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Mark Pisano

Richard Callahan
University of San Francisco, rfcallahan@usfca.edu

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Developing Effective Mechanisms that Promote Fiscal Sustainability

By Mark Pisano and Richard F. Callahan

Research shows that fiscal stresses are not a temporary feature of the local government landscape, and the lessons learned on leadership for fiscal sustainability will become increasingly valuable.

State and local governments will likely continue to face the stress and shortfalls caused by the Great Recession for an extended period. Three years of research on fiscal sustainability in local government in Southern California[1] identifies strategies that can be used to address this stress, including options for the executive, budget, and finance functions of these jurisdictions.

From the beginning of this research, the most obvious feature of the local government landscape in Southern California was the significant stress on each jurisdiction's budget, particularly in the context of a state government budget deficit reaching tens of billions of dollars. Now, as the third year of studies — totaling 12 cases — comes to a close, it becomes clear that fiscal stresses are not a temporary feature of the local government landscape, and will undoubtedly continue. As shown in Exhibit 1, the U.S. General Accountability Office projects increasing operating deficits in state and local government.

Additional research performed in conjunction with the GAO suggests that the demographic changes in the country may increase costs of government expenditure, reduce the growth of individuals' incomes and expenditures, and significantly reduce the growth of individual tax payments. This analysis points to continued pressure on all government budgets for decades.

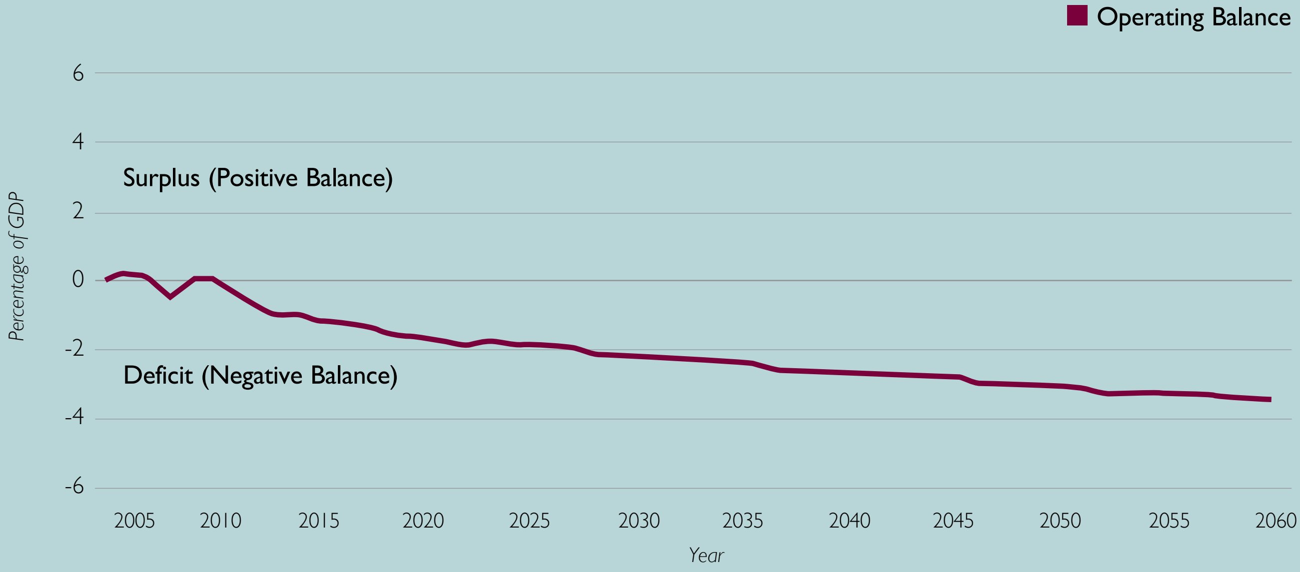
As a result, the lessons learned on leadership for fiscal sustainability will become increasingly valuable to career government finance and budget officers, as well as to the appointed public executives and elected officials who rely on their expertise.

RESEARCHING IN THE CURRENT FISCAL CONTEXT

The research looked at how leadership practices, including strategy development, correlated with a jurisdiction's fiscal sustainability. The leadership challenge was not limited to the impact of the Great Recession on local government property and sales tax revenues, coupled with state government deficits. An equally challenging component for staff in the California local jurisdictions studied has been how the political and social systems deal with the fiscal and demographic realities. The unwillingness of the populace and leadership to confront the numbers has been described as "magical thinking."[2] Similarly, a noted authority[3] outlined a budget approach where an electorate wanted a "free lunch" and elected leadership sought ways to deliver increased services without raising taxes.

The research team developed a process of searching for jurisdictions that

Exhibit 1: State and Local Governments Face Increasing Fiscal Challenges



Source: GAO simulations, updated April 2011.

Note: Historical data are from the Bureau of Economic Analysis's National Income and Product Accounts from 1980 to 2009. Data in 2010 are GAO estimates aligned with published data where available. GAO simulations are from 2011 to 2060, using many Congressional Budget Office projections and assumptions, particularly for the next 10 years. Simulations are based on current policy.

had successfully advanced fiscal sustainability, as well as those that did not — including one case of a city council filing for bankruptcy. The case study governments are listed in Exhibit 2.

The research explored how these local jurisdictions developed, or failed to develop, processes that not only addressed the "bad news" of the economic downturn, but also how they might develop strategies that anticipated fiscal bad news. The findings were drawn by studying the politics of governing board interactions with executive and finance staff and by researching how threatening the fiscal stresses appeared to the decision makers. The successful practices the research team found across a range of cases (or where these practices were absent, in cases of unsustainable budgets) can be summarized as follows.

1. Fiscal Decisions as Part of Strategy Development. First, fiscal decision making should be approached through the development of strategy. In practice this includes:

- Moving from departmental or functional silos that "stove pipe" decision making to treating the budget as a common pool of resources available to all departments.
- Accounting for the full costs of capital projects and negotiated collective bargaining agreements, including the immediate salary and benefit costs, as well as the long-term salary, benefits, and pension costs.
- Committing one-time revenues to one-time expenditures.
- Moving from assumptions that positive fiscal trends are inevit-

Exhibit 2: Case Study Governments

2011 Case Studies	2012 Case Studies	2013 Case Studies
County of Los Angeles	County of San Bernardino	City of Los Angeles
City of Brea	City San Bernardino	City of Pasadena
City of Long Beach	City of Santa Ana	City of Riverside
Whittier School District	City of Southgate	
	El Rancho School District	

Note: The first two years of case studies were published in the 2012 Spring and 2013 Spring issues of National Civic Review.

able and anticipating future fiscal stresses.

- Connecting environmental and planning processes to look at the long-term demands on budgets.
- Favoring decision-making processes that develop trust among the competing interests.

2. Fiscal Fluency: Professional Expertise Matters. This is the fiscal fluency of leadership. In successful jurisdictions, the language of finance is well known and is used to create shared meaning.[4] Fiscal fluency is consistent with research showing that effective leaders use language to develop clarity of purpose, allowing others in the organization to clearly see the challenges ahead and the steps needed to move forward.[5] Essentially, fiscal fluency is the development of professional, long-term staff with expertise in budgets, public finance, borrowing, demographics, and negotiations with federal and state funding sources.

3. Civic Infrastructure Can Support Strategy Development. The civic infrastructure — particularly a balance of voluntary associations and interest groups concerned with community maintenance — can significantly support the development of strategy needed to address fiscal downturns. Where public leadership connects with civic leadership, trust develops. Strategies for building this community capacity go beyond public participation and public education. Not all the cases of fiscal sustainability included the presence of civic engagement, but the absence of an engaged and vibrant civic infrastructure was observed in cases of fiscal instability.

4. The Value of Transparency. Transparency of information from budgets, official statements, audit findings, etc., creates an organizational culture that encourages public executives, budget and finance staff, and auditors to speak truthfully about the fiscal environment. Transparency supports the development of strategies to address immediate and long-term fiscal stresses. In the absence of transparency, the politics of short-term, incremental decision making enervate financial management. Poor short-term decisions based on financial unrealities will be made with the hope that, down the road, the future will be brighter. However, the GAO projections and related research suggest that the long-run financial picture will not be punctuated with growth trends sufficient to overcome poor fiscal decision making today. Transparency helps connect decision making with long-term consequences.

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5. Clearly Marked Lines of Authority. Executive authority should be clearly structured. When the lines of authority between fiscal executives and elected policymakers are blurred, confusion reigns and accountability becomes diffused. In several of the high-performing jurisdictions studied, the executive function had been strengthened. Structural dynamics need to make it easier for executive authority to directly address the short- and long-term fiscal sustainability of the jurisdiction.

MOVING FISCAL SUSTAINABILITY FORWARD

When fiscal stress is present and likely to endure, better-performing jurisdictions begin to address matters by being rigorous about future revenues. The five decision rules outlined above appear to move fiscal sustainability beyond simply a balanced budget. The professional experts consulted as part of the research repeatedly emphasized that fiscal sustainability goes beyond a singular objective to balance the budget. These managers cautioned that balancing through cost-cutting measures alone would eviscerate a community in the long term. Similarly, they cautioned that simply providing resources to public safety functions does not ensure a safer jurisdiction. Rather, they collectively discussed an operational definition of meeting community needs through short- and long-term fiscal stewardship, partnerships, and strategies.

The essence of this definition of fiscal sustainability is that, in the face of long-term fiscal stress, governmental entities will both manage known resources and help get the community involved in solving problems. This engagement will create the community maintenance process a jurisdictions needs to sustain it through the long-term stress ahead. Knowing and protecting these resources is the first step in this process. Further, given the uncertainties of the intergovernmental financial system, a policy of relying on intergovernmental transfers as long-term resources in a baseline budget should be carefully reviewed.

Developing an outcome- and performance-based decision-making framework can be an effective fiscal sustainability strategy. The successful leaders in the case studies all used strategies to compliment their stewardship principles in a manner that helped achieve community needs.

Another successful strategy is to connect fiscal sustainability to the community's environmental and business concerns. The key here is that the major new role of leadership, and particularly of elected officials, is to create the need for partnerships and for political space that allows organizations to join the discussion, making sure that all interests are considered. In other words, the responsibility for providing for community needs is not exclusively a function of the government. One of government's major responsibilities is that of institutional design — writing the rules of the game — so that all community organizations and individuals can become part of the problem-solving team.

CONCLUSIONS

The research this article is based on looked at leadership practices that develop effective mechanisms for fiscal sustainability. The complexity and dynamics of special interest groups can exacerbate ambiguity and thus reduce the clarity that is needed for fiscal sustainability. In this respect, the experience of the Great Recession may suggest updating charters and laws governing financial understanding, decision making, and accountability in local government so that executive leadership has the organizational capacity to be sufficiently independent in a way that allows it to bring information to the policy table without interference from the decision-making process. Many strategies for enhancing sustainability will require modifications to the jurisdiction's organizational structure, which might include changes in the government charter that make all its divisions part of the solution set. For example, charters need to create partnerships as a fiscal strategy mindset.

For several decades, there have been quick recoveries from negative business cycles, which have conditioned local and state officials to assume that positive fiscal trends are inevitable. This research demonstrates, however, that our past budgetary decisions have implications that are now outpacing our growth in revenues. This mismatch in expenditures and revenues is covered in the GAO state and local trend reports. Additional research also suggests that the demographic changes occurring in the United States are significantly reducing the growth rates in taxes paid. A current deficiency in state and local budgeting may be due to a lack of understanding and incorporating these long-term trends.

For each of the cases studied, the particular context matters greatly. The purpose of this article is not to recommend that one jurisdiction's success should be copied or that only one model exists for advancing fiscal sustainability. Rather, the research findings suggest varied factors that account for success, along with the importance of finding context-specific methods for implementing the practices and mechanisms needed. This work indicates that substantial change in the role and functioning of government is necessary to ensure that the executive and financial staff and functions can meet the challenge of long-term fiscal stress.

Notes

1. The project was funded by the John and Dora Haynes Foundation, with research partners from the University of Southern California, the University of San Francisco, and the National Civic League.
2. John L. Korey, "California: Failed State or Too Big to Fail?" *The California Journal of Politics & Policy*. (3)2, 2011.
3. Jeffrey Chapman, a public-sector economic professor and researcher who has studied California public finance since the passage of Proposition 13 in 1978.
4. This is a primary role of leadership, as outlined by Warren Bennis, *Why Leaders Can't Lead: The Unconscious Conspiracy Continues* (San Francisco: Jossey-Bass Publishers), 1989.
5. Marcus Buckingham, *The One Thing You Need to Know* (New York: Free Press), 2005.

MARK PISANO is a senior fellow at the Bedrosian Center for Governance of the University of Southern California. He is former director of the Southern California Association of Governments. Pisano can be reached at Mpisano@usc.edu. **RICHARD F. CALLAHAN** is associate professor and chair of the Department of Public and Nonprofit Administration at the University of San Francisco's School of Management. He formerly worked for local governments in California and New Jersey He can be reached at Rfcallahan@usfca.edu.