Hacienda Pública Española/Review of Public Economics

Manuscript 2578

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Abstract

Government outsourcing has emerged as a significant strategy for managing government organizations in the delivery of public goods and services, attracting considerable attention in the fields of public administration and policy studies. This study investigates the relationship between government outsourcing and fiscal balance while examining the moderating role of left- and right-wing political ideologies. Employing panel analysis of data from 31 OECD countries over the period of 2009–2019, the findings indicate that government outsourcing negatively affects fiscal balance, resulting in an increase in the primary balance deficit. However, the impact varies based on political ideology. Specifically, conservative ideology is associated with enhanced fiscal soundness through outsourcing, while progressive ideology is found to worsen fiscal balance. To infer the underlying mechanisms driving these outcomes, the study reveals that outsourcing, in conjunction with conservative ideology, is linked to reduced government expenditure and public employment. Conversely, progressive ideology is associated with increased government expenditure and public employment.

Keywords: outsourcing, fiscal balance, political ideology

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Funding declaration: This work is supported by the Ministry of Education of the Republic of Korea and the National Research Foundation of Korea (NRF-2022S1A5A2A0305221911).

Declaration of conflicting interests: No conflict of interests is associated with the document.

1. Introduction

Government outsourcing, also known as contracting-out, involves the delegation of public goods and services by a government to non-governmental entities, including private firms and non-profit organizations (Hodge, 2000). This practice serves as a significant administrative reform tool rooted in the principles of new public management (NPM). Governments pursue outsourcing to overcome the limitations of the public sector, such as inadequate competition and specialized expertise, thereby aiming to enhance the quality of public goods and services (Domberger and Jensen, 1997). The adoption of outsourcing has become widespread globally, particularly in OECD countries, driven by globalization and the spread of pro-market reforms that followed the emergence of NPM (Conway and Nicoletti, 2006).

In recent years, expansionary fiscal policies have been implemented worldwide to meet increasing welfare demands and to address economic and social crises. However, these policies have led to challenges concerning government inefficiency and fiscal integrity. Deteriorating fiscal conditions hinder a government's capacity to tackle economic and social issues effectively, highlighting the need for improved fiscal soundness and enhanced governmental responsiveness (Alesina et al., 1998; Persson and Tabellini, 2002; Alesina and Passalacqua, 2016). Outsourcing is positioned as a potential remedy for the decline in fiscal soundness. By lowering government costs and boosting operational efficiency, outsourcing can help ensure financial stability. Consequently, a considerable body of literature has explored government contracting from the perspective of achieving fiscal health within public organizations (Stein, 1990; Andrews, Boyne, Law, & Walker, 2005; Andrews and Van de Walle, 2013; Alonso, Clifton, and Díaz-Fuentes, 2017).[1]

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[1] Outsourcing has been a subject of ongoing debate in the field of government organizational management across different periods. In the 1980s, the emergence of the NPM approach aimed to

The literature on outsourcing is extensive, representing a significant area of inquiry within public administration and public policy. Research has examined various determinants and effects of outsourcing (Domberger and Jensen, 1997; Brudney et al., 2005; Bel and Fageda, 2007; Andersson, Jordahl, and Josephson, 2019; Kim and Choi, 2023). However, existing studies have produced mixed results regarding the effectiveness of government outsourcing in achieving positive outcomes, particularly in terms of improving fiscal balance through reduced expenditures and enhanced organizational performance. This has resulted in inconclusive findings regarding its overall impact (Jensen and Stonecash, 2005; Bel, Fageda, and Warner, 2010; Petersen, Hjelmar, and Vrangb, 2018).

Advocates of contracting-out argue that it can lead to fiscal savings and organizational efficiencies, particularly through competition, private ownership discipline, and the division of labor between private and public sectors based on comparative advantages (Boyne, 1998; Savas, 2000; Quélin, Kivleniece, and Lazzarini, 2017). Furthermore, outsourcing has recently been justified as part of fiscal austerity measures, facilitating governments' efforts toward fiscal consolidation and deficit reduction (Anderson, Hunt, and Snudden, 2014). However, opponents contend that outsourcing does not consistently reduce government expenditure or improve fiscal balance (Alonso, Clifton, and Díaz-Fuentes, 2017). They argue that outsourcing may worsen fiscal balance due to increased transaction costs, agency costs, fiscal illusion, and rent-seeking activities by interest groups.

address perceived issues within the public sector and prompted governments worldwide to adopt outsourcing as a means to enhance organizational performance (Hood, 1991; Pollitt and Bouckaert, 2004). However, in the 2010s, there was a renewed emphasis on the government's role in responding to financial crises and promoting social equity and fairness. This shift in perspective has led to the emergence of remunicipalization, which involves transitioning from outsourcing to in-house production (Clifton, Warner, Gradus, and Bel, 2019; Voorn, van Gengten, and van Thiel, 2020; Albalate, Bel, and Reeves, 2020).

Given that the theoretical and empirical understanding of the relationship between outsourcing and fiscal balance remains unclear, it is important to consider the potential moderating role of political ideology. Political dimensions are inherent in government decisions regarding contracting-out (Lynn, 2006; Brown, Potoski, and Van Slyke, 2006; Sundell and Lapuente, 2012; Alonso and Andrews, 2020; Rho, Kim, and Han, 2021; Chen and Lu, 2024). The outsourcing of public services to the private sector is a highly debated reform, intersecting with the left–right ideological spectrum. Ideological factors have been extensively examined as determinants of divergent approaches to using private providers for public-service delivery (McGuire, Ohsfeldt, and Cott, 1987; López-de-Silanes et al., 1997; Brudney et al., 2005). Still debated,[2] the literature addresses the influence of a government's political orientation on the choice between outsourcing and in-house production, with evidence indicating that conservative ideologies generally favor contracting out public-service delivery to the market and privatization, while progressive orientations tend to be opposed to such changes (Fernandez, Ryu, and Brudney, 2008; Elinder and Jordahl, 2013; Gradus and Budding, 2020).

A government's political ideology is closely intertwined with the formulation and implementation of fiscal policies (Potrafke, 2010, 2018; Bjørnskov and Potrafke, 2013; Pickering and Rocky, 2013), and it also influences how government organizations function within their external environments (Lewis, 2003; McDonald, 2004). As a result, political ideology can moderate the relationship between government outsourcing and fiscal soundness. Different ideological orientations may lead to varying effects on outsourcing

[2] The empirical literature on the relationship between political ideology and outsourcing has been extensively reviewed and organized in Alonso and Andrews (2020, p. 744). The findings from several studies indicate that the influence of political ideology on outsourcing is not straightforward (Pallesen, 2004; Wassenaar, Groot, and Gradus, 2013; Alonso, Andrews, and Hodgkinson, 2016). For instance, Bel and Fageda (2017) argue that there is a lack of a systematic relationship between local privatization and ideology.

decisions and fiscal balance (Sundell and Lapuente, 2012). For instance, right-wing ideologies may reduce government expenditure through competition and privatization, while left-wing ideologies may increase spending and expand the government's role. Despite the significance of political ideology as a moderator between outsourcing and fiscal balance, research on this topic remains limited. Some studies overlook political ideology or treat it as an independent variable without considering its interaction with outsourcing.

To address this gap in the literature, this paper examines the impact of government outsourcing on fiscal balance, considering the moderating role of political ideology. The analysis uses data from 31 OECD countries over the 2009–2019 period, providing a global perspective on the effects of outsourcing across multiple nations. The inclusion of multiple variables from various sources enhances the accuracy of the analysis, allowing for robustness checks with different analytical models.

The remainder of this study is organized as follows: we first discuss the conceptual framework, drawing on relevant literature. Next, we outline the data and empirical strategy. We then present the estimation results and discuss their policy implications. Finally, we conclude with a summary of our findings and suggestions for future research.

2. Conceptual framework and hypotheses development

Ensuring fiscal soundness has become increasingly critical worldwide, given the rising demand for social welfare and the persistent fiscal-policy deficits (Alesina et al., 1998; Persson and Tabellini, 2002). Additionally, inefficiencies resulting from politicized budget processes further underscore the need for reforms in government organizations (Brender and Drazen, 2005). Among these reforms, outsourcing plays a significant role in shaping fiscal balance, serving as a policy tool to constrain fiscal policy in the medium to long term.

Consequently, assessing the effectiveness of government fiscal management through outsourcing is imperative.

A commonly cited rationale for outsourcing is its potential to reduce government costs and enhance fiscal balance. These expected benefits are based on three key factors (Domberger and Jensen, 1997; Alonso, Clifton, and Díaz-Fuentes, 2015): the introduction of market competition, the discipline imposed by private ownership, and the division of labor between the public and private sectors based on comparative advantages. These factors can decrease government expenditure while improving the quality of public services.

First, competition is a central argument in favor of government outsourcing (Osborne and Gaebler, 1992; Boyne, 1998; Savas, 2000). Outsourcing exposes activities previously protected as in-house operations by bureaucrats to a market environment characterized by competition and discipline. For instance, the competitive bidding process in a specialized marketplace for service contracts is a distinctive aspect of outsourcing. This ex-ante competition encourages public services to be delivered at the lowest cost, leading to reduced government expenditures and improved fiscal soundness.

Second, private ownership incentivizes cost reduction, as the private sector's efforts to cut costs can generate profits (Kay and Thompson, 1986; Shleifer and Vishny, 1994; Hart, Shleifer, and Vishny, 1997; Savas, 2000). Unlike public-sector organizations, which often have broader and vaguely defined public-service objectives, private firms are client-oriented and driven by profit motives. This creates a greater incentive to innovate and reduce costs. These cost-saving efforts in service delivery can contribute to decreased government expenditure and improved fiscal balance.

Third, outsourcing allows public and private agencies to focus on their core activities and competencies (Quinn and Hilmer, 1994; Agranoff, 2006; Berrios, 2006; Quélin, Kivleniece, and Lazzarini, 2017). The literature on public–private partnerships emphasizes the unique expertise held by both private firms and nonprofit organizations. Private firms bring innovative capabilities, financial resources, and technological expertise, while nonprofit organizations, often closely connected to communities, offer lower labor costs. By leveraging the expertise of these external organizations, public agencies can enhance their efficiency and effectiveness in delivering public services through outsourcing. As a result, outsourcing can serve as a mechanism for improving fiscal performance.

There are, however, counterarguments suggesting that outsourcing does not lead to a reduction in government expenditure but can actually be detrimental to fiscal soundness (Alonso, Clifton, and Díaz-Fuentes, 2017). Several theoretical frameworks and empirical studies have identified potential negative impacts of outsourcing on fiscal balance, including transaction costs, diminished economies of scale, agency costs, fiscal illusion, budget maximization by bureaucrats, common-pool resource problems, government capture by interest groups, and negative externalities.

First, according to transaction cost theory (Williamson, 1991, 1999), the unique characteristics of public services—such as non-contractible elements, contractual incompleteness, and the limited availability of competitive suppliers—can hinder the effectiveness of outsourcing policies intended to reduce government expenditure. These features make it difficult to implement outsourcing in a manner that achieves lower costs compared to in-house production (Brown and Potoski, 2005; Hefetz and Warner, 2012).

Second, outsourcing may result in a loss of economies of scale, which can lower average production costs through in-house operations (Brown and Potoski, 2003; Milward and Provan, 2003). Smaller and fragmented organizations often allocate a larger share of their resources to administrative costs, which tend to be higher in smaller organizations compared to larger ones.

Third, agency costs associated with outsourcing can also impede fiscal soundness (Jensen and Meckling, 1976; Sappington and Stiglitz, 1987; Hart, Shleifer, and Vishny, 1997). Contracting-out introduces information asymmetries between the principal (government) and the agent (private-sector provider), creating the risk that private providers may reduce service quality to cut costs, potentially leading to higher social costs. Moreover, monitoring the performance and activities of external providers incurs significant costs, which can negatively affect a government's financial position (Yang et al., 2009; Pérez-López et al., 2015).

Fourth, outsourcing may obscure the true costs of private service delivery from the public. Outsourcing policies can create the perception of reduced costs for public-service delivery, leading to a form of fiscal illusion that may support excessive government spending (Wagner, 1976; Payton and Kennedy, 2013). Citizens and voters, believing that outsourced services are more efficient, may demand increased public services, thereby driving up government expenditure.

Fifth, the theory of bureaucratic budget maximization, alongside common-pool resource problems in government budgets, can explain the potential for increased government spending (Niskanen, 1971; Benson, 1990). Any cost savings from outsourced services are likely to be retained and reallocated within the government budget by public officials seeking to maximize their influence and resources. Consequently, any overall cost savings derived from outsourcing may be dissipated.

Sixth, rent-seeking behavior by interest groups may arise during the outsourcing process, wherein private-sector entities involved in government policies contribute to the misallocation of government funds (Mueller and Murrell, 1986; Benson, 1990; Ohlsson, 2005). Interest groups advancing their self-interests can influence policymakers to increase public spending for their benefit. Outsourcing may create new interest groups that advocate for goods or services to be contracted out, leading to lobbying efforts aimed at renewing contracts during the competitive bidding process. The influence of these interest groups may undermine any overall expenditure reductions expected from outsourcing policies.

Finally, the negative externalities associated with outsourcing on the operation of government organizations should not be overlooked (Boyne, 1998; Vrangbæk et al., 2015; Lee et al., 2019). According to psychological contract theory, public service motivation theory, and job satisfaction theory, increased outsourcing by governments may reduce public employees' job satisfaction and undermine the performance of government organizations. These negative externalities can impose additional costs on government operations.

Given these arguments, the relationship between outsourcing and fiscal balance remains theoretically and empirically ambiguous. Therefore, it is essential to empirically investigate how outsourcing affects fiscal balance, accounting for specific analysis targets, time periods, and variables. Based on this, Hypothesis 1 is proposed as follows:

Hypothesis 1: There is a relationship between outsourcing and fiscal balance, the specific direction of which is to be determined empirically.

The current literature on the relationship between outsourcing and government finance offers a less definitive account of the mechanisms that may result in variations in this relationship. In this regard, the moderating role of political ideology becomes particularly significant. Fiscal policy, being a political process, requires the coordination and reconciliation of values among diverse individuals and ideological perspectives. Ideologies, which encompass fundamental beliefs and preferences regarding the structure of political, economic, and social systems, provide a critical foundation for this process (Jost et al., 2009). Numerous studies have underscored the significance of political ideology in shaping policy processes (Poole and Rosenthal, 2011). Specifically, the ideologies of political elites—key executives and politicians—are central to influencing government operations and policy formulation (Jennings, 1992; Jewitt and Goren, 2016).

In democratic partisan politics, political ideologies are typically positioned along a left-to-right spectrum, with each orientation reflecting distinct perspectives on the function, role, and size of government. These ideological positions substantially influence fiscal and regulatory policies (Osborne and Slivinski, 1996; Brender and Drazen, 2013; Hicks and Swank, 1992; Bjørnskov and Potrafke, 2013; Potrafke, 2010, 2011, 2018). The traditional distinctions between left- and right-wing ideologies have been well-documented across various dimensions (Alt and Lowry, 1994; Blomberg and Hess, 2003; Reed, 2006; Pickering and Rockey, 2013; Bjørnskov and Potrafke, 2013). Left-wing governments are typically associated with a preference for increased government intervention and responsibilities, often pursued through expansionary fiscal and monetary policies aimed at promoting social equity and income equality. In contrast, right-wing governments generally advocate for free-market principles, supporting reduced government intervention and a market-oriented approach. Here, it is important to acknowledge that politicians often utilize the design of administrative structures to gain advantages over political opponents (de Figueiredo, 2002; Lewis, 2003; Moe, 1989). In this process, politicians may opt for specific government configurations concerning managerial and financial authority (McDonald, 2014). Moreover, organizations' responses to external conditions vary significantly depending on managerial strategies, which are inherently shaped by political power dynamics (Meier et al., 2007; O'Toole and Meier, 2015). For instance, the selection of contractors may influence fiscal sustainability by altering political incentives (Kim and Choi, 2023), suggesting that a government's political ideology can shape both organizational behavior and outsourcing choices. Therefore, right- and left-leaning governments may approach contracting decisions, involving different degrees and modalities of private-sector involvement, in ways that reflect their respective political environments and management practices (Cohen, 2001; Chen and Lu, 2024). Political ideology is deeply intertwined with government management and can significantly affect how outsourcing is implemented (Rho, Kim, and Han, 2021). Consequently, the relationship between outsourcing and fiscal balance may exhibit contradictory effects, depending on the prevailing ideological orientation of the government.[3]

By incorporating political inclination into our analysis, we can explore how government outsourcing varies according to left-wing and right-wing ideologies. Under a right-wing ideology, outsourcing is often viewed as a mechanism for transferring government functions to the private sector. This process is driven by competition, where only the most efficient private companies remain, effectively replacing governmental roles and leading to reductions in government expenditure and improvements in fiscal balance. In contrast, left-wing ideologies approach outsourcing as a means to extend government influence. Liberals emphasize that outsourcing addresses gaps in fiscal functions that the government is unable to fulfill, thereby turning it into a channel for increasing government spending (Biais and Perotti, 2002; Sundell and Lapuente, 2012).[4]

Given the influence of political ideology on fiscal policies and government operations, both left-wing and right-wing ideologies can significantly moderate the relationship between outsourcing and fiscal balance. However, there remains a lack of empirical studies that provide robust support for these theoretical expectations. To address this gap, we propose the following hypothesis:

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[3] Indeed, the significance of political ideology in explaining privatization and deregulation (Bortolotti, Fantini, and Siniscalco, 2004; Potrafke, 2010; Belloc, Nicita, and Sepe, 2014; Peña-Miguel and Cuadrado-Ballesteros, 2020) is noteworthy, as these processes share similar characteristics with contracting-out. Furthermore, political ideology has varying effects on outsourcing operations, depending on whether the entities involved are for-profit or non-profit companies (VanSlyke, 2006; Feiock and Jang, 2009), as well as the specific types of public services being outsourced (Petersen, Houlberg, and Christensen, 2015).

[4] The differences in outsourcing operations between political ideologies can be further accentuated by the synchronization between government and private organizations (Ashworth, Boyne, and Delbridge, 2009; Villadsen, 2013; Alonso, Andrews, and Hodgkinson, 2016).

Hypothesis 2: Political ideology moderates the relationship between outsourcing and fiscal balance, with conservative and liberal ideologies exerting distinct influences.

To further investigate the channels through which political ideology influences fiscal balance in the context of outsourcing, a series of tests can be conducted. First, the interaction between outsourcing and political ideology can be analyzed to assess its impact on government expenditure and revenue (Alonso, Clifton, and Díaz-Fuentes, 2017). Second, the effect of political ideology and outsourcing on public-sector employment can be examined (Potrafke, 2019). For instance, under a right-wing ideology, outsourcing may be used to reduce government size and foster private competition, potentially enhancing fiscal balance by lowering both government spending and public-sector employment. Conversely, under a left-wing ideology, outsourcing may lead to increased government spending and public-sector employment due to the reallocation of employees within the public sector.[5] Based on this reasoning, we propose an auxiliary hypothesis:

Hypothesis 2-1: The moderating effect of political ideology on the relationship between outsourcing and fiscal balance is particularly evident in the areas of government expenditure and public-sector employment, with conservative and liberal ideologies having distinct impacts.

3. Method

3.1. Data and variables

To examine the relationship between outsourcing and fiscal balance, as well as the

[5] The case of South Korea offers a relevant example (Lee and Eun, 2009; An and Lee, 2021), in which non-regular workers in the public sector transition into full-time positions through the outsourcing process. It is important to note that the outcomes of such processes can vary depending on the political ideology of the governing regime.

moderating role of political ideology, we construct an unbalanced panel dataset for 31 OECD countries[6] over the period 2009–2019. This time frame covers the post-global financial crisis and pre-COVID-19 period. Table 1 presents a comprehensive list of variables used in this study, along with their detailed sources and descriptions.

[Table 1 about here]

The dependent variable in our analysis is fiscal balance[7], which requires an indicator that reflects the overall fiscal situation of the government in question.[8] To capture this, we utilize the primary balance (PB) of the general government provided by the OECD as the main dependent variable. The primary balance represents the annual deficit excluding net interest payments. As a robustness check, we also use the cyclically adjusted primary balance (CAPB), which excludes net interest payments and accounts for cyclical factors.

The central explanatory variable in this study is outsourcing, derived from data provided by the OECD's Government at a Glance report, a widely recognized and reliable source of official statistics. This report defines government production costs as expenditures on goods and services, primarily consisting of wages and purchases. Outsourcing is operationalized as the share of these production costs procured from external entities, such as private companies or other public agencies. Additionally, we incorporate an alternative measure based on public

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[6] The countries in our analysis include Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

[7] When referring to fiscal soundness, it specifically pertains to the fiscal balance, which reflects the government's short-term fiscal position. The OECD defines fiscal balance as the difference between a government's total expenditures and its revenues. This measure indicates the extent to which government spending is financed by revenue generated within a given fiscal year. A surplus occurs when revenues exceed expenditures, whereas a deficit arises when expenditures surpass revenues. The fiscal balance is typically assessed as a proportion of GDP or the total budget to contextualize its size relative to the economy. Persistent deficits over time contribute to increasing government debt and higher interest obligations.

[8] It is important to note that using specific expenditure items may not provide an accurate reflection of the fiscal condition when governments simply reallocate budget deficits or savings to other areas of expenditure.

procurement data from the OECD, which captures purchases made by governments and state-owned enterprises for goods, services, and works.[9] Given that the dependent variable in this study is the government's revenue-expenditure ratio expressed as a percentage of GDP, using outsourcing as a GDP-relative measure could introduce a mechanical negative correlation. To address this methodological concern, we adjust the outsourcing variable to be expressed as a proportion of total government expenditures. Specifically, we achieve this by dividing (Outsourcing/GDP), sourced from the OECD, by (Government Expenditure/GDP), as provided by the IMF.[10]

The political ideology of the government functions as the moderating variable in this analysis, and we employ three distinct methods to measure it.[11]

First, given that most OECD countries are representative democracies, we primarily rely on data from the Comparative Political Data Set (CPDS) to assess the ideological composition of parliament. This is measured by the proportion of seats held by left-wing, centrist, and right-wing parties. The CPDS classifies parties according to their economic and political platforms, informed by expert evaluations, party manifestos, and other sources. Left-wing parties, such as social democrats, typically support state intervention, welfare expansion, and redistributive policies. Right-wing parties, particularly conservative ones, emphasize free markets, limited government intervention, and traditional values. Centrist parties, like Christian Democratic or

[9] Government spending that does not involve direct purchases, such as social welfare, unemployment benefits, and other transfers, is not considered a production cost within the context of our analysis.
[10] It is important to note that these variables typically reflect outsourcing activities at the central government level. This limitation constrains our ability to capture outsourcing dynamics at local or regional levels, necessitating cautious interpretation of the results.
[11] A government is composed of both a legislative and an executive body. Political ideology encompasses three main dimensions: left-wing (liberal), center, and right-wing (conservative). In this study, our primary focus is on the political ideology of the legislative branch. This choice is motivated by the significant role played by the parliament in the policy-making process, as its members are elected representatives of the public. It should be noted that this holds true regardless of the specific governmental system in place, whether it be a presidential or a cabinet system.

Catholic parties, fall between these two poles. We use annual data on the seat distribution across these ideological groups.

Second, recognizing that both legislative and executive branches contribute significantly to fiscal policy decisions, including outsourcing, we supplement the parliamentary data with information on the cabinet composition. Specifically, we incorporate the percentage of cabinet posts held by left-wing, centrist, and right-wing parties, drawing from the CPDS to ensure robustness in our measure of political ideology.

Third, to account for the influence of national leaders' ideological positions on government policy, we include the political ideology of the head of state or government for each country and year. The coding of leaders' ideologies follows the framework established by Herre (2023), which is based on a variety of sources, including leaders' public statements, personal histories, and other supporting evidence.

Table 2 presents the correlation matrix for these political ideology variables.

[Table 2 about here]

We incorporate a range of time-varying and country-specific control variables. The selection of covariates follows prior studies investigating the relationship between outsourcing and public finance (Bel and Fageda, 2009; 2017; Alonso, Clifton, and Díaz-Fuentes, 2017).

First, recognizing the strong link between macroeconomic conditions and both fiscal policy and outsourcing, it is crucial to control for the effects of underlying economic trends and the broader macroeconomic environment. In an increasingly globalized world, fiscal policies and government operations are also shaped by cross-border trade and capital flows. To account for these influences, we include variables such as GDP growth rate, GDP per capita, inflation rate, trade dependency, and capital openness. Additionally, with the growing fiscal pressures stemming from aging populations and declining birth rates in advanced economies, it is important to control for demographic factors that impact government spending and the provision of public services. Accordingly, we incorporate variables like population growth rate, age dependency ratio, and the proportion of the elderly population. Given that fiscal policies and government procurement processes are often influenced by the level of democratic development, we also consider political factors that may affect fiscal balance and outsourcing by including measures of democratic maturity. Finally, we introduce a variable that captures the size of the central government based on expenditure. Although the outsourcing variable does not differentiate between central and local government activities, controlling for the share of central government expenditure helps to address this limitation. To explore the potential channels through which the interaction between outsourcing and political ideology influences government operations, we utilize data on general government expenditures, general government revenues, and public-sector employment, sourced from the OECD. These variables offer critical insights into how government organizations, in conjunction with their political ideologies, allocate resources and manage financial operations.

3.2. Empirical strategy

To test Hypothesis 1, we employ the following regression model:

$$\mathrm{Fiscal\ Balance}_{it} = \beta \mathrm{Outsourcing}_{it} + X_{it}\Gamma + \delta_i + \lambda_t + \epsilon_{it}$$

In this model, i represents a country and t represents a year. X_{it} is a matrix of control variables, and we introduce two fixed effects, δ_i for country fixed effect and λ_t for year fixed effect, in the regression. Standard errors are clustered at the country level.

To ensure the robustness of our main model specification, we employ multiple model specifications. First, we estimate the model with and without covariates and use alternative dependent and explanatory variables to account for potential measurement errors. Second, in line with Alonso, Clifton, and Díaz-Fuentes (2017), we address concerns about potential endogeneity by applying different regression methods. Specifically, we estimate a model incorporating the lagged dependent variable among the regressors using the Generalized Method of Moments (GMM) to control for potential expenditure dynamics. Furthermore, we implement a two-stage least squares (2SLS) estimation, using the second lag of the outsourcing variable as an instrument to address endogeneity concerns. Finally, we conduct a heterogeneity analysis by examining different forms of government and political systems (e.g., presidential, parliamentary, and unitary systems) to assess whether the results remain consistent after accounting for these institutional differences.

Next, based on the main specification used to test Hypothesis 1, we examine the moderating effect of political ideology on the relationship between outsourcing and fiscal balance to test Hypothesis 2. The regression model is as follows:

$$\begin{aligned}\mathrm{Fiscal\ Balance}_{it} &= \beta_1 \mathrm{Outsourcing}_{it} + \beta_2 \mathrm{Ideology}_{it} + \beta_3 (\mathrm{Outsourcing}_{it} \times \mathrm{Ideology}_{it}) + X_{it}\Gamma \\ &\quad + \delta_i + \lambda_t + \epsilon_{it}\end{aligned}$$

In this model, the coefficient β_3 represents our primary interest, as its sign and magnitude may vary depending on the political ideology.

Finally, to test Hypothesis 2-1, we use general government expenditures, general government revenues, and public employment as dependent variables to examine the channels through which the moderating role of political ideology between outsourcing and fiscal balance is substantiated.

4. Results and discussion

Table 3 presents the estimation results for Hypothesis 1. Overall, the results consistently indicate a negative and statistically significant relationship between outsourcing and fiscal balance.

In Column 1, without control variables, outsourcing adversely impacts fiscal balance (r = -2.389, SE = 0.806). These results remain similar when we include time-varying economic, political, and demographic characteristics of each country in Column 2 (r = -1.843, SE = 0.764), indicating that a one percentage point increase in outsourcing as a share of government expenditures is associated with a 1.843 percentage point decline in the primary balance as a share of GDP, holding all other factors constant.

To address concerns about the precise measurement of outsourcing and fiscal balance, we examine the robustness of the results using alternative variables. In Column 3, we replace the primary balance with the cyclically adjusted primary balance, and the coefficients are comparable (r = -2.182, SE = 0.943). Furthermore, in Column 4, when we use public procurement as the independent variable, a negative association between outsourcing and fiscal balance is maintained (r = -1.435, SE = 0.312).

To mitigate potential endogeneity issues, we apply other model specifications. The dynamic estimation results in Column 5 yield similar outcomes (r = -1.775, SE = 0.779). Notably, the lagged dependent variable is positive and statistically significant, indicating a dynamic pattern in fiscal balance. In Column 6, the 2SLS estimates of the outsourcing effect remain negative and significant (r = -3.418, SE = 1.381).

Using the two-way fixed-effects estimation, Columns (7) to (9) present the results under sample restrictions for presidential systems, parliamentary systems, and unitary systems, respectively. While the reduced sample sizes may limit statistical significance, the findings consistently indicate a negative relationship between outsourcing and fiscal balance across political systems. Notably, these effects are more pronounced in presidential and unitary systems of government. Although identifying the exact reasons for these findings lies beyond the scope of this study, they may be attributed to weaker oversight mechanisms or less stringent fiscal regulations inherent in the centralized nature of presidential and unitary systems. This centralization may, in turn, exacerbate the fiscal impact of outsourcing decisions, as such decisions are often implemented on a broader scale.

[Table 3 about here]

Table 4 presents the estimation results for Hypothesis 2. Overall, the findings indicate that right-wing ideology interacts with outsourcing to enhance fiscal balance, while left-wing ideology, when combined with contracting-out, adversely affects fiscal balance. There is limited evidence to suggest that centrist ideology has a significant impact on fiscal balance through outsourcing.

Specifically, in Column 1, the interaction between government outsourcing and the parliamentary share of right-wing parties is associated with an improvement in fiscal balance (r = 0.017, SE = 0.007). This suggests that a one percentage point increase in outsourcing, combined with a one percentage point increase in the parliamentary share of right-wing parties, improves the fiscal balance by 0.017 percentage points of GDP. Similar results are observed when government ideology is assessed by cabinet-post shares in Column 2 (r = 0.009, SE = 0.005).

In contrast, Column 7 reveals a negative impact associated with left-wing parties (r = -0.010, SE = 0.005), indicating that a one percentage point increase in outsourcing combined with a one percentage point increase in the parliamentary share of left-wing parties reduces the fiscal balance by 0.010 percentage points of GDP. Furthermore, conservative ideology within the executive branch demonstrates a detrimental moderating effect on the relationship between outsourcing and fiscal balance in Column 8 (r = -0.006, SE = 0.003). Comparable findings are evident when applying the political ideology of leaders in Column 9 (r = -0.479, SE = 0.303).

These findings highlight that political ideology significantly moderates the relationship between outsourcing and fiscal balance, with right-wing parties generally enhancing fiscal outcomes through outsourcing, while left-wing and conservative executive ideologies appear to exacerbate fiscal imbalances.

[Table 4 about here]

The potential mechanisms through which left- and right-wing political ideologies may moderate the relationship between outsourcing and fiscal balance have been discussed in the preceding theoretical background. It has been highlighted that a government's operational methods, including government expense and employment practices, can vary significantly depending on its ideological orientation. The results of our testing for Hypothesis 2-1 are presented in Table 5.

Columns 1–3 display the results for the right-wing case, Columns 4–6 report the findings for centrist ideology, and Columns 7–9 present the results for the left-wing case. Within each ideological framework, we utilize general government expenditures, general government revenue, and public employment as the dependent variables.

Conversely, Column 7 demonstrates that left-wing ideology is positively associated with higher government expenditures (r=0.008, SE=0.004), implying that left-leaning governments are more inclined to expand spending. Similarly, Column 9 indicates that left-wing ideology facilitates an increase in public employment through outsourcing (r=0.003, SE=0.001), reflecting a potential focus on maintaining employment levels despite contracting-out practices.

Across all specifications, the coefficients are statistically nonsignificant when general government revenues are used as the dependent variable. This suggests that the interaction between outsourcing and political ideology primarily affects government expenditure levels and employment dynamics rather than revenue generation. These findings highlight how ideological preferences shape the relationship between outsourcing practices and fiscal outcomes, with distinct patterns emerging under right- and left-wing governance.

Our findings suggest that outsourcing engenders distinct forms of government management in the areas of expenditure and employment, contingent upon political ideology. This variation may serve as a mechanism affecting fiscal balance differently. These results align with theoretical predictions, whereby right-wing ideology advocates for a diminished role of government by transferring public responsibilities to the private sector, while left-wing ideology utilizes outsourcing to reinforce government influence over public services.

[Table 5 about here]

In terms of policy implications, it is crucial to reevaluate the widespread assumption that outsourcing inherently enhances fiscal stability by fostering competition and achieving cost reductions. Our analysis suggests that shifting the responsibility for producing and delivering public services to private entities does not automatically lead to improved fiscal results. Furthermore, the effects of outsourcing on fiscal balance are influenced by the prevailing political ideology of the government. Left-wing ideologies are associated with an increase in fiscal deficits, while right-wing ideologies tend to promote fiscal surpluses. We highlight that these differences may be attributed to the varying operational methods of government outsourcing in relation to expenditures and public employment. This underscores the importance of considering a government's political orientation when evaluating the consequences of outsourcing and emphasizes the need to understand how outsourcing is implemented within ideologically diverse frameworks.[12]

[12] For example, the employment contracts of workers within a government and across outsourced companies may vary significantly based on conservative and progressive ideologies, as shown in the country-specific cases (Lee and Eun, 2009; An and Lee, 2021). Therefore, it is crucial to conduct a specific review of these differences.

5. Conclusion

Improving government efficiency and ensuring fiscal soundness have been highly debated topics in the field of public administration and public policy. Outsourcing has emerged as a significant subject within this debate. This paper assesses the impact of outsourcing public-sector tasks on fiscal balance and investigates whether political ideology serves as a moderating factor between these two variables.

Our empirical findings consistently indicate that outsourcing is associated with a deterioration in fiscal balance. These results challenge the prevalent assumption that contracting out public-service production leads to reduced costs for governments. Additionally, our findings demonstrate that the relationship between outsourcing and fiscal balance can vary depending on the political ideology. A right-wing ideology moderates and improves fiscal balance, whereas a left-wing ideology exacerbates fiscal imbalances. These findings hold true for government expenditure and public employment. Consequently, the political ideology of a government should be considered as a crucial factor in understanding the functioning and outcomes of outsourcing.

While our analysis yields valuable insights, several limitations merit consideration for future research. First, we recognize that our causality test remains incomplete, despite our efforts to address this issue through various methodologies. To improve causal inference in subsequent studies, identifying exogenous natural experiments or appropriate instrumental variables will be critical. Given our inability to locate suitable instruments in this study, we highlight this as an essential direction for future inquiry.

Second, this study provides only indirect evidence regarding the differences in outsourcing operations influenced by a government's political ideology, without identifying the specific mechanisms driving these effects. Although we have sought to enhance these findings by analyzing government expenditures and public employment, it is important to acknowledge that other channels may also play a role. Therefore, it is necessary to establish more reliable indicators and to expand the analysis at a micro level. Future research could explore the specific variations in the implementation of government outsourcing based on political ideology.

Third, the current annual panel approach at the national level tends to adopt a somewhat macro-level perspective, making it challenging to establish precise causal links due to the various heterogeneities across countries that may influence these relationships. Consequently, a more micro-level approach should be pursued in future studies. For instance, by collecting data on outsourcing and fiscal conditions at different levels of government, we can analyze how outsourcing functions within the government hierarchy and its impacts on both national and local finances, as well as the interactions with political ideology. Furthermore, investigating the outsourcing practices of various countries at an individual level would enhance our understanding of the relationship between outsourcing, fiscal balance, and political ideology. This approach could also help mitigate one of the limitations of this study regarding sample size, offering significant policy implications for government operations in outsourcing.

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Table 1. Descriptive statistics

Variable	Mean	SD	N	Source and Description
Variables used as a dependent variable				
Primary balance	-1.046	3.786	341	Source: A Cross-Country Database of Fiscal Space Description: % of GDP
Cyclically adjusted primary balance	-0.111	3.462	308	Source: A Cross-Country Database of Fiscal Space Description: % of GDP
Variables used as an independent variable				
Outsourcing	29.116	12.112	277	Source: OECD and IMF Description: % out of Total Expenditure
Public procurement	39.794	14.729	340	Source: OECD and IMF Description: % out of Total Expenditure
Variables used as a moderate variable				
Parliamentary seat shares of right-wing parties	26.790	21.804	341	Source: Comparative Political Data Set (CPDS) Description: %
Parliamentary seat shares of center parties	11.511	16.350	341	Source: Comparative Political Data Set (CPDS) Description: %
Parliamentary seat shares of left-wing parties	15.813	17.908	341	Source: Comparative Political Data Set (CPDS) Description: %
Cabinet-post shares of right-wing parties	45.368	36.336	341	Source: Comparative Political Data Set (CPDS) Description: %
Cabinet-post shares of center parties	20.144	28.842	341	Source: Comparative Political Data Set (CPDS) Description: %
Cabinet-post shares of left-wing parties	29.150	33.346	341	Source: Comparative Political Data Set (CPDS) Description: %
Leader as rightist	0.499	0.501	341	Source: The Global Leader Ideology dataset Description: Indicator
Leader as centrist	0.135	0.342	341	Source: The Global Leader Ideology dataset Description: Indicator
Leader as leftist	0.358	0.480	341	Source: The Global Leader Ideology dataset Description: Indicator
Variables used as a control variable				
GDP growth rate	1.478	3.288	341	Source: World Development Indicators Description: %
GDP per capita (logged)	10.504	0.575	341	Source: World Development Indicators Description: logged price
Inflation rate	1.433	1.452	341	Source: World Development Indicators

				Description: %
Trade dependency	107.482	65.425	341	Source: World Development Indicators Description: (Import+Export)/GDP, %
Capital openness	0.932	0.164	330	Source: Chinn-Ito index Description: max=1.000, min=0.164
Electoral democracy	0.867	0.054	341	Source: V-Dem project Description: electoral democracy index (max=0.926, min=0.460)
Population growth rate	0.437	0.787	341	Source: World Development Indicators Description: %
Age dependency ratio	51.459	4.964	341	Source: World Development Indicators Description: %
Senior population ratio	17.609	3.019	341	Source: World Development Indicators Description: 65 and above population, %
Center government expenditures	36.136	9.096	341	Source: World Development Indicators Description: % of GDP
Variables used to infer the mechanism				
General government expenditures	45.694	6.908	250	Source: OECD Description: % of GDP
General government revenues	42.476	6.958	305	Source: OECD Description: % of GDP
Public employment	18.626	5.671	312	Source: OECD Description: % of total employment

Note: A Cross-Country Database of Fiscal Space is based on Kose, Kurlat, Ohnsorge, and Sugawara (2022). The Global Leader Ideology dataset is based on Herre (2023).

Table 2. Correlation matrix among political-ideology variables

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1)	1.0000								
(2)	0.9198	1.0000							
(3)	0.3548	0.4750	1.0000						
(4)	-0.4583	-0.4411	-0.0292	1.0000					
(5)	-0.4940	-0.4745	-0.0255	0.9541	1.0000				
(6)	-0.0093	-0.0717	-0.3937	0.3422	0.2965	1.0000			
(7)	-0.6255	-0.6644	-0.4768	-0.2036	-0.2229	-0.0880	1.0000		
(8)	-0.6190	-0.6561	-0.4834	-0.2595	-0.2700	-0.1347	0.9616	1.0000	
(9)	-0.3550	-0.4284	-0.7442	-0.2131	-0.1920	-0.2947	0.5490	0.5908	1.0000

Note. (1)=Parliamentary seat shares of right-wing parties, (2)=Cabinet-post shares of right-wing parties, (3)=Leader as rightist, (4)=Parliamentary seat shares of center parties, (5)=Cabinet-post shares of center parties, (6)=Leader as centrist, (7)=Parliamentary seat shares of left-wing parties, (8)=Cabinet-post shares of left-wing parties, (9)=Leader as leftist

Table 3. Hypothesis 1: Estimates of outsourcing on fiscal balance

Dependent variable:	(1) PB	(2) PB	(3) CAPB	(4) PB	(5) PB	(6) PB	(7) PB	(8) PB	(9) PB
Outsourcing	-0.796**	-1.843*	-2.182*		-1.775*	-3.418*	-5.621**	-1.060+	-2.885**
	(0.269)	(0.764)	(0.943)		(0.779)	(1.381)	(1.175)	(0.533)	(0.763)
Public procurement				-1.435**					
				(0.312)					
Lagged PB					0.268**				
					(0.065)				
GDP growth rate		0.128*	-0.051	0.166**	0.104	0.063	0.021	0.055	0.193**
		(0.062)	(0.072)	(0.050)	(0.088)	(0.091)	(0.117)	(0.106)	(0.063)
GDP per capita		-0.159	-6.823	1.482	-0.146	-1.003	5.416	-2.148	-0.913
		(2.695)	(4.280)	(2.170)	(1.746)	(3.115)	(9.339)	(3.706)	(3.801)
Inflation rate		-0.075	-0.147	-0.055	0.082	0.026	-0.406	-0.220	-0.030
		(0.224)	(0.313)	(0.180)	(0.185)	(0.242)	(0.247)	(0.242)	(0.221)
Trade dependency		0.035	0.023	0.038+	0.018	0.009	-0.109+	0.053	-0.013
		(0.030)	(0.033)	(0.020)	(0.028)	(0.047)	(0.057)	(0.036)	(0.028)
Capital openness		-1.240	-0.366	-1.541	-4.632+	-5.194	-2.157	-0.851	-7.070*
		(4.325)	(4.965)	(3.837)	(2.593)	(3.256)	(6.860)	(11.188)	(2.642)
Electoral democracy		9.118+	5.637	2.197	10.444*	9.538*	11.577	7.989+	12.457**
		(5.247)	(7.040)	(3.504)	(4.760)	(4.078)	(8.198)	(4.208)	(3.127)
Population growth rate		1.144+	0.597	1.183*	0.586	1.185**	-2.442	1.509*	1.938+
		(0.639)	(0.586)	(0.479)	(0.365)	(0.457)	(2.632)	(0.619)	(1.049)
Age dependency ratio		0.193	0.205	-0.084	0.208	0.188	0.990*	0.107	0.042
		(0.341)	(0.446)	(0.227)	(0.332)	(0.369)	(0.329)	(0.236)	(0.325)
Senior population ratio		0.063	-0.347	0.702	0.234	0.435	-2.142+	0.535	1.160
		(0.880)	(1.202)	(0.603)	(0.584)	(0.680)	(0.986)	(0.673)	(1.084)
Central government size		0.936+	0.136	-0.509	1.890**	1.750**	1.000	0.207	1.101
		(0.542)	(0.931)	(0.461)	(0.681)	(0.672)	(2.875)	(0.935)	(0.759)
Country fixed effect	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y	Y	Y	Y	Y	Y
R^2	0.497	0.555	0.455	0.630		0.504	0.738	0.561	0.608
N	277	266	239	329	205	226	71	195	202

Clustered standard errors at the country level in parentheses, ** p<0.01, * p<0.05, and + p<0.10.
Note: PB = Primary Balance; CAPB = Cyclically Adjusted Primary Balance. Two-way fixed-effects estimation is conducted in columns (1), (2), (3), and (4). Dynamic panel estimation is conducted in column (5). Two-stage least squares (2SLS) estimation is conducted in column (6). Columns (7) to (9) present two-way fixed-effects estimation under sample restrictions for presidential systems, parliamentary systems, and unitary systems, respectively.

Table 4. Hypothesis 2: Moderating role of political ideology between outsourcing and fiscal balance

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		Right-wing			Centrist			Left-wing	
Dependent variable:	PB	PB	PB	PB	PB	PB	PB	PB	PB
Outsourcing	-2.026**	-1.997**	-1.939*	-1.637*	-1.623*	-1.803*	-1.551+	-1.567+	-1.718*
	(0.636)	(0.641)	(0.749)	(0.636)	(0.632)	(0.753)	(0.762)	(0.778)	(0.775)
Political ideology	-0.174*	-0.098*	-0.935	0.131	0.060	-0.095	0.105+	0.056+	4.095
	(0.080)	(0.048)	(2.160)	(0.146)	(0.061)	(2.265)	(0.054)	(0.030)	(3.073)
Outsourcing × Political ideology	0.017*	0.009+	0.111	-0.011	-0.004	0.102	-0.010*	-0.006*	-0.479
	(0.007)	(0.005)	(0.195)	(0.012)	(0.005)	(0.182)	(0.005)	(0.003)	(0.303)
Covariates	Y	Y	Y	Y	Y	Y	Y	Y	Y
Country fixed effect	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y	Y	Y	Y	Y	Y
R^2	0.587	0.587	0.556	0.567	0.569	0.560	0.566	0.565	0.568
N	266	266	266	266	266	266	266	266	266

Clustered standard errors at the country level in parentheses, ** p<0.01, * p<0.05, and + p<0.10.
Note. PB=Primary balance, CAPB= Cyclically adjusted primary balance. Two-way fixed-effects estimation is conducted. Political ideology is as follows: (1)=Parliamentary seat shares of right-wing parties, (2)=Cabinet-post shares of right-wing parties, (3)=Leader as rightist, (4)=Parliamentary seat shares of center parties, (5)=Cabinet-post shares of center parties, (6)=Leader as centrist, (7)=Parliamentary seat shares of left-wing parties, (8)=Cabinet-post shares of left-wing parties, (9)=Leader as leftist

Table 5. Hypothesis 2-1: Potential channels on the moderating role of political ideology between outsourcing and fiscal balance

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Right-wing			Centrist			Left-wing		
Dependent variable:	Exp.	Rev.	Pub. Emp.	Exp.	Rev.	Pub. Emp.	Exp.	Rev.	Pub. Emp.
Outsourcing	2.800**	-0.526	0.324**	2.147**	-0.577	0.320*	2.576*	-0.299	0.219+
	(0.802)	(0.427)	(0.115)	(0.447)	(0.341)	(0.143)	(0.962)	(0.366)	(0.122)
Political ideology	0.152*	-0.035	0.035*	-0.236	-0.048	-0.005	-0.083+	0.063	-0.033*
	(0.068)	(0.027)	(0.013)	(0.190)	(0.034)	(0.014)	(0.042)	(0.044)	(0.013)
Outsourcing × Political ideology	-0.014*	0.004	-0.003**	0.018	0.004	0.001	0.008*	-0.006	0.003*
	(0.006)	(0.003)	(0.001)	(0.014)	(0.004)	(0.001)	(0.004)	(0.005)	(0.001)
Covariates	Y	Y	Y	Y	Y	Y	Y	Y	Y
Country fixed effect	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y	Y	Y	Y	Y	Y
R^2	0.699	0.472	0.654	0.701	0.473	0.627	0.680	0.481	0.652
N	184	236	245	184	236	245	184	236	245

Clustered standard errors at the country level in parentheses, ** p<0.01, * p<0.05, and + p<0.10.
Note: Exp. = General Government Expenditures; Rev. = General Government Revenues; Pub. Emp. = Public Employment. Political ideology is defined as the parliamentary seat shares of right-wing parties, center parties, and left-wing parties.