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Report to the Director of the Office of Management and Budget

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# PERFORMANCE BUDGETING

## State Experiences and Implications for the Federal Government

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The Honorable Leon E. Panetta
Director, Office of Management
and Budget

Dear Mr. Panetta:

We have prepared this report to convey to you, and others interested in the budget process, the uses and limitations of performance measurement and budgeting as experienced by selected states. This report describes the experiences of these states, regarded as leaders in performance budgeting, and discusses the potential implications of these experiences for the federal government.

Advocates of performance budgeting—budgeting that links performance levels with specific budget amounts—have argued that systematically presenting information on agency and program performance will improve budget decision-making by focusing choices on program results. The Senate's recent passage of the Government Performance and Results Act of 1992, which calls for a series of pilot projects dealing with performance measurement and performance budgeting, indicates renewed interest in this subject at the federal level.

## Results in Brief

Despite long-standing efforts in states regarded as leaders in performance budgeting, performance measures have not attained sufficient credibility to influence resource allocation decisions. Instead, according to most of the state legislative and executive branch officials we interviewed, resource allocations continue to be driven, for the most part, by traditional budgeting practices. Reasons for this condition include difficulties in achieving consensus on meaningful performance measures, dissimilarities in program and fund reporting structures, and limitations of current accounting systems.

Outside the budget process, state officials say that performance measures have aided managers in (1) establishing program priorities, (2) strengthening management improvement efforts, (3) dealing with the results of budgetary reductions, and (4) gaining more flexibility in allocating appropriated funds. Many officials in all five of the states we visited told us that performance measures are more likely to be used and maintained if they are linked directly to agency missions and program objectives and are agreed upon by both the legislative and executive branch.

To gauge the potential implications of these state experiences for the federal government, we convened a panel of federal officials from the Congress and the executive branch. The panel members generally concurred with the views of their state counterparts. They noted that the federal government has spent considerable effort and had some success in applying performance information to improve operations. Panel members suggested that obtaining agency managers' consensus on measures prior to use in the budget process may reduce their concerns that weak performance will result in funding reductions and may minimize efforts to bias the data. Although panel members generally agreed on the value of performance data within the budget process, they suggested that the tensions and obstacles that have frustrated state performance budgeting efforts, and the inherent difficulty of comparing performance across fundamentally different programs, would be at least as formidable at the federal level.

If enacted, the pilot project structure described in the Government Performance and Results Act may provide an appropriate forum at the federal level to further develop performance measures and test their applicability to the budget. However, based on the views of state and federal officials, we believe that a variety of factors—including improved performance measures and supporting mechanisms, such as cost accounting systems, as well as recognition of inherent conflicts with traditional budget decision-making processes—suggest that fundamental change will be required to support performance budgeting.

## Background

The traditional approach to budgeting focuses on incremental changes in detailed categories of expenses (for example, salaries, travel, equipment, supplies, and so forth) called line items. Reform efforts in federal, state, and local governments have attempted to change the emphasis of budgeting from line item expenditure control to the allocation of resources based on program goals and measured results.

The concept of performance budgeting was first championed in 1949 by the Hoover Commission at the federal level and by similar reform commissions at the state and local levels. The Commission envisioned performance budgeting as building upon detailed agency activities and being presented in terms of a few broad governmental functional classifications. Measures of the work and costs necessary to carry out activities were promoted as replacements for traditional line item controls. Under such a model, budgets would be developed based upon unit costs and service expectations followed by analysis of actual work performed compared with budget estimates.

In the 1960s, planning, programming, and budgeting systems attempted to further advance budgeting techniques by presenting budget choices more explicitly in terms of public objectives. With such systems, the cost and effectiveness of programs were to be evaluated in a multiyear framework and alternate approaches were to be considered. In the late 1970s, zero-based budgeting attempted to analyze the incremental change in a program's output at different levels of funding. For each program, a "decision package" would specify objectives and measures of efficiency, effectiveness, and work load for alternate levels of funding. However, despite these attempted reforms, traditional budgetary presentation and appropriation structures have persisted in many areas. At the federal level, program activities may be the centerpiece of an agency budget request, but the line item (called object classification) is often the de facto control used by appropriators.

Recently, the Congress has shown renewed interest in the use of performance measures at the federal level. In 1990, it passed the Chief Financial Officers Act, which requires the systematic measurement of performance by federal agencies. In 1992, the Senate approved the Government Performance and Results Act, which, if enacted, would establish at least ten 3-year pilot projects in program performance measurement beginning in fiscal year 1994 and at least five 2-year pilot projects in managerial flexibility that include waivers on personnel ceilings, compensation limitations, and restrictions on funding transfers between expense categories. Another provision of the bill would direct the Office of Management and Budget to conduct five 2-year pilot projects in performance budgeting starting in fiscal year 1998. According to this provision, "Such budgets shall present, for one or more of the major functions and operations of the agency, the varying levels of performance, including outcome-related performance, that would result from different budgeted amounts." In recent testimony,[1] we stated that changing the government's focus from ensuring that funds are spent properly to managing dollars to produce agreed upon results will be difficult, gradual, and require a strong commitment from those involved.

[1]Performance Measurement: An Important Tool in Managing for Results (GAO/T-GGD-97-35, May 5, 1992).

## Objectives, Scope, and Methodology

The objectives of this study were to gather information on (1) whether states regarded as leaders in performance budgeting used performance measures in state budgets for budget decision-making and (2) the potential implications of state experiences for federal efforts to institute performance budgeting.

To identify states regarded as leaders in performance budgeting, we relied on a state government association survey,[2] a study of states' use of performance information,[3] and a state legislative research paper.[4] We selected 12 states for further consideration based on a variety of factors, including their rating in the documents cited above and the type and coverage of measures presented. We contacted the budget officials in these states by telephone to find out how long performance measures had been included in their state budgets and to confirm that they were being used. Based on responses to our inquiries, we selected Connecticut, Hawaii, Iowa, Louisiana, and North Carolina to visit. These five states had the following self-reported characteristics:

- Each regularly published performance measures in its budget documents.
- Each reported using a variety of measures, including effectiveness and productivity measures.
- Each had used performance measures through at least two budget cycles in a program or modified program budget format.

We asked each of these state's central budget staff to identify (1) legislators who had expressed an interest in performance information and (2) program managers who, in their opinion, had used performance measures successfully. In each state, we interviewed these program managers, legislators and their staffs, and representatives from the office of the governor or central budget and planning staff, to determine if they used the performance measures reported in the state budget documents and to obtain their opinions on the usefulness of performance measurement. We asked each official to rate the potential and actual use of state performance measures for a range of applications, including budget justification, management improvement, efficiency optimization,

[2]"The Use of Performance Measures by the States, Performance Measures Special Study Group, National Association of State Budget Officers" (Chicago: April 6, 1991).

[3]Robert D. Lee, Jr., The Use of Program Information and Analysis in State Budgeting: Trends of Two Decades, Department of Public Administration, The Pennsylvania State University (University Park: March 1991).

[4]Development of a Performance Measurement System for Kentucky State Government, Research Report No. 247, Legislative Research Commission (Frankfort: February 1990).

resource allocation, decision clarification, and public reporting of program performance.

Finally, we convened a panel of federal legislative and executive budget officials familiar with the use of performance measurement in budgeting. We asked the federal representatives to review a written summary of our findings and to discuss implications for federal performance budgeting efforts. As in our state visits, we selected panel members based on their interest and involvement in developing and using performance data.

Between December 1991 and March 1992, we interviewed state officials and analyzed selected state budgets and program documentation. We convened the federal officials' panels on October 30 and November 2, 1992.

## Considerable Obstacles Inhibit the Use of Performance Measures in Resource Allocation Decision-Making

Generally, and despite inclusion of performance measures in some state budgets for many years, most state officials we visited reported little change in their budget process. Representatives from all groups of officials we interviewed were generally proponents of performance budgeting and thus said that there ought to be a stronger connection between performance and resource allocations. However, nearly all of the officials we interviewed were dissatisfied with the measures currently included in their budget documents. Each of the states we visited included performance measures in its budget, but these

- were usually appended as "overlays," adding to, but not supplanting traditional expense category data;
- were typically the remnants of earlier budget reform efforts and not (1) the product of deliberative and iterative efforts involving all participants or (2) focused on common understandings of where and how such measures would be used; and
- were generally incompatible with existing accounting systems and disconnected from traditional legislative decision processes and techniques.

### Legislative Branch Officials

Of the state officials we interviewed, legislators and their staffs were the least satisfied with current performance measures. Overall, they said that current performance measures have little credibility and are of little or no use in allocating resources.

Although budget documents in the states we visited included performance information, most legislators, according to their staffs, still rely on budgeting by categories of expense, commonly referred to as line item budgeting. Legislative officials told us that performance information tended to be ignored for two reasons.

- First, performance data have not replaced underlying expense category data, which are still provided in budget justifications. When expense category data are combined with the traditional legislative prerogative to earmark appropriations for specific spending priorities, the result is a process in which state legislatures are provided with familiar means to control and affect spending patterns.
- Second, performance information is program-based, while state appropriation account structures typically are not. As a result, legislators cannot easily relate program performance data to appropriation account structures, which form the basis for resource allocation decisions.

Comments of legislative staff in every state we visited disclosed tensions about the implementation of performance budgeting. Legislative officials recognized that performance information can enhance oversight of executive branch actions—and thus promote accountability—but that it can also complicate resource allocation decisions. For example, the link between performance measures and resource allocation decisions is not straightforward, even where there is agreement on particular performance measures; as one legislator noted, "a program that has good performance measures will not necessarily get rewarded in the budget process." Also, performance budgeting, especially when resources are limited, highlights trade-off decisions, thus stimulating disagreement in an already contentious process. Conversely, line item budgeting has the benefit of efficiently achieving budgetary decisions while masking inherent program trade-off questions.

Legislative staff also cited short legislative sessions, small staffs, and the need to respond to constituent priorities as factors that have inhibited legislators' ability to use or become involved with the development of performance measures. Many legislators and their staffs said that they also do not have the time or the resources to assess the reliability of performance data reported in budget documents. Some legislative staff noted that the data collected in a variety of accounting, personnel, and program-related systems are often incompatible or questionable. They noted, for example, that present accounting systems are unable to generate unit cost data, and that program data generated by agency-based systems are often viewed as self-serving and geared to promote specific priorities. One legislative analyst expressed the opinion that executive branch control of performance measurement development and reporting had increased executive discretion over spending priorities at the expense of legislative control of the budget process.

## Executive Branch Officials

Executive branch officials we met with included (1) central staff officials representing budget, planning, and administrative staffs and (2) program managers located in various state departments and agencies. Overall, central staff officials stated that performance measures had been useful principally for internal agency management purposes and justifications for initial budget formulations. Program managers tended to be more optimistic about the detailed performance measures that were kept internal to their agency and said that these measures had been more useful for management improvement efforts than in the budget process.

Central staff officials echoed the concerns cited by legislative officials: that constraints on time, resources, and data inhibit use of performance information in resource allocation decisions. In particular, they cited a budget schedule that does not allow for time needed to analyze and validate departments' performance data. Consequently, they said that measures often reflect what department managers feel comfortable reporting, rather than what central staff believe to be most useful for decision-making. Central staff officials told us that development of financial and outcome measures is still evolving and that these measures provide, at best, unaudited estimates of program costs and proxies for program results.

Central staff officials said that performance measures are not likely to become the "final arbiter" of funding decisions, given the political reality of the budget process. They noted that executive policy prerogatives, rather than program performance, will generally continue to drive the executive budget. Also, particularly during periods of fiscal stress, as we observed in four of the states we visited, central budget staff said that they tended to rely on across-the-board reductions to "spread the pain"—except for the highest priority programs. As one central budget official noted, "The success of a program is not important if we can't afford it."

Most program managers noted that they do not use measures currently reported in their budget documents. These measures are often (1) highly aggregated or (2) mandated remnants from earlier budget reform efforts. They said that internal management needs are best met by more detailed measures that reflect current operations.

Executive branch officials told us that they were not satisfied with the outcome measures produced so far. They noted that developing meaningful performance measures was demanding, time-consuming, iterative, and prone to controversy. Examples follow.

- The development of an education "report card" by one state led to disagreement among state officials concerning the factors affecting achievement. Resolving these issues has proven to be a complicated, contentious, and continuing process.
- One state developed, in response to a court order to provide services to mentally disadvantaged children, an extensive data collection system to track a total service population of less than 2,000. Despite this concerted effort, the state has been unable to develop outcome measures for this $100 million program.

Due to these concerns and the general lack of involvement of legislative officials with measurement development processes, executive branch staff expressed concern about how their legislatures would ultimately use performance information. They were uncertain about (1) the relative weight that would or should be given to this information within the budget process and (2) whether and when performance should be linked to funding decisions.

## Recent Initiatives Could Remove Some Impediments to the Use of Performance Budgeting

The experiences described above have caused some states to refocus their efforts. Many recent initiatives have not been tied directly to the budget process, but have been directed toward redefining relationships among agencies, central budget, and legislative officials, and redesigning management processes and information systems. These initiatives recognize the need to create an audience for performance information by

- including all participants in developing measures,
- emphasizing longer term planning horizons in lieu of annual budget cycles,
- fostering statewide efforts through pilot projects and program-based systems, and
- designing cost and performance data collection systems that emphasize comparability.

## Agreeing on Performance Measures

One concern of agency and program managers is whether and how measures will be used by decisionmakers. In Iowa, the governor holds monthly progress review meetings with his department managers. According to officials, this face-to-face meeting with the governor has served to motivate agency management and central budget staff to develop meaningful performance measures. Although the measures are not currently used for resource allocation decisions, the process has generated agreement on performance measures within the executive branch and trust among the participants.

The state of Louisiana is formalizing the participation of key legislative and executive branch staffs in the development of performance measures. In 1990, a law was passed to create six consensus estimating conferences, covering broad government functions, to generate agreement on the demand for and cost of providing state services. Conference membership, by law, consists of staff from both houses of the legislature, the governor's office, the Department of Administration, and the relevant department. The conferences, which had not met at the time of our visit, are expected to develop indicators and measures for use in budgeting and planning.

## Creating Planning Systems

Several states have begun to refocus their approaches to management and budgeting by emphasizing long-term planning. In many cases, these efforts have been built upon successful program pilots and department-based systems. Recent statewide efforts have avoided top-down directives in favor of a consensual approach to managing change.

For example, Louisiana in 1989 began implementing a comprehensive strategic management process that integrates policy development, strategic and operational planning, budgeting, and accountability. Since then, systems and procedures have been redesigned to support the strategic management concept developed by the state. Staff from its Office of Planning and Budgeting told us that they had invested considerable time and effort in training agency personnel. An important byproduct of this is the consensual working relationship that has developed between central staff and agency managers.

Agency managers voiced enthusiasm for Louisiana's strategic management orientation. Missions, goals, objectives, and performance measures are developed in the context of a 4-year strategic planning horizon. They said that the longer time frame is better suited for the development of performance measures than a 1- or 2-year budget cycle. Managers stated that budgets are no longer thrown together in 2 weeks but instead are now "pulled out" of annual operating plans based on the strategic plan. Some agencies have begun to tie specific action plans to budget resources. The legislature has also provided agency managers in a few pilot programs limited new authority to reallocate appropriated funds among expense categories. Managers are held accountable for annual performance plans through progress review meetings with the commissioner of administration prior to the submission of agency budget requests.

## Developing Performance Models

Legislative and central budget staff in Iowa are coordinating with the Department of Elder Affairs in a pilot program that will emphasize program outcomes. The department was selected for the pilot program because of management's strong interest. These officials expect to (1) define a common set of measures that can be used by both legislative and executive branch officials and (2) create a process in which agency managers will assess department roles, capabilities, and identify client needs.

Pilot projects have also created new accountability models. The Pioneer Funding System in the Division of Mental Health, Developmental Disabilities and Substance Abuse Services in North Carolina provides funding for core services based upon regional and local service-level goals in, as of our visit, 17 of the 41 state area mental health programs. Within broad state-defined priorities, the legislature granted agency management flexibility to determine how its appropriated funds would be distributed and spent by service providers. State officials described several critical factors that came together to make this program possible.

- The North Carolina legislature had a strong interest in mental health programs because of large budget outlays for treatment facilities across the state and an influential mental health lobby.
- A wealth of data on clients and services was available, including the resources of the legislature's 20-year Mental Health Study Commission.
- The close working relationship among the legislative study commission, research community, and program managers helped achieve consensus on core services and service levels to be delivered.

## Redesigning Information Systems

Overcoming the problems of incompatible reporting of program and fund-related data is central to Connecticut's efforts to develop its Automated Budgeting System (ABS). According to developers, the system will have the capability to accumulate costs for programs and projects across organizational structures and build unit costs for services while using existing accounting, personnel, and performance data. Also, ABS is designed to integrate data from various sources to generate program and financial performance measures.

As currently planned, ABS will be administered centrally outside the budget office where it is less likely to be perceived by managers as another fund control system. Instead, officials would like to see the system become institutionalized as a tool box for agency managers' use. The system is designed to collect data from the lowest activity level possible and to allow all users, including legislative staff and the public, on-line access to program and financial performance measures. Officials expect that these features will strengthen accountability and enhance the development of performance measures. They also expressed the hope that an official state data base will change the nature of debate from the validity of the data to the meaning of the data. In 1991, the system was implemented in 5 state agencies, with additional agencies scheduled to be included.

## Implications of State Experiences for the Federal Government

Many members of our expert panel agreed that performance information should be a consideration in budget decisions. However, they were not optimistic about the potential to establish direct "mechanistic" links between performance measures and resource allocations, particularly if performance budgeting is mandated before issues, such as those raised in this report, are addressed. Rather, they saw such measures as essential components of agency and program management, which, over time, could begin to influence budget decisions.

Panel members said that linking performance to specific levels of funding would likely increase tensions within the appropriations process. Under the existing budgeting system, winners and losers in the resource allocation process are less apparent than they would be with performance budgeting, which explicitly shows the amount of services or benefits to be distributed with available funding. Also, panel members questioned whether or how performance information could be used to make funding decisions between dissimilar program activities or even to relate the performance of similar program activities.

Panel members discussed another tension—that between resource allocation and the reliability of the measure. When measures are used for resource decisions, the potential or inclination to bias the data to show favorable results may be more pronounced. Assuredly, agencies will have little incentive to report accurately if they fear the results of measures will be budget reductions. To minimize this potential, panel members said that a consensus on measures should emerge over time as they are used to manage agencies, and that a consensus must be reached before measures are introduced in budgeting.

Panel members noted that federal agencies typically generate an abundance of performance-related data that frequently are not subject to interpretation and analysis. Some suggested that the Congress must be more explicit concerning the strategic objectives of programs, so that more pertinent measures could be developed and reported. Others observed that consensus on measures may more likely result after the Congress receives and responds to information in program performance reports. Most agreed, however, on the importance of customizing measures to fit specific programs and on the need to use more than a few measures to capture the complexity of a typical federal program.

Consistent with state officials, panel members saw the current disparity between budget, accounting, and program structures as serious obstacles to performance budgeting. The current appropriation account structure, with its emphasis on fund type and expense detail (for example, "salaries and expenses"), may be efficient for allocation and control, but it is not effective for program review and evaluation. Similarly, panel members noted that many agency accounting systems are unable to develop unit cost data, which is essential if performance is to be related to resources. Last, panel members noted that the common practices of collecting performance data from sources external to agency financial management systems and reporting the data in an unaudited or unanalyzable format diminishes its reliability and utility for budgeting purposes.

The panel agreed that continued development and use by executive agencies of performance data in administrative decision-making will increase their utility in the budget process. As one panel member said, through renewed attention to performance measures, "budgeting is being pulled back into the family of management." This panelist asserted that as elements that support performance measurement—strategic planning, cost accounting, and program auditing and evaluation—gain greater attention through legislation such as the CFO Act and, if enacted, the Government Performance and Results Act, resource allocations are more likely to be influenced by performance information.

## Observations

The state and federal officials we met with were strongly committed to improving performance measurement within the public sector, despite the conceptual and political difficulties just discussed. Pilot projects, as initiated in some of the states we visited and as envisioned in the Government Performance and Results Act, can serve as models for defining and reporting on agency performance, creating management incentives to improve performance, and promoting the use of performance data.

On the other hand, the applicability and utility of performance budgeting to the federal budget process requires a more cautious assessment. The nature of federal budgetary commitments, the variety of service delivery approaches, and the competing and, at times, conflicting goals of many federal programs raise serious implementation concerns.

Even if such questions can be resolved, the opinions of federal officials we spoke with and state efforts to date suggest that performance budgeting will not necessarily evolve naturally. A variety of other factors—including inherent conflicts with traditional budget decision-making processes and the general absence of essential supporting mechanisms, such as cost accounting systems—combine to emphasize that fundamental and extensive change, and not merely improvement in performance measurement, will be required to support performance budgeting.

Furthermore, the persistent difficulty in clarifying the link between program performance and resource levels serves to emphasize that merely changing the focus of the budget allocation process—from items of expense to measured program results—does not alter its fundamental nature as an exercise in political choice. Although performance measurement undoubtedly is an important tool for improving the management and efficiency of federal programs, it is less likely that performance budgeting will to any extent assist in addressing the most pressing federal budget issue—the deficit.

We are sending copies of this report to the Director of the Congressional Budget Office and interested congressional committees. Copies will be made available to others on request.

Please contact me at (202) 275-9573 if you or your staff have any questions. Major contributors to this report are listed in appendix I.

Sincerely yours,

Paul L. Posner

Paul L. Posner
Director, Budget Issues

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