

Performance Budgeting in the States: An Assessment

By Yi Lu and Katherine Willoughby

This article examines the state of performance budgeting in the 50 American states. We examine the evolution and institution of performance budgeting across a decade featuring two economic downturns, including the Great Recession. We update the status of performance budgeting laws in state governments and then assess the relationship of performance budgeting and state fiscal health. We talked with 27 public officials and managers from 10 state governments about their performance budgeting systems in addition to analyzing data on state budget laws and measures of state fiscal health.¹

Our findings indicate that performance budgeting, if conducted consistently, benefits the long-term fiscal health of the practicing state government. Most significantly, such systems can provide government officials and managers the data they need to manage effectively through hard times.

Benefits and Challenges of Performance Budgeting

Performance budgeting, or performance-informed budgeting, is defined here as an information system requiring the development and reporting of performance measures that are applied to government programs, services, and activities; and a system in which decision-makers use these measures in the budget process. The potential benefits of this reform seem obvious. A well-constructed and implemented performance budgeting system should restructure a decision-maker's thought process from a strictly accounting to a performance-oriented one; that is, from bean-counting to an interest in return on investment.

Performance information that is accessible, reported, and transparent can help to:

- Break down silos among departments, agencies, and programs and across branches of government
- Bring public officials and managers together to develop and support government-wide goals and plans, thereby unifying the direction for government



- Provide decision-makers, constituents, the general public, and others with a better understanding of what agencies are doing, how they are doing, and what changes to policy may be necessary to reach determined goals

There are significant challenges to successfully implementing performance budgeting in government. The effort must be championed by leaders in both the executive and legislative branches. Agency and program managers and staff, program clients, constituents, and the general public must trust that their government leaders support the system and actually use the information produced to inform their decisions. It takes political will on the part of elected officials to acknowledge and digest performance information when deliberating about budget and fiscal plans.

Measurement itself is a challenge—agreement on what measures to use; development of realistic, meaningful, valid, and reliable measures; and a mix of qualitative and quantitative analyses are necessary components of a strong performance



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budgeting system. One executive budget director says:

Whenever you are going through development of a budget or reviewing a budget request ... you should never look at one single source of information as the absolute and definitive. Performance measures are one piece and then there is a variety of other types of analysis, both quantitative and qualitative, about what is going on in agencies ... about what they are accomplishing. [Performance measurement] doesn't tell you the answer to every question. Often it helps us identify more questions than answers.

Perhaps most important, there needs to be a culture that embraces continuous improvement rather than one that is punitive. Punishing agencies that do not meet performance targets (such as by cutting their budgets) hampers implementation. Performance budgeting systems are strongest where data informs rather than drives budgeting decisions.

Legislating Performance Budgeting: What Difference Does it Make?

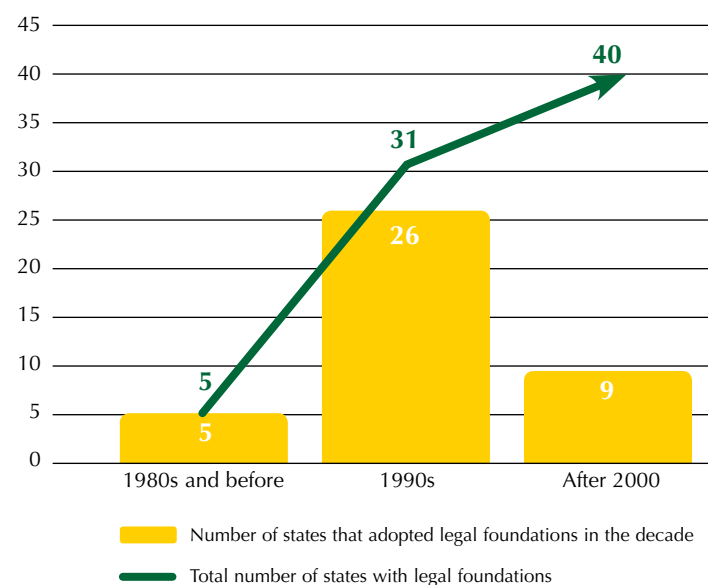
A vital foundation for an effective performance budgeting system is a legal requirement (Lu, Willoughby, and Arnett, 2009). And the more comprehensive the state law (legislation includes specifics regarding performance measurement development, information, and reporting, and clear stipulations of responsibility for information development and reporting), the stronger the performance system in action (Lu, Willoughby, and Arnett, 2011). The 1990s was an explosive decade for performance budgeting law in the American states, with 26 states adopting new performance budgeting laws. Just five states adopted such law in the 1980s or earlier.

By 2004, 33 states (66 percent) had maintained, amended, or added legislation requiring a performance budgeting system, while 17 states (34 percent) had an administrative requirement or executive mandate for such legislation (Melkers and Willoughby, 2004). An update of state performance budgeting laws indicated that by 2009, 39 had such legislation (Lu, Willoughby and Arnett 2009).

By January 2012, 40 states had a performance budgeting law on the books; the most recent addition is Pennsylvania.² Figure 1 presents the advancement of performance budgeting laws in the American states over several decades. Figure 2 ranks the 40 states with performance budgeting law according to the comprehensiveness of the legislation. Iowa and Alaska have the most comprehensive legislation.

We compared states with performance budgeting law versus those without against their Budgeting for Performance scores as graded by the Government Performance Project (GPP) in 2008.³ States with a law score higher for their performance budgeting systems as practiced. That is, 31 states with a law (79 percent) received mid-level or strong scores from the GPP for their conduct of performance budgeting, while four of 11 without a law (36 percent) received mid-level scores

Figure 1: Performance Budgeting Laws in States, by Decade





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for their use of performance information for resource allocation decisions.⁴ Most states without a law (seven of 11, or 64 percent) were scored as weak in their conduct of performance budgeting.

Does Performance Budgeting Matter to State Fiscal Health?

To assess the impact that a law and the practice of performance budgeting can have on state fiscal health, we collected data on performance budgeting laws and practices as well as measures of fiscal health in the 37 states with performance budgeting laws spanning the years from 2002 to 2010.⁵ We counted how many years a performance budgeting law was in place in each of these states for this decade to measure longevity of law. We used GPP scores for states in the management area, Information, as a proxy measure of the strength of practice of performance budgeting in these states across the years of interest.⁶ We calculated the following fiscal ratios for each state for each year in the decade of interest: current and operating ratios, long-term liability ratio, and expenses per capita (in real dollars).

After controlling for political, social, and economic factors, we found that:

- Law longevity is positively related to modest fiscal health improvement in two measures, current ratio and expenditures per capita. The longer a state has performance budgeting law on the books, the larger its current ratio. That is, a longer history of performance budgeting law positively impacts state liquidity.
- Longevity of a performance budgeting law dampens expenditures per capita. States that have laws in place for longer periods indicate significantly lower expenditures per capita than states where laws are new or quickly repealed. Lower expenditures per capita suggest stronger service-level solvency and less expensive government.
- Stronger performance budgeting systems (the proxy measure used for this was a higher GPP score for the use of performance information) lead to lower long-term finan-

cial liability ratios. That is, states with the strongest performance budgeting systems as practiced indicate stronger fiscal health in the long run, as evidenced by lower long-term liability ratios.

These results suggest that a consistent and strong application of performance budgeting positively impacts the long-term fiscal health of state governments. Over time, the culmination of decisions made using a performance budgeting system seems to foster stronger long-term solvency in these governments.

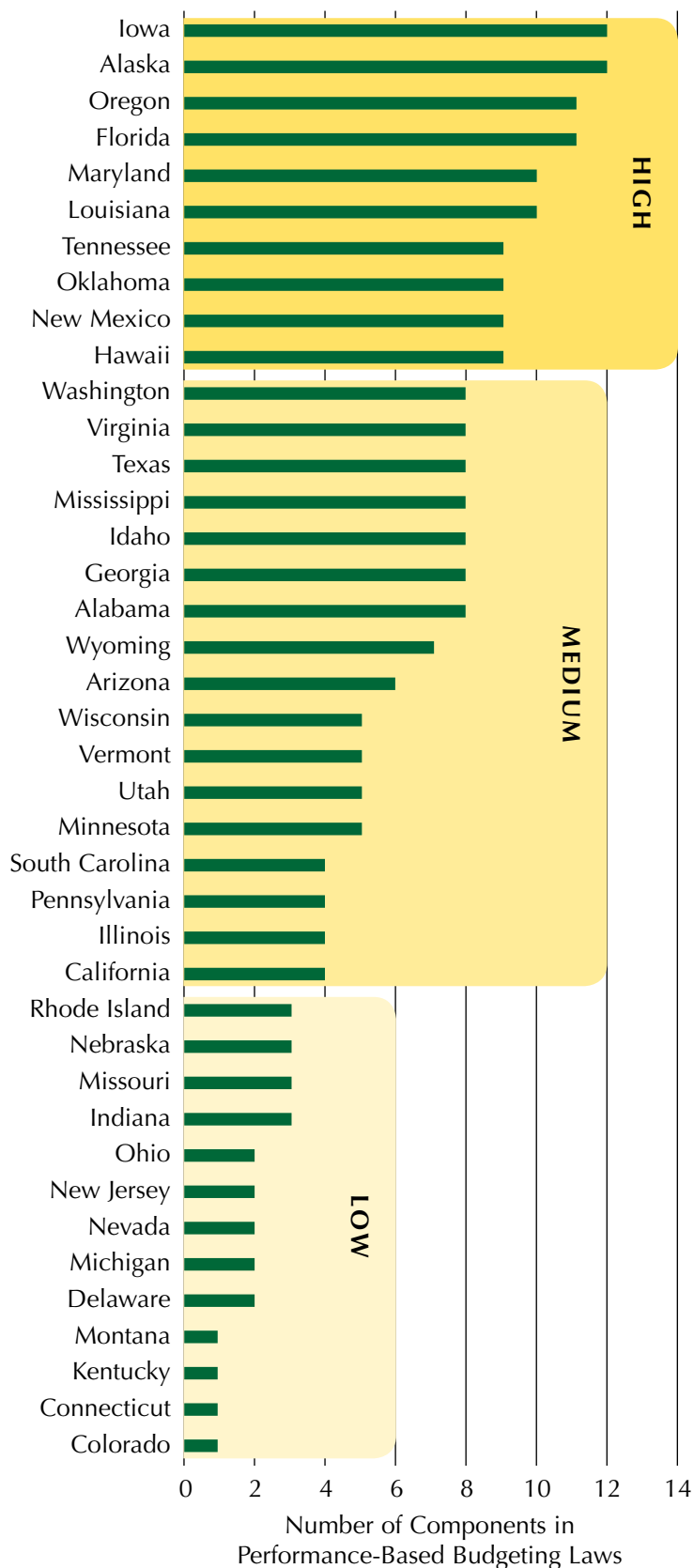
The Road Ahead: Recommendations

The most important finding is that there is a positive fiscal impact, albeit modest, related to legislating performance budgeting in state governments. The strongest impact of legally requiring and practicing performance budgeting is on government's long-term fiscal health.

Conversations with those whose states have a performance budgeting law say performance budgeting helps them make hard choices. In those states where performance budgeting



Figure 2: Comprehensiveness of Performance Budgeting Laws in the States



works (where the GPP score indicates that performance budgeting is strong), performance data may not be used for every budget decision, but when they are used, they are helpful and provide guidance. These systems suggest that it is important for the information to be there and for measures to be reliable and understandable. The result of using measures for decisions (sustained system implementation) is stronger fiscal health.

Given these findings, we set forth four recommendations for states to continue to advance performance budgeting:

- Recommendation One:** To the states that do not yet have performance budgeting law on the books, they should adopt a law prescribing a performance budgeting system to hasten system implementation. Legislating performance-informed budgeting improves the odds of shared responsibilities between the executive and legislative branches. Our research shows that the longevity of legal foundations for the conduct of performance budgeting is positively associated with cash solvency (higher current ratio) and service solvency (lower expenses per capita).
- Recommendation Two:** To the 40 states that have a performance budgeting law, they should periodically revisit and update it to strengthen what works and to repair or discard what does not. Tweaking laws improves comprehensiveness and can strengthen the use of performance information for decision-making. Specific attention to key components of law presented here can help strengthen an existing performance budgeting system. As an official commented in one state well known for using benchmarks that had been tracked for 20 years, the benchmarks needed to be refreshed, “the system needed a jumpstart.” Continuous attention to revise legislation as well as the process renews the culture of performance management and budgeting.
- Recommendation Three:** To all states that seek a strong performance budgeting system, they should create and cultivate a dialogue related to performance information among all staff, managers, and decision-makers in the process. The dialogue, to use one interviewee’s comment, “makes people ask themselves why are we doing this and what is the result we are expecting out of [it]? It starts a set of thought processes.” In addition, a performance dialogue emphasizes the social context of measurement that is different from auditing. According to another state official, “benchmarks are most useful, but what comes from that is a means to connect agencies with the community and creating a dialogue, what do agencies do? ... The [funding] decisions should not be driven by data, but informed by data.” This is the function of a performance dialogue.



- Recommendation Four:** To all states that seek a strong performance budgeting system, they should make the investment today and use it to focus on the long-term fiscal impact of a consistently practiced system. Particularly important is the investment in staff. One official reports, “At end of day, the most important thing you need is experienced staff. There’s no substitute for well-trained, experienced staff that understands what they are looking at when they look at the data. You could have performance data, but if you don’t have staff that understand and interpret and know the questions to ask then it’s just information and doesn’t do you any good. Experienced staff want multiple sources of information and pieces of data to help them make decisions.”

The research findings presented here indicate that having a performance budgeting law in place over time positively impacts state government fiscal health. Interviews with state officials from ten states that have performance budgeting law confirm the benefits of creating and using performance information for budgeting, as well as the challenges to conducting performance budgeting well. The results here are conclusive: a sustained commitment to performance budgeting improves the long-term fiscal health of American states. More specifically, performance budgeting, when consistently practiced, provides state officials, managers, and decision-makers the data they need to manage through hard times. Performance budgeting is well worth the investment. ■

References

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Notes

- We interviewed a mix of budget, finance and audit officers, managers, and analysts in the executive and legislative branches of ten state governments. Interviews were from 20 minutes to an hour each and were conducted from January to June, 2012. The sample included the following: executive budget office (10, representing eight states and including one group interview of three from one office); transportation department (5); legislative fiscal or budget office (7, representing six states with one group interview of two from one office); department or division of audits or performance audits (5). Those interviewed were assured confidentiality and are not personally identified here. Comments are identified by position title or office and branch of government and not by name or state.
- As of January, 2012, ten states do not have performance budgeting laws, including Arkansas, Kansas, Maine, Massachusetts, New Hampshire, New York, North Carolina, North Dakota, South Dakota, and West Virginia. These states may have had such laws in the past and/or may have vestiges of past administrative reforms or executive requirements for performance budgeting.
- The second criterion used to grade states on their management of information was titled Budgeting for Performance and was defined as “Elected officials, the state budget office and agency personnel have appropriate data on the relationship between costs and performance and use these data when making resource allocation decisions.” This criterion serves as the GPP’s proxy measure for performance budgeting as practiced in the states. For more information about the GPP surveys on state government management, measurement criteria, and scoring methodology, go to: <http://www.pewstates.org/projects/government-performance-project-328600>
- Pennsylvania just passed its performance budgeting law in 2012 and so is counted as a state with no law for the calculations here.
- Out of the 40 states with performance budgeting laws, Alaska, Nebraska, and Pennsylvania are not included in this analysis. Alaska is a fiscal outlier; Nebraska is a political outlier, and Pennsylvania adopted its performance budgeting law outside the timeframe under study.
- This variable is created using GPP grades A to D (scored A = 10, A- = 9, etc. to D = 1) for Information and Managing for Results in 2001 (average score serves as proxy for years 2002 and 2003); Information grades in 2005 (proxy for years 2004, 2005 and 2006) and Information grades in 2008 (proxy for years 2007 to 2010). Information grades in 2005 and 2008 incorporated criteria included in Managing for Results in the 2001 GPP. That is, Managing for Results was not a separate, graded category in the 2005 or 2008 GPP.
The Information criteria include five categories of measures: (1) strategic direction, (2) budgeting for performance, (3) managing for performance, (4) performance auditing and evaluation and (5) online services and information. For more detail about the measures within these five categories, go to: <http://www.pewstates.org/projects/government-performance-project-328600>