Managing Fiscal Stress

The Crisis in the Public Sector

Charles H. Levine

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Contents

Part One: Introduction

Part Two: Causes of Fiscal Stress

Part Three: Decision Making

PART ONE

Introduction

Charles H. Levine

1. The New Crisis in the Public Sector

Economic growth is a powerful solvent for the problems that trouble governments. Each increment of real growth in national income can enhance the take-home pay of citizens or can be used to create new public programs without accelerating the rate of inflation or forcing politically divisive tradeoffs between old programs and new demands. Because economic growth allows government benefits to expand without depriving anyone, it helps solve the most fundamental political problem of democratic societies: it helps maintain national consensus by reinforcing citizens' beliefs that their system of government works to their advantage and that their taxes are being well spent by a government that is equitable, stable, and efficient.

Throughout the 1970s, the economic growth rates of Western industrial nations declined from the levels attained during the 1950s and '60s. These declining growth rates have forced Western governments to confront some politically sensitive tradeoffs that are inherent in mixed economic systems but are largely ignored during periods of rapid growth. These tradeoffs include (1) the choice between inflation or unsatisfied public demands for goods and services; (2) the choice between providing services through tax-supported bureaucracies or through market arrangements; (3) the choice between attempting to provide equal health, housing, and educational opportunities to all citizens or (in effect) rationing opportunities to those who can afford to pay for them; and (4) the choice between spending for national defense or spending to alleviate the hardship of the poor, the sick, and the underprivileged (i.e., the dilemma of "guns vs. butter").

These politically sensitive tradeoffs have always shaped national policy choices, but throughout most of the 1950s and '60s they were less obvious and less constraining than they are now—at least in the United States. Economic necessities and political realities are now colliding in many countries as political leaders are being forced to face up to these tradeoffs without the comfort of knowing that they can retain the support of the electorate while implementing austerity policies. Aside from wartime, there is no formula for success when elected officials are forced to ask their constituents to accept a lower standard of living or fewer public goods and services at the same time these officials are seeking support for reelection.

These large-scale national policy issues provide a context for the problems of lesser scope that are increasingly plaguing public managers—both elected and appointed—in the United States. The combination of slow economic growth and double-digit inflation—"stagflation"—is causing some governmental units to stretch resources, ration services, cut back programs, make tradeoffs between programs and projects, close facilities, cancel projects, defer maintenance on public works and equipment, abolish positions, and lay off employees. Complicating these difficult management problems is the fact that they have to be solved in a political environment composed of clients and public employees who have come to expect and need *more* services, benefits, and wages from government, and who are not easily persuaded to lower their expectations or make some sacrifices.

This gap between the needs and expectations of citizens and government employees for government services and benefits and the inability of the economy to generate enough economic growth to expand (or even sustain, in some places) tax-supported programs without putting unacceptable demands on taxpayers' take-home pay defines *fiscal stress*. The symptoms of fiscal stress can be found almost everywhere in our govenmental system. For example, we have been told by the White House that a comprehensive national health insurance program is too expensive to undertake at this time. Some critics of the Social Security System have argued that we can no longer afford to expand social security benefits to keep up with inflation without bankrupting the system or further slowing economic growth. In the area of defense spending, a good part of the rationale behind the Strategic Arms Limitation Treaty (SALT II) is fiscal; neither the United States nor the Soviet Union can afford to expand rapidly changing high-technology weapons systems indefinitely without compromising social programs.

At the state and local government level, the legal requirement to balance budgets on a year-to-year basis has made the symptoms of fiscal stress more pronounced. Not only have we witnessed the economic and political chaos of New York City and Cleveland in bond default, but in the late 1970s we have also seen the negative response of taxpayers to rising taxes in the form of California's Proposition 13 and similar initiative movements that have developed in other states and localities.

These symptoms of an "era of limits" have created a number of stresses in government that require reexaminations of our revenue raising, spending, and management systems. These points of stress include (1) the methods used for setting priorities for government action and public programs, (2) the methods used for taxation and revenue generation, (3) the way public services are organized and public employees are compensated to produce services, and (4) the methods used for scaling down and terminating public programs that are no longer of high priority. These direct pressure points contain policies and procedures that are amenable to reform. As such, they provide an agenda for building management strategies for coping with fiscal stress that reflects new approaches to the formulation and implementation of public programs. Before proceeding with these management issues, it is important to reiterate that the struggle to alleviate fiscal stress is conditioned by four facts of political life:

1. Most taxpayers believe that government programs are wasteful. As inflation and recession cause them to experience increased personal financial stress, citizens are more inclined to demand that their taxes be lowered, that government productivity be improved, and that waste in government be eliminated.
2. Few citizens and public employees are willing to voluntarily surrender government services and benefits they have come to expect and depend on.
3. Public officials are forced to make changes within a structure of laws, rules, procedures, and regulations (e.g., merit systems, line-budget items, and special boards, commissions and authorities) that limit alternatives, rigidify decision making, and fragment authority. For the most part, these constraints were installed during periods of growth to control budget expansions and are limited tools for managing budget contractions.
4. Fine-tuning the finances and administration of public agencies and programs will not alone solve the larger problems of stimulating economic growth, but it may contribute—along with other government policies and private-sector initiatives—to restoring the economic growth rates of the 1950s and '60s.

These four facts of political life are both constraints and opportunities—constraints on the ability of public officials to fashion strategies to combat fiscal stress, and opportunities for them to take imaginative action to improve cost effectiveness in government.

Managing Fiscal Stress

In a world without politics, finding the optimal strategy for managing fiscal stress would be a straightforward task. First, one would take a long-range view of the causes of a government's fiscal problems by developing a multiyear forecast of its revenue-raising capacity and the demand for its services and benefits. Second, one would develop a list of priority rankings for all government programs, projects, services, and benefits so that high-priority items could be retained or augmented and low-priority items could be reduced or terminated. Finally, one would design an integrated strategy to generate new resources, improve productivity, and ration services so that both the revenue and expenditure sides of the budget could be neatly balanced. But, instead of an apolitical world that supports a comprehensive approach to the problem of maintaining fiscal solvency, most public management decisions—and especially those that involve cutting back services and benefits—are permeated by politics.

The involvement of interest groups in budgetary decisions usually produces a strategic response to fiscal stress composed of weakly coordinated short-run incremental tactics undertaken by financially pressed agencies at different places through the governmental system. This disjointed response to fiscal stress is usually predicated on the comfortable assumption that the resource shortfall will be temporary and that soon new resources will be found to restore, perhaps even to augment, previous program, service, and workforce levels. This approach is politically convenient because it avoids tradeoffs between programs and agencies and the political conflict that arises when one group or agency feels it is being singled out to make sacrifices while other groups and agencies are being spared. Among the short-run tactics used to "muddle through" fiscal stress, hiring and budget freezes, the absorption of attrition, across-the-board cuts, and the deferring of equipment replacement and maintenance schedules are the most popular because no one group or agency is targeted to make special sacrifices.

But even though this set of tactics is high in political expediency and acceptability, the assumption on which it rests—that the resource squeeze is temporary—may be invalid in a time of limited economic growth. Denying that fiscal stress may be a long-run situation may only put off the day when a real financial crisis will cause runaway inflation, force valuable employees to be laid off, property to be sold, and bonds and notes to be defaulted.

The possibility that fiscal stress is a long-run phenomenon—at least for some cities, regions, agencies, and sectors—suggests the need to develop a middle course for strategic planning that combines a managerial disposition to make government more cost effective with a realistic acceptance of the political forces that constrain comprehensive policy making. This approach should acknowledge, first, that there is no one best way to manage fiscal stress in government. The optimal strategy will differ from place to place and from time to time, depending on (1) the severity of the stress, (2) the size and power of the affected governmental units, (3) the power and alignment of interest groups, (4) the power and professionalism of public employees, and (5) the informal and formal power accumulated by political leaders.

Once fiscal stress is recognized, officials should do everything possible to clear away the underbrush of ambiguity and habit that stand in the way of making tough decisions and designing innovative solutions. Several questions are useful guides for organizing this task:

1. *What activities are mandated?* That is, what services and benefits are required by law? This question is intended to sort out activities that are "musts" from activities engaged in by habit or custom.
2. *What activities can be terminated?* This question focuses on activities that are nonmandated and may have low public support.
3. *What additional revenues can be raised?* Where can user charges and fees be instituted and raised? Where can uncollected taxes be collected? What services can be sold to other government units? What grants can be obtained from the federal government, the state, or private sources?
4. *What activities can be assigned to other service providers?* This question

helps identify services that can be shifted to other units of government, contracted out at lower cost, shared with other governments, provided by the private sector, or "co-produced" with client participation at lower cost.

5. *What things can be done more effectively?* This question addresses the broad area of productivity improvement. It should help generate alternative approaches to delivering existing services, changing organizations, and using technological improvements to reduce costs.
6. *Where can low-cost or no-cost labor be used?* Where can positions be reclassified and downgraded? Where can tasks be simplified, paramilitary jobs be manned by civilians, and paraprofessionals and volunteers be utilized?
7. *Where can capital investments be substituted for labor expenses?* At a time when labor expenses comprise 70 to 80 percent of many agencies' budgets, labor-saving technologies can yield substantial savings; this question seeks to identify opportunities for such savings.
8. *Where can information gathering methods be installed and improved?* Good information can improve financial forecasts and account for the direct and indirect costs and the benefits of service alternatives.
9. *Where can demand be reduced and services rationed?* Because many public services are free, they are often squandered. This question addresses the possibility of using fees and other means (e.g., eliminating low-usage hours in some public services and smoothing out peak hours in others) to reduce demand and pare down the availability of some services.
10. *What policies can help strengthen the economic base and promote economic development?* This question addresses the link between economic development and government policies. It suggests a careful look at the long-run payoffs of governmental policies and underscores the importance of private-sector investment decisions for public-sector fiscal solvency.
11. *What arrangements can be made to identify and strengthen the leadership of this process?* This final question underlies all others. Without able leadership the process of guiding a government through a fiscal squeeze may turn out to be haphazard and self-defeating. Decision-making structures that facilitate interest aggregation and build consensus are likely to reinforce leadership and help ease the adjustment to constrained budgets.

These eleven questions are a beginning for the development of broad management strategies for coping with fiscal stress. Together they provide the outline of a middle course between comprehensive planning and "muddling through" strategies while acknowledging the full importance of the basic mission of public management: balancing economic necessities with political realities.

About This Book

The selections in this book were chosen to help explore the political and economic problems, constraints, alternatives, and choices available to public managers wrestling with fiscal stress. This is a new field of inquiry. The literature, while growing, is not voluminous, but enough material is available to cover much of the subject with high-quality and useful research. As a whole, the readings here are intended to be both exploratory and suggestive—to explore the causes, constraints, and consequences of fiscal stress and to suggest alternatives for balancing fiscal solvency with adequate, equitable, and stable levels of public services and benefits. This book also contains a mix of descriptive case studies and prescriptive readings that underscore the choice and action components of public management roles. The services that public organizations deliver, the way services are organized and financed, and the way services are produced are not fixed and locked in place forever. Instead, they are amenable to managed change along lines suggested.

Situational Factors →	Managerial Factors →	Outcome Factors
1. Economic base	1. Decision-making methods	1. Fiscal solvency
2. Taxing capacity	2. Resource mix	2. Adequate, stable, and equitable services and benefits
3. Organization of taxing and spending authority	3. Productivity improvements	
4. Scope of governmental service responsibility	4. Cutbacks and terminations	
5. Citizen's service demands and expectations		
6. Interest-group and public-employee demands		

Figure 1.1. Managing Fiscal Stress: The Major Factors

This book is organized along the lines suggested in figure 1.1. Readings in the first two sections discuss situational factors that cause or contribute to fiscal stress. "Organizational Decline and Cutback Management" is intended to frame the study of managing fiscal stress by underscoring the ways in which declining resources force new constraints and decision-making procedures on public officials. The chapter by B. Guy Peters and Richard Rose, "The Growth of Government and the Political Consequences of Economic Overload," outlines the national economic and political forces that are overloading the governmental systems of some advanced industrial societies. Similarly, Edward K. Hamilton's "On Nonconstitutional Management of a Constitutional Problem" traces the economic problems of some state and local governments to issues of national economic development and their revenue-raising constraints. Hamilton argues that many fiscal problems of those governmental units are rooted in the way taxing authority and spending responsibility is organized in the United States. Economic-base erosion also underpins the fiscal plights of the cities. This factor and its consequences is discussed in David Stanley's "Cities in Trouble." But, as Martin Shefter's "New York City's Fiscal Crisis: The Politics of Inflation and Retrenchment" points out, economic-base erosion alone does not produce fiscal stress. Instead, the high demands and expectations of citizens for services and the unyielding demands of special-interest groups and public employees *combine* with lagging economic growth to produce fiscal stress. Finally, as Richard Lucier discusses in "Gauging the Strength and Meaning of the 1978 Tax Revolt," even where economic growth has been strong, citizens may constrain the taxing capacity of their governments with little consideration for the effects of constraints on the public provision of services and benefits. In combination, these chapters cover most of the forces causing fiscal stress at all levels of government. While some hint at means for resolving stress, they were selected primarily for their clear treatment of the causes of fiscal problems.

The remaining chapters suggest directions for managerial action—decision making, revenue generation, productivity improvement, and cutbacks and terminations. These managerial factors encompass the principal levers available to public officials for coping with fiscal stress on a year-to-year basis. (The causes of fiscal stress may also be amenable to change, but in most cases this would involve multiyear economic and political strategies requiring action beyond the authority of most public managers.)

The majority of the chapters deal with problems and alternatives confronting state and local governments. There are two reasons for this. First, fiscal stress has been felt most sharply at state and local levels. By law, most state and local governments must balance their budgets on a year-to-year basis, which causes any fiscal downturn to have almost immediate repercussions for their services. In contrast, a balanced federal budget is a rarity. Second, a number of federal agencies and private foundations have supported research on state and local government financial and service-delivery problems; many of the chapters in this book are by-products of this research commitment. Nevertheless, some authors have focused on the experiences of federal agencies and projects, and almost all the lessons the chapters teach are relevant to public managers at every level of government.

The decision-making chapters are both descriptive and analytic. Paul R. Schulman's "Nonincremental Policy Making: Notes Toward an Alternative Paradigm" is an analysis of decision making in the National Aeronautical and Space Administration (NASA) over the ten-year period of its growth and decline. Schulman's analysis points to the difficulties involved in trying to decide how to retrench public organizations gradually. Irene Rubin's "Universities in Stress: Decision Making Under Conditions of Reduced Resources" describes the decision-making strategies used by five state universities undergoing financial stress. Rubin's study underscores the importance of information and the uncertainty in decision making when administrations confront revenue shortfalls and difficult cutback decisions. David W. Singleton, Bruce A. Smith, and James R. Cleaveland's "Zero-Based Budgeting in Wilmington, Delaware," and Regina E. Herzlinger's "Zero-Base Budgeting in the Federal Government: A Case Study," are intended to illustrate the advantages and limits of zero-base budgeting in public-sector decision making. Singleton, Smith, and Cleaveland describe a successful application of ZBB in Wilmington, Delaware, a medium-size city, while Herzlinger analyzes a largely unsuccessful attempt to use ZBB in a huge, complex federal agency, the Public Health Service (PHS). Together, the decision-making chapters illustrate the difficulties involved in applying rational decision making to cutbacks and suggest areas where data analysis and decision-making aids can be useful in budgeting.

When a budget squeeze occurs, attention is immediately directed toward the revenue side of budgets, because increased revenues can eliminate the need to increase productivity or cut back services and workforces. The chapters on resources examine some directions and consequences of searching for new revenues. The primary source of such funds, is, of course, the federal government. But David B. Walker's "The New System of Intergovernmental Relations: More Fiscal Relief and More Government Intrusions" describes the growth of federal grants to state and local governments as a mixed blessing; fiscal stress may be alleviated, but local autonomy may be seriously compromised. Another approach to generating new revenues is discussed in Selma J. Mushkin and Charles L. Vehorn, "User Fees and Charges." The authors argue that instituting and hiking fees and charges for a wide range of services can generate additional resources and place the costs of public benefits directly on those who use them; such actions can also greatly improve the public allocation of resources. In certain cases fees and charges may be more fair than taxation. User charges, fees, and many other means for raising revenues and lowering costs are discussed in Charles A. Morrison's "Identifying Alternative Resources for Local Government." Morrison outlines strategies for seeking out nonlocal revenues from federal and state governments, private foundations, and local businesses and industries; developing local employees as resources; developing intergovernmental contracts and other interjurisdictional arrangements for sharing service-delivery burdens; utilizing volunteers and nongovernmental facilities; and finding nonservice alternatives to the actual delivery of services. Each of the strategies is intended to expand the range