Issue Brief

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Trade-off Time:

How Four States Continue to Deliver

EXECUTIVE SUMMARY

The United States is facing the gravest financial crisis in at least a generation. And while all levels of government are affected, the fiscal pain is felt most acutely by states. As we go to press, most states are in recession and facing significant budget shortfalls. The economic downturn is increasing demand for state services at the very time that the revenues that pay for those services are in free fall. The list of problems is familiar to anyone who reads the newspaper. Record job losses are spurring increased demand for safety net programs like food stamps and unemployment compensation. Many states' unemployment trust funds are close to insolvency. Shrinking incomes are projected to increase state Medicaid spending upwards of five percent in Fiscal Year 2009—while overall state general funds are declining.[1] And perhaps most unsettling , no one can predict when the economic situation will begin to improve—or stop getting worse.

States' response to this crisis is critical to the nation's overall economic and fiscal health. Some economists warn that deep state spending cuts in times of crisis can prolong downturns by increasing stresses on citizens. Others warn that raising taxes could stifle economic activity in the private sector. But states that make sound policy decisions will play a vital role in stabilizing the effects of recession and engineering a turnaround that benefits the entire nation now and in the future.

Helping states improve budget practices is a national imperative. *Trade-off Time: How Four States Continue to Deliver* shows how tough economic times can be a crucible forging better decision making and a heightened vigilance to ensure every precious tax dollar delivers maximum value for the public. This report features four states—Indiana, Maryland, Utah and Virginia—that are leaders in measuring the performance of government programs. And by using those measurements to drive smart budget cuts and new spending they are creating the foundation for a better economic and fiscal future.

1 "The Fiscal Survey of the States," National Association of State Budget Officers, December 2008.

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The process is not an easy one. By publishing this report, The Pew Center on the States (PCS) hopes to give states an edge in these times, by sharing good ideas for tackling the fiscal crisis and calling out efforts that have not been successful.

The Pew Center on the States has followed state government performance for more than a decade, studying good and bad practices and analyzing what works. Our research has shown that results-based budgeting systems can aid states during economic downturns by cutting wasteful spending on programs that are not showing results, and directing resources to programs that evidence has shown to be more effective. Such an approach also can provide lasting benefits, laying the foundation for a leaner, more effective government during the next economic upturn.

Trade-off Time: Tough Choices Made Smarter with Performance-Driven Budgeting

The unfortunate truth is that most states today do not have the tools in place to make well-informed programmatic and budget decisions. There is no way to know how much money states lose to mismanaged or underperforming programs. But those states that have begun to make policy decisions based on data measuring the performance of government, a process called "performance-driven budgeting," have saved impressive amounts of money—some in very short periods of time. The choices they have made have not been easier, but they have been smarter.

Although individual strategies vary, the states profiled in this report demonstrate common purpose in their approaches to performance-driven budgeting. States that deploy good budget practices:

- Define agency and programmatic missions and goals;
- Establish priorities and assess trade-offs;
- Target reductions with precision;
- Invest in initiatives that yield a return; and
- Institutionalize a culture of results-focused budgeting.

Following the Budget Leaders

Virginia: Using Strategy

The Virginia Performs data system closely monitors the progress of each state agency. Established by former Governor Mark Warner and expanded upon by Governor Tim Kaine to build on the commonwealth's tradition of good governance, Virginia Performs has created a culture of evidence-based decision making that allows Virginia's leaders to systematically tackle the state's budget crisis and increase agency productivity.

Virginia was able to use data from the system to make targeted cuts in corrections, which saved money without affecting public safety. Among other reductions, the Virginia Department of Corrections replaced private food service contracts at several prisons when data showed that the services could be provided more cheaply in-house for a total annual savings of $851,000.

With an eye toward reducing future crime and social services costs, the governor made the expansion of state-funded prekindergarten a high priority. To determine whether the state's investment in pre-k has led to better school achievement, legislators commissioned an audit to analyze the program's impact. Among other findings, data showed that at-risk children who had participated in state preschool passed kindergarten literacy tests at rates 4 percent to 5 percent higher than those who had not. The study was an important factor in the approval of additional funding for the program.

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DEAR COLLEAGUES:

The global economic crisis has been taking an increasing toll on our nation's states and communities. As we go to press with this issue brief, most states are in recession and are facing an uncertain fiscal future. Although economists debate how deep and wide this crisis will cut, there is no question that the fiscal and programmatic demands on state governments are growing while revenues are shrinking. And times are not likely to improve soon.

This issue brief provides policy makers and program managers with fresh insight from state innovators who are effectively using information about the performance of government to identify budget and program reductions—as well as new investments—in spite of daunting revenue and spending trend lines.

This analysis builds on The Pew Center on the States' Government Performance Project report, Grading the States 2008, an examination of all 50 states' management of money, people, information and infrastructure published in partnership with *Governing* magazine. While conducting the extensive analysis for that report, we observed a number of fiscal and management strategies that hold promise for all states—especially in these most difficult times—and we present some of those exemplars here. Our belief is that good ideas should be shared widely.

Although public managers are developing these tools in states as different as Utah and Virginia, and sometimes in partnership with private sector leaders, the impetus for these efforts reflects several similarities.

One common thread among these states was the shared commitment of everyone involved—including governors, legislators, state employees and citizens—to a new model of policy making. Without such commitment, efforts to make budget and programmatic decisions based on solid performance information are bound to fail. Pilot programs are an important first step, but real change comes only when the data-driven approach is applied across state agencies.

We noticed, too, a willingness among these states to invest the time necessary to do things right. Each instance of changing the culture in which budget and program decisions were made, took time. All are still works in progress. Although the building blocks of establishing priorities and goal-setting can be moved into place with some speed, the long-term effort cannot be rushed. It requires careful consideration, beginning with an examination of a state's strategic goals. What do policy makers want to accomplish in the short- and long-term? Regardless of where performance-driven

budgeting originates (with the governor, the budget office or the legislature), only when all involved understand the state's short-and long-term goals can leaders begin to base their financial decisions on program outcomes.

All the states showcased in this report gave all programs an opportunity to prove their worth, and avoided "punishing" or "rewarding" programs indiscriminately. In some cases, leaders provided less money to initiatives that were performing well, which contributed to improved efficiency. Conversely, in order to follow through on their initial promise, decision makers invested more resources into some programs that had not yet met their goals.

The governors, budget officials, agency heads and other leaders in these states have worked hard to engage citizens in this process, carefully explaining why it was more important to their overall goals to fund one program instead of another, or to make certain operating changes. Indiana's leaders, for example, were clear that funding child abuse prevention programs before providing counseling to parents waiting for services was necessary to better achieve the goal of improving the lives of children. Utah's team had to work hard to make the case that closing state offices one day a week could benefit citizens in the long run—fiscally, environmentally and in service delivery.

The unfortunate truth is that most states today do not have the tools in place to make better-informed program and budget decisions. It is also important to note that, since the fiscal crisis is ongoing, even some of the stakes featured here continue to be challenged by the fallout: As this issue brief went to press, both Maryland and Virginia began to tackle new, gaping budget shortfalls driven by the rocky economic climate.

The lesson here is clear: even in the most challenging economic conditions, states can achieve more for every tax dollar spent. As policy makers embark on efforts to solve these seemingly intractable problems, The Pew Center on the States is committed to serving as a partner in navigating this difficult historic passage.

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The state is also sharpening its calculations of agency productivity, tracking such measures as the cost of issuing a license or processing medical claims online, in-person or through the mail. Not only will the agency be able to track progress towards reducing costs and setting fees at the right level to cover those costs, but it also can help define the most cost-effective way to achieve specific programmatic goals.

Utah: Refocusing on Mission and Metrics

Since 2005, Utah has required more data to inform budget decisions. Using a "balanced scorecard" system developed at Harvard Business School, the state closely monitors performance achieved for every dollar spent. And now, the state requires that any new request for more than $100,000, or that requires one full-time position, has a specific, measurable goal to justify the request and gauge progress.

As a result, the state is and will continue to be better positioned to identify cuts and demand higher performance for the public. For example, the Governor's Office of Economic Development recently cut a $300,000 program to help businesses recruit employees when it could not show measurable success. Most of the savings were returned to the general fund, but a portion was used to fund an online recruitment program to encourage former Utah residents to move back to the state by matching their resumes with 120 companies in the state. The program has generated more than 1,500 new resumes and also connects local businesses to the state's higher education system graduates.

To achieve even greater savings, Governor Jon Huntsman issued a challenge to reduce state government's energy use 20 percent by 2015. Meeting the ambitious goal has led many state offices to make a radical change to four-day work weeks with 10-hour days. In addition to the $3 million the state expects to save in energy costs, it also estimates that employees will save $6 million annually in commuting costs. Constituents can access state services before and after their own workdays, traffic is down—and surprisingly, employee sick day and annual leave usage has dropped 9 percent.

Maryland: Leveraging Change Through Data

As mayor of Baltimore, Maryland Governor Martin O'Malley created CitiStat, a data management system that tracks indicators from murder rates to potholes. In its first six years, the program improved city services and generated an estimated $350 million in savings. It received the Innovations in American Government Award from Harvard University and sparked similar programs around the world.

StateStat, a statewide version of the program, is monitoring 10 major departments, including corrections, health, housing and transportation. Every two weeks, the StateStat team holds a 90-minute meeting where data are dissected and agency heads are grilled on their performance by the governor's chief of staff and sometimes, by the governor. There is a shared commitment to accountability that helps ensure that every dollar is spent for maximum benefit.

This monitoring of results is making it easier for the state to identify fat to trim and consolidations that achieve savings. For example, the state closed an under-capacity juvenile justice detention facility, saving the state $1.5 million. Of that money, $600,000 was transferred to less expensive community-based programs for youth, which use evidence-based family therapy and education programs proven to be more effective than incarceration.

Indiana: Organizing for the Long Term

"Demanding proof that government programs work before spending additional taxpayer money on them must become standard operating procedure," said Indiana Governor Mitch Daniels, who has been director of the U.S. Office of Management and Budget and an executive at Eli Lilly.

One of his first acts as governor was to create a new state Office of Management and Budget to closely follow the return on investment achieved for every budget item. At first, fewer than half of state programs had any measures of performance, and even fewer were linked to defined goals. Now the state has developed enough data to influence the 2007-2009 biennial budget. For example, the Indiana Department of Child Services was performing poorly on nearly all indicators: child support collection, investigation of abuses and the ratio of case workers to children. To improve the safety of Indiana's most vulnerable children, state policy makers funded an increase that doubled the number of caseworkers. Although it is too early to declare success, reports of repeat abuse are declining and children appear to be staying protected and safe for longer periods of time.

Close monitoring of results also helped Indiana effectively target budget cuts. For example, a $600,000-a-year program at the Indiana State Library to give grants to local and county libraries was cut because it did not have an explicit, measurable goal. Another $900,000 program for "value-added research" at the Indiana State Department of Agriculture was cut because the statutory language was so broad that funding for practically anything could be justified—thus no specific goals could be identified.

Indiana's fiscal stewardship earned the state's first AAA rating from Standard & Poor's in July 2008—a distinction shared by just nine other states. To maintain this momentum through increasingly difficult economic times, the state is institutionalizing its performance-informed budgeting to maximize every tax dollar by requiring all agencies to submit budgets with clear measurements and goals.

Avoiding the Budget Laggards

The economic meltdown is bringing out the good, the bad and the ugly in state government performance. Our state exemplars contrast with politically gridlocked states such as California, Florida and New York. Since November 2008 New York Governor David Paterson has proposed a series of budget changes to address a rapidly-shifting Fiscal Year 2009-10 budget shortfall currently estimated in excess of $13 billion. To date, the State Assembly has refused to act, and appears to be offering none of its own solutions.

California, too, is struggling with how to tackle a cumulative FY 2009-10 budget shortfall that could reach more than $40 billion. The controller's office warns that the state could run out of money in a matter of months. The state has halted major highway construction projects and the governor ordered furloughs for state employees just before Christmas. The executive and legislative branches again have been stuck since Governor Schwarzenegger vetoed the legislative budget in December 2008.

In a January 2009 special session, Florida's lawmakers patched a $2.4 billion dollar hole in the state budget through an almost straight party-line vote that raided trust funds and slashed agency budgets—including a $466 million cut to education. But the state's unfortunate confluence of increased home foreclosures, a significant fall in tourism, a rise in unemployment and Medicaid claims, and an increase in both incarceration costs and community college enrollments continues to take its toll. Lawmakers will return to session in March 2009 facing a fresh FY10 shortfall estimated at $3.3 billion.

Anatomy of a State Budget

Like many American families, responsible state leaders aim to live within their means, recover from mistakes and excessive debt, and plan for long-term goals that position states for success. Although state budgets are more complex than average family budgets, the same principles apply. A budget includes money coming in; money going out in spending for immediate, intermediate and long-term needs; and savings.

States have four broad categories of funds to spend:

General funds, the largest category, come mostly from state taxes, and comprise nearly half of all state spending (44 percent). When budgets are tight, states first look to cut programs financed through the general fund, because this category is the least restricted. But the choices for cutting are difficult. Roughly one-third, or 34 percent of general fund spending supports elementary and secondary education—and another 11 percent supports public higher education. Seventeen percent of state general fund expenditures support state match for the federally supported Medicaid program. More than one-fourth of state general fund expenditures (27 percent) support additional services for some of the states' neediest residents, ranging from the State Children's Health Insurance Program to services for the mentally ill and developmentally disabled, as well as expenditures on such core state functions as state police and employee pensions. State general fund dollars also support corrections (7 percent), public assistance (2 percent) and transportation (less than 1 percent).[2]

Federal funds, which include grants tied to a specific program like Medicaid or transportation, cover about one-fourth of state spending, or 27 percent.

Restricted state funds, which comprise 25 percent of state spending, come from revenue sources that must be tied to specific functions. For example, a portion of gas tax revenue might be linked to road maintenance through a state's highway trust fund.

Bonds supply about 2 percent of state funding. States issue bonds to pay for capital projects or to generate short-term cash for ongoing expenditures.

The revenue sources for these funds are increasingly volatile and are evaporating rapidly. Personal income taxes often provide the largest portion of state tax revenue, followed by sales taxes. Both are tied closely to the overall health of the economy. Frozen wages and rising unemployment have flattened income and sales tax revenues. These revenue sources simply will not cover the increasing costs of serving public needs.

Although most states have "rainy-day" funds or savings, they seldom comprise more than a few percentage points of their total budgets and are insufficient to address sustained economic downturns. And many states have already dipped into their reserves in response to the unexpected shortfalls that emerged during FY09—leaving little to help with even greater gaps projected for FY10.

When hard economic times hit, demands accelerate for social services, health care, economic and educational programs. In addition to anticipated safety net program needs, states are coming to understand that they have vastly underestimated maintenance costs for their existing roads, bridges and buildings. And as teachers and other public sector workers retire, they begin to draw their state pensions, which have been underfunded in some states, and hurt by the stock market freefall. These problems have been neglected and they have

2 "State Expenditure Report 2006," National Association of State Budget Officers, December 2007.

mounted. Ironically, today's crisis is helping decision makers in some states focus on these problems and unite to achieve solutions that serve the public good.

Creating a Road Map—and Using it to Make Tough Decisions

The examples cited here signal an encouraging new era of performance-driven budgeting. It is emerging not a moment too soon. Thirty-nine states now include performance measures in agency budget requests, and 42 states report some level of performance measures online, according to the National Association of State Budget Officers. In addition to using data to measure results and chart progress toward targets, state leaders are deploying the information to manage their agencies and programs. Furthermore, 22 state legislatures reported using performance measures to varying degrees in their budget decision making, according to a 2007 survey of legislative fiscal offices for the IBM Center for The Business of Government.

The four state budget leaders profiled here—Indiana, Maryland, Utah and Virginia—will not avoid all of the severe cuts and the acute strain on their resources, but they will be better positioned to weather bad times. With a more detailed and complete picture of how programs and agencies are serving the public, these states are making cuts that do the least damage and investments that provide the best return and using taxpayer dollars more wisely.

States that succeed in navigating these perilous times will be those that combine short-term strategies to balance their budgets with long-term fiscal and management investments that serve vital public needs and position themselves for the future.

Three Steps States Can Take to Strengthen Decisions and Management

1. Assess Your State's Unique Characteristics to Build a Long-term Strategic Framework.

State leaders must determine their priorities based on the state's demographics, desires and dollars. Reliable economic and revenue projections—although especially difficult in today's uncertain environment—form the foundation for a state's fiscal health.

Armed with a clearer understanding of their fiscal and economic outlook, policy makers can outline broad policy goals of a state with high enemployment that match the needs of people in their state. For example, the immediate goals of a state with high unemployment will be different from those of a state with low unemployment. Similarly, a state with a younger population may focus on educational programs, whereas states with older residents may need to devote more resources to health care. Within its existing constraints, each state must decide what it must do first, and what it can put off. But each state should plan for its long-term fiscal future—not merely react to the current crisis.

2. Refocus Agency Missions and Measures.

Clarifying an agency's mission is critical to understanding the agency's goals and allows policy makers to know what performance outcomes to measure—and how to improve them. In some states, well-intentioned but uncoordinated policy moves have led to a web of overlapping and sometimes conflicting goals that have accumulated throughout years or even decades.

After goals are clear, decision makers can define indicators that tell whether a given program is meeting solid, measurable goals in support of that mission. As the Indiana experience shows, each agency and program should strive to develop outcome measures that chart long-term progress toward goals, with targeted performance levels for each measure.

3. Use the Information to Engage the Public Around New Priorities.

With missions, goals and measures in place, executive and legislative leaders will be in a stronger position to engage one another—and the public—in a focused discussion of difficult fiscal and policy trade-offs. Measuring what really matters in terms of outcomes can significantly improve the quality of policy debates. And making data-driven decisions that are shared with the public in clear, easy-to-understand terms—as Virginia and Washington State are doing—can help bolster the legitimacy of the final resolution.

As each of the four states showcased here demonstrates, a degree of courage and calculated risk is essential to successfully making these important changes. If the goal is to cut a state's energy budget, it will take more than requesting employees to turn off their computers at night. As Utah found, it will require energy audits that link to repair and maintenance of capital assets—and perhaps even changes in service delivery. And some long-term expenditure reduction goals, such as saving money on state purchases of goods and services, may require new investments in information technology and staff capacity to analyze and temper state spending patterns. States may even consider using this period of crisis to rethink and revamp tax and revenue streams to be more stable and fair and avert future crises.

In today's environment, policy makers must say goodbye to the ideas that programs must be funded simply because they always have been and that in a fiscal crisis all new spending is off the table.

A performance-driven approach to budgeting like those demonstrated in these four states puts the public good front and center. This does not mean shirking difficult choices. It means knowing which investments of tax dollars are performing and which ones are not. It means identifying priorities for advancing the public good (health care, education, economic development) and having a budget that matches, as much as possible, those priorities. It is creating a new government culture of accountability and responsible stewardship of precious tax dollars.

The stakes for improving state budgeting could hardly be higher. In their unique roles as fiscal stabilizers and policy innovators, states can help our nation weather the most profound threat to its economy in modern times.

Trade-off Time

As bad as the fiscal crisis has been for the federal government, cities and towns, it has been catastrophic for many states. They are squeezed from the top and the bottom. Federal grants and grants-in-aid to states are declining, forcing states to pay more for health care, transportation and education. Sinking municipal revenues mean more requests to state capitals. As we approach mid-year Fiscal Year 2009, 22 states and the District of Columbia face shortfalls totaling more than $30 billion for this year. Twenty-eight states have already announced further deficits for Fiscal Year 2010 that total another $60 billion. With most states in recession, the latest revenue collection numbers are worsening.

Even after Florida cut $7 billion from its budget during its last legislative session, the state faced subsequent multi-billion dollar gaps. Arizona was already facing a $300 million deficit, and lawmakers project a FY09 shortfall of $1.2 billion—nearly 12 percent of the state's general fund. Before it was able to find private lenders, California, which projects at least an $8 billion deficit in 2009, appealed to the U.S. Department of the Treasury for a $7 billion loan to make up short-term cash flow. [3]

Balanced budget requirements—in every state but Vermont—preclude deficit spending to get through the upcoming hard times. Although most states have "rainy-day" funds, those seldom comprise more than a few percentage points of their total budgets—insufficient to weather sustained economic downturns. Thus most states struggle in lean times, slashing programs across the board and raising a grab bag of expedient taxes to eliminate shortfalls. Too many legislatures and state leaders fail to use the opportunity presented in tough economic times to fundamentally restructure and update obsolete tax and revenue systems to ensure that states have stable, reliable revenue sources.

Nationwide, the number of unemployed is at a 25-year high and many states' unemployment trust funds are close to insolvency. And while tax revenues are down, unemployed workers increase demand for programs such as food stamps, unemployment benefits and Medicaid services, which comprise a substantial portion of state budgets. State Medicaid expenditures alone are projected to increase upwards of five percent in FY09—while overall state general funds are declining.[4]

States' responses to this crisis are critical to the nation's overall economic and fiscal health. Those states that have eroded their fiscal capacity with overly generous tax cuts or unsustainable commitments to new spending can arguably exacerbate the next downturn. Some economists argue that cutting spending and further trimming taxes can prolong downturns by increasing stresses on citizens (resulting from decreased social services at the time they need them most).

States' responses to this crisis are critical to the nation's overall economic and fiscal health.

States have four broad categories of funds to spend. The largest category is the general fund, which derives mainly from state taxes. In 2006 (the most recent year in which data were available) that made up nearly half of all state spending (44 percent). Federal funds, which include grants tied to a specific program like Medicaid or transportation, covered about one-fourth of state spending, or 27 percent. Other state funds, which comprised 25 percent of state spending, came from revenue sources that are restricted by law for particular

3 All budget shortfall figures in this paragraph are from "State Budget Troubles Worsen," Center on Budget and Policy Priorities, December 2008.

4 "The Fiscal Survey of the States," National Association of State Budget Officers, December 2008.

functions or activities. For example, a portion of gas tax revenue might be linked to road maintenance through a state's highway trust fund. Finally, bonds supplied about 2 percent of state funding. States issue bonds to pay for capital projects or to generate short-term cash for ongoing expenditures.

States are restricted in how they spend federal funds, other state funds and bonds. When budgets are tight, they first look to cut programs financed through the general fund. But a look at how states spent their general funds in 2006 reveals that deciding where to cut required very tough choices. Roughly one-third, or 34 percent, of general fund spending supported elementary and secondary education—and another 11 percent supported public higher education. Seventeen percent of state general fund expenditures supported state match for the federally-supported Medicaid program. More than one-fourth of state general fund expenditures (27 percent) supported additional services for some of the states' neediest residents, ranging from the State Children's Health Insurance Program to services for the mentally ill and developmentally disabled, as well as expenditures on such core state functions as state police and employee pensions. State general fund expenditures on corrections (7 percent), public assistance (2 percent) and transportation (less than 1 percent), completed the picture.[5]

Falling Revenues. When the housing market began to slow, states reduced their estimates and developed plans to trim spending. Nonetheless, few were prepared to cope with the financial collapses in summer and fall 2008. According to the Nelson A. Rockefeller Institute of Government, state tax revenues declined 5.3 percent between the first quarters of 2007 and 2008—a trend that is expected to continue.

That decrease is a direct result of the intersection of the economic downturn and 50 different, diverse revenue structures. Personal income taxes provide the largest portion of state tax revenue in many states, followed by sales taxes, both of which are tied closely to the overall health of the economy. Frozen wages and rising unemployment have flattened income tax revenues—especially troublesome in states whose revenue mix tilts toward that component. Consumers stopped buying many nonessential and big-ticket items in fall 2008, further weakening the nation's manufacturing sector and driving down sales-tax collections, which is troubling in many states, but even more so in sales-tax-dependent states such as Tennessee and Washington State.

Consumer spending is not the only bleak indicator. The loss of capital gains taxes will adversely affect states with high-wage earners, of course. But many states face additional economic market factors, ranging from their stock portfolios to the rollercoaster ride taken by commodities prices and the resulting tax revenues.

- Most states factor interest from stock investments into revenue forecasts. Alabama, for example, funds its non-education activities in part through interest from the Alabama Trust Fund. The state's FY09 general fund budget assumed $117 million in interest, but the state now expects to receive much less, if anything, from the fund.
- As California's recent plea for federal assistance has showed, the credit crisis has complicated access to capital, especially with governments traditionally relying on the low cost of borrowing. Even higher interest rates have not enticed investors to purchase some municipal bonds that state and local governments typically issue to pay for long-term capital projects, and to raise short-term cash at the start of the fiscal year before tax revenues

5 "State Expenditure Report 2006," National Association of State Budget Officers, December 2007.

flow in. Connecticut, for one, was forced to cancel a September 2008 bond sale after selling only $88 million of a more than $400-million offering. As it becomes harder and more expensive for government entities to issue debt, they are canceling projects, suspending payments to schools and threatening to lay off employees. Although as of the publication of this report, the public sector bond market appears to have stabilized, states are not out of the woods yet.

- The fall in prices of most commodities has led to all sorts of problems for states. Gas taxes have been particularly susceptible to the downturn and turmoil in the international oil market. As consumers have substantially cut their use of cars, revenue has dwindled, constraining funding for the federal Highway Trust Fund, which provides states with matching funds to pay for highway maintenance, and for some mass transit costs. In September 2008, the U.S. Department of Transportation was forced to defer payments from the fund to states—just as many were finishing their summer construction projects. Energy-producing states such as Alaska, Colorado, North Dakota, South Dakota, Texas, West Virginia and Wyoming, initially insulated from the economic downturn due to their production of valuable natural gas, grain or coal, were beginning to see severance tax revenues plummet as fourth-quarter 2008 drew to a close.

Growing Expenditures. For years, states have felt steady pressure to increase expenditures, from Medicaid and prisons to longer-term challenges driven by state employee pensions and backlogs in infrastructure spending. But when hard economic times hit, demands for social services, health care, and countercyclical economic and educational programs accelerate further.

The U.S. Government Accountability Office has suggested that providing health care is the primary driver of fiscal distress in states.[6] In addition to the potential crisis in Medicaid payments, many states have been taking on new costs by attempting to provide health insurance to the uninsured. According to the National Conference of State Legislatures, 36 states have considered, or are considering, legislation to cover uninsured children, and 19 states have considered, or will consider, some form of universal health care legislation in the 2008–2009 legislative sessions. After implementing a new health care plan, Massachusetts' percentage of uninsured citizens dropped to the lowest in the nation. But the $630 million price tag in its first year was $150 million higher than projected.

Health care costs also can factor into state budgets in ways most citizens do not realize. For example, despite a decline in its prison population, California's spending on corrections has grown faster than any other state, primarily due to the growth in health care costs by 210 percent since 2000.[7] (In addition, a federal judge took over the state's prison system in 2006 and has since ordered more than $8 billion in services and new construction in order to bring the system up to constitutional standards.)

States are beginning to understand that they have vastly underestimated maintenance costs for their existing roads, bridges and buildings. This is in addition to the fact that economic competitiveness will require carefully targeted new construction. South Carolina's state auditor found that funding would need to grow by $1 billion a year for 10 years to bring the state's roads up to standards, as opposed to the $200 million annually that legislators appropriated. Massachusetts will need $19 billion over 20 years.[8] The next Congress may reauthorize

6 "Health Care Cost Growth and Demographic Trends Drive the Long-Term Fiscal Challenge," U.S. Government Accountability Office, April 2008 Update.

7 Pew Center on the States report "One in One Hundred: Behind Bars in America," February 2008.

8 Pew Center on the States report "Grading the States 2008," *Governing* Magazine, March 2008.

funding for surface transportation improvements, but in the meantime, the federal government has encouraged states to look for creative financing, such as privatizing parts of their toll roads, as Indiana has done, to pay for transportation maintenance and infrastructure improvements.

> This report goes beyond the grades—painting a more detailed portrait of how state leaders are managing to the bottom line.

Then, too, as teachers and other public sector workers retire, they will begin to draw their state pensions. And states are falling behind on those obligations. As of 2006, states' long-term pension liability of $2.35 trillion was about 85 percent funded.[9] But as resource-strapped states contribute less and less of the required annual contribution, or use one-time cash flows such as bond sales to make their payments, that percentage will surely decline. The bad news from Wall Street means that state funds are losing value. The Federal Reserve System reports that state and local pension plans lost $300 billion between 2007 and 2008.[10] Connecticut's fund lost more than 11 percent of its value between June 2008 and October 2008. North Carolina lost 12 percent of its $78 billion pension fund during the year ending in September 2008—even before the stock market went into freefall the next month. Although well-invested funds typically recover their value after markets correct themselves, some states have struggled to move back to a 100-percent funding level after the last downturn—indicating, perhaps, that recovery was outpaced by increases in the costs of benefits, and in the number of beneficiaries.

Finally, states have been hard hit by the increased stress on local governments, which rely heavily on federal and state grants, along with their property tax levies, to fund education, safety, hospitals, sanitation, utilities and infrastructure. In addition to the loss of property tax revenue, some cities have seen housing foreclosures lead to steep increases in the costs of providing services to areas with high vacancies. Local governments' worsening struggles have forced some states to step in with a greater share of education funding and increased aid so that municipalities can maintain their services. For example, Pennsylvania has taken over four school districts, including those of Philadelphia and Harrisburg.

Creating a Road Map—and Using It to Make Tough Decisions. During the past two years, as part of its assessment of overall state government performance, the Pew Center on the States (PCS) conducted thousands of hours of interviews with a wide cross section of officials and analysts in all 50 states to evaluate state performance in the areas of people, money, information and infrastructure. That analysis resulted in all states receiving letter grades in each of the four areas. As the global, national and local fiscal crises continued to take their toll on state budgets and programs throughout 2008, Pew's Government Performance Project (GPP) deepened its examination of how some of the best-managed states have used performance information to strengthen budgeting decisions.

This report goes beyond those grades to paint a more detailed portrait of how bottom-line-oriented state leaders are using a variety of approaches to change how they manage budgets and programs in order to meet

9 Pew Center on the States report "Promises with a Price," December 2007.

10 Federal Reserve System, Flow of Funds Accounts of the United States, Table L. 119, "State and Local Government Employee Retirement Funds," September 18, 2008.

changing circumstances. They are setting statewide policy priorities, and then using that framework to review agency and programmatic missions, activities and goals. The cases also demonstrate how states are using tools that assess the performance of programs within a fiscally constrained environment to establish new priorities and target necessary reductions—while at the same time continuing to invest in initiatives that yield a return. Finally, this analysis provides glimpses of how leading states are moving to institutionalize and sustain a performance-driven approach to budgeting and management.

State leaders use a number of terms to describe their budgeting efforts: "incremental," "zero-based" and "program" budgeting. Whatever it's called, performance measurement has become a part of most states' budgeting processes. Thirty-nine states now include performance measures in agency budget requests, and 42 states report some level of performance measures online, according to the National Association of State Budget Officers. In addition to using data to measure results and chart progress toward targets, state leaders are deploying the information to manage their agencies and programs. Furthermore, 22 state legislatures

How the Executive and Legislative Branches Can Collaborate in Using Performance Information

Why use performance information? Performance information can provide newly elected legislators with helpful background on the purposes of state-funded programs and the results they achieve, argues Judy Zelio, former fiscal affairs program director at the National conference of State Legislatures, in a new report from the IBM Center for The Business of Government, "Five Actions to Enhance State Legislative Use of Performance Information."

"Performance information helps, for example, to explain the results of previous legislative funding decisions," Zelio explained. Such information provides a stronger basis for estimating and justifying the potential consequences of new funding decisions. Careful review of performance data can encourage deeper legislative understanding of agency activities—and in some cases may even garner additional support for them.

Zelio offered the following five steps to improve legislators' use of such information.

Five Actions to Enhance State Legislative Use of Performance Information

1. Performance information should emphasize policy results.
2. Both legislative and executive staff should agree on key measures.
3. Agencies should provide regular performance reports.
4. Agency performance reports must be useful, accurate, brief, clear and timely.
5. Agencies must make performance information easily accessible.

"The bottom line is that performance information helps communicate what is received in return for the investment of tax dollars," Zelio said, "which is a key budget responsibility of both the executive and the legislative branches to citizens."

reported using performance measures to varying degrees in their budget decision making, according to a 2007 survey of legislative fiscal offices for the IBM Center for The Business of Government. (See Sidebar: "How the Executive and Legislative Branches Can Collaborate in Using Performance Information.")

How Four States Continue to Deliver in Tough Times

Executive branch leaders in several states, however, have used recent budget pressures to push performance measurement and management to the next level. Leaders in those states are examining program performance and outcomes to assess investment trade-offs and make hard choices—gauging effectiveness and reducing or eliminating entire programs.

At the same time, they have been able to use data to target spending that will most effectively serve public needs and invest precious tax dollars in ways that generate the largest returns. Decision makers have thought strategically about how to use revenues in tough times, turning budget crises into opportunities to make their budgeting systems more effective. By investing in sound management, those states have charted a course between expanding programs and cutting spending.

Institutionalizing a results-based budgeting system can aid states during economic downturns by helping cut wasteful spending on programs that are not showing results, and freeing resources for programs that evidence has shown to be more effective. Such an approach also can provide lasting benefits, laying the foundation for a leaner, more effective government during the next economic upturn. Most important, it can provide a framework for considering the value of past investments, and determining the most prudent course of investments for the future.

Budgeting and managing for performance can inform resource-allocation discussions by showing what programs and policies have made progress toward measurable goals, and how much has been achieved for the public good. Although budget decisions eventually depend on a state's strategic aims and the political values of its policy makers, all stakeholders benefit from having clear data on which to base tough choices. Such information can help reduce the influence of lobbyists, cut down earmarks and pork-barrel spending, and provide clear explanations to all whom may be affected by budget cuts. As Maryland Governor Martin O'Malley has said, performance-based government management is "omni-partisan."

There is no way to know how much money states lose to mismanaged or underperforming programs. But those states that have begun implementing effective performance-driven budgeting have saved impressive amounts of money, and some in very short periods of time. Although their individual strategies vary, the states demonstrate common purpose in their approaches to performance-driven budgeting within a statewide policy framework. Each is focusing on:

- Following agency and programmatic missions and goals;
- Establishing priorities and assessing trade-offs;
- Targeting reductions with precision;
- Investing in initiatives that yield a return; and
- Attempting to institutionalize a culture of results-focused budgeting.

The examples in this report, based on programs implemented in Virginia, Utah, Maryland and Indiana, show the clear benefits of data-driven budgeting decisions to the bottom line, as well as on developing sound policies to achieve both short- and long-term state goals.

Virginia: Using Strategy to Reorder Priorities

A culture of evidence-based decision-making has enabled Virginia's leaders to systematically tackle the state's budget crisis and prepare for calculating agency productivity.

Virginia has a tough fiscal future: In FY09, it will face a $1.1 billion shortfall in its $32.5 billion general fund biennial budget—and the projected gap in FY10 is $1.8 billion.

That $2.9 billion gap follows $300 million in cuts for Fiscal Year 2008, as well as a $351.5 million emergency infusion from the state's rainy-day fund. The state made most of the cuts by improving efficiency: increasing teleconferencing to cut down on travel expenses, posting documents online instead of printing, cutting discretionary expenses such as new computers, and imposing hiring freezes. But Virginia has run out of stopgap measures.

"I think we've reached a point where we have nipped and tucked all we can," said Don Darr, associate director for budget operations for the Department of Planning and Budget. In December 2008, the commonwealth announced a plan to tackle its current $2.9 billion gap for the next biennium. Among other initiatives, Virginia will move $490 million more from the rainy-day fund, and undertake $1.1 billion in targeted cuts to low-performing programs. "Instead of weakening a whole agency, we need to focus on those areas that are low-hanging fruit," Darr said.

TARGETING STRATEGICALLY

The administration has already had some success with strategically targeted cuts. To achieve the FY08 reductions, agencies submitted recommendations based on measures included in the commonwealth's performance measurement system, Virginia Performs, which tracks some 1,500 data elements. The Department of Aging, for example, proposed some $78,000 in cuts to grants to community organizations that measures showed were underperforming in delivering home care to the elderly.

> "It's very important as you develop and use systems of measurement to know what they can and can't do."
>
> —Jane Kusiak, director, Council on Virginia's Future

The biggest targeted savings were realized in the Department of Human Resource Management, which saved $3.2 million by canceling a contract for a wellness program that had not reached its target for employee participation. In fall 2008, the department began piloting a much less-expensive wellness outreach initiative. Instead of an outside contractor soliciting participation, employees encourage colleagues to take part.

Among other measures, the Department of Corrections replaced private food service contracts at several prisons when data showed that the services could be provided more cheaply in-house—$3.28 per inmate per day versus $3.68 per inmate per day—for a total annual savings of $851,000.

The Virginia Performs system also has laid the foundation for greater continuity in Virginia's fiscal and policy

decision making—important in a state with a one-term limit on governors. "I think it's very important as you develop and use systems of measurement to know what they can and can't do," said Jane Kusiak, director of the Council on Virginia's Future, a public-private commission launched in 2003 by former Governor Mark Warner. "They can help diagnose something, but they can't tell you what to do about the problem." After all, she said, it is useless to track data unless you set the proper goals and strategies in the first place.

For example, she said, the state could chart progress on the immunization of children, but it takes political will and community commitment to reach such a complex and important public health goal. And after a goal is established, fiscal decision makers must determine what programs will best meet that goal. Public health officials can stock supplies of vaccines, for example, but without a campaign to convince parents to have their children immunized, the doses will merely sit on shelves. "Frankly, performance budgeting is the beginning of the dialogue, but it certainly doesn't lead you to the solutions," Kusiak said. Where it can be useful, she said, is in comparing the relative benefits of several programs towards reaching a goal. "It allows you to put them side by side and make a meaningful decision about funding. It can be very profound in helping to determine whether the strategies we have employed have made a difference."

At the same time that the Virginia Performs system has supported targeted budget reductions, it also has been crucial in supporting increased investments in certain programs that have been shown to be cost-effective. A good example is the expansion of state-funded prekindergarten, a priority of the governor in the 2008 legislative session as a proven means of reducing law enforcement and social services costs in the long term. To determine whether the $60 million the state pays annually has actually led to better school achievement, legislators commissioned an audit report to analyze the program's impact. Among other findings, data showed that at-risk children who had participated in state preschool passed kindergarten literacy tests at rates 4 percent to 5 percent higher than those who had not.

The study was an important factor in the approval of an additional $22 million for the program, according to prekindergarten advocate John Morgan of Voices for Virginia's Children. "It has been an important arrow in the quiver," he said. "It says that the Virginia Preschool Initiative has been doing a good job, and [has] given the program more credibility among some legislators who were on the fence." To continue to judge the impact, however, the Department of Education has instituted more performance measures to determine whether the gains made by those children in kindergarten continue in later grades.

Data were also critical to approving increased funding for the state's foster care system, which had been one of the lowest funded systems in the country. Researchers from the Annie E. Casey Foundation found that 24 percent of the state's foster care placements were in group home settings, compared with a national average of 10 percent. Heeding national data indicating that private family placements are less expensive and more effective, the legislature changed the funding formula to allocate more state dollars to private placements. "It was an unpopular decision for facilities that provide congregant care," said Health and Human Services Deputy Secretary Heidi Dix. "And it was unpopular with communities who don't have community providers and systems in place, who now feel like they are being penalized."

At the same time, a bipartisan legislative push boosted the money paid foster care families by 32 percent to approach the national average—a $40 million increase. A legislative district scorecard helped make the case. The Council on Virginia's Future provided each member of the General Assembly with data comparing the

localities in his or her district with 15 statewide data variables, ranging from unemployment to high school graduation rates, which showed how each district compared statewide. Those scorecards, Kusiak said, were instrumental not only in showing how the foster care numbers compared unfavorably with nationwide numbers, but also correlating those numbers with the increased stress from other issues such as poverty, crime and teen pregnancy. "If you have a high percentage of people in your community who are struggling or at-risk, many times they have more than one challenge," Kusiak said. "Showing community performance and the national and state averages not only allows legislators to understand where they are weak or strong, but also

VIRGINIA

Up Next: Measuring Productivity

The popularity of performance measures is exceeded only by the difficulty of developing meaningful ones. But Virginia is carefully undertaking various efforts to determine the fastest, most effective way to provide services and benefits to citizens.

The goal of the overall effort is providing incentives to improve performance—not punishing agencies that are not achieving progress. The key, said Jane Kusiak, director of the Council on Virginia's Future, is how the measures are put into practice. "The progress we will make is inextricably linked to how leadership applies these measures, and whether they use them as a stick or a carrot. Done right, I think it elevates everyone's perspective."

"Basically we are looking at units produced versus cost," said Don Darr of the Department of Planning and Budget. The Department of Motor Vehicles, for example, will track a measure showing the cost of issuing a license—including the differential costs of applying in person, by mail or through the state's Web site. Not only will the agency be able to track progress towards reducing costs and setting fees at the right level to cover those costs, but it also can help define the most cost-effective way to achieve specific programmatic goals.

In another effort, the Department of Medical Assistance Services will gauge the cost of processing medical claims by dividing the total processing cost by the number of claims—also sorting by processing method such as paper, electronic or Web-based. Other agencies will start by measuring a single core function. The Department of Mines, Minerals and Energy, for example, will measure the cost to prevent negative environmental effects from its sites, dividing the total cost of prevention by the number of sites. The first data reports were due in January 2009, so that interested stakeholders, as well as the general public, can monitor the cost performance of agencies.

Virginia hopes the new data will allow it to expand its efforts in activity-based costing: developing meaningful definitions of activities; establishing databases that consolidate and analyze information; monitoring and adjusting performance indicators; and providing timely, understandable reports to all stakeholders.

Those are ambitious goals, and attaining them will be extremely difficult. But the commonwealth's economic downturn, coupled with personnel and program-funding cuts, make the effort essential.

to see how these different factors relate to one another within the community."

The state is now taking a big new step toward cost effectiveness and operational transparency by developing measures of productivity in each executive agency. (See Sidebar: "Up Next: Measuring Productivity.")

Utah: Refocusing on Mission and Metrics

Utah's leaders are refocusing on agency missions and metrics to manage toward a new bottom line.

Most newly elected governors appoint a transition team, one that helps shape the governor's policy priorities and scout for talented managers. By inauguration day, those teams have usually submitted a thick report, have posed for a photograph with the new governor and have returned to their daily lives.

But Utah Governor Jon Huntsman's team never left.

In 2004, that team was charged with developing objective measures to gauge performance of a few key agencies. Quickly, however, its charge expanded to include all agencies, using a "balanced scorecard" system, a strategic planning instrument developed at Harvard Business School. Eventually, the group evolved into the Utah Policy Partnership (UPP), which still regularly meets with the governor on areas of policy and government efficiency. The scorecard measures, meanwhile, have been institutionalized through the Utah Performance Elevated Initiative of the Governor's Office of Planning and Budget (GOPB), which uses them to more effectively manage agencies, and ensure that budgets are put to productive use for the public.

The Governor's Office of Economic Development (GOED), for example, recently cut a $300,000 program to help businesses recruit employees when it could not show any measurable successes. The program employed two full-time staff people to advise businesses on finding employees, but other than a few dozen hits to the initiative's Web site, did not show significant results. "Most of our companies were not looking for someone to tell them Monster.com is a good place to look for people," said Agency Head Jason Perry. "They wanted access to pools of talent."

During a six month period, Perry cut the program and returned $178,000 to the state's general fund. He also redirected the remaining savings to other programs in the department, including a one-time $20,000 investment to launch a new approach to online recruitment. The initiative has encouraged former Utah residents willing to move back to the state to post their resumes online, where they can be accessed by 120 participating companies. The new Web site averages 1,000 unique users a week, and has gathered 1,500 resumes. "That's 1,500 resumes we didn't have under [the old program]," said Clark Caras, GOED's director of marketing. In addition, companies can pay a fee to access to another 16,000 resumes collected by the state's university alumni associations. As of November 2008, participating companies were accessing an average of 90 resumes per week.

In new guidelines to agencies for FY08, GOPB required that any new request for more than $100,000, or that required one full-time equivalent position, come with a performance metric to justify it. The next phase of the system is to get the legislature on board during budget negotiations—a goal UPP has had since its inception. "We didn't want to create one set of metrics internally and another set for the legislature," said John Nixon, executive director of GOPB. Although the legislature did adopt the metrics, using them in decision making is a tall order. "I don't think there will be a wholesale buy-in from

the beginning," said Senate Finance Committee Chair Lyle Hillyard. "The governor's staff has one boss, and the legislative office has 104 bosses."

But there is at least some evidence to suggest that that the governor and legislature can indeed achieve consensus on evidence-based decisions. Although revenues from the booming energy sector have meant Utah's fiscal position is stronger than those of many other states, the state did anticipate some economic turbulence. In the summer of 2008, as insurance against a downturn, the governor's budget office directed each agency to use scorecard indicators to craft a range of budget-cut proposals with reduction targets of 1 percent, 3 percent and 5 percent.

MISSION-DRIVEN DECISIONS

Indeed, Utah's September 2008 revenue and spending estimates pointed to an $81 million shortfall for the last fiscal year—and projected an additional $272 million gap for FY09 on a total state-funded budget of $5.3 billion. When the governor convened a special legislative session that month to rebalance the budget, those plans were used to make the $354 million in cuts in two days with a minimum of political infighting—and without tapping the state's rainy-day fund. Rather than across-the-board cuts, the state targeted cuts by agency, with the bulk falling on health and human services.

"I have a universe of 75 programs," said Lisa-Michele Church, executive director of the Utah Department of Human Services, "and I make the value judgment that I am not going to do across-the-board cuts, so I protect some programs and cut others. The metrics are the basis of making those decisions." Specifically, Church looked at which programs were directly supporting the agency's mission of protecting the immediate health and safety needs of fam ilies and children.

For example, the number of foster children re-entering the system within 12 months after leaving foster care was above the national average of 8 percent. Church's call was to preserve funding for foster care programs in order to improve the stability and safety of those children. On the other hand, a $520,000 juvenile justice program to transition juvenile offenders back to their communities was cut because it did not reduce participants' recidivism rates.

Funding was also suspended for a $987,000 program to provide counseling to families on the waiting list for services for developmentally disabled children. "It is a good idea, but it is hard to quantify, and it doesn't meet the criteria of providing for immediate health and safety risks," she said. Neither was the program achieving its stated goal of reducing waiting lists. "Good ideas don't get funded unless they have outcomes."

> "Good ideas don't get funded unless they have outcomes."
>
> —Lisa-Michelle Church,
> executive director,
> Utah Department of Human Services

One change that did not require legislative approval stemmed from a target Governor Huntsman set: a 20 percent reduction in state offices' energy consumption by 2015. To meet that goal, the state took a radical approach: Starting in August 2008, most state offices began closing one day a week. (See Sidebar: "A Shift in Time and Energy.")

UTAH

A Shift in Time and Energy

Utah may depend on the energy sector more than the average state, but that has not stopped it from becoming a leader in energy conservation—both to combat climate change and to save money. Governor Huntsman's challenge to reduce state government's energy usage 20 percent by 2015 has led to a radical approach: having many state offices open four days a week, for 10 hours each day.

Since August 2008, most agencies have staffed their offices between 7 a.m. and 6 p.m., Monday through Thursday. (A few departments, such as public education and corrections, are exempt.) Besides the $3 million (in current dollars) the state expects to save in energy costs, it also estimates employees will save $6 million annually in commuting costs. There are other benefits as well. "Energy was the primary driver, but when you look at the total impact, it solved a number of problems," said Mike Hansen, the strategic planning manager in GOPB, who points to potential benefits in recruiting for critical positions such as transportation engineers, as well as to decreases in traffic—not to mention that residents can now secure services before and after their own workdays.

All those measures will be monitored. To gauge energy consumption, managers are using an online portfolio manager created by the U.S. Environmental Protection Agency, which uses national weather data to compare energy usage based on consumption and square footage. Managers are already inputting information for the last two years as a baseline to track potential savings. In addition, the program ranks buildings for efficiency on a scale of 1 to 100, so the state will be able to identify which buildings use the most energy, and thus target maintenance dollars more effectively.

Of course, the program has faced challenges from both employees and the public. Though an initial survey showed that most employees felt positively about the change, 21 percent viewed it negatively—and 7.5 percent indicated that they will look for jobs outside state government. "Any change is going to be disruptive," Hansen said, "but we are absolutely convinced that when we do the final survey those numbers will improve."

To alert citizens to the change, officials posted signs at government offices; produced public service ads for radio, TV and newspapers; sent mailings and e-mail to citizens; and even provided coffee and doughnuts outside of some offices the first morning of the closings. Nonetheless, initial media coverage focused on disgruntled citizens angry that the Department of Motor Vehicles was now open only four days a week, and several state senate leaders came out against the change after complaints from their constituents.

If the launch was rocky, however, the metrics already show some early benefits. After one month, energy usage in some buildings had dropped by 9 percent. And surprisingly, total employee sick day and annual leave usage dropped 9 percent from the same period the prior year.

Meanwhile, the number of citizen complaints to the Governor's Office of Constituent Services has dropped significantly after an initial spike. A state survey in September 2008 found citizen satisfaction to be 4.3 out of 5. Even the Department of Transportation received only eight complaints in September about the new schedule—out of more than 2,500 calls. The change is being closely watched by several other states, including Maine and Washington State, which recently implemented "4x10" work weeks as a pilot program at a few key agencies.

Maryland: Leveraging Change Through the Power of Data

Maryland's leaders shine a twice-monthly spotlight on agency performance—and are using that information to shift policy priorities in the current crisis.

Maryland Governor Martin O'Malley believes in the power of data. As mayor of Baltimore, he created CitiStat, a data management program that uses spreadsheets to track city activities from murder rates to potholes. He employed that information to challenge department heads to improve their performance, and to locate inefficiencies in their agencies. In its first six years, the program both improved city services, and generated an estimated $350 million in savings. It received the Innovations in American Government Award from Harvard University, and sparked similar programs around the world. It is not surprising, then, that when he took the reins as governor in 2007, Governor O'Malley immediately set out to recreate the success on a state level with StateStat.

Like CitiStat, the program has not only helped improve agency performance, but has also helped save the state money. Starting with a few pilot agencies, StateStat analysts have now brought their spreadsheets to bear on 10 major departments, including corrections, health, housing and transportation. Every two weeks, the StateStat team holds a 90-minute meeting where data are dissected, and agency heads are grilled by the governor's chief of staff, or sometimes the governor himself, on their performance. "We have a set of outcomes we are looking to reach, and we do relentless follow-up to make sure those outcomes are being met," said StateStat Director Beth Blauer.

"Budget decision making is never easy," said Blauer, who first encountered StateStat when she was chief of staff in the Department of Juvenile Services. "To have the governor's staff saying we are going to base these decisions on reliable data makes a huge impact. It's not like budget time comes and you have to school the governor's staff about how the agency works." As one example, Blauer cites a moment in her first StateStat meeting with Juvenile Services, in which the governor quizzed the agency head about excessive overtime numbers for a single employee at a specific institution. "I can't tell you how quickly change happened in the first six months," she said. "I saw things change in the agency that we had been trying to change for 10 years."

Because StateStat had its finger on the pulse of agency performance, it was called to make recommendations in the fall of 2008, when declining revenues forced the state to cut nearly $300 million from its general fund. In addition to pinpointing some budget-cut basics—eliminating staff vacancies and 40 filled positions, and closely managing the state's vehicle fleet, for more than $27 million in savings—other StateStat-informed trims were achieved through consolidating operations ranging from public affairs to print shops.

Programmatically, the StateStat team was able to recommend closing a juvenile justice facility that was operating under its capacity—and begin serving families in communities more cost-effectively. Though it had space for 80 youths, it could safely serve only between 30 and 40. The state closed the center, saving $1.5 million. Of that money, $600,000 was transferred to less expensive community-based programs for 100 youth (more than doubling those served), using national evidence-based research that shows family therapy and educational support to be more effective than incarceration with the target population.

REDIRECTING RESOURCES

Of course, like the other states in this report, Maryland continues to face budget challenges; revenue forecasts predict more than a $1 billion shortfall for FY10, which will lead to another round of cuts. As a spokesman for the governor recently said: "There's no more fat left to trim. Any more cuts that need to occur . . . are going to be trimming into flesh, and those are painful for everyone involved." But because StateStat is constantly monitoring agency performance, it can be instrumental not only in suggesting inevitable cuts, but also in helping agencies use the scarce funds they do have more wisely.

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>
> —Beth Blauer, director, StateStat

Such was the case in 2007 with BayStat, which monitors the health of the Chesapeake Bay. It helped the Department of Natural Resources better target purchases of conservation land, which have been funded in part by a dedicated fund generated from real estate transfer taxes.

As housing sales fell, the fund plummeted from $110 million to $37 million annually between Fiscal Year 2007 and FY09. Using a complex network of databases, officials scored every piece of public land in the state on factors including water quality and species habitat. In FY08, 84 percent of land acquired was scored as a "high-priority conservation area." BayStat also helped better use the state's $25 million Chesapeake Bay Trust Fund by targeting planting of cover crops to prevent runoff of nitrogen and other nutrients into the bay.

"In the past, the mantra has been we are going to offer the same deal to every community," said Dave Nemazie of the University of Maryland Center for Environmental Science (UMCES). "Now we are saying we are going to target the regions where the most nutrients are coming from." It is too soon to fully gauge the effect of these efforts—measurable results may take years. But at least one indicator of the bay's health is moving in a positive direction: On UMCES's 2007 annual water quality report card (released in April 2008) the bay rose in grade from a D+ to a C-.

Indiana: Organizing for the Long Term

Indiana's leaders started using performance information to temper spending before the downturn—and are working to institutionalize the management-focused approach.

It is difficult to use data to make budget decisions if there is not much data. Governor Mitch Daniels faced that situation when he took office in 2005, promising to implement more accountability in spending. At that time, Indiana had not balanced a budget in seven years, and had a $700 million backlog of payments due to local government and schools.

"Demanding proof that government programs work, before spending additional taxpayer money on them, must become standard operating procedure," said Daniels, who had been director of the U.S. Office of Management and Budget and an executive at Eli Lilly. One of his first acts as governor was to create a new state Office of Management and Budget to focus on government performance. "What we found was that Indiana didn't measure much of anything," said Cris Johnston, executive director of government efficiency and financial planning. A review of more than 400 programs revealed that less than half of them had any performance measures at all—let alone data linked to broader agency goals.

The office mandated the creation of outcome measures that would chart long-term progress toward goals, judging them by both progress from baseline levels and comparisons to other states' achievements. For each measure, agencies established two target ranges: one for a "satisfactory" level of performance where goals are being met; and another for a "superior" level of performance where goals are being exceeded.

Although budget officials admit that the system is still a work in progress, in just three years, it has achieved impressive results. In 2005, 62 percent of results were in the "unsatisfactory" range, whereas 22 percent were "satisfactory" and 16 percent were "superior." In the latest performance report for 2008, however, only 28 percent were unsatisfactory, with 27 percent satisfactory, and a full 45 percent superior.

The state developed enough data to influence negotiations on the 2007-2009 biennial budget. Rather than "performance-based budgeting," Deputy Budget Director Adam Horst prefers the term "performance-informed budgeting," to show that data set the context for discussion, not force outcomes. "We might have programs that are performing well but can be operated more efficiently," he said. "Or we might have programs that are doing poorly, but we think they can do better with an increased budget."

TARGETING STRATEGICALLY

The latter was the case for the Indiana Department of Child Services, which was performing abysmally on nearly all relevant indicators compared to national norms. The state was far below average in collection of child support, investigation of abuses, instances of repeated abuse and ratio of case workers to children. To improve the safety of Indiana's most vulnerable children, state policy makers aimed to reduce case loads to the national recommended average of "12/17"—12 new monthly investigations and 17 ongoing child cases—per social worker. To accomplish that, the administration and legislature doubled the number of case workers—from 800 to 1600 statewide—accompanied by a $50 million budget increase phased in from Fiscal Years 2006 through 2009.

Although it is too soon to gauge long-term outcomes, the investments appear to be having an effect. The state already has jumped into the "superior" range in the percentage of counties meeting the national 12/17 standard: 100 percent compared with 13 percent in 2006.

On the critical measure of re-abuse of children with a prior history of substantiated abuse, the state met its goal of raising the share of children who remained safe for 12 months from 85 percent to 87 percent—reflecting an increase of more than 150 abused children statewide who remained safe during that period. The state is tracking those indicators on a county-by-county basis as well.

In targeting cuts, Indiana looked first at programs that simply could not demonstrate measurable progress toward identified policy goals. A $600,000-a-year program at the Indiana State Library to give grants to local and county libraries, for example, was cut because the grants –between $200 and $20,000–formed a small part of individual library budgets, said Johnston, providing little impact or improved service. Another $900,000 program for "value-added research" at the Indiana State Department of Agriculture was cut because the statutory language was so broad that funding for practically anything could be justified.

The state's Area Health Education Centers, originally part of a nationwide federally funded effort to encourage health care professionals to train and practice in underserved areas, were slated to shift to general fund support in FY08; an initial $1.3 million general fund annual allocation was projected to rise to $4.5 million a year by 2014. Yet, since the program's inception, the percentage of Indiana University medical students pursuing residencies in primary care had fallen, whereas the percentage of counties federally designated as underserved had risen.

"A big part of the program was to convince elementary school students to become doctors. At what point is that pipeline going to pay off?" Horst asked. After long discussions with program managers, an agreement was struck on a budget reduction of more than half—with a new effort to track progress toward intermediate goals. The state will monitor the rate of participation in post-secondary school health training programs of people from disadvantaged backgrounds who significantly take part in clinic activities, for example, and will determine the percentage of health-career students who take part in some clinic programs and who choose to serve in underserved areas, compared with those without exposure.

> "Demanding proof that government programs work, before spending additional taxpayer money on them, must become standard operating procedure."
>
> —Indiana Governor Mitch Daniels

Although Indiana was just beginning negotiations for its 2009-2011 biennial budget in November 2008, it was in better shape than many states, with a balanced budget and $1.4 billion in total reserves. Its fiscal stewardship recently earned Indiana its first AAA rating from Standard & Poor's in July 2008—a distinction shared by just nine other states. Horst attributes the state's relative financial health to its containment of spending to less than 3 percent during the last three years.

Indiana's budget restraint stands in sharp contrast to average state general fund increases estimated in the 8 percent to 9 percent range in FY06 and FY07—with some states' spending increases soaring into double digits, according to the National Association of State Budget Officers. "All states will be feeling the pain of the current economic conditions," Horst said. "We're hopeful that Indiana's new pattern of spending restraint and replenished reserves will position us to better manage through this time than if we hadn't done so."

Building on the success of the performance budgeting system, Indiana agencies are now identifying performance measures along with line items in their budget request, not merely in a separate document, or on a Web site. One goal: using the budget plan as a management tool, facilitating mid-year budget adjustments as needed.

"The real question is, 'How do you institutionalize this so it doesn't matter who's in charge?' This is just what you do," Horst said. To hasten that day, the budget office raised the bar in 2008: "We said don't bother submitting your budget if you don't have measures. I was surprised that the response rate skyrocketed," Horst said. "Everyone had measures." Administration officials are heartened by program managers' newfound understanding that each new initiative will require a clear goal—and measurable results.

Putting It All Together

States that succeed in navigating these perilous times will be those that combine short-term strategies to balance their budgets with long-term fiscal and management investments to serve vital public needs and position themselves for the future.

Although this report details best practices, it does not suggest that achieving a state's budget goals is easy. The cuts to public services forced by financial crises can bring out anger and resentment and exacerbate political partisanship—all of which can lead to fiscal gridlock.

States That Are Struggling

Since November 2008, New York Governor David Paterson has proposed a series of budget changes to address a rapidly-shifting Fiscal Year 2009-10 budget shortfall currently estimated in excess of $13 billion. To date the State Assembly has refused to act, and appears to be offering none of its own solutions.

California, too, is struggling with how to tackle a cumulative FY 2009-10 budget shortfall that could reach more than $40 billion. The controller's office warns that the state could run out of money in a matter of months. The state has halted major highway construction projects and the governor ordered furloughs for state employees just before Christmas. The executive and legislative branches again have been stuck since Governor Schwarzenegger vetoed legislative budget in December 2008.

The California logjam will be especially difficult to break. All the choices are difficult: raise the sales tax, cut educational and other social-program funding, or eliminate some tax credits and exemptions, among other equally tough proposals. One ray of hope: Over the past year a consortium of foundations has banded together to launch a new nonpartisan campaign, California Forward (with which Pew Center on the States has collaborated), to cut through the morass, warning in a series of town hall meetings across the state of "the structural cracks in California's fiscal system."

In a January 2009 special session Florida's lawmakers patched a $2.4 billion dollar hole in the state budget through an almost straight party-line vote that raided trust funds and slashed agency budgets—including a $466 million cut to education. But the state's unfortunate confluence of increased home foreclosures, a significant fall in tourism, a rise in unemployment and Medicaid claims, and an increase in both incarceration costs and community college enrollments continues to take its toll. Lawmakers will return to session in March 2009 facing a fresh FY10 shortfall estimated at $3.3 billion.

Although leaders in other states may breathe a sigh of relief that their fiscal problems are not as severe as those of New York, California and Florida, no state will escape the current downturn unscathed. But fiscal crises can be a crucible for forging clearer decision making focused sharply on achieving maximum results for every precious tax dollar spent.

To be sure, there are plenty of obstacles to successfully negotiating a performance-driven approach to calibrating difficult policy trade-offs—politics, special interests, citizens' service demands and simple inertia. But none of those impediments, however real, is an excuse for not taking full advantage of the innovative practices that some states are putting to effective use.

Three Steps Your State Can Take to Strengthen Decisions and Management

Considering performance-driven budgeting as a short checklist can be useful, as long as policy makers remember that the process is fluid. Statewide strategic goals, agency missions and policy priorities change. Well-regarded programs outlive their usefulness, meaningful measures may become less so and technology advances. The following guidelines should be carefully adapted to conditions in each state.

Assess Your State's Unique Characteristics to Build a Long-term Strategic Framework.

Leaders in each state must determine their priorities based on the state's demographics, desires and dollars. Reliable economic and revenue projections—although especially difficult in today's uncertain environment—are the foundation for a state's fiscal health.

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Armed with a clearer understanding of their fiscal and economic outlook, policy makers can outline broad policy goals that match the needs of people in their state. The immediate goals of a state with high unemployment will be different from those of a state with low unemployment, for example. Similarly, a state with younger residents may focus on educational programs, whereas states with older residents may need to devote more resources to health care. Within its existing constraints, each state must decide what it must do first, and what it can put off. But each state should plan for its long-term fiscal future—not merely react to the current crisis.

Refocus Agency Missions and Measures.

Clarifying a public organization's mission in serving the public's interest is one of the most important and challenging foundations to improving performance outcomes and getting the most for every tax

dollar spent. In some states, well-intentioned but uncoordinated policy moves have led to a web of sometimes conflicting organizational purposes that have accumulated throughout years or even decades. Today's challenging environment provides a unique opportunity to take a fresh look at agency missions: How can each agency best organize itself to contribute to the state's long-term strategic goals?

> Measuring what really matters in terms of outcomes can significantly improve the quality of policy debates.

Then, in support of that agency mission, what key indicators will tell decision makers whether a given program is meeting solid, measurable goals in support of that mission? As the Indiana experience shows, each agency and program should strive to develop outcome measures that chart long-term progress toward goals, with targeted performance levels for each measure.

This work is enormously challenging. Everyone involved must understand the reasons for undertaking the time-consuming task of amassing information, and using it to make difficult decisions. We all must realize that, painful as its inception may be, performance-driven decision making pays off for everyone.

Use the Information to Engage the Public Around New Priorities.

With missions, goals and measures in place, executive and legislative leaders will be in a stronger position to engage one another—and the public—in a focused discussion of difficult fiscal and policy trade-offs. Measuring what really matters in terms of outcomes can significantly improve the quality of policy debates. And making data-driven decisions that are shared with the public in clear, easy-to-understand terms—as Virginia and Washington State are doing—can help bolster the legitimacy of the final resolution.

The current climate offers some hope for change. Because all state leaders will be held accountable for the economic woes, the shared responsibility can be used to craft solutions.

Each of the four states showcased here demonstrates that a degree of courage and calculated risk is essential to successfully making these important changes. If the goal is to cut a state's energy budget, it will take more than requesting employees to turn off their computers at night. As Utah found, it will require energy audits that link to repair and maintenance of capital assets—and perhaps even changes in service delivery. And some long-term expenditure reduction goals, such as saving money on state purchases of goods and services, may require new investments in information technology and staff capacity to analyze and temper state spending patterns.

Above all, each of these states' leaders has persevered, and in Virginia's case, across several administrations. Although each of the efforts met significant resistance at various points, leaders stayed the course, adjusting measures that did not work, collaborating with legislators and agency heads to grasp the importance of their efforts, and clearly demonstrating how the efforts would yield results.

In today's environment, policy makers must say goodbye to the idea that programs should be funded simply because they have always been, and to the idea that in a fiscal crisis all new expenditures are off the table.

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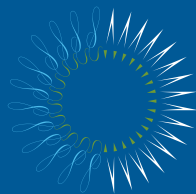
The Government Performance Project improves service to the public by strengthening government policy and performance. The Project evaluates how well states manage employees, budgets and finance, information and infrastructure. A focus on these critical areas helps ensure that states' policy decisions and practices actually deliver their intended outcomes.



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