How did we get here?

Gimmicks, tricks, and illusions

Getting back on track
Gimmicks, tricks, and illusions were born of necessity
- Record budget surpluses
- Early 2000’s Recession
- Mid-decade rebound
- Late 2000’s Recession (“The Great Recession”)

Perpetual Fiscal Crisis
- Budget difficulties at the federal and state level trickle down
- Obsolete tax structure
- Aging population
- Crushing pension debt
- Drained rainy day funds
- Resistance to major tax increases

Economic recovery will help, but it will not solve these problems.
Government Response
Many governments grabbed any solution that could keep their budgets balanced for another year, regardless of the long-term implications.
- Draw-down reserves
- Across-the-board cuts
- Gimmicks, tricks and illusions

Gimmicks, Tricks, and Illusions

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Conflicting Pressures
Revenue Enhancements
- Increase complexity of the tax structure, including the methods in which taxes are collected
  - Use of a large number of taxes or fees

Expenditure Manipulations
- Use of off-budget spending
  - Shifting payroll or other liabilities from one year to another
  - Delaying pension payments
Liability Recognition
- Reduce appropriation for self-insurance in a given year, but compensate for it in the next year
- Under-fund pension payments or skip them altogether
- Forego salary increases in exchange for higher pension benefits in the future

Debt Utilization
- Using debt for operating purposes
- Refinancing debt

Budgeting and Financial Reporting Practices
- Provides a larger set of opportunities to induce systematic misperception of the cost of government
- Works hand in hand with the other four categories listed previously
Seven Deadly Deceptions:
- Rob Peter to pay Paul
- Use accounting tricks to lie about spending or revenue
- Borrow
- Sell off assets
- Make something up
- Nickel and dime employees
- Delay maintenance and replacement of assets (and rely on hope)

Where Do You Fall?
- It's never OK! (moralist)
- It's OK, with moderation (pragmatist)
- Lesser of evils (pragmatist)
- It's a necessary evil (budget magician)

Illustrations

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One-Shot Revenues in the Budget

- Use of one-time revenue source to bridge a current revenue shortfall

- Citizens continue to demand services that are being paid for by a revenue source that is not sustainable, which indirectly distorts policy choices.

Examples

- Sale of property
  - Cell phone settlement
  - Tobacco Settlement Securitization
  - States balancing budgets with federal health care dollars that Congress has not yet appropriated

GO Debt Restructuring

- A period of low interest rates and the presence of present value savings provides a county government with an opportunity to refinance its debt.

- The county, however, also takes this opportunity to capitalize the current year's debt payment and also stretch out the debt payment schedule.

- Before the refinancing, 85% of the county's debt was going to be repaid in 16 years. After the refinancing, it will take 24 years to repay the same level of debt.
The mayor ran on a pledge of no new taxes during her first term in office. Faced with unexpected financial difficulties upon taking office, she requests that the finance officer finds creative ways to transfer profits from the Water and Sewer Authority to the General Fund.

- The finance department raises the fees to the Authority for services such as printing, fleet, payroll, and revenue collection, even though the economic costs for such services have not increased.

- Implementation of a “chargeback” system to recover the value of administrative support services provided through the General Fund.

- Budget employees that should be paid from the General Fund directly in the special revenue fund.

**Examples**
- Statute allows a state government to transfer “excess” fund balance to the General Revenue Fund to help defray the state’s operating costs.

- Efficiency Initiatives Revolving Fund
Examples
- Wisconsin 911 service fee
- New Hampshire recently ordered by State Supreme Court to put back $110 million that it took from a medical malpractice insurance pool to balance its budget.

Pension Obligation Bonds
- Fundamentally an arbitrage play that replaces a “soft liability” (the unfunded pension) with a “hard liability” (the debt service on the taxable pension obligation bonds).
- The “arbitrage play” reflects the structural relationship whereby the bond proceeds are sent to the pension fund with the objective that the fund will earn a higher return than the true interest cost on the pension bonds.

Examples
- Illinois
  - June, 2003: Issued $10 billion with maturities of up to 30 years
  - Proceeds provided funds to state pension systems ($7.3 billion) and budget relief during 2003-2004
  - Actuaries expected 8.5% annual return compared to a 5.05% interest rate on borrowed funds
New Jersey
- Issued $2.7 billion in 1997
- Equity markets flopped between 2000 and 2002
- State required to make debt service payments while making higher retirement contributions not forecasted in the original, optimistic funding plan.

Asset Sales and Leasebacks
- An asset sale effectively mortgages an already paid for asset (i.e., encumbrance free) as a means of generating a quick and (oftentimes) substantial upfront payment to the government.
- In return, the government must pay lease payments over an extended number of years, thus incurring the associated interest expense for a previously paid for asset.

Examples
- Indiana: 75-year lease of toll road ($3.8 billion)
- Chicago
  - 99-year lease of Chicago Skyway ($1.83 billion)
  - 75-year lease of city’s parking meters ($1.2 billion)
  - Tried to lease Midway Airport
Arizona received $735.4 million and will have to pay back $1.5 billion. Using the proceeds for operating expenses, there are no potential management efficiencies – the buildings are the collateral for the loan. California and Nevada are considering similar plans.

Nickel and Dime Employees
- Furloughs
- Pay Freezes
- Hiring Freezes
- Pay Cuts

Workforce Changes and Savings

Source: Center for State and Local Government Excellence
Connecticut tried to issue its own accounting rules

Hawaii has inaugurated a four-day school week

Utah/Iowa considering four-day work weeks

California accelerated personal income tax and corporate tax estimated payments and borrowed from local government property taxes
Illusions misrepresent the cost of providing services

- Embrace the new revenue reality
- Adopt a long term financial plan
- Focus on your structural deficit

Rowan & Picur’s Strategies
- Be Prepared
  - Use the “Household” Test
  - Practice Full Disclosure
  - Pass the Final Test

Osborne & Hutchinson’s Strategy
“Budgeting for Outcomes”
- Set the price of government
  - Set the priorities of government
  - Set the price of each priority
  - Develop a purchasing plan for each priority
Osborne & Hutchinson’s Strategy
“Budgeting for Outcomes”
- Solicit offers from providers to deliver the desired results
  - Buy the best, leave the rest
  - Negotiate performance agreements with the chosen providers

Other Resources
- GFOA
  - Consulting Services
  - Best Practices
  - Recommended Practices (NACSLB)
  - Publications
- Peers
- Industry Publications
- Media

Wrap-Up / Discussion
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Source List

Budget gimmicks, tricks, and illusions
GFOA of Missouri
Spring Institute
April 15, 2010

Sources

- City of Phoenix Budget and Research Department, 2010 Phoenix Budget for Community Review.