

Unier- Carleton, Norman Paterson School of International Affairs

SPENDING REVIEW IN A DECENTRALIZED SETTING: A TRANSATLANTIC
COMPARISON,
UNIER ROME NOVEMBER 5, 2012

Traditional Audit, Performance Audit Review and
Evaluation: Differences, and Complementarities

November 5th 2012

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Outline

1. Definitions
From Traditional Audit to Performance Audit Review (PAR) and to Evaluation
2. Impact Evaluation
3. Performance Audit Review and Evaluation in Practice
4. Differences, Similarities and Effectiveness: Conceptual Framework
5. Considerations
 - i. Government and Corruption
 - ii. PAR or Evaluation?
6. Conclusions

Objective

- An **apprehensive taxpayer wonders:**

- Would I be better off with my money spent in Government programs, or in my pockets?

- Assuming that some money is spent in Government programs how do I assure accountability?

- Traditional auditing, performance auditing and evaluation can support the fight to fraud and corruption and make the use of taxpayers' money more responsible and effective.



1. Definitions

From Financial Audit to Performance Audit Review and Evaluation

Definitions

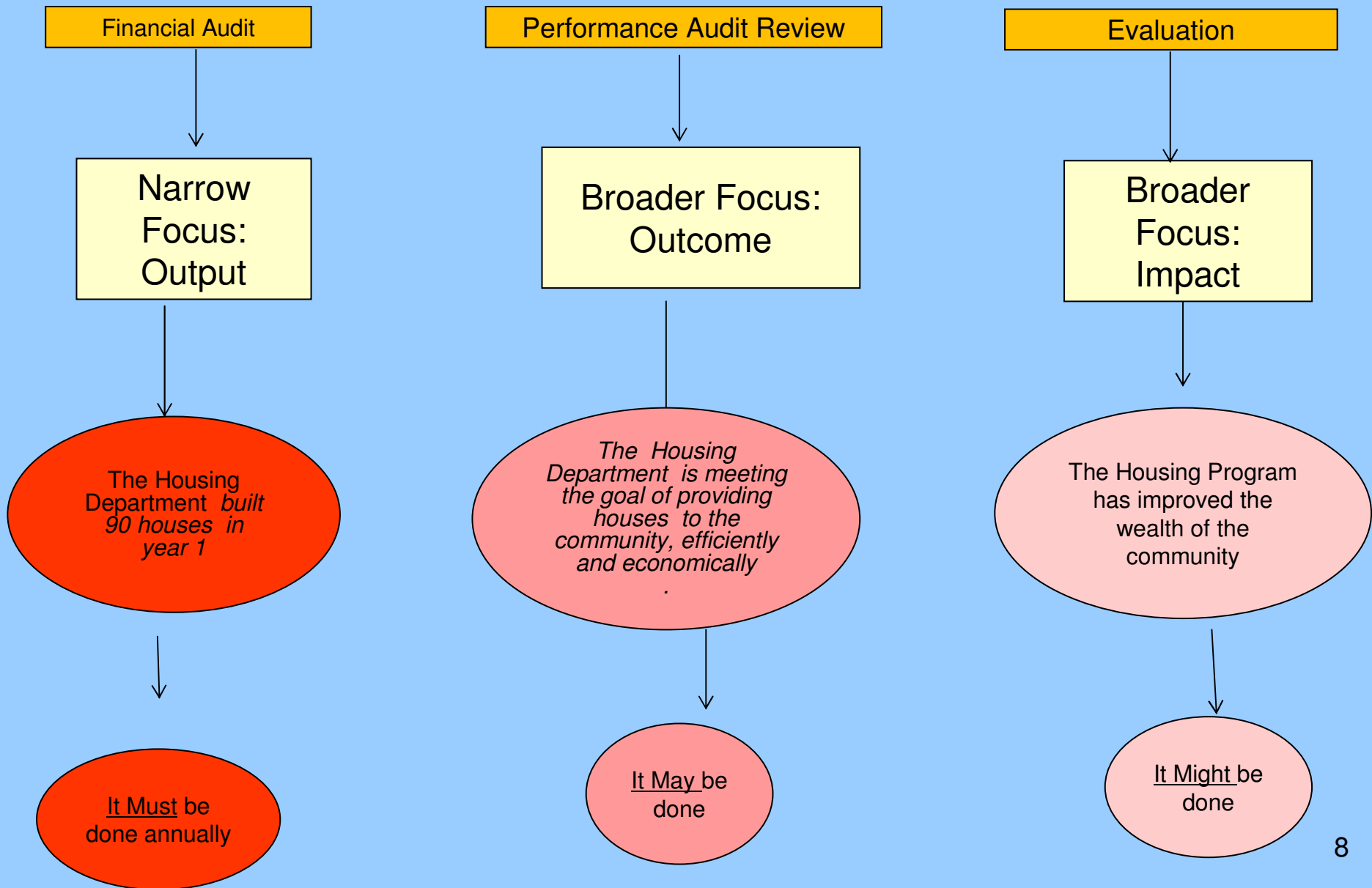
- **Need** is a problem which affects a group to which an intervention is directed.
- **Input** constitutes all the resources - human and financial, (e.g., grants, provided to the entity, to farmers or to MFI) -made available to implement a given intervention.
- **Output** is what is produced and accomplished with the additional input of resources, i.e., the number of micro loans to micro entrepreneurs; training courses delivered to unemployed; houses made; roads built; loans of a Multilateral Development Bank (MDB) like EIB.
- **Outcome** is the change that arises due to the intervention at which the change is related, e.g., increased number of micro entrepreneurs who started a business; road that increase traffic, trade and investments, but also raise the level of pollution and environment degradation. The outcome can be seen as expected or unexpected, and have positive and negative aspects.
- **Result** is the immediate changes that the beneficiary of the intervention sees because of his/her participation in the program, e.g., improved accessibility to finance, increased insurance coverage for a micro entrepreneur.
- **Impact** is a consequence that can be observed after the intervention is completed and affects the addressee (s) and might be caused by the intervention, i.e., the wealth of the micro entrepreneurs who received loans has increased and this is due to the program.

Definitions

- **Traditional Financial Audit** assesses whether Financial Statements give a true and fair view in accordance with the financial reporting framework and whether financial operations have been legally and regularly executed and accounts are reliable.
- **Performance Audit Review** assesses sound financial management in handling public sectors funds, i.e., taxpayers' money. It focuses on economy, efficiency and effectiveness with which audited entities use resources.
- According to Intosai, ISSAI 3000, a performance audit *is “the independent examination of the efficiency and effectiveness of government organizations, operations, or policies, with due regard to economy.”*; see INTOSAI, International Organization of Supreme Audit Institutions, 2010.
 - The principle of **ECONOMY** requires that the resources the audited entity uses for the pursuit of its activities are made available in due time, in appropriate quantity and quality and at the best price;
 - The principle of **EFFICIENCY** is concerned with the best relationship between resources employed and results achieved;
 - The principle of **EFFECTIVENESS** is concerned with attaining the specific policy objectives set and achieving the intended results.
- **Impact evaluation** assesses the changes in the well-being of individuals that can be attributed to a particular intervention. Thus the central challenge in carrying out effective impact evaluations is to identify **the causal relationship between the intervention and the outcomes of interest**.

Traditional Audit, Performance Audit and Evaluation





Financial Audit

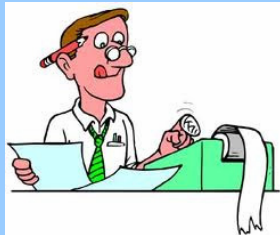
Performance Audit Review

Evaluation

Financial Audit, Performance Audit Review and
Evaluation move along two dimensions:
Accountability and Learning.

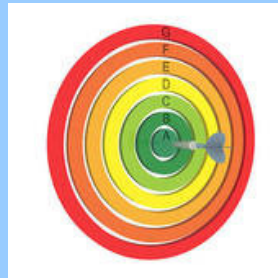
INDEPENDENCE

Financial Audit



<http://www.revisori.it/index.pag>

Performance Audit Review



<http://www.corteconti.it/>

<http://www.gao.gov/>

Evaluation



<http://www.valutazioneitaliana.it/new/>

http://www.oag-bvg.gc.ca/internet/English/admin_e_41.html

Traditional Audit, Performance Audit and Evaluation: Private and Public Sectors

Type of Analysis	Sectors	
	Private Sector	Public Sector
Financial Audit	yes	yes
Performance Audit Review	The market assesses the outcome	yes
Evaluation	Externalities can be attributed to the company	yes

Financial Audit, Performance Audit Review, Evaluation : Accountability

- The various forms of assessment and particularly performance audit are related to the increased role of government in the economy, and the need of being accountable for the use of taxpayers' money.
- The most concise **description of accountability** would be: *'the obligation to explain and justify conduct'*. This implies a relationship between an actor, the accountant, and a forum, the account-holder, or accountee (Pollitt 2003: 89).
- The need of "accountability" falls in two different traditions: the Anglo-Saxon where performance audit is more a matter for financial analysis; and the Latin view where performance audit is more matter for lawyers.
- **The need of accountability has led to an Audit Explosion:**
- **an "horizontal" explosion** of audits in many different fields: medicine, science, education, technology, environment, intellectual property, etc. Audit has assumed the status of an all purpose solution to problems of administrative control (Power 1994).
- **a "vertical" confusion mostly between performance audit and evaluation.**
 - Performance audits and particularly the analysis of effectiveness include evaluative elements and consider evaluation systems and information with a view to assessing their quality and, when they are considered to be satisfactory and relevant, use evaluation information as audit evidence.
 - **PAR and Evaluation: the most significant aspect of program effectiveness is impact**

2. Impact Evaluation

How do we Know an Intervention is Working?

- We cannot directly measure effectiveness through “sales” (no market for public sector services, e.g., health services), or profit,
- We cannot simply measure program outputs, which tells how money was spent.
- Effectiveness of Performance Audit does not link the intervention to the outcome.
- What is lacking is an **evidence** around the impact of targeted interventions. This **evidence-based policy** can only be achieved through proper evaluation.

What is Impact Evaluation?

IMPACT = an outcome or a portion of an outcome that can be attributed directly to a policy, program, project, or intervention of the public sector with taxpayers' money.

It measures the effect of a program or intervention on a beneficiary population controlling for all other factors that might have affected the target population during the program period, e.g., Economic downturn, Factory closure, Weather shock, Disease outbreak, Elections, New policy.

It is the difference, for the same target group or beneficiary population, between what happened with the policy, program, project and what would have happened without the program.

Impact evaluation requires the identification of the **counterfactual**.

Quantification of the benefits compared with the cost incurred to introduce the policy, program, project and conclude whether the intervention was warranted.

Impact evaluation can then defines lessons learned to improve the next intervention.

Measuring Impacts



Knowledge abt HIV, sexual behavior, incidence

IMPACT



Users at govt. clinics, USLs

OUTCOMES



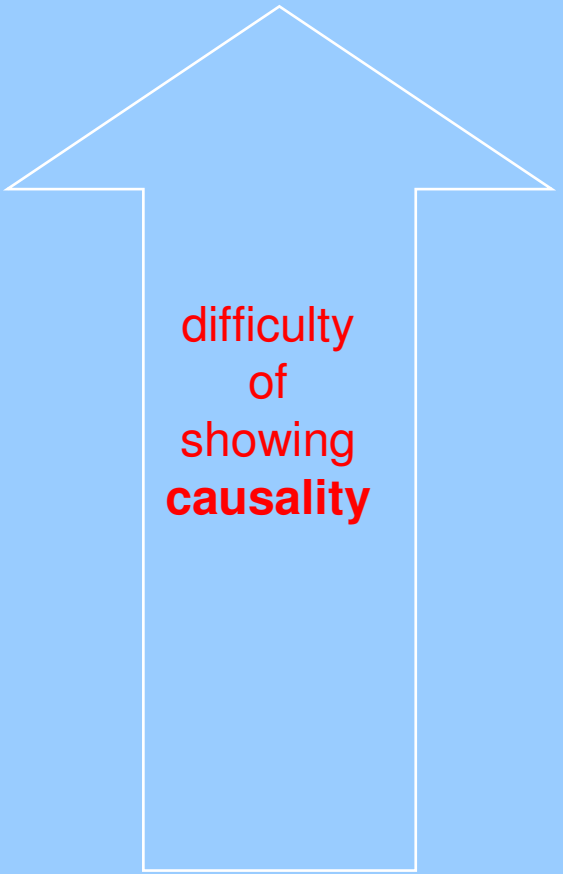
Number of Interventions

OUTPUTS

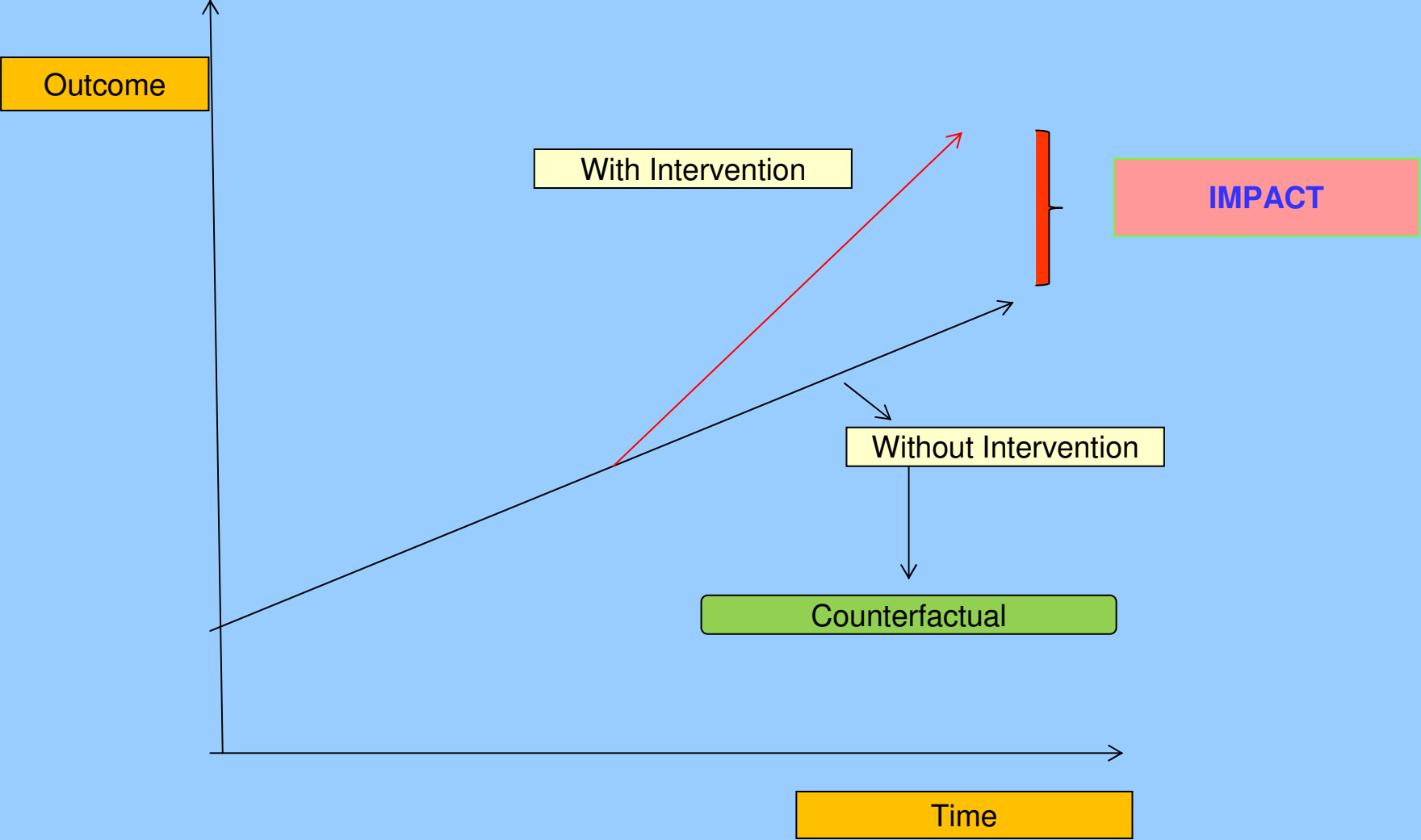


Resources for HIV Awareness Campaign

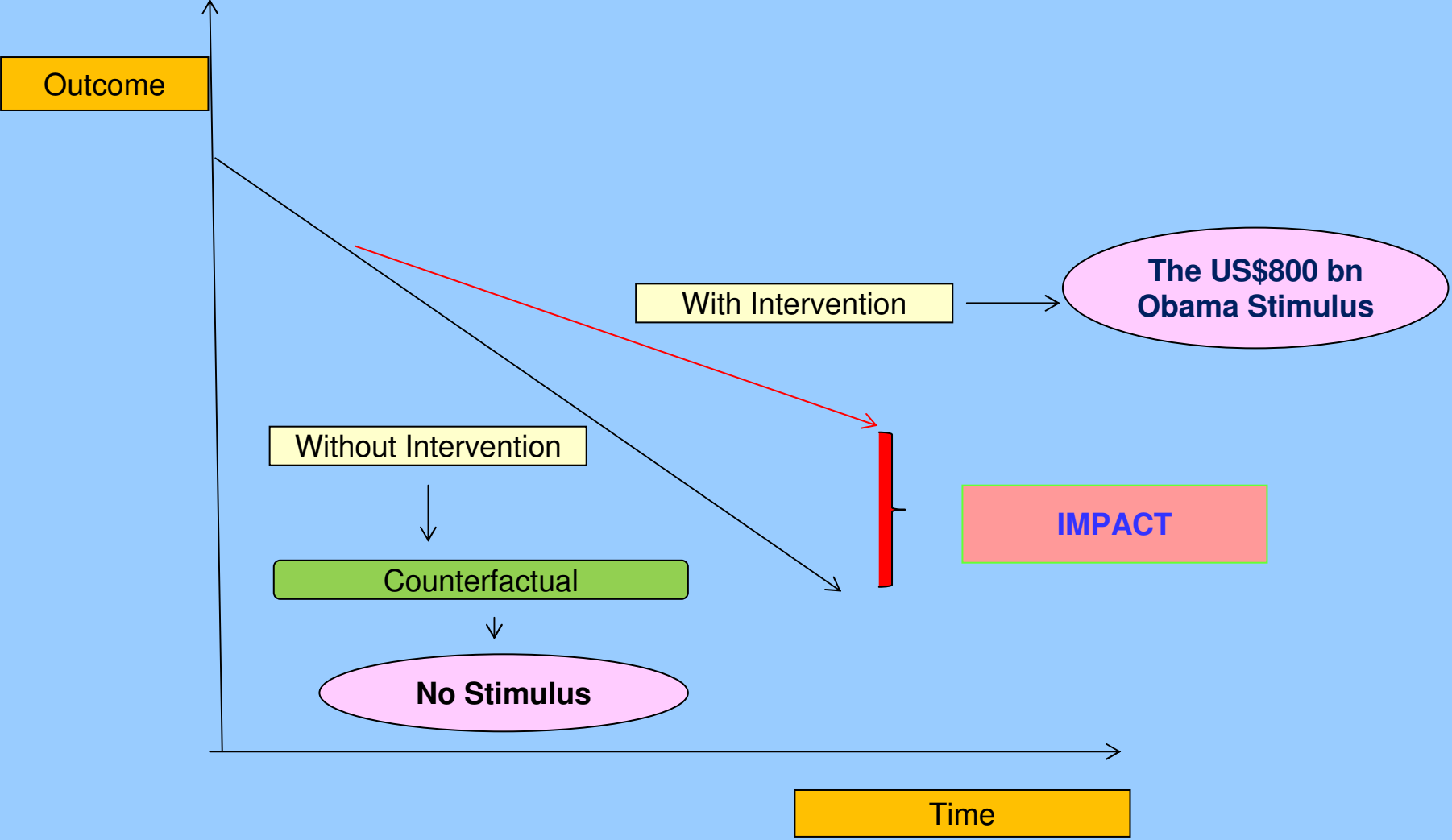
INPUTS



Impact



Impact



Goal of Impact Evaluation: Prove Causality

- Provide evidence that **Y(outcome)** happened because of **X (intervention)**, not for some other reason.
- Therefore, it is reasonable that if we **replicate X** again (possibly with some adjustment due to lessons learned) in a similar setting, **Y would happen again**.

Identification of the Causal Links

We need to know:

- i. The change in outcomes for the **treatment group** (measure them!!)
- ii. What would have happened in the absence of the treatment (“counterfactual”) for the **control group**
- iii. At baseline, the control group must be identical (in observable and unobservable dimensions) to the treatment group.

Impact Evaluation

The “final” outcomes are what we care about

- Identify and measure them

True “causal” effect of the intervention

- *Counterfactual*: What would have happened without the intervention?
- Compare measured outcomes with counterfactual → Causal effect

Toolbox for Impact Evaluation

Non or Quasi-Experimental

- 1) Before vs. After
- 2) With / Without Program
- 3) Difference –in-Difference
- 4) Discontinuity Methods
- 5) Multivariate Regression
- 6) Instrumental Variable

Experimental Method (**Gold Standard**)

7) Randomized Evaluation

Attribution and Contribution

A key question in the assessment of policy, program and projects is that of **attribution: to what extent are observed results due to program activities rather than other factors?** What we want to know is whether or not the program has made a difference—whether or not it has added value.

However, experimental or quasi-experimental designs that might answer these questions are often not feasible or not practical.

In such cases, **contribution analysis** can help to come to reasonably robust conclusions about the contribution being made by policy/programs to observed results.

Contribution analysis explores attribution through assessing the **contribution a program is making to observed results**. It sets out to verify the theory of change behind a program and, at the same time, takes into consideration other influencing factors. Causality is inferred from the following evidence:

1. The program is based on a reasoned theory of change: the assumptions behind why the program is expected to work are sound, are plausible, and are agreed upon by at least some of the key players.
2. The activities of the program were implemented.
3. The theory of change is verified by evidence: the chain of expected results occurred.
4. Other factors influencing the program were assessed and were either shown not to have made a significant contribution or, if they did, the relative contribution was recognized.

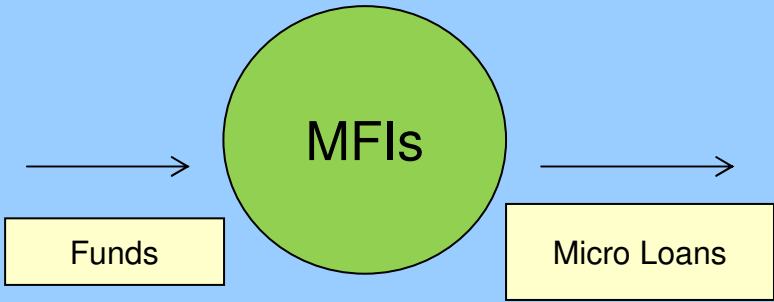
3. Performance Audit Review and Evaluation in Practice

Scope of Performance Audit Review and Impact Evaluation

- PAR and Evaluation are applied to policies, programs, projects, and institutions of so-called developed countries.
- **Examples** of Performance Audit Review and Impact Evaluation in USA are vast.
 - GAO Performance Audit on the **Federal Aviation Administration (FAA)**. From June 2011 to October 2012 in accordance with generally accepted government auditing standards. The report of GAO says that FAA has embarked on several initiatives to meet its goal of reducing the fatal general aviation accident rate by 2018. The strategy lacks performance measures for the significant activities that comprise it. Without a strong performance management structure, FAA will not be able to determine success or failure of the activities that underlie the 5-year strategy.
 - Concern about lack of evidence of the **impact of programs, policies and educational practices** has led to the choice of promoting experimental methods (randomized controlled trials, RCTs) to provide evidence-based knowledge to educators and policy-makers.
- Question: shouldn't the waste collection program of the Comune di Roma undergo a Performance Audit Review and an Evaluation?

Examples taken from Micro finance and Micro insurance

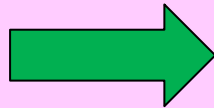
Donors,
MDBs
Finance
Micro
Finance
Institutions
(MFIs)



Micro entrepreneurs



1. Donors, MDBs want to know if the **funds they provide MFIs get to the micro entrepreneurs** economically, efficiently and effectively.



Performance Audit

2. Donors, policy makers want to know if the program of providing funds to MFIs with all its features is **having an impact of improving the opportunities of Micro entrepreneurs**. Is impact due to the program and is the program worth repeating? What are the lessons learned?



Evaluation

Example of Performance Audit for Micro Finance Institutions

Micro Finance Performance Indicators	
1. Outreach - Effectiveness	
Number of active clients or accounts	Number of active clients or accounts
2. Client Poverty Level - Effectiveness	
Average outstanding balance per client or account	Gross amount of loans or savings outstanding/Number of active clients or accounts
3. Collection Performance	
Portfolio at Risk (PAR) or	Outstanding principal balance of all loans past due more than x days/Outstanding principal balance of all loans
Loans at Risk (LAR) or	Number of loans more than x days late/total number of outstanding loans
Current Recovery Rate (CRR) together with	Cash collected during the period from borrowers/cash falling due for the first time during the period under the terms of the original loan contract
Annual Loan-loss Rate (ALR)	$1 - CRR/T$
4. Financial Sustainability (Profitability)	
For commercial institutions:	
Return on Assets (ROA) or	$\text{After-tax profits}/\text{Starting (or period-average) assets}$
Return on Equity (ROE)	$\text{After-tax profits}/\text{Starting (or period-average) equity}$
For subsidized institutions:	
Financial Self-Sufficiency (FSS) or	$\text{Business revenue (excluding grants)}/\text{Total expenses} + \text{IA} + \text{CFA} + \text{ISA}$
Adjusted Return on Assets (AROA) or	$\text{Accounting profit/loss (excluding grants)} - \text{IA} - \text{CFA} - \text{ISA}/\text{Period-average total assets}$
Subsidy Dependence Index (SDI)	$S/LP * i$
5. Efficiency	
Operating Expense Ratio (OER) or	$\text{Personnel and administrative expense}/\text{Period-average gross loan portfolio}$
Cost per client	$\text{Personnel and administrative expense}/\text{Period-average number of active borrowers [x GNI per capita]}$
<i>Source: UNDP</i>	

Example of Impact Evaluation
Randomized Impact evaluation of expanding access to credit in a new urban market Banerjee, Duflo, Glennerster, and Kinnan 2010

- Researchers partnered with **Spandana**, one of the largest and fastest growing MFIs in **India**, to identify 104 slums in Hyderabad as places where Spandana would be interested in opening new branches. **Fifty-two communities were randomly selected for the opening of a new MFI** branch offering loans to self-formed groups of six to ten women. The typical loan averaged Rs. 10,000 (US\$200), for families where the average monthly expenditure was Rs. 5,000 (US\$100) for a family of five.
- **Twelve to 18 months after the introduction of an MFI branch, a comprehensive household survey was conducted in a random sample of eligible households in both treatment and comparison areas.**
- Demand for the credit product was not high: take-up was 18.6 percent among households in the treatment group, 8.3 percentage points higher than in comparison areas.
- **People with access to microcredit were more likely to have started a business.** The probability of starting a business increased by 1.7 percentage points relative to comparison areas, implying that approximately one in five of the additional MFI loans in treatment areas was associated with the opening of a new business.
- **Beyond the impact on new business creation, there was no significant effect on average business profits, monthly revenues, inputs spending, or number of employees.**

Lending a Hand: A Quantile Regression Analysis of Micro-lending's Poverty Impact, Colorado College Working Paper 2009-10 December, Stephen W. Polk and Daniel K.N. Johnson

- Given the proliferation of micro-finance institutions, it is critical that the relative impacts of different business and lending models be analyzed.
- Evaluation of the impact of the micro-lending program of the Negros Women for Tomorrow Foundation (NWTF), in the **Philippines**.
- Results show that **clients do, on average, become wealthier as borrowing members of the NWTF**. The average client gained 1.51 points on their poverty score card, a rise that seems large only in context. Considering that a 2 point rise is equivalent to the replacement of walls or roof made of light materials such as bamboo with strong materials such as concrete or iron, these are very real gains in the fight against poverty.

4. Similarities, Differences between Performance Audit Review and Evaluation. A Conceptual Framework

Performance Audit Review and Evaluation

Performance Audit Review

Look at Monitoring & Process

- Is the MFI run efficiently and is it sustainable?
- Is program being implemented as efficiently as planned?
- Is program targeting the right population?
- Are outcomes being achieved and is it moving in the right direction?

Impact Evaluation

Look at Economic and Social Impact

- What was the impact of the program on outcomes?
- How do outcomes change under alternative program designs?
- Does the program impact people differently (e.g., females, poor, minorities)?
- Is the program cost-effective?

Similarities between Performance Audit Review and Evaluation

- Both Performance Audit Review and Evaluation involve the **examination of policy design, implementation processes and their consequences** to provide an assessment of economy, efficiency and effectiveness and impact of an intervention.
- In both cases, we deal with activities undertaken using **taxpayers' money**, i.e., public sector funds.
- **Independence** of Auditors and Evaluators is of critical importance. Auditors and evaluators maintain their independence to select and determine the manner in which to conduct their work, and report the results to the discharged authority, e.g., European Parliament acting on the recommendation of the Council for European Community funds.
- To carry a Performance Audit Review and an Evaluation **very experienced and skilled individuals are needed with high levels of education and continuous training.**
- Performance Audit Review and Evaluation imply a **significant direct cost** and also an opportunity cost, i.e., the resources devoted, or some of the resources devoted to control can be utilized in a more productive fashion.

Differences between PAR and Evaluation

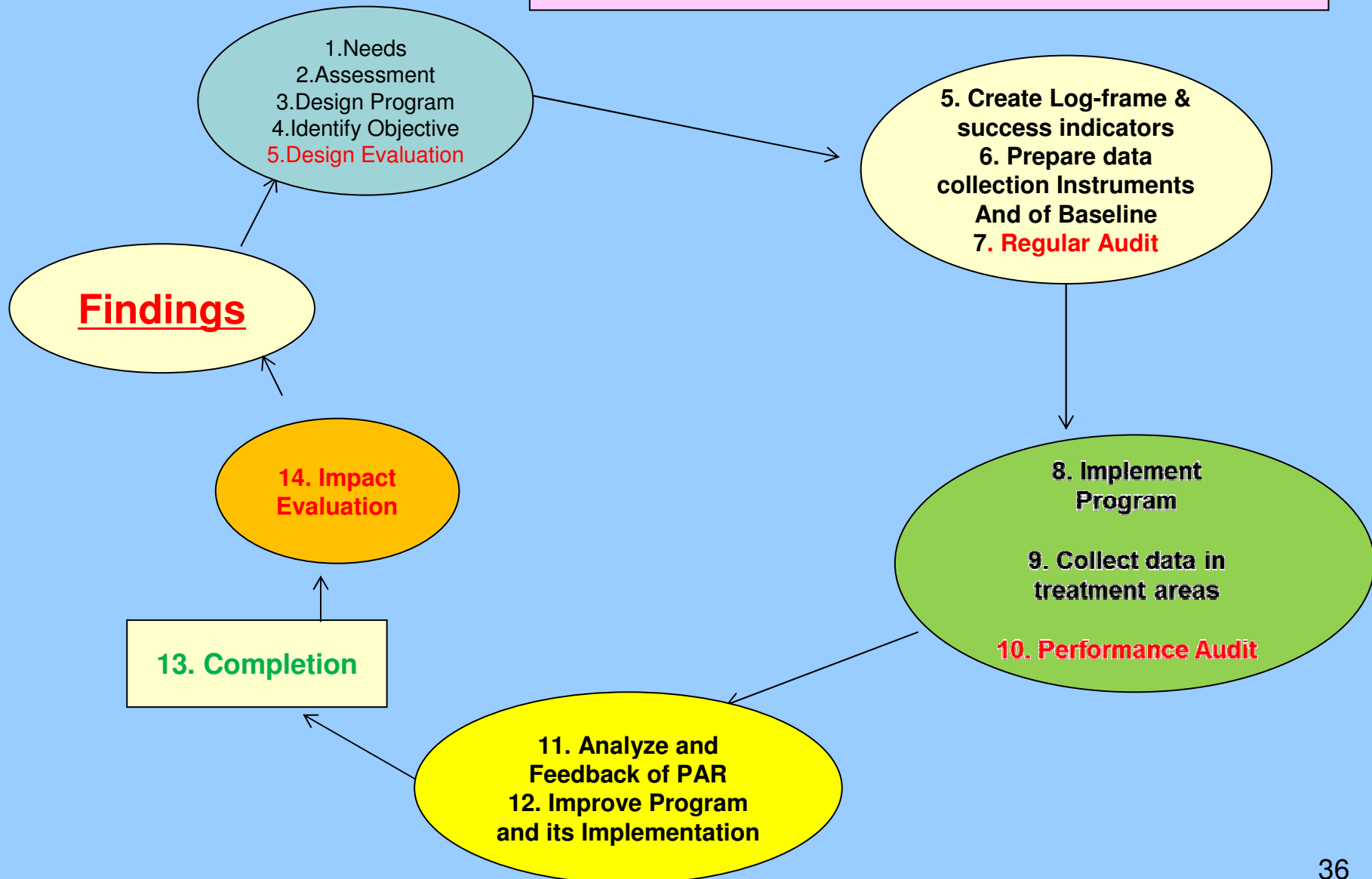
- **PAR intervenes before Evaluation and while the activity is under way.** Evaluation intervenes after completion.
- PAR is directed to the people's representatives, e.g., Parliaments. Evaluation is directed to policy makers, Governments. If representatives, politicians and policy makers are not responsive and not accountable to the electorate, the impact of reports and evaluations are at best modest.
 - Supreme Audit Institution do not deliver evaluations of programs and policies. Evaluation of Government and public entities' activities are the responsibility of the Government (e.g., Central Government, EU Commission), also requested by parliaments and carried out by specialized independent entities and experts.
- Performance Audit Review **is more oriented to Management.** PAR is superimposed on an accountability framework, which implies that the institutions and organizations concerned are held **accountable** for the management of taxpayers' funds and should provide meaningful and reliable information to demonstrate and take responsibility for performance in light of agreed expectations.
- **Evaluation is policy oriented and forward oriented** in terms of lessons learned that can be applied to future design of policies. Evaluation focuses more on the policy decisions and their impact and imply the possibility of **replicability** of the policy as well as the **political responsibility** for those who have chosen the policy. PAR Reports that show misuse of funds have a greater impact on the public opinion than an Evaluation that risks leading to a discussion with conclusions always subject to greater level of ambiguity than a PAR Report.
- **Evaluation does not detect fraud and corruption,** PAR may detect misuse of funds, fraud and corruption and at an earlier stage than Evaluation.

Conceptual Framework: Traditional Audit Performance Audit and Evaluation

Traditional Auditing, Performance Audit and Evaluation								
Type of Analysis	Object of the Analysis	Primary Goal	Dominant Form of Analysis	Function	Role	Skill	Conclusion	Implications
Traditional Auditing	Financial transactions, accounting and key control procedures of the Public Sector Entity	Compliance, Accountability	Auditing	Assess whether financial operations have been legally and regularly executed and accounts are reliable, i.e., verify information, find mismatches between actual and reported; compliance with accounting norms and principles	Auditor	Accounting and Legal	Annual report more or less standardized with findings directed to Management, Executive Board and Assembly	The accounts reflect the transactions - Qualified Opinion
Performance Auditing	Organization and procedures, systems (i.e., Input-Process-Procedures-Implementation-Output- Outcome) and ability to reach the goals stated in policy, program,	Performance, Accountability	Inspection	Assess whether public sector's funds have been used with Economy, Efficiency and Effectiveness	Analyst	Accounting, Legal and Financial, and also Socio-economic	Special Report published on ad hoc basis with varying structure depending on the objective and directed to Government, Parliament and public opinion.	That particular organization operates economically, efficiently and effectively
Program, Policy Evaluation	Policy, Program, Interventions aimed at improving well being and meeting certain needs	Impact. Does the impact justify the program or policy?	Research	Evaluate impact of intervention. Causality: We did program X, and because of it, Y happened	Evaluator	Public policy, Economics, Statistics	Report to Government and to Parliament and public opinion	Y happened because of X, not for some other reason. Thus if we did X again in a similar setting, Y would happen again.

Sources: OECD, Performance Audit and the Modernization of Government, 1966 and Performance Audit Manual of the European Court of Auditors - Table elaborated by the author

The Sequence of an Intervention



Performance Audit Review and
Evaluation are both Needed!!!!

5. Considerations

Considerations

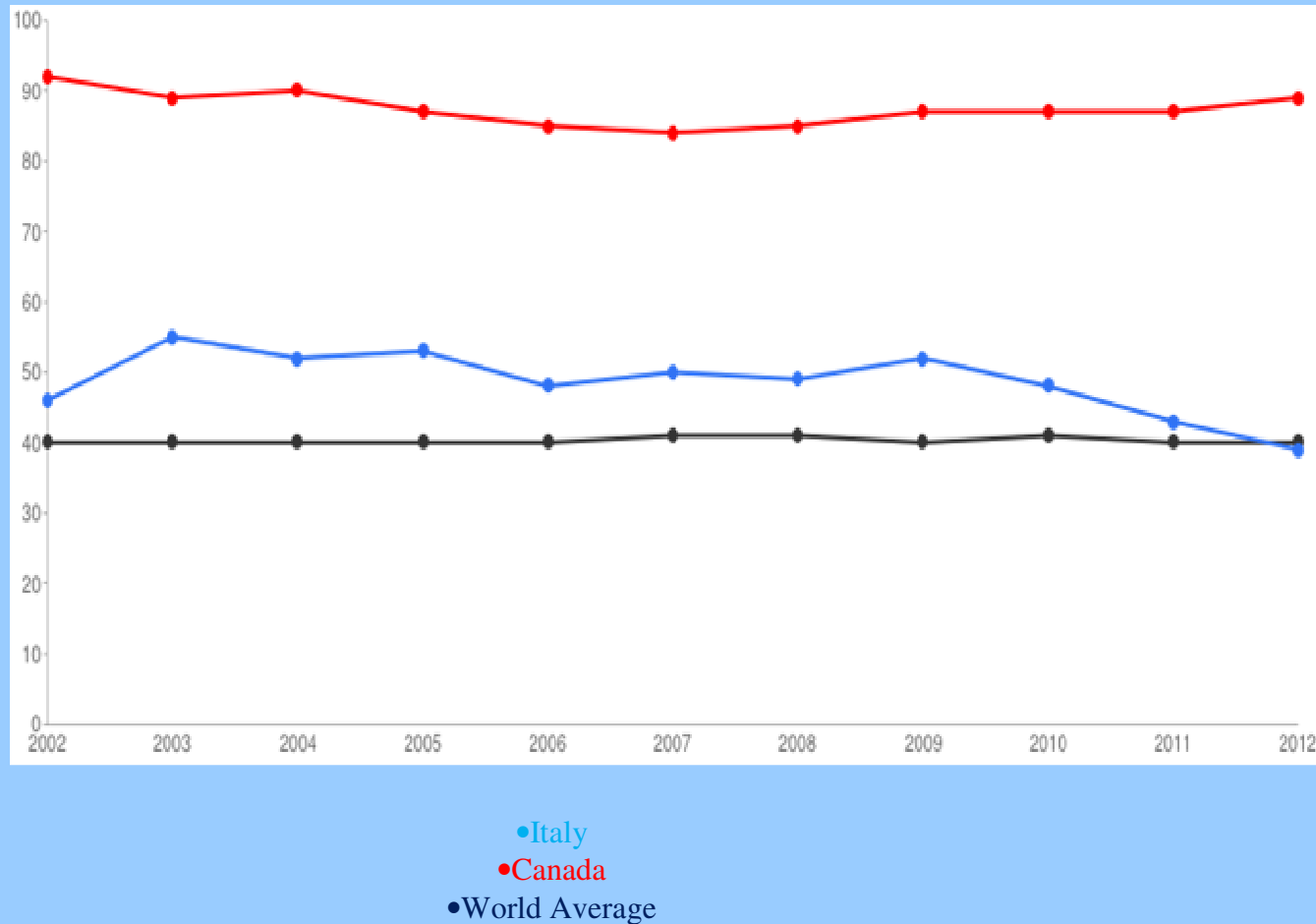
Given scarce resources two questions are appropriate to ask:

- Does more Government mean more Fraud and Corruption?

and

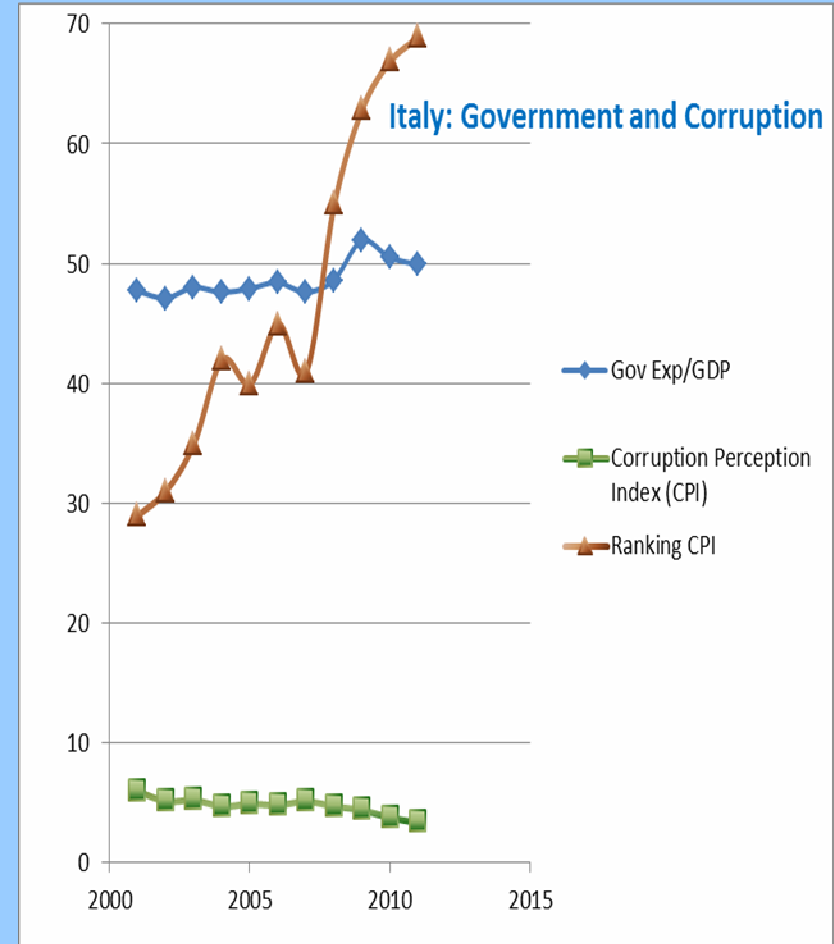
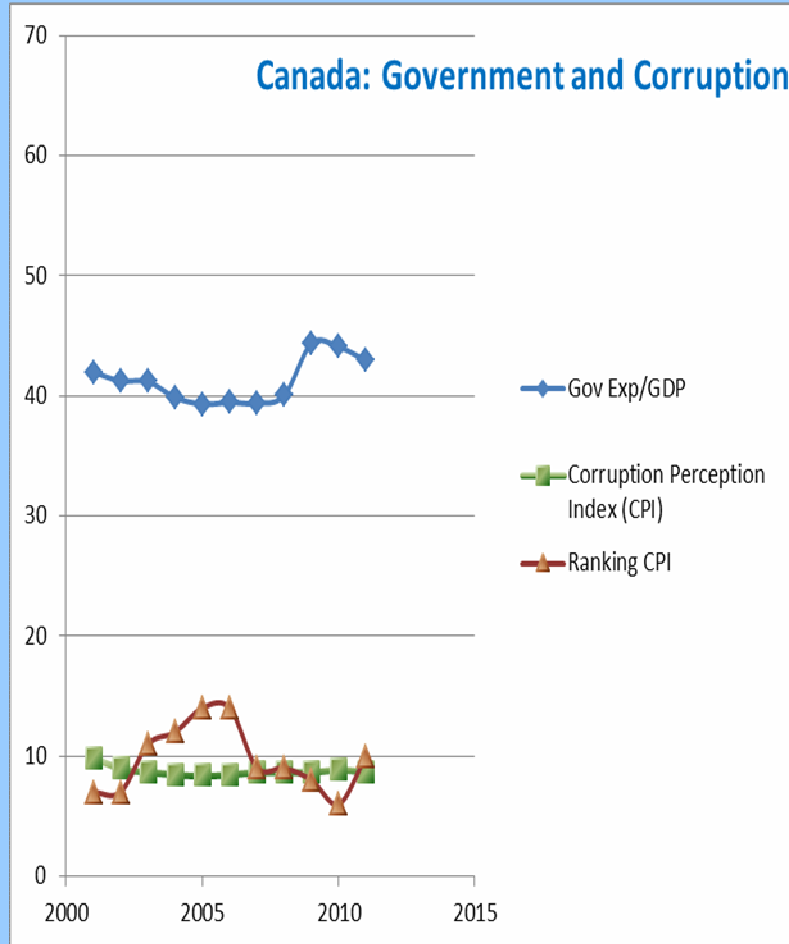
- Under what circumstances can Performance Audit Review and Evaluation be effective?

Freedom from Corruption



Heritage Foundation in partnership with The Wall Street Journal has tracked economic freedom around the world with the Index of Economic Freedom

Government and Corruption



Government and Corruption Correlation

Italy		
	<i>Gov Exp/ GDP</i>	<i>CPI Score</i>
<i>Gov Exp/ GDP</i>	1	
<i>CPI Score</i>	-0,75670832	1

Canada		
	<i>Gov Exp/ GDP</i>	<i>CPI Score</i>
<i>Gov Exp/ GDP</i>	1	
<i>CPI Score</i>	0,34804426	1

Correlation is not causation!!, but.....

Government and Corruption

- There is significant research (Acemoglu and Robinson. 2012) that shows that increased government expenditures facilitates inefficiency, fraud and corruption. Cutting drastically, and this is certainly true in Italy, public expenditure, should significantly reduce the problem of misuse, fraud and corruption, but also free resources to more productive activities.
- Government programs and projects can be eliminated when market can provide a solution.
- However, the cases of Italy and Canada show that there is **not a mechanical link between greater Government expenditure and corruption.**
- Conventional wisdom seems to show that the private sector is more efficient and effective than the public sector, but private sector corruption can be very damaging. Recent examples of private sector corruption are numerous: accounting scandals in 2001; financial crises in great part determined by unscrupulous behavior as well as inappropriate policies and lax regulation and supervision; recent cases involving Barclays and GlaxoSmithKline. Thus there is a need of regulation and supervision, a form of Government intervention, that require also to be assessed and evaluated,

Government and Corruption

- Performance Audit and Evaluation **have both a reason to exist** because have **different goals to assess the use of taxpayers' money.**
- There is little doubt that lack of appropriate institutional settings, absence of transparency and accountability, deficiency of a practice of Performance Audit and Evaluation, scarcity of trained and independent professionals lead to misuse of taxpayers' money, fraud and corruption.
- To make Performance Audit and Evaluation effective, there are two important missing links:
 - First, that the **institutional setting** facilitates an effective system of audit and evaluation,
 - Second, that **highly skilled and trained independent professionals** in audit, performance audit and evaluation are available to make Audit and Evaluation valuable and effective.

6. Conclusions

Conclusions

- Start the adoption and dissemination of the philosophy of **limited Government**;
- Reduce the **interventions of the Government** in the economy leaving many activities to the market;
- Strengthen the **system of transparency and accountability** in the management of public affairs;
- Increase **training for auditors and evaluators** to enhance knowledge and professional techniques and consolidate their independence.

Response to the questions of the taxpayer about the use of his or her money



“The strongest governments will be those that serve the people rather than a political elite—but guarding against the potential to backslide requires constant vigilance.”

October 21, 2012 by Daron Acemoglu, Professor of Economics at MIT. His most recent book, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, co-author James Robinson, published in March 2012.

The analysis focuses particularly on performance audit review and evaluation leaving aside the traditional audit, which is very relevant for private sector entities as well as for central and local governments and constitutes a first step to achieve transparency and accountability.

Thanks to:

CEGA Berkeley <http://cega.berkeley.edu/>

UC Berkeley [DeCal](#) Program

Auditor General South Africa

European Court of Auditors

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THANK YOU