



Theory and Practice for Coping with Economic Downturns at the Local Level: Part I

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Introduction

Local governments are stuck between the proverbial rock and a hard place when it comes to coping with recessions and economic downturns. Theory and research show that they are too small to stimulate their economies (Fisher 2008; Musgrave and Musgrave 1980) and that their best course of action to weather economic storms is to maintain spending levels, increase infrastructure spending, and avoid tax increases (Fisher 1997; Marlowe 2009; Miller and Svara 2009). However, this is not a simple task for local governments—for both fiscal and political reasons—and they do not often take these actions (Chapman 2009). Legal restrictions such as tax and expenditure limitations, mandatory spending dictated by state and federal governments, and balanced budget requirements all make budgeting during economic downturns a challenging task for local governments. The difficulties created by the legal restrictions in place are exacerbated by the increased demand for public services that often accompanies economic downturns.

Because of the restrictions and pressures simultaneously placed on local governments, it is important to know what best practices are suggested by the academic literature, where these practices differ from what local governments are actually doing, and which practices lead to success. This bulletin summarizes the relevant literature on strategies available to local governments during economic downturns. Additionally, it reports the results of a survey of county commissioners in California and Georgia conducted during the Great Recession. The survey provides insights on actual practices in other states and shows how county commissioners viewed the impact of the recession on their governments and how they responded to it.¹

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1. Although this publication is intended for a North Carolina audience, it is valuable to see how other states dealt with the recession. For details on how local governments in North Carolina coped with the

The survey suggests that county commissioners in California and Georgia believe that the best tactic to minimize the effect of negative shocks is to be proactive and plan ahead—for example, by building and being willing to use fund balances and carefully monitoring the local economy. However, the survey also reveals that the strategy most commonly employed by counties is budget reductions; specifically, cuts to capital spending and personnel. The strategy least often employed is the introduction of new taxes. In fact, 72 percent of respondents said that they made large budget decreases, whereas only 7 percent introduced new taxes, and only 18 percent increased tax rates. This should not be surprising given that increasing taxes is difficult for county and municipal governments for both legal and political reasons. Restrictions such as tax and expenditure limitations (TEs) have resulted in local governments becoming more reliant on state aid and have also constrained revenue-raising capacity (Chapman 2003). This is not the case in North Carolina, where very little money comes from the state, but it is critical to understand this aspect when looking at other states and literature/reports from national sources.

As recently as the 1980s and 1990s, it was common for local governments to choose a combination of expenditure cuts and tax increases to cope with fiscal stress. However, there was a shift during the 2001 recession (Scorsone and Plerhoples 2010), when states and local governments were either unable or unwilling to increase taxes (Maag and Merriman 2003). This appears to have been the case during the 2008 recession as well. The tax increases during the recent recession generally had a narrow focus and were insufficient to close the budget shortfall (Johnson, Nicholas, and Pennington 2009). Other studies found that only a quarter of cities increased their property tax rates and even fewer increased other tax rates (Hoene and Pagano 2009). A third of cities made cuts in non-public safety and social services spending (Scorsone and Plerhoples 2010).

This bulletin discusses the common effects of recessions on local governments, describes the survey tool used in the study, and reports how county commissioners perceived the effects of the recession on their counties. It then compares the coping strategies advocated by the academic literature to the strategies actually being used by local governments and briefly discusses the insights provided by the decision makers who responded to the survey. The concluding section deals with policy implications.

Local Governments and the Recession

Local governments are vital to the American way of life, but they receive much less attention from scholars than their state and federal counterparts. Does it matter that local governments receive less attention? Are they affected by recessions differently, and do they use different strategies to cope with recessions than other levels of government?

The simple answer is yes. Local, state, and federal governments are funded by different sources of revenue. The federal government's revenue is generated by income taxes. Most states, including North Carolina, rely on a combination of income and sales taxes. Local governments' own source revenue is primarily generated by property taxes (Delisle 2010), which are more stable than sales and income taxes (Cornia and Nelson, 2010; Groves and Kahn 1952;

Great Recession, see David N. Ammons and Trevor A. Fleck, *Budget-Balancing Tactics in Local Government* (UNC School of Government, February 2010), <http://sogpubs.unc.edu/electronicversions/pdfs/BudgetBalancing.pdf>

McCubbins and Moule 2010; Sobel and Holcombe 1996). This means that local governments' own source revenue is traditionally not as volatile as the revenue of their state or federal government counterparts.²

Local governments also raise revenues differently. In most states, local governments are constrained in the forms of taxes they can implement and the rates at which they can increase existing taxes. This is true in North Carolina, where local sales taxes, for example, have many rules and restrictions for their implementation and use. And unlike the federal government, most local governments, including those in North Carolina, must have balanced budgets.³

The Survey Tool and Reporting Counties

The survey discussed in the following section was designed to assess how counties had been affected by the Great Recession and the strategies they used to cope with it. The respondents were county commissioners, and the survey provides their perspectives on the recession and its effects on local government. Counties were chosen because the majority of research on local government and recessions focuses on municipalities (for example, Hoene and Pagano 2009; Levine, Rubin, and Wolohojian 1981; Weikart 2012). Although counties and municipalities share similar strategies, constraints, and difficulties, counties perform different services and operate in different environments than municipalities. There is also evidence that counties react to fiscal stress differently (MacManus 2008). From the survey, county governments can learn what their peers have tried and which strategies they have found to be successful. This information should be helpful for future planning.⁴

The survey was administered in the winter of 2010, and thirty-nine Georgia county commissioners and thirty-five California county commissioners (referred to as County Administrative Officers) responded. The counties that responded represent a great deal of diversity. There were forty rural counties and thirty-four urban counties, with self-reported populations ranging from 3,000 to 1,400,000 and unemployment ranging from 6.5 percent to 28 percent.

Seventy percent of the respondents were male, the average age of respondents was between thirty-five and forty-five, and more than 90 percent of respondents classified their race as white. The average length of service for a respondent in local government was seven to ten years, with an average of five to seven years in the respondent's current position. More than 90 percent of the respondents said that they were "very involved in the budget process" and that they "know a lot about the tax/revenue structure of [their] county." Also, 79 percent felt that "the budget process yields desirable results."

Georgia and California were selected because both states were hit hard by the recession. In an impact ranking of how large an effect the recession had on states, Georgia and California were in the top ten states most affected (Center for Social Inclusion 2009). Both states also exhibited diversity in the size and demographics of their counties and primary industries.

2. This is especially true immediately after a negative shock, because due to sluggish assessment cycles, it takes approximately three years for property tax revenues to reflect changes in home values (Lutz 2008). Negative shocks are unanticipated economic downturns or recessions.

3. Forty-eight of the fifty states have some sort of balanced budget requirement (Hou and Smith 2006).

4. For information on the specifics of the survey tool, see Afonso (2013a).

Georgia and California were also selected because they were facing the recession with very different recent histories. During the 2001 recession, Georgia was one of the states most affected in terms of job loss, whereas California was better insulated and was approximately in the middle of the pack. However, California had greater revenue shortfalls than Georgia (Boyd 2008). As well, Georgia and California rely on different industries (Boyd 2008) and thus could experience different effects of a recession, which in turn could affect their revenues and needs differently. This diversity provided a broader picture of the coping mechanisms needed and employed by local governments.

Georgia and California also differ greatly in their treatment of their balanced budget requirements. Even though both states are characterized as having the “most stringent” balanced budget requirements (Hou and Smith 2006), California is not as strict in its adherence to the requirements. At the time of the survey, there was an \$8.2 billion gap in California’s expenditures, and revenues being carried forward added to the state’s \$25.4 billion projected shortfall in fiscal year 2012 (NCSL 2010).⁵

The survey results paint an interesting picture. More than 61 percent of respondents said that property tax revenue was not sufficient to meet county needs during the recession. What is striking is that there appears to be a difference in how insufficient revenue is perceived in California and Georgia. One could assume that a greater percentage of commissioners would have viewed their property taxes as insufficient in California given the differences in the relevant TELs. California counties are limited in their assessment of property value increases and in their growth in property tax revenue, whereas Georgia counties are limited only in their conservation use (Yuan et al. 2009). However, only 45 percent of respondents in California reported that property tax revenue was insufficient, compared to 79 percent of respondents in Georgia.

Whatever the reason, TELs or otherwise, this need for additional revenue may explain the increased role of local option sales taxes, or LOSTs. In fact, more than 53 percent of the counties responding had a LOST in place. The average percentage of own source revenue from LOSTs among those with a LOST in place was reported to be just over 16 percent, and some respondents reported that it was as high as 50 percent of own source revenue. This is in keeping with previous estimates of LOST use (Jung 2001).

How Counties Saw Themselves during the 2008 Recession

There is a great deal of discussion and speculation about the recession’s effect on local governments, but an important assessment involves decision makers’ feelings about how their own local governments were coping. When asked to respond to the statement, “My county has been hit very hard by the recession,” an overwhelming number (85 percent) of county commissioners answered that it was true. Additionally, 74 percent perceived property values to be dropping in their counties, and 92 percent perceived businesses in their counties to be failing. These results are reported in Table 1. Not surprisingly, when asked in an open-ended question to highlight the major effects the recession had on their counties, 35 percent of respondents mentioned unemployment, and 30 percent mentioned reduced revenues. The county commissioners painted a grim picture.

5. Georgia had a projected shortfall for fiscal year 2012 of \$1.7 billion, but it included no carryover and constituted a much smaller percentage of the state’s total budget—10.3 percent versus 29.3 percent.

Table 1. County Commissioners' Perceived Effect of the Recession

| Survey Question | Number of Respondents Reporting That Answer | | | | | Total |
|---|---|----------------|---------|---------------|------|-------|
| | False | Somewhat False | Neutral | Somewhat True | True | |
| County was hit very hard by the recession | 2 | 4 | 5 | 27 | 36 | 74 |
| Home values have drastically decreased in my county | 2 | 6 | 11 | 21 | 34 | 74 |
| Businesses in my county have been failing | 1 | 1 | 4 | 36 | 31 | 73 |

Clearly, counties were in the midst of a crisis in the winter of late 2010 and early 2011. However, there may be a silver lining. The recession provided a unique opportunity to clean house and improve the efficiency of tax and budget policies. It is often said that the Chinese character representing crisis is composed of the characters for danger and opportunity. Whether or not the saying is true (Mair 2009), the wisdom is. Recessions are crises, but they also provide an opportunity to review a government's policies and priorities. Recessions are an opportune time to overhaul how governments budget and to adjust how they tax. In fact, economic downturns are prime times for innovation and experimentation (Svara 2009). *Innovation* in this context means adopting new approaches to improve the budgeting process or its results, even if an approach is only "new" to the government that adopts it (Svara 2009).

County Governments and Coping Mechanisms

The following statement is from a county commissioner respondent:

County voters are anti-tax. We cannot tax ourselves out of the recession. We took immediate and decisive steps to reduce spending and will continue to do so. We adopt budget principles every year, and we stick to them. Our workforce has decreased more than 10 percent in the past two years. We are a very conservative county. We cannot spend more money than we receive, and we have little to no way to increase our revenues. We have reduced General Fund appropriations 15 percent over 2 fiscal years. Luckily, we have had lots of experience with living within our means.

Are counties taking on the challenge of actually reconsidering how they operate rather than just making short-term fixes? This section considers that question. It also assesses how closely counties' actions resemble the academic recommendations.

Best Case Scenario: Academic Advice for Local Governments

The fundamental question of this bulletin is how local governments can weather the storm of a recession. Many scholars believe that the best thing local governments can do is to avoid being counterproductive while letting federal and state governments stimulate the economy (Fisher 1997; Fisher 2008; Marlowe 2009; Musgrave and Musgrave 1980). For example, cutting spending or increasing taxes is considered counterproductive and likely to worsen a downturn (Orszag

and Stiglitz 2001). But under what circumstances is it possible not to take such steps, especially in light of balanced budget requirements? In some instances, the use of intergovernmental transfers may allow counties not to change their behavior. Ideally, local governments would receive increases in intergovernmental transfers, specifically cash grants, which have been shown to have a greater (positive) effect on the economy than tax increases (Miller and Svava 2009).⁶ In many states, however, the unfortunate reality is that state and local governments are often facing the same economic downturn. State aid constitutes approximately 30 percent of local government revenues (Delisle 2010)—although North Carolina local governments receive much less in state aid—and in the 2001 recession, states cut aid to local governments by \$2.3 billion (Hoene and Pagano 2003). And while federal aid is more resilient and may even increase in the form of stimulus spending during a recession (Scorsone and Plerhoples 2010), it accounts for only 4 percent of local government revenues (Wildasin 2009).⁷

So what can local governments do to help themselves? One way counties (and municipalities) can avoid spending cuts and tax increases is through the use of fund balances, often referred to as *rainy day funds*. The traditional economic literature does not advocate subnational governments maintaining fund balances for stabilization purposes, but most local governments do,⁸ with estimates of such funds ranging from an average of 6 percent of total expenditures in Massachusetts (Gianakis and Snow 2007) to 60 percent in the suburbs of Chicago (Hendrick 2006). However, evidence shows that fund balances do not stabilize expenditures as much as expected at the local level (Marlowe 2005; Marlowe 2012; Wang and Hou 2012) and that smoothing expenditure patterns (that is, ensuring that expenditures do not change drastically over time) may not be the exclusive goal of maintaining fund balances (Gianakis and Snow 2007; Gore 2009). This is not to say that they are not advocated in the public administration literature or practice; for example, the Government Finance Officers Association (GFOA) recommends keeping at least two months of unrestricted fund balance (2009).⁹ It does appear, however, that such funds may not be utilized by local governments to their maximum smoothing potential.

According to Wolman (1980), this is the first step local governments take—they try to preserve existing service levels and maintain the workforce through short-term devices such as fund balances. However, a more recent study finds that local governments in Massachusetts are reluctant to use their stabilization funds as rainy day funds, because they use them for capital projects and believe that they are important to maintaining their favorable bond ratings (Gianakis and Snow 2007).¹⁰ This reluctance to spend down fund balances appears to be wide-

6. There is also the possibility for perverse incentives created by soft budget constraints, which may encourage local governments to incorporate the possibility of “bail out” into their budgets.

7. Intergovernmental transfers are not the only way in which states can affect the fiscal condition of local governments. State laws have a substantial impact on local governments—especially laws such as Dillion’s Rule, tax and expenditure limitations, balanced budget requirements, and laws on the debt level and how local governments are permitted to issue debt (Weikart 2012). Furthermore, numerous states have financial control boards and state level oversight of local government budgeting, such as the Local Government Commission in North Carolina (Cahill et al. 1994; Weikart 2012). There is quite a bit that states can do either to improve or worsen the financial situation for their local governments.

8. Local governments often cite balanced budget requirements, the timing of their revenue, and bond ratings as their reasons for maintaining fund balances (Marlowe 2012).

9. In North Carolina, the Local Government Budget and Fiscal Control Act encourages local governments to maintain a fund balance of at least 8 percent of their annual expenditures.

10. However, research shows large fund balances do not have much of an impact on bond ratings (Marlowe 2011).

Table 2. County Commissioners' Perceived Effect of the Recession on the Budget

| Survey Question | Number of Respondents Reporting That Answer | | | | | Total |
|--|---|----------------|---------|---------------|------|-------|
| | False | Somewhat False | Neutral | Somewhat True | True | |
| The recession has caused us to make small decreases in the budget | 20 | 10 | 5 | 11 | 26 | 72 |
| The recession has caused us to make large cuts in the budget | 11 | 7 | 3 | 15 | 38 | 74 |
| The recession has caused us to cut programs | 9 | 7 | 4 | 19 | 35 | 74 |
| The county government is still able to provide services at a responsible level | 3 | 6 | 8 | 25 | 31 | 73 |

spread, with a mere “decrease in the median fund balance level from 2007 to 2009 . . . between 2 percent to 5 percent of total revenue” for cities and counties (Marlowe 2012, 333). This seems to be the case in North Carolina, where most counties were reluctant to balance their budgets by spending down their fund balances and chose instead to reduce expenditures (Rivenbark, Roenigk, and Noto, forthcoming).

According to the literature, the local governments that are able to cope most successfully with economic downturns are the ones that have planned ahead and taken proactive measures to insulate themselves during the economic booms, thus making the busts more manageable (Lauth 2003). In many cases, they have achieved this by diversifying their local economies and revenue streams, maintaining large fund balances, and carefully assessing their policy missions and goals (Scorsone and Plerhoples 2010).

If the best way to handle a recession is not to raise taxes or cut expenditures, are counties doing nothing?¹¹ Table 2 offers some insights into that question. Twenty-seven percent of counties surveyed did not have to change their levels of program spending, and 28 percent also reported not making “large” budget decreases. According to these respondents, they began preparing for the recession a few years before it hit. Five commissioners highlighted their use of fund balance spending, and four of the five said they were heavily relying on it. Nine commissioners reported that they had been less affected by the recession because of long-term planning. Many of them specified that long-term planning meant that they began making cuts before the recession’s effects had been manifested, allowing them to build up their fund balances. This is called *consumption smoothing*, and it is a good practice.

As expected, the counties that reported being able to cope with the recession better and continue to provide services at a responsible level reported planning ahead. Notable responses include the following:

- “Since 2007 we have bee[n] penny pinching and not adding personnel until needed.”
- “[We] managed funds better.”
- “We cut spending over a year ahead of the recession, resulting in a three year growth in our reserve funds.”

11. This may only be possible with an unrealistic increase in inter-governmental transfers or the use of a fund balance, since deficits are illegal.

- “Our county is very frugal.”
- “We have zero debt. Using building permits as an indicator (1,800 new home permits in 2005 to 8 in 2009) we began making budget cuts four years ago.”
- “We know income can fall at any time. We therefore adjust our budget constantly to reflect down turns before they impact us. We saw this reduction of income three years ahead of its actual impact at the county level and were positioned to deal with it with only small corrections needed.”

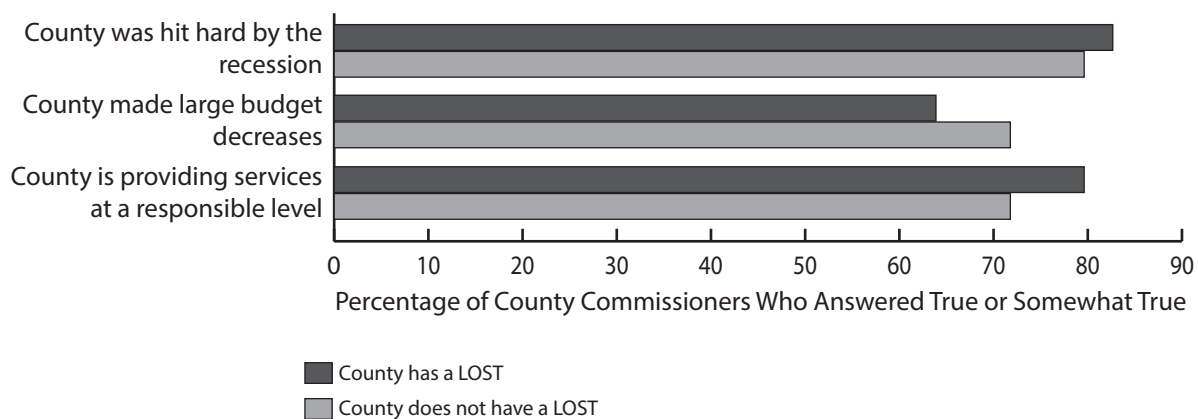
The trend among those commissioners who felt they were in the best position was not that they were fortunate to escape the impact; it was that they watched for signs that the recession was coming and began making adjustments as soon as possible. Local governments often do not have the capabilities for time series analysis. However, this recession did come in revenue waves. The first impact included state aid and sales tax revenue decreases, followed by losses in property tax revenue. Counties were able to foresee some of the impact and begin to prepare. This is in keeping with the literature that advocates changing spending and taxing behavior as little as possible in the midst of a recession (Marlowe 2009; Orszag and Stiglitz 2001).

An example of the importance of understanding revenue portfolios for planning purposes is the use of LOSTs. An important consideration when implementing a LOST is whether it will be a reliable stream of revenue. The literature suggests that sales taxes are more elastic than property taxes (McCubbins and Moule 2010; Sobel and Holcombe 1996), and additional research shows that LOST revenue increases own source revenue volatility (Afonso 2013b; Hou and Seligman 2010). Because most revenue volatility comes in the form of shortfalls (Hou and Seligman 2010), policymakers should look for balanced revenue portfolios and plan ahead. This academic assertion was echoed by the surveyed county commissioners.

Table 3. The Impact of LOSTs on Budgeting: Out of the 39 Counties That Report Having a LOST

| Question | Yes | No | I Do Not Know |
|--|-----|----|---------------|
| Has the use of a LOST increased the variability of tax revenues? | 25 | 12 | 2 |
| Has the use of a LOST restricted budget flexibility? | 5 | 34 | 0 |
| Are you pleased with your LOST? | 34 | 5 | 0 |

As Table 3 illustrates, more than 64 percent of respondents said that the use of LOSTs increased the variability of own source revenue. Only 31 percent said that it did not. Although 87 percent reported being pleased with their counties’ use of LOSTs, 13 percent said it had decreased budget flexibility. However, LOST use appears to have had only a modest impact, if any, on counties’ experiences during the recession. Figure 1 shows three major indicators of the severity of the recession’s impact: whether the commissioner believed the county was hit hard by the recession, whether the county made large budget cuts during the recession, and whether the county was still able to provide services at a responsible level. The responses are divided into two groups, counties with LOSTs and those without. There was no major difference between the two groups. However, more county commissioners from counties with LOSTs felt that they had been hit hard by the recession, as expected. Counterintuitively, fewer commissioners from counties with LOSTs reported making large budget decreases, and a larger percentage of them said

Figure 1. LOST Use and the Recession

that they were still providing services at a responsible level. This may mean that counties with LOSTs, knowing that those revenues are more volatile, instituted better measures to protect against fiscal stress than did their counterparts.

These results indicate that there are counties handling the recession in the way that the literature prescribes, although they are far from a majority. However, for local governments that are now dealing with a recession, the advice to plan ahead is not very helpful.¹² So how much advice can scholars give those local governments? Plenty.

Next Best Option: Increase Taxes

For local governments that cannot simply maintain the status quo, the academic literature suggests that the next best option is to temporarily increase taxes on the wealthy. "Tax increases on higher income families are the least damaging mechanism for closing state fiscal deficits in the short run" (Orszag and Stiglitz 2001, 2), because high-income families have a greater propensity to save than low-income families, which often spend their entire income (Dyan, Skinner, and Zeldes 2004; Johnson, Oliff, and Williams 2009; Orszag and Stiglitz 2001).¹³ Furthermore, there is evidence that tax increases are generally less detrimental to the fiscal health of local governments than cuts in spending (Chapman 2009). This may not be straightforward, though. Only fourteen states allow local governments to adopt local income taxes, and only five of those allow their counties to do so.¹⁴ North Carolina is not one of the states that permit local governments to adopt local income taxes. This is in contrast to the thirty-six states that allow their local governments to adopt LOSTs, and counties specifically may adopt them in thirty-one of those states (Mikesell 2010). Sales taxes are known to place a higher burden on low-income individuals.

12. Many of the suggestions about long-term planning have since been adopted by the responding counties, but that does not help them now. One county reported creating a reserve fund, and two have undertaken financial forecasting. Unfortunately, these moves were in response to the recession, but they should better position the counties in future downturns.

13. There is little specific information about how to do this, leaving questions such as the following: What taxes? What are the legal options? How do I convince the public to raise taxes?

14. Cities in California may adopt local income taxes, but counties may not. Georgia does not permit local income taxes at all (Mikesell 2010).

Table 4. Coping Mechanisms Employed by Counties

| To cope with the recession my county has | Yes | No | Total |
|--|-----|----|-------|
| Instituted furloughs | 35 | 39 | 74 |
| Decreased employee benefits | 39 | 35 | 74 |
| Instituted hiring freezes | 58 | 16 | 74 |
| Fired employees | 29 | 45 | 74 |
| Increased tax rates | 13 | 61 | 74 |
| Introduced new taxes | 5 | 69 | 74 |
| Increased fees | 34 | 40 | 74 |
| Introduced new fees | 20 | 54 | 74 |
| Reduced capital programs | 58 | 8 | 66 |

The decision to increase taxes is politically charged and difficult. For example, Wolman (1980) finds that local governments that do not have to get electorate approval for tax increases and are farther out from an election are more likely to raise taxes than their peers. Justice (2009) suggests introducing new user fees or increasing the existing rates in part because user fees are more palatable to voters. User fees are also viewed as being more fair (ACIR 1986).

As reported in Table 4, only 18 percent of survey respondents increased taxes, and only 7 percent introduced new taxes. As anticipated, user fees were a popular alternative, with 46 percent increasing fees and 27 percent introducing new fees. As mentioned above, the public often sees user fees as equitable. Scholars, however, often consider them regressive, putting an undue burden on lower-income citizens (Bird 2001; NCSL 1999). Additionally, LOSTs are also considered regressive and inequitable, so the options available for progressive taxes—in the form of additional taxes on the wealthy—are limited.

In an open-ended question about the effects of the recession, two counties noted that they had actually decreased their taxes. Five counties responded that they could not increase taxes, often citing the need for voter approval as a reason. The four counties that raised taxes indicated that the property tax rate increase was in response to a decrease in assessed value of property. Arguably, this means that they did not raise the tax neutral rate. Scholars encourage not just tax increases in general, but progressive taxes, and it does not appear that when local governments are increasing taxes they are doing it in this way.

Acceptable Responses: Strategic Cuts

The literature suggests that if local governments *must* make cuts to expenditures, they should try to make efficiency-improving strategic cuts. Expenditure reductions are a reality, and according to a 2009 survey, 90 percent of cities had made cuts to their expenditures and 82 percent anticipated making more cuts in the following year (Hoene and Pagano 2009). Therefore, information on how to make informed decisions on the appropriate expenditure reductions is vital.

One method for making reductions is the rational or efficiency method, which suggests that managers use information to make strategic cuts that align with their missions and priorities (Jick and Murray 1982; Lauth 2003). These cuts may also represent the areas that are the least disruptive to service delivery (Wolman 1980). Although the rational method may seem like

Table 5. Have Counties Changed the Way They Budget?

| Question | No | Yes, Until the Economy Rebounds | Yes, Permanently |
|---|----|---------------------------------|------------------|
| Has your government changed the way it budgets and operates in the face of the recession? | 28 | 25 | 14 |

an obvious strategy, it appears that cuts are often phased in with broad across-the-board cuts, which are then followed by targeted, major reductions in spending and programs that are not necessarily targeted for efficiency (Dougherty and Klase 2008; Levine, Rubin, and Wolohojian 1981).

One possible explanation for local governments not choosing cuts rationally is that they may be politically motivated (Jick and Murray 1982). For this reason, a great deal of the research advocates building alliances, incorporating internal and external actors in the process, and explaining the financial condition of the locality as a part of the budget formation and reduction process (Justice 2009; McTighe 1979; Plant and White 1982). It is also important for local governments to avoid making cuts that will have long-lasting effects on their fiscal health and ability to provide services. There has been limited work in this area. In one of the few studies of the long-term consequences of local governments' budget choices, the authors examined the long-run consequences of education cuts in New York City (Berne and Stiefel 1993). They found that cuts to teacher salaries and operating expenditures do not have long-lasting effects on education outcomes, whereas capital expenditures and freezing empty teaching lines have effects that are felt past the end of the period of fiscal stress.

So, do county commissioners feel that their counties have changed how they budget and incorporate strategy and mission into their processes? Only 41 percent of commissioners reported that they had not changed the way in which they budget. Furthermore, 20 percent said that the changes they made will be permanent, and they detailed those changes in response to an open-ended question. Four respondents said that they adopted zero-based budgeting; three combined and restructured departments; two adopted long-term planning; one created a reserve fund; eleven deferred or eliminated capital spending; and five reported that they increased efficiency in their local governments. These results are reported in Table 5.

It appears that many counties are attempting to make strategic and efficiency-improving changes. Commissioners made telling comments, including the following:

- “[We] reorganized some departments for efficiencies.”
- “Department recommended program reductions, countywide efficiency and reorganizations.”
- “Management has been asked to reduce their operating budgets without impacting services” [presumably through efficiency gains].
- “Some have been good—made for a leaner yet still effective government.”
- “Services have been re-engineered to be more efficient and to continue to provide the best quality services given the circumstances. Optional programs in all areas have been eliminated.”

Historical evidence suggests, however, that not all changes and cuts are strategic. Factors outside the recession may have discouraged strategic behaviors; for example, 60 percent of the

commissioners reported that property tax TELs discourage “strategic infrastructure improvements.” Others reported behavior that was decidedly not fiscally strategic: “[A]ll service providing programs have been cut through lay-offs. Pet projects are still funded.”

Not Advocated: The Remaining Strategies Counties Used

Some of the ways that county commissioners said they are handling the effects of the recession are, at least in part, in keeping with the literature. However, those behaviors do not represent the bulk of what counties have chosen to do. As illustrated in Table 2, almost three-quarters of respondents reported making deep cuts to their budgets and eliminating programs. Some of the largest cuts were made to personnel. Almost 80 percent of county commissioners reported implementing hiring freezes, more than half decreased employee benefits, almost half instituted furloughs, and 39 percent had to make layoffs.

Capital projects, which represent non-allocational spending, are also heavily affected during times of recession. According to Jordan (2003), non-allocational functions will be more affected during a recession than allocational functions, such as police and sanitation, because decreases in allocational spending may cause middle-class flight. This suggests that capital outlays are more affected by the economic cycle than other forms of spending (Booth 1988). Survey respondents reported that capital projects were heavily affected by this recession. More than 80 percent of county commissioners said that the recession had caused the county to reduce capital projects, despite the predictions of scholars that capital reductions may have long-term consequences (Berne and Stiefel 1993; Marlowe 2009; Miller and Svara 2009).¹⁵

Commissioners reported that across-the-board reductions were common, which is in keeping with the literature on previous recessions (Dougherty and Klase 2008). However, such reductions are not advocated by academics. One of the central recommendations in the literature is to try not to reduce spending (Marlowe 2009; Orszag and Stiglitz 2001). More than 51 percent of respondents had made small decreases to their budgets since the beginning of the recession, almost 72 percent had made large decreases to their budgets, and 73 percent had made cuts to programs. It is clear that large cuts are standard practice.

Given that theory suggests that large cuts will worsen the effects of a recession, how did survey respondents feel about their counties’ ability to maintain service levels? Almost 77 percent of the commissioners said that “the county government is still able to provide services at a responsible level.” Only 12 percent said that county government was not providing services at a responsible level.¹⁶ Does this suggest that local governments’ definition of “responsible” has changed? Is this evidence of a “new normal” or of previous waste? These are questions that only time and further research will answer.

Table 4 presents ways in which respondents said their counties were coping with budget shortfalls. Only one county out of seventy-four responded that it had not taken any of the steps listed, and no counties reported taking all of them. On average, counties reported using three or four of the following tactics:

- Freezing hiring (78 percent)
- Decreasing employee benefits (53 percent)
- Instituting furloughs (47 percent)

15. The literature is mixed. Some scholars reason that capital can be deferred without any long-term consequences (Hoene and Pagano 2003).

16. The remaining 11 percent felt that there was no change in how they were providing services.

- Increasing fees (46 percent)
- Firing employees (39 percent)
- Introducing new fees (27 percent)
- Increasing tax rates (18 percent)
- Introducing new taxes (7 percent)

Other strategies included offering early retirement incentives, closing libraries, freezing salaries, and replacing full-time positions with part-time ones. Some counties reported that they were even cutting public safety budgets, including police forces—a problematic tactic because crime rises in economic downturns (Gould, Weinberg, and Mustard 2002) and public safety cuts are often considered a last resort (West and Davis 1988).

Perspectives from Decision Makers

The survey respondents were elected officials—decision makers who answer directly to voters for the budget choices they make—and their comments reflect this role. They often discussed the effects of political tensions on taxpayers and service levels, the constraints imposed by other levels of government, and the use of citizen assistance. However, their general responses regarding their counties' efforts to cope with the recession are in keeping with the previous literature.

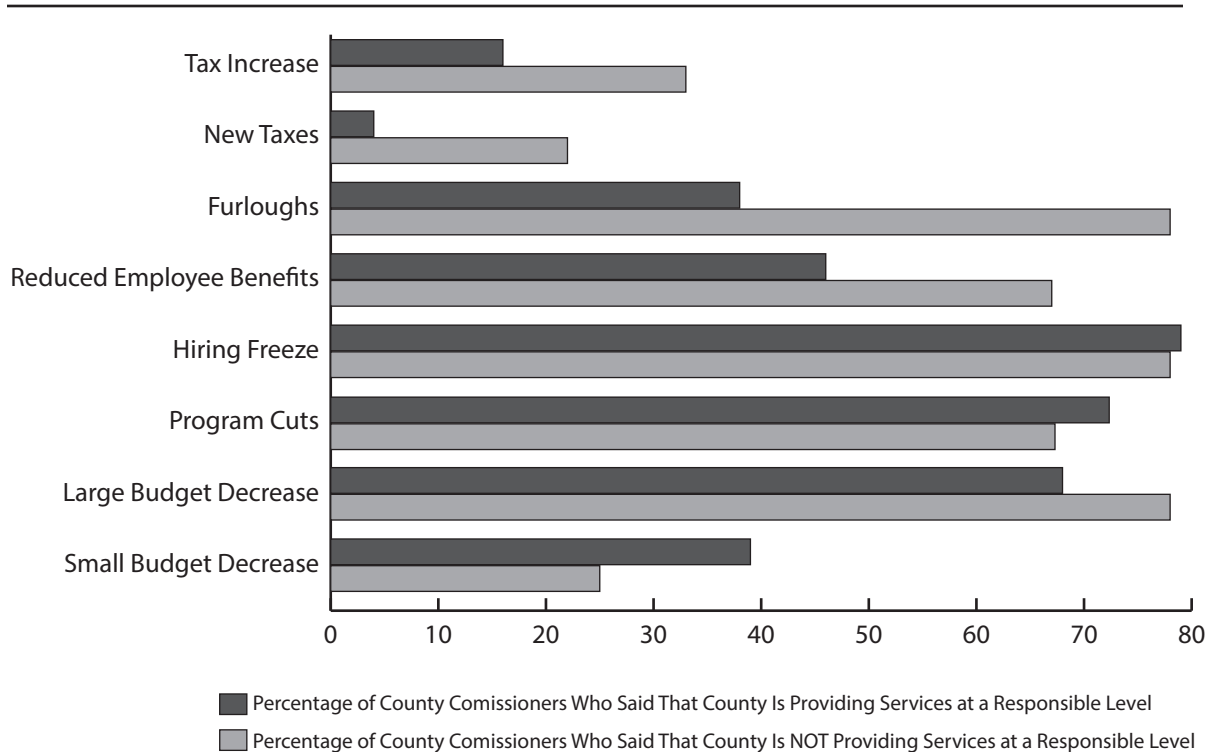
Policy Implications and Conclusion

The resounding lesson from the survey discussed in this bulletin is that counties should be planning ahead and monitoring their local economies to the extent possible. While some research advocates that it is better in the short run for counties to increase revenues rather than cut spending (Orszag and Stiglitz 2001; Scorsone and Plerhoples 2010), the survey provides additional insight into the reality of how local governments behave. It reveals that county governments employ a combination of increasing revenues and reducing expenditures to cope with recessions. However, budget decreases are much more commonplace. In the recent recession, 72 percent of responding counties made large budget decreases, whereas only 18 percent increased tax rates, 7 percent introduced new taxes, and 46 percent increased user fees. There is a clear gap between the theory and practice of coping with recessions.

Perhaps the counties that reported still providing services at responsible levels substituted increased taxes for budget cuts. Figure 2 presents the respondents' answers, divided by whether they felt that their county was still able to provide services at responsible levels in light of the different strategies they were employing. Overall, the counties that were still providing services at a responsible level employed fewer tactics than those that were not, the only exception being hiring freezes, program cuts, and small budget decreases. The biggest differences were in new and increased taxes and furloughs. This merits further attention and analysis from scholars.

Economic crises present both opportunities and dangers. They provide opportunities for local governments to re-evaluate priorities and practices. Dangers exist, however, because local governments are forced to make hard decisions during economic downturns, and they may not have enough information about the consequences of their choices.

Figure 2. Percentage of Counties and County Commissioners and the Strategies Used to Cope with Recession



Understanding the strategies discussed in this bulletin and local governments' reactions to different policies are early steps toward planning for future economic crises. This information is especially important because many researchers believe that local governments may be in a "period of permanent fiscal crisis" (Osborne and Hutchinson 2004, 1). Due to the basic cyclical nature of the economy, this will result in future economic downturns, and it is best to prepare in advance.

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