

# **PUBLIC FINANCE REPUBLIC OF IRELAND**

**Diploma stage  
December 2005**

## **MARKING SCHEME**



**Question 1**

- (a) Budget 2005 was framed around a borrowing requirement amounting to €3bn. Explain the crowding out hypothesis in the context of the issue of this debt.**

Introduction – inter-relationship between budget deficit and debt.  
Crowding out – definition.

2

Direct:

- Private economic activity cannot take place (eg construction).

2

Indirect (1):

- Explanation of credit market (supply & demand) & i rate behaviour.
- Understanding of implications of higher i rates.

2

Indirect (2):

- Impact on inflation.

2

Conclusions:

- Economic implications of public borrowing.
- Balance between sources of finance to minimise efficiency costs.
- Limited applicability due to EU membership.

2

Excellent understanding/original thought/linking to rest of syllabus.

4

(14)

- (b) The budget announced a full review of tax relief and incentive schemes. Using any relief/incentive as an example, examine its operation against the criteria of equity, efficiency and simplicity.**

Introduction – definition of a tax relief/incentive = anything that reduces your tax bill.

2

List 3 \* criteria & explain the purpose of criteria of taxation.

Example of holiday home/car parks/medical insurance/pension etc:

Equity:

- Assess against ability-to-pay.
- Assess against benefit principle.
- Discussion of trade-off of above.

2

Efficiency:

- Assess against impact on ec activity.
- Mention of deadweight.
- Mention of elasticity of demand & supply.

2

Simplicity

- Assess against admin & compliance costs.
- Mention of complexity.

2

Conclusions:

- Trade-off among criteria. 2

Excellent understanding/original thought/linking to rest of syllabus. 4

(14)

**(c) How does the Stability and Growth Pact impact on budget formulation?**

Introduction – Importance of pact in terms of a constraint. 2

Outline (any 3 of):

- Deficit limit of 3% and debt limit of 60%.
- Implications of total deficit measure for borrowing for capital purposes.
- Reporting requirements (updates and surveillance).
- Principle of low inflation. 4

Examples (any 3 of):

- Record of adherence.
- Warning about inflation (2001).
- No changes to indirect taxation (2005).
- Reference in gov programme to Pact. 4

Excellent understanding/original thought. 2

(12)

**(40)**

<b>Question 2</b>
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- (a) Drawing on appropriate examples, define the following forms of market failure and provide an example of government activity designed to combat the market failure:**

Introduction – defn of a public good & why the inefficiency results. 1

Understanding & explanation of:

1. Non-rival.
2. Non-excludable. 3

Relevant example including public solution (street lighting/ defence etc). 1

Excellent understanding/original thought. 1

(6)

Introduction – why imperfect info results in market failure. 1

Explanation of types of info failures.  
(price/quality). 3

Relevant example incl. Public solution (healthcare/foods). 1

Excellent understanding/original thought. 1

(6)

Introduction – why merit goods result in market failure. 1

Explanation of why merit goods are not in sufficient demand. 3

Relevant example incl. Public solution (education/seatbelts). 1

Excellent understanding/ original thought. 1

(6)

- (b) As suggested above, pressure to increase government spending makes it increasingly difficult to maintain a low tax regime. Outline any three theories governing the cause of public expenditure growth.**

Introduction – explanation of the G/GDP measure & upward trend across OECD over the last Century.

1

Causes (discussion of any three of):

- Baumol's law.
- Debt dynamics.
- Demographics.
- Wagner's law.

9

Reference to other areas of the course eg:

- Budget model.
- Latent spending pressures.
- Difficulty of reversing trend/Fin mgt reform.

1

Excellent understanding/use of relevant examples from the Irish public finances.

1

(12)

**(30)**

**Question 3****(a) The three primary shortcomings of the cash-based system of annual and management reporting.**

Introduction – tradition of cash-based system. Inadequate in terms of modern financial management.

1

Explanation of any three of:

- No measure of resource consumed.
- Absence of B/Sheet – eg condition of assets.
- Incentive to spend budget by year end.
- Non-cash items not recognised.

3

Excellent understanding/ original thought/linking to rest of syllabus.

2

(6)

**(b) For each of the shortcomings mentioned above, an explanation of how the accruals information can contribute to improved financial management.**

Introduction – brief explanation of accruals information.

1

Explanation of any three of:

- More meaningful way to hold a manager accountable.
- Existence of balance sheets requires that assets be managed.
- Less manipulation of timing of receipts & payments.
- Better matching – eg provisions with policies.

6

Excellent understanding/original thought/linking to rest of syllabus.

2

(9)

**(c) An assessment of the main difficulties associated with the incorporation of performance information into the budget process.**

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

1

Issues– any three of:

- (1) Dysfunctional effects.
- (2) Measurement of outcomes.
- (3) Service delivery.
- (4) Users cannot assess quality.
- (5) Conflicting perspectives on performance.

6

Excellent understanding/original thought.

2

(9)

**(d) The advantages of financial management reform for decision-making.**

Introduction – financial management reform required to support other managerial reforms.

1

Discussion at a higher level such as:

- Awareness of financial implications in all decision-making.
- Accruals focus has a more managerial emphasis.
- Better info can allow devolution & ownership of decision-making.
- Better quality info in resource allocation decisions.

4

Excellent understanding/ original thought/ linking to rest of syllabus.

1

(6)

**(30)**

<b>Question 4</b>
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**(a) Outline the theory of *Ricardian equivalence* as it applies to public sector borrowing.**

Introduction - context of public sector debt.	
Raising public monies can impact on the rest of the economy.	1
Explanation of traditional view of credit markets.	
Implication of traditional view.	3
Explanation of Ricardian view of credit markets.	
Implication of Ricardian view.	3
Excellent understanding/ relevance to Ireland/linking to rest of syllabus.	2
	(9)

**(b) Critically assess the provisions of the *Stability and Growth Pact* with regard to its influence on the Irish public finances.**

<b>Introduction</b> – Importance of pact in terms of finances.	1
<b>Outline</b> – understanding of deficit & debt provisions & principle of low inflation.	1
<b>Advantages:</b>	
Mention of any three of:	
• Limit to counter-cyclical policy (recession).	
• Neutral with regard to preferences.	
• Transparent.	
• Compliance assured.	4
Discussion/evidence/relevance to public finances.	2
<b>Limits:</b>	
Mention of any three of:	
• Asymmetrical.	
• Magnitude of criteria.	
• Changed economic conditions.	
• One size fits all?	4
Discussion/evidence/relevance to public finances.	2
Excellent understanding/original thought.	1
	(15)



**(c) Briefly describe the function and operation of a Government Bond.**

Introduction - as a type of debt instrument. 1

Role:

- Risk-free.
- Importance in credit market.
- Flexibility in terms of maturity options. 2

Operation:

- Outline of interplay between price & interest rates. 2

Excellent understanding/relevance to Ireland/ linking to rest of syllabus. 1

(6)

**(30)**