SFG – FRC for CSE 2024 | Eco #2 – Solutions | ForumIAS

Q.1)

Exp) Option b is the correct answer.

Statement 1 is incorrect: The FRBM Act was enacted in 2003 and in 2016. The FRBM Review Committee was formed by government in 2016 under the chairmanship of a former Revenue and Expenditure Secretary Nand Kishore Singh which submitted its report in 2017. But there is no such provision in the FRBM Act to form such Review Committee every five years from the enactment of Act.

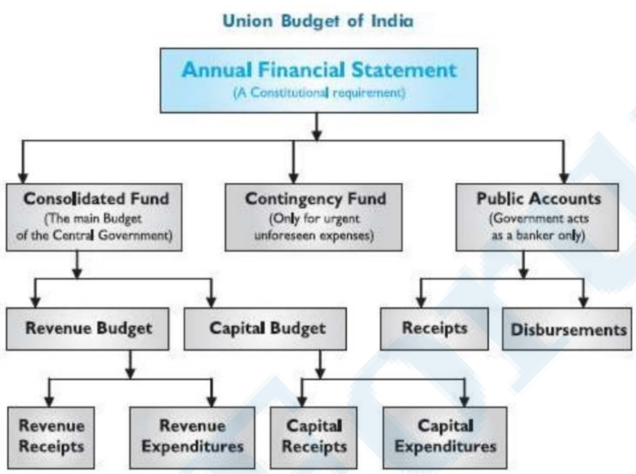
Statement 2 is correct: The committee recommended that the combined debt-to-GDP ratio of the Centre and states should be brought down to around 60 per cent (comprising 40 per cent for the Centre and 20% for states).

Statement 3 is correct: The Committee advocated formation of institutions to ensure fiscal prudence in accordance with the FRBM spirit through setting up an independent Fiscal Council. The Council will provide to central government several advisory functions such as whether conditions exist to permit a deviation for invocation in the escape or buoyancy clause

Q.3)

Exp) Option d is the correct answer.

Reduced government expenditure refers to a **decrease in the amount of money** that a government spends on all types of items, including **goods and services, subsidies, welfare schemes, and interest payments.**



Statement 1 is correct- When the government **privatizes a loss-making Public Sector Enterprise (PSE), it sells it to a private company.** This reduces government expenditure in two ways: 1) The government no longer needs to subsidize the PSE's losses, and 2) The private company often runs the PSE more efficiently, cutting costs.

Statement 2 is correct- Cutting defense imports can decrease government spending in three ways: by **saving foreign exchange reserves, promoting domestic production for job creation and economic growth, and reducing reliance on foreign suppliers**, enhancing strategic independence and resilience against supply chain disruptions.

Statement 3 is correct- Fuel subsidies mean that the government **gives money to businesses or people to make fuel (like gasoline, diesel, or gas for cooking) cheaper**. Fuel subsidies can be a major drain on government finances. Reducing or eliminating fuel subsidies can reduce government expenditure.

Statement 4 is correct- Zero-based budgeting is a process in which governments start each budget cycle from **scratch, justifying every expense.** This can help to **identify and eliminate unnecessary spending**.

Q.5)

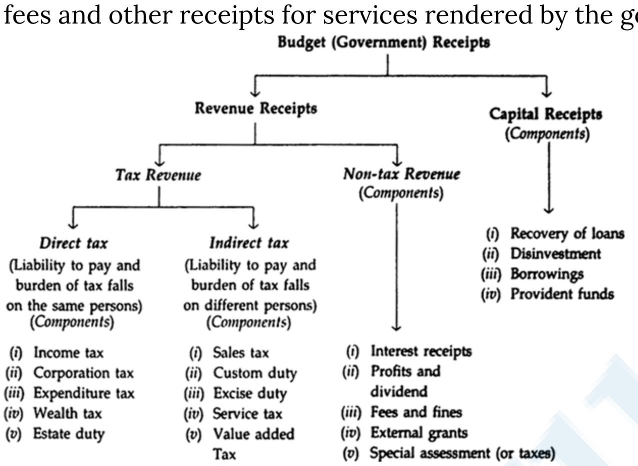
Exp) Option b is the correct answer.

Non-tax revenue refers to the income generated by a government from sources other than taxation. Non-tax revenue contributes to the government's overall income and is used to support public programs, services, and infrastructure development. Tax revenue is the income generated by a government through the imposition of taxes on individuals, businesses, or other entities.

Option 1 is correct. Grants-in-aid from foreign countries are considered non-tax revenue. Aid from any source, foreign or domestic, is categorized under non-tax revenue because aid does not need to be returned.

Option 2 is incorrect. Customs Duties are taxes collected on goods imported into the country, hence it **is tax revenue.**

Option 3 is correct. Fees and Fines are non-tax revenue of government. Fees and fines are the charges that cover the cost of recurring services that are provided and imposed by the government. These are the fees and other receipts for services rendered by the government.



Q.9)

Exp) Option b is the correct answer.

Option a is incorrect: A corporate entity intentionally borrows funds with the goal of reducing its tax liabilities, **is not related to the concept of debt trap.** An entity, by incurring interest expenses on the borrowed funds, can deduct those expenses from its taxable income, thereby lowering its overall tax liabilities.

Option b is correct: A **debt trap** is a situation in which someone is **compelled to continuously borrow more funds to settle their current debts.** Gradually, they find themselves caught in a situation where their debt accumulates uncontrollably, surpassing their ability to repay, leading to entrapment in a vicious cycle of debt. Thus, **borrowing by the Government mainly to meet its existing debt obligations** is an example of debt trap.

Option c is incorrect: Evergreening of loans is a practice where banks provide new loans or extend existing ones to a borrower who is struggling to meet their debt obligations. The purpose is to prevent the borrower's loans from being classified as bad debt or Non-Performing Assets (NPAs). By providing new loans, it can temporarily appear that the borrower is servicing their debts, even though the underlying financial health may be deteriorating.

Option d is incorrect: Haircut refers to the reduction in the **value of collateral assets that a bank or lender accepts to settle a loan or debt.** When a borrower defaults or is unable to repay their loan in full, the lender may seize and sell the collateral assets to recover as much of the outstanding debt as possible. The difference between the loan amount and the actual value of the collateral is the haircut.

Q.10)

Exp) Option c is the correct answer.

Statement 1 is correct: Off Budget Borrowings are the l**oans taken by government owned entities like Central Public Sector Enterprises (CPSEs)** on the **directions of the government** in order to **supplement the expenditure made by the government.**

Statement 2 is incorrect: Even though these borrowings have implications on government finances and macroeconomic stability, they are **not included in the Fiscal Deficit**. This is the reason they are called Off Budget or Extra-Budgetary Borrowings.

Statement 3 is correct: The i**nterest** as well as the **principal amoun**t incurred through such borrowings is the **liability of the Central Government** and has to be **paid from government resources/ budget itself (Consolidated Fund of India).** This is why off budget borrowings have implications for public finances and macroeconomic stability.

Statement 4 is correct: The **Parliament controls the Executive**, that is the Government by **restricting their appropriation of public funds collected via taxes, fees, etc from the citizens, from the Consolidated Fund of India.** However if the Executive uses alternative routes like directing CPSEs to take loans, which **are not a part of deficits or budget calculations, the legislature will not thus be able to question or control government expenditure or its quality (productive or wasteful)**, thus **reducing their accountability** to citizens.

Q.12)

Exp) Option a is the correct answer.

Statement a is correct: The fiscal deficit is the difference between the government's overall expenditure and its total receipts, without considering borrowing. It is a critical indicator of a government's financial health, showing how much, it needs to borrow to cover the shortfall. A high fiscal deficit may indicate financial instability, while a lower one implies better fiscal management.

Fiscal deficit = Total expenditure - Total receipts (excluding borrowings)

Statement b is incorrect: The Effective Revenue Deficit (not the Fiscal Deficit) is calculated by subtracting the grants for capital asset creation from the revenue deficit. It provides a more accurate reflection of the government's revenue spending, excluding expenditures related to capital investments. This concept is particularly important when analyzing the quality of government spending, as it focuses on recurring revenue expenses rather than capital investments, which can vary significantly from year to year. The government of India has stopped calculating the Effective Revenue Deficit in the Budget statement.

Statement c is incorrect: Monetized deficit (not the Fiscal Deficit) refers to the portion of the fiscal deficit that is financed by borrowing from the Reserve Bank of India (RBI). It represents the monetary support provided by the RBI to the government, involving the purchase of government bonds to cover the government's spending requirements.

Statement d is incorrect: The formula for Fiscal Deficit, as correctly stated, is:

Fiscal Deficit = Revenue Deficit + Capital Expenditure - Non-debt creating capital receipts

Non-debt creating capital receipts are sources of income for the government that do not result in the accumulation of debt. Examples include the recovery of loans and the proceeds from the sale of Public Sector Undertakings (PSUs). These receipts do not contribute to the government's overall debt burden, making them different from borrowings, which do increase the debt.

Knowledge Base:

Formulae for calculating fiscal deficit:

Fiscal deficit = Total expenditure - Total receipts (excluding borrowings).

Fiscal deficit = (Revenue expenditure + Capital expenditure) - (Revenue receipts + Capital receipts excluding borrowings).
Fiscal deficit = (Revenue expenditure - Revenue receipts) + (Capital expenditure - Capital receipts excluding borrowings).
Fiscal deficit = Revenue deficit + (Capital expenditure - Capital receipts excluding borrowings).

Q.19)
Exp) Option b is the correct answer.
Option a is incorrect: To differentiate between sources of income of Union and State Governments is not the primary purpose of the Capital and Revenue classification. While the source of funds for each type of expenditure may differ, the classification focuses on the nature of the expenditure itself.
Option b is correct: Capital expenditure is generally associated with the creation of assets that will benefit the government for more than one year. This includes infrastructure projects like buildings and bridges, purchase of machinery and equipment, and investments in research and development.
Revenue expenditure, on the other hand, covers the ongoing expenses of the government's day-to-day functioning. This includes salaries, pensions, interest payments, subsidies, and other administrative costs.
Therefore, the primary concept behind classifying a budget into Capital and Revenue components is to distinguish between investments that generate long-term benefits and regular expenses incurred for the government's routine operations.
Option c is incorrect: The distinction between capital and revenue budgets is primarily based on differentiating between long-term investments and routine operational expenses, rather than planned or non-planned activities. In fact, the classification of **planned and non-planned expenditure applies to both revenue and capital budgets.**
Option d is incorrect: While the Capital and Revenue classification can be used to inform budget allocation decisions, it is not the primary objective. The efficiency and effectiveness of budget allocation depends on various factors beyond this classification.

Q.23)
Exp) option b is the correct answer.
Effective Revenue Deficit is the difference between revenue deficit and grants for creation of capital assets. The concept of effective revenue deficit has been suggested by the Rangarajan Committee on Public Expenditure.
Option a is incorrect. If the balance of total revenue receipts and total revenue expenditures turns out to be negative it is known as revenue deficit, a new fiscal terminology used since the fiscal 1997–98 in India.
Option b is correct. Effective Revenue Deficit is the difference between revenue deficit and grants for creation of capital assets. In the 2012-13 budget, the concept of effective revenue deficit was introduced that excluded grants for the creation of capital assets from conventional revenue deficit.
Option c is incorrect. When the balance of the government's total receipts (i.e., revenue + capital receipts) and total expenditures (i.e., revenue + capital expenditures) turns out to be negative, it shows the situation of fiscal deficit, a concept being used since the fiscal 1997–98 in India.
Option d is incorrect. The fiscal deficit excluding the interest liabilities for a year is the primary deficit, a term India started using since the fiscal 1997–98.

Q.28)
Exp) Option b is the correct answer.
There has been a divergence between the official tax rate and effective tax rate in India—defined as the ratio of total tax collected to the aggregate tax base. The divergence occurs mainly on account of tax

exemptions. Tax expenditure also called revenue forgone refers to the opportunity cost of taxing at concessional rates. It includes providing exemptions, deductions, rebates, etc. to the taxpayers.

Statement a is incorrect: Tax Expenditure as the meaning of the word seems, is **not related to the expenditures incurred by the Government** in the tax collection exercise. It denotes concessions provided by the government to the taxpayers.

Statement b is correct: Tax expenditures refers to government revenue losses from various tax exclusions, and exemptions.

Tax expenditures lower the tax burden of individuals or businesses, through an exemption, deduction etc. But such forgone taxes do not necessarily mean that they have been waived off by the government. Better, it should be interpreted as incentives given by the government to promote certain sectors, in the absence of which they may not have come up.

Statement c is incorrect: Tax evasion means reduced liability by illegal means for the purpose of tax payment by an individual. It is not related to tax expenditure as the latter is provided by the government under taxation laws.

Statement d is incorrect: Expenditure on acquisition of assets like machines, roads, buildings etc. is called capital expenditure (not the tax expenditure). It is part of the annual budget statement of the government mainly focusing on infrastructure creation.

Q.35)

Exp) Option d is the correct answer.

Statement a is incorrect. Post Devolution Revenue Deficit Grants are not provided for development related projects and schemes. These are provided to states to meet the gap in Revenue Accounts of the states post devolution.

Statement b is incorrect. The Finance Commission decides the state's eligibility to receive this grants. This is based on the gap between assessment of revenue and expenditure of the State after taking into account the assessed devolution for the current financial year. So, it is not provided to all states.

Statement c is incorrect. The eligibility of States to receive this grant and the quantum of grant was decided by the Commission based on the gap between assessment of revenue and expenditure of the State after taking into account the assessed devolution. Statement d is correct. The grants are released in monthly instalments as per the recommendations of the Finance Commission to meet the gap in Revenue Accounts of the States post devolution

Q.44)

Exp) Option b is the correct answer

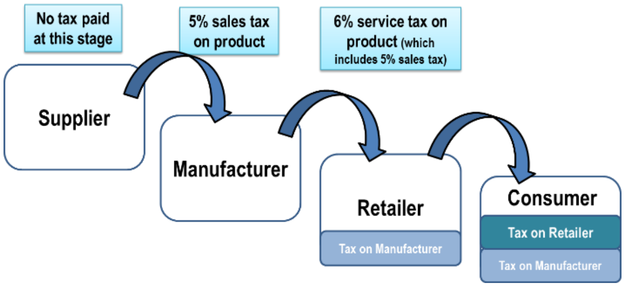
Fiscal stimulus is an action taken by government to increase aggregate demand in the economy. It can be in form of tax cuts or increased public spending. Fiscal stimulus also refers to policy measures undertaken by a government that typically reduce taxes or regulations—or increase government spending—in order to boost economic activity.

Q.46)

Exp) Option b is the correct answer.

United States of America tax refers to a system that imposes sales taxes on products at each successive stage in the supply chain from raw material to consumer purchase.

The term "cascading effect of taxes" refers to a situation where taxes are levied at multiple stages of production or distribution, **resulting in a cumulative impact on the final price of a product or service (rise in the price of the product).** Also known as "tax pyramiding" or "tax cascading," this effect can occur when a tax is imposed on each transaction or transfer of goods or services within a supply chain.



Q.48)

Exp) option d is the correct answer.

Under the concept of Effective capital expenditure the direct capital investment by the Centre is complemented by the provision for creating capital assets through Grants-in-Aid to States. "Effective Capital Expenditure" of the Centre would be budgeted at Rs.13.77 lakh crore i.e. 4.5% of GDP.

Option a is incorrect. A capital expenditure, or Capex, is money invested by a company to acquire or upgrade fixed, physical or non-consumable assets. Capex is used to buy or invest in tangible capital assets, such as real estate; raw materials, and plant, property and equipment (PP&E).

Option b is incorrect. Revenue Expenditure is the part of government spending that **does not result in the production of assets**. Salaries, wages, pensions, subsidies, and interest payments are all instances of revenue expenditures. In simple terms, it is the total cost incurred by a company in producing goods and services that contributes to revenue generation during a given accounting period.

Option c is incorrect. Effective Revenue Deficit is the difference between revenue deficit and grants for **creation of capital assets**. The concept of effective revenue deficit has been suggested by the Rangarajan Committee on Public Expenditure.

Option d is correct. **Effective capital expenditure** is defined as the **sum of capital expenditure and grants in aid for creation of capital assets**. To capture the true extent of public investment by the central government, a concept of 'effective capital expenditure' has been introduced. It is budgeted at Rs 13.7 lakh crore or 4.5% of GDP (Union Budget 2023-24).

Q.49)

Exp) Option a is the correct answer

Monetary policy is a set of tools used by a nation's central bank to control the **overall money supply and promote economic growth** and employ strategies such as **revising interest rates** and changing bank reserve requirements.

Statement 1 is correct: An accommodative stance means the central bank is prepared to **expand the money supply** to boost economic growth by **lowering the interest rate.** The central bank typically adopts an accommodative stance when **growth needs policy support and inflation is not the immediate concern.**

Statement 2 is incorrect: A hawkish policy also indicates tight monetary policy. A hawkish stance indicates that the central bank's top priority is to keep the inflation low. During such a phase, the **central bank is willing to hike interest rates to curb money supply and thus reduce the demand.**

Neutral Stance means that the central bank can **neither cut rate or increase interest rate**. This stance is typically adopted when the **policy priority is equal to both inflation and growth.**

Statement 3 is incorrect: In the Calibrated tightening stance of RBI, the rate hike will happen in a calibrated manner. This means the central bank may not go for a rate increase in every policy meeting but the **overall policy stance is tilted towards a rate hike.** Thus calibrate tightening does not mean rapid increase in interest rate to fight situations like hyperinflation.

Q.58)

Exp) Option c is correct.

Performance-based budgeting is the **allocation of funds based on programmatic results that contribute to organizational goals.** For governments, performance-based budgeting uses evidence to maximize the allocation of funds toward programs that work and away from those that don't. Performance-based budgeting is not intended to punish or reward departments or agencies, but instead to focus on progress toward measurable goals during the budget process.

Objectives of Performance Based Budgeting:

1. correlate the physical and financial aspects of programmes and activities;
2. improve budget formulation, review and decision-making at all levels of management in the government machinery;
3. facilitate better appreciation and review by the legislature;
4. make possible more effective performance audit;
5. measure progress towards long-term objectives as envisaged in the plan; and
6. bring annual budgets and developmental plans together through a common language**.**

Knowledge Base:

Other Types of Budgets

- **Zero Based Budgeting:** Zero-based budgeting is a method of budgeting in which all expenses are evaluated each time a Budget is made and expenses must be justified for each new period. Zero budgeting starts from the zero base and every function of the government is analysed for its needs and cost. Budget is then made based on the needs.
- **Outcome Budget**: Outcome Budget analyses the progress of each ministry and department and what the respected ministry has done with its Budget outlay. It measures the development outcomes of all government programs. It was first introduced in the year 2005.
- **Gender Budgeting:** The gender-budgeting is defined as "gender-based assessment of Budgets, incorporating a gender perspective at all levels of the budgetary process and restructuring revenues and expenditures in order to promote gender equality". It is actually budgeting for gender equity. Through Gender Budget, the Government declares an amount to be spent over the development, Welfare, Empowerment schemes and programmes for Females.