

Public Finance in India

EXERCISE [PAGES 79 - 80]

Exercise | Q 1.1 | Page 79

Choose the correct option:

Optional functions of Government :

- a) Protection from external attack
- b) Provision of education and health services
- c) Provision of social security measures
- d) Collection of tax

- 1. **b and c**
- 2. a, b and c
- 3. b, c and d
- 4. All of the above

Solution: b and c

Exercise | Q 1.2 | Page 79

Choose the correct option:

Obligatory functions of the Government:

- a) Provision of employment
- b) Maintaining internal law and order
- c) Welfare measures
- d) Exporting goods and services

- 1. c and d
- 2. a and b
- 3. **only b**
- 4. a, c and d

Solution: only b

Exercise | Q 1.3 | Page 79

Choose the correct option:

"Definition - Public finance is one of those subjects which are on the borderline between economics and politics." given by

- a) Adam Smith
- b) Alfred Marshall
- c) Prof. Hugh Dalton
- d) Prof. Findlay Shirras

- 1. only a
- 2. only b
- 3. **only c**
- 4. only d

Solution: only c

Exercise | Q 1.4 | Page 79

Choose the correct option:

Non-tax sources of revenue :

- a) Direct and Indirect Tax
- b) Direct Tax and Fees
- c) Fees
- d) Special Levy

- 1. b and c
- 2. a and c
- 3. a, b, c and d
- 4. **c and d**

Solution: c and d

Exercise | Q 1.5 | Page 79

Choose the correct option:

Trends shown by Public expenditure of any Government shows following trend.

- a) Constant
- b) Increasing
- c) Decreasing
- d) Fluctuating

1. only a
2. **only b**
3. only c
4. only d

Solution: only b

Exercise | Q 1.6 | Page 79

Choose the correct option:

Identify the right group of pairs from the given options.

Group A	Group B
i) Direct tax	a) Non-tax revenue
ii) Indirect tax	b) Inflation
iii) Fees and Fines	c) GST
iv) Surplus budget	d) Personal income tax

1. i-d ii-c iii-b iv-a
2. i-c ii-d iii-a iv-b
3. **i-d ii-c iii-a iv-b**
4. i-a ii-b iii-c iv-d

Solution:

i-d ii-c iii-a iv-b

Group A	Group B
i) Direct tax	d) Personal income tax
ii) Indirect tax	c) GST
iii) Fees and Fines	a) Non-tax revenue
iv) Surplus budget	b) Inflation

Exercise | Q 2.1 | Page 79

Distinguish between the following concept:

Public finance and Private finance.

Solution:

Points	Public finance	Private finance

Meaning	Public finance is concerned with the revenue/incomes and expenditure, borrowings, etc. of the economy or government.	Private finance is the study of income and expenditure, borrowings, etc. of individuals, households and business firms.
Adjustments	Government adjusts the income, according to the size of expenditure on different segments.	Individuals adjust their spending as per their income.
Objective	To promote social welfare.	To maximize profit.
Nature of Budget	The government prefers a deficit budget.	An individual attempts to maintain a surplus budget.
Financial Transaction	Transactions are open and known to all.	Transactions are kept secret.

Exercise | Q 2.2 | Page 79

Distinguish between the following concept:

Internal debt and External debt.

Solution:

Internal debt	External debt
i) When a government borrows from its citizens, banks, central banks, financial institutions, business houses, etc. within the country, it is known as internal debt.	i) When a government borrows from foreign governments, foreign banks or institutions, international organizations like International Monetary Fund, World Bank, etc., it is known as external debt.
ii) Internal debt is raised for internal requirements like financing the developmental plans.	ii) External debt is raised mainly for overcoming the balance of payment deficits and also for developmental plans.
iii) External debt has a greater burden on the economy than internal debt.	iii) In the case of external debt, when interest payments on the debt are due, money flows from the domestic economy to foreign countries

Exercise | Q 2.3 | Page 79

Distinguish between the following concept:

Developmental expenditure and Non-developmental expenditure.

Solution: Developmental Expenditure:

1. Developmental expenditure refers to the expenditure of the government which helps in economic development by increasing production and real income of the country.
2. Developmental expenditure on revenue is divided into developmental expenditure on revenue account and developmental expenditure on capital account.

Non-Developmental Expenditure:

1. It refers to those expenditures of the government which does not directly help in the economic development of the country.
2. Cost of tax collection, cost of the audit, the printing of notes, internal law and order, expenditure on defense, etc. are treated as a non-developmental expenditure. Pension to retired govt. employees, non-developmental assistance to states are also included in this category.

Exercise | Q 2.4 | Page 79

Distinguish between the following concept:

Special assessment and Special levy.

Solution: Special Assessment:

1. The payment made by the citizens of a particular locality in exchange for certain special facilities given to them by the authorities is known as 'special assessment.'
2. For example, local bodies can levy a special tax on the residents of a particular area where extra/special facilities of roads, energy, water supply, etc. are provided.

Special levy:

1. This is levied on those commodities, the consumption of which is harmful to the health and well-being of the citizens. Like fines and penalties, the objective is not to earn income, but to discourage the consumption of harmful commodities by the citizens.
2. For example, duties levied on wine, opium, and other intoxicants.

Exercise | Q 2.5 | Page 79

Distinguish between the following concept:

Direct tax and Indirect tax.

Solution:

Direct tax	Indirect tax
It is levied on income and activities conducted.	It is levied on products or services.
The burden of tax cannot be shifted in case of direct tax.	The burden of tax shifted for indirect taxes.
It is paid directly by the person concerned.	It is paid by one person but he recovers the same from another person i.e. person who actually bears the tax ultimate consumer.

It is paid after the income reaches in the hands of the taxpayer	It is paid before goods/service reaches the taxpayer.
Tax collection is difficult.	Tax collection is relatively easier.
Example Income tax, wealth tax, etc.	Example GST, excise duty custom duty sale tax service tax

Exercise | Q 3.1 | Page 80

State with reason whether you agree or disagree with the following statement:

Obligatory function is the only function of the Government.

1. Agree
2. **Disagree**

Solution: Disagree

There are two functions of the government Obligatory functions and Optional functions

Exercise | Q 3.2 | Page 80

State with reason whether you agree or disagree with the following statement:

Fines and penalties are a major source of revenue for the Government.

1. Agree
2. **Disagree**

Solution: Disagree

The government imposes fines and penalties on those who violate the laws of the country. The objective of the imposition of fines and penalties is not to earn income, but to discourage the citizens from violating the laws framed by the Government. For example, fines for violating traffic rules. However, the income from this source is small.

Exercise | Q 3.3 | Page 80

State with reason whether you agree or disagree with the following statement:

The goods and services tax (GST) has replaced almost all indirect taxes in India.

1. **Agree**
2. Disagree

Solution: Agree

Newly implemented Goods and Services Tax [GST] in India has replaced almost all indirect taxes, customs duty. The Goods and Services Tax [GST] came into effect in India on July 1, 2017.

Exercise | Q 3.4 | Page 80

State with reason whether you agree or disagree with the following statement:

Democratic Governments do not lead to increase in public expenditure.

1. Agree
2. **Disagree**

Solution: Disagree

The majority of the countries in the world are democratic in nature. A democratic form of government is expensive due to regular elections and other such activities. This results in an increase in the total expenditure of the government.

Exercise | Q 3.5 | Page 80

State with reason whether you agree or disagree with the following statement:

Public finance is more elastic than private finance.

1. **Agree**
2. Disagree

Solution: Agree

There is not much scope for changes in private finance therefore public finance is more elastic.

Exercise | Q 4 | Page 80

Read the given passage and answer the questions:

“The conventional notion of social security is that the government would make periodic payments to look after people in their old age, ill-health, disability, and poverty. This idea should itself change from writing a cheque for the beneficiary to institutional arrangements to care for beneficiaries, including by enabling them to look after themselves, to a large extent. The write-a-cheque model of social security is a legacy from the rich world at the optimal phase of its demographic transition when the working population was numerals enough and earning enough to generate the taxes to pay for the care of those not working. This model is ill-suited for less, well-off India with growing life expectancy, increasing urbanization, and resultant migration. Social security under urbanization will be different from social security in a static society.

1. State the conventional notion of social security.
2. What kind of conceptual change is suggested in the given paragraph?
3. What is a legacy of social security from the rich world?
4. Which features of India make the traditional model of social security ill-suited for the economy?

Solution:

1. The conventional notion of social security is that the government would make periodic payments to look after people in their old age, ill-health, disability, and poverty.
2. The conceptual change in the paragraph is writing a cheque for the beneficiary to institutional arrangements to care for beneficiaries, including by enabling them to look after themselves, to a large extent.
3. The write-a-cheque model of social security is a legacy from the rich world at the optimal phase of its demographic transition.
4. The traditional model is ill-suited for less, well-off India with a growing life expectancy, increasing urbanization, and resultant migration. Social security under urbanization will be different from social security in a static society.

Exercise | Q 5.1 | Page 80

Write answers in 'one' or 'two' paras each :

Explain the types of Government budget.

Solution:

There are three main types of the government budgets.

1. **Balanced budget**- It means the total budgeted expenditure is equal to the total budgeted receipts. In other words, balanced budget implies a situation where the total budget receipts of the government equals the total budget expenditure of the government. That is,

$$\text{Balanced budget} = \text{Government expenditure} = \text{Government revenue}$$
2. **Surplus budget**- It refers to the excess of the total budgeted receipts over the total budgeted expenditure. In other words, budget surplus implies a situation where the total budget receipts of the government are more than the total budget expenditure of the government. That is,

$$\text{Surplus budget} = \text{Government expenditure} < \text{Government revenue}$$
3. **Deficit budget**- It refers to the excess of the total budgeted expenditure over the total budgeted receipts. In other words, budget deficit implies a situation where the total budget receipts of the government fall short of the total budget expenditure of the government. That is,

$$\text{Deficit budget} = \text{Government expenditure} > \text{Government revenue}$$

Exercise | Q 5.1 | Page 80

Answer the following:

State the importance of the Government budget.

Solution:

Importance of Budget

- Union Budget is important because it affects people and economy in general in a number of ways.
- Taxes are the most interesting part of any budget. Taxes determine the fate of businesses and individuals.

- The level of disposable income of the taxpayers depends on the tax rates presented in the budget.
- Government expenditure on various heads such as defense, administration, infrastructure, education, and health care, etc. affects the lives of the citizens and overall economy.
- Also, the budget is important because Governments use it as a medium for implementing economic policies in the country.
- Budgetary actions of the Government affect production, size, and distribution of income and utilization of human and material resources of the country
- The scope and importance of public finance in a modern economy have undergone an immense change since the last 100 years.

Exercise | Q 5.2 | Page 80

Answer the following:

Explain the principles of taxation.

Solution: Following are the principles of taxation:

1. **Equity or Equality:** Every person will pay the taxes to the government in proportion to his 'ability to pay'. It means rich people should pay more tax compared to the poor.
2. **Certainty:** The taxpayer should know in advance how much tax he has to pay, at what time he has to pay the tax, and in what form the tax is to be paid to the government.
3. **Convenience:** Every tax should be levied in such a manner and at such a time that it becomes convenient to the taxpayer.
4. **Economy:** The cost of tax collection should be the minimum. If a major portion of the tax proceeds is spent on the tax collection itself, then such a tax cannot be considered as a good tax.

Exercise | Q 5.3 | Page 80

Answer the following:

Explain non-tax sources of revenue of the Government.

Solution:

Non-tax revenue:

Public revenue received by the government administration, public enterprises, gifts, and grants, etc. are called as non-tax revenue.

Brief information about non-tax revenue sources are as follows:

1. **Fees:** A tax is paid compulsorily without any return service whereas, the fee is paid in return for certain specific services rendered by the government. For example- education fees, registration fees, etc.
2. **Prices of public goods and services:** Modern governments sell various types of commodities and services to the citizens. A price is a payment made by the citizens to the government for the goods and services sold to them. For example- railway fares, postal charges, etc.

3. **Special Assessment:** The payment made by the citizens of a particular locality in exchange for certain special facilities given to them by the authorities is known as 'special assessment.' For example- local bodies can levy a special tax on the residents of a particular area where extra/special facilities of roads, energy, water supply, etc. are provided.
4. **Fines and Penalties:** The government imposes fines and penalties on those who violate the laws of the country. The objective of the imposition of fines and penalties is not to earn income, but to discourage the citizens from violating the laws framed by the Government. For example, fines for violating traffic rules. However, the income from this source is small.
5. **Gifts, Grants, and Donations:** The government may also earn some income in the form of gifts by the citizens and others. The government may also receive grants from foreign governments and institutions for general and specific purposes. Foreign aid has become an important source of development finance for a developing country like India. However, this source of revenue is uncertain in nature.
6. **Special levies:** This is levied on those commodities, the consumption of which is harmful to the health and well-being of the citizens. Like fines and penalties, the objective is not to earn income, but to discourage the consumption of harmful commodities by the citizens. For example- duties levied on wine, opium, and other intoxicants.
7. **Borrowings:** The government can borrow from the people in the form of deposits, bonds, etc. It also gets loans from foreign governments and organizations such as IMF, World Bank, etc. Loans are becoming a more and more popular source of revenue for governments in the modern times.

Exercise | Q 6.1 | Page 80

Answer in detail:

Explain various reasons for the growth of public expenditure.

Solution: It is observed that there is a continuous growth in public expenditure in a developing country like India. Let us study some of the important reasons:

1. **Increase in the Activities of the Government:** These functions include the spread of education, public health, public works, public recreation, social welfare schemes etc. It is observed that new functions are continuously being undertaken and old functions are being performed more efficiently on a large scale by the government. This leads to an increase in public expenditure.
2. **Rapid Increase in Population:** Population of developing countries like India is increasing fast. In 2011 Census, it was 121.02 crores. As a result, the government has to incur greater expenditure to fulfil the needs of the increasing population.

3. **Growing Urbanization:** Spread of urbanization is a global phenomenon of the day. This leads to an increase in the government expenditure on water supply, roads, energy, schools and colleges, public transport, sanitation etc.
4. **Increasing Defence Expenditure:** In modern times, the defence expenditure of the government is increasing even in the peacetime due to unstable and hostile international relationships.
5. **Spread of Democracy:** Majority of the countries in the world are democratic in nature. A democratic form of government is expensive due to regular elections and other such activities. This results in an increase in the total expenditure of the government.
6. **Inflation:** Just like a private individual, the government has to buy goods and services from the market for the spread of economic and social development. Normally, prices show a rising trend. Due to this, the government has to incur increasing costs.
7. **Industrial Development:** Industrial development leads to an increase in production, employment and overall growth in the economy. Hence, the government makes huge efforts for implementing various schemes and programmes for industrial development. This results in an increase in government expenditure.
8. **Disaster Management:** Many natural and man-made calamities like earthquakes, floods, cyclones, social unrest etc. are occurring more frequently. The government has to spend a huge amount on disaster management which increases total expenditure. Modern governments are working for 'welfare state'. Hence, there is a continuous increase in public expenditure.