

# PUBLIC FINANCE

## Diploma stage examination 14 December 2005

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

### ***Instructions to candidates***

*Answer three questions in total: **One** question from **Section A**, and **two** questions from **Section B**. The marks available for each question are shown in italics in the right-hand margin.*

*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

As the Director of Finance of South Borough Unitary Authority, you are currently working upon next year's council tax. As in previous years the authority is under significant pressure to minimise the percentage increase in council tax and you are carrying out some preliminary projections of what you expect council tax bills for South Borough to amount to. You have assembled the following projections and estimates to assist you.

	£m
Projected spending for that year	480
Expected level of central government support	330
Anticipated income from fees and charges	64
Projected income from other sources, eg European grants	21
Intended expenditure from reserves or balances	5
	%
Anticipated average council tax collection rate	97
Average percentage discount/exemption across the council tax bands	12

While you recognise that all of this data is provisional, you feel that it allows you to make a reasonable first estimate of the authority's council tax requirement.

Finally you obtain the following data on South Borough's current domestic properties stock.

Band	Properties	Council tax weighting
A	2,050	6
B	3,890	7
C	5,710	8
D	11,950	9
E	18,780	11
F	5,931	13
G	3,708	15
H	981	18

### • Requirement for question 1

- (a) Based upon the data above, estimate the band D council tax bill likely to be levied next year. 10
- (b) (i) Identify and briefly explain five criteria against which it is appropriate to evaluate a local tax. 5
- (ii) Evaluate council tax against each of these criteria. 5

- (iii) With reference to the main features of National Non-Domestic Rates, discuss whether it is a local tax. 5
  - (c) Should South Borough decide to engage in some long-term 'prudential borrowing', explain in broad terms the indicators it would be required to set by the CIPFA Prudential Code for Capital Finance in Local Authorities. 10
  - (d) Discuss the proposition that the CIPFA Prudential Code for Capital Finance exerts only a loose form of control on local authority borrowing. 5
- (40)**
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**SECTION B (Answer two questions from this section)****2**

In the 1980s a combination of supply side economic theory and the pursuit of electoral advantage led to the UK government offering a series of rate reductions on a number of taxes. With the exception of the Liberal Democrats, the main political parties still seek to present themselves as having a commitment to low taxation. Pressure for increased government spending is, however, making such a commitment increasingly difficult to meet.

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- **Requirement for question 2**

- (a) Using examples as appropriate, define the following forms of market failure and explain why they are held to require the government to levy some form of taxation:

- |                       |   |
|-----------------------|---|
| (i) public goods      | 8 |
| (ii) natural monopoly | 5 |
| (iii) merit goods.    | 5 |

- (b) As was suggested above, pressure to increase government spending makes it increasingly difficult to maintain a low tax regime. Explain the reasons why the demand for public sector output may grow over time. 12

**(30)**

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# 3

You are a CIPFA trainee and have recently begun a period of work experience in the treasury management unit of a medium sized UK registered social landlord. The head of the unit is meeting with you as part of your induction. He explains some of the activities of the unit and stresses the need for the maintenance of accurate documentation by those working in it. He also discusses some basic principles of treasury management and introduces you to some of the terminology that you will encounter during your work there, such as primary and secondary markets, and some of the financial instruments that the unit deals in.

He explains the unit's need to be risk averse in its approach to treasury management and discusses some of the risks that its activities face. In doing so, he mentions that the unit has implemented the treasury management indicators required of local authority units, as he feels that they provide a good framework for the management of some aspects of risk. Finally, he talks you through a recent purchase of UK treasury bills by the unit.

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• **Requirement for question 3**

- |     |       |  |   |
|-----|-------|--|---|
| (a) | (i)   | In the context of financial markets explain the terms primary and secondary market.  | 3 |
|     | (ii)  | Explain what is meant by a financial asset being 'liquid' and the implications for an asset's liquidity of whether or not it is traded in a secondary market.  | 5 |
| (b) |       | The unit head explained to you that the treasury bills were bought at issue for £485,000. He expected the unit to keep them until their maturity six months later when they would be redeemed for £500,000. Calculate the rate of discount at which they were purchased. | 3 |
| (c) |       | In what main areas does good practice suggest that records and documentation should be kept by a public service treasury management unit?  | 5 |
| (d) |       | Define the following types of treasury management risk suggesting how each might be managed:   |   |
|     | (i)   | interest rate risk on borrowing activity   | 7 |
|     | (ii)  | refinancing risk   | 4 |
|     | (iii) | market risk.   | 3 |

**(30)**

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# 4

The current UK government is somewhat more relaxed than its predecessors about the amounts of government borrowing in which it is prepared to engage.

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- **Requirement for question 4**

- (a)
    - (i) State the two fiscal rules that the government has adopted to guide its fiscal policy. 5
    - (ii) Explain the rationale for these rules. 6
    - (iii) Compare these rules with the view of government borrowing taken by Keynesian economic theory. 4
  - (b) It has become increasingly important for public sector bodies to maximise their grant income. Discuss what good practice in the management of grant application and claims work would entail for a UK public sector body. 8
  - (c) The EU structural funds are an important source of grant funding for the UK public sector. The EU has a clear process in which member state governments and bodies receiving structural funds are required to participate. Outline the main stages of this process through to the final signing off a completed project. 7
- (30)**
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