Baltimore County Budget Process and Documents: Description and Recommendations

Prepared for the Transition Report and for the Commission on Fiscal Sustainability

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Overview of Baltimore County budgeting and financial management

On the day he was inaugurated, County Executive Olszewski issued an executive order creating a Commission on Fiscal Sustainability. Of significant concern was Moody's warning on the county's credit outlook, moving it from "Stable" to "Negative." The county has long held the top credit rating of AAA from the three largest rating firms, and a downgrade to a lower level would increase the county's cost of borrowing for investments in schools and other essential facilities.

In his order creating the commission, Executive Olszewski also called for greater transparency of and increased public engagement with the budget process. While the county's AAA rating has reflected both the strength of the county's economy and the skillful management of the county's finances, members of the public and the County Council have complained that the justifications for budget decisions have at times been opaque and that there have been insufficient opportunities to participate in budget decision-making. In response to these concerns, during his campaign Executive Olszewski promised that the county will reform its budget process to generate efficiency savings, increase the transparency of budget documents, and better engage citizens in the process of making budget decisions.

The Commission on Fiscal Sustainability will find that much of the county's process for budgeting and financial management provides an essential foundation for the desired improvements in the process. In the county's adopted budget for fiscal year 2019, there is a list of financial policies and guidelines that "represent long-standing principles and practices that have shaped County budgets in the past and have helped maintain its financial stability" (p. 37). With exceptions that are described below, this claim is accurate. Among the most important of these policies are:

- systematically controlling expenditures to amounts approved in the budget
- focusing on reducing cost growth in major areas such as health care
- maintaining a diversified revenue system
- setting user charges and fees at the full cost of providing services

- prudently investing public funds to earn returns while preserving capital and meet cash needs
- limiting debt in relation to the county's economic strength and its ability to pay debt service

The process of formulating, adopting, and amending the county's budget is described on pp. 40-43 of the county's adopted budget for fiscal year 2019. The Office of Budget and Finance oversees the formulation process for the operating budget. It provides agencies with request ceilings, which are relatively difficult to exceed. This approach is generally known as a "top down" budgeting, one in which the public is excluded from participation. The total for agency requests is based on a forecast of expected revenues for the budget year, and informed by the limit established by the County Council's Spending Affordability Committee (which is discussed below). The county administrator submits the budget to the county executive, who has the final authority to make changes to the operating budget before it is submitted to the County Council.

Formulation of the capital budget is based on the county's master plan, and is related to the county requirement that bond sales for capital purchases must be approved in a public referendum.

The budget must be submitted to the County Council by April 16, and must be approved by a vote of the Council by June 1, a month before the fiscal year begins. Under the county's charter, Council members lack the power to change the form of the budget or the executive's revenue estimates, or to increase spending amounts above the levels requested by the executive. The approved budget is published by July 1. Included in this document are the proprietary fund financials for the county's business-type activities, such as water supply, though these amounts are not appropriated by the Council.

Recommendations on the spending affordability process

Since 1990, the County Council has used a "spending affordability process," which is a pre-budget consultation with the executive that can help the Council have more influence over the budget than allowed by the limited powers described above. The Spending Affordability Committee (SAC) consists of three Council members and two public members. After several meetings to receive a projection of the county's economic growth, to consider analyses provided by the county auditor (which is part of the legislative branch), and to ask questions of the county budget director, the committee makes several recommendations to the executive by February 15, prior to the executive's submission of the budget.

The most important recommendation is a spending guideline for the operating budget. The SAC makes several adjustments to the current year's budget in order to arrive at a "base" budget figure, and then multiplies this base times a "growth factor." In the most recent spending affordability process, this growth factor was an average of county personal income over the two previous years and forecasted county personal income over the current and budget years. The

SAC also suggests two ceilings: for debt outstanding as a percentage of assessed property value, and for debt service as a percentage of general fund revenues.

While this process has been credited for restraining spending growth, the mechanical calculation of a spending ceiling fails to provide a sufficiently accurate and comprehensive understanding of the county's financial position. In recent years, this has been partially recognized by the Spending Affordability Committee, as its report has warned about some of the important features of the county's finances that led to Moody's warning on the county's credit outlook. We therefore recommend that Executive Olszewski and the Commission on Fiscal Sustainability consider how the pre-budget consultation with the county Council could be made more useful.

One desirable change would be to deemphasize the forecast of the county's personal income over the current and budget year. The forecasts received by the Council have been overly specific, to the hundredth of a percent (e.g., 3.54%), without any consideration of likely forecast errors. In fact, the historical range of errors around county-level personal income point forecasts is quite large; growth rates of 2.54% and 4.54% are about as likely as the point estimate.[1] The two "actual" years in the 4-year average are in fact also estimates, as the federal government routinely revises historical data on personal income growth. In other words, using this specific a "growth factor" to arrive at a specific spending ceiling--one that is calculated to the last dollar--is an exercise in overconfidence.

More importantly, the focus on calculating this spending ceiling draws attention away from a more desirable comprehensive review of the county's finances. **The spending affordability process should be re-conceptualized as a pre-budget consultation that would commission and utilize analyses on other important considerations besides the potential rate of county personal income growth. In particular, this consultation should include:**

1. A stress test of the county budget, to inform how well the county is prepared for the next recession. The county has prudently increased its target for cash surpluses (i.e., unreserved general fund balances, including the revenue stabilization account) to 10% of general fund revenues. Meeting or exceeding this target may require foregoing some current spending, but this may be desirable if it prevents the need to make large cuts to spending during a recession. While the magnitude of this tradeoff is difficult to estimate, because the timing and magnitude of the next recession is hard to predict, stress testing has become a recommended tool for state and local governments. See, for example, this report from Moody's.

2. A summary report on conditions in the county from a data dashboard. This would ensure that the financial sustainability focus in the pre-budget process would be accompanied by information about the possible uses of county funds.

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[1] The personal income growth forecasts by the Council's consultant for the budget years of 2001-2010 had an average absolute error of 1.96% and a root mean square error of 2.57%. Calculations by author.

3. A multiyear forecast of operating budget spending, linked to an analysis of the adequacy of saving for long-lived liabilities. Unlike the capital budget, the operating budget is prepared for only a single year (see p. 41 of the approved FY19 budget). For some operating budget programs, the level of spending is likely to increase each year above the rate of revenue growth, compounding the problem of attaining fiscal sustainability. A multiyear forecast would focus more attention on these costs, potentially enabling a multiyear adjustment to this spending. An example of a multiyear general fund forecast for spending and revenues can be found on p. 3 of the Maryland General Assembly's Office of Policy Analysis spending affordability briefing.

4. A discussion of the adequacy of county saving for long-lived liabilities. Financial reporting requirements for the county include multiyear forecasts for the costs of defined benefit pensions and for "other post-employment benefits" (or OPEB, which are largely health insurance benefits for retirees). While the county's financial policies and guidelines have generally led to responsible policies, such as the reduction of the pension system's assumed investment rate of return to 6.75%, concerns have been raised about the risks of other recent actions, such as the sale of pension obligation bonds, the use of pension plan assets to finance facilities for waste transfer and single stream recycling, and the use of OPEB trust fund reserves for operating spending.

5. A supplement to the capital budget that systematically estimates capital needs, including the potential impacts of accumulated depreciation on the ability to provide services in the future. Arguably the need for the county to invest massively in new school construction and existing school renovation resulted from not paying enough attention to how school facilities were becoming obsolete. A sustainability projection should calculate the potential medium-term costs to the county for adapting to the effects of climate change, particularly sea level rise and severe weather.

6. A discussion of the adequacy and competitiveness of the county's current revenue structure. Balanced budgets are attained not only by controlling spending, but also by collecting revenues sufficient to cover spending. The current spending affordability process ignores the revenue side of the budget. It should be reformed to consider the county's revenue capacity and effort, drawing on documents such as this analysis from the General Assembly's Office of Policy Analysis.

Recommendations on county operating and capital budget formulation

Formulating the county's budget is an inherently difficult task. The county carries out many complex activities, and has the obligation to provide cost-effective, high quality services to its citizens. In allocating funds to programs, the county executive must make difficult tradeoffs, because available financial resources are always less than the amounts needed to meet worthy goals. The proposed budget must also be approved by the County Council, whose members represent different areas of the county, and who want to keep the executive accountable for his actions. Investors in county bonds, and particularly the firms that rate the security of these bonds, scrutinize the budget and the county's Comprehensive Annual Financial Report (CAFR) to understand the extent to which the county is being financially responsible. For these reasons and others, budget documents tend to be complicated and dense.

The FY19 approved operating and capital budget document is 237 pages long, and the supporting detail documents for the operating and capital budgets are 782 pages and 154 pages long, respectively. This total of 1,173 pages contain much useful information, some of which will be described below. However, users of these documents will also find these documents less useful than they would like.

Public Understanding of the Adopted Budget

For a typical county citizen, the budget is relatively inaccessible and difficult to understand. The FY19 adopted Baltimore County budget is not even on the Budget and Finance top web page. The county's Comprehensive Annual Financial Reports are, even though it takes specialized training on state and local government accounting to understand them. Assuming a citizen were to access the budget, it would still be difficult to understand its contents. The document's length, organization, and style overload a typical reader with "too much information."

To make the adopted budget more understandable and accessible to citizens, the county should prepare a "citizens' budget." This would be a very short summary of the adopted budget that highlights the most important data and decisions in the detailed budget. An excellent local example is the Baltimore City citizens' guide to the fiscal 2014 budget. It should be linked on the top page of county web site. The county could also distribute a version of the citizens' budget to accompany annual property tax bills. The International Budget Partnership has produced a useful guide to citizens' budgets that has been used worldwide.

Public Engagement During Budget Formulation

Citizens also lack sufficient opportunities to participate in budget formulation. During his campaign, Executive Olszewski promised to host multiple, citizen-driven budget meetings around the county. The first hearings of this type have already been scheduled, in collaboration with Council members.

In the first year of this administration, these meetings have the potential to serve as helpful listening sessions--for elected officials to learn about community requests about funding for county services, and for citizens to learn from elected officials about the financial status of the county. Successful meetings of this type are more likely when there is a high level of attendance, and when reports about the meetings are read by those who could not attend.

A Baltimore Sun editorial from December 6, 2018 suggested that the county go beyond this approach by hiring a university-based consultant to run a "public consultation" process. At a minimum, this would involve a representative sample of citizens, who, when presented with information about a range of budgetary policies for the county, would choose a recommended set of policies from these alternatives.

This approach is better than some polling practices because it requires respondents to make fiscally realistic tradeoffs. In practice, however, consultative surveys often do not provide enough information to justify claims that survey takers have been well-educated about alternatives. An approach that does overcome this challenge is sometimes called a "citizen assembly," in which a representative sample of citizens is convened for a day, presented with information from experts, and allowed to deliberate before attempting to reach consensus on choices. An even more ambitious approach to public engagement is "participatory budgeting," which has been used in developing countries to empower poor neighborhoods, allowing their residents to choose which one of several capital projects they most want to be funded in the budget.

Each approach requires significant effort from both government and citizens, and also seeks to replace the judgments of elected officials with those of a select group of citizens. The alternative, which is more consistent with the county's representative form of democracy, is to reserve policy decision-making to elected officials, while improving these officials' abilities to learn from constituents. **After experimenting with the open meetings on the budget, the county should develop a regular schedule and process for such open meetings, in which citizens can provide their views before the county executive transmits the proposed budget to the Council. The county should also periodically survey citizens on their concerns about conditions in the county and their perceptions about the quality of county services.** This latter approach should be part of the county's data generation and analysis strategy.

Making Cost-Effective Budget Allocations

In his campaign statement on how to fund county priorities, Executive Olszewski proposed to:

- streamline government and make operations more efficient
- reset county priorities to redirect funds to reflect fundamental goals while maximizing returns on investment
- increase innovative practices in county government to cut costs, improve services and bring local government in the 21st century
- outline exactly how much the county takes in and identifying where every dollar is spent, and what specific impacts that they make

While the full budget document of 1,173 pages for the FY2019 approved budget includes extensive information about county activities, it also reveals that the county currently uses an incremental budget process that is substantially different than Executive Olszewski's vision.

The beginning of the main document (pp. 1-10) contains the Budget Message, which is an easy-to-read summary of the county executive's interpretation of the budget, and a list of personnel hires and dollar amounts for the "funding highlights" in the budget, which are spending increases over the current year's budget allocations for selected activities (e.g., 3 new gifted and talented teachers, at a cost of $152,226).

These incremental adjustments are not explicitly connected to the section of the main budget document (pp. 27-36) that identifies what the document calls "missions and priorities," in four sectors: public safety, education, economic and workforce development, community conservation and public infrastructure. Funding highlights for these sectors are also described later (pp. 57-63) in the document.

Selected "performance measures" for the four sectors (e.g., number of gang members authenticated, % of students demonstrating readiness for kindergarten, number of construction permits issued, number of potholes filled) are also shown (on pp. 27-36). The main budget document also contains two other sections with "output only" performance data (pp. 69-71 and 210-216), which lack any textual explanation.

In the supporting detail document for the operating budget, page 4 provides a description of the county's "managing for results" approach. It states that each department has a strategic plan, and that there is an operational plan for each major program. Presented in the rest of the document are performance measures, which variously report on "demands, outputs, results, and efficiencies" for previous, current, and budget years. Also reported for each program appropriation are objects of expenditures (e.g., personnel services, contractual services, rent and utilities).

This supporting detail document leaves much to be desired. An example is the section on the Department of Corrections (pp. 50-55), which includes no performance measures, despite its textual summary that identifies several important strategic issues for the department. This is not the only major area of the budget document that fails to present essential performance measures; for example, less than a quarter of the police program appropriation displays include performance measures.

Many other areas of the operating budget detail illustrate some widely recognized problems with attempts to connect performance information to budget data. See, for example, the following display (from p. 132) for a grant-funded program with prior year, current year, and budget year expenditures of $45,000, $118,000, and $100,000.

MANAGING FOR RESULTS

FY 2019

Program: PDGRANT31 - Stop Gun Violence Project Enhancement

Purpose Statement: The purpose of the STOP Gun Violence Project Enhancement Grant is to provide additional undercover investigations and establish a Gun Tips Hotline to benefit County residents so that they can phone in about possible illegal gun activity to make neighborhoods safer.

Performance Measures		FY 2017 ACT	FY 2018 Proj	FY 2019 Est	Target
D	Number of guns seized	255	260	260	260
O	Number of gun arrests	107	90	90	90
R	Percentage of gun arrests	42	35	35	35
	Efficiency	$420.56	$1,311.11	$1,111.11	

The number of guns seized is shown as a measure of "demand," though a better measure of this would be the number of hotline tips. Once those tips are received, officers must respond (which could be reported as a related "activity"). A percentage of those responses would lead to gun recoveries. A percentage of gun recoveries would involve arrests, which is reported here as an output measure. The "results" measure, shown here as the percentage of total gun arrests contributed by the program, can't be verified because nowhere else in the document does the department report on total gun arrests. Nor does it connect this output to the results concept implied in the program's narrative description, which is a reduction in gun-related violence. The "efficiency" measure does not identify whether the denominator in this calculation is demand, output, or result (in fact, it is output). Interpreting the meaning of such "efficiency" is not possible without additional information; the same is the case regarding the target for the budget year.

The supporting detail document for the capital budget includes no performance measures. Instead, it provides summary tables on capital spending for the budget year and the five following years, as well as the different funding sources for capital projects. Then, for each sector of the capital budget (e.g., water supply, transportation, schools), it shows basic financial information for "capital projects," which are aggregations of individual capital projects. E.g., p. 30 shows funding for countywide relining, rehab, and replacement of county sewer lines, but without any quantitative projections of the number of treated lines or the reduction of pipe failures, and the resulting avoidance of health and environmental problems.

To be clear, the absence of such information in the budget documents does not mean that it has not been considered during budget formulation by the staff of Budget and Finance and of county departments. However, the limitations of the document suggest that the process of budget formulation could be substantially improved.

While there is an extensive literature on how to improve local government budgeting by focusing on desired outcomes, a particularly useful guide is the recently published book by Andrew Kleine, City on the Line. Kleine was the budget director for Baltimore City for the last decade; he is now chief administrative officer for Montgomery County.

Lessons from this text suggest that **to develop an effective and transparent method for making cost-effective budget allocations, Baltimore County should:**

Specify desired outcomes across the range of government responsibilities;

Reorganize budget accounts into services that are provided to the public;

Measure and report the activities and outputs, and to the extent possible, the outcomes of each service;

Identify key indicators for priority outcomes;

Require that budget requests take the form of requests for proposals that would reduce the cost and/or increase the quality of services that address priority outcomes; and

Use results teams, comprised of budget staff, department staff, and citizens, to evaluate budget requests.

Successfully implementing this approach will take several years. It will require leadership commitment to the approach, investments in data management, and training of staff.