AN ANALYSIS OF THE EFFICIENCY OF EDUCATION SPENDING IN CENTRAL AND EASTERN EUROPE

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Abstract:
The paper attempts to measure relative efficiency in utilizing public education expenditures in the new EU member states in comparison to the selected EU (plus Croatia) and OECD countries. As resources allocated to education are significantly limited, a special emphasis should be given to their efficient use regarding the institutional and legal constraints. By applying non-parametric methodology, i.e. Data Envelopment Analysis (DEA), a relative efficiency is defined as the deviation from the efficiency frontier which represents the maximum output/outcome attainable from each input level. An analysis of (output-oriented) efficiency measures shows that among the new EU member states Hungary, Estonia and Slovenia seem to be good benchmark countries in the field of primary, secondary and tertiary education, respectively. The empirical results also suggest that, in general, new EU member states show relatively high efficiency in tertiary education efficiency measures.

Keywords: public spending, education, technical efficiency, DEA analysis, CEE, EU, OECD

1. INTRODUCTION

Each nation's future wealth and competitive position in the globalised world depends increasingly on its ability to create and absorb knowledge. An essential feature of knowledge is that it requires human capital (educated persons) for both its production and its application. Indeed, long-term economic growth of the economy rests with its capacity to increase productivity through rapid technological progress. Therefore, the national system of education is the quintessential tool for the creation and application of knowledge. However, as most of the countries are faced with increasing demands on their limited (public) resources, there is an increasing pressure to improve resource allocation and utilisation. Accordingly, policy makers in a number of countries became increasingly concerned with measuring efficiency. With education expenditures comprising a relatively important amount of national income, the interest in examining whether such expenditures are cost-effective has increased, recently.

The paper joins the efforts of other scholars in investigating education efficiency by applying a non-parametric methodology. Hence, the purpose of the paper is to review some previous researches on the efficiency measurement of public education sector as well as some conceptual and methodological issues of non-parametric approach. Most importantly, Data Envelopment Analysis (DEA) technique is presented and then applied to the wide range of the EU and OECD countries, including Central and Eastern European (CEE) countries[1], to evaluate technical efficiency of the selected sector. The importance of examining public sector expenditure efficiency is particularly pronounced for emerging market economies where public resources are normally insufficient. When services are publicly provided, performance measurement becomes an inevitable management tool because when inefficiency continues, the constituents of that inefficient unit suffer. The government needs benchmarking tools to provide incentives to good performing sectors and to induce inefficient sectors to perform better. However, the focus of the paper is not on how to cut (public) expenditures, but rather more on investigating potential reserves to increase the value for money of public spending, i.e. how to make the most of limited public (and private) resources.[2]

The paper is organized as follows. In the next section we present a brief literature review of measuring public education expenditure efficiency. Section 3 shows a theoretical background of non-parametric methodologies with special focus on Data Envelopment Analysis (DEA) and the specifications of the models. Section 4 outlines the results of the non-parametric efficiency analysis of education sector. The final section provides concluding remarks.

2. A BRIEF LITERATURE REVIEW

Previous studies on the performance and efficiency of the public sector (at national level) that applied non-parametric methods find significant divergence of efficiency across countries. Studies include notably Fakin and Crombrugghe (1997) for the public sector, Gupta and Verhoeven (2001) for education and health in Africa, Clements (2002) for education in Europe, St. Aubyn (2003) for education spending in the OECD, Afonso et al. (2005, 2006) for public sector performance expenditure in the OECD and in emerging markets, Afonso and St. Aubyn (2005, 2006a, 2006b) for efficiency in providing health and education in OECD

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[1] In this paper, the group of Central and Eastern Europe (CEE) consists of Bulgaria, Cyprus, Czech R., Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

[2] Note, however, that it is not only public expenditure but also tax regulatory policies that affect the efficiency of the public sector. While expenditure is a relatively good proxy of the tax burden, we ignore the composition of tax revenue and other characteristics of tax system.

countries. De Borger and Kerstens (1996), and Afonso and Fernandes (2006) find evidence of spending inefficiencies for the local government sector. Additionally, Afonso et al. (2008) assess the efficiency of public spending in redistributing income. Most studies apply the Data Envelopment Analysis (DEA) method while Afonso and St. Aubyn (2006a) undertook a two-step DEA/Tobit analysis, in the context of a cross-country analysis of secondary education efficiency.

Other authors (e.g. Mandl et al., 2008 ; Jafarov and Gunnarsson, 2008) have tried to improve on the work by Afonso et al. (2005). The country-clusters resulted are very similar. Southern European countries present low general and educational performance, the CEE countries show low general performance but high educational one, and the Northern European and Anglo-Saxon countries with high scores in both items (although the differences among countries in the educational performance are high; e.g. Luxembourg with a high macroeconomic score but fairly poor results for the effectiveness of its education system). Additionally, a number of studies examine technical efficiency in education (see also Castano and Cabanda, 2007; Grosskopf and Mourtray, 2001; Johnes, 1996, 2006; Johnes and Johnes, 1995; Ng and Li, 2000; Cherchye et al., 2010).

3. NON-PARAMETRIC METHODOLOGY FOR ASSESSING EFFICIENCY IN PUBLIC SECTOR

A common approach to measure efficiency is based on the concept of efficiency frontier (productivity possibility frontier). There are multiple techniques to calculate or estimate the shape of the efficiency frontier. Most investigations aimed at measuring efficiency are based either on parametric or non-parametric methods. The main difference between the parametric and the non-parametric approach is that parametric frontier functions require the ex-ante definition of the functional form of the efficiency frontier. While a parametric approach assumes a specific functional form for the relationship between input and output, a non-parametric approach constructs an efficiency frontier using input/output data for the whole sample following a mathematical programming method.[3] A calculated frontier provides a benchmark by which the efficiency performance can be judged. This technique is therefore primary data-driven. Among the different non-parametric methods the Free Disposal Hull (FDH) technique imposes the fewest restrictions.[4] It follows a stepwise approach to construct the efficiency frontier. Along this production possibility frontier one can observe the highest possible level of output/outcome for a given level of input. Conversely, it is possible to determine the lowest level of input necessary to attain a given level of output/outcome. This allows identifying inefficient producers both in terms of input efficiency and in terms of output/outcome efficiency (Afonso et al., 2005).

An alternative non-parametric technique that has recently started to be commonly applied to (public) expenditure analysis is Data Envelopment Analysis (DEA).[5] DEA is a non-parametric frontier estimation methodology originally introduced by Charnes, Cooper, and Rhodes in 1978 that compares functionally similar entities described by a common set of multiple numerical attributes. DEA classifies the entities into "efficient" or "performers" versus "inefficient" or "non-performers." According to DEA framework, the inefficiencies are the degrees of deviance from the frontier. Input inefficiencies show the degree to which inputs

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[3] For an overview of non-parametric techniques see Simar and Wilson (2003).
[4] FDH analysis was first proposed by Deprins et al. (1984).
[5] DEA analysis, originating from Farrell's (1957) seminal work was originally developed and applied to firms that convert inputs into outputs (see Coelli et al. (2002) for a number of applications).

must be reduced for the inefficient country to lie on the efficient practice frontier. Output inefficiencies are the needed increase in outputs for the country to become efficient. If a particular country either reduces its inputs by the inefficiency values or increases its outputs by the amount of inefficiency, it could become efficient; that is, it could obtain an efficiency score of one. The criterion for classification is determined by the location of the entities' data point with respect to the efficient frontier of the production possibility set. The classification of any particular entity can be achieved by solving a linear program (LP).

Various types of DEA models can be used, depending upon the problem at hand. The DEA model we use can be distinguished by the scale and orientation of the model. If one cannot assume that economies of scale do not change, then a variable returns- to-scale (VRS) type of DEA model, the one selected here, is an appropriate choice (as opposed to a constant-returns-to-scale, (CRS) model). Furthermore, if in order to achieve better efficiency, governments' priorities are to adjust their outputs (before inputs), then an output-oriented DEA model rather than an input-oriented model is appropriate. The way in which the DEA program computes efficiency scores can be explained briefly using mathematical notation (adapted from Ozcan, 2007). The VRS envelopment formulation is expressed as follows:

$$VRS_p\,(Y_l,\,X_l,\,\mathbf{u}^l,\,\mathbf{v}^l):\;\;min\text{-}(\mathbf{u}^l s + \mathbf{v}^l e)$$

$$Y\lambda\text{-}s = Y_1$$

$$\text{-}X\lambda\text{-}e = \text{-}X_1$$

$$1\lambda = 1$$

$$\lambda \geq 0,\; e \geq 0,\; s \geq 0$$

For decision making unit 1, $x_{i1} \geq 0$ denotes the ith input value, and $y_{i1} \geq 0$ denotes the rth output value. X_1 and Y_1 denote, respectively, the vectors of input and output values. Units that lie on (determine) the surface are deemed *efficient* in DEA terminology. Units that do not lie on the surface are termed *inefficient*. Optimal values of variables for decision making unit 1 are denoted by the s-vector s^1, the m-vector e^1, and the n-vector λ^1.

Although DEA is a powerful optimization technique that can assess the performance of each country, it has certain limitations. When one has to deal with large numbers of inputs and outputs, and a small number of countries are under evaluation, the discriminatory power of the DEA is limited. However, analysts can overcome this limitation by including only those factors (input and output) that provide the essential components of "production", thus avoiding distortion of the DEA results. This is usually done by eliminating one of a pair of factors that are strongly positively correlated with each other.

In the majority of studies using DEA, the data are analyzed cross-sectionally, with each decision making unit (DMU) – in this case the country – being observed only once. Nevertheless, data on DMUs are often available over multiple time periods. In such cases, it is possible to perform DEA over time, where each DMU in each time period is treated as if it were a distinct DMU. However, in our case the data set for all the tests in the study includes an average data for the 1999–2007 period (including PISA 2006 average scores) in order to evaluate long-term efficiency measures as education process is characterized by time lags in up to 37 EU (plus Croatia) and OECD countires. The program used for calculating the technical efficiencies is the DEA*Frontier* software. The data are provided by Eurostat, OECD, UNESCO and the World Bank's World Development Indicators database.

The specification of the outputs and inputs is a crucial first step in DEA, since the larger the number of outputs and inputs included in any DEA, the higher will be the expected proportion of efficient DMUs, and the greater will be the expected overall average efficiency (Chalos, 1997). Common measures of teaching output in education used in previous studies are based on graduation and/or completion rates (see Johnes, 1996; Jafarov & Gunnarsson, 2008), PISA scores (see Afonso & Aubyn, 2005; Jafarov & Gunnarsson, 2008) pupil-teacher ratio and enrolment rate (see Jafarov & Gunnarsson, 2008).

Hence, similar to the former empirical literature, in this analysis the data set to evaluate education sector efficiency (at different levels) includes input data, i.e. (public) expenditure per student, tertiary (% of GDP per capita) or total expenditure on education (in % of GDP) and output/outcome data, i.e. school enrolment, tertiary (% gross), teacher/pupil ratio, primary completion rate, total (% of relevant age group), unemployment with tertiary education (% of total unemployment), labor force with tertiary education (% of total) and PISA 2006 average score. There are up to thirty-seven countries included in the analysis (selected EU (plus Croatia) and OECD countries). Different inputs and outputs/outcomes has been tested in four models (see Table 1).

Table 1: Input and output/outcome set for the DEA – Education Sector (at different levels)

Model	Inputs	Outputs/Outcomes
1 (Primary)	Expenditure per student, primary (% of GDP per capita) [2]	• School enrolment, primary (% gross) • Pupil-teacher ratio in primary education [2] • Primary completion rate, total (% of relevant age group) [2]
2 (Secondary)	Public expenditure per pupil as a % of GDP per capita. Secondary. [1]	• PISA 2006 Average [3] • School enrolment, secondary (% gross) [2] • Pupil-teacher ratio. Secondary. [1]
3 (Tertiary)	Expenditure per student, tertiary (% of GDP per capita) [2]	• Unemployment with tertiary education (% of total unemployment) [2] • Labor force with tertiary education (% of total) [2] • School enrolment, tertiary (% gross) [2]
4 (Total)	Total expenditure on education, (in % of GDP) [2]	• PISA 2006 Average

Sources: [1]UNESCO; [2]World Bank; [3]OECD.

4. EMPIRICAL RESULTS

This subsection shows the empirical application of the Data Envelopment Analysis (DEA).[6] When looking at the education results[7], by using model 1 (see Table 1) and applying the DEA efficiency frontier technique within a selected group of EU/OECD countries and Croatia to measure efficiency of primary education, Denmark, Hungary and Portugal are seen as most efficient. The efficient countries are also Greece, Iceland and Romania, however, their primary expenditures per student (in % of GDP) is very low and have averaged less than 12% (the EU/OECD average is 18.7% in the considered period). One can also see that some countries come very close to the frontier (e.g. Czech R. and Italy), while the other countries are further away and therefore less efficient (e.g. Turkey and Croatia) (see Table 2). Some

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[6] All the calculated results are available from the author on request.

[7] All of the results relate to DEA with an output orientation, allowing for variable returns to scale (VRS). An output orientation focuses on the amount by which output quantities can be proportionally increased without changing the input quantities used. Using an input orientation approach leads to similar efficiency results as those presented in the text.

less efficient countries should significantly decrease their input (primary expenditure per student) (e.g. Slovenia from 27.0 % to 22.0 %) and/or increase their outputs, i.e. school enrolment (e.g. Ireland and Poland), primary completion rate (Belgium) and teacher-pupil ratio (Turkey and Ireland) in order to become efficient.[8] Interestingly, the CEE countries are, in general, relatively more efficient than non-EU countries in the sample, however, they show relatively low efficiency against the old EU-member states.

In terms of the effiency scores of secondary education, even ten analyzed countires are labeled as efficient (see Table 2), however, only Romania and Slovakia represents new EU memeber states in this group of efficient countires. The average output efficiency score is 1.06715, which means that the average country could increase the outputs/outcomes for almost 7.0 % if it were efficient. The worse performers are Mexico and Bulgaria with a well below average PISA scores (considerably less than 490), school enrolment (significantly less than 103.6 %) and teacher-pupil ratio (less than 0.086). Indeed, both countries should increase their outputs by more than 10% in order to become an efficient (similar to the CEE countries average efficiency, which is the least efficient sub-group in the analysis).

Table 2: The Relative Efficiency of the EU Member States (plus Croatia) and OECD Countries in Education (Distribution by quartiles of the ranking of efficiency scores)

Level	I. quartile	II. quartile	III. quartile	IV. quartile
Primary education	Denmark Greece *Hungary* Iceland Portugal *Romania* *Czech Republic* Italy	Spain *Slovakia* Germany Norway Austria Finland	*Lithuania* Netherlands Ireland France *Bulgaria* *Cyprus* *Estonia* United States	*Slovenia* *Poland* *Latvia* Turkey Croatia Sweden Belgium
Secundary education	Belgium Finland Greece Ireland Korea Netherlands Norway Portugal *Romania* *Slovakia*	New Zealand Denmark *Estonia* *Czech Republic* Japan Sweden	*Hungary* Austria *Lithuania* *Poland* Germany Iceland *Latvia* *Slovenia* Croatia	Spain France Italy United Kingdom *Bulgaria* Mexico United States
Tertiary education	Canada *Czech R.* Finland Korea *Latvia* *Lithuania* *Poland* Russia *Slovakia* *Slovenia* United States	*Hungary* *Romania* *Bulgaria* Australia Austria Ireland Italy Greece	Portugal *Estonia* United Kingdom Sweden Japan New Zealand Croatia Norway Belgium	Turkey Iceland Switzerland Spain Netherlands France Denmark Mexico *Cyprus*

Notes: Relative efficiency scores are based on models presented in Table 1. Thirty-seven (or less) countries are included in the analysis (EU-27, OECD and Croatia). The CEE countries are presented in italic.
Sources: World Bank, 2010; UNESCO, 2010; OECD, 2010; own calculations.

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[8] The average output efficiency score for primary education is 1.050, which means that the average country could increase the outputs/outcomes for about 5.0% if it were efficient. The results also confirm our expectations, that larger public sector increases the inefficiency in a primary education.

When testing tertiary education efficiency, eleven among the 37 countries analyzed within the formulation for tertiary education presented in Table 1 were estimated as efficient. These countries are Canada, Czech R., Finland, Korea, Latvia, Lithuania, Poland, Russia, Slovakia, Slovenia and the United States. The results of the DEA analysis (Model 3) also suggest a relatively high level of inefficiency in teritiary education in a wide range of countries and, correspondingly, significant room to rationalize public spending without sacrificing, while also potentially improving tertiary outputs and outcomes. Indeed, the countries under consideration could improve their efficiency scores by decreasing their input (expenditure per student (in % of BDP)), in particular in Denmark and Switzerland. However, even more importantly, a significant increase of outputs/outcomes is need in the form of school enrolment (in particular in Cyprus and Mexico), and in the form of labour force with tertiary education (in Portugal, Turkey and Romania). In general, output/outcome scores could be higher for about 6 % on average. Interestingly, non-EU member states show significantly worse DEA scores as they should increase their tertiary outputs/outcomes by more than 13 % (in comparison to the old EU member states for about 7% and the CEE countries only for 1.4 %).

Table 3: The Relative Efficiency of the selected EU Member States (plus Croatia) and OECD Countries in Education (Distribution by quartiles of the ranking of efficiency scores) (Model 4)

Country	Output-Oriented VRS Efficiency	Rank	Benchmarks
Finland	1.00000	1	
Greece	1.00000	1	
Japan	1.00000	1	
Czech R.	1.01370	4	Greece, Japan
Netherlands	1.01971	5	Finland, Japan
Slovakia	*1.04248*	*6*	*Greece, Japan*
Estonia	*1.04817*	*7*	*Finland, Japan*
Germany	1.05221	8	Finland, Japan
Iceland	1.05541	9	Finland, Japan
Switzerland	1.07374	10	Finland, Japan
Croatia	1.07427	11	Greece, Japan
Poland	*1.07577*	*12*	*Finland, Japan*
Spain	1.07915	13	Greece, Japan
Belgium	1.08288	14	Finland
Ireland	1.08607	15	Finland
Austria	1.08700	16	Finland, Japan
United Kingdom	1.08986	17	Finland, Japan
Slovenia	*1.09281*	*18*	*Finland*
Hungary	*1.09307*	*19*	*Finland, Japan*
Sweden	1.09620	20	Finland
Denmark	1.10320	21	Finland
Italy	1.10961	22	Finland, Japan
Turkey	1.11606	23	Greece, Japan
France	1.11721	24	Finland, Japan
Lithuania	*1.12536*	*25*	*Finland, Japan*
Latvia	*1.13250*	*26*	*Finland, Japan*
Norway	1.13547	27	Finland
Portugal	1.13607	28	Finland, Japan
Romania	*1.15600*	*29*	*Greece, Japan*
Bulgaria	*1.19523*	*30*	*Greece, Japan*
Mean	1.082974		
Std. Dev.	0.046890		

Notes: Relative efficiency scores are based on Model 4 presented in Table 1. Thirty-seven (or less) countries are included in the analysis (EU-27, OECD and Croatia). The CEE countries are presented in italic.
Sources: World Bank, 2010; UNESCO, 2010; OECD, 2010; own calculations.

Further empirical analysis, testing the efficiency of the total expenditure on education (Model 4), shows that the worse efficiency performers are Bulgaria, Romania and Portugal (see Table 3). Indeed, if these countries would employ the resources in efficient manner, they could increase their PISA scores by 19.5 %, 15.6 % and 13.6 %, respectively. The main reason for the education inefficiency in these countries lies in transforming intermediate education outputs into real outcomes (see IMF, 2008) (same problems have some other CEE countries, particularly Latvia, Lithuania and Hungary). The results also show that the best performers (in terms of efficiency) seem to be Finland and Japan, while Greece presents a good efficiency result due the lowest education spending (averaged only 3.6 % of GDP in 1999–2007). Interestingly, output-oriented DEA results confirm that Scandinavian countries could attain the same result with lowering their education expenditure by up to 2.3 percentage points (in Denmark). However, the CEE countries, in general, show the same efficiency as the old EU member states (both groups could increase their PISA scores by around 10 % on average).

5. CONCLUSION

The empirical results show that technical efficiency in education sector differs significantly across the great majority of the EU (including the CEE countries) and OECD countries. The analysis of different (output-oriented) efficiency (under VRS framework) shows that Japan, Korea and Finland seem to be the most efficient countries in the field of education sector. When focusing only on the CEE countries, Hungary, Estonia and Slovenia seem to be good efficiency performers in the field of primary, secondary and tertiary education, respectively. The empirical results also suggest that, in general, the CEE countries show relatively high efficiency in tertiary education. All in all, the analysis finds evidence that most of the CEE countries have a great potential for increased efficiency in (public) spending of limited education resources. Nevertheless, the improvement of data quality and testing the influences of the environmental factors (such as climate, socio-economic background etc.) remain important issues for further research.

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