UNIVERSITY PAPER SOLUTIONS

APRIL - 2018

Time : 3 Hours **Marks : 100**

N.B. (1) All questions are **compulsory**.

(2) All questions carry **equal marks.**

(3) Use of simple **calculator** is **permitted.**

(4) **Draw** neat **diagrams** wherever necessary.

Q.1 (A) Explain the following concepts : (Any Five) **(10)**

1. Financial Administration
2. Net Social Advantage
3. Regressive Taxation
4. Impact of Tax
5. Revenue Expenditure
6. Concentration Effect
7. Zero Based Budget
8. Goods and Services Tax

Q.1 (B) Choose the right answer from the given options and rewrite the statement : **(10)**

1. PP curve is illustrated to explain ______.

(a) Economic efficiency (b) Public goods
(c) Government Policy (d) All of these

2. Which goods are characterised by two important features i.e. non-rival and non-excludability ______.

(a) Public goods (b) Private goods
(c) Agricultural goods (d) All of these

3. Which is Indirect tax ______.

(a) Corporate Income Tax (b) Capital gains tax
(c) Customs Duty (d) Gift tax

4. In case of forward shifting of a tax burden, it lies on ______.

(a) Producer (b) Consumer

(c) Worker (d) All of them

5. An adverse effect on taxation is ______.

(a) Discourage willingness to work

(b) Discourage ability to work

(c) Discourage willingness and ability to produce

(d) All of these

6. Which is not the canon of public expenditure ______.

(a) Surplus (b) Sanction

(c) Economy (d) Convenience

7. Which of the following programmes aims at Financial Inclusion ______

(a) Public Provident Fund

(b) Atal Pension Yojana

(c) Mahatma Gandhi National Rural Employment Guarantee Act

(d) Pradhan Mantri Jan Dhan Yojana

8. Revenue expenditure do not include ______.

(a) Interest payment

(b) Subsidies

(c) Debt repayment

(d) Expenditure on civil administration

9. Fiscal Deficit = ______.

(a) Total Expenditure – Total Receipt

(b) Total Expenditure – (Revenue Receipts + Non borrowing Capital Receipts)

(c) Total Expenditure – Revenue Receipts

(d) Total Expenditure – Capital Receipts

10. Deficit financing is resorted when ______.

(a) Public Expenditure > Public Revenue

(b) Public Expenditure < Public Revenue

(c) Public Revenue = Public Expenditure

(d) None of these

Q.2 Answer any TWO of the following: **20**

(a) Explain the meaning and functions of Public Finance.

(b) Explain the limitations of the principle of Maximum Social Advantage.

(c) Examine the role of government in correcting market failure.

Q.3 Answer any TWO of the following: **20**

(a) Explain the objectives of taxation.

(b) How do elasticities of demand and supply affect the incidence of taxation ?

(c) Write a note on Taxation as Anti-inflationary measure.

Q.4 Answer any TWO of the following: **20**

(a) Explain the effects of public expenditure.

(b) Examine the causes for increasing public expenditure.

(c) Write a note on public debt management.

Q.5 Answer any TWO of the following: **20**

(a) What are the objectives of Fiscal Policy ?

(b) State the features of Functional Finance.

(c) Explain features of FRBM Act 2003.

ANSWERS

Answer 1 (A):

1. **Financial Administration**

Ans: Financial administration is the mechanism by which public revenue, public expenditure and public debt are carried out. It includes the organization and functioning of the government machinery which are responsible for carrying out the fiscal functions of the government. The budget is the instrument of financial administration.

2. **Net Social Advantage**

Ans: Net social advantage (NSA)is the difference between marginal social benefit (MSB) and marginal social sacrifice (MSS). As long as MSB is greater than MSS, NSA will be positive and will add to total social advantage. When MSS is equal to MSB, NSA is zero and maximum social advantage is achieved. When MSS is greater than MSB, NSB will be negative resulting in reduction in total social advantage.

3. **Regressive Taxation**

Ans: A regressive tax is one in which the rate falls as income increases. The tax payer, having higher income under regressive taxation system, contributes in smaller proportion and the tax payer with lower income contributes in larger proportion.

4. **Impact of Tax**

Ans: Impact of a tax is felt at the point where the tax first comes into contact with the tax payers. It is always on the person who is statutorily liable to pay the tax to the government. Impact of a tax refers to initial stage of tax burden.

5. **Revenue Expenditure**

Ans: Revenue expenditures are in the nature of consumption expenditure, incurred for current flow of goods and services and to maintain capital stock and assets. It is that expenditure which covers the routine administrative expenditure of the government, such as wages and salaries, interest payments, subsidies, defence etc.

6. **Concentration Effect**

Ans: Increasing tax tolerance on part of the people, leads to greater concentration of economic activities in the hands of the government. The central government takes upon itself to fulfill larger and larger state activities, reducing the role of state and local governments. This is referred to as ***concentration effect*** of increasing state activities.

7. **Zero Based Budget**

Ans: In zero based budget every item in the budget has to be re-evaluated starting from zero base. In a zero based budget all expenses must be justified for each year. The needs and costs of every function of the government department are taken into consideration for the next year's budget. It is used when resources are limited.

8. **Goods and Services Tax**

Ans: GST is an indirect tax on goods and services that came into effect in India in July 2017. GST has eliminated and subsumed the previous 17 central and state indirect taxes and 23 cesses.

Answer 1 (B) :

1 - (a), (2) - (a), (3) - (c), (4) - (b), (5) - (d), (6) - (d), (7) - (d), (8) - (c), (9) - (b), (10) - (a)

Answer 2 :

(a) According to Hugh Dalton, "public finance is concerned with the income and expenditures of public authorities and with theadjustment of one with the other."

According to Otto Eckstein, "public finance is the study of the effects of the budgets on the economy, particularly the effects on growth, stability, equity and efficiency."

Functions of Public Finance - Refer Chapter - 1 : 1.5.

(b) The principle of MSA states that public finance leads to maximum economic welfare when public expenditure and taxation are carried out up to that point where the benefits derived from the marginal utility of expenditure is equal to marginal disutility of the sacrifice imposed by taxation. When marginal social benefit of government expenditure is equal to marginal social sacrifice of the taxation the social welfare is maximum.

Limitations of the Principle of MSA - Refer Chapter - 2 : 2.5.

(c) Market failure is an economic term that involves a situation where, in any given market, the quantity of a product demanded by consumers does not equate to the quantity supplied by suppliers. Market failure occurs when resources are misallocated, or allocated inefficiently.

Role of Government in correcting Market Failure - Refer Chapter - 3: 3.5.

Answer 3 :

(a) A tax is a compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the tax payer in return, and not imposed as a penalty for any legal offence.

Objectives of Taxation - Refer Chapter - 4 : 4.3.

(b) Incidence of tax refers to the point where the ultimate burden of a tax actually settles. It is the final resting place of tax.

Elasticities of demand and supply affecting incidence of taxation - Refer Chapter - 5 : 5.3 (A).

(c) *Refer Chapter - 6 : 6.5.*

Answer 4 :

(a) The term public expenditure refers to the expenses incurred by public authorities at the Centre, State and local governments, in order to fulfil their obligation to the people of a nation. The ultimate objective of public expenditure should be the well being of the people.

Objectives of Public Expenditure - Refer Chapter - 7 : 7.4.

(b) *Refer Chapter - 8 : 8.2.*

(c) Public debt means the loans raised by the government. Public debt is considered to be an important source of income to the government in times of financial crisis, emergencies like war, droughts, etc. or when additional taxes are burdensome in the economy. It is one of the instruments to cover budget deficits.

Public Management - Refer Chapter - 10 : 10.3 [Public Debt Management].

Answer 5 :

(a) Fiscal policy is the part of government policy that deals with raising revenue through tax and non-tax sources and deciding on the level and pattern of public expenditure. Fiscal policy is composed of several parts. These include, tax policy, public expenditure policy, investment or disinvestment strategies and debt or surplus management.

Objectives of Fiscal Policy - Refer Chapter - 11 : 11.3.

(b) *Refer Chapter - 12 : 12.3.*

(c) *Refer Chapter - 13 : 13.6.*

OCTOBER - 2018 (ATKT)

Time : 3 Hours **Marks : 100**

N.B. (1) All questions are **compulsory.**

(2) All questions carry **equal marks.**

(3) Use of simple **calculator** is **permitted.**

(4) **Draw** neat **diagrams** wherever necessary.

Q.1 (A) Explain the following concepts : (Any Five) **10**

1. Distribution function
2. Economic efficiency
3. Tax base
4. Progressive tax rate
5. Redeemable debt
6. Fiscal solvency
7. Unbalanced budget
8. Fiscal deficit

Q.1 (B) Choose the right answer from the given options and rewrite the statement : 10

1. Public finance is a ______.
   (a) social science (b) fiscal science
   (c) political science (d) none of these
2. Production possibility curve is illustrated to explain ______
   (a) economic efficiency (b) government role
   (c) government policy (d) all of these
3. Tax is a ______.
   (a) compulsory payment (b) optional payment
   (c) political phenomenon (d) all of these
4. Special assessment also means ______.
   (a) tax revenue (b) betterment levy
   (c) VAT (d) fines
5. If the tax rate declines with an increase in tax base it is called ______.
   (a) proportional tax rate (b) regressive tax rate
   (c) progressive tax rate (d) degressive tax rate
6. Government expenditure on interest payment is an example of ______
   (a) productive expenditure (b) capital expenditure
   (c) unproductive expenditure (d) security expenditure
7. The "Law of increasing state expenditure" was put forward by ______
   (a) Hugh Dalton (b) Adolph Wagner
   (c) Jack Wiseman (d) Alan Peacock
8. Social security schemes cover ______.
   (a) pension and health insurance
   (b) disability benefits
   (c) medical benefits
   (d) all of these
9. Primary deficit is fiscal deficit less ______.
   (a) interest payments (b) interest receipts
   (c) debt repayment (d) none of these

10. The 14th finance commission was set up under the chairmanship of ______.
    - (a) Pranab Mukherjee
    - (b) Rajiv Kumar
    - (c) Arvind Panagariya
    - (d) Dr. Y.V. Reddy

Q.2 Answer any TWO of the following: 20

- **(a)** Discuss the meaning and scope of public finance.
- **(b)** Explain Dalton's Principle of Maximum Social Advantage.
- **(c)** Examine the features of public goods and state the role of the government in providing them.

Q.3 Answer any TWO of the following: 20

- **(a)** Explain the various canons of taxation.
- **(b)** Examine the process of shifting and incidence of tax with respect to elasticities of demand and supply.
- **(c)** Analyse the economic effects of taxation.

Q.4 Answer any TWO of the following: 20

- **(a)** Explain the classification of public expenditure.
- **(b)** Trace the causes of growth in public expenditure.
- **(c)** Examine the burden of public debt.

Q.5 Answer any TWO of the following: 20

- **(a)** Examine the features of functional finance.
- **(b)** Explain the different types of budget.
- **(c)** Outline the key issues in fiscal federalism and decentralization.

ANSWERS

Answer 1 (A):

1. **Distribution function**: Taxation and public expenditure policies are used by the government to reduce inequalities and bring about better distribution of national income and resources. This is referred to as distribution function of public finance.

2. **Economic efficiency**: Economic efficiency ensures that the society is getting the maximum benefits from the scares resources available. In a free market economy this is achieved through the best possible resource allocation and production of optimum output. It is ensured when the economy achieves productive and allocation efficiency.

3. **Tax base:** Tax base is the level of income or wealth on which a tax charged. It is the minimum income or value or assets which is treated as base for imposing tax.

4. **Progressive tax rate:** Progressive tax is one under which tax rate goes on increasing with increasing in income. The tax liability increases with increase in income. A progressive tax tries to distribute the sacrifice caused due to taxation in a more just manner.

5. **Redeemable debt:** Redeemable debt is repaid at some specified future date and therefore, government has to make arrangement for repayment of interest and principal amount within a specific time period. These loans terminable.

6. **Fiscal solvency:** Fiscal solvency refers to the government's possession of assets in excess of its liabilities and its ability to meet debt obligation. Fiscal solvency ensures fiscal sustainability of a government.

7. **Unbalanced budget:** When the government's receipts and expenditures are not equal the budget is said to be unbalance. An unbalanced budget can be a surplus budget or a deficit budget. When taxes and other revenues exceed public expenditure, it is a surplus budget and when expenditures exceed revenue, it is a deficit budget.

8. **Fiscal deficit:** Fiscal deficit is the excess of total government expenditure (both revenue and capital) over revenue receipts and non-borrowing capital receipts, like recovery of loans, sale proceeds from disinvestment of government assets. It is the most comprehensive measurement of the budgetary imbalance.

   Fiscal Deficit = Total Expenditure – Total Receipts Net of Borrowings

Answer 1 (B) :

1 - (b), (2) - (a), (3) - (a), (4) - (b), (5) - (b), (6) - (c), (7) - (b), (8) - (d), (9) - (a), (10) - (d)

Answer 2 :

(a) Public finance deals with expenditure and income of public authorities of the state and their mutual relation as also with the financial administration and control. It is the study of the effects of the budgets on the economy, particularly the effects on growth, stability, equity and efficiency.

Scope of Public Finance : Fiscal operational areas - Refer Chapter - 1: 1.4.

(b) According to Hugh Dalton, the main objective of public finance is the maximization of social advantage. The best system of public finance is that which secures the maximum social advantage from the operations which it conducts.

Dalton's Principle of Maximum Social Advantage : Refer Chapter - 2 : 2.2.

(c) Market failure is an economic term that involves a situation where in any given market the quantity of a product demanded does not equate the quantity supplied. It occurs when resources are misallocated. Markets do not function in the usual manner due to various factor, one of them being the availability of public goods.

Public Goods : Refer Chapter - 3 : 3.4.

Answer 3 :

(a) Taxation is not only a source of revenue to the government but is also used to achieve objectives like redistribution of income, generate employment, achieve economic growth and stability. Canons of taxation describe characteristics of a good system.

Canon of Taxation : Refer Chapter - 4 : 4.4.

(b) In case of indirect taxes, though the tax is levied on the producer or the seller, the final burden of such taxes can be shifted to the consumer through the price. Incidence of tax refers to the point where the final or ultimate burden of a tax actually settles. The process of passing on the tax burden on someone else is referred to as shifting. Elasticity of demand and supply determine how much burden can be shifted to the consumers in a competitive market.

Refer Chapter - 5 : 5.3 (A).

(c) ***Refer Chapter - 6 : 6.1, 6.2 and 6.3.***

Answer 4 :

(a) The public expenditure refers to the expenses incurred by public authorities at the centre, state and local governments, in order to fulfill their obligations to the people. The classification of public expenditure is the systematic arrangement of different items of public expenditure on certain criteria.

Refer Chapter - 7 : 7.3.

(b) ***Refer Chapter - 8 : 8.2.***

(c) Public debt constitutes the financial obligation or liability of the government. The burden of public debt is associated with repayment of principal amount with interest.

Refer Chapter - 10 : 10.2 - A, B and C.

Answer 5 :

(a) The view that fiscal policy can be used to offset undesirable cyclical fluctuations in output is termed as functional finance.

Features of Functional Finance : Refer Chapter - 12 : 12.3.

(b) A public budget is a proposal of the government's planned expenditure and expected revenues from taxes and other sources during a given year.

Types of Budget : Refer Chapter - 13 : 13.3.

(c) Fiscal federalism is the study of how expenditures and revenues are allocated across different layers of administration. Fiscal decentralization refers to the transfer of taxing and expenditure powers from the control of central government authorities at sub-national levels.

Refer Chapter - 14 : 14.2.

APRIL - 2019

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(2) **All** questions carry **equal marks.**

(3) **Use** of simple **calculator** is **permitted.**

(4) **Draw** neat **diagrams** wherever necessary.

Q.1 (A) Explain the following concepts : (Any Five) **10**

1. Allocation Function
2. Production Efficiency
3. Progressive Tax Rate
4. Direct Tax
5. Cannon of Sanction
6. Tax tolerance
7. Revenue Budget
8. Functional Finance

Q.1 (B) Choose the right answer from the given options and rewrite the statement : **10**

1. Taxes are subject to increasing ______.
   (a) Marginal Social Sacrifice (b) Marginal Social Benefit
   (c) Both (a) and (b) (d) None of these
2. When the size of the budget is optimum then ______.
   (a) MSS < MSB (b) MSS > MSB
   (c) MSS = MSB (d) None of these
3. Direct taxes are ______.
   (a) Unproductive (b) Elastic
   (c) Contributed by all (d) All of these
4. Special levy means ______.
   (a) Tax on all people (b) Charges for specific benefits
   (c) Gift tax (d) None of these
5. GST has replaced a variety of
   (a) Direct Taxes (b) Indirect Taxes
   (c) Fees (d) Fines
6. Public expenditure should be incurred to reduce
   (a) Production (b) Employment
   (c) Income Inequality (d) Deficit Financing
7. Jack Wiseman and Alan T. Peacock carried out study on
   (a) Public borrowing (b) Taxation
   (c) Public expenditure (d) Deficit Financing
8. Sound Finance follow
   (a) Balanced Budget (b) Unbalanced Budget
   (c) Unified Budget (d) Multiple Budget
9. The key issue of Fiscal Federalism is
   (a) Only Revenue assignment
   (b) Revenue and expenditure assignment
   (c) Only expenditure assignment
   (d) None of these

10. Primary deficit is Fiscal Deficit less
    (a) Interest receipts (b) Interest payments
    (c) Subsidies (d) Defence expenditure

Q.2 Answer any TWO of the following: **20**

(a) Define Public Finance and its scope. $, 6, 7

(b) Explain the principle of Maximum Social Advantage as stated by Hugh Dalton, with assumptions and diagrams. 15 to 19

(c) Examine the role of government in correcting market failure.

Q.3 Answer any TWO of the following: **20**

(a) Explain the sources of Public Revenue. 50 to 56.

(b) Explain the process of tax shifting and incidence of tax with reference to elasticities of demand and supply. 85 to 88. 92

(c) What are economic effects of taxation? 100 to 104

Q.4 Answer any TWO of the following: **20**

(a) Explain different classification of public expenditure. 113 to 116

(b) Explain the social security programmes.

(c) Explain the burden of Public debt. 148 to 152

Q.5 : Answer any TWO of the following: **20**

(a) Explain the types of deficits in the budget. 200 to 202.

(b) Explain the features of Sound Finance.

(c) What are the basic characteristics of FRBM Act 2003? 175 to 177

ANSWERS

Answer 1 (A):

1. **Allocation Function:** The most important function of fiscal operations is to determine how the resources of the country will be allocated to different sectors of the economy in order to achieve predetermined goals. Allocation of resources depends upon the collection of revenue and the size and composition of public expenditure.

2. **Production Efficiency:** Productivity efficiency in an economy is achieved when it is impossible to reallocate resources to produce more of one product without producing less of the other product. It is explained with the help of the production possibility curve (PPC). It is achieved when an economy produces at any point on its PPC.

3. **Progressive Tax Rate:** Progressive tax is one under which tax rate goes on increasing with increasing in income. The tax liability increases with increase in income. A progressive tax tries to distribute the sacrifice caused due to taxation in a more just manner.

4. **Direct Tax:** Direct tax is a tax whose impact and incidence are on the same person and it is not possible to shift the burden of such a tax. Direct taxes are usually progressive in nature, that is, the burden of tax is more on the rich than on the poor. Example, income tax, corporate tax, wealth tax.

5. **Cannon of Sanction:** Every item of public expenditure must have prior approval of the appropriate authorities in order to prevent misusage and wastage of resources. The authorities sanctioning public expenditure should also have the power to ensure that the funds sanctioned are being used for the right purpose.

6. **Tax tolerance:** This is an effect described by Wiseman and Peacock while explaining the step-like manner in which public expenditure increases. During a war the government may impose higher and additional taxes to finance the war. After the war, the new tax rate and structure may remain the same. People get used to the expanded tax burden and accept them. This is known as tax tolerance.

7. **Revenue Budget:** revenue budget covers those items which are of recurring nature. It consists of revenue receipts and revenue expenditure. Revenue receipts include tax and non-tax revenues. Revenue expenditures are administrative expenditure, subsidies, interest payments etc.

8. **Functional Finance:** The view that fiscal policy can be used to offset undesirable cyclical fluctuations in output is termed as functional finance. Some of the fundamental beliefs of functional finance are importance of fiscal policy, the possibility of market failure, role of aggregate demand in determining national income, use of unbalanced budget to stabilize the economy, welfare capitalism, income redistribution.

Answer 1 (B) :

1 - (a), (2) - (c), (3) - (b), (4) - (b), (5) - (b), (6) - (c), (7) - (c), (8) - (a), (9) - (b), (10) - (b)

Answer 2 :

(a) Public finance deals with expenditure and income of public authorities of the state and their mutual relation as also with the financial administration and control. It is the study of the effects of the budgets on the economy, particularly the effects on growth, stability, equity and efficiency.

Scope of Public Finance : Fiscal Operational Areas - Refer Chapter - 1 : 1.4.

(b) According to Hugh Dalton, the main objective of public finance is the maximization of social advantage. The best system of public finance is that which secures the maximum social advantage from the operations which it conducts.

Dalton's Principle of Maximum Social Advantage : Refer Chapter - 2 : 2.2.

(c) Market failure is an economic term that involves a situation where in any given market the quantity of a product demanded does not equate the quantity supplied. It occurs when resources are misallocated. Markets do not function in the usual manner due to various factors like need to create public goods, externalities, asymmetric information, inequalities, market power, provision of merit goods, missing and incomplete markets and property rights. The government needs to intervene in the market to correct market failure.

Role of Government : Refer Chapter - 3 : 3.5.

Answer 3 :

(a) *Refer Chapter - 4 : 4.2.*

(b) In case of indirect taxes, though the tax is levied on the producer or the seller, the final burden of such taxes can be shifted to the consumer through the price. Incidence of tax refers to the point where the final or ultimate burden of a tax actually settles. The process of passing on the tax burden on someone else is referred to as shifting. Elasticity of demand and supply determine how much burden can be shifted to the consumers in a competitive market.

Refer Chapter - 5 : 5.3 (A).

(c) *Refer Chapter - 6 : 6.1, 6.2 and 6.3.*

Answer 4 :

(a) Public expenditure refers to the expenses incurred by public authorities at the centre, state and local governments, in order to fulfill their obligations to the people. The classification of public expenditure is the systematic arrangement of different items of public expenditure on certain criteria.

Refer Chapter - 7 : 7.3.

(b) Social security and social insurance programmes are designed to support low income groups of people.

Refer Chapter - 9 : 9.2.

(c) Public debt constitutes the financial obligation or liability of the government. The burden of public debt is associated with repayment of principal amount with interest.

Refer Chapter - 10 : 10.2 A, B and C.

Answer 5 :

(a) When public expenditure exceeds public revenue, there is a deficit in the budget. Deficits are financed through public borrowing.

Types of Deficit : Refer Chapter - 13 : 13.5.

(b) Sound finance is a system of finance wherein the role of the government is expected to be restricted to traditional areas like defence, law and order, justice and provision of civic amenities. The best budget is believed to be a one that is small in size and is balanced. In other word, sound finance is based on the principle of minimal government intervention and dominant role of free market.

Features: Refer Chapter - 12 : 12.2.

(c) The Fiscal Responsibility and Budget Management Act was enacted in 2003 to reduce public expenditure, public borrowing and reduce deficits.

Basic Characteristics : Refer Chapter - 13 : 13.6.