



David Osborne



Peter Hutchinson

Budgeting In Tough Times: The Three Decisions and Nine Strategies

David Osborne and Peter Hutchinson,
The Public Strategies Group, Inc.

Big fiscal challenges always bring with them big opportunities for reform. Rather than resorting only to traditional medicine, state government leaders should look to the many innovations that have been pioneered over the past two decades. This article lays out a twelve-step program for state leaders dealing with fiscal crisis: the three decisions that matter most and the nine strategies needed to cut spending without hurting services.

Two years ago public officials across the nation were touting tax cuts and rebates. Today, the same leaders are announcing and trying to manage shortfalls of comparable size. The size and breadth of the impacts is staggering. Virtually no unit of government has been exempt.

But big fiscal challenges always bring with them big opportunities. Rather than resorting only to traditional medicine – raising taxes, cutting spending and using reserves or accounting gimmicks to put off dealing with today’s fiscal realities – public leaders should look to the many innovations that have been pioneered over the past two decades to wring more bang out of the government buck. Below we explain our own twelve-step program for public leaders serious about kicking the habit of fiscal over-indulgence: the three decisions that matter most and the nine strategies needed to make it happen.

Budgeting in Tough Times: The Three Decisions that Matter Most

Decision 1. Get a grip on whether the problem is short term or long term. You cannot solve a budget problem when you are in denial. Begin by getting a grip on the extent and nature of the challenge you face. Budget deficits can be cyclical (short-term) or structural (long-term). Short-term deficits are typically caused by temporary economic downturns. Structural deficits are caused by long term gaps between projected revenue growth and the projected cost of government-funded services.

Many jurisdictions have built up “rainy day funds” to help them through temporary, short-term budget difficulties. It will be tempting to throw these reserve dollars at the problem right away. And if not reserves, there are a host of other short term “fixes” that will tempt officials faced with immense budget problems. But using one-time money in the face of long term or structural imbalances is a recipe for disaster.

To complicate matters, a budget deficit may include both cyclical and structural components. To choose the right strategies, gov-

ernments need to analyze the source of the problem. To decide when and how to use reserves versus other budget solutions, governments must:

- Develop a credible forecast of revenues both short and long term.
- Develop a credible forecast of current expenses both short and long term.
- Determine whether revenues will be adequate to meet forecast expenses in the long term.

(To identify possible structural gaps, it is best to forecast revenues and expenditures over at least a four-year period.) If revenues will be adequate to meet expenses over the long term, then the jurisdiction can use reserves or other mechanisms to meet its short-term needs and remain fiscally sound. Options include:

- Spending reserves
- Using unspent funds in various accounts
- Accelerating revenue
- Delaying spending
- Selling assets
- Capitalizing future revenue to pay current costs
- Temporarily cutting costs
- Temporarily raising revenue

If revenues will not be adequate to meet expenses in the long term—and this will most likely be the case— the jurisdiction will need to make permanent changes in its expenses, revenues or both. Once it has done so, it can use reserves to meet whatever short term needs remain or to help make a gradual transition to long-term solutions. But here’s the rub: delay makes the problem worse. Changes in spending or revenue accumulate over time. The sooner they are made, the more they contribute to a solution.

How should governments proceed when they have to make long-term fiscal changes? The normal response to the prospect of spending cuts is gloom and doom about service cutbacks. There will, of course, be reductions. Jobs will be lost. But when all is said and done, it is possible to increase the value created for citi-

cents for each dollar of spending. Here's how.

Decision 2. The next step is to secure agreement on how much your government wants to spend. Traditionally, governments start by looking at last year's budget; then they look at projected revenues; then they look at departmental budget submissions; next they reduce these submissions and add up the total; and finally they decide how much to increase or reduce last year's budget. This approach is driven by last year's costs.

This traditional approach focuses on the wrong things, in our opinion. The first question should be: How much do we want to spend? There are many ways to decide this; one is to look at what we call the "price of government" (POG). Simply put, the POG is what we pay in taxes, fees and charges out of each dollar of personal income for the whole range of government services we buy. The national average price of state and local government was relatively stable from 1970 through 1990; it then rose dramatically during the last recession and stayed at a higher level through the late '90s, in part due to rapidly rising health care costs. The tax cuts of the late 1990s were designed to bring the price more in line with its historic average.

While nationwide averages are interesting, each state and locality has its own, and often surprising, pattern. The price of government establishes revenues raised "locally" – so called "own source" revenue. Add to that amount revenue from inter-governmental transfers (state and/or federal aid) and you have total revenue.

There is no one "right" price of government. Each government will approach this issue differently. But it is useful to know how the current price compares to the past price and how governments in the same area compare to each other. It is also helpful to understand why the price of government may have changed.

Assessing and then getting political agreement on the desired price of government early in the budget process is a crucial step. By setting a long-term goal for the price of government, leaders can establish the fiscal context for their budgetary decisions. They can clarify how much revenue will be available, and therefore how much can be spent. Getting agreement about this helps put the emphasis where it belongs—on how to get the most value from every dollar spent.

Decision 3. Once agreement has been reached on the revenue side of the budget – the next step is to buy results that citizens value. Too much of the government budget process is focused on costs. We have literally thousands of "cost codes" in our public accounting systems. We can, with relative ease, report on the whereabouts of every penny of public money, but we know almost nothing about the results of all that spending. Sure, we want our money accounted for, but what really counts are the results we get for the money we spend. If a program manager or lobby group says that a budget should be raised because costs are going up, they should be told: "We don't pay for higher costs, we pay for better results."

Results-based budgeting is dramatically different from the traditional cost-based approach. It changes the focus from budgetary

inputs (dollars, number of employees, equipment, etc.) to outcomes – what results governments achieve. It focuses debate on how government spending makes a difference for citizens. Results-based budgeting requires a whole new set of "rules to the budget game" that managers and elected officials play.

Under these "new rules" decision makers are responsible for the three crucial decisions described above:

- Getting a grip on the real problem.
- Deciding how much they want to spend.
- Buying the results they want for citizens.

Budgeting in Tough Times: The Strategies to Make It Happen

The three decisions described above are critical to getting better results for citizens in tough times. They put the focus squarely on buying better results for citizens. Then the challenge is to actually produce those improved results, for less money. The nine strategies described below provide the means. They make it possible for managers and administrators to produce the desired results at the set price.

1. *Clear the decks.* Eliminate programs or activities that are not central to the government's core purposes or are no longer valuable to citizens. Divesting will almost certainly mean disruption, but in return, governments will have resources they can invest in and results that matter to citizens. One of the most visible examples of successful deck clearing has been the Defense Department's Base Closing effort. Similar challenges have confronted school districts with excess space and agencies with outdated programs. In the Minneapolis Public School District several years ago, for example, leaders first identified the "must do's," putting them on what they called their "dream list." With that list in front of them, they proceeded to identify the "can live withouts" that would make their dreams possible. In short, they divested in order to invest.

2. *Consolidate.* In many ways this is the favorite of politicians. Surely there are savings to be had from consolidating multiple agencies into super-agencies, or in consolidating smaller jurisdictions into larger ones or multiple service systems into one-stop centers. If all consolidation means is moving boxes around on an organizational chart, however, it is likely to result in many shotgun weddings, with few real savings and many new costs.

Consolidations most likely to produce savings or improve results include:

- Consolidating missions. Often when organizations are combined they bring with them their various missions. The result is a lack of focus, if not outright conflict between missions. Consolidations work best when the resulting organization has a clear, focused mission and set of clear, limited performance targets.
- Consolidating funding streams. Far more powerful than consolidating organizations is consolidating their funding streams. Categorical funding leads inevitably to categorical -- and there-

fore complicated -- organizations. Consolidate the funding, focus it on clear, high priority outcomes, and use it to purchase those priority outcomes from whatever organizations can best produce them.

- Consolidating “steering” authority. Most government organizations have both policy (steering) responsibilities and operating (rowing) responsibilities. These are not the same! Steering functions focus on doing the right things, while rowing functions focus on doing them right. By separating these roles, both can be performed better. Once separated, steering can be consolidated to assure that policy is integrated and mutually reinforcing across a government unit. Using consolidated funding streams, steering organizations can “purchase” key results from those who row.
- Consolidating “rowing.” Operating units that do similar kinds of work are good candidates for consolidation. Examples include the unit within a public works department that collects water fees and a similar unit in finance or treasury that collects taxes, or the units within highway and parks departments that both do grass cutting. In such cases the similarity of the work offers consolidation opportunities.
- Consolidating layers. In one urban county there were eight layers of management between the elected county board and the front line employees. Layers may have been necessary when communication was cumbersome and employees were poorly educated. But with today’s technology and workforce the justification for so many layers is gone. Consolidating layers can save money. It can also improve service by delegating more authority to those closest to the customers being served.
- Consolidating access. Much of what government does involves the collection and processing of information. Accessing what the government knows has often been cumbersome and expensive for those inside and outside of government units. Technology provides the opportunity to consolidate access -- and doing so reduces costs and improves service.
- Consolidating “back room” activities. Many organizations share common back room functions e.g. phone answering, purchasing, data storage – even though the activities that directly touch citizens are very different. In these cases there is an opportunity to create a common

“back room” to more effectively support citizens service.

3. *Make services accountable to their customers.* No one is in a better place to judge the value of a service than those who use it. By giving them power, we can force service providers to improve, even while cutting spending. We can make services accountable to their customers (and therefore of higher value) by:

- Giving customers choices about their services and making sure that the money follows the customers. This creates competition between service providers for the customers’ business. When school choice works this way, for example, school administrators begin to pay very close attention to what parents want.
- Requiring that governments post service standards and provide customers a rebate or other redress if they don’t live up to them. That’s how it works today when you apply for a passport. They either get it to you on time or you get your money back. The result is delighted customers who get passports much faster than they ever thought possible.
- Creating customer boards to provide direction to service providers. The Minnesota Department of Administration used a customer board to help it run the state’s internal telecommunications service.
- Making it possible for customers to serve themselves through e-government. Web based services give customers control over

Table I Rules of the Budget Game

	Cost-Based Budget	Results-Based Budget
What’s the starting point?	Last year’s costs.	This year’s price. A fixed number based on the Price of Government. PLUS Unit, agency or department results and performance targets.
What’s the focus?	Adding to and subtracting from last year.	Spending what is available to get the best results possible.
What gets added?	This year’s increased costs (inflation) plus the costs for enhancements.	Nothing– the price is given.
What’s a subtraction?	A “cut” from what was expected – including the additions.	Nothing– the price is given.
What is the budget submission?	Justification for the needs and the associated costs. Plus enough extra money so that there is enough left after the budget is “cut.”	Results to be achieved at the specified price.
What’s the job of the budget analyst?	Find inflated costs and unnecessary “needs.” Probe how work is done and push for more productive approaches.	Validate submitter’s ability to produce the results.
What’s the job of elected officials?	Choose what to cut - find the “hidden” costs.	Choose which results to buy. More of some, less of others. Choose agencies or organizations that give the most results for the money.
What are the incentives for budget managers?	Build up costs, then when asked, propose unacceptable cuts (‘Closing the Washington Monument’)	Produce results that really matter. Demonstrate the connection between results and the budget.

the time and convenience of the services they want. Catawba County, NC recently launched an internet site where citizens can track permits for which they have applied. In the future, the site is to be expanded to allow citizens to apply for permits, pay for them, and schedule inspections online. The National Oceanic and Atmospheric Administration put its commercial fishing permit renewals on the web and cut wait times from 30 to 2 days.

4. *Make performance consequential.* When there are no consequences (rewards or sanctions) for performance, the results are likely to be “good enough for government work,” but never as “good as possible.” The tools to get to excellence include:

- Enterprise management. Make service organizations that can sell their services “earn” their budgets by selling to citizens or other agencies – often in competition with private providers. Suddenly, survival depends on how well they please their customers and at what price. Many governments have turned their maintenance, printing, training, data processing and other internal service operations into competitive enterprises, for example. Minnesota, Milwaukee, the Edmonton school district, even Australia and the United Kingdom have used this approach. It can save 10 percent a year for several years.
- Managed competition. Use competitive contracting to make public agencies compete with other agencies or private firms to serve public needs. When public agencies are required to compete they unleash the creative potential of their employees, because the incentives for success are so direct. Indianapolis has used such competitions to improve services and lower costs by an average of 25 percent. The Milwaukee area’s wastewater treatment agency used this tool to cut its costs for operating its plant and field operations by more than 30 percent.
- Performance management. Require every agency to set performance targets and then measure and report results against those targets. Doing so focuses attention on what matters most – results. To strengthen the focus, add rewards for success –

both financial and psychological -- as well as penalties for poor performance. For example, use “gainsharing” to reward teams that cut costs while maintaining or improving service quality. In the late 1990s, managers at the Seattle area’s wastewater treatment operation agreed to let employees have half the savings they generated for the department. Over four years, total savings were \$2.5 million, with no reduction in service levels or effluent quality.

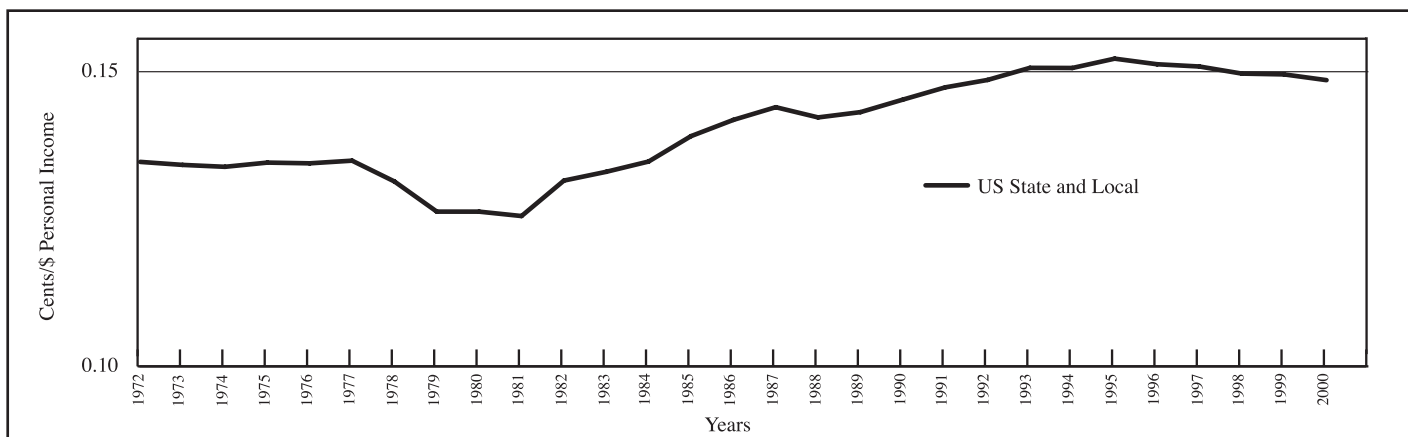
(It takes several years to develop an effective performance management system, and it requires serious investment. The first two approaches offer faster results and far greater savings; hence they are more useful during a fiscal crisis.)

5. *Increase flexibility in return for accountability.* In exchange for the new forms of performance accountability we have described, give programs and their managers flexibility in how services are delivered. Tying programs up in red tape while making them accountable for performance is a set up for failure. Give any organization willing to commit itself to specific results flexibility in how it hires, pays, purchases and invests. The Office of Federal Student Aid in the U.S. Department of Education is now operating in just this way. It is a “Performance Based Organization,” with both the accountability and flexibility it needs to succeed. Its performance has improved dramatically as a result.

A flexible performance agreement (FPA) is one way to assure accountability while increasing flexibility. An FPA is a written agreement that articulates the overseeing organization’s expectations, the service organization’s goals and freedoms, how performance will be reported, and how that information will be used to trigger consequences, either positive or negative.

6. *Reform how government works on the inside to improve its performance on the outside.* All organizations are creatures, and often prisoners, of their internal systems for budgeting, accounting, personnel, procurement, and auditing. The messages these systems send about following the rules of bureaucracy are much more powerful than all of the leadership exhortations to per-

Figure 1 Price of Government



Source: U.S. Bureau of the Census, State and Local Government Finances www.census.gov/govs/www/estimate.html and Bureau of Economic Analysis, Regional Accounts Data www.bea.doc.gov/bea/regional/reis.

form better. Lasting improvements in performance require improved systems.

Milwaukee's purchasing department, by simplifying processes, giving more authority to departments in return for accountability, and using technology to cut costs and provide better information, was able to cut its staff by nearly two-thirds and its budget by more than 55 percent.

Every one of these systems has a long history, and reform is often difficult. If you cannot redesign them in the short term, empower a panel of Bureaucracy or Barrier Busters to give organizations selective relief from rules that get in the way of results or add needlessly to costs. Doing so will help improve results and lower costs, while building the case for systemic reform.

7. *Cut the cost of mistrust.* The main purpose of 20-30 percent of all government spending is to control the other 70-80 percent. Much of that spending is based on the belief that most of us, if given the opportunity, will lie, cheat and steal. This level of mistrust is not only expensive, it undermines performance. For example, in special education today most teachers spend up to 50 percent of their time filling out forms to demonstrate compliance with federal and state rules and regulations. If we could cut this cost of mistrust and find less expensive ways to win compliance, we could give our schools a massive infusion of what they need most – time to teach.

Montgomery County, Maryland has given its departments authority to pay invoices in amounts up to \$5,000 rather than sending them to central accounts payable. This created flexibility for departments and allowed a more than 50 percent reduction in the accounts payable staff. Departments are still accountable for their actions, but at a much lower cost.

8. *Get a return on capital investments.* When operating budgets are tight, many governments turn to their capital budgets (supported by bonding) to deliver good news to their constituents. For a small increase in debt service (in the operating budget), governments can launch relatively large expenditures for roads, bridges, buildings and technology. Among the top priorities for capital should be investments designed specifically to make services better, faster and cheaper. Proposed investments that produce the highest return in service quality or cost savings should take precedence over those that produce a lower return.

9. *Target subsidies.* Some public spending really involves transfers of resources from one set of taxpayers to another. Subsidies exist when those who benefit from a service or activity are not those who pay for it. Sometimes this is done directly through assistance payments or tax credits. Other transfers are indirect, like the way most states subsidize college students by subsidizing the schools they attend. In both cases, however, these subsidies are often not targeted on those who truly need them (nor are they targeted on results). By limiting subsidies to those who need them, we can save money and make sure that the money we do spend is focused on results we care about.

Conclusion

For government leaders the past year has been very uncomfort-

able. Many have patched together budget balancing plans that cut services, raise taxes, and/or resort to accounting gimmicks to “shrink” the problem. But gimmicks don't solve problems – and hoping won't make them go away.

There is a third alternative: taking the opportunity this challenge presents to remake our public services as if the public really mattered. Doing so requires a combination of courage, creativity and good ideas. We have described a range of creative strategies above. That they have already been used and have worked in many jurisdictions should encourage our public leaders to act.

Editor's Note: This paper was prepared by The Public Strategies Group based on its partners' experience with fiscal crisis in the public sector over the last two decades. The Public Strategies Group (www.psgroup.com) specializes in designing creative solutions for those public organizations that want to delight their customers with outstanding service at reasonable prices. The firm consists of a small group of some of this country's most advanced thinkers and practitioners of post-bureaucratic government. For more information about how to implement these twelve steps, see *The Reinventor's Fieldbook*, by David Osborne and Peter Plastrik, and go to www.psgroup.com.

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Bios

David Osborne is the author or co-author of four books: *The Reinventor's Fieldbook: Tools for Transforming Your Government* (2000), *Banishing Bureaucracy: The Five Strategies For Reinventing Government* (1997), *Reinventing Government* (1992), and *Laboratories of Democracy* (1988). He is a managing partner of The Public Strategies Group (PSG), whose mission is to be the best resource in the world for transforming governance. 25 Belcher St., Essex, MA 01929. (978) 768-3244. David@psgroup.com.

Peter Hutchinson is President of the Public Strategies Group. He has served as a commissioner of finance in Minnesota, superintendent of schools in Minneapolis, and deputy mayor in Minneapolis. He has also served as a vice president of the Dayton-Hudson Corporation and chair of the Dayton-Hudson Foundation. 275 E. 4th St., Suite 710, St. Paul, MN 55101. (651) 227-9774. Peter@psgroup.com.

judge elected with party affiliation; and 72 percent said they are extremely, very or somewhat concerned that the impartiality of judges is compromised by their need to raise campaign money. The survey was released by the American Bar Association Aug. 12, 2002. Details can be found on the ABA's Web site, www.abanet.org.

²Survey conducted on behalf of Justice at Stake by Greenburg Quinlan Rosner Research and released Feb. 14, 2002.

³*Perceptions of the U.S. Justice System*, "Whites tend to be more positive than non-whites" about the justice system, page 75, published by the ABA, February 1999, based on a public opinion survey conducted by M/A/R/C Research.

⁴See *Republican Party of Minnesota v. White*, 536 US 765 (2002)

⁵Justice at Stake survey, 2002.

⁶*ibid*.

⁷Reports of the American Bar Association, Volume XXIX, 1906, 416-17.

⁸See, *Weaver v. Bonner*, 309 F.3d 1312 (11th Cir. 2002); *Spargo v. New York State Commission on Judicial Conduct*, 244 F. Supp.2d 72 (N.D.N.Y. 2003).

Bio

Alfred P. Carlton Jr. of North Carolina, President of the American Bar Association, is a partner with Kilpatrick Stockton LLP, 3737 Glenwood Ave., Raleigh, NC 27612. Prior to and during his term as president he championed improvements in state judicial systems because of the importance of a fair and impartial judiciary in America. The ABA headquarters is located at 750 N. Lake Shore Dr., Chicago, IL 60611. (312)988-5000. acarlton@kilpatrickstockton.com.

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their legislatures regarding the fiscal condition of their state, commonwealth or territory. Governors often use their address to lay out their policy and budget agendas for their upcoming or continuing administration. The 2003 state of the state addresses were accessed from January through March 2003 at the National Governors Association Web site at http://www.nga.org/nga/legislativeUpdate/1,1169,C_ISSUE_BRIEF^D_4796,00.html.

All quotes and data presented here are from these addresses, unless otherwise noted. Data for states for which addresses were unavailable at this Web site by March 10, 2003 (Illinois, Louisiana and Tennessee) are culled from press release material and gubernatorial reports available via these states'

homepages or Web portals.

⁸Alabama State of the State Address, March 4, 2003, Accessed on March 10, 2003 at <http://www.stateline.org/story.do?storyId=292328>; and Tennessee State of the State Address, "Address to the General Assembly – The Family Budget," March 10, 2003, Accessed on March 11, 2003 at <http://www.state.tn.us/governor/newsroom/speeches/03-10-03%20budget%20address.htm>.

⁹National Governors Association "The State Fiscal Crisis." February 22, 2003 Contact Christine LaPaille, Office of Public Affairs. Accessed on February 25 at http://www.nga.org/nga/legislativeUpdate/1,1169,C_ISSUE_BRIEF^D_5080,00.html.

¹⁰National Governors Association/National Association of State Budget Officers, 10.

¹¹National Governors Association/National Association of State Budget Officers, Figure 2, "Enacted State Revenue Changes Fiscal Years 1991 to 2003," page 2 of Tables and Figures Section.

¹²Robert Tannenwald, "Are State and Local Revenue Systems Becoming Obsolete?" *Government Finance Review* 19, no. 1 (February 2003): 21-24.

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