Local Governments: State Supervision of Budgets and Finance

Julia Beckett
Department of Public Administration and Urban Studies, University of Akron, Akron, Ohio, U.S.A.

INTRODUCTION

States supervise local government budgets by requiring specific actions and procedures, by establishing and limiting revenue sources, and by monitoring and reviewing budget actions of local governments. States fulfill their responsibility to supervise in five ways: states enable, authorize, and empower local governments; states set budget controls and fiscal limits; states impose requirements and mandates; states employ administrative supervision; and states intervene in fiscal crises.

The state supervisory role depends on state laws and practices, as well as on the type of local government involved. The patterns and types of state supervision can only be described in general terms because there is great variety within the 50 states and more than 85,000 local governments in the United States. The types of local governments include counties, cities, towns, townships, school districts, and special districts. The jurisdiction of local governments may be based on geography, services, or population. Counties and cities are general-purpose governments, and they provide a wide range of services. In contrast, special districts often provide one service or function, and they are the most numerous and varied type of local governments in the United States. Within this diversity, states exert control over local government budgets.

One of the most important government functions is budgeting. Budgeting links the ability to tax and spend with managerial planning. Other governmental powers linked to budgeting include the ability to contract and to define and undertake activities. By enabling and defining local governments, states both empower and limit local government budget authority. Few states directly charter local governments and define their authority in detail; it is more common for states to have general laws that express broadly the extent of local governments' powers and functions. The techniques of state supervision range from general to specific, and the amount of control states exert over local governments ranges between loose and tight.

STATES EMPOWER LOCAL GOVERNMENTS

The intergovernmental authority relationship between state and local governments is first defined as that of superordinate and subsidiary. This is often poetically stated as "local governments are the creatures of the states." This formal structure of power, also called Dillon's rule, is that local governments can be created or abolished by the state, and so they are subject to limits imposed by the state. States enable local government actions, including budgeting, spending, taxing, and borrowing. Local governments may exercise only those powers expressly granted by the state constitution or by state statutes. There is no common law right of local self-government, and local government powers to tax and spend are subject to state constraints.

In practice, states empower local governments through broad grants of powers; the specific type and manner of public activities undertaken are determined by local governments. The independent authority of local governments has been asserted through the use of municipal or county home rule charters, but this autonomy is limited. Some local government powers remain subject to preemption by the state. Quite often, even with home rule, states impose limits on local fiscal actions.

Although the hierarchical powers and derived authority description of local governments as being subsidiary and subservient to the states, the relationship between the state and local governments regarding budgets supervision is quite varied in practice. The manner that supervision takes is through intergovernmental techniques. State statutory authority of intergovernmental control is described in six major categories: 1) forms of government and home rule; 2) altering boundaries and responsibilities; 3) local elections; 4) administrative operations and management; 5) financial management; and 6) personnel management.

Commonly, supervision is defined as "directing the work or actions of another." The typical supervisory relationship is a manager and worker in an organization. This simple model of supervision within a hierarchical organization with centralized authority is, however, not consistent with American intergovernmental practices. In practice, state legislative and administrative review, oversight, and regulation of local governments are complex. States and local governments take cooperative, coordinated actions. State authority is often felt indirectly, rather than exerted directly. In practice, states and local governments work as a partnership, addressing shared public problems with mutually developed policies.

States establish rules, regulations, and conditions within the political and administrative systems that affect local government budgets. State statutes spell out detailed and stringent requirements on local governments' budget and revenues. However, the intergovernmental supervision has indirect means of review or enforcement, which often relies on self-implementation of requirements by local governments.

States enable local government to try management techniques to reduce budget costs. States encourage coordination and networking of governments in risk or purchasing pools. States enable contracting out and other methods to reduce costs of service production or provision.

States supervise indirectly by their grants of authority, by revenue sharing, by requiring actions and services, and by requiring standard accounting and auditing procedures. States control local government budgets by setting specific limits on revenue sources and amounts. In addition, states engage in monitoring local governments by requiring them to file budget and fiscal documents. States possess the authority (although they seldom exercise it) to intervene directly and circumscribe local government budget actions.

STATES SET BUDGET CONTROLS AND FISCAL LIMITS

States exert control over four areas of local government financial management: 1) budgeting; 2) raising revenue; 3) issuing debt; and 4) financial reporting. These four inter-related categories are essential to local governments' budgeting and management decisions; yet, few states require a comprehensive approach to financial management. Most states' legislation requires local governments to enact an annual budget and sets requirements for that budget. The required budget information may range from a simple summary of revenue and expenditures to a detailed line item budget format. Local governments are commonly required to follow a three-step procedure—first submitting the proposed budget to the local governing body, then providing for a public hearing, and finally formally adopting the budget by motion and vote of the governing body. The enacted budget is often required to be filed with the state.

State-required budget actions include prescribing budget content, level of detail, timing, and processes. Some states encourage using program or performance budget formats. Other states may specify using a fiscal year or impose a calendar for considering and enacting a budget. Often, the amount of information included in a budget varies by the size and type of local government, with more sophisticated approaches expected of larger city and county governments.

Some states institute more stringent requirements, using highly specified and detailed budget forms. Another stringent control prohibits local governments from making transfers between expenditure categories once a budget is enacted. Some states specify which local official, whether elected or appointed, is responsible for the form and management of the budget. These officers may have required qualifications such as certain training or experience.

State supervision over raising revenue takes various forms. It is common for state legislatures to institute stringent limits and controls on taxes and revenue sources for local governments. Types of statutory controls include limiting the types of revenues that can be raised, exempting some properties from the tax base, and placing caps on tax rates. States specify revenue types and sources available to local governments. Historically, property taxes were the predominant source of local government revenue and they continue to be the primary revenue source for school districts. State controls applied to property tax include methods of assessing property value, creating or denying exemptions, and limiting tax rates.

For local governments, other than school districts, revenue sources include sales, income, and excise taxes; non-tax revenues include user fees for services and enterprise funds. States exert budget spending control by limiting tax base or tax rates and, thus, limiting tax revenues collected. One stringent practice is indexing or limiting increases from previous years. States often earmark revenues by limiting the purposes that certain revenue can be used; for example, states may limit the revenue from gasoline taxes to be used for road repairs. States impose conditions for use of different types of taxes; an example is the centralized state collection of sales taxes.

An area of particular concern and attention is local government borrowing and use of debt to pay for expenditures. Many state provisions regulate local government borrowing based on the purpose, amount, and term of debt. Detailed conditions exist for both long- and short-term debts. Many states encourage local governments to institute capital budgets and to link long-range capital planning to managing debt. The particular processes and steps that states establish for local governments to enact budgets or borrow funds are often based on administrative and good government reform movements or are instituted by states in response to problems and scandals.

State constitutions limit local government budgeting, taxing, spending, and borrowing. The local government-balanced budget requirement is the most well-known constitutional budget restriction; it requires that the local governments' annual operating budget to balance which is enumerated as planned expenditures must not exceed projected revenues and reserves. Another common constitutional constraint requires voter referenda to approve general obligation debts, and this serves to limit borrowing. Since the 1980s, in response to citizen tax revolts, many states have added constitutional provisions that require voter referenda before local governments can increase taxes or user fees.

The purposes for state controls on local government budgets and revenues are to impose fiscal restraint and provide public accountability. Many states instituted limits and prohibitions after public outcry. For instance, state limits on borrowing were adopted after numerous local governments defaulted on development bonds in the 19th century. State-defined budget controls and spending limits are intended to impose fiscal restraint; however, local governments often respond by circumventing the regulations and limits through innovations and creative financing. For example, the innovation of revenue bond financing removed the requirement of public acceptance and authorization of debt. Local governments issue revenue bonds to avoid exceeding limits on permissible levels of general obligation debt. The use of special district governments is also seen as a way for local governments to circumvent state-imposed limits on debt and budgets. Other innovations include increased use of fees for services, public–private partnerships, and shifting service responsibilities.

State fiscal reporting requirements also affect local government budgeting. To ensure uniform practices and to improve fiscal management of local governments, states require general fiscal reporting, bookkeeping, accounting, and auditing standards. Historically, states required itemized budgets and detailed information to improve local governments' administration and operations. Revenue and borrowing provisions were enacted as constraints on local government spending. Financial reporting provisions also serve administrative functions for local governments and to provide information to the public.

State enforcement of budgeting requirements varies. Sometimes, there are statutory requirements for local governments, but no statutory enforcement mechanisms. Sometimes provisions are expected to be implemented by local government officials, with public pressure for compliance. Even when states have similar budgeting requirements, they may differ widely in approaches to ensure compliance. Whether minimal, advisory, or mandatory, these fiscal standards and practices affect the budgeting decisions and management of local governments.

STATES IMPOSE REQUIREMENTS AND MANDATES

One of the more contentious areas for local government budgeting in recent years has been the issue of mandates. State and federal government mandates have imposed increasing responsibilities on local governments, by requiring specific services, certain levels of public activity, or administrative procedures. For example, mandates concerning clean water impose new reporting and training activities, or mandates regarding public access require expenses of retrofitting buildings and sidewalks. State-required activities, services, or programs may be imposed through legislation, executive order, administrative rules, or court decree. The broad reach of mandates affects local governments by reducing discretion in service delivery and because the expenses entailed in satisfying mandates limit the personnel and resources available.

The controversy over mandates has frequently focused on whether the government that requires certain actions of local government should fund the required actions. Often, it is difficult to determine the costs and administrative burdens of mandates. For example, if a new state law requires local governments to install mechanical signs to warn of approaching trains for all streets that have railroad crossings at grade, then the question arises as to whether the state should pay the expenses for these signs. When states policies and citizen revolts have constrained revenue sources, mandates impose great pressures on local government budgets, because they require a greater number of expenditures.

State fiscal transfers and grants also affect local budgets. A major source of revenue for local governments has been state aid, and the timing and amount of this funding affects budgets. Grants-in-aid are awarded to local governments from state and federal programs. The direct conditions of grants may impose additional financial burdens in the form of requiring services, matching funds, or establishing additional procedures. Thus, in addition to general mandates, specific grants of aid have strings attached that serve to supervise local government practices.

STATES EMPLOY ADMINISTRATIVE SUPERVISION

States have administrative agencies that affect, advise, and regulate local governments both indirectly and directly. State administrative supervision of local government may range from informal advice to training, to periodic review, and to direct prior approval for local government action. Many states have administrative departments or divisions of local government that provide general training, advice, and support for activities such as economic development, budget preparation, or database management. Some state agencies provide advice in response to local government requests. Oversight, in these cases, may be informal and non-directive.

Other state agencies may have direct regulatory authority, including setting standards and requiring actions of local governments. For example, state departments of education set standards and requirements for school districts. States may have regulatory agencies that can approve or deny local government fiscal activities; for example, some states have agencies that authorize local governments to issue securities such as bonds.

States also require local governments to file copies of the budgets and annual financial reports with an agency, often the state auditor or state treasurer. The requirement to file these budgets and reports serves three purposes: they impose managerial practices; they provide the general public access to information; and they enable state agencies to review for fiscal responsibility. The offices of state auditor and treasurer often serve as regulatory agencies in regards to the filing, form, and substance of local governments' budgets and financial statements.

STATES INTERVENE IN FISCAL CRISES

A fiscal crisis of insolvency, default, or bankruptcy raises grave concerns about the stability of a local government. In the event of a fiscal crisis, states take a more direct role in the management of the local government's budget. When audits reveal that local governments have troubled fiscal conditions of ongoing deficits or insolvency, states intervene in the day-to-day operations to achieve budget stability and fiscal solvency. Some states impose increasingly stringent reporting and filing requirements regarding the fiscally troubled local government's financial obligations, contract and purchasing actions, fund management decisions, and general operational decisions. Other states provide for receivers to take over the financial management and governance of insolvent local governments, and some states allow local governments to reorganize debts in bankruptcy litigation.

It is in fiscal crisis situations that states take the most directive role in a local government's budget and operations. This stringent and direct control is temporary. Once the crisis is resolved, states return budget control to local officials.

CONCLUSION

State supervision of local government budgeting is complex and changing. In the federal system, states are expected to supervise local governments, and they employ various oversight techniques. In regards to the collection of revenue and the distribution of services, states affect local government budgets. States mandate functional and policy requirements that have serious budget implications. State supervision of local government taxing, spending, borrowing, and reporting includes both authorizing and setting limits on these activities. Through other means, such as giving advice, states exert control over local governments. The tensions between local governments asserting independence and states taking supervisory action raise continuing issues in intergovernmental oversight.

ARTICLES OF FURTHER INTEREST

Financial Resource Management in Local Government, p. 766.
Fiscal Federalism, p. 783.
Forms of Government, p. 800.

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