The Chartered Institute of Public Finance & Accountancy

STRATEGIC PUBLIC FINANCE

December 2021

Duration: 3 hours

Marking Scheme There are **6** questions on this question paper. Questions 1 and 2 are 30 marks each. Questions 3 – 6 are 10 marks each. Answer **all 6** questions

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. Marks will also be awarded for appropriate examples drawn from real life that demonstrate understanding and application of theory.

1

Dispute over 'absent' business case

Earlier this month, the London Borough of Hammersmith and Fulham approved a £5.8m plan to repair Hammersmith Bridge, London, which was closed for more than a year.

Baroness Vere, parliamentary under-secretary at the Department for Transport wrote to the authority last week, stating that the government would not provide support, as the business case omitted some key costs.

However, the leader of the council responded to the minister yesterday, stating that she had been "misinformed", and that these costs were, in fact, factored into business plan.

He asked the minister to correct her statement. In addition, he said that he was disappointed "that in relation to the business case our comments have been interpreted as suggesting that rigour should not be applied in public funding decisions. We have never sought to brush aside the business case process."

The council queried the lengthy assurance and approvals process for the business case, which required approval from DfT's Investment Portfolio and Delivery Committee (IPDC) and the Treasury's Approval Point. (TAP)

He said: "Given the scale of the £5.82m stabilisation costs, based on advice from our advisers, this appeared to be disproportionate and inconsistent with the scale of projects that typically require IPDC and TAP approval. We also see an urgency in expediting the work so it can be finished in time for next summer, thus avoiding the threat of potential further closures due to extreme high temperatures."

Under the Transport for London funding agreement in June 2021, the costs of the repairs would equally split between the transport body, the council and the DfT.
Source: Public Finance 26 Aug 2021

The Treasury's business case development process is an iterative process over time that goes through three key stages (Strategic Outline Case, Strategic Business Case and Full Business Case) which each incorporate the five dimensions of the strategic, management, economic, financial, and commercial cases. The level of detail and the completeness of each of the five dimensions are built up at different rates during each of the key stages.

Requirement for question 1

a) Describe the **steps** and **stages** in the process for developing a business case using the Treasury's Model, explaining how the SOC, SBC and FBC are built up over time.

   You should also explain the positive benefits that the Model is reported to deliver.

   Note: You are **not** required to provide details of the **content** of the Five dimensions (cases) within the Model in this part of the question but should discuss the extent to which they are considered at each stage.

(18 marks)

b) Robust business cases should be produced for major projects following the Treasury's Five Case Model. Define the **purpose** of the Economic Case.

(2 marks)

c) Describe **what** should be included in the Economic Case and explain why these elements are important.

(10 marks)

(30 marks)

2

Services rethink needed over £36m budget gap

The unitary authority of Dorset (a council in the UK) has forecast pressures of around £8.3m, based on returns over the first quarter of 2021-22, mainly attributed to increased social care costs and reduced incomes for the Council.

However, legacy pressures could crystalise next year, leaving a £36m funding gap requiring additional savings and changes to services.

The portfolio holder for finance commercial and capital strategy, said: "The truth of the matter remains that this council is underfunded by government, when compared with councils of similar size, and over the coming budget process we will need to consider how we can change that situation."

"Can we think differently? Can we consider whole new ways to operate and, importantly, to raise income, not just from existing sources with new and innovative methods? Over the coming months we have some very, very tough challenges ahead."

This year's budget was based on the assumption that £10.8m of savings was achievable. However, £5.2m of savings were deemed high risk and unachievable, with a further £3.4m rated amber, and at some degree of risk, the report said.

Over the last two financial years, the authority has used reserves to balance budgets, but the council has agreed to not use these buffers to manage in-year spending.
Instead, the council said it will work on a spend-to-save basis, identifying proposals that can provide long-term savings.
Source: Public Finance 7 Oct 21

Requirement for question 2

(a) In terms of public services financial planning, discuss with examples from your experience or learning:

- **why** the development of medium and longer term financial plans is important
- the key assumptions for sources of income and types of expenditure you would expect to see in medium and longer term forecasting
- the benefits and problems associated with medium and longer term financial planning.

(10 marks)

(b) Define and discuss the differences between incremental budgeting and zero-based budgeting, and evaluate the appropriateness of these methods for at least two different public sector organisations.

(10 marks)

(c) There is a continuing debate around the value of building reserves, and whether this represents prudent financial management, or is an inappropriate use of scarce resources. Reliance on reserves by councils has also been criticized.

From you experience or learning, present ideas about how councils are determining and managing suitable reserve levels, and where they can innovate and make best use of reserves and assets to help them maintain their financial resilience.

(10 marks)

(30 marks)

3

The PEFA framework was developed under the PEFA Program, which is closely aligned with the international aid effectiveness agenda.

Requirement for question 3

Describe the purpose and objectives of the PEFA framework, and discuss the advantages and disadvantages of relying on a standard set of performance indicators to measure aid effectiveness.

(10 marks)

4

Benchmarking can be a key element of measuring performance and success. In some cases, you can only assess whether a project or service is successful if you can compare with others. Benchmarking is used widely in public service organisations, both within sectors and between other sectors.

Requirement for question 4

a) Define the term Benchmarking.

(1 mark)

b) Explain the objectives of benchmarking, and discuss the factors that public sector organisations should consider when undertaking benchmarking against other organisations.

(9 marks)

(10 marks)

5

Public services acknowledge that charging for some services can be a contentious issue.

Requirement for question 5

Discuss with use of examples, the range of desirable characteristics for public services to consider, where charging for a service is an option.

(10 marks)

6

Devolution of fiscal powers can bring large financial responsibilities onto finance professionals.

Requirement for question 6

With the use of examples from your experience or learning, discuss the advantages and disadvantages of devolving fiscal powers from any central government to local government.

(10 marks)

Marking Scheme

Question 1

Syllabus Ref C3 Workbook 11

a)

A well-prepared business case supports evidence-based decisions and can be used to provide a clear framework for thinking about spending proposals or transformation of services, and a structured process for appraising, developing and planning to deliver best public value.

It provides a framework for thinking and a process for approval, which is flexible and scalable along with a range of tools that can be applied proportionately to provide clarity in the decision support process. For smaller projects the Business Justification Case can be used. The approach also provides a clear audit trail for purposes of public accountability.

The Treasury guidance claims that the application of the Five Case Model has been shown to:

- reduce the costs and timescales associated with producing business cases and to improve the efficiency and throughput of the spending approval process through clearer structure and presentation
- raise the quality of spending proposals, both in terms of their scoping and delivery and public value, as a result of the more effective comparison of alternative options for the achievement of objectives
- support the prioritisation of spending proposals and the management of spending portfolios through provision of standard information.

Templates are available online for all of the stages of the Five Case Model.
It is important to remember though, that the full model is often not appropriate for small projects, and in practice many organisations develop business plans that do not use, or need to use, all the stages described for the model.

Process for developing a business case
Business cases are important because policies, strategies, programmes and projects will only achieve their spending objectives and deliver benefits if they have been:
scoped robustly
planned realistically from the outset the associated risks and costs have been taken into account.

The business case, both as a product and a process, provides decision makers, stakeholders and the public with a management tool for evidence based and transparent decision-making, and a framework for the delivery, management and performance monitoring of the resultant scheme.

The business case in support of a new policy, new strategy, new programme or new project must evidence the five 'cases' or 'dimensions', namely:

- the strategic case: intervention is supported by a compelling case for change that provides holistic fit with other parts of the organisation and public sector
- the economic case: intervention represent best public value

- the commercial case: the proposed deal is attractive to the market place, can be procured and is commercially viable
- the financial case: the proposed spend is affordable
- the management case: what is required from all parties is achievable

Stage 0 – Determining the strategic context and preparing the Strategic Outline Programme (SOP) Step 1: ascertaining strategic fit Gate 0: strategic fit

Stage 1 – Scoping the proposal and preparing the Strategic Outline Case (SOC)

Step 2: making the case for change Step 3: exploring the preferred way forward Gate 1: business justification

Stage 2 – Planning the scheme and preparing the Outline Business Case (OBC)

Step 4: determining potential VFM

Step 5: preparing for the potential deal

Step 6: ascertaining affordability and funding requirement Step 7: planning for successful delivery

Gate 2: delivery strategy

Stage 3 – Procuring the solution and preparing the Full Business Case (FBC)

Step 8: procuring the VFM solution

Step 9: contracting for the deal

Step 10: ensuring successful delivery

Gate 3: investment decision

Stage 4 – Implementation

Gate 4: 'Go Live'

Stage 5 – Evaluation

Gate 5: benefits realisation

The Strategic Outline Case

This needs to:

- confirm the strategic context of the investment proposal set out the rationale
- make a robust case for change at a strategic level set the background to the proposal
- explain the objectives that are to be achieved
- provide stakeholders and customers with an early indication of the proposed way forward (not the preferred option).

The **Strategic Case** should be completed in full at this stage. However, some revisions (refining of detail) are permissible at future iterations of the case (i.e. Outline and Full Business case).

The strategic policy context and the fit with wider public policy objectives should be satisfactorily explained. This information will be reviewed by key policy areas - potentially across departments and sectors - and needs to appropriately explain fit with their policy area; show any interaction dependency with other policy programmes; and identify the main stakeholder groups and any potential conflicts/competing demands. Investment objectives are critical to the strategic case; these need to be strategic, measureable, accurate, realistic and timely (SMART). They will form the benefit realisation plan of your project and ultimately demonstrate the return on investment.

Outline Business Case (OBC)

The OBC is the second stage of the business case submission. The purpose and key elements to be assessed at OBC are:

Commercial

Set out the procurement strategy, ownership of any assets and key contractual issues identified and explained

Financial

Contains a detailed analysis of affordability and any funding gaps

Management

Develops in more details how the programme/project will be delivered with an outline of the proposed programme/project management plan and provides details of how the programme/project will be managed in accordance with the appropriate methodology.

Full Business Case (FCB)

The FBC is the final stage of the business case submission. The purpose and key cases to be assessed at FBC are:

Commercial

Identify the ‘market place opportunity’ which offers optimum VFM (value for money). Set out the negotiated commercial and contractual arrangements for the project

Financial

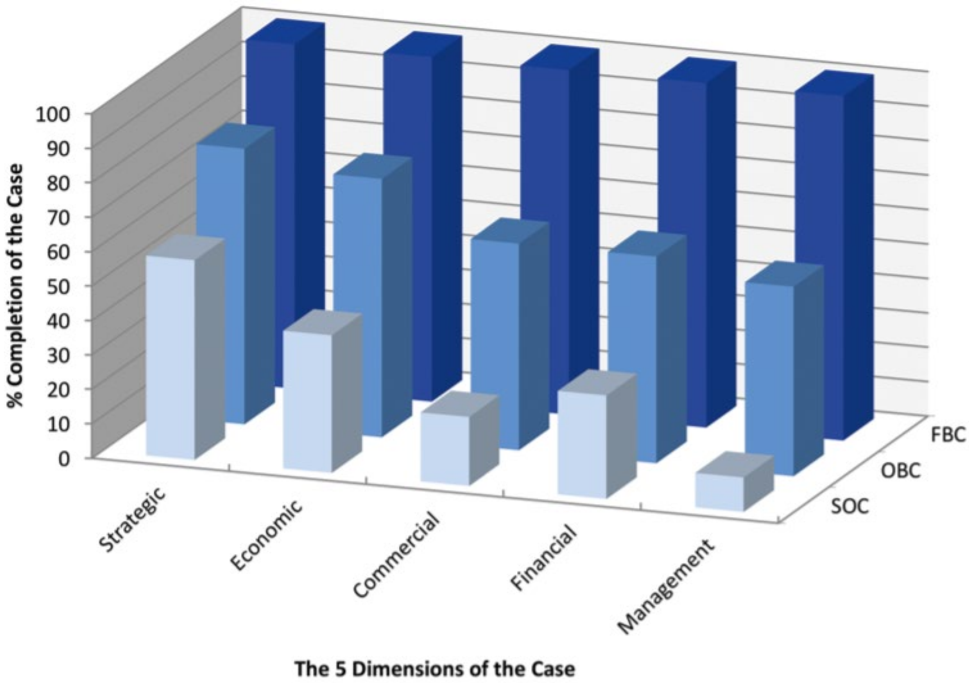
Demonstrate that the project is fully affordable.

Management

Put in place the detailed management arrangements for the successful delivery of the scheme.

From Treasury - Guide to developing the project business case

At conclusion of the FBC, the development of the business case across the five dimensions of the Five Case Model will have been completed as illustrated below.



1 mark per point up to 6 marks for the process and benefits of the Model. 1 mark per stage described up to 6 marks. Up to 2 marks for SOC, 2 marks for OBC, 2 marks for FBC (no marks for naming them as provided within the question deliberately to steer away from detailing the Five cases within the Model) Total 18 marks

b)

Syllabus Ref C3 Workbook 11

Economic case

The main purpose of the Economic Case is to demonstrate that the spending proposal optimises value for money (for public services as a whole, rather than the individual organisation). It explains how this is achieved by identifying and appraising a wide range of realistic and achievable options, known as the long list, in terms of how well they meet the spending objectives and critical success factors agreed for the scheme; and subjecting a reduced number of options, known as the short list, to cost benefit analysis (CBA).

Total 2 marks Must include reference to value for money and the long to short list option appraisal process to gain full marks

c)

The economic case should include the following:

Element to include	Why
critical success factors (the attributes essential to the successful delivery of the scheme, against which the available options are assessed)	So that the reasons for doing the project can be clearly established. Identifying the criteria by which success can be measured – Did we get what we wanted?
long listed options	To ensure the full range of options is at least considered in the first instance
short listed options (including do minimum. Three or four is the recommended number)	To enable useful comparison of the viable options
status quo; do nothing option (unless this is not credible)	So we can measure whether it is worth doing the project – will it be better than what we have now, this might be financial savings or improved quality, or both.
economic appraisals of costs and benefits with CBA	To fully understand the comparative costs, and identify the benefits
distributional analysis (where relevant)	To enable the comparisons and range of outcomes
optimism bias adjustment	To ensure that the project is realistic
risk assessment	To ensure the risks are properly documented so they can be appropriately managed
sensitivity analysis	To establish the impact of changing some of the variables, so the variables with the most impact can be managed where possible
the preferred option	To give a clear indication of the best option based on all the analysis above to support a decision.

½ mark per element identified (left column) up to 5 marks that should be included in the case. Up to 5 further marks for explanation why these areas are important (right column). (max 10 marks for this part)

Question 2

Syllabus Ref B4 Workbook 9

a)

A good medium-term financial plan / strategy should act as the organisation's route planner that plots the path ahead by focusing on policies and priorities in an organised, coherent and systematic manner. It should not seek simply to give provisional budget figures, but rather provide an insight into business trends.

It is important to:

- give clear direction and assurance that the strategy is affordable
- identify potential problems before they arise
- provide opportunity for scenario planning and development of contingency plans
- flexibility to accommodate changes in the environment through the planning period

Clearly the longer the planning assumption, the greater the extent to which they will be high level forecasts built on a number of significant assumptions. The uncertainties around leaving the EU and the economic and fiscal pressures resulting from the Covid-19 Pandemic (in relation to both central government spending and local government spending) could influence all other assumptions simply because it is hard to predict the impact until more facts are known.

When forecasting, the significant key assumptions will include:

- the main sources of income:
  - central government settlement
  - Fees and charges
  - business rates and growth
  - Council tax income
  - Commercial income opportunities

- key spending assumptions:
  - pay awards
  - non pay inflation
  - cost of supplies and services
  - expected demand for services
  - known future commitments/liabilities.

There will be degrees of uncertainty in forecasting both income and expenditure streams into the distance. Nevertheless, by making informed decisions on the main elements, the likely level of affordability limits for service planning can be derived.

Further refinements to forecasts can be achieved through sensitivity analysis, which can enhance the quality of financial information to the betterment of front line services.

Benefits of developing a MTFS are:

- Clear framework of planned expenditure to support decisions made already and to inform future decisions
- Transparent tracking of adjustments year on year
- Increased predictability of funds available, which can force clarity around criteria for spending in the short and medium term

Problems with MTFS may be:

- Figures included for later years might be considered as entitlement to budgets by managers
- Assumptions made might turn out to be wrong because of unexpected changes in service demand, the economy, political changes to central policy, or within the organisation itself.

A good MTFS relies on the skill and knowledge of the finance managers developing it, reliable information from the organisation's teams and realistic forecasting.

1 mark per point allocated as: up to 3 marks for why MTFS is important, up to 4 marks for examples of assumptions, up to 3 marks for discussion of advantages and disadvantages. (maximum 10 marks)

b) Syllabus Ref B4 Workbook 9

In the recent past, the majority of public sector bodies use an **incremental** approach to budget setting. It is considered straightforward to explain and understand, and quick to implement.

Incremental budgeting involves taking the budget for the previous year (or period) and changing it by known factors such as inflation and known grant income. The incremental approach is especially applicable for **local authorities** because:

- central government restrictions apply in increasing local taxation income (unless a local referendum supports increases in Council Tax)
- central government grants are paid annually
- there are restrictions on the ways in which other income sources can be exploited, e.g. caps on fees and charges, or nationally set charges for things like planning application fees and gaming licences
- a range of statutory services must be delivered every year so:
  - There is often good knowledge of demand e.g. how many households require refuse collection
  - The changes from year to year are minimal.

As the governments around the world implement their plans to re-organise the finances in the wake of the economic impact of the global pandemic, annual budgeting at a government level might be common in the next few years.

Annual budgets are used to closely monitor the adherence to the budget. In public sector organisations there is much less (if any) scope for increasing charges during the financial year to balance extra expenditure, as:

- the income in the form of grants are fixed for the year, and are therefore a finite amount of money;
- public sector bodies must report annually on their out-turn (actual expenditure) compared to the set and approved budget;
- any fees or charges are also set annually in line with the budget process.

Zero based budgeting is as it's name suggests, starting from zero rather than a previous year's budget amount. It involves reviewing and estimating what goods and services are required for the year to deliver the required level of services. These estimates should reflect the plans of the organisation.

Zero based budgeting could be applied successfully to central government services such as **Defence**. Rather than increase the budget incrementally each year, starting afresh with a proper evaluation of the actual needs over the short term could reveal many areas where activities are no longer required.

In time of financial uncertainty, there is even more substance to the arguments for using **zero-based** budgeting in the public sector as it encourages:

- Critical evaluation of which services must be delivered;
- Hard thinking about which traditional services may no longer be required or can be delivered in a
- different way that costs less;
- Re-thinking the real cost of services and being innovative about how to pay for them.

1 mark for each definition, 1 mark per different PSO (Local government and defence in this model answer) 1 mark point in discussion about differences and evaluation of appropriate methods – broadly 3 marks for discussion about incremental and 3 marks for ZBB (max 10 marks)

c) Syllabus ref B5 workbook 10

Managing reserves is a key activity for financial managers in all types of organsiations. Making decisions or recommendations regarding when and if to hold reserves (and where to invest them), and when to spend, are especially important when formulating strategies to cope with volatile funding.

A number of high profile articles have been written in recent years about the level of cash reserves being held by public service organisations – particularly local authorities and the NHS.

There are differing views on reserves and the levels being maintained by organisations. Prudent financial managers will argue that building reserves is critical to ensuring financial resilience is possible in times of austerity or unforeseen crisis.

Finance managers will ear-mark reserves and ring-fence them for specific projects set aside monies to cope with a crisis and undertake clever investment to generate income from interest wherever possible.

Organisations should also be investigating where investment in assets or projects should be undertaken to generate revenue income going forward.

Finance managers are responsible for ensuring 'appropriate' levels of reserves, and particularly in local government for producing a budget that is balanced and affordable in year – i.e. through income generated and use of reserves.

Requirement to take a long term view – reserves can be used as one-off. They are not a sustainable source of income.

Need to allow for contingencies such as unexpected demand for services. Might be as a result of a natural disaster, epidemic, or some other crisis.

Important to have the skills to identify what level of reserves is prudent, but not so cautious that the keeping of reserves reduces service provision to an unacceptable level. Having the financial skills to get the balance right is critical.

Investment in revenue-generating assets such as:

- hotels

- business parks and similar

May be appropriate when borrowing costs are cheap, but this must be done within prudent borrowing rules. The risks of owning (and sometimes operating) these assets bring other problems and associated costs. Especially if there is a gap in skills for managing these types of properties.

Risks need to be appropriately managed and mitigated to prevent loss of assets or reserves.

Look at building on the resilient income streams, especially in light of the impact of the global pandemic, where income streams that were previously considered relatively safe and reliable, have either completely evaporated, or heavily reduced or delayed. (Such as car parking, leisure income)

Candidates may come up with a range of suggestions not included above. Sensible suggestions with assumptions will gain credit.

(Total 10 marks)

Question 3

Syllabus ref A2 Workbook 2

The PEFA framework is a diagnostic tool intended to act as an agreed assessment of the performance of the Public Financial Management (PFM) system of a country, that allows an accepted starting point to discuss reform requirements of governments and increasingly sub national governments. The assessment of a country's PFM, through applying the PEFA framework, provides valuable information to donor and lending organisations, such as the World Bank.

The PEFA framework has been developed as a means to assess whether a country has the tools to deliver the following three main budgetary outcomes:

- aggregate fiscal discipline
- strategic resource allocation
- efficient use of resources for service delivery

The objectives of the PEFA framework are to:

- provide reliable information on the performance of PFM systems, processes and institutions over time contribute to the government reform process by determining the extent to which reforms are yielding improved performance and by increasing the ability to identify and learn from reform success
- facilitate harmonisation of the dialogue on PFM performance, reform needs and donor support between government and donors around a common PFM performance assessment and therefore contribute to reduce transaction costs for governments of the countries involved.

Advantages from following the PEFA framework and PIs:

- Delivering a credible, comprehensive and evidence-based diagnostic that can be compared over time and serve as a basis to monitor the results of PFM reform efforts, through repeat assessments and/or by building PEFA indicators into a country's own monitoring and valuation mechanisms.
- Enabling country governments to lead PFM assessments or become actively engaged in work led by external agencies, through a clear and specific assessment framework with objective rating criteria.
- Providing harmonization and standardization of the information requested by external agencies using a common assessment tool.
- Providing a common platform for stakeholder dialogue on PFM reforms by facilitating priority setting and defining key entry-points for PFM reform plans.
- Strengthening country capacities to promote alignment with and use of country systems (such as PFM, procurement, statistics, monitoring and accountability systems).
- Promoting 'capacity development' through peer-learning and regional PFM groupings.

Disadvantages from using PEFA PIs

The focus on results comes with some risks that will be familiar from debates around results-based management in any public services, and whether quantitative targets can have unhelpful unintended consequences. One method of measurement may not fit all circumstances, some of the standard PIs might not always be relevant.

In the context of aid, there is a risk of projects being chosen because it will be easy to demonstrate impact, as opposed to doing what is best to promote development.

There is also the possibility of 'what gets measured gets done' rather than focusing on the actual needs of the recipients, and the outcomes that will improve their well-being and development opportunities.

The cost of monitoring and evaluating the effects of aid can result in difficult trade-offs for donors.

Oversight can be expensive, and cause aid workers to be behind a computer screen filling out forms when they should be out in the field, diverting resources away from delivering the services required, in favour of number crunching to demonstrate records have been kept and processes have been followed.

Showing compliance with the system and processes for donors to see, may actually reduce the chance of achieving the best outcomes for the recipients.

4 marks for explaining purpose and objectives of PEFA

3 marks for advantages, 3 marks for disadvantages of using fixed PIs

(10 marks)

Question 4

Syllabus Reference C5 Workbook 13

Benchmarking can be defined as:

'the measurement (of the quality / efficiency /effectiveness) of an organisation's policies, performance, strategies, costs, etc., and their comparison with standard measurements, or similar measurements of its peers'.

The objectives of benchmarking are:

- to determine what and where improvements are called for
- to analyse how other organisations achieve high performance levels
- to use this information to improve performance.

Who to benchmark with

When considering benchmarking, the choice of comparators is important and should be the organisations that will give the most informative and relevant comparison.

For example, many organisations in local government could benchmark with their geographical neighbours, when the demographics of those neighbours may be very different. A better comparison could be those local authorities with a similar demographic profile.

Factors to consider when choosing benchmarking 'families' are:

- organisation type / sector
- organisation size
- size and nature of the area covered by the organisation
- demographics
- geographical location
- strategic / policy approach

Looking at each of these factors in turn:

Organisation type / sector

Most organisations will wish to compare themselves with others who operate in the same sphere as

themselves – housing, hospitals, police forces, etc.

The advantage of this approach is that there may already be contacts across that sector and there will be information readily available to be shared.

For example, for Police, Her Majesty's Inspectorate of Constabularies (HMIC) produce annual profiles which compare performance and data from all Police Forces in England & Wales. Similarly, CIPFA produce a wide range of statistics for public sector organisations, featuring all those who participate in the data collection exercises.

A disadvantage of these sector-specific comparisons is that if the sector as a whole is not performing as well as it should, the value of benchmarking for improvement will be limited. Consider whether your own organisation would want to promote itself as being 'one of the best of a bad bunch'? In these circumstances, some comparisons **outside** the sector – with other organisations that share similar characteristics – could be more useful.

Organisation size

Whilst many performance measures are taken as a unit cost or a cost per head of population, rather than absolute values, there may still be differences due to the size of an organisation. Factors such as economies of scale, purchasing power and influence may mean that comparisons between a small organisation and a much larger one are not valid.

When establishing a group of suitable peers to be in a benchmarking group it is advisable to look at the number of employees, overall budget and the population served.

Size / Nature of area covered by an organisation

Undertaking benchmarking comparisons between an organisation serving a large urban population and one serving a small, spread-out rural population would not give the best results – the needs of clients (and the ability to deliver services) will be very, very different.

Demographics

In a similar way, the needs of a population that is served by an organisation can be very different due to demographics. A well-off, wealthy but primarily elderly area will have a set of needs that do not match those of an area with more young people, with high levels of deprivation and poverty, and it follows that the organisations serving these areas will be different too.

Geographical location

For the same reasons as for demographics and size of area, geographic areas can be a factor to consider in benchmarking. In some cases, comparing performance with its nearest neighbours can be the best option for an organisation, especially if the geography does affect service levels, demand and cost. Clearly, this is also a factor when considering international or global comparisons.

Strategic / Policy approach

Organisations that take the same position on service delivery can make good and useful comparators. For example, looking at other organisations which have adopted an outsourcing approach for back-office services would be a suitable approach for an organisation which has contracted out its Finance, HR and ICT functions.

1 mark for benchmarking definition, 1 mark for benchmarking objectives. 1-2 marks per factor discussed up to a maximum of 8, discussion should include reasoning. Half marks only for just listing factors. (10 marks maximum)

Question 5

Syllabus Ref A6 Workbook 11

The desirable characteristics for public services where charging is an option include being:

- Affordable - in terms of sustainable service delivery and cost recovery, or affordability in terms of any subsidisation.
- Equitable – fair to users
- Competitive, but without unfair advantage through use of public money
- maintaining a service level that is acceptable (and does not lead to additional costs for reparation)
- legal – the organisations must not be prohibited by a specific law to charge for a particular service.

Charges should be:

- easily determined and calculated: the methodology should be relatively simple and straightforward and should not involve undue time and effort expended on the part of those responsible.
- equitable: public sector organisations have a responsibility to the users of services and to taxpayers. Charges which are made should be fair to all parties and should be seen to be fair.
- Transparent and understandable: in order to reinforce the fairness and encourage people to willingly pay the charges, the basis of charging should be clear to those paying the charges.
- Sufficient: that is, sufficient to meet whatever financial objectives have been set in relation to the service being provided. This may be:
    - full cost recovery
    - to limit the level of subsidy where the subsidy is a fixed amount
    - to limit demand by high pricing
- Compatible with other objectives: the charge should not be set in such a way as to work against the meeting of other, service based objectives. It is important that the mission and purpose of the organisation is recognised clearly and that charges should not conflict with achieving them.
- Related to ability to pay: the local authority provides services that should be available to all, irrespective of ability to pay. In these cases charges should not act as a barrier preventing people from using the services.
- Cost-effective: the charges made should at least cover the administrative cost of recovering them unless there is some other motive behind charging such as encouraging responsible use.

1 mark per basic desirable characteristic listed in first 5 bullet points. 1 mark per further bullet point that gives more detail that can link back to those 5 headings. Total 10 marks

Question 6

Syllabus ref A3 Workbook 4

The arguments for greater fiscal decentralisation fall into three broad categories that are the constant

theme of good public financial management:

- greater democratic engagement
- improved allocative efficiency
- improved operational efficiency

National fiscal discipline will continue to be controlled by fiscal rules/legislation regarding local government.

Arguments in favour:

- Sub-national governments know better what local people want - this moves the decision making closer to the end users and take account of very specific local needs. For example the local health care needs may vary dependent on ethnicity (pre dispositions to certain illnesses), local environment and local industry. By moving the spending decisions closer to the local area these demands can be better reflected in provision of services. As well as better needs assessment there is also a better reflection of local priorities when resources are scarce. This can be particularly important in times where resources are being reduced as where the cuts are made can reflect local priorities.
- Sub-national governments have a better idea of best local sources of revenue - this links to allocative efficiency in that taxes can be targeted to meet local circumstances. For example, in areas of high tourism a room tax on hotels can be a very useful source of revenue that does not impact on the level of tourism as the impact is likely to be small. Examples here are in the Kilimanjaro areas of Tanzania and capital cities, such as Rome, whereas in other areas that may not be appropriate. In China mining taxes are appropriate in Anshan region but not in Shanghai.
- Sub-national governments can provide services more efficiently - operational efficiency can be improved where the local scrutiny is higher and the hierarchical structure reduced. This is one of the principles of subsidiarity.
- Improves the democratic processes - Local representation should increase access to marginalised groups, promote an opportunity to be involved in the decision making process, allow greater scrutiny of political choices and improve governance of local activities.
- Whilst the above arguments offer strong incentives to increase fiscal decentralisation, care must be taken. There are a number of dangers that must be managed effectively. If they cannot be managed, then they may prevent the benefits being achieved or make the position worse than a centralised system.

Arguments against:

- Lack of capacity at local level - the skills required for good local governance and good local financial management are scarce. In many developing countries there is not the capacity in terms of skills to meet these needs. The capacity not only needs to be developed but also retained. This can take some considerable time and investment in both human and institutional capacity building.

- Risk of (extra layer of) corruption - one of the key arguments promoting decentralisation was greater scrutiny at local level reducing potential corruption. A counter argument is the capture of institutions by local elites that add an additional layer to the system and use that to benefit themselves.

- Replication of systems - operational efficiency may be reduced as the optimum size for operational efficiency may be greater than for the other aspects resulting in replica systems being developed adding costs that are not efficient.

- Additionally, some countries are very small and so the need for localised knowledge is not there, for example city states like Singapore.

- The ideas of decentralisation have been based on geographic policies rather than sector policies. This can lead to the following difficulties when sector policies do not link to geographical areas:

- Lack co-ordination between different agencies - there can be difficulties co-ordinating policies between national and local agencies on areas such as health and education as well as co-ordinating resources and service delivery. This can be particularly acute where there is a partial overlap of policy for example in health and social care.

- Difficult to link to national policies - there may be a more fundamental problem when local and national policies are at odds with each other. For example, whether the solution for the expansion in airport capacity should be a third Heathrow runway. These are often of strategic national importance and policies rather than local policies where the benefit is seen elsewhere in the country.

For policy on the level of fiscal decentralisation it can be seen as a balance between conflicting pressures and with the political will, capacity and institutional structures of a country all coming together to shape the outcome. If we add to these influences those of pan national organisations, such as the IMF in its conditionality packages, or the EU for applicant countries, the key thing to remember is the complexity of the process.

The starting point of fiscal decentralisation should be asking the question 'What public services should sub-national governments deliver'?

Sub-national governments spending assignments will vary according to size of country (population and area), geography, heritage and political situation.

When allocating services to each level of government the concept of 'subsidiarity' should be kept in mind.

That is, each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalise the benefits and costs of such provision.

This includes thinking about whether services may be more efficiently provided locally where: preferences can be voiced; oversight can be promoted; and benefits from taxation observed.

The retention of business rates locally is the start of fiscal devolution, and in England, the aspiration of the government is to move from the 50% retention currently, towards full retention locally by 2020.

The advantages and disadvantages of fiscal devolution are laid out above. The most significant problem that will always remain with local tax retention and no equalisation by central government, is, how to cope with the national imbalances that will affect areas of economic deprivation or very rural areas, where there are limitations on the amount of business rates that can be raised. Arguably these areas may need more public spending locally than areas that are more economically prosperous.

1 mark per well explained point for the advantages and disadvantages, or for examples provided. Limit to 5 marks if only one side of the argument is presented or if no examples are included.

Maximum 10 marks