Chapter 1

Introduction: Theme, Objectives and Structure of the Book

1.1 Theme and Objectives of the Book

In recent years, public budgets in Germany have undergone a wave of consolidation. The current economic crisis, however, has put significant strain on government budgets - worldwide. Given the fact that in recent times, governments all around the world have spent huge amounts of money to alleviate the consequences of the economic crisis, the discussion about the sustainability of public finances will also be back on the agenda in Germany. The effects of the economic crisis, however, are unlikely to be limited to the national level. Indeed, the economic crisis will also put severe strain on the public finances of local governments. Usually, public budgets are consolidated either by cutting expenditures or by increasing income sources. But apart from the possibilities of cutting public spending by offering less public goods and services or by developing new sources of revenue (e.g. by levying new taxes or increasing current taxes), governments can also try to reduce public expenditures by operating more efficiently or, in other words, by producing a higher amount of public goods and services given a certain amount of (public) expenditures - provided that there is a potential to increase efficiency, of course.

Furthermore, the performance or efficiency of the public sector is also important with regard to the competition for mobile factors like (high-skilled) labour and capital (e.g. in local jurisdictions). Since local governments operating at a rather low efficiency level are not able to provide the same amount of public goods and services as local governments which operate at higher efficiency levels (for a given amount of costs), the former will not be able to attract as many mobile factors as the latter. The reason is simply that - for a certain amount of public spending - the latter governments can offer either a higher amount of public goods and services of the same quality or the same amount of public goods and services of higher quality, since they are using their means more efficiently (in comparison to the former governments). Thereby, inefficiencies in the public sector can be manifold: First, public administrations
can be oversized, which, in turn, means that part of the (public) money spent provides no additional utility for the resident enterprises and households. In addition, it is possible that local governments do not choose the most competitive provider for certain tasks. Finally, a further potential source of inefficiency is the quality of public goods and services. Since the quality of public goods and services is sometimes hardly or even not all observable (by the citizens), the public sector can vary the quality substantially without sanction. An example on the local level would be the waste recycling. For a single citizen of a municipality it is very difficult to control whether the recycling of waste is of the same quality as in the neighbour municipality.

The above-mentioned examples demonstrate that the elimination of potential inefficiencies in the public sector could be used as a (concomitant) tool to consolidate public finances. In order to eliminate potential inefficiencies, however, we must first detect the main sources of these inefficiencies. Subsequently, this information can then be used by policy-makers to take action which, in turn, reduces potential inefficiencies. While there are numerous studies on the measurement of local governments’ (in)efficiency (as a whole and for specific areas of public goods provision like schools, hospitals, etc.), the analysis of the main sources or drivers of this (in)efficiency has attracted far less attention in the literature.\footnote{For an extensive review on the literature of the efficiency of the public sector, see chapter 3.} Moreover, as will be shown in the literature review in chapter 3, there are only few studies on the efficiency of the German public sector. In fact, there exist only a couple of studies on the efficiency of specific areas of public goods provision (universities, hospitals, electricity distribution utilities and water supply utilities); efficiency studies on the (German local) public sector as a whole, however, do not exist at all. Therefore, the main focus of this book is on different aspects of the efficiency of the public sector in Germany; thereby, the object of investigation will be the local governments of the German state Baden-Württemberg.

1.1.1 Definitions

Since the performance of the public sector is the main topic of this book, it is necessary to first give detailed definitions of several concepts. First of all, the term “performance” can be divided into two components: (i) \textit{efficiency} and (ii) \textit{effectiveness} (see also Worthington and Dollery, 2000). While the former describes how well a decision-making unit (e.g. local government) employs resources in producing (public) goods and services, the latter describes the degree to which a decision-making unit achieves its programme and policy objectives. In turn, effectiveness can be decomposed into three components reflecting desired aspects of the programme outcome: (a) appropriateness (i.e. do the services match the needs of the clients?), (b) accessibility (i.e. can the clients afford the services?), and (c) quality (i.e. do the services meet the required standards?). In the present analysis, the focus is solely on the efficiency and not on the effectiveness of the provision of public goods and services. Closely related to the term “efficiency” is the concept of \textit{productivity}, since - according to Fried et al. (2008a) - the