

Managing Budgetary Pressure during Economic Downturns

By Allen J. Proctor

The economic recession is creating difficult budget problems for governments throughout the United States. As tax revenue growth stagnates, many governments will face significant budget pressures over the next few years. Except for those governments that still have large fund balances, the prospect of depressed revenue growth for the next several years means that governments must find ways to do business differently if they are to keep their budgets in balance.

The most important factor that will single out the governments that will successfully weather the next several years is the capacity to adopt and adhere to a program of actively anticipating budget problems and responding in the early stages. For a finance officer, this policy would support comprehensive risk analysis (i.e., What are the problems that might be expected to emerge?) and contingency planning (i.e., How will the government respond should the problems materialize?). Such a program would make it possible to routinely set aside appropriate reserves for delinquent taxes, adverse judgments and disallowances, extraordinary spending needs, etc. It also would establish a routine timetable for revising revenue and expenditure estimates and responding to those revisions with new tax and spending plans. Without such a program, budget problems are unlikely to be recognized until they come to a head, and responses are unlikely to be formulated and approved until cash is literally running out and a crisis is at hand.

Six Steps for Maintaining Budgetary Balance and Service Stability

Unfortunately, finance officers often are given their strongest mandate after a crisis has begun. Once that occurs, finance officers need to simultaneously implement six steps designed to enhance the ability to maintain budget balance and to begin a process of restoring stability to government policymaking and service delivery. The six steps are as follows:

1. Disrupt purchasing and hiring,

2. Establish and maintain close monitoring of revenues and spending,
3. Determine whether stopgap financing is needed until budget actions reach full savings potential,
4. Utilize the media to build public awareness of the crisis,
5. Initiate analysis of why the problem became a crisis and how this can be avoided in the future, and
6. Consider requesting state oversight or intervention.

These steps are designed to achieve three purposes. First, establish control of the current situation so as not to become a passive victim of economic developments. Second, expect to encounter problems and try to anticipate where they will occur and how to respond promptly. Third, make sure the fix includes rehabilitation so that budget planning and control mechanisms will be stronger when the next set of problems emerges.

In a crisis, the foremost priority must be to stop, or at least slow, the momentum of spending. Even when budget problems are well known, bureaucracies exhibit the human tendency to maintain the status quo, continuing to handle purchasing, hiring, and contracting in routine ways. This routine must be interrupted.

Disrupt Purchasing and Hiring. In a crisis, the foremost priority must be to stop, or at least slow, the momentum of spending. Even when budget problems are well known, bureaucracies exhibit the human tendency to maintain the status quo, continuing to handle purchasing, hiring, and contracting in routine ways. This routine must be interrupted. Although the obvious objective is to make permanent changes in appropriations and spending policy, the first step must be to prevent the fiscal problem from needlessly worsening.

Spending is most effectively disrupted through immediate freezes on hiring and purchasing. The purpose of such freezes is to buy time until analysis and decision making is completed so that permanent spending changes can be implemented. At that time, freezes should be lifted.

Any freeze must have exceptions, and the determination of exceptions is the most important decision to be made. Personnel turnover always occurs; finance officers should know in what departments and

titles to expect turnover and what the dollar value of leaving those positions vacant will be. In addition, a hiring freeze must have a procedure for granting exemptions for critical positions which, if left vacant, would lead to undesirable breakdowns in basic service delivery. Ideally, attrition analysis and exemption planning already will have been completed as part of routine contingency planning. If not, valuable time will be lost while the analysis and planning is performed. On the other hand, if the freeze is imposed without analysis and planning, the effectiveness of the freeze will be compromised because department heads will hesitate in hopes that decisions are not final and that they will ultimately be granted exemptions.

Effective ways to rapidly slow purchasing are necessarily less specific. First, if the current budget includes funds to offset inflation, that inflation funding should be cancelled immediately. In addition, all encumbrances should be cancelled—to be restored on a case-by-case basis only after review by budget officials as to the government's contractual obligations and the relative importance of the purchase to basic service priorities.

Establish and Maintain Close Monitoring of Spending and Revenues. Officials cannot contain the budget crisis without knowing if the disruption to spending is succeeding. That knowledge can come only through a vigilant monitoring process. The process should ensure that departmental spending adheres to annual and monthly targets and that the solutions are working (i.e., spending reduction initiatives are meeting targeted monthly savings, tax and fee increases are meeting targeted monthly collections, etc.).

It is essential that accountability for implementing the response to the crisis go beyond central budget and finance staff and reach deeply into departments. Major initiatives should have detailed implementation schedules with progressive deadlines. Specific individuals in the departments should be held accountable for achieving targeted savings by pre-specified dates. The budget or finance office should establish pre-specified dates to review the progress of each initiative and to decide whether and how to redirect budget-balancing efforts when slippage is identified. The process can be successful only if departmental managers know that their efforts are being monitored and that any effort to postpone or avoid the spending

cuts will be identified and foiled.

Determine Whether Stopgap Financing Is Needed Until Budget Actions Reach Full Savings Potential. Having disrupted spending and established effective controls to ensure budget actions are taking place, there may be a temporary period of cash shortfall before all the new actions achieve enough savings to close the budget gap entirely. This situation is more likely the more severe the budget crisis, because substantial changes in tax policy or service delivery typically take six months to a year to develop the proposals, attain any necessary legislative approvals, and implement the changes. (At the simplest level, for example, the annualized savings called for in the budget will take 12 months to reach full value.) Thus, although the budget fixes are coming up to speed, some sort of stopgap financing may be necessary, ranging from cashflow assistance within a fiscal year to deficit financing across fiscal years.

Although the precise possibilities will differ across jurisdictions based on varying legal authority and financing arrangements, temporary financing has three basic sources: publically issued notes, the state government, and the public pension system. The most common and straightforward method of temporary cashflow financing is the public issuance of tax anticipation notes or revenue anticipation notes. In difficult circumstances, the issue may be feasible only if it can be privately placed. If the fiscal crisis is sufficiently severe and public confidence is weak, one may need to look to the state government or public pension system.

Since state aid is a significant part of most localities' budgets, the schedule of receipt of state aid can be a significant source of temporary cashflow help. In particular, arrangements can be made with the state to distribute aid on an accelerated basis in order to build cash balances while cash needs are gradually slowed by the locality's budget actions. If the need is more prolonged, direct short-term loans (or guarantees of private loans) can be sought from the state.

The public pension system can be a safe and responsible source of temporary funding when other alternatives are not available and solvency is at risk. Obviously, the pension system must not be abused and the fiduciary obligations of government require that even a hint of abuse be avoided. In that strict context, there are responsible ways to seek assistance from the pen-

sion system as a sympathetic creditor while providing safeguards to the system that are identical to those demanded by private lenders. Temporary help can take the form of delays in scheduled payments to the pension system, with interest paid to the system at the same average rate of other system investments. Payment at a lower rate would be a clear abuse of the pension system. Alternatively, this can be done more formally through direct loans or through private placement of tax or revenue anticipation notes, which have pledges and escrow procedures identical to publicly placed notes. Provision of weaker pledges and procedures would be an abuse of the pension system.

Utilize the Media to Build Public Awareness of the Crisis. A major tool in catalyzing a response to the budget crisis is the media. In particular, the media can be utilized to ensure that there is a widespread perception that a budget problem truly exists and continues to exist. An

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effective media effort also can develop the essential awareness that the solutions available are limited, the services one receives and the taxes one pays are in immediate jeopardy, and therefore the establishment of priorities and the elimination of low-priority programs must be confronted.

The primary objective of outreach to the media is to challenge complacency, inertia, routine, and "business as usual" among bureaucrats and elected officials. The reason for this is that once implementation of a budget reduction program begins, the abstraction of budget cuts becomes concrete reality, and support for the budget balancing effort can quickly erode both among the bureaucracy (which hopes the crisis will go away) and among the elected officials (who will bear the brunt of citizen complaints about the spending cuts and the tax or fee increases). This tendency toward erosion of support must be actively countered through extensive discussions and interviews with all available media.

Ideally, the government will have established credibility with good, responsible

reporters well before the need for media attention arises. Remember that the effort to sustain commitment to fiscal repair is easily undermined by speculation, "crying wolf," and idle threats of worst-case spending cuts. These actions should be avoided at all times. Instead, contact with reporters must be dominated by facts: what deficits already exist, what service effects are known versus what effects are speculative, what options are available and what options are not available, what decisions have been made and what decisions have not been made, what was the cashflow deficiency for the month and what is its significance, and so forth.

Initiate Analysis of Why the Problem Became a Crisis and How This Can Be Avoided in the Future. Once a mechanism for slowing spending has been implemented, short-term financing arranged, and a media effort established, it is time for some reflection and reform. Given the uncertain outlook of the national economy, getting

out and staying out of today's budget problems will require a multi-year effort, which means multi-year financial planning.


Finance officers should first view the crisis as an opportunity to establish a better mechanism for anticipating problems, since current problems developed because of failure to get ahead of them.

This new mechanism should include procedures for risk analysis and contingency planning, as well as the establishment of adequately funded reserve funds, as discussed earlier.

Second, finance officers must identify long-term solutions. This is difficult and involves confronting very hard choices; however, the media effort that is helping sustain support for current budget actions also can help to build support for discussing long-term solutions, including the basic options of permanently eliminating services, raising taxes, introducing new or higher fees, and reducing the cost of existing services. The sense of immediacy of long-term changes is subjective but essential. Early identification of critical near-term deadlines for implementation of multi-year solutions will allow distant goals to make immediate demands on policymakers, the bureaucracy, and the citizenry. However ambitious or naive this objective may seem, one must not let the present opportunity for change and reform slip away as the memory of the budget crisis fades with time.

Exploitation of that opportunity

requires thoughtful analysis of the fundamental problems that led to the budget problems. Officials must determine if there were persistent errors in budget estimates or procedures that were not corrected and thereby led to crisis. Officials also must determine if the problems were transitory or structural. Transitory problems allow for a solution that primarily buys time until the problem disappears on its own. In these circumstances, governments should focus reform on developing better monitoring and more effective ways to anticipate problems. Structural problems, however, require major policy changes. Examples of structural problems are a sustained decline in the local economy and tax revenues; service demand growth that chronically exceeds the growth capacity of the local tax base; legal mandates or contractual rules that limit the controllable share of expenses so that the normal volatility of revenues becomes a major budget balancing problem; and, of course, permanent changes in the level or type of federal or state budget support.

State Oversight or Intervention. If anticipating, responding, and getting ahead of problems is beyond the scope of local financial and political resources, it may be appropriate to seek state oversight or intervention to attain these three objectives. The possible roles of the state can include the establishment of formal oversight agencies, statutory prohibition of practices that chronically lead to local budget problems, and various forms of credit enhancement such as statutory dedication of revenues, statutory bond covenant pledges, statutory escrow procedures, or other statutory means of forcing behaviors on the locality that have otherwise proved elusive. 

ALLEN J. PROCTOR was the executive director of the New York State Financial Control Board when this article was written for the GFOA Budget Bulletin in 1992.

BUDGET BALANCING STRATEGIES

Listed below are some common strategies used by local governments to avoid budget deficits. The strategies are not presented in any particular order and the list is by no means exhaustive. No one strategy is recommended or discouraged. Each government must decide which techniques best serve its unique situation and adapt those techniques as needed.

- Reduce hours of operation for public facilities (e.g., libraries, recreation centers, swimming pools)
- Close facilities that are receiving low use or are in need of extensive repair
- Reduce service frequency (e.g., reduce garbage collection from twice a week to once a week) or scale back existing programs
- Investigate the possibility of regional service consolidation
- Use fund reserves or contingencies
- Postpone hiring of selected positions or freeze all vacant and new positions during a specified period
- Refinance debt
- Examine the duties and hours of part-time and temporary staff to determine if the positions are truly needed
- Use volunteers wherever possible to reduce salary and benefit costs
- Replace full-time staff with less costly part-time personnel
- Spread capital equipment costs over several years through lease-purchase agreements
- Limit or reduce overtime and callback pay
- Increase user fees, licenses, and permits
- Create new service charges for user-specific services currently funded by other means
- Update asset inventory list to assure purchases are for essential items
- Institute safety programs for employees to reduce claims and employee absenteeism
- Extend the useful life of equipment
- Examine departmental organizations and employee responsibilities for possible position consolidation, transfer to needier departments, or position downgrading
- Postpone the implementation of new programs or services or provide a scaled-back version
- Use inexpensive employee recognition practices to generate cost-saving ideas
- Provide early retirement incentives to produce salary and benefit savings by keeping the position vacant or filling it at a lower salary
- Institute a mandated or voluntary employee furlough (e.g., unpaid leave of absence)
- Delay or cancel capital projects
- Require employees to pay part of health insurance or increase the amount that employees pay
- Freeze spending in controllable areas of the budget (e.g., office supplies, travel, subscriptions, capital, etc.)
- Sell assets no longer needed or in use
- Transfer services or programs to enterprise funds, if appropriate, in order to free up general fund dollars
- Lease or rent property that the government owns but currently has no plans to use
- Maximize net collections through timely billings and aggressive pursuit of delinquent tax payments
- Establish a joint purchasing agreement with other government agencies to take advantage of reduced prices for larger purchases
- Use attrition to incur savings over time
- Implement across-the-board cuts