

EPRU Working Paper Series

**Economic Policy Research Unit
Department of Economics
University of Copenhagen
Studiestræde 6
DK-1455 Copenhagen K
DENMARK
Tel: (+45) 3532 4411
Fax: (+45) 3532 4444
Web: <http://www.econ.ku.dk/epru/>**

The Causes of Fiscal Transparency: Evidence from the American States

James E. Alt, David Dreyer Lassen,
and Shanna Rose

2006-02

ISSN 0908-7745

**The activities of EPRU are financed by a grant from
The National Research Foundation**

The Causes of Fiscal Transparency: Evidence from the American States

James E. Alt

Department of Government, Harvard University

David Dreyer Lassen

Department of Economics, University of Copenhagen

Shanna Rose

Department of Political Science, SUNY-Stony Brook

This version forthcoming, *IMF Staff Papers*

Abstract

We use unique panel data on the evolution of transparent budget procedures in the American states over the past three decades to explore the political and economic determinants of fiscal transparency. Our case studies and quantitative analysis suggest that both politics and fiscal policy outcomes influence the level of transparency. More equal political competition and power sharing are associated with both greater levels of fiscal transparency and increases in fiscal transparency during the sample period. Political polarization and past fiscal conditions, in particular state government debt and budget imbalance, also appear to affect the level of transparency

The authors thank Gian Maria Milesi-Ferretti, Ilyana Kuziemko, and participants at the Colloquium on Law, Economics, and Politics, NYU, and the IMF Annual Research Conference for helpful suggestions. Lassen thanks the EPRU-network for funding.

1. Introduction

From a policy perspective, government transparency has been an integral part of attempts to reform public sector governance since at least the early 1990s. Broadly defined, government transparency is the overall degree to which citizens, the media, and financial markets can observe the government's strategies, its actions, and the resulting outcomes. In this paper, we focus on one important aspect of transparency: fiscal (or budget) transparency. Fiscal transparency now plays a key role in public sector design; both the OECD and the IMF have recently implemented Codes of Best Practice for Fiscal Transparency to guide countries towards a more open fiscal policy decision process, partly in recognition of the fact that fiscal transparency does not always come about by itself. While it is sometimes possible for supranational institutions or higher-level governments to push for—or downright require—reforms of the budgetary process as a part of a stabilization package, the causes of government transparency during “budgetary peacetime” remain less well understood.

In this paper we investigate, conceptually and empirically, the determinants of fiscal transparency. There exists a fairly large literature on the effects of institutions—both fiscal and political—but very little work considers the endogeneity of such institutions. Understanding the causes of institutional change is important for two reasons: First, it will help us to determine when we can reasonably expect institutions to emerge by themselves and when outside actors are needed for institutional change to take place. Second, it will enable us to estimate the effects of institutions on policy choices and outcomes. While institutions obviously do not change as frequently as does policy, the fact that institutional change is typically deliberate in itself makes it difficult to assess the direct impact of institutions on policy. The reason is that observed

changes in policy could be a function of past outcomes that also affect the scope and desire for institutional change, rather than a function of (changing) institutions per se.

To investigate the causes of transparency, we have collected a unique data set on transparent budget practices in the American states from 1972 to 2002. This period saw substantial changes in the degree of fiscal transparency in state government budgeting. Since we consider both a large number of cases and a measure with considerable variation, our analysis is an important improvement over existing studies of institutional change in budgetary procedures.

The next section reviews the conceptual framework that guides our empirical analysis. Section 3 describes our panel data on transparency in the American states. Section 4 offers a qualitative analysis of some interesting and important cases of reform. Section 5 describes the empirical specification for the quantitative analysis, section 6 reports the results, and section 7 concludes and describes our next steps.

2. Theoretical framework

Institutions—fiscal or otherwise—set the stage on which political actors, voters, and markets interact. “Institutions affect behavior primarily by providing actors with greater or lesser degrees of certainty about the present and future behavior of other actors” (Hall and Taylor 1996, p. 939). The insight that institutions matter for choices and outcomes is the basis for the past two decades’ increased focus on principles of good governance, of which transparency of government is a prominent part.

Increasing fiscal transparency is a way of providing voters, observers, financial markets, and sometimes politicians themselves with more information about the intentions behind fiscal policy, the actual actions taken, and the immediate and longer-term consequences of specific policies. This eases the task of forecasting future fiscal policy, and of attributing fiscal outcomes

to policies, and fiscal policies to particular politicians. A comprehensive definition of fiscal transparency is given by Kopits and Craig (1998, p.1):

“Fiscal transparency is defined ... as openness toward the public at large about government structure and functions, fiscal policy intentions, public sector accounts, and projections. It involves ready access to reliable, comprehensive, timely, understandable, and internationally comparable information on government activities ... so that the electorate and financial markets can accurately assess the government’s financial position and the true costs and benefits of government activities, including their present and future economic and social implications.”

There are literatures that analyze the consequences of transparency in government,¹ international organizations, monetary policy, and fiscal policy, which is our focus in this paper. The next section reviews this literature, while the following section turns to the causes of transparency.

Imperfect information and agency models

Transparency is an issue only when there is imperfect information. In a simple sense, more transparency means “more information transmitted.” Many academics and policy-makers see more transparency as generally beneficial. The reasons, according to Posen (2002) include

¹ Petrie (2003) provides thoughtful suggestions on how to make the implementation of transparency reform more effective.

trust,² predictability,³ reduced noise in markets,⁴ credibility, and coordination.⁵ However, more transparency also trades off the value of sunlight with the danger of over-exposure, as Heald (2003) puts it. “Too much” transparency can produce excessive “politicization” and reduce flexibility. If information is revealed to third-parties who use it harmfully, increasing transparency can be bad.⁶ Finally, as Geraats (2002, 2005) points out, transparency can also affect incentives. For instance, if not keeping explicit promises is costly, transparency might lead politicians to keep promises when not doing so might be better.

Several authors examine the effects of transparency in the context of imperfect information models. Milesi-Ferretti (2004) develops a reduced form model that allows him to investigate the interactive effects of transparency and fiscal rules, such as those imposed by members of the European Union under the Maastricht Treaty of the 1990s. He assumes that politicians are myopic (perhaps due to the positive probability of being replaced in the next election), and therefore prefer to run larger deficits than the public would like. He finds that, in

² Trust increases when transparency means “tell them what you’re going to do.” If a politician has a history of having nothing to hide, then when he needs someone to take something on faith, he is more likely to get it. Transparency reassures people that he has not abandoned long-term goals, which could give him greater flexibility.

³ Greater disclosure makes your actions more predictable when transparency means “give them details and justifications.”

⁴ In the political market, voters get a clearer view of performance, and can make more effective use of votes. In financial markets, participants are not misled and risks are reduced (see Glennerster and Shin n.d.). Generally better observability is welfare-improving, as it reduces transaction costs in the broadest sense.

⁵ Lowry and Alt (2001) provide such an interpretation of balanced budget rules, conditional on market behavior. In monetary policy, an incumbent wishing to be seen to fight inflation can do so more effectively if the standard for what will count as fighting inflation is unambiguous.

⁶ In this way, “harmful” competition advantages secret voting (Dal Bo 2005).

this context, transparency affects politicians' responses to fiscal rules: under high transparency, rules induce politicians to make the real fiscal adjustments needed to bring the budget into balance, while under low transparency such rules simply encourage "creative accounting."

In another line of inquiry, using the probabilistic voting model of Lindbeck and Weibull (1987), Gavazza and Lizzeri (2005) investigate the effect of transparency on competition among different groups of voters who value targeted transfers. Where competing parties engage in pre-electoral competition, transparency on the expenditure side of the budget is welfare improving, while transparency solely on the revenue side can result in lower welfare as it reduces the marginal political costs of offering wasteful transfers. We return to this distinction in the empirical section by separately examining the causes of expenditure and revenue transparency.

However, unlike these two papers, most work on transparency in political economics has taken place within a class of models known as political agency models, due to Barro (1973) and Ferejohn (1986). These models adapt the principal-agent framework, in which the agent is better informed than the principal, to a political setting such that voters, as principals, elect politicians who, as agents, make policy choices that affect voters. For an application to fiscal policy, see Persson, Roland and Tabellini (1997).⁷ A direct focus on transparency, interpreted as the degree to which voters can observe characteristics of or actions taken by the agent, is not common, but we return to examples below.

In a political agency model combining adverse selection and moral hazard, Besley (2005) and Besley and Smart (2003) show that increasing transparency has two countervailing effects

⁷ For a different asymmetric information model applied to fiscal policy, see Rogoff (1990). Geraats (2002) analyzes transparency in a signaling model where the incentive effects of transparency are sometimes set against the effects of inflation fighters' reputations.

on voter welfare. On the one hand, increasing transparency allows voters to better screen good politicians from bad ones. On the other hand, greater transparency at the same time disciplines politicians in their rent-seeking, which makes it harder for voters to distinguish between good and bad politicians. The net result on the quality—and turnover—of incumbents is ambiguous. In Alt and Lassen (2006a), politicians do not seek rents for personal gain; rather, the politician's concern for re-election is driven by a desire to implement policy. Therefore, the disciplining effect disappears and transparency unambiguously increases voter welfare through improved screening.

Prat (2005) considers a distinction, introduced by Ferejohn (1999; see below), between the effects of transparency on consequences and actions.⁸ In Prat's (2005) career concerns model, where both voters and the politician are uncertain about the politician's type, improving the transparency of consequences is always beneficial to voters, but more information about the agent's actions can be detrimental if it causes the agent to disregard private informative signals with an aim of appearing in a certain way to the public. The same idea motivates Morris and Shin's (2000) treatment of transparency in monetary policy.

Theoretical results on the effects of transparency on fiscal policy come from Shi and Svensson (2002), Besley and Prat (2006), Alt and Lassen (2006a,b), and Besley (2005). All model transparency within a political agency framework, where electoral promises are non-enforceable and voting is retrospective. Voters hold incumbents accountable for their policy choices in the previous period, and transparency alleviates informational asymmetries between voters and politicians. The precise effects of transparency depend on the issue under consideration, but the main empirical conclusions of this literature are that increasing

⁸ See also Stavasage (2004) and Fox (2005).

transparency reduces debt accumulation and the scope for generating political budget cycles. A separate, empirical literature has investigated the effects of transparency on financial markets. Glennerster and Shin (n.d.) find that higher transparency lowers borrowing costs in sovereign debt markets, and Gelos and Wei (2005) find that emerging market funds invest less in less transparent countries.

Models of endogenous transparency

Although empirical studies have uncovered evidence that transparency has some welfare-improving effects, the theoretical literature also suggests that the effects of transparency (and, therefore, for our purposes, perhaps the causes as well) are not always beneficial to voters. However, even if fiscal transparency were unambiguously desirable from the public's point of view, it would still be the case, as noted by Alesina and Perotti (1996, p. 403), that "... politicians typically do not have an incentive to adopt the most transparent practices," since doing so decreases their informational advantage over markets and voters—an advantage useful for political and re-election purposes. Why might politicians dislike transparency? As suggested in the foregoing discussion of the literature, there are many possible reasons: rent-seeking politicians do not wish to be disciplined; bad politicians do not wish to be distinguished from good politicians; re-election-minded politicians want to generate political business cycles; myopic politicians want to run bigger deficits than the public would like. For politicians, these factors militate against increasing transparency, and might even motivate decreasing transparency.

Although politicians may not have incentives to increase transparency, it nevertheless does sometimes happen, even in the absence of outside pressure. Thus, the question arises: under what circumstances will politicians implement more transparent budget procedures? We explore

two broad sets of explanatory factors: the *political setting* and the *fiscal environment*. We look as well at the interaction between the two, since different factors can pull in different directions and institutional change can depend on which dominates at a particular time. We look first in some detail at the political setting, and then turn to the fiscal environment.

Political setting

The political setting can influence the demand—or lack thereof—for fiscal transparency in a number of ways. First, there are what we call *partisan* changes in transparency. These occur when incumbent politicians change the degree of transparency in order to further a specific partisan goal, such as an increase or decrease in the size of the public sector. Then there are *non-partisan* changes, which can arise for a number of different reasons. Sometimes non-partisan changes take place when pressure for reform arises from within the bureaucracy. They can also reflect attempts to accommodate financial markets, or in a broader context, supranational institutions. Most importantly for our analysis, non-partisan changes can arise when the political context, described by levels of political competition and polarization, provides current politicians with incentives to change transparency, independent of their partisan goals. An important feature of these political but non-partisan goals is the desire of some set of politicians to tie other politicians' hands—whether the others are potential successors or other incumbents contemporaneously sharing power. In summary, we use “non-partisan” to indicate behavior that might be partisan but would be equally likely under either party.

In the theoretical literature described above, the degree of transparency is given as a parameter determined outside of the model, before the economic and political choices of interest are taken. Only one contribution known to us (Ferejohn 1999) explicitly considers the “constitutional choice” of an information structure. Ferejohn introduces into a political agency

model the degree of transparency, modelled as the precision of a signal of the incumbent's action, which is chosen by the incumbent before a typical period begins. In his model, voters—as principals—will, under certain parameter restrictions, allocate a larger part of their resources to the agent—the public sector—when they receive a more precise signal of the political agent's action.

Ferejohn's model implies that politicians who wish to increase the size of the public sector should increase transparency so as to make voters trust them with more resources. Evidence that, in the American states, Democrats' preferred level of spending is greater than that of Republicans (Alt and Lowry 2000) suggests that partisan changes in transparency will be driven by Democratic incumbents hoping to increase the size of government.

An alternative, non-partisan view of the constitutional choice of transparency is based on the logic of strategic institutional design. Alt and Lassen (2006a) argue that transparency reform is closely analogous to delegation to an independent judiciary. Consider Hanssen's (2004) delegation model, in which two parties compete for office and the incumbent faces an exogenous risk of replacement by the opposing party. The incumbent can choose to delegate policy choice to an independent institution, the judiciary. By doing so, the incumbent risks the possibility that the judiciary will make a decision that will favor the opponent; however, if the risk of replacement—and with it the risk of an adverse policy choice—is sufficiently large, the latter consideration outweighs the former and the politician will favor delegation.

Similarly, an incumbent who is considering maintaining a low-transparency regime trades off the probability of remaining in office and enjoying the informational advantages afforded by low transparency against the risk of being replaced by an opponent who, if elected, would use a low transparency regime to pursue his own, opposing political goals. If the

incumbent instead chooses high transparency at the constitutional stage, he ties his own hands, but also those of his potential successor. If the probability of being replaced is large, the expected benefits of restricting the opponent outweigh the costs of restricting himself, whereas if he is likely to be re-elected, the expected benefits from increasing transparency are small. Thus, our testable hypothesis is that the level of fiscal transparency increases with political competition.⁹ As discussed below, we measure competition in a variety of ways.

Incumbents might want to tie the hands of not only their potential successors but also other politicians with whom they contemporaneously share policy-making authority. Indeed, power-sharing among incumbents simply reflects another variety of political competition. This form of competition is clearly more palpable under divided government (in which different parties control different branches of government) than under unified government (where the same party controls both branches). Therefore, one might expect to see increases in transparency where divided government is more common.

In addition to the probability of being replaced by (or the need to share power with) the opposing party, the degree of political polarization can also affect the trade-off politicians face in choosing the level of transparency. This can work in two directions. First, following from Hanssen, increased political polarization can raise the cost of being replaced by the other party, if it means that opponents in low transparency environments will choose policies that incumbent politicians particularly dislike. This suggests that polarization increases the benefits of tying the hands of a partisan adversary. Second, and alternatively, it could be the case that some sort of

⁹ Alt and Lassen (2006a) find support for this hypothesis in a cross-section of advanced OECD economies for the 1990s. They use this, and a measure of legal origin (common vs. civil law), to instrument for transparency in an analysis of the effects of transparency on government debt.

agreement is needed in order for reform to take place. This possibility is reflected in the hypothesis of North (1990, p.191) that “political institutions constitute *ex ante* agreements over cooperation among politicians.” If this is true, a more polarized polity could be a hindrance, rather than a catalyst, to transparency. We will examine this issue empirically.

Fiscal environment

Along with political factors, fiscal policy outcomes can also influence politicians’ incentives to implement more transparency in the budgeting process. Historically, fiscal institutions often have been implemented or reformed following periods of fiscal distress.¹⁰ In particular, if a lack of transparency in the budget process contributed to a negative fiscal shock, an appropriate response would be to increase transparency. In New Zealand, wide-ranging fiscal reform was implemented in the 1990s when a new incumbent took office and found a big undisclosed fiscal obligation (Campos and Pradhan 1999). Substantial stabilization packages, and in some cases bail-outs, are often accompanied by reforms, either as required by outsiders or as a consequence of political turnover. Such reforms are not in the political interest of the incumbent(s) responsible for the negative shocks if they help voters attribute the bad outcomes to them. On the other hand, to the extent that transparency leads voters to attribute a newly improved fiscal situation to current politicians, it may be optimal for politicians expecting good fiscal records to increase transparency. There is a trade-off here between the incumbent’s fear that voters will punish him for the crisis and the desire to get credit for shaping up, even at a cost of other foregone opportunities.

¹⁰ For example, the introduction of balanced budget rules in the 19th century took place as a result of fiscal crises following from the construction of canals (Heckelman et al 1999).

3. Transparency Index

Our transparency measure for state government budget procedures is based on Alt, Lassen and Skilling (2002). Using cross-sectional data for the 1990s from the National Association of State Budget Officers and the National Conference of State Legislatures, the authors code nine dichotomous budget procedures and create an index equal to the number of items for which each state had the more transparent procedure.¹¹ The nine items are:

1. Is the budget reported on a GAAP (Generally Accepted Accounting Principles) basis? (Yes = more transparent, since shared language facilitates communication)
2. Are multi-year expenditure forecasts prepared? (Yes = more transparent, since more information about plans and the expected consequences of action is disseminated)
3. What is the frequency of the budget cycle? (Annual = more transparent than biennial, since more frequent action means more up-to-date information)
4. Are the revenue forecasts binding? (Yes = more transparent, since binding estimates increase the costliness of being misleading)
5. Does the legislative branch have (or share) responsibility for the revenue forecast? (Yes = more transparent, since legislative or consensus forecasts involve more officials, reducing the likelihood that estimates are misleading or manipulative)
6. Are all appropriations included in a single bill? (Yes = more transparent, since a single location facilitates monitoring)
7. Does a nonpartisan staff write appropriations bills? (Yes = more transparent, because these staff have less partisan incentive to be misleading)

¹¹ Alt and Lassen (2006a) presents a transparency index based on similar principles for nineteen OECD countries.

8. Is the legislature prohibited from passing open-ended appropriations? (Yes = more transparent, because published figures will be closer to ultimate outcomes)
9. Does the budget require published performance measures? (Yes = more transparent, because these create more explicit standards and information for judging politicians' actions)

In this study, we extend the data back in time in order to construct a panel on budget transparency. We have collected a unique data set, comprised of survey responses to a questionnaire sent to the budget officers of all fifty states, to construct an annual score for each year between 1972 and 2002. We focus on the 48 contiguous states for the period 1976-1999 (due to the inclusion of four year lags, see below), in total 1152 cases. We could not reconstruct the nine-item scale for all states in all years: 176 of the 1152 cases (15.3%) are missing one data item, 59 cases (5.1 %) are missing two items, and 12 cases (1.0 %) are missing three items. No case is missing more than three items. We code our transparency variable (“pctscore”) as the ratio of items scored = 1 to total items answered. Figure 1 shows the histogram for our 1152 cases. The distribution is unimodal, with a median of 0.444 (4/9).

[Figure 1 here]

In some cases, a change in the transparency index reflects a change in the number of reported items, rather than an actual change. This would be the case, for example, if the respondent did not know the status for a particular year for a particular item. Excluding such cases does not change the impression of Figure 1 and, further, the statistical results presented below also are unaffected by such missing data.

Figure 2 shows the evolution of transparency in the fifty states from 1972 to 2002. Most states saw some changes in the degree of fiscal transparency (on the vertical axis) over the three

decades (horizontal axis). Some states saw quite substantial increases in transparency, some of which we will investigate in case studies, while seven states did not change their degree of transparency at all during the period. Overall, budget transparency increased from a cross-state average of 0.41 in 1972 to 0.54 in 2002. There was essentially no change in annual average scores until the early 1980s, when an upward trend began and later intensified during the 1990s.

[Figure 2 here]

4. Four Cases of Reform

Four states made significant progress toward increasing transparency within a relatively short time frame. Specifically, these states' scores on our nine-point transparency index increased by at least three points over a period of five years or less. The states—and the periods during which their reform bursts took place—are Delaware (1978-1980), North Carolina (1991-1995), Rhode Island (1990-1991), and Wyoming (1993-1997). This section explores the political and economic circumstances surrounding these states' reforms.

Delaware

Delaware was among the states hit hardest by the national recession of 1973-1975. By January 1977, when Republican Governor Pete du Pont took office, its unemployment rate had reached an all-time high of 8.2 percent and the state's finances were in a shambles (Bureau of Labor Statistics 2005). Du Pont's election followed a period of unusually high party turnover in the governor's office, compared to the state's historic tendency to elect Republican governors. Both chambers of the legislature were newly under Democratic control, having been controlled by the Republican party during the previous decade, and by Democrats during the decade before that.

In 1977, the state was trying to recover from two previous administrations that had brought it to the brink of fiscal disaster. When Governor Pete du Pont found resistance to efforts at change, he decided to throw a serious scare into the legislature, the rating agencies and the citizenry by telling everyone that as far as he was concerned, Delaware was virtually bankrupt (*Governing* 2005).

That year, Governor du Pont issued an executive order calling for the creation of Delaware's Economic and Financial Advisory Council (DEFAC), an independent, nonpartisan group of public and private sector experts charged with forecasting revenues. Since its inception, DEFAC's revenue forecasts have been accepted without question by both the executive and legislative branches, and the council has been widely credited with helping Delaware to weather subsequent recessions better than many other states. Many observers, including State Treasurer Jack Markell, attribute DEFAC's continuing success to the memory of the fiscal crisis: "It helps a lot that the state went through what it went through 30 years ago" (*Governing* 2005).

North Carolina

At the time of North Carolina's 1990-1991 budget crisis, Republican James Martin had just been re-elected governor by a state that had, up until that point, almost always elected Democratic governors; the legislature, however, was firmly controlled by the Democratic Party, as it had been for many decades.

In 1991, North Carolina's fiscal problems grew to a crisis level. The state began the year with a \$222 million General Fund balance and ended it with \$400,000.

To address its severe fiscal crisis, the General Assembly was forced to reduce and restrict hiring and operating expenditures, defer capital projects, draw down

reserves, reduce non-recurring expenses, increase taxes by \$637 million, [and] cut expenditures by \$576 million (GPAC 1992).

“As a consequence of fiscal pressures,” the Democratic legislature in 1991 commissioned the newly-created Government Performance Audit Committee (GPAC) to conduct a year-long performance audit to identify ways to “reduce the costs of program service delivery and... strengthen the financial planning, budgeting, and management systems” (GPAC 1992). The Committee—consisting of the leadership and select members of the House and Senate, the State Auditor, and several private sector leaders—together with accounting firm KPMG Peat Marwick made several recommendations to the government of North Carolina (among them performance budgeting) which were subsequently implemented by the government.

Rhode Island

In the early 1990s, Rhode Island was, like North Carolina, in the midst of a major fiscal crisis. The state was experiencing its largest deficit since the Great Depression, as well as the biggest government scandal in the state’s history: the failure of Rhode Island Share and Deposit Indemnity Corporation (RISDIC), the organization that insured the state. The governor at the time—Edward DiPrete—was the first Republican elected to that office in nearly two decades. DiPrete was unpopular; at one point his job approval rating dipped as low as 16 percent (and after leaving office he was indicted for extortion and accepting bribes). Among other things, DiPrete was widely blamed for a budget process that was “political and inefficient,” according to Gary Sasse of the Rhode Island Public Expenditure Council, the state’s most prominent watchdog group. The legislature at the time was, as usual, controlled by Democrats. A Democratic legislator named Paul Crowley successfully introduced legislation proposing binding

consensus revenue forecasting. The forecasting process is widely believed to have improved dramatically since then—it is less political and produces more realistic revenue forecasts, according to Mr. Sasse.¹²

Wyoming

While Wyoming’s legislature has long been a Republican stronghold, the state has seen frequent party turnover in the governor’s office over the past fifty years. At the time of the 1990-1991 recession and fiscal crisis, the governor was Democrat Mike Sullivan. In the wake of the crisis, a bipartisan, inter-branch consensus emerged that the state needed to reevaluate and improve its budget process, according to Fiscal Administrator Mike McVay. In 1994, Republican legislator and gubernatorial hopeful Jim Geringer submitted legislation calling for a new system that would use performance measures to link public spending to outcomes. Geringer went on to win the governorship, returning the state to unified Republican control in 1995. As governor, he oversaw the implementation of performance budgeting and continued to be a strong advocate of the new approach, despite growing resistance from the legislature. According to a legislative source who wished to remain anonymous, “the legislature has basically said ‘we’re not having any part of this.’ They want an appropriations process that focuses on the nuts and bolts of spending, down to the number of paper clips”—that is, the line-item format with which they had grown familiar. Mr. McVay concedes that the state, under the new administration of Democratic Governor Dave Freudenthal, is still “fine-tuning” the process.

¹² Around the same time, Rhode Island took many other steps to open up the legislative process to public scrutiny.

For a summary of these reforms, see <http://www.rilin.state.ri.us/studteaguide/RhodeIslandHistory/chapt9.html>

In summary, several common themes emerge from these states' experiences: in all four cases, measures to increase transparency were adopted in response to recession-induced fiscal crises, during periods of divided government, following periods of high party turnover in the governor's office. Interestingly, legislative turnover was virtually nonexistent in three of the four states. In some cases, the new measures seemed to reflect a consensus among policy-makers, while in other cases one party or branch of government – not necessarily the same one in each case – clearly imposed reforms on the other. In the next section, we turn from qualitative to quantitative analysis in order to investigate the political and economic determinants of transparency in the full sample of American states.

5. Empirical Methodology

Our dependent variable is the transparency index summarized in Section 3. As mentioned above, one of our main explanatory variables is political competition. A cursory look at the literature suggests that there exists no single agreed-upon measure of political competition. Therefore, in our empirical analysis, we utilize three different measures: (1) divided government, which is a dichotomous variable equal to one if different parties control the executive and legislature and zero otherwise;¹³ (2) gubernatorial competition, as measured by the share of Democratic votes in the gubernatorial election, folded such that the index captures absolute deviations from one half; and (3) legislative competition, as measured by Besley and Case (2003) as the (folded) Democratic seat shares in the upper and lower houses.¹⁴

¹³ If control of the legislature is split between parties, we code the case as divided government. We return to this in table 5, below.

¹⁴ It is defined as $-1 * \text{abs}(\text{share of seats in lower house held by Democrats} - .5) * \text{abs}(\text{share of seats in upper house held by democrats} - .5)$.

To measure political polarization within a state, we follow Hanssen (2004) in using measures of ideology based on roll-call voting in the U.S. Congress, as no comparable data on political polarization at the state level exists. The data are taken from Poole and Rosenthal (1997). The authors estimate the positions of members of Congress along two dimensions. Like Hanssen (2004), we use the first of these, the liberal-conservative axis, to calculate average ideology scores for each state's members of Congress. For each year and state, we measure policy distance by the absolute difference between average ideology scores.

Our key fiscal variables of interest include the deficit and debt, and general revenues, all measured in real per capita terms. Socioeconomic controls include real per capita income, income squared, population size, population squared, percent elderly, and percent school-aged. Finally, we include state fixed effects to capture permanent differences among states and year effects to capture common exogenous shocks. Summary statistics are presented in Table 1.

[Table 1 here]

Empirical specification

We want to estimate the effect of political and economic variables on the level of the fiscal transparency index. Our basic specification is:

$$y_{st} = \alpha_s + \gamma_t + \chi p_{st} + \beta' x_{st} + v_{st}$$

where y_{st} is the level of fiscal transparency in state s in year t , α_s is a state fixed effect, γ_t is a year indicator variable, p_{st} is the measure of political competition, x_{st} comprises other political and economic variables, and v_{st} is the error term. When we estimate the model, we allow for heteroscedasticity in the error terms and always report F -tests based on robust standard errors.

To allow for the fact that institutional changes occur infrequently, we add to the basic model two features. First, we include a series of lags for the independent variables, so that even when the conditions for change are in place, the dynamics of the political process may delay the actual implementation of a new procedure. Specifically, we include lags from $t - 2$, and $t - 4$. Second, we also include the lagged dependent variable (at $t - 4$) on the right-hand side. While there are well known issues with the fixed-effects estimator in the presence of lagged dependent variables, we are reasonably confident that any bias is minimal as the length of the panel spans three decades. We also note (following Judson and Owen 1999) that any bias will mostly affect the coefficient on the lagged dependent variable, which we include as a control, but which is not a variable of interest to us. As a robustness check, below we also consider a dynamic panel data model estimated by GMM and show that results are unaffected.

6. Empirical Results

The first column of Table 2 reviews our hypotheses. As explained in Section 2, we expect incumbents to tie the hands of both their potential successors and other politicians with whom they contemporaneously share policy-making authority; thus, political competition should be associated with increased transparency. We also expect greater increases in transparency under Democratic control of government, as Democratic politicians arguably have greater incentives to make voters trust them with more resources. Polarization and poor fiscal performance might be hindrances or catalysts to increasing fiscal transparency, for reasons explained above.

The second column of Table 2 summarizes the actual signs of the coefficients on these variables in the empirical analysis that follows. A comparison of the first and second column shows that the findings are largely consistent with our hypotheses. We now turn to a detailed discussion of our results.

[Table 2 here]

We present the results of our quantitative empirical analysis in several tables. Table 3 reports results from our basic specification, Table 4 restricts the sample to states that experienced changes in the level of transparency, Tables 5 and 6 introduces interaction effects between the political setting and the fiscal situation, and Table 7 decomposes the transparency index into expenditure transparency, revenue transparency, and general transparency.

The tables report F -test statistics for (groups of) variables and their lags, the corresponding p -values, and the sign of the aggregate effect, which is the simple sum of the (current and lagged) coefficients on the variable, by a + or – sign. We comment on some magnitudes of effects in the text below. We focus on six groups of variables and their lagged values, in addition to the lagged endogenous variable: (1) political competition measures; (2) political polarization; (3) partisan composition of government; (4) debt; (5) fiscal surplus; and (6) fiscal deficit. We also include, but do not report, socioeconomic controls, a dummy variable for large deficits (which equals a dummy for Rhode Island in the early 1990s and is positive and strongly significant), a dummy variable for independent governors (negative and significant) and state and year fixed effects (which are jointly significant, respectively).

Table 3 reports results from basic specifications on the full data set. The table holds five sets of results, one for each of the three measures of political competition, one for party control and one for fiscal imbalance. The first column reports the results when we use divided government as our measure of political competition. The F -test statistic value of 1.91 is the result of the joint test that $\sum divgovt_k = 0$ for $k = t, t - 2, t - 4$. The test has (1, 1029) degrees of freedom and the resulting p -value is 0.167. The sum of the coefficient estimates is positive, which implies that the presence of divided government increases the level of fiscal transparency,

though only in a marginally significant way. The regression reported in the first column also shows that political polarization is associated with lower transparency.¹⁵ Jointly, the continuous polarization measure and the dummy variable for one-party states have significantly negative effects on the degree of transparency.

[Table 3 here]

The next pair of columns reports results from similar regressions where the measures of political competition are, respectively, legislative competition and gubernatorial turnover. We find, across the measures of political competition, broadly similar results, clearest in the case of legislative competition. Political competition tends to increase the level of fiscal transparency, which supports the idea of strategic or “non-partisan” institutions. In state governments characterized by high degrees of turnover or by divided government, incumbent majorities of both parties can benefit from increasing transparency as this restricts potential successors from the opposing party.

To sum up, there is evidence that political competition is associated with higher transparency while polarization is associated with lower transparency. This could suggest that bipartisan cooperation on changing transparency is possible to a lesser extent when parties are polarized.

The fourth column considers party control of government. An implication of Ferejohn’s (1999) model, supported empirically by Alt, Lassen, and Skilling (2002), is that higher

¹⁵ Recall that a polarization measure is available only for states represented by more than one party in Congress. States that elect only one party to Congress will, besides typically having small populations, have some degree of polarization and may even be more polarized, everything else equal. For consistency, they are represented in our analysis by a dummy variable, since a “zero” score indicates minimal polarization, as well as only one party in Congress.

transparency is associated with a larger public sector. A possible implication of that finding is that parties favoring a larger public sector would have an incentive to increase transparency to gain voter support. The Democratic Party is widely recognized as more favorable than the Republicans to a larger public sector. Indeed, Democratic control of the governorship and legislature is associated with increased transparency. However, neither variable achieves statistically significant estimates.

In addition to the political variables, fiscal variables also appear to matter for the adoption of fiscal transparency. Higher levels of debt are associated with lower transparency. Elsewhere, there is cross-sectional evidence that lower transparency produces higher debt,¹⁶ But here the inclusion of fixed effects means that this result is based on time variation. Moreover, departures from budget balance are associated with higher transparency. Both higher deficits (the deficit is presented as a positive number; see Table 1) and higher surpluses contribute to higher transparency. The deficit result has the familiar interpretation that when times are bad, politicians need to open up, explain, and justify their actions. The conjunction of debt and deficit results suggest that a deficit motivates reform more where the stock of debt is lower, i.e., where the deficit more resembles a surprise or “crisis.” The surplus result looks like a confirmation that politicians with good fiscal records are more likely to open the books for outsiders to see, but the debt result goes against this. We return to these issues below.

Across all specifications of Table 3, the controls for population, income, and revenues are usually insignificant, while the percentage of the population that is elderly (school-aged) has a positive (negative) effect on transparency. Table 4 eliminates insignificant controls and reports results from a set of regressions including both fiscal variables and significant political variables

¹⁶ Alt and Lassen (2006a) show that in a sample of OECD countries lower transparency leads to higher debt.

in Table 3. The regressions are repeated for each of the three competition measures, both for the full sample and for a restricted sample of states that changed transparency at some point during the sample period. This restricted sample excludes states with constant percentage scores as well as states where changes in the score reflect the in- or exclusion of particular items rather than real changes. The restricted sample includes 38 states.

[Table 4 here]

Compared to Table 3, the results for fiscal variables are essentially unchanged: debt has a uniformly negative effect, and imbalance a positive effect, on transparency. The political competition results are stronger than before. The coefficients on all of the competition measures are significantly positive, regardless of measure and sample. The effect of political polarization is slightly inconsistent, but usually negative and significant (as above) when the sample is restricted to states that actually changed transparency. Polarization aside, the general impression is that the causes of fiscal transparency identified above are not identified by cross-state comparisons with states that did not change transparency, but rather, since we control for state fixed effects, are driven by within-state changes in our explanatory variables.

How big are the effects of the explanatory variables? Since our specification includes contemporaneous and lagged values of explanatory variables and a lagged dependent variable, we calculate the magnitudes of effects as follows. Consider the coefficient on legislative competition reported in Table 4, column 3. Suppose legislative competition increases by one standard deviation (0.05, as shown in Table 1) and sustains this new level forever, or at least long enough for the effects of lagged variables to cumulate. The sum of the coefficients is 0.252 and the coefficient on the lagged dependent variable is 0.558. Then the magnitude of a one-time, one-standard-deviation, sustained increase of 0.05 in legislative competition is $(0.05 \cdot 0.252) / (1 -$

0.558) = 0.0285, with most of the change taking place in the first eight years. That may not seem like a big effect, but recall that 0.1 is one extra transparency item in the index, so the magnitude of this effect is between one-quarter and one-third of an item. Intriguingly, if we consider the impact of a negative fiscal imbalance using the same estimates, the cumulative effect of a sustained, one-standard-deviation increase in the deficit is also on the order of 0.03, or about three-tenths of a one-item reform.

Interactions of political and fiscal variables

In Table 5, we report results from a specification that allows interactions between the political and fiscal variables in their effect on transparency. Specifically, we consider the interactive effect of one measure of political competition (divided government) and deviations from budget balance (absolute deviation or separate measures of surpluses and deficits) on the degree of transparency. Essentially, political competition and fiscal imbalance appear to act like substitutes. We find that the presence of divided government strongly reduces the positive effects of fiscal imbalance on transparency, independent of the sample used. One interpretation of this result, to be explored further, is that divided government makes it less likely that, for example, a governor can increase transparency under good budget performance to look good to observers. Conversely, divided government may limit the ability of a government to provide a prompt institutional response to negative fiscal shocks,¹⁷ though we note from columns 3 and 4 that the substitution effect is less well determined in the case of deficits than surpluses.

¹⁷ In fact, what Table 3 shows is that, absent fiscal shocks, the effect of divided government is stronger than it appeared in Table 1. This may be because divided government is slow to respond to fiscal shocks (Alt and Lowry 1994). We will also re-examine the other competition indicators, whose effects were stronger in Table 1, for evidence of interactions.

[Tables 5 and 6 here]

Until now, we have classified governments with split legislatures as divided governments. Table 6 builds on the two first columns of Table 4, above, but distinguishes “pure” divided government, where a governor faces a unified legislature of the opposing party, from split legislatures, in which each chamber is controlled by a different party. The results from Table 4 remain: debt has a negative effect, imbalance a positive effect, and polarization an inconsistent (but negative in the restricted sample) effect on transparency. We see that, controlling for the effects of debt, imbalance, and polarization, a Democratic legislature is indeed positively associated with transparency. However, it is no more so with a Democratic governor than without. The combination of a Democratic legislature, Republican governor, and fiscal deficits observed in some of the case studies appears to be generalizable as a source of transparency reform. Similarly, a split legislature is positively associated with transparency and seems to account for most of the effect of political competition – the effect is large while the pure divided government indicator becomes considerably smaller and less precisely estimated. However, the split legislature and fiscal imbalance effects are substitutes, as described above. The combined effects of a Democratic legislature and fiscal surpluses are reduced by the presence of divided government.

Components of transparency

We also consider a decomposition of the transparency index into items related (primarily) to expenditures, (primarily) to revenues, and equally to both sides of the budget. The expenditure index contains items 2 (multi-year expenditure forecasts), 6 (single appropriations bill), 7 (non-partisan appropriations bill), 8 (non-open-ended appropriations), and 9 (published performance measures). The revenue index contains items 4 (binding revenue forecasts) and 5 (shared revenue

forecasts), and the general index contains items 1 (GAAP) and 3 (budget cycle frequency). Table 7 reports the results for the three sub-indexes for each of the three political competition measures.

[Table 7 here]

Political competition affects different types of transparency in different ways. While all three competition measures are associated with higher expenditure transparency, gubernatorial turnover is negatively related to revenue transparency and legislative competition likewise negatively related to general transparency. Furthermore, the effect of political polarization also differs markedly across indexes. While it is weakly related to higher expenditure transparency, more polarized states are significantly less likely to have implemented GAAP and have an annual budget. Finally, the strong effects of budget imbalances on our main fiscal transparency index can be traced to increases in expenditure transparency, while revenue transparency is not associated with the fiscal policy setting at all. These preliminary results confirm the intuition of Gavazza and Lizzeri (2005) that revenue and expenditure transparency can be conceptually different, but the stronger results on expenditure transparency may also partly be attributable to the fact that there is more variation in that variable, as it contains five items.

*Robustness considerations*¹⁸

As a robustness test, we included a variable for the governor's approval rating, which was generally significant and negative, although it also reduced the number of cases. This finding suggests once again that the "doing badly, clean up the act" motive for reform is stronger than the "doing well, show more" incentive. Note also that insofar as Alt, Lassen, and Skilling (2002)

¹⁸ All robustness test results are available from the authors upon request.

showed that transparency was good for approval ratings, the fact that we find low approval causing transparency is in spite of any endogeneity bias. As a second robustness test, we explored the possibility that governors who cannot stand for re-election are less concerned with undertaking reforms that yield future benefits. In every specification containing an indicator for a “lame duck” governor, we observed a negative (as expected) but insignificant coefficient. The relationship between political competition and transparency was also robust to employing a variety of alternative revenue definitions and measures. Finally, we found no interaction between polarization and divided government.

We also tried omitting the lagged dependent variable, which had some effect on the results, but we believe that including the lagged dependent variable to represent the stickiness of transparency is more important than any bias induced in its coefficient. We also examined cross-sectional effects; the results stand up with two-year averages, but begin to drift when more years are averaged. With five-year averages the polarization effect drops out but the competition effect usually remains correctly signed and nearly significant, and the split legislature effect remains significant. We included a variety of trends and squared trends, and the results remained intact—perhaps not surprisingly, as the time fixed effects pick up trends anyway. We looked for regional trends and diffusion of transparency innovations, but only found these for one item in our index: performance measures.

As a final robustness check, we used an Arellano-Bond (1991) first difference GMM estimation, rather than fixed effects, of the main equations.¹⁹ Overall, the results are highly

¹⁹ The estimation was carried out using Stata's `xtabond2` procedure (Roodman, 2003) with the `noleveleq` option. There was no sign of overidentification or second-order autocorrelation in the first-differences. For computational reasons, the instrument matrix was constructed using `xtabond2`'s *collapse* option, which drastically reduces the dimension of the instrument matrix, which becomes large in Arellano-Bond estimation of long panels. In long

consistent with the earlier findings. As in Table 4, political competition in the forms of divided government and legislative competition is again associated with a higher degree of transparency, while gubernatorial competition does not seem to affect transparency. Fiscal surplus continues to be associated with higher transparency. In contrast to the previous results, political polarization does not appear to significantly affect transparency in the GMM estimation, although the signs are the same as before. Real per capita debt remains significantly negatively associated with fiscal transparency, but a Democratic-controlled state legislature is now significantly associated with a higher degree of transparency. In comparison to the results in Table 6, divided government remains positive and becomes marginally significant while polarization retains its sign but becomes insignificant. One interaction becomes stronger, one becomes weaker. Virtually nothing now depends on whether we include all cases or only states that experienced changes in transparency.²⁰

7. Conclusions and implications

This paper has tried to disentangle the causal effects of political and fiscal factors on transparency. The results of our empirical specifications, including long lags of the independent variables and lagged values of the transparency variables, together with the findings of the case studies, suggest that both politics and fiscal outcomes affect the level of transparency. Political competition tends to increase the level of fiscal transparency; this result holds up across different definitions, specifications, and estimation methods. Fiscal imbalance, in the form of higher

panels, the collapse correction reduces efficiency, which implies that the reported standard errors are conservative, but at the same time counters problems with bias arising from the number of instruments approaching the number of observations.

²⁰ We also experimented with a random effects Tobit model, with no qualitative effect on the results.

surpluses or deficits, also appears to contribute to higher transparency. That relationship is a little less robust in the quantitative analysis than in the case studies, which were designed to examine “big” cases of reform.

While these results are intriguing, there is still more work to do. One concern is that since transparency trends upward in our sample period, some of the apparent causes could actually be spurious consequences of other trending series, in spite of our inclusion of time fixed effects. Future work will examine whether in the short run, an increase in polarization could produce divided government and thus also produce transparency, while in the long run more transparency is associated with less polarization. Finally, we have collected a panel on cable television penetration in order to estimate the relationship between demand for transparency and media consumption. In this way we hope to distinguish the effects of access to information from those of quantity, justification, and verifiability.

References

- Alesina, Alberto and Allan Drazen. 1991. "Why Are Stabilizations Delayed?" *American Economic Review* 81, 1170-1188.
- Alesina, Alberto and Roberto Perotti. 1996. "Fiscal Discipline and the Budget Process." *American Economic Review* 86, 401-407.
- Alt, James E. and David Dreyer Lassen. 2006a. "Fiscal Transparency, Political Parties and Debt in OECD Countries." *European Economic Review*, forthcoming.
- _____. 2006b. "Transparency, Political Polarization, and Political Budget Cycles in OECD Countries." *American Journal of Political Science*, forthcoming.
- _____ and David Skilling. 2002. "Fiscal Transparency, Gubernatorial Popularity, and the Scale of Government: Evidence from the States," *State Politics and Policy Quarterly* 2, 230-250.
- Alt, James E. and Robert C. Lowry. 1994. "Divided Government, Fiscal Institutions, and Deficits: Evidence from the States," *American Political Science Review* 88, 811-28.
- _____. 2000. "A Dynamic Model of State Budget Outcomes under Divided Partisan Government." *Journal of Politics*, 62, 1035-1069.
- Barro, Robert. 1973. "The Control of Politicians: An Economic Model." *Public Choice*
- Besley, Timothy. 2005. *Principled Agents? The Political Economy of Good Government*. Oxford: Oxford University Press, forthcoming.
- Besley, Timothy and Anne Case. 2003. "Political Institutions and Policy Choices: Evidence from the United States." *Journal of Economic Literature* 41, 7-73.
- Besley, Timothy and Michael Smart. 2003. "Fiscal Restraints and Voter Welfare." Manuscript, LSE, October.

- Besley, Timothy and Andrea Prat. 2006. "Handcuffs for the Grabbing Hand: Media Capture and Government Accountability." *American Economic Review* forthcoming.
- Bureau of Labor Statistics. 2005. *Current Unemployment Rates for States and Historical Highs/Lows*. <http://www.bls.gov/web/lauhsthl.htm>
- Campos, J. Edgardo and Sanjay Pradhan. 1999. "Budgetary Institutions and the Levels of Expenditure Outcomes in Australia and New Zealand," in J. M. Poterba and J. von Hagen (eds.) *Fiscal Institutions and Fiscal Performance*, University of Chicago Press.
- Dal Bo, Ernesto. 2005. "Bribing Politicians." UC Berkeley, mimeo.
- Fearon, James. 1999. "Electoral Accountability and the Control of Politicians." In Przeworski, Manin, and Stokes (1999), pp. 55-97.
- Ferejohn, John. 1999. "Accountability and Authority: Toward a Theory of Political Accountability." In Przeworski, Manin, and Stokes (1999), pp. 31-53.
- Fox, Justin. 2005. "Government Transparency and Policymaking." Working paper, Yale University, March.
- Gavazza, Alessandro and Alessandro Lizzeri. 2005. "Transparency and Economic Policy". Working paper, New York University.
- Gelos, Gaston and Shang-Jin Wei. 2005. "Transparency and International Portfolio Holdings." *Journal of Finance*, forthcoming.
- Geraats, Petra. 2002. "Central Bank Transparency." *Economic Journal* 112, F532-F565.
- _____. 2005. "Transparency of Monetary Policy: Theory and Practice." Working paper, University of Cambridge.

- Glennerster, Rachel and Yongseok Shin. n.d. "Do Sovereign Bond Markets Reward Transparency?" Manuscript, University of Wisconsin. Previous version presented to the Jacques Polak Fifth Annual Research Conference, IMF.
- Governing. 2005. *The Government Performance Project: Grading the States '05*.
<http://governing.com/gpp/2005/de.htm>
- Government Performance Audit Committee (GPAC). 1992. *Performance Audit of Planning, Budgeting, and Program Evaluation Processes: Final Report, December 1992*.
<http://www.ncga.state.nc.us/GPAC/planbud.html>
- Hall, Peter, and Rosemary Taylor. 1996. "Political Science and the Three New Institutionalisms." *Political Studies* 936-957.
- Hanssen, F. Andrew. 2004. "Is There a Politically Optimal Degree of Judicial Independence?" *American Economic Review* 94:712-729.
- Heald, David. 2003. "Fiscal Transparency: Concepts, Measurement and UK Practice." *Public Administration* 81 (4), 723-759.
- IMF. 2003. "Assessing and Promoting Fiscal Transparency: A Report on Progress." Washington, D.C. Available at <http://www.imf.org/external/np/pdr/sac/2003/030503s2.pdf>
- Judson, R. A. and A. L. Owen. 1999. "Estimating Dynamic Panel Models: A Guide for Macroeconomists." *Economics Letters* 65, 9-15.
- Kopits, George, and Jon Craig. 1998. "Transparency in Government Operations," IMF Occasional Paper 158.
- Lindbeck, Assar and Jurgen Weibull. 1987. "Balanced-Budget redistribution as the Outcome of Political Competition." *Public Choice* 52, 273-97.

- Lowry, Robert C. and James E. Alt. 2001. "A Visible Hand? Intertemporal Efficiency, Costly Information, and Market-based Enforcement of Balanced-Budget Laws." *Economics and Politics* 13, 49-72.
- _____ and Karen E. Ferree. 1998. "Fiscal Policy and Elections in American States." *American Political Science Review* 92, 759-774.
- Milesi-Ferretti, Gian Maria. 2004. "Good, Bad or Ugly? On The Effects of Fiscal Rules with Creative Accounting." *Journal of Public Economics* 88, 377-94.
- North, Douglass C. 1990. "Institutions and a transaction-cost theory of exchange," in J. E. Alt and K. A. Shepsle (eds.), *Perspectives on Positive Political Economy*, Cambridge University Press.
- OECD. 2001. *OECD Best Practices for Budget Transparency*. PUMA/SBO(2000)6/FINAL, May.
- Persson, Torsten, Gerard Roland and Guido Tabellini. 1997. "Separation of Powers and Political Accountability." *Quarterly Journal of Economics* 112, 1163-1202.
- Petrie, Murray. 2003. "Promoting Fiscal Transparency The Complementary Roles of the IMF, Financial Markets and Civil Society," IMF Working Papers 03/199, International Monetary Fund.
- Posen, Adam. 2002. "Six Practical Views of Central Bank Transparency." Working paper, IIE.
- Prat, Andrea. 2005. "The Wrong Kind of Transparency." *American Economic Review* 95, 862-77.
- Przeworski, Adam. 2003. *States and Markets*. New York: Cambridge University Press.
- _____, Bernard Manin, and Susan C. Stokes (eds.) 1999. *Democracy, Accountability and Representation*. New York: Cambridge University Press.

Rogoff, Kenneth. 1990. "Equilibrium Political Business Cycles." *American Economic Review* 80, 21-36.

David Roodman, 2003. "[XTABOND2: Stata module to extend xtabond dynamic panel data estimator](#)," [Statistical Software Components](#) S435901, Boston College Department of Economics, revised 18 Jan 2006.

Shi, Min and Jakob Svensson. 2002. "Conditional Political Budget Cycles." Manuscript, IIES, Stockholm, October.

Stavasage, David. 2004. "Public versus Private Deliberation in a Representative Democracy." Working paper, LSE.

von Hagen, Jürgen. 1992. "Budgeting Procedures and Fiscal Performance in the European Community." EEC Economic Papers 96.

Table 1. Summary Statistics

Variable	Number of Observations	Mean	Standard Deviation	Minimum	Maximum
Transparency score	1152	0.46	0.19	0	1
Divided government	1128	0.54	0.50	0	1
Legislative competition	1128	-0.04	0.05	-0.25	0
Gubernatorial competition	1152	-49.31	11.74	-98.5	0.5
Polarization	1152	0.48	0.30	0	1.17
One-party state	1152	0.23	0.42	0	1
Democratic governor	1152	0.56	0.50	0	1
Independent governor	1152	0.01	0.10	0	1
Democratic legislature	1152	0.57	0.50	0	1
Per capita debt	1152	4047.49	1536.98	950.21	9376.47
Per capita surplus	1152	58.91	81.78	0	734.20
Per capita deficit	1152	13.55	32.27	0	344.12
Per capita budget imbalance	1152	72.46	78.30	0.003	734.20
Per capita general revenues	1152	1573.65	405.39	825.57	3283.30
Per capita income	1152	23168.48	4060.33	14615.39	40594.95
Population (millions)	1152	5.07	5.31	0.40	33.50
Percent school-aged	1152	19.87	2.20	7.07	26.87
Percent elderly	1152	12.14	1.90	7.46	18.77

Table 2: Summary of Hypotheses and Results

Dependent variable: Transparency score = index value / # available indicators		
	Expected sign	Actual sign
Political competition		
Divided government	+	+
Legislative competition	+	+
Gubernatorial competition	+	+
Political polarization	?	+/-
Partisan composition of government		
Democratic governor	+	+
Democratic legislature	+	+
Economic conditions		
Debt	?	-
Surplus	?	+
Deficit	?	+

? indicates two hypotheses working in opposite directions.

+/- indicates that the sign is sensitive to the regression specification.

Table 3: The Causes of Fiscal Transparency

Dependent variable: Transparency score = index value / # available indicators										
	Political competition measure:						Party Variables	Fiscal Variables		
	Divided government		Legislative competition		Gubernatorial competition					
<i>t</i> -test: Lagged dependent variable, 4 years (p-value)	+	14.54 (.000)	+	14.73 (.000)	+	14.62 (.000)	+	14.99 (.000)	+	14.32 (.000)
<i>F</i> -test: current and lagged political competition (p-value)	+	1.91 (.167)	+	6.77 (.009)	+	1.1 (.295)				
<i>F</i> -test: current and lagged political polarization (p-value)	-	3.02 (.049)	-	4.04 (.018)	-	3.45 (.032)				
<i>F</i> -test: current and lagged Democratic governor (p-value)							+	0.88 (.349)		
<i>F</i> -test: current and lagged Democratic legislature (p-value)							+	2.56 (.110)		
<i>F</i> -test: current and lagged fiscal debt (p-value)									-	5.93 (.015)
<i>F</i> -test: current and lagged fiscal surplus (p-value)									+	16.31 (.000)
<i>F</i> -test: current and lagged fiscal Deficit (p-value)									+	7.7 (.006)
Number of observations		1127		1127		1152		1152		1152
Years		1976-98		1976-98		1976-98		1976-98		1976-98

Note: All regressions include further controls not shown: per capita revenues, per cent elderly, per cent school-aged, income, income squared, population, population squared, a constant term, state fixed effects, and year indicators. Calculations based on robust standard errors. Divided government includes split legislatures.

+/- denotes the sign of the coefficient or, in the case of lagged variables, the sign of the sum of all coefficients.

Table 4: The Causes of Fiscal Transparency: Full Model

Dependent variable: Transparency score = index value / # available indicators												
Political competition measure:	Divided government		Legislative competition		Gubernatorial competition							
<i>t</i> -test: Lagged dependent variable, 4 years (p-value)	+	13.58 (.000)	+	11.59 (.000)	+	14.03 (.000)	+	12.07 (.000)	+	13.76 (.000)	+	11.79 (.000)
<i>F</i> -test: current and lagged political competition (p-value)	+	4.08 (.043)	+	3.48 (.062)	+	9.68 (.001)	+	6.02 (.014)	+	3.85 (.050)	+	5.04 (.020)
<i>F</i> -test: current and lagged political polarization (p-value)	+	6.70 (.001)	-	1.98 (.139)	-	8.16 (.000)	-	3.14 (.044)	+	7.70 (.000)	-	2.83 (.060)
<i>F</i> -test: current and lagged Democratic governor (p-value)	+	0.45 (.501)	+	0.27 (.601)	+	0.36 (.548)	+	0.25 (.615)	+	2.49 (.115)	+	2.66 (.103)
<i>F</i> -test: current and lagged Democratic legislature (p-value)	+	2.23 (.135)	+	1.83 (.177)	+	1.81 (.179)	+	1.87 (.172)	+	1.75 (.186)	+	1.89 (.170)
<i>F</i> -test: current and lagged fiscal debt (p-value)	-	7.90 (.005)	-	9.09 (.003)	-	3.66 (.056)	-	4.53 (.034)	-	8.74 (.003)	-	8.29 (.004)
<i>F</i> -test: current and lagged fiscal surplus (p-value)	+	19.22 (.000)	+	18.59 (.000)	+	16.98 (.000)	+	16.57 (.000)	+	19.45 (.000)	+	19.62 (.000)
<i>F</i> -test: current and lagged fiscal deficit (p-value)	+	18.21 (.000)	+	16.32 (.000)	+	15.82 (.000)	+	15.32 (.000)	+	18.60 (.000)	+	18.45 (.000)
Number of observations		1127		912		1127		912		1152		936
Years		1976-98		1976-98		1976-98		1976-98		1976-98		1976-98

All regressions include a control for per cent elderly, a constant term, state fixed effects, and year indicators.

Calculations based on robust standard errors.

Divided government includes split legislatures.

+/- denotes the sign of the coefficient or, in the case of lagged variables, the sign of the sum of all coefficients.

Table 5: The Causes of Fiscal Transparency: Interactive Effects

Dependent variable: Transparency score = index value / # available indicators								
Political competition measure:	Divided government							
<i>t</i> -test: Lagged dependent variable, 4 years (p-value)	+	13.61 (.000)	+	11.40 (.000)	+	13.56 (.000)	+	11.36 (.000)
<i>F</i> -test: current and lagged political competition (p-value)	+	18.92 (.000)	+	19.38 (0.000)	+	16.85 (.000)	+	16.11 (.000)
<i>F</i> -test: current and lagged political polarization (p-value)	+	5.66 (.004)	+	1.14 (.320)	+	6.06 (.002)	+	1.45 (.235)
<i>F</i> -test: current and lagged Democratic governor (p-value)	+	0.50 (.482)	+	0.27 (.601)	+	0.53 (.466)	+	0.32 (.570)
<i>F</i> -test: current and lagged Democratic legislature (p-value)	+	1.06 (.304)	+	0.49 (.177)	+	1.25 (.264)	+	0.67 (.414)
<i>F</i> -test: current and lagged fiscal debt (p-value)	-	7.44 (.007)	-	9.59 (.002)	-	7.63 (.006)	-	9.57 (.002)
<i>F</i> -test: current and lagged fiscal Imbalance (p-value)	+	41.16 (.000)	+	41.31 (.000)				
<i>F</i> -test: current and lagged fiscal Imbalance * pol. competition (p-value)	-	16.51 (.000)	-	18.69 (.000)				
<i>F</i> -test: current and lagged fiscal surplus (p-value)					+	35.42 (.000)	+	37.39 (.000)
<i>F</i> -test: current and lagged fiscal surplus * pol. competition (p-value)					-	15.24 (.000)	-	17.65 (.000)
<i>F</i> -test: current and lagged fiscal deficit (p-value)					+	18.72 (.000)	+	13.72 (.000)
<i>F</i> -test: current and lagged fiscal deficit * pol. competition (p-value)					-	2.91 (.089)	-	1.91 (.167)
Number of observations		1127		912		1127		912
Years		1976-98		1976-98		1976-98		1976-98

All regressions include a control for per cent elderly, a constant term, state fixed effects, and year indicators.

Calculations based on robust standard errors.

Divided government includes split legislatures.

+/- denotes the sign of the coefficient or, in the case of lagged variables, the sign of the sum of all coefficients.

Table 6: The Causes of Fiscal Transparency: Interactive Effects

Dependent variable: Transparency score = index value / # available indicators				
	Party variables			
<i>t</i> -test: Lagged dependent variable, 4 years (p-value)	+	14.15 (.000)	+	12.25 (.000)
<i>F</i> -test: current and lagged political polarization (p-value)	+	5.84 (.003)	-	3.52 (.030)
<i>F</i> -test: current and lagged Democratic governor (p-value)	-	0.39 (.531)	-	0.81 (.368)
<i>F</i> -test: current and lagged Democratic legislature (p-value)	+	14.89 (.000)	+	16.69 (.000)
<i>F</i> -test: current and lagged fiscal debt (p-value)	-	5.87 (.016)	-	4.20 (.041)
<i>F</i> -test: current and lagged divided government (p-value)	+	1.34 (.247)	+	0.37 (.545)
<i>F</i> -test: current and lagged split legislature (p-value)	+	36.81 (.000)	+	43.32 (.000)
<i>F</i> -test: current and lagged fiscal surplus (p-value)	+	36.34 (.000)	+	35.47 (.000)
<i>F</i> -test: current and lagged fiscal surplus * divided govt (p-value)	-	9.57 (.002)	-	11.57 (.000)
<i>F</i> -test: current and lagged fiscal surplus * split legislature (p-value)	-	15.20 (.000)	-	17.79 (.000)
<i>F</i> -test: current and lagged fiscal deficit (p-value)	+	20.66 (.000)	+	15.82 (.000)
<i>F</i> -test: current and lagged fiscal deficit * divided govt (p-value)	-	0.09 (.770)	+	0.08 (.781)
<i>F</i> -test: current and lagged fiscal deficit * split legislature (p-value)	-	4.45 (.035)	-	3.48 (.062)
Number of observations		1152		936
Years		1976-98		1976-98

All regressions include a control for per cent elderly, a constant term, state fixed effects, and year indicators.

Calculations based on robust standard errors.

Divided government *excludes* split legislatures.

+/- denotes the sign of the coefficient or, in the case of lagged variables, the sign of the sum of all coefficients.

Table 7: The Causes of Expenditure, Revenue and General Transparency

Political competition measure	Expenditure transparency			Revenue transparency			General fiscal transparency		
	Div gov	Leg comp	Gub comp	Div gov	Leg comp	Gub comp	Div gov	Leg comp	Gub comp
<i>t</i> -test: Lagged dependent variable, 4 years (p-value)	+ 7.97 (.000)	+ 8.16 (.000)	+ 7.67 (.000)	+ 5.65 (.000)	+ 6.01 (.000)	+ 5.61 (.000)	+ 12.02 (.000)	+ 11.72 (.000)	+ 11.80 (.000)
<i>F</i> -test: current and lagged political competition (p-value)	+ 1.76 (.153)	+ 2.07 (.103)	+ 4.11 (.007)	+ 3.05 (.028)	+ 2.30 (.076)	- 2.06 (.104)	+ 4.25 (.006)	- 1.74 (.158)	+ 1.67 (.172)
<i>F</i> -test: current and lagged political polarization (p-value)	+ 1.53 (.166)	+ 1.65 (.130)	+ 1.40 (.212)	+/- 1.03 (.406)	+/- 1.29 (.257)	+ 1.10 (.359)	- 4.31 (.000)	- 3.46 (.002)	- 3.50 (.002)
<i>F</i> -test: current and lagged fiscal debt (p-value)	3.27 (.001)	2.97 (.002)	3.36 (.001)	1.21 (.288)	1.22 (.277)	1.19 (.300)	2.50 (.008)	2.99 (.002)	2.98 (.002)
<i>F</i> -test: current and lagged fiscal surplus (p-value)	+ 10.52 (.000)	+ 10.35 (.000)	+ 11.53 (.000)	+ 0.15 (.928)	+ 0.16 (.923)	+ 0.15 (.933)	- 0.71 (.546)	- 0.72 (.542)	- 0.69 (.556)
<i>F</i> -test: current and lagged fiscal deficit (p-value)	+ 9.05 (.000)	+ 8.85 (.000)	+ 8.92 (.000)	- 0.52 (.672)	- 0.49 (.688)	- 0.50 (.685)	- 1.91 (.313)	- 1.44 (.229)	- 1.61 (.185)
number of observations	865	865	865	865	865	865	865	865	865
Years	1976-98	1976-98	1976-98	1976-98	1976-98	1976-98	1976-98	1976-98	1976-98

All regressions include a control for per cent elderly, a constant term, state fixed effects, and year indicators. Calculations based on robust standard errors. Divided government includes split legislatures.

+/- denotes the sign of the coefficient or, in the case of lagged variables, the sign of the sum of all coefficients.

Figure 1

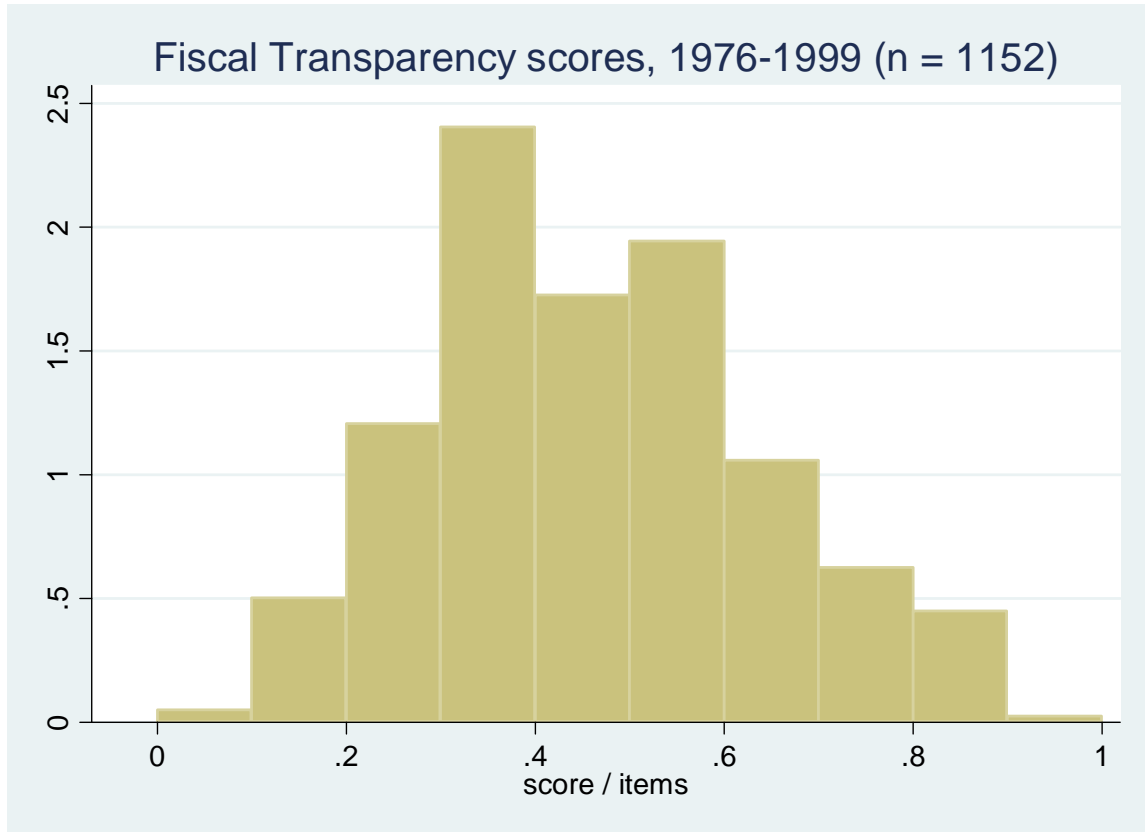
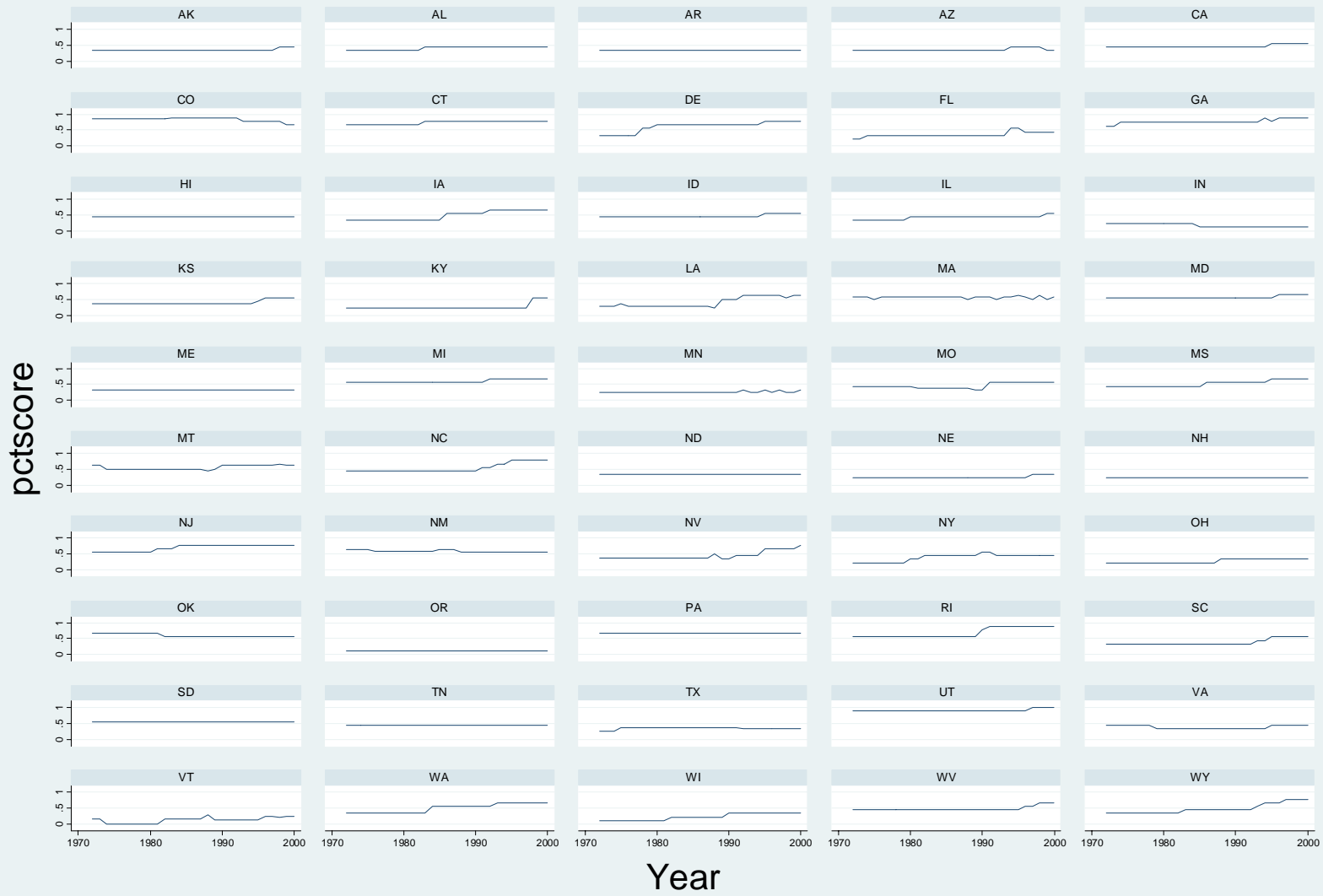


Figure 2: Fiscal Transparency in the American States: 1972-2002



Graphs by State