

PUBLIC FINANCE

Diploma stage examination

12 December 2007

From 2.00pm to 4.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

*There are **four** questions on this question paper*

*Answer **three** questions in total*

One compulsory question from Section A

Two of the three questions from Section B

*The question in Section A carries, in total, **40** marks*

*The questions in Section B each carry a total of **30** marks*

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.



SECTION A (Compulsory)

1

Grassington University is in considerable financial difficulty as Jim Graham, the newly appointed Finance Director, is rapidly finding out. Jim left his post at Grassington District Council three months earlier attracted by a new challenge and expecting to finish his career at the university.

However, he is now confronted with major financial difficulties, which appear likely to grow more significant as time passes. Poor budgetary control has meant that costs have failed to fall in line with the declining student numbers which Grassington has experienced for many years, particularly in the area of overseas students. Not surprisingly, morale has fallen in many areas of the university's activities – this is expected to be reflected in poor assessments of the university's research activity with corresponding reductions in research related income and is also contributing to problems in the university's office responsible for grant applications.

Jim had been told that his experience in administering Grassington District Council's procedures for the revenue support grant had been a major reason for his appointment to the university post. However, Jim finds it difficult to see much parallel between the chaos he has inherited at the university and the systems he left at the council. Having identified the grants office as a priority, Jim is dividing his time between seeking to improve systems for the administration of existing grants and trying to encourage applications for new sources of funding, particularly from the European Union (EU).

Since much of the university estate is in poor repair as a result of planned maintenance falling behind schedule, another priority facing Jim is to consider the most appropriate way of addressing this. He has asked the head of the grants office to investigate the availability of grant income for building new accommodation, whether that be from the funding council or elsewhere. He is also considering whether an arrangement under the Private Finance Initiative might be an appropriate way forward.

• **Requirement for question 1**

- (a) What principles of good practice would assist Jim in his attempts to improve the application for and administration of grants at the university? 10
- (b) Explain briefly what the EU structural funds are and outline the steps which the grants office would need to take in order to successfully access such funding. 8
- (c) While at the district council, Jim would have been familiar with the formula based approach of the revenue support grant. Identify both the advantages of such an approach to the allocation of central government grant to local authorities and the conditions necessary for formula based allocation to operate effectively. 8
- (d) Distinguish between the terms Public Private Partnership and Private Finance Initiative, illustrating your answer with examples of each. 8
- (e) In recent years it has been suggested that a revised accounting treatment of PFI arrangements would place in jeopardy the ongoing achievement of the government's sustainable investment rule. Outline the main arguments supporting this proposition. 6

(40)

SECTION B (Answer two from three questions)

2

In the public sector the management of risk is fundamental to treasury management. This is due to the sector's fiduciary responsibilities to taxpayers and other stakeholders and to the inevitably high profile that would be generated in the media by any significant financial losses that could be ascribed to inadequate financial control.

• **Requirement for question 2**

- (a) Explain the following treasury management risks and discuss ways in which public sector treasury managers can manage them.
- (i) Liquidity risk. 5
 - (ii) Inflation risk. 6
 - (iii) Credit and counterparty risk. 3
- (b) The use of risk management techniques has a wider application than to just treasury management activities. Outline the main stages of risk identification and management within that wider context. 6
- (c) As suggested above, public sector treasury managers are required to act in a relatively risk averse manner.
- (i) Demonstrate how the pattern of investment by local authority treasury managers, both internal and external, reflects a risk averse approach. 4
 - (ii) Defining your terms appropriately, discuss how far the existence of a secondary market increases the liquidity of government bonds, thus making them a less risky investment for public sector treasury managers. 6

(30)

3

All commentators agree that the immediate future will see lower rates of increase in government expenditure than has been the case for some time.

This will require some hard decisions concerning spending priorities, since the demand for government financed provision is likely to remain high. In addition, it is likely to remain necessary to implement further supply side reforms to the delivery of government funded provision.

• **Requirement for question 3**

- (a) Outline the main factors that supply side theories of government expenditure growth suggest could lead to greater efficiency and effectiveness in the delivery of government funded goods and services. 7
- (b) What are the main demand side factors that drive increases in the demand for government expenditure? 10
- (c) Reduced growth in government expenditure should, other things remaining equal, lead to reduced long term borrowing by government and possibly reduced rates of taxation. Trace out the economic implications of:
 - (i) Reduced long term borrowing by government. 5
 - (ii) Reduced rates of income tax. 3
- (d) Explain the impact of reduced long term government borrowing upon the achievement of the government's two fiscal rules. 5

(30)

4

For some years central government has considered a variety of proposals for national road charging, for both cars and lorries, although it has yet to announce any definitive scheme.

• **Requirement for question 4**

- (a) Using economic theory as appropriate, outline the rationale for road pricing. 5
- (b) Economic theory states that user charges can only be imposed on private goods and not public goods. Explain what is meant by a public good and why it is not sensible to levy user charges on such goods. 5
- (c) Public goods are an example of market failure. Market failure is an accepted rationale for raising taxation by government. Identify two other rationales for government economic intervention involving taxation and discuss the way in which government typically seeks to achieve its objectives under each rationale. 10
- (d) Identify the major criteria by which national taxes can be evaluated. Describe each criterion and evaluate income tax against each criterion. 10

(30)
