THE PREREQUISITES OF PUBLIC SECTOR PERFORMANCE: GOVERNANCE AND EFFECTIVENESS

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Abstract: In modern economies, the public authority entrusted to manage the public affairs of the community is the state. In fulfilling their objectives the public decision makers assume a number of tasks according to the doctrines embraced by the government. The government results as an outcome of the election process and thus, faithful to its own doctrine is more or less invasive in the economy provides more or less protection and public goods therefore increasing or decreasing its spending according to its needs. The final outcome pursued by the state is the welfare of its citizens. Eventually, the way this goal is achieved as well as the perception the society has regarding the way the state performs is a matter of choice the state makes in order to fulfill its tasks. Traditionally, the main roles assumed by the state are: the distributive role, the regulation role, the stabilising and the assurance role.

Key words: public sector, governance, public spending, performance

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1. Public sector performance

The intensive financial flows, migration and trade raise the question defining the public goods in the context of globalisation. Under these circumstances several issues must be addressed:

- firstly, the identification of fiscal authority enabled to collect taxes on income and wealth for individuals and firms residing abroad in order to prevent free riding;
- secondly, the provision of public goods to accommodate the new needs of the community.

Such questions become more acute for the European Union which faces new challenges in achieving sustainable development. Under the new economic environment, the global public goods become ever more important. Within the EU individual countries should make efforts to subordinate their local interests to the general welfare of the community. This approach requires a revision of public goods definition. Traditionally they are considered as the goods whose consumption by an individual does not diminish another individual consumption (meaning they are non-exclusive and non-rival). Under the new circumstances this definitions should be extended by considering as public goods *the advantages the society is taken from the provision of utilities meant to satisfy certain particular wants, eradication of poverty, disease, environment protection, and social protection.* Moreover, it should be clearly stated that whether they are referred to as goods or public services they should bring advantages to the society as a whole, as well as individually. Though public goods are traditionally supplied by government bodies, their provision can be delegated to private entities under certain conditions: the quality of goods and services, availability and price.

Moreover, public goods should be cost effective, should enhance productivity and diminish unemployment. All these aspects become more challenging because nowadays public goods become global, range beyond national borders, and once put in place the future generation can benefit of their advantage.

Given the high costs of public goods, either merchandise or services, and the limited funds available to finance them the question of expenditure effectiveness is raised. Therefore the public goods should complement private goods, and the intervention of the state should not trespass the line beyond which private incentives diminish. We consider that the provision of public goods and advantages to the society should support individual development, should sustain economic activity and tax benefits toward contributors should be maximized. Global sustainable development will require an unprecedented level of international co-operation in the field of public sector. And it must be a co-operation in which the developing countries are brought in as true partners and not underdogs. Key challenges for achieving this objective are the eradication of poverty and the protection of our environment from the damaging processes. Existing models of economic globalization are not delivering these results. More specifically, the European Union has to deal with problems it has not encountered before. The economies within its frontier have deep differences of structure, development, and face specific problems. Its peoples belong to different cultures, have different morals, and different points of view on the Union's problems. Therefore it is compulsory for the European Union to support poverty reduction, reduce the gap between the poor and the rich nations, to preserve the quality of the environment and harmonize the European economy as a whole. To achieve these goals, social measures that promote democracy and participation, expand education, improved access to medicine and healthcare and help the transfer of technology are to support economic growth. Countries need transportation and telecommunication infrastructure to sustain commerce and trade, the more so in a global competitive world. Fuel and energy services are necessary for agriculture and modern industrial functions. Water and sanitation services are essential to support population settlements in both urban and rural areas. Whether provided by the public or the private sector, the extent and quality of infrastructure services is critical for growth and development. If public goods fail to provide these services we may assist to a ever divided Europe, wide spreading migration, free riding, waste and exhaustion of financial resources and turmoil that will affect the stability of the economies. Performance may be achieved on many ways, none of them ensuring success: there are approaches relying on administrative procedure, others on political and/or professional techniques. Some approaches follow the traditional public administration while others are founded on the *new public management*. In search of better performance governments use formal and informal remedies but often neglect the principles of good governance. Performance also has both managerial and political dimensions. Therefore there is an interrelated connection between politicians and managers: political encouragement often helps managers focus on what their work and dedicated managers help politicians in implementing their visions. Because politicians and managers often speak different languages and have variant interests, it is hard to get the interface between them right. When breakdowns in performance occur, the culprit often is confusion or misunderstanding over the respective roles and responsibilities of elected leaders and senior managers. Getting the relationship right is a necessary condition for the performing state. The discussion on public sector measurement rests on the processing mechanisms (input, output, income, impact). For instance, in education services *inputs* are the resources assigned for this purpose: teachers, equipment, facilities, etc. and their social value is measured by their costs (i.e. the value the society tags to this task). The budgeting performance criterion corresponding to inputs is *compliance,* i.e., defined as close adherence to budgetary ceilings and *ex ante* allocation, as well as a proper but agile procurement process.

Output is the service itself, number of pupils and students. The social value of output is approximated by the market price for the same or the closest equivalent service (or, in its absence, by total unit cost). The performance criterion corresponding to outputs is *efficiency*, i.e. minimizing total input cost per unit of output (or maximizing the quantity of output in relation to a given total cost of inputs).

Outcome is the purpose that is achieved by producing the service—e.g., literacy vs. illiteracy, number of graduates and employment. The social value of outcomes is subjective and arbitrary, except as revealed by public reaction in the political arena. The performance criterion corresponding to outcomes is *effectiveness,* i.e., maximizing outcomes in relation to the outputs produced.

The i*mpact*, is defined as the *value added* from the activity. It can be explained by the positive externalities induced on the counterpart fields (transfer of productivity by hiring educated labour).

Processing management is the manner in which inputs are procured, outputs produced, or outcomes achieved. For inputs, good process consists of intelligent compliance with input acquisition and utilization rules and, of course, integrity. In some areas of public activity, such as law or politics, "due process" has its own independent validity and is a key element of good governance.

Building performance indicators is not an easy task. Nevertheless, measuring is of an utmost importance because what gets measured will presumably get done In order to have a valid measurement three rules should be considered: a correct and accurate definition of what must be measured; the goods and services must be measured correctly; consequences if tasks are not fulfilled. In the public sector, these rules are quite difficult to apply, because seldom, the least measurable activities may be the most important ones. Moreover, the rules should be adjustable, entailing behavioural changes. It is important to assess the long term outcomes of measurements because the benefits or dysfunctions depend on the ways and fairness of the performance assessment system. Because of the difficulties in measuring the public sector performance, a system of benchmarks is necessary. For this purpose, the best performances of similar countries are to be considered as benchmarks. Benchmarking and performance measurement are closely linked. Performance measurement can be the first step towards improving the performance of a public sector organization and, if backed by an appropriate incentive system, it can help shift organizational focus from inputs to outputs and outcomes and thus improve efficiency and effectiveness. However, the real benefits come from using the performance measures as the basis for internal or external comparisons with the objective of improving the performance of an organization. This is called Benchmarking, which can be defined as the technique of comparing *business practices* and *performance levels* between organizations to identify opportunities for making improvements in *economy, efficiency or effectiveness* of an organization's activities.

There is a long debate going on whether the public sector enhances economic performance. Nevertheless, economists agree that there are circumstances in which lower levels of government spending would enhance economic growth and other circumstances in which higher levels of government spending would be desirable. If government spending is zero, presumably there will be very little economic growth because enforcing contracts, protecting property, and developing an infrastructure would be very difficult if there were no government at all. In other words, some government spending is necessary for the successful operation of the rule of law. Economists generally agree that government spending becomes a burden at some point, either because government becomes too large or because outlays are misallocated. In such cases, the cost of government exceeds the benefit. Generally, the public sector is not (or should not be) profit seeking and public spending requires costly financing choices. Since public spending requires public funds collecting the necessary funds means that the public authorities are confronted with the taxpayers' reluctance to comply with the tax laws, especially if taxes discourage productive behaviour. Government spending displaces private-sector activity. This dampens growth since economic forces guide the allocation of resources in the private sector, whereas political forces dominate when politicians and bureaucrats decide how money is spent.

Some government spending, such as maintaining a well-functioning legal system can have a high "rate-of-return." In general, however, governments do not use resources efficiently, resulting in less economic output. Anyway, the impact of public spending on welfare and growth is not straightforward, and therefore the question that it is raised concerns whether the problem should be addressed in an aggregate manner, considering the public spending as a whole, or by judging each type of spending individually. Obviously, economic spending differs as nature and characteristics from the social and administrative public spending. While the first category is regarded as having a direct, positive impact on growth, the latter (i.e. the administrative spending) is regarded as GDP consuming with a negative influence on growth.

One of the biggest challenges of the extended European Union is to set up a harmonised financial policy in order to accommodate the needs of the older as well as the new member states. The challenges concern the collection of funds, the level of tax compliance, but foremost providing quality public goods under financial constraints. In addressing these issues, the main goal pursued should be the economic growth and the welfare of the citizens.

The framework to discuss these problems contains public sector governance, transparency and credibility as well as defining the public goods and their beneficiaries. In addressing these issues the EU must face cultural differences, customs and habits that define the financial behaviour of its citizens i.e. tax compliance and public funds spending. It further affects the efficiency and effectiveness of public expenditure. Of course, individuals and firms express their options for public goods according to the goods offered by the state. From the state's point of view, the individual preferences should be aggregated thus complying with the mutual interest of the community and stating an objective pursued by the community. The efficiency and effectiveness of public expenditure in the European Union are critical to outcomes, including growth. A country that spends resources in a way that does not complement private sector initiatives or in a cost-effective way will undermine its growth prospects. In the new member states, cost-overruns, poor project management, and poor maintenance of new assets result in inefficient creation and maintenance of infrastructure assets. Leakages and waste may imply that increases in health and education spending do not necessarily translate into better outcomes. Typically these reflect underlying problems of capacity for budget management and, in some cases, of governance. If institutional weaknesses and problems of governance that cause poor outcomes are not addressed, even spending on potentially high return programs will have little impact on growth. The net impact will be to erode the government's solvency and reduce its fiscal space.

Country specific conditions are therefore important in the design of fiscal policy for long-term growth. Creating fiscal space will depend on initial conditions in a country and the strengths of its public sector institutions and the likely trajectory of ongoing reforms to improve their performance. Fiscal policy design that emphasizes the deficit but ignores the composition of spending effectively ignores an important transmission channel for the growth impact of fiscal policy. There is a rich but not uncontroversial literature, for example, on the relationship between public investment and growth. The sustainability of a fiscal deficit itself depends on the productivity of the expenditure. By allowing a fuller consideration of the growth effects of fiscal decisions, an explicit focus on the composition of expenditure would allow both stabilization and growth objectives to be addressed in more sustainable ways.

Comparing public sector in EU countries, it could be easily stated that the dimension of this sector reaches different levels. There are several old member states that have a large public sector. Those countries are mainly Sweden, Netherlands, Denmark, and Austria. In opposition to those countries are situated Eastern European countries with a smaller public sector. This situation is due to several factors. Firstly it is worth mentioning the specific financial behaviour.

Scandinavian countries but also Austria and other western countries seem to assume a higher compliance to taxes and agree a larger public sector. Consequently, the protection offered by the state in those countries to the citizens is much more important. Eastern countries but also Ireland and other western countries tried to encourage private sector for growing their economies by reducing taxes. Anyway, this is also correlated to the lower trust which people show towards public institutions in eastern countries.

Another important issue would be the composition of public expenditure and the comparison of productive and not productive public expenditures. There are countries like Sweden, Denmark, Italy but also Poland that spend important percent of their GDP for social security while others like Romania, Czech and Hungary spend little money for social security. There is also very obvious evidence that eastern European countries have small budgets for sectors like health and education but do spend more money than western countries on economical activities. The authors will present in the final paper through suggestive figures the composition of the expenditure for different countries, the differences and an analysis of the resulting effects.

The issue of the impact of public spending on welfare and growth is even more acute for the emerging economies, since the authorities, in these countries, need as many a tool as possible in order to ensure a sustainable growth. It is well known that beside the taxation tool, public spending may be an important channel to boost the economy. Since these countries are en route to harmonise their economies and living standard with the more developed countries in Europe a well proportioned mixture of private and public spending may be of valuable help. Above all, spending in education and health may be rewarding on medium and long term due to their positive impact induced on productivity.

2. The Romanian state performance beyond rhetoric

The structure of the Romanian state budget for 2008 foresees 10% of expenditures for the state administration, 19% for law and order, 7% for defence, 12% for education, 3% for health, 19% for social security, 20%for economic activities, etc.

At first sight, such a budget, structured by book, resembling a developing country, stresses non productive expenditures and economic ones. Given the decentralisation of education and health services, a smaller percentage is distributed for these activities. A significant percentage of expenditures go to social security. So, theoretically at least, there is nothing wrong with the figures stated in the budget, and its structure is not a problem *per se*. But, when corroborated with the facts in the economy and the wellbeing of the population, the budget becomes an issue.

Firstly, public services – or "services of general interest" – must be recognised not only rhetorically but also through corresponding policies as a central element of a European Social Model based on solidarity and fairness. Public service provisions in the liberalised sectors must be strengthened and implemented and where this becomes increasingly difficult, a tighter direct public control should be envisaged, including new forms of public ownership and administration. The exemption from the internal market and competition rules should apply to all public services – even if they are of an economic character. The European dimension of these services can best be served by the definition of minimum standards with upward convergence, co-operation in border regions and joint research and educational projects.

Discussing the efficiency of public services comes to a contradiction when compared to the performance indicators such as corruption, infant mortality, life expectancy, illiteracy, poverty, emigration, stability. In spite of the high percentage allocated to administration and law and order, these fields are highly inefficient given that 3 individuals out of 10 working people are enrolled in the public sector having low wages. Moreover, according to the corruption perception index (CPI), Romania ranks above the average having a CPI of 3[68], showing a high degree of rent seeking attitude among public servants. Education and health are quasi public expenditures considered as investments in human capital, able to increase productivity and wealth.

The highest percentage of these expenditures is covered by the local authorities considering that they have better knowledge of such needs. Nevertheless, the lack of effective educational programmes and further enrolment of graduated renders these expenditures highly inefficient. For primary education 9,8% of

GDP is allocated for education go to the primary education, 15% to the secondary one whilst for the tertiary education 26,2 % is allocated per student. We think that, this distribution of funds is ineffective given the low level of knowledge provided in primary and tertiary education. Moreover, tertiary education students tend to emigrate, meaning that a percentage of GDP is transferred to host countries. Therefore a higher percentage of funds should be allocated to basic education in the primary and tertiary education, whilst in the tertiary education should prevail the privately obtained funds, including research.

The heath sector is also confronted with a gross inefficiency of expenditures. There are only 20 doctors to 10000 inhabitants and 6,6 hospital beds to 1000 inhabitants. Infant mortality is still high 16,5 to 1000 living births, the mortality rate is 11,9 to 1000 inhabitants, and the life expectancy barely exceeds 71,9 year.

Poverty is another matter of concern. About 40% of the population is affected by moderate poverty, while 11% by extreme poverty (under 1 dollar per day). There are also regions with a high rate of exclusion, about 30% in the NE, for individuals above 15. Under these circumstances, more than half of the population receives a form of assistance, justifying the 20% of expenditures channeled for this purpose. The question that is raised is why isn't there rather financed inclusion, value adding programs than such ineffective forms of assistance that only deepen poverty. Corroborated with the economic expenditures it means that these aren't channeled towards efficient, expending areas, but towards loss making areas.

Conclusion

Under actual requirements, the construction of the expenditure part of the state budget is highly ineffective, a great volume of funds being absorbed by either the black holes in the economy or by nonproductive destinations. Moreover, these ineffective destinations are publicly funded, requiring a greater volume of funds each year. The manner public funds are spent influences tax compliance at great length, given that tax payers are interested in the taxation benefits, i.e. the quantity and quality of public goods and services provided by the state.

Therefore, given the limited funds the budget can make use of it is imperative that the budget be built on effective programs that may add value to the economy and sustain growth.

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[68] A CPI of 10 is the lowest perceived corruption and 0 is the highest.

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