

PN-ACC-760

**MODERNIZING FINANCIAL  
MANAGEMENT FOR  
HUNGARIAN LOCAL  
GOVERNMENTS**

**PILOT YEAR SEMINAR  
OCTOBER 30 - 31, 1996**

Prepared for



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Prepared by

Ritu Nayyar-Stone

The Urban Institute



**THE URBAN INSTITUTE**  
2100 M Street, NW  
Washington, DC 20037  
(202) 833-7200  
www.urban.org

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## TABLE OF CONTENTS

### MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTS PILOT YEAR, OCTOBER 30 - 31, 1996

I	October 30, 1996	1
	A Training Session I	2
	B Training Session II	3
II	October 31, 1996	5
	A Training Session I	7
	B Guest Speaker	8
	C Training Session II	8
III	Background Reading	9
IV	Local Government Homework	9
V	Conclusions	9

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**MODERNIZING FINANCIAL MANAGEMENT FOR  
HUNGARIAN LOCAL GOVERNMENTS  
PILOT YEAR, OCTOBER 30 - 31, 1996**

This report is a brief description of the October seminar on modernizing financial management for Hungarian local governments. The program aims at providing financial officers of Hungarian local governments with skills and information to help them improve budgeting and financial management within their cities. The October seminar was the third of six seminars which will be held throughout the Hungarian local budget cycle from June 1996 - March 1997.

The two day seminar was held on October 30 - 31, 1996 at Hotel Rubin in Budapest. The course material handed out to participants, the agenda, and a list of participants are included in Annex A. Eleven local governments attended the October seminar. Table 1 shows the list of local governments who have attended the three seminars held this far. The participating local governments represent a wide range of size and location, ranging from large cities such as Győr and Pécs and two districts from Budapest to the smaller towns of Püspökladány and Orosháza.

**I October 30, 1996**

The program started with an introduction and follow up of the last meeting by Mr. József Hegedus from the Metropolitan Research Institute (MRI). Mr. Hegedus briefly mentioned the topics covered by the previous seminars and stated the skill areas which would be presented at the present workshop. He outlined the sequence of presentations and stated that topics covered in the first day of the seminar had been prepared such that they were specifically applicable to the housing and communal services program areas. This was deliberately done so that all examples would be practical and non-abstract.

Following the introduction, Mr. Philip Rosenberg (consultant to the Urban Institute) did a follow up from the last meeting. He requested the participants to think about the following questions, and asked each local government representative to talk briefly the following day about where they were in the budget process, what they were doing differently in the budget due to their participation in the seminar, and, what were their successes and failures. He reminded the participants that the program enabled field trips and visits and that a trip was being made to the city of Debrecen to meet with the city council to explain the importance and applicability of this program to the city, and to reinforce their commitment to the process of bringing about change in their budgetary practice. If any other city needed a similar or technical visit, they should inform MRI. Mr. Rosenberg also reminded the participants about their role in the budgetary process—either as advisors, facilitators or implementors—and their customers being the mayor, office of the mayor, department heads, institutions and of course citizens of the community.

Ms Andrea Tonko and Ms Judit Kalman of MRI followed Mr Rosenberg's presentation by providing a comprehensive background on the structure of housing and communal service programs at the municipal level respectively. They outlined the functions of local governments, tools available to the local government in implementing the programs, possible alternative sub-programs and the revenue sources and possible expenditures in these two program areas.

Ms Katalin Pallai (Hungarian local trainer) did a review of the homework submitted by local governments since the last seminar in September. Municipalities had been asked to develop a municipal policy for their city, goals and objectives, and priority programs and sub-programs. The homework revealed that participants were confused about the link and distinction between the goal of a municipal policy and goals and objectives of programs and sub-programs. Ms Pallai structured her presentation to clarify this point, and used the homework of three local governments—Kispest, Jaszladany and Gyor to illustrate the distinction.

### **A Training Session I**

After Ms Pallai's presentation, Mr Blue Wooldridge (consultant to the Urban Institute) revisited the topic of budget reform, steps in developing a program budget and search for possible solutions to achieve program objectives which had been discussed in the September workshop. He also briefly discussed the difference between strategic goals and strategic program objectives to complement Ms Pallai's presentation. After Mr Wooldridge's presentation, the participants did an exercise on writing strategic objectives and possible solutions. Two groups were formed, one using housing as the focus of the exercise, while the other used communal services. Results of the exercise are as follows:

#### ***Housing Group***

Program Housing Construction and mobility

Strategic Goal A new housing goal which includes plot preparation, increasing the number of floors to existing housing, and financial assistance to the housing sector

Strategic Objective A 30 percent yearly increase by the year 2000 in new construction. For every 100 units of new and existing housing units, 300 individuals would be housed (become mobile)

Criteria used in selecting the solution

- How much central grant is available for the housing sector and for what purpose
- Volume of municipal finances available (housing fund)
- Paying/burden bearing ability of the residents
- Construction cost
- Preference of the tax system

Proposed solution New construction



## **Waste Management Group**

Program Solid Waste

General Goal Create a clean environment

Strategy Professional and safe method of collection and treatment of waste in the community

Alternatives

- Selective or bulk collection
- Technological change
  - Collection and treatment by one or several organizations
  - Local or regional level
  - Landfill or incinerator

Criteria

- Forecast of volume
- Modernization of investment
- Efficiency
- Long term solution
- Possibility to intervene/impact
- Comply with professional standards

### **B Training Session II**

The second training session was in the area of performance measurement (PM) Mr Blue Wooldridge started with a theoretical background on performance measurement and Ms Ritu Nayyar-Stone (the Urban Institute (UI)) presented the application of performance measurement to the programs of housing and communal services Mr Wooldridge defined PM and explained the uses of PM data He also stated the different PM indicators frequently used and the criteria for selecting a final set of measures He ended his presentation by outlining the steps in establishing a PM system

Ms Nayyar-Stone focused her presentation on the housing and communal services program Performance measurement indicators were developed for the following sub-programs housing allowance, land servicing, solid waste collection, solid waste disposal and street cleaning Due to lack of time, slides were presented only for the housing allowance and solid waste disposal sub-programs Ms Nayyar-Stone started by defining a strategic goal for the broad program area and a more specific strategic program objective She then presented a cause and effect logic diagram which would help quantify a program's intermediate and end outcomes and also lead to an identification of input, output, outcome and efficiency performance measures Finally, detailed performance measures were developed in the 4 categories above and she concluded with the sources of data available to a finance officer in developing PM techniques

Following the two presentations, participants were again divided into two groups dealing with housing and communal services respectively and PM indicators were developed for two sub-programs associated with the above programs

### ***Housing Group***

Goal To ensure convenient, modern and affordable housing

Sub-Program Housing construction (subsidize private construction per year)

#### Strategic Objective

- To build 300 housing units by year 2000, of which 200 will be private and 100 social housing Of the 100 social housing units, 20 will be for an elderly population, 25 for students, 30 for social and 25 rehabilitated units

#### Input performance measures

- Cost of municipal investment in housing
- Volume of subsidies for private construction
- Central assistance
- Administrative cost

#### Output performance measures

- Number of new units built
- Increase in mobility

#### Outcome measures

- Decrease in the number of households needing assistance
- Decrease in the number of households waiting for a flat

#### Efficiency Measures

- Cost per square meter
- Cost per transaction
- Central subsidy for 1 HUF of municipal cost

#### Other explanatory information

- Demographic changes
- Location
- Price of existing housing

#### Sources of data

- Housing department
- Housing stock
- Central statistical office
- Real estate agency

### ***Waste Management Group***

Goal To contribute to a healthy drinking water and environment of the city

#### Objective

- Increase the households joined to the sewage by 10 percent by 1998

- By 1999 build a treatment plant for liquid sewage which will have a 1000 cubic meter capacity per day
- Decrease in illness caused by contaminated water by 1999

#### Input Performance Measures

- Cost of sewage construction and liquid plant construction
- Vehicles
- Personnel
- Capacity

#### Output Performance Measures

- Number of customers (households) served
- Total volume of treated sewage
- Length of new pipelines
- Volume of liquid sewage

#### Efficiency Measures

- Cost per number of households served per 1 meter of sewage pipe
- Cost per 1 meter of pipe
- Cost of collection per 1 meter of waste
- Volume of sewage waste per capita

#### Explanatory information

- Capacity of the treatment plant

Following the training sessions, Mr Philip Rosenberg (consultant to UI) and Mr Peter Laszlo (city government of Szolnok) made a presentation on Implementing Program Budgeting in Your Municipality. Since Szolnok is the first city in Hungary to implement and incorporate program budgeting in their 1996 budget, other cities are very keen to hear about Szolnok's experience in this endeavor.

Mr László talked about the procedure adopted by Szolnok in incorporating program budgeting. The key motivating factor was that budgeting was in a state of crisis, due to limitations in revenue collections and expenditure possibilities. One solution was to bring about change in the attitude and process of budgeting. The technique employed was to focus on strategic planning and organization of programs which would help in the decision making process, rather than on expenditure and revenues. A schedule was made for the next three years to (1) involve city hall in program budgeting, (2) expand program budgeting to the institutions, and (3) coordinate all the activity together. Eight programs were defined for city hall in 1996, and they had to compete for funds. It was important to obtain commitment for this process from all the players which required several meetings and brainstorming sessions. The result was that new information was included in the budget—to make it more accessible and readable by the layman and citizens. New computers and software was also bought to facilitate change in the budget manual.

The seminar started at 9 00 a m on the second day, with Mr Rosenberg reviewing the forecasting homework submitted by the local governments. Mr Rosenberg commented that in general he was pleased with the forecasting ability of the local governments since their revenue and expenditure estimates were quite close to actual or realized values. However, some local governments seemed to follow an ad hoc policy of infrastructure investment, by diverting revenue estimates/allocations for infrastructure investments into other categories depending on need.

Mr Rosenberg then reminded participants about the questions he had posed to them the previous day regarding their current status in the budgetary cycle, and the impact/value of these seminars in changing their budgetary practices. Following is a brief summary of the feedback provided by each participating local government representative.

### ***Baja***

1996 has been a difficult year for this city. They had no new loans, which had affected their budget. The city therefore tried to sell its fixed assets to serve as a cushion or buffer to cover the absence of loans. The city plans to decrease expenditures from 1997, and also plans a rolling budget for the years 1997 - 2001.

### ***Budapest District XIX***

District XIX has already prepared its budget policy, which will be discussed on November 17. The budget policy is based on the past two years and focuses on the areas of financing, education, welfare and culture. The city has taken on a service focus in their budgeting, by attempting to determine financing percentages for different service areas. Since 1992, District XIX has maintained separate capital and operating expenditure budgets. They experienced some financial difficulty in 1994.

### ***Debrecen***

The city is currently preparing its budget policy for 1997. The new element in the 1997 budget is that the city is analyzing the budget trends of previous years in the following areas: 1) housing stock, 2) debt balance, 3) city property (sale of city assets, and what the funds have been used on), 4) establishment of normatives in the health and education sectors, 5) revenue estimates of 1996 (financially the city is in a critical situation—grants cover only the salary of employees, therefore other expenditures need to be covered from other credits), and, 6) credit—the city cannot get new loans due to their financial condition, therefore a deeper analysis of the budget is necessary to examine if bridging loans are possible.



### **Győr**

The city had problems with liquidity and a budget deficit in 1994. They have already taken steps to reverse the situation and initiated the small treasury system as in Bekescsaba. However, the system in Győr is based on a new electronic network and referred to as ad hoc financing. This was initiated in June 1994. Since then the city has not taken on any new loans.

The 1996 budget is now considered as being ad hoc by the city. An analysis of the last three years data has confirmed this to be a fact. Even though the city is no longer experiencing any liquidity problems, some services have not been presented well in the budget. The city has therefore realized that it needs to impose greater accountability for service provision and also stricter deadlines.

Győr has undertaken a comparison of actual versus estimated revenues since 1992-1993. The conclusion is that the city is better at estimating its own revenues versus central transfers. The revenue possibilities for 1997 have now been outlined based on this past study. Revenue estimates of HUF 2 billion have been forecasted. However, expenditure responsibilities of the city are so many that they cannot all be realized.

Lessons learnt: The city tried zero based budgeting, but did not succeed in achieving this for the operational budget. A housing plan which was created until the year 2000 has also not been followed.

### **Hajdúszoboszló**

This was the first seminar being attended by the city. Hajdúszoboszló has a 50 percent budget surplus which it will incorporate into their 1997 budget. They have recently restructured the different organizations in the city and are currently working on establishing the small treasury system.

### **Orosháza**

Orosháza is currently in the process of preparing their budget policy. Their main goal is to stop indebtedness. The city is also accessing its property with a focus on housing rehabilitation and renovations.

### **Pécs**

The city has already prepared its budget policy which will be passed by the committee on November 7. The changes initiated in their budget are (1) introduction of program budgeting in the area of welfare, (2) development of financial indicators (the city

has initiated data requests from the different institutions, and, (3) forecasting revenues and expenditures for 1997

### ***Puspokladány***

The city plans to use program budgeting in its education sector

### ***Szentes***

Szentes is going to initiate program budgeting in the communal services program from 1997. The sub-programs will be park maintenance and street cleanliness. The city's objective is to start fiscal year 1997 without a budget deficit. In June 1996 they introduced a small treasury system and have chosen their own bank. They are currently collecting data for the purpose of evaluation under their new system of program budgeting.

## **A Training Session I**

Following the brief presentations by representative local government official, Mr Robert Kovacs (MRI) and Mr Andras Vígvari (Hungarian local trainer) made a presentation on forecasting techniques for designing municipal incomes and expenditures. They started with a saying "Forecasting is similar to driving a car with blindfolded eyes and having someone give us directions who is looking out of the back window." This saying summarizes two important elements of forecasting: (1) its risk and uncertainty, and (2) the fact that forecasting is built upon the past.

The following elements of forecasting were explained by Mr Kovacs and Mr Vígvari: forecasting functions, types of forecasting (by period of time and by functions), forecasting methods (expert estimation, deterministic estimation, and econometric models), information base for forecasting (external and internal), methodological problems of information handling, and finally, a detailed explanation of the Credit Locale de France (CLF) model of forecasting which has been used by several Hungarian cities. This system has a practical base of grouping different elements of the budget together and developing forecasts of revenues and expenditures.

Following the presentation, local governments were divided into two groups for the practical exercise of practicing the CLF model and doing inflationary adjustments. Based on the data provided, the groups had to make calculations for the CLF model, make inflationary adjustments for total revenues, and prepare a forecast of the aggregate figures of the CLF table under different assumptions. After completing the exercise the two groups made their presentations.



## **B Guest Speaker**

The guest speaker at the seminar was Dr. Sandor Varga from the Ministry of Finance. He gave a speech about intergovernmental transfers and budgetary changes at the central government level which would impact the functioning of local governments. Following are a few highlights of his speech. Dr. Varga stated that there would be a 4 percent reduction in staff in the following year, which implies a loss in 20,000 jobs. However, with a reduction in jobs, the wage rate of the remaining staff would increase. There would be a decrease in the real value of central government investment in 1997, even though the nominal value would remain unchanged. Next year would also see an increase in targeted and addressed subsidies to local governments, but share of personal income tax (PIT) allocated to local governments would continue to be 36 percent. However, the criteria of PIT allocation would change. Currently local governments get 25 percent as an outright share and 11 percent on a normative basis. This will change to 22 percent being shared with all local governments and 16 percent being allocated on the basis of normatives.

Dr. Varga also stressed that the three year rolling plan would be mandatory for the 1997 budget, forcing local governments to plan for and consider several years commitments. Mandatory staff planning would also be a new element enforced by the central government. Another objective of the central government was to decrease inflation to 13 percent by 1998, and 10 percent by 1999.

Dr. Varga finally concluded that the new Treasury system would not be in place by 1998, but later,<sup>1</sup> and stated that local governments own revenues would have to account for a greater percent of their total revenues, since the number of normative subsidies could be decreased.

## **C Training Session II**

The second half of the day dealt with revenue alternatives in a joint presentation by Mr. Philip Rosenberg and Mr. Mihaly Lados (Hungarian local trainer). They started by giving a few examples of revenue alternatives faced by local governments: user fees, impact fees (such as betterment fees/contributions) and other local taxes. The participants suggested the following additional examples of revenue alternatives:

- own revenues
- interest from investment funds
- user fees

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<sup>1</sup> See *Modernizing Financial Management for Hungarian Local Governments, Pilot Year Seminar* September 12-13 1996 by Ritu Nayyar-Stone for a description of the new treasury system.

- rents
- asset yields
- local duties
- grants (funds for operational services)

After contrasting the characteristics of taxes and user fees, Mr Rosenberg and Mr Lados suggested factors which should be taken into consideration while designing a fee structure. Pricing policies and different types of rates were also discussed.

Following the presentation, participants did an exercise on establishing user fees for a hypothetical city. After hearing the participants analysis, Mr Rosenberg discussed the correct answers.

#### **D Background Reading**

The binder handed out to participants included background or additional reading on various topics covered during the two day seminar. These were provided so that participants would have access to more detailed and specific issues related to the topics covered.

#### **E Local Government Homework**

Since the philosophy of the municipal budgeting program is to have an interactive and hands-on dialogue with local governments, they are required to complete and return some exercises prior to the next seminar. Homework is based largely on material just presented and learned during the seminar, and partly on material which will be covered in the next seminar. The objective is for trainers to have an idea about their understanding and approach to future topics. The homework assignment in this seminar had the following elements: 1) defining programs and sub-programs, 2) developing performance measures for each sub-program, 3) identifying revenue alternatives, 4) forecasting the budget for the next three years, and, 4) providing information on current capital programming and budgeting practices/needs which will be incorporated into the December 1996 seminar.

#### **F Conclusions**

A post mortem of the two days was held at Hotel Rubin immediately following the conclusion of the seminar. It was attended by the following MRI staff, local Hungarian trainers and Urban Institute staff. From MRI—Mr Jozsef Hegedus, Ms Judit Kálman, Ms Andrea Tonko, and Mr Robert Kovacs. The Hungarian trainers included Ms Katalin Pallai, Mr Mihaly Lados and Mr Andras Vigvari. The UI staff included Ms Katharine Mark and Ms Ritu Nayyar-Stone, and the UI consultants Mr Philip Rosenberg and Mr Blue



Wooldridge The draft agenda for the next seminar on December 5—6, 1996 was drafted, and the trainers and experts gave their feedback on the seminar just concluded. The following conclusions were reached on the basis of the discussion:

- There was a need for greater feedback and participation from the local government officials so that the seminar could be adapted to their needs. Mr. Rosenberg's insistence that municipal officials give feedback about their current budgetary status at the start of the second day of the seminar, had already provided valuable insight on the budgetary problems and innovations of the different cities. It was necessary to encourage and insist on greater interaction by the different cities.
- There were too many new topics being covered in each seminar, and participants seemed to be overloaded with information.
- Seminars were too long and intensive.

Based on the above conclusions, it was decided that the December seminar would focus on only one substantial new area, that is, capital programming and budgeting, and be only a day and a half long. Each city participating in the seminar would have to make a presentation in the December seminar—either giving feedback on an homework assignment, or make a program budget presentation on the sector which would be incorporated as a program in their city's 1997 budget.

**Table 1**  
**List of Cities Participating in the Initial and September Seminar**

No	Cities	Population	June 27, 1996	September 12-13, 1996	October 30 - 31, 1996
	Baja	39,800	✓	✓	✓
	Budapest District VIII	40,042		✓	✓
	Budapest District XIX	78 400	✓	✓	✓
	Debrecen	24 900	✓	✓	✓
	Derecske	9 500	✓		
	Dunavarsany	5,201		✓	
	Eger	61,400	✓		
	Gyor	131,100		✓	✓
	Hajduszoboszló	23,387			✓
	Jaszladany	6,100	✓	✓	
	Kistelek	7 900	✓		
	Nagykanizsa	53 353			✓
	Oroshaza	34 600	✓	✓	✓
	Pecs	167,400	✓	✓	✓
	Püspökladány	17,000	✓	✓	✓
	Szentes	33,000	✓	✓	✓
	Szombathely	85 200	✓	✓	
	Szolnok	81,500	✓	✓	✓
	Zalaegerszeg	62,485		✓	

ANNEX A

*United States Agency for International Development*  
**MODERNIZING FINANCIAL MANAGEMENT FOR  
HUNGARIAN LOCAL GOVERNMENTS**

*Hotel Rubin 1118 Budapest Dayka Gabor u 3  
October 30 - 31 1996 Budapest*

## TABLE OF CONTENTS

Agenda

List of Participants

### **A Transparencies**

A 1 Presentation of two program areas

A 2 Homework review

A 3 Budget Reform and Search for Possible Solutions

A 4 Performance Measurement

A 5 Implementing Program Budgeting

A 6 General Forecasting Techniques

A 7 Revenue Alternatives

### **B Exercises and Worksheets**

B 1 Strategic Objectives and Possible Solutions

B 2 Developing Performance Measures for program areas

B 3 Forecasting Exercise

B 4 Identifying Revenue Alternatives

### **C Background Reading**

C 1 Housing and Waste Management Program in Hungary by Andrea Tonkő and Judit Kalman

C 2 "Identifying Obstacles to the Implementation of Budgetary Reform in Government" by Blue Wooldridge and Claire L. Alpert

C 3 "Putting Teeth into the Efficiency and Effectiveness of Public Services" by Richard E. Brown and James B. Pyers

C 4 "Measuring Government Performance: Experimenting with Service Efforts and Accomplishments Reporting in Portland, Oregon" by Richard C. Tracy and Ellen P. Jean

C 5 “Service Efforts and Accomplishments Reporting Its Time has Come An Overview Edited by Harry P Hatry, James R Fountain, Jr , Jonathan M Sullivan and Lorraine Kremer

C 6 “Estimate Revenues ’ by Philip Rosenberg

C 7 “A Possible Method for Government Financial Capacity Analysis and Forecast (the CLF method) ” by Andras Vigvan

C 8 “User Fee Establishment Depends on Community” by Philip Rosenberg

C 9 “Evaluating Alternative Revenue Sources” by Ian J Allen

**D Local Government Homework**

**Agenda**  
**MODERNIZING FINANCIAL MANAGEMENT**  
**FOR HUNGARIAN LOCAL GOVERNMENTS**

*October 30-31 1996 Budapest*  
*Hotel Rubin 1118 Budapest Dávká Gábor u 3*

**October 30, 1996**

- 9 30 -10 00 a m           Registration
- 10 00 - 10 15 a m       Introduction  
*Jozsef Hegedus Varoskutatas*
- 10 15 - 10 30 a m       Follow up from Last Meeting  
*Philip Rosenberg The Urban Institute*
- 10 30 - 11 30 a m       Presentation of Two Program Areas  
*Judit Kalman and Andrea Tonko Varoskutatas*
- 11 00 a m               Coffee served during presentation
- 11 30 - 12 00 a m       Review of Municipal Policy Goals Objectives and Program Homework  
*Katalin Pallai City Government of Budapest*
- 12 00 - 12 30 p m       Budget Reform and Search for Possible Solutions  
*Blue Wooldridge The Urban Institute*
- 12 30 - 1 15 a m       Exercise Writing Strategic Objectives and Choosing Possible Solutions  
*Blue Wooldridge The Urban Institute*
- 1 15 - 2 15 p m         Hosted Luncheon
- 2 15 - 3 00 p m         Group Presentation and Critique  
*Blue Wooldridge The Urban Institute*
- 3 00 - 3 45 p m         Presentation of Performance Measurements  
*Ritu Nayyar-Stone and BlueWooldridge The Urban Institute*
- 3 45 - 4 45 p m         Exercise Developing Program Performance Measures for 4 Program Areas  
*Ritu Nayyar-Stone and BlueWooldridge The Urban Institute*
- 4 30 p m               Coffee served during exercise
- 4 45 - 5 30 p m         Group presentation and critique  
*Ritu Nayyar Stone and BlueWooldridge The Urban Institute*
- 5 30 - 6 00 p m         Implementing Program Budgeting in your Municipality  
*Philip Rosenberg The Urban Institute*  
*Laszlo Peter City Government of Szolnok*
- 6 00 p m               Adjourn and Reception

**October 31, 1996**

- 9 00 - 9 15 a m         Review of Forecasting Homework  
*Philip Rosenberg The Urban Institute*

9 15 - 10 30 a m	Presentation on General Forecasting Techniques Specific example of the city of Eger <i>Robert Kovacs Varoskutatas</i> <i>Andras Vignari Budapest Bank</i>
10 30 - 11 30 a m	Exercise Forecasting <i>Robert Kovacs Varoskutatas</i> <i>Andras Vignari Budapest Bank</i>
11 00 a m	Coffee served during exercise
11 30 - 12 30 a m	Group presentation and critique <i>Robert Kovacs Varoskutatas</i> <i>Andras Vignari Budapest Bank</i>
12 30 - 1 30 a m	Hosted Luncheon
1 30 - 2 30 p m	Guest Speaker <i>Dr Sandor Varga Ministry of Finance</i>
2 30 - 3 30 p m	Revenue Alternatives <i>Philip Rosenberg The Urban Institute</i> <i>Mihaly Lados Hungarian Academy of Sciences Center for Regional Studies</i>
3 30 - 4 15 p m	Exercise Revenue Alternatives <i>Philip Rosenberg The Urban Institute</i> <i>Mihaly Lados Hungarian Academy of Sciences Center for Regional Studies</i>
4 00 p m	Coffee served during exercise
4 15 - 5 00 p m	Exercise Presentation and Critique <i>Philip Rosenberg The Urban Institute</i> <i>Mihaly Lados Hungarian Academy of Sciences Center for Regional Studies</i>
5 00- 5 30 p m	Work assignment for participants <i>Philip Rosenberg The Urban Institute</i>
5 30 p m	Adjourn

## LIST OF PARTICIPANTS

### Local Governments

- |    |  |    |   |
|----|--|----|---|
| 1  | Jozsef Marjanovity<br>Counsellor of Property Management<br>Office of the Mayor Baja                  | 2  | Peter Butterer<br>Head of the Finance Department<br>Office of the Mayor Baja                              |
| 3  | Karolyne Szentivanyi<br>Finance Department<br>Office of the Mayor Budapest<br>VIII District          | 4  | Laszlo Mester Zsuzsanna<br>Head of the Finance Department<br>Office of the Mayor Budapest<br>XIX District |
| 5  | Jozsefne Mészner<br>Head of the Finance Department<br>Office of the Mayor Budapest<br>XXIII District | 6  | Laszlo Kovacs<br>Head of the Finance Department<br>Office of the Mayor Debrecen                           |
| 7  | Istvan Sziget<br>Head of the Financial Committee<br>Office of the Mayor Debrecen                     | 8  | Zoltan Fauszt<br>Head of the Notary Office<br>Office of the Mayor Debrecen                                |
| 9  | Margit Zadravecz<br>Head of the Finance Department<br>Office of the Mayor Győr                       | 10 | Laszlo Lőrincz<br>Head of the Finance Department<br>Office of the Mayor Hajduszoboszló                    |
| 11 | Laszlo Balog<br>Head of the Finance Department<br>Office of the Mayor Jaszladány                     | 12 | Czeczene dr. Szirmai Gabriella<br>Notary<br>Office of the Mayor Jaszladány                                |
| 13 | Istvan Tutto<br>Deputy Mayor<br>Office of the Mayor Nagykanyizsa                                     | 14 | Tothne Kremer Maria<br>Finance Department<br>Office of the Mayor Nagykanyizsa                             |
| 15 | Zsolt Volencsik<br>Deputy Mayor<br>Office of the Mayor Oroshaza                                      | 16 | Dezső Gombkotó<br>Head of the Economic Department<br>Office of the Mayor Oroshaza                         |
| 17 | Jozsef Mészlai<br>Deputy Head of the Economic Department<br>Office of the Mayor Oroshaza             | 18 | Yorty Ian<br>Peace Corp<br>Office of the Mayor Oroshaza   |
| 19 | Ivan Píliszanovich<br>Office of the Mayor Pecs   | 20 | Labadyne Csaba Aniko<br>Head of the Budget Department<br>Office of the Mayor Pecs                         |
| 21 | Csilla Horvath<br>kozgazdasagi osztaly vezetője<br>Office of the Mayor Pecs                          | 22 | Ferencne Kurtliv<br>Head of the City Management Office<br>Office of the Mayor Puspokladány                |
| 23 | Sandorne Krajsoczki<br>koltsegvetesi csoportvezeto<br>Office of the Mayor Szentes                    | 24 | Janos Liptak<br>Head of the Technical Department<br>Office of the Mayor Szentes                           |
| 25 | Sandor Varga<br>Technical Department<br>Office of the Mayor Szentes                                  | 26 | Gyorgyi Balogh<br>Technical Department<br>Office of the Mayor Szentes                                     |

## Participating Experts

- |    |  |    |   |
|----|--|----|---|
| 27 | Michael Jackson<br>Senior Local Government<br>Training Advisor<br>ICMA Budapest      | 28 | Judit Deilinger<br>Deputy Project Manager<br>ICMA Budapest  |
| 29 | Marilinne B. Davis<br>City Manager<br>ICMA Debrecen                                  | 30 | Andrea Deák<br>Assistant<br>ICMA Debrecen   |
| 31 | Craig Steensland<br>City Manager<br>ICMA Szeged                                      | 32 | Gabriella Bakos<br>Assistant<br>ICMA Szeged   |
| 33 | Steve Herbalv<br>City Manager<br>ICMA Zalaegerszeg                                   | 34 | Lawrence E. Birch<br>Senior Housing Advisor<br>USAID Budapest                                     |
| 35 | Katharine Mark<br>Municipal Finance Specialist<br>The Urban Institute Budapest       | 36 | Ritu Navar Stone<br>Municipal Finance Specialist<br>The Urban Institute USA                       |
| 37 | Philip Rosenberg<br>Senior Municipal Finance Specialist<br>The Urban Institute USA   | 38 | Blue Wooldridge<br>Senior Municipal Finance Specialist<br>The Urban Institute USA                 |
| 39 | Mihály Lados<br>Senior Research Fellow<br>West Hungarian Research Institute Győr     | 40 | Peter Laszlo<br>Head of the Finance Department<br>Office of the Mayor Szolnok                     |
| 41 | Katalin Pallai<br>Special Counsellor<br>Municipality of Budapest Budapest            | 42 | Dr. Sandor Varga<br>Deputy Head of Urban Department<br>Department<br>Ministry of Finance Budapest |
| 43 | Andras Vígvar<br>Head of Business Analysis and Devt. Dept.<br>Budapest Bank Budapest | 44 | Jozsef Hegedus<br>Local Government Specialist<br>Varoskutatas Kft Budapest                        |
| 45 | Judit Kalman<br>Fellow<br>Varoskutatas Kft Budapest                                  | 46 | Robert Kovacs<br>Senior Fellow<br>Varoskutatas Kft Budapest                                       |
| 47 | Andrea Tonko<br>Fellow<br>Varoskutatas Kft Budapest                                  |    |   |

# TRANSPARENCIES

### **Housing related municipal services:**

- to provide social welfare support to those in need
- to control the development and operation of the housing market and the market for rental flats and lands for construction
- to develop master plans that are in line with the expected housing demands of the community

### **Municipal tools available**

- they have the authority to define the use of individual pieces of land (master plan)
- they have ownership over land and housing units
- they receive normative subsidies for housing services, they have the income from sales of apartments started as of January 1 1994
- they have the right to determine the rents for rental flats in municipal ownership

## HOUSING PROBLEMS

### 1 Critical housing situations

- the problem of acquiring a first flat
- buildings with one flat units
- pension homes
- forced tenancy
- private tenants and subtenants

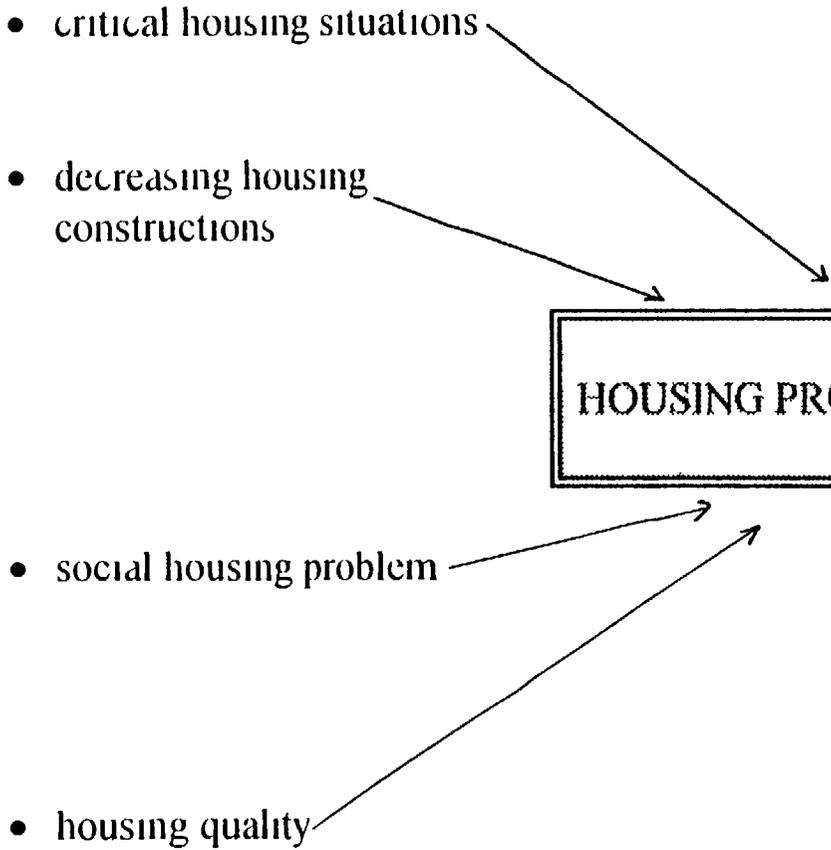
2 The decreasing housing construction as a problem which is related to the decreasing demand or the shortage of building sites or the lack of credit etc

3 The social housing problem (the affordability of housing costs and the related problems of social situations and slumming)

4 Housing quality (worn down units, renovation)

5 Mobility

**Housing problems  
(strategic objectives)**

- critical housing situations
  - decreasing housing constructions
  - social housing problem
  - housing quality
- 

**HOUSING PROGRAM**

**Subprograms**

**Alternatives**

- housing construction
  - 1 for sale
  - 2 public housing
  - 3 non-profit
  - 4 mixed ownership
- rehabilitation
- living area extension program
  - 1 for sale
  - 2 subsidized land plot prices
- giving building sites for developers
- subsidies for buying a first flat
- reform of the rental sector

## Incomes and expenditures in housing sector<sup>9</sup>

INCOMES	EXPENDITURES
Normative subsidies for housing related services (housing management, interest subsidies, remote heating subsidies rents subsidies)	Maintenance rehabilitation
Incomes from housing privatisation	Subsidies <ul style="list-style-type: none"> <li>• housing</li> <li>• remote heating</li> <li>• rents</li> <li>• first home buyers</li> <li>• interest subsidy</li> </ul>
Housing incomes (rents + expected rents in arrears)	Other expenditures <ul style="list-style-type: none"> <li>• housing mobility</li> <li>• construction loans and interests</li> <li>• subsidies to municipal employees</li> <li>• payments in arrears</li> </ul>
Incomes from sales of land and use of land	

## Tasks and Responsibilities /Legal Background/

- earlier professional regulations made a clear distinction between „*public cleanliness*” and „*communal cleanliness*”
- the regulation of activities and setting of professional standards is divided even between Ministries  
communal management MoI ↔ waste management MoERD

- **1990. LXV. Local Government Act:**

*„it is the responsibility of the local government to protect the natural and artificial environment to ensure communal cleanliness” – it is not required as a mandatory local government function*

**1991. XX. Act (on the spheres of responsibilities)**

*LG task identifying the place for liquid communal waste disposal, providing for the cleanliness of public areas and hauling – the tasks of handling, collecting and treating solid communal waste are not legally regulated*

**1995. XLII. Act on the obligatory utilization of certain local public utility services**

The owner of a property is obliged to make use of these services

*LG is setting fees*

**1995. LIII. (Environmental Protection) Act**

*„the local government (or more than one local governments together) develop an independent community environmental protection program canm create a municipal environmental fund*

**16/1996. (VII 15.), joint decree by the Interior Ministry and the Ministry of Environmental Protection and Regional Development**

*the task collecting, transporting and safely disposing-the waste*

## Alternative ways of service provision

Three main actors

- consumer
- producer
- arranger

In most services the municipality is the arranger, and the provision can be made in many ways  
The fact that I G is not a direct service provider does not mean it gives up the responsibility of ensurment and control

## **The tasks of LG in different cases**

### **LG service provision**

provides services with own institution or companies

### **Contract – out**

- managing citizen demand,
- act as professional “buyer”
- control quality of service,
- efficiently manage finances

### **Concession**

Gives monopoly position in a specific service provision for one company, but with the condition of keeping price control in LG hand

### **Privatization**

creates service standards

## REVENUES

	From the central budget <sup>1</sup>	Local government own	Service provider
<b>Operation</b>	<i>communal service normative</i> (17637 M Ft) 16373 Ft/person	waste collection user fee	
	<i>personal income tax share</i> (11% reallocated =217107 M Ft) 1741 Ft/person	local communal tax	
	<i>centrally allocated grant</i> to support treatment of liquid communal waste (224 MFt)		fee for emptying the sewage containers directly paid by the households
	<i>30% of the environmental protection fines</i> levied by the regional environmental authorities	100% of the legally approved environmental protection fines levied by the local government	
			revenues from the rent or sale of assets
			repair of vehicles maintenance work for others

<sup>1</sup> Actual figures are from the 1996 budget

24

<b>Investment</b>	<b>LARGE TID SUBSIDY</b> construction of solid communal waste dump- 30% (1998-40%) construction of communal liquid waste treatment plant- 40% (1998-50%)	development contribution from the households + the service sector (if this component is not built in the fee)
	<b>SEPARATE FUNDS</b> <b>Environmental</b> for investments directly promoting the protection of the environment (subsidy or subsidized loan or interest subsidy for existing loans for 30-60% of the planned costs of the investment) <sup>2</sup>	
	<b>Economic development</b> mainly production investments assisting the use of up-to-date technology for infrastructure development contribution	
	<b>Regional development</b> for communal waste management investments (the subsidy cannot be more than 70% of the costs of the investment)	

<sup>2</sup> But local governments companies performing public service with a majority share of local government or state ownership budgetary institutions and civil organisations are also eligible

Possible programs-subprograms in a program budget

**COMMUNAL SERVICE – PROGRAM**

- 1 Parks
- 2 *Public cleanliness* →
3. Streets, bridges
- 4 Public lighting
- 5 Maintenance of cemeteries
- 6 Drainage and flood protection
- 7 Agricultural and livestock health service tasks
- 8 Supervision of public areas
- 9 Civil defence
- 10 City decoration

**PUBLIC CLEANLINESS – SUBPROGRAM**

**A) Solid waste management**

- *collection*
- *carriage*
- *disposal*
- *recycling*

**B) Public space management**

- *clearance*
- *snow removal*
- *dust removal*
- *hauling*

**C) Liquid waste management**

- *collection*
- *carriage*
- *disposal*

# **BUDGET REFORM**

## **ATTRIBUTES OF NEW BUDGET**

- **IDENTIFICATION OF GOALS & OBJECTIVES**
- **LINKED TO COMMUNITY NEEDS, TRENDS, & GOVERNMENT PRIORITIES**
- **SHIFTS EMPHASIS FROM WHAT GOVERNMENT BUYS TO WHAT GOVERNMENT DOES AND WHAT IT ACCOMPLISHES**
- **ESTABLISHMENT OF COMPREHENSIVE PERFORMANCE MEASURES**
- **CONSIDERATION OF ALTERNATIVES, THEIR RESPECTIVE COSTS, AND THE EFFECTIVENESS OF EACH ALTERNATIVE**
- **ESTABLISHMENT OF DIFFERENT LEVELS OF SERVICE FOR DIFFERENT FUNDING LEVELS**
- **PROJECTION & SCHEDULE OF WORK TO BE DONE**
- **COMPARISON OF BUDGET REQUESTS WITH PRIOR ACTUAL EXPENDITURES AND ACCOMPLISHMENTS**
- **EXPENDITURES CATEGORIZED ACCORDING TO OBJECTS OF EXPENDITURE**

## STEPS IN DEVELOPING A PROGRAM BUDGET

- GATHER AND ANALYZE COMMUNITY DATA
- IMPLICATION ANALYSIS
- ANALYZE COMMUNITY STRENGTHS, WEAKNESSES, THREATS AND OPPORTUNITIES
- DEVELOP A STATEMENT OF MUNICIPAL POLICY
- IDENTIFY STRATEGIC GOALS
- ESTABLISH GOVERNMENTAL PROGRAMS
- DEVELOP PROGRAM GOALS
- ESTABLISH SUB-PROGRAMS
- DEVELOP STRATEGIC OBJECTIVES
- GENERATE POSSIBLE SOLUTIONS
- DEVELOP EVALUATION CRITERIA
- DEVELOPMENT PERFORMANCE MEASURES
- RECOMMEND PREFERRED SOLUTION

## SEARCH FOR POSSIBLE SOLUTIONS

CENTRAL TO EVERY USEFUL PROGRAM ANALYSIS IS THE DEVELOPMENT OF AN APPROPRIATE SET OF ALTERNATIVES THAT MIGHT ACHIEVE THE PROGRAM OBJECTIVES THE FOLLOWING SOURCES OFTEN HELP IDENTIFY PROGRAM ALTERNATIVES

- IF THE ANALYSIS HAS BEEN INITIATED BY SPECIFIC PROPOSALS BY GOVERNMENT OFFICIALS, THESE OFFICIALS MAY ALSO IDENTIFY ALTERNATIVES THEY WISH CONSIDERED
- PROGRAM PERSONNEL OFTEN HAVE SPECIFIC IDEAS ON ALTERNATIVES AS WELL AS A THOROUGH KNOWLEDGE OF WHAT AGENCIES IN OTHER GOVERNMENTS ARE TRYING
- INDIVIDUALS AND GROUPS OUTSIDE THE GOVERNMENT, INCLUDING CITIZENS, COMMUNITY ORGANIZATIONS, PUBLIC INTEREST ASSOCIATIONS, AND THE NEWS MEDIA WILL OFTEN MAKE PROPOSALS
- APPROACHES OF OTHER GOVERNMENTS TO THE SAME PROBLEM SHOULD BE EXPLORED IDEAS BEING USED BY OTHERS CAN OFTEN BE IDENTIFIED THROUGH PROFESSIONAL MEETINGS, JOURNALS, GOVERNMENT PROFESSIONAL INTEREST GROUPS, AND WORD OF MOUTH
- DIFFERENT SIZES OF THE SAME ALTERNATIVES, SUCH AS EXPANSIONS OR CONTRACTIONS OF AN EXISTING PROGRAM, OFTEN NEED TO BE CONSIDERED
- COMBINATIONS OF INDIVIDUAL ALTERNATIVE MAY BE DEFINED AS NEW ALTERNATIVES

- DURING THE ANALYSIS, NEW VARIATIONS OR NEW IDEAS MAY BE SUGGESTED TO ALLEVIATE THE APPARENT WEAKNESSES OF BASIC ALTERNATIVES THAT ARE FOUND
- IT MIGHT BE USEFUL TO HOLD 'BRAINSTORMING' SESSIONS WHERE ANALYSIS AND AGENCY PERSONNEL AND PERHAPS OTHERS TRY TO GENERATE IDEAS
- PILOT TESTS OF A NEW APPROACH, RATHER THAN FULL-SCALE IMPLEMENTATION MAY BE APPROPRIATE IN SOME SITUATIONS

HARD, KNOWLEDGEABLE, AND CAREFUL THINKING ABOUT A PROBLEM IS OTHER A NEGLECTED SOURCE OF WORTHWHILE ALTERNATIVES

## GOALS AND OBJECTIVES

**GOALS** THE BROADEST AIMS OF GOVERNMENT, RELATIVELY TIMELESS, NORMALLY NOT QUANTIFIABLE, USUALLY ASSOCIATED WITH THE TOP LEVEL OF A PROGRAM BUDGET STRUCTURE

A GOAL STATEMENT MIGHT BE

“MAINTAIN AN ENVIRONMENT IN WHICH EACH CITIZEN OF THE COMMUNITY IS SAFE FROM CRIME”

OR

“PROVIDE OPPORTUNITIES FOR EACH CITIZEN OF THE COMMUNITY TO ENGAGE IN SATISFACTORY LEISURE ACTIVITIES”

AS YOU CAN SEE GOAL STATEMENTS ARE BROAD “DESIRED STATES OF NATURE” AN OBJECTIVE IS ANOTHER MATTER HOWEVER

**OBJECTIVE:** THE SPECIFIC AIMS OF PROGRAMS, SIMILAR TO GOALS BUT NOT TIMELESS OR BROAD, CAPABLE OF QUANTIFICATION, USUALLY WITH LOWER LEVELS OF A PROGRAM STRUCTURE

## STRATEGIC AND ADMINISTRATIVE GOALS AND OBJECTIVES

STRATEGIC	ADMINISTRATIVE
<p><b>GOALS</b></p> <p><u>Definition</u> The broadest aims of government. Relatively timeless</p> <p><u>Example</u> <i>All senior residents in our community will have access to affordable, comfortable, convenient, safe, and satisfactory shelter</i></p>	<p><b>GOALS</b></p> <p><u>Definition</u> Organizational mission statement Relatively timeless</p> <p><u>Example</u> <i>The department of Housing will build and maintain housing units for senior residents</i></p>
<p><b>OBJECTIVE</b></p> <p><u>Definition</u> A precisely-defined statement of intended accomplishments Specifies the what, how much and the when Described the desired outcomes, changes in clients</p> <p><u>Example</u> <i>By the end of FY 1997, the % of senior residents having access to affordable, comfortable, convenient, safe and satisfactory shelter will increase from the current level of 80% to at least 90%</i></p>	<p><b>OBJECTIVE</b></p> <p><u>Definition</u> A precisely-defined statement of intended accomplishments Specifies the what, how much and when Describe program outputs and efficiency measures</p> <p><u>Example</u> <i>By the end of FY 1997, the Department of Housing will construct at least 250 units of housing for seniors at a cost not to exceed 60,000 forints per square meter</i></p>



# HOW TO MEASURE PERFORMANCE IN THE PUBLIC SECTOR

- PERFORMANCE MEASUREMENT
- PRODUCTIVITY MEASUREMENT
- SERVICE EFFORT AND ACCOMPLISHMENT

## DEFINITIONS

ANY METHOD OF OBJECTIVELY DETERMINING HOW WELL SERVICES ARE BEING PERFORMED

ANY SYSTEMATIC ATTEMPT TO LEARN HOW RESPONSIVE A LOCAL GOVERNMENT'S SERVICES ARE TO THE NEEDS OF THE COMMUNITY, AND TO THE COMMUNITY'S ABILITY TO PAY

INDICATORS THAT ARE USED IN ASSESSING AN ASPECT OF PROGRAM PERFORMANCE OR NEGLECT

## **USES FOR PERFORMANCE MEASUREMENT DATA**

- **IMPROVING DECISION MAKING**

  - BUDGETING AID

  - ALLOCATION OF RESOURCES

- **IMPROVING PERFORMANCE**

  - IDENTIFY AREAS NEEDING IMPROVEMENT

  - PROVIDE FEEDBACK ON IMPROVEMENT ACTIVITIES

  - HELP MOTIVATE MANAGERS AND EMPLOYEES

  - PERFORMANCE APPRAISAL

  - CONTRACTOR MONITORING

- **COMMUNICATING WITH THE PUBLIC**

TYPE	DEFINITION	EXAMPLES
<i>Input Measures</i>	measure of resources employed	number of position required for a program, cost, classroom space, supplies used, equipment needed
<i>Output Measures</i>		
Program Size	the magnitude of program coverage or effect	number of classes number of projects number of people served
Workload	volume of work to be done	number of letters answered number of applications processed number of inspections made
Product	volume of goods or services produced	number of graduates number of successful rehabilitations
<i>Process Efficiency</i>	*conversion of resources into program outputs	cost/training hour staff hour/% decrease in class II burglaries % space actually used
<i>Impact</i>	the effect (intended and unintended) that the program has on its environment	
Effectiveness Measures	degree to which the intended objectives of the service is being met,	% increase in employment among low skilled employees % reduction in traffic accidents
Benefit Measures	measures of the value to society of attaining an objective expressed in monetary terms	increase in expected earnings as a result of completing training program reduction in welfare costs

\*Harry P Hatry, How Effective Are Your Community Services? (Washington, DC The Urban Institute, 1977), p 233

## SERVICE EFFORT AND ACCOMPLISHMENT MEASURES

**I MEASURES OF EFFORT** Efforts are the amount of financial and non-financial resources that are put into a program or process

a **Financial Information** These are financial measures of expenditures/expenses

b **Non-financial Information**

1) Number of personnel

2) Other measures These may include the amount of equipment or other capital assets used in providing a service

**II MEASURES OF ACCOMPLISHMENTS:** Accomplishment measures report what was provided and achieved with the resources used

a **Output Measures**

1) Quantity of a service provided These indicators measures the physical quantity of a service provided

2) Quantity of a service provided that meets a certain quality requirement These indicators measure the physical quantity of a service provided that meets a test of quality

b **Outcome Measures** These indicators measure accomplishment or results that occur because of services provided

**III MEASURES THAT RELATE EFFORTS TO ACCOMPLISHMENTS**

a **Efficiency measures that relate effort to outputs of service** These indicators measure the resources used or costs per unit of output

b **Cost-outcome measures that relate efforts to the outcomes or results of services** These measures report the cost per unit of outcome or result

## **CRITERIA FOR SELECTING FINAL SET OF MEASURES**

**IMPORTANCE** Does the measure provide useful and important information on the program which justifies the difficulties in collecting, analyzing, or presenting the data?

**VALIDITY** Does the measure address the aspect of concern? Can changes in the value of the measure be clearly interpreted as desirable or undesirable, and can the change be directly attributed to the program?

**UNIQUENESS.** Does the information provided by the measure duplicate or overlap with information provided by another measure?

**ACCURACY** Are the likely data sources sufficiently reliable or are there biases, exaggeration, omissions, or errors which are likely to make the measure inaccurate or misleading?

**TIMELINESS** Can the data be collected and analyzed in time for the decision?

**PRIVACY AND CONFIDENTIALITY.** Are there concerns for privacy or confidentiality which would prevent analysts from obtaining the required information?

**COSTS OF DATA COLLECTION.** Can the resource or cost requirement for data collections be met?

**COMPREHENSIVENESS** Does the final set of measures cover the major aspects of concern?

**EASILY UNDERSTOOD** Will the measure be reasonably understood by Government officials?

**POTENTIAL FOR ENCOURAGING PERVERSE BEHAVIOR** Will the measure result in behavior that is contrary to the overall objectives of the organization?

# STEPS IN ESTABLISHING A PERFORMANCE MEASUREMENT SYSTEM

- I DECIDE WHAT UNITS/PROGRAMS WILL USE THE SYSTEM
- II DOCUMENT UNIT/PROGRAM MISSIONS, GOALS, AND OBJECTIVES
- III DECIDE WHAT ACTIVITIES ARE TO BE MEASURED  
Identify Key Results Areas
- IV FROM A REVIEW OF THE LITERATURE IDENTIFY RELEVANT  
EXAMPLES OF PERFORMANCE MEASURES
- V ESTABLISH UNIT/PROGRAM PERFORMANCE MEASURES
- VI EVALUATE PERFORMANCE MEASURES USING CRITERIA
- VII ESTABLISH DATA COLLECTION SYSTEM
  - A Trained Observer Ratings
  - B Citizen Client Surveys
  - C Operational Information
    - 1) Historical Data
    - 2) Other Jurisdictions
    - 3) Professional Standards
    - 4) Engineering/Work Standards
  - D Time Records
- VIII CONDUCT IMPLEMENTATION FEASIBILITY/FORCE FIELD  
ANALYSIS
- IX MODIFY PERFORMANCE MEASUREMENT EFFORT IN LIGHT OF  
ANALYSIS
- X IMPLEMENT MODIFIED PERFORMANCE MEASUREMENT PROJECT
- XI REPORT THE RESULTS

# The Application of Performance Measurement To Housing and Communal Services

Inputs

Outputs, Outcomes  
Efficiency

# Performance Indicators

- **Program**

Housing

- **Sub Programs**

Rehabilitation

Help for the homeless

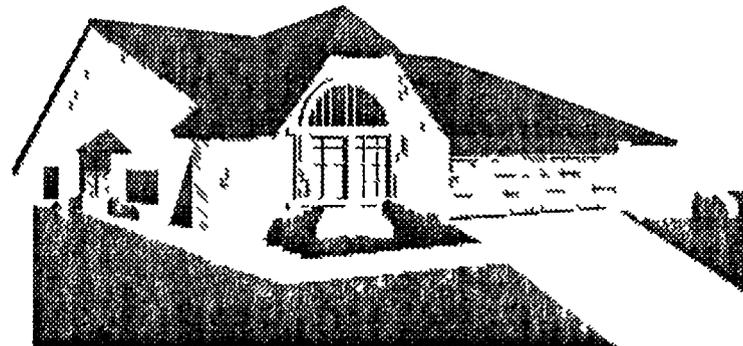
Housing Code enforcement

Housing infrastructure

Housing allowance

Rental management

Land servicing



5

# Strategic Goal and Program Objective

## Housing Allowance (Rent Subsidy)

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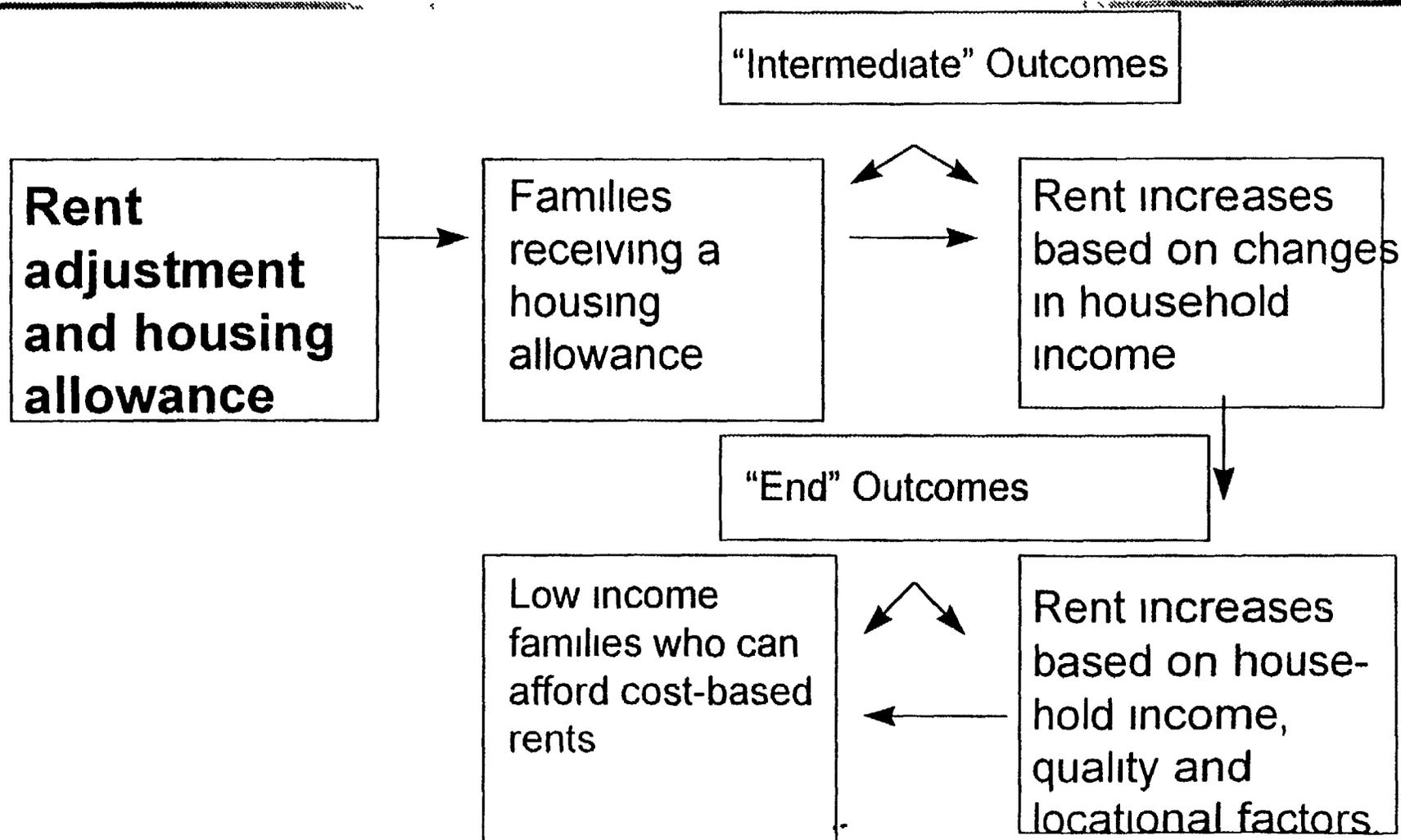
### ● Strategic Goal

“Low income citizens will have access to a minimum level of housing that is affordable, safe, convenient and satisfactory.”

### ● Strategic Program Objective

“Increase the percentage of low income individuals who can afford rental housing at market rates from X to Y percent by end 199X.”

# Example of a "Cause-Effect" Logic Diagram : Housing Allowance Program





# Performance Indicators Housing Allowance Program

---

- **Inputs (cost of the program)**

  - Percent of rent subsidy

  - Number of personnel hours

- **Outputs (units produced/quantity of service provided)**

  - Number of eligible households participating

- **Outcomes(result of service provision)**

  - Number of households receiving assistance that have become mobile

  - Percent of qualifying households missed/rejected?

  - Percent of rent subsidy not made on schedule

  - Percentage decrease in rent burden (percent of rent program)

  - Percentage increase in rents per year

# Housing Allowance Program

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- **Efficiency\***

  - Total rent revenue as a percent of total cost of the program

  - Administrative cost per household served

  - Cost per subsidy given

- **Other Explanatory Information**

  - Targeted income group of rent subsidy program

  - Service area population (in thousands)

  - Capacity (total funds available for the program)

\* Assess cost of the assistance relative to its accomplishments Also enable comparisons over time

# Strategic Goal and Program Objective

## Land Servicing

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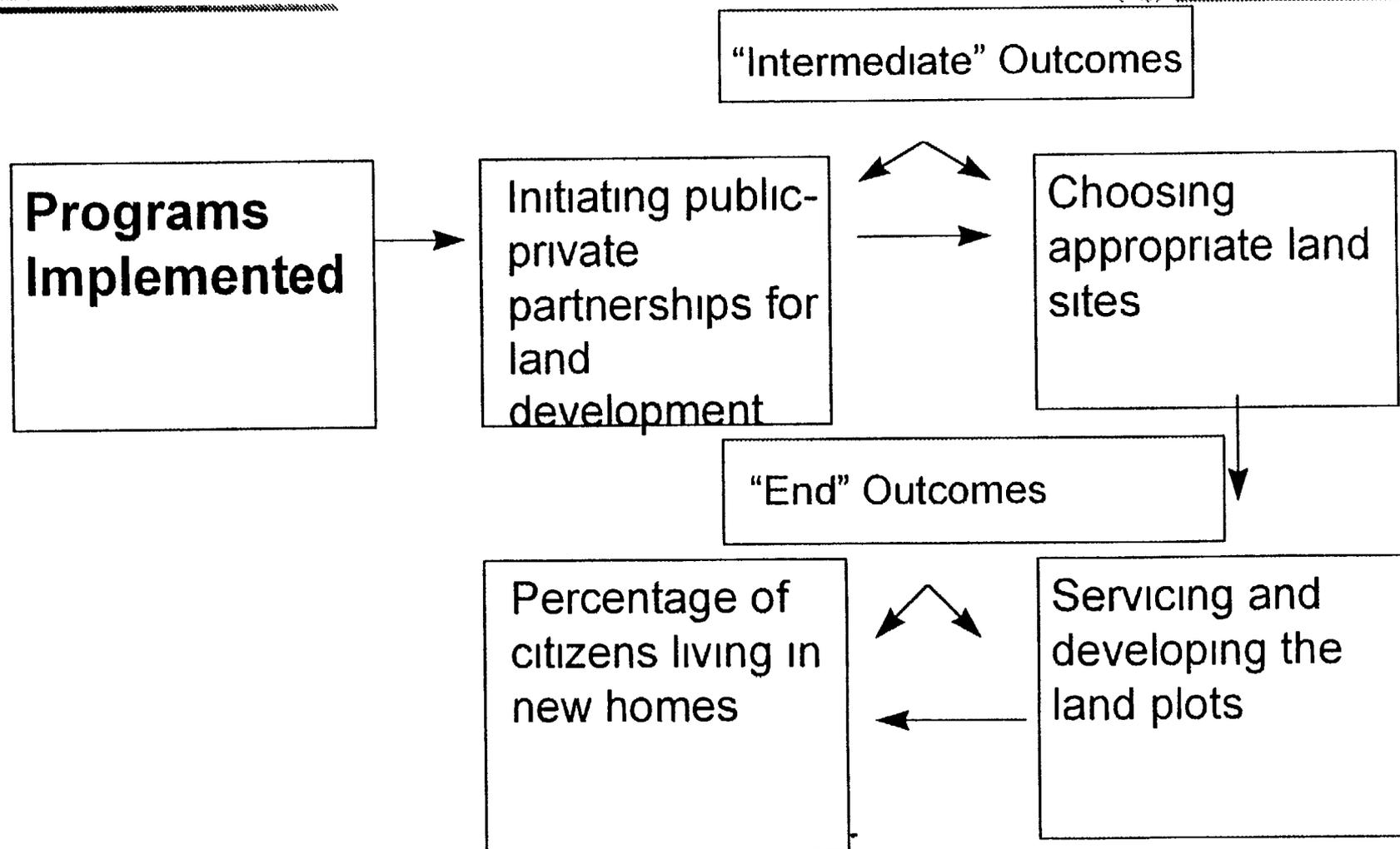
### ● Strategic Goal

“Residents will be able to purchase or build new homes more easily.”

### ● Strategic Program Objective

“Increase the percentage of residents who live in new homes from X to Y percent by the end of FY 199X.”

# Example of a "Cause-Effect" Logic Diagram : Land Servicing Program



# Performance Measurement Indicators

## Land Servicing

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- **Inputs**

- Proportion of public/private money used in servicing and developing land

- Number of personnel

- **Outputs**

- Number of land parcels serviced

- Number of new home buyers

- **Outcomes**

- Revenue from serviced land

- Percentage of land not serviced on schedule

- Percent of serviced land sold

- **Efficiency**

- Revenue as a percentage of cost

53

# Land Servicing

Cost per square meter of serviced land

- **Other Explanatory Information**

Location of sites

Contracting for infrastructure servicing

Number of new home buyer applicants

Number of private partnerships

# Sources of Data

## ● Financial Records

Accounting

Payroll

Tax

Land use

## ● Housing Allowance

Administrative agency

Housing agency

Household survey

## ● Land Servicing

Developer surveys

Utility companies

Citizen surveys

SS

# Performance Indicators

- **Program**

  - Communal services

- **Sub Programs**

  - Street lighting

  - Public Cleanliness

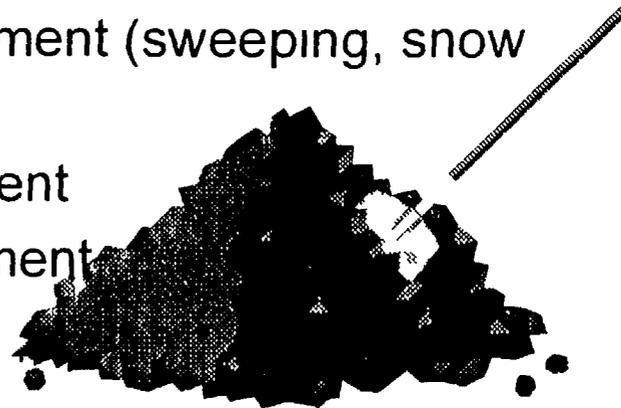
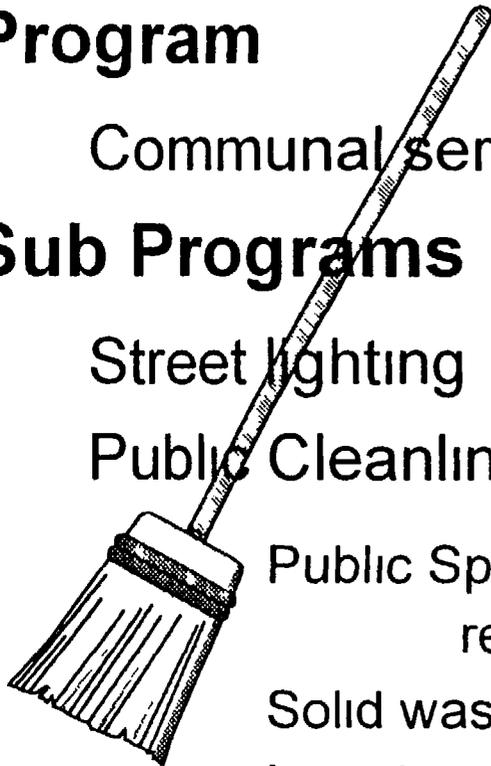
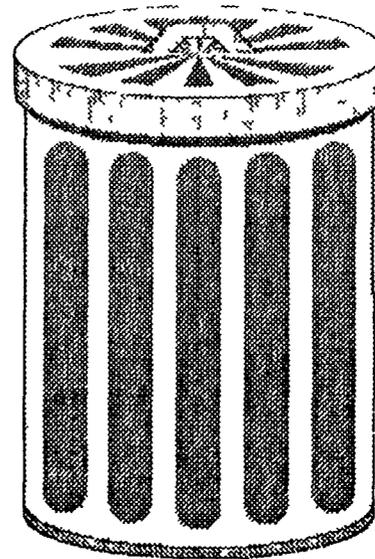
    - Public Space Management (sweeping, snow removal)

    - Solid waste management

    - Liquid waste management

  - Parks

  - Cemeteries



# Strategic Goal and Program Objective

## Waste Management

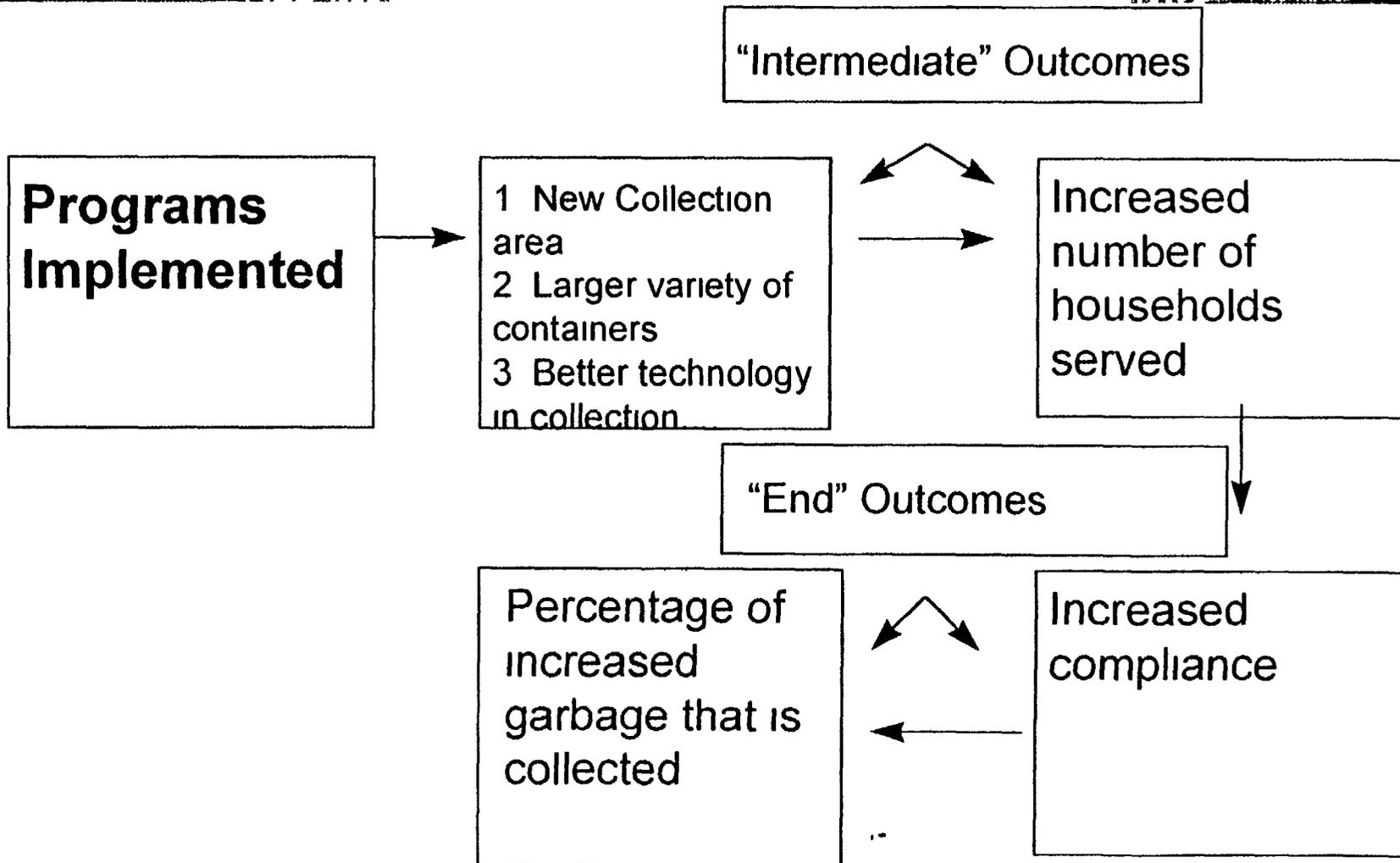
### ● Strategic Goal

“Promote the aesthetics of the city and health and safety of the citizens by providing a clean environment, free of the hazards and unpleasantness of uncollected refuse.”

### ● Strategic Program Objective

“By the end of FY 1997, increase the percentage of garbage that is collected from the current rate of X% to Y%.”

# Example of one possible "Cause-Effect" Logic Diagram: Solid Waste Collection Sub-Program



5-8

# Performance Measurement Indicators

## Solid-Waste Collection\*

4

\*From "Service Efforts and Accomplishments Reporting Its Time Has Come" Edited by Harry P. Hatry, James R. Fountain, Jr., Jonathan M. Sullivan and Lorraine Kremer GASB 1990

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- **Inputs (cost of service)**

  - Expenditures (constant and current forint)

  - Number of personnel used by local government and/or company

  - Number of vehicles

- **Outputs (units provided/ quantity of service provided)**

  - Number of customers served (business, residential)

  - Tons of waste collected

- **Outcomes (results of service provided)**

  - Percentage of streets rated acceptably clean

  - Percentage of area covered by solid waste collection

  - Average customer satisfaction rating

  - Number of customer complaints

59

# Solid-Waste Collection

Percentage of scheduled collections missed

Percentage of scheduled collections not completed on schedule

- **Efficiency\***

Cost per ton of solid waste collected

Cost per customer served

Tons of solid waste collected per household

- **Other explanatory information**

Frequency of collections

Location of collections

Average number of customers per collection route-mile

Average crew size on vehicles

Types of vehicles

\* Assess cost of the assistance relative to its accomplishments. Also enable comparisons over time

# Performance Measurement Indicators

## Solid-Waste Disposal \*

6

From "Service Efforts and Accomplishments Reporting Its Time Has Come" Edited by Harry P. Hatry, James R. Rountain, Jr., Jonathan M. Sullivan and Lorraine Kremer GASB 1990

### LANDFILLS

#### ● Inputs

Expenditures (current and constant forint)

Number of personnel

Number of vehicles

#### ● Outputs

Actual tons processed during period

Average daily tons processed

Cubic meters of landfill used

#### ● Outcomes

Percentage of quantity deposited in the-landfill that meets environmental standards

61

# Solid-Waste Disposal

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Tons of toxic material as percentage of total material deposited  
in landfill

Number of inspections to check if standards are being met

Number of citizen complaints

Cost due to personal or property damage from landfill operation

Revenue received from landfill customers

Total operating revenue as a percentage of cost

- **Efficiency**

Cost per ton of solid waste processed

- **Other explanatory information**

Type of pollution controls

Percentage of recyclable waste recycled

# Solid-Waste Disposal

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Capacity (daily processing and number of years)

Type and amount of landfill cover

## **SELECTIVE COLLECTION CENTERS & RECYCLING**

### ● **Inputs**

Same as stated earlier, plus expenditure for dangerous waste

### ● **Outputs**

Tons of selective garbage deposited at center

Tons of selective waste recycled

Percentage of recycling capacity utilized

Number of program participants

### ● **Outcomes**

Percentage of selective waste recycled

# Solid-Waste Disposal

Percentage of recyclable waste recycled

Percentage of eligible customers participating

- **Efficiency**

Cost per ton of selective waste deposited at the center

Cost per ton of solid waste recycled

- **Other explanatory Information**

Capacity and daily processing (in tons)

Nature of recycling program

Types of material recycled

Types of selective material deposited at center

Service area population (in thousands)

Separating techniques

# Performance Measurement Indicators

## Street Sweeping \*

10

From "Service Efforts and Accomplishments Reporting Its Time Has Come" Edited by Harry P Hatry,  
James R, Rountain, Jr , Jonathan M Sullivan and Lorraine Kremer GASB 1990

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### ● Inputs

Same as stated earlier

### ● Outputs

Number of street-miles cleaned

Percentage of street-miles receiving regular street sweeping

Tons of refuse collected

### ● Outcomes

Percentage of street sweeping not completed on schedule

Average customer satisfaction rating

Percentage of streets rated acceptably clean

### ● Efficiency

Cost per mile of street cleaned



# Street Sweeping

Cost per ton of refuse collected

- **Other explanatory information**

Frequency of street cleaning per month

Miles of street requiring street cleaning

Terrain

Climatic conditions

Vehicle traffic

Parking conditions

Building density

## Sources of Data

- Financial accounts
- Trained observer ratings
- Household survey
- Business survey
- Fire department records
- City or county health records
- Sanitation department records

# Results Report

Strategic Objective	1994	1995	1996		1996	
	<u>Actual</u>	<u>Actual</u>	<u>Plan</u>	<u>Actual</u>	<u>Guideline</u>	<u>Guideline</u>

## INPUTS

- Indicator
- Indicator

## OUTPUTS

- Indicator
- Indicator

## OUTCOME

- Indicator
- Indicator

## EFFICIENCY

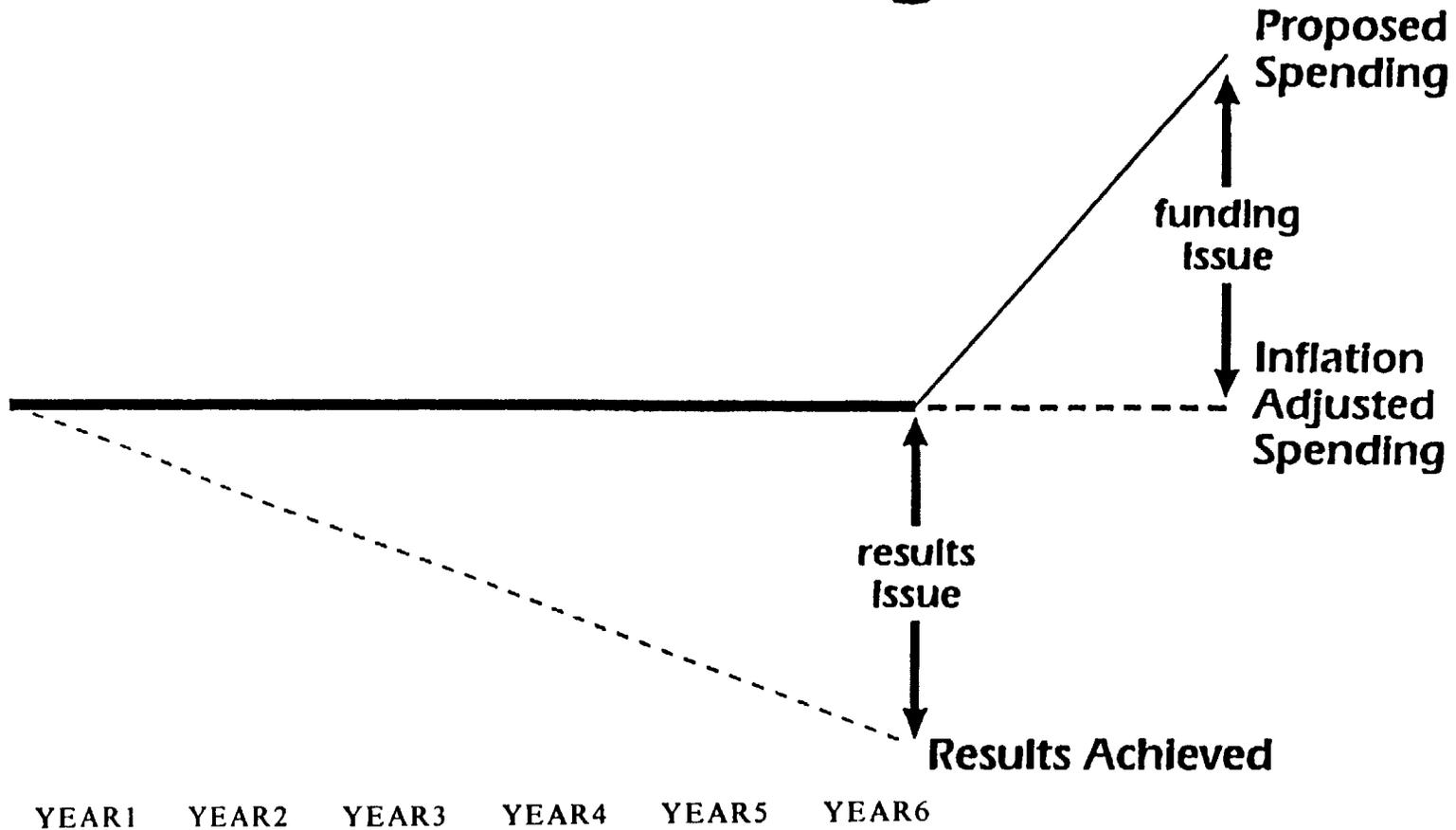
- Indicator
- Indicator

# Management Analysis of Results

## Quick Checks

1. Plan vs. Actual
  - ✓ Both positive and negative variances should be investigated
2. Trend Over Time
  - ✓ To set standards
  - ✓ Are plans realistic?
  - ✓ Is performance changing?
3. Results Issue
  - ✓ Spending is within budget but performance is declining
4. Incremental Results
  - ✓ What % change in results follows a % change in resources?
5. Benchmarks
  - ✓ Similar organizations can be compared:
    - to each other
    - to median, average, mode
  - ✓ Trends over time can be used to compare unlike organizations
6. Doing the Right Things
  - ✓ Is operational success resulting in program effectiveness?
7. Monitor Strategic Results
  - ✓ Different rates of progress guide operational planning and control

# Spending Steady, Performance Declining



## **IMPLEMENTING PROGRAM BUDGETING**

- **DEVELOP YOUR DEFINITION**
- **OBTAIN COMMITMENT**
  - **EDUCATE ON NEED FOR AND BENEFITS OF BUDGET REFORM**
  - **PROVIDE EXAMPLES FROM OTHER CITIES**
  - **IDENTIFY EXISTING PROBLEMS**
  - **OBTAIN COMMITMENT FROM ALL PARTICIPANTS**
    - MAYOR**
    - COUNCIL**
    - INSTITUTIONS**
  - **CLEARLY IDENTIFY OBJECTIVES**
    - WHAT CAN WE ACCOMPLISH THIS YEAR/FUTURE YEARS?**

## **DEVELOP DATA BASE**

- **INVENTORY EXISTING POLICY**
  - LEGISLATION**
  - EXECUTIVE DIRECTIVES**
  - GOALS & OBJECTIVES**
  - INSTITUTION PRACTICES, SERVICES**
  - MUNICIPAL FINANCIAL POLICIES & PRACTICES**
- **IDENTIFY NEW DATA NEEDS**
- **PREPARE HISTORICAL AND FORECAST DATA**
  - TRENDS (ECONOMIC, FISCAL, DEMOGRAPHIC)**
  - PRIOR ACCOMPLISHMENTS**

## **INTEGRATE INTO BUDGET PROCESS**

- **DEVELOP BUDGET REVIEW FORMAT**  
GOAL & OBJECTIVE FORMULATION  
STRATEGIC PLANS  
LONG-RANGE FORECASTS  
ANNUAL BUDGET GUIDELINES
- **INTEGRATE INTO BUDGET PROCEDURES & SCHEDULE**  
USE THROUGHOUT BUDGET PROCESS  
USE IN BUDGET REQUEST, FORMS & FORMATS  
OBTAIN EXECUTIVE DIRECTIVE  
ISSUE MANUAL & GUIDELINES
- **TRAIN INSTITUTIONS & OFFICE OF THE MAYOR**  
PROVIDE INFORMATION ON PROCESS, POLICIES
- **ORGANIZE REVIEW SESSION**
- **DETERMINE NEED FOR CITIZEN INPUT**

## **BUDGET ASSEMBLY**

- **BUDGET REQUESTS**  
RELATE TO GOALS, OBJECTIVES, PRIORITIES
- **BUDGET REVIEW**  
COMPLIANCE WITH DIRECTIVES  
IDENTIFY ISSUES  
MAKE RECOMMENDATIONS TO EXECUTIVE
- **EXECUTIVE REVIEW**  
IDENTIFY NEW ISSUES/PRIORITIES
- **BUDGET HEARINGS**  
REVIEW COMPLIANCE  
RESOLVE ISSUES  
DEVELOP DIRECTIVES  
CITIZEN INPUT

### **APPROVE/ADOPT BUDGET**

### **IMPLEMENT BUDGET**

- **MONITOR COMPLIANCE**
- **CONDUCT SPECIAL STUDIES**
- **HOLD SPECIAL HEARINGS**

### **EVALUATE**

- **MEET WITH INSTITUTIONS/MAYOR'S OFFICE STAFF**
- **FINE TUNE PROCESS**
- **MONITOR BUDGET PERFORMANCE**
- **GO ON VACATION**

### **START OVER**

**Forecasting techniques  
for designing municipal incomes and expenditures**

**by Kovács Róbert - Vígvári András**

Motto. "Forecasting is similar to driving a car with blindfold eyes and having someone to give us directions who is looking out of the back window "

October 31, 1996

## Forecasting functions

**The term** process and end result The process is the most important

### Functions:

- 1.) Preparation of the annual budget The adopted budget itself is also a forecast
- 2 ) Preparations for decision/making - preparing the basis for selections among several alternative decisions,
  - operative decisions (e g selecting from various credit opportunities)
  - project decisions (an area in the municipal financial management that can well be delineated, e g rationalization of the network of institutions, a specific project, etc ),
  - strategic decisions,
- 3 ) One tool for marketing, or “selling” the city policy
  - positive (what happens if we do so) and negative (what happens if do not do anything) images of future,

# Types of forecasting

## 1.) By period of time

- 1 1 short-term - under a year - cash flow analysis  
(e g liquidity management)
- 1 2 middle-term - preparation of the annual budget  
(e g revenues, expenditures, various segments of the budget)
- 1 3 long-term - rolling capital budgeting  
- investment projects

## 2.) By functions

- 2 1 normative forecast = finding approach(es) to a specific aim  
(e g prepare a program budget)
- 2 2 descriptive forecast = description of expected changes in societal,  
economic, political processes

# Information Basis to Forecasting -External Information

## 1.) Grouping

- 1 1 Official (state) - private, independent sources
- 1 2 Fact data - forecasts - other information

## 2. Sources

- 2 1 CSO - statistics on society, demography, economy, regions,
- 2 2 MoF, MNB - financial statistics  
state supervisions
- 2 3 Business organizations - e g professional economic research and audit firms, banks, large corporations;
- 2 4 Print media - professional literature

## **Information Basis to Forecasting -Internal Information**

1 ) Infancy of public finance accounting practices,

2 ) Objectives of accounting and financial analysis / forecasting are different,

3 ) **Structuring** municipal accounting information

**Structuring** = creation of groups of similar economic nature,

### **Options**

3 1 current, and capital (expenditures/revenues)

3 2 coming from centrally, own

3 3 by sectors

4 ) Designing indicators

## Methodological Problems of Information Handling

1 ) Necessity of organizing, structuring information of “own production”

2 ) Problem of the time-value of money Currencies in different point I time are not comparable

$$1 \text{ DM} \neq 1 \text{ USD}$$

$$100 \text{ Ft}_{1994} \neq 100 \text{ Ft}_{1995}$$

Two problems are to be handled when bringing them to a common derivative

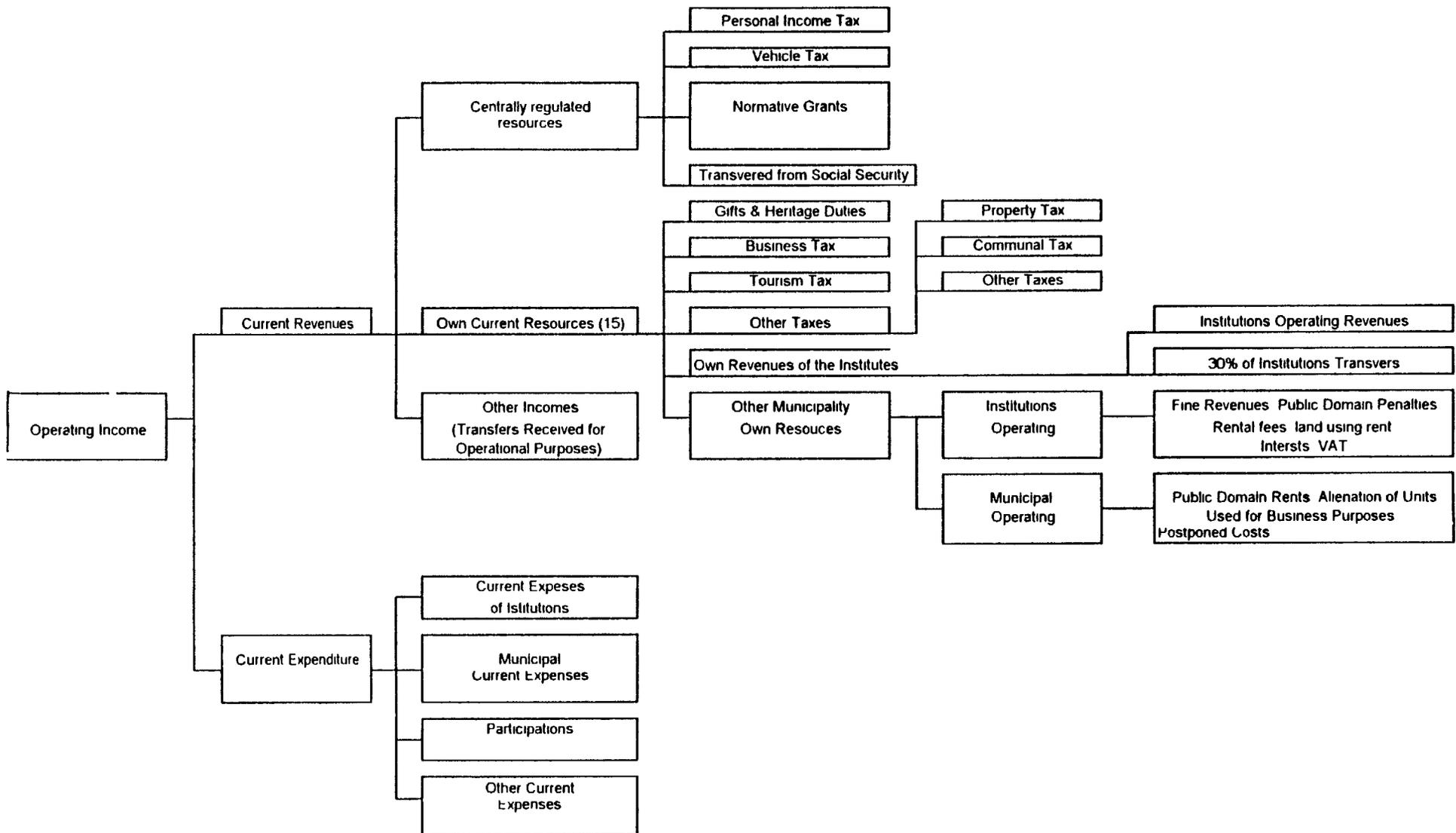
2 1 Handling inflation (what price index?, consumers price index?)

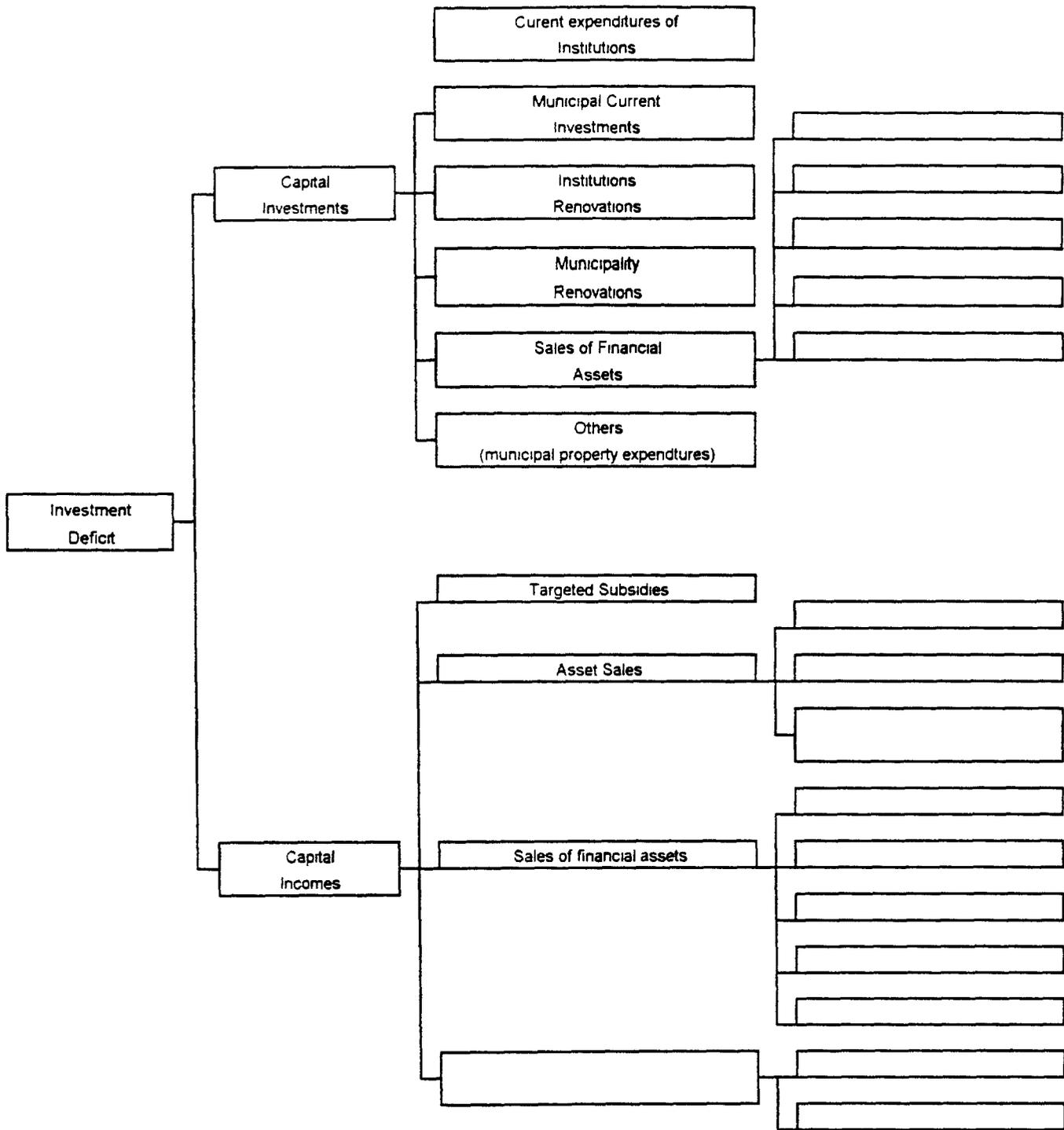
2 2 Handling alternative approaches for usage,  
⇒ see **capital budgeting**, later,

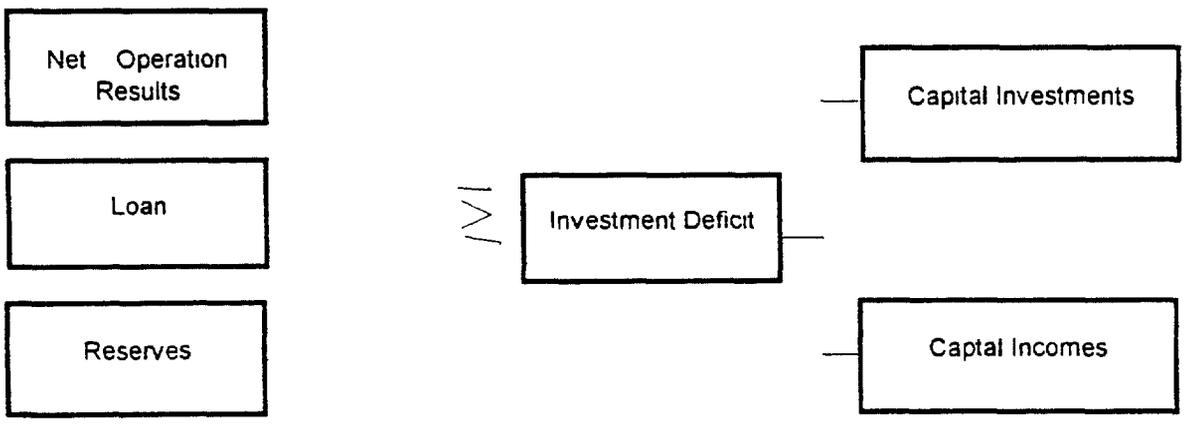
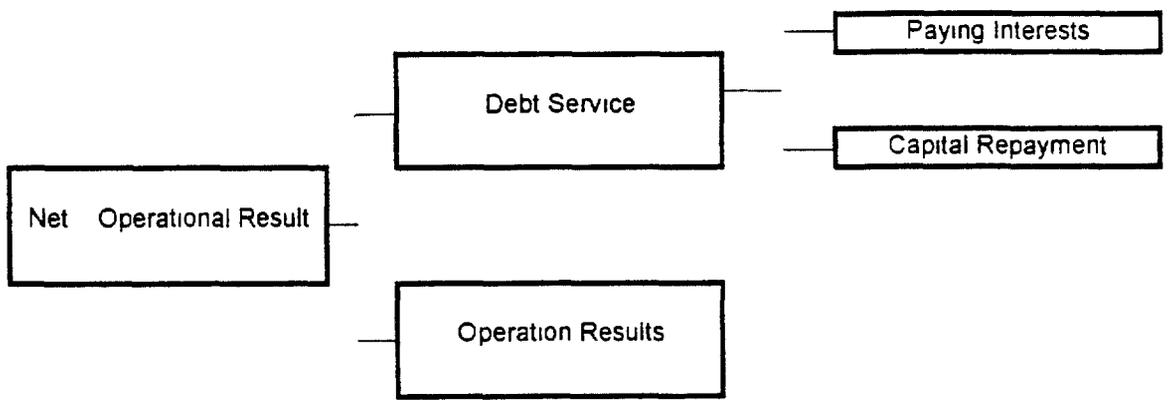
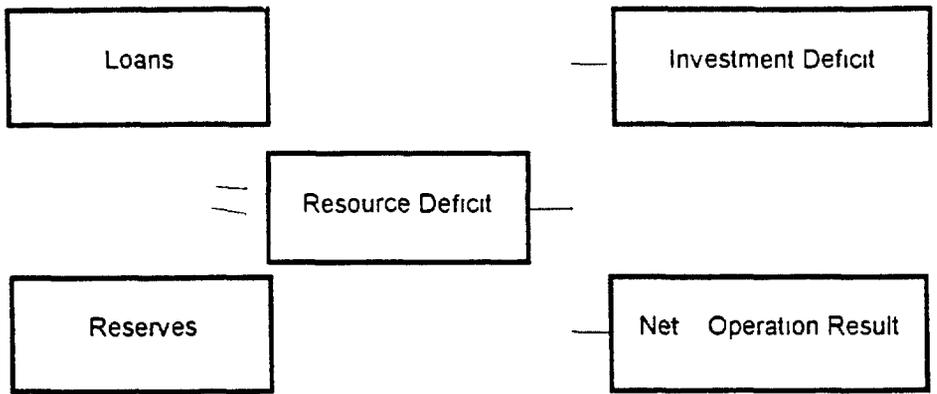
3 ) **Method** → discounting,

Method of inflating

Current price in Millions of HUF	1990	1991	1992	1993	1994	1995	1996	1997
basic case	100	100	100	100	100	100	100	100
increasing amount case	100	140	190	220	230	250	275	290
consumer price index (previous year 100%)	100	135	123	122,5	118,8	128,8	124	122
index in 1995's base	3,11	2,31	1,87	1,43	1,28	1	0 81	0 66
index in 1990's base	1	0,74	0,60	0,49	0,44	0 34	0 26	0,21
<b>IN 1995's PRICES</b>								
basic case	311,25	230,55	187,44	143,10	128,00	100,00	80,65	66,10
increasing amount case	311,25	322 78	356,14	314,83	294,40	250,00	221,77	191,70
<b>IN 1990's PRICES</b>								
basic case	100,00	74,07	60,22	49,16	43,94	34,12	25,91	21 24
increasing amount case	100,00	103,70	114,42	108,16	101,06	85,29	71 25	61,59
<b><math>F_{t_{90}} * (1 + CPI_{91/90}) = F_{t_{91}}</math></b>								







## REVENUE ALTERNATIVES

- *USER FEES*
- *IMPACT FEES*
- *LOCAL TAXES*
- *OTHER????*

### THESE ARE FORMS OF:

- *DEDICATED REVENUE*
- *SELF SUPPORTING*

## CONTRASTING CHARACTERISTICS OF TAXES AND USER FEES

	<u>TAXES</u>		<u>USER FEES</u>
1	SERVICE MUST BE SUPPLIED ON A GROUP BASIS	1	SERVICE CAN BE SUPPLIED TO AN INDIVIDUAL
2	BENEFITS ACCRUE TO THE COMMUNITY AT LARGE	2	BENEFITS ACCRUE TO AN INDIVIDUAL
3	CANNOT WITHHOLD SERVICE TO INDIVIDUALS WHO REFUSE TO PAY	3	CAN WITHHOLD SERVICE FROM INDIVIDUALS WHO REFUSE TO PAY
4	MERIT GOODS - TO BE PROVIDED TO ALL REGARDLESS OF ABILITY TO PAY (PUBLIC EDUCATION)	4	COST CAN BE PASSED ON TO ULTIMATE BENEFICIARY
5	DEGREE OF UTILIZATION DIFFICULT OR IMPOSSIBLE TO MEASURE	5	DEGREE OF UTILIZATION CAN BE MEASURED
6	GOVERNMENT NOT ABLE TO COMPETE WITH PRIVATE SECTOR	6	COMPETITION WOULD RESULT IN IMPROVED EFFICIENCY
7	GOVERNMENT UNABLE TO EFFECT USAGE PATTERNS	7	RATIONING OR BALANCING USAGE PATTERNS

## FACTORS

- *DEFINE WHAT WILL BE PRICED*
- *DEFINE UNIT OF MEASURE*
- *DETERMINE COST*
- *SET BASES FOR PRICE*
- *ESTABLISH BILLING AND COLLECTION PROCEDURES*
- *MONITOR AND UPDATE*

## PRICING POLICIES

- *COST - RECOVER COST OR GENERATE REVENUE IN EXCESS OF COST*
- *COMPETITION - WHAT WOULD USER PAY TO OBTAIN SERVICE FROM ANOTHER SOURCE*
- *DEMAND - PRICE VARIES IN RELATION TO # OF USERS WHO WANT THE SERVICE IN PARTICULAR WAYS, CERTAIN TIMES, OR SPECIFIC LOCATIONS*
- *SOCIETAL - PRICES ADJUSTED TO REFLECT SOCIETAL OBJECTIVES (POOR PAY LESS, RATION DEMAND, DISCOURAGE TYPE OF COMMERCE)*

## CONSIDERATIONS

- *BREAK EVEN*
- *WILLINGNESS TO PAY*
- *ABILITY TO PAY*
- *SOCIAL BENEFITS*
- *DEPENDABILITY*
- *CAN USER BE IDENTIFIED*
- *ARE BENEFITS MEASURABLE?*
- *DOES IT REDUCE WASTE /OVERCONSUMPTION?*

- *WHAT DOES IT COST?*
  - *CONSTRUCTION*
  - *DELIVERY*
  - *AMOUNT CONSUMED*
  - *DENSITY AND DISTANCE*
  - *OPERATIONAL COSTS*
- *COMPETITIVE POSITION*
- *EASE OF COLLECTION*
- *WILL IT GENERATE REVENUE?*

## TYPES OF RATES

- MARGINAL
- FLAT
- INCREMENTAL
- MEASURED
- SOCIETAL
- PEAKLOAD/SEASONAL
- DECLINING BLOCK
- ZONE
- CLASS

**QUANTITY**  
*Amount Consumed*

**CAPACITY**  
*Cost to Produce*

**LOCATION**  
*Density/Distance*

## EXERCISES

WORK SHEET  
WRITING STRATEGIC OBJECTIVES AND POSSIBLE SOLUTIONS

NAME OF PROGRAM AREA \_\_\_\_\_

STRATEGIC OBJECTIVE FOR THIS PROGRAM AREA \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

POSSIBLE SOLUTIONS FOR ACHIEVING THIS STRATEGIC OBJECTIVE

- 1 \_\_\_\_\_
- 2 \_\_\_\_\_
- 3 \_\_\_\_\_
- 4 \_\_\_\_\_

CRITERIA USED IN SELECTING SOLUTION

- 1 \_\_\_\_\_
- 2 \_\_\_\_\_
- 3 \_\_\_\_\_
- 4 \_\_\_\_\_

SOLUTION RECOMMENDED

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

# Case Study: Development of Performance Measures "Your City"

## Assignment

Define the program and sub-program which will be the area of focus for *your city* in this first year of the municipal budgeting program. State the strategic goal and strategic program objective and then develop performance measures (input, output, outcome and efficiency) for this program. Also identify the possible sources of data which can help you in calculating the performance measures.

One person from your group will be asked to present the above material. He/she will have 5 - 10 m for the presentation.

# Performance Indicators

- Program
- Sub Programs

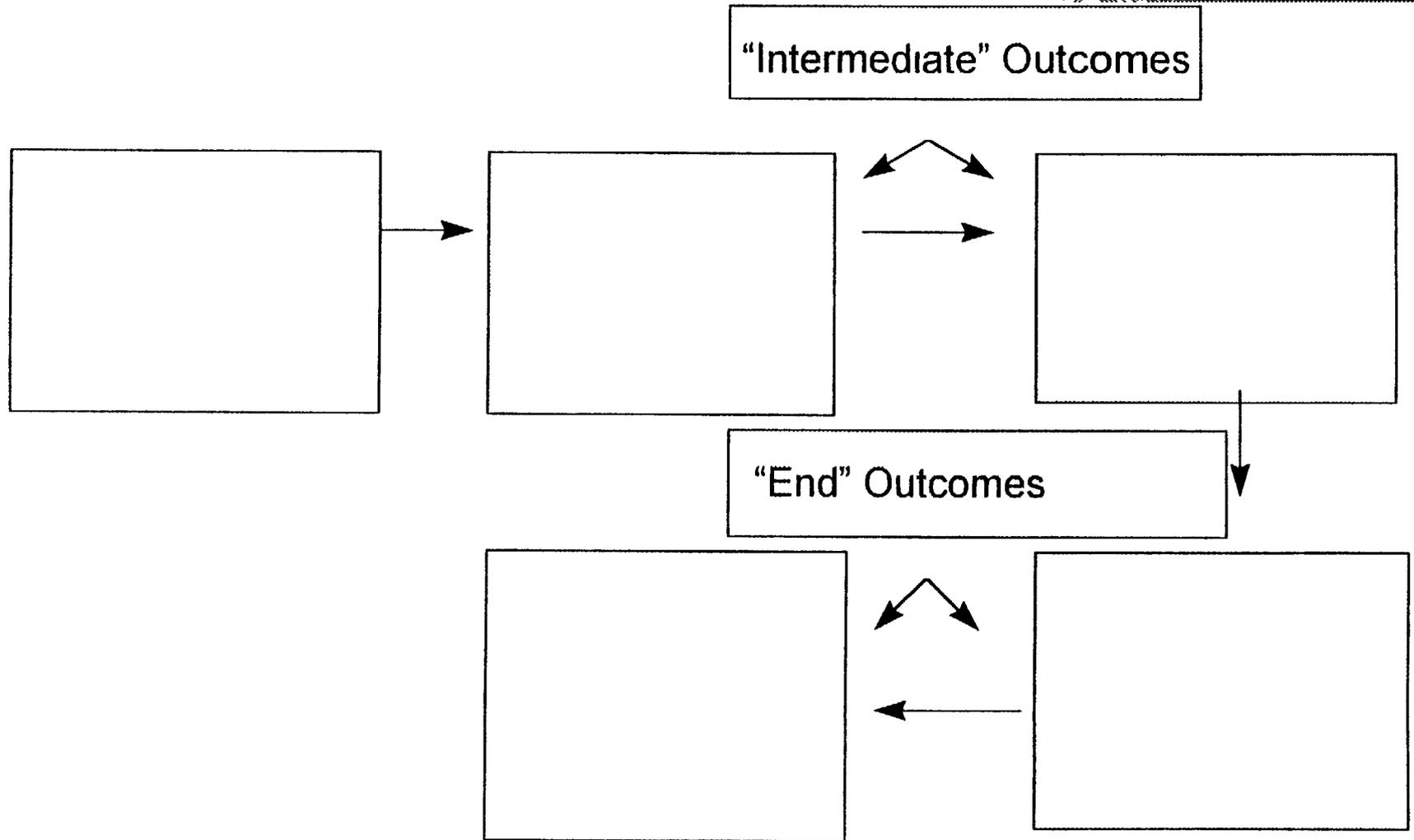
# Strategic Goal and Program Objective

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- **Strategic Goal**

- **Strategic Program Objective**

# Example of one possible "Cause-Effect" Logic Diagram: for the Chosen Program



# Performance Measurement Indicators

- Inputs
- Outputs
- Outcomes

# Performance Measurement Indicators

- **Efficiency**
- **Other explanatory information**



**Practical Exercise**  
**for the Morning of October 31, 1996**  
**(practising the CLF method and inflationary adjustment)**

Based on the "Average City" database, make the following calculations

- 1 Based on the fact data, prepare the CLF tables for 1992-1995
- 2 Prepare the adjustment of line "Total revenues" at 1992 prices for 1993-95  
(Consumer price index data 1993/1992=122,5, 1994/1993=118,8,  
1995/1994=128,8)
- 3 Prepare a forecast of the aggregate figures of the CLF table under the following assumptions
  - consumer price index 1996/1995=124, 1997/1996=122,
  - the amount of each current revenue should be defined by the trend analysis method
  - an annual 2% real decrease is expected in total current expenditures
  - debt service will remain of the same level in both years
  - for calculations, use an investment surplus of 1% of current expenditures for 1996, and an investment deficit of 2% of current expenditures for 1997
- 4 Your speaker should interpret the calculation results over max 5 minutes

## Average City

current price

1995 price level

		1992	1993	1994	1995	1992	1993	1994	1995
<b>Revenues</b>									
r1	Total revenue	2 622 262	2 960 386	3 736 024	4 129 957	4 922 869	4 536 851	4 819 471	4 129 957
	Centrally regulated sources	1 485 178	1 632 240	1 841 139	2 123 409	2 788 180	2 501 441	2 375 069	2 123 409
r2	Shared taxes (PIT vehicle)	367 808	314 415	388 345	519 530	690 499	481 848	500 965	519 530
r3	Normative subsidies	1 010 998	1 194 951	1 200 331	1 207 198	1 897 983	1 831 287	1 548 427	1 207 198
r4	State transfers (addressed targeted subsidies)	106 373	122 873	252 463	396 681	199 697	188 306	325 678	396 681
	Own operating revenues	602 204	675 207	836 609	962 076	1 130 540	1 034 768	1 079 225	962 076
r5	Local taxes (local business tax)	48 048	70 509	111 261	149 955	90 202	108 057	143 527	149 955
r6	Local taxes (property tax tourist tax communal)	23 302	30 404	31 132	23 317	43 745	46 595	40 160	23 317
r7	User charges fees other own revenues	530 855	574 294	694 216	788 804	996 594	880 117	895 538	788 804
	Own capital sources	136 250	155 932	337 487	415 521	255 786	238 968	435 358	415 521
r8	Revenue from asset sales	113 383	140 516	310 211	356 729	212 858	215 344	400 172	356 729
r9	Revenue from property	22 867	15 416	27 276	58 792	42 929	23 625	35 186	58 792
r10	Loans	132 300	199 064	365 513	289 950	248 372	305 070	471 512	289 950
r11	Social Security transfer	193 565	229 082	266 023	279 309	363 386	351 073	343 170	279 309
r12	Transfers from the previous year	72 243	67 887	87 561	54 718	135 624	104 038	112 953	54 718
r13	Other outer source	523	974	1 693	4 973	981	1 493	2 184	4 973
<b>Expenditures</b>									
e1	Total expenditures	2 406 978	2 811 389	3 623 405	4 058 666	4 518 709	4 308 510	4 674 193	4 058 666
	Operation cost	1 977 008	2 362 640	2 856 764	3 205 222	3 711 511	3 620 793	3 685 225	3 205 222
e2	Office of Mayor	264 641	365 610	474 598	602 037	496 820	560 305	612 232	602 037
e3	Health	304 237	338 786	365 235	407 845	571 156	519 197	471 153	407 845
e4	Education	1 075 817	1 262 178	1 539 025	1 694 779	2 019 672	1 934 313	1 985 343	1 694 779
e5	Social	123 423	155 620	190 120	235 203	231 706	238 491	245 255	235 203
e6	Public Utilities	194 797	213 719	263 958	235 524	365 699	327 528	340 506	235 524
ee4	Other operation cost	9 009	21 480	16 297	21 391	16 913	32 919	21 023	21 391
	Capital investments	411 141	421 322	625 576	730 291	771 851	645 685	806 993	730 291
e7	Office of Mayor	140 444	134 023	189 809	170 544	263 660	205 394	244 853	170 544
e8	Health	22 558	9 660	17 234	15 642	42 348	14 805	22 232	15 642
e9	Education	93 511	132 867	116 101	177 365	175 552	203 622	149 770	177 365
e10	Social	4 819	8 072	3 333	9 250	9 047	12 370	4 300	9 250
e11	Public utilities	148 265	131 480	197 829	170 875	278 343	201 496	255 200	170 875
ee7	Other tasks	5 085	5 103	7 530	8 299	9 546	7 820	9 714	8 299
e12	Debt service	19 327	29 269	224 058	309 479	36 283	44 855	289 035	309 479
e13	Other investment	1 046	3 529	8 261	366	1 964	5 408	10 656	366
	Balance of the previous and present year remainings	55	1 917	3 805	1 145	103	2 938	4 909	1 145
	Closing cash	12 174	10 692	5 283	7 945	22 854	16 385	6 815	7 945
<b>Statistical Indicators</b>									
s1	Population	57 393	57 693	57 691	57 640	57 393	57 693	57 691	57 640
s2	PIT per capita	7 706	7 905	11 672	8 288	14 467	12 114	15 057	8 288
s3	Local government employees	546	556	552	551	546	556	552	551
s4	Outstanding debt	163 522	356 315	629 440	1 149 294	306 986	546 059	811 978	1 149 294
s5	Value of the asset	2 961 811	4 231 647	5 234 988	5 774 188	5 560 317	6 485 037	6 753 135	5 774 188
s6	Unemployment rate	8.7	10.8	8.8	7.8	8.7	10.8	8.8	7.8
s7	Number of newly built units	97	107	135	113	97	107	135	113
n	New business permits	949	966	834	709	949	966	834	709

trening

<b>Current price in Millions of HUF</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
Own current resources						
Centrally regulated current resources						
<b>Current revenues</b>						
<b>Current expenditures</b>						
<b><u>Operating income</u></b>						
<b>Debt service</b>	19327	29269	224058	309497		
<b><u>Net operating income</u></b>						
Own capital resources						
Centrally regulated capital resources						
<b>Total capital revenues</b>						
<b>Total capital expenditure</b>						
<b><u>Investment deficit</u></b>						
<b><u>Total financing need</u></b>						
<b>Closing balance</b>						
<b>Consumer price index (previous year 100%)</b>						

102

## FEE CASE NARRATIVE

Based on accounting records, all operating and capital costs of the Szolnok Sanitation Department have been classified into the three following categories

Collection	FT 800,000,000
Hauling & Disposal	FT 500,000,000
Administration	FT 200,000,000
Total	FT 1,500,000,000

The City is considering establishing user charges for sanitation services. The City wants to develop a pricing strategy that recognizes that the cost of providing the service to each customer is not the same. It would not make economic sense to divide the Sanitation Department's total cost by the number of customers and charge this price to each customer. A factory produces more waste than an apartment, for example. Why should the apartment unit pay the same price as the factory when residential costs to the City are lower than industrial costs?

### Your Role

Complete the attached worksheet building upon the information listed on the worksheet. Your analysis will determine the user charges for various kinds of customers by relating the user charge to the cost of service. User charges should cover total costs - FT 1,500,000,000 - of the sanitation department so that no financing from the Szolnok budget is required. The objective is to set a fee for different types, or classes, or customers.

### Factors to Consider

The major component of collection costs is the labor of the pickup crews. The resulting time and related labor cost of collecting from various customer sites will depend on the density of the area, the pickup location (e.g., curbside or back of a lot), amount of refuse collected, and other factors.

Disposal costs are determined by many factors, the two most important being the weight and volume of the refuse.

Administrative costs are not significantly affected by the type of customer served.

**SZOI NOK SANITATION DEPARTMENT FEE WORKSHEET**  
(FT IN 000, KILOS IN 000)

	MULTI FAMILY	SINGLE FAMILY	COMMERCIAL	INDUSTRIAL	OTHER
A # of customers	20,000	5,000	4,000	500	100
B Average collection time per pickup (minutes)	1	15	5	1	2
C Collections per week	2	2	2	3	5
D Total collection time	?	?	?	?	?
E Total collection time per week all customers (A x D)	?	?	?	?	?
F % of total collection time (E as a % of 61,500)	?	?	?	?	?
G Allocation of collection costs (total annual costs of FT 800,000 x F)	?	?	?	?	?
H Annual collection costs per customer (G/A)	?	?	?	?	?
I Estimated average kilos per customer per week	025	025	025	1	4
J Total kilos per week (A x I)	?	?	?	?	?
K % of total kilos (J as a % of 1,625)	?	?	?	?	?
L Allocation of hauling & disposal costs (total annual costs of FT 500,000 x K)	?	?	?	?	?
M Annual hauling & disposal costs per customer (L/A)	?	?	?	?	?
N Fixed administrative costs per customer (FT 200,000 / total customers = 29,600)	FT 7	FT 7	FT 7	FT 7	FT 7
O Annual estimated sanitation fee (H+M + N)	?	?	?	?	?

## BACKGROUND READING

:

## Local government housing programs

### I Responsibilities and tools of local governments in the housing sector

Housing is an important problem of social policy since its impacts are present in employment production investments and the expenditures of households. The government however has an ever decreasing level of competence in housing issues since the trends dominating the housing sector has increasingly become the functions of decisions interests and requirements of forces outside the government. The local governments therefore has an important role to play in this area. The Municipal law does not define exactly the housing management and housing services related responsibilities of local governments. Therefore individual local governments will have to make decisions for themselves as to what services they want to provide.

There are three basic groups of housing related municipal services

- to provide social welfare support to those in need
- to control the development and operation of the housing market and the market for rental flats and lands for construction
- to develop master plans that are in line with the expected housing demands of the community

Municipalities have the following tools available to them

- they have the authority to define the use of individual pieces of land (master plan)
- they have ownership over land and housing units
- they receive normative subsidies for housing services they have the income from sales of apartments started as of January 1 1994
- they have the right to determine the rents for rental flats in municipal ownership

### II. Housing problems

Before a local government decides to make a housing program first of all they have to describe the evaluation of the housing situations and identifying the type of the housing problem. There are different types of housing problems

#### 1 Critical housing situations

- the problem of acquiring a first flat
- buildings with one flat units
- pension homes
- forced tenancy
- private tenants and subtenants

2 The decreasing housing construction as a problem which is related to the decreasing demand or the shortage of building sites or the lack of credit etc

3 The social housing problem (the affordability of housing costs and the related problems of social situations and slumming)

4 Housing quality (worn down units renovation)

5 Mobility

Different communities have to face very different housing problems. Still it would be important to be able to take sides about priorities concerning the social weight of the problems. Priorities for the communities can exceed the housing policy goals in the narrow sense. So for example we can aim at improving the social demographic composition of a community or at increasing the amount of subsidies coming to the community.

A housing problem can give answers to different housing problems depending on its internal structure. So local governments have to start from the given housing problem and to construct programs related to it. Examine the costs of the alternative solutions and then select one from them.

### III Local government housing programs

#### 1 Local government housing constructions

1 a Construction of houses owned by the local government. This program wants to resolve the social problem but it has effect on mobility as well. These kind of programs are very dangerous because in long term this investment will produce deficits since rents will not cover the costs. In recent years in the case of local government housing constructions usually those have been given priority who gave their former flat to the local government or those who were buying their first flat. It happens quite often that one flat units are built and tenants have to take part in pre saving schemes.

1 b Local governments as developers. Local governments less and less often act as housing developers in order to sell their flats. This would be economically justified if private developers did not enter the market or if the housing supply is very inflexible and the local government think they have to provide for the demand not met by the market. Another reason for new construction can be if units are bought and taken by the local government in order to start some development at the site or if areas used with bad efficiency are freed and units have to be provided for the residents in exchange.

The local government as a housing developer however takes a high risk the cost of which is paid by the communal sector and it is doubtful whether it is justified and if the conditions of profitability are present.

#### 1 c Mixed ownerships (private and public)

The local governments invest money in these constructions and it will become owner in some portion. In this way subsidy can be given to people whom eligibility hardly could be measured. The advantage of this program is that the real value of the invested money will not decrease.

#### 2 Rehabilitation

According to studies the demand for rehabilitation is very high but because of the magnitude of the problem only programs based on private resources are possible. If a local government is planning rehabilitation it has to think it through how the program can be adopted to the structure of the market segments and internal problems (former rental units in cities, housing estates, single family houses). When creating the subsidies for rehabilitation programs we should aim at helping rehabilitation on the one hand and preventing segregation as the consequence of renovation. The two problems have to be handled through different instruments.

#### 3 Giving building sites for developers in exchange for temporary units

The local government may decide to give a building site free for a developer in exchange for building temporary units besides the units built for sale. This program also wants to resolve social problems.

#### 4 Living area extension program

Local governments struggling with a serious problem in lacking financial resources and having a favourable geographical location may choose to attract people with high income and good qualifications in order to increase their personal income tax and normative revenues. This makes it necessary to form new living areas (area development, new building sites, infrastructure).

#### 5 Subsidies for buying a first flat

Helping young people to buy their first flat is part of the program of nearly all the local governments. The present system however has serious shortcomings which make it necessary to revise this subsidy system. The problem can be managed by considering the financial standings of young applicants beside their regular income. Not only real estate but personal property high value could be considered (e.g. cars).

#### 6 The reform of the rental sector: increasing the rents of municipal rental flats to a level that reflects the real costs on flats

Reasons: lack of funds for repair and renovation  
the operating deficit uses up funds for other purposes

the indirect subsidy realised by low rents is not always needed or fair

Implementation gradual increases of rents (first 100% later 50% than in line with inflation annually)

new rents should reflect the quality of flats and they should be proportional to the value of those flats

#### 7 Introduction of a new housing subsidy

Reasons it is closely related to increased rents it is based on neediness the city provides subsidy to those low-income households only who are not able to pay the higher rents and public utility bills calculated normally on the basis of family size

Implementation the housing subsidy program replaces the remote heating subsidy and the rents subsidy The social policy department administers it

The city sets up standards

- share of income for housing costs (the limit is 35%)
- standard unit (per family + persons)
- standard rent
- standard utilities charges

#### 8 The rental system reform

The new rental contract should be made for a definite period without obligation for making another home available to tenants

#### 9 Utilisation of privatisation incomes

They should be spent on the problems of the remaining rental flat sector and possibly to the management of the stock until a private rental flat sector able to survive evolves

#### 10 Management and maintenance of rental flats

A competition should be introduced in the area of property management

#### Costs of the program

If the local government intends to create a housing program it has several alternatives to choose from In each case it has to be examined carefully what problem that certain program addresses what it costs and what elements of the budget are involved The local government also has to think it over how efficient it could be in implementing a certain program In many cases this only can be done by careful analysis The following table tries to collect the main incomes and expenditures of the sector

Incomes and expenditures in housing sector?

INCOMES	EXPENDITURES
Normative subsidies for housing related services (housing management interest subsidies remote heating subsidies rents subsidies)	Maintenance rehabilitation
Incomes from housing privatisation	Subsidies <ul style="list-style-type: none"> <li>• housing</li> <li>• remote heating</li> <li>• rents</li> <li>• first home buyers</li> <li>• interest subsidy</li> </ul>
Housing incomes (rents + expected rents in arrears)	Other expenditures <ul style="list-style-type: none"> <li>• housing mobility</li> <li>• construction loans and interests</li> <li>• subsidies to municipal employees</li> <li>• payments in arrears</li> </ul>
Incomes from sales of land and use of land	

## WASTE MANAGEMENT

### 1 *Facts*

- According to estimates *20 million m<sup>3</sup> solid communal waste* is created yearly in Hungary. This is probably only an approximate figure since in 20% of the municipalities there is no organized waste collection at all and it is not clear how you can measure this quality either. 65-67% of the households in the whole country are involved in regular waste collection which means approximately 10 million m<sup>3</sup> waste.
- The proportion of household sewage not in public network and the *liquid communal waste* is 40% nation-wide.
- In the cities specialized organizations and companies do the work on the basis of detailed agreements while in the villages the local governments tend to use their own work force and equipment often doing the job manually. At some places waste is collected by the inhabitants themselves.
- Where there is organized solid waste collection the order and frequency of it is regulated through local government decrees (the frequency of collection varies in different types of communities) while the activities concerning liquid waste (collection, handling, treatment) are not regulated at all by many local governments. Therefore they do not have any information about the quantity of the collected liquid waste and the way it should be treated etc. although it would be very important concerning the protection of the environment.
- The vessels used for collection may be different in size and type but the technical solutions for transporting and dumping have not really changed in the past few years - partly because the necessary developments were not realized due to the lack of financial resources. The average age of vehicles and other equipment is high few of them use up-to-date technology.
- The conditions of dumping and treating solid waste (i.e. orderly dumping, composting, burning) are also not favorable there is only one plant where waste is burnt in Budapest there are very few places where waste is treated in a way to reduce its volume and according to estimates 8-10% of the waste which is collected is not even dumped in an orderly way.
- In small communities due to the lack of adequate protection a significant amount of industrial waste - including hazardous waste - is dumped in the communal dump which means an even more intensive pollution of the environment.
- In most waste dumps the quantity cannot really be measured although it is stated in m<sup>3</sup> the actual load on the vehicles is not measured.

### 2 *Legal background - the tasks and responsibilities of the local governments*

The legal regulation of the activities and the precise definition of functions was formed through a difficult and slow process. Earlier professional regulations made a clear distinction between *public cleanliness* and *communal cleanliness* the first including the activities concerning solid waste and the cleaning of public areas (street

cleaning removing snow ice and dust) while the other was only used concerning liquid communal waste

*The regulation of the activities is divided even between ministries* that is the 39/1990 and 43/1990 Government Decrees made the activities related to communal provisions and municipality operations the responsibility of the Interior Minister while determining the professional regulations and requirements of waste management became the responsibility of the Minister of Environmental Protection and Regional Development

#### **1990 LXX (Local Government) Act**

8 § (1) *it is the responsibility of the local government to protect the natural and artificial environment to ensure communal cleanliness*

*It was not clear what it really meant although it suggested that it included all functions concerning cleanliness but in an amendment in 1994 the word public cleanliness was placed beside it and it is not required as a mandatory local government function*

#### **1991 XX Act (on the spheres of responsibilities)**

20 § identifying the place for liquid communal waste disposal and creating a treatment plant for the public benefit

21 § providing for the cleanliness of public areas and hauling

138 § deciding on supporting the public services not carried out through the budgetary organizations of the local government

This means that the tasks of handling collecting and treating solid communal waste are not legally regulated

#### **1995 XLII Act on the obligatory utilization of certain local public utility services**

1 § (1) The owner of a property in an area covered by public services organized by the local government to collect and locate solid and liquid waste is *obliged to make use of these services*

(3) the local governments invites *open tenders* for the performance of these public services (the invitation has to specify the location of treatment plants)

2 § f) the local government decides whether the owner is obliged to pay a fee the amount of the fee the order of payments and the allowances (if there are any)

#### **1995 LIII (Environmental Protection) Act**

46 § (1) - 47 § the local government (or more than one local governments together) develop an *independent community environmental protection program* which has to include the cleanliness of the environment of the community the task and requirements for communal waste management concerning the community

58 § the local government can create an *environmental protection fund* to be used for the protection of the environment and the revenues of which are the following 100% of environmental protection fines levied by the local government 30% of environmental protection fines levied by the regional environmental protection authorities and a certain part of the environmental fees and utilization fees as specified by the law

111

**16/1996 (VII 15), joint decree by the Interior Ministry and the Ministry of Environmental Protection and Regional Development on the provision of local public services concerning solid and liquid communal waste**

*the task collecting transporting and safely disposing the waste*

collecting and transporting must not cause pollution only legally permitted dumping or treatment sites may be used (using other locations is therefore illegal!) collection must be performed in closed containers specifically allocated for this purpose

communal solid waste must be collected at least once a week trash collection must take place at least once a year

the local government can create a *waste yard* for the selective collection and treatment of waste

Later amendments make the interpretation of concepts and the scope of responsibilities clearer e.g. liquid waste treatment has still no uniform interpretation anyone can take it to any length which creates a lot of problems since there is an especially high number of private contractors in this field

### **3 Financing**

At present in Hungary these services are performed *in many different kinds of organizational frameworks* so the list below may change according to whether it is a budgetary institution or a separate enterprise and whether it is a local government owned or private ownership company. The dumping sites are in private hands in many cases and there is a large number of private contractors especially for liquid waste transport

**From the point of the municipality this all means that the structural form the service is provided in (see the text below) influences the possibilities it has and consequently content of the budgetary program defined by it (see 4) and elements to be incorporated in this program**

### 3.1 Revenues

	From the central budget <sup>1</sup>	Local government own	Service provider
Operatio n	<i>communal service normative</i> (17637 M Ft) 1637.3 Ft/person	waste collection user fee	
	<i>personal income tax share</i> (11% reallocated = 21710.7 M Ft) 1741 Ft/person	local communal tax	
	<i>centrally allocated grant</i> to support treatment of liquid communal waste (224 MFt) <sup>7</sup>		fee for emptying the sewage containers directly paid by the households
	<i>30% of the environmental protection fines</i> levied by the regional environmental authorities	100% of the legally approved environmental protection fines levied by the local government	
			revenues from the rent or sale of assets
			repair of vehicles maintenance work for others
Invest- ment	TARGETED SUBSIDY construction of solid communal waste dump - 30% (1998-40%) construction of communal liquid waste treatment plant <sup>4</sup> - 40%	development contribution from the households + the service sector (if this component is not built in the fee)	

<sup>1</sup> Actual figures are from the 1996 budget

We should add that according to the text it was used to assist waste collection in the interest of the protection of water bases and has been confined to treatment only since 1995. All the local governments are eligible that have this service performed either through their own organisation or an outside contractor. The amount of the subsidy is a function of the amount of waste treated and can be applied for only after treatment has taken place. It is 106 forints/m<sup>3</sup> but measuring the quantity is not possible at most places so estimates are used and proofs of it are often lacking.

If there is no site with free capacity within 20 kms or the site provides for more than 10 000 people or the site is officially declared to be harmful or if the site endangers a sensitive water base (1/1)

1996 priority large plants 1988 only in association

	(1998-50%)		
	<b>SEPARATE FUNDS</b> <b>Environmental</b> for investments directly promoting the protection of the environment (subsidy or subsidized loan or interest subsidy for existing loans for 30-60% of the planned costs of the investment) <sup>5</sup>		
	<b>Economic development</b> mainly production investments assisting the use of up-to-date technology for infrastructure development contribution		
	<b>Regional development</b> for communal waste management investments (the subsidy cannot be more than 70% of the costs of the investment)		

\* the local government multiplier figure for areas which are backward or where unemployment is higher than the national average is 2

### 3.2 Expenditures

*Solid waste* - if as it happens at present in Hungary in most of the cases the local government has contracts with one or more companies expenditures mean bills to pay for it but it has an influence on things since it is the customer for the services. In this case it is also important to compare the revenues allocated for this purpose - either specifically or from general resources - and the expenditures that is to measure the efficiency of the program

There are only few examples of this in Hungary see for instance communities included in the USAID-LEM project Győr Ózsd Edeleny

If the same communal service company performs collection and dumping as well it is still worth separating the expenditures according to the specific locations defined on the basis of activity (e.g. collection transport disposal individual contracts)

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<sup>5</sup> Condition drinking water through public works - should be suitable for connection to sewage system in the future and it should also be possible to make it suitable for sewage treatment (Except the largest special status cities and Budapest)

But local governments companies performing public service with a majority share of local government or state ownership budgetary institutions and civil organisations are also eligible

***The present structure of expenditures (for companies)***

OPERATION

- Staff costs (wage social security tax etc )
- Material
  - materials
  - assets
  - rents
  - operation costs of vehicles
  - spare parts
- Administrative costs

INVESTMENT

- Vehicles
- Containers
- Disposal sites

In the case of **liquid waste** usually it is not the local government that is in contract with the contractors but directly the households

The **cleaning of public areas** - this is done by the local governments using their budgetary resources

**3 3 Problems**

***The subsidy system***

*The community operational normative grant* provides subsidies for all the communal road bridge and even administration functions. It has never fully covered the expenditures and the proportion of public cleanliness costs compared to this normative grant was e.g. 13% in 1993

The *centrally allocated special normative grant* which can only be used in connection with liquid waste and is supposed to subsidize a local government function – which is yearly 200-220 M HUF – its definition is not clear on who is entitled to use it – the party doing the treatment or the one doing the collection or the households and accordingly which local government can have access to it and for what purpose only for treatment or for collection and some other function as well (e.g. a statement by the Interior Ministry and the Ministry of Finance in 1992 included the expansion and rehabilitation of sites or the reduction of fees as well). Furthermore the conditions of utilisation are not clear either since they are related to the amount of waste measured and proved but measuring is possible only in certain places and practically it is based on self-performed estimates and it is not usual to differentiate between waste coming from household and public sources

Partly it may have been the reason why nearly half of the 78 municipalities examined in a study by the State Audit Office (SAO) in May 1995 did not make use of this government subsidy

It has also been observed that the majority of private entrepreneurs performing this service do not apply for this subsidy - they choose illegal disposal instead of acquiring the certificate and paying the disposal fee

Consequently this subsidy does not provide enhanced protection for the environment and the water bases and its role in bringing about adjustment in the fees paid by the households can only slightly be felt - it is not efficient enough and its existence is not well justified

### *The organizational structure.*

In most places there have not been significant changes the former so-called communal service companies were transformed mostly motivated by considerations of asset management but neglecting other considerations concerning economy

It is interesting to note that the study by the State Audit Office (SAO) we have mentioned above found that the expenditures related to public cleaning activities are higher in municipalities where the local governments do waste collection - but of course the local governments can have their own revenues from waste collection only in this case

The legally correct operational conditions of dumping sites are often missing there are sites which operate without official permit and their technical modernization has failed to take place this may be because they have no owner to look after them the waste management is not a priority issue for the local governments

### *Involving the private sector privatization*

Private entrepreneurs have joined to provide the services and so have companies founded by the local government but operating as separate business entities Their main problem is that the local governments which are responsible for setting the fee for waste collection (see the study by the SAO 1995 p 12 ) set the fee too low in accordance with the interests of the citizens and not according to profitability making the activity of these enterprises unprofitable

### *Acquiring capital for the developments*

One of the most serious problems of Hungarian utility companies at present is they do not have the investment resources necessary for obtaining efficient service provision Either belonging to LGs or being already privatized assets are in extremely bad condition old needing change or reconstruction However infrastructure investments are multi-year programs and the depreciation funds or present fee revenues of companies are not sufficient for these - therefore according to present practices municipalities are contributing either from their own general financial resources or by applying for central special grants (As it is seen in the table above)

**So from the point of efficient service provision it is important that LGs and service providers together analyze long term needs, compare those to existing capacities present condition of infrastructure and prepare capital investment program regarding quantity type and schedule of necessary investments**

#### 4 Possible subprograms in a program budget

##### 4.1 Communal Service program

If we would like to see larger units as programs then the Public Cleanliness program can be a subprogram in this and the same breakdown can follow

- A Maintenance of parks and green areas
- B Public cleanliness**
- C Road- bridge functions
- D Public lighting
- E Maintenance of cemeteries
- F Drainage and flood protection
- G Agricultural and livestock health service tasks
- H Supervision of public areas
- I Civil defence
- J City decoration

##### 4.2 Public cleanliness program

If we take **public cleanliness and community cleanliness** as a separate **program** then the possible **sub-programs** are the following

###### A Solid waste management

- *collection*
- *transport*
- *disposal*
- recycling - in Hungary it means a separate *waste yard* only in few places yet but community programs such as composting techniques can be initiated to reduce the quantity of waste

###### B Cleaning public areas

- cleaning
- removing snow and ice
- removing dust
- trash collection

###### C Treatment of liquid waste

Although most of the local governments do not deal with it at present and think that the function is well performed through contracts between private contractors and the households This practice however is wrong since this activity is important concerning the protection of the environment and it is worth including it as a subprogram just because of the cases of misuse illegal activities on the one hand and the existing targeted subsidy program and the efficient management of the centrally allocated grants

- *collection*

- *transport*
- *disposal*

## 5 Possible future actions for the local governments

- thinking over the level of services in view of the cost in the case of which subprogram should the level be raised and in which cases maybe lowered
- the problems of organizational transformation is it sure that service can be provided the best in this present organizational form (maybe after a transformation already) or taking considerations of economy (the end of the sentence seems to be missing)

## 6 Terms

*Community cleanliness services* cleaning and sterilizing sewage containers ditches and ditch systems not connected to the public sewage system collecting transporting and treating the liquid waste of communities

*public cleanliness services* collecting transporting temporary storing and treating solid communal waste cleaning of public areas removing snow and ice (according to the sectoral selection scheme of the Central Statistical Office)

*solid communal waste* household or other waste except for hazardous and radioactive waste

*liquid communal waste* sewage and sewage dirt not flowing into the public sewage system

technologically not deriving from production and service activities

*environmental protection fine* a fine to be paid when breaking some environmental protection regulation according to the extent gravity and frequency of the pollution above the environment pollution fee and the utilization fee

*environmental pollution fee* to be paid after the measurable emission of certain materials and types of energy according to exact calculations

*utilization fee* to be paid for using certain elements of the environments

## Identifying Obstacles to the Implementation of Budgetary Reform in Government \*

Blue Wooldridge and Claire L. Alpert

All too often it is assumed that once a decision has been made to carry out a governmental activity or program that activity will be successfully implemented. Unfortunately in many cases this assumption is invalid. The growing recognition of the tremendous gap between legislation and execution or between plans and operations has made the study of program implementation a vital aspect of public management. Graham Allison of Harvard's Kennedy School after reviewing recent attempts to implement public programs concludes: "Implementation is a very large part of most public policy problems—in some cases 90% of the problem and in some cases 10% about half of the average."

A background study suggests however that problems in converting public plans into successful operations might be mitigated by a systematic attempt to identify potential obstacles before implementation is initiated. The purpose of this paper is to facilitate budgetary reform through the identification of implementation obstacles encountered by public agencies. This identification has been made through a tracing of the literature describing attempts to change public budgeting systems in this country during the past seventy years.

### Line-Item Budgets

Over the past 70 or 80 years there have been four major phases of local government budgetary reform starting with line item budgets in the early 1900's.

Prior to acceptance of the line item budget legislatures appropriated money in a haphazard hit-or-miss fashion with little or no effort being made to systematically consider the entire financial status of the governmental unit. A myriad of appropriation bills would be approved with little consideration of the availability of revenues or duplications of appropriations and with no specific group responsible for monitoring the financial status, expenditures and policy of the government. The line item budget was adopted to bring structure to government budgets and to provide a means of monitoring and controlling the expenditures of local government.

The orientation of line item budgets is control. In New York City for example the Bureau of Municipal Research concluded that expenditure control was more

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critical to the budget system than a need for a planning emphasis. In the opinion of those who were in charge of the development of a budget procedure, the most important service to be rendered was the establishing of central controls so that responsibility could be located and enforced through elected executives.<sup>4</sup> Line item budgets detailed to object of expenditure accounted for items bought and provided the desired tight control on government expenditures.<sup>5</sup>

These advantages have to be compared with the limits of the system which include the reduction of administrators' discretion in making expenditures, lack of performance accountability, and inattention to the major goals of the department due to immersion in line item detail. Fiscal control was achieved through line item budget, but flexibility and measurement in attaining overall goals were not aided.<sup>6</sup>

Since line item budget systems demanded given categories of classification and standardized accounting systems, implementation encountered several obstacles. To standardize accounting systems across agencies it was necessary to require that all agencies use common categories of classification. Due to the inclusion of categories different from those in practice before line item, department heads had difficulty obtaining reliable estimates for the expenditure categories. Additionally, comparing expenditures in the new line item budget request with current and previous lump sum appropriations was nearly impossible. Implementing the line item budget was difficult due to these obstacles, especially if department heads were not willing to cooperate with the new system and not willing to assist in converting to the new object classification system. Another obstacle encountered during adoption of the line item budget was the perceived inflexibility of the system. Department heads were accustomed to submitting piecemeal appropriation bills on an as needed basis. When confronted with a system requiring appropriations by category on an annual or bi-annual basis, they feared work would be hindered due to constrained resources. Department heads comfortable with the former haphazard system considered it impossible to plan for the long term needs of their departments.<sup>8</sup>

Budget reformers also encountered other fears when developing the line item budget. Department managers were inexperienced in projecting expenditures and concerned about being locked

into appropriations that would be inadequate for the department's needs. The operational complexity of the line item system, as perceived by managers, also created obstacles to implementing the change. Transferring of funds during the year occurred frequently, perhaps due to inadequate expenditure projections. There were no effective methods in place for checking the transfers for duplicity with other agencies. Once a line item appropriation was in place, managers frequently reverted to the former haphazard appropriation system for the acquisition of supplemental and transfer funds.<sup>9</sup>

Inexperienced agency heads and their budget staff, rigid classifications of expenditures and structured long term appropriations created the major obstacles to implementing the line item budget. As summarized by Bruere, segregation results in a degree of regimentation which restricts and in a measure paralyzes the freedom with which the organization provided in the appropriation may be employed or the funds for purchases may be utilized.<sup>10</sup> The managers feared a rigid inflexible system that would hinder operation of the agency during the budget year.

## The Performance Budget

As the functions of government expanded and expenditures escalated, it became both difficult and costly to track the details of the line item budget. Additionally, during the years of line item budgeting, laws and regulations had been passed that helped to alleviate potential abuse by



Blue Wooldridge

Blue Wooldridge, Extension Professor at the Institute of Public Service, University of Connecticut, was until recently the Director of the Graduate Program in Urban Affairs in Northern Virginia, Virginia Polytechnic Institute and State University. Previous work experience includes serving as Director of the Urban Management Curriculum Development and Training Associate with the National Training Development Service, Coordinator of Federal Programs, Office of the Director of the Budget, Government of the U.S. Virgin Islands, and in the department of Finance, City of Philadelphia. He holds graduate degrees from the University of Pennsylvania and the University of Southern California.

public officials of the budget process. These changes reduced the importance of strict detailed line item controls in the budget process. At the same time the New Deal began a decade during which total Federal expenditures tripled. These greatly increased expenditures necessitated a budget process less focused on control and more oriented toward the efficient management of resources. A budget process was slowly being developed that organized expenditures by functions, activities and projects. This budget process was termed the performance budget.<sup>11</sup>

The performance phase in budgeting moved the government from strict control orientation to a management orientation. The intent of its proponents was to assist administrators in determining and improving where possible the efficiency of the organizational units. Budget classifications and associated work cost measurements estimates for discrete measurable units were developed for functional classifications to aid in the efficient operation of government's activities.<sup>12</sup>

The classifications used in performance budgeting provided an additional level of analysis intended to increase the responsibility and accountability of department heads. These managers should have gained increased perspectives of their program from the resulting performance analysis. Performance budgeting also altered the roles of central budget office and operational level budget offices. Many of the budgeting duties shifted from the central office to the departmental units leaving the Budget Bureau more time to study operating units and to coordinate activities across agencies. The performance budget then increased the organization and management functions of the central budget office.<sup>13</sup>

Implementing the new procedures required for performance budgeting added additional burdens to the budget office already constrained by deadlines. Resources, especially staff time, could not be properly allocated to meet the existing deadlines in addition to the increased data needs of the performance budget. The performance budget also increased the complexity faced by operating departments due to the required increase in the number of accounts to maintain. Not only did the massive amount of detail obscure the agency's program, it also tended to confuse legislators and to decrease their ability to understand the total budget.<sup>14</sup>

The degree of success in implementing the performance budget was directly proportional to the

amount of discontent with the existing process and to the perceived relevance of the performance budget to the needs of budget and policy officials. An obstacle often encountered in the performance budget was the lack of perceived usefulness of the material developed. The narrative intended to bolster the agency's budget claims and provide information to legislators and evaluators was seldom reported to be helpful by budget makers and other insiders and rarely dealt with questions of performance. In addition, the greater the incompatibility of a performance technique with existing procedures, the less likely were the chances for adoption.<sup>15</sup>

Other obstacles encountered when implementing performance budgeting were staff resistance and lack of support at various levels within an agency. Resistance was created when operating units were not consulted in the development of the performance budget, yet required to implement its controls at the activity level. Operating units too often feared the consequences of providing detailed information to central control agencies. The main concern seemed to be an adverse effect on their individual powers in executing the budget. Often operating unit personnel were indifferent to the innovation since the responsibility for its implementation was lodged in the central budget office. The implementation of the change to performance budgeting met resistance when operating units did not understand the use of the data and were not involved in the process of developing and evaluating the required material. The attitudes of budget personnel also affected the implementation of the



Claire L. Alpert

Claire L. Alpert was with the Office of Solid Waste Environmental Protection Agency where she recently completed a tour as a Presidential Management Intern. Previous work experience included the Department of Planning, State of Maryland, and the Department of Public Works, Howard County, Maryland. She received a Master of Urban Affairs from Virginia Polytechnic Institute and State University, her undergraduate degree from Western Maryland College.

performance budget. If the reform was perceived as effectuating only superficial change, budget personnel tended to give low priority to performance budget tasks.<sup>16</sup>

## The PPBS Experiment

In the late 1960s through early 1970s budgets became a planning tool as well as a performance monitor. With the McNamara approach of relating outputs to costs in an overall plan as its basis, this period brought an emphasis of planning into the budget process. Due to impediments to implementation not anticipated, the planning budget initiated by the planning programming budgeting system (PPBS) was never universally adopted as an inclusive budget approach.

A major failing was the lack of support for PPBS in terms of both staff and other resources. PPBS required financial commitment and legislative and executive support. Generally agencies respond mainly to policy directives from top executives. Where these executives' support was not assured prior to implementation, attempts to change to PPBS were neutralized and conflict with the traditional budget system intensified. Agencies often believed that PPBS was being imposed on them, and therefore implementation was thwarted since the nature of PPBS demands that those with it must fully support it. Major obstacles to implementing PPBS were also encountered when elected officials did not support the change in the budget system, and when interest groups were opposed to the system. Without support from all involved in the budget process, those attempting to implement PPBS encountered major obstacles.<sup>17</sup>

Obstacles to the PPBS were often created due to the location of the analysis group and lack of coordination with the regular budget staff. Often the PPBS staff was separate from and isolated from the central decision making group. When this happened, PPBS carried very little influence and implementation was restricted. Such structural organization also allowed traditional budget staff to maintain their set routines and ignore PPBS. To avoid this obstacle in the future, the PPBS staff should be a part of the central management staff involved in developing and planning agency goals.<sup>18</sup>

Introducing budgetary reform created resistance from the existing staff and budget directors.

A major obstacle was often created by implementing a change to the existing system without understanding the status quo. Along with this lack of understanding, there frequently existed obstacles caused by poorly defined goals, poor instructions, and the complex requirements of PPBS. Lack of familiarity with the new system was one of the major impediments to its adoption. Further, the budget staff was under constant deadlines which impeded adapting new procedures in the budget process. The time constraint combined with the lack of familiarity created major obstacles to PPBS implementors.<sup>19</sup>

The complexity of the PPBS was another major obstacle to its implementation. PPBS mandates clear definition of goals and objectives of the agency. In non-defense areas, programs were often difficult to define in such terms, and it was difficult to delineate all alternative means of attaining goals.

Further, PPBS often led to so many intricate details and procedures that the intent of the budget system was lost. The data became too detailed for major decision makers to assimilate, creating a mass of data that was never used.<sup>20</sup>

It is clear that the implementation of PPBS met major obstacles where guidelines and instructions were unclear. The lack of clear policies and procedures led to confusion on how to undertake PPBS and to low morale, two conditions that created major obstacles to implementing a new budget system. Without clear guidelines, there was faltering organizational staff training, leading to staff inadequately prepared to implement PPBS. Without the required training, staff had difficulty in securing and analyzing data due to uncertainty as to the data needed.<sup>21</sup>

A successful implementation of PPBS is dependent on having adequate time to change from the existing to the reformed system. Obstacles can be created by implementors forcing the new system on the organization too quickly. The system must be phased in, building understanding and consensus for the new practices and allowing time to make changes to the existing budget practices. Part of the phased transition process must include measures to mitigate the obstacle of staff not understanding the usefulness of PPBS to the agency by showing how the system can support agency/legislative goals, and by stressing the need for accurate and reliable data. Implementors must overcome the obstacles created by a data base not wholly intelligible or

relevant and the need to have measures that result from detailed analysis

Implementors must be cognizant of the traditional means of budgeting in the agency and the deviations from this tradition. PPBS or any new system demands. As Schick states, in budgeting, no reform is won easily. The cards are stacked in favor of repeating next year what was done this year and in earlier years. Small changes are achieved through large efforts; each wave of reform leaves its modest legacy and prepares the way for future improvements.<sup>3</sup> When the new system is incompatible with existing budget structure or is divorced from traditional accounting and information gathering methods, major obstacles will be encountered. Budgeting demands routine, yet routine creates a block to innovation. These routines then must be anticipated and incorporated in the change if it is going to be a successful change.<sup>4</sup>

Successful implementation of PPBS then requires avoidance of obstacles caused by poor planning of the transition process, lack of evaluation of existing procedures that will require change, lack of agency and elected official understanding of the PPBS data requirements and benefits of the system, lack of adequate staff training, isolation of PPBS staff from existing budget staff, and inadequately phased implementation of the system into the agency.

## The ZBB Phase

In the mid seventies, governments began to experience a decline in revenues coupled with an increased demand for government services. Budgets began to be used as a tool to make basic policy decisions regarding the services government would provide and the level of these services. The zero-based budget (ZBB) with clearly defined services and associated levels of cost budgeted at incremental levels represents a policy oriented approach to budgeting.

Implementors of the ZBB encountered obstacles created by trying to mesh the ZBB requirements with the existing systems. The frustration of staff attempting to use the ZBB process was an obstacle to be overcome in the early stages of implementation. The complexity of the system created another major problem when implementing the system. The level of funding approach was often cumbersome to work with

and the large number of decision packages made effective ranking difficult. In the Federal Government, its size and diversity made application of universal ZBB operating instructions difficult. As summarized by Draper and Pitsvada, ZBB was asked to do too much including:

- identifying issues
- setting objectives
- determining alternative means of performing the program

Complexity of the system then was a major obstacle to implementing ZBB.<sup>5</sup>

ZBB implementation was also hindered by the large amount of paperwork and duplication of pages required in the budget package. This obstacle of excessive paperwork, as well as the requirements of budgeting on incremental levels, created a major increase in time required to prepare the agency budget. This resulted in budget preparation being behind schedule and management having to schedule more time for budgetary decisions, a major obstacle to be anticipated when implementing ZBB.<sup>6</sup>

In addition to the obstacle of time required to prepare the ZBB package, accumulating the amount of data required by the budget created a major obstacle. Many agencies did not have accumulated data to provide program measures at the various incremental levels and were unable to provide a desirable level of documentation of the program measure. The poor quality of some of the data submitted and the fact that the ZBB justifications were no more sound factually or analytically than in previous budget systems created an unwillingness in management to devote the amount of time to the system successful implementation required.<sup>7</sup>

The ZBB process and the levels of funding also created fear on the part of agency heads. Some felt that budgeting a service level below current funding might be misconstrued as a recommendation to operate at that level and therefore resisted proposing reduced levels. An obstacle was also created by the threat felt by bureaucrats toward a process that evaluates the effectiveness of their program. Further, agency heads feared defending their ranking before Congress or client groups and becoming victims of their own priorities. ZBB then created a fear of the consequences of the system in those who were supposed to be supporting and converting to that system.<sup>8</sup>

## Conclusions

It is clear from the above background analysis that the implementation of each stage of budgetary reform has encountered significant obstacles. What might be surprising is the great deal of commonality among the types of obstacles encountered. Obstacles that hindered the implementation of zero base budgeting during the 1980's also constrained the managers attempting to install line item budgeting in 1913.

- Common categories of obstacles include
- resistance from staff and line personnel
  - incompatibility with existing systems
  - lack of adequate commitment and support
  - inadequate skills and data base

A word of caution: the obstacles described above were identified either by professional public managers responsible for making the changes in budgeting practices or by researchers quoting such managers. Little effort has been made to ascertain obstacles identified by other central staff personnel, by line managers, staff, and elected officials. The lack of these viewpoints identifies a gap in the knowledge of the implementation of budgetary reform and should be filled by further research.

## Implications of this Analysis

The authors became interested in this topic when one of them was asked to assist in preparing state managers to use program budgeting. This request came before proper guidelines had been prepared and in such a short time frame that almost guaranteed an inadequate level of skill attainment. To one author who observed a similar attempt to implement PPBS in the City of Philadelphia during the late 1960's and other attempts at budgetary changes in the U.S. Virgin Islands during the early 1970's, this experience produced a feeling of *deja vu*. There appeared a need for managers to systematically learn from the experiences of other budget reformers. The authors feel that those managers contemplating a change in their budget practices can gain useful insight from a better understanding of the implementation process from this review of the literature presented in this paper.

There is a need for much more research designed to identify obstacles to implementing innovations, especially budget and financial manage-

ment systems. Since it is generally accepted that perceptions are influenced in part by one's organizational role, researchers should attempt to identify the reasons for unsuccessful implementation as perceived not only by the manager of the implementation of the innovation, but also other individuals including elected officers, other involved staff personnel, and both line managers and staff. The degree of difficulty presented by an obstacle and the contextual factors that make one obstacle more of a hindrance than another should also be explored.

For the practicing manager, the most important lesson gained is that budget reformers must anticipate obstacles to any attempt at changing the existing budgeting practices and procedures. Such anticipation should lead to very careful and well thought out pre implementation planning. Since many of the obstacles result from resistance on the part of the personnel being required to use the system, efforts must be made to convince these individuals of the utility of the new system to *them*. Resistance cannot be allowed to develop based on the perception (either justified or not) on the part of staff that they do not know the purpose of the new practices, the implementation plans, or the revised expectations that this specific budgetary reform places on them. While these authors do not hold to the conventional wisdom that participation will remove resistance, when such resistance is caused by uncertainty, the active involvement of as many affected staff as possible (or at the least representatives from *all* significant segments of the organization) will go a long way to dispell initial suspicions. Budget reformers must anticipate the impact of change on the status and prestige of affected individuals and develop strategies to adequately respond to the reactions caused by such impact.

As obvious as the need might be, this review suggests that insufficient attention has been paid to staff training and development. Managers of budgetary change must realistically assess the demands that the new system will place on personnel, develop training objectives whose achievement will provide the necessary knowledge and skills, and design training experiences that effectively meet the objectives. Adequate staff training will not only provide the ability to carry out needed operations but will go a long way to melting any resistance created by anxiety due to feelings of inadequacy.

Assessments must be made as to the degree of

compatibility of the new system with existing organizational procedures and other systems. The budgetary system is very much dependent on the data available and of course closely linked to the budget execution and control system and its accounting component as well as the audit procedures used within the agency. The greater the degree of incompatibility between the new budget process and these other components of the financial management system, the greater the obstacles to successful implementation.

The authors would like to leave their reader with a guarantee that thoughtful pre implementation planning leading to the identification of obstacles will lead to successful budgetary reform. Unfortunately, our study does not report many success stories of the causes for this fortunate outcome. What the analysis does tell the observant reader is that many pitfalls await the public manager courageous enough to endeavor change in that extremely important subsystem of public organizations—the budget process.

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# Putting Teeth into the Efficiency and Effectiveness of Public Services\*

Richard E. Brown, Kent State University  
James B. Pyers, City of Wooster, Ohio

Formed in 1984 as the successor to the National Council on Governmental Accounting, the Governmental Accounting Standards Board (GASB) establishes accounting principles for state and local governments. These principles largely dictate the form and nature of the financial information which is annually disclosed by financial officers to elected officials, the public, and the media through a public jurisdiction's annual report. GASB has recently embarked upon a research project which could have a profound impact on this public reporting mechanism. Through the fuller disclosure of relevant data on performance, the changes envisioned could also bring greater pressure on governments to provide public services in more efficient and effective ways.

In May 1985, a year after its creation, the five-member GASB board passed a resolution to encourage experimentation by state and local governments in the area of "service efforts and accomplishments" reporting, using the accountants' terminology for the economists' performance indicators.<sup>1</sup> In the newsletter releasing

Resolution GASB stated that "research on service efforts may not start for several years (and) there is relatively little information on which to build appropriate (accounting) standards if standards are desirable. Encouraging experimentation by governmental entities in these matters will make it clear that the GASB considers these projects to be important. Experimentation will prompt research in these areas by both the academic community and practitioners." GASB's resolution concluded: "The GASB will actively seek out those wishing to experiment. Those who are ready providing data or who wish to start should contact the GASB director of research."<sup>2</sup>

A number of entities agreed to work with GASB on the project. The City of Wooster, Ohio, with a population of about 20,000 had, since the summer of 1984, been working on a related effort which the City dubbed "single cost measurement system." The use of a single indicator's articles for illustrative purposes only, many state and local governments have advanced performance reporting systems, some more advanced than Wooster's.

The GASB project took on a new dimension in the fall of 1987 when the Board decided to organize a pro-

■ *The Governmental Accounting Standards Board (GASB) which establishes accounting principles for state and local governments embarked in 1985 upon a research effort which may have a profound impact on public financial management. If successful, the research could lead to the creation of accounting guidelines encouraging, perhaps ultimately requiring, state and local finance officers to include performance measures of efficiency and effectiveness in their annual financial reports. These reports in turn are readily available for decision making by governmental officials, taxpayers, the media, credit rating firms, and other financial institutions. This article reports on GASB's research effort, using the participation of the City of Wooster, Ohio, as well as ongoing research in the hospital field, to illustrate the details and potential impact of this endeavor. In a sense, the GASB research project is the culmination of decades of research-oriented attempts to measure efficiency and effectiveness in the public sector to develop performance based budget systems and to encourage meaningful financial reporting.*

ject team for more aggressive research and field work in a number of public service areas. The team is headed by James Fountain, GASB's assistant director of research and former assistant city manager of Dallas. He is assisted on the project team by Harry Hatry of The Urban Institute and Richard Brown, one of the authors of this article. Using the project team and, on a part-time basis, a number of university professors throughout the country, the researchers are now attempting to determine the current extent of performance reporting in a variety of municipal services, higher education, and hospitals. The indicators used, the form in which the indicators are reported, and the users and uses of the data are among the issues facing the researchers.

This article describes the GASB research in more detail and places it in the larger environment of governmental performance measurement. It also analyzes Wooster's participation in the project and presents some tentative findings for hospitals, one of the service areas under study. Finally, the implications of the research for public administration are discussed.

## GASB's Objectives of Financial Reporting

In a December 1986 newsletter, GASB elaborated a bit on the meaning of "service efforts and accomplishments." It stated:

For purposes of the experiment, service efforts and accomplishments information was broadly defined as information not normally included with general purpose financial reports, including but not limited to statistical data, economic data, trend data on financial condition, data that attempt to measure the economy and efficiency of services or programs, and data designed to measure the effectiveness and results of services or programs. (italics added)

In the 1986 newsletter, GASB offered an example of information published by the City of New York on its street cleaning program and on the Department of Sanitation that is shown in Table 1.<sup>12</sup>

This New York City illustration was not intended by GASB to be a startling example of a revolutionary performance indicator, and that is not the purpose here. Rather, it is a basic effectiveness measure which has been in use for many years and which may be important because it is suggestive of the essential kind of information in which GASB is interested.

GASB's concern for efficiency and effectiveness issues becomes more apparent when one reviews GASB's release on *Objectives of Financial Reporting*. In the summary to that concepts statement, GASB states:

The Board has identified three groups as the primary users of external state and local governmental financial reports: the citizenry, legislative and oversight bodies, and investors and creditors. Financial reports are used primarily to compare actual financial results with the legally adopted budget, to assess financial condition and results of operations, to assist in determining compliance with finance-related laws, rules, and regulations, and to assist in evaluating efficiency and effectiveness. (italics added)

Such statements are important, of course, because they are guiding the current research work by GASB, research which could lead to the issuance of accounting and reporting guidelines for governmental controllers and other accountants to follow in their reports to elected officials, the public, and the media.

At another key point in the concepts statement, GASB ties the entity's budget, performance review, and service efforts and accomplishments together. It states: "It (the budget) may provide a basis for evaluating performance. Comparisons of actual results to the legally adopted budget can provide information to help assess

whether revenues were obtained and expended as anticipated. Detailed performance evaluation, however, requires the government to establish service efforts and accomplishments goals and to accumulate actual data for comparison purposes."

Finally, under the heading "Assisting in Evaluating Efficiency and Effectiveness," the concepts statement comments:

Citizen groups and legislators, in particular, want information about service efforts, costs, and accomplishments of a government entity. This information, when combined with information from other sources, helps users assess the economy, efficiency, and effectiveness of government and may help form a basis for voting or funding decisions. To be of value, the information needs to be sufficiently detailed to permit comparisons with other years and other governmental entities. Grantor agencies, including higher levels of government, are also concerned with the efficient and effective expenditure of grant funds.

In summary, much of GASB's concern with "service efforts and accomplishments" relates to data which help the user—including elected officials and the public—evaluate the "efficiency and effectiveness" of governmental activity. Moreover, this information could be an important part of the budgetary process, permitting periodic assessments of actual performance against the budget plan. Finally, these service efforts and accomplishments data are, at least for the foreseeable future, outside the scope of the traditional financial statements. They may, however, be a part of an entity's comprehensive annual financial report, which includes customary financial statements.

Following its standard procedures, GASB issued its original exposure draft of *Objectives of Financial Reporting* in January 1986, and it held a public hearing on the draft in March 1986. The Board received 58 written responses from a variety of representatives of the accounting and finance community. A revised exposure draft was issued in October 1986, and 51 responses were received on this draft. The final concepts statement was released in May 1987. Some respondents to the concepts statement were troubled by the ramifications of the statement. The issue most often raised by the respondents was on the broad scope of the statement, with the belief that it was perhaps too broad to achieve. Concern was also expressed about the audit implications of what appeared to be such a major change. Could such data, some asked, be audited? Other respondents argued that information needed to satisfy the objectives would not be sufficiently useful or reliable to justify the high cost of developing it.

GASB's response was guided by the majority of respondents who essentially agreed with the statement, and the objectives remained basically unchanged in the final version of the concept statement. GASB's comment on the responses is noteworthy, however. The Board stated that, first, developing standards in these more difficult areas "is likely to occur over a relatively long time," second, an analysis of costs and benefits, while difficult, would be important in determining the contribution of developing and using data on service

TABLE 1  
Citizen Perception of Street Cleanliness  
in New York City

Rating of Streets	1975	1980	1986
Acceptable/Clean	71.3%	53.0%	74.0%
Marginal	20.7	33.0	22.1
Dirty	8.0	14.0	3.9

efforts and accomplishments third the data developed may not be required to be presented in the basic financial statements and may not be required to be audited last such data are essential to achieve true accountability \*

### The Need for Reporting of Service Efforts and Accomplishments Data

Measuring the hard-to-measure contributions of governmental programs has preoccupied scholars and practitioners for many years GASB explains it well in *Objectives of Financial Reporting* GASB states that external resource providers cannot measure governmental performance in terms of profit or return on investment and that they may not be familiar with the services provided because often they are not direct recipients of them This explains the long-standing interest in pricing (user charges) and in extending the pricing concept as far as possible perhaps including even elementary and secondary education through an experimental voucher system It also helps to explain the preoccupation for generations with performance measurement

In his textbook, *Introduction to Nonprofit Organization Accounting* Emerson Henke includes a rather evolutionary chapter for an accounting text entitled "Use of Accounting Data By Externally Interested Parties" Henke explores the linkages between the more usual accounting data and financial reports of the private sector and the unique requirements of the public sector

analyzing the financial statements of pure nonprofit organizations externally interested parties are concerned with evaluating the basic characteristics that they are concerned with in the profit area They want to evaluate the efficiency and effectiveness of operations However due to differences in operating objectives and organizational characteristics the relationships and ratios used for financial purposes are significantly different The basic technique for measuring the efficiency of any organization is to relate its outputs to its inputs In the profit area we do this by matching revenues and expenses and by relating net income to equity investments The major problem in measuring this relationship for a pure nonprofit organization is that we seldom have an objective quantitative measurement of the values of outputs If we could objectively determine the values related with the services provided by such an organization we could develop a ratio of those values to the cost of providing the services or we could quantitatively match those two sets of data to arrive at efficiency indicators

Actually the accountants interest in measuring the results of governmental programs is quite recent Modern economists and others have been struggling with it for at least two generations The early cost-benefit analysis work associated with water projects began in the 1920s and 1930s as did the efforts in performance based budgeting In the 1960s much of this work was packaged as program planning budgeting systems (PPBS) with its emphasis on cost-benefit analysis and measurement Some researchers and even organizations have built strong reputations around demonstrating the use of performance measurements in assessing governmental programs \*

Performance or expanded-scope, auditing first appeared on the American scene in the 1950s and 1960s, and it gained considerable momentum in the 1970s As with many other "innovations," this work too had its roots in the early performance budgeting and cost-benefit analysis activity The essential premise of performance auditing is of course, that governmental accomplishment can, at least to a degree, be measured Using workforce training as a program illustration, the fundamentals of a performance audit can be described as follows

- *Goals* What are the program's goals? To train what kinds of people? In what kinds of skills? In what numbers? To take what sorts of jobs?
- *Measures* How is the success of this program evaluated? The numbers of trainees completing a program? The cost per trainee? The number of trainees getting a job in the area of training? The length of time the trainees kept their jobs?
- *Procedures* What methods are used to do the audit work to secure objective, professional answers? Interviews? If so, with whom? A partial or complete search of the files? A statistical sample of the files? A telephone, mail, or in-person survey of employers, trainees?
- *Comparisons* What do the findings or results mean? Are results better or worse than similar programs in other communities? Than norms or standards issued by some institute or accrediting body? Than those of the preceding year?

The major obstacles in the path of successful performance auditing are both technical and behavioral While performance auditors have been able to generate their own measures and data, the lack of accounting systems with such measures built into them often proved controversial, sometimes even fatal Moreover governmental managers are not accustomed to having their performance measured They see only bad and little good coming from the process Also, elected officials tend to favor performance measurement only until it adversely impacts a favorite program

Despite the difficulties encountered, performance auditing has survived and sometimes thrived at the federal, state, and even local levels of government and it has demonstrated the positive value of reporting information on program accomplishment It has helped to bring recognition that merely "coming in under budget" does not say much about managerial performance i.e. the estimate may have been too high needed services may have been curtailed, etc Performance auditing has also helped to instill the notion that generating and maintaining such data really is a responsibility of management \*

GASB's concern with levels of service efforts and actual accomplishments is opportune, building as it does on this heritage and tradition The experimentation is also timely in indicating the need for a fully integrated financial management system In such a system, the accounting subsystem automatically captures and reports

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on the execution of the *budget subsystem* allowing for meaningful comparison of actual expenditures to budgeted estimates. The *audit subsystem*, in turn, can rely on the accounting subsystem to test budget execution without forcing the auditors to generate their own performance measures or data. While such a *complete system* is many years off, it would be well within the reach of GASB's research work if it proves successful.

Ultimately, the integrated financial management system must be able to do more than the current system, which reports on dollars expended vis a vis dollars budgeted, even if those amounts are being presented by program or subprogram. To learn, for example, that \$950,000 was actually expended rather than the \$1 million budgeted, is not very helpful. It suggests that the manager may retain his or her position because he or she stayed within budget or perhaps that the manager is frugal providing the needed level of services far under the budgeted amount. It could also suggest that the manager did not provide needed services but instead, being an experienced manager, has learned to cut services to produce the desired surplus. In reality, the current system does not allow one to know what actually transpired. A truly integrated system, based on performance based data, would allow the citizenry to know how much work was done and at what cost (efficiency). It might even let the taxpayers know whether a good quality job was done (effectiveness).

It is interesting to note that, following on the work of earlier scholars, the U.S. General Accounting Office (GAO) in 1985 released a report outlining such an integrated system and making it a priority of the Comptroller General.<sup>10</sup> If the GAO emphasis will help focus on the structure of the financial system, the GASB research will focus on its content—the GASB research is assessing the importance of including performance based data in the system as well as the specific formats in which to include and report such data.

### The Wooster Experiment

Wooster's unit cost measurement project helps to illustrate the potential power and pitfalls of performance reporting. Wooster, located 60 miles southeast of Cleveland and 20 miles west of Akron, is the headquarters of nationally known companies, such as Rubbermaid, Inc. and the Wooster Brush Company, and it is also the home of the College of Wooster.

In late 1974, Wooster began a process of identifying its financial strengths and weaknesses, with the clearly identified goal of achieving financial reporting in accordance with generally accepted accounting principles and earning by 1980 the Certificate of Conformance awarded by the Governmental Finance Officers Association. This goal was ultimately achieved. The city already had a number of competent operating managers, a reasonably well paid staff with considerable tenure, strong working relations between the council and the administrative arm of government, and a tradition of "good" government with a minimum of

political rancor. In addition, while not a wealthy community, Wooster is at least "average" from an economic point of view. Median family income in 1985 was about \$27,000 and unemployment averaged about 7.6 percent. The city's property tax levy has remained unchanged for several years, and its income tax is among the lowest in the state. Moody's has given the city a bond rating of A-1 in recent years. If not outright affluent, Wooster has had at least enough fiscal stability to provide the city with a degree of flexibility in focusing on and improving its internal operations.

### Unit Cost Project

With a great many improvements made in its basic financial management system during a previous ten year period, the mayor elected in 1984, a retired Rubbermaid executive, formed a task force to look into installation of unit cost measures in every city cost center. This development occurred for several reasons:

- The mayor was accustomed to having more meaningful financial data.

**TABLE 2**  
City of Wooster, Ohio  
Unit Cost Measures Adopted by Cost Centers

Cost Center	Unit Cost Measure
Police Division	Cost per patrolman hour
Fire Division	Cost per capita
	Cost per response
Community Service Division	Cost per dollar of cost of services
Planning Department	Cost per \$1,000 of real property value
Maintenance Division	Cost per direct labor hour
Engineering Division	Cost per \$100,000 of fixed assets
Transit Division	Cost per passenger trip
Building Standards Division	Cost per inspection
Parks Division	Cost per acre maintained
Recreation Division	Cost per participant
Community Center Division	Cost per participant
Law Department	Cost per dollar of cost of services
Finance Department	Cost per dollar of cost of services
Accounting Division	Cost per transaction
Accounts Receivable Division (City Income Tax)	Cost per dollar of tax collected
Information Systems Division	Cost per CPU hour
Personnel Division	Cost per dollar of personnel service cost
Accounts Receivable Division (Utility Billing)	Cost per bill issued
(Utility Service)	Cost per work slip
Water Treatment Division	Cost per million gallons of water treated
Water Pollution Control Division	Cost per million gallons treated

- The city charter provided for such cost accounting information
- The project seemed to be a logical extension of the city's investment in improving its financial system

Wooster began this effort with a pilot project to test ideas gather information, and build interest and acceptance of the concept. The pilot project involved 7 of the city's 15 departments, with managers or assistant managers serving on a user committee. The controller, a key member of the Finance Department, was project director. The committee received considerable support from the mayor and the director of finance and assistance from two external advisors: a former controller and a former vice president of finance from the private sector, both then in retirement. A quality control team involving the mayor, the external advisors, and key members of the Finance Department also met periodically to discuss problems both potential and actual.

The user committee did most of its work in the summer and fall of 1984. Members agreed on the following broad criteria for the selection of unit cost measures:

- The unit must be relevant to the department's mission statement
- The unit must impact the decision-making process of the department
- The unit should be measurable, objective and verifiable
- The unit should be selected by the department

This system was structured so that initially each department would select a single measure, although the Fire Department ultimately adopted two measures. Reporting was to be on a monthly basis. The Finance Department was responsible for assembling the data and reporting back only to each department. The annual budget for the relevant expenditure area was to be broken out by unit cost measures. Year-to-date data were to be accumulated and reported for each measure to arrive at an updated cost per unit, allowing for ongoing variance analysis throughout the year and building an historical database for future analysis. The unit cost

measures selected by the city departments are shown in Table 2. An excerpt from a typical monthly report is shown in Table 3 for two cost centers.<sup>11</sup>

1988 Status

At the beginning of 1988 the unit cost information was still collected by Wooster's Finance Department and was reported back only to each operating department. Because it was still considered to be a pilot project the information was not systematically reported to the mayor and/or council, and it was not yet used as the basis of budget/justification discussions or other important policy meetings. The unit cost information was not verified, and it was not routinely compared to other municipalities or to any existing performance standards. However, it was compared to the beginning-of-the-year estimates.

The "system" remained only a partial one in 1988 although it had been in operation for about three years. The project was moving ahead very slowly. Having started the system no one seemed anxious to use it to its fullest. Instead, a strategic decision seemed to have been made at least for a while, to allow the operating managers to use the data as they alone deemed proper. Comments by city officials on the status of the project were mixed and included the following observations:

- Maybe the system has gone as far as it can. There is no need for urgency.
- The project is on hold. We have not met on it now for more than a year.
- Full use of this system is 10 to 20 years off. It will probably have to be mandated by someone outside.
- Someday this information will be included in the city's comprehensive annual financial report.
- I am not at all sure outside groups will know what to do with this information.
- Some line opposition has developed to moving ahead with the system.<sup>12</sup>

Similarly, those operating managers who commented on the use and usefulness of the unit cost data had mixed reactions. There was understandably some un-

TABLE 3  
Unit Cost System—Wooster, Ohio  
Excerpts from Monthly Report

	Current Month			Year-to-Date		
	Budget	Actual	Variance	Budget	Actual	Variance
<i>Community Center</i>						
Participants	3 333	3 451	118 F	19 998	22 059	2 061 F
Cost participant	\$9 57	\$6 55	\$3 02 F	\$10 04	\$6 91	\$3 13 F
<i>Public Transportation</i>						
Passenger trips	15 417	15 346	71 U	92 502	83 397	9 105 U
Cost passenger trip	\$2 86	\$2 09	\$ 77 F	\$2 65	\$2 11	\$ 54 F

F = favorable variance U = unfavorable

139

certainty as to how to use the data. Occasionally, some time-honored maxims would surface:

- If you stay with your overall budget, you're okay
- Why spend too much time worrying about your costs if you can't do anything about them?

Still, however, most of the managers interviewed seemed to believe that the unit cost data would make it easier for them to spot deficiencies and correct them. Also, they did not seem to fear a misuse of the data by outside parties. They were somewhat concerned, on the other hand, that some involved in the decision making process would not understand the reasons for variances between budgeted and actual costs. They also wanted to separate out costs outside the managers' control, i.e., any allocation of overhead costs by the Finance Department. Managers in some functional areas were satisfied that systematic reporting processes were already being used in their fields, either by the state or federal governments or by a professional or trade association, to permit valid comparisons with other entities; others were less certain of existing practices. Finally, some managers worried that if comparisons were made with other municipalities, no one could guarantee that all entities were reporting on the same basis and including the same items in their cost data.

### Hospital Reporting of Service Efforts and Accomplishment Data<sup>13</sup>

Along with research into state and local governments, GASB is reviewing university and hospital use of performance reporting. Several things can be said of hospital reporting of performance data. First, such reporting has virtually exploded in recent years. Second, this volume of reporting is almost certain to continue and even increase. Third, while much of the current reporting is of a workload or activity nature, there is clear movement toward measuring and reporting both efficiency and effectiveness data.

The growing interest in hospital performance and quality of care are illustrated by some recent newspaper coverage of the topic. On July 28, 1987, the *Wall Street Journal* published a story about hospitals using mortality statistics in their ads to attract heart patients. Popular interest in what would seem to be a very esoteric subject was further heightened by the federal government's 1987 release of mortality data for all hospitals with Medicare patients, which includes most hospitals.<sup>14</sup>

Of course not all data relating to hospital performance are so dramatic, but the volume and variety of the reporting are indeed overwhelming. A given hospital is likely to report periodically to the American Hospital Association (AHA) which annually publishes a comprehensive survey called *Hospital Statistics*. If the hospital wishes to obtain a special report of these data, tailored to the hospital's needs and with comparisons to relevant peer groups, it can subscribe to the AHA's *Monitrend* service. State hospital associations and some regional

associations perform the same type of service. The Joint Commission on Accreditation of Healthcare Organizations calls for internal quality assurance committees and it is moving toward a more formalized system of reporting of quality of care measures.

State and federal governments are also demanding more reporting of data on efficiency and effectiveness. In Maryland and Pennsylvania, state regulatory agencies require such reporting of all hospitals. The Health Care Financing Agency (HCFA), the federal government's agency for administering the Medicare and Medicaid programs, not only requires performance type reporting from hospitals but also uses Peer Review Organizations (PROs), private firms under contract with HCFA, to actually verify such data by on-site examination of patient files.

As indicated, much of the hospital data currently reported are "utilization" data—admissions, discharges, average length of stay, occupancy rate, out-patient visits, etc. However, the tradition of reporting such data, coupled with HCFA's requirement for an annual Medicare cost report, increasingly allows hospitals quickly to calculate efficiency and productivity measures such as cost per inpatient day, cost per discharge, or nursing hours per inpatient day. But effectiveness or quality of care now seems to attract the most attention. The Joint Commission on Accreditation, some hospital associations, and state and federal governments are either currently testing or requiring the reporting of indicators such as mortality rates, readmissions, and infection rates.

Thus, to those who would argue that it is impossible to measure the quality of health care, the retort must be: it is certainly difficult and controversial to do, but it is being done.

### GASB Research in Perspective

Research to date shows, perhaps contrary to the belief of some, that an effort such as GASB's to examine the need for reporting requirements relating to service efforts and accomplishments data is evolutionary rather than revolutionary and timely rather than futuristic. While this is true in a general sense, what are the specific lessons and problems encountered in attempting to implement such reporting?

The hospital research demonstrates that within that field there is a long and established tradition of reporting performance data, both to hospital associations and accreditation bodies and to state and federal governments. While past data tended to relate to workload, the trend toward reporting more efficiency and effectiveness measures is clearly established. Given these facts, it is unlikely that great incremental costs would be associated with further formalizing the existing reporting requirements. GASB researchers find that this is often the case in most service areas.

Aside from concerns about patients' rights, three key issues are involved with hospital reporting. The first is to ensure that performance data systematically finds its

way to members of the hospital board of trustees or other policy makers. Presently, this is very much a "hit-or-miss" proposition. The second issue is one which permeates reporting in any given service area. What reporting format should be used to ensure that the material is constructively used? If information becomes a part of the larger annual financial report, it takes on the aura which is usually afforded that document. On the other hand, if it is added to what already may be a large and complex annual report, that may virtually guarantee that it will not receive useful attention. The third issue relates to the validity of the data reported. Currently, little verification of data occurs—a fact that is inconsistent with encouraging greater reliance on the information for decision making. A call for formalized external audits, however, raises other important concerns relating to cost and to the current ability of the auditing profession to conduct such reviews.

The Wooster experiment with unit cost measures is of course a long way from complete. Indeed, one could say it is just beginning. Still, a number of observations can already be made. The tentative conclusion can be drawn that this measuring and reporting system, if continued, would make government more accountable by disclosing data on efficiency and effectiveness. The unit cost project has been implemented slowly with the support of top management and with the active involvement of staff and line managers through a user committee. The unit cost measures for each cost center were selected by the managers of those centers and, equally important, the city avoided the data overload and frustration which result from trying to use too many measures. Moreover, the monthly reporting of the measures has thus far been limited to the program managers themselves, thus avoiding outside criticism and possible misuse of the data in the formative stages of the project. Finally, a student of financial management would likely conclude that the unit cost measures can indeed provide essential data on operations—data which are likely to interest external parties.

On the other hand, some possible limitations are apparent. First, nearly all of the unit measures now in use are either input, workload, or efficiency measures. Useful as some of these may be, they do not address the quality of services provided. It is probably wise, however, to begin with efficiency measures (since they are more understandable and less controversial) and later to add effectiveness measures. Another question is how many performance measures are needed for a given program. Is one such measure too limited to capture the complexities of a program—are 8 to 10 so many as to overwhelm the users of such data? The answer to this question is clearly difficult, and it must be worked out on a case-by-case basis.

Eventually, costs controllable and noncontrollable by managers will have to be reported separately in order to enlist the complete cooperation of the managers. They have already indicated their concern about being held responsible for costs they cannot impact. Also, not much detailed analysis has been done of the variances between budgeted and actual unit cost measures. Ulti-

mately, comparisons between Wooster's measures and accepted standards in the functional areas, or data for similar entities are needed. Also, as historical development allows, the *budgeted* unit cost measures should be refined. At present they are often merely one twelfth of the year's planned activity in any functional area. Finally, an evaluation is needed of the costs and benefits of the reporting. While the cost data are currently being collected, an evaluation of the benefits would be premature at this time. However, when one assesses the cost and benefits of generating and using such data—a part of the cost consideration must be—in the absence of such data, how can a public program be truly managed? Or, phrased differently, how can policy makers ask the taxpayers for funds *without* collecting basic data on how the funds are being used and what is being accomplished with them?

One could suggest that Wooster's experiment is wisely being implemented slowly over a period of years. On the other hand, one could conclude it is moribund. The experience in Wooster, a community with a "good government" tradition, suggests the need for outside pressure, however subtle, perhaps in the form of reporting requirements associated with its accounting system.

### Conclusion

As indicated, GASB's research in the area of service efforts and accomplishments draws on experiences occurring over several years in public organizations throughout the United States. The GASB research team is examining many aspects of performance reporting, including which and how many measures seem to be most acceptable and practical in a wide range of program areas; how such information is used in the decision processes; how might such data best be reported for disclosure purposes; and what are the costs and benefits of generating such data. Coverage is expected to extend to states, cities, counties, public hospitals, school districts, and public universities. Still, the research conducted thus far provides some useful, if tentative, lessons.

It is likely that environmental and behavioral difficulties—and not technical ones, will be the most difficult problems to overcome in integrating service efforts and accomplishments into the traditional financial management structure. Some of these have surfaced in Wooster and have slowed implementation. When HCFA released data on hospital mortality rates, the immediate reaction of many hospital officials was to explain to the media and others why such data were misleading. The literature on performance auditing is filled with references to the controversial nature of that work. That is simply the flip side of including unit cost measures in the accounting system—it is using unit cost measures for auditing purposes.

The idea of performance measurement has broad support, but it is often opposed in specific instances of practice. Measures provide powerful signals about performance. Government managers and their view of performance data are reminiscent of the old football story

"I don't pass because if you do three things can happen to you and two of them are bad." With the systematic use of performance data, government managers perceive mostly bad things happening to them. They do not foresee an era of bonuses or stock sharing, instead they can generally envision only negative uses of performance data.

The use of service efforts and accomplishment data in the governmental arena approximates the profit signals of the private sector. To simulate the private sector fully, however, considerable economic, social, and behavioral changes are needed before the system can work completely. Installing a performance measurement system may turn out to be the least difficult part of the task. The design of training, education, and incentive systems to alter the environment may be the greater challenge. On the other hand, one could make a strong case that simply generating and using data on service

efforts and accomplishments will positively *change* the environment of and current behavior in government.

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**Richard E. Brown** is Professor of Accounting at Kent State University, former state auditor of Kansas and a partner in Shaffer, Brown & Associates. Dr. Brown is a GASB research fellow for the 1987-88 academic year and is conducting research for GASB in the area of service efforts and accomplishments.

**James B. Pvers**, Certified Municipal Finance Administrator, is Director of Finance, City of Wooster, Ohio and member of the Special Review Executive Committee of the Governmental Finance Officers Association and member of the GASB Small Cities Task Force.

### Notes

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3. GASB, *Concepts Statement No. 1: Objectives of Financial Reporting* no. 037 (May 1987), p. 1.
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7. Emerson O. Henke, *Introduction to Nonprofit Organization Accounting*, 2d ed. (Boston: Kent Publishing Co., 1985), pp. 475-476.
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9. For a discussion of performance auditing, see Richard E. Brown, *Auditing Performance in Government* (New York: John Wiley

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10. See Robert N. Anthony and David W. Young, *Management Control In Nonprofit Organizations* (Homewood, IL: Richard D. Irwin Inc., 1984), especially Chapter 1 and U.S. General Accounting Office, *Managing the Cost of Government: Building An Effective Financial Management Structure* (Washington: U.S. Government Printing Office, February 1985).
11. The account of the development of Wooster's unit cost system is based on review of the minutes of the user and quality control committees and on other materials from the city's records including actual monthly unit cost and activity reports. Special thanks to Cadillac G. Gard, Controller for the City of Wooster for making available a copy of his report, *Application of Management Accounting to the City Government of Wooster, Ohio: A Change Process* (January 1985).
12. As a part of the research for this article, Professor Brown conducted nearly a dozen interviews with officials and managers in Wooster, Ohio. These comments come from these interviews.
13. This information is based on a research report prepared for GASB by one of the authors, Richard Brown. The research included the collection and analysis of actual performance reports and interviews with over 20 officials in the hospital field, including those in the American Hospital Association, the Joint Commission on Accreditation of Health Care Organizations, the Health Care Financing Administration, the Healthcare Financial Management Association, the American Medical Review Program, The Urban Institute, and several state hospital associations and hospitals.
14. Frank K. James, Controversy Mounts Over Efforts to Measure Quality of Health Care, *Wall Street Journal* (December 17, 1987), p. 29; Michael Waldholz, Report on Medicare—Patient Death Rates Draws Fire of Hospital Representatives, *Wall Street Journal* (December 18, 1987), p. 44.

# Measuring Government Performance: Experimenting with Service Efforts and Accomplishments Reporting in Portland, Oregon\*

*Council, budget analysts and the public use the city auditor's yearly Service Efforts and Accomplishments Report in many ways during the annual review of budget requests*

By Richard C. Tracy and Ellen P. Jean

The performance of government is a continuing subject of debate between citizens, elected officials and government managers. For the most part this debate revolves around the amount of government spending and the level of taxes. In the past several years, however, interest in government performance has begun to move from what goes *into* government programs to what comes *out*. Citizens and government officials are concerned not only about the amount of spending but also about the government programs and the achievement of intended results at a reasonable cost.

The need to better information to measure and monitor government performance has spawned a number of efforts at the federal, state and local levels over the past several decades. Some of these efforts have proved disappointing while others have had continuing success and benefits for the governments. Although public interest in government performance is driven in large part by taxpayer dissatisfaction with the value received from taxes provided, public managers also are influenced by the quality revolution in the private sector and believe these new management principles should apply to public enterprises as well.

This article discusses the experiences of the Office of the City Auditor in Portland, Oregon, with performance measurement and reporting during the past three years. The article will describe the process used

by the Portland city auditor and city departments to define, collect, audit and report information called service efforts and accomplishments (SEA) information. In addition, the article will assess impacts of SEA reporting to date, lessons learned and continuing challenges to successful implementation.

## Designing the SEA Report

The elected city auditor of the City of Portland, Oregon, is authorized by city charter to provide comprehensive auditing services in order to promote accountability

and help improve the performance of city government services. In 1988, the audit services division of the city auditor's office was authorized to pursue experimentation with the concept of service efforts and accomplishments reporting.

A 1991 test of the feasibility of SEA reporting in Portland found that it would be possible. Auditors concluded that sufficient, reliable data existed in city departments to support an SEA reporting effort and that city managers generally were willing to participate in the process. While better effectiveness and efficiency indicators were needed, the feasibility study recommended preparing an annual

### GOVERNMENT FINANCE OFFICERS ASSOCIATION POLICY STATEMENT SERVICE EFFORTS AND ACCOMPLISHMENTS

The Government Finance Officers Association believes that performance objectives and measurement are critical components and key tools for use in budget planning and decision making and program management by all levels of government.

Good budget practice encompasses strategic, operational and financial planning that establishes performance objectives and results in the measurement of service accomplishments.

Service efforts and accomplishments (SEA) are one facet of effective use of performance objectives in planning and budgeting.

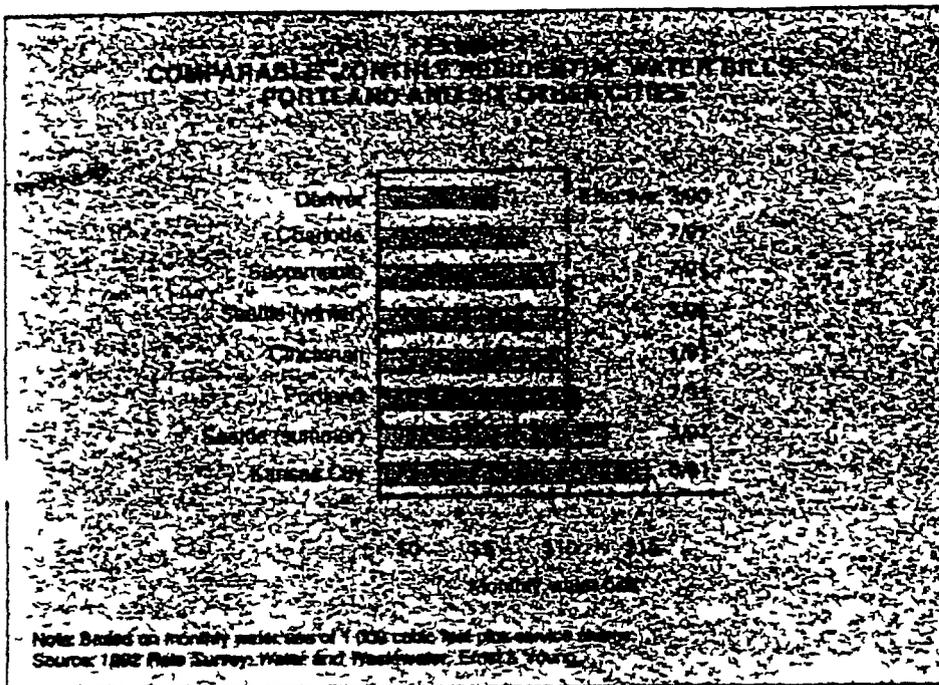
Performance objectives and measurement logically fall within the purview of budgetary practice rather than financial reporting.

The Government Finance Officers Association directs its Committee on Governmental Budgeting and Management to develop recommended practices, budget award criteria, and budget guidelines for performance objectives and measurement in conjunction with the national task force on state and local government budgeting.

Adopted May 4, 1993

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B4



- 1 Make it a cooperative joint effort between city departments and the city auditor focus on improvement not punishment
- 2 Make sure the information in the report is useful to managers and the public
- 3 Use existing data and management information where possible coordinate and link with other performance reporting
- 4 Limit reporting to the largest and most visible services do not overload citizens with data on all programs
- 5 Keep terms simple and clear and the report easy to read use a few well selected indicators that are reliable and valid
- 6 Aim for continuous improvement over time do not expect perfection

### The SEA Report Cycle

The working principles were carried out in each phase of Portland's SEA Report cycle. The cycle includes developing or refining SEA indicators for each service, collecting and auditing SEA data, analyzing and reviewing trends, presenting and reporting results, and improving indicators and reporting from year to year. Each phase of the cycle is described below.

**Development and Refinement of Indicators**  
SEA indicators were initially developed and continually are reviewed and refined cooperatively with management and staff of service departments. A number of meetings were required during the first year of reporting, but subsequent reports have required less time and consultation between auditors and department staff. Audit staff help clarify service objectives, refine performance indicators, and improve performance reporting where possible. The auditors critique indicators but generally rely on the departments to agree on a set of indicators for their service area. Auditors also work closely with each service manager to develop appropriate questions for the annual citizen satisfaction survey.

**Collecting and Audit of Data**  
Data for the SEA Report are collected and submitted by service departments to the audit services division on forms provided by the division. The departments also provide information on the source of the data and a contact person to call if auditors have a concern about the data. Audit staff test and review the accuracy and reliability of the SEA data, collect information from comparison cities and

SEA report that would include refined performance indicators and the results of a citizen satisfaction survey. Since the feasibility test, the audit services division has prepared and issued an annual report on the performance of the city's largest services in 1992 and 1993, with a third annual report due in January 1994. This report is issued not as a part of the city's annual financial report but as a separate document emanating from the auditor's office.

The City of Portland Service Efforts and Accomplishments Report contains information on the performance of the city's six largest services: police, fire, parks and recreation, water, wastewater, and transportation. These services comprise about 75 percent of the city's staffing and spending. The report displays information on each service organized in four sections:

- a brief description of the service, mission, goals, objectives and major activities
- background information on service area, spending and staffing levels
- service workload and demand data, and
- performance data on service results, outcomes and efficiency.

To aid the interpretation and evaluation of the information, several different kinds of comparison techniques are used. Spending and staff levels are compared to six other cities: Seattle, Sacramento, Denver, Kansas City, Cincinnati, and Charlotte. Exhibit 1 illustrates a chart used in reporting these comparative data. In addition,

five years of Portland data are displayed for each indicator so that trends can be seen over time. Most importantly, where possible, performance accomplishments are compared to planned goals, standards or benchmarks. Shown in Exhibit 2 is a report of five years of performance indicators for the fire bureau. If the data show unusual trends, poor or good performance, or very different spending compared to other jurisdictions, the report contains some explanatory information if available.

The SEA Report also displays the results of an annual citizen satisfaction survey administered by the audit services division. The survey questions are intended to provide information on effectiveness and service quality from the citizens or customers' point of view. Citizen opinions are reported for each of the seven major neighborhoods comprising the City of Portland.

The audit services division undertook the SEA reporting effort with two primary goals in mind: first, to improve the accountability of Portland by annually reporting to the public on the performance of city services and second, to help make city programs work better by providing information to managers and elected officials that would help improve decision making. Consistent with these objectives, the division developed several working principles for carrying out SEA measurement and reporting.

135

**EXHIBIT 3  
CITY OF PORTLAND FIRE BUREAU PERFORMANCE**

	Fires/1,000 residents		Total fire loss (\$ in constant dollars)
	Structural	Total	
FY 1988-89	3.3	7.8	\$34.81
FY 1989-90	3.0	7.0	\$48.26
FY 1990-91	2.9	6.4	\$35.26
FY 1991-92	2.5	6.9	\$48.74
Goal (91-92)	—	—	<1.9
Average annual % change	-9%	-4%	+67%

\*No more than 97% of prior years' average.

administer the annual citizen survey. Review and Analysis of Trends After the SEA data are audited, auditors review and analyze trends and changing conditions. A draft report is prepared and each service area receives a working draft to review and comment on. Usually the departments provide explanatory information to help clarify the outcome of their programs. While some of the SEA data are presented in narrative form, the report often uses graphs and tables to present the data. Some data are displayed in a map of the city by the seven neighborhood coalitions, as shown in Exhibit 3.

**Dissemination of Results** The final SEA Report is issued publicly to the city council, all city managers, citizen groups, the media, business and civic groups, neighborhood associations and other interested parties. A formal presentation is made to the city council, and a press release is issued to major print media and television and radio stations.

**Evaluation** After each year's SEA report, staff of the audit services division meet with representatives of each department to get feedback on the report and to agree on modification and improvements on next year's report. Council members and managers provide suggestions on how to make next year's report more useful.

**Costs of SEA Reporting**

Each year since preparation of the initial feasibility study in 1991, the audit services division has spent less time and effort on the SEA Report. Auditor and support staff hours have declined from 3,000 hours for the first annual report to 1,800 hours for the second annual SEA Report issued in 1993. Audit hours include indicators

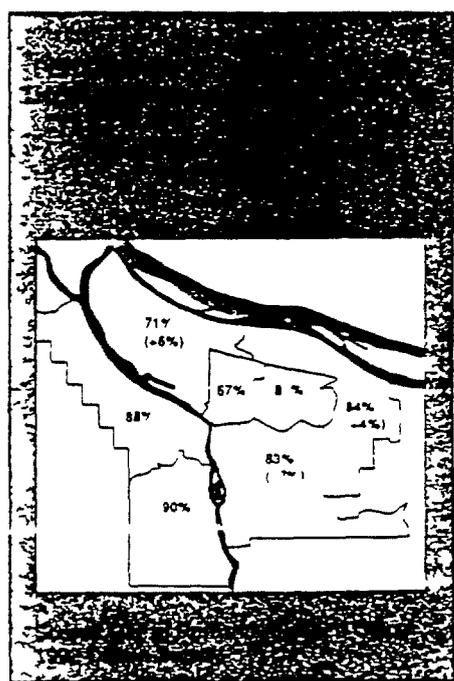
development, auditing of SEA data provided by departments, collection of data from other cities, administration of the citizen survey, and report writing, layout and production.

Time spent annually by service departments collecting SEA data has varied from five hours in one department to 20 hours in another. Average time spent by the six service areas represented in the SEA Report averaged about 10 hours. Additional efforts began in 1993 in some departments to design and implement projects to collect missing management information which will provide data for several SEA indicators. For example, the city's parks and recreation department is spending several hundred hours in 1993 to develop a process for trained observer logging use of parks and recreation facilities. This process will help the bureau measure its progress and performance in maintaining facilities and parks.

The annual citizen survey administered by the audit division has cost about \$17,000 per year. The anonymous, statistically valid survey was administered by mail and included several features: three separate mailings to 10,000 addresses selected at random; telephone survey of non-respondents to test reliability of respondent information; data entry of returned surveys into a database for statistical analysis; and contracting out for printing and mailing services.

**Effects and Benefits**

After the first two annual SEA Reports, the audit services division has identified a number of preliminary effects and benefits. The SEA reporting process has had an impact on program management, the budget



process, citizen accountability and audit effectiveness.

**Better Program Management** The process of defining missions, clarifying goals and identifying performance indicators has encouraged managers to focus on the purpose of their programs and helped increase understanding of performance measurement in the departments. Many believe that it managers have a clear focus on intended results and outcomes of their programs, ongoing decisions have better connection with mission and more clarity of purpose, resulting in more coordinated and rational management.

Portland's SEA Reports have stimulated discussion leading to specific actions to

improve operations in several departments. For example, the 1992 SEA Report showed a negative trend in water turbidity, a important indicator of the quality of the city's drinking water. The city council noted the trend during a public presentation of SEA results and asked for an explanation from the water department. After some review, it was discovered that some data in the department's annual public brochure on water quality were not comparable from year to year and needed to be revised.

In another case, auditor discussions with managers about developing better data to document achievement of employee empowerment goals caused the police department to design and initiate an annual employee job satisfaction survey.

**Improved Public Accountability.** While it is premature to assess the SEA Report's ultimate impact on public accountability, the report has been used on several occasions by citizen groups and the local media to assess and evaluate the performance of city government. The newly elected mayor provided dozens of copies of the report to her transition team to help formulate plans and recommendations for her administration. Hundreds of copies of the report have been distributed to local media, neighborhood associations and civic groups. These groups have used the report to prepare newspaper editorials, comment on the annual budget, and educate themselves on the performance of their city government. Because the document reports both positive and negative performance information that is provided by staff from the elected auditor's office, it is viewed as credible and objective.

**Improved Information for Budget Decisions.** The SEA Report has been used in a variety of ways to assist the council, budget analysts and the public in the annual review of budget requests. The report was used by the city council during a series of budget workshops that preceded public hearings in 1993. They found the report invaluable in conducting budget oversight well. Budget analysts use data in the report to analyze department budget requests and to prepare budget analysis. SEA data and graphs also were presented at the adopted city budget.

**More Effective Auditing.** The annual preparation of the SEA Report has indirect benefits for the audit services division. The nature of the report helps audit staff stay in frequent contact with the city's major departments and keeps the spotlight

on major problem areas. Unexplained negative trends in a performance indicator may suggest the need for more focused performance audit work. Audit staff increase their knowledge of service areas so that future detailed audit work in a department may be more directed and require less time. The public reporting of SEA indicators has encouraged managers to publicly commit to several program improvements that can be followed up on by audit staff.

### Lessons and Challenges

A number of lessons have been learned from the SEA reporting effort in the City of Portland. The auditors most involved in this city's three-year process believe others may reach similar conclusions about the process:

1. Valid and objective SEA data can be collected, audited and reported. The relative ease of collection and audit may be due in part to Portland's experience with performance measurement in prior years and the availability of performance audit staff. SEA reporting may take longer to plan and implement in jurisdictions with little experience with performance reporting or budgeting.
2. SEA reporting is an ongoing process that improves incrementally over time. The annual nature of the effort helps educate and culturalize managers and users, provides historical trends and longer term perspective, and gives the organization time to refine and improve the product continually.
3. Consistent reporting of valid performance information creates a demand for more and better information. Users are requesting more conclusions and analysis of impact, more highlighting and explanations of warning trends, specific suggestions for council action, and additional opportunities for public discussion of report results.
4. SEA reporting requires less time, effort and cost with each subsequent report. Routines become established, data collection is faster, and auditing methods are refined.
5. SEA information can complement and enhance traditional financial information.

SEA reporting in Portland also faces some continuing challenges that may reduce its effectiveness as an accountability tool for citizens, public managers and elected officials. These challenges include

- developing better methods for communicating results to reach more citizens
- devising new and creative techniques for presenting large amounts of data in easy to read and inviting ways
- improving coordination with federal, state and regional performance measurement efforts to reduce duplication and inconsistency, and
- creating more incentives to use the data.

### Conclusion

The preparation of Portland's Service Efforts and Accomplishments Report has required significant staff effort and resource investment. The process of developing, collecting and reporting performance indicators is slow, and improvements are incremental. Early indications are, however, that the effort is justified. City analysts and citizen groups use it regularly, and city council members find it a useful tool in overseeing city programs. Department managers differ in their opinions; those most in need of performance information use it greatly, while others with better management information systems find the SEA Report too brief and simplified. A number of other local governments, state offices and the federal government have found Portland's report useful as an aid in designing their own experiments with performance reporting.

Portland's service efforts and accomplishments reporting has shown promise in helping improve accountability. The city's initial efforts indicate that the process can benefit the organization. The concept remains experimental, and much needs to be learned about how best to carry it out. Continual experimentation and refinement by others will contribute to better understanding of effective ways to measure government performance. □

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RICHARD C. TRACY, director of audit of the City of Portland, Oregon, since 1983, is adjunct professor of public administration at Portland State University and frequently speaks at GFOA and other professional conferences on auditing and financial management topics. ELLEN P. JEAN, a senior management auditor for the City of Portland, has been auditor in charge of the annual SEA reports. In addition to government performance auditing, she has worked in higher education, supporting academic research and managing computing services.

## ESTIMATE REVENUES

Philip Rosenberg

One of the first steps that must be taken to prepare a budget is to estimate how much money the municipality will have available to spend in the coming fiscal year. Such an estimate will be a summation of

- The amount of transfers from the central government, and
- The amount of local revenue expected to be collected in the budget year

Important revenue issues to consider in making this estimate are growth, flexibility, dependability, diversity, and ability to expand with economic growth. In Hungary, the role of inflation weighs heavily on revenue estimates. Rapid increases in inflation impact both revenues and expenditures. When making year-to-year comparisons for the purpose of a revenue (or expenditure) forecast, an inflation factor must be considered in all projections.

Preliminary revenue estimates should be developed in the early phases of budget preparation. In fact, it is desirable to present the Mayor with a preliminary estimate of fund availability when the overall budgetary policy guidelines are being established. Initial estimates prepared early in the budget preparation process should be refined later, as necessary. Any significant changes in revenues or in local economic conditions could signal the need to review and revise estimates. Accordingly, expenditure levels will be impacted since municipalities must have a balanced budget.

### *IDENTIFY REVENUE BASE*

To make reliable estimates, a complete understanding of the principal revenues upon which the municipality relies and the factors affecting them is necessary.

Some revenues are based on existing assets (e.g., property taxes), some on income, some on economic transactions (sales taxes), some on privileges (business licenses), and some on the sale of goods and services. Therefore, it is important for municipal officials to monitor the economic activity taking place within the community.

### *PERFORM THE ANALYSIS*

The method used to project local revenues will vary by the revenue source. Several methods can be used to estimate revenues, but a simple, straightforward approach is best. We present one possible method.

A suggested technique for making such estimates is known as trend analysis. Trend analysis can be applied to all revenue sources including business licenses, building permits, sales taxes, etc. The approach requires

- Analyzing historical data (for at least three years),
- Accounting for changes in local revenue sources,
- Identifying positive and negative economic conditions,
- Making adjustments for inflation, and
- Making good judgments in analyzing these data

### **Exhibit**

### **Steps in the Revenue Estimation Process**

Estimate revenues for the upcoming fiscal year by following these basic steps

- 1 Identify and list each revenue source
- 2 Project each revenue source separately. Each source is unique and therefore trends will vary by source.
- 3 Find the difference in collections between each year. For example, the difference between 1994 and 1995.
- 4 Calculate the percentage change between each year.
- 5 Repeat the above Steps 3 and 4 for other years covered by the analysis and arrive at an average percentage change for all years. Divide this total by the number of percentage changes (e.g., for three years of historical data, there would be two percentage changes). This will provide the average annual percentage change for the period studied.
- 6 Calculate the budget fiscal year revenue estimate by multiplying the current fiscal year revenue by the average annual percentage change (from Step 5). Add the result to the current fiscal year revenue to project revenue for the upcoming fiscal year.

To perform simple trend analysis, assemble information from at least the past three years (a longer period is preferred) on revenue to be projected. Then calculate the changes from year to year to identify a trend. When trying to identify the trend, the best variable to measure is the change in the revenue base (e.g., growth or decline in property taxes, sales taxes, etc.). First, the change in the base for each of the previous three or more years needs to be determined. Second, an average change over the period is computed. Third, the average rate of change is multiplied by the revenue base in the current year to obtain an estimate for the budget year. Fourth, the budget year estimate should be adjusted down or up based on changes in inflation, population growth or decline, laws impacting local revenues, and economic activity.

The following example shows how trend analysis may be used. Consider the revenue source "business licenses." A review of the financial records reveals the following:

FISCAL YEAR	AMOUNT IN FORINT
1991	1,000
1992	1,200
1993	1,300
1994	1,500
1995	1,900
1996	2,100
1997	?

For fiscal year 1997, how much money should be anticipated for this particular revenue source? By using trend analysis, that is, determining the average rate of change in the amount collected over the past six years and applying it to fiscal year 1996 collections, the estimated revenue to be collected from business licenses is 2,436 forint. This estimate is developed by completing the following steps:

**STEP 1** Compile the total business license receipts for each fiscal year.

**STEP 2.** Calculate the difference in the amount collected between each fiscal year to determine a rate of change. Over a six-year period, as in this example, there should be five rates of change. Using the years 1991-1996, the following rates of change are developed:

$$\begin{array}{lcl}
 \text{a} & \frac{\text{FY 1992} - \text{FY 1991}}{\text{FY 1991}} & = \frac{1,200 - 1,000}{1,000} = 2 \text{ or } 20\% \\
 \text{b} & \frac{\text{FY 1993} - \text{FY 1992}}{\text{FY 1992}} & = \frac{1,300 - 1,200}{1,200} = 08 \text{ or } 8\% \\
 \text{c} & \frac{\text{FY 1994} - \text{FY 1993}}{\text{FY 1993}} & = \frac{1,500 - 1,300}{1,300} = 15 \text{ or } 15\%
 \end{array}$$

$$d \quad \frac{\text{FY 1995} - \text{FY 1994}}{\text{FY 1994}} = \frac{1,900 - 1,500}{1,500} = 26 \text{ or } 26\%$$

$$e \quad \frac{\text{FY 1996} - \text{FY 1995}}{\text{FY 1995}} = \frac{2,100 - 1,900}{1,900} = 10 \text{ or } 10\%$$

**STEP 3** Sum up all the rates of change and compute the average rate of change over the period

$$\begin{array}{r} 20\% \\ 8\% \\ 15\% \\ 26\% \\ \underline{10\%} \\ 79\% \text{ divided by } 5 = 16\% \text{ average rate of change} \end{array}$$

**STEP 4** Take the average rate of change, which is 16%, and apply it to last year's collection of 2,100 forint:

$$\begin{array}{r} 2,100 \\ \times \quad 16 \\ \hline 336 \end{array}$$

**STEP 5** Add 336, which represents the estimated growth rate, to last year's collection of 2,100 forint, to obtain estimated revenue from business licenses for fiscal year 1997

$$\begin{array}{r} 336 \text{ average rate of change in forint over past 6 years} \\ \underline{2,100} \text{ last year's collection} \\ 2,436 \text{ FY 1997 estimated business license revenue} \end{array}$$

If a municipality does not have sufficient data on the revenue base to make a projection, an alternative method of trend analysis can be applied. Instead of developing historical trend data on the revenue base, a trend can be computed based directly on the actual revenues collected in each year. An average rate of change is established and multiplied by current year revenues to obtain the budget year estimates (again adjusted for changes in inflation, population growth or decline, laws impacting local revenues, and economic activity). For municipalities with limited staff resources, the latter approach to trend analysis could suffice.

In addition to identifying local revenue, estimates should be made of the level of central government transfers likely to be received. This major component of municipal revenue is very difficult to predict both in terms of the level of transfer to be provided and the timing of its receipt. Assumptions must be made, regardless of how unreliable they might prove, to make some projection of this critical revenue source. As a starting point, these revenue

projections should be based on the prior fiscal year's receipt, adjusted for inflation and any actions the Ministry of Finance and the Parliament are likely to take

This analysis should account for the following

- Changes in the law that impact the municipality's ability to collect the revenue source
- Rate of delinquent taxes and fees Are all revenues due the municipality being collected in a timely fashion? If not, what actions will correct this situation?
- Out of the ordinary or seasonal changes in the revenue source For example, was a large one-time revenue received?
- Adjustments due to inflation so that real growth in revenue can be identified
- Problems in collecting a particular revenue source
- Conservative forecasting It is more important to underestimate revenue projections than overstate them This will help to avoid budget shortfalls and the need to cut back services once the budget is implemented

After the analysis is completed, identify when in the fiscal year each revenue source will be received and the amount to be collected This will serve as a revenue and cash flow plan for the fiscal year Once the fiscal year begins, monitor actual revenue collections against this plan and make adjustments accordingly

**A Possible Method for  
Government Financial Capacity Analysis and Forecast  
(the CLF Method)**

by Andras Vigvari

**Introduction**

This paper discusses a possible method for municipal budget analysis and forecast. The method was first used by Credit Local de France (CLF), a bank for local governments for analysing and forecasting its customers' financial capacities. The major businesses of CLF Bank (keep in mind, that the operating budgets of local governments in France are financed from the State Treasury) is providing advise for local governments on the preparation of communal/infrastructure projects, providing advice on financing alternatives and financing. The model handles the most important relations of municipal budgeting. The main purpose of the method is to establish and forecast municipal credit-worthiness. This purpose reflects the method's benefits and strengths as well as its disadvantages and weaknesses. The process explained below has been designed as an adaptation of CLF calculation methods to domestic situations.

The method sharply separates current, or operating budget from capital budget. Each term used by the method is applicable for analysis and forecast because, unlike terms used in Hungarian public finance accounting, the terms used by the method can be interpreted relevantly. The method uses **four key terms** for analysis and forecast. These are the following:

- 1 operating income (in other terms gross savings)
- 2 net operating income (in other terms net savings)
- 3 investment deficit
- 4 total financing need/surplus

**1 Analysis**

**1.1 Operating income**

By that we mean the *difference of current revenues and current expenditures* in the budget.

There are three components to current income: centrally controlled funds, funds taken over for operating purposes, and current own revenues.

By current expenditures we mean the operating expenses of the budgetary agencies and the mayor's office, funds handed over for operating purposes and

other current expenditures (primarily repayment of normative state contributions)

Under a normal, balanced financial management, the operating income is **positive**, which means that current incomes realised by the local government provide enough cover not only for current expenditures but also some *investment and or debt servicing purposes*. A zero or negative operating income reflects insufficient financial management **and/or** financial conditions (funds control)

It should be noted here, that the logic reflected in the term is not perfectly relevant under Hungarian circumstances for several reasons. First, because the most part of current revenues of local governments in Hungary come from the central budget and the Health Fund, and those funds usually *fail to cover* the costs of services prescribed, therefore *no savings* can generally be achieved from this group of current incomes. The second problem is that within own municipal revenues (that are low enough in themselves) the *proportion of taxes is low*. That means that taxes have little possibility to fulfil their function to provide funds for capital developments in the community. Taxes, therefore, cannot at present finance the capital investments necessary for providing public goods. The third problem is that operating fee revenues include no or occasionally some depreciation, therefore the costs of former capital investments will not or not fully be recovered.

## 1.2 Net operating income

The net operating income is the difference of the operating income and debt servicing. By debt servicing we mean interest payment and principal repayment on any loan funds (e.g. loan repayment, bonds repayment) in the current fiscal year. The debt servicing level is subject to the level of indebtedness and the changing money and capital market conditions. Because the nominal amount of indebtedness is misleading many times, usually several indicators are used for measuring it, including debts per capita, debts/current revenues, debt servicing/operating income, etc.

A positive net operating income shows that operations generate some funds that can be used by the local government for capital investment purposes. A negative net operating income shows that the local government must use funds for debt servicing either from its own property revenues or additional loans. The former practically means using up property, the latter getting into a "debt trap".

## 1.3 Investment deficit

That term means the difference of investment or capital type of expenditures and revenues. Under normal financial management that part of the budget is in **deficit**. This situation means that investment funds come from own property revenues, reserves made earlier, the current budget (usually tax revenues).

**and/or loan funds** In the case of investment *surplus* either some reserves are made or the net operating deficit is financed from investment funds. If debt serving on investment loans are financed from investment funds, it only means actual realisation of own property revenues advanced earlier. When the operating deficit is financed from investment funds it means using up own property. In the present period of the Hungarian municipal system, investment surpluses are generated many times due to fluctuation in own property income and privatisation of municipal property. Investment surplus may also arise due to the unique mechanism of application for and award of state funds (note e.g. projects with more than 100 percent subsidies)

#### **1 4 Total financing need/surplus**

That term means the final balance of revenues and expenditures in the current year, which is the resultant of the two parts of the budget (the net operating income and investment deficit/surplus). A positive value of this shows making reserves, a negative value shows the use of reserves and/or use of loan funds

## **2 Forecast**

With the help of the model, forecasts can be made for the local government sector as a whole, for major types of communities or specific communities. If figures on facts are calculated using the above logic, then it becomes clear that it is rather risky to make forecasts on trends. Attached are some calculations under the CLF model for the local government sector as a whole. With appropriate input figures applied, the method can be used for analysing the financial capacities of specific communities or for developing investment alternatives and forecasts necessary for credit-worthiness analysis

### **2 1 Input figures for a community forecast**

#### **2 1 1 Macro economic input figures**

- inflation rate (easy to quantify)
- expected interest rates (quantifiable, too)
- changes in funds control and state subsidies (difficult to quantify, scenarios with various conditions are worth to use here)
- likelihood of revolutionary changes to happen (e.g. changes in municipal competencies, introduction of net wage financing, integration of the sector into the state treasury) (these are difficult to quantify as well, various scenarios are to be used)

#### **2 1 2 Input figures on local societal and economic conditions**

- changes in the size and composition of the population as well as in economic activities in the community (in order to estimate educational, health and social care needs)

- changes in the economic output of the community (changes in PIT, and local taxes)
- expected capital investments in the community
- local real property prices (for estimating sale incomes, duties and tax bases)

### 2 1 3 Assumptions on municipal financial management

- estimations on the operating costs of the network of institutions
- rehabilitation and capital investment needs
- ideas about possible state grants for capital investment (whether local capital investment goals are generally supported, abilities for lobbying, etc ) (scenarios)
- property management and capital budgeting strategies (property valuation, policy on investments and borrowings) (scenarios)

## 2 2 Steps of the community level forecasting

2 2 1 Forecast the operating income based on estimations about normal values of current incomes, and real values of current expenditures (Under the adopted city policy, there is no automatic real calculation for current revenues, and there are ones on the expenditure side )

2 2 2 Determine the net operating income using the estimations on debt servicing

2 2 3 Determine the amount of investment deficit based on estimations about own property incomes (under various scenarios) and rehabilitation/capital expenditures (several alternatives)

2 2 4 Determine the financing needs

**CLF model for the municipal sector as a whole**

At current prices in Ft 'million	1990	1991
Own current revenues		
State controlled current revenues		
Total current revenues		
Total current expenditures		
<u>Operating income</u>		
Debt servicing		
Net <u>operating</u> income		
Own property income		
Own property income from the state budget		
Total own property income		
Investment and own property type expenditures		
Investment deficit (surplus)		
Financing needs (surplus)		
Balance sheet total		
Consumer price index (% previous year - 100)		

# User Fee Establishment Depends on Community\*

By Philip Rosenberg

User fees and charges pose unique concerns regarding the financing of service delivery. While there are a number of advantages for establishing a system of fees and charges, the public is clearly concerned with how much it will have to pay. In formulating user fee financing strategies, public officials must be prepared to deal with how service costs will be distributed among the various users, present and future.

Community investments support a diverse array of facilities, services and programs. Some facilities, such as recreational services, are used voluntarily, while other services benefit the general public, regardless of the needs or requirements of the individual. While certain facilities provide benefits in direct proportion to consumption, other services prove administratively difficult to measure on a usage basis.

In establishing pricing strategies, local officials should consider whether the needs to be served are for those services that provide benefits to the entire population of the community or should the services be financed through general revenues.

Once a decision is made to establish a fee, what is the basis for the amount charged? Should the fee established recover a portion or the full cost of capital development? Should the fee cover only operating, maintenance and service delivery costs? Should everyone pay the same amount? Can the user and non-user be identified? Should persons of varying incomes pay the same amount? Should pricing include the marginal cost of capital development to meet the needs of particular users? Indeed, there are many questions to be answered, especially regarding the following pricing considerations:

- **Cost oriented** — Prices are generated to recover costs or revenues in excess of cost.
- **Competition-oriented** — Prices are influenced in part by what the user would have to pay to obtain that service from an alternative available source.
- **Demand oriented** — Prices vary in relation to the number of persons who want the service in particular ways during particular times at particular locations.
- **Convenience oriented** — Prices vary to reflect the value of the convenience

of the service or the manner in which the service is paid.

- **Society-oriented** — Prices are adjusted to reflect societal objectives (lower prices for the poor, higher prices to discourage certain types of activities such as over-consumption of limited resources).

In selecting the appropriate strategy, the single major issue associated with fees and charges is related to the equity of pricing public goods and services. Although some officials may argue that fees are inherently equitable because the user pays for the goods and services



consumed while the non-user does not subsidize the capital cost provision, there are two dimensions to the establishment of a fee structure that is fair and equitable:

- pricing to reflect the cost of serving the individual user, and
- pricing to reflect the individual user's ability to pay.

Local government services are not provided to the public without cost. Yet the equitable distribution of the cost is typically demanded by the public, since the portion of service costs not supported by fees represents a public subsidy.

If public officials could accurately apportion costs to the user, then every one would pay their fair share. This would require the application of marginal pricing techniques where the user pays the precise portion of necessary costs. Marginal pricing is based on such variables as capital capacity and demand.

Strict adherence to marginal cost pricing could mean that full costs are not recovered. For example, one addi-

tional homeowner linked to a wastewater treatment facility that is operating under capacity adds very little to the operational and development costs of the facility. Because of these complexities, local officials either opt for a flat rate fee structure or a modified version of marginal pricing.

The degree of benefit an individual receives from a capital asset will also be variable, and the pricing strategy selected may reflect approximations of the benefits actually received. For example, capital improvements in a commercial development district may give a greater benefit for owners of developed land than owners of vacant land. In these cases, a certain degree of unfairness is inevitable, and public officials must strive to select the pricing mechanism that offers the least net penalty.

## Horizontal equity

One approach to establishing an equitable fee is to apply an identical charge across the entire user population — horizontal equity. By creating a fee structure that promotes horizontal equity, local officials seek to collect a uniform amount that spreads program costs evenly among all users. In some cases, this approach is both rational and appropriate where those who make equal use of services pay equal amounts and where there is constant service demand throughout the year.

However, horizontal equity may not properly distribute the real cost to all users. A flat rate sewer charge means that those residents at some distance from the sewage treatment plant pay the same amount as those residents near the plant. The flat rate sewer charge may look fair (everyone receives service, everyone pays for it) but does not reflect the true capital cost per user, since the community expends more dollars to provide the service as development spreads to new areas. Because infrastructure design must meet the potential demands of most peak load situations, a flat rate will not reflect the incremental or marginal capital cost associated with expanded capacity. Individuals using the facility in off-peak hours will, in essence, be subsidizing individuals who use the facility during peak load situations.

User fees have often been cited as a form of regressive taxation because

1483

lower income families and individuals pay a disproportionate share of their income for public goods and services. Instituting a fee to cover capital and operating costs may exclude the poor from benefitting from services that had previously been provided free of charge.

Additionally, some officials argue that fees are a more equitable pricing mechanism than the property tax. This argument suggests that low income persons, through the property tax or indirectly through rent, pay for services they may or may not use. In his book *Rebuilding America: Financing Public Works in the 1980s*, Roger J. Vaughn makes the case that low income households represent a disproportionate share of mass transit and public school users. Conversely, the poor use less than their population share of water, sanitation, library and museum services. Because fees offer the flexibility to select those public goods and services one wishes to consume, the poor will have an increased opportunity to pay for only those services they actually use.

In spite of these arguments, public officials have instituted differential pricing mechanisms that are designed to meet the needs of the low income, the elderly and the youth of their community. Vertical equity refers to the distribution of costs among users based on differing levels of income (ability to pay) or differing consumption levels. Senior citizen or youth fares for public transportation are not uncommon.

The decision to give preference to these groups in pricing may also be influenced by administrative simplicity. Pricing water on the basis of one's ability to pay may cause administrative nightmares. In these situations, it has been suggested that the poor be provided with some form of direct subsidy to pay for these services.

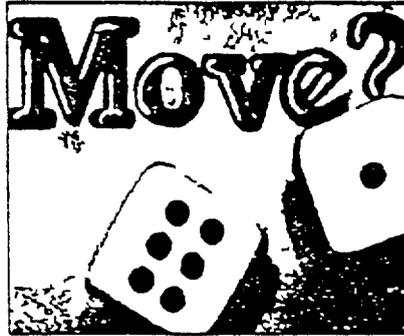
Local governments compete with each other to attract or retain business and industry. When establishing a fee structure, care must be taken to consider the fees imposed by neighboring jurisdictions and communities of similar size and service delivery. Do they charge a user fee? How much do they charge? What are the bases for the fee? If fees are too high and too numerous in comparison with comparable communities in the surrounding area, the community's competitive position can be adversely affected.

#### Identifying fee services

Beyond the public policy and equity issues associated with the establishment of user fees, there are some questions that must be answered before a fee is determined. What services should be financed by fees? Who will pay? How much will they pay?

Generally, the use of fees to finance specific types of services will be influ-

*In selecting the appropriate strategy, the single major issue associated with fees and charges is related to the equity of pricing public goods and services.*



enced by the local government's legal capacity to levy a charge, the availability of alternative revenue sources, the social and political climate of the jurisdiction, and the public's willingness to pay.

Service can be provided as a continuum with pure community-wide facilities (public schools, police protection) at one end and pure private-type facilities (public utilities) at the other end. Within the two extremes fall a number of services that have both public and private qualities. As the service provision moves across the continuum from public to private, the funding composition shifts from general revenue financing to fee-based financing. Those capital items falling in the middle may be financed depending on public policy by a combination of each revenue source.

Another important consideration is the ability to distinguish those who pay for service provision from the non-payer. There are a number of services for which it is relatively easy to identify and charge the consumer for service use.

Conversely, a betterment charge for the installation of street lighting may benefit not only residents of the street but those who travel through the area. If the non-payer cannot be excluded from the benefits of a fee-based service, there will be a number of negative results. First, those who pay for service will voice considerable protest to what they may consider to be an unfair charge. Second, no one will pay for the service if they can receive the benefits

without cost. Third, those receiving service provision without cost may over-consume.

#### Determining price

Ideally, no activity should have a singular basis for determining its price. The development of a fee structure has three essential elements:

- Quantity — charge on the amount consumed

- Capacity — charge on the full cost of producing and

- Location — charge related to density and location

A fee may be designed to incorporate components of each of these three elements. For example, water supply may incorporate zone (location), peakload (capacity) and the amount consumed (quantity).

Essential to establishing the fee is the availability of accurate cost information. The establishment of a rate that is built upon faulty cost information creates a multitude of problems.

The total cost of any activity is derived from two elements: direct costs and indirect costs. Direct costs can be readily attributable to the provision of a specific good or delivery of a particular service. Direct costs include labor and contracted services, materials and supplies. Indirect costs are not readily attributable to a service yet the costs support service provision. Typically, indirect costs include data processing, finance, personnel, utility costs and other costs that cannot be related to a specific service or activity.

The fee selected will be influenced by a community's pricing objectives. If the principal aim of establishing a fee is to guarantee, where possible, full cost recovery, local officials need to examine the capability of the fee to generate revenue equal to the capital and operating cost of service. If the purpose of pricing is to control demand and lessen waste and over-consumption, the fee should reflect this concern. If there are significant capital, time or material cost differences, these factors likewise need to be considered in the pricing strategy.

Administrative capacity to establish, collect and monitor various types of fees should also influence the fee selection decision. The desire for administrative simplicity and the high costs associated with monitoring certain variable pricing structures may lead to the establishment of less precise pricing mechanisms. Where this is the case, a community may use such variables as land area, front footage or land value as proxies for more accurate indicators of individual use.

*Philip Rosenberg is the founder of Philip Rosenberg & Associates, a financial and management strategies consulting firm for government in Orleans, La.*

The Government Finance Officers Association

# Research Bulletin

*Research & Analysis on Current Issues*

January 1992

## Evaluating Alternative Revenue Sources\*

by Ian J Allan

Local governments continue to operate in a difficult fiscal environment made worse by the effects of an economic recession. Of increasing concern to many finance officers is the drop in revenues from economically sensitive sources that has led to budget shortfalls and deficits. The financial difficulties encountered by state governments has led to cutbacks in state aid to localities and compounded the problems faced by local governments.

While reductions in spending can be a part of the solution to the fiscal problems of local governments, many have found that expenditure demands have increased during the current recession. As a result of this situation, many local governments are considering the adoption of alternative sources of revenue to bolster sagging collections. This task has been made more difficult by tax revolts in some areas that have made it increasingly problematical for local governments to raise needed revenues through the use of the real property tax.

The purpose of this Research Bulletin is to provide guidance to those finance officers contemplating the adoption of alternative revenue sources and to encourage local governments to develop formal statements of revenue policy. It includes discussion of local government revenue policy and appropriate policy goals, a procedure for identifying tax and other revenue alternatives, a method for evaluating specific tax and user charge alternatives, and the implications of revenue structure reforms for a local government's credit standing. This information can assist finance officers in conducting evaluations of the revenue structure and in providing policy advice to the elected officials who are ultimately responsible for adopting changes.<sup>1</sup>

### Evaluating Local Government Revenue Policy

Revenue policy, in its simplest form, represents the set of decisions made regarding the raising of revenues to fund the operations of government, and is reflected in the taxes, fees, and user charges imposed within a particular jurisdiction. Many local governments lack a formal comprehensive statement of revenue policy; their tax and revenue actions are made, instead, on an ad hoc, fragmentary basis.

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Government Finance Officers Association  
Government Finance Research Center  
1750 K Street, N.W., Washington, D.C. 20006  
(202) 429-2750

Ideally, revenue policy will reflect a community's fundamental values, such as the desire to ensure that the living standards of elderly and/or low-income homeowners are not adversely affected by rising residential property values and property tax bills. In reality, state restrictions on local revenue-raising authority prevent revenue policy from fully reflecting these fundamental values. In many states, it is not possible to reduce local dependence on the real property tax and, thus, blunt the impact of rising property tax bills, because state governments have restricted the ability of local governments to diversify their revenue structures through the imposition of income or sales taxes.

Why reform the current revenue structure? Reforms are often proposed as a means of defusing a fiscal or political crisis. For example, at the present time, an economic slowdown is forcing many local governments to review and revise their existing revenue structures in order to generate sufficient funds to meet growing expenditure demands. Another typical example of reform is where a local government responds to growing complaints about rising property tax bills by attempting to diversify the jurisdiction's revenue base and reduce its dependence on the real property tax. Revenue policies are also reformed because one feature of the tax and revenue system has fallen out of line. For example, the need for and pursuit of revenue adequacy may create inequities in the tax burden that must be addressed at some point in time.

### Policy Goals

While opportunities for comprehensive reform of a local government's revenue policy and revenue structure are rare, evaluation of individual revenue sources is quite common. Prior to conducting an evaluation of the local revenue structure, it is important to review what are generally considered to be the appropriate goals of revenue policy. The goals discussed below are not listed in order of importance, nor are they mutually exclusive; conflicts and trade-offs between them will be inevitable.

**Political Acceptability.** Taxpayers expect fairness in the distribution of the tax burden and an understanding of how the burden is allocated. To increase taxpayer understanding of the tax and revenue system, complexity should be kept to a minimum, and the assumptions underlying the revenue policy made explicit.

Politically acceptable revenue policies will to a certain extent reflect local tradition and political attitudes. Prior to altering existing revenue policy a review of the political environment must be conducted. An important component of this review is an examination of existing revenue capacity and revenue effort including comparisons with other jurisdictions if such data are available. Revenue capacity gauges the ability of a government to raise revenues and is measured in terms of per capita personal income. Revenue effort is a measure of the actual amount of revenue raised by a government, and is often measured in terms of revenue per capita. Evaluating local revenue capacity and effort can reveal citizens' attitudes and preferences towards taxation and the level of taxation that they are willing to bear.

**Revenue Adequacy and Stability** The revenue structure should provide the government with sufficient revenues to finance desired public services. Creating an equilibrium between the growth of revenues and the activities that governments finance will be difficult to achieve but is a worthwhile objective. Ideally revenue yields will be responsive to income and population shifts, will be dependable and predictable. Economic recessions and changes in state and federal aid distributions can have a negative impact on revenue growth. At the present time due to the effects of economic recession revenue adequacy is a major concern of governments at all levels.

**Revenue Diversification** An optimal revenue structure includes a balance among the major taxes of property, sales and income, minimizes the use of nuisance taxes and relies on user charges where feasible. Taxes should be as broadly based as possible to allow for lower tax rates and improve economic efficiency. Diversity in the revenue structure is desirable for political and social reasons.

A diversified property tax base with a balance between the different classes of property is desirable because it will be less vulnerable to economic shifts. To achieve this aim linkages between tax policy and planning/zoning policy should be forged. In the short term a balance between the various classes of property will be hard to achieve; in the long term particularly in growing communities such balance is a good possibility.

**Equity** The distribution of the tax burden and the benefits of public services should be equitable. Horizontal equity requires that the treatment of persons in similar economic circumstances be equal. Vertical equity requires fairness in the distribution of liabilities among persons in different circumstances.

**Economic Neutrality** The tax and revenue system should maintain economic neutrality, promoting growth and the efficient allocation of the economy's resources. The goal here is to minimize unintentional interference with private economic decisions in the process of raising needed revenues.

**Administrative Feasibility** The complexity and cost of

collection of revenues must be considered prior to adoption of a particular tax or revenue source. Compliance should be made simple, certain and inexpensive for the taxpayer and administration easy and economical for the tax collector.

**Self Sufficiency** To the extent possible it is important not to be overly reliant on federal and state aid so that aid reductions or cutoffs do not interfere with the provision of vital services or distort budget decisions.

**Political Feasibility** The use of particular taxes or revenues by state governments may preclude their use at the local level because states may wish to reserve the tax or revenue base for their use alone. Local governments should consider this when evaluating revenue alternatives and pursue those alternatives which are politically feasible. Legislative advocacy may be required in some cases.

**Political Accountability** Increases in local taxes or other revenues should be the product of deliberate legislative action and not inherent structural features of the tax and revenue system that result in automatic rate hikes. A good example is the real property tax and property assessments that have increased from the previous year resulting in higher property tax bills unless the tax rate is lowered. Some local governments deal with this phenomenon by adopting a truth-in-taxation law that sets a constant property tax yield rate and prohibits increases in property tax levies unless public hearings are held.

**Accounting for Tax Exemptions, Abatements and Relief Programs** By tracking and accounting for the value of taxes and other revenues foregone by a local government for the purposes of providing incentives to businesses or for tax relief for low income property owners, a government can more easily compare its costs with the benefits obtained.<sup>2</sup> A word of caution: it can be difficult to measure the benefits associated with tax abatements and other relief programs and local governments should be careful not to exaggerate their size.

**Exporting the Tax Burden** Tax exportability can be defined as the ability to levy taxes or other revenues in such a way that the burden is borne by taxpayers outside of the jurisdiction of the local government. Exporting the tax burden is a desirable goal because it lessens the burden on a local government's residents. Retail sales and hotel/motel accommodations taxes are generally the most exportable.

Taxes can also be exported to the federal government when local governments take advantage of the deductibility of local property and income taxes from the federal income tax. When searching for revenue alternatives deductibility (or the lack of it) should be a consideration.

**Ordinance Consolidation** To ensure greater control over a government's revenue policy, local laws regarding taxes, fees and user charges should be consolidated. This will enable the local legislative body to review them on a

regular basis -easily and comprehensively--and reduces the chance that 'old' rates will remain in effect due to administrative neglect

**Other Valid Goals** A local government revenue policy may reflect other goals of the community such as the preservation of historic properties or provision of property tax relief to homeowners. These goals may conflict with other policy goals such as the need for revenue adequacy and stability or the desire to maintain economic neutrality.

In the process of examining alternative revenue options the goals outlined in this section can be used as a means of assessing the feasibility and desirability of the various options as they might be applied in a local jurisdiction. Failure to fully consider these goals could lead to future fiscal and/or economic difficulty particularly if decisions are made regarding revenue sources that account for a large proportion of the jurisdiction's revenue base. The application of these goals to specific revenue alternatives is more fully discussed in the section on evaluating alternative revenue sources.

#### **Linkage with Fiscal Policy**

Revenue policy is inextricably linked with fiscal policy. An evaluation of revenue policy should not be undertaken without an evaluation of expenditure policy. Of particular importance is the identification of the level and mix of services that taxpayers wish to support. Essentially a political decision, this is one of the more difficult challenges facing any government. Nonetheless, only by identifying this target level of taxation can reform of the revenue structure be completed successfully. An additional concern is that the revenue structure continue to generate sufficient revenues to meet future spending requirements while meeting other revenue policy goals.

#### **Linkage with Economic Development Strategy**

The revenue policy in place in a local jurisdiction directly affects the business climate and economic development efforts. Policy makers need to understand how the current revenue structure affects the economy and how proposed changes may improve or hinder future economic activity and take into account the interaction between taxation and economic activity when adjusting local tax rates.

Local government policy makers aware that they are in competition with other jurisdictions for economic development projects attempt to maintain a healthy business climate in order to discourage businesses from relocating to another jurisdiction and to encourage businesses located elsewhere to relocate in the local jurisdiction. Fear of developing a less competitive tax climate than neighboring jurisdictions has caused many local governments to raise revenues through the imposition of additional user charges and fees rather than by raising major tax rates. This can result in a more balanced tax and revenue system and may ultimately be of greater benefit to a local

government's residents and enhance economic development efforts.

Important questions to ask are: 'Would a tax or other revenue change force a business to leave?' 'Have any businesses complained of heavy tax burdens and financial difficulties?' 'Would tax incentives offered to businesses undermine revenue stability?' 'Would a tax or other revenue change contradict past policies including the granting of tax abatements to businesses?'

#### **Steps in the Identification of Alternative Revenue Sources**

Local governments considering the reform of their revenue policies will want to identify alternative revenue sources. The identification of such alternatives can be accomplished systematically through an examination of existing local revenue raising authority, a review of the experience of other jurisdictions and an evaluation of the local economy.

#### **Examine Local Revenue Raising Authority**

Local revenue raising authority varies from state to state depending on a number of factors including whether the state in which the local government is located allows "home rule" or is governed by what is known as 'Dillon's Rule'. Local governments granted home rule status are often allowed wide latitude in the selection of taxes and other revenue sources and only those taxes and revenues specifically prohibited by the state constitution or statutes are unavailable for their use. In Dillon's Rule states only those tax and revenue sources specifically approved by the state for local government use are available to those governments. Currently, forty-one states have granted home rule to their cities while twenty-eight states have provided home rule to their counties.

Taxes and other revenues that are not currently legal under state constitutional or statutory law would require changes in those laws or the passage of enabling legislation prior to their adoption at the local level. This does not preclude local governments from pursuing such changes but may make it difficult to adopt certain types of taxes and revenues.

Once the review of the state constitution and statutes has been conducted the next step is an examination of local law. Two things are important: what revenue raising authority currently exists and what enabling legislation would need to be passed in order to adopt new taxes or other revenues. In most jurisdictions local ordinances will be necessary in order to adopt new taxes, fees or user charges.

#### **Examine the Experience of Other Jurisdictions**

Along with the review of local revenue raising authority it is usually worthwhile to examine the experience of similar jurisdictions both within the state and in other states. The revenue raising experience of other local governments

154

located within state is particularly helpful because the residents of those jurisdictions may have similar attitudes and traditions regarding taxation. This information will be helpful in gauging the feasibility of imposing new taxes or other revenues in a jurisdiction.

The experience of jurisdictions in other states is often the best source of information about potential tax and revenue options. Such a review will not only provide information on tax and other revenue options that are not permitted in your state, but can also provide a sampling of innovative revenue raising practices in use around the nation.

In evaluating the experience of other jurisdictions, the tax and user charge evaluation criteria discussed in the next section can be utilized. By reviewing the experience of other jurisdictions it will be possible to get a better idea as to what has worked in the past and is likely to work in the future.

### Evaluate the Local Economy

Finally, it is important to consider the state of the local economy when evaluating revenue policy. Of particular importance is an examination of relevant economic and demographic trends including population, per capita personal income, proportion of AFDC recipients, job trend and workforce, fair market value of real property and taxable retail sales. Such trend analysis will help to provide the framework for any redesign of revenue policy, can lead to a greater understanding of the environment in which budgetary policy operates, and enable a more practical evaluation of revenue alternatives, including a better understanding of the revenue potential of different options.

While all revenue alternatives may impact or be affected by the local economy, certain alternatives should be evaluated in greater detail. In some instances, the state of the local economy will preclude a local government from imposing certain taxes, fees, or user charges. For example, imposing a tax on energy consumption, such as electricity usage, could have a substantial negative impact on an energy-dependent industrial firm that may be experiencing financial difficulty due to the effects of an economic downturn. The loss of jobs and tax revenues due to the closing of such a business could have a devastating effect on a community.

### Evaluating Alternative Revenue Sources

A local government's evaluation of alternative revenue sources should involve taxes, fees, and user charges. The evaluation of taxes and user charges is slightly different and documented in the following paragraphs. The evaluation of fees can be conducted along these same lines.

### Tax Evaluation Criteria

The following criteria can be used in evaluating specific tax options. The criteria provide a means by which each can be measured against the goals of revenue policy. They

can also force local government policy makers into explicit choices when selecting one alternative over another. Exhibit 1 on pages 6 and 7 shows how these criteria were applied in an actual analysis of alternative revenue sources conducted by the Government Finance Research Center for Baltimore County, Maryland in 1989.

**Economic Efficiency** This criterion is concerned with the possibility that the imposition of a tax or a change in the tax rate or base will result in a change in the relative price of a good or service sold in a jurisdiction and have an effect on private economic choice. A change in relative prices could cause consumers to shop elsewhere for goods and services (the so-called 'border city' effect) or cause businesses and individuals to alter their locational choices. If businesses and/or individuals alter their decisions, the tax is said to create efficiency costs.

The price elasticity of demand for a good measures the sensitivity of demand to changes in price. The higher the price elasticity of demand for a good, the more sensitive demand will be to changes in price. The price elasticity of demand for a good is determined by the availability of substitutes. The more substitutes for a good available, the higher will be the price elasticity of demand for that good; thus, that good will be a less likely candidate for taxation. If demand for a good is price inelastic, demand will be unaffected by price, and there will be little need to be concerned about the effect of the imposition of a tax on private economic choice, as there will be little effect.

It is possible to calculate the price elasticity of demand for a wide range of goods, but local governments in the process of evaluating their revenue structures rarely do so. Instead, many governments rely on assumptions regarding price elasticities when making revenue policy decisions. For example, when considering the imposition of a local retail sales tax, local governments often assume that the price elasticity of demand for retail goods is high when there are a number of shopping centers located in adjacent communities that do not impose a local retail sales tax and are viable substitutes for local retailers.

In order to minimize efficiency costs, taxes can be imposed on goods with price inelastic demand. Efficiency costs are also minimized when broad-based or flat-rate taxes are imposed.

**Equity** This criterion is concerned with the effect that a tax change will have on equity between individual taxpayers. The important question to answer is: Who bears the burden of the tax?

One of the basic goals of revenue policy is to design an equitable tax and revenue system. While there has been basic agreement that each taxpayer should contribute his or her fair share to the cost of public services, there has been disagreement over what that fair share represents. Two approaches have been developed that attempt to deal with this issue. The first approach involves the application

of the so-called benefit principle" while the second approach rests on the ability to pay principle

Applying the benefit principle an equitable revenue system is considered to be one in which each taxpayer contributes in accordance with the benefits he or she receives from public services. The ability to pay principle on the other hand requires that taxpayers contribute to the cost of public services in line with their ability to pay. Although the benefit principle is utilized as a justification for the imposition of fees or charges for certain types of public services such as for the use of recreational facilities the ability-to pay principle is widely accepted by economists as the appropriate guide to the determination of equity for revenue policy purposes.

The ability to-pay approach utilizes two rules in the determination of equity among taxpayers that are important to this analysis. The horizontal equity rule requires that people with equal incomes pay the same amount of taxes, while the vertical equity rule requires that people with greater incomes pay a higher proportion of their incomes as taxes. Generally speaking the use of a graduated (progressive) rate structure improves vertical equity while the use of a flat rate tax structure is better for horizontal equity.

Progressivity, proportionality and regressivity are important equity concepts used in describing the burden of a tax or group of taxes across income levels. Progressivity refers to a situation in which taxes as a proportion of income increase as income increases. Proportionality occurs when taxes as a proportion of income are the same for all individuals. Regressivity refers to the case where taxes as a proportion of income decline as incomes increase.

In evaluating tax equity it is important to determine the effect of a tax on disposable income i.e. what amount of purchasing power was taken away by the tax? Equity may not be as important an issue if a tax amounts to an insignificant proportion of a low income taxpayer's total income. Equity will be an issue if a great deal of purchasing power is taken away.

The income elasticity of demand is another important concept that indicates what percentage of marginal income is spent on a good. If the percentage of marginal income spent on a good increases as incomes increase this is a potential candidate for taxation. Although it is possible to calculate the income elasticity of demand for a wide range of goods local governments rarely attempt to do so when evaluating revenue alternatives. Rather many governments rely on assumptions regarding income elasticities when making revenue policy decisions. For example the federal government taxes luxury items such as yachts and expensive jewelry in an effort to exact additional revenues from the wealthiest taxpayers and because these types of goods have a high income elasticity of demand.

**Administration** This criterion is concerned with the administrative burden of a tax. Several questions should

be answered including 1) is the tax easy to evade? 2) what does the tax cost to administer? 3) who pays the cost of administering the tax? and 4) what is the cost of administration of alternative taxes? The point of this exercise is to ensure the efficient collection of taxes and other revenues. Failure to accurately estimate the burden of administering new taxes or other revenues could lead to situations in which the cost of administering a tax exceeds the cost of alternative taxes or exceeds the revenue collected from the tax.

Determining the cost of administering new taxes may be difficult without detailed study. Information on such costs particularly for small revenue generators is almost nonexistent. Generally speaking broad based and flat-rate taxes are easier to administer while taxes with graduated rate structures (such as a progressive income tax) offer incentives for taxpayers to avoid paying.

**Political/Legal Considerations** In evaluating the political feasibility of imposing a new tax or increasing a tax rate it is worth reviewing the findings of the U.S. Advisory Commission on Intergovernmental Relations, which has consistently found that the public attitudes are generally positive towards the taxation of sales but negative towards the taxation of income and property. It is also generally accepted that taxes with broad bases and/or graduated rate structures are harder to sell to the taxpayer while taxes with narrow bases and/or flat rates are easier to sell.

As noted earlier part of the review process involves a determination of the extent to which a local government has state constitutional or statutory authority to impose particular taxes, fees or user charges or increase their rates. In evaluating a specific tax option it is important to determine the legal steps necessary for its imposition.

Once a new tax has been adopted the possibility exists that legal difficulties related to this option will arise involving such things as conflicting interpretations of statutes or challenges on the grounds of discriminatory taxation. The experience of other jurisdictions in these matters may assist a local government in gauging the likelihood of such a situation occurring.

**Yield and Elasticity** This criterion examines the potential revenue yield and elasticity of each tax option. The yield depends on the size of the base and the rate applied. It is important to note that higher yields are often possible at lower rates if a broader base is used.

The elasticity of a tax measures the responsiveness of tax revenue to changes in the underlying base of the tax. For example the elasticity of an income tax is often measured as the percentage change in income tax revenue divided by the percentage change in personal income. A key question to answer is "will revenues generated by the tax match the growth in expenditures?" In order to answer this question it is important to examine the elasticity of the tax and of the expenditure structure. Elastic taxes feature revenue growth greater than growth in the underlying base of the tax such

as local personal income or the local economy. On the other hand, revenue growth for income-inelastic taxes increases at the same or a lower rate than that of the underlying tax base. Graduated (progressive) tax rates can increase the elasticity of a tax, while flat rates often result in limited revenue growth.

**What is a good tax?** Although there are many who would argue that there are no good taxes, public finance economists generally believe that a good tax has some of the following characteristics:

- it is imposed on a good with price-inelastic demand
- it is imposed on a good with a high income-elasticity of demand,
- it is simple and inexpensive to administer;
- it is acceptable to the vast majority of taxpayers and is beyond legal challenge; and
- its revenue yield grows at a rate that matches or exceeds growth in expenditures.

### Evaluating User Charges

When public sector goods or services are similar to those offered by the private sector, the possibility exists that local governments will be able to charge individuals for the use of those goods and services. The ability of local governments to impose user charges for the goods or services that they provide depends on the technical and economic feasibility of the user charge in question. A proposed user charge is technically feasible when the benefits of a good or service accrue to particular individuals and when it is possible to exclude nonpayers from receiving the benefits of that public good or service. User charges are economically feasible when it can be determined that the costs of administering the proposed charges are less than the benefits expected from the substitution of user charges for taxes.

User charges should be set at levels that will allow a local government to recover the costs of providing a service, including direct labor costs, supervisory and administrative costs, supplies and materials costs, and appropriate indirect costs. By setting user charge rates in such a way, the unintentional subsidization of services with tax revenues can be avoided. In some instances, such as with municipal electric utility charges in several states, charges may be set above cost in order to earn additional revenues for a government. In both cases, state statutes often provide guidance as to appropriate user charge rates.

Local governments considering the imposition of user charges should also note that they are not deductible from federal income taxes, as real property and income taxes are.

### Implications of Revenue Structure Reforms for Credit Standing

Reform of a local government's revenue structure could have important implications for its credit standing. Today, the most common reasons why a local government chooses

to undertake these reforms is to bolster sagging revenue collections and/or reduce reliance on the real property tax. The most common method used to achieve this is revenue diversification.

Credit analysts generally consider revenue diversification a good thing up to a certain point. The introduction of income and sales taxes, which can reduce a government's dependence on a single revenue source such as the real property tax, and add elasticity to the revenue structure is generally regarded as a positive step. Ideally, a balance between these major revenue sources will be established. Overreliance on a local retail sales tax is not looked upon favorably by credit analysts, however, because its revenues are susceptible to swings in the business cycle.

The real property tax is considered to be the foundation of the local government revenue structure due to its reliability and predictability. Credit analysts view this as a good thing because it indicates that the government has a steady source of revenue to meet its debt service obligations and fund government operations. Reliance on other revenue sources may not provide the stability necessary to conduct the affairs of government in an orderly manner.

Overdiversification could have an adverse impact on a local government's credit standing. Replacing a reliable revenue source such as the real property tax, with a number of smaller, more volatile revenue sources could be interpreted as an indicator of a weaker fiscal position, which could have adverse credit impacts. A well thought out program of implementation that is not viewed as a scrapping of the real property tax probably would not have such impacts.

### Endnotes

<sup>1</sup> For those interested in additional information on the evaluation of revenue sources, see Robert L. Bland, *A Revenue Guide for Local Government* (Washington, DC: International City/County Management Association, 1989) and Robert Berne and Richard Schramm, *The Financial Analysis of Governments* (Englewood Cliffs, NJ: Prentice Hall, 1986). For additional information on fees and charges, see the forthcoming publication, *Catalog of Fees and Charges* (Chicago, IL: GFOA).

<sup>2</sup> For more information on accounting for tax abatements, see Edward V. Regan, *Government Inc.: Creating Accountability for Economic Development Programs* (Chicago, IL: GFOA, 1988).

<sup>3</sup> See U.S. Advisory Commission on Intergovernmental Relations, *Changing Public Attitudes on Governments and Taxes 1991 Report* (Washington, DC: U.S. ACIR, 1991).

Ian J. Allan is an Assistant Director with the GFOA's Government Finance Research Center (GFRC). The opinions expressed herein are those of the author and do not necessarily reflect those of the Government Finance Officers Association.

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155

# HOMEWORK

## HOME WORK ASSIGNMENT

WHAT PROGRAMS ARE YOU INCLUDING IN YOUR BUDGET FOR THE NEXT FISCAL YEAR?

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WHAT SUB-PROGRAMS ARE YOU INCLUDING IN YOUR BUDGET FOR THE NEXT FISCAL YEAR?

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FOR ONE OF YOUR SUB-PROGRAMS FILL IN THE FOLLOWING

NAME OF SUB-PROGRAM \_\_\_\_\_

STRATEGIC OBJECTIVE FOR THIS SUB-PROGRAM

POSSIBLE SOLUTIONS FOR ACHIEVING THIS STRATEGIC OBJECTIVE

1 \_\_\_\_\_

2 \_\_\_\_\_

3 \_\_\_\_\_

4 \_\_\_\_\_

CRITERIA USED IN SELECTING YOUR SOLUTION FOR THIS STRATEGIC OBJECTIVE

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SOLUTION RECOMMENDED

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FOR THIS RECOMMENDED SOLUTION, IDENTIFY THE FOLLOWING SET OF PERFORMANCE MEASURES

INPUT MEASURES

1 \_\_\_\_\_

2 \_\_\_\_\_

3 \_\_\_\_\_

OUTPUT MEASURES

1 \_\_\_\_\_

2 \_\_\_\_\_

3 \_\_\_\_\_

OUTCOME MEASURES

1 \_\_\_\_\_

2 \_\_\_\_\_

3 \_\_\_\_\_

EFFICIENCY MEASURES

1 \_\_\_\_\_

2 \_\_\_\_\_

3 \_\_\_\_\_

# REVENUE ALTERNATIVE HOMEWORK

Identify two or three potential new revenue sources your city is considering. Once the revenues are identified, evaluate the acceptability of each revenue source using the evaluation criteria listed on the Options Matrix.

In the first column on matrix, identify the potential revenue source. In the subsequent columns, indicate whether the fee responds positively, or negatively, to the criterion listed at the top of the column. At the completion of the analysis, determine the overall acceptability of the revenue. Identify the name of your city at the top of the matrix and return it to MRI.

# CAPITAL PROGRAMMING & BUDGETING HOMEWORK

## CHARACTERISTICS OF INFRASTRUCTURE

### DEFINITION

My city's definition of a capital improvement, or infrastructure, is

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### EXPENSIVE

In my community, infrastructure projects are those costing more than FT \_\_\_\_\_

### USEFUL LIFE

In my community, infrastructure projects last more than \_\_\_\_\_ years

### PROGRAMMING AND BUDGETING

My city has a multi-year capital improvements program \_\_\_\_\_yes \_\_\_\_\_no

My city has a separate capital budget from the operating budget \_\_\_\_\_yes \_\_\_\_\_no

**NEEDS**

In my community, the five most critical infrastructure projects and their corresponding estimated cost, priority, and urgency are

<i>PROJECT</i>	<i>COST</i>	<i>PRIORITY</i>	<i>DESCRIBE URGENCY</i>
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
	= TOTAL COST		_____
	(-) FUNDS AVAILABLE		_____
	= FUNDS REQUIRED		_____

Identify the sources of funds required to finance the critical infrastructure needs identified above

<i>SOURCE</i>	<i>AMOUNT</i>
_____	_____
_____	_____
_____	_____
_____	_____

What are the major issues preventing your community from meeting its infrastructure needs

\_\_\_\_\_

\_\_\_\_\_

### **Homework on Forecasting**

Prepare the CLF tables for your own community based on fact figures in the budgets for 1991-1995 and preliminary figures for 1996

Prepare the CLF table of the 1997 budget concept of your community, and a forecast of similar structure for 1998-1999 (rolling plan)

Based on the results, please analyse briefly (max 1 page) the period between 1991-1996, and write down the conclusions you drew in relation to the budgets for next year(s)' budget

You are also requested to write down all the major assumptions used for the forecasts for 1997-1999 (E g amounts of inflation rate, state subsidies, local taxes, institutional and social expenditures, etc )

Please send your calculations and analysis to the address of Varoskutatas Kft before November 15, 1996

## CLF model for local governments

### **Current price in Millions of HUF**

Own current resources

Centrally regulated current resources

**Current revenues**

**Current expenditures**

**Operating income**

**Debt service**

**Net operating income**

Own capital resources

Centrally regulated capital resources

**Total capital revenues**

**Total capital expenditure**

**Investment deficit**

**Total financing need**