ANSWERS OF MAJOR TEST

ANS 1. C] donations.

ANS 2. A] rs.4,000

ANS 3. A] balance

ANS 4. B] borrowings

ANS 5. D] all of the above

ANS 6. D] the income earners

ANS 7. 2] (ii) – (b)

ANS 8. C] sale of shares of a public sector undertakings to X pvt,ltd.

ANS 9 B] it is a statement of expected annual receipts and expenditure of the government.

ANS 10 E] revenue deficit v] revenue expenditure less revenue receipts

ANS 11. Revenue deficit = Revenue expenditure – Revenue receipt

= Rs.21,40,612 cr – Rs.17,29,682 cr

= Rs. 4,10,930 cr

Fiscal deficit = total expenditure – (revenue receipt + recoveries of loss and other receipts)

= Rs.24,57,235cr – (Rs.17,29,682cr + Rs.93,155cr

= Rs.6,34,398cr

OR

Fiscal deficit = borrowing and other liabilities

= Rs.6,34,398cr

Primary deficit = fiscal deficit – interest payment

= Rs.6,34,398cr – Rs.5,87,570cr

= Rs.46,828cr

[Implying that : Fiscal deficit = primary deficit + interest payment

= Rs.46,828cr + Rs.5,87,570cr

= Rs.6,34,398cr]

ANS 12. The government budget contributes to growth , because a significant percentage of budget expenditure is committed to the growth and expansion of public sector enterprises. The government also offers subsidies to the producers to maintain high level of production of the essential goods. Stability is promoted by combating inflation through fiscal discipline and combating deflation through liberal spending by the government. Fiscal discipline aims at lowering AD during inflation. Liberal deficit promotes AD during deflation.

OR

Two observation can be made in this respect :-

[i] Higher expenditure on health is expected to make our workforce strong and efficient. Rise in efficiency implies a rise in productivity which leads to a rise in GDP. It is an index of economic growth.

[ii] Higher expenditure on education is expected to booster skill formation in the country. It facilitates the use of new technology. Application of new technology would shift PPC of the economy to the right. Implying a higher level of output with the same resources.

AND 13.

[i]SUBSIDIES : Revenue expenditure because it neither reduce liability nor creates assets of the government.

[ii]GRANTS GIVEN TO STATE GOVERNMENT : Revenue expenditure because it neither reduce liability nor creates assets of the government.

[iii]REPAYMENTS OF LOANS : Capital expenditure because it reduces liability of the government.

[iv]CONSTRUCTION OF SCHOOL BUILDING : Capital expenditure because it adds to the assets of the government.

ANS 14. Government budget is an annual financial statement of the government , showing item wise estimated receipts and estimated expenditures under various heads , for the coming financial year. Government affects saving, investments, production of goods and services, distribution of resources, distribution of income and wealth, consumption of households, international trade, etc. That`s why budget is an important tool for the government to implement its various policies. The various objectives of the government budget are as follows :-

[i] Economic stability : economic stability means stability in price level. Because if price is stable than economy can grow with much faster rate. Government adopts surplus of deficit budgeting to prevent business fluctuation and try to maintain economic stability.(i.e.tries to increase employment and output by keeping price constant). During depression government adopts deficit budgeting (government try to increase the spending and cut down the taxation), so that the money supply increases which increases the aggregate demand and during inflation it adopts surplus budgeting (government try to increase the taxation and cut down the spending), so that the money supply decreases which decreases the aggregate

demand to control price. The government ensures price stability particularly of essential commodities and services by opening fair price shops, keeping sufficient stock of food grains ,etc.

[ii] Economic growth : economic growth means continuous increase in level of output of goods and services. Growth of the country depends on the rate of savings and investment. With the help of budget , government tries to increases the rate of saving and investment, which increases growth rate of economy. Besides this , government can promote economic growth by setting up basic and heavy industries like iron and steel, chemical, cement, machines, etc. these industries are not normally taken up by the private sector because these involves huge amount of investment expenditure and their profit margin is very low. These industries creates a strong base of development of small scale and medium scale industries. Due to that economic growth of the county also promotes. Beside this government can encourage the investment by providing tax concession or tax holidays to private investors.

[iii] Economic equality(reducing inequalities of income) : budget is a powerful tool which is used to reduce economic inequalities or disparity of income and wealth. To decrease the income and wealth gaps between rich and poor, government imposes more taxes on income of rich persons and standard deduction on the income of economically weaker person by progressive taxation on income (it will decrease the disposable income of rich person) or increasing the exemption limit of income tax and make expenditure on social security , subsidies to poor, provide food items,etc which rises the level of poor people.

[iv] Reallocation of resources : Many times market fails to allocate the resources idealy and creates certain types of disparity and imbalances(such as economic disparity, regional disparity and sectorial disparity) which are not according to the social and economic requirement of the country.

[v] Management of public enterprises : there are some industries and enterprises which affects the growth and development of economy and important from strategic point of view. These industries are controlled and regulated by government.

[vi] Generation of employment : to generate the employment level in economy, government make expenses on public works, like construction of roads, dams, canals, bridges, schools, hospitals,etc. through the budgetary expenditure. These programmes generate large employment directly and indirectly.

[vii] External balance : sometimes external imbalance is created when external payments are more than external earnings (means foreign exchange reserves are short). Government uses fiscal measures to restore external balances such as heavy import duty, import substitution, subsidies on exports, tax concession to exporters, etc. this helps in increasing exports and reducing imports.

[viii] Providing effective administration : to fulfil this objective , government incurs expenditure on policies, military, legislations, courts, government offices, etc.

[ix] Providing infrastructural facilities : for this the government spends on education , health, sanitation, water, etc.

ANS 15. [i] High deficit raises an alarm for the government either to cut its expenditures or increase its receipts.

[ii] It measures the fiscal irresponsibility of the government. It represents the failure of government on economic front. It indicates that the government is unable to generate sufficient receipts.

[iii] It also reflects the conditions of economy. If government intentionally formulates deficit then it represent that there is a problem of deflation or slow growth or unemployment in economy.

[iv] If government is not able to increase the receipts, then it will try to cover it by borrowings (which will increases the liability) or by disinvestment (which will decrease the assets) or by issue of new currency(which will create inflation).

[v]It indicate the extent to which current government policy is increasing or decreasing the future burden of past policies.

[vi] It indicates that to which extent the government is borrowing for its wasteful expenses.

[vii] Decrease in deficit indicates that government has become aware of the need of improving financial management.

OR

Generally deficit of budget may be financed by four different ways:-

[i] Money expansion : printing of new currency to the extent of the deficit. In this condition government borrows from central bank through the issue of treasury bills to the central banks.

[ii] Market loans : the deficit may be financed by borrowing from the public through market loans or borrowings from foreign government. But this measure increases the liability of the government.

[iii] Withdrawing from RBI : government may withdraw its cash balance from RBI. This will leads to increase in money supply which in turn may leads to rise in prices.

[iv] Disinvestment : government may shares to public sector undertakings or sale its fixed assets or may sale the firm or plant to arrange funds. It will decreases the assets of government and also decreases the income of government in future.

ANS 16. (a)

A balanced budget is that in which government receipts are equal to government expenditures.

MERITS:-

1. The government does not indulge into wasteful expenditure.
2. The government avoids interfering in economic functioning of the system.
3. It ensures financial stability.
4. It ia an ideal budget in normal conditions.

DEMERITS :-

1. It does not offer any solution to the problem of unemployment during depression.
2. It is not better for the growth and development in developing or backward countries.
3. Welfare activities decreases during such type of budgets.

(b) there are seven main documents in the budget of the government :-

1. Speech of financial minister: it includes [i] general economic scene of the economy [ii] direct and indirect tax proposals.

2. Annual financial statement : it shows estimate receipts and estimated expenditure of government for coming financial year.

3. Budget at a glance : it presents the summary of the whole budget in the form of data and graphs.

4. Finance bill : it includes the tax proposals of government.

5. Receipts budget : it includes detail explanation of revenue and capital receipts.

6. Expenditure budget : it includes detailed explanation of various ministries planned or unplanned expenditures.

7. Demand for grants : it gives detailed description of demand for economic grants.

ANS 17.(A)

(a) PLAN EXPENDITURE: Plan expenditure refers to those government to be incurred during the year, on the programmes under the current five year plan. It can be further classified into revenue expenditure and capital expenditure. Such as expenditure on rural development , irrigation and flood control, transport , communication , science , social activities, etc.

(b) NON PLAN EXEPENDITURES : Those government expenditure other than the expenditure related to the current five year plan and those government expenditure which is incurred on routine functioning of the government is treated as non plan expenditure such as expenditure on subsidies ,payment of salaries and pensions, defence, law and order, payment of interest on loans by government, etc.

(B)

BASIS	DIRECT TAXES	INDIRECT TAXES
MEANING	Direct tax refers to financial charge, levied directly on the taxpayer, and paid outrightly to	Indirect tax is when the taxpayer is just the hands that deposit the amount of tax to

	the authority which imposes it, by the taxpayer.	the authority imposing it, while the burden of tax falls on the final consumer.
EXAMPLE	Income tax, corporation tax, etc.	Gst, sales tax , custom , etc
NATURE	Progressive	Regressive
BURDEN	Cannot be shifted to another person.	Can be shifted to another person
INCIDENCE&IMPACT	It falls on the same person.	It falls on different persons

OR

(A)

[i]Development expenditure:- expenditure of Government on activities which are directly related to economic and social development of the economy is termed as development expenditure. They are directly affect the flow of goods and services. Such as expenditure on agricultural and industrial development, scientific research, health, education, infrastructure etc. These services are not treated as a part of essential function of the government. It is optional for the government to provide these services.

[ii] Non government expenditure:- expenditure of government on activity which are indirectly related to economic and social development of the economy is termed as non development expenditures. They directly does not affect the flow of goods and devices in the economy. Such as expenditure on administration, police and military, law and order, collection of taxation etc. expenditure on such essential general service is treated as non development expenditure.

(B)

SRN	SURPLUS BUDGET	DEFICIT BUDGET
1	it represent that the estimated receipt of the government is more than the estimated expenditure of government	it represent at the estimated receipt of the government is less than estimated expenditure of government
2	it decreases the money supply in the economy	it increases the money supply in economy
3	it is helpful in decreasing aggregate demand	it is helpful in increasing aggregate demand
4	it can be used to solve the problem of excess demand	it can be used to solve the problem of deficit demand
5	it is an ideal budget in inflationary condition	it is an ideal budget in deflationary condition

ANS 18. A] Equillibrium.

ANS 19. D] Export of goods and services iv] recorded as positive items in bop a/c.

ANS 20. A] RS.1,100 cr

ANS 21. C] Both a & b

ANS 22. B] Deficit of Rs.1,300 lakh

ANS 23. a]trade deficit ii] export of goods < import of goods

b] merchandise v] export and import of goods

c]autonomous items i] cause of BOP imbalance

d]current transfer iii] an element of invisibles

e]portfolio investment iv] foreign institutional goods.

ANS 24.

Suppose the value of export = X

Balance of trade = Rs 10,000 crore

import = ½ of export

= ½ (X)

we know, balance of trade = export - import

= X – ½ (X)

= Rs.10,000crore = X – X/2

= Rs.10,000crore = X/2

= X = Rs.20,000 crore

So, exports = Rs. 20,000 crore.

ANS 25. BOP deficit (or surplus) is estimated in terms of an oral BOP balance. It is found out by combining the balance related to current account BOP and capital account BOP. Also errors and omissions (indicating statistical discrepancies) are taken account of. Thus the overall balance (deficit or surplus) is estimated by specifying the following equation :

overall balance = current account balance + capital account balance + error and omission

In case is found to be positive, it is called BOP surplus.

In case it is found to be negative, it calls BOP deficit.

OR

Cancellation of coal blocks allocation is likely to cause a fall in supply of coal, particularly for the production of electricity. Since coal is the core input for the generation of power in India, a cut in domestic supply is bound to cause a rise in imports. Our import bill is bound to rise. A rise in import payment implies a rise in CAD, other things remaining constant.

ANS 26. The capital account of balance of payment show all the inflows and out flows of capital. These flows of capital may be in the form of borrowings from the lending to abroad or maybe investment and disinvestment both by private and government sector in rest of the world or by non resident inside the domestic territory. Components of capital account of Balance of payments can be classified into three main categories :-

[I]PRIVATE CAPITAL : it include short term and long term capital, which includes

(a) short term capital: purchase of short term security, speculative purchase of foreign currency , etc.

(b) long term capital : foreign direct investment, portfolio investment, long term loan, etc.

[II]OFFICIAL CAPITAL : it includes loans, re-purchase and re-sale of security sold to the foreigners, sale or purchase of gold from abroad, etc.

[III] BANKING CAPITAL : banking capital essentially covers movements in the external financial assets and liabilities of commercial and cooperative banks authorised to deal in foreign exchange.

The purchase of an asset in another country is included in the debit side and sale is included in credit side.

ANS 27 (A) It is the account indicating reserves of forex with RBI.

(B) No, it is incorrect to say that surplus in capital account reflects prosperity of the nation. Because surplus in capital account balance of payments may have been achieve through loans which are financial obligation to rest of the world.

OR

Balance of payments are balanced in accounting point of view. Balance of payments accounts are made according to double entry system in which debit side must equal credit side. So a negative balance in current account is equated through positive balance in capital account (by borrowing loans etc). surplus of current account is used to meet the deficit of capital account. if BOP is in disequilibrium condition than it can be balanced by accommodating items.

ANS 28 (A) false, balance of trade includes only visible items where is current account of balance of payment includes both visible as well as invisible item.

(B) true, improvement in countries exchange rate may in fact cause deficit pop equilibrium because exports may decrease in imports may increase.

ANS 29.(A) balance of trade can be classified in

[i] favourable balance of trade:- when value of visible export exceed value of visible imports than balance of trade shows a surplus. In such case balance of trade is considered as favourable or positive. Favourable balance of trade = visible export > visible inputs

[ii] unfavourable balance of trade :- when value of visible imports exceed value of visible exports and balance of trade shows a deficit. In such case BOT is considered as unfavourable balance of trade = visible export < visible imports.

(B) There are many factors which are responsible for dis equilibrium in balance of payment. These factors are classified in

[i]economic factor

[ii]political factor

[iii] social factors

[i]economic factors:-

- large scale development and expenditure required large import
- cyclic fluctuation in general business activity
- increase in imports due to High domestic prices
- new sources of supply ,new and better substitute of commodities and change in cost affect the direction of trade.

[ii] political factor:- the political in stability of government may decrease the foreign direct investment and portfolio investment in the economy. It also decrease the level of export and increase the level of import.

[iii] social factors :- change in patient taste in preference will affect the imports and exports of the country

OR

(A)AUTONOMOUS ITEM :- autonomous item in the BOP account refers to those international economic transaction that takes place due to economic motives such as profit maximization. These items are independent of the state of countries balance of payment. These are official and unofficial transaction. These items are termed as above the line item. for example items of current and capital account.

ACCOMMODATING ITEM :- accommodating items in BOP account refers to those International official transaction which is carried by government and Central Bank with some economic policy objective. These are mean to correct the equilibrium in autonomous Balance of payments. These are only official transaction. These items are termed as blow the line items. for example borrowings from IMF or from monetary authorities of other countries.

(B) The adverse effect of equilibrium deficit in BOP are :-

[i] create barriers in the development of economy or down grading of the economy in the world community

[ii] debt burden on the economy will increases

[iii] stock of foreign exchange reserve will decreases etc

ANS 30 (A)[i] Balance of payments account includes the country's foreign received and payments with a view to correct the unhealthy Trends

[ii] it provides necessary information on the strength and weakness of the country in international economic transactions

[iii] we can find overall gains or losses from International transaction by analysing Balance of payments accounts of past year

[iv] it also help in evolution of past policies it gives warning signals or raw material in the form of data of future policy formulations

(B) VISIBLE ITEMS(Merchandise) :- it refers to all such items of exports and imports which are visible (or material goods). Current account showing exports and imports of visible goods are known as balance of trade accounts.

INVISIBLE ITEMS :- it refers to all such items which are rendered to abroad or received from abroad in the form of services. All types of services are invisible. It includes :

[i] receipts and payments of shipping, banking, insurance , travel services

[ii]receipts and payments of income from foreign investments

[iii] Government's current expenditure in foreign countries on Embassy and other organisations

[iv] receipts and payment of Donations

(C) an act of purchasing and asset in other country and at the same time acquiring control of it is known as foreign direct investment. For example acquisition of a firm in one country by a farm in another country, purchase of a house abroad by individuals etc.