



Politics and Finance in Spanish Municipalities *

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Received: October, 2013

Accepted: November, 2014

Abstract

This paper undertakes an analysis of the Spanish local governments from the perspective of public choice theory. A set of hypotheses from a theoretical analysis is examined including alternative modes of public management, the possible use of financing instruments that generate fiscal illusion and the influence of certain pressure groups on the size of the municipal budget. We work with a sample of 140 Spanish municipalities with more than 50,000 inhabitants for the period 2002-2010.

Our results support an (expansive) impact of the construction sector and the fiscal illusion hypothesis. Most controversially, our evaluation of the management modes seems to indicate that the indirect modes of public management adopted by local councils do represent attempts to escape from the rigid corsets that administrative legislation set out.

Keywords: Politics, Public Choice, Local Government Management, Municipalities, Local Finance.

JEL Codes: H7, H11, H83.

1. Introduction

The interrelations between politics and the economy has given rise to the fruitful field of *Political Economy*, one of the goals of which is to analyse the economic factors that influence the way people vote, as well as to determine the political factors and social organizations that influence the economic decisions taken by the public sector. The manifest concern of public opinion for economic affairs is made apparent each time a survey is reported by a specialist body. Such surveys show that voters, without losing sight of the importance of

* We wish to thank Pilar Sorribas (University of Barcelona), participants at the *XX Encuentro de Economía Pública* (University of Sevilla, 2013) and the *I Jornadas Iberoamericanas de Financiación Local* (Toledo, 2011) for insightful comments. The authors also acknowledge support from grant 2009SGR102 (*Generalitat de Catalunya*) and from projects ECO2012-37131 and MINECO-13-CSO2013-43359-R (Ministry of Economy and Competitiveness). Usual disclaimers apply.

other areas of public affairs, are concerned primarily with the state of the economy when they declare their voting intentions. Thus, voters will express varying degrees of support for the prevailing level of fiscal pressure and the tax structure, for the measures adopted by the government to address unemployment and the financial crisis and for directives to review wage policies.

Political economy suggests that the expected outcomes of actions taken by public agents (politicians and bureaucrats) in the economic area are far from being exogenous and unlikely to depend exclusively on the taxpayers-voters will. It is perhaps easier to believe that these outcomes are more specifically determined by these agents maximising behaviour and their attempts at balancing private objectives that are not always compatible with their presence in the “political market”. For example, it can be claimed that politicians seek power and once they attain it simply want to hold onto it, while bureaucrats seek the best working conditions, prestige, high salaries and influence, etc. At the same time, voters select the combination of public and private services that maximises their level of utility. As such, there is no reason as to why these different objectives might be achieved by adopting the same measures.

Moreover, asymmetry in the distribution of information between the various agents tends to cause imperfections in the “political market”, the main consequence of which is likely to be the exploitation of certain monopoly powers by those who enjoy a position of comparative advantage.

This study undertakes an analysis of the Spanish local governments from the perspective of public choice. To do so we examine a set of hypotheses emanating from a theoretical analysis conducted with a sufficiently broad sample of medium-sized and large Spanish municipalities.

The fact that this study is carried out in the local environment is of particular interest for three basic reasons. First, this is the nearest level of government to the citizens, who are therefore better able to keep a closer watch on politicians and acquire more accurate information about their actions. As a result political responsibility, or accountability, is fostered. Indeed, one of the arguments forwarded by political economy in support of the decentralization of government or political power (Lockwood, 2006) is the boost it represents to accountability, since the rent-seeking activities of politicians fall under stricter control. This increase in citizen participation encourages a rendering of accounts and with it increased government efficiency. Persson and Tabellini (2000) and Hindriks and Lockwood (2005), for example, show how the degree of electoral control enjoyed by voters differs between situations of centralized and decentralized government, while Fisman and Gatti (2002) report that fiscal decentralization results in less corruption.

Second, a focus on the local environment allows us to examine the way in which relations with higher levels of government might influence the decision-making of local government. And, third, the study of local governments is of interest simply because of their

number (well above that of government entities operating at other levels of the public administration), a fact that is of particular advantage when conducting empirical analyses.

Specifically, the hypotheses we seek to test here take as their points of reference modes of public management, the possible use of financing instruments that generate *fiscal illusion* and the influence of certain pressure groups on the size of the municipal budget. We work with a sample of 140 Spanish municipalities with more than 50,000 inhabitants for the period 2002-2010.

The following section examines how these explanatory factors of expenditure –bureaucratic behaviour, institutional modes of management, interest groups and fiscal illusion– have been dealt with in the literature. The third section presents the empirical model and describes the sample and the variables used. In the fourth section the results are presented and the last section presents a set of conclusions.

2. Literature review

2.1. Bureaucracy and institutional modes of management

Since Niskanen (1971), a trend of thought has been developed, which supposes that civil servants or bureaucrats are not neutral in the activities they undertake in the public sector, but rather that they act in accordance with their own interests, seeking to maximise a set of factors (salaries, prestige and power) that are positively related to the size of the budget. There have been numerous subsequent contributions on the behaviour of bureaucrats. So, we can highlight Migué and Bélanguer's (1974) study, which concludes that bureaucratic behaviour gives rise not only to allocative inefficiency (as opposed to optimum production), but also to cost inflation. A more recent contribution, Bendor and Moe (1985), has shown bureaucratic power from a new perspective, while a more extensive review of the theoretical literature is to be found in Rodríguez and Suárez-Pandiello (2003).

Empirical evidence in relation to bureaucratic behaviour at the local level has been found in support of this bureaucratic hypothesis. For example, Spann (1977) attributes a good part of the relative losses in productivity suffered by sub-central American entities to such behaviour; Romer and Rosenthal (1982) find a bureaucratic explanation for increases in the educational material budget in Oregon's school districts, and Chang and Turnbull (2002) show how the utility of the bureaucracy behaves as a growth function in employment in all the functions of government and local public expenditure.

In Spain, two empirical analyses of the bureaucratic hypothesis have been undertaken: Monasterio and Suárez-Pandiello (1989) and Bosch and Suárez-Pandiello (1993b). In the first analysis, although the variable representing bureaucracy is not perfect¹, it is significant and it does provide explicit support for the bureaucratic hypothesis. Bosch and Suárez-Pandiello (1993b) test the decentralization hypothesis propounded by Brennan and Buchanan

(1980) according to which decentralization provides incentives for competition and limits the expansion of the public sector, by testing a hypothesis “*a contrario sensu*”. They show that the multiplication of bureaucratic structures associated with decentralization can increase the size of the public sector rather than reduce it. Their findings are in line with the bureaucratic hypothesis and as such contradict Brennan and Buchanan’s decentralization hypothesis.

A further field that has attracted research attention is that of the modes of management of public services, that is, modes of direct and indirect management. The former can be conducted through the municipal entity itself or through autonomous organizations and local public companies that depend on it. The latter, on the other hand, involves the establishment of a management contract (the best-known form of which is the concession), whereby the municipality entrusts the provision of a public service to a private person or concessionaire for a certain period of time and they, in return, receive the payment of a tariff from the users of the service. It is expected that bureaucratic behaviour will have a greater influence on the results in the direct mode. A fuller explanation of both modes can be found in García Valiñas and Suárez-Pandiello (2006).

Many studies have examined whether the externalization of the management of public services is efficient. For example, Domberger and Jensen (1997) found that when contracting out competition was introduced into the public sector, savings were made in the provision of public services. More recently Ohlsson (2003) has shown that the costs of the public production of refuse collection in a sample of Swedish municipalities were 6% lower than under private production. Brudney *et al.* (2005), who analysed the externalization of public services in the American states through state agencies, found that in 50% of cases externalization improved the quality of the service but barely one-third of the agencies reported cost reductions.

In Spain, Bosch *et al.* (2000) found no evidence to indicate that the private production of local refuse collection (externalization by concession) is more efficient than public production. However, the data used has certain limitations, failing to provide information about the mode of public management (whether it is delivered via the municipality itself, independent organizations, or public companies) and about the administrative conditions of the concession. A further study of the Spanish case is provided by Bel and Miralles (2003) in which the authors analyse whether the externalization of the refuse collection service is undertaken for ideological reasons. Their results, however, show that the decision is more usually taken for pragmatic reasons.

It is not always the case that decentralized modes of management are adopted to improve efficiency. There are occasions on which this objective is not easily separated from others that are intrinsically political, due to the particular goals of politicians and bureaucrats. This is the case of the recent proliferation of autonomous organizations, foundations and public and/or mixed companies created by many public administrations in Spain in response to the directive on budgetary stability restricting their borrowing capacity. This phenomenon has

been analysed with respect to Spain's regional governments by Fernández Llera and García Valiñas (2013) and their results support the existence of this type of behaviour. The studies of Fernández Llera (2005) and Cuadrado and Carrillo (2008) reach similar conclusions. Anyway, the public private partnership approach is controversial and it is possible to identify several problems with it (Kakabadse and Kakabadse, 2001).

2.2. Interest groups

Olson's (1965) pioneering study of interest groups and their influence on public budgets has generated many theoretical and applied studies. Mitchell and Munger (1991), for example, conducted a review of the literature examining how interest groups influence politics in democracies and how government institutions should be designed to control these groups².

In Spain, Bosch *et al.* (2000) have examined whether the degree of commercial activity in Spanish municipalities (which determines the strength of retail associations) has any influence on the efficiency with which public services are provided. A positive relation was found between efficiency and commercial activity, pointing to greater control being exercised by retailers over local government, thus fostering efficiency. As such, the hypothesis that the activity of interest groups results in less efficient behaviour was not verified. However, a negative relation was found between the level of tourist activity and efficiency in the provision of local public services, reflecting the fact that entrepreneurs in this sector are likely to undertake rent-seeking activities or that tourism generates seasonal congestion costs.

2.3. Fiscal illusion

Collective choice theory holds that individuals can make an efficient fiscal choice, correctly evaluating their various alternatives, insofar as they can attribute the real cost to the price/tax they have to pay. Hence, they can identify a direct relation between their tax payments and the benefits they can expect to obtain from public expenditure. However, this relation becomes increasingly indirect as the tax structure affects the way in which the alternatives are perceived. Thus, an individual's perception can be distorted by their fiscal illusion, causing them to falsely identify the alternatives available to them. In other words, fiscal illusion arises as a consequence of the way in which the individual perceives the costs or the benefits of the various alternatives, which are falsely identified, generally underestimating public service costs.

At the turn of the last century, Puviani (1903) made a fundamental contribution developing his theory of fiscal illusion. Yet, it was not until the 1960s that Buchanan (1967) promoted further studies in this area. Both authors mention that certain types of fiscal illusion

can be produced depending on the structure and nature of the fiscal institutions. The fiscal illusion thus generated can be grouped into two basic categories: the illusion that arises from connecting tax obligations to events that the taxpayer considers favourable and that which arises from hiding the charging of taxes. For example, the first category would include taxes on inheritances or donations or taxes related to gambling. Indirect taxes, such as a general consumption tax, would be included in the second category. These are camouflaged in the price of goods, which means the taxpayer is quite unaware of the quantity of tax paid and even, in many cases, of its very existence. This concealment of tax payments causes people to underestimate the cost of public services.

Other types of public financing that can give rise to fiscal illusion include intergovernmental transfers and borrowing. In these instances, the fiscal illusion is created because individuals do not perceive clearly how they participate in the financing of public services.

More recent studies in this field include Mourao (2008), who compiled a fiscal illusion index for 68 countries between 1960 and 2006. At the local level, Islam (1998) provides some evidence that the subsidies received by the local governments create fiscal illusion. On the other hand, Worthington and Dollery (1999) do not find support to the existence of the fly-paper effect resulting from subsidies to Australian municipalities, while Campbell (2004) studied the phenomenon of fiscal illusion and Leviathan behaviour in overlapping local jurisdictions, supporting the hypothesis of fiscal illusion³.

Bosch and Suárez-Pandiello (1993a, 1994, 1995) and Bosch *et al.* (2012) examine the phenomenon of fiscal illusion in relation to local government financing in Spain. In a sample of Spanish municipalities they present empirical evidence of the fact that local taxes that are hard to perceive together with subsidies cause fiscal illusion. Similarly, García-Alegre and López-Casasnovas (2006) analyse how, among a group of Catalan municipalities, fiscal illusion can arise by a confusing accounting system.

3. Empirical analysis

In this empirical analysis we want to test whether the expenditure of Spanish local governments is affected by the three factors summarized in the previous section: 1) public service management modes (i.e., direct modes, by employing their own civil servants or municipal employees, or indirect modes, by creating *ad hoc* organizations or resorting to externalization); 2) the pressure brought to bear by certain interest groups in the planning of the municipal budget and 3) the structure of their financing (the degree of perceptibility of their revenues in the eyes of the population)

The equation to be estimated is the following one:

$$E_{it} = \alpha_1 + \alpha_2 RT_{it-1} + \alpha_3 RC_{it-1} + \alpha_4 FC_{it-1} + \alpha_5 Ex_{it-1} + \alpha_6 CG_{it-1} + v_i + u_{it}$$

where

E is the total non-financial expenditure per capita in municipality i at year t ;

RT are the revenues obtained by the municipality from taxes that are clearly perceived by the taxpayers;

RC represents an approximation of the impact of the construction sector on the local budget;

FC is an index that reflects the weight of financial charges for interest and amortization of the principal on the municipality's current account income;

Ex is a variable that approximates the level of externalization of public services supplied by the local council;

CG are the per capita current grants received by the municipality. The sub-index i and t represent the identification of the municipality and the year of the data, respectively.

α_i are the parameters to be estimated; and

$v_i + u_{it}$ is the value of the residuals. Specifically, v_i only captures variations between units (differences between units, but its value is constant for each). In itself $u_{it} = v_i + e_{it}$ is the residual with the usual econometric properties (zero mean, uncorrelated with the independent variables and with v and homoscedastic), which in turn comprises two components – the variation in time (v_i) and the standard residual.

The equation is estimated by ordinary least squares and fixed effects (appropriate data panel specification according to the Hausman test). As Veiga and Veiga (2007), all the explanatory variables are included with one lag in order to avoid their potential endogeneity. Given the persistence of the public expenditure pattern, a lag of the expenditure is included as an explanatory variable. This lag would be correlated with the error term, making OLS estimator biased. To overcome this problem the Generalized Method of Moments (GMM) developed by Arellano and Bond is used. All the specifications include time dummies.

3.1. Variables

Up to this juncture we have been unable to obtain detailed information for certain variables that must be deemed important. Consequently, we have had to accept the use of approximations that are fairly rough and ready for our purposes and for this reason our results must be treated with a certain degree of caution.

Specifically, the Ex variable, constructed to test the effects of the different management modes, is defined as the relation between expenditure on *employees* (Chapter 1 in the expenditure budget) and expenditure on *materials, supplies and others* (Chapter 2, paragraph 22 in the expenditure budget, which includes the outsourced services by the local government) for each municipality and year. As the value of this variable increases, we expect to find a greater

proportion of local expenditure being managed directly by the municipality itself. In contrast, a low value should be indicative of a more intensive externalization of the services that are the competence of the municipality. Moreover, we would have liked to test the bureaucratic hypothesis (using, for example, the number of workers providing a service for the municipalities) and the modes of management separately (using as a variable, for example, the proportion of the municipal budget that is managed indirectly, or even the number of decentralized bodies involved in the management). We do not rule out performing such an exercise in the future but to date a lack of data prevents us from doing so. As for the expected sign, there are two alternatives: a positive sign would indicate that in municipalities in which direct management predominates, total expenditure is greater and, consequently, it can be deduced that those who have externalized their management have done so in pursuit of efficiency via cost-savings; alternatively, a negative sign would support the hypothesis propounded by Fernández Llera and García Valiñas, whereby the externalization of management can be seen as an instrument for avoiding the restrictions imposed by the budgetary stability directive.

The variable *RV* has been approximated using the proportion of the ordinary income of each municipality and for each year that the cash tax revenue from the recurring taxes most directly perceptible by citizens represents (namely, the property tax, vehicle tax, and water, refuse collection and sewage disposal rates). We have therefore omitted those taxes most susceptible to being transferred, *a priori*, to persons other than to the taxpayer (as is the case of the tax on economic activities) and those taxes that are not homogeneously distributed over time because of their sporadic (for the taxpayers) nature, even when they are collected every year by the municipalities (such as optional taxes on construction and building work and taxes on the increase in the value of urban building land). Certainly, this variable is not a perfect proxy because the tax collection includes two components (tax capacity and tax effort) and only the second is under direct control of local authorities. However we think that this little bias may be assumed for our purposes. A negative sign for the coefficient of this variable would confirm the fiscal illusion hypothesis in the sense that it would mean, conversely, more expenditure in those municipalities in which there is a more intense use of financial instruments that are less perceptible to citizens, such as intergovernmental transfers or taxes that are easy to hide.

To test the effects of interest groups, we selected at the outset what we considered to be two, *a priori*, relevant sectors: first, construction, which is highly dependent on regulation by local governments; and, second, hotels and restaurants, also closely tied to a specific area⁴. Here again, however, a paucity of information has forced us to be modest in our assessments. Our main objective in selecting variables was to use those that could capture the relative weight of both sectors (separately) in the economic activity of each area. However, because of the absence of reliable data on municipal production and income, and more specifically on decentralization by branch of activity (this being exacerbated by the new regulations on the tax on economic activities, which removed fiscal control from many activities), we were once more forced to use a rather imperfect proxy variable. Thus, in this initial approach, we opted not to study the hotel and restaurant sector, while to evaluate the construction sector we elaborated an *ad hoc* variable based on fiscal data. The variable *RC* is defined as revenue collected per inhabitant in each municipality of a set of taxes directly associated with activity in construction and public works. These taxes are the tax on construction, installation and

public works and the tax on the increase in the value of urban land, as well as rates and public charges for public works licences, charges for urbanization and the use of urban areas and special contributions. A positive sign for the corresponding coefficient would confirm the importance of this economic sector for the municipal budget.

Furthermore, we included an additional variable to test, at least tentatively, the degree of “responsibility” characterising the political conduct of those in local government. Thus, we included the variable *FC*, which measures the portion of current account revenue that is assigned to servicing incurred debt (interest and amortization of the principal). A negative coefficient would imply that the government was restricting expenditure because of increases in debt charges, which would support the hypothesis of responsible behaviour.

Finally *CG* are included as control variables given their important weight in the municipalities’ revenues, as well as time effects.

Table 1

**SUMMARIZES THE ABOVE INFORMATION ABOUT HYPOTHESIS, VARIABLES
APPROACHING THEM AND EXPECTED SIGNS**

HYPOTHESIS		VARIABLE PROXY	EXPECTED SIGN
Fiscal Illusion	<i>RT</i>	(Revenues from property tax + vehicle tax + water, refuse collection and sewage disposal rates)/Current revenue	-
Interest Groups	<i>RC</i>	Revenue collected from a set of taxes directly associated with activity in construction and public works per capita	+
Financial Responsibility	<i>FC</i>	Portion of current account revenue that is assigned to servicing incurred debt	-
Modes of Management	<i>Ex</i>	Relation between expenditure on employees and expenditure on materials, supplies and others	?

3.2. Sample

To estimate our model we initially drew on a sample comprising a panel of 140 Spanish municipalities (all of those with a population of over 50,000 inhabitants in 2010) for the period 2002 to 2010.

Table 2
REPORTS OUR DESCRIPTIVE STATISTICS FOR 2002 AND 2010
(THE FIRST AND LAST YEARS IN THE SAMPLE)

	Maximum			Minimum		
	2002	2010	% Δ	2002	2010	% Δ
Pop	3,016,788	3,273,049	8.49%	21,488	51,177	138.17%
E	2,166.61	2,871.77	32.55%	451.51	519.84	15.13%
Ex	0.736	0.542	-26.36%	0.025	0.030	20.00%
RT	411.14	225.72	-45.10%	4.10	0.70	-82.93%
RC	82.270	43.013	-47.72%	0.026	0.583	2,142.31%
FC	3.249	11.079	241.00%	0.212	0.523	146.70%
CG	552.83	1,352.57	144.66%	149.36	146.35	-2.02%
	Average			Median		
	2002	2010	% Δ	2002	2010	% Δ
Pop	154,750	170,745	10.34%	79,691	88,284	10.78%
E	780.25	888.19	13.83%	711.03	829.41	16.65%
Ex	0.395	0.309	-21.77%	0.395	0.303	-23.29%
RT	81.73	32.22	-60.58%	63.48	23.16	-63.52%
RC	12.394	8.649	-30.22%	11.335	8.107	-28.48%
FC	1.388	2.401	72.98%	1.297	1.795	38.40%
CG	222.30	284.83	28.13%	193.84	237.24	22.39%
	Standard deviation			Coefficient of variation		
	2002	2010	% Δ	2002	2010	% Δ
Pop	292,593	313,454	7.13%	1.891	1.836	-2.91%
E	281.25	306.44	8.96%	0.360	0.345	-4.17%
Ex	0.104	0.091	-12.50%	0.263	0.296	12.55%
RT	62.74	31.78	-49.35%	0.77	0.98	27.27%
RC	8.184	5.002	-38.88%	0.660	0.578	-12.42%
FC	0.497	1.647	231.39%	0.358	0.686	91.62%
CG	78.54	143.47	82.67%	0.35	0.52	48.57%

If we inspect the columns illustrating the temporal development of the figures, the first thing we notice is that the population is highly dispersed, even though, it is limited (as is the sample) to the most highly populated municipalities. In fact, according to 2010 figures, only two municipalities had populations greater than one million inhabitants (Madrid and Barcelona) and only four had more than 500,000, while 83 had fewer than 100,000.

The variable representing the institutional structure, *Ex*, also shows this to be highly dispersed, with a trend, moreover, that is negative. This points to overall advances in the process of externalizing services.

As for the remaining variables, we can note the high variability of the variables *RT* and *RC*. *FC* seems more volatile. This can be explained by the fact that from 2008 on the effects of the economic crisis had already begun to appear, having an especially significant impact on the construction sector, reflected in the evolution of financial charges, which show a negative trend.

4. Results

Table 3 show the results of the analysis conducted for three alternative estimations: ordinary least squares, fixed effects (appropriate data panel specification according to the Hausman test) and Arellano-Bond GMM, run in order to avoid possible problems of endogeneity. In all cases we used the total non-financial expenditure per capita as a dependent variable and the continuous variables were used in logarithmic form and the explanatory variables have been lagged a year.

All the specifications gave results aligned with the hypothesis to be tested, and so we believe we have found interesting results which in any case should be supported by further research.

A more specific inspection shows that the negative signs of the coefficients of the variable representing the management modes (*Ex*) seem to serve as proof (or at least an indication) that the indirect modes of public management adopted by local councils have generated an increase in costs (i.e., the municipalities in which expenditure on employees predominates over the externalization of services spend relatively less). Thus, our data results allow us to conclude that these modes are being used to escape administrative control and strict budget restrictions along the lines forwarded by Fernández Llera and García Valiñas (2013) or that they include a certain multiplication of parallel bureaucratic structure factors as Bosch and Suárez Pandiello (1993b) suggested in reference to another area.

Nevertheless, we cannot say anything conclusive about the analysis of the variable *FC*. The negative coefficient sign provided by estimations could mean a certain degree of support for the evidence that Spanish municipalities have behaved responsibly insofar as when the weight of financial charges for incurred debt rises a contraction of expenditure seems to become apparent in order to avoid a certain snowballing effect. However the t values for the coefficients are not big enough to consider that effect statistically significant.

The fiscal illusion hypothesis is upheld by all the specifications proposed, given the negative and statistically significant sign presented by the relevant variable, *RT*. As the budgetary weight of those taxes that are clearly perceived by the citizens rises, per capita expenditure falls.

Finally, the positive and highly significant sign of the variable *RC* is indicative of the marked impact of the construction sector on municipal budgets, although this claim needs to be tempered given the nature of the proxy variable employed.

Table 3
RESULTS

Dep Var: LogEt	(1)	(2)	(3)
	OLS	Fixed effects	GMM A-B with L=2
	N = 1126	N=1126	N=1122
$\log RT_{t-1}$	-0.144*** (-4.82)	-0.0699*** (-3.40)	-0.540** (-3.07)
$\log RC_{t-1}$	0.176*** (8.78)	0.0545*** (3.55)	0.448*** (3.36)
$\log FC_{t-1}$	-0.0127 (-0.61)	-0.0178 (-1.55)	-0.0707 (-1.78)
$\log EX_{t-1}$	-0.0883** (-2.68)	-0.148*** (-5.92)	-0.214*** (-5.71)
$\log CG_{t-1}$	0.214*** (3.73)	0.0380 (0.96)	0.119* (2.14)
$\log E_{t-1}$			0.00315 (0.02)
Cons	4.814*** (14.45)	6.371*** (27.19)	4.104*** (5.97)
R ²	0.3835	0.2581	
F	58.57***	50.56***	
σ_v		0.1980	
σ_u		0.1378	
ρ		0.6738	
Arellano-Bond test for AR(1) in first differences:			z = -5.24 Pr > z = 0.000
Arellano-Bond test for AR(2) in first differences:			z = 1.42 Pr > z = 0.156
Sargan test of overid. restrictions:			chi2(6) = 25.45 Prob > chi2 = 0.000

t statistics in parentheses * p<0.05, ** p<0.01, *** p<0.001

5. Summary and Conclusions

The essential goal of this paper is to explore the possible relations that exist between economic and political factors in Spain's institutions of local government. Specifically, in this paper we have explained the behaviour of medium-sized and large Spanish municipalities in relation to modes of public management (directly, through their own civil servants or municipal employees, or indirectly, through the creation of *ad hoc* organizations or through externalization), the possible use of financing tools that generate fiscal illusion and the in-

fluence of certain interest groups on the size of municipal budgets, between 2002 and 2010, a period that combines both, years of affluence and some final years when the current crisis had already appeared with all its ferocity at the local level.

Unfortunately, owing to problems of data availability, we have not had access to all the statistical information necessary to evaluate our hypotheses more conclusively, especially with regard to the management modes and the impact of interest groups on municipal budgets. This inevitably means that our results should be viewed with a degree of caution, although most are in line with previous findings in the literature.

The (expansive) impact of the construction sector is a robust result of the estimations carried out here. However inconclusive outcomes can be found about the attitude taken by municipal governments when they see a rise in the servicing of the debt they have incurred. The negative sign of the representative variable could point towards the “responsible” behaviour of local leaders, but the parameter is not statistically significant. As for the fiscal illusion hypothesis, the significance of the negative coefficients in all the estimations carried out seems to support its effects.

Finally, and most controversially, our evaluation of the management modes seems to indicate that the indirect modes of public management adopted by local councils do represent attempts to escape from the rigid corsets that administrative legislation and, in particular, the directive on budgetary stability have placed upon the managers of local affairs, as is often suggested. Our results suggest that externalization did not serve to reduce costs, or conversely that local councils that have done at least by way of adopting methods to decentralize expenditure spend relatively more per capita. However, we are aware that the model’s implicit assumptions are great in this respect, and so further study is indispensable before these results can be considered conclusive.

Notes

1. The variable used is (Expenditure on employees/total expenditure) • (N.º of councillors).
2. It should also be mentioned for their contributions Winden (1999), Epstein and Mealem (2009) and Horgos and Zimmermann (2009). At the local level, see Browne (1978), Menzel (1990), and Cooper *et al.* (2005).
3. Other studies to be mentioned are Wagner (2001) and Cohen and Percoco (2004).
4. We can’t test the second group because the lack of available information.

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Resumen

Este trabajo analiza la conducta de los gobiernos locales españoles desde la perspectiva de la teoría de la elección pública. Se examinaron un conjunto de hipótesis a partir de un análisis teórico que incluye modos alternativos de gestión pública, la posible utilización de instrumentos financieros que generen ilusión fiscal y la influencia de ciertos grupos de presión en el tamaño del presupuesto municipal. Trabajamos con una muestra de 140 municipios españoles con más de 50.000 habitantes para el período 2002-2010.

Nuestros resultados apoyan la presencia de un impacto (expansivo) del sector de la construcción y la hipótesis de ilusión fiscal. Lo más polémico puede ser que nuestra evaluación de los modos de gestión parece indicar que los modos indirectos de gestión pública adoptados por algunos gobiernos locales pudieran estar representando intentos de escapar de los corsés rígidos que establece la legislación administrativa.

Palabras clave: Política, Elección Pública, Gestión de los Gobiernos Locales, Municipios, Financiación Local.

Códigos JEL: H7, H11, H83.