

When Budgeting, Focus on Value

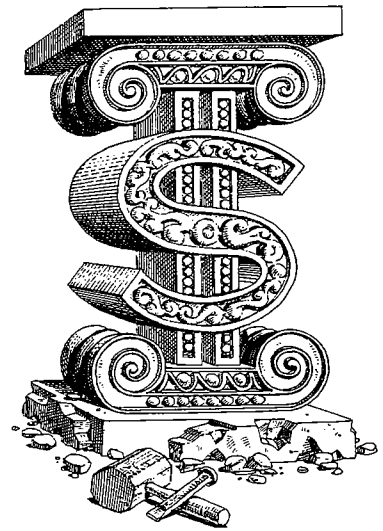
Many, if not most, government budgeting processes lack a clear, rigorous, and consistent focus on maximizing the use of public funds. Instead of allocating resources based upon incremental value to the community, local budgets often are the result of stasis, rivalries, voter apathy, and interest-group haranguing—in other words, politics. This article suggests that when budgeting, local governments should focus more clearly on value provided to the community. Accordingly, the author offers nine strategies for doing so.

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**Nine
Strategies
For Value
Basing
Steven Falk**

**Decisions,
Decisions**

After several hours of budget deliberation, a city's finance director announced that the city council still had \$100,000 available to be allocated for the next fiscal year. One councilmember suggested that the city hire an additional police officer; another suggested that a storm drain be replaced; a third proposed to fund a study to revive the city's downtown retail district. A fourth suggested that the city just salt the money away and let it earn interest.



How can these seemingly incomparable projects be evaluated against each other for funding? In most cases, governing bodies lack the time and/or expertise to challenge the underlying assumptions or designs that support such proposed expenditures, Legislators often are swayed by the government engineer, who can rattle off technical details describing the need for the storm drain: the neighborhood watch captain, making a plea for a beat officer; or the director of the local homeless shelter, seeking funding to keep people from freezing.

One option that localities have pursued when attempting to compare such programmatic apples and oranges involves starting from scratch and ranking proposals on a priority basis. Without firm grounding, however, such "baseline budget reviews" are easily polluted by interest-group politicking and do not necessarily result in the highest-value expenditures for the community.

In these tough budgetary times, local governments should be more rigorous in their analysis when preparing their budgets. In the private sector, corporate analysts compare the net present values they could expect to receive from each proposed expenditure. Finance textbooks provide students with sophisticated models to use in budgeting, and legions of MBAs are graduated each year to guide businesses in their quests to maximize value and return on investment. But rarely do governments subject their own expenditures to such rigorous analyses. How many managers and councils regularly use discounted cash flow, internal rate of return, or net present value when evaluating significant investment decisions?

Value Budgeting

Not many local governments use these tools because, unfortunately, they cannot use the same bag of tricks that private corporations use.

The impact
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10 percent.

Internal rate of return, for instance, is not useful in comparing a Drug Abuse Resistance Education (DARE) program against a new stoplight. Benefit/cost analyses are useful in evaluating the efficacy of individual projects, but such detailed analysis is unwieldy and impractical in reviewing the hundreds of program items that most local government budgets contain. And net present value (NPV), while valuable when assessing risks and returns, is difficult and time-consuming to apply to such local services as swim programs and open space preservation efforts. NPV also is less intuitively understood, which hampers its effectiveness as a decision-making device.

These difficulties, however, do not mean that officials should drop their attempts to value projects objectively and should rely instead solely upon instinct. Indeed, many cities and counties have developed such systems as the baseline budget to identify and deliver high rates of return on expenditures to their constituents. Because such techniques explicitly favor projects with high community rates of return, they can be called *value budgeting* techniques.

Value budgeting requires that officials first establish a context or framework by which they will judge proposed budget expenditures. Budgeteers lay out alternatives, predict the consequences of decisions, and value the various potential outcomes before the decisions are made. This structured approach allows decision-makers to make better choices.

The impact of value budgeting is enormous. Local governments often can cut their expenditures by more than 10 percent with little change in the quality of services provided to the public. And by focusing investment on high-value opportunities and reducing or eliminating low-value programs, a higher level of citizen satisfaction can be achieved. In Lafayette, California, for instance, a special citizen finance committee composed primarily of management consultants recently identified more than \$400,000 in annual savings to be won by applying value budgeting techniques.

To gain value, budgeteers must:

- Reduce the potential for minority stakeholders and other nonvalue-based drivers to dominate the decision process, instead maintaining a consistent focus on providing the greatest good for the largest number of citizens.
- Create incentives for employees to explore and implement lower-cost options for delivering programs and projects.
- Pay attention to day-to-day project and program execution.

Survey-Based Value Budgeting

Walnut Creek, California, uses city-wide surveys as a means of grounding its budget decisions. Every two years, 400 residents are asked to rank city services by importance; the contract survey firm also elicits responses on the services most in need of improvement. Walnut Creek's decisionmakers subsequently study the results of the survey and, ostensibly, make budget decisions based upon the values that the community has espoused on the survey. When most citizens, for example, rank police services as most important and walkway improvements as less important, the council has a firm footing on which to make tough budgetary trade-offs. Surveys tune the council to the community.

The survey technique, while relatively expensive and time-consuming, is increasing in popularity among local governments. It assumes, however, that citizens are perfectly informed about the wide variety of community problems and needs. And while certain needs, such as crossing guards and weed abatement programs, are more visible, others, such as storm drain replacement and pavement crack-sealing programs, are less apparent to the public. A budget based strictly on public perceptions may concentrate expenditures "above ground" while underfunding below-ground and other less visible improvements.

Surveys also are subject to temporary influences. If big rains and localized flooding occur around the time that the survey is taken, for instance, people might be artificially focused on the need for more storm drainage. This focus might divert survey results from larger issues.

Staff Contributions

As a way to counterbalance the pitfalls of surveys, many localities look

Five Symptoms of Inefficient Budgeting

If your budget has any or all of these five symptoms, it may be time to reevaluate the budgeting system.

- 1. Myopic planning.** Budgets set on an annual, incremental basis rather than as part of a multiyear investment program can result in feast-or-famine syndromes and often favor short-run fixes over long-term solutions.
- 2. Blanket budgeting.** Large portions of many budgets often are allocated automatically for preexisting programs that do not require economic justification. Such programs should be tested for value alongside new ones.
- 3. Separate operational and capital improvement budgets.** Operational and capital budgets should not be discussed and treated separately but rather in an integrated fashion.
- 4. Year-End Spending Sprees.** Localities that base next year's budget on expenditure levels in previous years encourage year-end spending sprees with little focus on incremental community value.
- 5. Wrongheaded Incentives.** Inflexible budgets and poorly structured incentives punish field personnel for budget and timeline overruns without considering risk management or economic implications.

to their staff members for suggestions. It often is the staff, at the grass-roots level of the organization, that recognizes where dollars are best spent. Because they monitor the programs most closely, staffers often have the information and insight necessary to make efficient capital decisions. For instance,

- Parks and recreation directors know when baseball diamonds are over- or underused, if tot lots are dangerously crowded or vacant, and whether painting classes are fully enrolled or not.
- Construction inspectors often know which storm drains are most heavily corroded and subject to failure.
- Traffic engineers can guide decisionmakers to the most heavily affected streets.

Employees throughout the organization have years of experience with and insight about the organization. "Home-grown" budget recommendations often can be more accurate, effective, and readily implemented than those conceived off-site. While the public might have perceptions about certain operations based upon incidental experiences, staff members bring years of experience to the table. Naturally, then, they often have good suggestions regarding which programs deliver the most value to the public. Also, employees "own" their recommendations and are likely to ensure their successful implementation.

Nine Strategies for Value-Basing the Budget

There are a number of ways to base a budget more closely on value to the

community. Among them are the following nine approaches:

1. Make your budget a multiyear one. Expenditures on large capital improvements often stretch across several years, and multiyear budgets allow decisionmakers to more accurately compare the values of such projects with each other and with other programs. Two-, three-, or five-year budgets also allow start-up costs of programs to be assimilated into and paid back by long-run operations, thereby reducing perceived financial hurdles and in turn encouraging innovation. Multiyear budgets reduce the opportunity for year-end spending sprees and cut the costs associated with budget preparation and review.

2. Survey your citizens to determine community values, and shape your budget on these priorities. Local governments must develop yardsticks of sorts, and the best way is by using a scientific survey, conducted by professionals. Telephone surveys are more effective than mailers because they require less effort on the part of the respondent and are more immune to self-selection biases. When properly conducted, surveys broaden the governing body's exposure to include all citizens and reduce the influence of narrowly focused interest groups.

3. Evaluate capital and operating budgets at the same time, using the same yardsticks. A dollar is still a dollar, whether it is spent on a storm drain or a police officer. And while localities receive many "pots" of specially earmarked monies, the dollars should—to the greatest extent possible—be allocated according to ranked incremental value to the community. If a survey, for instance, indicates that higher levels of street repair are a top priority for the community, less important general-fund

Suggested Reading

Copeland, Thomas E., and Ostrowski, Kenneth J., "The Hidden Value of Capital Efficiency," *The McKinsey Quarterly*, Number 2, 1993.

Gaebler, Ted, and Osborne, David, *Reinventing Government*, Reading, Massachusetts: Addison-Wesley Publishing Co., 1992.

"A 'How-To' Guide for Assessing Effective Service Levels in California Cities," booklet published by the League of California Cities' City Manager's Department, 1994.

Schelling, Thomas C., *Micromotives and Macrobehavior*, New York: W. W. Norton & Company, 1978.

Stokey, Edith, and Zeckhauser, Richard, *A Primer for Policy Analysis*, New York: W. W. Norton & Company, 1978.

programs should be eliminated to fund the pothole repairs.

4. Do not be afraid to challenge the value of long-running, well-established programs. A program's longevity or size bears no necessary relation to the value it provides the community.

5. Listen to your line employees and provide incentives to focus on value. Staff may have ideas for improving value that are not readily apparent to your citizens. Likewise, it is essential that the managers nurture and leverage employee awareness of value. Incentives are a good way to do this. When employees identify ways to save money, reward them. Fostering upward communication throughout

the organization is critical; workshops can be conducted to help identify and compare value ideas and to brainstorm new ideas.

6. Allow departments to carry savings over from budget to budget. Carryovers encourage savings, reduce the temptation to binge at year-end, and reward managers for their good financial management.

7. Measure results. By quantifying performance levels—such as number of times streets are cleaned or number of drug arrests—decisionmakers can evaluate the effectiveness of programs against each other and over time. Performance measures give decisionmakers insights into ways to achieve cost savings and are the best tool to use when deciding, for example, whether services should be contracted out, remain in-house, or be eliminated. Finally, performance measures establish a vocabulary and therefore lay a foundation for communication, both internally and externally.

8. Do not unnecessarily penalize employees for cost overruns; demand instead ample notice and value justification. A city engineer may have good reasons to explain why a storm drain project goes over-budget: the expenditure may have been required to prevent a large sinkhole from occurring on a major thoroughfare. By allowing staff to exercise good field judgment, the government may save money over the long haul.

9. Finally, do not be afraid to tinker with your budget as better values arise. Advances in computer systems and software have made amending the budget a relative snap, so elected officials and managers should not hesitate to make budget adjustments as better values arise throughout the budgeting cycle. ■

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