Chapter 7

Public Spending and Governance Performance: Evidence from Europe and the MENA Region

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ABSTRACT

The main objective of the chapter is to study the interaction between the level and composition of government expenditure and governance performance in Europe and in MENA countries. The perceived level of corruption provides a possible measure of governance performance. The idea is that more corruption entails greater than optimally volumes of public expenditure and an inefficient allocation of this. The study involves a descriptive and a simple econometric analysis. Results are enlightening and point out that total government expenditure appears to be positively correlated to poorer governance performance, and hence to more corruption, only when the volumes of public expenditure is already high.

INTRODUCTION

Plenty of evidence has to these days confirmed the idea that government expenditure may provide public officials opportunities for rent-seeking or predator behavior. This implies that government expenditure may be purposefully inflated and manipulated in order to increase rent-extraction and bribes. In other words, corrupt bureaucrats and politicians may increase the volume of public expenditure beyond efficient levels just to extract resources for their own sake. With similar intent, public expenditure may be allocated towards that sectors which involve greater opportunities for corruption to occur. And this is the reason why one observes corruption affecting some public sectors, such as defense, or some kind of public expenditure, such as public investment, rather than others. The effects of this activity is that public expenditure may be inefficiently high and badly allocated among the different alternatives.

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Yet measuring and quantifying inefficiency in public expenditure is extremely difficult. It is difficult both because one has to have clear what is the “social optimum” prior to determine the “sub-optimal” and inefficient provision of public goods and because public expenditure by its own nature is a multifaceted entity which is difficult to express in one measurable variable. For this reason, usually the efficiency of government’s expenses and interventions are measured through various variables. For example, the World Bank provide six proxies for “governance performance” and implicitly for measuring government efficiency. Corruption is one on these. The idea is that more corruption is indeed an indicator of inefficiency in public expenditure. By following this route, we attempt to study the interconnection between public expenditure and government performance, measured through the perceived level of corruption, in the European countries and MENA countries. The results are enlightening. Total government expenditure appears to be positively correlated to poorer governance performance, and hence to more corruption, only when the volumes of public expenditure is already high. And indeed, in European countries rather than in MENA countries more public expenditure is associated to more inefficiency in the working of government. Moreover, the effect of government expenditure on governance performance also depend on which kind of expenditure one considers. Public expenditure in education, healthcare, welfare and public expenditure in defense all influence differently governance performance. This highlight the importance of other context factors affecting the interplay between corruption, government efficiency and public expenditure.

The chapter is structured as follows. In the second section, we review the related literature and provide some definitions and stylized facts. In the third section, we provide a descriptive analysis of public spending and governance performance in Europe and in the Middle East and North Africa (MENA). The forth section contains a simple econometric analysis of the interplay of these variables. The last section concludes.

RELATED LITERATURE

One of the main causes of corruption and, hence, a determinant of the quality of governance performance is the pervasive presence of the State in the economy. Government may contribute to the (private) economic activities through different channels and penetrate the market to a different degree. Since corruption entails the illicit actions of public officials who attempt to extract rent through the abuse of their public power, the higher is the level of involvement of the government in the economy, the larger is the set of potential rents on which corruption may feed. Of course, a high degree of government intervention in the economy is only a necessary but not a sufficient condition for corruption to occur. To this extent, other factors need to be in place. For example, as suggested by Mauro (1997), bureaucrats’ degree of discretion, and hence their potential rent extraction, increases as it increases the opacity of the laws and of the regulation system. Along these lines, Clements et al. (1995) argue that government subsidies for industries multiply the opportunities for rent-seeking behaviors. Other factors which feed corruptive behavior are the provision of public goods and services above market prices (Tanzi, 1998), the level of public sector wage (Acemoglu & Verdier, 2000) and the nature of the system of tax collection (Blackburn, 2012).

Though it is reasonable to argue that the working of the system through which public funds are allocated influences corruption, it is also reasonable to conjecture that corruption, in turn, may influence public expenditure and finances. Indeed, to the extent that bureaucrats sets rules to allocates funds and
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