Corrigendum/Explanation SFG 2025 Level 1 Test 16

There are no changes to the solutions/answers. Explanations have been provided for the students who have raised doubts.

In Q.36) There was a doubt raised with respect to Statement 1 of the question that Tax elasticity refers to the change in tax revenue in response to changes in tax rate.
Explanation-Statement 1 is incorrect. As per the International Monetary Fund the elasticity of a tax measures the **automatic response of tax revenue to changes in the tax base. The elasticity excludes the effects of discretionary changes in the tax structure (tax rates, coverage, exemptions, and deductions) or administration, as well as the introduction of new taxes.**
Tax elasticity is also defined as the automatic response of tax revenue to GDP changes **less the discretionary tax changes.** So, it would be incorrect to say that the tax elasticity refers to the change in tax revenue in response to change in tax rate because it **excludes the effects of discretionary changes in the tax structure** (tax rates, coverage, exemptions, and deductions) or administration, as well as the introduction of new taxes.
Note: At different sources we have noted an oversimplified definition of Tax elasticity has been given, they have not taken into consideration that tax elasticity excludes the effects of discretionary changes in the tax structure.
Source: https://www.imf.org/external/region/tlm/rr/pdf/aug3.pdf
https://mof.portal.gov.bd/sites/default/files/files/mof.portal.gov.bd/page/17643e1a_542c_47c8_a833_91a90d156ac7/chapter3.pdf

In Q.44) There was a doubt raised regarding the explanation part of the second row that the Reserve Bank of India increases or decreases the money supply for reflation.
Explanation- Reflation in the economy is required when there is a situation of deflation in the economy and the central bank needs to introduce measures to generate the inflationary force in the economy. For the reflation in the economy, the Reserve Bank of India (RBI) **increases the money supply** and tries to decrease overall interest rates **by decreasing the repo rate to facilitate the growth in an economy.**

For Future Reference:

Q.44) With reference to Indian economy, consider the following information

Term	Refers to	Action taken by Reserve Bank of India
1. Stagflation	Inflationary phase with stagnant economic growth	Significantly decreasing the repo rate
2. Reflation	Phase when the inflation increases in a seasonal pattern.	Increasing the repo rate
3. Disinflation	characterized by a decrease in the rate of inflation	significantly increasing the repo rates and selling government securities in market

In how many of the above rows is the given information correctly matched?

a) Only one
b) Only two
c) All three
d) None

Ans) d
Exp) Option d is the correct answer.
Row 1 is incorrect: Stagflation (stagnation plus inflation) refers to the situation where an economy grows very slowly or at near zero rate (stagnant) and prices keep rising. It presents a unique challenge for central banks because the usual tools to combat inflation (raising interest rates) can further hurt growth, and the tools to stimulate growth (lowering interest rates or increasing money supply) can worsen inflation. Hence rather than changing the inflation rate, the stagflation has to be addressed from the supply side of the economy by boosting production. **The RBI's response to stagflation involves a mix of tightening monetary policy (repo rate hikes) to control inflation while also addressing supply-side constraints to support growth.**
Row 2 is incorrect: Reflation is a monetary or fiscal policy that aims to stimulate the economy and combat deflation. **It can also refer to the period of economic expansion that follows a recession.** During this phase, the Reserve Bank of India (RBI) **increases the money supply by decreasing the repo rate to facilitate the growth in an economy.**
Row 3 is incorrect: D**isinflation is an economic phenomenon characterized by a decrease in the rate of inflation**, implying a slowdown in the increase of general price levels over a certain period, yet maintaining a positive inflation rate. If **RBI significantly increases the repo rate and starts selling government securities in a situation of disinflation then it may further boost the disinflation as the money supply in the market and the demand in the market may further decline, and the economy may fall in the trap of deflation**. In case of disinflation RBI generally keeps the repo rate unchanged in the short term till the targets of inflation as per the Monetary Policy are achieved. If the inflation further falls below the desired target of 4 percent then RBI may decrease the repo rate to boost the demand in the economy.
Source: Indian Economy Redbook- Ch: 3 - Inflation, Pg: 25
Subject:) Economy
Topic:) Inflation
Subtopic:)