



The impact of functional decentralization and externalization on local government transparency



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ABSTRACT

Local governments are increasingly establishing functional decentralized agencies, such as autonomous organizations, public companies, foundations and public business entities to provide public services. Furthermore, they are also introducing the private sector, contracting out public services to a private company and creating mixed companies. Our aim is to analyze the effect of functional decentralization and externalization (outsourcing or contracting out) processes on public transparency levels, since theoretically, they are aimed toward good governance and accountability. To do so, we use a sample composed of the 110 largest Spanish cities for the period 2008–2010. The results show that decentralized agencies, especially public companies and foundations, impact positively on levels of public transparency. However, there is no evidence that suggests that the introduction of the private sector, using outsourcing and mixed companies, affects the transparency of local governments.

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1. Introduction

As providers of resources, citizens increasingly require information and accountability (Scott, 2006) in relation to the activities that are defrayed by their resources. Information regarding this should help citizens know where and how much financial resources are being allocated, and how are they being used (Jorge, Moura e Sá, Pattaro, & Lourenço, 2011). In this regard, transparency favors an understanding of the policies implemented by governments, and citizens should be encouraged to take part in decision-making (Guillamón, Ríos-Martínez, & Vicente-Oliva, 2011).

Transparency enables the observation and analysis of the ways in which governance, business and public affairs should be conducted (Heald, 2006). The OECD (2001) defines transparency as “openness about policy intentions, formulation and implementation”. In general, “transparency” and “openness” are used as synonyms, although some authors find distinctions between them. For example, Larsson (1998) posits that transparency extends beyond the concept of openness to make it more simple and comprehensible, and also states that transparency requires external recipients that are capable of processing the information provided.

Other authors define transparency as the access by the public to timely and reliable information on decisions and performance in the public sector (Armstrong, 2005), as well as the overall degree to which citizens, the media and financial markets can observe the government's strategies, its activities and the resulting outcomes (Alt, Lassen, & Shanna, 2005). More recently, Piotrowski and Bertelli (2010) have

posited that transparency is the degree to which access to government information is available.

Furthermore, the economic difficulties that many countries and local governments are suffering have led to higher authorities, such as the World Bank, the International Monetary Fund and the European Commission, among others, to focus on the behavior of the public sector. More specifically, several financial scandals that have become public knowledge have intensified interest in particular topics like transparency. Sharman and Chaikin (2009) posit that good governance is initially assessed in terms of the degree of transparency in decision-making and policy implementation. This assessment affects the image that citizens have of their government, which has led to a trend toward “open government” in the United States and most OECD countries. In addition, globalization and competition in the global economy has provided an incentive for governments to show openness, since business leaders contend that access to information is critical for efficient markets (Relly & Sabharwal, 2009).

Several authors have focused their attention on the relationship between transparency and socio-economic and political factors. For example, Laswad, Fisher, and Oyelere (2005) found that leverage, municipal wealth, press visibility and types of council are related to financial disclosures of local governments in New Zealand. Alt et al. (2005) showed that more equal political competition and power-sharing are related to greater levels of fiscal transparency in American states. They found that political polarization is related to lower transparency, and past fiscal conditions also affect levels of transparency.

Piotrowski and Van Ryzin (2007) found that there are several dimensions to the public's demand for transparency, including fiscal, safety and government concerns, and principled openness. Factors

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such as age, political ideology, confidence in government leaders, etc., affect the public's demand for transparency.

Gandía and Archidona (2008) found that disclosure levels in Spanish local governments depend on political competition, public media visibility, access to technology and educational levels. More recently, the results of a study by Cárcaba-García and García-García (2010) show that size, capital investment and political competition are positively related to information disclosure by Spanish local governments, but that press visibility and voluntary financial disclosure are negatively related to it.

Guillamón, Bastida, and Benito (2011) found that local governments with higher levels of taxes and transfers per capita, a left-wing party in power and a higher population tend to be more financially transparent. Furthermore, the same authors (2011b) showed that government fragmentation is related to higher levels of transparency, but that the unemployment rate impacts negatively on levels of financial transparency.

As we can see, most previous literature is focused on socio-economic and political determinants of public disclosures, but we have not found any studies that analyze the impact of the different modes of public service delivery on levels of public sector transparency. Partially, this could be due to that fact that measuring the concept of transparency is a complex task and, in addition, it has been difficult to find reliable data, especially at the local level, until now (Guillamón, Bastida, & Benito, 2011). In this regard, the organization Transparency International Spain has undertaken this task with a great amount of effort. Thanks to this group, there are now useful data about public transparency from 2008, which makes it easier to analyze this concept. As Guillamón, Ríos-Martínez, and Vicente-Oliva, (2011) suggested, the publication of this information has meant an incentive for local governments to improve their level of public transparency.

In this respect, the main aim of this study is to observe the effect of functional decentralization and externalization processes on the level of Spanish local governments' public transparency. Our goal is to further contribute to this line of research by: (1) specifying the impact of functional decentralization and externalization processes; (2) conducting a complete analysis of functional decentralization, considering we have taken into account the creation of different entities (public companies, foundations, autonomous organizations and public business entities); and (3) choosing a time period that permits the use of panel data methods, which provide more robust results than cross-sectional studies by the control for unobserved heterogeneity. This method also allows for the correction of endogeneity problems between dependent and independent variables.

Very briefly, we advance that decentralized entities involved in the creation of different types of agencies have greater autonomy in the achievement of their objectives. Politicians and agents become more directly responsible for their actions and, as a result of these higher levels of direct responsibility, their ethical behavior may be improved (Persson & Tabellini, 2000). Decentralization increases transparency because the decision-makers (politicians) are more accountable to citizens for their actions, improving their responsiveness too (Regmi, Naidoo, Greer, & Pilkington, 2010; Vrangbaek, 2007).

In the case of outsourcing, despite the advantages of this process in terms of the efficiency and quality of services, some scholars argue that outsourcing may lead to fraud (Frederickson, 1999; Kettl, 1993; Pessoa, 2009), since politicians may intervene too often in the selection of the providers of these services, with cases of favoritism in the assignation of contracts (Fernández, 2007; González, Gascó, & Llopis, 2011). Thus, local governments tend to be less transparent so as to avoid citizens knowing about these situations. Externalization of public services considers private markets, which operate generally for profit motives rather than public accountability (Regmi et al., 2010). Subsequently, there is much debate about the ethics of outsourcing in relation to accountability in public service delivery (Johnson, 1995; Moss, 1997). Although the private sector tends to be more accountable for results, it falls shorter in terms of process transparency (Mulgan, 2002).

With the aim of testing these previous ideas, we have selected a sample of the 110 largest Spanish cities, for which information regarding their transparency has been published by the non-government organization Transparency International Spain. This information is available for the years 2008, 2009 and 2010, so this is the period of time that concerns our study.

Our results show that the most transparent municipalities are those that present higher levels of functional decentralization for public service delivery, specifically through public companies and foundations. However, the introduction of the private sector (through outsourcing and mixed companies) does not affect the municipalities' levels of public transparency.

2. Modes of public service delivery in Spain

In 2008, there were 8112 municipalities in Spain, 60% of which had a population of less than 1000 people, a figure that rises to 91% if we take into account towns with a population of less than 10,000.

Article 11.1, Act 7/1985 of April 2, of the Regulatory Law for Local Governments (*Ley Reguladora de Bases de Régimen Local* – LRRL), states that municipalities are the basic local entities of the territorial organization of the state, with legal personality and full capacity for fulfilling their purposes.

With regard to their organizational structure, municipal administrations are composed of two types of bodies: the political body, formed by the mayor and the town councilors, with either possessing decision-making functions or duties related to the management of service provisions; and the executive body, comprised of the set of services and units that carry out the decisions taken by the former.

The responsibilities attributed to local governments are set out in chapter 25.2 of the LRRL, and are strongly linked to the population of each municipality. This law sets out a series of minimum services to be provided by local authorities, including public lighting, refuse collection, street cleaning, water provision, sewerage, access to population centers, road maintenance, food and beverage control, and cemetery management. In addition, municipalities with more than 5000 inhabitants must provide at least one public park, a library, a market and waste-processing facilities; those with more than 20,000 inhabitants must provide civil protection services, social services, fire prevention and fire fighting services, and sports facilities; finally, those with more than 50,000 inhabitants must also provide collective transport and environmental protection services.

In addition, article 28 poses the possibility for municipalities to offer complementary services related to aspects such as education, culture, promotion of women's rights, housing, health care and environmental protection.

The aforementioned Regulatory Act allows the provision of municipal services through direct management, autonomous local entities (decentralization), or private agents (contracting-out) and mixed companies, as follows:

- Direct management: Public services are managed and controlled by the local authority itself.
- Functional decentralization (decentralized direct management): Public services are provided by smaller and more flexible entities in which a business culture predominates (Aberbach & Rockman, 1999). Local governments are able to create different decentralized entities such as autonomous organizations, public companies, public foundations and public business entities. The main characteristics of these entities are shown in Table 1.
- Externalization (outsourcing or contracting-out): Local governments enter into agreements with private sector entities for the management and provision of municipal services. Nevertheless, the local administration continues to enjoy ownership, and maintains decision and control capacity to a large degree. The main formats of indirect management or externalization are administrative concession, self-

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