

PUBLIC FINANCE

Diploma stage examination

16 June 2006

From 10.00am to 12.00noon
plus ten minutes reading time from 9.50am to 10.00am

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**

Just over six years ago Blackbush Council launched its urban tramway. This was the culmination of eight years planning and construction, which had involved extensive consultation with local and national transport and environmental pressure groups.

The Council Scrutiny Committee has requested a review of the tramway's performance. Fare and usage data have been provided by the tramway management team and are summarised below.

Table 1

Year	Fare (£)	Revenue (£000)
1999	1.00	3,050
2000	1.10	3,170
2001	1.20	3,620
2002	1.35	3,810
2003	1.40	3,910
2004	1.50	4,400

Note. Passengers under 16 and over 60 travel for free; consequently they are excluded from the above data.

As might be expected, the tramway has generated considerable controversy during both its planning and operation. When launched it was seen as a radical initiative which would have significant environmental implications for Blackbush. At the end of 2000 the Council sought to enhance the tramway's ability to reduce car usage further through a significant and unpopular increase in city centre car park prices. Critics of the tramway suggested that it would not cope with the predicted increases in usage. However, capacity did not prove to be a problem.

Passengers have always paid a flat rate fare irrespective of the length of their journey. At the tramway's launch, the then leader of the Council claimed that the flat rate fare was a 'brave attempt to compensate low income residents in the outer estates of Blackbush for the regressive nature of the UK's local and expenditure based taxes.' Opposition parties' claims that the flat rate fare had contributed significantly to the tramway's operational deficits have been rebutted by the Council. Nevertheless the review will be examining the tramway's approach to fare setting, although the cabinet member responsible for the tramway has warned that this should be done 'fully recognising the significant burden of local and national taxation already borne by many residents.'

• **Requirement for question 1**

- (a) Define the term 'price elasticity of demand' and, using examples as appropriate, identify circumstances in which demand is likely to be inelastic. 7
- (b) Basing your analysis upon the data in table 1, evaluate whether demand for the tramway was inelastic over the period 1999 - 2004. 5
- (c) Discuss the impact of the increase in city centre car park prices on the use of the tramway in 2001. Comment upon how precise your conclusion is able to be. 6
- (d) The flat rate fare was justified in terms of the 'regressive nature of the UK's local and expenditure based taxes.' Explain whether or not value added tax is regressive. 8
- (e) Identify principles of good practice in charge setting, which could inform that element of the tramway review. 6
- (f) The cabinet member responsible for the tramway wants the review to take account of both local and national taxation. Concerning national taxation
- (i) What are the major criteria by which it is appropriate to evaluate a tax? 5
- (ii) What do supply side economists see as the consequences of a significant tax burden on both individuals and companies? 3

(40)

SECTION B - (Answer two questions from this section)

2

Patient care will suffer unless NHS managers get a stronger grip on their finances, the health service's "watchdog" said this week, as it revealed that almost one in four trusts is in deficit.

The latest and final set of star ratings, published by the Healthcare Commission, showed that financial management was a significant area of weakness and had caused several trusts to lose a star. Acute trusts were singled out as a particular concern, with a third not breaking even.

Healthcare Commission chief executive, Anna Walker, said poor financial management was a 'fly in the ointment' of the health service.

'Quality of care is inextricably linked to good financial management. Temporary instability must not lead to a permanent problem. If it does, patients will lose out because the standards of care will suffer,' Walker said.

Nor were elite foundation trusts immune from financial headaches. The troubled Bradford Teaching Hospitals NHS Foundation Trust underachieved on financial management and dropped from three-star to two-star status. Peterborough Hospitals NHS Foundation Trust also missed its financial target and was stuck on two stars.

Excerpt from Public Finance 29 July 2005

• **Requirement for question 2**

- (a) Compare the financial freedoms and responsibilities of foundation and conventional NHS trusts. 9
- (b) A key element of financial management is the effective investment of surplus monies. Explain the main features of the following money markets, commenting upon the appropriateness of the instruments traded within them for investment by public sector treasury managers.
- (i) Certificate of deposit market. 4
- (ii) Local authority market. 5
- (iii) Eurocurrency market. 3
- (c) Outline the main characteristics of government bonds and explain why they normally face an upward sloping yield curve. 9

(30)

3

In recent years central government funding of local authorities has received significant attention. The Balance of Funding Review concluded that a greater proportion of English local authority finance should be raised locally. This led to the Lyons Inquiry, which was charged with looking at how a change in the balance might be achieved and whose scope was subsequently extended to include consideration of the role and functions of local government.

• **Requirement for question 3**

- (a) While the extent of central government funding of local authorities has been criticised by many, including the Balance of Funding Review, arguments in favour of a substantial level of central government support remain. Outline the main rationales for central government support of local services. 5
- (b) Many central government grants, such as the Revenue Support Grant to local authorities and the unified allocation to Primary Care Trusts, are determined by means of formulae. What are the advantages and disadvantages of formula-based approaches to grant distribution? 9
- (c) In 2003/04 the UK government introduced the Formula Spending Share (FSS) system for the distribution of the Revenue Support Grant in England. What changes were brought about by the replacement of the Standard Spending Assessment by FSS? 6
- (d) Many recipient organisations fail to maximise their income from grants. What would you recommend that they do to guard against this happening? 10

(30)

4

After the Chancellor this week redefined the economic cycle, many economists and opposition politicians are demanding that the government's fiscal policy be assessed by an independent body based on statistics free from suspicion of political interference.

Gordon Brown's decision on July 19 to move the start of the current economic cycle from 1999 to 1997 – increasing the chance of meeting his 'golden rule' by including an extra £12bn of budget surpluses – has infuriated his critics.

Excerpt from Public Finance 22 July 2005

• **Requirement for question 4**

- (a) Explain what is meant by 'the economic cycle' and discuss how government finances typically behave across the cycle. 6
- (b) (i) Explain in more detail why the inclusion of an extra £12bn of 'budget surplus' by redefining the duration of the cycle increases Gordon Brown's chances of meeting his 'golden rule.' 3
- (ii) Explain why the government's 'golden rule' needs to be complemented by the sustainable investment rule, distinguishing between the government's current and capital budget as you do so. 5
- (c) Why does the achievement of the four traditional objectives associated with economic policy typically vary across the cycle? 8
- (d) What impact might significant volumes of government borrowing through the issue of bonds have upon each of the objectives considered in (c) above? 8

(30)
