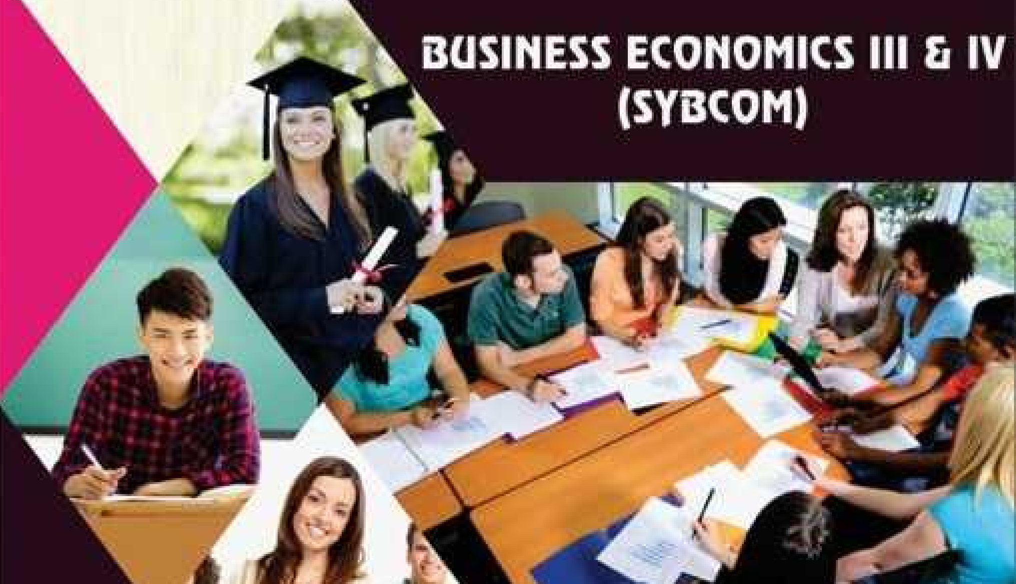
Sadhana Education Society

L. S. RAHEJA

COLLEGE OF ARTS & COMMERCE,

SANTACRUZ (W), MUMBAI - 400 054.

BUSINESS ECONOMICS III & IV (SYBCOM)



GLOSSARY & DIAGRAM PRACTICE WORKBOOK

PREPARED BY

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BUSINESS ECONOMICS III
SYBCOM SEMESTER III
GLOSSARY

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The document gives a brief explanation of different concepts in Business Economics III, SemesterIII. It is also an assignment for practicing diagrams.

Disclaimer : The concepts are taken from different sources.

MODULE 1

1. **Macroeconomics** is the branch of economics that studies the behavior and performance of an economy as a whole. It focuses on the aggregate changes in the economy such as unemployment, growth rate, gross domestic product and inflation. Macroeconomics (from the Greek prefix makro- meaning "large" + economics) is a branch of economics dealing with the performance, structure, behavior, and decision-making of an economy as a whole. This includes regional, national, and global economies.

2. **Two sector Economy**: It is the economy which consists of two sectors: households and firms. Households spend all of their income (Y) on goods and services or consumption (C). There is no saving (S). All output (O) produced by firms is purchased by households through their expenditure (E).

3. **The three-sector economy** is one in which economics divides economies into three sectors of activity: extraction of raw materials (primary), manufacturing (secondary), and services (tertiary).

4. **Four sector economy/ Open economy**: The circular flow model in four sector economy provides a realistic picture of the circular flow in an economy. Four sector model studies the circular flow in an open economy which comprises of the household sector, business sector, government sector, and foreign sector.

5. **Closed Economy**: A closed economy is self-sufficient, which means no imports come into the country and no exports leave the country. A closed economy's intent is to provide domestic consumers with everything they need from within the country's borders. An economy that does not interact with the economy of any other country.

6. **The circular flow of income** or circular flow is a model of the economy in which the major exchanges are represented as flows of money, goods and services, etc. between economic agents. The flows of money and goods exchanged in a closed circuit correspond in value, but run in the opposite direction.

7. A **Financial market** is a market in which people trade financial securities and derivatives such as futures and options at low transaction costs. Securities include stocks and bonds, and precious metals.

8. **National Income** is the total value of all final goods and services produced by the country in certain year. The growth of National Income helps to know the progress of the country. In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income.

9. **GDP**: Gross Domestic Product (GDP) is a monetary measure of the market value of all the final goods and services produced in a period of time, often annually or quarterly. Nominal GDP estimates are commonly used to determine the economic performance of a whole country or region, and to make international comparisons.

10. **GNP/GNI**: The gross national income (GNI), previously known as gross national product (GNP), is the total domestic and foreign output claimed by residents of a country, consisting of gross domestic product (GDP), plus factor incomes earned by foreign residents, minus income earned in the domestic economy by non-residents.

11. **Depreciation:** It is defined as the reduction of recorded cost of a fixed asset in a systematic manner until the value of the asset becomes zero or negligible.

12. **Green GDP**: The green gross domestic product (green GDP or GGDP) is an index of economic growth with the environmental consequences of that growth factored into a country's conventional GDP. Green GDP monetizes the loss of biodiversity, and accounts for costs caused by climate change.

13. **NDP**: The net domestic product (NDP) equals the gross domestic product (GDP) minus depreciation on a country's capital goods. Net domestic product accounts for capital that has been consumed over the year in the form of housing, vehicle, or machinery deterioration.

14. **NNP:** Net national product (NNP) refers to gross national product (GNP), i.e. the total market value of all final goods and services produced by the factors of production of a country or other polity during a given time period, minus depreciation.

15. **PCI** : Per capita income (PCI) or average income measures the average income earned per person in a given area (city, region, country, etc.) in a specified year. It is calculated by dividing the area's total income by its total population.

16. **National Income at Factor cost** is a measure of national income or output based on the cost of factors of production, instead of market prices. This allows the effect of any subsidy or indirect tax to be removed from the final measure.
    National Income at Factor Cost = NNP at Market Price – Indirect Taxes + Subsidies.

17. **National Income at Market Price** : Gross (or net) national income (at market prices) represents total primary income receivable by resident institutional units: compensation of employees, taxes on production and imports less subsidies, property income (receivable less payable), (gross or net) operating surplus and (gross or net) mixed income. Gross national income (at market prices) equals GDP minus primary income payable by resident units to non-resident units plus primary

income receivable by resident units from the rest of the world. Gross national income (at market prices) is conceptually identical with gross national product (GNP) (at market prices), as hitherto understood in national accounts generally.

18. **National Income at Constant Price**: It is the money value of final goods and services produced by normal residents of a country in a year, measured at base year price. Base Year is a normal year which is free from price fluctuations.

19. **National Income at Current Price**: It is the money value of final goods and services produced by normal residents of a country in a year, measured at the prices of the current year. For example, measurement of India's National Income of 2013-2014 at the prices of 2013-2014.

20. **The Business cycle/ Trade cycle**, also known as the economic cycle or trade cycle, is the downward and upward movement of gross domestic product around its long-term growth trend. The length of a business cycle is the period of time containing a single boom and contraction in sequence.

21. **Say's Law of Market**: Say's law of markets is a classical economic theory that says that production is the source of demand. According to Say's law, the ability to demand something is financed by supplying a different good. An important element of classical economics is Say's Law of Markets, after J.B. Say, a French economist who first stated the law in a systematic form. Briefly stated, this law means that 'supply always creates its own demand.'

MODULE 2

22. **Aggregate demand**: It is the total demand for final goods and services in an economy at a given time. It specifies the amounts of goods and services that will be purchased at all possible price levels. This is the demand for the gross domestic product of a country. It is an economic measurement of the sum of all final goods and services produced in an economy, expressed as the total amount of money exchanged for those goods and services.
    Agg Demand = C+I+G+(X-M)

23. **Aggregate supply** or domestic final supply : It is the total supply of goods and services that firms in a national economy plan on selling during a specific time period. It is the total amount of goods and services that firms are willing and able to sell at a given price level in an economy.

24. **Effective demand**: It is the total demand for goods and services in an economy at various levels of employment. Total demand for goods and services by the people is

the sum total of all demand meant for consumption and investment. In other words, the sum of consumption expenditures and investment expenditures constitute effective demand in a two-sector economy. According to Keynes, the level of employment is determined by the effective demand which, in turn, is determined by aggregate demand function or aggregate demand price and aggregate supply function or aggregate supply price. In Keynes' words; "The value of D (Aggregate Demand) at the point of Aggregate Demand function, where it is intersected by the Aggregate Supply function, will be called the effective demand."

25. **Consumption Function** is a "functional relationship between two aggregates, i.e., total consumption and gross national income." Symbolically, the relationship is represented as C= f(Y), where C is consumption, Y is income, and/is the functional relationship. Thus the consumption function indicates a functional relationship between C and Y, where C is the depend at and Y is the independent variable, i.e., C is determined by Y. This relationship is based on the ceteris paribus (other things being equal) assumption, as such only income consumption relationship is considered and all possible influences on consumption are held constant.

26. **Marginal Propensity to Consume** : The marginal propensity to consume may be defined as the ratio of the change in consumption to the change in income or as the rate of change in the average propensity to consume as income changes." It can be found by dividing change in consumption by a change in income, or MPC – $\Delta C/\Delta Y$.

27. **Investment Function** : An investment multiplier refers to the concept that any increase in public or private investment spending has a more than proportionate positive impact on aggregate income and the general economy. The multiplier attempts to quantify the additional effects of a policy beyond those immediately measurable. The Size or Value of Investment Multiplier: The multiplier tells us how much increase in income occurs when autonomous investment increases by Rs. 1, that is, investment multiplier $\Delta Y/\Delta I$ is and its value is equal to 1/1-b where b stands for marginal propensity to consume (MPC).

28. **Liquidity Trap:** The liquidity trap is the situation in which the current interest rates are low and savings rates are high, rendering monetary policy ineffective. In a liquidity trap, consumers choose to avoid bonds and keep their funds in savings because of the prevailing belief that interest rates will soon rise. liquidity trap is a situation, described in Keynesian economics, in which, "after the rate of interest has fallen to a certain level, liquidity preference may become virtually absolute in the sense that almost everyone prefers [holding] cash [rather than] holding a debt which yields so low a rate of interest."

MODULE : 3

29. **The IS curve** represents all combinations of income (Y) and the real interest rate (r) such that the market for goods and services is in equilibrium. It shows inverse relation between rate of interest and national income.

30. **The LM curve** gives the combinations of income and the interest rate for which the demand for money (or desired liquidity) equals the money supply and hence for which the domestic economy is in asset or stock equilibrium.

31. **The Phillips curve** is an economic concept developed by A. W. Phillips stating that inflation and unemployment have a stable and inverse relationship. The theory claims that with economic growth comes inflation, which in turn should lead to more jobs and less unemployment.

32. **Stagflation:** It is a condition of slow economic growth and relatively high unemployment, or economic stagnation, accompanied by rising prices, or inflation. It can also be defined as inflation and a decline in gross domestic product (GDP). Stagflation occurs when the government or central banks expand the money supply at the same time they constrain supply. It is the economic phenomenon in which unemployment increases along with rising inflation causing demand to remain stagnant.

MODULE 4

33. **The Demand for money** is the desired holding of financial assets in the form of money that is, cash or bank deposits rather than investments. It can refer to the demand for money narrowly defined as M1. The demand for money balances is the total stock of money that the private sector wishes to hold.

34. **The Supply of money** is the total stock of money available for use in transactions, and held by the private sector. It includes all currency (notes and coins) in circulation, all checkable deposits held at banks (bank money). A somewhat broader measure of the supply of money is M2, which includes all of M1 plus savings and time deposits held at banks.

35. **Velocity of circulation of money** is the amount of units of money circulated in the economy during a given period of time. Description: Velocity of circulation is measured by dividing GDP by the country's total money supply. A high velocity of circulation in a country indicates a high degree of inflation.

36. **The Transaction velocity of money** is the rate at which money is exchanged from one transaction to another. It also refers to how much a unit of currency is used in a given period of time.

37. **The Income velocity of money**, is the frequency at which the average same unit of currency is used to purchase newly domestically-produced goods and services within a given time period.

38. **Core inflation** represents the long run trend in the price level. In measuring long run inflation, transitory price changes should be excluded. Core inflation is the change in costs of goods and services, but does not include those from the food and energy sectors. This measure of inflation excludes these items because their prices are much more volatile.

39. **Headline inflation** is a measure of the total [inflation] within an economy, including commodities such as food and energy prices (e.g., oil and gas), which tend to be much more volatile and prone to inflationary spikes.

40. **Reflation** is the act of stimulating the economy by increasing the money supply or by reducing taxes, seeking to bring the economy (specifically price level) back up to the long-term trend, following a dip in the business cycle. Reflation is a fiscal or monetary policy, designed to expand a country's output and curb the effects of deflation, which usually occurs after a period of economic uncertainty or a recession. Reflation policies can include reducing taxes, changing the money supply and lowering interest rates.

41. **Deflation** is a decrease in the general price level of goods and services. Deflation occurs when the inflation rate falls below 0% (a negative inflation rate). Inflation reduces the value of currency over time, but deflation increases it.

42. **Food inflation** refers to the condition whereby there exist increase in wholesale price index of essential food item (defined as food basket) relative to the general inflation or the consumer price index.

43. **Disinflation** is a decrease in the rate of inflation – a slowdown in the rate of increase of the general price level of goods and services in a nation's gross domestic product over time. It is the opposite of reflation.

BUSINESS ECONOMICS III
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SYBCOM SEMESTER-III

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AN ASSIGNMENT FOR PRACTICING DIAGRAMS.
DISCLAIMER : DIAGRAMS TAKEN FROM VARIOUS SOURCES. ONLY FOR LSRC STUDENTS.

Identify the titles of the following diagrams, redraw and explain them .

Module 1

Q1.

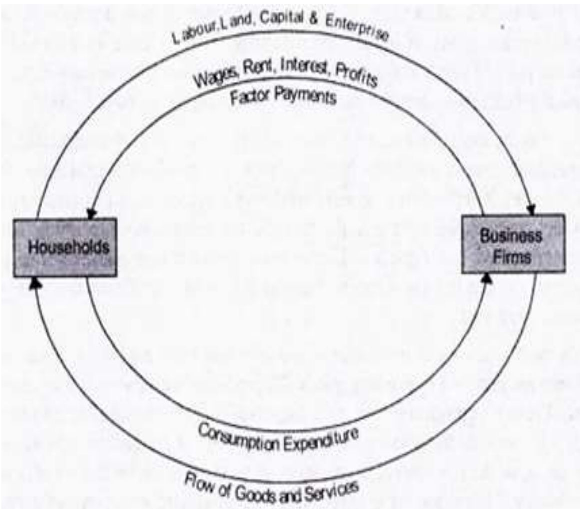


Fig. 6.1. *Circular Flow of Income in a Simple Two Sector Economy*

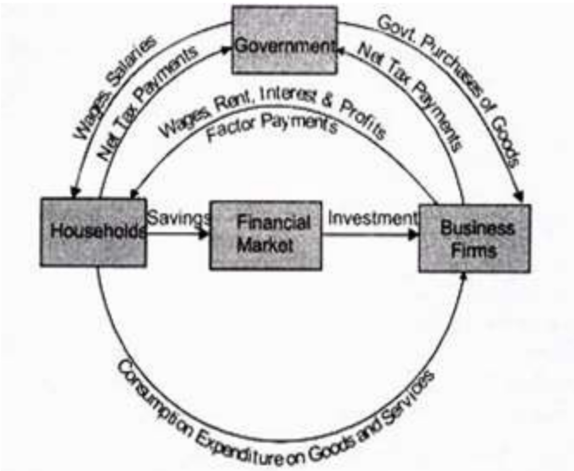


Fig. 6.3. *Circular Income Flow Model with Government*

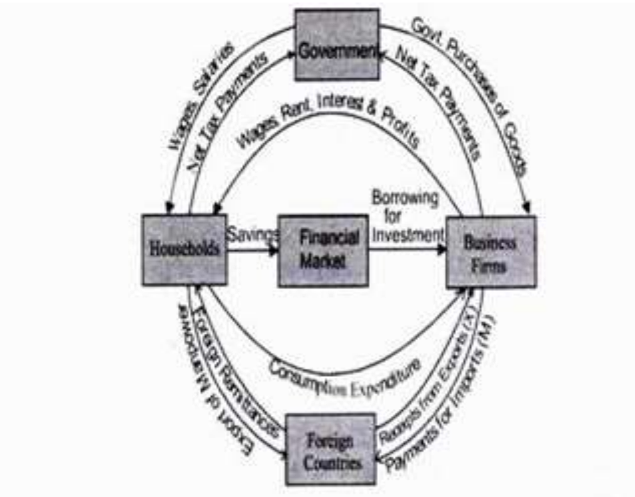
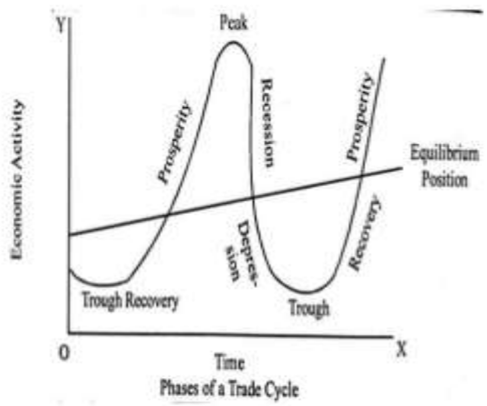


Fig. 6.4. *Circular Flow of Income in an Open Economy with Government and Foreign Sector*


Y
Peak
Economic Activity
Prosperity
Recession
Prosperity
Equilibrium
Position
Depres-
sion
Recovery
Trough Recovery
Trough
0
Time
X
Phases of a Trade Cycle

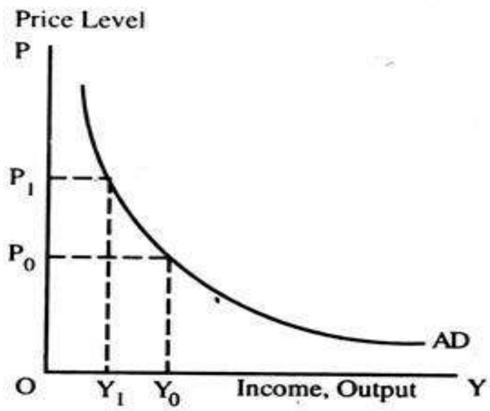
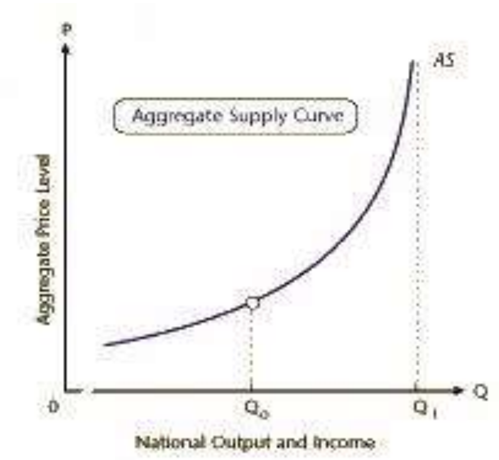


Fig. 10.1 Downward Sloping Aggregate Demand Curve


P
AS
Aggregate Supply Curve
Aggregate Price Level
0
Q
Q_0
Q_1
National Output and Income

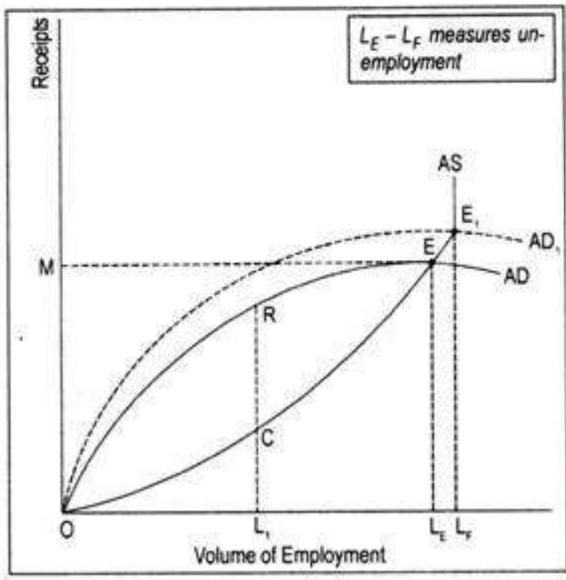
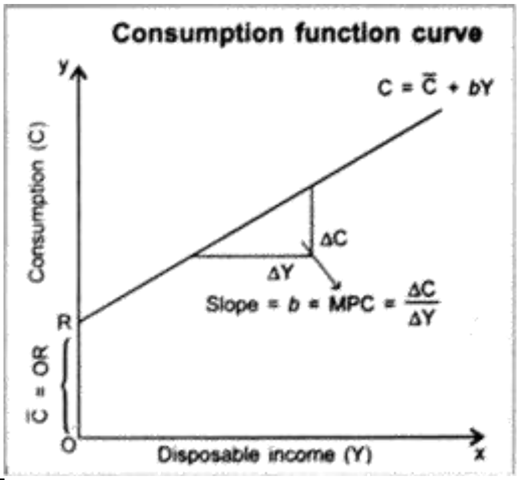


Fig. 3.4: Effective Demand and Determination of Employment


Consumption function curve
y
$C = \bar{C} + bY$
Consumption (C)
ΔC
ΔY
Slope = b = MPC = $\frac{\Delta C}{\Delta Y}$
R
$\bar{C}$ = OR
O
Disposable income (Y)
x

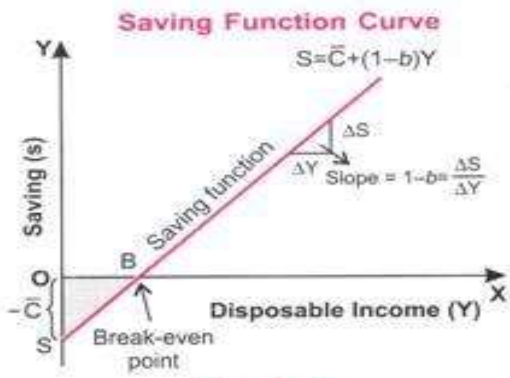
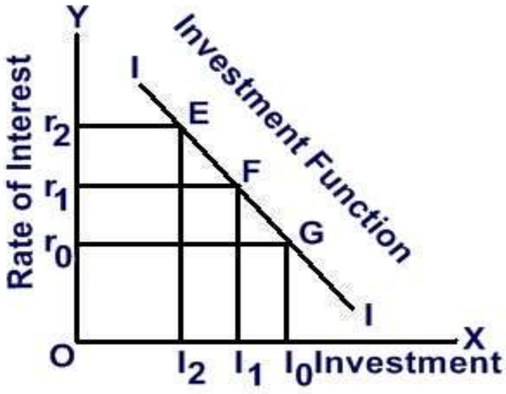

Saving Function Curve
S=C̄+(1–b)Y
Y
ΔS
ΔY
Slope = 1–b= ΔS/ΔY
Saving function
Saving (s)
B
O
–C̄
S
X
Disposable Income (Y)
Break-even point

Fig. 8.6


Y
Rate of Interest
Investment Function
I
E
F
G
I
r_2
r_1
r_0
O
I_2
I_1
I_0 Investment
X

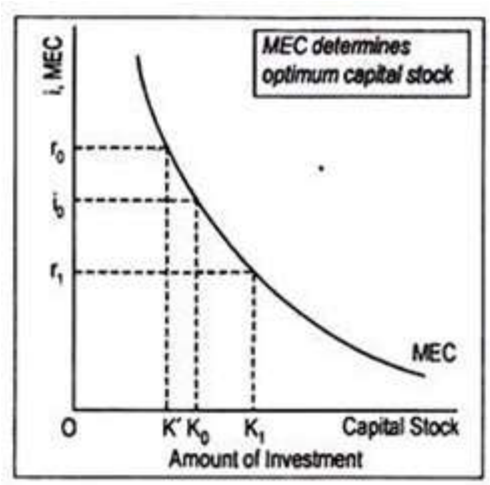
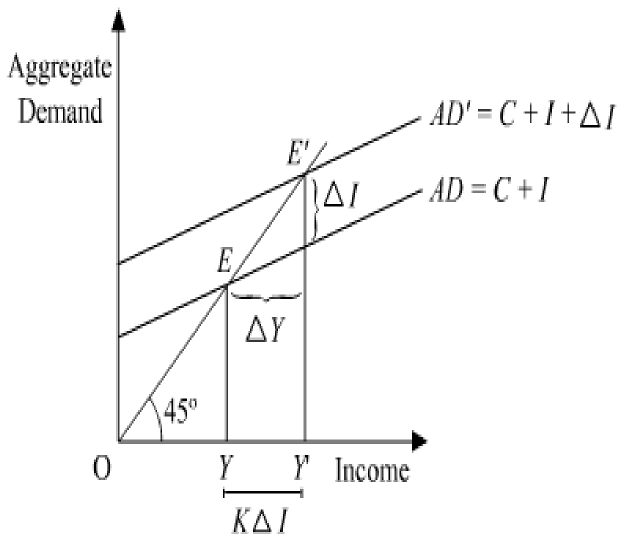


Fig. A1: MEC and i


Aggregate Demand
$AD' = C + I + \Delta I$
E'
ΔI
$AD = C + I$
E
ΔY
45^o
O
Y
Y'
Income
$K \Delta I$

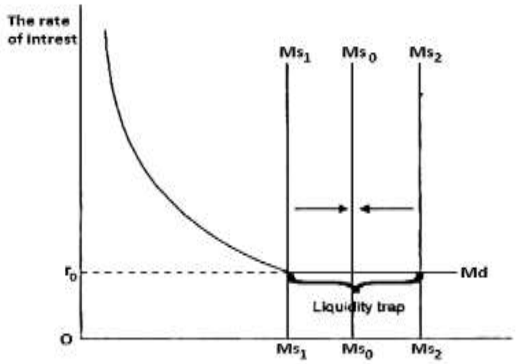


Fig. 7 : Liquidity Trap

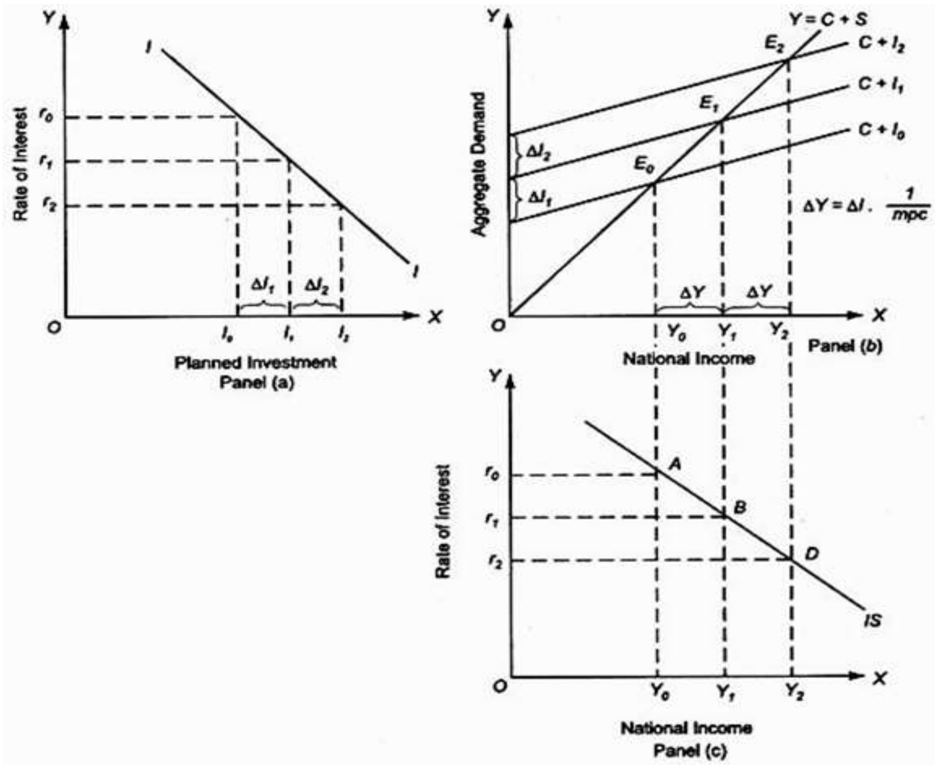


Fig. 20.1. *Derivation of IS Curve : Linking Rate of Interest with National Income through Investment and Aggregate Demand*

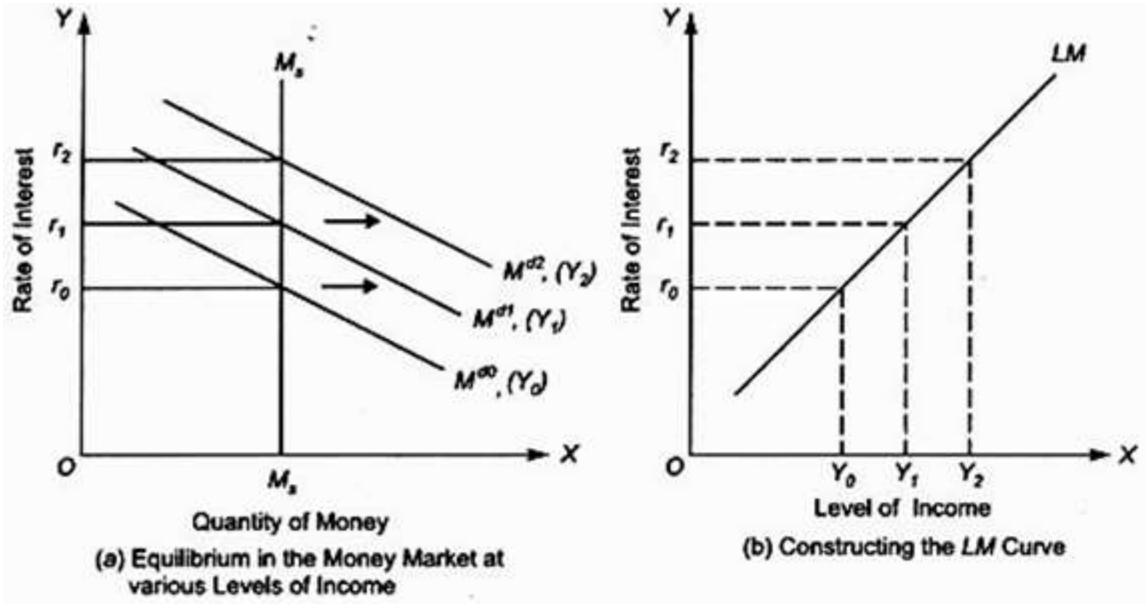


Fig. 20.2. *Derivation of LM Curve*

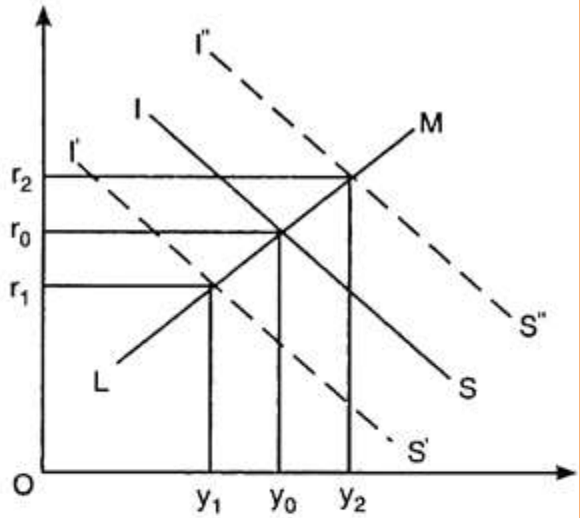


Fig. 17 : Shift of the IS curve

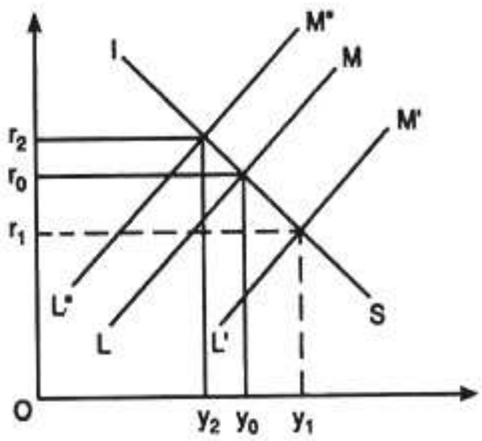


Fig. 16 : Shift in LM curve

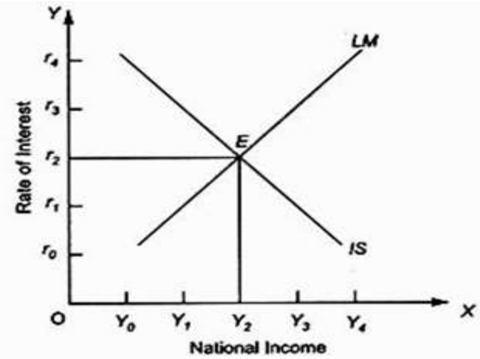
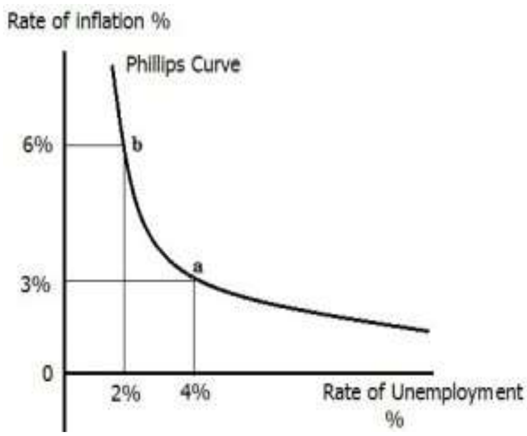
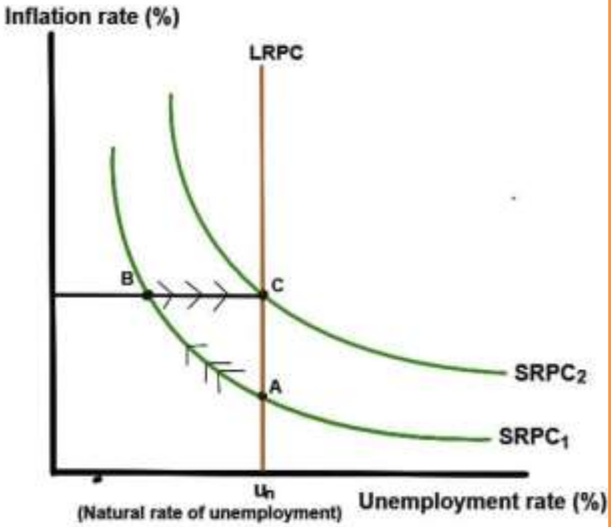


Fig. 20.3. *The IS and LM Curves Combined: The Integration of Commodity and Money Markets and Joint Determination of Interest Rate and Income Level*


Rate of Inflation %
Phillips Curve
6%
b
3%
a
0
2%
4%
Rate of Unemployment
%


Inflation rate (%)
LRPC
B
C
A
SRPC2
SRPC1
un
(Natural rate of unemployment)
Unemployment rate (%)

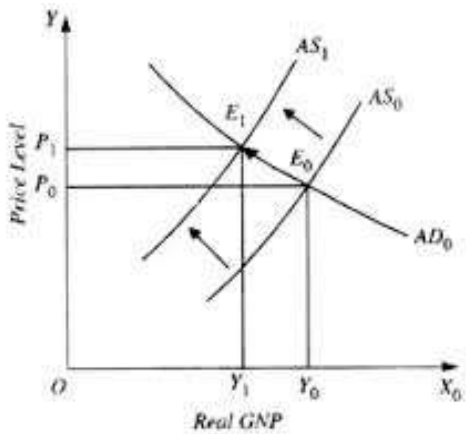
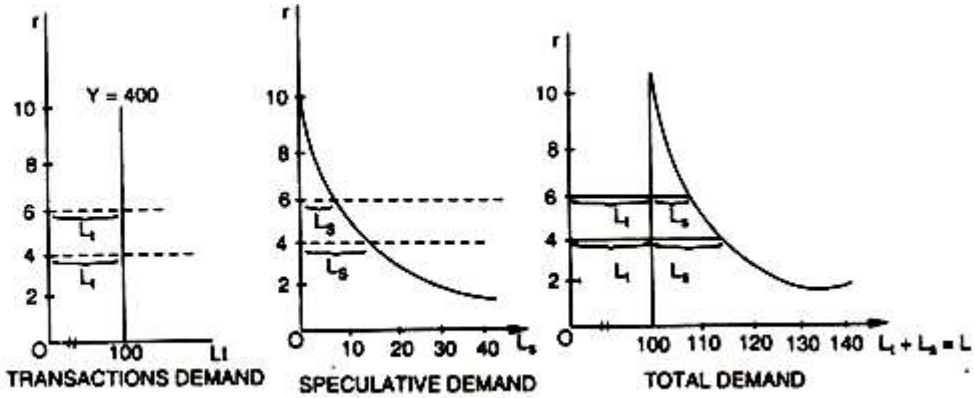


Fig. 26.1. *Stagflation arising from an Adverse Supply Shock*



TOTAL DEMAND FOR MONEY

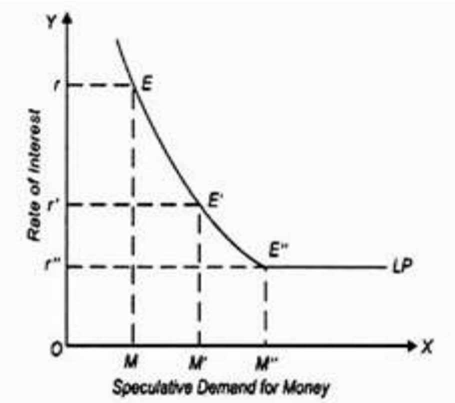
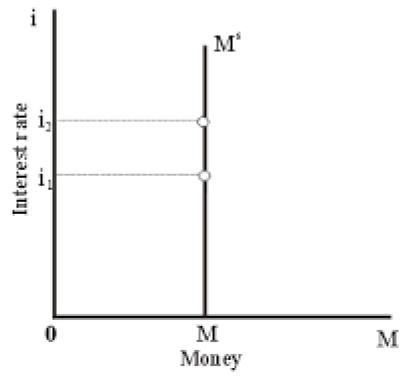


Fig. 15.2. *Liquidity Preference Curve and Liquidity Trap.*


i
Interest rate
M^s
i_2
i_1
0
M
Money
M

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SYBCOM SEMESTER IV
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The document gives a brief explanation of different concepts in Business Economics IV, Semester IV. It is also an assignment for practicing diagrams.

Disclaimer: The definitions, explanations and diagrams are taken from various sources.

Only for LSRC students.

MODULE I

1. **PUBLIC FINANCE**: The word public refers to general people and the word finance means resources. So Public Finance means resources of the masses,how they are collected and utilized.Thus, it is the branch of economics that studies the taxing and spending activities of government. It is that branch of general economics which deals with the financial activities of the state or government at national, state and local levels. The discipline of public finance describes and analyses government services,subsidies and welfare payments,and the methods by which the expenditures to these ends are covered through taxation,borrowing,foreign aid and the creation of money.

2. **SCOPE OF PUBLIC FINANCE**

   Prof.Dalton categories the scope of public finance into four areas which includes public income, public expenditure public debt and financial administration.

   (a) Public revenue: The study of various sources of government's income, the principles guiding the raising of income (e.g. canons of taxation), their relatives merits and demerits and their effects on the economy (e.g. impact and incidence of taxation).

   (b) Public expenditure: The study of the manner in which public expenditure is classified, the principles guiding public expenditure (canons of public expenditure), causes of growth and effects of public expenditure.

   (c) Public debt: The study of public debt forms a very important part of public finance in modern times as governments are increasingly resorting to debt to meet the growing needs of the people. Public finance studies the sources, burden and impact of public debt.

   (d) Financial administration: This includes the study of the preparation, passing and implementation Of the budget, budgetary policies and their socio-economic impact, inter-governmental financial relations, fiscal management and fiscal responsibility.

3. **FUNCTIONS OF PUBLIC FINANCE**.

   The functions of public finance all activities with regard to collection of revenue and expenditure on various activities .Earlier theories public finance narrow definition of the functions to be carried out by public authorities. It is clear that the area of state activity has enlarged over the past two decades which increased the functions and scope of public finance.

4. **ECONOMIC ACTIVITIES OF THE STATE** The scope of public finance was confined to the traditional functions of the state, that is, provision of defense, law and order, justice and civic amenities. But with the emergence of welfare states the scope of public finance was broadened public finance now includes the use of the budget as a tool to correct distortion in the economy, to mobilise resources, to maintain price stability create employment prevent market failure, achieve growth equity and maximize social welfare.

5. **FUNCTIONAL FINANCE:** The government should maintain a reasonable level of aggregate demand at all times by using the budget. Most developed economies followed

functional finance policies in order to control trade cycles. Developing countries followed such policies to promote economic growth.

6. **FISCAL OPERATIONS :**The scope of public finance includes fiscal operations and their objectives. Fiscal operations refer to raising public revenue, spending to achieve certain goals and financial administration. For such operations, the government uses fiscal tools like taxation, public expenditure and public debt.
The following are the objectives of fiscal operations;

(a) Allocation of resources: The most important objectives of fiscal operations is to determine how the Country's resources will be allocated to different sectors of the economy in order to achieve predetermined goals. The national budget determines how funds are allocated to different heads of expenses. The policy of public expenditure is used by the government to directly undertake resource allocation for different sectors. On the other hand, the government can use taxation and subsidies to indirectly influence resource allocation.

(b) Distribution: Fiscal operations can be effectively used affect the distribution of national income and resource Taxation and public expenditure policies are used by the government to reduce inequalities. Progressive direct taxation impose heavier burden on the rich than the poor. Public expenditure on social infrastructure and subsidies on food housing, health and education help reduce income inequality.

(c) Stabilisation: Developed economies experience business cycles. Economic stability implies absence of sharp cyclical movements in the form of booms and depressions. To bring about such stability, counter-cyclical fiscal operations are adopted. To counter depression and recession, government expenditure is increased to generate employment and taxes are reduced to encourage consumption and investment. During inflation, public expenditure is reduced and taxes are raised.

(d) Economic growth: In developing and underdeveloped economies, the objectives of fiscal operations are more promotional in nature. The basic focus of fiscal operations in such economies is the use of budgetary operations to achieve growth and development. This is done by encouraging capital formation and investments through public expenditure and tax incentives to private sectors.

7. **DALTON'S APPROACH TO MAXIMUM SOCIAL ADVANTAGE:**

According to Dalton the principle of maximum social advantage is the most fundamental principle lying at the root of public finance. According to the principle of maximum social advantage, the best system of public finance is that which secures the maximum social advantage from its fiscal operations. The maximum social advantage is achieved when the state in its financial activities maximise the surplus of social gain or utility (resulting from public expenditure) over the social sacrifice or disutility (involved in payment of taxes.) The principle of public finance, thus, requires the state to compare the sacrifice and benefits of the society in its fiscal operations.

8. **MUSGRAVE'S APPROACH TO MAXIMUM SOCIAL ADVANTAGE :** According to Richard Musgrave, the principle of maximum social advantage is called as **Maximum Welfare Principle of Budget Determination.** According to Musgrave, the principle explains that taxation and public expenditure should be carried out up to that level where satisfaction obtained from the last unit of money spent is equal to the sacrifice from the last unit of money taken in terms of taxes.

9. **PUBLIC GOODS:** A **public good** is a good that is both non-excludable and non-rivalrous in that individuals cannot be effectively excluded from use and where use by one individual does not reduce availability to others.

10. **PRIVATE GOOD**: A **private good** is defined as an item that yields positive benefits to people that is excludable, i.e. its owners can exercise private property rights, preventing those who have not paid for it from using the good or consuming its benefits; and rivalrous, i.e. consumption by one necessarily prevents that of another.

11. **MARKET FAILURE:** is the economic situation defined by an inefficient distribution of goods and services in the free market. Furthermore, the individual incentives for rational behavior do not lead to rational outcomes for the group. Put another way, each individual makes the correct decision for him/herself, but those prove to be the wrong decisions for the group. In traditional microeconomics, this is shown as a steady state disequilibrium in which the quantity supplied does not equal the quantity demanded.

MODULE II

12. **TAX: A tax** is a compulsory contribution to state revenue without quid-pro-quo, levied by the government on workers' income and business profits, or added to the costs of some goods, services and transactions.

13. **NON-TAX REVENUE:** is the recurring income earned by the government from sources other than taxes. The most important receipts under this head are interest receipts (received on loans given by the government to states, railways and others) and dividends and profits received from public sector companies.Various services provided by the government -- police and defence, social and community services such as medical services, and economic services such as power and railways -- also yield revenue for the government.

14. **DIRECT TAX: A direct tax** is paid directly by an individual or organization to the imposing entity. It is the tax of which impact and incidence is on the same person/ organization and the burden of tax cannot be shifted. A taxpayer, for example, pays **direct taxes** to the government for different purposes, including real property **tax**, personal property **tax**, **income tax** or **taxes** on assets.

15. **INDIRECT TAX: An indirect tax** is collected by one entity in the supply chain (usually a producer or retailer) and paid to the government, but it is passed on to the consumer as part of the purchase price of a good or service. The consumer is ultimately paying the **tax** by paying more for the product.

16. **PROGRESSIVE TAX**: A **progressive tax** is a **tax** in which the **tax** rate increases as the **taxable** amount increases. The term "**progressive**" refers to the way the **tax** rate progresses from low to high, with the result that a taxpayer's average **tax** rate is less than the person's marginal **tax** rate. A **progressive tax** is a **tax** that imposes a lower **tax** rate on low-income earners compared to those with a higher income, making it based on the taxpayer's ability to pay. That means it takes a larger percentage from high-income earners than it does from low-income individuals.

17. **PROPORTIONAL TAX**: A **proportional tax** is an income **tax** system where the same percentage of **tax** is levied on all taxpayers, regardless of their income. A **proportional tax** applies the same **tax** rate across low, middle, and high-income taxpayers. Proportional tax is a tax imposed so that the tax rate is fixed, with no change as the taxable base amount increases or decreases. The amount of the tax is in proportion to the amount subject to taxation.

18. **REGRESSIVE TAX:** A **regressive tax** is a **tax** applied uniformly, taking a larger percentage of income from low-income earners than from high-income earners. It is in opposition to a progressive **tax**, which takes a larger percentage from high-income earners. A **regressive tax** is a **tax** imposed in such a manner that the **tax** rate decreases as the amount subject to **taxation** increases. "**Regressive**" describes a distribution effect on income or expenditure, referring to the way the rate progresses from high to low, so that the average **tax** rate exceeds the marginal **tax** rate.

19. **IMPACT OF TAX:** Impact refers to the initial burden of the tax. The impact of a tax falls upon the person from whom the tax is collected and can or cannot be shifted as per the type of tax. The impact of a tax is on the person on whom it is imposed first. The impact of a tax, as such, denotes the act of impinging.

20. **INCIDENCE OF TAX:** Incidence refers to the ultimate burden of the tax. The incidence rests on the person who pays it eventually. It is the extent to which an individual or organisation suffers from the imposition of a **tax**. Dalton incidence as the direct money burden of tax on the person who ultimately pays it. Incidence, thus, rests on the person who cannot shift the money burden of the tax to any other person.

21. **REDISTRIBUTIVE EFFECT OF TAXATION:** Redistribution of income and redistribution of wealth are respectively the transfer of income and of wealth (including physical property) from some individuals to others by means of a social mechanism such as taxation. It is also called as redistributive effect of taxation.

22. **CANONS OF TAXATION:** By canons of taxation we simply mean the characteristics or qualities which a good tax system should possess. In fact, canons of taxation are related to the administrative part of a tax. Adam Smith first devised the principles or canons of taxation in 1776.

23. **Canon of Equality:** Canon of equality states that the burden of taxation must be distributed equally or equitably among the taxpayers. If everyone is asked to pay taxes according to his ability, then sacrifices of all taxpayers become equal. This is the essence of canon of equality (of sacrifice).

24. **Canon of Certainty:** The tax which an individual has to pay should be certain and not arbitrary. According to A. Smith, the time of payment, the manner of payment, the quantity to be paid, i.e., tax liability, ought all to be clear and plain to the contributor and to everyone.

25. **Canon of Economy:** This canon implies that the cost of collecting a tax should be as minimum as possible. Any tax that involves high administrative cost and unusual delay in assessment and high collection of taxes should be avoided altogether.

26. **Canon of Convenience:**

    Taxes should be levied and collected in such a manner that it provides the greatest convenience not only to the taxpayer but also to the government. Thus, it should be painless and trouble-free as far as practicable.

27. **Canon of Productivity:**

    According to a well-known classical economist in the field of public finance, Charles F. Bastable, taxes must be productive or cost-effective. This implies that the revenue yield from any tax must be a sizable one. Further, this canon states that only those taxes should be imposed that do not hamper productive effort of the community. A tax is said to be a productive one only when it acts as an incentive to production.

28. **Canon of Elasticity:** This canon implies that a tax should be flexible or elastic in yield. It should be levied in such a way that the rate of taxes can be changed according to exigencies of the situation. Whenever the government needs money, it must be able to extract as much income as possible without generating any harmful consequences through raising tax rates. Income tax satisfies this canon.

29. **Canon of Simplicity:** Every tax must be simple and intelligible to the people so that the taxpayer is able to calculate it without taking the help of tax consultants. A complex as well as a complicated tax is bound to yield undesirable side-effects. It may encourage taxpayers to evade taxes if the tax system is found to be complicated.
30. **Canon of Diversity:**
Taxation must be dynamic. This means that a country's tax structure ought to be dynamic or diverse in nature rather than having a single or two taxes. Diversification in a tax structure will demand involvement of the majority of the sectors of the population.

31. **Tax tolerance** : It is the amount of tax that a population is willing to tolerate and put up with. According to Wiseman-Peacock, people's capacity to bear tax burden with an increase in public expenditure

32. **Revenue Budget**: It comprises revenue receipts and expenditure met from these revenues. The revenue receipts include both tax revenue (like income tax, excise duty) and non-tax revenue (like interest receipts, profits).

33. **Capital Budget** consists of capital receipts (like borrowing, disinvestment) and long period capital expenditure (creation of assets, investment). Capital receipts are receipts of the government which create liabilities or reduce financial assets, e.g., market borrowing, recovery of loan, etc. Capital expenditure is the expenditure of the government which either creates assets or reduces liability. Capital budget is an account of assets and liabilities of the government which takes into consideration changes in capital.

MODULE III

34. **Public expenditure** is spending made by the **government** of a country on collective needs and wants such as pension, provision, infrastructure, **Public expenditure** refers to **Government expenditure** i.e. **Government** spending. It is incurred by Central, State and Local governments of a country.

35. **Public debt** refers to a part of the total borrowings by the Union Government which includes such items as market loans, special bearer bonds, treasury bills and special loans and securities issued by the Reserve Bank. It also includes the outstanding external **debt**.

36. **Solvency** is the ability of a company to meet its long-term **financial** obligations. **Solvency** is essential to staying in business as it demonstrates a company's ability to continue operations into the foreseeable future. **Solvency**, in finance or business, is the degree to which the current assets of an individual or entity exceed the current liabilities of that individual or entity. **Solvency** can also be described as the ability of a corporation to meet its long-term fixed expenses and to accomplish long-term expansion and growth.

MODULE IV

37. **FISCAL POLICY**: It is the means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy. **Fiscal policy** is the use of government revenue collection (mainly taxes) and expenditure (spending) to influence the economy. **It** is often used to stabilize the economy over the course of the business cycle.

38. **COUNTER-CYCLICAL FISCAL POLICY** A counter-**cyclical fiscal policy** refers to strategy by the government to counter boom or recession through **fiscal** measures. It works against the on-going boom or recession trend; thus, trying to stabilize the economy. Understandably, **countercyclical fiscal policy** works in two different direction during these two phases.

39. **FUNCTIONAL FINANCE** : It refers to an economic theory which hopes to put an end to business cycles through appropriate government policy. It was developed by British economist Abba P. Lerner during the Second World War. Lerner proposed that the taxation, borrowing and spending decisions of the government be actively targeted at upholding economic growth and controlling inflation while ignoring other concerns. For instance, a government that hopes to boost growth by increased spending and cutting taxes should worry only about the policy's effect on growth, not about the rise in debt due to such a policy.

40. **BUDGET**: A budget is an estimate of costs, revenues, and resources over a specified period, reflecting a reading of future financial conditions and goals. A **government budget** is an annual financial statement showing item wise estimates of expected revenue and anticipated

expenditure during a fiscal year." Just as your household **budget** is all about what you earn and spend, similarly the **government budget** is a statement of its income and expenditure.

41. **DEFICIT:** A deficit is an amount by which the expenditures in a budget exceed the income. A Government Deficit is the amount of money in the set budget by which the government expenditure exceeds the government income amount. This deficit provides an indication of the financial health of the economy.

42. **BUDGETARY DEFICIT**: It is the difference between all receipts and expenditures in revenue and capital accounts. This is a very narrow concept of deficit which reflects only a part of the resource gap in current fiscal operations.

43. **FISCAL DEFICIT**: It is the difference between total revenue and total expenditure. It indicates the total borrowing needed by the government. It occurs due to either revenue deficit or a major increase in capital expenditure. It is the excess of total expenditure including net lending. Thus fiscal deficit refers to the excess of total expenditure excluding repayment of debt over total receipts excluding debt capital receipts.

44. **MONETISED FISCAL DEFICIT**: Monetised deficit means the increase in the net RBI credit to the central government, such that the monetary needs of the government could be met easily.

45. **REVENUE DEFICIT**: Revenue deficit is the excess of revenue expenditure (the government expenditures which do not result in capital formation) over revenue receipts. This occurs when the actual amount of revenue received or the actual amount of expenditures do not correspond with the predicted revenue and expenditure figures

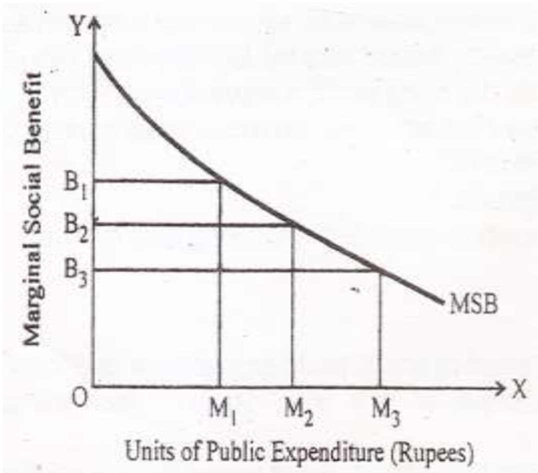
46. **PRIMARY DEFICIT:** It refers to difference between fiscal deficit of the current year and interest payments on the previous borrowings. Primary Deficit = Fiscal Deficit – Interest Payments.

47. **FISCAL FEDERALISM**: It deals with the division of governmental functions and financial relations among levels of government of an economy. Fiscal Federalism refers to the division of responsibilities with regards to public expenditure and taxation between the different levels of the government.

48. **FISCAL DECENTRALIZATION**: It means devolution of power and responsibilities of national (central), government towards sub-national (local), governments. Fiscal decentralization **involves shifting some responsibilities for expenditures and/or revenu**es to lower levels of government.

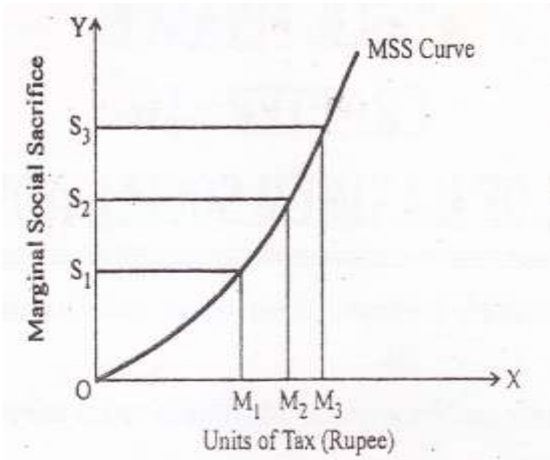
DIAGRAMS

1. MARGINAL SOCIAL BENEFIT CURVE



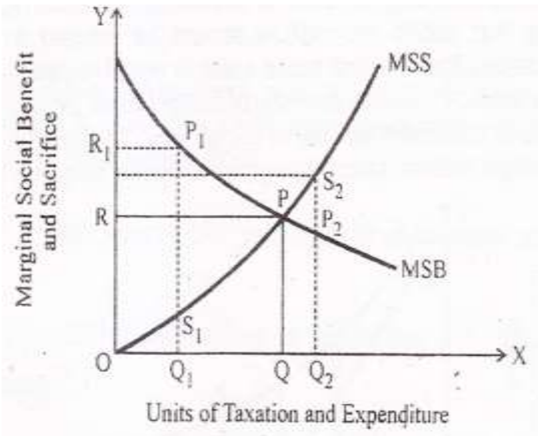
Diminishing Marginal Social Benefit Curve

2. MARGINAL SOCIAL SACRIFICE CURVE



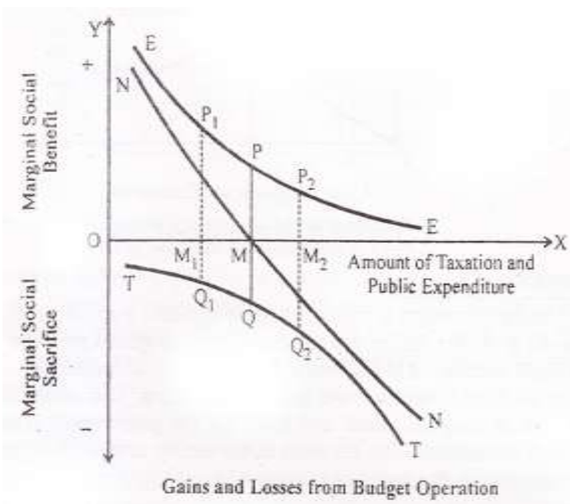
Increasing Marginal Social Sacrifice Curve

3. MAXIMUM SOCIAL ADVANTAGE



Maximum Social advantage is obtained at the Point of Intersection of MSS and MSB Curves

4. MUSGRAVE'S APPROCAH TO MSA



5. TAXATION

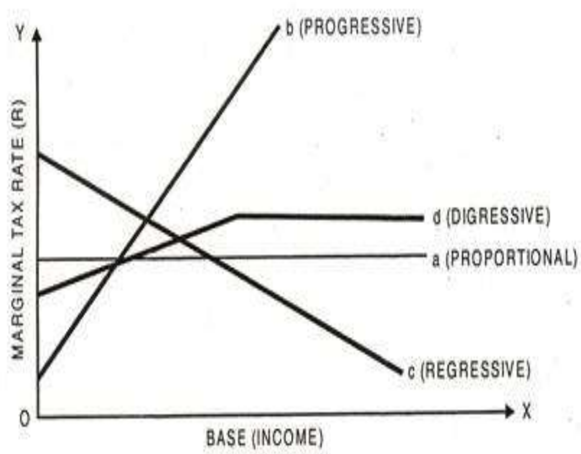
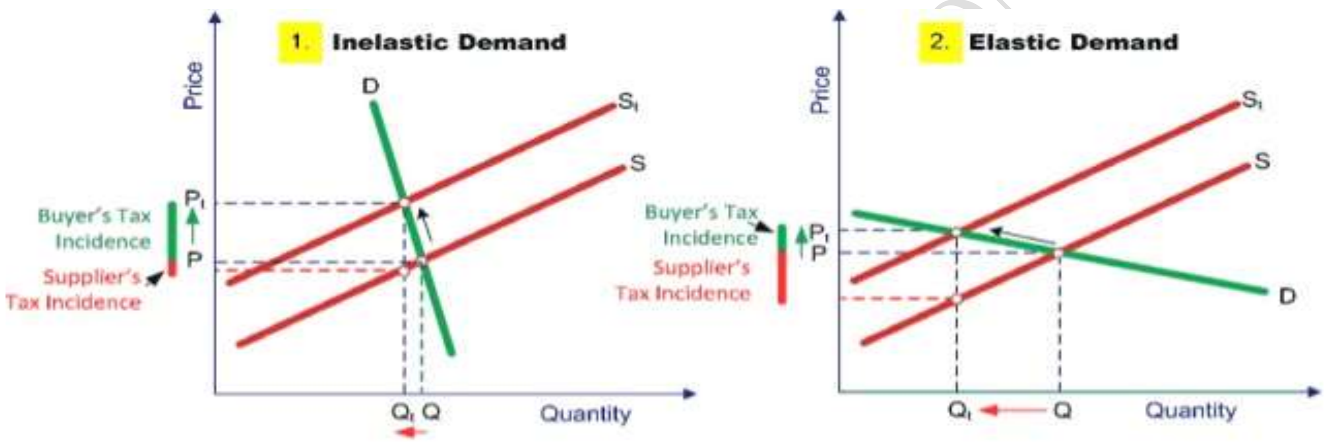
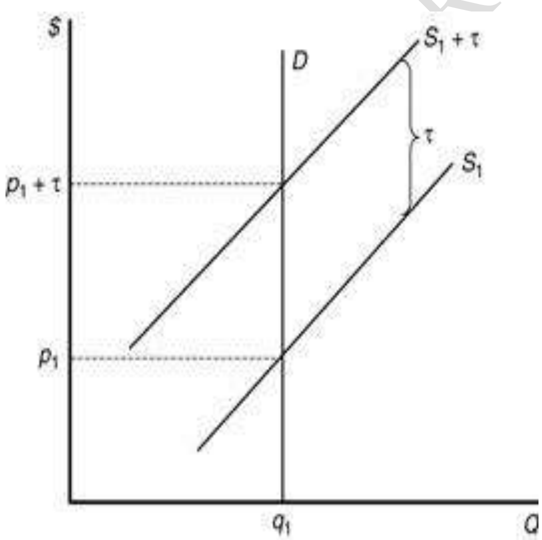


Fig. 1. Different Tax Rates.

6. INCIDENCE OF TAX AND ELASTICITY OF DEMAND





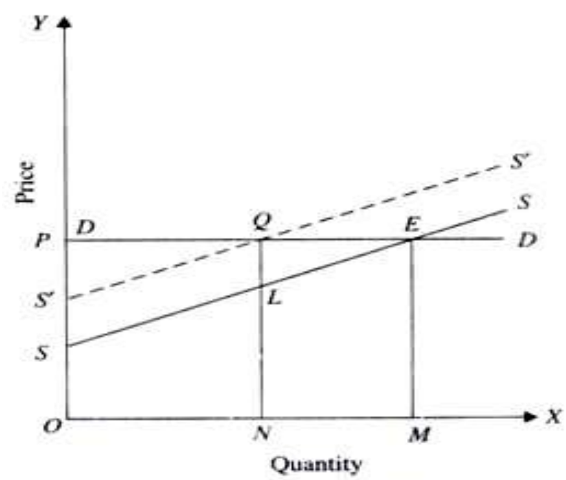
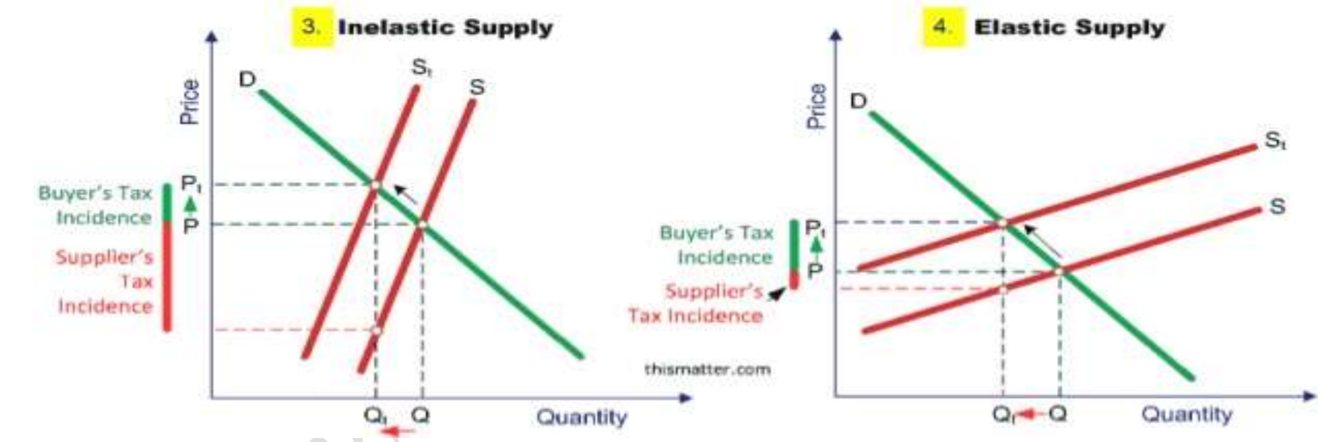


Fig. 32.4. *Incidence of a Tax in Case of Perfectly Inelastic Demand*

INCIDENCE OF TAX AND ELASTICITY OF SUPPLY



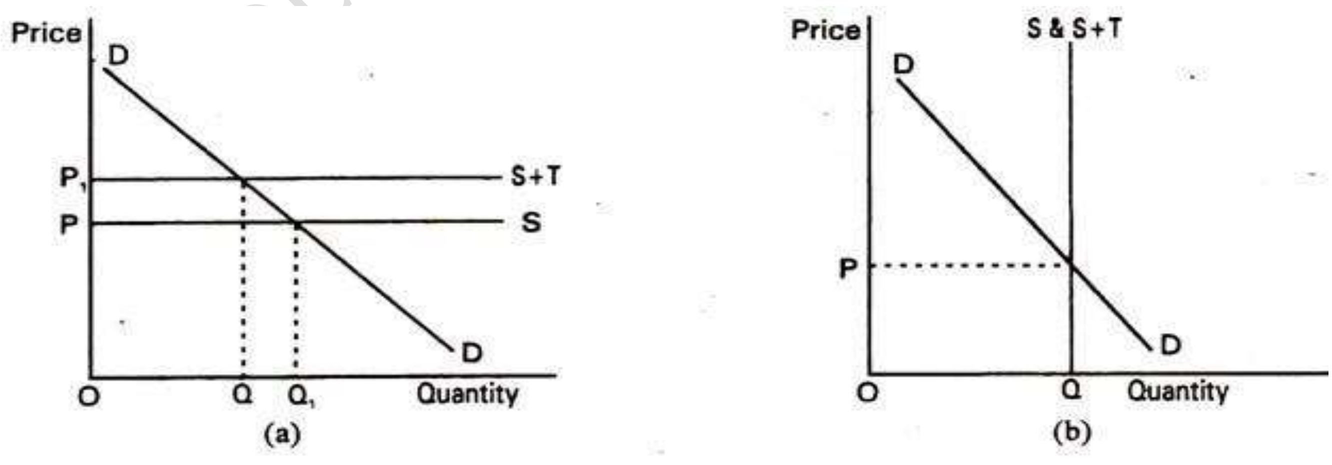


Fig. 9.15. Perfectly elastic and perfectly inelastic supply

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7. STRUCTURE OF UNION BUDGET