Key answers and Explanations

Unit – 6
Government Budget and the Economy

1. a) Subsidies
2. b) The difference between the government's total expenditure and total receipts excluding borrowings
3. d) Tax revenue
4. c) Revenue Deficit
5. c) Investment in roads and bridges
6. c) The government's borrowing requirement excluding interest payments
7. b) Fiscal deficit includes primary deficit plus interest payments
8. c) Borrowings from RBI
9. c) To balance government revenue and expenditure
10. c) To manage the country's financial resources and allocate them to priority areas
11. c) By allocating funds for infrastructure and industrial development
12. b) To achieve price stability through controlling inflation
13. b) Progressive taxation and social welfare programs
14. a) Ensuring that the deficit stays at a manageable level
15. b) Managing inflation and unemployment
16. a) Ensuring that the country's import and export values are equal
17. c) Ensuring that borrowing is sustainable and does not burden future generations
18. b) Allocating funds for healthcare, education, and poverty alleviation
19. b) The distribution of financial resources among different sectors of the economy based on priorities
20. b) Borrowings from the public
21. a) Creation of assets
22. b) Construction of roads and bridges
23. b) Investments that aim to promote economic growth
24. c) Interest payments on public debt
25. c) Funding for education and healthcare
26. a) Non-developmental expenditure
27. c) Generated from day-to-day government activities
28. b) Interest payments on government borrowings
29. b) Investment in the development of public services like education
30. d) They include taxes collected by the government
31. a) It may limit the government's ability to stimulate the economy during recessions.
32. b) Higher public debt and interest payments
33. b) Economic growth slowdown due to underinvestment
34. b) Borrow from external or domestic sources
35. c) Paying off existing public debt
36. b) The economy is in a recession and needs a fiscal stimulus
37. c) It avoids inflationary pressures caused by excessive government spending
38. c) Reduced government debt

39. b) The government borrows money to meet its expenditure needs
40. a) Fiscal discipline, with no borrowing or accumulation of debt
41. d) A decrease in national savings and investments
42. c) Raising tax rates or improving tax collection efficiency
43. a) The government's total borrowing requirement after interest payments
44. d) The government is balancing its revenue and expenditure, excluding interest payments
45. c) Increasing non-tax revenue sources like privatization
46. c) Increasing public sector borrowing
47. b) The government is borrowing excessively to finance interest payments
48. b) Raising taxes and improving the efficiency of tax collection
49. b) Higher government borrowing and public debt
50. b) Privatize state-owned enterprises and reduce subsidies

Explanation and clarification for all the answers

1. **Subsidies (Answer: a)**
   Revenue expenditure refers to the day-to-day expenses of the government, which include subsidies, salaries, and interest payments. Subsidies are direct government support to sectors like agriculture, food, or energy, and are considered a form of revenue expenditure because they do not create assets or long-term benefits.
2. **Fiscal Deficit (Answer: b)**
   A fiscal deficit occurs when the government's total expenditure exceeds its total receipts, excluding borrowings. It is a measure of the government's borrowing needs and reflects the excess of its spending over its income from taxes, duties, and other non-debt receipts.
3. **Tax Revenue (Answer: d)**
   Tax revenue is considered a part of the government's current income, and not a capital receipt. Capital receipts involve funds received from borrowing (domestic or foreign), or from the sale of assets or liabilities, whereas tax revenue is part of revenue receipts.
4. **Revenue Deficit (Answer: c)**
   Revenue deficit occurs when the government's revenue receipts (tax and non-tax revenues) are less than its revenue expenditure. This indicates that the government is borrowing or using capital receipts to finance its operational expenses, which is unsustainable in the long term.
5. **Investment in Roads and Bridges (Answer: c)**
   Capital expenditure is spent on creating assets, such as infrastructure. Investment in roads and bridges is classified as capital expenditure because it contributes to the long-term development of the economy by creating valuable assets for public use.
6. **Primary Deficit (Answer: c)**
   Primary deficit indicates the government's borrowing requirement excluding the interest payments on past borrowings. It shows the fiscal health of the government, reflecting its borrowing to cover new expenditures without considering past debt obligations.
7. **Fiscal Deficit and Primary Deficit (Answer: b)**
   The fiscal deficit includes both the primary deficit and interest payments on existing

government debt. The primary deficit is a measure of the government's current borrowing needs, while the fiscal deficit includes the cost of servicing the debt from previous years.

8. **Borrowings from RBI (Answer: c)**
   To finance a fiscal deficit, the government may borrow from various sources, including the Reserve Bank of India (RBI). Borrowing from the RBI is a direct method for financing the deficit, which increases the government's liabilities but provides short-term liquidity.
9. **Balance Government Revenue and Expenditure (Answer: c)**
   A key goal of the government budget is to ensure that the total revenue (from taxes and other sources) matches the total expenditure, keeping the fiscal deficit under control. A balanced budget helps in managing the country's finances efficiently and sustainably.
10. **Allocate Financial Resources to Priority Areas (Answer: c)**
    The primary objective of a government budget is to allocate resources effectively among competing sectors, like healthcare, education, infrastructure, and defense. This ensures that funds are used in areas that support national development goals and address economic challenges.
11. **Promoting Economic Growth (Answer: c)**
    The government budget can promote economic growth by allocating funds for infrastructure projects, industrial development, and other growth-enhancing activities. This increases productivity, creates jobs, and contributes to long-term economic development, stimulating private sector investment.
12. **Fiscal Policy and Price Stability (Answer: b)**
    Fiscal policy aims to control inflation and stabilize the economy by adjusting government spending and taxation. By controlling inflation, the government ensures that the cost of living remains stable, which helps to maintain the purchasing power of consumers and the health of the economy.
13. **Income Redistribution (Answer: b)**
    Income redistribution is typically achieved through progressive taxation, where higher earners pay more taxes, and through social welfare programs that provide financial support to the economically disadvantaged, thus reducing income inequality.
14. **Fiscal Discipline (Answer: a)**
    Fiscal discipline is maintained by ensuring that the government's deficit (both fiscal and primary) remains manageable. This helps avoid excessive borrowing, which could lead to unsustainable debt levels and put pressure on future economic growth.
15. **Stabilize the Economy (Answer: b)**
    The government budget is used as a tool to stabilize the economy by managing inflation and unemployment. Through fiscal policies, the government can influence demand, adjust spending, and set tax rates to mitigate economic fluctuations.
16. **Balance of Payments (Answer: a)**
    Ensuring a balance of payments refers to managing a country's foreign exchange transactions, including imports and exports. A surplus or deficit in the balance of payments can be influenced by budgetary measures such as trade policies, tariffs, and government spending.
17. **Public Debt Management (Answer: c)**
    The government budget plays a key role in managing public debt by ensuring that

borrowing is done sustainably and does not overburden future generations. It involves careful planning to avoid excessive debt servicing that can limit future fiscal flexibility.

18. **Social Welfare (Answer: b)**
    The government budget can manage social welfare by allocating funds to programs that promote public health, education, and poverty alleviation. These investments aim to improve the quality of life for vulnerable populations and foster long-term economic stability.
19. **Resource Allocation (Answer: b)**
    Resource allocation refers to how the government distributes financial resources among different sectors based on national priorities. It includes funding for critical areas such as healthcare, defense, infrastructure, and education to achieve overall development goals.
20. **Borrowings from the Public (Answer: b)**
    Capital receipts include funds from borrowing, whether from the public or foreign governments. These receipts are used to finance capital expenditure, such as infrastructure development, and are repaid over time.
21. **Revenue Expenditure (Answer: a)**
    Revenue expenditure does not lead to the creation of assets. It involves regular operational expenses like salaries, subsidies, and interest payments. Unlike capital expenditure, which creates long-term assets, revenue expenditure is recurrent and does not contribute to future asset generation.
22. **Capital Expenditure (Answer: b)**
    Capital expenditure involves spending on creating long-lasting assets. Construction of roads, bridges, and other infrastructure projects is considered capital expenditure because it generates physical assets that provide long-term benefits to the economy.
23. **Plan Expenditure (Answer: b)**
    Plan expenditure refers to government spending aimed at promoting economic growth, such as investments in infrastructure, education, and healthcare. These expenditures align with the goals of economic development and social welfare.
24. **Non-Plan Expenditure (Answer: c)**
    Non-plan expenditure primarily consists of recurring costs such as interest payments on public debt and social security benefits. These expenditures are necessary for maintaining existing services and obligations, rather than promoting new investments or development projects.
25. **Developmental Expenditure (Answer: c)**
    Developmental expenditure is spending on activities that promote long-term economic development, such as education, healthcare, and infrastructure. These investments improve social welfare and contribute to national growth.
26. **Defense Expenditure (Answer: a)**
    Defense expenditure is generally classified as non-developmental expenditure because it does not contribute directly to economic growth. It is necessary for national security but does not generate long-term economic returns like infrastructure investment.
27. **Revenue Receipts (Answer: c)**
    Revenue receipts are generated from regular government activities such as taxes, duties, and fines. These receipts fund the day-to-day functioning of the government and are typically non-recurring, unlike capital receipts.

28. **Non-Developmental Expenditure (Answer: b)**
    Interest payments on government borrowings are considered non-developmental expenditures. They do not contribute directly to economic development or the creation of assets, but are necessary for maintaining government financial stability.
29. **Plan Expenditure (Answer: b)**
    Plan expenditure refers to government spending directed towards development goals, such as funding for public services, education, and health. These investments aim to improve the country's long-term economic prospects.
30. **Revenue Receipts (Answer: d)**
    Revenue receipts consist of money collected by the government through taxes, fines, and other non-borrowed sources. These funds are used for daily government operations and do not add to public debt.
31. **Balanced Budget (Answer: a)**
    A balanced budget may limit the government's ability to stimulate the economy during recessions, as it does not allow for deficit spending. This can reduce the effectiveness of fiscal policy in addressing economic downturns.
32. **Deficit Budget Risks (Answer: b)**
    A long-term deficit budget can increase public debt and the cost of servicing that debt, leading to higher interest payments. This can crowd out investments and limit the government's ability to invest in future growth.
33. **Surplus Budget (Answer: b)**
    A surplus budget occurs when government revenues exceed expenditures. While this reduces public debt, it could lead to underinvestment in critical areas, slowing economic growth.
34. **Deficit Budget Financing (Answer: b)**
    To finance a deficit budget, the government may borrow from external or domestic sources. Borrowing helps cover the gap between revenue and expenditure, but it increases the public debt burden.
35. **Surplus Budget Use (Answer: c)**
    In a surplus budget, the government has excess funds and can use them to pay off public debt, reducing the overall debt burden and interest obligations.
36. **Deficit Budget Use (Answer: b)**
    A deficit budget is often used when the economy is in recession, requiring fiscal stimulus to boost demand and economic activity. Government borrowing is necessary to finance this stimulus.
37. **Balanced Budget (Answer: c)**
    A balanced budget avoids inflationary pressures because it ensures the government does not overspend or increase the money supply excessively, maintaining economic stability.
38. **Surplus Budget Effect (Answer: c)**
    A surplus budget reduces government debt by using excess revenue to pay down outstanding obligations, which helps improve the country's financial stability and reduces future interest payments.
39. **Deficit Budget Situation (Answer: b)**
    A deficit budget arises when the government's expenditure exceeds its revenue, requiring borrowing to cover the gap. This can lead to an increase in public debt.

40. **Balanced Budget (Answer: a)**
    A balanced budget reflects fiscal discipline, as the government does not need to borrow to cover its spending. This helps avoid excessive debt accumulation.
41. **Deficit Budget Risks (Answer: d)**
    A government running consistent deficit budgets could face reduced national savings and investments, as borrowing increases and resources are diverted to servicing debt, leaving less available for productive investments.
42. **Reduce Revenue Deficit (Answer: c)**
    Improving tax collection efficiency or raising taxes can increase revenue receipts, thus reducing the revenue deficit. It ensures the government can meet its operational costs without excessive borrowing.
43. **Primary Deficit (Answer: a)**
    Primary deficit represents the government's borrowing needs excluding interest payments. It reflects the difference between current expenditure and revenue, showing whether the government is borrowing for current operations or to meet debt obligations.
44. **Primary Deficit Zero (Answer: d)**
    If the primary deficit is zero, it indicates that the government is managing to balance its current revenue and expenditure, excluding interest payments. This is a sign of fiscal discipline.
45. **Revenue Deficit Reduction (Answer: c)**
    Increasing non-tax revenues, like through privatization or selling state assets, can help reduce the revenue deficit by generating additional funds for the government without increasing borrowing.
46. **Fiscal Deficit Containment (Answer: c)**
    Increasing public sector borrowing is not a sustainable way to contain the fiscal deficit. Instead, reducing wasteful expenditure and improving tax collection should be prioritized.
47. **Primary Deficit Significance (Answer: b)**
    A primary deficit signals that the government is borrowing excessively to finance interest payments, indicating an unsustainable fiscal situation that needs to be addressed.
48. **Reduce Revenue Deficit (Answer: b)**
    Raising taxes and improving tax collection efficiency are effective ways to increase government revenue, thereby reducing the revenue deficit and ensuring that the government can meet its operational expenses.
49. **Fiscal Deficit Consequences (Answer: b)**
    A large fiscal deficit typically leads to higher government borrowing, which can increase public debt and interest payments. Over time, this could lead to economic instability if not managed properly.
50. **Reducing Fiscal Deficit (Answer: b)**
    Privatizing state-owned enterprises and reducing subsidies are effective measures to reduce fiscal deficits. These actions decrease government spending, improve efficiency, and reduce reliance on borrowing.