

## PUBLIC FINANCE

### Diploma stage examination

**6 June 2008**

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

Phare is a small country which has in recent years vigorously pursued moves to a more market orientated economy. The success of its economic policy has been accompanied by a substantial increase in the value of its currency, the peso. Below we reproduce some excerpts from the 2008 edition of the Phare Abstract of Statistics, which calculates figures on an April to April financial year basis.

Phare Gross Domestic Product (billion peso, constant prices)

1990/01	49.63
2000/01	70.48
2007/08	108.30

Phare Public Expenditure (billion peso, constant prices)

1990/01	20.84
2000/01	29.17
2007/08	33.30

Number of employees within Phare public sector (full time equivalent)

1990/01	907,120
2000/01	910,140
2007/08	690,850

Age structure of Phare Population (%)

	0-21 years	22-40 years	41-65 years	66+ years
1990/01	28	29	31	12
2000/01	28	25	29	18
2007/08	21	27	33	19

Productivity growth (%) over the following periods

	Private Sector	Public Sector
1990/01 – 2000/01	37	12
2000/01 – 2007/08	28	18

A new Minister of Finance for Phare was appointed in 2005 who has publicly declared that she will seek to emulate some of the successful policies seen in Gordon Brown's time as UK Chancellor of the Exchequer. In her first financial statement in 2006 she announced the introduction of two fiscal rules - the golden rule and the sustainable investment rule - framed in exactly the same terms as their UK counterparts.

Nevertheless in 2007 she departed somewhat from Brown's approach to taxation when announcing a fundamental simplification of the Phare system of taxation and a substantial reduction in the real value of social security payments to job seekers and others on low incomes.

---

• **Requirement for question 1**

- (a) Using the figures provided from the Phare Abstract of Statistics, identify:
- (i) trends in Phare's economic growth; 2
  - (ii) trends, measured in different ways, in Phare's public expenditure. 8
- (b) With reference to appropriate figures and calculations comment on your findings in (a). 6
- (c) With reference to appropriate figures and calculations, consider how far other excerpts from the Phare Abstract of Statistics help to explain trends in public expenditure. 9
- (d) Explain the two fiscal rules - the golden rule and the sustainable investment rule - and identify how these two rules might contribute to the health of Phare's public finances. 8
- (e) What effects might the Minister of Finance's tax reforms have upon Phare's public expenditure performance? 7

**(40)**

---

**SECTION B (Answer two from three questions)**

**2**

As well as granting the Bank of England independent power to set UK interest rates, the Blair government also established the Debt Management Office (DMO) as an executive agency of the Treasury.

• **Requirement for question 2**

- (a) The DMO borrows on behalf of government by issuing both government bonds and treasury bills. Traditional textbook theory has suggested that these have different economic consequences from each other.
- (i) Demonstrate the traditional textbook view of the economic consequences of substantial issues of government bonds and treasury bills. 10
- (ii) Analyse how far the effects of bond and bill issues are as distinct as textbook theory suggests. 2
- (b) (i) Analyse the relationship between interest rates on new issues of bonds and the price of bonds in secondary financial markets. 4
- (ii) Apply the reasoning in your answer to (b) (i) to explain the concept of a bond's yield curve and demonstrate why the yield on a 50 year bond is likely to be higher than that on one issued with a shorter period to maturity. 4
- (c) Demonstrate how the DMO is able to influence the maturity structure of the government debt it holds and what advantages to the DMO may be derived from it achieving a longer average time to maturity. 4
- (d) Demonstrate the conflict of interest which the establishment of the DMO in 1998 was designed to resolve. 6
- (30)**

# 3

The Private Finance Initiative (PFI) offers an excellent case study of a policy whose objectives, emphasis and detailed implementation have changed significantly over time. In addition changes in the wider accounting environment have generated consequences for the policy that are markedly different from those envisaged by its original designers.

---

- **Requirement for question 3**

- (a) The Finance Act 2007 required that public sector accounts conform to International Financial Reporting standards. Demonstrate the effect that this will have on PFI's impact upon the government's fiscal framework. 4
- (b) Identify and discuss the main advantages that PFI has been argued to offer compared to conventional public sector capital asset procurement. 6
- (c) (i) Identify and define **seven** criteria by which the attractiveness of different sources of finance might be evaluated. 7
- (ii) Evaluate PFI as a source of finance against these criteria. 7
- (d) Evaluate the extent to which benchmarking and market testing have contributed to improvements in the ongoing value for money provided by PFI projects. 6

**(30)**

---

# 4

The reform of local taxation has been a high profile issue for many years, being considered in both the Balance of Funding Review and the Lyons Inquiry.

• **Requirement for question 4**

- (a) The Lyons Inquiry rejected calls for the localisation of National Non Domestic Rates (NNDR).
- (i) Demonstrate how far Business Improvement Districts (BIDs) and the Local Authority Business Growth Incentive Scheme (LABGI) generate a degree of local flexibility within the NNDR system. 6
- (ii) Demonstrate how the Lyons Inquiry proposal for reform of NNDR stopped short of full localisation. 3
- (b) Assess the main strengths and weaknesses of the BIDs scheme. 5
- (c) Some of the issues concerning local government finance addressed by the Lyons Inquiry included its flexibility and fairness. Drawing upon the Lyons Inquiry material analyse how far and why:
- (i) local government finance in England is flexible; 6
- (ii) the Council Tax is fair. 4
- (d) Identify and define **three** other evaluative criteria specifically relevant to a local tax and provide a brief assessment of Council Tax against them. 6

**(30)**