

The effects of poor financial information systems on public expenditure and on the long-term sustainability of local public services. Empirical evidence from the spanish municipalities

Guillem López, Eugeni García* and Iván Moreno**

In this paper we describe the ways in which financial illusion (FI) in public accounting can be created by misreporting actual expenditure and revenues. We test the effects of FI, due to the absence of sound financing capital policies, on current public expenditure increases and on the future sustainability of local public services. We relate these features to the lack of incentives amongst public managers for accurate financial reporting when short term electoral interests prevail. Our hypothesis is tested for Spain using a sample of 42 municipalities with population above 20,000 for the financial years 1993-2001. We build this unique database on the Catalan Audit Office Reports. Results confirm that there is statistical relationship between FI and high current expenditure, net assets variation and managerial slackness. Mechanisms for FI creation have to do with overvaluing revenues and underestimating costs, inadequate provision for bad debts and lack of appropriate capital funding.

En este trabajo describimos las formas a través de las cuales se puede crear ilusión financiera (IF) en la gestión pública a través de una información contable confusa, cuando no engañosa, de los gastos y de los ingresos reales. Analizamos los efectos de la IF, debido a la falta de unas políticas de financiación del capital fidedignas, en el aumento del gasto público actual y en la sostenibilidad futura de los servicios públicos locales. Relacionamos estas situaciones con la falta de incentivos de los gestores públicos para

* Department of Economics & Business. Pompeu Fabra University. This author acknowledges financial support in this research field from SEC2003-05045/ECO. We thank Pilar Garcia for useful comments.

informar de forma precisa cuando prevalecen los intereses electorales a corto plazo. Contrastamos nuestra hipótesis para una muestra de 42 municipios de Cataluña con una población superior a los 20.000 habitantes en los años que median entre 1993 y 2001. Esta base de datos se ha creado a partir de los informes de la Sindicatura de Cuentas de Cataluña. Los resultados constatan la existencia de una relación estadística entre la IF y un mayor gasto presente, la variación neta de activos y una gestión poca cuidadosa del capital. Los mecanismos para la creación de la IF tienen que ver con la sobrevaloración de ingresos y la infra estimación de costes, la provisión inadecuada de impagos y la falta de una financiación del capital apropiada.

Key words: public management, financial information systems, financial illusion, Spanish local authorities

JEL Classification: H72, H74, H81, M14

INTRODUCTION

In most OECD countries over recent decades, conventional accounting information systems have been superseded by systems that exploit new information technologies. The potential for better budget reporting has improved greatly (see Heller 2003). The aim of improving public accountability through better information is indeed at the core of new public management (Lopez et al. 2003). However, implementation depends on the incentives of managers and politicians, and things are much less clear in this arena.

Under related models of bureaucratic behaviour and fiscal illusion (Niskanen 1971)¹, it is plausible to assume that lack of transparency is here to stay. As it helps to hide inefficiency, poor financial reporting may favour managerial slack against the public interest.

Although the above assumptions may be extended to public administration in general, our interest here is to test some particular propositions related to the creation of financial illusion (FI) at the local public sector level. Mayston (1992) has shown that this is an appropriate field of analysis given the great diversity in existing practices.

¹ A good introduction to the topic can be found in Bonner (1972) and in Bayoumi and Eichengreen (1994).