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Reforming the public administration: The role of crisis and the power of bureaucracy

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ABSTRACT

The need to balance austerity with growth policies has put government efficiency high on the economic policy agenda in Europe. Administrative reforms that boost the internal efficiency of bureaucracy can alleviate the trade-off between consolidation and public service provision. Against such a backdrop, this paper constructs (and makes available) a novel reform indicator to explore the determinants of public administration reforms for a panel of EU countries. The findings support political-economic reasoning: An economic and fiscal crisis is a potent catalyst for reforms, but a powerful bureaucracy constrains the opportunities of a crisis to promote reform. Furthermore, there is some suggestive evidence for horizontal learning from other EU countries, and for vertical learning associated with a particular type of EU cohesion spending.

1. Introduction

The recent European crisis has put the issue of government efficiency high on the agenda of economic policy reform. With strictly binding budget constraints, the pressure on more effective public service provision has grown. Policy measures that alleviate bureaucratic slack and red tape can also alleviate the trade-off between consolidation and public service provision. Reforms aiming at higher productivity in public service provision - such as strategies of devolution and decentralization, implementation of competitive mechanisms within the public sector, revised budget practices and procedures, performance-oriented approaches to budgeting and management, and reliance on e-government – can then be a substitute for cuts in spending or tax increases (Curristine et al., 2007).

Hence, fostering public administration efficiency is a natural candidate for any long-run growth agenda in general, and for countries in fiscal trouble in particular. It is not surprising that approaches to improve the organization and working properties of public administration are part of virtually all reform programs of European governments under fiscal stress. However, it cannot be taken for granted that reform rhetoric always stands for reform substance. Reform activity is deeply rooted in bureaucratic incentives, principal-agent problems and political-economic equilibria. This paper tries to understand some of these determinants of public administration reform with a particular focus on the role of crises and the power of bureaucracy.

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There are at least three closely related and well-developed strands in the empirical literature (briefly surveyed in the next section), which, however, hardly ever focus on efficiency enhancing internal reforms of public administration. First, there is a larger field studying the timing and extent of reform decisions in general. The covered reform areas are typically related to product and labor markets, welfare benefits and tax reforms, whereas efficiency enhancing internal reforms of public administration have so far been almost completely neglected. Second, there is a growing literature that measures efficiency and productivity of public service. These studies aim at understanding the existing heterogeneity in jurisdictional efficiency but are hardly helpful in understanding dynamic changes and reforms. Third, a substantial literature concentrates on the drivers of fiscal consolidation. These studies, inter alia, also study adjustments of administrative spending. However, those spending cuts do not provide direct information on efficiency enhancing reforms, since these cuts may simply represent a reduction of service provision quality.

Our study adds to the reform literature by addressing a neglected but important topic: The determinants of reforms that aim at improving the efficiency of public administration in providing services and raising revenues. We explicitly disregard reforms changing the extensive margin of the public sector through increasing or decreasing the level of service provision. Instead, our sole interest lies in reforms that potentially change the intensive margin by improving the technical efficiency of administrative production (see Bonesronning (2013), for this distinction in the context of educational reform).

Our study is also novel with respect to the database employed. We construct (and make available) our reform indicator based on the European Commission's MICREF database. This choice is guided by our focus on internal reforms of the public administration. For that purpose, our reform indicator has to fulfill several requirements: It should identify a procedural innovation related to public service production or tax administration. At the same time, it should not be based on these reforms' economic outcomes that may be influenced by several other factors.

Typical outcome-related reform indicators like public expenditures or – to a lesser degree – size of the staff suffer from a fundamental identification problem since exogenous factors (business cycle, expectations, financial market conditions, etc.) may impact the measurable outcome so that the contribution of a preceding reform is hardly recognizable (Wiese, 2014). To some extent, this problem also holds for reform indicators like the World Bank's Doing Business Indicators or indicators of economic freedom that are based on expert surveys. These indicators are highly popular as a proxy for reform episodes (e.g., Pitlik and Wirth, 2003; Heinemann and Tanz, 2008; Rode and Gwartney, 2012; Giuliano et al., 2013; Leibrecht and Pitlik, 2015). However, expert opinions may also be influenced by a country's overall economic and social performance.

The search for outcome-unrelated indicators of policy inputs has recently motivated the so called “narrative approaches” in the empirical literature on fiscal policy (e.g., Romer and Romer, 2010). This literature analyses narrative records like speeches or parliamentary debates to identify those changes in fiscal policy that are not motivated by the cyclical situation and, in this respect, are exogenous. We share this literature's objective to employ a reform indicator that can serve as a policy input indicator unrelated to economic outcomes or to *anti*-cyclical strategies.

In light of these indicator requirements, the MICREF database offers several appealing features. It collects information on microeconomic reforms implemented in EU member states and provides a fine-grained classification of reform areas. This allows us to isolate reforms of public administration from other types of structural reforms. Moreover, real changes in policies or institutions are measured independently from their budgetary implications, output-related consequences, the overall budgetary stance or the current cyclical environment. Hence, MICREF nicely corresponds to the objectives of the narrative approaches. And compared to the frequently employed survey based indicators of administrative efficiency, MICREF provides less subjective measures of reforms and innovations in public administration.

In the next section we present a survey of the related literature mentioned above. In the subsequent theoretical section we analyze which factors should potentially change the political-economic equilibria that determine bureaucratic slack and, consequently, derive our testable hypotheses. The empirical part starts with a description of our reform indicators taken from the MICREF database followed by an econometric analysis. Our results, based on panel estimations of all EU countries over the years 2000–2013, confirm our theoretical reasoning: The frequent finding in the empirical reform literature that crisis induces reforms also holds for public administration reforms as a general pattern. This positive crisis effect is, however, conditional on our proxies for the power of bureaucracy: With a large bureaucracy, an economic crisis is less likely to push innovations in public service provision. Another finding relates to learning or policy-diffusion. We observe vertical learning associated with a particular type of EU cohesion spending and horizontal learning from the reform examples of other EU countries.

2. Relevant strands in the literature

Over the past decade a growing strand of literature has explored the drivers of structural reforms in industrial countries. The starting point was the observation that despite a common international environment characterized by increasing global competition, countries differed considerably in their speed of adjustment to these new constraints. The literature's empirical workhorse is the study of country panels. Examples are Abiad and Mody (2005), Dreher et al. (2009), Pitlik and Wirth (2003) or Pitlik (2010). Reforms that have been examined cover financial deregulation, product market opening, trade liberalization, labor market deregulation and adjustments of pension systems.

The existing studies focus on a rich set of potential drivers of reforms, for example, the role of political leaders' individual characteristics (Dreher et al., 2009), the role of trust (Heinemann and Tanz, 2008; Leibrecht and Pitlik, 2015) or the constraints resulting from the introduction of the euro (Duval and Elmeskov, 2006). Beyond these particular interests of single studies, there are, however, common patterns in the literature: First, the occurrence of reform is typically modeled to depend on the institutional starting point, which, if highly inefficient, indicates a high need for reforms. Second, study designs frequently allow for regional