

# PRIORITY-BASED BUDGETING

We recommend that legislature move to a “priority-based budgeting” system. It is crucial that the structure for setting a State budget more closely conform to the reality of expected income, not only for the ensuing year but well into the future. Washington State adopted this type of budget reform, and is now being employed in New Jersey to deal with a budget crisis.

The process of creating a budget also might be modified to evolve the current system to one that works somewhat differently. The role of 94 legislators should expand while the process provides more direct input to the Joint Budget Committee (JBC).

The move to performance-based budgeting is not a partisan issue. For years the Democrat Leadership Council actively has lobbied its members to embrace outcome-based budgeting:

*That citizens want value for their money is no mystery. We all want as much value as we can get from each dollar we spend—including what we spent on government. The price and value of government are up against the price and value of housing, food, clothing, health care and countless other goods and services that meet people’s needs. The price of government is limited, therefore, by the value that citizens want—and get—from government, compared with the value they want and get elsewhere.*

*Government can compete—and stay relevant—only by delivering more value per dollar. But the only way to accomplish this is to reinvent the way we do the public’s business. Our public institutions must learn to work harder, but more important, they must learn to work smarter.<sup>1</sup>*

In 2010, conditions of several states are objectively worse than the balance of the states: California, New York, New Jersey and Michigan are among those most frequently identified. In his first year in office, Governor Chris Christie has forcefully led the charge to fix the perceived problem in New Jersey rather than follow the poor examples being set elsewhere. While California is issuing I.O.U.s due to running out of funds<sup>2</sup>, New Jersey is addressing the problem with priority based budgeting. It should be noted that the four worse-case examples are states that have respectively the 6th, 2nd, 1st and 27th highest state and local combined tax burdens.<sup>3</sup> Collecting more taxes does not shield a state from budgetary woes, and counter-intuitively, even appears to exacerbate them.

Regardless of the mechanism through which priority-based budgeting is implemented, this change will require a new way of thinking that breaks the traditional mold of business-as-usual budgeting.

- a. Each program currently begins on a relatively equal footing simply because it was funded in the previous year. A small program that helps few people, or might be nearly incapable of reaching its goals, is afforded the same time and focus as one of the programs that make up the largest and most central of government responsibilities. A new system would deal first and foremost with the core functions.
- b. Programs would have to change from defending their costs, expenses or inputs, and would instead be defended by the extent to which stated outcomes are fulfilled. The JBC holds hearings with the cabinet officers for each department, and

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detailed discussions can focus on specific line items within a program budget. The process is long and involved, but frequently misses the bigger picture. This important description of the current process is addressed in detail on page 23.

- c. Many more clear choices and trade-offs would be available to legislators, who then would be able to concentrate on how their decisions impact taxes and spending. They will be able to address such questions as: “Is it better to perform a program with lackluster support in order to add another program, or is it better to finance the more-highly desired program at the full level, even if it means ending or not starting another program?” There undoubtedly will be different conclusions reached at different times on trade-offs such as these, but the recommended system likely would give focus to the real costs of legislative choices.
- d. The present system lacks priorities. The recommended system would provide them.

Colorado’s legislative branch, with support, cooperation and collaboration of the executive branch, would need to answer questions based on Washington’s model:

### **Question #1. What is the forecasted revenue for the next budget cycle?**

The expected revenues, as limited by the Constitution, establish the outer bounds of what can be spent. A small reserve to handle fluctuations must exist, too.

### **Question #2. What are the essential services the state must deliver to citizens?**

What should state government do, and in what priority? Colorado’s elected leaders should develop a meaningful set of core government principles. All existing programs should fit within one of the core functions, or they should be abolished. For each core function measurable outcomes should be

identified and agency activities prioritized.

After core functions are identified, legislators prioritize activities within these functions to deliver the expected outcomes. Otherwise, state budgets resemble an iceberg, with decades worth of spending unseen and unexamined under the water, while the debate rages year after year over the small part that sticks out of the water. The longer state lawmakers continue to use the cost-plus model, the more “hardwired” their funding problems will become.

Taxpayers understand priority-based budgeting is the better way of doing business, but elected officials who urge its acceptance must explain the process in simple, compelling terms: If Colorado families and businesses must set priorities and live within their means, then state government can be expected to do the same. This new type of budgeting protects the programs deemed most important from budget cuts. It holds agency directors responsible for spending taxpayers’ dollars in the best way possible to deliver the best services possible. It protects vulnerable programs from election-year rhetoric. The worst solution is to absorb ever-more taxpayer dollars but not to deliver proportional improvements.

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**Question #3. How will the state measure its progress in accomplishing those goals?**

As priorities are established, elected leaders develop measureable outcomes for each of the identified core functions. Then, agency programs can be prioritized further, based on how effectively and efficiently each will help meet the goals. A priority-based system must include these indicators of success; and delivery of desired services *must* be measurable.

**Question #4. What is the most effective way to accomplish the state's goals with the funds available?**

The first three questions in performance-based budgeting are about developing meaningful and measurable goals. This question, by contrast, is about using market forces and competition to deliver those goals effectively and efficiently without compromising cost and quality.

To make this process functional, each state agency should develop what it believes to be its mission as established by law. Once its mission is defined, the agency must outline the goals and objectives necessary to accomplish it. Each activity should be categorized as high, medium, or low priority, and performance indicators should be identified. The agency's budget request should reflect those priorities and guidelines. At the point

where agencies complete an analysis of mission and goals, the legislature steps into action. It is the role of the legislature to review, and ultimately determine, the proper mission, objectives, and performance indicators for all agencies under their jurisdiction in order to determine whether or not they comply with the core functions of government adopted in the joint resolution.

This step leads directly to legislators debating the "make or buy" issue. By following this budget process, a government "buy list" is created, directing the discussion away from "cuts" to instead what outcomes are being purchased. Performance-based budgeting provides a logical process for measuring the activities of government against desired performance outcomes and using that as a tool to make decisions accordingly. This budget process also greatly increases spending efficiency and economy.

As described by a 1995 Evergreen Freedom Foundation report, Washington State instituted the process in 1981 when the Department of Social and Health Services was faced with the necessity of recommending real cuts:

*Top managers decided to highlight 40% of the SDHS budget in a 'visible bank' of potential cuts. They used a three-point prioritization program to determine where the cuts should be made.*

*Managers defined the mission for each program, prioritizing major components. These priorities established the guidelines and criteria for budget-cutting decisions. Cuts in 'priority three' services were generally acceptable. 'Priority two' cuts would reduce the department's effectiveness and 'priority one' cuts would destroy its purpose.<sup>4</sup>*

At the margin, government leaders will be able to show they have been able to fund the most important functions. If those leaders wish to implore citizens to buy more public goods rather than keep

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the funds in the hands of families, it will be clear what the trade-offs are. It is important that the structure reinforces the selection of the most important functions.

## WASHINGTON STATE

The original full development and implementation of priority-based budgeting occurred in Washington State in response to the

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need to close a large budget hole in 2002. Democratic Governor Gary Locke did not believe his administration or the legislature could or should figure a way to raise enough taxes to eliminate the deficit. The figure stood at \$2.8 billion in a state only a little larger than Colorado. By utilizing the new method, Governor Locke was able to close the budget hole without raising taxes.

Washington's Priorities of Government approach goes beyond conventional budgeting, which often ignores the efficiency and

effectiveness of existing state programs. Rarely is the question asked about how to improve existing programs or how to maximize the return on tax dollars that are collected.

Washington's legislature determined that its core functions are:

1. Improve student achievement in elementary, middle, and high schools.
2. Improve the value of post-secondary learning.
3. Improve the health of Washingtonians.
4. Improve the security of Washington's vulnerable children and adults.
5. Improve economic vitality of businesses and individuals.
6. Improve statewide mobility of people, goods, and services.
7. Improve the safety of people and property.
8. Improve the quality of Washington's natural resources.
9. Improve the cultural and recreational opportunities throughout the state.
10. Strengthen government's ability to achieve results efficiently and effectively.

As a result of following this performance-based budgeting, Washington salvaged a budget without making across-the-board cuts—a less responsible method than the more enduring step of establishing priorities. The reductions in spending were not haphazard or routine. They came from determining the most important things to buy in order to deliver the most important services. The Governor directed agencies to provide more details on the specific services they delivered, who benefited, how much the services cost, and what results the agencies expected to achieve. Agencies further were required to designate all their activities as high, medium, or low priority, with at least one-third of the agency's expenditures in the low priority category. By focusing on specific activities—not programs or agencies—the governor's budget staff created lists across the entire government for each of the core functions and proposed to fund those activities which contributed most directly to each core function.

The results generated from this process surprised nearly everyone, especially those who initially believed it was just another public relations program. Its success scared agency directors, unions, many lobbyists, and lots of lazy legislators who suddenly realized they had to pay attention and say "No" to special interests that could not prove high value for a dollar spent.

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Colorado can achieve similar favorable results by following the steps that Washington took:

## **Step #1. Establish a forecast of state revenue for the next budget cycle.**

The legislature already has in place an annual resolution in which they agree to accept a certain level of expected funding. The non-political staff at the Capitol generate quarterly economic studies and projections. For decades these studies have been accurate to an impressive degree, especially in light of the vicissitudes of taxable income from one year to the next. There is already a “statutory reserve” that must be funded every year at 4 percent of the general fund budget to ensure unexpected conditions do not run the state government out of operating dollars.

## **Step #2. Reach a conclusion of what the essential services are that the**

### **state must deliver**

**to citizens.** The budget components should be presented by goal topic. Each program, no matter in which agency it is housed, should appear to make its case for funding.

This new process

will bring to the fore the opportunity to identify duplication and overlap, and point out positive opportunities for program consolidation and cooperation.

A priority-based budgeting system would not reach its final form within one year.

Rather, it will be an evolutionary process of improvement. It will take strong, visionary leadership to push this reform forward and to keep it progressing. Implementation might look like:

- A. In the first, transitional year the budget already will have been prepared using the current methodology. Near the beginning of the 2011 legislative session, the General Assembly would have to come to a decision to modify the structure.
- B. Beyond arriving at a decision to alter the system, the only new action the legislature need accomplish would be to delineate core government functions and to place them in priority. The creation of a rather simple list would be immensely difficult and require scheduling by legislative leadership. The process likely would mean each body would caucus for one or two days before beginning the debate on the Resolution, which itself would probably absorb two or three days in each chamber.
- C. Establishing broad priorities reasonably early in the session should assist in defining the acceptable changes in the 2011-12 budget that must be approved before the end of the session in May. It also will set up the process for the next year.
- D. In the case where a downturn reduces the budget from one year to the next, a possible evolution would involve the 10 Committees of Reference, or standing committees. These committees are each tasked with oversight of one or more executive branch departments. Within the limits laid down in the Resolution, each committee could propose cuts for the JBC to consider and compile. The emphasis would change from a question of “How do we fund everything?” to “How do we fund the most important mix of government services?”

## **Step #3. Establish outcome measures to track achievement the State’s objectives.**

In the “Budget Process” section, page 23, we have tackled in great detail the need to move from focusing only on the cost inputs (how many employees, leased space, vehicles, etc.) to focusing on the outcomes of expenditures. Nowhere does the need become more clear than in a priority-based system. It also highlights that the incoming gubernatorial

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administration must accept the idea of change, since legislators do not have the staff, time or constitutional position that would allow them to determine outcomes independently. One weakness in the transition is that a Governor whose positions about spending reform are antithetical to the recommended change could drag out the process, or even thwart it.

#### **Step #4. Create the “Buy” list of those actions that will**

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**most effectively reach the State’s goals with the funds available.** The elected officials who report back to their constituencies must take responsibility

for how taxpayer funds are used. More than occurs with a simple up-or-down vote on the annual Long Bill, a priority budget will delineate the choices to be made by the people’s representatives.

#### **ACKNOWLEDGEMENTS**

**Penn R. Pfiffner** was one of the authors of this section. See his biography in the authors section.

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**The Honorable Mark Hillman** provided a great deal of perspective and understanding and rewrote a large portion to reflect his better interpretation of the proposed implementation. See his biography in the authors section.

**The Honorable Kent Lambert** added perspective and insights about current operations of the legislature. He serves in the

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#### **ENDNOTES**

<sup>1</sup> David Osborne and Peter Hutchinson, “Budgeting For Outcomes: How government can deliver more value for the tax dollars citizens spend,” *Blueprint Magazine*, May 7, 2004. [http://www.dlc.org/ndol\\_ci.cfm?contentid=252574&kaid=125&subid=162](http://www.dlc.org/ndol_ci.cfm?contentid=252574&kaid=125&subid=162).

<sup>2</sup> <http://cbs5.com/local/california.budget.IOU.2.924701.html>.

<sup>3</sup> National Tax Foundation.

<sup>4</sup> “The Washington State Budget, A Herd of Sacred Cows,” Evergreen Freedom Foundation, 1995.