

Local Government

Readings

The Role of City Managers

- How does the politics v. administration dichotomy work regarding appointments, budgeting, and day-to-day operations?

Others

- The governing board—the elected city council or county commission
- The manager—the city or county manager

I. Cities and counties

A. Three forms of government

1. Strong mayor-council in cities (Elected executive in counties).

- a. Found mostly in large cities (e.g., NY, Chicago, Cleveland, Detroit, LA). Exceptions include: San Diego, Austin, San Antonio, Dallas, and San Jose, which were relatively small when the council-manager plan was adopted and are more ethnically homogeneous than strong-mayor cities.
- b. 39% of cities over 50,000 have a Chief Administrative Officer (CAO), which is recommended by the Model Charter. 50% of CAOs are appointed by the mayor with Board approval, 38% by the Board, and 12% by the mayor alone.

2. Weak-mayor council (Weak-executive commission in counties)

- a. Found in governments too small to have a manager or paid full-time mayor.

3. Council-manager (CM) in cities (Commission-manager in counties). Grew out of the reform movement. First CM city was Staunton VA in 1908.

- a. Role of mayors. Preside over the council but has no more formal powers except veto power in 13% of cities. Can only vote in case of a tie in some cities.
Two main roles
 - a. All mayors perform a ceremonial role representing the city.
 - b. Some mayors play an expanded role as network builders and policy initiators

- b. **City Councils—Over 75% are non-partisan. Usually bimonthly or monthly meetings in towns below 10,000 in population. Two types of committees: standing and ad hoc. In over 90% of cities standing committees make policy recommendations to the full council**
- c. **The politics versus administration dichotomy in theory and actuality**

Form of Government	Direct day to Day Operations	Submit a Balanced Budget	Hire and Fire Department Heads
<ul style="list-style-type: none"> • Strong Mayor-Council • Weak Mayor-Council • Council-Manager 	<p>Mayor</p> <p>Governing Board Manager</p>	<p>Mayor</p> <p>Governing Board Manager</p>	<p>Mayor</p> <p>Governing Board Manager</p>

B. Differences between cities and counties in NC. Counties have:

1. **Elected officials (Sheriff, Coroner, Register of Deeds, District Attorney, Clerk of Court)**
2. **More board members that run on partisan ticket**
3. **More board members elected by district (core equitable but less efficient).**
4. **The Chair appointed by the Board**
5. **Three major departments (Health, Mental Health, and Social Services) that have policy setting boards**
6. **Joint funding of Community Colleges, Ag. Extension, and Public Schools**
7. **Less urban services (especially water & sewer)**
8. **More urban mandates, e.g., TANF, Medicaid, and other social services**
9. **More heterogeneous boards**

Discussion Questions

- **Why does the Strong-Mayor Council form exist in most very large cities?**
- **Why does the Council-Manager form exist in some large cities?**
- **What are the pros and cons of being a city v. county manger?**

State Government

Readings

The General Assembly and the Budget

- Balanced budget
- Advisory Budget Commission
- Continuation, expansion, and capital improvements budgets
- OSBM. Office of State Budget and Management
- Fiscal Research Division

NC Legislative Budget Process

- Biennial Budgets
- Consensus revenue forecasting

I. How NC state government is organized

A. Citizens legislature: Part time v. full-time

1. How representative of the general population is the General Assembly?

II. Trends in state government nationally and in NC

A. Decline in the number of agencies headed by elected state officials

1. No change in NC

B. Veto power strengthened

1. NC governor given limited veto power (can only veto only a whole bill). 43 states have line item veto power.

C. Increase in Republican governors (34 states now)

1. Martin elected for two four-year terms.

D. Increase in partisan power splits

- 1 Republicans controlled the House for four years.

E. Number of two-year terms reduced

1. No change in NC

F. Increase in legislative term limits. 18 of 22 states since 1996

1. Pros: new blood; cons, more power to interest groups and to staff

II. Other NC Trends

- #### A. More egalitarian. From Supersub of 7 in 1985 to 86 of 120 house members serving on appropriation committees in 2001

B. More legislative staff

C. Washingtonization of Raleigh (proliferation of lobbyists)

D. More think tanks, e.g., John Locke (conservative), NC Budget and Tax Center (liberals).

E. Longer sessions (low pay) making it more difficult to serve, hence more retirees, rich people, and less lawyers

III. Assessing governors' performance

A. Performance—Opinion polls

B. Institutional powers

- 1. Number of separately elected officials (Council of State); tenure potential; appointment power; veto power; budget power; congruence of political party control**

C. Personal powers

- 1. Size of election victory (mandate); previous elective office experience (ambition); future; personal style**

D. Interactions with administration, legislature, and media

E. Key programs and policies passed

Powers	Hunt	Easley	Nationally
Performance	4.5		3.3
Institutional	2.9		3.4
Personal	4.1		3.4
Interactions	3.8		3.2
Programs	Smart Start, teachers to national average	More at 4	

IV. State budget

A. Why the crisis?

- 1. Since 1998 \$1.7 billion spent to increased teacher pay to the national average and \$140 million for ABC bonuses**
- 2. Since the early 1990s \$650 million for Smart Start**
- 3. After Republicans gained control of the House in FY 1996, taxes were reduced by \$1.3 billion. The state tax burden fell from 30th to 28th**
- 4. In FY 1998 courts ordered the state to pay \$799M in taxes improperly collected from pensions on government employees**
- 5. In FY 2000 the state took \$286 million from its Rainy Day Fund for flood victims**
- 6. In FY 2001 budget Medicaid costs increased. 800,000 cases in 1999 family and children (\$4.3B) to about 1,500,000 cases (\$6.6B) in 2002. Recession**
- 7. 2001 tax increase. Increase sales tax by ½ percent. Create a new income tax bracket of 8.25% on high-income taxpayers. Close loopholes on telecommunications, satellite TV, luxury autos, and HMOs/Blue Cross.**
- 8. 2002. Budget Gap = 8.3% of 2002 General Fund Budget. Took \$95M, \$79M, and \$26 M in reimbursements made to local units for inventory, utility, and beer and wine taxes, respectively; gave local units the option of imposing a ½ cent sales tax increase in return; cut state pension contributions; took money from the Tobacco Trust Fund; and cut expenditures.**
- 9. 2003-2004. Extended the ½ sales tax and income tax increases of 2001; used up Hurricane Floyd funds, used tobacco settlement proceeds.**
- 10. 2004-2005. Funded with certificates of participation university medical research facilities.**

Discussion Questions

- Which formal powers are most important to the Governor of NC and why?**
- How well is Easley doing regarding the criteria?**

- **How effective was the state in dealing with the economic downturn?
What have been the political issues?**

Accounting

Readings

- Financial Accounting, Reporting, and Auditing
- Government Finance Officers Association (GFOA)
- The Governmental Accounting Standards Board (GASB)
- The American Institute of Certified Public Accountants (AICPA)—Professional Association of CPAs. *Audits of State and Local Governmental Units.*
- Generally accepted accounting principles (GAAP)
- Financial Accounting Standards Board (FASB)

Others

- The General Accounting Office (GAO)—Auditing arm of Congress
- Encumbrance—An obligation in the form of a purchase order or contract
- Reversions—Moneys not spent at the end of the fiscal year that lapse into unreserved fund balance. Contributing most to fund balance are lapsed salaries because governments usually assume a *full employment budget*, i.e., that all positions will be filled for the entire fiscal year.
- Financial report (audit)—Evaluation of the financial transactions of governments to determine whether they have complied with GAAP. Done by CPAs for local units and by the State Auditor for the state
- Local Government Commission (LGC)—Division of the State Treasurer's Office that reviews and approves all local bond issues; approves audits of local financial statements; assists with the implementation of GASB standards; analyzes local year-end financial statements
- The Institute of Government (IOG)—Created in the 1930s, extensively trains local government and school managers and assists the General Assembly in research

I. Fund balance

A. Unreserved fund balance

1. How to calculate fund balance. Year-end fund balance/prior year's expenditures.

E.g., Year-end fund balance (\$5,000,000)/Prior year's expenditures (\$55,000,000) = 9%

2. How to assess whether fund balance is too low or too high

- a) Local governments. LGC requires a minimum of 8% to issue bonds but the LGC recommends that units meet the average amount for like-sized units
 - b) States. General norm is a Rainy Day Fund of 5% of expenditures and a fund balance of about 2-3%, but no state wide norms exist
 - c) Nonprofits. No national or state norms, but United Way funded agencies require at least 3 months operating funds
3. Ideally units should have a policy.
- a) The state of NC a portion of year-end reversions be put into the Rainy Day fund until it reaches 5%.
 - b) Local governing boards ideally should adopt a policy stating the amount of desired fund balance (e.g., the average amount maintained by like-sized localities.
 - (1) Pros: Protects the manager if the unit has a high fund balance
 - (2) Con: Target for tax cutting interest groups
4. Ways to increase fund balance in local units
- a) Increase the property tax
 - (1) Revenue from a 1 cent increase on the property tax.
 - b) Reduce expenditures
 - c) Overestimate next year's expenditures (typically 5% of budgeted expenditures).
 - d) Underestimate next year's revenues (usually 3% of budgeted revenues).
 - e) Make interfund transfers to the general fund for overhead support services (e.g., purchasing, accounting, human resource department, auditing, and legal.
 - (1) Local governments. Possible methods:
 - (a) In lieu of taxes utilities the utilities (e.g., water, sewer, electric) would have paid if privately operated
 - (b) A-87 Cost Allocation Plan method.
 - (2) States. Charges Highway Trust based on lost license revenues; Clean Water Trust, Tobacco Settlement funds are charged based on politics.

II. Basis of accounting: cash, modified accrual, full accrual

Type of Accounting	When Revenues Are Recognized	When Expenditure (Expenses) Are Recognized
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Cash	When moneys are received	When and expenditure/expense is made
Modified Accrual	When moneys are received (except the property tax, which is accrued)	When a obligation is made in the form of a purchase order or contract
Full Accrual	When a bill (e.g., water, sewer) is sent out	When an obligation is made in the form of a purchase order or contract

1. Modified accrual is recommended for governmental funds and full accrual for proprietary and fiduciary funds

a) Local Units. Large units have accrual; small units have cash

(1) Pros of converting from cash to accrual accounting: better accounting control, appreciated by bond rating agency. Con of converting: unreserved fund balance is reduced in the first year after conversion, requires an automated bookkeeping system

b) NC. Cash accounting during the year; reports on both a cash and accrual basis

c) Nonprofits. Operate on a cash basis.

III. Internal service funds (ISFs)

A. States. Use all possible ISFs (Prison enterprises, motor fleet, courier service, temporary solutions, computing services, telecommunication).

B. Local Units. Large units have ISFs (e.g., motor equipment, printing, data processing, custodial services, stores inventory). Should a smaller unit create an ISFs? Small units can fairly easily create IT, custodial service, and printing ISFs; however motor equipment and inventory are more complicated requiring expertise, software, and manpower.

C. Nonprofits. Do not have ISFs.

IV. Accounting for indirect costs

A. States. All states have A-87 Indirect Cost Allocation plans to recover indirect costs expended by state agencies on federal grants.

1. NC State's rate is 40%

B. Local Units. Large local units similarly have A-87 plans as do units participating in the Institute of Government's performance benchmarking project.

C. Nonprofits. Auditors must approve the method for allocating indirect costs to various funding sources. Usually a simple method (e.g., percentage of costs of each direct funding source). Generally

administrative expenses should be 25% or less if a United Way funded agency.

Discussion Questions

- **Why is the LGC so valuable?**
- **Your fund balance is \$1,000,000 and the prior year's expenditures were \$15,000,000. You need to issue bonds. How much more fund balance do you need and what are your options for increasing it?**
- **You are the Governor. Your Rainy Day Fund is 2% and you want to increase it to 5%, what information do you need?**
- **You are the new city manager and do not have accrual accounting, make no charges to the water and sewer funds for central services, and have not ISFs, what would you do?**

Calculating and Increasing Unreserved Fund Balance

Local Units

FY 2002

Prior Years' Expenditures	\$5,000,000
Year-end Fund Balance	100,000

1. What is the percentage of fund balance?
2. How much more is needed to issue bonds (8%)?

FY 2003

	Budgeted	Actual	Difference
Revenues	\$5,200,000		
Expenditures	\$5,200,000		
Total	-		

1. What is the new fund balance amount and percentage, assuming that revenues are underestimated by 3% and expenditures are overestimated by 5%?

State Government

FY 2002 (In millions)

Prior Year's Expenditures	\$14,000
Year-End Fund Balance	140
Rainy Day Fund	-

1. What is the percentage of fund balance?
2. How much money is needed to get to a target of 5% in the Rainy Day Fund and 2% in fund balance?
3. Using the Senate and Governor's proposals and assuming a 5% expenditure lapse, what would you recommend?

Non-Profit Organizations

1. No specific targets have been set, though industry averages exist.

Budget Preparation: Revenues

Readings

Public Revenues

- Base
- Ad valorem
- Exemption
- Revenue (tax) expenditure
- Incidence
- Earmarked revenue

Revenue Forecasting

- Average change, moving average, regression, and causal revenue forecasting

Others

- Loophole—Exception made in a revenue for a particular type of taxpayer
- Consensus revenue forecasting—the SBO and FRD agree on revenues or the lower estimate is used
- Fiscal impact fee

I. Criteria for evaluating revenues

A. Reliability. Elasticity (change in income/change in taxes). More than 1.0 elastic; less than 1.0 inelastic.

1. Sales tax fluctuates more in the short-term; income tax more in the long term when in recession. Property tax fluctuates the least

B. Equity

1. Horizontal—Whether persons and businesses of the same economic circumstance are taxed or charged the same.
Loophole example: NC taxes some services but not others

2. Vertical

- a) Regressive: the lower the income, the higher the tax or fee *rate*
- b) Progressive: the more the income, the higher the tax or fee *rate*
- c) Proportional: regardless of income, persons pay the same amount. The overall rate in NC is almost

proportional because of the mix between the income (progressive) and sales (regressive) taxes

3. Two philosophies

- d) Ability to pay. Those with more income should pay a higher rate (state and federal progressive income taxes. The view taken generally by Democrats.
- e) Benefit received. People should pay the benefits they receive (e.g. social security, sales tax, and user fees). The view generally taken by Republicans

C. Ease of taxpayer compliance and administration

D. Competition with other governments (especially important for the state of NC.

E. Neutrality—Extent of exemptions

F. Obsurability. E.g., excise and corporation income taxes are imbedded in the price. 32% of state legislators viewed this to the key determinant.

G. Politics/public acceptance. The reason why the sales not income tax continues to increase rather than the income tax. Anger against the federal income tax prevents from passing state income taxes.

II. Property tax

A. Tax base—Real property (land and anything attached to it) and personal property (anything movable)

B. The tax rate

1. Calculation: tax rate x assessed valuation x expected collection rate

E.g., \$.60 x \$200,000,000 = \$1,200,000 x 97% =
\$1,164,000

1 cent on \$300,000,000 equals what?

2. How to determine how high or low the property tax rate is

- a) Cities: compare to like-sized units in the county
- b) Counties: compare to similar counties in the region, recognizing localities are assessed every 8 years on a rotating basis

3. Property tax mix: residential v. commercial/industrial—ideally should be about 30% commercial/industrial and 70% residential

a) If a local unit is limited in being able to attract commercial/industrial development, it may limit the amount of residential less than a specified size, e.g., only 30 houses less than 1,400 square feet can be built in Wendell annually.

C. The delinquency rate—according the LGC must be at least 95% to issue bonds

1. How to improve the collection rate: 1. put names of taxpayers in the newspaper; 2. put lien on paycheck if the employer is known; 3. if not successful follow the law, which ultimately results in selling the property for back taxes

D. Types of reforms

1. Circuit breakers—low income persons only pay a specified percentage of their income in property taxes

2. Deferrals—farmers are taxed at the agricultural value until the land is sold when the farmer must pay the taxes that were deferred if the property had been taxed at its fair market value. In NC only the last three years before sale of property are exempt. Some developers wait for properties to become suitable for development by operating tree farms.

E. Exemptions

1. Government property, 2. religious and charitable organizations, 3. homestead, 4. veterans, and 5. old age

F. Assessment methods

1. Mass cyclical—in NC every 8 years

2. Segmental—a portion of the city or county every year

3. Annual—most desirable because revenues stay up with inflation but rare because of the extent of automation needed

III. Sales tax

A. Excise taxes

1. Sumptuary—e.g., jewelry, furs, entertainment, tobacco and alcohol

2. Transportation—e.g., fuels on gas guzzler autos, domestic crude oil

3. Environment—e.g., hazardous substances and nuclear waste

B. Issues

- 1. Regressivity and increased dependence on the sales tax, 2. Internet sales are tax exempt (About \$14B), and 3. only applies to some services (58% of services in 2000). For instance accountants and lawyers are exempt.**

IV. Income tax

- A. Corporation income tax was 8% of revenues in 1990s; now is 4%**

A. Heavy reliance on income tax makes the state tax system almost proportional.

V. Lotteries

A. Pros: \$350 million in new revenue; all neighboring states have one (lose about \$200 million to them annually); people will gamble anyway; according to polls a strong majority want a lottery; will increase voter turnout when a referendum is held (pro for Democrats).

B. Cons: Very regressive; not reliable; often used to simply supplement the General Fund in other states; will increase voter turnout when a referendum is held (con for Republicans).

VII. Service charges and regulatory fees

Four types: 1. utility charges, 2. user charges for services (e.g., garbage collection and recreation), 3. licenses (e.g., business, fishing) and permits (e.g., building construction permits), and 4. development fees (e.g., building inspection and impact fees)

C. User charges

1. Benefits: a. record public demand and may improve operating efficiency, b. improve equity for services to nonresidents, c. may improve cost and price signals, d. more politically acceptable than taxes.

2. Cons: a. penalize the poor, b. expensive to administer, c. may be resented, and d. are not deductible from state or federal income taxes

3. User fee policy—Adopted by the governing board, which explicitly states what percentage of costs (0-100%) will be recovered annually for fee-supported services

a) Pro: Revenues increase with costs each year

b) Con: Rationales of the governing board (often political) are transparent to the public; therefore, though recommended are rarely adopted

D. Public utilities—Should cover the cost of the service

1. Types of rates: uniform (each type of customer—residential, commercial, and industrial are charged the same rate); recommended; declining block (rates decline from residential to commercial to industrial customers because larger users require less of peak demand); ascending block—rates increase to conserve water ; and seasonal in which seasonal customers pay more.

a) Should charge uniform rate to conserve water and because they are simple for the public to understand *unless* a major customer(s) may relocated if imposed.

2. Charge residents outside of the city 200% of the bill inside of the city

a) Rationale: residents outside enjoy city services without paying for them (e.g., roads, police, and parks), higher rates may be an inducement for them to accept being annexed after which their rates would be halved

3. Residential sewer charge. Only large companies have sewer meters, other customers should thus be charged 100% of the water bill, which assumes a correlation between the amount of water used and sewer service

E. Impact fees. Placed on developers for the impact that growth will have on services

VIII. Revenue forecasting

A. Types of forecasting

1. Federal government—Econometric modeling

2. State government—Econometric modeling by forecasting change in state income. Buy time from a model in Massachusetts. Also use expert judgment. Law says that if OSB and FRD do not agree, the lower estimate should be used.

3. Local government. Small units use deterministic and some average change. Larger units use the same plus moving average and regression for the revenues that best fit the regressions.

4. Nonprofits. Grants usually easy to forecast unless the federal and/or state governments are changing requirements and funding levels. United Way funding has decreased in some areas because more donors are designating and the economic decline. Activity fees, conference fees, and membership fees are usually easy to predict.

B. Tips in forecasting

- 1. Use conservative estimates in all but a few situations**
- 2. Get a consensus at the staff level. Required by the state of NC or must use the lower estimate.**
- 3. Know the institutional framework in which estimates are being made including budget policies, history of past decisions, personalities of key players (including interest groups), timing issues**
- 4. Bring in experts to support view point (e.g., Mike Walden)**
- 5. Be forthright with the details of the forecast**

C. Politics of revenue forecasting

- 1. Election year maneuvering—don't raise taxes in an election year**
- 2. CBO v. OMB during the deficit years—From 1982 until 1993, OMB has inflated revenue estimates to understate the size of the deficit**
- 3. Revenue estimating when there is a surplus be conservative**

Discussion Questions

- How high are taxes in NC?**
- If the water rate was less than 200%, sewer rate less than 100%, used declining block rates, and had no user fee policy what you recommend as the new manager?**
- The countywide average tax rate is \$.50; your tax rate is \$.45; the collection rate is 97%; and the assessed valuation is \$300,000,000. You need a fire truck costing \$200,000 and cannot fund it from fund balance. What might you recommend regarding raising property taxes?**

Budget Preparation: Expenditures

Readings

Types of Budgets

- Line-item budget
- Program/performance budget—Governing board does not receive line items when reviewing the budget; rather, review is based on performance measures. When the budget is adopted, line items are used in the accounting records to maintain control.
- Zero-base budgeting
- Target base budgeting
- Entrepreneurial budgeting

Budget Methods and Practices

- Checklist of budget justification
- The budget message
- Rosy scenarios
- One shots

Performance Management in NC Cities and Towns

- How well do NC local governments measure performance?

Others

- Line-item performance budget—line item budget that includes performance measures of any kind
- Multi-year budgets—Operating budget projected for more than one year
- Benchmarking—Three possible definitions: compare to a best practice, compare to statistic, a performance target
- Managed competition—Systematically seeking private sector competition and contracting out where cost effective

I. CEO initiates the budget process

A. Meet up front with governing board?

1. Local government. Pro: CEO gets better policy direction. Cons: may deviate from the manager's priorities, possible (but minimal) cost if a facilitator is used.

2. State government. Governor of NC is supposed to meet every two years with the Advisory Budget Commission, which tours the state, but does not now meet

3. Nonprofits. Some CEOs get a lot of input; others very little.

B. Meets with department heads?

1. Local government. Pros: heads see the big picture, become less parochial, and have more of a team approach. Con: takes more time.

2. State government. Not done.

3. Nonprofits. Almost always done because of the small size of most nonprofits and the autonomy exercised by program managers.

C. Type of budget?

1. Local units—usually line-item or line item performance budgets. Sophisticated units use program-performance where great trust exists between the CEO and governing board. Need to have good measures. Target budgets when revenues are strained.

a) Whether apply for the GFOA Award for Distinguished Budget Presentation? Pros: bond rating agencies give credit, makes the government and budget officer look good. Cons: costs money (a little) and takes a considerable amount of time, especially in the first year. Only 33 units in NC have recognition.

2. State governments. Most use line-item performance budgets, but legislators rarely use performance measures.

3. Nonprofits. Small agencies typically use line item budgets. Larger agencies and United Way funded agencies must have program outcome measures.

D. Type of measures (output, efficiency, intermediate outcome, end outcome, impact)?

1. Guidelines for measures

a) Should *inform* decision makers at *all* levels (board members, CEO, agency heads, and line managers)

b) Involve stakeholders

c) Avoid goal displacement: the means become the ends.

d) Measure both quantity and quality

e) Beware of the problem of comparing between jurisdictions.

f) If possible, tie measures to costs.

E. Issue a budget calendar; guidelines such as expenditure limits, limits on percentage increases, restrictions on new capital assets;

budget request forms; written instructions; a sample budget; rates for fringe benefits; inflation rates; utility rates; and equipment prices

- 1. How many forms should an organization use? Small local units and nonprofits usually justify only salaries, fringes, travel, and capital outlay. Large local units and state agencies justify most or all line items.**

II. Agency perspective

A. How much to ask for? Too little and employees and interest groups are offended; too much and CEO is offended.

- 1. Agency head should put self in the CEO's shoes: what fiscal pressure is the agency under; what is the governing board's policy agenda; what is the CEO's policy agenda?**

B. Write persuasively—Use the active voice, consider who is the primary decision maker, what questions may be asked, and how much credibility you have

III. Budget reviewer's perspective

A. How involved will the CEO be in the budget process?

- 1. Federal government. Varies widely with president (E.g., Carter v. Reagan)**
- 2. State governments. Governors set overall priorities and leave the preparation and cutting to budget staff.**
- 3. Nonprofits. Director heavily involved along with finance director/accountant**

B. What role will the budget analyst play?

- 1. Federal government. OMB analysts are very political carrying out the President's policy agenda**
- 2. State governments. Budget analysts: watchdogs, advocates, or both?**
- 3. Local units. Only large units have budget analysts. Most cut the initial budget requests. As with state analysts may be watchdogs, advocates, or both.**
- 4. Nonprofits. Do not have budget analysts**

C. Attributes of a good budget analyst: healthy skepticism, strong curiosity, wants to make a difference in the world, good analytical skills, a good poker player, seeks out weak claims—not weak claimants, knows as much about the agency as possible, knows

what can and should be measured, knows well the politics of the policy making process.

D. Cutback management

1. Cutback theories

a) Across the board

b) Budgetary decisions depend on the condition of the economy. Five phases: 1. Windfall growth; 2. incremental growth; 3. slow or moderate growth; 4. moderate decline; 5. severe decline.

c) The garbage can model—all types of strategies are used. Research supports only this model

2. Types of cutback strategies

a) Typical—Not fill vacancies; cut capital, overtime, travel, pay raises, reimbursements to other governments, supplies; financial management improvements; raise user fees; privatize

b) Gimmicks—delay salary increases to next fiscal year, reduce pension fund contributions.

Discussion Questions

- Which types of budgets work best in what types of governments under what conditions?**
- Why is performance budgeting so little done in the U.S.?**
- If you had a strict line item systems, which system would you change to?**
- What would be your budget strategy as the head of an agency? As a budget analyst?**
- What are the challenges of being a new budget analyst with little governmental experience?**

Preparing the Capital Budget

Readings

Debt Management

- Capital Improvement Programs (CIPs)
- How to inventory of existing equipment and facilities
- Pay-as-you go v. pay-as-you use
- Consulting engineer
- Fiscal advisor
- Bond counsel
- Underwriters
- The call privilege
- Moody's, S & P, and Fitch's

Strategic Planning

- Environmental scan
- SWOT analysis
- How does strategic planning differ from capital improvement planning?

Others

- Pork. Appropriations with a zip code.
- Capital outlay v. capital improvement—Both have a life of at least 1 year. Capital outlay items (e.g., desks, tools) are budgeted in the operating budget; capital projects, specified by a dollar minimum (e.g., over \$20,000, are budgeted in the CIP/
- Certificates of Participation (COPs) and Installment Purchases (IPs)—IPs are issued by one bank while COPs are bid upon by investors like bonds. Rated one full rating less than the government's G.O. rating (e.g., A = B). Bonds reduced the unit's debt capacity. Both avoid a vote of the people.
- State debt capacity—two measures: net tax supported debt as a % of personal income and net tax-supported debt per capita.
- The federal government does not prepare a CIP.
- States do no prepare CIPs for all agencies. To receive federal transportation funds, they must have a long-range (10-year) Transportation Improvement Plan (TIP). The most progressive states prepare a two-year CIP.
- Nonprofits do not prepare CIPs.

I. The CIP process

A. Select the CIP team: planning, budgeting, engineering.

B. Establish a debt policy: who prepares the CIP; the value of capital improvements; how much pay-as-you-go v. pay-as-you use funding; percent of debt limit used; length of maturities.

1. States Policies. Include selection of bond counsel, selection of underwriters, investment of bond proceeds, repayment period, and credit enhancement. NC has no formal debt policies but 22 informal ones

C. Inventory facilities and equipment

1. Local governments

a) Use long-range master plans as a guide for parks and recreation, thoroughfare, water and sewer.

(1) Water and sewer. If at 80% of capacity, must have plans or a moratorium is imposed. If at 90%, construction must be underway. Localities must know what amount of capacity is on paper and what has been permitted.

2. State of NC. Only have a long-range plan for roads (Transportation Improvement Program-TIP) and higher education.

D. Prioritize the improvements

1. Use a committee of affected department heads to hold each other honest and prioritize

2. Identify possible increased operating costs

E. Identify environmental trends (e.g., population growth, demographic and economic changes)

F. Select advisors: engineer, bond counsel, and fiscal advisor (only if a revenue bond in NC)

1. National v. local counsel. Pros: national counsel is more experienced, better known to the investment world. Cons: payments go outside of the local units, does not affect the marketability of highly rated bonds.

G. Identify funding capacity

1. Local governments

a) G.O. bonds—benchmark against comparable local units regarding debt per capita and debt as a % of assessed valuation.

b) Revenue bonds—Effect of debt cover on utility rates. The net revenues must be 1.2 times the annual debt (principal and interest) costs

c) COPS and IPs. Two types of projects: 1. not very controversial but much needed, e.g., schools, water and

- sewer, health centers and 2. controversial, e.g., Charlotte Convention Center, Durham Bulls stadium
- d) State water and sewer revolving funds—must have at least a 75 from the NC Municipal Council to be eligible for
- e) Lease-purchase equipment

2. State of NC

- a) No benchmark set. Measure G.O. debt per capita and as a % of personal income
 - (1) Richard Moore wants the state to set maximums
- b) Issuing COPs for the first time

3. Nonprofits

- a) A few borrow from banks to build buildings but most do not

II. Bond issuance process

A. Individuals (40%); mutual funds (35%); insurance companies (14%); banks and S&Ls ((8%). They are tax exempt. If interest rate is 5% and you are in a 30% bracket, what is your effective return?

B. Public v. negotiated sale. In NC G.O. bonds must be publicly sold; revenue bonds must be privately negotiated.

- 1. Public sale. Pro: costs less in interest costs. Cons: cannot time the issuance as well as a negotiated bond sale to take best advantage of market conditions.

C. If a G.O. bond sale, must secure voter approval

- 1. If the vote will be close, form a committee
 - b) Carefully pick the chair
 - c) Brief the committee well
 - d) Carefully time the campaign
 - e) Promote the issue widely
 - f) Show how the tax rate will be affected
 - g) Spend money wisely

D. Get approval from the LGC

E. Design the issue. The bond prospectus. Decide whether to have a call feature.

F. Improve bond rating

- 1. Establish rapport with raters. Send them useful information that they probably do not have regarding the community.

2. Improve economy (Income growth, household income, employment mix, building activity, and dependence on largest taxpayers). Affects the rating the most but is hardest to accomplish)

3.Improve debt picture (Direct and overlapping debt per capita, debt as a percentage of the tax base, what percentage of debt will be retired over the next 10 years). May recall debt if interest rates drop. High debt is not necessarily bad if needed infrastructure (e.g.,water, sewer, and roads) is being built).

4.Improve governmental features. (CIP, tax collection rate, how professional is the management team, tax rate limits, property tax assessment ratios, GFOA recognition of the budget and the audit). Some of these are easy to accomplish.

5.Improve financial features (Unfunded pension fund liabilities, management letter, fund balance).

6. Make a good ratings presentation. Take a small, well-informed team to New York. Do not belabor what the ratings analysts already know. Keep it short—less than one hour.

6.Buy bond insurance. Guarantees at least a AAA- rating. Must compare the cost of buying insurance to the savings in interest paid over the bond's life due to getting a better rating.

III. Strategic planning versus CIPs

A. Generic versus comprehensive strategic planning

1. Every organization should do generic strategic planning, anticipating future trends. However, only agencies with a strong political consensus should undergo comprehensive strategic planning, which is costly and time consuming.

Discussion Questions

- Why do no other states have an LGC?**
- Why do not states have a 6-year CIP, and only a few (not NC) have a 2-year plan?**
- In a typical city or county in NC what would you do to improve the rating, other than by buying insurance?**
- You have assessed valuation of \$400,000,000; outstanding G.O. debt of \$4,000,000 and need a new city hall (\$1,500,000; a new fire pumper (\$500,000); sewage treatment plant expansion (\$2,000,000); and a new**

park (\$700,000). What else do you need to know? What funding options do you have?

Budget Execution and Financial Management

Readings

Budget Execution

- Allotments
- Transfers
- Budget adjustments
- Pre-audit of expenditures
- Position controls
- Monitoring revenues and expenditures

Usefully Engaging Budget Analysts During Budget Execution

- What are four ways of structuring a budget office? What variables affect whether a budget office will be high, medium, or low on the policy continuum during budget execution?

I. Methods of budget execution

A. Legislative intent included in the authorizing legislation (Federal and state governments)

B. Allotments. Federal government and 41 states use allotments. Usually quarterly but during the past two fiscal years they have been monthly. 22% of cities use allotments nationwide but rarely in NC and in nonprofits.

C. Preaudit of expenditures to ensure funds are budgeted

D. Midyear changes in the budget

1. About 3% in one state over 9 years

2. Reasons to adjust: poor revenue estimating, economic decline, federal or state mandates, increased revenues, federal crisis (e.g., Kosovo, Desert Storm, etc.)

E. Budgetary transfer controls

1. Local units. Manager can transfer without legislative approval between funds (13% in cities), between departments (33% in cities), between programs within departments (very common), within objects within departments (more common still).

2. State of NC. Does not permit transfer of lapsed salaries, which are the basis of increasing fund balance and funding capital improvements. NC has, however, permitted

universities to carry over all of their reversions to the next year, unless the Governor has declared a fiscal emergency.

II. Financial management

A. Effective cash management procedures

- 1. Adopt a cash management policy specifying who is the cash manager, the amount that can be invested in particular instruments, and long out funds can be invested**
- 2. Collection procedures**
 - a) Establish a cash collection policy: when should cash be collected from remote locations?**
 - b) Lock boxes from which banks, for a fee, pick up large deposits (e.g., property tax bills from electric utilities) which can then earn same day interest**
 - c) Automated collection of taxes**
 - d) Direct deposit of payroll**
- 3. Disbursement procedures**
 - a) Zero-balance accounts. For a fee, banks “sweep” all cash into an overnight investment account daily.**
 - b) Electronic funds transfer**
 - c) Credit cards. Reduce the cost of making individual purchases but need strict accounting controls.**
- 4. Select the best investment instrument respecting safety, liquidity, and yield in that order**
 - a) Low yielding: CDs, money market accounts**
 - b) Medium yielding: the NC Cash Management Trust Fund**
 - c) High yielding: Commercial paper, Banker’s acceptances, federal T-bills, T-bonds, and agencies (e.g., Fannie Mae and Freddie Mac). The best now is agencies.**
- 5. Evaluate the efficacy of the cash management system. Should invest 100% of funds at a competitive return rate (compare to the T-bill average).**

B. Effective purchasing procedures

- 1. E-Commerce: e.g., vendor catalogue, electronic bids, vendor lists.**
- 2. Take discounts for timely payment to vendors. Rarely done in government because of slow accounting systems.**

3. Cooperative buying, e.g., local governments should, where cost effective, buy items on state contract.

4. Good inventory. Economic order quantity (EOQ). Minimize the amount of inventory on hand while assuring needed equipment and supplies are available.

C. Effective risk management procedures

1. Effective safety program. Experience modification factor (EMF) for workers' compensation. If rating is 1.2 and the 1.0 premium would be \$30,000, you would pay \$36,000 (1.2 x \$30,000)

2. Buy not too much or too little insurance

Discussion Questions

- Issue: Should agencies be permitted to carry over unspent moneys into the next fiscal year (called entrepreneurial budgeting)? NC has permitted universities to do so for many years.**
- What financial management techniques would you implement in a small local unit or nonprofit to save money?**

Auditing/Financial Analysis

Readings

Auditing

- Reasonable assurance
- Financial audits: GAAS audits, GAGAS audits, single audits
- RFP
- Opinions: qualified, disclaimer, adverse, unqualified
- Performance auditing
- Internal auditors
- Audit committee
- Management letter
- Reportable condition
- Material weakness

Other

- Comprehensive Annual Financial Report (CAFR)—awarded by GFOA for exemplary reports. Particularly, they include statistical sections.

I. Types of audits

A. Financial and compliance with the law and with GAAP

1. Financial audit (less than \$100,000 in federal grants)
2. Yellow audit (\$100,000 - \$300,000)
3. Single audit (more than \$300,000)

B. Performance audit

1. May be conducted by independent parties or by internal staff
2. Typically focus on agencies or functions within agencies
3. Follow GAO's Governmental Auditing Standards

C. Alternatives to an audit in nonprofits

1. Compilation. CPA firm prepares the statements and thus cannot give an opinion
2. Review. Some assurance but less than a full audit.
3. Agreed upon procedures. E.g., examine internal controls.

4. **Members' Audit.** Volunteers conduct audit with advice from an auditor.

5. **Prepare 990.** All nonprofits must file a 990, which satisfies some contributors and regulatory bodies.

II. Who does auditing?

A. **Federal Government: GAO, Inspector Generals (IGs)**

B. **State government: State Auditors**

C. **Local government: CPAs or state**

D. **Nonprofits. CPAS**

III. Selecting and auditor

A. **Selecting an auditor:** Should use a request for proposal (RFP); should base selection decision first on relevant past experience, then on cost. Give a 3-4 year contract; audit should be delivered on a timely basis.

IV. Format

A. **Whether to seek GFOA recognition by GFOA, getting a Certificate of Achievement for Financial Reporting (CAFR)**

1. **Pros:** bond rating agencies credit it, statistical section enables better fiscal analysis, makes management look good.
Con: small cost and time commitment

B. **Management letter.** NC requires a management letter in all local unit audits as does the United Way

1. **LGC sends a letter to the governing board if the past year's management letters' recommendations have not been implemented**

C. **Whether to have an audit committee?** If past audits have been late or there has been corruption.

V. Fiscal analysis. In NC see www.osc.state.nc.us/financial for evaluations of local units.

1. **How to read and use the financial report**

Discussion Questions

- **If your governing board did not want to seek competition for preparing the financial report, what strategy would you take to convince them otherwise?**

- **Why are annual financial reports, rather than budgets, best for analyzing fiscal history?**
- **Why must one be careful when interpreting fiscal indicators: give specific examples?**
- **Why might a governing board (in another state than NC) not want the auditor to provide a management letter?**

The Federal Budget

Readings

A Brief Introduction to the Federal Budget Process

- The Budget Enforcement Acts of 1990 and 1997

Others

- Appropriations
- Authorization
- Backdoor spending
- Continuing resolution
- Controllability: uncontrollable (entitlements, interest on debt), relatively controllable (defense), and controllable spending (only about 25%) occurs only if Congress and the president take action
- Debt ceiling
- Entitlement
- Off-budget v. on-budget. Social security is on budget. Implications for the surplus.
- Spending committees: appropriations committees for discretionary programs; authorization committees for entitlements
- Revenue committees: House Ways and Means, Senate Finance

I. History

A. 1981. Reagan revolution. Supply side economics. The Laffer curve

1. Decreased regulations
2. Decreased taxes (\$55 billion). Indexed the code to inflation
3. Increased defense (4.9% of GDP to 6.3% in 1986)
4. Cut discretionary spending (5.2% to 3.8% of GDP in 1986)
5. Balance the budget

B. 1982. End of the “boll weevil” coalition. Republicans lose the house. GRIDLOCK!

C. 1983. Increase in social security taxes is the same amount as the 1981 tax cut

D. 1985. Gramm-Rudman-Hollings (GRH) enacted. Specific deficit targets or sequestration. Had little effect on the deficit because Congress lacked discipline.

E. 1987. Republicans lose the Senate.

F. 1990. Budget Enforcement Act (BEA). Now the goal is not to limit the deficit but to limit spending and guarantee that the baseline level of revenues was collected

1. Discretionary spending cannot be increased above prescribed caps even if offset with increased revenues or lower entitlement spending

2. Pay-As-You-Go (PAYGO). A revenue loss must be offset by either an increase in revenues or a decrease in mandatory spending. Likewise an increase in mandatory spending must be offset.

G. 1990. George Bush tax increase (“Read my lips”)

H. 1990-91. Recession. Largest deficit ever.

I. Omnibus Budget Reduction Act (OBRA) 1993. Increased gas tax by 4.3%; increased the highest tax bracket from 34 to 36% if single and making more than \$115K or married and \$140K

1. Deficit reduced from \$302B to \$176B, but public debt grew from \$700B in 1981 to \$3.5T.

J. 1994. Democrats lose control of Congress. Gingrich contract with America

K. 1995. Budget shut down. Clinton’s shining and lowest moment.

L. 1997. BEA extended until 2002

M. 1998. Clinton puts Social Security in a “lock” box to avert Republican tax decreases.

N. 1999. Surplus was \$236B.

O. 2001. Tax cut. \$1.25T over 10 years. Democrats wanted \$800B; the Republicans \$1.8T. At the time \$5.6T surplus was projected over 10 years (\$2.5T from Social Security, \$500B from Medicare, and \$2.6T from the General Fund.

P. 2002. The 2001 surplus, projected at over \$300B, was \$127B. Deficits are projected for at least three years. Bush wants the tax cut, to be phased out in 10 years, to be made permanent.

Q. 2003. Bush gets a \$350B tax cut; wanted \$700 billion in tax cuts (\$350B to eliminate tax on dividends and \$350B to accelerate the 2001 cuts.

Issue	Republican Spin	Democratic Spin	Facts
Why the deficit of the 80s and 90s?	-Too high domestic spending -Too high social security	-Reagan's too high tax cut -Too high defense spending	-Tax cut -Increase in entitlements -Initially defense, not thereafter
Why the deficit declined under Clinton?	-Improved economy -Actions of the FED -The budget caps	-Clinton's tax increase -The budget caps -Clinton's handling the economy well	-All of the factors cited by both sides
Why the recession and the deficits under Bush?	-September 11 -The Iraq War	-Bush's too high tax cut -Bush's recession	-1/4 of \$4T in lost surpluses due to recession; 3/4 due to tax cuts -Caps ignored in 2000 and 2001; spending increase of \$200B -\$85B Defense increase
Is the deficit a problem?	Republicans Say No: -Only 3.5% of GDP -The deficit crowds out unnecessary social programs. -The deficit does not affect interest rates -Future Social Security and Medicare cost are over dramatized	Some Democrats Say Yes. -Will be 5.4% (\$639B) in FY 04 -Does not include Iraq War costs; extending tax cuts after 10 years (\$1.9T); changing the Alternative Minimum Tax (\$690B); has low spending estimates (2.7%); and high GDP growth (3%). -Impact of Drug Benefits package. -Crowds out necessary social spending -Future social securing and Medicare costs are understated if anything.	

R. Issues

1. **Social Security and Medicare. Social Security will run out of money in 2041 and Medicare in 2019.**

Discussion Questions

- **Give the Democratic and Republican spin on: Why did the deficit continue and grow under Reagan and Bush? Why did the deficit decline under Clinton? Why do we now have deficits?**
- **How relevant is the Social Security problem?**

Intergovernmental Relations (IGR)

Readings

North Carolina

- **Local bills.** Affects 15 or fewer counties. During the long session can be brought up by any member of the local delegation without prior consent. During the short session all members of the delegation must give prior approval.
- **Legislative courtesy**
- **Home rule**
- **Extraterritorial jurisdiction (ETJ).** Up to one mile for cities less than 10,000, 2 miles (10-25K); and 3 miles for cities over 25K. All city's zoning, subdivision, and building code regulations apply in the ETJ
- **Incorporation limits**
- **Annexation methods in NC**
- **Unfunded mandates**

Others

- **Local delegation—the state representatives and senators representing a particular city or county.** Decide whether to pass local bills requested by local elected officials
- **Five types of annexation nationally: legislative, popular, municipal, judicial, and quasi-legislative.**

I. IGR trends since 1981

- A. **Shift from categorical to block grants in 1981 and 1982. 57 categorical grants consolidated into 9 block grants. Less regulations; less money targeted at Democratic, poor, central cities.**

B. Decrease in federal aid to state and local governments during the Reagan years. 1981-1987 real outlays decreased by 33%

C. Mandates continued during the Reagan years. 27 new mandates; some initiated by Congress.

D. Reagan cut red tape. Pages in the Federal Register decreased by 46% from 1980-1986.

E. Mandates continued during the Bush and Clinton years. Six new mandates (1990-94), e.g., Family Medical Leave and ADA.

F. Funding increased to state and local governments during the Bush and Clinton years.

G. Temporary Assistance to Needy Families (TANF) replaced AFDC in 1996. What will happen when the deadline for getting off TANF is reached for all?

H. 2001. Republican philosophical reversal: From eliminated the Department of Education to increasing funding by 20% and targeted at schools based on poverty rates, e.g., NY gets a 29% increase.

I. 2002. No Child Left Behind mandated program passed.

II. How the federal government affects state and local governments

A. Grants

1. Categorical. Project (e.g., EPA), 70% of funds; formula (e.g., Interstate Highway); and open ended (e.g., Medicare and Medicaid)

2. Block grants.

B. Mandates. Pro: usually for a good purpose. Cons: often imposed without sufficient funding and one size often does not fit all

III. How state governments affect local governments

A. Home rule versus Dillon's rule

1. In a home rule state, local units can perform any function not legislatively prohibited

2. In a Dillon's rule state, local units can only do what is specifically legislated. Therefore must get local legislation, e.g., Hotel-Motel tax, meals tax, impact fees v. impact taxes, Wake

consolidation of Health, Mental Health, and Social Services, and stop lights.

a. NC is a Dillon's rule state

B. Funding to local units

1. Powell Bill. 1 $\frac{3}{4}$ cents of the 24 cents. Must have a comprehensive transportation plan.
2. Water and sewer grants, e.g., Cleanwater Trust Fund
3. The politics of grants—in any grant there are winners and losers. E.g.s gas tax distribution and school distribution to local units
 - a) Road bonds. 1/2 population, 1/4 miles, 1/4 split evenly
 - b) Schools. Average daily attendance (ADA)

C. Mandate Types: 1. personnel benefits (e.g., specifying police and fire pensions), 2. equity (e.g., mandating planning and assessments), 3. requiring a minimum level of service (e.g., health, education, and welfare), 4. requiring minimum entry training (e.g., police, fire, water, and sewer personnel).

VI. How local units affect each other

A. Cooperation. E.g., mutual aid, service contracts.

B. Transfer of functions from cities to counties

1. Double taxation a cause for transfer, e.g., tax administration, libraries.
2. Sources of double taxation: Sheriff, parks and recreation, libraries, roads (not in NC), fire (not in NC), planning, taxation (not in NC). E.g., 2.5 cents for persons Wake cities (AV \$250,000) and 8.4 cents for persons in the unincorporated area if a tax district were formed.

B. Annexation

1. Five types nationally: (1) legislative—by a special act of the state legislature, (2) popular—by a vote of the affected property owners, (3) municipal—by unilateral action of the government, (4) judicial—courts determine, (5) quasi-legislative—by independent, nonjudicial boards.
 - a) Incidence of each nationally
2. Annexation in NC. Must be contiguous; have a density of at least 2 per acre; and deliver urban services within 2 years.

Most people are annexed unilaterally; most land by a vote of the people. Benefits to NC of having unilateral annexation: cities able to grow. Cost: citizens have no say.

a) State law permits satellite annexation of up to 10% of population. In Wake County nine towns have exemptions through local legislation. 10 other towns in NC also have exemptions.

Costs of Annexation	Benefits of Annexation
<ul style="list-style-type: none"> • Increased property tax rate (\$200,000 house at \$.50 = \$1,000) 	<ul style="list-style-type: none"> • Water and sewer bill halves if receiving service from the city • Better police protection • Better fire protection • Possibly lower cost of garbage collection • Can deduct tax from federal income taxes

D. Regional Councils (COGs). 18 created by the state in 1974.

E. League of Municipalities and the Association of County Commissioners

Discussion Questions

- What IGR features make NC unusual compared to other states?

Nonprofit Budgeting

Readings

Investigation of Leadership Skills

- **What characterizes affected non-profit chief executives and board members? What other factors characterize an effective Director than those cited by Herman?**

Board Practices

- **What statistically valid qualities do high-performing boards have?**

I. Characteristics of non profits v. governments

A. Less secure revenue sources

B. Cannot pay employees as much but have very worthwhile missions

C. Need to be entrepreneurial regarding both raising revenues and mission

D. Management does not have as much formal education or training.

II. Budgeting factors

A. Relationship with the Board

B. In some instances, relationship with the United Way

III. Effective Boards

A. Need to able to raise funds

B. Should give the Director good feedback.

The Economy

Key Terms

- **OMB—Office of Management and Budget**
- **CBO—The Congressional Budget Office**
- **GAO—The Governmental Accounting Office**
- **Gross Domestic Product (GDP)—the aggregate of personal consumption, private domestic investment, net exports, and governmental services**
- **Federal debt—the accumulated difference between revenues and expenditures**
- **Annual federal deficit or surplus—the annual difference between revenues and expenditures**
- **Full employment—typically defined as 3 or 4%**
- **Recession—two consecutive decline in the GDP**

I. Why government?

A. Redistribute Income (e.g., Temporary Assistance for Needy People [TANF], Medicaid, Food Stamps, Social Security, Title 1)

1. The poor are getting poorer
 - a) 37% reduction in manufacturing in NC in the 1990s
 - b) Top 1% have about 40% of the income *and* assets combined

B. Market Failures

1. Imperfect information: Ideally consumers and sellers have perfect information about markets, but do not therefore government (E.g., Agricultural Extension, Labor, and Commerce)
2. Externalities—spillover to others: negative (EPA, DENR, Corrections, SBI, police, and fire and positive (education and recreation)
3. Public goods—once provided, cannot be divided (E.g., Wildlife, Defense, and Courts)
4. Natural monopolies and oligopolies (market controlled by a few companies) (E.g., FCC, FTC, the state Utilities Commission)
5. Private sector could provide the service but transaction costs are too high (e.g., DOT)

C. Stabilize the economy

- 1. Fiscal policy**
 - a) Supply-side economics: Cut taxes to stimulate the economy, e.g., Bush tax cut.**
 - b) Keynesian economics: Increase spending to stimulate the economy.**

- 2. Monetary policy by the Federal Reserve System (FED)**
 - a) Buy and sell government bonds**
 - b) Most important: Open market operations, set the discount rate which is the rate charged to member banks**
 - c) Set bank requirements regarding how much banks must hold in reserve**

- 3. Automatic stabilizers—progressive income tax, unemployment benefits**

Discussion Questions

- Why have the poor gotten poorer and will continue to do so?**
- Why did the U.S. rely on monetary policy from 1981 until now?**
- How do conservatives and liberals regarding the role of redistributing income, regulation, and fiscal policy? Give current examples.**
- How effective is monetary policy today?**
- How do supply-siders and Keynesians view what should be done to stimulate the economy?**

