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Financial situation and political parties in local governments: Empirical evidence in the Spanish municipalities

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ABSTRACT

In contrast to several studies presented in the literature which analyze how different political elements affect specific aspects of financial management of public institutions, we have investigated from a comprehensive perspective how various political factors influence the financial situation of the municipalities. To do this, we use diverse multivariate techniques, the concept of financial condition and a large sample of Spanish municipalities. By isolating the electoral cycle and analyzing the essence of political factors, our main findings are that conservative and progressive parties do not present different behavior in relation to any of the financial dimensions. The territoriality of political parties influences the relationship between fund transfers received by the municipalities and certain expenses and investments. Furthermore, we did not detect that, in Spain, a partisan alignment exists between municipalities and the upper-level institutions.

Situación financiera y partidos políticos en los gobiernos locales: evidencia empírica en los municipios españoles

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RESUMEN

En contraste con los diversos estudios presentes en la literatura que analizan cómo los diferentes elementos políticos afectan a aspectos específicos de la gestión financiera de las instituciones públicas, hemos investigado desde una perspectiva integral cómo varios factores políticos influyen en la situación financiera de los municipios. Para ello hemos usado diversas técnicas multivariantes, el concepto de condición financiera y una amplia muestra de municipios españoles. Aislando el ciclo electoral y analizando la esencia de los factores políticos, nuestros principales hallazgos son que los partidos conservadores y progresistas no presentan distintas conductas en las diferentes dimensiones financieras, y que la territorialidad de los partidos políticos influye en la relación entre los fondos recibidos por transferencias y ciertos gastos e inversiones. Además, no hemos detectado que exista un alineamiento partidista entre los municipios españoles y las instituciones de nivel superior.

1. Introduction

Studies analysing the influence of political factors on specific aspects of financial management of public administrations, as deficit, expenditures, tax burden, revenues, public debt, and transfers at different territorial levels are, numerous (Benito & Bastida, 2010; Poterba, 1994; Rattsø & Tovmo, 2002; Roubini & Sachs, 1989; Solé-Ollé & Sorribas-Navarro, 2008; Veiga & Veiga, 2007).

Unlike these previous studies, García-Sánchez, Mordan, and Prado-Lorenzo (2012) analyzed the effect that political ideology and strength have on overall financial management of local governments through analysis of the financial condition concept in the largest Spanish municipalities. However, this study was limited because they directly assigned indicators to the financial dimensions, and performed individually the political variables on each of the indicators from a limited set. Furthermore, using various indicators which may reflect the same behavior tends

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to distort the analysis because this promotes the assessment of aspects in a duplicate manner (Cabaleiro, Buch, & Vaamonde, 2012).

Different from the rest of the studies presented in the literature, our paper is based on a more comprehensive vision that eliminates the analysis of redundant financial aspects and it intends to explain how different political factors such as ideology, political weakness of governments, and alignment between political hierarchical institutions (which have not presented conclusive results in previous works), or territoriality of political parties (which have not been empirically verified) may be influencing the overall financial health of local governments.

2. Literature review: background and hypotheses

2.1. The financial health of local governments

Various terms that correspond to different methodological approaches were used in the literature to analyze the same reality, the financial health (Berne, 1992; Clark, 1994; Carmeli, 2003; Kloha, Weissert, & Kleine, 2005; Wang, Dennis, & Tu, 2007), and the financial condition is one of the terms most widely used (Cabaleiro et al., 2012; Rivenbark & Roenigk, 2011; Sohl, Peddle, Thurmaier, Wood, & Kuhn, 2009; Wang et al., 2007). In this sense, Honadle, Costa, and Cigler (2004) noted that financial condition of local institutions is a term closely linked to the concept of fiscal health and Wang et al. (2007) pointed out that this concept represents the ability of an organization to meet its financial obligations on time.

As financial condition is a concept that is not directly observable, literature has focused on assessing the different aspects or dimensions that compose it (Clark, 1977; Groves, Godsey, & Shulman, 1981; Hendrick, 2004; Mercer & Gilbert, 1996). Groves et al. (1981) note that financial condition is composed of cash solvency (government's capacity to generate enough cash or liquidity to pay its bills), budgetary solvency (the city's ability to generate sufficient revenues over its normal budgetary period to meet its expenditure obligations and not incur deficits), long-run solvency (the long-run ability of a government to pay all the costs of doing business, including expenditure obligations that normally appear in each annual budget, as well as those that show up only in the years in which they must be paid), and service-level solvency (it refers to whether a government can provide the level and quality of services required for the general health and welfare of a community), and this approach was assumed by the International City/County Management Association [ICMA] (2003) for its extensive application in local governments in USA.

Another significant contribution for the local level is made by the Canadian Institute of Chartered Accountants [CICA] (1997, 2009) which assesses the concept through the dimensions of sustainability (degree to which a government can maintain its existing financial obligations without increasing the relative debt or tax burden on the economy within which it operates), flexibility (degree to which a government can change its debt or tax burden on the economy within which it operates to meet its existing financial obligations), and vulnerability (degree to which a government is dependent on sources of funding outside its control or influence or is exposed to risks that could impair its ability to meet its existing financial obligations).

To assess the financial condition, numerous indicators have been used. It should be noted that there has not been a common view in their selection, use, and application (CICA, 1997, 2009; Clark, 1977, 1994; Groves et al., 1981; Hendrick, 2004; ICMA, 2003).

On the contrary, the financial condition of governments and socioeconomic variables are interrelated aspects (Carmeli & Cohen, 2001; Honadle et al., 2004). The characteristics of a socioeconomic environment are diverse and varied in nature, that is, the economic sectors, nature of the territory, population structure and population movements, and economic policies developed by state public institutions (Honadle, 2003). In addition, the ICMA (2003) includes among the "environmental factors" the variables of population size, density, the level of unemployment, and business activity. Wang et al. (2007) analyzed the relationship between the financial condition and population (population size and growth rate) and economic factors (personal income per capita, gross state product per capita, and percentage change in personal income), and concluded that these variables can be used to predict the financial condition with a certain level of accuracy.

2.2. The political factors on the financial health of local governments

The ICMA (2003) considers that issues of a political nature must also be taken into account among the various factors to consider in the analysis of the financial management of public institutions. Except the limited study of García-Sánchez et al. (2012), there have been no empirical studies evaluating the relationship between the global financial situation of public institutions and political factors, although diverse political factors have been used to predict specific aspects of financial management (Alesina & Perotti, 1995; Alesina & Tabellini, 1990; Ashworth, Geys, & Heyndels, 2005; Benito & Bastida, 2010; Curto-Grau, Solé-Ollé, & Sorribas-Navarro, 2012; Solé-Ollé & Sorribas-Navarro, 2008).

A first political issue that we could not ignore is "The political cycle theory" or "Political opportunism", which assumes that the primary interest of a politician or party is being re-elected and there are no ideological motives. Franzese (2002) notes that this theory is focused on the impact of the timing of elections, and this causes changes in some financial variables (debt, deficit, expenses, and transfers).

The "partisan theory" attributes central importance to the ideological differences between groups within a society and the parties that represent these groups (Persson & Svensson, 1989; Tuffe, 1978). In this line, unlike the conservative parties, progressives tend to increase public spending, showing greater laxity in public financial management (Tuffe, 1978). However, this theory has not been confirmed empirically in some studies at municipal level as in those made by Bosch and Suarez-Pandiello (1995) and Benito and Bastida (2010).

Some papers have examined the effect of political decentralization on the organization or cohesion of political parties (Desposato, 2004; Wildavsky, 1967). Territorial (local and regional) parties are thought to exist because these geographical areas have unique interests and concerns that cannot be or are not being addressed adequately by existing parties to other level (Brancati, 2008; Hearl, Budge, & Pearson, 1996).

Following the line of study based on "weak government" or "fragmented governments", Roubini and Sachs (1989) initiated a line of empirical work studying the influence of fragmentation of governments on the finance of public institutions. At the municipal level, the works that researched any aspect of public finances have been few and they have also presented different results (Ashworth et al., 2005; Borge, 2005; Bruce, Carrol, Deskins, & Rork, 2007; Geys, 2007; Goeminne, Geys, & Smolders, 2008; Rattsø & Tovmo, 2002).

Another political factor is based on the "hypothesis of the partisan alignment". In this context, the research carried out was articulated from different perspectives: "clientelism" (Diaz-Cayeros, Magaloni, & Weingast, 2006; Scheiner, 2005), "perverse accountability" (Stokes, 2005), and the "model of pork barrel"