

**PUBLIC FINANCE
REPUBLIC OF IRELAND**

Diploma stage examination

13 December 2006

MARKING SCHEME



Question 1

(a) Excess burden of taxation

Context = three criteria of taxation 1
Purpose of three criteria = to assess & improve on taxation policy 1

Discussion of efficiency to include any **five** of:-

- Invisible hand of the market
- Impact of taxes on price mechanism
- Distorted decision-making
- Examples (labour/ consumption/ investment)
- Understanding that economic activity is reduced
- Factors that impact on the magnitude of excess burden (i.e. shape of market)
- Concept of fiscal neutrality

2 marks per point up to a maximum of 10

(12)

(b) Minimisation of excess burden

Discussion of price elasticity of demand & supply to include:

- Elastic vs. inelastic curves
- Examples to indicate understanding 4

Further discussion on any **two** points/ examples such as:

- Levying taxes where it is difficult to change behaviour
- Notion of "spreading" of taxes (as opposed to concentration)
- Avoidance of sliding scales (towards flat rates)
- Taxing negative externalities (where an inefficiency can be eliminated)

2 marks per point up to a maximum of 4

(8)

(c) Other factors

Discussion of (1) equity and (2) simplicity

Equity

- Ability to pay vs. benefit taxes
- Horizontal & vertical equity
- Use of relevant examples 3

Simplicity

- Administration & compliance costs
- Factors that aid/ hinder collection
- Use of relevant examples 3

Fact that the three criteria are often in conflict, i.e. very difficult for an individual tax to accord with all three 2

(8)

(d) Burden of debt

Understanding that the existence/ otherwise of a burden depends on interactions in the economy. 1

Use of **two** scenarios to illustrate understanding such as:

- Direct crowding out (current generation)
- Indirect crowding out (higher interest rates affect next generation)
- Extent to which the funds are borrowed domestically/ abroad
- Use of the debt (benefits outweigh the cost?)

3 marks per appropriate scenario up to a maximum of 6

(7)

(e) Government Bond

Introduction - as a type of debt instrument. 1

Function (any two of):

- Flexible debt instrument (timing/ issuing/ buying back)
- Importance in stock market
- As a risk-free instrument for investors

1 mark per point up to a maximum of 2

Operation:

- Explanation of interplay between price and yield 2

(5)

(40)

Question 2

(a) G/GDP

Acts as a proxy measure of government size. 1

Above the line (G) =

- Current spending on final goods & services
- Capital spending
- Transfer payments & servicing of debt 2

Below the line (GDP) =

- National income (eg. $C + I + G + X - M$) / any other "intuitive" explanation for National income 1

(4)

(b) Trend of G/GDP

Usefulness/ meaning of comparator to OECD average 2

Discussion of trend to include any **four** of the following points:

- Higher than OECD average in early-1970s
- Grew at faster rates in response to the oil crisis
- Peaked at an excess of 50% in the early 1980s
- Government response
- On the decline since early 1980s
- At lowest point (early 1990s) circa 30%
- Creeping back up towards OECD average in response to lower growth (more recently)

1 mark per point up to a maximum of 4

(6)

(c) Factors that influence the measure

Affected by movements above/ below the line/ both

Description of any **three** of:

- Economic growth
- Government policies
- Public sector efficiency
- Political ideology
- Methods of intervention

2 marks per points made up to a maximum of 6

Ability to reference to Irish public finance/ topical issues

1 mark per example up to a maximum of 3

(9)

(d) International Comparisons (risks)

This section draws on the ideas in the Lawlor/ McCarthy reading.

Arguments for/ against increased or reduced public spending based on international comparison of this ratio. 1

Must be tempered by (any **three** of):

- Pension arrangements
- Demographics
- Stage of economic cycle
- Levels of public debt
- GDP vs. GNP debate

2 marks per example up to a maximum of 6

(7)

(e) Government objective to reduce this ratio

Any qualitative argument **for** (such as):

- Creation of awareness that the public finances are a scarce resource
- Should drive public sector efficiency

Any qualitative argument **against** (such as):

- Does not tackle appropriate funding of spending
- General nature of measure
- Ignores micro spending issues

4 marks for any reasonable argument for/against

(4)

(30)

Question 3

(a) Budget 2006

Current surplus:

- Definition of current spend (permanence/ public sector pay)
- Composition of revenues (taxation)
- Definition of surplus
- Recent trends (tax receipts performance)
- Relative to growth (expect a surplus)
-

6

Capital deficit:

- Definition/ composition of capital spending (NDP/ PCP)
- Definition of deficit (normal – lack of capital resources/ inter-generational)
- Recent trends (growing deficits & why)
- Relative to growth (infra. Deficit – recommended to borrow)

6

Debt ratio:

- Context: EU - SGP (60% rationale)
- Definition (general government debt)
- Recent trends (comfortably within criteria)
- Relative to growth (easy to reduce with fast growth in GDP)

6

(18)

(b) Stability & Growth Pact

Knowledge of:

- Criteria (deficits & debt)
- Objective of a balanced budget in the medium term
- Commitment to price stability

1 mark per point up to a maximum of 3

Added qualitative discussion of **two** more points/ issues (eg):

- Requirement for current budget surplus given capital commitments
- Compliance issues
- Suitability for Irish context
- Recent loosening of the Pact.

1 ½ mark per point up to a maximum of 3

(6)

(c) Theories of public expenditure growth

Description of any two theories such as:

- Demographics
- Baumol's disease
- Public spending pressures as a result of ec growth
- Levels of debt
- Electoral cycle

Up to 2 marks per point up to a maximum of 4

Ability to relate the arguments to the Irish public finances / use of topical examples

1 mark per example up to a maximum of 2

(6)

(30)

Question 4

(a) Rationale for government intervention

Allocation:

- Oldest role for government
- Economic rationale
- Correction of market failures
- Relevant example

5

Re-distribution:

- Followed the Great Depression
- Social rationale
- Correction of skewed distribution of wealth
- Relevant example

5

Stabilisation:

- Followed the oil crisis
- Economic rationale (at macro level)
- Correction of extremes in the economic cycle
- Relevant example

5

(15)

(b) Performance Information

Introduction: understanding of the context of performance information - wider accountability focus/ comments of NESC/ C & AG/ role in international FM reform

1

Discussion of any **three** of:

- Dysfunctional effects
- Measurement of outcomes
- Service delivery
- Users cannot assess quality
- Conflicting perspectives on performance

3 marks per example up to a maximum of 9

(10)

(c) NESC Report suggestions

Context of the NESC Report –post SMI assessment of financial management

1

Discussion of any **two** recommendations such as:

- Incentivising cross-departmental activity
- Investing in public sector research
- Incorporation of performance indicators into the budget
- Movement towards more multi-annual decision making

2 marks per recommendation up to maximum of 4

(5)

(30)