THE POWER TO KNOW®

Reinventing State Budget Formulation Through Outcome Management

Implementing a program-centric approach to evaluate and optimize outcomes

Table of Contents

Across the US, governments are experiencing budget shortfalls, slower if not stagnant growth, declining revenues and depleted reserves. While the federal government is confronted with an almost insurmountable national debt, state governments find themselves challenged to meet balanced budget requirements in the face of multibillion-dollar budget shortfalls. Budget directors and elected officials are trying to draft their budgets under the watchful and demanding eyes of their constituents. Despite the weakened economy, this could be the most favorable environment in decades for redefining state budget formulation.

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Current Budget Climate

The cyclical nature of revenue growth at the state level and the ever-increasing requirements for recurring expenditures – such as Medicaid, student enrollment increases and the rising cost of employee salaries and benefits – coupled with a major downturn in the economy, have confronted governors and budget directors with historical budget shortfalls. Along with these challenges, many distressed citizens now need public services more than ever before. However, a crippled employment market leaves states with decreased revenues due to fewer taxpayers to help support the cost of services. All of this is further compounded by the fact that such budget shortfalls are now reaching into the third and, for some states, the fourth consecutive year. These extended shortfalls have led to a mandate for less government costs and more focused results for programs that must be continued to serve the citizens. States have been able to manage the shortfalls in the last few years with an infusion of federal tax dollars to help support programs and to offset the falling tax collections. However, these federal dollars are non-recurring and will no longer be available to states after the 2011 fiscal year.

Responsibilities

This unprecedented challenge creates an opportunity for governors and budget directors to “right size” and “reset” government. Elected leaders are no longer able to respond to these ongoing fiscal crises with traditional budgeting models and tools. The requirements of state constitutions and statutes to balance budgets and meet legal mandates continue to exist, but the methods used to achieve them must be modified to allow for the most effective decision making by elected leadership. Simply balancing the budget is no longer sufficient for a governor. Governors and budget directors must:

1. **Be fiscally responsible:** Ensure the most effective use of resources to develop a structurally sound plan for providing the most important and necessary services to the public.
2. **Maintain and restore short- and long-term fiscal stability:** Maximize limited resources and implement long-term strategic planning.
3. **Be transparent in the expenditure of state funds:** Support and defend decisions to either fund, or not fund, high-priority programs.

Governors are struggling to meet these goals with slowly growing revenues and rapidly growing needs for services. Thus, managing the current year budget while developing out-year budgets has become increasingly challenging.

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Traditional Budget Formulation

State government budget development and execution has evolved over the years with states adopting unique aspects to their individual processes. However, the foundation of the traditional budget development process is the review of the base budget, or continuation budget as some states refer to it, with a second-tier of review focused on the expansion budget – or new spending using excess revenue beyond that needed for the base budget. The base budget has evolved as the recurring set of expenditures, which essentially represents the core services of state governments. Within this structure is the funding required for public schools, universities, community colleges, human service programs such as Medicaid, environmental protection programs, correction and public safety programs and transportation programs for highways and bridges. In theory, the base budget is intended to represent programs supporting the constitutional requirement of state governments. These programs have been expanded, reduced or modified depending on such factors as student growth, enrollment increases, eligibility and health cost increases, incarceration requirements due to the increase in crime, land development and investments into highways, waterways or other transportation needs.

Governors and legislators conduct the budget review process by developing the base budget with various levels of scrutiny, then comparing that cost against estimated revenue availability. When the excess revenue of availability minus the base budget is insufficient to meet the priorities of a governor or legislature, adjustments are made to the base budget to allow for identification of additional revenue to be used for expansion budget purposes.

As new programs are added, or existing programs are expanded, the new spending then becomes a part of the base budget, and the process continues year after year on that basis. As with existing programs in the base budget, rarely are there any performance measures adopted to measure the results of the new programs added by elected officials. Accordingly, as state budgets are developed by governors with assistance from budget directors, programs that have been ingrained into base budgets generally are not given the same level of scrutiny as might be given to expansion budgets.

The traditional budget process described above and used by governments has sustained itself over the years and through many economic booms and downturns. In the good times, new programs have been added and existing ones expanded, with little emphasis on the success of programs. Even in economic downturns, sufficient revenues were available to allow state officials to manage through the limited funding possibilities and still avoid the necessity of evaluating programs. However, the combination of increasing costs to existing programs and the impact of an ongoing weak economy have placed elected officials in a position of trying to balance state budgets in the face of unprecedented budget shortfalls.

Challenges

Very little, if any, emphasis is given to evaluating the effectiveness of programs in the base budget in order to determine which programs should be continued, or if more investment is needed to make the program successful. Without specific performance measures (outcomes as opposed to outputs) connected to programs, no effective evaluation can be accomplished in order to prioritize successful programs and redirect resources from unsuccessful programs to new areas of need.

With the reduction in state revenues, governors and elected officials are forced to institute budget reductions that have severe consequences to services for the public. This impact is being felt in the execution of current year budgets, but the impact on government spending and program services in future years is even more severe. Unfortunately, many of these programs will be reduced without the opportunity for decision makers to know the consequence and impact on the people served by these programs. Most state governments do not have program outcome measures upon which such decisions can be effectively made; therefore, program funding is reduced. Or stated another way, not only do programs lack measures to demonstrate their effectiveness, but elected leadership may reduce programs based on the fact that no measurable results can be identified by program management, thereby concluding that the program provides little or no benefit.

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The traditional approach to budgeting simply expands on existing funding levels without measuring outcomes or seeking to achieve goals for the investment. This approach has led to significant broader challenges:

- Multiple years of budgeted requirements exceeding revenue.
- Depletion of fiscal reserves.
- Expiration of federal stimulus funds.
- Inability to meet requirements for a balanced budget.

Outcome Management

Decisions regarding funding of state programs must now be subjected to the question of "What is the value added to the public?" in order to best direct limited state resources. Governors must establish a set of guiding principles for budgeting while developing the necessary tools needed for decision making. This approach must include metrics required to evaluate the tools and the programs in order to adequately defend decisions.

Outcome management provides performance measurement and forecasting methods that allow states to develop such metrics, use these measures to support decisions, and predict the impact of such decisions on the public. Developing effective metrics using outcome management can enhance the short-term success of a governor's programs while attaining long-term strategic goals and fiscal stability.

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The Program-Centric View

Without the ability to determine if programs are achieving the expected impact on the public, and lacking shared data between agencies, programs tend to wander into silos, often duplicating efforts but rarely coordinating efforts for mutual benefit. This result found in government is based on the traditional organization model that focuses on a constituency. A *program-centric approach* integrates information between program areas so that each program can be viewed holistically. This gives governors and elected officials the ability to review each program in its entirety to properly assess the value and impact of public programs, and examine *outcomes* versus *outputs*.

Governments often operate under the old models of “How much was spent?” and “How many were served?” without understanding the impacts of their work on the citizens served. A program-centric approach evaluates the extent to which a program has affected an individual, a family or a community.

Outputs	Outcomes
How many people were served by this program? How much money was spent on this program?	What impact has this program had on individuals, families and the community? Has this program made a difference? How are the lives of program participants better as a result of the program? What costs have been saved or avoided?

A program-centric view provides many benefits in the evaluation of state programs:

- Eliminate duplication of effort.
- Ability to justify hard decisions.
- Efficient use of limited resources.
- Improved services to the citizen.

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Example

Many states have various programs to assist in creating new jobs, such as corporate incentives that help existing companies expand or new companies relocate to a community; workforce training to provide skill sets needed in local communities for new jobs; and enhancement of community college curriculum to address a changing workforce environment. Some states are organized to seek new corporate clients through the Department of Commerce or a similar title, while workforce training may be in an employee-focused department such as the Employment Security Office. Further compounding the disconnection is the retooling through educational programs in the community college system, or newly adopted curriculum in the university system to address new labor markets. While each program/department has benefits and is funded to address needs within that particular organization, there may be little coordination of these programs due to the lack of a holistic or program-centric approach, ineffective outcome measures, and subsequently, a void in outcome management. It is difficult to determine if each program is supporting objectives of the other, and therefore it fails to address and maximize the overall outcome of the state. Additionally, each program may overlap in terms of its actual outcomes, resulting in duplicated efforts and inefficient investment of resources.

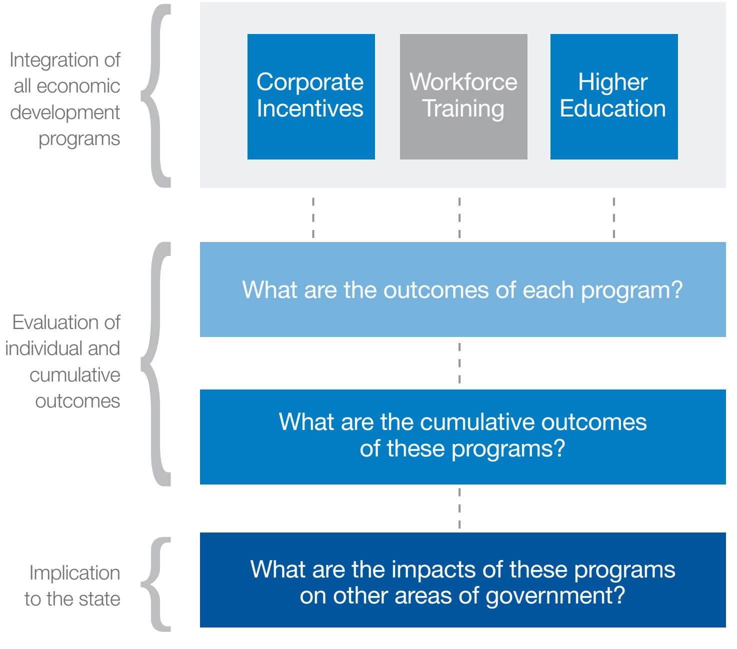

Figure 1: Program-Centric View of Economic Development Efforts by State Government.

Figure 1 depicts the implementation of a program-centric approach to evaluate economic development programs. This approach can address such issues as the ones below to help create a more efficient and effective budget.

- What impacts do economic development programs have on:
  - o Education?
  - o Unemployment?
  - o Transportation?
  - o Infrastructure?
  - o Human services?
  - o Environment?
- What efforts exist in state government to provide coordination between training programs to meet specific local needs and new curriculum instructional programs in the educational system such as community colleges or the university system?
- How can state government work collaboratively with local governments to ensure that state investment is consistent with, and coordinated with, local economic development efforts?
- Are state and local infrastructure investments for support services such as water, sewer, fiber optics and highways being coordinated, meeting the needs and obtaining the expected results?

By evaluating outcomes and impacts through a program-centric approach, governments can make informed budget decisions regarding economic development resources. For example, a governor can discover if the local government needs state assistance to attract industry – perhaps in terms of highways, water/sewer construction, infrastructure investment or other assistance that cannot be provided by a county or town with a little tax base. Additionally, as a budget is developed, targeted funds can be recommended for specific projects to attract new jobs to a specific region. For instance, funding recommendations can be made for the local community college to implement specific job training to provide skill sets needed for a new industry. And as the skills are developed and the industry expands with more available jobs, unemployment is reduced, thus employment security commission workload and unemployment tax is reduced. With more people employed, more children may be moved off of Medicaid rolls, thereby reducing caseloads in the Medicaid area and in child support enforcement. Furthermore, as an area increases in prosperity, ideally crime is reduced, which would positively affect the court system and the prison population. On the other side, a rising population demands more services locally for streets, garbage collection, fire, police and other services provided by local government.

A program-centric approach allows governors to make budget correlations with program outcomes, improving the budget development and evaluation process and demonstrating effective use of taxpayer dollars.

The state budget should reflect the collaboration of efforts between all affected areas to ensure the economic well-being and growth of the state. It is evident that the impacts of programs are far-reaching and that they must be considered to establish fiscal stability. A program-centric approach allows governors to make budget correlations with program outcomes, improving the budget development and evaluation process and demonstrating effective use of taxpayer dollars.

Analyzing Future Outcomes

A program-centric approach presents a vast array of opportunities to take budget formulation to the next level with predictive analytics. Predictive analytics give states the ability to answer questions related to future outcomes, such as "How many citizens will become eligible for a program in the future?" and "What is the cost impact for this increase in eligibility?" By analyzing future outcomes, a state can accurately forecast expenditures and citizen needs to better estimate future monetary needs and the timing of when the state appropriations will be needed. Furthermore, predictive analysis helps states formulate budgets that will encourage long-term stability and sustainability.

Predictive analytics give states the ability to answer questions related to future outcomes, such as "How many citizens will become eligible for a program in the future?" and "What is the cost impact for this increase in eligibility?"

Future Outcomes

Future Outcomes
How will this decision directly or indirectly affect other programs?
What will the resultant impacts of this program be on individuals, families and communities?
What will the individual and cumulative impact of this decision be across multiple programs?
What are the future costs associated with this program?
What actions can be taken now to prevent a negative outcome later?

This predictive component of outcome management provides significant additional benefits:

- **Strategic long-term planning:** Forecast the budget impact of various program outcomes for multiple years.
- **Proactivity:** Forecast budget surpluses or deficits during the fiscal year and identify early warnings on revenue shortfalls, so that governments can react quicker and more effectively.
- **Optimize citizen services:** Analyzing service trends allows governments to respond quickly to changing constituent needs.

Example

Revisiting the economic development example, a program-centric view shows us that numerous areas of government are affected by economic development activity. Put into an analytical environment, this information can be integrated with historical data to predict what types of issues and trends may arise in the future. This enables states not only to plan for the short term, but to plan for years ahead, to optimize outcomes in the future and to reduce the probability of negative impacts. Ultimately, the goal is to implement proactive decision making in order to increase financial efficiencies and to formulate current and out-year budgets that promote long-term economic growth.

Knowing the future impacts and financial needs of economic development activity beforehand gives a governor the capability to accurately plan across all program areas of a state. It allows states to address forward-thinking issues such as:

- What will the future impacts of these programs be to:
    - o Education?
    - o Unemployment?
    - o Transportation?
    - o Infrastructure?
    - o Human services?
    - o Environment?
- Will the continuation of these programs positively affect economic growth?
- What are the implications of these programs to the state one, five and 10 years from now?
- What are the costs associated with long-term funding of these programs?
- Will an expansion of programs be needed?
- What collaborative program efforts can be put in place to optimize future economic growth and reduce costs?

Conclusion

The economic crisis confronting governments at all levels has now forced a revisiting of traditional budget formulation in order to achieve maximum results from reduced resources. Existing budgeting tools and processes used by governors and elected officials have been tested in recent years and found to be outdated and incapable of providing the information needed for proper evaluation of government programs. Today's citizens demand transparency of expenditures and assurance that investment of tax resources are allotted to programs with measurable and effective outcomes. Implementing a program-centric approach to evaluate outcomes and to predict future outcomes must become the norm for future government programs in order to set priorities, provide needed services and prioritize investment of government resources.

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