:** All municipal Acts has provisions for issuance of license. Local authorities are also authorized to charge and collect fees both regulatory and services supplied. So non-tax revenue of local authorities consist of fees, fines and other income from public undertaking like buses, power distribution and tramways. But this is only small revenue. Where industry concentration is high the revenue is quite high. The Village Panchayats have some income from trees, ponds, lakes etc. in addition they also earn income as rental returns from the shops and stalls constructed by them in market places.
3. **Grant-in-aid:** Grant-in-aid is an important factor of municipal finance. There are two types of grants. 1) General purpose grant and 2) Specific purpose grants. The general purpose grants are intended to expand the revenue of the local institutions for discharging their normal functions. The specific purpose grants are used for specific requirements for example, increase in wage bill due to inflation, education grants, public health, road maintenance etc.
4. **Borrowings and loans:** Municipal bodies can have a loan from the state government and other agencies when they cannot afford to meet their expenditures with their existing revenues. The borrowing power of local government is regulated under Local Authorities Act (1914). This act provides that Municipal Corporations can borrow for development activities and for payment of debt charges. Local bodies are permitted to borrow for the activities of construction, provision of relief and the establishment or maintenance of relief work in times of scarcity or famine, prevention of the outbreak of any dangerous epidemic, acquisition of land, repayment of outstanding of loans etc.
5. **Share of taxes:** Earnings from some of the taxes levied and collected by the state governments are shared with local institutions. A share of motor vehicle tax revenue is shared by all states with local institutions. Land revenues are shared by some other states with local Panchayats and Zila Parishads. In other cases the whole entertainment tax collected by the state government if transferred to the local bodies.

Conclusion:

A local self government can generate revenue from tax sources, non-tax sources, grant-in-aid, through borrowing and loan and through their share of tax in state government.

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Multiple Choice Questions:

1. Which factor is closely related with the people of public economy from the following?
   (A) Central government (B) State government (C) Local Government (D) None
2. Which are the main sources of income of Gram Panchayat from the following?
   (A) Entertainment tax (B) Octroi (C) Grant-in-aid (D) Income from land
3. Which grants are given for education from the following?
   (A) Specific grant (B) General grant (C) Percentage grant (D) Block grant
4. In which tax revenue, local self government get shares from the taxes which are levied by state government?
   (A) Sales tax (B) Motor vehicle tax (C) Land revenue (D) Profession tax
5. State governments get share from the central government's tax revenue from the following?
   (A) Custom duties (B) Corporation tax (C) Excise duties (D) Service tax
6. Who recommended giving shares to the state from the centre's tax revenue?
   (A) Prime Minister (B) Finance Minister (C) Finance Commission (D) Planning Commission
7. In recent period, the main share of state revenue is of the following tax.
   (A) Land revenue (B) Sales tax (C) Duty of stamp and registration (D) Tax on rural immovable property
8. Income-tax is exempted up to limit of Rs. ________ in India in 2012-13 budget.
   (A) 1 lakhs (B) 1.5 lakhs (C) 2 lakhs (D) 2.5 lakhs
9. The ________ trend has to be seen of public expenditure all over the world.
   (A) Increasing (B) Decreasing (C) Stable (D) Unstable
10. Before nineties, what was the main objective of public expenditure?
    (A) Internal peace and external protection (B) Economic development (C) Social welfare (D) Economic stability
11. FRBM Act was implemented in year ___________ in India.
    (A) 1991 (B) 2000 (C) 2003 (D) 2005
12. As per FRBM Act, which deficit was expected to be zero in March 2009.
    (A) Revenue (B) Primary (C) Fiscal (D) Capital
13. What is the main objective of FRBM Act?
    (A) Revenue receipts (B) Transparency in administration (C) Reduce inequalities (D) Control expenditure
14. What was appointed to efficient implementation of FRBM Act's recommendation?
    (A) Task force (B) Taxation Inquiry Commission (C) Raj Committee (D) Wanchhoo Committee
15. The transfer of ownerships of industrial unit is called _________________.
    (A) Liberalisation (B) Globalisation (C) Privatisation (D) Disinvestment
16. The privatization policy was accepted in India during the year of ___________.
    (A) 1981 (B) 1991 (C) 2001 (D) 2005
17. Who were very much against privatization and disinvestment in India?
    (A) People (B) Traders (C) Producers (D) Labour union
18. Disinvestment has been broadened in the year of _____________.
    (A) 1991 (B) 1995 (C) 1998 (D) 2000

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Answers: 1. Local self government 2. Grant-in-aid 3. Specific grant 4. Motor vehicle tax 5. Excise duties 6. Finance commission 7. Sales tax 8. 2 lakhs 9. Increasing 10. Internal peace and external protection 11. 2003 12. Revenue 13. Transparency in administration 14. Task force 15. Privatisation 16. 1991 17. Labour union 18. 1998

Unit 4: Public Debt

Q-1 Explain economic effects of public debt. (6 Marks – 2013, 2014; 4 Marks – 2012, 2015)
Introduction:
In modern times, government performs numerous functions. For performing these functions government needs huge funds which it collects through tax and other non-tax sources. But many a time government is not in a position to collect sufficient revenue. So for bridging the gap between revenue and expenditure government needs to borrow money internally and externally, these borrowings by government is known as public debt.

Economic effects of public debt
Following points show effects of public debt on an economy:

1. **Effects on consumption:** When people purchase government securities/ bonds out of their past idle savings, their current consumption remains unaffected because current expenditure is not affected. If they purchase bonds by decreasing their current expenditure, their consumption is decreased. In case, people are forced to purchase government bonds, it will reduce their consumption expenditure. On the other hand when government spends these borrowings on public works like roads, canals, power etc. it leads to increase in consumption. in the same way, public debt is used to increase production of goods, it will increase consumption.
2. **Effect on production:** If people purchase government securities by withdrawing money from industrial concerns, or by selling debentures and shares of industrial concerns, private investment is unfavourably affected. The net effect on investment will depend upon how the money is used by the government. If the government operates this money in public works, the total investment available for production may not be adversely affected, but if the government operates it on non-productive works, the entire investment may be unfavourably affected.
3. **Effect on distribution:** Those people who buy government securities are mostly rich people of the society. But the burden of taxes, imposed for finding money for interest payments fall on poor classes too. Hence, the tendency of public debt would be to increase the disparities of income. Thus, the public debt may not have desirable effects upon distribution. If the bond holders and tax-payers are the same, then there will be no distribution of income. Thus, disparities of income will not rise, but, usually, it is not true.
4. **Effects on private sector:** Generally public expenditure leads to rise in the demand of private sector's goods since public expenditure raise the purchasing power of people. Further the borrowing of funds are used by the government to buy goods and services from the private sector. In the same way, if the borrowed funds are used to pay wages for government employees, it raises their purchasing power and their demand for goods and services from the private sector. Hence, the effects of public debt are said to be favourable.
5. **Effects on the production cost:** The cost of production depends upon the prices of raw material and other inputs used in production. Government operates the borrowed funds to provide raw material to the producers at reasonable rates and to supply transport and other facilities. Government may also operate these funds in promoting industrial research or in giving subsidies to private enterprises. In all cases, the expenditure of borrowed funds decreases the cost of production.
6. **Effects on investment:** It is normally assumed that public borrowing have adverse effects on investment. Though, if the government have a loan from commercial bank or the central bank of the country, it will provide additional purchasing power to the society and therefore, it will not press for any curtailment of funds for investment.
7. **Effects on working of the Money Market:** The government has to compete with the private sector for funds. Generally, if the rate of interest paid by private sector on borrowing is high, the government also will have to increase its interest rate to attract

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funds. On the contrary, if the government tries to borrow from commercial bank and central bank more than what is available at present rate of interest it leads to currency expansion.

8. **Effects of foreign loans on the economy:** External debt in the economic development of developing countries have made possible the import of high priority goods or goods to be used to create and build capacity for accelerating the rate of the growth of the economy. It affects both consumption and investment favourably. However external debt may be adverse in some cases. For instance, if foreign debts are used to finance a war, the effect will not be positive on domestic investment. Repayment of borrowed amount and interest creates burden on the government.

Conclusion:
Effects of public debts are wide-ranging, on various aspects of economic life. These wide-ranging effects of public debt help to decide whether public debt program is advantageous. Public debt has become an important fiscal instrument and it should be used along with taxation and public expenditure policies to bring stability in the economy.

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Q-2 'Burden of internal public debt and external public debt.' Explain (6 Marks – 2013, 4 Marks – 2015)

Introduction:
Over the years, the public debt of the India's Central and that of State government has increased considerably during the planning period. The Government borrows funds by way of public debt to meet the various development and non-development expenses. This debts creates various burden on the economy of a nation.

The Burden of Internal Public Debt
Following points discuss burden of internal public debt:

1. **Internal debt trap:** One of the bad effects of internal debt is the interest paid by the government. Such interest payments increase public expenditure and may become a cause for fiscal deficit. If internal public debt is not checked and kept within limits, it may take the country to the worst position called 'Internal Debt Trap'.
2. **More burden on poor and weaker sections:** Internal debt provides opportunities for the rich and higher middle class to earn a higher rate of interest from the state on their lending. At the same time the pobr suffer a lot due to the tax burden. The government levies taxes to repay interest on public debt. But the tax burden does not necessarily fall on the rich unless it is progressive in nature. In the case of indirect taxes. the burden is felt more by the poor than the rich.
3. **Increasing interest burden:** Public borrowing may become costlier for the government especially when it resorts to public borrowing by issuing bonds and debentures. Such bonds and debentures carry a high rate of interest to the extent of 15 percent. The impact of such interest payments may develop manifold and still worsen in the future if the government stick to the same policy of borrowing in the years to come.
4. **Unjustified transfer:** The servicing of internal debt involves transfers of income from the younger to the older generations and from the active to the inactive enterprises. The government imposes taxes on enterprises and earnings from productive efforts for the benefit of the idle, inactive, old and leisurely class of bond holders. Hence work and productive risk taking efforts are penalised for the benefit of accumulated wealth. This adds to the net real burden of debts.
5. **Indirect real burden:** Internal debt involves an additional indirect real burden on the community. This is because the taxation required for servicing the debts reduces the tax payer's ability to work and save and affects production adversely. The government may also economise social expenditure thereby, reducing the economic welfare of the people. Taxation will reduce the personal efficiency and desire to work. Thus there would be a net loss in the ability and desire to work. The creditor class will also not have any incentive to

work hard due to the prospect of receiving interest on bonds. This would further cause a loss to production and increase the indirect burden of debt.

The Burden of External Public Debt

External debt is beneficial in the initial stages as it increases the resources available to the country. But its repayment & servicing creates a burden on the debtor country.

1. **External debt trap:** The external debt creates direct money burden. This is because; it involves transfer of funds from the debtor country to foreign citizens. The degree of burden depends upon the interest rate, and the loan amount. The loans are normally to be paid in foreign currency. Therefore, the funds are mostly transferred from export earnings or by raising more funds from foreign markets. Borrowing by way of additional loans would put extra burden on the country. The situation may become so worse, that the country may be caught in the external debt trap. It may have to borrow from foreign markets to repay the interest amount and it would be very difficult to repay the principal amount.
2. **Direct real burden:** The external debt may also result in direct real, burden. The citizens of the debtor will have to suffer loss of economic welfare to the extent of repayment of principle amount and interest burden. The foreign currency earned through exports would have been utilized to import better goods and technology. Which would have increased the economic welfare of the citizens of the debtor country. But because of external debt repayment, they have to restrict their welfare which the imported goods would have provided. In other words, the citizens of debtor country are deprived of imported goods and service to the extent till the loans and interest amount is repaid.
3. **Decline in expenditure to public welfare programmes:** When the government spends a significant portion of its resources towards the payment of foreign debt it reduces the government expenditure to that extent which otherwise would have been spent for public welfare programmes.
4. **Decline in the value of nation's currency:** The repayment of external debt involves an increase in the demand for the currency of the creditor country. This will raise the exchange rate of the creditor country's currency, and aggravate the problem of foreign exchange crisis. The creditor country may also be adversely affected if it is induced to import more from the debtor country. This may hinder the growth of their domestic industries and cause unemployment.
5. **Burden of unproductive foreign debt:** The magnitude of external debt burden depends upon whether the debt is incurred for productive purposes or for unproductive purposes. If it is incurred for unproductive purposes, it will create a greater burden and sacrifice on the citizens of the debtor country.
6. **Political exploitation:** In recent years, it was found that the lending countries who dominate international organisations like World Bank & international monetary fund use the lending opportunity as an instrument to exploit the borrowing countries economically & politically.

Conclusion:

When expenditure of government exceeds its incomes, it has to depend on public debt. Public debt can be internal or external. Both the debt creates burden for existing as well as future generations so government have to use public debt very carefully.

Q-3 Explain (i) Direct monetary burden of internal debt and external debt and (ii) Direct real burden of internal debt and external debt. (6 Marks – 2014; 4 Marks – 2012) OR Write a note on monetary and real burden of internal and external debt.

Introduction:

The burden of public debt indicates that the sacrifice imposed on the society and effects of a rise in taxation at the time of repayment of the principal amount and regular interest payments. To the amount of rise in tax level, the income of people is transferred to the government. The resultant loss in the income of the people might be called as financial burden of public debt.

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Burden of internal debt:
When the government increases a debt within the country, it is known as internal debt. The internal debt obliges burdens on the community as follows:

1. **Direct money burden:** People have to pay tax to government for the repayment of principal and interest. This is considered as direct money burden. If burden falls on the same person i.e. tax payers and bond holders, there will be no direct money burden. There is only transfer of money within the society. If the tax payers and bond holders are different person, there will be change in the distribution of income. If lower income groups give more towards taxes to be paid to rich bond holders, the money burden of debt is heavier on the poor. The redistribution of income will be in favour of rich people.
2. **Direct real burden:** The direct real burden is in the form of decline in economic welfare and the damages and pressures undergone by the tax payers. If the tax payers are the bond holders and each tax payer gives accurately the equal amount identical to the interest received from the government, the direct real burden would consist of the strains and stresses in filling forms, making tax payment etc. If the tax payer and bond holder are different the real burden will depend upon the persons who pay taxes. If the bonds are held by rich persons and the taxes are raised from the poor, the real burden of tax is on the latter in the form of loss in their economic welfare and vice versa. The bond holders are relatively old people, while the tax payers are mostly young. This leads to the argument that the burden of debt passes on to the active people (young people).

   The direct real burden is also influenced by the increase and decrease in the price level. When prices increase, the value of money decreases and the direct real burden of debt also reduce. People pay less in actual term in taxes.
3. **Indirect money burden:** The indirect money burden is also experienced by its effects on production. If the loans have been used for productive purpose, the indirect money burden will not be heavy because a large portion of debt will be repaid out of the monetary benefits flowing from the projects. But in case of an unproductive debt such as to finance a war, its repayment after the war involves a heavy indirect money burden. This is because at the end of the war there is reduction in production and mass unemployment.
4. **Indirect real burden:** The indirect real burden of debt is also experienced by its ultimate effects on production. When the government imposes and levies taxes to pay the interest and repay debts, it depresses the willingness of tax payers to work and save more. It will thus, unfavourably affect production in the country. the indirect real burden of tax will be heavy.

Burden of external debt:
The external debt refers that a country borrows from foreign countries and institutions i.e. IMF, World Bank, etc. It involves direct and indirect money burden and direct and indirect real burden on the people and the economy. Following is the brief description regarding burden of external debt:

1. **Direct money burden:** The amount which a debtor country pays to the foreign creditor country in the form of interest and principal is direct money burden of an external debt. The foreign currency is used for the repayment of debt and payment of interest to the foreign country. This imposes a direct money burden on the borrowing country.
2. **Direct real burden:** The direct real burden of an external debt is the loss of economic welfare of the people of the debtor country when they make repayments to foreign creditors. So as to pay the interest and debt, the debtor country exports more to earn foreign exchange or pay the interest and debt, the debtor country exports more to earn foreign exchange or pays the debt to the external creditors in the form of exports of goods and services. Consequently, the people of the country are denied of those goods and services. This is the direct real burden of the external debt. The direct real burden of external debt will also depend upon the section of the society which is taxed. If indirect taxes are imposed on item of mass consumption, the burden will be heavier on poor people. If

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progressive taxes are imposed on the richer, the direct real burden will be less than it would be on the low income groups.

3. **Indirect money burden:** If the external debt is used for productive purposes such as on buildings, roads, channels, power projects etc. and establishing industries, this will raise employment, income and production. Its monetary burden will not be heavy as the payment of the principal and interest will be more than compensated by the benefits flowing from productive points. In the view of Prof. Domar, if the interest payments on external borrowings increase, the tax burden on the people will also raise which will lead to decline in the net income of the country. This imposes a heavy indirect money burden on the economy.
4. **Indirect real burden:** The imposition of more indirect taxes on commodities with the purpose of paying interest and principal on external debt places heavy burden on the people. This is because their capacity to work and save decreases. This leads to a decrease in production. If the interest on external debt consumes a large part of national income, the government is forced to reduce social and developmental expenditures. The burden of debt will be more. The indirect real burden is another time very heavy if the external debts are used in unproductive channels like a war.

Conclusion:
From the above discussion we can say that direct money burden of internal debt is not much heavier but the indirect money burden and the direct real burden of public debt are higher. On the other hand for external debt the direct and indirect real and money burden are more than its direct money burden.

Q-4 Write meaning of public debt and explain its types. (6 Marks – 2012, 2014) OR (i)Write a note on productive and unproductive public debt (ii) Write a note on short run and long run public debt (4 Marks 2013) OR Write a note on (i) Voluntary and compulsory debt (ii) Write a note on internal and external debt (4 Marks 2014)

Introduction:
Over the years, the public debt of the India's Central and that of State government has increased considerably during the planning period. The Government borrows funds by way of public debt to meet the various development and non-development expenses.

Types of Public Debt:
Major forms of public debt are: 1. Internal and External Debt 2. Productive and Unproductive Debt 3. Compulsory and Voluntary Debt 4. Redeemable and Irredeemable Debts 5. Short-term, Medium-term and Long-term loans 6. Funded and Unfunded Debt.
Chart 1 shows different types of public debt. Which is followed by discussion about the same:

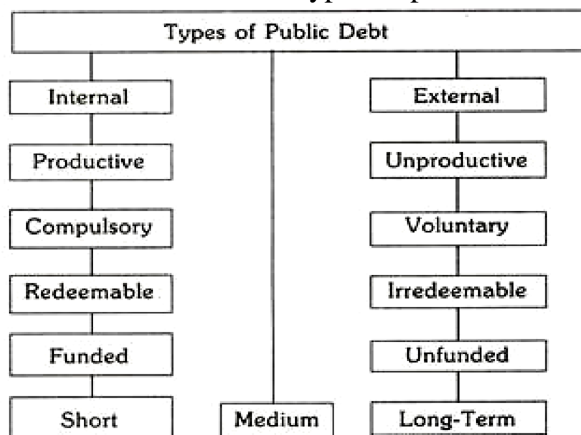

Chart I.

1. Internal and External Debt:
Public loans floated within the country are called internal debt. Public borrowings from other countries are referred as external debt. External debt represents a claim of foreigners against the real income (GNP) of the country, when it borrows from other countries and has to repay at the time of maturity.
External public debt permits import of real resources. It enables the country to consume more than it produces.

The following points of distinction between internal and external debts are noteworthy:

a. An internal loan may be voluntary or compulsory, but an external loan is normally voluntary in nature. Only in the case of a colony, an external loan can be raised by compulsion.

b. An internal loan is controllable and can be estimated before hand with certainty, while external loans are always uncertain and cannot be estimated so confidently. Its realisation is very much conditioned by international politics and foreign policies of the lending government.
c. Internal loan is in terms of the domestic currency, while external loans are in terms of foreign currencies.

An important feature of external debt is, that usually foreign exchange resources of the borrowing country increase when the loans are received in terms of foreign currencies. But, when there is repayment of such loans, i. e., debt servicing charges, foreign exchange reserve is depleted to that extent.

Sometimes, however, external loans are repayable in the borrowing country's domestic currency, so that foreign exchange resources are least affected. For instance, in the post-independence period India received loans from U.S.A. under P.L. 480, which were repayable in Indian rupees.

Since under internal debts, borrowing takes place within the country, the availability of total resources does not arise. Simply the resources are transferred from the bond-holders — individuals and institutions — to the public treasury, and the government can spend, these for public purposes.

Similarly, payment of interest for repayment of principal of internal loans would transfer resources from tax-payers to bond-holders. An internally- held public debt, thus, represents only a commitment to effect a certain transfer of purchasing power among the people within the country. It has, therefore, no direct net money burden as such. It amounts to only a redistribution of income in the community from one section to the other.

External debt, on the other hand, leads to a transfer of wealth from the lender nation to the borrower nation. When the loan is made through the means of external loans the resources available to the borrowing nation increase.

However, when a foreign loan is repaid or interest is paid on such loans, there would be a transfer of resources from the debtor to the creditor countries, causing a decline in total resources of the debtor country.

To cover the interest and repayment of the principal of an external loan, the debtor government has to curtail its expenditure in the future or reduce private spendings by increasing taxation, thus cutting the use of resources at home.

The Structure of the Internal Public Debt:

The structure of the internal public debt may be constituted by various types of loan instruments/obligations of the government. It may be classified as follows:

In particular, for instance, the government of India's debt obligations includes:

(1) Dated and non-terminable Rupee loans consisting:
   (a) Marketable long-term loans including the portion subscribed by the State Bank of India out of the rupee counterpart funds;
   (b) Dated loans issued by the Government to the Reserve Bank of India in exchange for ad hoc Treasury Bills outstanding; and
   (c) Miscellaneous debt such as the Prize Bonds issued in 1961.

(2) Treasury Bills — the short-term issues (90/ 180 days) of the Government in order to bridge the gap between revenue and expenditure.

(3) Small Savings — a non-inflationary means of finance — effectuated/tapped through instruments such as Post Office Savings Bank Deposits, Cumulative Time Deposits, Post Office Recurring Deposits, National Defence Certificates, 15-year Annuity Certificates, National Savings Certificates, National Savings Annuity Scheme, National Development Banks, National Savings Account, Indira Vikas Patra, Kisan Vikas Patra.

(4) Other miscellaneous obligations of the Central Government constituting the internal public debt in India are: Compulsory Deposit Scheme, Gold Bonds, Public Provident Funds, and items of unfunded debts and special securities issued to the United States Embassy for the Rupee Counterpart funds since 1961, unclaimed balance of State Provident

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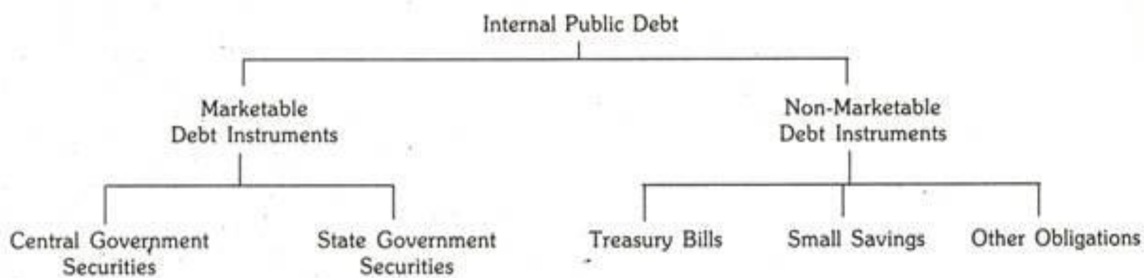
Funds, and other accounts such as General Family Pension Fund, the Hindu Family Annuity Fund, the Postal Insurance, Life Insurance, Life Annuity Fund, etc. and unclaimed balance in respect of three-year Interest-free Prize Bonds.



2. Productive and Unproductive Debt:

Public debt is said to be productive or reproductive, when government loans are invested in productive assets or enterprises such as railways, irrigation, multipurpose projects etc., which yield a sufficient income to the public authority to pay out annual interest on the debt as well as help in repaying the principal in the long run.

As such, a productive public debt is self-liquidating in nature; so the community experiences no net burden of such debt.

An unproductive debt, on the other hand, is one which does not add to the productive assets of a country. When the government borrows for unproductive purposes like financing a war, or for lavish expenditure on public administration, etc., such public loans are regarded as unproductive.

Unproductive loans do not add to the productive capacity of the economy, so they are not self-liquidating. Unproductive public loans thus cast a net burden on the community, as for their servicing and repayment purpose, government will have to resort to additional taxation.

3. Compulsory and Voluntary Debt:

When government borrows from people by using coercive methods, loans so raised are referred to as compulsory public debt. Under the Compulsory Deposit Scheme in India, tax-payers have to compulsorily deposit a prescribed amount and defaulters are punished. This is a case of compulsory debt.

Usually, public borrowings are voluntary in nature. When the government floats a loan by issuing securities, members of the public and institutions like commercial banks may subscribe to them.

4. Redeemable and Irredeemable Debts:

On the criterion of maturity, public debts may be classified as redeemable or irredeemable. Loans which the government promises to pay off at some future date are called redeemable debts. For redeemable debts, the government has to make some arrangement for their repayment. They are, therefore, terminable loans.

Whereas loans for which no promise is made by the government regarding the exact date of maturity, and all that the government does is to agree to pay interest regularly for the bonds issued, are called irredeemable debts.

Their maturity period is not fixed. They are generally of a long duration. Under such loans, society is burdened with a perpetual debt, as tax-payers would have to pay heavily in the end. Therefore, redeemable debts are preferred on grounds of sound finance and convenience.

5. Short-term, Medium-term and Long-term loans:

According to their duration, redeemable loans may further be classified as short-term, medium-term or long-term debts. Short-term debts mature within a short period say, of 3 to 9 months. For instance, Treasury Bills are an instrument of credit extensively used as a means of short-term (usually 90 days) borrowing by the government, generally, for covering temporary deficits in the budgets. Interest rates on such loans are generally low.

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Long-term debts, on the other hand, are those repayable after a long period of time, generally, ten years or more. For development finance, such loans are usually raised by the government. Long-term loans usually bear a high rate of interest.

Similarly, loans of medium-term (in between short-term and long-term) are floated by the government, bearing intermediate interest rates. For war finance, or to meet expenditure on education, health, relief work, etc., such loans are generally preferred.

6. Funded and Unfunded Debt:

Funded debt is, in fact, a long-term debt, exceeding the duration of at least a year. It comprises securities which are marketable on the stock exchange. Funded debt in its proper sense is, however, an obligation to pay a fixed sum of interest, subject to the option of the government to repay the principal. In such debts, the creditor bond-holder has no right to anything but the interest.

Unfunded debts, on the other hand, are for a comparatively short duration. They are generally redeemable within a year. Unfunded debts are, thus, incurred always in anticipation of public revenue, a temporary measure to meet current needs.

Conclusion:

Different types of borrowing options are available to government of any country. But of all the types, Internal and external debt are the main division of public debt.

Q-5 Write: Controversy regarding burden of public debt. (Opinion of Prof. Lerner or Buchanan) (6 Marks – 2012, 2015) OR "The burden of internal public debt cannot be shifted to future generation." Discuss Prof. Lerner's opinion. (4 Marks 2013, 2014)

Introduction:

From long time there is a going on controversy regarding burden of public debt. Whether public debt is a burden for future generation or not? Many economists shared their opinion. Here we have discussed opinion given by Prof Lerner and Prof. Buchanan.

Prof. Lerner's viewpoint regarding public debt:

Prof. Lerner has challenged the assumptions of public debt which had been given by classical economists. He does not consider public debt as burden. The important views of Lerner regarding public debt can be explained by the following statements:

1. The comparison between public debt and private debt is fallacious.
2. The real primary burden of public debt cannot be shifted on future generations.
3. The internal public debt and external public debt are fundamentally different in their impact.

Any private individuals can increase debt for achieving more goods and services, and can give future income for his exchange. It is possible for individual because of another individual sacrifices his rights on commodities for giving loan to those individuals who borrow. In other words, he is ready to leave such amounting resources. On the contrary, when we consider internal public debt, however, since it is borrowed from individuals and institutions within the country repayment will constitute only a redistribution of resources without causing any change in the total resources of the society. When state increases internal public debt, at that time resources are transferred from individual to state. In other words, the incomes of individual (tax-payers) are reduced, and the incomes of creditors' bond holders' will increase, but the total position of the society will, nevertheless, remain the same. In the view of Lerner, the reduction in the incomes of individual can be considered as burden of internal public debt falls on present generation.

But in the case of external debt, Lerner agree that its burden falls on future generation. Because when state receives resources through foreign debt, at that time, present generation have not to make sacrifice. In future at time of refund, country has to pay in the form of real resources and consumption of such resources, future generations has to sacrifice.

External foreign debt must be compared with private individual's debt. Both receives more resources, consequently, a deadweight loss is suffered by future generation, when the debt financing cause an adverse effect on the incentive to work and save, thereby checking production in future.

At the time of payment of internal debt, it is necessary to impose taxes on future. The reduction in the income of tax-payer leads to increase in the income of bond holders. Both are the generation of same time period, therefore, the aggregate position of the community will remain the same. There is no burden on aggregate future generation.

Prof. Buchanan's viewpoint regarding public debt:
Prof. J. M. Buchanan in his book 'Public Principles of Public Debt' clarifies that there are three main propositions of the public debt. This theory is also referred to as modern theory of public debt. Following are the three propositions made by Prof. Buchanan:

1. **The creation of public debt involves transfer of the primary real burden to future generation:** It is clear from the above proposition that the burden of the government debt and expenditure activity falls during the period in which it is generated and it is the real burden on the initial generation. He also examined that the public debt acquired now leaves not only a compulsion to the future generation but also a claim. Whatever transfer of funds occurs is only between the future members of the society. The taxpayer's children inherit tax burden and the bond holder's children acquire an equal benefit. The loss of taxpayer is compensated by the gains of bond holders and, thus, for the economy as a whole the net burden will be nil. Thus, public borrowing may cause intergeneration transfers but not a loss to the society. It is on this ground that it has been concluded by most economists that internal debts must not be considered as debt in the normal meaning of the term, and that they do not represent shifting of the burden of future generations.
2. **The analogy between public debt and private debt is factual:** An individual is concerned only with the outcome of his action upon his business. The outcome of his own economic activity upon other persons is important for him only in so far as this, in turn, affects his balance sheet. The balance sheet tells him all that he wants to know with the purpose of judging the correctness of different lines of business policy. In the case of public finance, though, it is a rather otherwise. The success or failure of the public policy can be resolute only by noting the effect of expenditures, taxes and loans on the total national income and on how that national income is distributed. Therefore, it may be concluded that a public debt internally held is different in nature from a private debt.
3. The **internal public debt and external public debt are fundamentally similar:** External debt services as transfer of resources from the domestic economy to the foreigners, which mean a net loss to the whole economy. We can say that the transfers of resources reduce the real income of future generations. As taxes are levied and tax rates are enlarged in future for servicing the debt, the burden of external public debt can be transferred to future generations.

Conclusion:
It may be concluded from the above discussion that internal public debt does not create any burden to future generations but external debt may prove burdensome to future generations. According to Prof. Musgrave every debt involves a burden and it should be borne equitably by all generations.

Q-6 Discuss the difference between taxation and public debt. (4 Marks – 2013, 2014, 2015)
Introduction:
Tax and public debt are the main sources of government revenue. Sometimes, the governments face the difficulty whether certain expenditure should be met out by increasing taxes or by increasing debts.

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Difference between taxation and public debt

Following table shows the main differences between taxation and public debt:

Sr.	Point of Difference	Taxation	Public Debt
1	**Compulsion**	Taxes are compulsory payment whether they are direct or indirect	Public debts are voluntary except in case of crisis and emergency like war.
2	**Limit**	Taxes cannot be increased beyond taxability of the people.	There are no specific limits on public debt.
3	**Charge on income**	Taxes are charged on the present income of the taxpayers.	Under the conditions of debt, people buy government bonds and securities out of their past and present savings.
4	**Purchasing power**	Taxes decrease the current purchasing power of the tax payer.	Debts reduce the future purchasing power of people.
5	**Payments**	Taxes are once for all payments. They are not to be paid back by the government.	Debts are repayable with interest by the government. So it creates burden on future generation.
6	**Burden time period**	The burden of taxes is put on a short period.	The burden of public debt is put on long period because interest is to be paid every year and principal at the end of the loan period.
7	**Saving power**	Taxes diminish the saving power of the people.	Debts induce people to save more to earn interest.

Conclusion:

Both taxes and debt are source of income for government which government can utilize. But taxes do not create any burden of interest and responsibility of paying the money back while debt creates burden on present as well as future generations especially when it is from external sources. Debt also creates responsibility of paying back the principal. So every government should use debt very carefully.

Q-7 Discuss the usefulness of public debt. (4 Marks – 2012)

Introduction:

Hardly is there government in the world which does not contract public debt (government debt). Since Second World War, the size of- public debt has been increasing day by day. The continuous rise' in public expenditure has necessitated the rise in public debt for the welfare of the society.

The following points show usefulness of Public debt (government debt) :-

(1) Meeting Wartime Expenditure: The unwarranted situation arising out of war and the prosecution of war cannot be possibly met out of ordinary tax-revenue. Hence, the government has to resort to public borrowings to collect sufficient funds to meet the cost of war. There is no other way left with the government to meet this abnormal expenditure.

(2) Fighting against Contingencies: Contingencies are uncalled situation that need a lot of money to fight against them. In such circumstances. public debt is only way out with the government to meet the cost of such contingencies like floods, famines, drought, earthquakes etc. Such situations need immediate solutions for which the public debt (government debt) is the only answer because tax collection requires a tot of time.

(3) Coping with Depression: In order to fight against depression in the economy, the government generally goes in for public debt. The depression brings an atmosphere of despair and frustration especially among producer because of low demand for goods and services due to falling prices and profits. The government, in fighting such a situation, resort to large scale construction of public works such as railway, roads. dams, canals etc. to provide employment opportunities to the unemployment.

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(4) Financing Development Projects: The government cannot speed up the pace of economic development only with its tax- revenues specially in under-developed countries because the taxable capacity in such countries is low and therefore, the huge amount required for the development of the economy cannot be collected through taxation. But the development is must and this can only be achieved through public borrowings. With the help of these loans, the government may take steps to bring about the speedy development of various sectors of the economy i.e. agriculture, industry, transport and other basic infrastructure.

(5) Providing for Social Services: Public borrowings finance the social services like educations, medical aid, cheap housing, social. security measures etc. They require huge sums to be invested. These loans add to the productive capacity of the people hence they turn to be productive. The amount to be spent on these services cannot be sufficiently be raised through taxation.

(6) Containing Inflationary Pressure: Public debt may be used as an instrument to check inflationary pressures in the economy. The government draws out a lot of money in circulation from the people who have surpluses. It keeps their mounting expenditure to a modest size. Drawing out of purchasing power from the public may help check the inflation.

(7) Advantages to Investors: Lenders of public debt are also benefiting by it. Their investment is safe with the government in the sense that its interest and the principal are guaranteed by the government and therefore, it has no risks of losing their investment. The liquidity of government debt is more because they can be sold at any time in the open market.

(8) Finance to Public Enterprise: Public sector plays a significant role in the development of the economy of a country. The nature of public enterprises is such as to take up such projects which are not undertaken by the private sector due to heavy investment. The government borrows funds from the public and finances them towards their capital to facilitate them to undertake such projects. Besides producing goods and services, they help in building sound economic foundation and putting the economy out of the vicious circle of poverty.

Conclusion:
Thus, public debt is very much necessary for the development and protection of a nation as well as to protect poor section of society. It also helps in increasing welfare of society.

Q-8 Differentiate between public debt and private debt. (4 Marks – 2012)
Introduction:
Debt means borrowing of funds from another. Public debt therefore, refers to an amount borrowed by the government from it public or from foreign agencies to meet the deficit of public revenue and public expenditure. An individual also takes loan from another person or institution. Which is known as private debt
Difference between public and private debt:
Following table shows difference between public and private debt.

Sr.	Point of Difference	Public Debt	Private Debt
1	**Compulsion**	Government can force people to lend her in case of emergency.	An individual cannot force another individual to lend him even in emergency.
2	**Repudiation (rejection)**	Government can repudiate the loans taken by her from public at any time.	An individual cannot refuse to pay back loan money. He can be legally forced to pay back.
3	**Durability of debts**	Government can secure loan for very long period of time.	An individual can get loan for short period of time.
4	**External and internal**	Government can borrow from internal as well as external sources.	An individual can borrow from internal sources only.
5	**Payment through taxation**	The repayment of debt and payment of interest is done by taxing people.	An individual cannot collect tax. He has to pay back loan from his own income.

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6	**Rate of interest**	Government gets debt at low rate of interest.	An individual has to pay high rate of interest on loans.
7	**Purpose of loan**	Social welfare	Personal welfare
8	**Liquidity**	Government securities can be sold in market so public debt instruments are liquid.	Private debt instrument cannot be traded and the individual has to repay it from his income.

Conclusion:

Public debt is incurred by government for the greater good of society and development of an economy while private debt is incurred by individuals for their own welfare. Public debt plays a vital role in economic development of a nation while private debt plays very small role in economic development.

Multiple Choice Questions:

1. Which debt is not considered public debt of the following?
   (A) Central government (B) State government (C) Private firm (D) Local self government
2. Which of the following is not a characteristic of public debt?
   (A) Unlimited proportion (B) Compulsion (C) Less interest (D) Maximum profit
3. In which instrument, there is only a transfer of ownership?
   (A) Internal Public Debt (B) External Public Debt (C) Taxation (D) Public Expenditure
4. Government borrows to build a bridge, such type of debt is called **_____________**.
   (A) Productive debt (B) Unproductive debt (C) Redeemable debt (D) Inactive debt
5. In which of the following, using of public debt is not considered as burden of debt.
   (A) For war (B) For natural disasters (C) For productive assets (D) For revenue expenditure
6. What affect the public debt has in the income inequality.
   (A) Increases (B) Decreases (C) Zero (D) Stable
7. According to _________ 'The burden of internal public debt cannot be shifted on future generations.'
   (A) Lerner (B) Meede (C) Buchanan (D) Domar
8. According to _________ 'Public debt is burdensome.'
   (A) Lerner (B) Dalton (C) Classical economists (D) Buchanan
9. For the repayment of debt ____________ reduces the social welfare.
   (A) Direct money burden (B) Direct real burden (C) Indirect money burden (D) Indirect real burden
10. In the view of __________ the burden of internal public debt falls on future generation.
    (A) Classical economists (B) Dalton (C) Lerner (D) Buchanan
11. Buchanan has not considered the impact of public expenditures because of public debt. This criticism has been given by _________________.
    (A) Lerner (B) Dalton (C) E. J. Missan (D) Musgrave
12. Public debt has become burdensome because of the use of the following purpose.
    (A) Industrialisation (B) Infrastructure (C) Unplanned expenditure (D) Planned expenditure

Answers: 1. Private firm 2. Maximum profit 3. Internal public debt 4. Productive debt 5. For productive assets 6. Increases 7. Lerner 8. Classical economists 9. Direct real burden 10. Buchanan 11. E. J. Missan 12. Unplanned expenditure.

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University papers
December 2012

1(A) Discuss the meaning and features of mixed economy (6) OR
1(A) Give the meanings of public and private finance and differentiate between them. (6)

(B) What are the basic problems of the society? (4) OR
(B) Discuss the meaning and importance of government budget (4)

(C) Differentiate between private goods and public goods. (4) OR
(C) Distinguish between surplus budget and deficit budget (4)

2(A) Classify taxes on the basis of impact and incidence of a tax (6) OR
2(A) Discuss the role of taxation in economic development (6)

(B) State the meaning and features of progressive taxes (4) OR
(B) State the main shortcoming of Indian tax structure (4)

(C) Distinguish between tax avoidance and tax evasion (4) OR
(C) Explain merits and demerits of direct taxes. (4)

3(A) Discuss the sources of revenue for the central government of India. (6) OR
3(A) Explain reasons for the growth of public expenditure in India. (6)

(B) Write a note on 'Privatisation.' (4) OR
(B) Write a note on 'Disinvestment Policy of public enterprises.' (4)

(C) Write a short note on "FRBM Act." (4) OR
(C) Explain productive and unproductive public expenditure. (4)

4(A) Discuss meaning and types of public debt (6) OR
4(A) Discuss the controversy of the burden of public debt. (The views of Prof. Lerner and Buchanan) (6)

(B) Explain: (1) Direct money burden of an internal debt and (2) direct money burden of an external debt (4) OR
(B) Explain effects of public debt on consumption and production. (4)

(C) Discuss the usefulness of public debt. (4) OR
(C) Distinguish between public debt and private debt. (4)

5. Objective or Multiple Choice Questions (14) (Options in bold are answers.)

1. Indian economy is a **(A) Mixed economy** (B) Capitalist Economy (C) Socialist Economy (D) None of the above.
2. Budgetary deficit + borrowing and other liabilities taken by the government is known as (A) Primary Deficit **(B) Fiscal Deficit** (C) Revenue Deficit (D) None of the above
3. Street light is a (A) Central subject (B) State subject **(C) Local self government subject** (D) Concurrent subject.
4. Corporate tax comes under (A) Regressive tax(B) Indirect tax (C) Proportional tax **(D) Direct tax**
5. The share of direct tax is ____________ than indirect tax in India. (A) More **(B) Less** (C) Constant (D) Equal
6. The reason for tax evasion is **(A) High marginal rate of taxation** (B) Low marginal rate of taxation (C) Constant marginal rate of taxation (D) None

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7. The revenue from custom duties come under (A) State government (B) Municipality (C) Gram Panchayat **(D) Central government**
8. Expenditure on steel plants, electricity projects etc. are **(A) Capital expenditure** (B) Revenue expenditure (C) Transfer expenditure (D) None
9. Productive expenditure creates **(A) Asset or increased production** (B) Debt or decreased production (C) Debt and decreased production (D) Nothing
10. The burden of public debt is borne by present generation. This is the view of (A) Buchanan (B) Pigou (C) Keynes **(D) Lerner**
11. The public debt incurred due to earthquake is (A) Productive debt **(B) Unproductive debt** (C) External debt (D) Internal debt
12. If people buy government bonds out of past savings, their consumption will **(A) Remain unaffected** (B) Increase (C) Decrease (D) None
13. Which of the following is a case of public goods? (A) Cloth (B) Car (C) Food grains **(D) Defense**
14. To reduce tax burden through tax planning is (A) Tax evasion **(B) Tax avoidance** (C) Tax incidence (D) Tax shifting.

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1(A) Discuss the meaning and features of capitalist economy (6) OR
1(A) What does Federal Finance mean? Discuss the problems of Federal Finance. (6)

(B) Discuss the meaning and functions of an economic system. (4) OR
(B) Write a short note on 1) Balanced budget 2) deficit budget and 3) Surplus budget (4)

(C) Write short note on 1) Private goods 2) Public goods 3) Merit goods (4) OR
(C) Explain the meaning of 1) Revenue deficit 2) Budget deficit 3) Fiscal deficit and 4) Primary deficit (4)

2(A) Explain the meanings of direct tax and indirect tax and discuss merits and demerits of any one of them (6) OR
2(A) Show the defects of Indian tax structure and give suggestions to correct them. (6)

(B) Write a short note on 1) Progressive tax 2) Proportional tax 3) Regressive tax (4) OR
(B) Explain main objectives of Tax Policy in India (4)

(C) Discuss the meaning of Tax Evasion and Tax Avoidance and differentiate between them. (4) OR
(C) “Taxation and Economic Development” Critically discuss. (4)

3(A) Explain the meaning and objectives of Public Expenditure (6) OR
3(A) Discuss the sources of Revenue for the State Governments in India. (6)

(B) Explain reasons for the growth of Public Expenditure in India. (4) OR
(B) Discuss merits and demerits of Disinvestment and Privatisation of Public Enterprises. (4)

(C) Write a short note on “FRBM Act” in India. (4) OR
(C) Write a note on planned expenditure and non-planned expenditure (4)

4(A) Explain economic effects of public debt (6) OR
4(A) “Burden of internal public debt and external public debt.” Explain (6)

(B) Explain: (1) Productive and Unproductive debt (2) short term and long term debt (4) OR
(B) Discuss the differences between taxation and public debt (4)

(C) "The burden of internal public debt cannot be shifted to future generation." Discuss Prof. Lerner's opinion (4) OR
(C) Explain 1) Voluntary and Compulsory debt and 2) Internal and external debt. (4)

5. Objective or Multiple Choice Questions (14) (Options in bold are answers.)

1. Which of the following country has capitalist economy? (A) India (B) Pakistan **(C) America** (D) China.
2. Which of the following good is public good? (A) Bread (B) Fridge **(C) Bridges** (D) Residential houses
3. What type of budget is desirable during depression? **(A) Deficit** (B) Surplus (C) Balanced (D) None of the above
4. Service tax is a (A) Direct tax **(B) Indirect tax** (C) Regressive tax (D) Specific tax
5. Tax evasion is (A) Legal (B) Illegal (C) Just (D) None of the above
6. The rate of a tax remains the same irrespective of the size of taxable income is called (A) Progressive (B) Regressive **(C) Proportional** (D) None
7. Direct taxes are (A) Not productive **(B) Most certain** (C) Uncertain (D) Not paid directly
8. Who will get revenue from property transactions? (A) Central government **(B) State governments** (C) Municipality (D) Gram panchayat
9. Who will get revenue from taxes on Vehicles and Animals? (A) Central government **(B) State governments** (C) Municipality (D) Individuals
10. Who will get the Revenue from Income Tax? **(A) Central government** (B) State governments (C) Municipality (D) Gram Panchayat
11. Government expenditure on Health, Research etc. are (A) Productive expenditure **(B) Unproductive expenditure** (C) Futile expenditure (D) Non-planned expenditure
12. If a loan is subscribed to by the citizens of a nation, it is a case of **(A) Internal debt** (B) Long term debt (C) Short term debt (D) External debt
13. "The burden of public debt can be shifted to future generation" This is the view of **(A) Buchanan** (B) Lerner (C) Adam Smith (D) None of the above.
14. When the government borrows money from people, the purchasing power of people **(A) Get reduced** (B) Get increased (C) Get expanded (D) Remains the same

December 2014

1(A) Differentiate between Capitalism and Mixed economy (6) OR
1(A) Compare public finance with private finance (6)

(B) Write a note on private goods and merit goods (4) OR
(B) Distinguish between surplus budget and deficit budget (4)

(C) Discuss reasons of failures of market mechanism (4) OR
(C) Distinguish between fiscal deficit and revenue deficit. (4)

2(A) Discuss meaning and characteristics of direct taxes (6) OR
2(A) Write a note on "Role of taxation in economic development." (6)

(B) Explain various types of taxes on the basis of the rate of tax (4) OR
(B) Discuss the defects of tax structure in India at present (4)

(C) Discuss merits and demerits of direct taxes. (4) OR
(C) Describe merits and demerits of indirect taxes (4)

3(A) Discuss the sources of revenue for the Central government of India. (6) OR
3(A) Discuss the meaning and importance of public expenditure. (6)

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(B) Write a critical note on "Privatisation in India." (4) OR
(B) Write a note on 'FRBM Act.' (4)

(C) Write a short note on the sources of revenue for the state government (4)
(C) Write a critical note on 'disinvestment of public enterprises in India.' (4)

4(A) Explain i) Direct monetary burden of an internal debt and an external debt and ii) direct real burden of an internal debt and an external debt (6) OR
4(A) Write a note on 'Effects of public debt.' (6)

(B) Explain: (1) Internal and External debt (2) Voluntary and Compulsory debt (4) OR
(B) Explain (1) Productive and Unproductive debt (2) Long term and short term debt (4)

(C) Discuss the differences between taxation and public debt (4) OR
(C) Discuss Prof. Lerner's opinion on the burden of internal public debt. (4)

5. Objective or Multiple Choice Questions (14) (Options in bold are answers.)

1. Under mixed economy state controlled prices are known as (A) Support prices **(B) Administrative prices** (C) Issue prices (D) Market prices.
2. Which of the following is a case of public goods? **(A) Defence** (B) Car (C) Housing (D) Food grain
3. Under which situation, deficit budget is desirable? (A) Prosperity (B) Inflation (C) Boom **(D) Depression**
4. Private finance relates to the income and expenditure of **(A) An individual** (B) The central government (C) State government (D) Local bodies
5. Custom duties are (A) Direct taxes **(B) Indirect taxes** (C) Regressive taxes (D) Specific taxes.
6. Tax avoidance is **(A) Legal** (B) Illegal (C) Productive for government (D) None
7. The rate of a tax remains the same irrespective of the size of taxable income, it is called (A) Progressive (B) Regressive **(C) Proportional** (D) None
8. Direct taxes are (A) Not productive (B) Not paid directly (C) Most uncertain **(D) Most certain.**
9. Who get revenue from wealth tax? **(A) The central government** (B) The state government (C) The municipality (D) The gram panchayat
10. Government expenditure on human capital is, **(A) Productive expenditure** (B) Non-productive expenditure (C) Futile expenditure (D) non-planned expenditure
11. Productive expenditure creates **(A) Asset or increase production** (B) Debt or decrease production (C) Debt and decrease production (D) Nothing
12. If a loan is subscribed by foreign institution, it is a case of (A) Internal debt (B) Long term debt (C) Short term debt **(D) External debt**
13. "The burden of public debt can be shifted to future generation" This is the view of (A) Adam Smith (B) Jagdish Bhagwati (C) Lerner **(D) Buchanan**
14. In ___________ debt, purchasing power is transferred within the country from domestic creditors to the treasury. **(A) Internal** (B) External (C) Foreign (D) None of the above.

December 2015

1(A) Discuss the meaning and features of capitalism (6) OR
1(A) What is Federal Finance System? Discuss the problems of Federal Finance System (6)

(B) Write a short note on: 1) Balanced budget 2) Surplus budget and deficit budget (4) OR
(B) Write short note on: 1) Private goods 2) Merit goods (4)
(C) Write: Limitations of market mechanism (4) OR
(C) Explain the meaning of (a) Fiscal deficit (b) Primary deficit (4)

2(A) Classification of taxation on the basis of tax impact and incidence of tax (6) OR

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2(A) Show the defects of Indian tax structure and give suggestions to correct them. (6)

(B) Write short note on: 1) Progressive tax 2) Proportional tax and Regressive tax (4) OR
(B) Examine merits of Direct tax. (4)

(C) Discuss the meaning of tax evasion and tax avoidance and differentiate between them.(4) OR
(C) "Contribution of Taxation in Economic Development" – Critically discuss (4)

3(A) Write the meaning of public expenditure and aims behind it. (6) OR
3(A) Discuss the sources of revenue for the state government of India. (6)

(B) Explain reasons for the growth of public expenditure in India. (4) OR
(B) Disinvestment and Privatisation of public enterprises. (4)

(C) Write a note on FRBM Act in India. (4)
(C) Write a note on planned expenditure and non planned expenditure (4)

4(A) Write: Meaning of public debt and types of it. (6) OR
4(A) Write: Controversy regarding burden of public debt (Opinion of Prof. Lerner or Buchanan) (6)

(B) Write a note on effects of public debt. (4) OR
(B) Discuss the differences between Taxation and Public debt. (4)

(C) Discuss usefulness of public debt. (4) OR
(C) Explain: 1) Direct monetary burden of internal debt 2) direct monetary burden of external debt. (4)

5. Objective or Multiple Choice Questions (14) (Options in bold are answers.)

1. Indian economy: **(A) Mixed economy** (B) Capitalist economy (C) Socialist economy (D) None of the above
2. Private finance relates to the income and expenditure of **(A) An individual** (B) The central government (C) State government (D) Local bodies
3. Budget deficit + government withdrawal and other liabilities mean (A) Primary deficit **(B) Fiscal deficit** (C) Revenue deficit (D) None
4. Which among the given below is public good? (A) Bread (B) Refrigerator **(C) Dams** (D) Residential houses.
5. Company tax is (A) Regressive tax (B) Indirect tax (C) Proportional tax **(D) Direct tax**
6. Service tax is a (A) Direct tax **(B) Indirect tax** (C) Specified tax (D) Regressive tax
7. Who earns the income of vehicle tax and animal tax? (A) Central government **(B) State government** (C) Municipality (D) An individual
8. Tax avoidance is (A) High marginal rate of tax (B) Low marginal rate of tax (C) Stable marginal rate of tax **(D) None of the above**
9. Tax avoidance: **(A) It is legal** (B) It is illegal (C) Productive for the government (D) None of the above
10. Who receive income from wealth tax? **(A) central government** (B) state government (C) Municipalities (D) Gram panchayat
11. Iron plants, electricity plants etc expenditure. **(A) Capital expenditure** (B) Revenue expenditure (C) Transfer cost (D) None
12. On health, research's government expenditure is **(A) Productive expenditure** (B) Non productive expenditure (C) Useless expenditure (D) None
13. Present generation only going to bear the burden of public debt. Who says? (A) Buchanan (B) Pigou (C) Keynes **(D) Lerner**
14. How many type of burden are there in case of public debt? (A) two (B) three **(C) four** (D) Five

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