

Public Spending and Outcomes: Does Governance Matter?

● *Andrew Sunil Rajkumar and
Vinaya Swaroop*

Public spending has virtually no impact on health and education outcomes in poorly governed countries

There has been much emphasis recently on good governance as a key to development effectiveness. It has been argued, for example, that merely spending money on public goods and services may not lead to desirable outcomes if the country does not have the right governance environment.

While this proposition seems straightforward and difficult to disagree with, no serious empirical work has been done to support it. In a recent paper Rajkumar and Swaroop study the impact of public spending on outcomes at different levels of governance. What constitutes good governance? There are several definitions. The World Bank, in *Governance: The World Bank's Experience*, defined it as “epitomized by predictable, open, and enlightened policy making (that is, transparent processes); a bureaucracy imbued with a professional ethos, an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law” (Washington, DC: World Bank, 1994).

The basic idea of the authors' research is to examine the link between specific budgetary allocations and outcomes and to see how these relationships are affected by improved governance. They use two indicators of governance in a country: the level of corruption and the quality of bureaucracy.

Many past studies have looked at the link between public spending and outcomes (for example, the impact of public spending on economic growth or on such outcomes as health status or educational attainment). Where public spending is found to have a

low or negligible impact, these studies have given two explanations. The first is that the link between public spending and development outcomes could be severed because an increase in public provision could lead to a “crowding out” of private sector provision. This line of reasoning does not question the efficacy of public spending; instead, it contends that because of the substitution of public for private spending, additional public provision in many cases has a negligible net marginal effect. The second explanation centers on poor targeting or institutional inefficiencies such as leakage in public spending and weak institutional capacity.

The authors' analysis helps explain the surprising result that public spending often does not yield the expected improvement in outcomes. It shows empirically that the differences in the efficacy of public spending can be explained largely by the quality of governance. Public health spending lowers child mortality rates more in countries with good governance. Similarly, public spending on primary education becomes more effective in increasing primary education attainment in countries with good governance. More generally, public spending has virtually no impact on health and education outcomes in poorly governed countries.

These results have important implications for enhancing the development effectiveness of public spending. Simply increasing public spending on health and education is unlikely to lead to better outcomes if countries have poor governance. These findings

are particularly relevant for developing countries, where there is an ongoing debate on how to achieve the Millennium Development Goals. In this debate it is often assumed, explicitly or implicitly, that sufficiently increasing public spending

in specific areas is the way to achieve the goals. Indeed, for most of these countries quantitative models have been developed to estimate how much additional public spending (including on health and education) is needed. But in these countries the average level of governance is quite poor.

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to improve governance. But as the authors' findings suggest, in the absence of better governance the easier option often does not translate into the expected achievement of better health and education outcomes.

Their results also show that while public spending has a greater impact on outcomes when there is good governance, this impact could still be well below its true full potential. Public spending may still be relatively inefficient in improving outcomes in many countries even when there is good governance. The inefficiency in spending could be due to a variety of factors, including the possible substitutability between public and private spending. The efficiency question needs to be examined in future research.

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