FGV EBAPE

RAP
BRAZILIAN JOURNAL OF PUBLIC ADMINISTRATION
1967-2017

Democratic *vs.* efficiency: how to achieve balance in times of financial crisis

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Public Administration is forced to strike a balance between efficiency and democracy in defining its agenda and course of action. One of the characteristics of Public Administration is that all decisions must reflect democratic values, in addition to being efficient. Nevertheless, administrative reform, motivated by financial stress, tends to highlight the importance of financial performance while overlooking the democratic and political aspects of public management. This research seeks to analyze the link and tension between efficiency and democracy in light of the latest global financial crisis. The paper uses a quantitative approach and collects data from Portuguese local governments to test the argument of an inverse linear relationship between financial performance and democratic procedures. Findings confirm Waldo's argument (1948) of an inverse relationship while the evidence gathered shows that the financial crisis increased the negative effect of democratic procedures on financial performance.

Keywords: democracy; financial crises; local governments.

Democracia *vs.* eficiência: como alcançar equilíbrio em tempo de crise financeira

A administração pública é forçada a encontrar um equilíbrio entre eficiência e democracia na definição da sua agenda e curso de ação. Uma das características da administração pública é que todas as decisões devem refletir valores democráticos, para além de serem eficientes. No entanto, a reforma administrativa, motivada por dificuldades financeiras, tende a destacar a importância do desempenho financeiro, em detrimento dos aspetos democráticos nas políticas de gestão pública. Esta pesquisa visa analisar a relação e tensão entre a eficiência e a democracia à luz da mais recente crise financeira global. O trabalho utiliza uma abordagem quantitativa e recolhe dados de governos locais portugueses para testar o argumento de uma relação linear inversa de desempenho financeiro e procedimentos democráticos. Os resultados confirmam o argumento de uma relação inversa, definida por Waldo (1948). Adicionalmente, os resultados também permitem concluir que a crise financeira evidenciou o efeito negativo dos procedimentos democráticos no desempenho financeiro.

Palavras-chave: democracia; crise financeira; governos locais.

Democracia *vs.* eficiencia: como buscar un equilibrio en tiempos de crisis financiera

La administración pública se ve obligada, en el decurso de su acción, a encontrar un equilibrio entre la eficiencia y la. Una de las características de la administración pública es que, además de ser eficiente, todas las decisiones deben reflejar los valores democráticos. Sin embargo, la reforma administrativa, motivada por el estrés financiero, tiende a poner de relieve la importancia de los resultados financieros, pasando por alto los aspectos democráticos y políticos de la gestión pública. Esta investigación busca analizar la relación y la tensión entre la eficiencia y la democracia en el decurso de la reciente crisis financiera global. El trabajo utiliza un enfoque cuantitativo y recoge datos de los gobiernos locales portugueses para poner a prueba el argumento de una relación lineal inversa entre el rendimiento financiero y los procedimientos democráticos. Los hallazgos confirman el argumento de Waldo (1948) de una relación inversa, mientras que la evidencia reunida muestra que la crisis financiera incrementó el efecto negativo de los procedimientos democráticos en el desempeño financiero.

Palabras clave: democracia; crisis financiera; gobiernos locales.

DOI: http://dx.doi.org/10.1590/0034-7612165400
Article received on November 2, 2015 and accepted on September 20, 2016.

1. INTRODUCTION

The New Public Management reform, in the wake of a deep financial crisis, focused on the use of market mechanisms for market delivery, the fragmentation of public units, pressure on efficiency, and pressure on private-sector management styles (Hood, 1991). No attention has been paid to political issues related to enhancing the quality of democracy or securing civic engagement. One reason is that the reform agenda focused on aspects that needed to be changed. In the 1980's, as in the recent sovereign debt crisis, political aspects of democracy were thought not to be at risk. Thus, changes focused on financial performance and the way this could be improved by governments. Moreover, reform initiatives appeared to separate political values from the decision-making process. Waldo's argument (1948) of a trade-off between democracy and efficiency supported this alternative. The understanding is that political agenda and democratic procedures can place rigid restrictions on efficient management (Svara, 2008). Waldo (1948) believes in a negative, linear relation between efficiency and democracy, explained by the impossibility of reconciling two different views of public administration: the first, drawn from a managerial perspective, relies on the primacy of an efficient government through the discretional power of bureaucrats, their expertise and the use of market solutions; the second, closer to political science, is based on the primacy of democracy, legitimacy, and civic engagement. Dollery (2010) and Overeem (2008) claim that this is a recurrent clash portrayed in the literature under different excuses. It has been called as the tension between technical knowledge and peoples' will, discretionary power and legitimacy or a dispute between bureaucracy and civic culture, a trade-off between local voices and diversity, accountability, and political responsiveness, and a primary concern with structural efficiency. Waldo's classic argument of a negative relation has been tested under different contexts yet with inconsistent results (Gasiorowski, 2000; Skelcher, 2007; Vigoda, 2002).

Recently, a number of scholars adopted an alternative approach and argued the exact opposite of Waldo's hypothesis. Norris (2012), based on a unified theory, stated that democratic governance can boost prosperity, welfare and peace in developing countries. At the local level, some studies found evidence that supported a non-tradeoff, i.e. a positive relation, between local democracy and efficiency (Aulich, 2005; Boyne, 1992; Dollery, 2010). The main purpose of this article is to shed light on the relation between financial performance and the quality of the democratic testing both hypotheses of positive and negative linear relation. It also seeks to determine the effects of recent managerial initiatives on the link between democracy and efficiency. This last objective was prompted by the Portuguese financial situation, which drove the government to implement a reform agenda according to the memorandum of understanding signed with the International Monetary Fund (IMF), European Union (EU) and European Central Bank (ECB) (the troika).

The article's contribution to the literature is the confrontation of the alternative approach with Waldo's classic argument of the democracy-efficiency link. The paper aims to contribute to the literature of two different fields of expertise: management and political science.

This research employs data from Portuguese municipal governments in 2005 and builds an index of financial performance, used as a proxy for efficiency, and another of the quality of democracy. Using these indexes, the paper suggests that there is a negative linear relation between democracy and efficiency, confirming Waldo's argument. Moreover, the paper found evidence that the recent reform initiatives imposed by the assistance program only serve to intensify the negative relationship between financial performance and the quality of democracy.

This paper is structured as follows. First, the paper introduces the literature on the classic link between democracy and efficiency. Then, the paper presents the arguments for democratic efficiency. The third section discusses the operationalization of democracy and financial performance indexes. The fourth and fifth sections describes the research context, the data and methods employed in the empirical analysis. Finally, research findings are discussed, and policy implications and conclusions are presented.

2. WALDO'S CLASSIC TRADE-OFF

Waldo's argument can be summarized as the major drawbacks of democratic procedures in efficiency efforts in public organizations. Better quality democracy can be achieved by increasing the accuracy of representation, engaging citizens and encouraging a better fit between citizens' will and political decisions. However, following Waldo's argument, this strategy may strive for further integration and more decentralization, proposing a new balance of power-sharing with citizens. However, there definitively has a risk of jeopardizing the ability to make efficient decisions. In fact, democracy is considered to have at least three drawbacks for an efficient decision-making process: pork barrel strategies; rent-seeking, and political cycles. First, increasing representation could lead to a situation where citizens could fully accomplish their preferences, which may have unbearable consequences for financial sustainability. Citizens tends to prioritize their own preferences claiming importance over others'. Each one, using a pork barrel strategy, would be driven to request more public services, increasing overall spending since they internalize part of the cost (Weingast, Shepsle, and Johnsen, 1981). Second, elected officials are traditionally defined as rational agents seeking to implement strategies that guarantee their re-election. Likewise, vote-seeking strategies promote the implementation of the political agenda based on other values apart from economic ones. As such, elected officials may find it hard to approve and comply with bills that impose restrictions on themselves and their electoral support, which might pose a threat to financial performance (Gasiorowski, 2000). Likewise, the literature points out the classic arguments of political cycles (Nordhaus, 1975) and the median-voter (Downs, 1957), in which elected officials have a political definition of efficiency driven by self-interest, and manage economic variables and financial situation in such a way as to maximize their utility.

Excessive expenditure, painful tax levels, and distrust of elected officials accentuate the need to focus on efficiency in public services (Pierre, 2009). Efficiency is probably one of the most fully explored, well-defined concepts in management literature. It describes the extent to which effort and cost are harnessed for an intended task or purpose. Efficiency is also defined by the most suitable relationship between outputs and the resources needed to obtain them. The quest for efficiency has been at the heart of most traditional works on administrative sciences since their inception. Economic crises and the increasing difficulty of controlling public expenditures heightened interest in the issue of public sector efficiency. However, more emphasis is placed on financial performance, cost cutting and making the best use of the taxpayers' money (Cope, 1992; Hood and Dixon, 2013; Scorsone and Plerhoples, 2010). Financial performance, centralization and extra layers of control on public expenditures dominated the reform agenda drawn up in the wake of the sovereign debt crisis. The goal was to rescue governments from fiscal stress and prevent public entities from going bankrupt.

The managerial approach dominated the agenda, eliminating a more democratic attitude, since it believed that no significant cuts would be possible without placing some restrictions on residents' ability to participate in these decisions.

3. DEMOCRATIC EFFICIENCY

From a political science perspective, the alternative argument builds on the idea that decentralization, civic engagement, active citizenship and better representation of citizens are not only able to preserve the legitimacy of political action but also to enhance public service performance and efficiency. The emphasis on financial performance approximate public to private management style, which, of course, has its advantages. However, it may seriously distance its uniqueness and the respect for democratic values that is supposed to ensure. In fact, no democracy can survive if the government lacks the ability to provide citizens with the services they need. However, no expectations of prosperity are sustainable if stripped of legitimacy (Thomas and Memon, 2007). Local governments are therefore expected to balance the trade-off between financial performance and democratic values. Norris (2012) centers on the Democratic Efficiency argument, a combination of political competition, and civic participation mechanisms with full access to information that leads to transparency and accountability, which in turn promotes accurate service delivery and financial sustainability.

This approach challenges previous arguments supporting the benefits of managerial decisions without taking into account the political agenda. Particular interests may dominate reform initiatives since popular scrutiny is unable to participate in the decision-making process. Democratic procedures increase accountability, transparency and bring legitimacy to public decisions, which is particularly important when public decisions concern restrictive measures. Giving excessive discretionary power to bureaucrats allows them to make decisions with a reduced level of responsiveness. We can end up with a perfect solution, technically speaking, but one that does not have any democratic value at all. Moreover, without any democratic controls, there is the additional risk of bureaucratic decisions being diverted and addressing interests that diverge from citizens' wishes. Public Choice theorists dealt with the problem of controlling bureaucracy by using market mechanisms. Although the market gives back to citizens the ability to express their preferences, this involves performance accountability rather than procedure (Pierre, 2009).

Democracy is an essential aspect of government. It provides legitimacy to those chosen to act on behalf of the community in the quest for the common good and ensures a system whereby key players are held accountable for their decisions. There is no consensus on the definition of democracy, or the ways it can be measured among academics. According to Schumpeter's (1976) definition, democracy is an institutional arrangement of collective decision-making processes, whereby individuals acquire the ability to decide through a competitive mechanism of election. This understanding of democracy is relatively straightforward and easy to measure since it is only based on an electoral mechanism. However, the understanding of democracy has changed over the years. The mere fact of having an electoral process does not suffice to ensure higher standards of democracy (Beetham, 1999). The definition of democracy as a system in which the power of the people acts on behalf of the people was replaced by a situation with formal power of the people, where civic involvement initiatives with the community were used to target problems and solve them (Haus and Klausen, 2011). The legitimacy to hold a political office becomes separated from the legitimacy of using its power. The first is acquired through the electoral process while the second is a constant process of civic involvement.

Three significant positive outcomes can be obtained from the effects of democracy on efficiency. First, a democratic system promotes a mechanism of representation of citizens' needs. In an indirect democracy, the accurate representation of constituents' preferences is determined by the veracity of the mechanism and the structure of governance (Copus, 2003). Second, political competition forces politicians to deliver a good performance since it is a mechanism of punishment that identifies and eliminates incompetent agents. It also improves the dissemination of information through several agents by avoiding situations of asymmetric information. Lastly, democracy brings transparency and accountability to political decision-making and implementation. Accountability will make elected officials more responsive to citizen's demands even if using a vote-seeking perspective (Norris, 2012) while transparency gives citizens better judgment over political actions. Adam and colleagues (2011) argue that civic engagement and governmental transparency also provide better control of political opportunism by increasing budget slack in service delivery.

4. WORKING HYPOTHESES

The literature review suggests two opposing arguments. Those who seek and uphold democratic values claim that reform initiatives that impose austerity and restrictions on individuals' well-being must have a solid basis of legitimacy. Thus, we ensure transparency and facilitate public acceptance. On the other hand, the opposite argument states that some measures must be decided within a smaller circle. The rationale of politics tends to shy away from unpopular, but necessary courses of action. Hence, efforts to enhance financial performance may be limitedly elected officials' evaluation of their political costs. The paper seeks to test these two opposing hypotheses. One is in line with the argument of Waldo's trade-off:

H_1: *There is a linear negative relation between democracy and financial performance; increases in the level of democracy will reduce levels of financial performance.*

The hypothesis is grounded in the assumption that bringing the decision-making process closer to the political arena will increase the risks of vote-seeking and logrolling. Moreover, public disclosure of a decision prior to its implementation may elicit political opposition that will lead to negotiation costs and pork barrel strategies. The alternative hypothesis upholds an argument in line with the idea of coexistence between democracy and efficiency:

H_2: *There is a linear positive relation between democracy and financial performance; increases in the level of democracy will increase levels of financial performance.*

In this case, democratic procedures increase accountability, responsiveness, and transparency. Bureaucrats' decision will be closer to citizens' wishes, which will minimize the risk of lobbying strategies.

4.1 FINANCIAL PERFORMANCE INDEX

Several academic publications focus on appraising a correct measurement of public sector efficiency and face several problems regarding its application. The origins of the concept are grounded in the private sector, based on the need to find the ratio between weighted outputs and inputs (Afonso and

Fernandes, 2008). Public service outputs are rarely measured in prices that reflect the costs of their inputs while market fails to give prices for those services. Despite this drawback, some techniques are used to measure service efficiency without the requisition of defining relative weights for outputs and inputs. Non-parametric estimations can drive efficiency scores, based on a production function frontier, on the basis of relative distances of inefficient observation from the frontier (Afonso and Fernandes, 2008; Moore, Nolan, and Segal, 2005).

In this paper, we use financial performance as a proxy for local government efficiency. We acknowledge the difference between the two concepts, but we justify their goodness of fit for two main reasons. First, we found very little consensus in the literature on the measurement of efficiency. Second, and most importantly, we think that reform initiatives implemented in countries such as Portugal, Greece and Ireland focused on financial issues, cutback policies, and austerity measures. The motto is "doing less with less", where financial performance is a key concept that captures the specific objective and efforts of managerial initiatives.

Financial performance of local governments is assessed using two indicators: government capacity and productivity. Government capacity means its ability to ensure institutional roots, and public services (Kaufmann, Kraay, and Mastruzzi, 2010; Stiglitz 1989). Financial crises trigger environmental entropy, which jeopardizes this capacity. Governments become unable to comply with all the demands of public service and begin to rethink the scope of government, opting for a policy of cutback management and streamlining businesslike processes (Scorsone and Plerhoples, 2010). Public sector productivity captures the added-value of bureaucrats to public service and seeks to assess the degree to which the government structure fits the context in which it operates.

4.2 THE QUALITY OF LOCAL GOVERNMENT DEMOCRACY INDEX

There are several ways to calculate democracy indexes: the Freedom House Index (FHI); the Effective Democracy Index (EDI); the Economist Intelligence Unit's Index of Democracy and Political IV.

FHI (House, 2011) is widely used among academics to measure democracy. FHI is closely linked to a concept of democracy based on the electoral process and the presence of democratic institutions (Knutsen, 2010). It rates countries by civil liberties and political rights. Conversely, EDI stresses the importance of measuring substantive democracy, in other words the actual functioning of democratic institutions (Inglehart and Welzel, 2005). The Economist Intelligence Unit's Index of Democracy (Economist, 2010) rates democracy by electoral process and pluralism, political participation, democratic political culture and civil liberties. Political IV establishes elements of executive constraint and recruitment to determine the level of democracy.

However, these indexes were supposed to be used at the national level. Adapting them to the local level must consider the responsibilities given to this tier of government as well as its limitations and differences. For the purpose of the paper, we built an index that reflects the reality of local government. The Quality of Local Democracy Index will be calculated using two elements: electoral competition and accuracy of representation.

Electoral competition and pluralism are the checks and balances that hold officials accountable for their actions. Competition increases accountability, transparency and concern for citizens' needs. An extremely competitive election will encourage officials to implement vote-seeking strategies to avoid losing the next elections. As a result, elected officials, driven by their basic survival instincts, will provide proposals that are better suited to citizens' interests, to obtain their vote (Downs, 1957).

In addition to the emphasis on citizens' needs, competition may also increase transparency. A narrow win, where the difference of votes between winner and loser is minimal, can motivate both sides. In the quest for popular support, the winner will strive to present himself as trustworthy and reliable in order to guarantee his re-election and a larger win. The defeated party, encouraged by a larger number of votes, will increase its supervision of the official elected to make them accountable for their actions. Ultimately, we can compare the electoral process to a political market: citizens' choices will determine who wins or loses. So, the more intense the disputed election, the better will be for citizens. As long as the competition intensity decreases, officials' accountability towards the citizens diminishes, meaning that they become more reliant on their electoral strength and legitimacy.

Together with competitiveness, pluralism plays a significant role in the intensity of democracy. Pluralism in governing bodies ensures the accurate representation of constituents' preferences (Copus, 2003). Excessive focus on the average voter's preferences may result in a tyranny of the democratic majority (Weimer and Vining, 2010). In this situation, indirect democratic mechanisms will fail to achieve their mission to represent people's trust and sovereignty.

5. RESEARCH CONTEXT

The recent sovereign debt crisis puts local governments under stress, making their ability to comply with their responsibilities and affecting constituents' well-being vulnerable. Municipalities were therefore under serious pressure to increase revenues and obtain financial sustainability at any cost. Moreover, the external environment was characterized by adverse conditions, prompted by the central government's decision to apply for the international financial assistance mechanism. The Memorandum of Understanding with the troika envisages a set of reforms to improve financial capacity and maximize revenues. All the reforms began in late 2010 and reached a peak in the 2012 election that drew up a new governance framework, set to be implemented by the beginning of 2013.

Reform agendas imposed by local governments can be classified into three main categories: centralization, revenue maximization, and popular representation reduction.

Centralization was expressed through organizational and financial perspectives. Central government restricted the municipality's freedom of self-organizations. Since 1978, mayors have been authorized to organize their municipalities as they wanted to. Municipal services and internal departments were created, merged and eliminated whenever the municipality saw fit. As a result of the reform, central government established a major restriction on local governments' ability to self-govern. Departments and staffing are now a direct expression of the relation to the size of the jurisdiction's population. The overarching aim is to endow municipalities by establishing an optimal structure of municipal services for different types of demographic configuration. In financial terms, changes occurred in the local financial act. Most of the municipal budget is supported by a grant obtained from the tax revenues collected by central government. The local finance act regulates all municipal revenues while focusing mainly on the regulation of central government grants to local government. A central council is created comprising several ministers, including the minister of finance, and local government representatives. If necessary, the council has the power to overrule the law, reduce local government grants and balance the national budget. In addition to this supervisory council, the local financial act establishes two additional forms of financial support, to be used only in case of fiscal stress: municipal financial restructuring and municipal financial rebalancing. In both cases, financial indicators trigger a mechanism whereby a containing plan must be drawn up to specify all the measures to be undertaken to ensure long-term financial sustainability. During this period, elected officials lose some of their freedom and autonomy regarding central government. The idea is to ensure credit from central government to municipalities under fiscal stress, which, in exchange, can appoint a city manager to control the use of funds.

Revenue maximization is mostly felt in the management of public municipal corporations. Created as local entities with legal personality and administrative, financial, and patrimonial autonomy, they are regulated by the law of public enterprises and the private commercial partnership's code. Supported by the international trend of externalization and agencification, the number of municipal enterprises never stopped growing. Reform initiatives changed that status. Municipalities ceased to have the power to decide whatever they wanted to maintain or eliminate these entities. As a result of high levels of indebtedness, local enterprises rapidly became a scapegoat for the poor financial situation of local governments. Nowadays, a set of financial indicators (indebtedness, net profit, municipal financial dependency) has been established and are applied to all municipal enterprises. Failure to comply with these measures lead to a compulsory shut down of that local government, in a process directly triggered by the minister of finance.

Lastly, reform initiatives also reduced popular representation. Every municipal jurisdiction is divided into smaller jurisdictions known as parishes. These entities have two specific political roles. The first is to give citizens a voice, identify their needs and provide a solution to their problems. Moreover, parishes play a significant role in the governance scheme in the structure of municipalities. Each parish is entitled to have one representative on the city council. On average, parish representatives comprise nearly half the city council. The reform adopted by the troika reduced the number of parishes. It used the argument of excessive fragmentation and its consequences on the capacity to promote efficiency, arguing that it caused excess spending. The political costs of excluding representatives were completely overlooked in the quest to improve financial efficiency.

6. DATA AND METHODS

This research addresses the following research questions: what is the link between financial performance and democracy in the Portuguese local government context? What are the effects on this link motivated by the reform agenda implemented to deal with the sovereign debt crisis? In order to address the research questions in the paper, we used panel data analysis and simple OLS regression, and our database covers the period since 2005. The data set was divided into three periods: one corresponding to the political cycle of 2005-08, another matching the political cycle of 2009-12, and, lastly 2013. Prior to 2005, municipalities did not use accrual accounting to produce financial information, meaning that it was impossible to compute the financial performance index used in the paper for the 2001-04 political cycle. For each cycle, the paper uses panel data analysis and random effects and computes two models. The first is used to test the linear relationship between financial performance and democracy, while the second tests the consistency of the first model, by adding control variables that measure the economic background of each local government. Since the last political cycle only includes one year (2013), we used OLS regression.

Our models can be represented by:

$$\textit{Financial Performance Index} = \alpha + \beta_1 \,(\textit{Quality of Local Government Democracy Index}) + \mu \qquad [1]$$

$$\textit{Financial Performance Index} = \alpha + \beta_1 \,(\textit{Quality of Local Government Democracy Index}) + \beta_2 \ln(\textit{Population}) + \beta_3 \ln(\textit{Income}) + \beta_4 (\textit{Density}) + \text{Size} + \mu \qquad [2]$$

The empirical analysis was undertaken in two sequential steps. First, we computed the financial performance index and the quality of local government democracy index. Then, we used econometric techniques to compute models for three political cycles. In each, we computed two models: [1] [2]. Models were computed for the 278 jurisdictions of mainland Portugal.

Both indexes were built using the same methodology (Morris and McAlpin, 1982). For each indicator, the paper establishes the best and worst value in such a way that all indexes became unidirectional and could be combined (Dholakia, 2005). Each indicator is placed on a 0 to 1 scale, with 0 representing the worst observed score and 1 the best. Then, indexes are appropriately weighted. For the purpose of this paper, all indicators were equally weighted (0.5). To compute both indexes, the indicators used are structured as follows:

CHART 1 FINANCIAL PERFORMANCE AND THE QUALITY OF LOCAL GOVERNMENT DEMOCRACY INDEX

Index	Variable	Indicador
Financial Performance	Government Capacity	Indebtedness, per capita
		Proportion of own resources
	Productivity	Productivity of public servants
		Net benefit, per capita
Quality of Democracy	Electoral Competition	Difference of votes between the two most voted parties
		Participation rate
	Accuracy of Representation	Number of different political parties in city council
		Number of parishes per municipal jurisdiction

Source: Elaborated by the authors.

6.1 FINANCIAL PERFORMANCE INDEX

The levels of financial performance of each local government are obtained by the combination of two variables: government capacity and productivity. Government capacity is a measure of the level of municipal indebtedness and the proportion of the municipalities' own revenue. The argument for using municipal indebtedness as a proxy for government capacity is that the troika's reform agenda focuses on implementing measure to increase income and reduce debt at all levels of government. The level of indebtedness provides a clear indication of how well the municipality is performing and how (un)balanced it is. Financial indebtedness is estimated by the difference between financial liabilities and assets. Governing capacity is also estimated by using the proportion of own revenues generated by each municipality. This indicator provides information about the capacity of each municipality to maximize revenues using its structure, without the need for central government funds. Both indicators are obtained from official financial data from the National Office of Local Administration (*Direção-Geral das Autarquias Locais*).

Financial Performance is also computed using municipal productivity. This paper considers two types of productivity: internal and external. Internal productivity is calculated by the ratio between the total amount of income and the number of public servants. It provides an estimation of the value added of each public servant and indicates the organisation's goodness of fit to its demand. External productivity is obtained from the ratio between net income and population. This measure makes it possible to assess the value that municipality adds to its community.

6.2 THE QUALITY OF LOCAL GOVERNMENT DEMOCRACY INDEX

The quality of local government democracy index is calculated using two indicators: electoral competition and accuracy of representation.

Electoral competition is evaluated by means of two factors: voting difference between the two parties with the highest number of votes, and the number of votes. The distance between winners and losers in the electoral outcome may reflect the competitive pressure on the elected official to focus on constituents' preferences. A narrow win will therefore encourage incumbents to be more accountable to their voters. Another indicator of electoral competition is voters' attendance. A higher level of participation is a good indicator of an electoral dispute. Usually, competitive elections tend to attract the attention of more constituents, therefore increasing participation levels.

Accuracy of competition between representatives is also evaluated by means of two factors: political fragmentation and the number of parishes. Political fragmentation is determined by the number of political parties in the city council. It is argued that governing bodies with greater diversity are better able to represent and cover all the varieties of preference of a community. Data for all the indicators was obtained from the National Electoral Commission with reference to municipal executive election of 2005-09-12. Lastly, the paper uses the number of parishes per municipality as a measure of representativeness. The purpose of this sub-municipal government is to give voice to citizens' demands by focusing on public services that are needed, and to play a major role as full members of the city council. Hence, a higher number of parishes can be used as a proxy for a more accurate representation.

6.3 CONTROL VARIABLES

In the second model estimated in the paper, three control variables were used: population, population density and income. Control variables are used as a proxy of the economic context of local government, which somehow interferes the level of efficiency. Population, population density and population size are control variables that capture the effect of economies of scale that may boost municipalities' financial performance. Finally, per capita income is used to control the effect of citizens' capacity to pay for public services and is one of the most important revenue-based municipal taxes.

7. EMPIRICAL FINDINGS

The results show significant variations in the financial performance index during the period under review (table 1). Between the 2005-08 and 2009-12 political cycles, we find an increase of inequalities of financial performance and an increasing disparity between municipalities. Although the average score improved from 0.44 to 0.46, the fact is that there were fewer municipalities with a financial performance score above 0.5, dropping from 34% in 2005-08 to 32% in 2009-12. Furthermore, the distance between municipalities increased even though it is insignificant. Scores may reflect the effects of the beginning of the international sovereign debt crisis. Nevertheless, the effect was muted by the legislative election period in 2010-11. The incumbent government struggled to avoid external intervention, using public resources to deal with financial problems at various government levels.

Significant changes are identified in the comparison with the political cycle initiated in 2013. The number of municipalities with a financial performance above 0.5 increased to 63%, meaning an increase of 100% in comparison with the 32% of 2009-12. The average score also increased and is now positive with a score of 0.53, while the disparity between the highest and lowest score decreased to 0.52.

This result allows us to argue that financial performance improved significantly in 2013, which cannot be isolated to the reform agenda implemented in late 2010.

TABLE 1 FINANCIAL PERFORMANCE INDEX EVOLUTION (2005-13)

	Financial Performance Index		
Period	Proportion of LG with score higher then 0.5	Average Score	Difference between highest and lowest score
2005-08	34%	0.44	0.71
2009-12	32%	0.46	0.73
2013	64%	0.53	0.52

Source: Elaborated by the author.

Our results confirm Waldo's argument of a trade-off between financial performance and democracy. They provide evidence that a higher degree of democracy has a negative effect on financial performance and mainly, that this effect has deteriorated in the recent years, in the repercussion of the implementation of the reform agenda agreed with the troika. All models displayed a negative value for the quality of local government democracy index, indicating an inverse relationship with the financial performance index.

TABLE 2 ESTIMATION RESULTS MODELS

	Panel Data Random Effects				OLS Model	
	2005-08		2009-12		2013	
VARIABLES	Simple	w/controls	Simple	w/controls	Simple	w/controls
Democracy	-0.0506	-0.0805*	-0.1005**	-0.0637**	-0.2240***	-0.2169***
Index	(0.0507)	(0.0431)	(0.0428)	(0.0277)	(0.0631)	(0.0505)
Population		0.0276***		0.0339***		0.0463***
(ln)	–	(0.0036)	–	(0.0028)	–	(0.0047)
Population		-0.0000		-0.0000		-0.0000
Density	–	(0.0000)	–	(0.0000)	–	(0.0000)
Income		0.1108***		0.1330***		0.0487
(ln)	–	(0.0288)	–	(0.0189)	–	(0.0366)
Size		-0.0000		-0.0000		-0.0000
	-	(0.0000)	-	(0.0000)	-	(0.0000)
Observations	1,112	1,094	834	834	278	278
Wald Chi2	1	128.80	5.52	438.06	.	.
Prob>Chi2	0.318	0.000	0.02	0.000	.	.
rho	0.08	0.037	0.444	0.11	.	.
F	.	.	.	.	12.63	38.88
Prob>F	.	.	.	.	0.000	0.000
R-squared	0.004	0.35	0.02	0.63	0.05	0.428

Source: Elaborated by the author.

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

In the period from 2005-08 the simple model cannot be considered since it is statistically insignificant. The complete model, with the control variables, shows evidence of a negative relation. The quality of local government democracy index has a score of -0.0805, representing a decrease in the financial performance index resulting from the increase of one unit of quality of local government democracy index. The statistic *rho*, which measures the variation in the dependent variable due to differences across panels, has a low value of 3,7%. As expected, population and income have a positive impact on the financial performance index score, supporting the effect of economies of scale and citizens' financial capacity on a better financial performance.

During the period from 2009 to 12, both models show statistical significance. In the simple and complete models, we find evidence of a negative impact of the quality of local government democracy index on the financial performance index. Increases of one unit in the quality of local government democracy index result in a decrease of -0.1005 and -0.0637 in the financial performance index, respectively. Control variables effects were consistent with the previous period and are still consistent with our expectations. The statistic *rho* displays a value of 44% indicating the variation explained by the differences between municipalities on the panel. Nevertheless, the score decreases in the complete model.

The last estimation concerns 2013. This is the first year of the political cycle incorporating all the modifications in the governing institutions and structure. Again, both models were statistically significant. The models show a much higher impact on the quality of local government democracy index than on the financial performance index. In both models, the negative impact of an increase in quality of local government democracy index is approximately -0.22. Compared to the other models, the negative relation clearly increases. The model estimated after the implementation of the reform agenda displays the highest value: -0.22 for 2013, -0.0637 for 2009-12 and -0.0805 for 2005-08. Among the control variables, only population has statistical significance and, as expected, has a positive impact. The R^2 statistic of 0.428 in the complete model suggests that, approximately, 43% of the variation of the dependent variable can be explained by the model.

8. CONCLUSION AND DISCUSSION

The sovereign debt crises have been seen worldwide in the past recent years. Several European countries were forced to apply for financial assistance from the troika. Each country was obliged to sign a Memorandum of Understanding specifying the terms of the reform agenda to achieve financial stability. Several reform initiatives were decided in a centralized way and imposed on countries. Despite the significant differences from the Emergency Managers' Initiatives in Michigan (see Scorsone and Plerhoples, 2010; Mears, 2012; Anderson, 2011), this attitude led the EU to reconsider much of the *modus operandi* of the troika for dealing with democratic values and principles.

In the Portuguese case, at the local government level, the reform agenda negotiated with the troika focused on centralization, revenue maximization, and reduction of popular representation. In the literature, we found a set of theoretical arguments supporting this option. Waldo's work (1948) focused on the impacts of democratic procedures on the efficiency of governments. The author argued that public decisions are challenged by political guidelines and might limit their level of efficiency. The literature also offers a set of arguments confirming the positive effects of democratic procedures and civic engagement.

The paper tests both the arguments using the financial performance index, as a suitable proxy for efficiency in the context of sovereign debt crises, and the quality of local government democracy index. The results allowed us to argue the existence of an inverse linear relation between financial performance and democracy. The goal of this paper is to shed light on the relation and trade-offs between financial performance and democracy. Moreover, the results support the argument that this negative relation tended to increase as a result of the implementation of the reform agenda negotiated with the troika.

We also need to highlight the fact that the first period under analysis is one of economic expansion: GDP grows 1,19% from 2005-08. On the contrary, the following periods are of clear economic depression. From 2009-12 GDP drops 3,99% while public debt grows from 83,6% of the GDP to 126,2%; and the year of 2013 recorded a drop in the GDP of 1,13% and the public debt reached the top value of 129% of the GDP. The trend displayed by our results are consistent with the economical cycles since the trade-off between efficiency and democracy is more evident in the second and third period when compared with the first.

In addition, two further ideas should be highlighted. One of the traditional arguments of political science is that a democracy that is unable to provide wealth and prosperity for a nation will soon be overtaken by a revolution or regime change. As Norris (2012) suggested, "People can't eat democracy" and, sooner or later, they will recognize the huge opportunity costs of the democratic system if it reduces well-being. Despite the results presented in the paper, 12,5% of the municipalities bypassed the general trend and managed to maximize the financial performance and democracy index. This is a case of optimization where democratic procedures promote financial performance. These cases require in-depth analysis to determine the factors that lead to such a situation. This would give us a glimpse of how to balance the trade-off and maximize both financial performance and democracy.

Another point that is to note regards future scenarios of governance management. These reform initiatives emphasize financial performance, centralizing procedures and limiting civic representation. This raises significant issues related to the identity of local governments. Since 1974, local government autonomy was implicitly assumed as an expression of the democratic revolution and civic involvement in local communities. In some ways, financial crises and the subsequent reform initiatives threaten the democratic legacy. If the reform agenda continues to focus solely on financial performance, municipalities and parishes will become mere extensions of central government. They will become an administrative apparatus solely interested in achieving better financial indicators rather than commitment to their communities. This scenario is quite difficult to understand, since it assumes an ultra-minimalistic perspective, while local government missions involve more than service delivery. They are the building block of our citizenship and the grassroots of a democratic regime. This said, we risk being on the edge of an era where public organizations become self-aware and follow a path of satisfying their needs to survive rather than overseeing their constituents' interests.

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