

## Chapter 91

# Transparency as a Determinant of Local Financial Condition

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### ABSTRACT

*This study is an attempt to understand the importance of the broadcasting of information about the financial health of local governments. For this, a sample comprising the 110 most important Spanish cities has been used, for the period 2008–2010. Results show that transparency about local governments' actions improves their financial condition. If citizens know this information, the uncertainty over how the resources are used by leaders decreases, encouraging them to carry out efficient governance.*

### INTRODUCTION

The traditional model of public management became obsolete and an international-level movement, called New Public Management (NPM), began to develop in the 1980s in countries such as the UK, New Zealand and Australia, and that later extended to the USA, Canada, Holland and Sweden. This was the first attempt to modernize public administrations with the purpose of improving operations (Pollitt & Bouckaert, 2000). One of the basic tenets of NPM is its critical view towards the bureaucracy and organizational system of public management (Dunleavy, 1991), which is characterized by inefficiency and severe hierarchical inflexibility (Pierre & Guy, 2000). Such weaknesses were overcome by adopting a market orientation, thereby improving transparency (Vigoda-Gadot & Meiri, 2008).

Among the doctrinal components of NPM proposed by Hood (1991), it is important the emphasis on accountability and transparency, as well as a stress on greater discipline and more economical use of resources (Vigoda-Gadot & Meiri, 2008). This paper focuses on these two key values of NPM, since the

several financial scandals around the world have intensified the interest in topics such as transparency,<sup>1</sup> corruption<sup>2</sup> and public resource management. In fact, transparency has become a symbol of accountable and good governance (Torres, Pina, & Yetano, 2011).

Transparency enables observation and analysis of the ways in which governance, business and public affairs should be conducted (Heald, 2006). The OECD (2001) defines this concept as openness<sup>3</sup> with regard to policy intentions, their formulation and implementation. It facilitates the comprehension of the policies implemented by governments, encouraging citizens to take part in decision-making (Guillamón-López, Ríos-Martínez, & Vicente-Olivera, 2011a; Guillamón-López, Bastida, & Benito, 2011b), and it is essential in order to prevent corruption in governments (Tanzi, 1998). According to Alesina and Perotti (1996b), transparent procedures should lead to more fiscal discipline, which is required for accountability (Schaltegger & Torgler, 2007). This leads local governments to an efficient management of public resources, in the sense that they may develop public policies and fulfil financial obligations (CICA, 2007). Therefore, the authors expect a positive link between the level of public transparency and the financial health of local governments.

In this study, the authors use the concept of financial condition to refer to the financial situation of local governments. More specifically, a local government is in good financial condition if it is able to provide public services without damaging its ability to face future obligations (GASB, 1987). In general, local governments in poor financial health are unable to contend with their financial obligations and still provide public services, resulting in the quality/quantity of these services often becoming damaged (Raphael et al., 2010).

Financial condition became relevant in the 1970s and 1980s in the USA, when some cities such as Cleveland and New York suffered financial difficulties (Zafra-Gómez & López-Hernández, 2006). Nowadays, the international financial crisis is the main reason for the situation suffered in many countries. All these different events in national and local contexts have attracted attention and have led to the financial condition of local governments being measured and reported (Petersen, 1977).

With the aim of testing the expected association between transparency and financial health, the authors use a sample composed of the 110 largest Spanish cities, for which Transparency International Spain (Transparencia Internacional España) has published information regarding the level of transparency for the period 2008–2010. Our results show that the lack of transparency in local governments is related to a worse financial condition. Disclosing indicators on local transparency encourages governments to manage their resources better.

This study contributes to the extant literature in several ways. Firstly, as far as the authors know, this is the first attempt to analyse the link between transparency and financial condition. Several authors have focused on the socio-economic and political determinants of public transparency, e.g. the unemployment rate (Guillamón et al., 2011a, 2011b), access to technology and education level (Gandía & Archidona, 2008), public debt and municipal wealth (Laswad, Fisher, & Oyelere, 2005), modes of public service delivery (Cuadrado-Ballesteros, 2014), political competition (Alt, Lassen, & Shanna, 2006; Cárcaba-García & García-García, 2010; Gandía & Archidona, 2008), political ideology (García-Sánchez, Mordán, & Prado-Lorenzo, 2012; Guillamón et al., 2011a, 2011b; Piotrowski & Van Ryzin, 2007), the proximity of elections (Cuadrado-Ballesteros, 2014) and media pressure (Cárcaba-García & García-García, 2010; Gandía & Archidona, 2008; Laswad et al., 2005), among others. In addition, the financial condition of Spanish local governments has also been analysed in terms of socio-economic and political factors (e.g. Cabaleiro-Casal, Buch-Gómez, & Vaamonde-Liste, 2014; Cuadrado-Ballesteros, Mordán, & García-Sánchez, 2014; García-Sánchez, Mordán, & Cuadrado-Ballesteros, 2012; García-Sánchez et al., 2014;

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