PARTICIPATORY BUDGETING AND TRANSPARENCY IN MUNICIPAL FINANCES

H. Anthony Crossman
Brooklyn College

Dov Fischer
Brooklyn College

Key Words: Participatory budgeting, state and local governments, transparency, open budgets, open governments, citizen's budgets, International Budget Project.

JEL Classifications: H5, H6, H7, H83

Abstract

In the recessionary years following the 2008 financial crisis, prominent voices predicted an imminent crisis in state and municipal finances. The voices - including Bill Gates, Josh Ruah, Meredith Whitney, Paul Volcker, and Richard Ravitch – declared or implied that the road to fiscal responsibility lies in reining in the pensions and benefits of public servants. We argue that painting public employees as villains introduces divisiveness in what should be a universal goal of sound public finances. We suggest that the road to fiscal responsibility lies with budgetary transparency and widespread public knowledge of state and municipal finances. A potential key to achieving these objectives is participatory budgeting. We motivate a research question on the local government level: Does participatory budgeting increase transparency? Although it is too early to

test this question on the local level, we use country-level data from the International Budgetary Partnership to explore ways to operationalize budgetary transparency in order to measure the association between participatory budgeting and budgetary transparency.

I. INTRODUCTION

The post-recessionary years of 2011 to 2013 saw a proliferation of dire predictions about the financial prospects of state and local governments. A range of leaders in business, government, and academia predicted impending apocalypse. We refer to them as the "traditional critics."

Representative of these voices was that of Richard Ravitch, former New York State lieutenant governor and chairman of the New York City Metropolitan Transit Authority (MTA). After leaving the office of lieutenant governor in 2011, Ravitch joined Paul Volcker in a crusade to improve the fiscal discipline of state and local governments. Not surprisingly, the two have paid special attention to underfunded pensions. As far as pension funding, it is not New York, but Illinois that has come under special scrutiny, with a pension and benefits funding shortfall of almost $200 billion (*The Economist*, 2014). Ravitch and Volcker proceeded to found the *State Budget Crisis Taskforce*, which was loosely affiliated with the Research Foundation of the City University of New York.

On the other hand, there has emerged a movement towards participatory budgeting, particularly at the municipal government level. This essay argues that such a progressive approach towards public engagement in the budget process holds the key towards greater fiscal transparency, accountability, and responsibility in government finances.

The study is organized as follows. The second section describes a traditionally critical voice of state and local government finances. Under this view, ordinary citizens do not have much of a

constructive role to play in ensuring budgetary transparency and fiscal responsibility; if anything ordinary citizens perpetuate fiscal irresponsibility as members of interest groups like government unions. The third section presents an alternative view of ordinary citizens as participants in the budget setting process. We further hypothesize that participation actually leads to public demand for budget information and thus results in increased budgetary transparency. The fourth section provides country-level data showing such an association between participation and transparency. The fifth section concludes.

A REPRESENTATIVE "TRADITIONAL VOICE": RICHARD RAVITCH

Richard Ravitch's memoir (2014) shares lessons from a career spanning over five decades in the private and public sectors. Ravitch was a successful contractor of public housing before he joined the public sector. Between 1979 and 1982, he served as chairman of the MTA at a time when New York City and the MTA were on the cusp of a renaissance after two decades of neglect and decline.

Ravitch also served as New York State's lieutenant governor from 2009 to 2010. After his term as lieutenant governor ended, Ravitch joined former Fed Chair Paul Volcker to found the State Budget Crisis Task Force to study the budgets of large states such as New York, California, Illinois, New Jersey, Texas, and Virginia. In the last two chapters, Ravitch (2014) assesses state budget crises and that of New York in particular.

The memoir relates that soon after becoming lieutenant governor in 2009, Ravitch set out to answer a basic question about New York's widening budget gap: Was the gap a cyclical consequence of the Great Recession or did it reflect a more-serious structural deficit? Ravitch concluded that it was the latter. He observes the demographic challenges faced by the state as its population declined from 10 percent of the country's total in 1950 to 6 percent today. Ravitch states that New York's political leaders

and citizens have not adjusted to the sobering reality that their state has been eclipsed as the nation's economic engine, and still maintain their belief that their "empire state" has essentially unlimited resources. As a consequence of this lack of economic self-assessment, the state has grown its public spending at a 20 percent higher pace than revenues in the past decade.

Due to political expediency, New York State enacted legislation that mandates balanced budget provisions. However, Ravitch describes how the state has circumvented the mandate. The state budget consists of some five hundred special funds, but the constitution only requires that the general fund be balanced. This budgetary loophole provides a natural incentive to transfer revenues from special funds to the general fund and to transfer costs from the general fund to special funds.

The period between 2011 and early 2014, marks the lifespan of Ravitch's and Volcker's Taskforce, which coincided with the works of other prominent business and academic leaders that focused attention on the state budget crises (Lyman and Walsh, 2014). For example, Bill Gates (2011) gave a widely-covered TED talk which painted public pensions as the scrooge that robs kids of educational resources. Josh Ruah published a widely cited academic paper, which claimed that unfunded state and local pension liabilities totaled an astronomical $3 trillion (Ruah and Novy-Marx, 2011). Meredith Whitney (2013), a star banking analyst, predicted an imminent wave of municipal defaults which has not materialized. Paul Volcker continues to sound the alarm on state budgets under the Volcker Alliance platform (Walsh, 2015).

The above-mentioned "traditional voices" imply that the solution to real and imagined budget crises is austerity. Critics of state finances tend to single out the pensions and benefits of public employees as a drain on taxpayers and other government services. We view this negative perspective as unlikely to achieve public engagement. Rather, it will polarize constituencies without achieving improvement in state finances.

THE PARTICIPATORY-BUDGETING ALTERNATIVE

An alternative approach would be to increase the engagement of the general public in understanding state finances. One key to introducing citizens to the state budgetary process is Participatory Budgeting, a process in which citizens directly and democratically decide how to allocate part of a budget (Baiocchi and Lerner, 2007). Participatory Budgeting (PB) was pioneered in Rio de Janeiro, and has spread to cities throughout Europe and North America, including New York City. For example, New York City allocates up to $2 million to each councilman's district to be spent based on initiatives of voters within the district. Voters propose and then vote on alternative projects. In many cases, the city has chosen to fund projects that came out of the PB process even if they were not voted PB funds (New York City Council, 2015).

The benefit of engaging citizens through the PB process is not just that it gives citizens a voice in how their tax dollars get spent. The PB process provides a further benefit in that citizens become curious about how the PB funding fits into the larger scheme of city finances.

In the case of Ravitch, he ponders the probable causes of New York's budget woes, and lays it at the feet of entrenched *structural deficit*. This conclusion is reasonable, but also represents a missed opportunity to offer new or unpopular proven solutions. Political insiders are reluctant to embrace solutions that subject them to the intense glare of the citizenry. The dynamics of participatory budgeting are akin to those of activist investors serving on the corporate Board of Directors of the firms they are pressuring to maximize shareholder value.

By helping ordinary citizens become educated about public finances, PB can help overcome the stranglehold that special interests hold over state budgets. In many cases, it is currently a narrow contest between public employee unions against right-wing groups whose agenda is to crush those unions. The public interest

probably lies somewhere in between, and citizen engagement through PB can help give voice to that middle ground.

The financial maneuvering that Ravitch describes would be less likely if states engaged in constructive, transparent, participatory budgeting framework. Benito and Bastida (2009) find that legislators intentionally make budgets complex in an effort to reallocate funds to further their political agendas. Participatory budgeting would force politicians to define clear, concise budgets that would ultimately result in achieving greater budgetary compliance and fiscal responsibility. Advocates such as Lerner and Secondo (2012) of the Participatory Budgeting Project have extolled the benefits from a democratic perspective. We advocate that a side effect of PB is greater public literacy of public finances, and this increased awareness will lead to more responsible fiscal and tax policies throughout government.

As a traditional voice, Ravitch advocates solutions such as the use of accrual accounting for both government budgets and government financial statements. He points out that in the aftermath of New York City's financial crisis of the 1970's, the State now requires the City to publish both the budget and financial statements under the accrual method. However, for itself, the state reserves a double standard. While it does publish accrual based financial statements, the state budget is prepared using the cash method.

But as Ravitch himself points out, the special interests will find a way to work around any financial reforms implemented as long as the general public is disengaged. Ravitch singles out big banks, such as JPMorgan Chase, who come under Ravitch's ire for enabling states to play budget games. New York State has more than $60 billion of debt outstanding, but only $3 billion of general obligation debt which requires voter approval to issue. Instead of putting bond issues to voter approval, the state routinely issues debt through its various public authorities. To exacerbate the problem, close to $10 billion of this debt was used for operating costs rather than for capital projects. Ravitch faults big banks for

enabling the state to engage in such dubious budgetary practices. The aforementioned observations by Ravitch are clear examples of states willful desire not to engage its citizens in fiscal affairs.

The efforts and dedication of Ravitch in keeping fiscal and budgetary transparency in the public sphere have not gone unnoticed. Ravitch states that he received enthusiastic support from staffers at the Federal Reserve Bank of New York and the U.S. Department of the Treasury. These staffers purportedly told Ravitch that there is a lack of transparency and knowledge about the finances of state and local governments. Ravitch does not elaborate on why these officials felt that transparency was lacking and on how to improve transparency and reporting.

He attributes this knowledge deficit to the fact that the "political elites" (presumably the media and think-tanks) focus on federal spending, even as state governments affect the day-to-day lives of people to a much greater extent. For example, the federal government employs two-and-half million civilians, while state and local governments employ almost nineteen million.

Clearly, these officials recognize that the budgetary process is broken, but seem reluctant to offer viable solutions for the common benefit of all stakeholders. It would appear that they take refuge in stating the obvious – that government must "do more with less", but lack the fortitude to call for bold corrective measures.

Given the dissatisfaction of the public and the recurring call for fiscal transparency, it is unlikely that political insiders and their cohorts have not pondered ways to improve the management and execution of public funding. A major gap in the overall management and execution of public funding is that the decision making is highly centralized. The widely held belief that all politics are local lends support to participatory budgeting.

Proponents of participatory budgeting argue that the citizens of local jurisdiction are better positioned to strategically target funds where the needs are greatest, and that fiscal transparency and accountability under this framework are more

likely to increase. Baiocchi and Lerner (2007) identify five benefits and outcomes of PB: transparency, democracy, equity, education, efficiency. Figure 1 provides a representative of these five outcomes. Democracy is the overarching framework of PB. A transparent budgeting process lends itself to an educated public, who can then participate in improving efficiency and equity. In fact, Russon-Gilman (2012) finds that, sometimes, the process of PB provides more benefits than actually achieving the results originally anticipated.

As a traditionalist, Ravitch opines that the quality of state and local leadership has declined over the nearly half a century of his public service. He attributes this relative decline to the lack of incentives in the form of money and prestige for ambitious and bright young people to pursue a career as state elected officials. Ravitch does make an exception for New York State's budget staffers, whom he considers highly competent professionals, now as ever. Ravitch's aforementioned statement is quite audacious and implies that comparable bright men and women are not serving their respective communities with the same valor and competence. Many young people across the nation voluntarily immerse themselves in public service with hopes of effecting positive, indelible change. Many, however, become disillusioned by the extent of corruption, bureaucracy, and managerial malfeasance that they encounter.

As Ravitch deliberates the political horizon, he cites a political trend that is likely to exacerbate future state budget crises: the declined influence of the two major political parties in recent decades. This phenomenon is manifested at the national and state levels. Because of this decline, there is less of a meeting of the minds between state and federal officials than in a previous era, when national and local officials had closer ties. As an example of the federal and local disconnect, one unidentified state governor expressed to Ravitch his confidence that the federal government would never stand by if a state was ever in the dire position of default. However, in conversation with leaders from inside the

beltway, Ravitch heard a different story. Ravitch believes that state officials are misplacing their confidence in the federal government. For example, Erskine Bowles of the Bowles-Simpson Commission and congressional leader Paul Ryan openly acknowledged to Ravitch that they did not give serious thought to the effects of their federal priorities on state budgets.

Transparency is a highly desired virtue in the political arena; yet many politicians and public figures avert it through vagaries and ambiguities. Ravitch does a good job in explaining how State budgets lack transparency. Unfortunately, he conflates the goal of transparency with fiscal soundness. While both are worthwhile goals, they should be advocated for separately. Within the context of budgetary prudence and fiscal responsibility, the virtue of transparency and a balanced budget are mutually exclusive. A broad-based consensus to improve budget transparency can only be reached if the issue of budgetary transparency is divorced from opinions and positions on tax policy or spending priorities. Critics of state budgets often confound the lack of transparency with criticism of social programs, such as Medicaid. They insinuate that Medicaid and other nondiscretionary spending are black holes that consume resources that could be better spent elsewhere.

Recognizing the critical condition of state and local government finances, Ravitch concludes with a call to the president to assume responsibility for the problem by offering solutions, "not by writing a check," but by providing "discipline and incentives" that will force local governments to address their own fiscal futures. Budgetary transparency does not actually require much in the way of discipline and incentive. Rather, it requires adherence to a set of best practices. A transparent budget, even an unbalanced but transparent budget, can serve as a catalyst for informed public dialogue about the basic choices facing state government: raise taxes, reduce spending, or increase borrowing.

OPERATIONALIZING BUDGETARY TRANSPARENCY

Traditional approaches to transparency fail to take into account its most important feature: How accessible is the budget to ordinary citizens who wish to participate in the democratic process? The traditional approaches measure transparency based on the accounting system used (GAAP vs. non-GAAP), whether the government issues budget forecasts, the nature of the budget cycle, and other features which mean little to the ordinary citizen (Alt et al, 2002, 2006).

Citizen's Budget

Our proposed research questions are whether public participation is associated with budgetary transparency and if so, whether public participation causes an increase in transparency. In this section, we explore potential measures of transparency. The ideal measure of transparency for purposes of our research questions is the existence of a nontechnical citizen's budget to enable broad public understanding of a government's plan for raising revenues and spending public funds in order to achieve policy goals. Citizen's budgets are typically written in accessible language and incorporate visual elements to help non-specialist readers understand the information (International Budget Partnership, 2016).

Exploratory Results

The main interest of this paper is on participatory budgeting on the local level, but the data is only available on the national level. To inform future research on the local level, we present some of the data and results on the national level. Some of the countries that provide citizens' budgets include Chile, France, India, Indonesia, Italy, Mexico, New Zealand, Norway, the Philippines, Russia, South Africa, South Korea, Sweden, Thailand, Tunisia, the United Kingdom, Vietnam; but notably not the United States (International Budget Partnership, 2015).

The *Open Budget Survey* uses the existence of citizen's budgets among other factors to construct a transparency index. It also constructs indices for participation, legislative oversight, and auditing oversight. We are primarily interested in the transparency and participation indices.

Table 1 indicates that for the transparency index, the minimum for the 102 countries was zero (Qatar and Saudi Arabia), while the maximum on a scale of 100 was New Zealand at 88, with South Africa, Norway, and the U.S. in second, third and fourth place (86, 84, and 81, respectively). The mean and median were 45 and 46.

For the participation index, the mean and median were much lower at 25 and 23, respectively. This makes sense, since a minimum level of transparency is almost a requisite for public participation. Five countries scored a zero for participation, including Qatar and Saudi Arabia, which scored a zero for transparency as well. South Korea scored highest, at 83, followed by Norway, Brazil, the U.S., the Philippines, New Zealand, and South Africa.

Figure 2 presents a scatterplot, which shows that the strongest association between *Transparency* and *Participation* is when *Transparency* is neither very high nor very low – that is the area of the shaded box, where *Transparency* ranges from thirty to eighty. For this intermediate range of transparency, the *Participation* variable ranges from zero to sixty, and the two variables are strikingly correlated. On the other hand, when levels of *Transparency* and *Participation* are both high (oval area), there actually exists a negative, but statistically insignificant, correlation between *Transparency* and *Participation*.

Other approaches to transparency

Seattle and Los Angeles provide examples of innovative ways to increase budget transparency which make use of interactive and location-based technology. The City of Seattle's website allows citizens to interactively explore where in the city

the capital budget is being spent. Los Angeles, for its part, provides a "word cloud" to allow citizens to quickly grasp the relative size of different spending initiatives.

V. CONCLUSION

While the country-level data show a promising association between budgetary participation and transparency, we intend to focus future research on the municipal level, which is where the core of the participatory budgeting movement lies (Shah 2007, 2). Considering that our interest is in U.S. cities, this will be a challenge, as the U.S. has been rather late in adopting participatory budgeting compared to other regions such as South America, Europe, and Southeast Asia (Piexoto, 2016). As of June 2016, there are five large U.S. cities engaging in participatory budgeting: New York City, Boston, Chicago, Saint Louis, San Francisco, and one small city - Vallejo City, California (Piexoto, 2016).

In future research, we plan to use both quantitative and qualitative measures of transparency to answer our research questions: Is participatory budgeting associated with an increase in transparency?

TABLE 1, FIGURES 1, 2, 3

Table 1
Descriptive Statistics on transparency and participation

	Transparency	*Participation*
Highest	88 New Zealand	83 South Korea
Lowest	0 Saudi Arabia, Qatar	0 Saudi Arabia, Qatar, Sudan, Bolivia, Algeria
Mean	45	46
Median	25	23
N	102	102

Correlation between *Transparency* and *Participation* 0.75, t-statistic 11.35; Data: International Budget Project (2015): 71-72.

Figure 1
Representation of the five benefits and outcomes of Participatory Budgeting

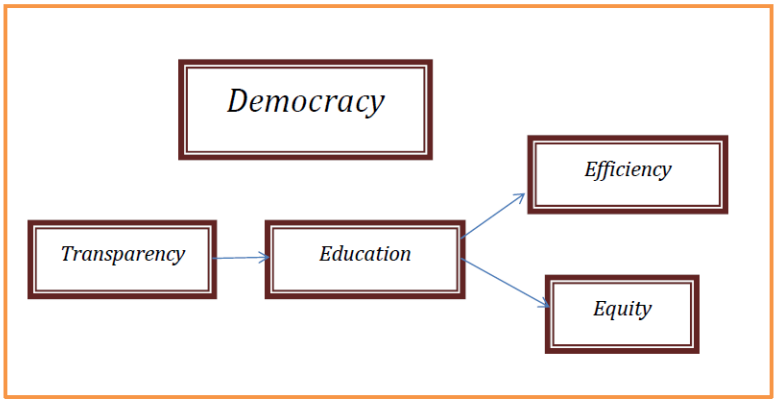


Figure 2
Scatterplot for all 102 countries

Figure 3
Innovative ways Seattle and Los Angeles promote budgetary transparency

Panel A. Seattle – Location of Capital Budget projects https://capitalprojects.seattle.gov

Explore Operating Budget

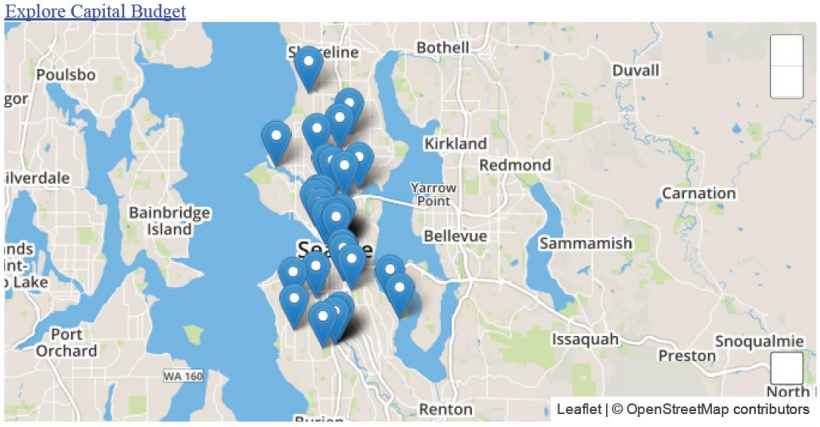
Capital Budget Summary

Capital Budget

$ 1.02 billion Current Capital Budget

These funds go toward one-time infrastructure and improvement projects.

Explore Capital Budget



Powered by Socrata
Customer Login Get this Data on Socrata

Figure 3 (continued)**.** Innovative ways Seattle and Los Angeles promote budgetary transparency

Panel B. Los Angeles – Word Cloud of relative size of spending initiatives https://controllerdata.lacity.org/data?cat=Budget

ACKNOWLEDGEMENT

We thank workshop participants at Brooklyn College; roundtable participants at the 2016 American Accounting Association government and non-profit section midyear meeting; and appreciate comments from the research forum at the 2016 American Accounting Association annual meeting. Support for this project was provided by a PSC-CUNY Award, jointly funded by The Professional Staff Congress and The City University of New York.

REFERENCES

Alt, J., D. Dreyer-Lasses and D. Skilling. 2002. Fiscal Transparency, Gubernatorial Approval, and the Scale of Government: Evidence from the States. State Politics and Policy Quarterly 2 No.3 (Fall): 230-250.

Alt, J., D. Dreyer Lasses and S. Rose. 2006. The Causes of Fiscal Transparency: Evidence from U.S. States. IMF Staff Papers 53.

Baiocchi, G. and J. Lerner. 2007. Could Participatory Budgeting work in the United States? The Good Society 16 No.1: 8-13. DOI: 10.1353/gso.0

Benito, B. and F. Bastida. 2009. Budget Transparency, Fiscal Performance, and Political Turnout: An International Approach. Public Administration Review 69 No.3 (May/June): 403-417. DOI: 10.1111/j.15406210.2009.01988.x

The Economist. 2014. America's Greece? (20 December). http://www.economist.com/news/united-states/21636786-illinois-risks-default-if-it-fails-tackle-its-public-pension-crisis-americas-greece

Gates, B. 2011. How State Budgets are Breaking U.S. Schools. Ted Talk (March) http://www.ted.com/talks/bill_gates_how_state_budgets_are_breaking_us_schools?language=en

International Budget Partnership. 2015. Open Budget Survey. http://www.internationalbudget.org/wp-content/uploads/OBS2015-Report-English.pdf

International Budget Partnership. 2016. Citizens Budgets. Internationalbudget.org. http://www.internationalbudget.org/opening-budgets/citizens-budgets/

Lerner, J. and D. Secondo. 2012. By the People, For the People: Participatory Budgeting From the Bottom Up in North America. Journal of Public Deliberation 8 No.2: article 2. http://www.publicdeliberation.net/jpd/vol8/iss2/art2/

Lyman, R. and M.W. Walsh. 2014. Task Force Report Urges Municipalities to Stop Hiding Fiscal Troubles. The New York Times (January 14). http://www.nytimes.com/2014/01/15/us/task-force-urges-local-governments-to-stop-obscuring-fiscal-troubles.html?_r=0

New York City Council. 2015. 2015 Vote Results: See the Status of Winning Projects from Previous Years. council.nyc.gov. http://council.nyc.gov/html/pb/voteresults.shtml

Piexoto, T. 2016. Participatory Budgeting: Where has it worked? A GoogleMap. Participatorybudgeting.org. http://www.participatorybudgeting.org/about-participatory-budgeting/where-has-it-worked/

Ravitch, R. 2014. So Much to Do: A Full Life of Business, Politics, and Confronting Fiscal Crises. New York: Public Affairs – Perseus.

Ruah, J. and R. Novy-Marx. 2011. Public Pension Promises: How Big Are They and What Are They Worth? Journal of Finance 66 No.4: 1207-1245. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1352608

Russon-Gilman, H. 2012. Transformative Deliberations: Participatory Budgeting in the United States. Journal of Public Deliberation 8, No.2 (December): article 8. http://www.publicdeliberation.net/jpd/vol8/iss2/art11

Shah, A. 2007. Participatory Budgeting, Public Sector and Accountability Series. The World Bank. https://openknowledge.worldbank.org/bitstream/handle/10986/6667/399960PAPER0Bu10082136939301PUBLIC1.pdf

Walsh, M. 2015. Volcker Sees Hidden Peril in State Budgets. New York Times (9 June) http://www.nytimes.com/2015/06/09/business/dealbook/volcker-sees-hidden-peril-in-state-budgets.html?_r=0

Whitney, M. 2011. Fate of the States: The New Geography of American Prosperity. New York: Portfolio/Penguin.