



**STRATHMORE BUSINESS SCHOOL**

MASTER OF DEVELOPMENT FINANCE

END OF SEMESTER EXAMINATION

MDF 8108: PUBLIC SECTOR FINANCE

**Date:** Wednesday, 2nd August 2023

**Time:** 3 Hours

**Instructions**

1. This examination consists of **SIX** questions.
2. Answer **QUESTION ONE and any other THREE** questions.

**Question 1 (30 marks)**

Zambaquee is a lower middle income country with a moderate growth rate. It is estimated that about 40% of the country's citizens live below the poverty line. Furthermore, the government relies on domestic resource mobilisation and borrowing (domestic and external) to finance its budget. While the government has made considerable effort to enhance revenue collection, the tax base is narrow because of having a large informal sector. Recently, the national government has reported high budget deficits, leading to an increase in domestic borrowing using treasury bills and bonds. Various stakeholders are have expressed concern about the level of debt, which is high and possibly unsustainable. The country has a devolved system of governance, where the county governments have autonomous powers to generate and spend revenue.

- a) Discuss whether the government should be concerned with increased domestic borrowing **(4 marks)**
- b) (i) Explain the meaning of 'debt being unsustainable' **(2 Marks)**  
(ii) Highlight **TWO** implications of a public debt being unstainable? **(2 marks)**
- c) Due to the increase in fiscal deficits, the government is considering additional sources of revenue. Rank the following sources of revenue and comment on their efficiency and redistribution of wealth.
  - i. Imposing VAT at the standard rate of 16% on basic commodities such as milk, bread and flour, which were previously zero-rated **(4 Marks)**
  - ii. Increasing excise tax on tobacco products **(2 Marks)**
  - iii. Increasing income tax on rental income **(2 Marks)**
  - iv. Introducing a turnover tax on the informal sector **(2 Marks)**

- d) (i) Explain briefly the meaning of tax incidence **(2 Marks)**  
(ii) Suppose there is excess supply of rental houses. With the aid of a suitable diagram, explain how the burden of the increase in rental income tax will be shared between the landlord and tenant **(4 marks)**
- e) One of the elements of fiscal decentralization is the assignment of functions. Explain THREE challenges encountered during the assignment of functions. **(6 marks)**

**Question 2 (10 marks)**

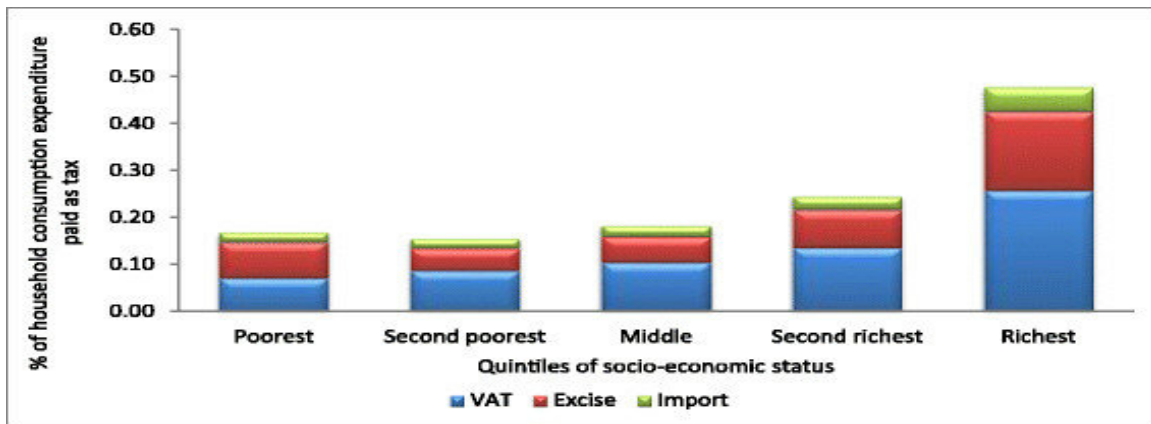
Many governments are concerned about the increasing levels of environmental (both air and solid waste). With the aid of a suitable daigram, explain how the government can use taxes and subsidies to address this problem.

**Question 3 (10 marks)**

The government of Kenya is considering subsidizing the cost of healthcare to low-income households as one measure to achieve universal healthcare. The households are granted health insurance cards to access health care services for free. With the aid of suitable graphs, explain the market effects of the health subsidy.

**Question 4 (10 marks)**

The diagram belows presents a summary of the tax incidence analysis of indirect taxes. Discuss the findings and highlight whether each of the taxes is regressive or progressive. (Note that the lower part of the bar chart is VAT, the middle part is excise tax and the upper part is import duties).



Source: Authors' computations based on UNHS 2009/10

**Question 5 (10 marks)**

A company has factory with a forty-year processing equipment that requires regular maintenance. The factory is now faced with the decision of whether to continue maintaining the old equipment or purchase a new one. The average cost of maintaining the old equipment is KES. 7,500,000 per year while the cost of acquiring a new machine is KES. 50,000,000, with maintenance cost of KES 500,000 per year from the second year of purchase. Using a 10-year period and a 5% discount rate, advise the management on whether to continue using the old machinery or purchase a new one. (10 marks)

**Question 6 (10 marks)**

Discuss FIVE pillars of Public Financial Management performance.