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FINANCE**

**FINANCIAL PERFORMANCE IN LOCAL PUBLIC ADMINISTRATION AND THE  
ECONOMIC DEVELOPMENT OF COMMUNITIES**

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## **Key words**

Financial performance, local economic development, local public administration, performance measurement, local communities, indicators

## **Introduction**

Our research is an interdisciplinary approach that identifies the link between the financial performance of local authorities and economic development of communities. The interdisciplinary perspective of this thesis lies in the areas involved: public finance, economic and administrative sciences.

In our research we developed specific tools for measuring the performance of local governments and community economic development degree, which allowed us to create rankings of municipalities' performance.

The main argument of the thesis is that the degree of economic development of the community affects the financial performance of local authorities.

The thesis is divided into four chapters, the first three presenting the state of knowledge on the issue of performance and its measurement in the public sector, financial performance and local economic development. In the last chapter we conducted an empirical research carried out from theoretical concepts discussed above.

In the first chapter we conducted an analysis of performance issues starting from the broader context of patterns and trends in the public sector establish a framework of principles of functioning of administration (New Public Management and its successor models). In this context we discussed ways of defining the concept of performance, and identify the performance measurement tools. In our research we developed a conceptualization of the performance of public sector perspective. The next stage of the literature review involved the presentation of models that frame the complex nature of the concept of performance, highlighting the causal links that are established in the measurement process. The purpose of these models is, in our opinion, to build performance measurement methodologies, and providing a guide in establishing the principles and steps that must be taken into account when developing and implementing any measurement system.

The second chapter is the one that makes the transition from general (public sector characteristics, performance in public administration), towards specific (financial performance of local authorities), and it is focused on financial performance analysis models. Another

direction in the research done in this chapter was that of analyzing the most popular risk assessment models, the ones used by rating agencies (Standard & Poor's, Moody's and Fitch). The third chapter focuses on conceptualizing term `local economic development`, and on identifying those factors that generate it. Therefore we have reviewed the main theories in the field and identified instruments to measure the economic development of local communities which facilitated the effort to create an instrument for measuring the level of local economic development for Romanian local communities.

In the fourth chapter, we conducted a research on the financial performance of Romanian local authorities and the degree of development of the communities they serve, at municipality level (except Bucharest). Thus, we used a complex of methods and tools to develop two indices - one of the financial performance and other of economic development, both built on sets of indicators. In addition to document analysis and literature review, in identifying the most appropriate indicators we used other research methods such as interview and a research on local government transparency in providing financial data to citizens.

Based on the analysis, we developed two indices which allowed us to create rankings of the best municipalities and identifying communities with the highest level of economic development. In the financial performance assessment we also ranked the municipalities based on benchmarking of local authorities with similar characteristics.

Further on, we tested the link between the financial performance of municipalities and economic development of the communities by using a simple linear regression model, and identified a strong and statistically significant relationship, in the sense that economic development affects financial performance. Later, based on a multiple regression analysis we identified which variables of economic development that have the greatest explanatory power in predicting financial performance of local authorities, starting from the previously demonstrated relationship. In the last part of the research we analyzed the most significant results obtained from carrying out correlations between indicators that make up the two indices.

## **Research Objectives**

Based on the theoretical framework analyzed in the literature review we have outlined a set of general objectives (goals) and specific objectives of this research.

### *Goals:*

1. To identify and empirically explore of possible links between economic development of communities and the financial performance of local authorities.

2. To develop and test a tool to measure the financial performance of Romanian local authorities.

3. To develop and test a tool to measure the economic development of local communities.

*Specific objectives:*

O1. Analysis of the financial performance of local authorities of municipalities in Romania (except Bucharest);

O 1.1. Creating an index of financial performance based on a set of performance indicators;

O 1.2. Develop a ranking of municipalities based on financial performance index scores;

O 1.3. An analysis of the level of transparency of local authorities as regards the publication of information on the financial statements;

O2. Analysis of the economic development of local communities (municipalities).

O 2.1. Creating an index of local economic development based on a set of indicators;

O3. Exploring relationships between indices and between financial performance indicators and local economic development.

### ***Research design***

The analysis of the financial performance of local authorities and the level of economic development of the communities in which they operate requires an approach to a set of research strategies.

Thus, our research has focused on two main directions:

- Local authorities' financial performance analysis of 102 municipalities (which included an analysis of the transparency level);
  - Analysis of the degree of economic development of 102 municipalities;
- Regarding the time period analyzed, we considered data from 2008 to 2013.

In conducting the analysis, we used its own model, developed from studying several models from which we selected indicators applicable in Romania, and for which data are available.

### ***Methods and tools used***

The theoretical considerations (models analyzed) led us to following methods and tools:

- Quantitative analysis of official documents
- Quantitative analysis of official statistics
- Secondary data analysis
- Quantitative content analysis
- Structured interview guide
- Local authorities` website analysis grid

We conducted the research on 3 main directions: applying an interview to a number of experts, research on the transparency achieved by analyzing the websites of the 102 municipalities and analysis of the financial performance and degree economic development of the 102 municipalities.

## **Research results**

Our research uses the indices on which makes a comparison of the financial performance of local authorities and the degree of economic development of communities. Both concepts are complex and therefore multidimensional. For this reason, the indicators are grouped into dimensions, and each index is calculated as the sum of the dimensions. ,

In calculating the scores of the indicators we used normalized values, like other research (Hendrick, 2004, Wang et. Al., 2007, Arnett, 2014). Although in other similar approaches the dimensions are weighted, in order to avoid subjectivity, we avoided this practice.

Like other studies (Hendrick, 2004), our research seeks correlations between indicators. If the above-mentioned studies do not show statistical significance correlations between variables, our analysis clearly mentions it.

Regarding the financial performance, starting from the assumption that different municipalities act in different contexts and conditions, comparing the results between units with similar characteristics is much more desirable (Zafra-Gomez et al, 2008 Sohl et. Al., 2009). If some authors (Maher and Nollenberger, 2009 exclusively grouped municipalities according to population, our model performs grouping the Romanian municipalities through a cluster analysis, based on several criteria.

The results of our research are encouraging. The analysis is made at each indicator level, and financial performance analysis involves dissecting every dimension, and creating a ranking on each dimension. The index values calculated as the sum of scores dimensions gives us the big picture on the financial performance of local authorities. According to our measurement model the best performing municipality is Arad, followed by Miercurea-Ciuc, Sibiu and Brasov. Miercurea Ciuc, Slatina and Medias municipalities also obtained very good scores, which shows that their local government is at the same level of performance as those of cities such as Cluj-Napoca, Brasov, Constanta. If it was expected that academic centers to generate a high level of financial performance (government having more chances to recruit people with a high level of education), and we can say that municipalities such as Timisoara and Iasi score below community potential, which shows an underperforming local public administration, based our analysis criteria.



The worst performing municipalities were found to be those in the municipalities Motru, Roșiori the Vede and Barlad, followed by Resita, Sighet and Moreni, municipal authorities which got low scores in almost all dimensions analyzed, which shows an underperforming local administration.

As regards the economic situation of the communities, local economic development index scores sum the 5 dimensions, thus relieving our mission to identify the real level of economic development of each of the 102 cities of the analysis.

Cluj Napoca get the best aggregate score, followed by Timisoara, Sibiu and Arad, at a significant score difference. Slatina is the 5th municipality at the index score, followed by Brasov, Oradea, Constanta, Targu Mures and Ploiesti. The least developed economies are those of Lupeni, Dorohoi and Calafat, who score below par of the index, followed by Aiud, Adjud, Toplița Moinești, Vulcan, Barlad and Pașcani.

The last part of the research was conducted with the objective of exploring the relationship between financial performance and local economic development for communities, starting from the assumption that economic development in the community or economic conditions affect the financial performance of local authorities. We chose to test this relationship possible through linear regression models.

In the first phase, starting from the assumption that the degree of community economic development affects the financial performance of the local authority, we have considered the financial performance as the dependent variable and the level of economic development as the independent variable. We observed a strong and statistically significant correlation (.00), with an R value of 0.728 between the financial performance of municipalities and community economic development. The association between the two indices is strong, the values of R square and adjusted R squared 0.53, which implies that 53% of local authorities' financial performance variation is explained by the degree of economic development of the community. Beta coefficient indicates that an increase in the LED index by 1 point would increase the financial performance of 0.454 points.

In the second phase we have tested the relationship between the index of financial performance and several indicators of economic development through a multiple regression model, in order to identify those economic development indicators within the index that best explains the relationship with financial performance. The analysis conducted through SPSS has identified a number of 3 variables that have the greatest explanatory power: capital stock, entrepreneurial capacity and diversification of the local economy.

The last stage of the research was to explore the relationship between financial performance indicators and the local economic development indicators and test a set of hypotheses based on Pearson correlation. We explored bivariate correlations among 3 possible relationships: between economic development indicators, between the financial performance indicators, and between financial performance indicators and those of economic development, and also introduced other variable in the analysis, like population, and found interesting results.

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