Objectives of the Course
The primary objective of this course is to provide students with an introduction to issues of financial management in state and local government. The course will explore three inter-related areas: (1) raising revenues - including the trade-offs associated with establishing a sustainable tax-base; (2) raising capital - by borrowing in the Capital Markets; and, (3) investing funds - in the context of both cash management and funding pension systems.

Course outline
The course is intended to illustrate the range of financial decisions in the state and local sectors. We will begin with the issues involved with identifying revenue sources for public services and infrastructure and will develop a framework for evaluating policy option in the context of transit finance, school finance, privatization and economic development. From there we move to debt issuance and an exploration of the municipal markets. We will survey the bond market and learn how public officials relate with rating agencies, investment bankers and investors. We will learn how bonds are rated and priced. The course concludes with a discussion of investment practices in the public sector in the context of cash management and public pension funds.

Audience
This course is designed for students who anticipate working in state and local government, or for private sector financial institutions, bond rating agencies or other private groups with significant interest in the public sector. Students who have policy interests where state and local governments play a predominant role (e.g., education, transportation, infrastructure) may also find this course useful.

This is a course in financial policy making at the state and local level. It is NOT a substitute for courses in corporate and project finance or the capital markets. The course is probably not suitable for students: (1) whose work experience, or prior coursework in finance has already given them an exposure to basic issues of financial management and the capital markets; (2) who are primarily interested in corporate finance, quantitative analysis of financial transactions, the capital markets; (3) whose primary interest is
outside the United States.

**Expectations**
Students are expected to read the assigned materials and come to class prepared to participate in an active discussion. In some cases, teams of students may be assigned responsibility for leading class discussion and/or role-playing key actors from the cases.

*Because a major feature of the course is the discussion of policy issues and financial transactions that are currently taking place, students should assume that timely and newsworthy materials may cause revisions in both the reading list and the timing for discussions.*

In addition, there will be one or two problem sets to reinforce quantitative skills, a midterm policy memo and a take-home final exam. Students are welcome to work together on problem sets and to prepare for class. However, specific answers to problem sets and assignments should be submitted independently.

All assignments will be distributed in class and should be returned to Ayres Heller (Taubman 157) by 3:00 p.m. on the due date, unless otherwise announced. Late penalties will be assessed. Faxes/email will be accepted only in extraordinary situations. It is reasonable to expect that grades will be determined by the quality of class participation (15%), problem sets (25%), the midterm policy memos (30%) and the final exam (30%). *These percentages may be adjusted somewhat depending, in part, on class size.*

**Prerequisites**
There are no formal prerequisites for this course. Although a microeconomics course similar to API-101/102 would be helpful, a prior understanding of finance is not required. Students will need to use Microsoft Excel (or an equivalent spreadsheet program) to complete certain assignments.

**Course Materials**
The course will use a collection of readings and cases (available from the CMO and the WEB). The primary text for the course is *Local Government Finance: Concepts and Practices* published by the Government Finance Officers Association. *This text is currently between printings and is not generally available.* Excerpts will be included in the reading packets from the CMO. Students are also expected to download both text and audio from the Web.

- **Available through NEXIS and WWW:** *The Bond Buyer*
- **Available at the CMO:** All other course materials. Separate packets will be created for readings that are recommended, but not required.

In addition to these readings, there will be regular assigned readings from various web
sites and news publications that will be posted on the course web site. Finally, regular review of the “Credit Markets” section of the Wall Street Journal or NY Times is recommended.

Session # 1, Introduction and User Fees, Feb. 3rd

A - Introduction to State and Local Revenue Systems

Required:
*Tannenwald, Robert, “Are State and Local Revenue Systems Becoming Obsolete?”, State Tax Notes, April 8, 2002.


Recommended:


B – User Fees

CASE: Graduate Student Fees in California Differentials in California Public Higher Education, C16-87-783.

Peterson and Strachota, Chapter 8, pp. 135-151.


We will overview state and local revenue systems, focus on ways to measure tax liabilities and identify factors that drive revenue decisions in the context of both past practices and economic and technological changes.

User fees initiate private sector pricing and are a popular revenue source for state and local governments. We will consider the basic rationale for user fees and examine the advantages and disadvantages associated with their use.

Session # 2, User Fees (Continued) and Sales Taxes, Feb. 10th
CASE: Financing Mass Transit in Philadelphia: SEPTA


Peterson and Strachota, Chapter 7, pp. 113-133.


Federation of Tax Administrators, Website Streamlined Sales Tax Pursuit.

Sales taxes are major sources for state and local government revenues. We will look at the impact a shift to the service economy may have on issues regarding sales taxes and what this may mean for state and local government finance.

Session # 3, Sales Taxes (Continued) and Income Taxes, Feb. 17th


We shall continue the discussion of the sales tax and look at the role the personal and corporate revenue taxes play in state and local government finance. A focus of the discussion will consider the relationship between
income taxes and state economic competitiveness.

Session # 4, Property Taxes and School Finance, Feb. 24th

Required:


Peterson and Strachota, Chapter 6, pp. 85-111.


Starkey, D., “Stung By a Grab of Property Taxes by the State, County Governments are Fighting Back,” California Journal, August 1993, pp. 21-23.


*New, Michael J., “Proposition 13 and State Budget Limitations – Past Successes and Future Options”, CATO Institute Briefing Papers No. 83 (June 19, 2003)

Recommended:


The case highlights some of the issues associated with this revenue source. We will also consider the property tax revolt in California and Massachusetts and the impacts today.

Application: School Finance

Required:


Recommended:


The conflicts that appear between the tradition of local provision of elementary and secondary public education and attempts at fiscal equalization provide the focus for this class. The case goes beyond questions of fiscal equalization and considers adequacy which today is driving the debate over school funding. The Kozol article is a very poignant (although one-sided) discussion of an urban school system.

Session # 5, Revenue Enhancements, March 3rd

A. Privatization:

Required:

CASE: “Privatizing the Albany County Airport,” with “Epilogue,” KSG Case # C16-91-1024.0

Recommended:


A quick look at some issues associated with privatization. The case illustrates a city’s attempt to be innovative and highlights some of the dilemmas facing policy makers.

B. Vice, Virtue and State Finance

Required:

CASE: “The Massachusetts Lottery”, HBS Case# 9-590-009


Recommended:


With “traditional revenue sources” tightening, the lottery has become the fastest growing source of state revenue. How does the lottery work and is it appropriate for the government to encourage people to gamble?

Session # 6, The Inter-Governmental Context, March 10th

A. Fiscal Federalism / Devolution

Required:
Petersen and Strachota, Chapter 2, pp. 9-27


A quick look at the division of power and functions between the national, state and local governments. Why is government involved and what is the appropriate role for each division? How will the downsizing of the federal government affect state budgets?

B. Economic Development

Required:


Recommended:


Interstate bidding wars have become increasingly common in the 90’s. This case asks you to give the Governor advice on his industrial recruitment strategy. This case is not in the reading packet. You can reach it from the KSG home page.
Session # 7, Techniques and Tools for Financial Analysis, March 17th

A. Net Present Value Analysis

Required:

“How to Avoid Getting Lost in the Numbers,” HBS Case 682-010


“Selected Investment Alternatives,” HBS Case 9-287-010, Questions 1-4

B. Bond Pricing / Transaction Structure

Required:

Petersen and Strachota, Chapter 15, pp. 293-320.


We begin to combine the principles of net present value and the conventions of the tax exempt bond market. Why do bond prices and yields fluctuate and how are they related to the taxable fixed income market?

Session # 8, Capital Markets and Public Finance, March 24th

Role of State and Local Borrowing / Debt Policies and Practices
Required:


Petersen and Strachota, Chapter 14, pp. 263-273.


Recommended:


Before turning to the inner-workings of the financial markets, we will spend a day considering why state and local governments borrow.

Spring Break – March 25-April 2 – No Class

Session # 9, Introduction to Municipal Markets, April 7th

Required:


Petersen and Strachota, Chapter 14, pp. 274-292.


How do state and local governments borrow? We will devote the next two classes to answering this question. This class considers the tax treatment of municipal securities, the two major types of state and local government bonds and the major provisions in the bond indenture.
Session #10, Credit Ratings, April 14th

Required:


Investors place tremendous faith in the ratings of municipal bonds by independent analysts. What do the bond ratings mean and what do the rating agencies look for? How are the ratings used as a measure of fiscal stability for political purposes? We will also look at the different ways to bring debt offerings to market and the advantages and disadvantages of each approach.

Session #11, Transaction Analysis and Distribution, April 21st

Required:


CASE: Triborough Bridge and Tunnel Authority (TBTA)


CASE: “New Jersey Sports and Exposition Authority,” HBS Case #9-278-709
We move on the important roles played by various professionals in bond process.
How do underwriters make their money and what can we learn from recent investigations and court decisions?

Recommended:


This case looks at the redirection of bridge and tunnel revenues to a variety of other transportation projects. The issues of authority revenue surpluses, bondholder needs and security analysis are considered. A side issue is the appropriate role for public financing authorities. The excerpt from The Power Broker provides interesting background.

Session #12, Cash Management and Pension Management, April 28th

Required:

Petersen and Strachota, Chapter 13, Cash Management, pp. 241-262.


Petersen and Strachota, Chapter 19, pp. 369-391.


Session #13, Course Wrap-up, May 5th

- Final Exam (take home) distributed in last class
- May 6 – 17 Reading Period
- May 19 Final Exam due by 3pm
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