New Forms of Local Governance: A Theoretical and Empirical Analysis of Municipal Corporations in Portugal

ANTÓNIO F. TAVARES & PEDRO J. CAMÕES
Department of International Relations and Public Administration,
School of Economics and Management, University of Minho, Portugal.

Correspondence Address: António Tavares, Department of International Relations and Public Administration, School of Economics and Management, University of Minho (Campus de Gualtar), 4710-057 Braga, Portugal. Tel.: +351 963 350978; fax: +351 253 676375 Email: atavares@eeg.uminho.pt

Notes on Authors

António Tavares received his Ph.D. in Public Administration from the Reubin O'D. Askew School of Public Administration and Policy at Florida State University. He is currently an assistant professor in the Department of International Relations and Public Administration at the University of Minho, Braga, Portugal. His main research interests comprise topics in the fields of local government and urban politics such as service delivery, solid waste management, and land use management and urban growth. His work appeared in *Policy Studies Journal, Local Government Studies*, and *International Journal of Economic Development*. He has recently published an edited book, *Estudo e Ensino da Administração Pública em Portugal*, debating research and teaching of Public Administration in Portugal.

Tel: +351 253 604510 (ext. 5527)
Fax: + 351 253 676375
E-mail: atavares@eeg.uminho.pt

Pedro J. Camões is an Assistant Professor of Public Policy and Administration at the University of Minho in Braga, Portugal. He received his Ph.D. in Political Science from the University South Carolina. His general research interests are local government and public budgeting and finance. Specifically, the main focus is on fiscal and political institutions of decentralization, namely the determinants of institutional change and their effects. He published in *Journal of Public Administration Research and Theory*, *Local Government Studies*, and *Canadian Journal of Administrative Sciences*. He is member of the Center for Research on Public Policy and Administration (NEAPP). He is the coordinator of a publicly funded research project on the importance of local accounting in the performance of municipal governments.

Tel: +351 253 604510 (ext 5521)
Fax: + 351 253 676375
E-mail: pedroc@eeg.uminho.pt

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Abstract

What factors influence local governments to rely on municipal corporations to provide public services? This article seeks to identify which factors lead local governments to use local corporate public sector organizations, particularly municipal corporations, for service delivery. Based on the ideas of the neo-institutionalism approach to public administration developed by Murray Horn (1995), we argue that local officials trade-off bureaucratic costs of in-house production with agency costs of external delegation to municipal corporations when deciding how to deliver local public services. Econometric models are employed to test this explanation for the adoption of municipal corporations by the 278 Portuguese local governments. The results indicate that organizational size, financial independency, and fiscal surplus, as well as ideological concerns and the activity of local interest groups, drive choices of local governance structures.

Key Words: municipal corporation, public authority, service delivery, transaction costs, governance structures

Background

During the last decade, Portugal experienced a substantial expansion of new forms of local governance, mainly due to the enactment of the *Municipal, Intermunicipal and Regional Corporations Act* of 1998[1]. According to official data, 269 of 308 Portuguese local governments (approximately 88 per cent) have invested capital in public and private corporations. The increase in these forms of service delivery has occurred through the accelerated growth of the local corporate public sector[2] demonstrated by the increase in number of municipal corporations from 34 in 1999 to 114 in 2001 and stock companies with connections to local governments from 143 (1999) to 187 (2001) (Almeida 2001).

In Portugal, it is generally accepted that these new forms of local governance are the result of an attempt to improve financial management, relax public procurement rules, and circumvent civil service laws and their implications for personnel management, contract agreements and organization. Rigorous controls imposed by national institutions such as the Accounting Court (*Tribunal de Contas*[3]), the General Inspection of Territorial Administration (*Inspecção Geral da Administração do Território*) and the General Inspection of Finances (*Inspecção Geral de Finanças*), as well as the requirements of civil service laws are avoided by these new forms of governance, even though this does not mean the complete subordination to general labour laws applied to the private sector (Oliveira 2001).

Contrary to Anglo-Saxon common law, Portuguese Law separates civil service law (administrative law) and private labour law. While the former applies to national and local public administration services (direct government), the later applies to the private sector, government corporations, government-sponsored enterprises, and indirect

government. The main differences lie in the detailed procedures to be followed in managing human and financial resources, procurement decisions, and the degree of ex-ante and ex-post controls. In general, administrative law requires much more burdensome procedures than general labour law, which contributes to explain the tendency to shift of services from public bureaus to municipal corporations, also known as public authorities in the Anglo-Saxon literature (Gulick 1947; Frant 1997; Bourdeaux 2005). While this is an obvious reason to create municipal corporations, it does not explain why some directly elected mayors rely more than others in this form of indirect government.

The Portuguese central government has a limited number of instruments to monitor the creation of local government-sponsored corporations; individual monitoring activities are expensive and a single monitoring strategy for all municipalities may be inadequate to the diversity of situations. As a result, in a situation of public monopoly, local elected officials are relatively free to choose the governance structure of service delivery that enhances political efficiency, translated in electoral gains.

The proliferation of municipal corporations with local government capital in the last decade has led us to question the reasons for this significant growth. More specifically, we are interested in the research question suggested by Murray Horn (1995: 170): If the government does want to own the producer of these goods and services, why does it choose the local government-owned enterprise [public authority] form of organization rather than the bureau form? We argue that local elected executives trade-off bureaucratic costs of in-house production with agency costs of external delegation to municipal corporations when deciding the governance structure to deliver local public services.

First, we discuss the alternative institutional arrangements of public service provision at the disposal of local governments. Next, we briefly review the literature on institutional arrangements of local service provision linking it with the transaction costs literature. Third, we explore the motivations of local elected officials to shift the provision of services to public authorities by highlighting the internal costs of delegation to bureau civil servants. Fourth, we identify the external delegation costs involved in providing services using the local corporate public sector and some of the possible explanations for why municipalities may shy away from using these types of organizations for service delivery. In the fifth section we formulate our hypotheses and describe the variables employed in the empirical analysis conducted in section six. We close with a short set of conclusions and directions for future research.

The Context of the Expansion of Municipal Corporations in Portugal

Municipal corporations are set up as separate corporate entities legally distinct from the rest of the local government, which controls the corporation. Accordingly, they fit the profile defined by Stanton and Moe (2002) to describe government corporations, by showing high degrees of coerciveness and directness, and low degree of visibility. Given these features, municipal corporations are clearly distinct from government-sponsored enterprises (Stanton and Moe 2002).

Although municipal corporations are a relatively new form of service delivery in Portugal, they possess features similar to service public authorities as defined by Sbragia (1996). Like public authorities, Portuguese municipal corporations are single-purpose organizations not allowed to levy taxes, rely on revenues derived from user fees, are governed by an appointed, rather than elected, executive board, and have independent corporate status (including the right to own property and the right to sue

and be sued) (Doig 1983; Sbragia 1996; Frant 1997; Bourdeaux 2005; Eger III 2005).

Local government officials are responsible for appointing the members of the executive

boards of municipal corporations. Also, unlike municipal enterprises or enterprise funds

that may be on or off budget and may or may not be for the purpose of raising capital

(Rubin 1988), Portuguese municipal corporations are created as completely separate

entities from the enacting local government, even though municipal budget transfers

may occur at times to cover shortfalls. For these reasons, what is known from the

municipal enterprises literature (Rubin 1988; Stumm 1996) may not apply to Portuguese

municipal corporations. Given the similarities in terms of institutional arrangement

features, we employ the concept of service public authorities throughout the article as

equivalent to Portuguese municipal corporations.

Before the enactment of the *Municipal, Intermunicipal and Regional*

Corporations Act of 1998, the provision of municipal level services was the

responsibility of local officials, while the local bureaucracy was fully in-charge of the

production activities. Upon the enactment of the legislation, elected officials began

creating municipal corporations and delegating the task of service production to the

executive board of the corporation. Since local executives nominate the members of the

executive board and the majority of the capital invested in public authorities is

municipal, elected officials retain, in practice, the responsibility for service provision[4].

Upon the formation of municipal corporations, public sector employees were

simply transferred from the local government payroll to the municipal corporation

payroll without changing the civil service status of the existing workforce. Hence, the

establishment of municipal corporations was also characterized by a high degree of

automaticity, with the production of municipal services largely remaining the

responsibility of the same workforce (Stanton and Moe 2002).

The choice of municipal corporations in Portugal to provide municipal services is also clearly distinct from contracting out or privatization decisions. Portuguese municipal corporations are governance structures essentially designed to circumvent civil service and financial management restrictions imposed by administrative law. However, the decision to keep service provision under a public bureau or shift it to a municipal corporation can be best described as an institutional choice, since it constitutes a change in the rules of the game (Ostrom 1990; Clingermayer and Feiock 2001).

Hence, more relevant than the creation of local public sector corporations, it is the decision to change the rules for local service provision that matters. The focus of our analysis is the institutional change and the transaction costs present in the decision faced by local officials. The choice between the two types of institutional arrangements (public bureaus *versus* municipal corporations) is determined by the trade-off between the bureaucratic costs of managing internal service provision and the agency costs of managing municipal corporations.

Institutional Arrangements and Local Service Delivery: The Literature

The neo-institutionalism literature explores the role played by transaction costs in institutional design and choice (Epstein and O'Halloran 1999; Goodin 1998; Horn 1995; Milgrom and Roberts 1990; Miller 1992). At the local government level, empirical research employed the transaction costs framework both to explain contracting and sector choice decisions (Clingermayer, Feiock, and Stream 2003; Feiock, Clingermayer and Dasse 2003; Clingermayer and Feiock 2001; Ashton 1998; Nelson 1997), service delivery performance (Brown and Potoski 2003), and the choice of functional areas to transfer to municipal corporations (Tavares and Camões 2007).

The costs of direct provision of the service, the protection against uncertainty present in the political arena, and the protection of social values such as justice, equity, and the public interest have also been mentioned as factors influencing institutional choices (Donahue 1989; McGuire, Ohsfeldt, and Van Cott 1987; Smith 1996).

These analyses emphasize the public-private sector choice, but neglect the decision to shift governance structures of local service provision within the public sector. Horn (1995) presents a theoretical discussion of the choice between public enterprises and public bureaus as alternative ways of providing government services. The transaction costs framework allows us to develop "…falsifiable predictions about institutional choice" (Horn 1995: 13), and helps clarify the choice between public enterprises and public bureaus. More importantly, this framework provides the tools to describe institutional change as the result of a political process largely dominated by local government officials as suppliers of formal governance structures (Alston 1996). Before identifying the transactions costs involved in institutional provision choice, it is necessary to characterize public bureaus and the different types of organizations that comprise the local corporate public sector so as to get a better sense of the features motivating the choices made by local officials.

The institutional arrangements of public service provision are extremely diverse (Ostrom and Ostrom 1977; Ostrom 1983; Smith 1996; Salamon 2002). Here, our concern is not with contracting or privatization decisions, since these are grounded in different goals and decision-making processes. Our central argument is that the choice between public sector options is motivated by the desire to circumvent civil service and financial restrictions without relinquishing control over provision and production decisions.

Public bureaus are primarily tax-financed, compete with each other for budget allocations, and are more subject to political interference. Bureau officials and employees do not retain any part of surplus as personal income and, in general, revenues are not generated from the sale of output at a per-unit rate (Niskanen 1971). In Portugal bureaus are subject to administrative law, which involves strict civil service laws, public procurement rules, and financial management limitations. Auditing by the Accounting Court follows strict procedures and it occurs both ex-ante and ex-post all hiring decisions and most procurement and financial decisions. Administrative law applies to direct government, but not to indirect government, that follows standard private law.

In contrast, municipal corporations are governed by a board presided by a CEO, have larger managerial discretion in administrative and human resource decisions, avoid limits on public borrowing, and are mainly self-financed through output sales at per-unit rate. Still, the distinction between public bureaus and municipal corporations is less clear when the later run large and persistent deficits, forcing local officials to finance losses with budget allocations (Horn 1995).

In Portugal, the local corporate public sector is composed of several forms of public and public-private arrangements including public corporations, stock companies with public capital, public foundations, and cooperatives. The share of public funds invested by local governments varies from one form to another, but all these display at least fifty per cent of public capital as the initial investment. Still, the variation within these different governance structures is much smaller than the variation between the local corporate public sector organizations and the public bureau form of organization.

The specialization of municipal governments using corporate-like forms has been the subject of several empirical studies over the last decade. These analyses concentrate on the determinants of municipal enterprises (Rubin 1988), special districts

(Foster 1996), and public authorities (Bourdeaux 2005). In a study of New York State solid waste public authorities, Carolyn Bourdeaux (2005) suggests that the determinants of public authorities can be divided into three groups: public finance, political motivations, and interjurisdictional concerns. The results of the analysis show that public authorities are created to circumvent debt limitations, but this is only part of the picture. Elected officials design institutional features of public authorities in order to insulate service provision from political competition.

In order to take this argument into account, the neo-institutionalism literature provides an explanation for the institutional choice between bureaucratic and public authority service provision. This choice aims to minimize political transaction costs associated with service delivery, but the consequences of choice and implementation cannot be fully anticipated. In other words, individuals act in ways intentionally rational, while subjected to uncertainty (Horn 1995; Williamson 1988). One alternative becomes more attractive relative to the other as it increases the chances of re-election of local officials. To hold office, elected officials must please their constituents, while appointed officials require the continued support of those outside actors who appointed them (Bauroth 2005). The following section explores the decision by local officials to delegate authority as a product of the trade-off between the bureaucratic costs of managing service provision and the agency costs of managing municipal corporations.

Delegation of Authority in Local Service Delivery: A Principal-Agent Framework

Public provision of municipal services always involves delegation of authority. If a municipality produces the service directly using an in-house workforce, the delegation of authority is internal and the costs incurred by elected officials can be aggregated under the heading of bureaucratic costs associated with internal monitoring

of subordinate behavior. When a municipal corporation produces the service, the delegation of authority is external, and agency costs involved in monitoring will be present. Once local government officials sponsor the shift of service delivery to municipal corporations (solid waste collection, water supply, transit systems, parks and landscape maintenance, sewage collection and treatment, among many others), agency costs increase, essentially due to allocative inefficiencies involved in the loss of political control to the external provider.

Bureaucratic Supply, Internal Delegation, and Decision-Making Costs

Traditionally, local governments prefer direct production of services that the market is unable or unwilling to produce and/or provide. The maintenance of public parks, the regulation of medical drugs, the control of pollution, or road works are examples of services the market fails to produce in efficient quantities and that, therefore, become central or local government responsibility. The hierarchy, as opposed to the market, is more efficacious in the pursuit of these goals.

The literature on principal-agent theory argues that the internal production of publicly provided services involves delegation from the mayor or municipal council to the bureaucrats or administrative ranks, acting as agents. Bureaucrats have a better understanding of the minimum cost of service production and ask for a higher budget than their needs – the discretionary budget (Niskanen 1971) – and can engage in on-the-job shirking due to the lack of flexibility of civil service laws barring effective personnel management. These practices are the product of information asymmetry between elected local officials and administrative employees and result in internal delegation costs and inefficiencies.

The lack of flexibility of civil service law in Portugal is usually mentioned as an obstacle to efficient management. This rigidity is justified as a means to guarantee the continuity and political neutrality of public servants, even if it entails inefficient behaviour. The decision to change institutional arrangements from bureaus to municipal corporations can be partly explained by the minimization of decision-making costs, defined as the time and effort it takes local officials to reach an agreement or decision. As an example, hiring and firing public sector employees under civil service laws is much more cumbersome than under general labour laws that apply to all private as well as municipal corporations.

Decision-making costs will be lower if municipal corporations, rather than bureaus, are in charge of local service provision because corporations are agents independent from political intrusion in terms of financial budgeting rules, procurement laws, and human resource management. In general, municipal corporations also guarantee the visibility of service quantity and quality that can be adequately monitored by consumers due to the link between service and rate. In turn, this protects local taxpayers from fiscal risks associated with inefficient service provision by bureaus and explains why local officials may prefer municipal corporations in a context of higher tax burdens.

As the number and diversity of services to be provided increases, decision-making costs are likely to rise sharply due to the multiplication of the number of citizens as well as organizational departments and bureau employees. The increased pressure exerted over local officials due to conflicting interests between stakeholders will lead to a shift in institutional arrangement. Thus, it is not surprising that local officials frequently opt for municipal corporations to deliver local services, in order to

escape budget limitations (Aharoni 1986) and avoid responsibility for solving difficult problems (Tierney 1984).

Municipal corporations also help to reduce bureaucratic inefficiencies because they insulate the provision of specific services from the competition for resources and budgets, reduce the number of transfers between services, and stimulate each corporation to search for own revenues. In addition, local bureaucracies are much more subjected to inefficiencies than municipal corporations because local officials have to periodically stand for election.

There are, of course, allocative inefficiencies associated with the creation of these entities, mainly as a result of the loss of control by local officials, resulting in lower response to voter's preferences (Frant 1996). After discussing bureaucratic costs and productive inefficiencies present in local bureaus, we now turn to allocative inefficiencies associated with municipal corporations.

External Service Delivery, Allocative Inefficiency and Agency Costs

The shift in service delivery rules to a municipal corporation is equivalent to a delegation of authority, entailing both economic and political efficiency arguments. Economically, service delivery by municipal corporations is likely to produce savings and improve efficiency in service delivery. When the delegation is made to a municipal corporation, administrative and civil service rules and regulations no longer apply and the new governance structure is characterized by significant managerial discretion. A recent study of the impact of corporatization of public agencies in Canada shows positive effects of corporatization on output and revenues, revenues-to-expenditure coverage, cost efficiency, and employee productivity (Bilodeau, Laurin, and Vining 2007).

The creation of municipal corporations requires the authorization of the municipal council and is subjected to *ex-post* control by the Accounting Court. Other than these requirements, all Portuguese municipal corporations enjoy high flexibility of organization, have greater discretion to enter in contracts with other public or private organizations, and face less strict hiring and firing rules, absence of ex-ante procurement controls, and the possibility to incur debt without strict legal limitations faced by local governments. Additionally, municipal corporations can enter into agreements with other municipalities to expand service areas and appropriate scale economies. As single-purpose organizations, corporations explore specialization gains through better production technology, highly skilled workforce, and financial investments. Municipal corporations also constitute an alternative for municipalities to avoid situations where the market fails, such as the outsourcing of companies in monopolist or oligopolist markets, which is likely to be the case in industries providing services where local government-sponsored corporations usually operate, such as water supply, transportation, and social/affordable housing (Horn 1995).

Contrary to public bureaus, the absence of reelection incentives reduces the likelihood that public authorities are used by elected officials as tools for political advantage, increasing productive efficiency and reducing opportunistic behaviour (Clingermayer, Feiock, and Stream 2003). However, the same institutional structure that insulates management decisions from unduly political interference also generates loss of control over service provision and an increase in agency costs. The use of municipal corporations in service delivery poses questions regarding the definition and protection of public purpose, since the lines of accountability become less clear to citizens and voters (Salamon 2002; Koppell 2003; Skelcher 2006).

Hence, agency costs will be higher for municipal corporations because these institutional arrangements are less politically responsive than public bureaus. Service delivery decisions are made by politically appointed officials that have incentives to signal their abilities as managers to private sector employment opportunities (Horn 1995). In Portugal, the relative independence of municipal corporations is even more likely to involve increased agency costs for elected officials, since there is very limited to no competition for service delivery at the local level. In addition, delegating service delivery responsibilities to municipal corporations creates path dependency problems, because this decision involves loosening civil service constraints and increasing financial management discretion. Loss of political control and decrease in democratic accountability become acceptable only if internal delegation costs and bureaucratic inefficiencies are significant.

Of course, in some situations, political insulation and blurry accountability lines can actually be useful in terms of political preferences (Moe 1984; 1990). Political efficiency, measured in terms of the probability of re-election of local officials, can be reached whenever elected executives foresee problems in service delivery. In these cases, service transfers can shield the executive from unpopular decisions such as increases in user fees, service disruptions, or other undesirable events related with service performance. After the 1998 Law, municipal corporations boomed in Portugal because local officials recognized this new governance structure as an opportunity for economic benefit, as well as political gain.

Hypotheses and Variables

The previous section shows that the principal-agent framework enables us to contextualize service delivery choices in Portuguese municipalities. Theoretically, it

would be possible for municipalities to retain internal control over all public service production. However, resource and organizational limitations entailing significant bureaucratic costs force delegation of activities to a greater or lesser extent to external providers. The size of the local bureaucracy (*Bureaucracy*) is a reliable indicator of the amount of decision-making costs faced by local officials. If the number of local government employees is large, bureaucratic costs will be high, leading local officials to transfer service delivery to municipal corporations. The formation of single-purpose municipal corporations is likely to reduce bureaucratic costs generated by excessive organizational complexity and size of traditional municipal services.

H1: The size of the local bureaucracy is positively associated with the creation of municipal corporations.

Portuguese municipalities can be highly fragmented, since they face organized local interests in each parish. The parish is the smallest territorial unit of self-government in Portugal, with a low number of competences and heavily financially dependent on the municipal government. The number of parishes per municipality varies from one to 89. This type of fragmentation at the municipal level is likely to increase the number of municipal corporations because each *parish* operates as an interest group, lobbying the municipal government for more and better services. In municipalities with many parishes competing for limited budgets, elected officials face tremendous decision-making costs, because they have to deal with these interest group pressures placed on in-house bureaucracies.

The number of *parishes* is a good proxy for preference heterogeneity at the local level. Single-purpose municipal corporations may be better equipped to deal with

heterogeneous service demands and preferences (Foster 1996; Nelson 1997). The heterogeneity of community preferences increases internal delegation costs and generates incentives to transfer services to a separate entity, more politically insulated from the elected executive. Since municipal corporations are created as single-purpose entities they tend to possess better production technology, highly skilled workforce, and financial resources required to respond more adequately to preference diversity. Hence, we expect that:

> *H2: Local governments with a large number of parishes will be more inclined to create municipal corporations in order to respond to increased interest group competition.*

In municipalities characterized by large population growth, the need for delegation will be higher, not only because the pressures for the municipality to provide a larger amount and diversity of services is higher, but also because interest groups will be more active and in larger number in calling for specific services. The motivation behind this option of service delivery is that when public service demand increases, the response of the municipality may become inadequate due to the size and complexity of internal organization. The creation of municipal corporations produces economies of scale for some services, hence ensuring a more efficient response to service needs (Tavares and Camões 2007). Even though economic efficiency may not be the prime target of elected politicians, transferring services to municipal corporations is politically desirable. If performance improves as a result of the transfer, politicians can claim credit. If performance declines, elected officials are more insulated from criticism because the chain of accountability is less clear for voters to follow. Population growth

(*Popgrowth*) is measured as the rate of municipal population change over the last two Censuses (1991-2001).

> *H3: Local governments facing large population growth are expected to create more municipal corporations in response to an increase in the heterogeneity of community preferences.*

In Portugal, local revenues consist of two large parcels: local taxes and central government grants. The financial situation faced by local governments influences the decision to create municipal corporations. Contrary to the outsourcing literature (Ferris 1986; Ferris and Grady 1991; Hodge 2000; however see Pallesen (2004) for the Danish experience), we have two reasons to believe that municipal governments are more likely to transfer service delivery to municipal corporations when experiencing good financial health. First, since many of the services transferred involve user fees[5], these revenues are essential in situations of heavy local government dependency on central government grants, so that it would be politically unwise to transfer services to a separate entity. Second, strong local finances allow elected officials to deal with external costs of delegation associated with transferring services to municipal corporations and help secure against eventual losses that can occur if these go bankrupt. When facing a strong reliance on central government grants, local government officials experience high agency costs involved in relinquishing control over user fees, making them more likely to opt for public bureau service delivery. Financial dependency (*FinDep*) from the central government is the proportion of central government grants over total municipal revenues.

H4: Local governments facing significant financial dependency are less likely to rely on municipal corporations for service delivery.

Rubin (1988) has argued that, when financial conditions are adverse (high deficits), municipalities avoid the creation of municipal enterprises, apparently because these drain resources from the general fund. In contrast, the empirical literature on contracting suggests that fiscal stress increases contracting-out for service delivery with private organizations (Ferris 1986; Ferris and Grady 1991; Hodge 2000), but no studies have explored the link between local deficits and the formation of public authorities (see Bourdeaux). In order to capture financial hardship in municipal budgets, we employ the total deficit (*Def*), measured as the difference between total revenues and total expenditures and, consistently with H4 concerning financial dependency, suggest the following hypothesis:

H5: Municipalities with larger local deficits create less municipal corporations, since local governments will be pressed for revenues from user fees and will not relinquish these greatly needed resources.

Local governments where local taxes (*Taxpc*) represent a larger share of total revenues are expected to display larger numbers of municipal corporations. The reason is obvious: when the tax burden is already high, the transfer of services involving user fees to municipal corporations allows local government officials to shift blame to the corporation. Any increases in user fees for water supply, garbage disposal, among other services, are less likely to affect local politicians' chances at reelection because municipal corporations operate as a shield to blur the chain of accountability for

ratepayers. Indirectly, this corresponds to a comparative increase in internal costs of delegation, since the external option becomes more politically attractive. Hence, we expect that:

> *H6: Elected officials in communities where local taxes represent a larger proportion of total revenues are more likely to create municipal corporations.*

The creation of municipal corporations can also be driven by an ideological orientation of municipal service delivery. The most representative political parties in Portugal cover the political spectrum from the left to the right and it is expected that right-leaning municipal governments will be more supportive of service transfers to municipal corporations. The four major parties in the Portuguese political system are the Portuguese Communist Party (PCP), coded "0" on the left, the Socialist Party, coded "1" center-left, the Social Democratic Party (PSD), coded "2", center-right, and the Christian-Democratic Party/Popular Party, coded "3" on the right. Parties close to the center of the political spectrum have alternated in the National Government for the last 22 years and control about 82,7 per cent of all municipal governments.

Although right-leaning parties are inclined to favour privatisation or contracting out to private firms to deliver municipal services, they may not be able to convince the electorate to accept such a radical solution, given the Portuguese tradition of public bureaucratic production and provision of municipal services. In this context, municipal corporations are a middle of the road strategy to move municipalities away from in-house production (Leavitt and Morris 2004).

H7: Municipalities controlled by right or right-leaning parties are more likely to create municipal corporations.

In addition to the party ideology measure (*PartyId*), we employ a dichotomous variable (*Majority*) identifying a single party majority in the executive body of the municipality. It is expected that the presence of a majority will increase the number of municipal corporations, essentially because decision-making costs in the executive body are substantially reduced (Horn 1995). When a single party holds the majority, veto points in the executive are absent and decisions are not constrained by the opposing parties. In this context, it is more likely that delegation to the local corporate public sector will occur.

H8: The presence of a single party majority in the executive body of the municipality increases the likelihood of creation of municipal corporations.

The index of social development (*ISD*) is included as a control variable for the socio-economic conditions prevailing in the municipality. The ISD is an equal weight formula composed by three indicators: expected life at birth index, educational level index, and living conditions index (electrical power, water, and wastewater supply from public sources). The area of the municipality (*Area*) is measured in squared kilometres and is used as a control for our fragmentation variable.

[Insert Tables 1 and 2]

Table 1 summarizes the hypotheses and variables described above and their expected effects on the creation of municipal corporations. It also presents a brief definition and measurement of each variable, as well as the data source. Table 2 shows the summary statistics for the variables used in the analysis.

Empirical Analysis

The empirical analysis of the hypotheses presented in the previous section involves the use of two different but related dependent variables. The first is the total number of the various corporate public sector organizations (with more than fifty per cent of public capital) created in the 1999-2002 period. As argued previously, the structural variation within the corporate public sector is much smaller than the variation between these governance structures and public bureaus, which justifies treating these organizations additively as a count variable. The second dependent variable (*MunCorp*) is a dichotomous variable identifying whether or not the municipal government transferred at least one service to a municipal corporation. Whereas the first dependent variable reflects the intensity of choice, the second tests local officials' willingness to adopt a governance structure different from the traditional bureau form.

In the first analysis, we employ a Poisson regression model. This is the appropriate estimation technique to treat event counts, since the major assumption is that the conditional mean of the distribution equals the conditional variance (equidispersion). However, we are aware that, more often than not, the variance exceeds the mean (overdispersion) so that the Poisson model is no longer adequate. Then, the first step in determining the appropriateness of this model is to test for overdispersion (Long 1997; Green 2003). The goodness-of-fit χ^2 test does not allow us to reject the null hypothesis that the data are Poisson distributed, so a Poisson regression model is used in the estimation. The Poisson regression results are presented in Table 3.

[Insert Table 3]

The likelihood ratio test based on a chi-square distribution compares the log likelihood of the unconstrained model with the log likelihood of a model only with the constant. If the constraint significantly reduces the likelihood, the null hypothesis is rejected (Long 1997). The likelihood ratio for this model is statistically significant providing the indication that the full model is adequate. The pseudo-R^2 should be carefully interpreted, since the usual interpretation – the proportion of the variation in the dependent variable explained by the independent variables – is not fully satisfactory. Long (1997) advises that large values are, obviously, better than lower values, but there is no clear cut criterion to judge the value of 23,3 per cent obtained for our estimated model.

In more substantive terms, the results provide general support for the hypotheses we developed in the previous sections. Concerning the political variables, the ideology of the party governing the municipality matters. The analysis supports the idea that a right-leaning composition of the local council increases the probability of using a larger number of corporate public sector governance structures. Therefore, we have reason to argue that rightist parties use public municipal corporations as a middle road strategy to move away from in-house production[6].

Turning to hypotheses essentially derived from the transaction costs approach, the hypothesis regarding the effect of internal delegation costs is strongly supported. This means that as organizational complexity increases (hierarchical levels and number of actors) so do the benefits of turning to municipal corporations and other CPS governance structures.

The variable measuring the number of parishes in the municipality is also supported, which suggests that more fragmentation means more interest groups lobbying the municipal government for more and better services. In this sense, the obvious rational strategy is to rely on organizational structures that are, in fact, much more insulated from these political demands.

The three public finance variables are supported with high statistical significance and virtually robust to every modelling specification. Budgetary limitations are an evident concern in the decision. Fiscal crises (budgetary deficits) constrain local decision-makers to rely more on in-house, thus more controllable, delivery of local public services. In the same way, tax limitations and financial dependency concerns also seem to influence local governance choices. The more the municipalities are able to raise own sources of financing through local taxation – and, symmetrically, the less they are financially dependent – the more they rely on alternative organizational structures for delivering services.

To advance a step further, Table 4 shows the computation of what Scott Long (1997) calls factor changes. They are derived from the Poisson regression model shown in Table 3. Simply put, a factor change means that, holding all variables constant, for a unit change in a given independent variable X_k, the output count changes by a factor of *exp(B_k)* (Long 1997, 225). This factor has an important advantage when it comes to interpreting the results. Contrary to what happens with the standard Poisson coefficients, the factor changes do not depend on the level of the variable of interest or all other variables in the model.

[Insert Table 4]

To illustrate, the factor change attached to the variable measuring party ideology is 1.1495. This means that a change in the party securing local power to the party immediately on its right is expected to increase, on average, the number of corporate public sector organizations by 14.95 per cent. Thus, the effect is strong and uniform for the entire ideological spectrum. Similarly, holding all other variables constant, having one more parish in a municipality implies having about 1.13 per cent more corporate organizations in that given municipality. It should also be obvious that a factor change of 0.24 of the financial dependency variable means a decrease. On average, it means the creation of less 76 per cent corporate organizations for each unit increase in that variable.

Turning to the second dependent variable, the results are less supportive of the suggested hypotheses. Recall that this is a dichotomous variable to measure the mere choice to transfer service delivery to at least one municipal corporation in a given local government. As we saw in the previous sections, this type of organization has some common characteristics with all other corporate public sector organizations, such as that they are governed by a board presided by a CEO, have larger managerial discretion in administrative and personnel decisions, avoid limits on public borrowing, and are mainly self-financed.

[Insert Table 5]

The results presented in Table 5 show, nevertheless, two important regularities. The hypothesis concerning the relevance of internal delegation costs is, again, strongly supported. More importantly, these results are robust to many different specifications of the model[7] and dependent variables collected from different sources. This means that

organizational complexity (hierarchical levels and number of actors) is a strong determinant in the decision to rely on municipal corporations for service provision.

The second regularity relates to the number of parishes, seen as pressure groups demanding for more services to be delivered. Since it is also a good proxy for the heterogeneity of preferences at the local level, our results confirm prior finings that specialized municipal corporations may be better equipped to deal with heterogeneous service demands and preferences (Foster 1996; Nelson 1997).

Conclusions and Future Research

The large number of municipal corporations and corporate-like organizations justifies an inquiry to the causes of local government service delivery transfers to these governance structures. The different socio-economic and political characteristics of Portuguese local governments are relevant to explain the reasons for the delegation of authority from the municipalities to a set of corporate public sector organizations rather than in-house production.

The size of the municipal government's in-house production services generates high internal delegation costs, due to excessive centralization of authority. Delegation costs are also present in municipal corporations, but the smaller size and lower complexity makes these costs more manageable at this level. Then, it seems clear that, when size and complexity of internal organization become a problem, local governments opt for a specialized organization for service delivery. As the empirical analysis has shown, the heterogeneity of preferences of local citizens is an additional source of pressure for the creation of municipal corporations.

Whereas this work is concerned with decision-making from the local officials' perspective, the next step in this research agenda is to investigate the municipal

corporations themselves. Municipal corporations are separate organizations, even from a legal standpoint. Future work will further explore these single-purpose organizations by looking at their service delivery activities, personnel, and financial status.

NOTES

1. Portuguese municipal corporations have many institutional features in common with what the Anglo-Saxon literature identifies as public authorities (Gulick 1947; Sbragia 1996; Frant 1997; Bourdeaux 2005). Throughout this article we employ the concepts interchangeably.

2. The local corporate public sector includes all forms of organizations involving a majority of public capital, namely municipal corporations, stock companies, public foundations, and cooperatives.

3. Judicial branch organization that inspects and evaluates the legality and conformity of public budgeting and spending practices producing decisions valid for all public organizations.

4. The provision choice relates to the decisions about what services to provide, quality standards of those services, and the criteria for raising revenue. Production, on the other hand, refers to the technical aspects of arranging resources to manufacture a product or deliver a service (Parks and Oakerson 1989).

5. The most prevalent are solid waste, water supply, public parking, and affordable housing.

6. We also tested this hypothesis using a set of three dummy variables representing the four political parties. The results are consistent with the findings reported here.

7. The different specifications were not included here due to space limitations but will be made available upon request to the authors.

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TABLE 1 – VARIABLES DESCRIPTION, EXPECTED SIGNS, AND SOURCES

Variable	Description	Expected Sign	Source
CPS	Dependent Variable; the number of Corporate Public Sector Organizations with more than 50 per cent of public capital created by 2001.		Almeida (2001)
MunCorp	Dependent Variable; Dichotomous variable to measure the choice to create Municipal Corporations only. 1 if one or more corporations were created and 0 if none was created.		Direct Survey to Municipalities
PartyId	Left-right ideological measure of the party securing the majority of the local council; PCP (left) coded as 0, PS (center-left) coded 1, PSD (center-right) coded 2, and PP (right) coded as 3.	+	DGAL (2001)
Majority	Dummy variable which takes the value of "1" when the winning party has the majority of seats in the executive body. "0" otherwise.	+	DGAL (2001)
Bureaucracy	The number of employees of the in-house municipal organization.	+	Direct Survey to Municipalities
Parishes	Number of Parishes in the municipality.	+	DGAL (2001)
PopGrowth	Variation in the population between two census.	+	DGAL (2001)
Area	Area in squared kilometers	+	DGAL (2001)
ISD	Index of social development as measured by Portuguese government.	+	DGAL (2001)
Taxpc	Local taxes per capita.	+	DGAL (2001)
Def	Total local budgetary balance (a negative number is a deficit).	+	DGAL (2001)
FinDep	Financial dependency, that is, the proportion of central government grants in total local revenues.	-	DGAL (2001)

TABLE 2 – SUMMARY OF THE DESCRIPTIVE STATISTICS

Variable	Obs.	Mean	Std. Dev.	Min	Max
CPS	278	2.9353	2.7592	0	22
MunCorp	278	.3273	.4701	0	1
PartyId	278	1.2986	.7510	0	3
Majority	278	.8921	.3108	0	1
Bureaucracy	276	399.5797	714.6057	46	10306
Parishes	278	14.5216	12.7717	1	89
PopGrowth	278	.8000	12.2127	-19.22	78.06
Area	278	319.0423	283.0178	7	1721
ISD	278	.8456	.0457	.6392	.9347
Taxpc	278	12.3871	13.0934	.3586	157.4417
Def	278	- 64358.09	794486.4	- 1.28e+7	831195
FinDep	278	0.4556	0.1705	.1007	.903

TABLE 3 – RESULTS OF THE POISSON REGRESSION MODEL

Variable	Coefficient	Std. Err.
PartyId	.1396***	.0534
Majority	.0226	.1130
Bureaucracy	.0004***	.0001
Parishes	.0112***	.0026
PopGrowth	.0025	.0031
Area	.0002	.0002
ISD	.8872	1.3151
Taxpc	.0099***	.0024
Def	2.79e-07***	5.05e-08
FinDep	-1.4096***	.3531
Const	.0954	1.2206
Num Obs.	276	
LR chi^2 (10)	304.03	
Prob > chi^2	.0000	
Pseudo R^2	.2338	
Log-L	-498.2765	

*** p > .01.

TABLE 4 – FACTOR CHANGES OF THE POISSON REGRESSION MODEL

Variable	Factors	Std. Err.
PartyId	1.1495	.0614
Majority	1.0228	.1156
Bureaucracy	1.0004	.0001
Parishes	1.0113	.0025
PopGrowth	1.0025	.0031
Area	1.0002	.0002
ISD	2.4284	3.1936
Taxpc	1.0099	.0024
Def	1	5.05e-08
FinDep	0.2442	.0862

TABLE 5 – RESULTS OF THE LOGIT REGRESSION MODEL

Variable	Coefficient	Std. Err.
PartyId	.0322	.2136
Majority	.9068*	.5442
Bureaucracy	.0016**	.0007
Parishes	.0254**	.0129
PopGrowth	-.0036	.0177
Area	.0013**	.0006
ISD	7.1952	5.1918
Taxpc	.0156	.0139
Def	-1.62e-07	7.28e-07
FinDep	-.4144	1.5845
Const	-9.0835*	4.8825
Num Obs.	276	
LR chi^2(10)	55.69	
Prob > chi^2	.0000	
Pseudo R^2	.1591	
Log-L	-147.1333	

** $p > .05$; * $p > .1$.