Government Finance

Very short answer questions [for 1 marks]

i. Define government finance.
⇒ Government finance is that branch of economics which deals with income and expenditure of the government. It is also called public finance. It studies the income and expenditure policies of the government and their effect in the economy.

ii. State the four objectives of government finance.
⇒ Four objectives of government finance are:
1) To protect infant industries.
2) To carry out planned economic development.
3) To regulate consumption habits.
4) To reduce inequalities.

iii. Define tax.
⇒ Tax is the compulsary monetary charge imposed by government for its citizens and institutions for the services provided in different sectors. Taxes are collected by the government for the public welfare purpose. They are of two types: direct tax and indirect tax.

iv. State the meaning of direct tax.
⇒ Direct tax is that tax whose burden cannot be shifted to anybody else. The impact as well as the incident of direct tax falls on same person. It is leived on income and property.

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v. What is the meaning of indirect tax?

⇒ The tax whose burden can be shifted to another person is called indirect tax. The impact and incident of indirect tax falls on different people. The examples of indirect tax are custom duty, value added tax, sales tax, excise duty, etc.

vi. Define progressive tax.

⇒ The tax which increases with the increase in income of the people is called progressive tax. Under progressive tax system, the rich have to pay more taxes and the poor and the middle class have to pay minimal or no taxes.

vii. What is meaning of tax revenue?

⇒ Tax revenue is the income generated by the government by levying direct and indirect taxes on its citizens. It is the major source of revenue in the country.

viii. State the meaning of non-tax revenue.

⇒ The income generated by the government from the sources other than imposing taxes to its people is called non tax revenue. The revenue generated from fees, fines and penalties, escheat, special assessment, income from public entreprises and gifts and grants fall under non-tax revenue.

ix. Define public borrowing.

⇒ The money or fund taken by the state in the form of loan from different sources is called public borrowing. It is also called government borrowing.

x. Define government budget.

⇒ Budget is the statement of estimates of government revenue and expenditure for the period of 1 fiscal year. It is generally prepared for 1 year. It has a ~~section~~ sanction of public authority. It is presented by finance minister in parliament.

xi. State the meaning of market borrowing.

⇒ If the government borrows the loan by selling transferable securities like treasury, bills, national saving papers, government bonds etc. it is called market borrowing. It is voluntary in nature.

xii. What is the meaning of non-~~revenue~~ market borrowing?

⇒ If the ~~borro~~ government borrows loan without selling its securities, it is called non-market borrowing. Under this, government collects loan from public sector organizations such as insurance companies, Agriculture Development Bank, Postal Saving Bank, etc.

B. Short questions: For 5 marks

i. Explain the importance or roles of government finance.

⇒ Government Finance is that branch of economics which deals with income and expenditure aspects of the government. It is also known as public finance. Some of its importance or roles are explained below:

1) Protection to infant industries: Government helps in the protection of infant industries by ~~substituting~~ subsidizing them with the taxes collected from various sources. It helps to lower their cost of production and consequently they are able to earn a good sum of profit and also opt for large scale production.

2) Planned economic development: The primary role of government is to develop various types of infrastructures like transportation, communication, electricity, schools, college, university, ~~driv~~ drinking water and so on. Though the use of its revenue, the government can carry out use of its revenue, the government can carry out planned econonic development in these sectors.

3) Regulating consumption habits: People having more money tend to purchase more and more amount of luxurious goods. When the government, imposes high taxes on such goods, this habit is controlled. Same is the case in products that are injurious to health like alcohol, tobacco, cigeratte, etc.

4) Reducing inequalities: Government finance plays a crucial role in reducing economic and social inequalities, through its fiscal policies. For this, the government can levy heavy taxes on the rich sections and spend the money so received on the poor.

5) ~~Economic stability~~ Economic stability: various kinds of economic instabilities such as inflation, deflation, trade cycle may occur in a country. With the help of monetary and fiscal measures, government can maintain the economic instabilities such as inflation, deflation, trade cycle may occur in a country. With the help of monetary and fiscal measures, government can maintain the economic stability by imposing expansionary and contractionary fiscal policies.

In addition, government finance helps in efficient allocation of resources, capital formation, price stability, infrastructure development etc.

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111. How is classification of public expenditure made? Explain.

⇒ Public expenditure refers to government spending in various ~~aspec~~ sectors for the benefit of the public. It is growing every years as people's needs and government responsibilities are also increasing. Government makes its expenditures in the sectors like: health, education, drinking water, etc.

There are two broad headings under which the classification of public expenditure is made. They are:

1) Regular or administrative Expenditure
2) Capital or ~~Developme~~ Development Expenditure

1) Regular or Administrative Expenditure

It includes the expenditure made by the government on various government offices for daily administration and to provide salary and allowance for civil service sector. Government makes regular expenditure on the following headings:

a) Constitutional organs
b) General administration
c) Revenue administration
d) Economic administration and planning.
e) Judicial administration
f) Defence
g) Social and economic services
h) Miscellaneous.

2) Development or Capital Expenditure

Development ~~or~~ expenditure which is also called capital expenditure is related with the long-term expenditures made for the development of various infrastructures like roads, communication, irrigation etc. These expenditures can be explained under following headings:

a) Constitutional organs
b) General administration
c) Revenue administration
d) Economic administration and planning.
e) Judicial administration.
f) Defence
g) Social and economic services.
h) Miscellaneous.

iv. Explain the various sources of public revenue.

⇒ Government revenue includes all the income and receipts, irrespective of their sources and nature that the government happens to obtain during any period of time. The various sources of government revenue are broadly classified as tax revenue and non tax revenue.

1) Tax Revenue

A tax is a compulsary contribution to the state from the citizen. Tax revenue is the major source of revenue. It consists of the following:

a) Taxes on property, profit and income: It includes income tax from citizens and institutions and also the taxes ~~from citizens~~ levied on their property.

b) Taxes on land revenue and registration: It is the tax levied on land, house and its registration by reason of its ownership.

c) Custom duty: It is the tax levied on international trade and transaction of goods and services.

d) Domestic taxes on goods and services: These taxes are based on production of goods and services. It includes excise duty, sales tax, VAT etc.

2) Non-tax Revenue

The income received from other sources than tax is known as non tax revenue of the government. It consists mainly of the following sources:

a) **Fees, fines and penalties**: Fees is the amount received from those individuals who received some special benefits from services rendered like license of vehicles, firm registration fees, etc. Fines and penalties are charge imposed on individuals as punishment for violation of a certain law of a country.

b) **Escheat**: Escheat is the property undertaken by government if its owner dies without claiming any legal hier of the property.

c) **Special assessment**: The payment made by the individuals of an identified locality in exchange for special services provided to them by the government such as construction of roads is called special assessment.

d) **Income from public entreprises**: It is the income from government owned enterprises like Nepal Electricity Authority, Nepal Oil Corporation etc.

e) **Gifts and Grants**: Gifts and grants are voluntary contribution from non-government organization to the government for specific purpose.

Hence, government revenue can be classified as tax and non tax revenue.

V. Explain the concept of progressive, proportional, regressive and degressive tax.

⇒ The concept of progressive, proportional, regressive and degressive tax is explained below:

Progressive Tax

If the tax amount increases with the rise in income level, it is called progressive tax. Under progressive tax, the richer person pays not only more tax but also a higher rate of tax. So, the burden of a progressive tax falls more heavily on the richer person. This helps to reduce the gap between rich and poor.

Proportional Tax

A proportional tax is a system in which the rate of tax remains same whatever be the income level. A person who ~~remains~~ earns greater income should pay the same rate of tax as the person who earns lower income. The amount of tax increases and decreases with the rise in fall of income, ~~respo~~ respectively. But, the tax rate remains the same.

Regressive Tax

A regressive tax is a system in which the rate of tax decreases with increase in income and vice versa. A person who earns greater income should pay lower rate of tax. Under regressive tax system, the burden of tax is relatively more on the poor. Thus, it is inequitable in nature.

Degressive Tax

Under degressive tax system, upto a certain limit of income the rate of tax increases and becomes constant after a certain limit. This type of tax is also called mild progressive tax. It is a mixture of progressive as well as proportional tax system.

Hence, progressive, proportional, regressive and degressive are four different tax systems.

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vi. Describe the various objectives of public borrowing.

⇒ Public borrowing refers to borrowing raised by a government from within a country or outside the country. Some of its objectives are described below:

a) Maintain balance between revenue and expenditure: One of the important goal of government borrowing is to fill the gap between revenue received by the government and proposed expenditure during the year. The purpose of public borrowing is also to meet unforseen calamities like earthquake, famines, floods etc.

b) To develop infrastructures: Generally, government borrows fund for construction of infrastructures in nation. They include the development of transportation and communication, dams, railway etc. These development need to invest huge amount of fund which is only possible from government borrowing.

c) Economic development: Under-developed and developing countries always face the problem of funds. Taxation capacity of such countries is low. Under such condition, government borrowing is only the way to manage fund for economic development.

d) Efficient allocation of resources: In order to allocate its resources efficiency, a country needs a lot of funds. Hence, government borrowing is made inorder to allocate its efficiently.

e) Expansion of education and health service: Government is the one who is responsible for the expansion of education and health services. Government borrows from internal and external ~~borrowi~~ sources in order to meet these requirement.

vii. Describe the various sources of public borrowing.

⇒ There are two major sources of public borrowing i.e. internal and external.

i) Internal Borrowings

It is one of the most important way to mobilize the internal resources in under developed countries. The fund which the government raises in the form of loan, ~~dom~~ domestically is called internal borrowing. The internal borrowing can be collected from following sources:

a) Borrowing from individuals: Government can sell its securities to the individuals to earn revenue.

b) Borrowing from commercial banks: Government can also borrow loan from commercial banks or sell its securities to them.

c) Borrowing from non-banking financial institutions: Government can borrow loan from finance companies, insurance companies, trusts and saving bank or sell its securities to them.

d) Borrowing from the Central Bank : Government can borrow loan from the central bank according the volume of its securities.

2) External Borrowing

External borrowing means borrowing from another country if domestic resources are inadequate to meet the financial requirement for the economic development. It has the following sources :

a) Borrowing from foreign government : It is also known as bilateral borrowing. To perform different development activities, a government can borrow loan from the government of its friendly nations.

b) Borrowing from international financial institutions : It is also known as multilateral ~~language~~ borrowing. It refers to borrowing loans from World Bank, IMF etc. for major development project.

∴ In this way, government can borrow from various internal and external sources.

C. Long questions : For 8 marks

i. Explain the various merits and demerits of direct tax.

⇒ Direct tax are those taxes which are paid by the persons on whom it is levied. The burden of direct tax cannot be ~~satisfied~~ shifted to anybody else. So, impact and incidence falls on the same person.

Some merits and demerits of direct tax are explained below:

Merits

1) Economical: Direct taxes are economical as they are collected directly from the sources of income and very less time and effort is required for its collection.

2) Equitable: Direct taxes are equitable as they are paid by the owners, earners and the rich. The poor are exempted or levied very low tax.

3) Elastic: Direct taxes are elastic as they can be increased or decreased by the government by changing the tax rate and tax ratio.

4) Certain: Direct taxes are certain as the tax rate for a year is fixed in advance. Hence, both tax payers and government can plan accordingly.

5) Educative value: A person feels the burden of direct taxes which causes them to develop a sense of civic consciousness.

Demerits

1) Inconvinent: Since the burden of direct taxes is felt by tax payer, they feel a sense of uneasiness in giving away the share of their hard-earned money to the government. So, it can be said that direct taxes pinches the tax payers.

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1) Convinent
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2) Evadable: The government lets the citizens publish their income statement by themselves. Hence, many people easily evade taxes by showing less income.

3) Arbitrary: The tax rate is defined by the government as per wish. It fails to give a proper logic behind the rate.

4) Not suitable to under developed countries: Direct taxes are not suitable to under developed countries as the people donot have high level of income.

5) Obstacles to capital formation: Direct taxes lower people's income which consequently lowers their savings causing obstacles in capital formation process.

In this way, direct taxes have their own merits and demerits.

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iii. Describe the various merits of indirect tax.

⇒ Indirect taxes are those taxes which is imposed on one person, but is paid either partly or wholly by another person. The impact and incidence of tax fall on different persons. These taxes are generally levied on goods and services. Custom duties, VAT, sales taxes, excise duties are examples of indirect taxes.

Some of the merits of indirect tax are explained below:

1) Convinent: Indirect taxes are generally included in the price of the commodity and the burden of tax is not felt by the consumer. They are completely

unaware in some cases. It does not feel like a major sacrifice. Moreover, the taxpayers or consumers should not bear extra burden to keep the records of indirect tax. Therefore, indirect tax system is easy and convenient to the tax payers.

2) Not evadable: Unlike indirect tax system, it is almost impossible to avoid or cheat the payment of indirect taxes because it is included on the prices of goods and services. The consumer, who purchases goods and services, must pay tax. A person can only evade indirect tax, if he chooses a non taxed commodity.

3) Contribution from poor: The rate and amount of indirect tax is same for the people of all income level. When people purchase a product, they must pay the same amount of VAT whatever be their income.

4) Suitable to under developed countries: Unlike direct taxes, indirect taxes are suitable to the people of under developed countries. Although, very less income can be generated from direct taxes in under developed countries, indirect taxes can help government to collect the targeted revenue from the citizens.

5) Elastic: Indirect taxes are highly elastic in nature as the revenue from these taxes can be increased as and when desired. When government feels it necessary to increase, they can increase it.

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6) Broad base of tax collection: Since, indirect tax is imposed on goods and services and it is included in their prices, it is collected from all consumers who consume such goods and services. All consumers pay the tax because they purchase goods to consume. So, indirect tax is paid by both rich and poor consumers.

7) Progressive in nature: Consumers consume different types of goods in their daily life such as basic and necessary goods, luxurious goods etc. More tax is ~~tis~~ levied on luxurious goods which are purchased by the rich and less tax is levied on necessary goods. So, indirect tax is progressive in nature.

8) Maintains social norms and values: Government imposes high rate of tax on the products like cigarattes, tobacco, wine, alcohol etc. which are injurious to health. The revenue so ~~cat~~ collected is used in social welfare programs.

Hence, indirect taxes are beneficial in many ways.

iv) What are the demerits of indirect tax? Explain.

=> Indirect taxes are those taxes which are levied on one person, but is paid either partly or wholly by another person. The impact and incidence of indirect tax fall on different persons. These ~~taxes~~ taxes are generally levied on goods and services. excise duties Custom duties, VAT, sales taxes, excise duties are examples of indirect tax.

Some of the demerits of indirect tax are explained below:

1) Uneconomical: Government should spend more resources and manpower to collect indirect tax. It must establish custom offices with more manpower, VAT department, sales ~~#~~ tax and excise duty departments with more infrastructure and manpower. So, a large amount of money should be spent for collecting tax.

2) Regressive in nature: The amount of VAT on a particular good is fixed. Hence, it implies that rich have to pay lower rate of tax and the poor have to pay higher rate of tax. Hence, they are regressive in nature.

3) Rise in price: When indirect taxes are levied on goods and services, their prices increase. Higher prices for purchasing of goods and services is a loss to consumer.

4) ~~Certain~~: Uncertain: The revenue to be collected from the indirect taxes is very difficult to be predicted. Since, quantity demand will greatly affect price, the price keeps on changing. So, the taxes also vary from time to time.

5) No educative value: Indirect taxes are levied on the commodities. So, consumer does not feel burden of tax. It makes the citizens less conscious in the government expenditure system.

6) Fall in Consumption: Indirect taxes are included in prices. So, indirect taxes raise the prices of commodities. The consumption of lower income groups is bound to fall because of rise in prices of commodities. Fall in the consumption of essential ~~goo~~ commodities worsens health and efficiency of the masses.

7) Restriction in free trade: Indirect taxes like custom duty do not allow free ~~t~~ trade. Free trade is restricted as the taxes on imported products become higher due to custom and excise duties.

8) Burden for poor people: Indirect taxes causes price rise in even basic and necessary goods which is a burden for poor people. So, these taxes are not very suitable for low income people.

In this way, indirect taxes are demeritious in many cases.

v. Explain the various canons of taxation.

=> ~~Taxation re~~ Canons of taxation refers to the essentials or the characteristics of good tax system. Some of the canons of taxation are:

1) Equity: A good tax system is based on the principle of equality. Equality may be considered to be same as justice. In this ~~pr~~ principle the tax must be levied according to the tax paying capacity of the individuals. The burden of tax in a good tax system should be minimum.

2) Productivity: Taxes must be levied inorder to accumulate enough money for the government to run its administration efficiency. The tax system should ~~be~~ yield a satisfactory return to the government to meet the government expire.

3) Elasticity: The tax system should be elastic in nature. If government needs more income at the time of crisis, the tax should be capable of yielding enough income through an increase in tax rate.

4) Convinience: The taxes should be levied and collected in such a manner that it provides the maximum of convenience to the tax payers. The tax payers must be given sufficient time to pay the ~~tax~~ tax at his ~~convin~~ convenience. Besides, the laws must be shape and easily understandable.

5) Economy: The tax system of a country must be economic in sense that minimum possible money should be spent in the collection of taxes. The minimum point of the tax should be collected through banking channel.

6) Maximum Social Advantage: The main objective of the system of taxation ~~is~~ should be to attain certain social objectives such as redistribution of wealth, income and to reduce inequalities.

7) Simplicity: A good tax system should be so simple that the taxpayer can understand its implications without the help of tax experts. If the tax system is complex, the taxpayer will have to seek the assistance inorder to understand its implications.

8) Certainity: The tax payer should be known in advance how much tax he have to pay and at what time. At the same time, a good tax system also ensures that government is also certain about the amount to be collected.

Hence, the good tax system must have above mentioned qualities.

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vi. Explain the roles or importance of public borrowing in context of underdeveloped nations like Nepal.

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Public borrowing refers to borrowing raised by government from within the country or outside it. At the time of dificit budget, government borrows loan from other. In underdeveloped countries like Nepal, government most of the time is in deficit budget. Hence, public borrowing is very important.

Some importance are:

1) Maintenance of balance between revenue and expenditure: One of the important goals of government borrowing in underdeveloped countries is to fill the gap between revenue received by the government and proposed expenditure during the year.

2) Infrastructure Development: The development of infrastructure like road, dams, railway etc. requires a lot of budget which is generally unavailable for underdeveloped country's government. Hence, public borrowing helps to meet the expenditures of such project.

3) Economic development: Underdeveloped countries always face the problem of funds because the taxation capacity of such countries is very low. Under these conditions, government borrowing is the only way to generate funds for economic development.

4) Efficient allocation of resources: Government requires a huge amount of money for efficient allocation of resources which is not available to the government of developed countries. Hence, public borrowing helps to manage the resources efficiently so as to maximize national output.

5) Expansion of education and health service: The government of underdevelop countries can utilize the fund generated from public borrowing in the expansion of productive sectors like education and health service.

6) Industrialization: The government of underdeveloped countries borrows loan from different sources in order to speed up the industrialization process of the country.

In this way, government borrowing plays a great role in developing countries like Nepal.

iii) Define government budget. Explain the process of budget formation.

→ Government budget is the statement of estimates of government revenue and expenditure for the period of 1 fiscal year. It is generally prepared for one year. It has a sanction of public authority. It reflects the plans and policies of government.

A budget is formulated in the following process:

1) Operation schedule: Budget formulation starts with schedules of operation. In our context, it is prepared by the finance ministry. It specifies steps to be taken to arrive at income expenditure estimates.

2) Estimates: There are various organs of the government, ministry, department and units. The Ministry of Finance provides the budget forms to these organs. They fill the form and return to MoF. In this way, estimates of expenditure requirements are collected from them. Estimates of income possibilities are also collected from revenue offices.

3) Review: Ministry of Finance reviews the estimates with reference to regular requirements and possibilities, development programs and past trends. On the basis of this review, MoF sets the priority of different sectors in the budget allocation.

4) Discussion: Review is estimated by discussion. There is discussion between the ministry of finance and concerned departments and offices. The conclusion derived from the discussion would be the most useful guideline

in the preparation and implementation of budget. It may lead to revision of estimates.

5) **Proposals**: If deficit is estimated, additional amounts have to be collected from various sources. Proposals have to be made for new taxes, revision of existing tax rates, internal and external borrowing, etc.

6) **Final document**: Budget document becomes ready in this process. It is completed before the fiscal year starts. It is completed before the fiscal year starts. It is announced and discussed in parliament and finalized with ammendments if necessary. The budget should be approved by the majority of the members of parliament.

7) **Supplement**: Revision of heads and additional allocations may become necessary after some time because of unforseen circumstances. These are incorporated with what is known as supplementary budget.

In this way, budget is formulated.