



## Daily Subject wise Quiz Day 25 Economy VII (Online Prelims Test)

1) Which of the following is not a part of the expansionist monetary policy of RBI?

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

Select the correct answer using the code given below:

- a. 1 and 2 only
- b. 2 only
- c. 1 and 3 only
- d. 1, 2 and 3

Answer : b

- Expansionary monetary policy works by expanding the money supply faster than usual or lowering short-term interest rates.
- For example, when the benchmark federal funds rate is lowered, the cost of borrowing from the central bank decreases, giving banks greater access to cash that can be lent in the market.
- During the Expansionary Money / Cheap Money / Dovish Monetary Policy, RBI will try to increase the supply of money and/or reduce the loan interest rates.
- So reducing the SLR, bank rate and repo rate will help in that regard.
- Increasing the MSF will raise the loan interest rates, so, if RBI pursues an Expansionary policy, it'll not do it.

2) Consider the following statements with respect to the Pro-cyclical Fiscal Policy stance during an economic boom

1. In this fiscal policy stance an increase in government expenditure will increase growth.
2. In this fiscal policy stance, the government also increases the tax rates.

Which of the statements given above is/are correct?

- a. 1 only
- b. 2 only
- c. Both 1 and 2
- d. Neither 1 nor 2

Answer : a

## Pro-cyclical Fiscal Policy

- In a pro-cyclical fiscal policy, the government reinforces the business cycle by being expansionary during good times and contractionary during recessions.
- Pursuing a pro-cyclical fiscal policy is generally regarded as dangerous. It could raise macroeconomic volatility, depress investment in real and human capital, hamper growth and

harm the poor.

- In Recession, the government takes the route of Expansionary Fiscal Policy i.e. the government expenditure is decreased and taxes are increased.
- This decreases the consumption potential of the economy and deepens the recession.
- In Economic Boom, the government takes the route of contractionary Fiscal Policy i.e. the government expenditure is increased and taxes are decreased.
- This increases the consumption potential of the economy and amplifies the economic boom.

3) Which of the following are not an objective of FRBM Act?

1. Achieving long-term macroeconomic stability
2. Better coordination between fiscal and monetary policy
3. Transparency in fiscal operations of the Government
4. Reducing the debt burden of the future generation

Select the correct answer using the codes given below

- a. 1 and 2 only
- b. 2 only
- c. 4 only
- d. None of the above

Answer : d

## FRBM Act

- The Fiscal Responsibility and Budget Management Act, 2003 (FRBMA) is an Act of the Parliament of India to institutionalize financial discipline, reduce India's fiscal deficit, improve macroeconomic management and the overall management of the public funds by moving towards a balanced budget.
- Objectives of the FRBM act are

1. Reduction of fiscal deficit and revenue deficit;
2. To achieve inter-generational equity in fiscal management by reducing the debt burden of the future generation;
3. Achieving long-term macroeconomic stability;
4. Better coordination between fiscal and monetary policy;
5. Transparency in fiscal operations of the Government.

4) Consider the following statements with respect to the 15th Finance Commission

1. It was under the chairmanship of Rahuram Rajan, its recommendations will cover from the year 2021-22 to 2025-26.
2. It has recommended maintaining the vertical devolution at 41% for revenue sharing.

Which of the statements given above is/are incorrect?

- a. 1 only
- b. 2 only
- c. Both 1 and 2
- d. Neither 1 nor 2

Answer : a

## 15th Finance Commission

- The Finance Commission (FC) is a constitutional body, that determines the method and formula for distributing the tax proceeds between the Centre and states, and among the states as per the constitutional arrangement and present requirements.
- The 15th Finance Commission was constituted by the President of India in November 2017, under the chairmanship of NK Singh.
- Its recommendations will cover a period of five years from the year 2021-22 to 2025-26.
- Vertical Devolution (Devolution of Taxes of the Union to States) - It has recommended maintaining the vertical devolution at 41% - the same as in its interim report for 2020-21.
- Horizontal Devolution (Allocation Between the States) - For horizontal devolution, it has suggested 12.5% weightage to demographic performance, 45% to income, 15% each to population and area, 10% to forest and ecology and 2.5% to tax and fiscal efforts.

5) Which of the following statements are correct with respect to Horizontal Devolution Criteria?

1. The population of a State represents the needs of the State to undertake expenditure for providing services to its residents.
2. Income distance is the distance of the Gross State Domestic Product (GSDP) of a particular state from the state with the highest GSDP.

Select the correct answer using the codes given below

- a. 1 only
- b. 2 only
- c. Both 1 and 2
- d. Neither 1 nor 2

Answer : c

### Horizontal Devolution Criteria



- It is a revenue-sharing formula proposed under 14th and 15th finance commission which includes the following criteria
- **Population** - The population of a State represents the needs of the State to undertake expenditure for providing services to its residents.
- It is also a simple and transparent indicator that has a significant equalizing impact.
- **Area** - The larger the area, the greater is the expenditure requirement for providing comparable services.
- **Forest and Ecology** - By taking into account the share of the dense forest of each state in the aggregate dense forest of all the states, the share on this criteria is determined.
- **Income Distance** - Income distance is the distance of the Gross State Domestic Product (GSDP) of a particular state from the state with the highest GSDP.
- To maintain inter state equity, the states with lower per capita income would be given a higher share.
- **Demographic Performance** - It rewards efforts made by states in controlling their population.
- This criterion has been computed by using the reciprocal of the total fertility ratio of each state, scaled by 1971 population data.