Course Learning Outcomes for Unit III

Upon completion of this unit, students should be able to:

4. Identify political factors that influence and determine financial management practice in the public arena.
   4.1 Summarize budgeting tools of national and sub-national governments.
   4.2 Explain the impact of market inefficiencies of national and sub-national governments.
   4.3 Infer sub-national government approach to rainy day funds.

Reading Assignment

Chapter 6:
Cost-Benefit Analysis and Government Investments

Chapter 12:
Budget Balance and Government Debt

Unit Lesson

So far in the course, our central focus has been on providing public goods and services through political institutions. Now, we will center on funding the delivery of goods and services through budget allocations. Public budgeting is facilitated by both national (federal) and sub-national (state/local) governments. Budgeting is woven into the fabric of our nation's democracy. Therefore, this mechanism (budgeting) identifies how public resources will be utilized to provide public goods and services.

Conventional budgeting tools employed to determine funding levels of government agencies include incrementalism, performance, program, and zero based budgeting (Hyman, 2014). Slight changes or variations (incrementalism) in funding levels usually produce little resistance when enacting budgets (Anderson & Harbridge, 2010). Performance budgeting seeks to analyze inputs into a program (Joyce, 2011). In contrast, program budgeting is based on the output of agencies. Budgeting includes balancing revenues and expenditures. The lack of balance threatens the long-term fiscal health of national and sub-national governments. Poor fiscal health generally results in the government's lack of ability to meet existing commitments. Therefore, budgeting is not an exact science. Many factors complicate the budget process and create gaps in revenue or funding, resulting in public scrutiny.

A review of government financial crisis can aid us in understanding the importance of a balanced budget. Budget deficits have become increasingly visible over the past decades. Our nation's highly publicized deficit highlights the discrepancies that can happen between revenue and expenditures.

First, let us consider the national government, which is not required by law to have a balanced budget. Many may recall market reactions to fiscal imbalances and increasing public debt levels during the 2007 recession (Hyman, 2014). External budget stresses or dilemmas for national and sub-national governments contributed to several market inefficiencies such as the recession, national credit rating reduction, government shutdowns, sequestration, and sub-national bankruptcies (Marcel, 2013; Meyers, 2014). These events led to the eroding of fiscal sustainability.

Key economic staff members meeting in White House Roosevelt Room
(Souza, 2009)

Often, a public budget can reflect political and social conditions. For example, during 1998 and 2001, the U.S. national budget reported surpluses (Hyman, 2014). Converging on the political nature of budgets, some experts suggest the surpluses began eroding when tax cuts favoring wealthier citizens were implemented and marked the beginning of budget deficits for the United States (McGahey, 2013). Additionally, McGahey (2013) asserts that budget deficits and debt accumulation were exacerbated because the government maintained the tax cuts beyond their expiration date of 2012. Other contributing factors included the two wars in Afghanistan and Iraq.

A social perspective of budgets can be examined through the lens of the economic snowball of 2007. The snowball began with the subprime mortgage crisis (also known as the housing bubble) and ended with high levels of unemployment. As many as 800,000 jobs were lost in one month alone (January 2009), giving rise to increased demands for social programs, services, and goods (McGahey, 2013). High-levels of unemployment translated into lower collections of tax revenue, thereby resulting in budget gaps.

Historically, public officials' responses to budget shortfalls have led to the development of many fiscal policies (Campbell & Sances, 2013). President Obama's fiscal response to this crisis was the American Recovery and Reinvestment Act, which distributed $500 billion into government programs. However, this act contributed to the deficit reaching the maximum amount allowed by law, prompting the debt ceiling crisis (Meyers, 2014). Other fiscal policy created included the Budget Control Act of 2011, allowing the president to raise the debt ceiling in exchange for budget cuts. These market reactions resulted in Moody's, a credit rating agency, downgrading the U.S. national credit rating from AAA to AA (Meyers, 2014). The reason cited was increased lending risk due to the lack of political leadership in dealing with pending crises. Other national budget negotiations included the fiscal cliff of across-the-board spending cuts through sequestration.

Sequestration, as you may recall, prompted the 2013 government shutdown of services deemed "nonessential" for sixteen days (Meyers, 2014). This political budget gridlock impacted public services such as the Environmental Protection Agency that monitors environmental threats; the Food and Drug Administration, which approves life-saving drugs and devices; and tourism of the Statue of Liberty, a national landmark. Government employees of these agencies were furloughed. However, entitlement programs such as Social Security, Medicare, and veteran's benefits received automatic funding (Hyman, 2014).

Next, let us shift our focus to chronic deficits of sub-national (state/local) governments. Sluggish tax collections, balanced budget requirements, external debt, and limited revenue options exacerbate budget shortfalls (Elder & Wagner, 2013). Due to cyclical fluctuations, many states instituted rainy day funds. This budget stabilization tool is designed to reduce fiscal stress during economic downturns (Elder & Wagner, 2013).

Approximately 34% of sub-national revenues come from national aid (federalism) (Hayes, Pangallozzi, & Erbeck, 2013). Therefore, national government activities impact state and local budgets. For example, the American Recovery and Reinvestment Act appropriated $100 billion to state governments for Medicaid (Municipal Bond Market, 2011). However, after the expiration of this act, state governments were required to fill the budget gap in funding (Hayes et al., 2013).

Let’s think back to a previous discussion of services provided by the Federal Emergency Management Agency (FEMA) (National Association of State Budget Officers, 2011). The Budget Control Act of 2011 included cutting $1 trillion in discretionary spending across the board, resulting in a minimal 2.6% cut in FEMA’s budget. However, this minimal cut at the national level translated into a 57% reduction for state and local services provided by FEMA (National Association of State Budget Officers, 2011). Reductions in federal aid can often time result in state governments shifting funds or making tradeoffs between public services.

Unlike the national government, sub-national governments do not have the luxury of printing money. Therefore, as a result of the 2007 recession, many state governments experienced deficits, layoffs/furloughs of state employees, increased taxes, reduced expenditures, cuts in public services, and in extreme cases, defaults and bankruptcies (Hyman, 2014).

A review of the fiscal stress experienced by sub-national governments can aid us in understanding the tremendous impact on public services. Hyman (2014) indicates internal debt, usually experienced by national government, is owed to its citizens. In contrast, sub-national government experiences external debt owed to creditors, which diverts income away from residents in that jurisdiction (Williams & Fadairo, 2013; Hyman, 2014). Payment of this debt reduces revenue to provide local services and increases budget gaps, which can result in default on obligations, ultimately leading to bankruptcy.

Jefferson County, Alabama, filed bankruptcy of approximately $4.2 billion in 2011 (Richardson, 2015). The bankruptcy resulted from lingering debt consisting mostly of borrowed funds from the 1990s and 2000s as well as declining tax revenue and repairs to county sewers (Richardson, 2015). Despite the multifaceted approach to combat the debt problem, such as laying off employees, closing county facilities, reducing employees’ pay, and cutting public services, Jefferson County, Alabama, concluded that bankruptcy was the only remaining option.

San Bernardino County, California, filed bankruptcy of approximately $500 million in 2012 (Callahan & Pisano, 2014). Factors contributing to bankruptcy were major industry closures resulting in high levels of unemployment, reduction in home ownership, interstate construction, declining tax base, the 2007 recession, and decreases in federal funding (Callahan & Pisano, 2014). These factors resulted in budget cuts that precipitated the closure of county courts, county employee layoffs and salary cuts, and reducing county welfare and food stamp programs, although requests for these public services were increasing.

Stockton, California, filed bankruptcy of approximately $1 billion in 2012 (Pryor, 2014). Mounting budget deficits, shrinking revenue, and increased housing foreclosure rates were major contributors to the city’s decision to file bankruptcy. These factors contributed to a series of drastic cuts to public services, such as downsizing the police force by one-fourth, prompting higher levels of crime; downsizing the fire department by one-third; and reducing other city employees by 40%(Associated Press, 2012).

Detroit, Michigan, filed bankruptcy of $18 billion in 2013 (Hayes et al., 2013). With no signs of an imminent solution, the largest city in Michigan found itself under great public scrutiny. Often referred to as the “Motor City,” the industrial giant of three automakers and a major producer of domestic and sporting goods became trapped in a downward spiral of fiscal unsustainability. Factors of this bankruptcy included excessive borrowing, industry closures, and poor accounting procedures, along with the great recession of 2007 (Skeel, 2015).

Public budgeting presents the financial health of an organization or government based on resources and expenditures. Revenue is yielded from citizens’ payment of taxes. Expenditures result from demands of services and goods. The process of public budgeting involves fiscal governance and management by public officials.

United States Bankruptcy Court
Eastern District of Michigan

Voluntary Petition

Name of Debtor (if individual, enter Last, First, Middle)
City of Detroit, Michigan

Street Address of Debtor (No. and Street, City, and State)
2 Woodward Avenue
Suite 1126
Detroit, Michigan 48226

County of Residence or of the Principal Place of Business:
Wayne

Chapter of Bankruptcy Code Under Which the Petition is Filed (Check one box.)
☐ Chapter 7 ☒ Chapter 9 ☐ Chapter 11 ☐ Chapter 12 ☐ Chapter 13 ☐ Chapter 15 (Main) ☐ Chapter 15 (Non-Main)

Type of Debtor (Form of Organization) (Check one box)
☐ Individual
☐ Corporation (includes LLC and LLP)
☐ Partnership
☒ Other (State type of entity)
Municipality

Picture of Detroit, MI bankruptcy petition
(Rfc1394, 2014)

References

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Pryor, C. S. (2014). Municipal bankruptcy: When doing less is doing best. *American Bankruptcy Law Journal*, *88*(1), 85-125.

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Suggested Reading

For assistance in comparing and contrasting the fiscal problems of various cities to events in their jurisdictions, please see the following article that can be located in the Academic Search Premier database in the Waldorf Online Library.

Moringiello, J. M. (2015). Bankruptcy and beyond: Exploring the causes of and solutions to municipal financial distress. *Widener Law Journal*, *24*(1), 1-8.