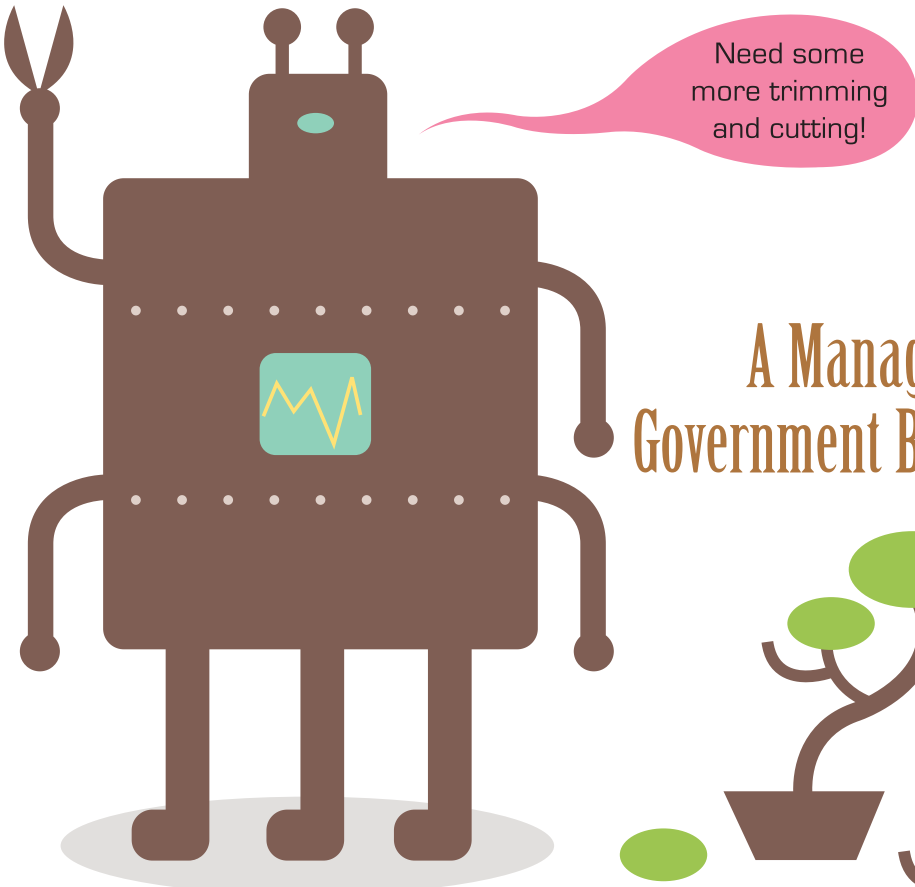

Backcast Budgeting: A Managerial Approach to Local Government Budgeting in Hard Times

By Chris Hartung, Chris Hartung Consulting, and former City Manager, City of Denton

Introduction

As local governments around the United States continue to deal with the problem of major declines in revenues, articles in the media proliferate discussing the sacrifices that are being made by government agencies. Typical comments include things like:

> ***"We have already cut the fat!"***
>
> ***"Any further cuts will be bone and sinews!"***
>
> ***"What services do citizens want to give up?"***

In many cases, local governments have followed the same budget-cutting patterns we have seen in previous economic slowdowns. Traditional responses include the freezing of vacant positions and salaries, cutting travel and training, and delaying or eliminating seemingly discretionary items like street maintenance and replacement of equipment. Other steps have included cutting back on the use of consultants (Ugh! I hate that one!), employee furloughs, and other one-time cost-cutting measures.

Local governments are approaching the problem of lower revenues as a short-term, temporary situation. The consensus seems to be, "If we can just hold things together for a few more months, growth will resume, revenues will recover, and we can return to normalcy." This viewpoint exists in the face of article after article of online and published news bulletins, as well as a number of books, that say this economic downturn is a deeper, longer-term problem. Economic experts forecast the possibility of high unemployment for years to come. Multiple media sources have already referred to the present time as "The Great Recession." Disappointing and unanticipated revenue shortfalls experienced by local governments that are mentioned in recent news articles are just another sign of the magnitude of the challenge facing these organizations.

Another significant difference for local governments between this and previous economic downturns is the issue of the spiraling federal budget—the federal deficit and federal debt. Some financial experts view federal spending as unsustainable. Shortfalls at the state level add to the problem.

As higher levels of government deal with their own problems, aid to local governments will probably not be one of their priorities. In fact, funding cuts in state and federal programs for local governments are a probability. *(Editor's Note: For Texas cities, this is a minor consideration, since there is virtually no state aid to cities in Texas.)* And we haven't even mentioned the daunting problems of unfunded liabilities for pension systems and post-employment benefits or the problem of America's deteriorating infrastructure. Nor have we talked about the fact that local governments have recently enjoyed a period of negligible inflation and declining energy costs. So, what if the current, lower level of revenues is the "New Normal"? What if flat revenue is the new up? What are local governments to do?

The Expenditure Problem

The answer can't be solely based on the reduction of governmental fat and waste. For one thing, that alone is insufficient, although fat and waste should be curtailed wherever we find them. I really do believe that local government in general does a much better job from an efficiency standpoint than state and federal governmental agencies. Another reason to not place the emphasis on cutting fat and waste is the reality that what is fat and waste to you or me, is a vital governmental service to someone else. However, if we are limited in our ability to raise additional revenues, we must look at the expenditure side of this equation. While core services will likely survive, it is imperative that local government's initial mindset be realigned to challenge the justification of all issues and programs.

When discussions shift to cutting cost through service reductions, I am reminded of several examples that indicate how difficult that process can be. Back in the days of Zero-Base Budgeting, I ran across a story that was referred to as "the Washington Monument Syndrome." As the story goes, during a previous economic downturn, a proposal was made to reduce the budget of the National Park Service (NPS). Immediately, the NPS powers-that-be announced that they would meet the budget-cut targets by closing the Washington Monument. Point being, when faced with the threat of a budget reduction, agencies may offer up the things they know to be the least acceptable.

I also remember a number of actual incidents that illustrate the frustrations encountered in cutting local government budgets. In one case, a city faced significant revenue losses to the point that even public safety departments were getting hit by major reductions. In this environment, the library budget went up five percent. It seems the library's director proposed to close a major branch library in a minority community. A strong community outcry stopped the closing, and the library budget was actually increased. Friends outside the bureaucracy can be influential in the budget process.

In another case, a city had previously experienced a major expansion of revenues that allowed a 10-percent increase in the number of employees over a relatively short period of time. A subsequent contraction of the economy resulted in a loss that set the number of employees back to the previous level. As we studied the organization, we uncovered some interesting facts. While increasing positions, the agency added a number of supervisory personnel. When the number of positions was reduced during the contraction, hardly any supervisory positions were cut. The agency ousted the people who do the work, leaving work units needlessly top-heavy. We literally found units in which one person supervised one person who supervised one poor individual who had to do the work.

So, what if the current situation isn't just a temporary contraction? What if today's level of revenues *is* the new normal? What if the political environment of the existing situation really does impede local government's ability to generate new revenues through increased tax rates or significant new use of fees and other charges? Maybe we really do have to rethink the way we approach municipal budgeting in times of economic hardship, as we adjust to a subdued revenue base that reflects the new reality.

During my career as a manager in local government, I have been through Program Budgeting, Zero-Base Budgeting (ZBB), Target Budgeting, Line Item Budgeting, and Incremental Budgeting. In my opinion, none of these methodologies is adequate for the current situation. In fact, most budget-cutting efforts by local governments today seem to be the inverse of the old incremental budgeting approach from the past. The agency assumes the current level of expenditures is the base level, and the discussion revolves around what increment is going to be cut from the budget. The current revenue picture presents a profoundly different mandate to be confronted.

Backcast Budgeting

Because of the severity of the downturn—and my belief that this is a long-term problem, not a short-term problem—I believe a new method of budgeting for local governments is needed. I propose we consider ***Backcast Budgeting, a managerial approach to reducing expenditures in hard times.***

"Backcasting" is a process typically used in land use and utility planning. It involves the development of a vision of the future and works backwards from that vision to the present time. This process identifies the steps necessary to achieve the vision by working back from the vision. Backcasting is contrasted with forecasting, which extends current trends into the future. Wikipedia describes this process as follows: "backcasting starts with defining a desirable future and then works backward to identify policies and programs that will connect the future to the present." The fundamental question backcasting asks is: "If we want to attain a certain goal, what actions must be taken to get there?"

I am proposing a variation of backcasting for this discussion of local government budgeting. ***"Backcast Budgeting"*** involves the use of:

(1) A very conservative process of forecasting revenues for the future budget period.

(2) Looking back to agency budgets for past fiscal periods to find a level of expenditures for the organization that is at least ten percent (10 percent) below the organization's forecasted revenues.

Depending on the level of reductions needed, the percent might be higher. The reason for establishing a base budget that is below the forecasted revenues is to allow funding for the continuation of some high priority items.

This lower level of expenditures becomes the "Base Budget" for the organization. It also establishes the base budget for all organizational subunits. We make the assumption that at the lower level of funding during that past point in time, the organization was performing at some acceptable level of service. Increases in the level of expenditures from a base budget typically occur over time. A number of factors—including general price inflation (not the CPI), salary increases, new programs, and so on—create this situation.

Backcasting in this application involves developing detailed information to identify the specific causes of the expenditure increases for each organizational unit for each fiscal period between the base period and the current fiscal period. Examples of the types of increases identified might be across-the-board items (such as the cost of a pay or benefit increase for all employees) or department specific items (such as the additional cost required for opening a new fire station). All costs associated with a program change should be identified. If a rate increase or a new fee was attached to an increased level of expenditure, that should be identified as well. Depending on the sophistication of the organization's budget process, this Backcast might be at the program level or at the line item level. The method of presenting this information might follow the "Decision Package" format used in Zero-Base Budgeting.

The Backcast analysis requires agency personnel to use a "last-in, first-out" process of identifying potential program cuts while it limits the game-playing that can creep in to more traditional approaches. The organization's managers should be encouraged to look for creative solutions to the funding problems, such as outsourcing, joint services/facilities with other agencies, cross-training and cross-utilization of personnel, or other methods of productivity improvement to meet their base budget levels. We want to change the focus of the discussion from the justification of the status quo to looking for effective ways to lower long-term costs.

Once the Backcast analysis is complete, policymakers can then review the individual budget packages to determine the current priorities of these expenditures. In effect, we are giving policymakers an opportunity for a "do over" of budget decisions made over some past period of time, with the advantage of new information. The fundamental question Backcast Budgeting asks is: "If we knew then what we know now, would we make the same funding decisions?" It is highly likely that the priority of a proposed expenditure might change if it were proposed in a period of declining or flat revenues rather than in an environment of budget surpluses and a strong economy.

Through this process, policy makers will have the opportunity to roll back expenditures by eliminating or reducing the expenditure items that caused the increase. This process also might reveal the need to eliminate other lower-priority expenditures in the Base Budget. It could also highlight the need to build future revenues through rate increases or new fees to pay for the specific expenditures. It is important to point out that in the current methodology, rate increases or new fees are usually justified as necessary to maintain the status quo in services. In Backcast Budgeting, rate increases and new fees would be justified to pay for specific, albeit ongoing, expenditures.

Conclusion

Backcast Budgeting gives local government policy makers a stronger management tool to use in adjusting to the "New Normal" of the current hard economic times. It may also be a useful tool for the future as the economy strengthens and agencies begin to face the need to evaluate requests for new, higher levels of expenditures. These expenditures may include requests to reestablish funding for items cut in the current crisis. Backcast Budgeting can be used to "ratchet back" some expenditures to allow for the accommodation of increased funding. We can rest assured there will be a flood of these requests when the economy (hopefully) recovers. ★