



## COUNTY OF SAN MATEO

### County Manager's Office



**DATE:** September 29, 2010  
**BOARD MEETING DATE:** October 5, 2010  
**SPECIAL NOTICE/HEARING:** None  
**VOTE REQUIRED:** Majority

**TO:** Honorable Board of Supervisors  
**FROM:** David S. Boesch, County Manager  
**SUBJECT:** **October 5<sup>th</sup> Board Workshop – Budgeting for Outcomes**

#### **RECOMMENDATION:**

Provide direction on designing a different budgeting process for San Mateo County.

#### **BACKGROUND:**

The impacts of the economic downturn on County services have resulted in increased tension and competition for remaining resources. Your Board recently adopted the third year of our five-year plan to restore structural balance to our budget by FY 2012-13. While significant progress has been made to cut costs, the General Fund's structural deficit is still projected to reach \$124 million by FY 2014-15. Sustained growth from all major sources of income has failed to materialize. Costs continue to outpace revenues. The State habitually neglects its responsibility to California residents by failing to pass a balanced budget and adequately fund mandates to schools, cities and counties.

#### **DISCUSSION:**

As an organization, we must look for new ways to allocate resources that ensure that our limited resources are invested in programs that demonstrate results, are cost effective, meet mandates, and provide the most important services to the community we serve.

The purpose of the Board Budget Workshop scheduled for Tuesday, October 5, 2010 is to explore other possibilities for allocating resources through an interactive dialogue with Board Members, Department Heads and the County Manager's Office. The workshop will be facilitated by Babak Armajani (Armi), Chair of the Public Strategies Group (PSG). PSG has been assisting more than twenty public agencies over the last six years to move toward a "Budgeting for Outcomes" model.

The agenda for the day includes a morning session with the Board to discuss the current budget process in the County and desired changes, and to introduce outcome-based budgeting principles. The afternoon session will move to Room 101 at 455 County Center, where Board Members and Department Heads will learn more about how Budgeting for Outcomes works, and engage in conversation with each other about how it

could potentially work in San Mateo County.

I'm convinced it is well worth our time to explore other approaches. We will either discover they are not for us, or we will find ways to use these ideas in our budgeting process. We owe it to our residents to explore these possibilities.

Exploring new ways to allocate resources contributes to the Shared Vision 2025 outcome of a Collaborative Community by addressing the County's structural budget deficit and the need to maintain quality programs and services with fiscal accountability and concern for future impacts.

**FISCAL IMPACT:**

Board direction will be used to guide the development of the County budget for Fiscal Years 2011-12 and 2012-13.

**ATTACHMENTS**

1. Agenda – October 5, 2010 Board Budget Workshop
2. Online Survey – for Board Members and Department Heads (due September 30)
3. "Budgeting That Really Works," Jim Chrisinger, *Governing.com*, May 17, 2010.
4. "A Solution for Uncertain Times: Budgeting for Outcomes," Anne Spray Kinney and Beverly Stein, *California Counties (CSAC)*, May/June 2008.
5. "Budgeting for Outcomes: Delivering Results Citizens Value at a Price They Are Willing to Pay," David Osborne and Peter Hutchinson, *Government Finance Review*, October 2004.



## COUNTY OF SAN MATEO

Board of Supervisors - Budget Workshop

Tuesday, October 5, 2010

10:00am – 5:00pm

Board Chambers and Room 101



**Facilitator:** Babak Armajani (Armi), Chair, Public Strategies Group

### Desired Outcomes:

- Obtain feedback from the Board and County staff on last budget cycle, identify needs and concerns, desired changes for the future
- Introduce the Board and County staff to outcome-based budgeting principles, and share best practices from other jurisdictions that are budgeting for outcomes
- Engage Board members and Department Heads in exploring the possibility of designing a new budget process for San Mateo County
- Obtain input from the public on issues and concerns about what is being explored
- Obtain direction from the Board to move forward with designing a new process

### Pre-Workshop Activity and Reading Materials:

1. Online survey – link to be e-mailed to Board and Department Heads (due September 30)
2. "Budgeting That Really Works," Jim Chrisinger, *Governing.com*, May 17, 2010.
3. "A Solution for Uncertain Times: Budgeting for Outcomes," Anne Spray Kinney and Beverly Stein, *California Counties (CSAC)*, May/June 2008.
4. "Budgeting for Outcomes: Delivering Results Citizens Value at a Price They Are Willing to Pay," David Osborne and Peter Hutchinson, *Government Finance Review*, October 2004.

## AGENDA

**10:00 – Noon**

**BOARD CHAMBERS, 400 County Center, First Floor, Redwood City, CA**

- Purpose and Overview of Workshop
- Conversation: The Way We Do Things Today vs. How I'd Like Things Done Tomorrow
- Introduction to Principles of Budgeting for Outcomes
- Public Comment

**1:30 – 5:00pm**

**ROOM 101, 455 County Center, First Floor, Redwood City, CA**

SMALL GROUPS (Board Members and Department Heads)

- Budgeting for Outcomes – How It Works
- Best Practice Models
- Explore Possibilities – San Mateo County
- Public Comment
- Board Discussion and Direction

[Exit this survey](#)

San Mateo County



We are exploring the possibility of a new approach to budgeting. I'm convinced it is worth a day of our time to do so. We will either discover that this approach is not for us, or we will find ways to use these ideas in our budget process. We owe it to our residents to explore these possibilities.

The purpose of the October 5, 2010 Board Budget Workshop is to explore other possibilities for allocating resources through an interactive dialogue between Board Members, Department Heads and the County Manager. The workshop will be facilitated by Babak Armajani (Armi), Chair of the Public Strategies Group (PSG). PSG has been assisting more than twenty public agencies over the last six years to move toward a "Budgeting for Outcomes" model.

In discussions with Armi about how to do the Workshop, he made several important points based on his experience:

- (1) Outcome budgeting comes with culture that is dramatically different from most organizational cultures. That is why so many jurisdictions are pursuing it.
- (2) You should expect anxiety about exploring a change as significant as this one. One would have to be sedated not to get anxious about even discussing a new way of budgeting. It is normal and it is okay. The anxiety will raise issues we need to solve together to design an approach that will work best in San Mateo County.
- (3) The workshop is to explore possibilities. On October 5, we are going to explore the possibility of using some of these ideas. If we decide to do so, then we will design the process (a one day activity). Then we will train people in the new system. Then we will prepare our next budget using the new system. (If you don't run parallel systems, the new budget process will likely take less time to prepare than the old one.)

To assist PSG in preparing for the workshop, please take a couple of minutes to complete this anonymous survey. It is designed to get you thinking about some of the workshop themes and to gather your perspectives on the budget process. A summary of the aggregated data will be shared at the workshop

**1. Think of budgeting as a "competition" for resources. For members of the Board, what constitutes "winning?" Jot down a few of your thoughts in the box below. Be candid.**

**2. For department heads what constitutes "winning?" Jot down a few of your thoughts in the box below. Be candid.**

**3. For the County Manager and the Budget Office what constitutes "winning?" Jot down a few of your thoughts in the box below. Be candid.**

Now, think about the strategies these "competitors" in the budget process use to "win." For each group, jot down a few of your thoughts about the main strategies or tactics used by each group. Again, your candor will help the County find better ways to do budgeting.

**4. Strategies used by the Board of Supervisors**

**5. Strategies used by department heads**

**6. Strategies used by the County Manager's Office**

**7. These are 2 or 3 things I think would make our budget process more effective in allocating scarce resources:**

**8. These are 2 or 3 things I think would make our budget process less burdensome:**

**9. So that your perspectives can be aggregated by group, please indicate which group you are in:**

- ☐ Member of the Board of Supervisors
- ☐ Department Head or executive
- ☐ County Manager's Office

Thank you for your candid responses. I look forward to our time together on October 5.

David Boesch  
County Manager

Done

May 17, 2010

## Budgeting that Really Works

By Jim Chrisinger

The Public Strategies Group. Senior Partner

The fiscal mess facing government is spawning a slew of alternative approaches to budgeting: performance-based budgeting, budgeting for results, outcome budgeting, and others.

While the need for improved budgeting is clear, how these various approaches work is anything but clear. Not only is the nomenclature confusing, but the same name may mean different things in different places.

What you find most often under any of these labels are performance measures and sometimes data pasted into a line-item budgeting system. The budget may be reorganized around programs, policy areas, or maybe high-level results, but it's still a line-item budget.

These budgets seldom accomplish much. The "new" approach works only as long as a dedicated champion makes it work. When the champion rides off, so does the discipline.

Even with a new name, budgeting usually still starts with last year's numbers. Departments and line items remain its core. New ideas and better ways of doing things struggle to overcome inertia. The incentives in the budget game remain. On the department side, the game is hide and pad. On the executive side, it's cut, cut, cut. The bottom line is that budgeting is still all about the dollars and who's up or down by what percent. Performance is left by the wayside.

In tough times, this "new" budgeting still degenerates into "finding cuts" or "finding savings." This approach assumes the priorities of last year's budget and makes incremental changes from that starting point, or anchor. It assumes the work will be done using current methods. Budgeteers "find" money by trimming fat and more, if necessary. "Let's cut where it does the least damage and pray for more revenue—soon."

The fundamental flaw is that no intrinsic, action-forcing mechanism makes outcomes and performance more consequential. Nothing systematically challenges the status quo. The basic budgeting dynamic, its DNA, remains intact.

As a result, today's budgets crash and burn, under whatever name. Our moment in history demands better. We can no longer afford the old way or "new" ways that apply a superficial veneer of data on top of the old way.

We need to yank budgets off autopilot -- way off. We need to generate measurable value from every dollar. We need to jettison lower-value activities, regardless of how painful. We need a self-executing dynamic that rewards effectiveness and innovation, not special interest pull or longevity.

The budget's primary criterion should be value, defined as outcomes per dollar, not just dollars.

It can be done. Begin by flipping the question from negative to positive. Instead of "How can we cut projected spending to meet revenues?," ask "What's the best way to produce the most value with the dollars we have?" Ask this question without consideration of what you're spending the money on now.

It's about smart spending, not smart cutting.

Over the last decade, pioneering state and local government leaders, with the assistance of the Public Strategies Group, have developed a budgeting model that addresses this issue. We call this model "budgeting for outcomes" but the name doesn't matter. Maybe we need a name that's less confusing, such as "budgeting that actually works."

The model is still evolving, and each jurisdiction has unique challenges. The experience from twenty-plus different governments to date, however, proves the value of this approach.

Here's how "budgeting for outcomes" works:

**1. Set the price of government:** Decide up front how much citizens are willing to spend. Get political agreement on a revenue forecast and any tax or fee changes, or just go with the revenue forecast. Most jurisdictions do the latter. Quit wasting so much energy on how much will be spent.

**2. Set the priorities of government:** Define the outcomes that matter most to citizens, with citizen input, and identify indicators to measure progress. Allocate the funds available among the priority outcomes.

**3. Develop a purchasing plan for each priority:** Create a team to act as a purchasing agent for citizens, including citizens, for each priority. Ask each team to research and identify the strategies that will best produce the desired outcome.

**4. Solicit "offers" to deliver the desired outcomes:** Have the teams issue "requests for outcomes" to all comers, public and potentially private: "tell us what outcomes you can deliver for what price." Critique initial offers and negotiate better deals.



**5. Prioritize the offers:** For each outcome, fund the best offers, those that will provide the best results within the money available. Do not fund the other offers.

**6. Negotiate performance agreements with the chosen providers:** Spell out the expected outputs and outcomes, how they will be measured, the consequences for performance, and the flexibilities and support needed to maximize provider performance.

There's more to it than this high-level outline, of course. It should be clear, however, that different DNA drives this process; this is not the same-old budgeting under a new banner. Fundamentally, higher-value activities force out lower-value activities in a strategic, zero-based, competitive arena.

Because offers compete on the basis of value, innovative and entrepreneurial offers have a better chance against the status quo.

The Iowa Department of Revenue collections unit had no luck getting the legislature to sign off on purchasing new software and granting authority to better integrate and co-locate operations with a private-sector partner. So they "offered" a deal they hoped could not be refused: Let us do what we think needs to be done, and we'll promise you \$42 million in additional, already owed but uncollected revenue over the next three years. The legislature bought the deal and Revenue delivered: \$120 million in additional revenue and counting.

In aggressive jurisdictions, requests for offers could reach beyond government, to the non-profit and for-profit sectors. The power of internal and perhaps external competition to spur creativity and efficiency – within parameters that accord with our values and the public interest – busts the old budget DNA. Why wouldn't citizens and taxpayers want the budget offers that produce the greatest value, regardless of who provides the service? We owe our citizens and taxpayers no less. If, through this process, we fund what we currently do because it delivers best value, great. If we choose other ideas over what we currently do to get more value, that's great too.

In the State of Washington, where this approach debuted during the last big fiscal downturn, the *Seattle Times* [editorialized](#), "The usual, political way to handle a projected deficit is to take last year's budget and cut. It is like taking last year's family car and reducing its weight with a blowtorch and shears. But cutting \$2 billion from this vehicle does not make it a compact; it makes it a wreck. What is wanted is a budget designed from the ground up."

This approach also gives the facts a better chance against politics and special interests. Based on the evidence of value to student achievement, bi-partisan supermajorities in both houses of the Washington State legislature in 2003 temporarily suspended citizen-initiated initiatives backed by teachers' unions to lower class sizes and raise teacher salaries.

Tough choices, but the money was better spent elsewhere.

A micro-example: Ft. Collins, Colorado identified nighttime “dial-a-ride” service as low-value, primarily because of its more than \$90/ride cost. Rather than just cut the service, they negotiated less-than-\$20 evening rides with a local taxi company.

Other jurisdictions with experience using this approach include the cities of Baltimore, Dallas, Redmond, and Savannah; the Louisiana Department of Culture, Recreation & Tourism; and the following counties: Mesa, Colo.; Multnomah, Ore.; Polk, Fla.; and Snohomish, Wash.

Make no mistake, budgeting this way is hard work, especially the first time through. There is no magic wand. It does not eliminate hard decisions; it does present better questions in a framework that incents better answers. Politics may still often prevail. It does make performance data matter. When programs with no or sketchy data go away or are cut dramatically, all of a sudden there’s genuine interest in data.

The budget offers us the most powerful leverage to achieve more focus, performance, innovation, and value. In times like these, we would be crazy not to use it.

WHAT KIND OF BUDGETING DO WE WANT?		
Key Questions	Today's Budgeting	Tomorrow's Budgeting
What's the basic task?	Fund departments, fund programs, fund costs	Purchase outcomes
Where does the process focus energy?	At the margins, where there are cuts and adds from last year's numbers	Across all the outcomes and all the money
What is the system's basic dynamic?	Inertia maintains current spending	Competition generates better options; prioritization forces better choices
What's the incentive for government departments? How do you "win" the budget game?	Hide, pad, and threaten dire consequences if there are cuts	Offer the most outcomes per dollar
What's the bottom line?	Dollars	Value

This column originally posted at [Governing.com](http://Governing.com) - *Better, Faster and Cheaper*, May 17, 2010 and reprinted with permission.

# A solution for uncertain times:

BY ANNE SPRAY KINNEY AND BEVERLY STEIN

Anne Spray Kinney is research and consulting director of the Government Finance Officers Association, and Beverly Stein, former elected county executive of Multnomah County in Oregon, is senior managing partner and co-owner of the Public Strategies Group.

**M**ost government budget processes follow a traditional path. In proposing the budget, the government's top executive starts with last year's spending and the programs that were funded in that previous year. When faced with budget gaps, the most common solution is to focus on how to cut 10 or 15 percent from an already "tight" budget. Across-the-board cuts are a too-frequent occurrence that doesn't distinguish what is working from what is not.

## **A better way?**

Isn't there a better way to budget in such an uncertain economic environment? And isn't the real question: "How can we get the best value for our tax dollars?" Instead of starting with the previous year's budget and justifying increases or cuts from that base, Budgeting for Outcomes calls upon government leaders to start with a set of results that matter to citizens and then fund programs according to their value in achieving those results.

This approach assigns funding to the desired jurisdiction-wide results at the beginning of the process and then budgets for activities and programs deemed most likely to achieve those high-level results, without reference to organizational structure. States, cities, counties and school districts in the United States have adopted this approach. Examples include the City of Fort Collins, Colorado; Mesa County, Colorado; City of Redmond, Washington; Multnomah County, Oregon; the City of Dallas, Texas; State of Washington; Snohomish County, Washington; and Jefferson County Schools,



# Budgeting for outcomes

Instead of starting with the previous year's budget and justifying increases or cuts from that base, Budgeting for Outcomes calls upon government leaders to start with a set of results that matter to citizens and then fund programs according to their value in achieving those results.

Colorado, among others.<sup>1</sup>

After the State of Washington adopted this approach in 2002 and successfully used it to deal with a \$2 billion deficit, an editorial from the *Seattle Times* summarized the benefits:

The usual, political way to handle a projected deficit is to take last year's budget and cut. It is like taking last year's family car and reducing its weight with a blowtorch and shears. But cutting \$2 billion from this vehicle does not make it a compact; it makes it a wreck. What is wanted is a budget designed from the ground up.

—*Seattle Times*, Nov. 17, 2002

## **Budgeting for Outcomes includes six key steps:**

**1. Set a revenue target.** At the beginning of the budget process, the government conducts an analysis of the jurisdiction's historical revenue patterns and a comparison of a jurisdiction's "price of government" (taxes, fees and charges paid by residents and businesses as a percentage of aggregate personal income) to that jurisdiction's historical price and to neighboring jurisdictions to establish the amount of revenue that will be used as the basis for budgeting. The chief executive officer may set the revenue target, or it may be set with the agreement of the legislative body, depending on the jurisdiction's preferences.

**2. Articulate results.** The government then selects a relatively small number of high-level results that matter most to its residents. Results, in this process, are not the same as costs, activities, programs or organizations.

Across-the-board cuts are a too-frequent occurrence that doesn't distinguish what is working from what is not.

Rather, they are outcomes: future conditions the government wants to achieve. Mesa County, Colorado, identified 10 priority areas through its process. Those priorities are in Exhibit 1 on page 13.

Governments base their priority results on needs assessments, and research about citizen preferences, using methods such as citizen surveys, "town hall" meetings and focus groups.

**3. Allocate revenues to results.** The third step in this system is to allocate all revenue from step 1 to the results established in step 2. Mesa County's percentage allocations are shown in Exhibit 2 on page 12.

Clearly this step requires judgment; there is no precise formula for this task. It is based on a combination of perceived citizen priorities, the realities of what the jurisdiction does and what has been allocated in the past. Snohomish County, Washington, allocated a small percentage to an education result because their surveys showed that people value education so highly. The county did this even though the county does not run the school system.

**4. Ask service providers to propose activities and programs for achieving results.** At this stage, the Budgeting for Outcomes approach diverges significantly from

SEE "BUDGETING" - PAGE 12



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“BUDGETING” - FROM PAGE 11

department-by-department budgeting. Rather than asking departments to develop their budgets consistent with overall priorities, as would be typical even in a performance budgeting system, teams are established for each priority. The teams “buy” activities or programs from whichever departments will best achieve the results.

In step 4, each team conducts research and analysis to identify factors and strategies that, according to evidence, are most likely to produce desired results. Teams use evidence from other governments, the private sector, and their own experience as subject matter experts. The teams then solicit proposals from the government’s agencies or departments. (External providers such as not-for-profit organizations and private firms may also be solicited if a government so chooses.)

**5. Submit proposals to achieve results.**

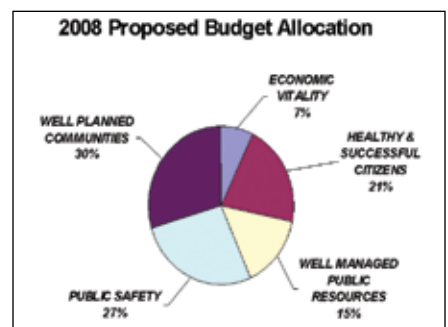
“Sellers” then submit their proposals to the teams describing the activities or services they would provide, how these activities would produce desired results, and at what cost — a promise of performance at a price. Because activities are selected both on their ability to achieve results and on their price, sellers have an incentive to control the cost of their proposals.

**6. Rank proposals and fund the best proposals.** Each team then ranks the offers from the sellers according to their assessment of perceived value (results per dollar spent). Offers on the ranking list are proposed for the budget down to the point where the money runs out.

**An ongoing process**

Does Budgeting for Outcomes work over time? The experience of Snohomish County, Washington, offers a helpful example. County Executive Aaron Reardon was a state legislator when the State of Washington initiated Budgeting for Outcomes. When he became county executive of Snohomish

**Exhibit 2**

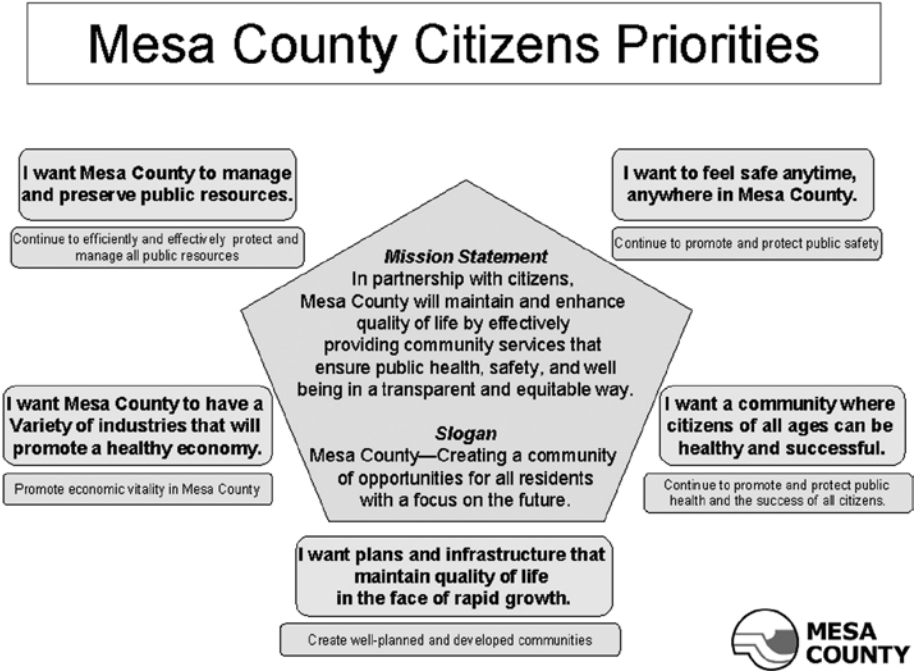


County, he sought to duplicate the state's success in changing the budget process to a Budgeting for Outcomes approach. In a recent interview, Reardon's Finance Director Roger Neumaier discussed the county's

experience.<sup>2</sup>  
**Q: How long have you been doing Budgeting for Outcomes in Snohomish County?**  
A: Snohomish County has been using

the Budgeting for Outcomes process since 2005 (budget year 2004). This year, we will complete our fourth budget with the process. We use the Budgeting for Outcomes process for all funds and all departments. Over the four years, the county has been stabilized fiscally as reflected in our bond rating.

Exhibit 1



**Q: What has changed about how you use it over the last four years?**

A: The first year, we were focused on learning the differences in approaches between Budgeting for Outcomes and a traditional budgeting process. Each year, we get better. There is less training. The first two years, each offer went through two iterations. By the third year, we were down to one. However, most importantly, the county culture now expects Budgeting for Outcomes. For example, the first year we heard a lot about mandates and how we were mandated to provide certain services. We went through a process where we documented all legal mandates and minimum level of services that were to be provided and found that there were very few. Because of Budgeting for Outcomes, Snohomish County now provides services to the community that citizens value versus

SEE "BUDGETING" - PAGE 14

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providing a service because we perceive we have to.

**Q: What have been some of the key positive outcomes from using Budgeting for Outcomes?**

A: Fewer complaints about what is in (and not in) the budget and a much broader and more comprehensive understanding of the county fiscal situation. Also, it is clear that we provide outcome-based services that have a value to the public. We do not fund processes; we fund outcomes. Culturally there has been a big shift at the county and it is only partially about budgeting — we have changed the way we think about government. We are now a county government that understands it exists to provide value to (rather than processes for) the public. If we are not providing sufficient value, we should stop providing a service.

**Q: You have a Trailblazer Grant from the National Center for Civic Innovation — how will you use this to improve performance measurement and link to Budgeting for Outcomes in the future?**

A: As a result of the Trailblazer Grant, we will be adjusting and improving our emphasis on performance measures. The executive

office and budget office will work directly with county programs to better define, develop and report outcome information. Additionally, we will hold a second round of public input by utilizing focus groups to better understand the types of performance measures the public is interested in.

**Q: What advice would you give to other counties just starting the Budgeting for Outcomes process?**

A: Know the purpose of your program. Knowing what your products/outcomes are has to be the starting point. Understand citizen expectations. The full support of senior management is essential. Having our county executive be the clear sponsor of the process gave us a level of momentum from the start that made a huge difference.

**Conclusion**

The contrast between traditional budgeting and the Budgeting for Outcomes approach is stark. Rather than having as the starting point what was funded — by department — in the previous budget, or what needs to be cut from each service, the starting point becomes the results the jurisdiction wants and needs to achieve for

Elected officials spend more time making decisions based on what evidence produces the desired results and less time on deciding how much and where to cut the budget.

its residents and businesses.

The budget office works with teams to identify activities and programs most likely to achieve results, rather than the traditional task of cutting back departmental budget requests to fit the amount of revenue available. Elected officials spend more time making decisions based on what evidence produces the desired results and less time on deciding how much and where to cut the budget.

The incentives for agencies and departments change from making it difficult for the budget office to find places to cut their budgets to figuring out what activities work best to achieve results and how to provide those activities at the best price.

Embarking on this approach requires careful consideration of a government's management capacity and risk tolerance. For governments that have adopted it, the benefits have been great. The logic of spending on results as opposed to traditional methods of cutting budgets is clear.

The Public Strategies Group, Inc. and the Government Finance Officers Association Research and Consulting Center jointly offer a Budgeting for Outcomes toolkit designed for smaller governments wishing to implement Budgeting for Outcomes. To request information on the toolkit and a short video demonstration, e-mail [bfo@gfoa.org](mailto:bfo@gfoa.org). ❖

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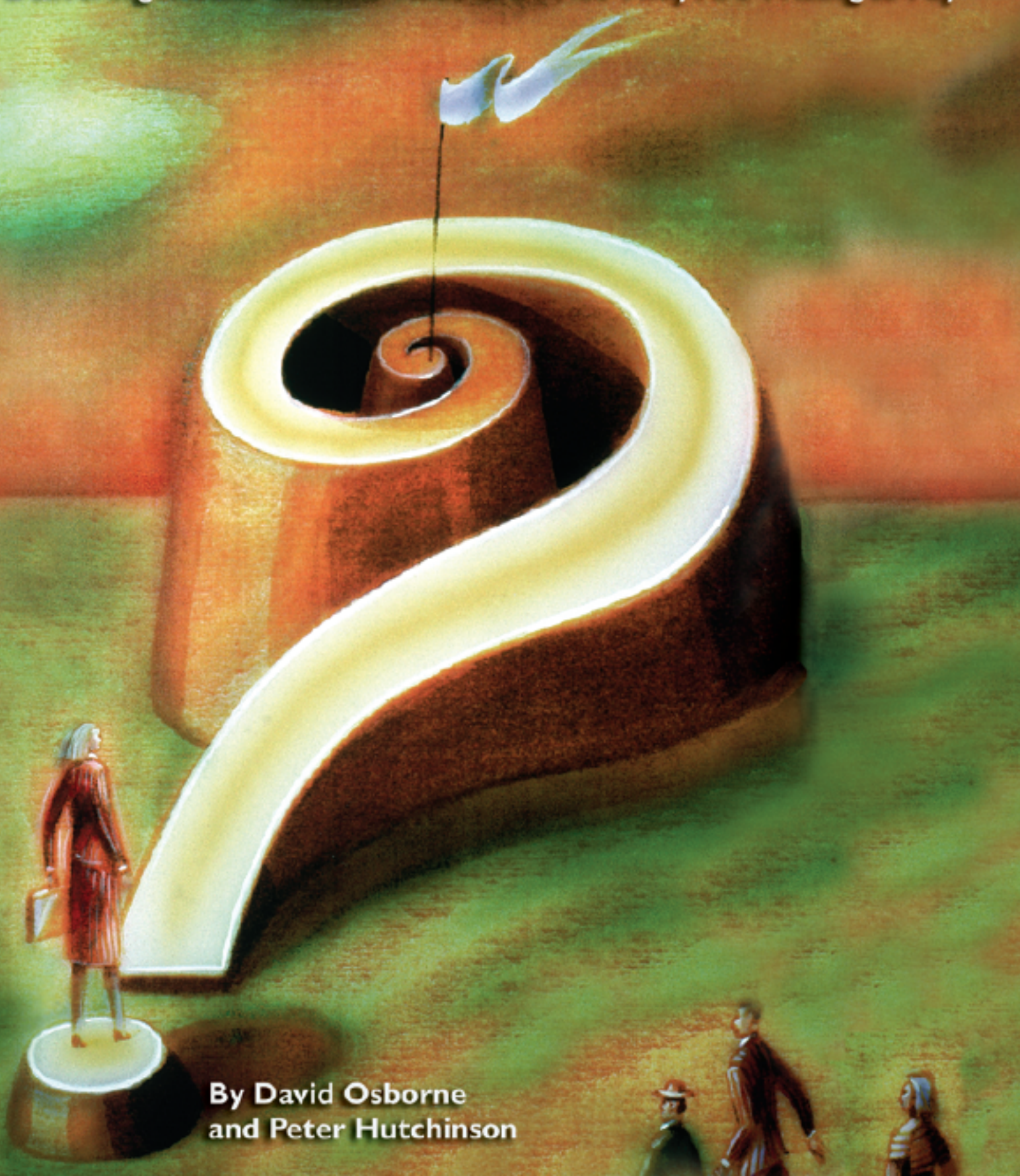
<sup>1</sup> The Budgeting for Outcomes approach is described in detail in David Osborne and Peter Hutchinson, *The Price of Government: Getting the Results We Need in an Age of Permanent Fiscal Crisis*, Cambridge, MA, 2004, Basic Books.

<sup>2</sup> This interview was excerpted from Beverly Stein, "Budgeting for Outcomes: The Right Results for the Right Price," *Government Finance Review*, October 2007.



# Budgeting for Outcomes

Delivering Results Citizens Value at a Price They Are Willing to Pay



By David Osborne  
and Peter Hutchinson



**N**ative Americans have many sayings, and one of the wisest is this: When you're riding a dead horse, the best strategy is to dismount. Traditional budgeting, which focuses on costs rather than results, is the dead horse of the public sector. When we budget for costs, we get more of them. What we don't get is the innovation and accountability for results we need if we are to win the competition for public support.

Winning back the public support we have lost over the past 40 years is the greatest challenge we face in government today. Yet when faced with deficits, many governments resort to politically expedient budget and accounting practices that only deepen public cynicism. The public finance literature refers to such practices as "fiscal illusions," since they distort the ability of stakeholders to evaluate the true costs and benefits of government programs. Seven such illusions are particularly harmful to the financial credibility of state and local governments:

**1. Robbing Peter to pay Paul.** When that general fund gets in trouble, some leaders start eyeing "off budget" funds as resources to be mined. One state government helped balance its budget by transferring the cost of running a waterway system from the general fund ("on budget") to the toll road authority ("off budget"). Another state transferred management of a convention center and parking garage to the state pension fund to lower its cash contribution from the general fund. Technically, this allowed the state to show a savings of \$175 million. Robbing Peter to pay Paul can plug a hole to make the budget look better this year, but the same hole will reappear next year, when Peter and Paul will both be worse off.

**2. Using accounting gimmicks to disguise fiscal problems.** As the Enron debacle showed, accounting presents leaders with many dangerous choices. Quick-fix accounting gimmicks include pretending (or even requiring) that money you expect to receive early next year will actually come in late this year. The opposite side of the coin is to pretend (or even require) that expenses planned for this year will be made, technically, next year. For example, some states have informed school districts expecting a school-aid payment in the current fiscal year that they will not receive it until the next fiscal year, thus making the current year's

expenses look smaller. Similarly, some states have urged retailers that normally submit their June sales tax receipts in July (next fiscal year) to do so in June, thus propping up the current year's revenues. It's all legal and properly accounted for, but it does not reflect the government's true financial condition.

**3. Borrowing.** Even when the general fund is legally prohibited from being in debt, governments find ways to borrow. New York City mastered this dubious art in the 1970s, when it piled up so much debt that it landed in receivership. Both the city and state of New York are still trying to figure out when and how to pay off all the bonds issued back when New York truly was, in former Mayor John Lindsay's famous phrase, "Fun City."

During the current fiscal crisis, several states have proven that the "what me worry" politics of borrowing works for both political parties. Instead of making the difficult decisions necessary to secure their long-term fiscal health, these states borrowed their way to "balanced" budgets either through outright deficit financing or less transparent means such as pension obligation bonds. These maneuvers failed to convince the credit rating agencies, which in some cases lowered their ratings to junk-bond status.

**4. Selling off assets.** When times are tight, it is popular to sell surplus buildings, land, or other assets, and then use the proceeds to plug a hole in the operating budget by treating the real estate money as though it were "normal" revenue. For example, instead of resolving a significant structural budget problem, the leaders of one city government decided to sell the water and sewer

works to the off-balance sheet entity that operated it. A year later, the city sold \$51.2 million in tax and sewage liens—money due to the city that it not yet been able to collect—for \$32.2 million. The city has continued to rely on one-shot revenue sources to balance the annual budget, putting off the crisis for one more year.

**5. Making something up.** A budget is really just a forecast, a statement of expected revenues and expenses. If done correctly it can be a serviceable estimate. But in the end, every budget is based on assumptions, and you can make it look better or worse simply by changing those assumptions.



Ronald Reagan's approach in 1982 was a classic example of making the budget "work" by working the assumptions. To justify massive tax cuts, his budget director, David Stockman, forecast 5 percent growth for 1982. According to "supply side" theory, this would help create a \$28 billion surplus by 1986. As it turned out, the gross domestic product fell by 2 percent in 1982—and the largest deficits since World War II soon followed. In his memoirs, Stockman admitted that the entire effort, sardonically nicknamed "rosy scenario" by White House insiders, was a sham.

**6. Nickel and diming employees.** Too often, the political response to budget problems is symbolic. Leaders order coffee pots unplugged, travel budgets slashed, and consultants banned. To save energy, they force workers to endure hotter offices in summer and colder offices in winter. Some even outlaw potted plants. In one state last year, the governor ordered that every other light bulb in government buildings be unscrewed. While such actions may send a message, they have two critical consequences: they don't save much money and they kill morale.

**7. Delaying maintenance and replacement of assets (and relying on hope).** When our personal budgets get tight, we sometimes don't take our car in for its regular oil change, or we don't fix the crack in the driveway. We can save a little money now, but if a missed oil change leads to overheating, we can crack the engine block. The people who make Fram oil filters said it well: "You can pay me now or pay me later."

Fiscal illusions may help our leaders solve the math problem and claim that their budgets are balanced. But they fail utterly to address the real problem: how to deliver the results citizens want at the price they are willing to pay.

So does the other common dead horse solution: across-the-board cuts. Across-the-board cutting allows us to avoid the hard work of making choices, but it is nothing more than thinning the soup. Every time we use it, we pretend that everything our organizations do is equally valuable to our citizens. We also pretend that they won't notice. Done enough times, thinning the soup makes government services distasteful—contributing directly to lost citizen confidence.

## BUDGETING FOR OUTCOMES

In 2002, Gov. Gary Locke of Washington concluded that it was time to find a new horse. He turned traditional budgeting on its head—accepting the challenge of delivering results citizens valued at the price they were willing to pay. In so doing he literally

changed the rules of the budget game. His success has inspired others to follow. The City of Spokane and Snohomish County, in Washington, the cities of Azusa and Los Angeles, in California, and the State of Iowa have all embraced Budgeting for Outcomes. The State of Washington is now completing its second budget using these principles. "One of the lasting achievements of Gov. Gary Locke should be to make permanent the budget process he used two years ago," the Seattle Times recently editorialized. "The state is using it again, and it needs to keep using it after he is gone."

The following steps constitute the core of Budgeting for Outcomes:

**1. Set the price of government.** Establish up front how much citizens are willing to pay for the results they want from government: what percent of their personal income they are willing to devote to taxes, fees, and charges. Every jurisdiction has its own price, and it is usually quite stable over time. The price of government for the U.S. as a whole, including all federal, state, and local governments, has averaged about 36 percent of personal income for the last 50 years. History is a good guide, since leaders must ensure that the price they set is acceptable, adequate, and competitive.

**2. Set the priorities of government.** Define the outcomes that matter most to citizens, along with indicators to measure progress. Citizens don't think in terms of programs or activities (and certainly not in terms of departments). They want results—things like safety, jobs, and health. Elected officials need to find out and articulate what matters most to their constituents, using many of the same methods they use to get themselves elected:

- Polling—random sampling of public opinion.
- Focus groups—multiple discussions with randomly selected participants.
- Town hall sessions—multiple public discussions with whoever shows up (facilitated by experienced staff).
- Civic journalism—news media initiatives to engage readers, listeners, and viewers in interactive discussions, debates, and feedback about priorities.
- Web sites—feedback collected in response to efforts to heighten awareness.

Generally, you should select 10 or fewer outcome goals. In the end, these priorities should be expressed in citizen terms using indicators that citizens would use to assess progress. In choosing indicators:

- Include both subjective and objective measures (citizen perceptions of safety and the crime rate, for example).

- Don't settle for activity data that is readily available; commit to indicators of real results.
- Use an index if necessary to capture multiple sources of related data. Washington developed an index of health that combines data on the incidence of major diseases, for instance.

■ In the end, the acid test is whether the priorities and indicators you have chosen make sense to citizens. Snohomish County in Washington literally put their priorities in the terms that citizens use. Here they are:

1. **Transportation**—I want reasonable and predictable travel times.
2. **Safety**—I want to feel safe where I live, work, and play.
3. **Education**—I want kids in my community schools to pass the state school achievement tests.
4. **Health and Vulnerability**—I want to improve the health of people in the community and reduce vulnerability of those at risk.
5. **Community**—I want to live in a thriving community, one with infrastructure sufficient to support planned growth.
6. **Preparedness**—I want my community to be prepared to respond to emergencies.
7. **Effective, Efficient, and Transparent Government**—I want to get the level of service I need at an affordable price and see that my dollars are spent wisely.

**3. Set the price of each priority.** Divide total revenue among the priority outcomes on the basis of their relative value to citizens. Here again, ask citizens for guidance. Give them \$100 or 100 percent to divide among the priorities, based on their assessment of relative value. There is no right answer to this question—it is a matter of judgment. The goal is to put a relative value on each result citizens seek. Executives must make the final call, but knowing what citizens think makes their job a lot easier.

**4. Develop a purchasing plan for each priority.** Create “buyer teams” to act as purchasing agents for the citizens. Ask each one to determine what matters most when it comes to delivering its assigned result. This is a crucial step—and an exciting one. It challenges team members to get outside of their day-to-day work, step back, and explore which factors have the most impact on the desired result, whether they are part of what government does or not.

This means answering questions such as, “When it comes to student achievement (or the health of citizens, or decreasing congestion), which factors have the most impact, and how do different factors interact?” The answers can be compiled into cause-and-effect maps that provide the basis for deciding which routes to follow.

Creating such a map requires those involved to be clear about how they think activities add up to results. Doing so subjects each “theory of what matters most” to a challenge from every competing theory—exactly the kind of debate the budgetary process should stimulate.

These cause-and-effect maps help purchasers choose from among many possible strategies and to assign a relative priority to each. Washington State's health team identified four possible strategies: increasing healthy behaviors (getting citizens to eat better, drink less, quit smoking, get more exercise, etc.); mitigating environmental hazards (ensuring cleaner water, air, and food); identifying and mitigating risk factors related to gender, socioeconomic hardships, and genetic predispositions; and providing access to appropriate physical and mental health treatment. These four strategies appeared on the state's map.

When the team ranked these strategies in terms of their contributions to the end result, it decided that mitigating environmental hazards was most important, increasing healthy behaviors was second, providing access to health care was third, and mitigating risk factors was fourth. With limited resources, it decided to increase the state's emphasis on the first two. Research data had convinced team members that this was the way to get the most bang for its buck, even though it meant reducing spending on more traditional—and highly expensive—patient care. In fact, their analysis showed that these two strategies would yield a 16-to-1 return on investment.

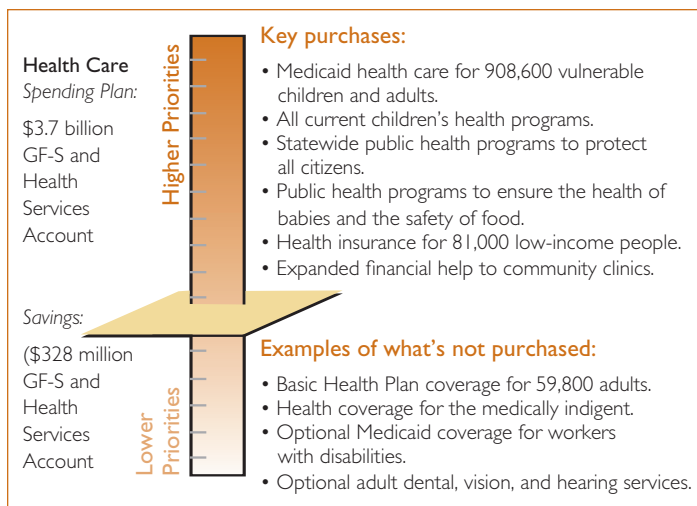
The old budget game would have led the health team to focus on the strategies with the greatest costs. The new approach required the team members to ignore last year's numbers and figure out where the best results could be obtained for the money available.

**5. Solicit offers from providers to deliver the desired results.** With their outcome goals and strategies clearly in mind, buyers then solicit offers to see who can deliver the most results for the money. This is the step that departs most radically from the old budget game. Instead of asking agencies or departments to add or subtract from last year's costs, the purchasing agents incorporate the results, price, and purchasing strategy they have settled upon into something like a request for proposals—call it a “request for results”. This solicitation replaces the traditional budget instructions. The request for results can be sent to all agencies and departments, to other governments, even to unions, nonprofits, and for-profit organizations. It asks each of these potential suppliers to identify how they would help deliver the expected results, and at what price.

In developing their responses, sellers need not, indeed cannot, take anything for granted. They must assume that for each result there will be many proposals from many potential sellers. If they expect to get funded, they have to offer up proposals that deliver the needed results at a competitive price. Since an individual bidder may choose to submit multiple proposals (for its various programs and activities), it is in a sense competing against itself. This forces it to challenge its own practices, to make them as competitive as possible.

Sellers are not limited by the past; the process encourages them to come up with new approaches and creative twists. Some will forge partnerships across departments or agencies, with other governments, and with nongovernmental organizations. The bidding process also encourages them to consider ways they could contribute to more than one of the priority outcomes. While it is challenging to bidders, the process also liberates them.

**6. Buy the best, leave the rest.** After the offers are in, the buyers must rank them in terms of results delivered per dollar, then move down the list, buying according to priority until available funds have been exhausted. Then draw a line. Those proposals above the line are in, the rest are out. This buying plan becomes the budget. It is a list of keeps, not cuts—positive choices for spending the citizens’ resources to buy the citizens’ results. The diagram below, from the Washington budget presentation, shows how this was done for the health result.



Laying out the budget this way is another radical departure. In tough times, the traditional process makes us put 100 percent of our time and energy into finding the 5 to 15 percent to cut. When we are done, we publish the list and set ourselves up for attack by the interests directly affected. In Budgeting for Outcomes our energies go into deciding what to keep, and where to draw the line. At

the end of this process, the support of those above the line can counterbalance the opposing arguments of those below.

**7. Negotiate performance agreements with the chosen providers.** Finally, frame the budget as a collection of performance agreements. These should spell out the expected outputs and outcomes, how they will be measured, the consequences for performance, and the flexibilities granted to help the provider maximize performance. As a result, accountability is built into the budget.

## LEADERSHIP THAT “CHANGES THINGS TO MAKE THINGS BETTER”

When Peter Hutchinson was superintendent of the Minneapolis Public Schools, his favorite activity was visiting classrooms. One day, in a fourth grade classroom, the teacher stopped the class to introduce him. She explained that he was the superintendent of schools and asked the class if anyone knew what a superintendent was.

Hands flew into the air. (Fourth graders are so enthusiastic about learning that they will take a stab at any question.) The teacher called on an eager young man who proudly announced that the superintendent was the guy in charge of Super Nintendo. The teacher allowed as how that was a very creative answer, then explained that the superintendent was the leader of the schools.

“Does anyone know what a leader is?” she asked. Hands flew again. The teacher called on a young girl in the back who was raising her hand so hard and high that Peter was afraid it might become detached from her body. She stood very straight and tall as she answered, “A leader is someone who goes out and changes things to make things better.” Hutchinson was stunned: A fourth grader had articulated perfectly what government needs—and what people expect.

It’s time for leaders to dismount the dead horse strategies that are taking us nowhere. Budgeting for Outcomes means saddling up to “change things to make things better.” Can we live up to that fourth grader’s expectations? Given what is at stake, do we have any other choice? ■

This article is adapted from *The Price of Government: Getting the Results We Need in an Age of Permanent Fiscal Crisis*, a new book by **DAVID OSBORNE** and **PETER HUTCHINSON** (Basic Books, 2004). Both Osborne and Hutchinson are partners in the Public Strategies Group ([www.psg.us](http://www.psg.us)), a consulting firm whose mission is “transforming governance.”