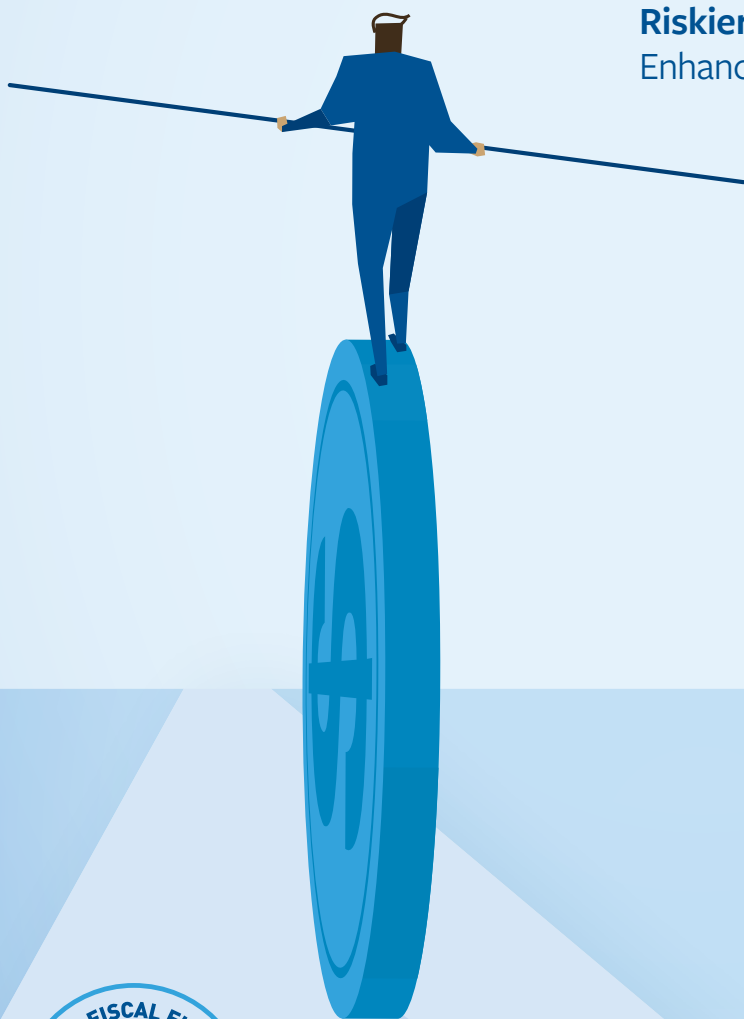


Balancing the Budget in Bad Times

PART 2

Riskier Treatments for Reducing Cost and Enhancing Revenues in the Next 12–18 months



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Government Finance
Officers Association

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The Government Finance Officers Association (GFOA) represents approximately 20,000 public finance officers throughout the United States and Canada. GFOA's mission is to promote excellence in state and local government financial management. GFOA views its role as a resource, educator, facilitator, and advocate for both its members and the governments they serve and provides best practice guidance, leadership, professional development, resources and tools, networking opportunities, award programs, and advisory services.



Table of Contents

Introduction	2
Evaluating Near-Term Treatments	3
The Cautionary Near-Term Treatments	6
Control Personnel Costs	7
Reduce Near-Term Capital Spending, Equipment Costs, and Annual Debt Costs	9
Organizational Strategies	10
Sourcing Strategies	12
Enhancing Revenues	13
The Extreme Caution Near-Term Treatments	14
Reducing Expenditures	14
Enhancing Revenues	15
Inadvisable Near-Term Treatments	17
Conclusion	19

Introduction

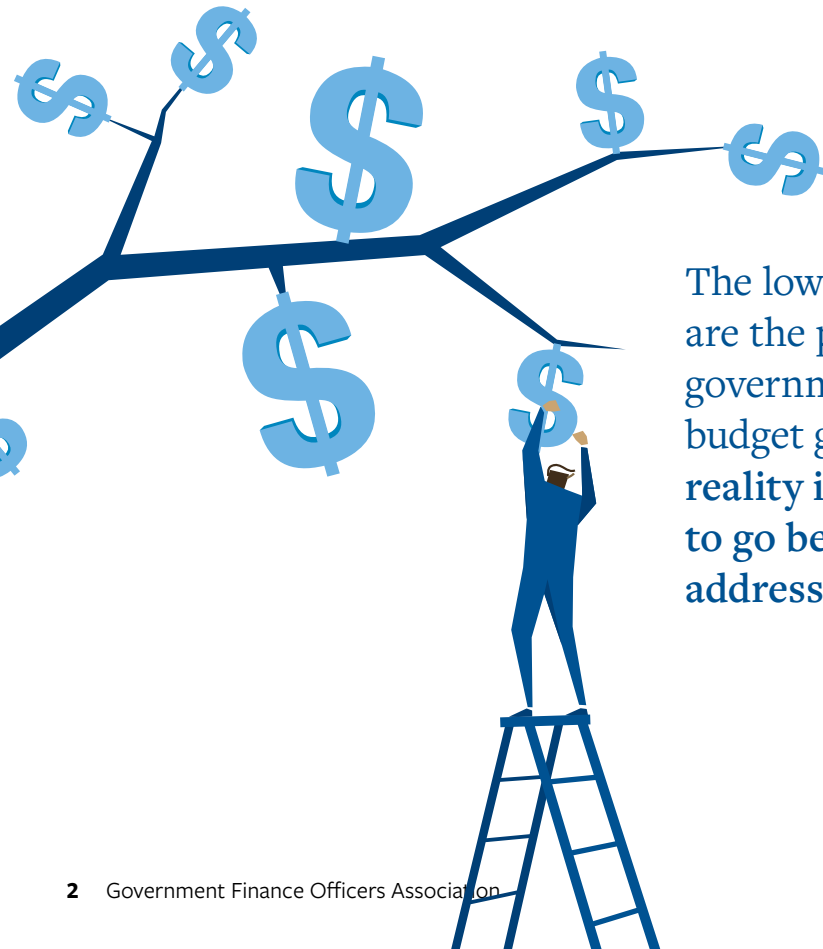
Step 5 of the GFOA 12 steps to recover from financial distress is called “Near-Term Treatments.” This paper is the second in a two-part series. The first paper covered “primary” or lowest risk Near-Term Treatments and how to create the right decision-making environment and management disciplines to get the most out of all Near-Term Treatments.

The lowest risk Near-Term Treatments are the proverbial “low-hanging fruit” that government leaders often seek to close budget gaps in good times and bad. But the reality is that many governments will have to go beyond the primary techniques to address their economic and fiscal challenges. Governments facing a drop in revenues, increases in expenditures, spikes in demand for services, and loss of capacity are unlikely to overcome those problems by doing the basics well. Leaders will likely have to consider some of the riskier techniques and evaluate them carefully.

We have structured the discussion in this paper to help manage this risk. The first section describes how to evaluate Near-Term Treatments. A defined set of criteria will help you make a clear-eyed assessment of the risk. After the evaluation discussion, we present groupings of riskier Near-Term Treatments, where each group includes techniques of greater risk. The groups are cautionary, extreme caution, and inadvisable.

Diagnosis Before Treatment

Step 4 of the recovery process is the “initial diagnosis.” You might wish to refer to this step along with reading this paper to help focus your use of the Near-Term Treatments.



The lowest risk Near-Term Treatments are the proverbial “low-hanging fruit” that government leaders often seek to close budget gaps in good times and bad. **But the reality is that many governments will have to go beyond the primary techniques to address their economic and fiscal challenges.**

Evaluating Near-Term Treatments

The most obvious factor to consider when evaluating the need to employ riskier techniques is the size and nature of the projected deficits. How large are they? How quickly will they arrive? Will they grow over time or remain constant? Are there underlying structural issues that have been worsened by a crisis? Or will the government's problems end once the crisis does? [Cash flow forecasting](#) and [scenario planning](#) (see [Step 4](#) of the 12-step process, Initial Diagnosis) can help shed light on these questions. With any financial crisis, especially the COVID-19 pandemic, it is impossible to answer these questions with certainty. Even so, an analysis—presented with transparency around the assumptions and commitment to update as information becomes available—is better than flying blind.

Once you determine the likely size of the deficit—or better yet, outline different [scenarios](#) that suggest a range—then you can make decisions on how to address it, including techniques you will go to first and those you might save for later if the situation continues to deteriorate. As the name implies, Near-Term Treatments are not exhaustive of every treatment a government might need to regain financial health. However, they do provide a place to start. You can evaluate the potential of Near-Term Treatments according to the following criteria. A [scoring sheet](#) is available at the Fiscal First Aid website that summarizes these evaluation criteria.

Do we have the authority to do it? At first glance, these criteria may seem basic and not worth mentioning. However, research has shown that local governments consistently overestimate constraints placed on them by enabling legislation, other levels of government, and labor contracts.* Local government often underestimate their ability to change the constraints that exist. So, before ruling out a technique because you believe you don't have the authority, consider doing the following: Start by reading the letter of the law or the labor contract. You may find you have the authority after all. See if other governments—particularly those in the same state—are using the same technique you are considering. Check to see if there is clear, settled case law that mitigates the risk of future legal challenges. If the technique you are considering is truly not authorized, find out if state or federal agencies have the administrative authority to grant you leeway. You could also work with other local governments to lobby for change, but that might need to happen later—after you've bought yourself some time with other Near-Term Treatments.

What is the potential financial benefit? Estimate the potential cost reductions or revenue increases from Near-Term Treatments. Treatments that generate small or uncertain benefits can be set aside in favor of those that generate larger and/or more certain benefits.

Not Mandated After All—A Real Life Example

Many years ago, a large city was faced with severe funding shortfalls. The city ran several homes for the aged. These were thought to be mandated, so they were initially exempted from the search for cost savings. However, a careful reading of the law revealed the city was only required to operate a single home. This did not lead to widespread elimination of the homes, but it did bring them to search for cost savings.



* Frederick M. Hess. *Cage-Busting Leadership*. Harvard Education Press (February 1, 2013).

The estimate should consider the following:

- What is the projected benefit in the first year, factoring in time for implementation?
- What are the projected benefits over a multiyear period? How does the financial impact change over time? For example, a one-year base salary freeze creates savings in subsequent years when future salary increases are applied to a lower base. In contrast, revenue gained from increased parking fines may drop over time as compliance with the ordinance increases.
- What are the financial costs for implementation?

What is the service impact? Some Near-Term Treatments may reduce service levels. This could be an important consideration for services that are involved in responding to the COVID-19 public health threat. If your government has a capacity to measure and monitor the performance of public services, then evaluating service impact will be easier. If not, even basic data about the demand for services that could be negatively impacted by Near-Term Treatments can be helpful, such as the number of emergency response calls, the number of patrons at libraries or recreational facilities, etc.

You can also consult with the managers of services that could be negatively impacted by proposed Near-Term Treatments. Seek to learn whether the

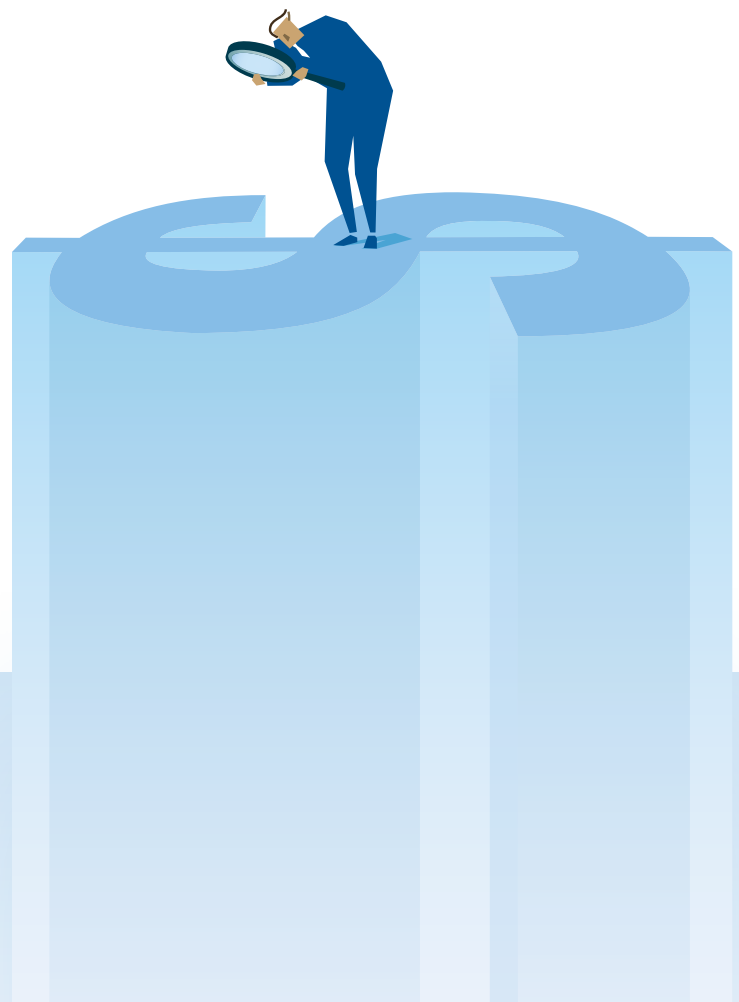
impact will be felt in a small way across a large number of people or more pronounced in a smaller population. This is important for making sure that service cuts don't fall unfairly on certain groups of citizens and that vulnerable populations are not harmed.

Where possible, leaders should get input from the constituents most likely to be affected. Even in instances where financial needs outweigh service concerns, it is better to communicate the move ahead of time and give the impacted citizens a chance to be heard.

Finally, when Near-Term Treatments will reduce service, consider if there are ways to mitigate the impact. For example, can a service be provided at a reduced level rather than eliminated? Can service be restored later? Are there less costly ways to provide service?

How feasible is implementation? Leaders should consider whether they have the time, staff capacity, technology, information, and other resources

Before ruling out a technique because you believe you don't have the authority, **start by reading the letter of the law or the labor contract.**



to implement a given Near-Term Treatment. For example, some fees may be hard to implement without adding staff to issue bills, collect cash payments, and pursue delinquent accounts. Other fees will be easier to implement where there is staff and a billing/collection process in place. Selling or leasing an asset may produce a financial benefit, but the process may also require an investment of time and professional expertise that is hard to muster during a crisis. Also, during the COVID-19 pandemic or a resurgence of the virus, it may not be practical for employees to work together—or for citizens to come into government facilities or engage in activities that would otherwise have been attractive options.

For each initiative, local leaders need to understand whether implementation will be limited or complicated by collective bargaining agreements. *A crisis can be an opportunity* to renegotiate terms under collective bargaining agreements. Always negotiate in good faith to maintain trust with employees.

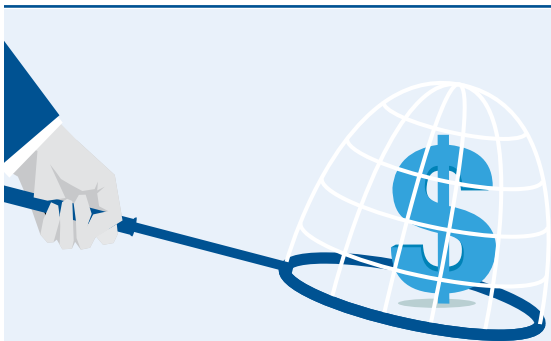
Will elected officials support it? Many Near-Term Treatments will have to be approved by a body of elected or appointed officials, either as standalone measures or as part of a larger budget. While a

financial crisis is no place for sacred cows, elected and appointed decision-makers do not have an unlimited supply of political capital either.

Investing time and effort in developing strategies, for which it will be almost impossible to win approval, diverts resources from initiatives that may be politically palatable. This does not mean that certain strategies should be dismissed by uttering, “that will never pass.” But political consideration has to be part of how strategies are prioritized and how they are presented.

Politically challenging Near-Term Treatments could be considered if local leaders are able to make the case in a way that reflects the current conditions. That’s why assessing the nature and size of the budget hole is important, as are the recommended steps designed to gather data on the financial and operational impacts of proposed strategies. As important, by considering politically difficult alternatives, it may help the case for less draconian but still challenging steps.

With an evaluation framework in place, you are ready to consider the riskier Near-Term Treatments. We’ll start with the “cautionary” treatments, which present the least risk of those in this paper.



Never Let a Crisis Go to Waste

A financial crisis may present an opportunity to take on sacred cows or other long-standing arrangements that some officials have realized is not a good use of public money but haven’t had the motivation and/or opportunity to address up to this point. The financial recovery could provide the impetus.

The Cautionary Near-Term Treatments

The Near-Term Treatments in the cautionary category are riskier than those we reviewed in the first paper in this series. However, governments may have no choice but use them when in financial distress. Governments do need to be mindful of the risks these techniques entail and be ready to mitigate those risks. They have been put into the following categories: control personnel costs; reduce near-term capital spending, equipment costs, and annual debt costs; organizational strategies; sourcing strategies; and enhancing revenues. Exhibit 1 overviews the techniques in these categories.

Governments need to be mindful of the risks these techniques entail and be ready to mitigate those risks.



Exhibit 1 – Overview of the Cautionary Techniques

Control Personnel Costs
Wage freeze
Hiring freeze
Increase part-time labor
Reduce hours worked and pay
Close facilities
Layoffs or reduction in force
Increase employee contributions to pensions or OPEBs

Organizational Strategies
Small and/or temporary across-the-board budget cuts
Reorganization
Centralize financial management and human resources activities

Reduce Near-Term Capital Spending, Equipment Costs, and Annual Debt Costs
Defer and/or cancel capital projects, maintenance, and/or replacement
Defer noncapital special projects
Use short-term debt to pay for vehicles
Restructure debt

Sourcing Strategies
Outsource
Insource
Divest

Enhancing Revenues
Revisit interfund transfer policies
Obtain better returns on idle cash

Control Personnel Costs

Wage freeze. A wage freeze limits personnel costs without making employees worse off—meaning their nominal compensation is not reduced. This technique will be difficult where employees are covered by a collective bargaining agreement. Even if a wage freeze is possible, care should be exercised, as it might encourage capable employees to leave. It might also make it harder to recruit high-quality employees. That said, during high unemployment, these risks may be reduced.

One way to lessen the impact of a wage freeze on morale is for top management and/or elected officials to take a temporary pay cut for the duration of the wage freeze. This promotes a culture of frugality and a sense of shared sacrifice.

The Risks

- It may be hard to enact in a collective bargaining environment.
- Wage freezes may encourage staff, especially your best staff, to consider other employment options.
- The broad nature of a wage freeze makes it harder to take a results-oriented and data-driven approach to recovery planning.

Part-timers can be a cost-effective way to help with temporary demands related to the pandemic, even if overtime for full-time staff is not an issue.



Hiring freeze. A hiring freeze is different from the vacancy control technique described under the Primary section. A hiring freeze is a blanket stop on all or almost all hiring. It will help control costs and can be used with an attrition strategy to cut the size of the workforce. However, a hiring freeze is a blunt instrument. Vacancy control, in contrast, is more akin to a scalpel and asks the recovery leadership team to consider holding positions vacant on a case-by-case basis. A hiring freeze makes it harder to take a focused approach on what to cut and what to keep. It is important to set up policies governing the hiring freeze, especially exceptions, and adhere to the policies, if possible, to avoid a lack of trust and morale issues.

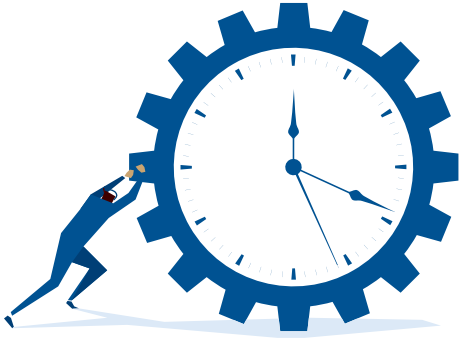
The Risks

- The nature of a hiring freeze makes it harder to take a results-oriented and data-driven approach to recovery planning.
- Some exceptions to the freeze may be necessary. If these are seen as unfair or capricious exemptions, support for the recovery could decrease.

Increase part-time labor. This could transform labor into a variable cost and reduce benefits costs. Part-timers can also cut overtime costs by adding staff at times of peak demand. Part-timers can be a cost-effective way to help with temporary demands related to the pandemic, even if overtime for full-time staff is not an issue. However, increasing part-time labor could increase exposure to risk. For example, part-time police officers may not have the same training standards as full-time officers or have the same familiarity with the community.

The Risks

- Be cautious when substituting part-time employees for full-time employees. Part-time employees may have less training, knowledge of the job, etc. This could increase the government’s exposure to risk.
- Morale can be affected, depending on how the changes are viewed. For example, employees who are involuntarily changed to part-time status will still be part of the organization and may negatively impact the work atmosphere.
- Collective bargaining agreements might limit the government’s ability to use this technique.



Closures or reduced operations should be part of a **strategic, prioritized approach to service reduction.**

Reduce hours worked and pay. A furlough or a change in work schedule (e.g., going from a 40-hour week to 35) can reduce personnel costs while providing employees with more personal time. This gives employees a reasonable trade-off: more personal time in exchange for reduced pay. The salary savings depend on how many furlough days are required of employees. Some cities have realized up to 10% in salary savings. This technique will reduce the cost of fringe benefits that are based on salary but will not impact other benefits, like health care, that are provided equally, irrespective of salary.

Similar to what we suggested under the wage freeze, to lessen the impact on morale, top management and/or elected officials could take a temporary pay cut that is about equal to the impact of the furlough on employees. Again, this promotes a culture of frugality and a sense of shared sacrifice.

The Risks

- Not all employees will value personal time and wages equally. Those who value wages more may become dissatisfied, lose productivity, create morale problems, or leave the organization.
- Consider the impact of reduced work hours on services. Is the government willing to accept lower levels of quality or timeliness for certain activities? Will some activities be discontinued?

Close facilities (or reduce hours of operation). This reduces costs by reducing the need for personnel to staff the facility and by reducing utility costs. Closures or reduced operations should be part of a strategic, prioritized approach to service reduction. Consider supplementing closings with availability of online options to mitigate service impacts. Online options could be important when in-person interaction becomes difficult under social distancing guidelines. Identify and evaluate service impacts with an emphasis on what alternatives are available when the office is closed. Thorough communication is needed before changes in hours to ensure a smooth transition.

The Risks

- Make sure that closings do not fall unfairly on vulnerable populations.
- Reducing hours of operation reduces costs only when employees are not paid for the time. Getting the most from this technique raises personnel issues (see the earlier technique of reducing hours worked).

Layoffs or reduction in force (RIF). A layoff or reduction in force (RIF) is different from reducing hours worked and pay because a RIF separates staff members from their jobs. Because personnel costs are a large part of most governments' cost structures, it may be necessary to cut the number of employees to cope with fiscal stress. A RIF can lead to significant and, perhaps, ongoing cost savings.

The Risks

- A RIF will be one of the greatest challenges to maintaining good morale of any Near-Term Treatments we have examined so far.
- A RIF could reduce service effectiveness more than most other Near-Term Treatments.

Increase employee contributions to pensions or OPEBs. A short-term solution to growing liabilities for pension or other post-employment benefits (like health care) is increased employee contributions or retiree co-payments, deductibles, or premiums. Some jurisdictions may need suspend retirement earnings credits during periods of distress (no pension benefits are accrued and thus no liabilities are created, thus no payments required).

This technique runs the risk of compounding the burden on employees. That said, this may be more politically feasible if required employer contributions are increasing as a result of market losses.

The Risks

- The technique will be less politically feasible if employees are already enduring wage cuts, furloughs, etc.
- For most governments with organized labor, the contracts often run several years, and benefits changes are hard to negotiate.

Reduce Near-Term Capital Spending, Equipment Costs, and Annual Debt Costs

Defer and/or cancel capital projects, maintenance, and/or replacement. This is a relatively common strategy and can be useful. However, the government must be careful not to delay projects that are crucial to the viability of the community. In the primary techniques, we advocated for long-term capital planning and maintenance/replacement schedules for existing assets. This will help manage the risks associated with delaying or canceling projects.

When considering deferral/cancellation of capital projects, consider potential cost and revenue impacts. For example, perhaps a road project is needed to improve access to commercial areas, which would increase business activity and sales taxes. Identify the point at which delaying a capital project becomes fiscally unsound. For example, might the delay of a major road repair project require large-scale replacement reconstruction later? [Lifecycle costing](#) is a proven and powerful technique for identifying the most cost-effective point at which to maintain/replace an asset. [Risk analysis](#) can help determine the consequences of deferral.

The Risks

- This strategy is popular because it allows expenditures to be taken off the budget without impacting day-to-day services or staffing in the near term. Make sure that a delay of a capital project is not just a delay of the financial reckoning day; make sure that it won't negatively impact the operating budget.

- Risks associated with delay can include higher maintenance costs later, increased downtime, decreased productivity, extra costs to restart a project, violating the terms that grants used to fund the project, and perhaps decreased safety.

Defer noncapital special projects. Some projects can be costly and important but not necessarily urgent. For example, perhaps an update to a comprehensive land-use plan and master plan could be put off for a year or two without irreparable harm. Make sure to understand the potential consequences of deferring these projects. For example, will an out-of-date community master plan make it harder to make capital spending decisions or get grants?

The Risks

- Make sure that delaying the project won't create difficulties in other areas. For example, would deferring planning projects make it harder to make wise decisions with community resources?

Use short-term debt to pay for vehicles. This spreads out the cost of these assets over many years. While this strategy offers breathing room, it must be paired with a policy that limits the life of debt to the life of the asset. Otherwise, the strategy comes dangerously close to issuing debt for operational expenses. Also, this strategy is limited to situations where the capacity for issuing debt exists. Otherwise, financial flexibility may be reduced.

The Risks

- The usefulness of this strategy will vary with the type of vehicles purchased and how many are purchased. For example, debt would be helpful for a long-lived asset, like a fire engine, than for a short-lived one, like a pooled car that will be driven many miles each year.
- If the term of debt exceeds the life of the vehicle, then the government will have more serious financial problems.
- Bank loans and direct placements have similar disclosure requirements compared to traditional bonds. The government should discuss financing instruments with their municipal advisor.

Restructure debt. Payment schedules might be able to be changed to reduce financial pressure. Options for restructuring debt could include stretching out the term of the loan, backloading the principal repayment schedule, and making interest-only payments. In some cases, loan forgiveness may be possible. However, be mindful that even though extending the maturities of debt can provide a near-term cash flow fix, it can also increase total debt service costs over the life of the issue.

The Risks

- Beware of causing intergenerational inequity issues by stretching debt out past the life of the asset it is funding.
- Consider the operating impacts of debt restructuring on future budgets, especially when evaluating structures such as interest-only flexible payments and other shifts in payments over time. Backloading a debt issue with higher principal payments can be harmful to future years' budget conditions.
- Tight credit markets may limit the ability to use this technique.
- State/provincial law might limit the use of this technique. For example, the law might limit the allowable term of debt for local governments.
- Credit rating agencies will likely view the restructuring of debt for anything other than interest cost savings negatively.

Small across-the-board budget cuts can be as useful as a Near-Term Treatment because they enlist managers in the solution by giving them a target to meet.



Organizational Strategies

Small and/or temporary across-the-board budget cuts.

Small across-the-board budget cuts can be as useful as a Near-Term Treatment because they enlist managers in the solution by giving them a target to meet. It is an uncomplicated and reversible tactic and is perceived as equitable. Also, it starts the conversation about how budgets can be reduced. For example, department heads could be asked to provide options for how their budgets could be reduced by different increments (e.g., a 5% cut versus a 10% cut).

However, across-the-board budget cuts have drawbacks—chief among them being that the reductions are disconnected from priorities. Rather than aligning spending with services, all services are provided at a lesser level. Therefore, if a small across-the-board cut is used to buy time, it should be followed by a planning and budgeting approach that better matches priorities and spending.

The Risks

- Be wary of overreliance on this tactic, as it eventually harms core services. See *The Extreme Caution Near-Term Treatments* for more discussion of this point.

Reorganization. Your organization structure could lead to higher expenditures if there is too much overhead, too many layers of management, too many managers per frontline staff person, etc. You can evaluate your organization structure for savings opportunities. However, be aware that research has shown that the savings available from reorganizations are often overestimated.* For instance, if a reorganization moves around the boxes on an organizational chart but doesn't impact the underlying processes or result in better use of staff time, then the benefit will be limited or nonexistent. Also, the managers of consolidated departments often demand higher pay, eating into the potential savings. Further, reorganization can elicit a great deal of internal resistance. That said, if there are opportunities available from using a reorganization to apply efficient processes and make use of human resources, it would

*Note that we are not referring to eliminating lower priority programs or closing underutilized facilities as part of a "reorganization." Reorganization refers to streamlining reporting structures, reducing overhead, etc.

be realistic to expect 2% to 3% in near-term savings and perhaps more over the long term.*

Start by diagramming processes and lines of communication. What is the reporting structure? Who approves what? Who is responsible for key steps in the workflow? Are there handoffs between employees or departments where work is lost or delayed, thereby increasing costs? Can certain tasks be done in parallel that are now done sequentially? Also, evaluate the ratios of supervisors to frontline employees. Are there too many managers per frontline staff person? Use benchmarking to compare with other organizations. See how many layers of management there are between the chief executive and frontline staff. Explore ways to flatten the organization and/or combine departments where there are opportunities to reduce overhead. Positions and the size and complexity of the organization should drive the administrative structure of any department, not promotional opportunities for long-time employees.

Restructuring might be useful for correcting systems that contributed to financial distress and may be required as a prerequisite for far-reaching reform. For example, perhaps certain kinds of decision-making authority need to be more centralized to make faster changes. Or perhaps lower levels of management need to be empowered to make other kinds of decisions.

The Risks

- The potential savings of reorganizations are often overestimated.
- Reorganization can elicit a lot of resistance from people who lose power and authority in the new structure.

Centralize financial management and human resources activities. In a crisis, it is important to have an understanding of and control over inflows and outflows of cash. This could mean personal review by the CFO (in a small government) or by centralized finance staff of proposed expenditures until the emergency has passed. Not only will centralization slow the rate of expenditure, but it will give the CFO a better understanding of spending patterns and may highlight problems that make financial

Restructuring might be useful for correcting systems that contributed to financial distress and may be required as a prerequisite for far-reaching reform.

challenges even more difficult. Centralization can also improve working capital by rounding up cash from decentralized divisions and dormant bank accounts. After the emergency has passed, responsibilities can be redistributed to emphasize accountability and teamwork.

Concerning human resources, only the largest and most service-diverse organizations call for human resources staff in each department to address grievances and administer needed process variances. Centralized HR will help create consistency in personnel policies and practices throughout the organization, which is important, as fiscal distress may require personnel actions.

Centralization strategies may reduce headcount by eliminating duplicative positions and tasks in departments. The trade-off is that centralized resources will have less knowledge of departmental operations, so they might be less effective at serving departments in certain respects.

However, centralization is not necessarily a good long-term strategy. Even in the short term, it could reduce the organization's ability to respond quickly to on-the-ground emergencies. It risks limiting the ability of the organization's best managers to do their jobs. Many of the same benefits can be achieved with the right information technology. For example, a good control system ensures spending does not exceed defined parameters—without requiring centralized staff to manually review the transactions. Modern IT systems also can give the finance office up-to-the-minute spending information without having to implement more centralized controls (which might add nonvalue-added overhead).

* Reorganization research was popular during the 1980s when this was a common response to financial distress. A survey of the research from this period is available in: James Conant, "Reorganization and the Bottom Line." *Public Administration Review*, Vol. 46, No. 1 (Jan. - Feb., 1986), pp. 48 - 56.

The Risks

- Centralization may make the organization less nimble, which is important to consider in a public health crisis.
- Centralization fails to make the best use of the organization's talent outside of the centralized functions. For example, the best managers outside of the centralized functions will not be able to realize their full potential. This works against making managers manage.
- Many of the same benefits can be had from using modern information technology to create real-time controls on spending without the need for human intervention.

Sourcing Strategies

Outsource. Many public officials consider outsourcing as a way to cut costs. However, cost savings are far from guaranteed. For financially stressed governments, a first step is to look at services where the private sector market for a service is stable. *Benchmark* to see what services other governments outsource. This will help reduce risk.

Studies have shown that outsourcing does not always save money. You can evaluate outsourcing opportunities against several key [criteria for realizing cost savings from outsourcing](#). Be specific in defining the service requirements and expectations so that service quality and quantity are as expected.

One way to ensure a cost-beneficial outcome from outsourcing is to use partial provision of the service by public employees as a “check and balance.” For example, years ago, one large city outsourced half of its waste collection by moving existing union staff to one side of the city and outsourcing the other half. This allowed the government to compare the costs and productivity of outsourced versus insourced collection. The private sector had to prove that they continued to be a low-cost alternative. This provided protection against the risk of vendor “lock-in,” where an incumbent provider gains a huge advantage over other providers.

The Risks

- Make sure outsourcing is cost beneficial over the full term of the contract and possibly longer. For example, some vendors pursue a “loss leader” strategy, where they offer a service at an artificially low initial cost with the intention of making it back (and maybe more) later in the deal or subsequent deals, if it will be too expensive for the government to switch providers.
- Getting savings from outsourcing often requires giving up control of how the service is provided. For many public services, it might matter how the service is provided. For example, the fair treatment of all constituents is an important characteristic of how a service is provided.
- Outsourcing can be hard to undertake in a unionized environment.
- Outsourcing usually entails start-up costs (political and economic) so the cost-benefit decision should consider these.

Insource. In some cases, private contractors may be more expensive than public employees. Examine services that are outsourced now and compare them to [the criteria for outsourcing cost savings](#). If the criteria are not met, then there is a chance that insourcing could be cost beneficial. Even if insourcing is not cost beneficial, the government can avoid the pain associated with reducing the cost of public employees by reducing the money spent on contractors and then having public employees take over the work. For example, a lot of design contracts are entered into because the government staff lack capacity to do the work. If staff now have more time, those contracts could be canceled and the work done by staff.

The Risks

- If contracting was the most efficient arrangement before, having public employees do the work may be a step backward on the road to a strong financial foundation for the local government.
- Depending on how much flexibility the local government has in its labor structures, it might be challenging to outsource the service again in the future.

Divest (or at least temporarily halt) subsidized enterprises. Governments sometimes get into business-like activities that don't cover their own costs and have to be subsidized by the general government. This siphons tax dollars away from general services. Examples are airports, golf courses, or parking garages. Divesting these activities or putting a temporary stop or a slowdown on their operations can stop the losses and may generate revenue through the sale of assets and/or putting the property back on the tax rolls. Divesting or halting subsidized activities is often done through a data-driven and results-oriented budget process. Such a process allows decision-makers to consider what is important as core services of government—and to weigh the value of the enterprise against other services that compete for funding.

The Risks

- Certain types of loss-generating enterprises might be politically sensitive because the clientele of the enterprise will resist losing their subsidy.
- If a government tries to sell an enterprise to a third party during financial stress, it may not be negotiating from a position of strength.

Enhancing Revenues

Revisit Interfund Transfer Policies. A distressed government could reexamine its policy for transfers to the general fund from other funds (particularly self-supporting enterprise operations, such as utilities) to see if there is a basis for increasing the amounts transferred. Perhaps the general fund has been unintentionally subsidizing the activities of other funds. For instance, perhaps the other funds have not been paying the full cost of technology services, insurance, or other support services. Such a strategy must be pursued carefully, though, in case it degenerates into unjustified subsidization of general services at the expense of the clientele of these other funds.

It could be that the general fund is subsidizing other funds, thereby causing a drain on general tax dollars. It may be worth revising these policies to see if the policy should continue.

The Risks

- This can be a risky technique because cross-subsidization is a quick and easy fix to financial woes within a fund. There may be good reasons for revisiting subsidization policies, but the policies must follow sound financial reasoning.

Obtain better returns on idle cash. Better investment strategies could provide new revenue, but chasing yields could increase risk. The opportunities are probably going to be limited in an economic downturn. Consider benchmarking investment return performance against a conservative standard. Make sure there is a comprehensive investment policy in place to guide decisions. Look at investment pools that exhibit strong, stable histories and are affiliated in some way with many governments.

The Risks

- Chasing yields could increase the risk to principal. At best, a higher yield strategy will probably require investing in less liquid assets. Liquidity could be especially important during a downturn.
- In an economic downturn, the benefit of this technique will probably be limited and undependable.

Better investment strategies could provide new revenue, but chasing yields could increase risk.



The Extreme Caution Near-Term Treatments

The techniques described here are riskier than those listed in the cautionary category. Though they could be viable options for distressed governments, they should be among the last options considered. These techniques have been categorized into expenditure reductions and revenue enhancements. Exhibit 2 overviews these techniques.

Exhibit 2 – Overview of Extreme Caution Techniques

Reducing Expenditures
Large or sustained across-the-board budget cuts
Across-the-board wage cuts
Defer compensation
Offer an early retirement program

Enhancing Revenues
Levy a broad tax increase
Create an independent special district with its own taxing authority
Long-term borrowing without a supporting resource for repayment
Tax anticipation notes
Review opportunities to refinance debt at lower interest rates

Reducing Expenditures

Large or sustained across-the-board budget cuts.

We listed small or one-time across-the-board cuts as a “cautionary” technique. Expanding the use of these cuts evaluates it to “extreme caution.” Across-the-board cuts have a cursory sense of fairness because they “spread the pain” equally. However, this assumes that all services are of equal importance to the citizens and that programs have equal ability to absorb cuts.

Across-the-board cuts usually reduce the value created by public services. This problem is amplified when the cuts are large or when they are repeated. Reduced value lowers citizen opinion of the government, making it harder to gain support for constructive reform. Also, vulnerable populations are more likely to be hurt when programs are cut indiscriminately.

The Risks

- Local government misses the opportunity to plan cuts and size and shape programs to fit the current environment.
- The important services are cut as much as the less important services.
- Sometimes the notion behind across-the-board cuts is that departments can “cut the fat.” However, this rests on two dubious propositions: First, the “fat” is equally distributed. It probably isn’t. Second, managers know how to find it. The less skilled managers probably have more fat in their programs and are less able to find and eliminate it.

Across-the-board wage cuts. Across-the-board wage cuts are seen as riskier than the other Near-Term Treatments to reduce personnel costs that we have reviewed so far. First, though some of the other techniques we have seen earlier also reduce pay (e.g., furloughs, reduced schedules), they also compensate employees with personal time. Across-the-board wage cuts don’t provide this, at least partially, offsetting gain. Hence, the cuts will provoke more resistance than these other techniques, especially in a unionized

environment. Second, across-the-board cuts are untargeted. Reducing everyone's wages by the same amount could drive off the local government's best employees.

The Risks

- Across-the-board wage cuts are harmful to morale and could drive off the best employees.
- Similarly, this technique would create more resistance than other techniques to reduce personnel costs.

Defer compensation. If a local government doesn't have the funds to compensate employees in the current period, then some of that compensation can be deferred to future periods. Examples include post-retirement health benefits or increased pension benefits. However, this only defers the financial reckoning day and can create large liabilities that hit the budget sooner than people may have expected. This is a slippery slope and can be difficult to reverse. If this technique is going to be considered, a government must use data like other post-employment benefits (OPEB) liability and pension funding ratios to disclose and analyze the cost and impact of deferred compensation.

The Risks

- Deferring compensation creates future liabilities, making it harder to achieve a long-term, solid financial foundation for your government.
- This doesn't just "defer" costs, it increases total costs when considered over a multiyear period.

Offer an early retirement program. An early retirement program (or early retirement incentive) is simple in concept, but realizing savings can be complicated. The government must figure out how to redesign its work to reduce the number of positions. Otherwise, if all the positions are filled with new employees, then the government will again be in a position of unaffordable personnel costs. Further, this practice often shifts the costs to the pension fund, which will be repaid by the employer—along with interest rates that are often much higher on average compared to other kinds of debt governments have access to. Finally, veteran employees often have valuable knowledge. If they take the earlier retirement system, the government loses that knowledge and incurs the cost of replacing it or operating without it.

The Risks

- Many early retirement plans are more costly than a budget alone reveals. These programs can increase long-term costs associated with pension contributions and retiree health care coverage. These may not be paid directly from the operating budget or are masked in the total contribution rate. This makes their negative impact on a government's financial condition harder to see.
- Work processes must be redesigned to reduce the need for personnel. Replacing retired employees with lower-cost junior employees may result in short-term savings. Structural imbalances will be perpetuated.
- The employer can have difficulty predicting who will take the incentive, making the financial and operational impact harder to predict.
- You can read about other risks of early retirement incentives [here](#).

Enhancing Revenues

Levy a broad tax increase. While a broad tax increase is fair—everyone pays—it may not be in the best long-term interest of the government. It could reduce citizen support for the government, hurt economic competitiveness, and remove pressure for needed reform. It is essential to evaluate all legal and economic implications of a proposed tax increase. If a tax increase is a necessary part of the recovery, consider a targeted tax increase that is aligned with services that citizens want, as described in the earlier Near-Term Treatment about new taxes with a connection to the desired service.

The Risks

- A broad tax increase may not be affordable for the community, especially in an economic downturn.
- Broad tax increases generate much less public support than tax increases that are aligned with services that the public finds valuable.
- A broad tax increase should not be used as a way to escape other needed reforms.

Create an independent special district with its own taxing authority. Special districts are units of government separate from general purpose local governments, with their own governing board, elections, etc. In some cases, special districts have

been used to get around tax limitations on general purpose government by creating a new unit of government, with its own taxing authority, and shifting service responsibility to the new unit. This is different from the Near-Term Treatment we described earlier about aligning taxes with valued services through a taxing district. This is because the taxing district is under the control of the governing board of the general purpose local government. This helps maintain accountability to the public for public spending. Creating an independent special district could be acceptable if the public has a demand for the service that the district would provide, but if it is an alternative way to raise taxes, then it might work against the long-term health and livability of the community.

The Risks

- Creating special districts increases government fragmentation, thereby increasing the total cost of government to the public.
- Fragmentation makes it hard for the public to understand their government, perhaps eroding their support.

Long-term borrowing without a supporting resource for repayment. Debt can be useful during a financial recovery for freeing up cash in the near term. For example, if a government was going to use accumulated cash to pay for an asset, then the debt could be used to spread the payments out over time, creating more financial flexibility. This strategy becomes riskier if there is no underlying support for repayment of the debt, in the form of accumulated cash or a dedicated revenue stream for repayment (e.g., like is often associated with general obligation bonds). Without support for repayment, debt may harm your ability to balance future budgets.

The Risks

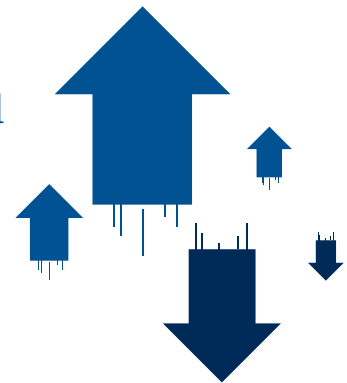
- Debt without a supporting resource for repayment will make balancing the budget in the future difficult.
- Becoming overindebted will harm a government’s credit rating, leading to higher interest rates and financial problems.

Tax anticipation notes (TANs). TANs are a form of short-term debt that local governments can use to receive an injection of liquidity, with repayment based on tax revenue that is anticipated later in the year. Normally, TANs are used only by governments that have mismatches between the timings of their inflows of cash and their outflows. For example, a government that is dependent on property taxes might receive the majority of its revenues during just a few months of the year, when taxes are due. However, it likely spends its budget in even monthly amounts during the year. During an economic downturn, more governments might find themselves with a mismatch between inflows and outflows and take an interest in TANs to provide relief, especially if internal sources of working capital are exhausted.

The Risks

- TANs are a form of borrowing for operations, which means the local government is accruing interest costs to pay for operations.
- It is not impossible that during the uncertainty associated with the COVID-19 downturn that fewer tax revenues could be received than was expected. This would complicate repaying the debt.
- Given the uncertainty associated with the COVID-19 downturn, it is not inconceivable that the market for short-term debt could behave abnormally. This might make TANs a less reliable technique than under normal economic conditions.

During an economic downturn, governments might find themselves with a mismatch between inflows and outflows and take an interest in TANs to provide relief.



Inadvisable Near-Term Treatments

These are the riskiest techniques. They have great potential drawbacks. Exhibit 3 overviews the inadvisable treatments.

Exhibit 3 – Overview of Inadvisable Treatments

Underfund accrued liabilities like pensions
Pension obligation bonds
Default on debt
Shift operational costs into capital budgets
Dilute/dismantle internal controls
Use accounting manipulations
Have an asset “fire sale”

Underfund accrued liabilities like pensions. The government can use its available resources to fund current obligations rather than future obligations. For example, pension contribution “holidays” can preserve cash but will likely have long-term costs. This is because of the foregone investment income the government could have had by making its contribution during depressed market levels and “buying low.”

The Risks

- This is a way of sticking tomorrow’s generations with today’s tab.
- This can create negative repercussions on bond ratings, public perception, and employee relations as well as large liabilities that impact future budgets—and probably sooner than people expect.
- It is a lost opportunity to “buy low” and pay off liabilities during opportune market conditions.

Pension obligation bonds. In a regular economic climate, governments should avoid issuing pension obligation bonds (POBs). POBs are issued to fund the underfunded portion of pension liabilities. This involves investment risk and requires timing of

the market. Public finance officers (or few other people) can successfully time the market. While economic downturns present market opportunities, governments should look elsewhere for cost savings.

The Risks

- POBs are complex financing instruments that must be scrutinized.
- Proceeds might fail to earn more than the interest rate owed over the term of the bonds, leading to increased liabilities.
- POB issuance may not be viewed as credit positive by rating agencies and market investors, given their inherent risk.
- Beware of causing intergenerational inequity issues as POBs are often structured in a way that defers the principal payments or extends repayment over a period longer than the actuarial amortization period.
- GFOA has an official advisory recommending that state and local governments do not issue pension obligation bonds.

Pension contribution “holidays” can preserve cash but will likely have long-term costs.



Default on debt. A government could refuse to pay back creditors in whole or in part. That would save the cost of the debt payments but would likely eliminate or curtail the government’s ability to access the market in the future.

The Risks

- The government may not be able to access the debt market in the future, limiting its ability to build capital assets.
- At the very least, creditors would demand higher interest rates, increasing the cost of borrowing.

Shift operational costs into capital budgets.

Governments can inflate the budgets of capital projects to carry operating and maintenance costs for a time.

The Risks

- This distorts the true cost of capital investments and makes governments vulnerable to unsustainable operating and maintenance costs when the capital financing runs out.
- This is not permitted under some state/provincial laws, which require operating expenses to be paid from operating revenue. Even if it isn’t illegal, using this technique endangers the organization’s credibility and its ability to return to good practices in the future.
- If the capital program is supported by debt, there are restrictions on what the proceeds can be used for outlined in the debt offering documents.

Dilute/dismantle internal controls. Some temporary advantage might be gained from ignoring (or dismantling) important internal controls. For example, perhaps there would be saving in staff costs by not separating duties between as many staff people so you could operate with a lower headcount. However, this establishes a bad precedent and opens up the door to fraud. The risk of fraudulent activity generally rises during times of crisis. Unscrupulous people may suspect that controls and monitoring may be reduced and/or people may be placed in decision-making roles that they do not normally occupy.

The Risks

- Internal controls exist to prevent fraud, waste, and abuse. Without proper controls, the government risks incurring fraud, waste, or abuse exceeding the cost to operate the controls.
- Even beyond a simple cost/benefit analysis, any instance of fraud, waste, or abuse will decrease the credibility of management, making it harder for them to lead the recovery process.

Use accounting manipulations. Accounting practices can be manipulated to disguise the nature and magnitude of the problem. Examples include delaying deliveries, payrolls, and payments to the next fiscal year, manipulating or distorting estimates/forecast, or recognizing anticipated (or even worse, speculative) savings or revenues.



The risk of fraudulent activity generally rises during times of crisis.

The Risks

- This only makes the problem worse by creating a culture of unaccountability and delaying the recognition of the problem.
- “Accuracy above balance” is the fundamental rule of budgeting. If the budget is balanced but not accurate, it is not balanced!
- Future trust and credibility and the ability to manage is damaged by false or misleading information or by the perception of intentionally being misinformed.
- Condoning the use of accounting manipulations is a step toward deeper corruption and malfeasance.

Have an asset “fire sale.” Normally, selling or leasing assets to a third party can work if assets are underutilized or if the government has made a decision to leave the associated line of business. Selling or leasing land (or other types of facilities) could generate ongoing revenue by putting the property back on the tax rolls or adding an ongoing lease payment to the revenue budget. However, at the point of applying Near-Term Treatments, a local government may be desperate for financial relief and find little demand for the assets. This can lead the government to accept prices below the actual value of the asset. Worse, the government could be in a position to have to repurchase the assets later. For instance, it may not be advisable to sell or lease away

parcels of vacant land that might be needed for the expansion of government facilities in the future.

The Risks

- A government may be in a poor negotiating position and/or not have the time to plan a sale or long-term lease during a financial crisis. “Fire sales” can lead to a perception of mismanagement.
- It may be hard to determine the fair price of a public asset with no clear market analog, especially under the stressful and time-constrained conditions associated with applying Near-Term Treatments.
- An asset sale is a one-time revenue. Normally, leasing would be a better option to generate a continuous revenue stream and to maintain ownership over the underlying asset. If one-time revenue is all that can be obtained, be sure the revenues are used to create a permanent solution, not just plug holes in the budget that will open up again next year.

Conclusion

The Near-Term Treatments in this paper can help reduce expenditures or enhance revenue but present risks in doing so. By evaluating these techniques and being aware of the risk, you can get the most out of the techniques while limiting your risks.



For more information about GFOA's Fiscal First Aid program, visit www.gfoa.org/FFA.



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