NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART II – 1st SEMESTER FINAL EXAMINATION – DECEMBER 2006
PUBLIC FINANCE I: [CFI 2104]
TIME ALLOCATED: 3 HOURS 10 MINUTES

1.   Attempt any <u>FIVE</u> Questions
2.   All questions carry equal marks [20 marks]
3.   Write legibly

<u>QUESTION 1</u>   **(20 marks)**

(a)   Distinguish between the allocative and distributive functions of the Government.   **[8 marks]**

(b)   With the aid of the circular flow of income, expenditure and goods and service, explain the relationship that exists between the public and private sector.   **[12 marks]**

<u>QUESTION 2</u>   **(20 marks)**

(a)   Mutare City Council is considering developing a parking mall to be established under Park Street in Mutare. The cost of the development will amount to $25m. There will be 250 parking bays. The council intends charging a fixed charge of $2 300 per bay per month for the first 10 years of use, and a fixed charge of $360 per bay per month indefinitely thereafter. Ten million dollars is due immediately to the building contractors and the balance of $15m is due on completion of the mall in a year's time. The council's required rate of return is 21% per annum, interest compounded monthly. The ongoing operating cost per bay will amount to $30 per month once the mall is completed. This operating cost is expected to increase by 1% per month indefinitely into the future due to inflation.

   Required

   Use the Net Present Value (NPV) analysis to determine whether the council should go ahead with the parking mall.   **[8 marks]**

(b)   In a social cost-benefit analysis, what are shadow prices? How do they differ from market prices?   **[4 marks]**

(c)   Outline four costs and four benefits which should be considered in a cost benefit analysis for a proposed airport.   **[8 marks]**

QUESTION 3   **(20 marks)**

(a)   Distinguish between a public good and a private good. In what ways does efficient provision of public goods differ from efficient provision of private goods?   **[16 marks]**

(b)   Explain the meaning of the "free-rider problem" in the provision of public goods.   **[4 marks]**

QUESTION 4   **(20 marks)**

(a)   You are told that the price elasticity of demand for bread in Zimbabwe is 2.65. After some negotiations with the government, producers agree to raise the price by 12 percent. How much will the quantity demanded fall?   **[2 marks]**

(b)   When the price of milk increased from $250 per litre to $360 per litre, Busi's demand for cereal fell from 4.5 kgs per month to 2.25 kgs per month. What is the cross elasticity of demand?   What   does   it signify?   **[3 marks]**

(c)   Explain the significance of the concept of elasticity of demand:
      (i)   to the Finance Minister
      (ii)   to a trade union
      (iii)   for business decisions
      (iv)   in international trade
      (v)   in explaining the paradox of poverty in plenty.   **[15 marks]**

QUESTION 5   **(20 marks)**

With the aid of a diagram, demonstrate how the Paretian concept of optimality can be achieved. Your discussion should further provide the conditions that should be satisfied for effective implementation of the concept.   **[20 marks]**

QUESTION 6   **(20 marks)**

(a)   Evaluate any two methods of empirical analysis that are used in positive analysis.   **[10 marks]**

(b)   In welfare economics, demonstrate how the Marshallian Approach to consumer surplus differ from the Hicksian Approach.   **[10 marks]**