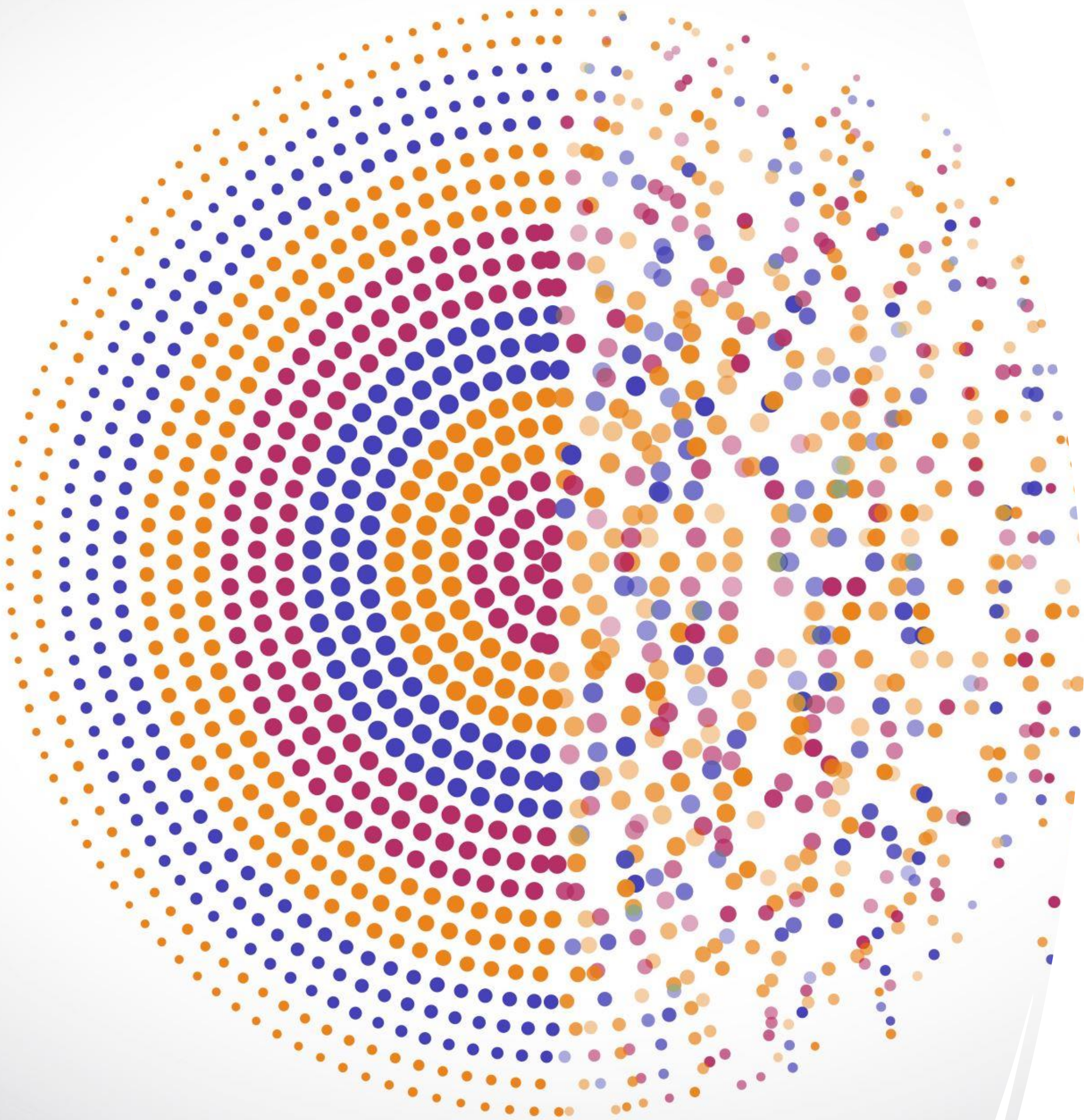
Fiscal Fluency in Public Public Organizations Organizations

BM **by Brian Byung Hee Min**
(Ph.D. in Public Administration)
Assistant Professor, Department of Political Science

WAYNE STATE UNIVERSITY

Big Question

- **Fundamentality across the Universe**
- **Uniqueness of Locality**

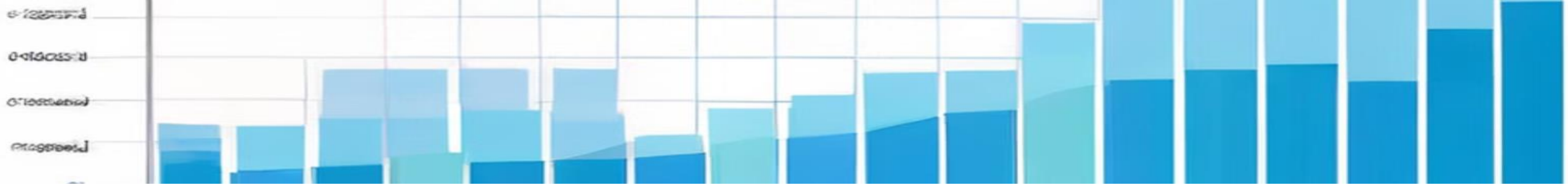


Overview

- **Understanding Government Budgeting and Finance**
- **Think and rethink the budgeting and finance fundamentals**
- **Explore the future of local public budgeting and finance**

Some Terminologies

- **Fiscal Fluency:** The understanding and application of various financial concepts and the ability to use that knowledge to make informed and effective decisions with all of one's financial resources.
- **Financial management** is the subset of management that focuses on generating financial information that can be used to improve decision making. (Finkler, 2016)
  - **Accounting:** a system for keeping track of the financial status of an organization and the financial results of its activities.
  - **Finance:** the uses of the organization's financial resources and alternative sources. (Investing, borrowing, lending, budgeting, saving, and forecasting)
  - **Budgeting:** process of creating a plan to manage and allocate financial resources over a specified period.



Budgeting Fundamentals: Revenues, Expenditures, and Balancing

1 Revenue Generation

Taxes, fees, grants, and other forms forms of revenue generation contribute to the government's financial resources.

2 Expenditure Management

Government spending includes education, healthcare, infrastructure, public safety, and social welfare.

3 Budget Balance

concept of budget balance, where where total revenues equal...

4 Budget Cycle

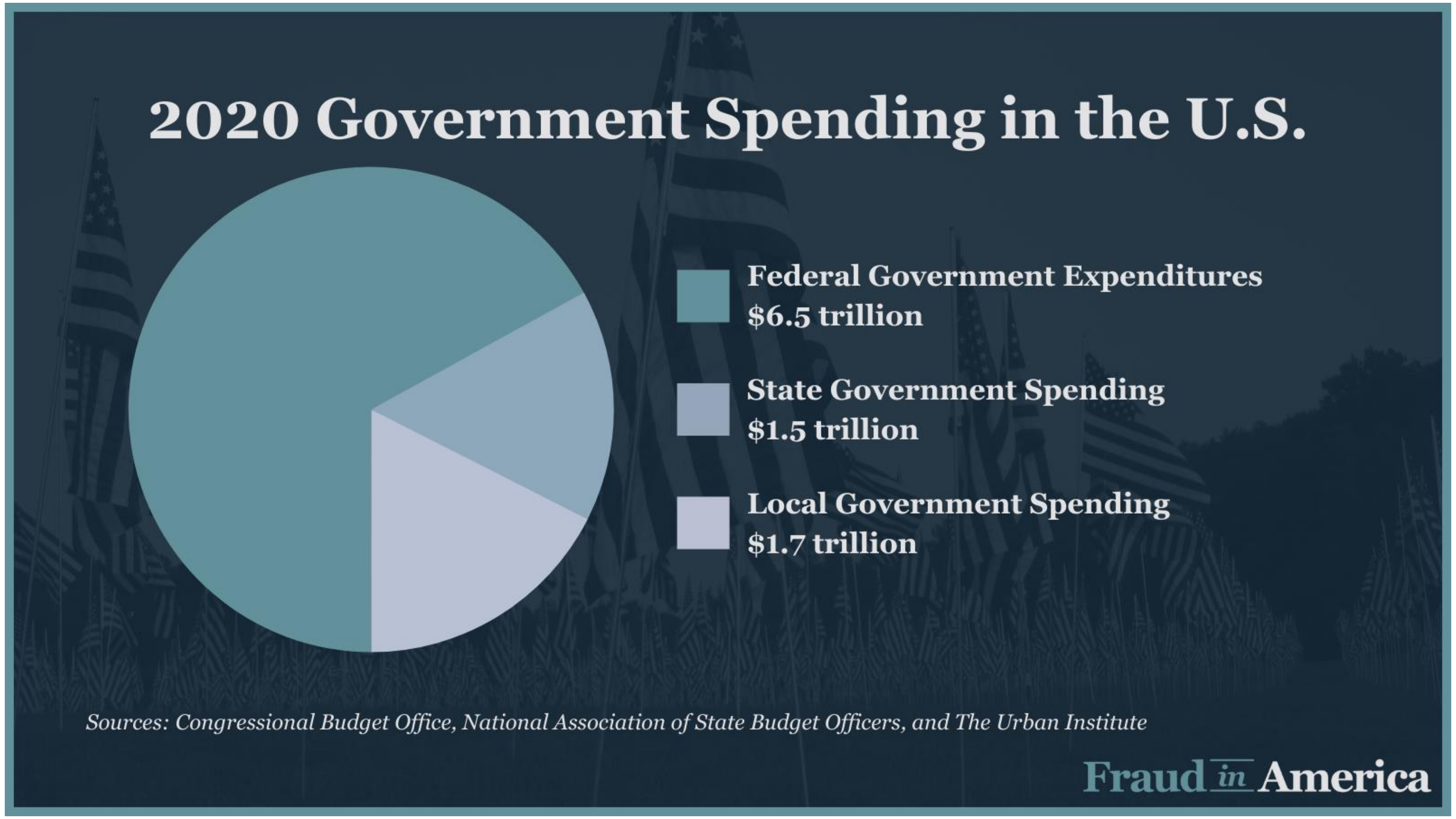
the stages of the budget cycle, including planning, preparation, adoption, execution, and evaluation. evaluation. Understand the key players involved in each stage and and their roles.

Some Facts about the Federal Government

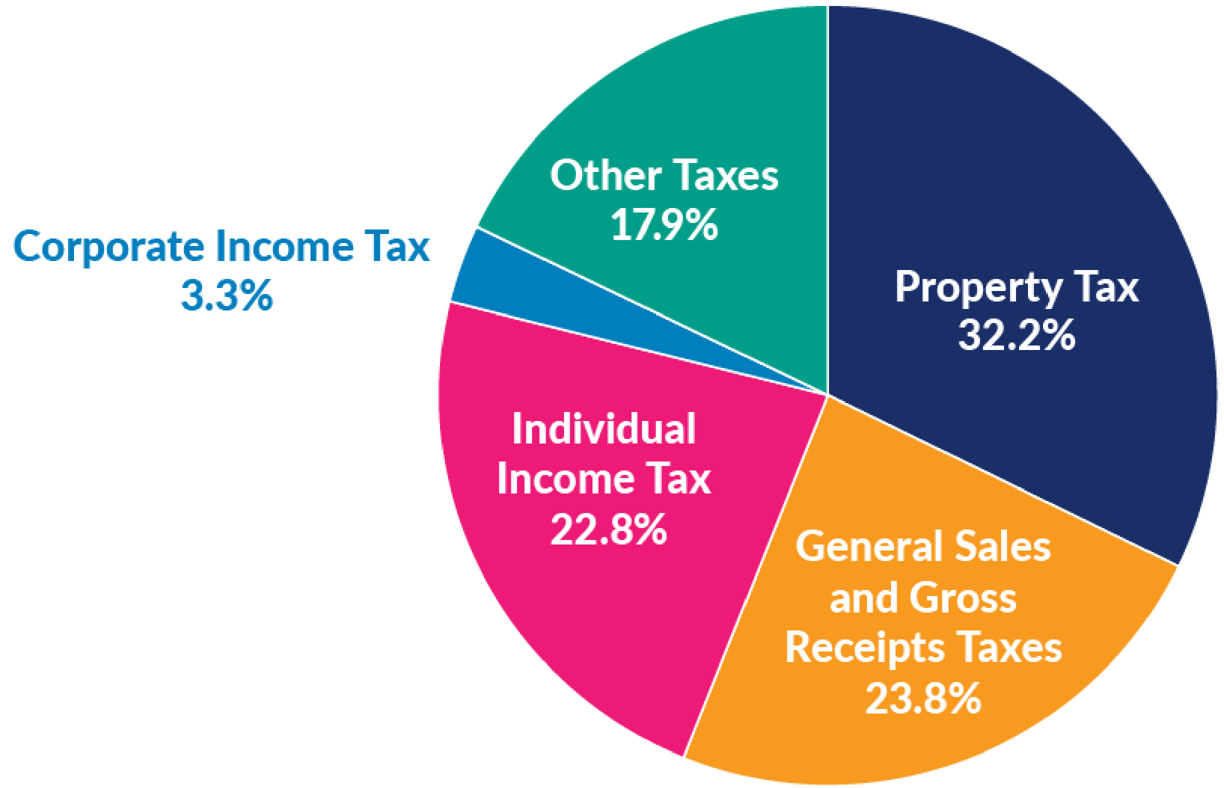
Some Facts about the Federal Government

- Federal Government spending is more than $7 trillion.
- **Mandatory Spending**: Social Security, Medicare and Medicaid, and other spending including unemployment insurance, food assistance programs like SNAP, and federal employee retirement benefits.
- **Discretionary Spending:** Defense and Non-Defense funding including education, transportation, housing, environmental protection, and scientific research.
- Funds are used to provide public services that vary according to the level of government.

State and Local Government Spending



Sources of State and Local Tax Collections (All States, FY 2020)



Source: U.S. Census Bureau; Tax Foundation calculations.

State and Local Receipts

Navigating Complex Funding Sources

1

Federal Grants

Categorical Grants: These grants are designated for specific purposes and come with strict guidelines on how the funds must be used. Examples include grants for education, transportation, and health services.
Block Grants: These grants offer more flexibility, allowing local governments to decide how to allocate funds within broad program areas. Examples include Community Development Block Grants (CDBG) which support housing, infrastructure, and economic development.

2

State Aid

Revenue Sharing: Direct transfers of funds from the state to local governments, often governments, often based on formulas that consider population size, property values, property values, and other factors.
Specific Purpose Aid: Funds earmarked for particular functions such as education, public education, public safety, or transportation. For example, many states allocate significant significant portions of their budgets to support local school districts

3

Local Taxes

different types of local taxes, including property taxes, sales taxes, and income taxes.

4

Private Investments

Private investments refer to funds provided by private entities, including businesses and non-profit organizations, for public projects.

Private Investment in Michigan : Partnerships in Downtown Detroit's Revitalization

- Dan Gilbert, founder of Quicken Loans, has significantly invested in downtown Detroit through his company, Bedrock Real Estate.
- Gilbert's investments, totaling approximately $5.6 billion, include the acquisition and redevelopment of over 100 properties, transforming historic buildings into residential and commercial spaces.
- These efforts aim to create a vibrant, walkable downtown area that supports economic development and community activities

Major Local Taxes and Revenue Sources

1. **Property Taxes**: This is the largest source of revenue for local governments in most states, accounting for 61% of local tax revenue overall. For instance, property taxes make up 98% of local tax revenue in Connecticut and Maine. They are considered stable and broad-based, making them a reliable revenue source
2. **Sales and Use Taxes**: General sales taxes are another significant revenue source, particularly in states like Oklahoma, which comprise 66% of local tax revenue. These taxes are applied to the sale of goods and services and are critical for many local budgets
3. **Income Taxes**: Although less common than property and sales taxes, local income taxes are an essential revenue source in some states. For example, localities in Kentucky and Ohio derive a substantial portion of their revenue from income taxes, accounting for 45% and 41% of local tax revenue, respectively
4. **User Charges and Fees**: Many cities generate revenue through charges for services such as water, sewer, and waste management. These charges can constitute a significant portion of a city's budget, particularly for cities that operate substantial utility services.
5. **Intergovernmental Transfers**: Cities and counties often receive funds from state and federal governments. These transfers can support a variety of local services and projects, ranging from education to infrastructure improvements
6. **Other Taxes and Fees**: Local governments also collect revenue from selective sales taxes on items like alcohol, motor fuel, and tobacco, as well as various licenses and fees (e.g., business licenses, and permits).

Major Local Taxes and Revenue Sources (Other taxes and fees)

- **Hotel and Lodging Taxes:** Many cities impose taxes on hotel stays. For example, in New York City, a hotel room occupancy tax is levied in addition to state and local sales taxes on room rentals. This tax is typically used to support tourism and hospitality services.
- **Amusement and Entertainment Taxes:** These taxes are applied to the sales of tickets for events and entertainment venues. Chicago, for example, has an amusement tax that applies to ticket sales for movies, theaters, concerts, and sporting events.
- **Business License Taxes:** Local governments often require businesses to pay a fee for the privilege of operating within their jurisdiction. San Francisco charges an annual business registration fee, which varies based on the business's gross receipts.
- **Parking Fees and Fines**: Cities like San Francisco and New York generate substantial revenue from parking meters and parking violation fines.
- **Development Impact Fees:** These are charged to developers to offset the costs of providing public services to new developments. In San Diego, developers pay impact fees to help fund infrastructure improvements necessary due to new development projects.
- **Licensing Fees:** Various licenses for activities such as selling alcohol, owning pets, or operating taxis generate revenue for local governments. For example, in Los Angeles, pet owners must pay an annual license fee for their dogs.
- **Franchise Fees**: Cities may charge companies for the use of public property, such as cables running under city streets. Los Angeles charges cable television providers a franchise fee for the use of public rights-of-way.

Group Discussion 1: Major Local Taxes and Revenue Sources

- What types of taxes and fees contribute the most to the revenue in your locality?
- Discuss the implications of relying on these specific revenue sources for local government funding.
- Compare your locality's revenue sources with those of other regions. Are there notable differences or similarities in the types of taxes and fees that are most important?

Short-term Impact of COVID-19 on Revenue Sources

- **Income Taxes:** Decreased by 30.5% during the second quarter of 2020, but then recovered by more than double—99.7%—in the third quarter. Income tax revenue from higher wage earners remained strong during the pandemic, supporting states that rely on income tax revenue from high-income earners. Higher-wage earners—who pay more income tax than lower wage earners—were able to telework throughout the pandemic, while lower-wage earners, largely in service industries, experienced significant job losses.

- **Sales Taxes**: Decreased by 14% in the second quarter, but then increased by 18% in the third quarter. After an initial shock, consumer spending remained resilient as people purchased more online, which contributed to sales tax revenue.

- **Property Taxes:** Compared to the other 3 taxes, revenue from property taxes experienced a lower rate of decline after the onset of the pandemic due, in part, to the amount of time it takes state and local governments to reassess the amount of taxes owed on property.

- **Corporate Income Taxes:** Decreased by 44% in the second quarter and then nearly tripled in the third quarter. Many states extended the deadline for corporations to file taxes, which may explain why the timing of this income shifted.

Group Question 2: Impact of COVID-19 on Revenue Sources

Short-Term Responses:

- What immediate steps did local governments take to address the sudden drop in revenues during the pandemic?
- How effective were measures such as budget cuts, emergency funding, and federal aid in stabilizing local finances?
- Can you provide examples of your local governments that successfully navigated the financial challenges of the pandemic? What strategies did they use?

Long-Term strategies:

- How can local governments leverage technology and data analytics to improve revenue collection and forecasting?

Future of Public Budgeting? Potential usage of AI for budgeting and finance

Revenue Forecasting:

- Implement AI to analyze historical revenue data and economic indicators to forecast future revenue streams more accurately.

Expenditure Analysis:

- Use AI to monitor and analyze spending patterns, identifying inefficiencies and suggesting cost-saving measures.

Fraud Detection:

- Deploy AI systems to detect and prevent fraudulent activities by analyzing patterns and anomalies in financial transactions.

Optimizing Resource Allocation:

- Apply AI to evaluate various budget scenarios and optimize the allocation of resources based on priorities and expected outcomes.

Automating Routine Tasks:

- Utilize AI to automate repetitive tasks such as data entry, report generation, and compliance checks, freeing up staff for more strategic work.

Future of Public Budgeting? Example- The City of LA

The City of Los Angeles has been at the forefront of integrating AI into its budgeting and finance processes, primarily through its SmartLA 2028 strategy and the Open Budget Initiative.

- **SmartLA 2028 Strategy**:
  - The strategy includes leveraging AI to assist in policy-making, real-time community engagement, and infrastructure planning. By utilizing AI, the city can better forecast revenues, analyze spending patterns, and optimize resource allocation.
- **Open Budget Initiative**:
  - The Open Budget platform uses data analytics to present the city's budget in a user-friendly and interactive format, allowing stakeholders to understand and engage with the financial data more effectively. The initiative supports better financial planning and accountability by providing detailed insights into how public funds are allocated and spent.
- **AI in Revenue Forecasting and Expenditure Analysis**:
  - AI tools in Los Angeles help forecast future revenue streams by analyzing historical data and economic indicators. These tools also assist in monitoring and analyzing expenditures to identify inefficiencies and suggest cost-saving measures. For instance, the city can predict the financial impacts of various policy decisions and economic conditions, leading to more informed and strategic budgeting

Future of Public Budgeting? Group Discussion 3:

- How can AI improve the accuracy and efficiency of local government budgeting processes?
- What are the potential challenges and limitations of implementing AI in government finance?
- How can local governments ensure transparency and public trust when using AI for financial decision-making?
- What measures can be taken to train and prepare government employees for the integration of AI tools?

Basic components of budgeting and finance

Concept 1: Time value of Money
Concept 2: Accrual accounting

Concept 1: Time Value of Money

Suppose your bank wants to sell you an investment product. You need to deposit $10,000 to your investment account for n years and the bank promises to pay back more than $10,000 after n years. How much is the payment that will get you to buy the product?

If you will need to deposit your $10,000 for 1 year…..

- 2 years…..
- 5 years….
- 10 years…..

Concept 1: Time Value of Money

- A dollar today is worth more than a dollar tomorrow.
- Influenced by opportunity cost, inflation, uncertainty
- The rate used to make future money comparable with money today is known as the **discount rate**
- Discount rates can vary, widely, by sector or industry
- It seriously influences people or organizations' decision making!

Hypothetical Scenario for Local Government Investment Decision

Background

- The City of Lakeside has $100,000 available for investment and is evaluating two potential projects to determine the best use of these funds. The decision will be based on a comparison of the financial returns, risks, and impacts of each project

Project Options

<u>Option 1: 5-Year Infrastructure Project</u>

- Initial Investment: $100,000
- Total Cost: $500,000 (to be spent over 5 years)
- Expected Return: The project is expected to enhance transportation infrastructure, leading to long-term economic benefits, including increased business opportunities, higher property values, and improved local transportation networks. The projected return at the end of 5 years is estimated to be $1,000,000.

<u>Option 2: 3-Year Community Center Project</u>

- Initial Investment: $100,000
- Total Cost: $300,000
- Expected Return: This project aims to build a community center that will serve as a venue for local events, educational programs, and recreational activities. The projected return at the end of 3 years is estimated to be $1,000,000, including increased rental income, enhanced community services, and improved public engagement.

Hypothetical Scenario for Local Government Investment Decision

- **Other factors that you need to consider**
  - **Risk and Uncertainty:** duration projects face more uncertainties, such as economic fluctuations, political changes, and potential cost overruns.
  - **Funding and Financial Constraints**
  - **Community Impact:** positive impact on transportation infrastructure, economic growth, and property values.
  - **Strategic Alignment**
  - **6Opportunity Cost:** Potentially missing out on other investments or projects with faster returns.

Identifying and Mitigating Financial Risks Risks and Challenges

Economic Downturns

Develop strategies to manage revenue shortfalls, adjust spending, and spending, and protect essential services during economic recessions. recessions.

Natural Disasters

Prepare for and respond to natural disasters by maintaining emergency emergency funds, implementing disaster recovery plans, and seeking seeking federal and state assistance.

Population Shifts

Monitor demographic trends, anticipate changes in service demands, demands, and adjust budgets accordingly to meet evolving community community needs.

Cybersecurity Threats

Protect sensitive financial data and systems from cyberattacks by by implementing robust security measures, conducting regular vulnerability assessments, and maintaining data backups.

Hypothetical Scenario for Local Government Investment Decision

$$\text{Present Value (PV)} = \frac{\text{Future Value (FV)}}{(1 + \text{Discount Rate})^{\text{Period}}}$$

1. Time Value of Money

To compare these projects, we need to calculate the present value (PV) of the future returns, using a discount rate of 5% per year.

Calculations:

- **5-Year Infrastructure Project**:
    - **Future Value (FV)**: $1,300,000
    - **Present Value (PV)**: PV=≈1,018,564
- **3-Year Community Center Project**:
    - **Future Value (FV)**: $1,000,000
    - **Present Value (PV)**: PV=≈863,838

Concept 2: Accrual Accounting

- In accounting, there are basically two ways to keep track of financial events.

- The term "recognition" means that there is an acknowledgment that some financial event has occurred.

- ***Cash Accounting*** recognizes revenue when payments are received in cash and expenses when a resource is paid for in cash.

- ***Accrual Accounting*** recognizes revenue when the goods or services have been delivered and the organization has earned the right to be paid. Expenses are recognized when a resource has been used in the operation of the organization.

Example 1: Cash vs. Accrual Accounting

Assume that an organization charges $5,000 for its services, but only collects $3,250 this year. The remainder will be collected next year. The organization's only cost is the salary of its manager who earned $4,500, but was only paid $3,750. The balance will be paid next year. What is the impact on how the organization appears if it uses cash and if it uses accrual?

	Cash	***Accrual***
Revenue	**$3,250**	**$5,000**
Expense	**3,750**	**4,500**
Surplus/(Deficit)	**$ (500)**	**$ 500**

Question:

Which accounting do you use in your government? And why?

What are the Cons and Pros?

Cash vs. Accrual Accounting

Aspect	Cash Accounting	Accrual Accounting
Simplicity	Simple and easy to manage	Complex and requires detailed understanding
Financial Accuracy	Less accurate, does not account for receivables/payables	More accurate, matches revenues with expenses
GAAP Compliance	Not GAAP compliant	GAAP compliant
Cash Flow Tracking	Provides a clear view of cash flow	Can obscure actual cash position

Types of Budgeting

Incremental Budgeting:

- **Definition:** This method involves using the previous year's budget as a base and making adjustments for the new budget period.
- **Pros:** Simple and easy to implement, ensures stability and continuity.
- **Cons:** May perpetuate inefficiencies and does not encourage cost-saving innovations.

Zero-Based Budgeting (ZBB):

- **Definition:** Every expense must be justified for each new budget period, starting from a "zero base."
- **Pros:** Promotes efficient allocation of resources, helps eliminate unnecessary expenses.
- **Cons:** Time-consuming and resource-intensive, can be difficult to implement.

Performance-Based Budgeting:

- **Definition:** Allocates funds based on the performance and outcomes of programs and activities.
- **Pros:** Encourages accountability and effectiveness, links funding to results.
- **Cons:** Requires reliable performance metrics, may be challenging to measure certain outcomes.

Line-Item Budgeting

- **Definition**: Line-item budgeting, also known as traditional budgeting, lists each expenditure category separately along with the allocated funds for each. It is one of the simplest and most widely used budgeting systems.
- **Pros**: Simplicity and ease of use/ Clear accountability for each expenditure item.
  Disadvantages: Focuses on inputs rather than outputs or outcomes./ Lacks flexibility and may not encourage efficiency.

Outcome-Based Budgeting:

- **Definition:** Similar to performance-based budgeting but focuses more on the long-term outcomes and impacts of spending.
- **Pros:** Aligns resources with strategic goals, emphasizes long-term value creation.
- **Cons:** Difficult to measure outcomes, requires long-term tracking and evaluation.

Example Case Study: City Parks and Recreation Department

- **Scenario:** The City Parks and Recreation Department is planning its budget for the upcoming fiscal year. The department is responsible for maintaining public parks, organizing community events, and providing recreational facilities.

- **Incremental Budgeting Group:**
  - Use last year’s budget as a base.
  - Adjust for inflation and any known changes in costs or funding.
- **Zero-Based Budgeting Group:**
  - Start from zero and justify every line item.
  - Prioritize expenditures based on necessity and impact.
- **Performance-Based Budgeting Group:**
  - Allocate funds based on past performance and outcomes of programs.
  - Set clear performance targets for the new budget period.
- **Outcome-Based Budgeting Group:**
  - Allocate funds based on expected long-term outcomes.
  - Link budget allocations to strategic goals and measurable impacts.

What Types of budgeting do you usually use in your local government?

Back to the Original Questions: Goals of Public Financial Management

- **Three specific goals for government financial management**
  - Survival: Can the organization survive and sustain?
  - Effectiveness: Does the organization accomplish its missions?
  - Efficiency: Does the organization achieve its goals with minimum resources?

Thank you

Brian Min
bhmin@wayne.edu