

Urban Governance in times of fiscal stress: muddling through efficiency and democracy

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FIRST DRAFT

Recent worldwide financial crisis puts local governments under sever stress to change and reshaped their strategy, attitude and commitments to citizens in order to control spending patterns. Cutting-back services, breaking contracts, rethinking welfare and additional austerity measures are a worldwide path that local governments follow to handle financial adversities. In this trouble times, although keeping in mind the need to ensure the basic conditions for local government to perform its functions and the capacity to implement them, several actors struggle to reshape urban governance, according to their preferences (Pierre 1999). Political parties, unions and interest groups are joined by engaging citizens and aggressive media to build new forms of social ties (Clark 2000). The way in which rules, values and behaviors are established can alternate the equilibrium between the elements of urban governance forcing a change in kind and nature. Oscillations occur in a democracy-efficiency *continuum* promoting four alternative forms of urban governance: autocratic efficiency, democratic inefficiency, democratic efficiency and autocratic inefficiency (Waldo & Miller 1948; DiGaetano & Strom 2003; Norris 2012).

The goal of this paper is to analyze the different divers that constrain the settings of urban governance. The paper claims that urban governance is the grass root for a compatible combination among civic engagement, political responsiveness and efficient mechanisms of service delivery. The main hypothesis of the paper suggests an optimal level of democracy translated into an invert U-shape relation between democracy and efficiency.

Using a quantitative approach, the paper collects data from all Portuguese local government and builds two set of indexes to test the hypothesis. Findings confirm the supported argument and contribute to some clarification on the interaction between democratic procedures, and managerial initiatives to achieve higher standards of democracy.

INTRODUCTION

The idea of trade-off between democracy and efficiency goes back to Waldo's work (1948) and it's a recurrent topic in academic works albeit shaped under different covers. It has been called as a tension between technical knowledge and peoples' will, between discretionary power and legitimacy or an altercation between bureaucracy and civic culture or yet, a trade-off between local voice to diversity, accountability and political responsiveness and a premium concern with structural efficiency (Overeem 2008; Dollery 2010).

Basically the argument is the same, politics and administration are two parts of the same world that imposes hard restrictions on each other but need to be balanced as two sides of the same coin (Waldo & Miller 1948; Svava 2008). The argument believes that increasing the size of democracy will undermine the ability to act efficiently. The key difference between sides relies on the decision making process. While administration efficiency relies on the discretionary power of bureaucrats and their expertise, democracy rather trust on popular judgment. Ultimately, the former believes on the ability of technical knowledge to deliver an efficient outcome whereas the later tend to enroll popular legitimacy of decision.

In times of financial distress, the pressure for managerial efficiency is overwhelming. Although difficult, if not impossible by definition, to imagine a democratic system striped of elections, party competition and active civic participation, the fact is that this democratic system is at the edge of a financial breakdown that challenge the ability of governing structures to comply with their mission. The need to balance public finances and control the size of public debt makes it easy to consider civic participation and active citizenship as disposable, or at least a non-mandatory procedure. Bureaucrats use the argument "that people can't eat democracy" (Norris 2012) and need an administration that takes accurate and timely decisions. They believe that the legitimacy of their decisions comes from its technical superiority instead of popular approval. However, at least three remarks can be made to this argument. One is that bureaucrat decision making process can also be capture by interest group, losing its ability to comply with the common good. Second, decisions tend to be too much focus on

technical aspects and devoid of any social sensitivity, having the risk to jeopardize social cohesion. Third, as a consequence of their alienation, citizens find it hard to comply with public decisions.

This classical argument of a trade-off between democracy and efficiency has been tested by several academics, in numerous contexts. After comparing countries and political regimes Gasiorowski (2000) claim that democracy tends to lead to higher inflation rates and slower economic growth, due to larger fiscal deficits. Besley *et al.* (2006) achieved to establish a positive relation between democracy, health and welfare. Skelcher (2007) focuses on mechanisms of participation as a way to measure democracy and advocate a direct relation between accurate levels of civic participation and organizational performance. While most works look to the effect of democracy on performance, Vigoda (2002) seeks to assess the opposite. His work confirms the direct and indirect effects of different levels of public sector performance on civic engagement. Recently some works focus on an alternative approach using the combination of democracy and efficiency. Evidence of such was found in Australian structural reform of municipality's consolidation. While Boyne (1992) argued the need to focus on democracy contrasting to the Aulich (2005) efficiency believes, Soul and Dollery work supports the view of a no trade-off between local democracy and efficiency (2010). More recently, the work of Norris (Norris 2012), based on a unified theory, stated that democratic governance can boost prosperity, welfare and peace in developing countries.

This paper contribution to the literature relies on the approach to this issue combining two dichotomy approaches. Waldo (1948) and Norris (2012) argue a linear relation between democracy and efficiency, where both are mutually exclusive. Waldo argument goes on with the major drawbacks that democratic procedures represent to efficiency objectives that is, increments in democratic measure will challenge the ability of managerial decision to be efficient. Whereas Norris arguments acts in the opposite direction stating that increases in democratic measure will drive government to higher efficiency standards. Combining the two arguments, this paper argues a non-linear relation between democracy and efficiency. Thus, increases in the degree of democracy will endorse higher levels of efficiency until a moment where additional democracy will undermine efficiency standards. Urban governance is the key factor that enables a

plausible equilibrium between democracy and efficiency, by boosting social capital, ensuring institutional structures and appropriate governance agreements to service delivery urban governance can ensure transparency, control, civic voluntary compliance, *ie*, assures democracy responsiveness along with efficiency standards. In this sense, this research employs data from Portuguese municipal governments to address the effect of democracy on efficiency. Using the indexes of democracy and efficiency the paper suggests that there is an optimal level of democracy translated into an invert U-shaped relationship between the index of democracy and the index of efficiency.

Using tobit regression the paper's hypothesis was tested the relation between indexes and found evidences that the relation between democracy, and efficiency is non-linear and has an invert U-shape.

This paper is organized as follows. First, the paper introduces the literature on urban governance as the setting pieces between democracy and efficiency. Then the paper presents the interaction among them. Section two discusses the operationalization of democracy and efficiency indexes. Section three describes the research context which is followed by the section of the data and methods employed in the empirical analyses. The findings are discussed in section five. The article closes with the conclusions and policy implications of this investigation.

URBAN GOVERNANCE

Urban governance is the playground where democracy meets efficiency. Urban governance can be analyzed through structural, cultural and rational glances (DiGaetano & Strom 2003). The structural approach sees it as a market interaction of governmental power and private resources. Cultural perspective includes a broader range of actors in a new political culture. Political parties, unions and organized groups are replaced by citizens, media and outside expertize and urban governance is the place where they exchange values and create social ties (Clark 2000). Rational perspective, grounded on public choice and regime theory, conceives it as informal arrangements by which public bodies and private interests function together in order to be able to make and carry out governing decisions (DiGaetano & Strom 2003). Despite some differences, an integrative perspective defines urban governance as a coalition process of community based actors to

consolidate a collective strategy about local economy and social development (Bramwell 2012; Laurila 2004; Stone 1993). It is a process through which authorities, in concert with private interest, seek to enhance collective goals. It is shaped by political, economics and social values that confer legitimacy to political choices and ensure state capacity to comply (Pierre 1999:374). The overall objective of urban governance is to achieve two main goals: to ensure the basic conditions for local government to perform its functions and, secondly, to ensure local government the capacity to implement the needed public policy.

The way in which rules, values and behaviors are established can shape urban governance in kind and nature. Pierre (1999) argues that urban governance shape shift from managerial to corporatist, progrowth and welfare depending on their objectives, participants, instruments and outcomes. DiGeetano and Strom (2003) propose five modes of governance: clientelistic, corporatist, managerial, pluralist and populist based on governing relation, logic, key players and political objectives. Acknowledging the differences between above models, all classifications respond to Waldo's argument of a trade-off between democracy and efficiency and can be joined up in two large and wide groups, as presented in table 1.

[Table 1 here]

The two groups represent the extremes of a democracy-efficiency *continuum*. Local governments are expected to accomplish this two opposite functions: to voice local aspirations; and to provide a mechanism for efficient service delivery (Dollery 2010). As such, an urban governance that follows the path of democracy, seeking deeper integration and sharing power with citizens, will lose, along the way, the ability to be efficient. Oscillations between the kinds of urban governance vary with the intensity in which each element is felt and needed (Hendriks & Tops 2002). No democracy can survive if the government does not have capacity to ensure the basic set of rules and public services. However, no expectations of prosperity are sustainable if strip of popular engagement and legitimacy (Thomas & Memon 2007). Thus, urban governance is traditionally understood as a search for as equilibrium between the trade-offs of democracy and efficiency.

Schumpeter (2010) defines democracy using a very minimalist notion. Following his definition, democratic regimes are those governments elected under a competitive

election. The definition is not incorrect but the truth is that it is the thinness notion of democracy. To be faithful to this notion one must assume that all democratic regimes are equal since they all are the result of an electoral process. However, it may be hard to cope with this idea when comparing regimes inclusive of citizen's opinions with ones that confine the civic interaction to the electoral process at the end of each term. It is, at least, awkward to argue that, in this case, we are facing the same kind of democracy. At least, two additional layers of democracy can be identified besides the competitive multiparty system election. One is the direct democracy. That is, a democracy that seeks to establish a frequent link to its community to enroll citizens in political process as a way to increase legitimacy of the political decisions (Yang & Callahan 2007; Knutsen 2010; Handley & Howell Moroney 2010). Another level deals with the institutional agreement to avoid asymmetric information. The role that media play is a basilar essence of democracy. Their action promotes the dissemination of information within a competitive multiparty system making accountability increase over political decision.

Three major positive outcomes can be drawn from the effects of democracy on efficiency. A democratic system close to citizens will provide an accurate representation of constituents' preferences and attitudes (Copus 2003). Political competition drives politicians to good performance since it is a mechanism of punishment that identifies and eliminates incompetent agents. Finally, democracy brings transparency and accountability to political decision-making and implementation. Accountability will make elected officials more responsive to citizen's demands in a vote-seeking perspective (Norris 2012), while transparency gives citizens a better judgment over political actions. Adam *et al.* (2011) argue that civic engagement and governmental transparency control political opportunism of increase budget slack in the production of public goods.

However, democracy has also some drawbacks to efficiency. Being responsive to citizens and allowing them to fully accomplish their preferences, may have unbearable consequences to the best interest of all. Each citizen tends to overlook their preferences claiming their importance over the others. Each will be motivated to ask for more services increasing overall spending but internalizing only part of the cost, in a pork barrel strategy (Weingast *et al.* 1981). Elected official, in a vote-seeking strategy, will be tempted to comply. This may lead to a situation of financial unsustainability that they will

have to solve. However, political agents find hard to approve and comply with bills that impose restrictions on themselves and on their electoral support (Gasiorowski 2000). Political agenda also play a major role damaging efficiency. The foundation of political cycles (Nordhaus 1975) and median-voter (Downs 1957) arguments work in the same direction, that elected officials have a specific and very own meaning of efficiency driven by political self-interest issues rather than economic and financial ones.

Excessive expenditures, painful tax levels and mistrust in elected officials stressed the need to focus on a scheme to pull efficiency in public services (Pierre 2009). Urban management's orientation is pushed forward to the concern of financial issues. Reform agenda tend to adopt strategies to reduce fiscal stress at any cost, even if it means to reduce the level civic participation on the decision-making process. The managerial approach comes to dominate democratic dimension since it believes that no significant cuts will be possible without some restrictions being placed on the ability of residents to participate in these decisions. Efficiency gains become an imperative to avoid fiscal stress and to prevent public entities to run out of money. Otherwise the consequences of a financial breakdown could spread over and have a contagious effect jeopardizing the ability of public agents to provide the needed services to citizens. Efficiency is perused by two alterative strategies: rather it focus on in-house management improvement solutions, rather it trusts third party capacities using externalization of services. As a result of the first strategy, gains can be obtained in government efficiency and financial sustainability. However, the major issue is that we need to believe that bureaucrat knowledge and decision match civic needs and will, which is not necessarily truth. The efficient decision may not be the not supported by citizens. If the bureaucrat's call is follow, one can raise serious doubts about the legitimacy and accountability of the process. Democracy holds politician responsible for their decisions but this procedure is devoid of any real use if the actual decision maker stays on the sidelines. Alternative strategy is the externalization of service delivery, which is also committed with some flaws. The reform agenda embrace the adoption of managerial initiatives but moves discretionary powers away from legitimate governments to unelected institutions. Advocates of Public Choice theory may argue that services still are accountable to citizens by the use of market mechanism where they voice their preferences, however this

is a performance accountability only, not one of procedure (Pierre 2009:602).

Urban Governance Combination's

This paper argues the possibility of an alternative model of urban governance. The central argument of the paper is that urban governance can also promote a combination that fall outside the linear *continuum* democracy-efficiency. It upholds a kind of governance inclusive to citizens without jeopardizing the government capacity to foresee their goals. The objective is to enhance performance in public services, as well as assuring voice to citizen. Decision making process includes, citizens, groups, local government, mass media and political parties and local governments manage community's welfare through a pluralist network. Expected outcomes are higher levels of financial sustainability allied with larger popular legitimacy of political choices and increased accountability. Summing up, urban governance, within democratic efficiency scope, is the setting pieces and the equilibrium that improves legitimacy of choices, transparency in procedures, accountability in rule setting as well as shared power, responsibility and efficiency. In other words, the will of citizens and the community best interests implemented in the most accurate and financially sustainable way.

The paper's argument assumes that the democracy-efficiency continuum is replaced by a combination of two axes. Vertical axis represents the degree in which urban governance focus on efficiency and horizontal axis the degree in which democracy plays a key role in the setting of rules, behaviors and objectives. All possible combinations between democracy and efficiency are represented in table 2.

[Table 2 here]

On the upper right and down left quadrants are the expressions of Waldo's argument. In an *Autocratic Efficiency* public officials focus on bureaucratic expertize and on the state capacity to deliver services. A strategy of civic avoidance is implemented to uphold the faculty of decision making grounded on financial/economic criteria rather than political ones. On the opposite side, the *Democratic Inefficiency* is a situation where officials are capture by citizens and interest groups and are unable to perform as well as in the previous situation. Decisions tend to do the best for each individual damaging the welfare of the community. The *Autocratic Inefficiency* is, by far, a situation to be avoided. Striped of any restrains imposed by democratic procedures, discretionary power

gets capture by particular interests and drift away from roots of efficiency. The *Democratic Efficiency* a result of a combination between political competition, mechanisms of civic participation and share access to information, that leads to transparency and accountability, and the aggregation of agents' skill, leading to accurate service delivery and financial sustainability. That is, a stage where a community strength simultaneously inclusive voice to citizen and government capacity to manage and oversee service delivery.

LEGITIMATION, TRANSPARENCY AND CONTROL

Democracy is a key element to government. It provides legitimacy to the ones that are chosen to act in behalf of the common good and it ensure a system were they will hold accountable for their decisions.

The definition of democracy and the way that it can be measure it is a matter of no consensus between academics. Surely if we trusts on Schumpeter's (1976) way to define democracy as an institutional arrangement for arriving at political decision in which individuals acquire the power to decide by means of a competitive struggle for the people's vote, it is relatively simple and easy to measure since it is based on electoral mechanisms. However the understanding of democracy changed over the years. The simple fact of having an electoral process is not sufficient to ensure the true essence of democracy, *ie*, the popular control over politics (Beetham 1999). If so, democracy would cease to a variable to become a constant in every country. The understanding of a system where one have the power of the people to act for the people gave place to a situation where one have the formal power of the people and uses involvement initiatives with the community for targeting problems and solving them (Haus & Klausen 2011). The legitimacy to hold a political office becomes separated from the legitimacy of using its powers. The first is acquired with electoral process while the second is a constant process of civic enrollment. As such, democracy varies in intensity and the literature provides a range of alternative indexes to measure it.

Freedom House Index (FHI) (House 2011) is, among academics, a wide spread way to measure democracy. FHI is highly connected to the first conception of democracy and it plays a particular attentions to electoral process and the presence of democratic

institutions (Knutsen 2010). FHI scores countries based on Civil Liberties and Political Rights. The first is used to assess the freedom of association, assembly and belief as well as to gauge the power of the rule of law. The second is used to measure fairness of electoral process, the existence of an opposition and the levels of corruption.

Effective Democracy Index (EDI) rather stresses the importance to measure substantive democracy, that is, the actual functioning of democratic institutions (Inglehart & Welzel 2005). EDI is composed by the Democratic Right Index (DRI) and the Rule of Law Index (RLI). DRI measures private and public freedoms and participation rights. RLI measure how strictly government agents abide by the laws (Alexander *et al.* 2012).

The Economist Intelligence Unit's Index of Democracy (Economist 2010) scores democracy by the combination of 60 dichotomous and three-points scoring grouped in five units of analysis: Electoral Process and Pluralism, to assess the competitiveness and fairness of the electoral process; Functioning of Government, to gauge the independence and accountability of the government; Political Participation, to measure the citizens' engagement with politics; Democratic Political Culture, to weigh the perception of the people regarding the democratic process; Civil Liberties, to capture the freedom of association and expression.

Political IV establishes a three elements evaluation to classify democracy. Executive Recruitment figures out the origin and freedom of the political power. Executive Constraints assesses the institutional mechanisms to control political powers. Political Participation is used to measure accuracy and fairness of the electoral process.

However these indexes are built to be use at national level. The adaptation to local government must consider the responsibilities trusted to this tier of government as well as its limitations and differences. For the purpose of the paper, democracy will be assessed through the evaluation of three elements: Electoral Competition and Pluralism; Civic Participation; Political Culture and Civic Liberties.

Electoral competition and pluralism are the check and balance that holds officials accountable for their actions. Competition increases accountability, transparency and concern for the citizens' need. A highly competitive election will drive officials to assume a vote-seeking strategy to avoid losing next election. As a consequence politicians, driven by their basic survival instincts, will provide the proposals that better

suite citizens interests to gain their preference (Downs 1957). Besides the emphasis on citizens' needs, competition also increases transparency. In search of popular support politicians will be forced to show how trustworthy and reliable they are. The fact is that competition also plays a roll on the loosing side. Motivated by the possibility to get in office, opposition is motivated to increase their supervision over political choices to make officials accountable for their actions. Ultimately, a highly competitive electoral process is driven by the same forces of those of a regular market: the costumer's choices will decide who wins or loose. As long as the competition intensity decreases officials' accountability towards citizens fades away since they become more reliant on their electoral strength and legitimacy. Side by side with competitiveness, pluralism plays an important role in the intensity of democracy. Pluralism in governing bodies assures the accurate representation of the constituents' preferences (Copus 2003). An excessive focus on the median voter's preferences may result on a tyranny of the democratic majority(Weimer & Vining 2010). In this situation, the indirect democratic mechanisms will fail their mission to represent the trust and the sovereignty of the people.

The second element used to measure democracy is civic participation. Scholars argue that it can lead to more information, better decisions and, ultimately, more effective democracy (Irvin & Stansbury 2004; Lowndes et al. 2001). For some time civic participation was mistakenly reduced to the expression of voter turnout in city election. This understanding has an enormous flaw and fails to cope with the idea of a market-based model of service delivery. It lies on a traditional institution of democratic accountability. It believes that popular control through voting in city election is enough to held officials accountable, assuming that officials have effective control over service delivery when, after the managerial reform, actually, they do not. The use of alternative governance arrangements imposes changes on the institutional design to provide transparency, accountability and legitimacy (Pierre 2009). In this way civic participation is used to improve process legitimation sustaining political decisions and providing fairness, equity and honesty (J. C. Thomas 2010; Van Ryzin 2011).

Civic Participation can be understood in two different ways. First it entails legitimacy to government decision through the use of political mechanism, provided by local governments, to improve the degree of political responsiveness by securing citizen's

rights to information on policy alternatives and a role in the policy decision making process (Cope 1997). Examples of such mechanisms are local referendum, participatory budget, public hearings, study circles and informal meetings (Hug & Tsebelis 2002; Hamel 1998). Still, the use of such instruments depends on the mayors' commitment and willingness to support citizen participation. Mayors that value citizen voice and display concerns for the public interest and social equity are also expected to devote more time and efforts into making participatory tools available to the community (Yang & Callahan 2007; Handley & Howell Moroney 2010). Second, it increases the link between citizens and their community. Democracy also comes from the way in which people feel connected to their neighborhood and are willing to engage their problems. Individuals may choose to invest time and resources to embrace common problems. This choice is regardless of any mayor's judgment to allow the use of participatory mechanism and represents the expression of direct democracy, where the people take matter into own hands to decide and implement the needed policies. Civic participation can be captured besides the use of political tools of participation, namely by the action of voluntary and non-profit organization (Tavares & Carr 2012).

Last element is political culture and civic liberties. The supporting argument is that political profile of citizens shape local democracy. Communities where citizens have high political profiles are expected to have more responsive officials. Citizens become more self-aware of official's responsibilities and are more demanding for accountability. Yang and Callahan (Yang & Callahan 2007) find evidence that this high political culture is found in communities with higher education levels. Political culture also reflects the extension of political freedom in communities. Political freedom is a demanding concept grounded on liberal democracy and supports basic human rights such as the freedom of speech, expression and the press; freedom of religion; freedom of assembly and association; and the right to due judicial process (Economist 2010). The availability and use of popular rights entitle people to make their own choices in individual matters and to have their choices count in collective matters (Alexander *et al.* 2012:42). Sherrod *et al.* (2010) argue that political participation, at the local level, must be seen as a dynamic process where the desire to participate, regardless of its format, results from communication and information that favors community integration. However, high

political profile and liberal democracy are meaningless without the rule of law to enforce them. As stated, the rule of law is the extension of which democratic rights and liberties are imposed over officials' behavior. It reflects the assurance that rules and law will override any attempt to manipulate democratic practices.

EFFICIENT GOVERNMENT

Although the importance of democracy, public services must comply with efficiency demands to avoid situations of financial stress, which can ultimately lead to bankruptcy, and to ensure their ability to respond to citizens' need for public services. The focus on public sector performance became relevant with the New Public Management (NPM) reform agenda (Hood 1991) and, despite all efforts, still is an unconscious concept.

Efficiency is one of most worked and defined concepts in management literature. It describes the extents in which effort and cost are used for an intended task or purpose. Efficiency is also described by the most adequate relationship between outputs and the necessary resource to obtain them (Camões et al. 2007). The search for efficiency was at the heart of most traditional works in administrative sciences since the early days of Taylor's Principles of Scientific Management (Taylor 1911). Economic crises and the increasing problems to control public expenditures increased the interest in the issue for public sector efficiency. The focus is to make the better use of taxpayer's money maximizing the relation between inputs and outputs (Camões et al. 2007).

Reform agenda targeted public service institutional transformation favoring the creation of autonomous operative agencies or using private sector agents through contracting-out or/and privatization. Although following different paths, bought strategies aim to increase operative capacity retrieving any bureaucratic barrier to public sector efficiency (Pollitt 2004). The creation of agencies is part of a consolidated strategy to economize spending restore trust on public services and increase quality of public services (Pollitt et al. 2001). The fragmentation of large and amorphous unites into single-purpose organizations allow the clarification of a core business that guides to a higher focus, specialization and expertize. Agencies are more self-aware of their mission, objectives and purpose and are easily accountable by a set of performance indicators to a system of audits and inspections, and quality assessment that emerges as a natural to replacement of the direct control of in-house production (Julnes & Holzer 2001).

Separating out agencies, relaxed from public regulation, become more flexible, manageable and more responsive to publics' and environmental demands. Disaggregation goes beyond structural dimension and moves to functional dimension separating policy making and implementation. The distancing of agencies from political gameplay encourage a more professional approach to management (Elston 2013; Christensen & Lægreid 2006). Privatization is an alternative solution, mostly to more commercial services, to improve public sector performance. The potential of using private markets for public services includes the cost saving behaviors induced by competition and the purge of potential political rents, budget maximization and perverse incentives of public bureaucracies (Hefetz & Warner 2011). As such, reform agenda tend to consider market solutions as more efficient than hierarchic mechanisms. It is based on a strong assumption that the market can maximize efficiency throughout better coordination between assets and labor (Hood 1994; Kettl 2005; Stein 1993; Osborne & Gaebler 1993; Ferris & Graddy 1998). Overall strategy focus on gathering executive authority away from political judgment to service delivery structures steered by a public-choice-style market-like exchanges that maximize citizen's preferences purging, at the same time, excessive and inefficient production (Pollitt & Bouckaert 2011).

Beside the overall assumption of efficiency through governance agreement grounded on externalization and market-type mechanism, several academic works focus on appraising the effective measurement of public sector efficiency. Some problems may be raised from applying the concept of efficiency to public sector. The origins of the concept are grounded in the private sector, based on the necessity to find a ration between weighted outputs and weighted inputs (Afonso & Fernandes 2008). Public services outputs are hardly measured in prices that reflect the costs of their inputs or market fails to give prices to services of not for profit nature. Despite this drawback, some technics are used to measure service efficiency without requiring the definition of weights. Non-parametric estimations can derive efficiency scores, based on a production function frontier, on the bases of relative distances of inefficient observation from the frontier (Afonso & Fernandes 2008; Moore et al. 2005). Data Envelopment Analysis (DEA) and Free Disposal Hull (FDH) are the most recurrent methodologies used to assess public sector efficiency/performance (De Borger & Kerstens 1996; Gonzalez et al. 2011; Rogge

& De Jaeger 2012; Afonso & Fernandes 2008). DEA had become widely used, along with its extension Value Efficiency Analysis (VEA), seeking to draw a production frontier and to assess relative efficiency by the comparison of data on inputs and outputs of productive units.

In this paper efficiency of local government will be assessed using three elements: state capacity; service delivery; and staff quality. State capacity deals with the necessity to have a government that has the ability to build and sustain the proper institutional roots, such as property rights, rule of law, control of corruption and regulatory quality, for economic and social development (Kaufmann et al. 2010; Stiglitz & undefined author 1989). Financial crises triggered environmental entropy that threatened this capacity. Governments found themselves unable to comply with situations of fiscal stress and were forced to evaluate the scope of government, to initiate an era of cutback management and streamlining businesslike process (Scorsone & Plerhoples 2010). To assure a sustainable and well-functioning government financial aspect stressing the value for money and the need of doing more with less became the major issue in the political agenda. The tools of efficiency rely on revenue increase, expenditures cuts, hiring freeze and cancellation of planned infrastructure projects that oversize local economy (Anderson 2011).

Managerial reform changes the institutional design of service delivery (Ostrom & Ostrom 1978). The roles had been stated «Incorrect Verb Form: Singular subjects always take singular verbs.» a political power were confined to the control and overview of services delivery whereas market-based solutions were promoted as responsible for service provision (Osborne & Gaebler 1993). Public choice approach supports the argument of efficient service delivery using market-like situations where citizens, as customers, are empowered to articulate their preferences (Brown et al. 2006; Ferris 1986; Stein 1993).

Finally, the third aspect is linked with the capacity of the bureaucracy to ensure impartiality with regards to effectiveness, legality, efficiency, ethics and integrity. A very traditional notion of efficiency grounded on Weber's (1924) idea of a group of non-elected officials that carried out their mission upon a rational legitimacy of rules.

RESEARCH CONTEXT

Local government in Portugal is structured in two layers: municipalities and parishes. The later are smaller jurisdiction, highly fragmented and less powerful with few own competencies then the former. Over the years, central government followed the path of progressive decentralization increasing the degree of autonomy of municipalities. Today, they are responsible to deliver much of the everyday services to citizens, such as energy, water, garbage disposal, transports, education, health, housing, leisure, civil protection and municipal police.

Most recent financial crises put local governments under stress threatening their ability to comply with their responsibilities and, as such, the welfare of their constituents. Therefore, municipalities were under serious stress to increase efficiency and obtain financial sustainability at all cost. As an additional factor, the adversities of the external environment characterized by a memorandum of understanding with the IMF, UE and ECB, that favors financial revenues over every other values. Therefore, reform initiatives rather focus on financial aspect and revenues maximization. Financial aspects of Portuguese municipalities are strictly formalized in the Local Finance Act.

Municipal income sources vary between one of four alternatives: Municipal taxes, collected by central government and transferred to local authorities, they charge real estate and its transition, vehicle tax, and a surcharge on corporate income; Fees, prices of municipal services directly collected by municipalities; Central Government transfers, resulting from the reallocation of income taxes and Value Added Taxes that are collected from central government; Loans, credits obtained by the municipality among private banks. The Local Finance Act regulates all municipal revenues and it is where we can also find two additional forms of financial support only to be use in case of fiscal stress: the municipal financial restructuring and the municipal financial rebalancing. The first is an instrument triggered by the local government and it consists on a loan, given by the central government, to reschedule debt and consolidates financial liabilities. The second, can be triggered both by local government or central government if one of two conditions exists¹. If financial stress is reported the municipality must elaborate a

¹ Debts over 50% of last year revenues and debts, overdue by three month, related to social security, civil servant wages, leasing contracts.

containing plan specifying every measure that needs to be undertaken to ensure long term financial sustainability. The local government is then authorized to contract a 20 year loan (maximum). Throughout this time, elected officials lose some of their independence and freedom regarding to central government. Hiring personal and public procurement is now under the direct judgment of central government.

More recently, the Local Financial Act has been the center of an intended reformulation. The central government is proposing the creation of an instrument similar to the Emergency Managers (see Scorsone (2010), Mears (2012) and Anderson (2011)). The idea is to ensure a central government specific credit to Municipalities in fiscal stress and, in exchange, to have the ability to appoint a city manager to control the use of the money.

DATA AND METHODS

This research addresses two questions. First, what is the outcome that democracy has over efficiency? Second, can urban governance set an equilibrium between efficiency and democracy? In order to answer these questions, we analyze data from the 278 local governments of Continental Portugal in an attempt to test the link between efficiency, measured by capital expenditures and the annual investment plan, and the density of democratic representation.

The paper argues of an invert U-shaped relationship between democracy and efficiency. Increasing the levels of democracy will, initially, drive to higher standards of efficiency. More democracy assures a more accurate representation of the constituents' preferences at the same time that it increases political competition enhancing transparency and accountability which as a positive effect on efficiency. However, a turning point can be reached where elected officials tend to overlook their preferences assuming a pork barrel and vote logrolling strategies. In this situation, democratic procedures, where each agent is looking to maximize their welfare, lead to public finance decisions that have no other outcome than the overspending and lower levels of efficiency.

The main argument of the paper can be tested by the following hypothesis:

H1: Efficiency of local governments has an inverted-U shape relation with the level of democracy

The paper uses three models to test its argument. The first model is used to test the linear relation between efficiency and democracy. The second model uses a second degree function, the democracy index and its square, to assess the non-linear relation with efficiency. And the third model is used to test the consistency of the second model, after the addition of control variables that measure the economical background of each local government.

Our model can be represented by:

$$\text{Efficiency Index} = \alpha + \beta_{\beta 1} (\text{Democracy Index}) + \mu \quad [1]$$

$$\text{Efficiency Index} = \alpha + \beta_{\beta 1} (\text{Democracy Index}) + \beta_{\beta 2} (\text{Democracy Index}^2) + \mu \quad [2]$$

$$\begin{aligned} \text{Efficiency Index} = & \alpha + \beta_{\beta 1} (\text{Democracy Index}) + \beta_{\beta 2} (\text{Democracy Index}^2) + \beta_{\beta 3} \\ & \ln(\text{Income}) + \beta_{\beta 4} \ln(\text{unemployment}) + \beta_{\beta 5} \ln(\text{Real-estate transactions}) + \mu \end{aligned} \quad [3]$$

Efficiency index is used as the dependent variable. The efficiency level of each local government is gauge by the combination of three variables: state capacity, service delivery and service quality. State capacity is assessed by the financial situation of each municipality. Two indicators are used to this effect: financial indebtedness and *per capita* financial autonomy. The argument is that efficiency will be higher if the municipalities have a lower level of financial indebtedness and higher levels of financial autonomy. Financial indebtedness is estimated by the ration between the financial liabilities and assets while the *per capita* financial autonomy is obtained by the ration from the result of the subtraction of the financial liabilities and assets with the population of the local government. Both indicators are gathered from official financial data, from the year 2011, published by the National Office of the Local Administration (*direção-geral das autarquias locais*).

To compute the efficiency index the paper also uses, as indicated, a service delivery variable. This variable is gauge by the level of externalization of municipal

services and the cost efficiency of processed services. Externalization is considered to be an indicator of a quest for more efficient levels of service delivery (Hood 1994; Kettl 2005; Stein 1993; Osborne & Gaebler 1993; Ferris & Graddy 1986). Reform agenda traditionally assume that market solution can produce a better combination between financial resources and service output. Externalization level is estimated by the ratio of expenditures used in contracts and transferences to alternatives to in-house solutions of services delivery and the total of expenditures. The argument is that higher levels of externalization lead to better efficiency. Data was collected, for the year 2011, from the National Office of the Local Administration (*direção-geral das autarquias locais*). The second indicator is the cost efficiency of service delivery. «Incorrect Present Tense of Verb.» This indicator is measure using Data Envelopment Analysis that draws a production frontier and to asses relative efficiency by the comparison of data on inputs and outputs of municipalities. It is expected that higher levels of cost efficiency of service delivery represent better efficiency. Data was collected from Afonso and Fernandes (2008) list of efficiency throughout Portuguese municipalities.

Third variable of efficiency index is service quality. The paper uses two indicators to weigh service quality: productivity and staff qualification. Productivity is measured by the ratio of municipal gross added value (GAV) and the number of public servants. Staff qualification is gauge by the ration of public servants with an academic degree and the total number of public servants in a municipality. In both cases the paper argues that better productivity and more staff qualification lead to higher standards of efficiency. It is expected that *per capita* GAV represent an effort of each public servant to overall productivity, *ie*, to the municipal efficiency. The paper assumes that GAV increase will have a linear and positive behavior with the workforce qualification. Data was gathered from the National Bureau of Statistics and the National Office of the Local Administration.

On the other hand democracy index was built using three variables: electoral competition and pluralism, civic participation and political culture.

Electoral competition and pluralism were measured using three indicators: number of consecutive terms, voting difference between the winner and political fragmentation. The number of consecutive terms served by elected official is considered

to be a drawback to efficiency since it could damage the reliability on public policies to suite citizens interests. In the same way, the number of votes that separate winners and losers, in an electoral turnout, could reflect the competitive pressure to the elected official to focus on constituent's preferences. As such, a close victory will enhance incumbents to be more accountable to their voters. The last indicator for political competitiveness is political fragmentation. This indicator is determined by the subtraction from 1 of the Hirscham-Herfindal index of concentration (2011). The argument is that a less concentrated executive² will be better able to cover all the variety of preferences. Data for all three indicators were collected from the National Electoral Commission with reference to municipal executive election of 2009.

Civic participation is the second variable used to measure democracy and it was assessed by: electoral participation and non-profit organizations. The electoral participation is gauge by the ration between the numbers of express voters and the number of total electors in the 2009 executive municipal election. Higher levels of participation are a proxy for a healthy democracy and civic engagement in the political process. Nevertheless, civic participation can be express outside political participation and can be measured be the number of non-profit organizations in each jurisdiction (Tavares & Carr 2012). Data related to de non-profit organization was gather by the registration in 2011 with the Social Security Financial Management Office of the Ministry of Labor and Social Security.

Last variable of the democracy index is the political culture that was measured by the number of newspapers published in each municipality and the degree of education in each jurisdiction. The paper's argument in based on the assumption that the number of newspaper in a municipality will concur directly to the level of information and transparency and accountability. The degree of education is the proportion of the total resident population of the normal age group for attending an educational cycle that is actually attending that cycle. The belief is that an educated population will be more aware of their rights and will hold incumbents accountable for their actions. Both data were collected from the National Bureau of Statistics.

² Municipal executives in Portugal reflects the electoral turnout proportionality. That is, parties defeated in the electoral process are entitled to terms in municipal executive

Both indexes were built following the same methodology (Morris & McAlpin 1982). For each indicator the paper establishes the worst and best value in a way that all the indexes became unidirectional and could be combined (Dholakia 2005). Each indicator is put in a 0 to 1 scale where 0 represents the observed worst score and 1 the observed best. Then indexes are properly weighted. For the purpose of this paper all indicators were equally weighted (0.5) but the non-profit organizations and the number of newspapers (0.25). This fact is due to the impossibility to separate among the non-profit organizations the ones that, although without the propose of profit, have a commercial nature. To what concerns the number of newspapers, we could separate the ones that are published in one jurisdiction but have a national range.

[Insert table 3 here]

The last model includes three control variables: income, unemployment and real-estate transactions. The control variables are used as a proxy to capture the economical context of the local government. Per capita income (*Income*) should be positively related to efficiency since it gauge the capacity of citizens to pay for public services and is one of important municipal revues of the as an income tax over the population. Unemployment represents a typical indicator of less economical strength and should be negatively related to efficiency. Finally, real-estate transactions are a suitable indicator for economic performance at local level and it is expected to be positively related with the efficiency index. Real Estate is one of the most important sources of own revenues for municipalities. Municipality charge a price for the proper licensing house building, they also charge an annual tax for the ownership of the house, and a transactions tax in each selling occasion. All taxes are indexed to the house value.

Table 4 presents summary statistics for all variables included in the analyses.

[Insert table 4 here]

Tobit regression is employed to estimate the models since dependent variable is censored in the left (0) and right (1) limits. Table 4 presents Tobit results for three different models.

[Insert table 5 here]

[Insert figure 1 here]

EMPIRICAL FINDINGS

The overall results confirm the existence of a non-linear relation between democracy and efficiency. Although the simple model behaves as predicted by Waldo, the inclusion of a quadratic term will unveil a more complex relation. Increments in democracy will induce improvements in efficiency «Incorrect Verb Form: Singular subjects always take singular verbs.» until a point where higher levels of democracy will, actually, damage the later.

Results in the figure 1 show a high concentration of municipalities in the fourth quadrant indicating a low level of efficiency and a high level of democracy in 80.14% of Portuguese local government. However, only 1.8% are on the extreme opposite. The rest is dispersed between the second and third quadrants. 6.14% in the one that represents high efficiency and high democracy and 12.27% in the quadrant for low efficiency and democracy.

The first specification in Table 4, which tests a simple and linear relation between efficiency and democratic indexes, points out, as suggested by Waldo, a negative relation between them. Each additional point in democracy reduces the score in efficiency in 0.18. The second interaction, where a quadratic term is added to the simple regression, is consistent to the paper's argument. Results indicate an inverted U-shape relationship between the efficiency and democracy indexes. Solving the quadratic equation produces an estimated optimal level of democracy of 0.5 matching an optimal of 0.39 for efficiency. Given this result, 86% of Portuguese Municipalities are above the optimal level for democracy.

The third specification in Table 4, which adds control variables to the previous interaction, shows consistent results to the previous ones and, consequently, with the paper's arguments. Controlling the effect of income, unemployment and real-estate transactions in local economic context, results still show evidence of an inverted U-shape relationship between the efficiency and democracy indexes. The control variables display, in some situations, coefficient signs consistent with our expectations. Income is positively related with local government efficiency although it misses statistical significance. Real-estate transactions are, as expected, positively related with local government efficiency.

CONCLUSION AND DISCUSSION

The paper's main objective was to add a new perspective on the literature that focus on the effect that democracy has on efficiency. Since Waldo's work many academics focus on this topic analyzing the dilemma of public decisions that need to follow a path between satisfying peoples' need or choosing the most cost efficient behavior regardless of peoples' preferences. This paper contributes to this literature by upholding a non-linear relationship that develops between the democracy and efficiency indexes.

In times of financial stress this topic has a renew interest and reform agendas tend to focus on managerial and efficiency improvements at the cost of democratic values. Democracy can promptly be relegated to the underdog status because of the extreme fiscal distress that endorses cost efficient initiatives.

Our findings have three major implications that need to be highlighted. First, the results show evidences that allow us to consider the invert U-shape relation between democracy and efficiency. It means that urban governance can be structure to maximize both values without falling automatically into a trade-off. The proper pieces can be seated to find equilibrium between institutional engagements to civic enrolment, pluralist and inclusive decision-making process and cost efficient and financial sustainability initiatives.

Second, Portuguese local governments are mostly, 80.14%, in a democratic inefficiency kind of urban governance. This is a situation were public decision is capture by political agenda that compromise the levels of efficiency. Vote-seeking strategy, the natural tendency of citizen to overlook their preferences claiming their importance over the others and the difficulty of to approve and comply with bills that auto-impose restrictions on constituents' welfare drive urban governance away from financial sustainability. Reform agenda will need to free decision making process away from local interest and base it on solid technical knowledge to avoid the risk of a general bankruptcy.

Third, the Local Financial Act that proposes the creation of an Emergency Managers, to manage the specific credit given to municipalities by central government, in

situations where indicators of fiscal stress are triggered, can be a walkout from the democratic inefficiency. Managerial initiatives that force economic and financial agenda can produce a positive effect and be an opportunity to bring balance in the equilibrium equation between democracy and efficiency.

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Table 1

Characteristics	<i>Models of Urban Governance</i>	
	<i>I</i>	<i>II</i>
<i>Objective</i>	Efficiency	Democracy
<i>Decision Making Process</i>	Conflict	Consensus
<i>Key Players</i>	State and Private	State and Citizens
<i>Local Government relation with citizens</i>	Exclusive	Inclusive

Table. 2

Democracy

		Low	High
Efficiency	High	1 Autocratic Efficiency	2 Democratic Efficiency
	Low	3 Autocratic Inefficiency	4 Democratic Inefficiency

Source: Adaptation of Norris (Norris 2012)

Table. 3

VARIABLES	Worst	Best	Formula
Financial autonomy (<i>per capita</i>)	0.0378	0.809	$\frac{(0.809-V)}{(0.809 - 0.0378)} \times 100$
Financial Indebtedness	915.5	-6,695	$\frac{(-6,695 - V)}{(-6,695 - (-915.5))} \times 100$
Productivity	1.490	76.08	$\frac{(76.08 - V)}{(76.08 - 1.490)} \times 100$
Staff qualification	0.0667	0.430	$\frac{(0.430-V)}{(0.430 - 0.0667)} \times 100$
Electoral Participation	44.05	81.11	$\frac{(81.11-V)}{(81.11- 44.05)} \times 100$
Voting difference	58.47	0.0400	$\frac{(0.0400-V)}{(0.0400- 58.47)} \times 100$
Political fragmentation	0	0.678	$\frac{(0.678-V)}{(0.678- 0)} \times 100$

Non-profit organization	0	782	$\frac{(782-V)}{(782-0)} \times 100$
Number of terms	10	1	$\frac{(1-V)}{(1-10)} \times 100$
Efficiency (DEA)	0	1	$\frac{(1-V)}{(1-0)} \times 100$
Externalization	0.157	0.806	$\frac{(0.806-V)}{(0.806-0.157)} \times 100$
Degree of Education	50.80	183.8	$\frac{(183.8-V)}{(183.8-50.80)} \times 100$
Number of newspapers	0	0.0148	$\frac{(0.0148-V)}{(0.0148-0)} \times 100$

Table. 4

VARIABLES	N	mean	sd	min	max
Unemployment	278	0.0355	0.0131	0.0105	0.0895
Democracy Index	277	0.591	0.0886	0.292	0.763
Efficiency Index	278	0.373	0.0853	0.147	0.659
Income (ln)	278	6.679	0.161	6.368	7.419
Real-Estate Transmission (ln)	278	9.420	1.525	6.436	14.38

Table. 5

VARIABLES	Simple model	Quadratic model	Complete model
Democracy Index	-0.1818*** (0.0568)	1.1090** (0.5177)	0.9719** (0.4736)
Democracy Index (square)		-1.1478** (0.4577)	-0.9700** (0.4186)
Unemployment			0.6940* (0.3536)
Income (ln)			0.0281 (0.0342)
Real-Estate Transmission (ln)			0.0199*** (0.0037)
Constant	0.4808*** (0.0339)	0.1278 (0.1447)	-0.2542 (0.2515)
Observations	277	277	277
LR Chi2	10.04	16.26	66.90

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