

April 7, 2018

THE  
CENTER  
FOR  
STATE  
AND  
LOCAL  
FINANCE

Alex Hathaway  
Center for State and Local Finance

---

# Fiscal Transparency across the States: A Volcker Alliance Paper

by  
Jesseca Lightbourne, Alex Hathaway, Emily Franklin,  
Bethel Habte and Bart Hildreth

# Overview

- Review of the transparency literature
- Methodology
- Results
- Conclusions

# Review of the Transparency Literature

- Theory
- Benefits
- Drawbacks
- Best practices

# Review of the Transparency Literature

- Little research at state level, with non-expert focus
- Theoretical framework
  - Principal-agent problem
- Benefits
  - Improved accountability, trust, and fiscal performance
- Drawbacks
  - Vulnerability to interest groups
  - Misinterpretation of information
- Best practice guidelines
  - Show underlying assumptions
  - Timely, accessible, understandable information
  - Auditing component

# Methodology

- Data collection
- Transparency index
- Regression model

# Methodology: Data Collection

- Transparency defined in terms of whether a non-expert (citizen/voter) or investor can get an accurate view of *the structural health of a state*
- Timely and complete information
  - Executive proposal, legislative analyses/review, forecasting document, fiscal outlook
  - CAFR not a timely document
- Accessible and understandable information
  - Easily found on state website(s)
  - Regularly produced
  - Format includes detailed narrative explanations

# Methodology: Data Collection (cont.)

- Data from Volcker Alliance project (FY16) and NASBO's *Budget Processes in the States*
  - Multiyear revenue and expenditure forecasts?
  - Detailed forecasting rationale?
  - Tax expenditures?
  - Debt projections?
  - Explicitly disclose structural problems?
  - Consolidated website or group of related sites?
  - Performance measures inform executive proposal?
- Incorporated in transparency index
  - Scale from 1 (low) to 9 (high)

# Methodology: Descriptive Statistics of Regression Variables

- Regression looks at association of state-level fiscal and institutional factors on transparency.
- **Dependent variable**
  - Transparency index
- **Credit Rating**
  - Moody's
  - Scaled 0-10
- **Budget cycle**
  - Annual=1
  - Biennial=0
- **State Senate Turnover**
  - Number of seats
- **Controls**
  - Population
  - Average annual income
  - Unemployment rate

Descriptive Statistics of All 50 States, FY 2016				
Variable	Mean	Std. Dev.	Min	Max
<b>Debt (billions \$)</b>	12.738	19.357	0.0260	112.555
<b>Expenditures (billions \$)</b>	34.594	42.521	3.723	255.295
<b>Revenues (billions \$)</b>	34.107	42.592	3.539	255.725
<b>Surplus per capita (\$)</b>	-162.77	1026.39	-7039	402
<b>Credit Rating</b>	8.50	1.52	2	10
<b>Budget Cycle</b>	0.62	0.49	0	1
<b>State Senate Turnover</b>	2.76	6.29	0	28
<b>Population (millions)</b>	6.454	7.285	0.585	39.297
<b>Average Annual Income</b>	49,416	7,313	38,144	67,940
<b>Unemployment Rate (%)</b>	4.64	0.99	2.90	6.90



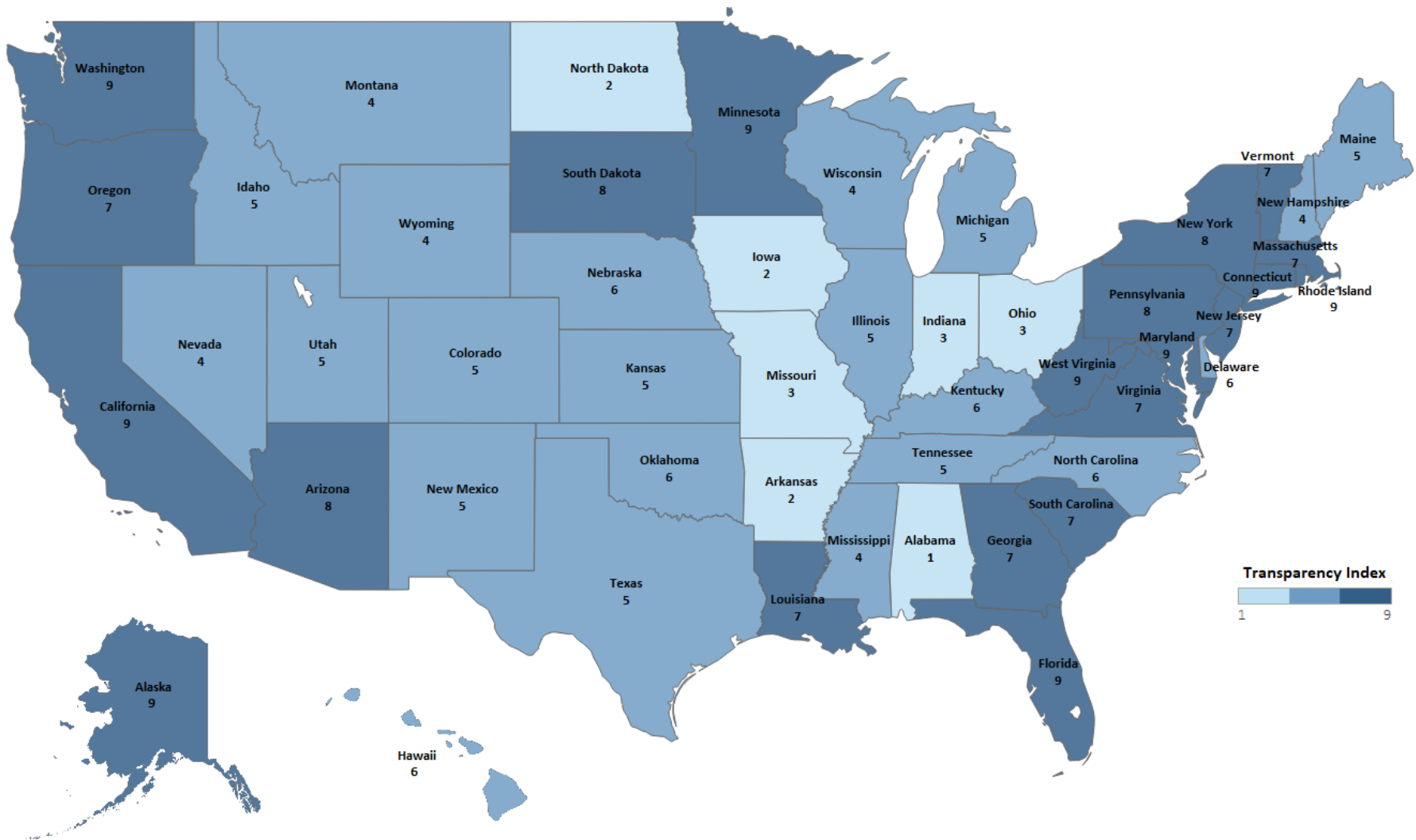
# Results

- Transparency index scores
- Score mapping
- Best practices
- Regression model

# Results: Transparency Index Scores

State Ranks Based on Index Score, FY 2016		
Index Score	n	State
9	9	Alaska, California, Connecticut, Florida, Maryland, Minnesota, Rhode Island, Washington, West Virginia
8	4	Arizona, New York, Pennsylvania, South Dakota
7	8	Georgia, Louisiana, Massachusetts, New Jersey, Oregon, South Carolina, Vermont, Virginia
6	6	Delaware, Hawaii, Kentucky, Nebraska, North Carolina, Oklahoma
5	10	Colorado, Idaho, Illinois, Kansas, Maine, Michigan, New Mexico, Tennessee, Texas, Utah
4	6	Mississippi, Montana, Nevada, New Hampshire, Wisconsin, Wyoming
3	3	Indiana, Missouri, Ohio
2	3	Arkansas, Iowa, North Dakota
1	1	Alabama

# Results: Transparency Index Scores

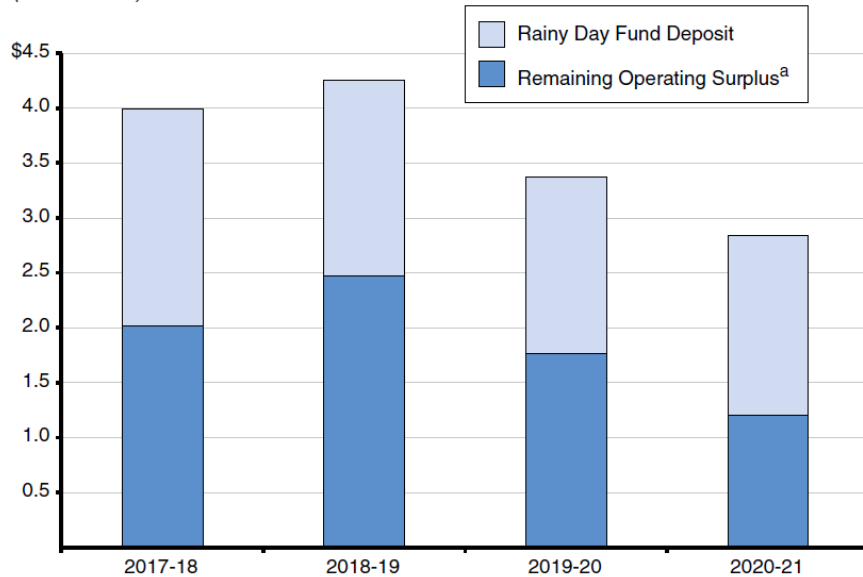


# Best Practice Example: California's Fiscal Outlook

Figure 24

## General Fund Surpluses and Reserve Deposits Under Economic Growth Scenario

(In Billions)



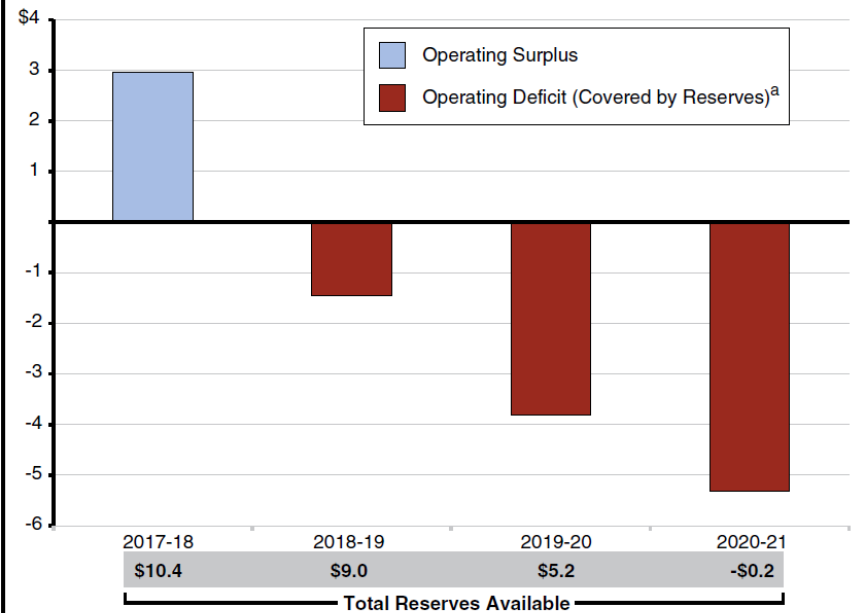
<sup>a</sup> Amount that can be allocated in budget or used to build additional reserves.

State of California — The 2017-18 Budget: California's Fiscal Outlook, p.52

Figure 25

## Reserve Balances Cover Operating Deficits in Mild Recession Scenario

(In Billions)



<sup>a</sup> A small portion (\$154 million) of the operating deficit in 2020-21 is not covered by reserves.

# Best Practice Example: West Virginia's Executive Budget Report

## Expenditures

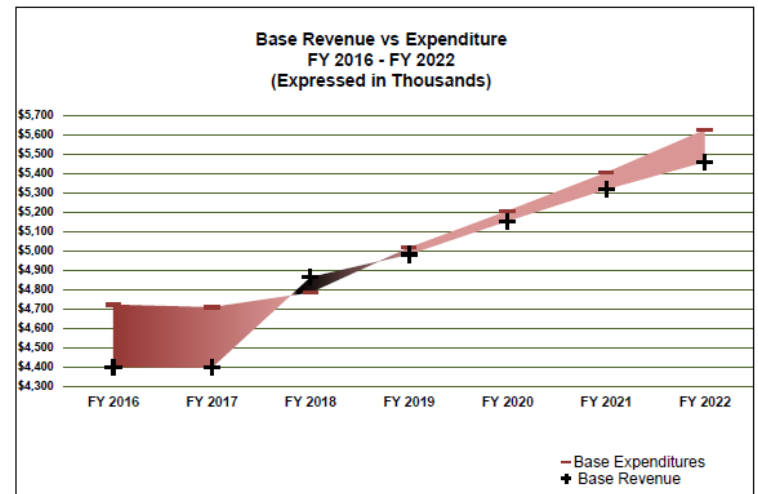
The FY 2018 budget development is the fourth budget that has been submitted using the state's new accounting system wvOASIS. This new system is web-based and paperless. The implementation of this system has required many training hours for agency employees, and again this year all agencies successfully submitted their budgets in a timely manner. Budgets generally, require information that is preloaded to be revised, which is much more efficient than the procedure used in the past, and requires much less data entry.

In preparing the Governor's FY 2018 budget during the last few months, the state faced an estimated budget gap of \$497 million for upcoming FY 2018. After consecutive years of state agencies submitting their budget requests at reduced levels, they were asked to submit their FY 2018 General Revenue appropriation requests at 100% of the FY 2017 current base funding level. To help close the anticipated FY 2018 budget gap, and to help in structurally balancing ongoing base budget expenditures in the out-years, the Governor has chosen to make various targeted base budget reductions to selected areas of the budget. In addition, the Governor recommends substantial increases in appropriations for the Teachers' Retirement System employers' match and for the Medicaid Program's State Share. The Governor also recommends an \$808 pay raise (average raise of 2%) for classroom teachers, and includes substantial new funding for Infrastructure and Economic Development.

The FY 2018 General and Lottery revenue base budget of \$4.783 billion as recommended by the Governor is only \$75.379 million higher than the FY 2017 base budget funding level of \$4.708 billion (even though retirement contributions alone increased by \$72.987 million). Since FY 2015, the state will have reduced its expenditure base budget funding levels, as proposed by the Governor, by (\$25.43 million.) The biggest base funding increases are for the retirement systems, the Medicaid program, and the Classroom Teacher Raise. The retirement contributions from the General and Lottery Funds increase the base by \$72.987 million. Medicaid's General and Lottery Revenue base funding increases by \$10.401 million. All other base

funding items in the FY 2018 budget decrease by a net (\$8.009 million.) Various onetime appropriations being recommended by the Governor are \$105.505 million for Infrastructure and Economic Development and \$8 million for major repairs for buildings.

FY 2019 through FY 2022 project manageable future budget gaps in the Six Year Financial Plan. The key to structurally balancing our out-years' budgets lies in total base budget expenditure reductions or increases in ongoing revenues. These reductions, and/or revenues, play a crucial role in aligning our base expenditures with base revenues in the upcoming out-years budgets.



*State of West Virginia — FY 2018 Executive Budget Report (Volume I), p.5*

# Regression Results: Associations with Transparency

- Positive association
  - Expenditures
  - Surplus per cap
  - Credit rating
  - Income
- Negative association
  - Revenue
- Not statistically significant
  - Debt
  - Budget cycle
  - Senate turnover
  - Population
  - Unemployment

Association of Fiscal, Political, and Institutional Factors on Transparency Index, FY 2016					
Variable	$\beta$	RSE	t-value	Sig.	
Debt (log)	-0.040	0.219	-0.180	0.856	
Expenditure (log)	12.456**	6.002	2.080	0.045	
Revenue (log)	-11.752*	5.921	-1.980	0.054	
Surplus per capita	0.001**	0.001	2.210	0.033	
Credit Rating	0.240*	0.126	1.910	0.063	
Budget Cycle	0.587	0.434	1.350	0.184	
State Senate Turnover	0.011	0.027	0.390	0.697	
Population (log)	-0.672	0.946	-0.710	0.482	
Average Annual Income (log)	4.471*	2.281	1.960	0.057	
Unemployment Rate	36.170	30.579	1.180	0.244	
Intercept	-58.230***	18.809	-3.100	0.004	
No. of Observations	50				
F (10, 39)	3.86				
R-Squared	0.3623				
Root MSE	1.4884				
*** $p < .01$ ; ** $p < .05$ ; * $p < .10$ . RSE = Robust Standard Error					

# Conclusions

- State results
- Objectivity
- Future research

# Conclusions

- Every state has room to improve its transparency practices
  - Public access alone does not constitute fiscal transparency
- Information should be:
  - Accessible
  - Understandable
  - Timely
- Objective transparency indicators
  - Identify states that best use transparency strategies
  - Common characteristics
  - Understand why some states are more transparent than others
- Future Research
  - Use model to explore the extent to which transparency affects the environment in which officials make decisions about resource allocation



# Thank You!

Alex Hathaway  
nhathaway2@gsu.edu

*Special thanks to the Volcker Alliance  
and the other southeastern research teams:*

University of Kentucky (Merl Hackbart & Rhonda Trautman)

Florida International University (David Guo)



**THE VOLCKER ALLIANCE**

*Working for Effective Government*