Coping with Fiscal Stress

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How do some organizations manage to cope with and recover from even severe fiscal stress, while others fail and are pushed by stress toward fiscal emergencies? Terry Nichols Clark (1994) and others have emphasized that fiscal health reflects the adaptation of a local government's revenues and expenditures to the resources and constraints provided by its environment. (Relevant resources and constraints include governing law, intergovernmental assistance, and the local private-sector activity that creates the demand for services and supports the payment of taxes and fees.) Adaptation takes place over the long term across business cycles, and in the short term within a cycle, responding to local and global trends as well as a variety of organizational and environmental contingencies and shocks. Over the long term, adaptation positions a local government organization to sustain a politically and economically appropriate level and mix of services consistently across the business cycle, accumulating reserves when revenues cycle up that are sufficient to take the organization through normal downturns without making disruptive cutbacks or requiring future taxpayers to pay for past and present residents' services.

As we enter what may prove to be a sustained and severe economic downturn, strategies for long-term adaptation may prove as important as and complementary to short-term coping tactics. Politically palatable but unsustainable coping tactics (such as selling still needed assets, deferring maintenance, postponing the payment of long-term obligations, and so on) will not suffice. There may even be opportunity in crisis: Elected officials and other stakeholders can sometimes be impelled by an imminent crisis to endorse adaptations toward longer term sustainability and efficiency that they might resist in less obviously perilous times.

Much of the common wisdom here has proved sound over time in a variety of settings. Local governments do well to: avoid excessive commitments to fixed expenses such as debt service and unfunded post-employment liabilities; be efficient and flexible in spending; try to have access to revenue sources that are diverse, locally controllable and fairly stable across economic cycles (such as the property tax, especially if it is feasible to increase the tax rate); engage in long-term financial planning; maintain an adequate level of reserves for dealing with abrupt, temporary shocks; and work to educate stakeholders about their jurisdiction's financial situation and the need for fiscal planning and prudence (see Advisory Commission on Intergovernmental Relations [ACIR], 1973; Honadle, Cigler, & Costa, 2004). Good long-term adaptation will not repeal the business cycle or prevent all fiscal shocks, but it can make short-term coping in response to cycles and shocks considerably less damaging and easier for all concerned.

In the short term, however, coping with recessions and other exigencies requires responding to specific situations from the jurisdiction's current position and with the resources available. Again, there is a body of generic common wisdom that can serve as a starting point, much of it developed and tested nearly three decades ago in a previous period of severe fiscal challenges for local governments (see for example ACIR, 1973; Behn, 1985; Clark & Ferguson, 1983; Honadle et al., 2004; Levine, 1978, 1979; Martin, 1982). Most of the standard advice will sound familiar: stressed organizations are advised to move promptly to rein in controllable expenses and adjust revenue mix and tax rates to the extent permitted by state law and other constraints (in some cases, the need to comply with state mandates and local charter requirements may even provide political cover for politically difficult choices); look for opportunities to improve productivity and financial management practices; consider shedding activities that can be appropriately divested or eliminated; and consider introducing or increasing charges for services that can appropriately and feasibly be priced.

On the revenue side, successful coping tactics have included enacting temporary tax-rate increases (as in the case of East Haven, Connecticut [ACIR, 1973]); securing new revenues, including taxes, special assessments and user charges, whether permanent or temporary; and doing so in the context of a long-term revenue strategy and policy. Moving from a pay-as-you-go approach to financing capital projects to a debt-financed capital budget supported by a multi-year capital improvement planning process and appropriate debt-management policies is one way some jurisdictions may be able to use debt sustainably. On the expenditure side, some organizations may be able to adopt productivity improvements, purchasing efficiencies (in Delaware, the State Treasurer recounts saving hundreds of thousands of dollars simply by standardizing ballpoint pens across agencies), and in some cases intergovernmental cooperation, service sharing, or even consolidation (but only after careful analysis—see Honadle et al., 2004). In the area of staffing reductions, some governments have used furloughs for short-term savings. Permanent (or semi-permanent) reductions in payroll through attrition and redeployment might reduce the need for involuntary layoffs, but can also diminish organizational efficacy compared to more targeted reductions (Levine, 1978).

Some jurisdictions are already lean and efficient, have reached legal or political limits on revenue increases, and may have to take more drastic steps to close cyclical or structural budget gaps. The ACIR (1973) reported that Cleveland, Ohio, and Hamtramck, Michigan, made major reductions in services without catastrophic consequences. Even a sharp critic of zero-based budgeting recommends conducting periodic zero-based reviews of service mixes and levels (Anthony & Young, 1988). Of course cutting back is generally messy, conflict-laden and riddled with paradoxes, requiring professional leadership and advocacy for systematic thinking and managerially sound adaptation strategies, even when they may conflict with (internal as well as external) political expedience (Levine, 1979). The political environment often presses managers to disguise deficits by repeatedly using one-time revenues, deferring large amounts of current costs to the future, allowing needed capital and human resources to deteriorate, and/or ignoring the long-term, full costs of activities and liabilities (Nollenberger, Groves, & Valente, 2003, pp. 147-152, provide a long list of practices to avoid). The City of Eugene, Oregon, has successfully used participatory techniques (Simonsen & Robbins, 2000) and structured internal reviews (Petry, 2004) to manage cutbacks without causing long-term organizational or political harm. Indeed, structured and participatory processes can both improve the political acceptability of cutbacks and help increase the visibility of existing services (as recommended by Clark & Ferguson, 1983).

As usual, however, there is no free lunch here for managers. In order to bring internal and external stakeholders along, it is necessary first to help them understand (1) the seriousness and causes of the situation; (2) why some superficially attractive short-term coping responses (such as underfunding maintenance, engaging in "rosy-scenario" budgeting that underestimates costs and/or overestimates revenues, or deferring pension-fund contributions) may be inappropriate, especially early in what may be a protracted downturn; and (3) how to generate and evaluate potential solutions, and choose the ones that improve rather than degrade organizational adaptation and the long-term sustainability of public services needed and desired by the community.

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