Policy Brief
UMBC Policy Brief No. 5 – June 2007

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Addressing Maryland's Structural Deficit through Better Performance Budgeting and Priority-Setting

by Roy T. Meyers

About the Author

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Issue

Maryland faces difficult budgetary choices in fiscal year 2009 (FY09) and future fiscal years. General fund projections show a large continuing deficit—exceeding $1.5 billion a year. Projections of the separate transportation fund show that revenues are insufficient to finance current plans for highway and mass transit facilities and operations. And the budget does not include any future costs of meeting goals held dear by many citizens, such as expanding health care access to the uninsured or improving protection of children in foster care.

How should Maryland respond? Citizens, elected officials, and state employees can think about this question in two different ways—by considering the different <u>policies</u> that would be required, and by reflecting on the best <u>process</u> for choosing those policies. This policy brief analyzes the latter. It recommends improvements to the process that should help Maryland choose appropriate policies.

Background

Since Maryland has the strongest possible bond rating, an emphasis on process may seem misplaced. However, ask yourself: how could it be that the state has developed large projected deficits when the state's economy has been strong and forecasts assume that will continue?

Experts generally agree on the list of major causes. They include:

- high rates of spending growth in selected "mandatory" programs, especially Medicaid;
- a low tax yield relative to the state's wealth, especially after the tax reductions of the Glendening administration;
- an extraordinarily large increase of roughly 60 percent over the last five years in state aid for elementary and secondary education; and
- reliance in recent years on "one-time" methods of financing general fund budget deficits, particularly by transferring in rainy-day and other non-general fund balances.

The latter practice of temporary fixes reveals a problem with Maryland's process. Step back to early 2006, and consider that budget projections from the Department of Budget and Management (DBM) and the Department of Legislative Services (DLS) showed deficits for FY08. Yet, as 2006 was an election year, Governor Ehrlich and the General Assembly decided to stay the course—not changing underlying policies, but reserving temporary cash excesses with the intent of fully spending that cash in FY08. The election campaigns of 2006 ignored the looming structural deficit.

This year, Governor O'Malley proposed a budget that was consistent with the previous year's plan to spend down cash balances, and the legislature followed along. The only "action" by the Governor and legislative leaders to cope with the structural deficit was to reject most popular proposals for new spending. But they also deferred serious consideration of major revenue enhancing proposals. Throughout the session, the quiet consensus was that the deficit would be dealt with later—perhaps in a special session, or at the very latest, in the 2008 regular session.

Part of that consensus was based on the view that Maryland must raise taxes given spending commitments for education and health. Aspects of Maryland's tax system are obsolete, such as the sales tax being imposed primarily on goods while the economy has been increasingly dominated by services. But politicians also know that it is politically dangerous to raise taxes without preparing the public to accept this burden. So Maryland's Democrats made the choice to emulate Democratic Governor Mark Warner of Virginia, who had convinced a reluctant legislature to raise taxes only after imposing significant spending cuts.

Executive Budgeting and StateStat: Advantages and Disadvantages

The executive-dominated budget process of Maryland is particularly suited to this strategy of cutting spending before increasing taxes. The state constitution makes it quite difficult for legislators to add spending to the operating budget proposed by the governor. Once the budget is enacted, DBM apportions funds to agencies and controls agency hiring and other decisions. Through executive orders or with the support of the Board of Public Works, the governor can reduce appropriated funds.[1]

The O'Malley administration entered office ready to use these powers. It appointed experienced administrators to run state agencies, and is implementing "StateStat." Based on the nationally-recognized "CitiStat" approach used in Baltimore, StateStat will require agency leaders to meet frequently with the Governor's office to discuss operational data and actions.[2]

On May 10, 2007, just a month after the legislature approved the stay-the-course budget, Governor O'Malley told agencies to cut spending by $200 million in FY07 and FY08. The intended cuts focused on administrative expenses: reducing staff, limiting travel, cutting inventories, reducing overtime, and centralizing purchasing. Ironically, the current governor was emulating his predecessor, who on June 30, 2003 proposed cuts of $208 million through the Board of Public Works, having neglected to suggest such cuts in the legislative session just concluded.

It is commonly argued that deficits can be eliminated by targeting administrative waste. Maryland has a long tradition of "efficiency and effectiveness" ("E and E") commissions, some of which made important contributions along these lines. The latest "E and E" was appointed in 2003 by Governor Ehrlich as the "Commission on the Structure and Efficiency of State Government." That commission repeatedly violated the Open Meetings Act, and produced little in the way of substantive recommendations.

Because the StateStat approach is at the center of this administration, it will generate savings. Yet these savings are likely to be small. While StateStat will closely examine personnel spending, both DBM and the General Assembly already review and limit personnel spending in great detail. And since these existing controls are complicated and inflexible, arguably they contribute to waste. Approval and audit processes for travel, purchase cards, centralized procurement, and the like appear to be similarly inefficient. In contrast, many other states, the federal government, and other developed countries have "reinvented" government by streamlining administrative processes. StateStat's potential to drive significant cost reductions may hinge on whether Maryland will follow their leads.

The rest of this policy brief analyzes how adopting two related approaches to public management reform could help Maryland address its structural deficit.

The first is commonly known as "performance budgeting." Its premise is that focusing on the costs of inputs, such as personnel and travel, distracts attention from the critical question of whether programs are attaining intended results. Performance budgeting instead gives program managers more flexibility to manage the mix of inputs, and shifts attention to the design and implementation of programs so that intended results are more likely to be reached.[3]

The second approach discussed below is sometimes called "strategic planning," but is probably better described in the public sector as "priority setting." Simply put, the government uses a regular process of data collection and public deliberation to identify major concerns which budgetary and other policies should address.[4] It differs from StateStat in that the focus is broader than agency operations.

Before I discuss these topics, let's remember one of the major causes of the structural deficit—the massive investment in elementary and secondary education. All Marylanders want successful schools. But were the large increases in education funding sufficiently targeted to produce intended results? And what other critical goals have not been addressed because of that investment? Neither the state's leaders nor its citizens can now answer those questions because the budget process is not designed to help them do so. The following sections explain why and suggest solutions.

The Current Status of Performance Budgeting in Maryland

Almost every state has adopted performance budgeting of some type—the reputational benefits are too large not to go through the motions. Skilled people have worked hard in Maryland on performance budgeting, but Maryland has not yet developed an excellent process.

After being prodded by the General Assembly, in 1997 Governor Glendening proposed a system called "Managing for Results" (MFRs); it was continued by Governor Ehrlich. Agencies developed performance measures under the guidance of an interagency steering committee. However, the Legislative Auditor reported in 2003 and 2004 that many agency data were unreliable, and it was often unclear how performance measures related to how programs were supposed to produce results.[5]

In response, a 2004 law required DBM to report to the General Assembly on MFRs; DBM released this report in November 2006, five months later than its statutory due date. The report reasonably argued that MFRs should be informative rather than determinative in management and budgetary processes. Though the report also admitted that agency performance measurement systems needed improvement, it claimed that "Maryland compares favorably to other states in the areas of defining a strategic direction and budgeting for performance."[6]

But independent experts have rated Maryland's performance budgeting as much lower than reported by DBM. In 2005, the Government Performance Project (GPP) and the magazine Governing said Maryland was "weak" in "budget process" and "budgeting for performance."

> The glaring flaw was the state's Managing for Results initiative. Maryland implemented this program in 1997, but it hasn't taken hold and budget decisions continue to be made without being tied to performance data. . . The state's budget process is hardly transparent, however. Maryland needs to pry open the doors to its budget process and let citizens more fully participate in the taxing and spending decisions of this government.[7]

(continued on reverse)

Other evidence of Maryland's limited performance budgeting capacity is provided by the 2004 Ehrlich Administration "strategic budgeting" initiative. Agencies were asked to provide an agency-level strategic planning summary, rank programs by priority, and use a variety of analytical techniques.

This initiative didn't work well in practice. In its recent MFR report, DBM admits that the process was very labor intensive. Most agencies were not prepared to use the recommended techniques. And most importantly, the instructions asked for very little information about program effectiveness. While the Ehrlich Administration threatened that this approach would put 12 percent of agency funding at substantial risk, it later did not report on any significant reductions or eliminations.

Budget preparation instructions for FY08 reveal that the emphasis on performance has been restricted to non-transparent discussions between DBM and selected agencies: "The discussion of program performance will not be published in the budget books, but will be used by budget decision-makers as part of the strategic budgeting process to assess program performance."[8]

A timely example of the limits of this closed performance budgeting process is provided by the FY08 budget for prisons. The summary of the executive budget mentioned increases in funding for additional correctional officers, security cameras, and inmate medical services, but did not clearly connect them to performance measures. Then in March, the Governor closed the Maryland House of Correction (MHC) because of its obsolescence and resulting inefficiency and violence. Media reports emphasized that this prison had long been of great concern within the Department of Public Safety and Correctional Services (DPSCS).

The DPSCS's FY08 operating budget detail included 58 pages of data by object-of-expense and major category, and 44 pages of personnel salary data. There one could find the salary of the MHC's "inventory control specialist" and the amount spent by the prison on "additional equipment." One could not find, however, the MHC's levels of inmate-on-staff or offender-on-offender violence. These data were bundled with similar data for the other maximum security prisons, and included in 64 pages of MFR data. This section included much potentially useful data. It started with the DPSCS's key goals and performance measures (including one for recidivism, which though important is largely out of its control). Yet in 166 pages of detail, there was no display or analysis that clearly described for legislators and citizens the performance problems at MHC or discussed how they might be addressed through budgetary means.[9]

DLS staff has picked up some of the slack by evaluating selected performance measures for the General Assembly during consideration of budget requests. The DLS analysis of DPSCS's MFRs ignored prison violence, but looked at the projected number of canine unit drug scans and compared this activity to the increase in positive urinalysis tests in the Jessup region (where MHC was located). Such analysis can help suggest to legislators ways by which they might change policy and oversee policy execution. However, observers in Annapolis tend to believe that many delegates and senators do not yet rely on MFRs when making budget decisions.

Finally, MFRs do not cover tax deductions, credits, and other preferences; the revenue losses from these preferences are called "tax expenditures," and are often comparable to regular spending. Reporting of tax expenditures is now only biennial, in a printed report that is not distributed widely—it is not available on the web. The report also fails to estimate the costs of a significant number of tax preferences. Other states treat tax expenditures more systematically.[10]

In sum, since MFRs do not yet provide data of sufficient quality and transparency, budget reduction exercises in recent years have not generated many savings, and in particular have not selectively defunded programs that do not work.[11]

To improve, Maryland could emulate a Bush administration initiative called the Program Assessment Rating Tools (PARTs). Like CitiStat, this approach has won a JFK Innovation in American Government Award. Completed PARTs provide answers to many important questions about program design and management. Templates provide appropriate questions depending on the types of programs being "PART-ed." Managers of programs interact with Office of Management and Budget experts to develop PARTs iteratively, and web availability of the results tends to minimize the risk that partisan bias colors the evaluations (see: http://www.whitehouse.gov/omb/expectmore/). While PARTs are unfortunately not yet used extensively by the Congress, they have substantially influenced executive branch budget preparation and management in recent years.

Priority-Setting

In 2002, Governor Glendening released a "strategic plan" entitled "Moving Maryland Forward." But not a single representative of the legislative branch was involved in its preparation, and the plan had no impact on legislative policy-making. Planning in the Glendening administration was primarily concerned with land use and related Smart Growth policies.

Then in 2004, the General Assembly enacted SB381, which required the state to develop a state comprehensive plan using MFRs. The draft of the bill included legislative participation, but that was edited out of the bill on DBM's insistence.

SB381 was not well implemented by the executive branch, as the state failed to develop clear goals or increase the transparency of its performance. DBM submitted its plan February 2005, and has not updated it since then. The plan merely listed selected MFRs categorized by Governor Ehrlich's "Five Pillars," the loosely-defined priorities of the Ehrlich-Steele Administration.[12]

The DLS analysis of the FY06 budget complained that the "comprehensive plan" included only performance measures, omitting both goals and actual results. In the following year, DLS's analysis of the FY07 budget did complement the same plan for being connected to some existing accountability frameworks in selected departments, such as that imposed by No Child Left Behind. However, DLS also observed that the plan lacked measures for important concerns such as poverty and land use, included some outdated measures, did not provide relevant historical data, and was not fully accessible to the public. It argued that:

> Developing a plan and putting it on the shelf will not result in success. . . DLS recommends that the Executive Branch develop a more comprehensive annual report on progress toward the State's goals and make this information readily available to the public.[13]

Perhaps the best example of this failure to inform the public is the first MFR for DBM, which is an "index of 30 outcome-related performance measures reported by state agencies and other sources." This index—an example is shown in Table 1—is generally not distributed to the public.

The index takes 30 performance measures (including some not in the comprehensive plan), calculates the change for each from the base year to the index year, and then averages these indexed changes with all 30 measures weighted equally. To illustrate what's wrong with this approach,

TABLE 1 PERFORMANCE INDEX FOR SELECTED KEY PERFORMANCE AREAS FOR MARYLAND STATE GOVERNMENT

Performance Measure	Base Year Value	Index Year Value	Index
MSA -3rd grade reading % scoring proficient or better	58	75.8	130.7
MSA -3rd grade math % scoring proficient or better	65	76.2	117.2
High School Graduation Rate	83.13%	84.83%	102.0
Drop-out rate grades 9-12	3.91%	3.69%	105.6
Six year graduation rate for USM graduates	58%	64%	110.3
% of Maryland babies born at low and very low birth weight	8.7%	9.4%	92.0
Death rate among Maryland infants under 1 year of age (per 1,000 live births)	7.4	8.5	85.1
Rate of births to adolescents 15 and 19 yrs of age (live births per 1,000 women, calendar yr)	42.5	33.3	121.6
% of Maryland children (19-35 months) fully immunized	74.8%	81.3%	108.7
% of Maryland children and youth (0-17) living in poverty	6.6%	10.6%	39.4
% of current child support collected	60.3%	61.9%	102.7
Age-adjusted cancer mortality rate	211.0	194.3	107.9
Rate of syphilis incidence	5.7	5.7	100.0
Three year average of Pertussis cases	108	107	100.9
Three year average of Hepatitis A cases	313	195	137.7
Blue Crab landings	13,476.7	13,340.8	99.0
Oyster Landings	1,099.1	116.2	10.6
Watersheds impaired by nutrients	126	97	123.0
Three year average of days 1 hour ozone standard was exceeded	8.3	1.33	184.0
Rate of traffic fatalities (per 100 million vehicle miles traveled)	1.22664	1.16696	104.9
Firearm homicide rate	5.72	6.53	85.8
Walk-offs and escapes from DPSCS settings or facilities	119	170	57.1
Rate of arrests of youth for violent crimes (ages 15 to 17; per 100,000 youth)	879	884	99.4
% Change in Maryland Employment -12 mo. Average	2,719,501	2,798,613	102.9
Ratio between Maryland's unemployment rate and US rate	0.8787	0.8174	107.0
Rate that adult employment program trainees enter employment	75%	86.1%	114.8
Roadway mileage with acceptable ride quality	83%	82%	98.8
Maryland legally loaded bridge %	100.0%	100.0%	100.0
Total Ridership Bus and Rail Transit	100,360	91,633	91.3
Total acres under Agricultural Land Preservation easement or in preservation districts	382,988	410,865	107.3
		Equal weight index	**101.6**

Source: Maryland Department of Budget and Management

select just two measures that are highlighted in Table 1: the six-year graduation rate from University System of Maryland (USM) campuses (higher is good), and the increase in low birth-weight babies (higher is bad). The index suggests that the state is "better off" because the good of a 10.3 percent increase in the six-year graduation rate from USM outweighs the bad of an 8 percent increase in low birth-weight babies. This approach elevates simplistic mathematics over policy choices by informed citizens and elected leaders.

Over the years, Governors of Maryland have espoused priorities through slogans such as "reach the beach," "smart growth," or "legalize slots," and through more detailed State of the State addresses, which usually list the Governors' priorities. But the other "State of the State" is the actual economic, social, environmental and other conditions across the state. Valid and reliable data on these conditions are needed to understand fully the extent to which Maryland faces significant policy problems.

MFRs, in theory, could serve as indicators of strategic direction for the public and the General Assembly. But the legislature rarely discusses policy priorities using MFRs. Consider the Spending Affordability Committee (SAC), which is comprised of legislative fiscal leaders. Every December, the SAC recommends a spending ceiling to the governor. That ceiling is simply a percentage increase above the current year's level. While informal spending ceilings can help promote fiscal responsibility, they should also relate explicitly to the major policy problems faced by the state. Unfortunately, the committee's deliberations and report are not substantive in that they do not link policy priorities to budgetary limits.

Now is an especially opportune time to adopt a formal priority-setting process. The budgetary challenge will require spending cuts, preferably in those programs that address less important concerns. And documenting conditions in the state and using them to develop priority goals will help the public consider the merits of proposed tax increases.[14]

Governors and legislators in more advanced states engage in serious discussions of goals and tradeoffs. They collect and widely distribute geocoded data that show economic, social, and environmental conditions, relate these conditions to agency plans and operations, and involve legislators and citizens in defining priority goals. Described briefly below are two states, Virginia and Oregon, which have won plaudits along these lines, though both have faced serious challenges while implementing the approach. Another state, Washington, is also described briefly to illustrate the dangers of relying too much on the executive branch for priority-setting. The complexities in these and other leading states (e.g., Florida, Texas) deserve further study, but the stories told here show how far behind we are in Maryland.

Virginia[15]

Close to home, Virginia provides a great model for the use of strategic planning and performance management. In 2003, the Council on Virginia's Future set an ambitious goal to make the state the best managed in the nation. Indications are that it is on its way to meeting this lofty objective: in 2005, Virginia was one of only two states to receive an overall grade of A from the Government Performance Project.

Virginia's management model starts with statewide strategic planning. The Council is an 18-member panel of cabinet members, legislators and community leaders that was authorized in 2003 by legislation which had the strong support of Governor Warner. The Council has identified long-term objectives for health, education, environment, transportation, and other areas. It submits The Virginia Scorecard in conjunction with the Governor's budget bill. The scorecard shows how state agencies have been making progress with the long-term goals.[16] In addition, the state's Joint Legislative Audit and Review Commission (JLARC) conducts performance audits of "remarkably high quality," according to the GPP.

Virginians can access information on the progress the state is making at the "Virginia Performs" website (http://vaperforms.virginia.gov/). This very impressive site features not only performance measures but also demographic information and geographic breakdowns.

Oregon[17]

Oregonians have an unusual degree of direct involvement in government, as shown by their extensive use of initiatives and referenda. But though Maryland has a different political system, we can still learn from Oregon about benchmarking and about incorporating citizen input into the priority-setting process.

In 1990, Democratic Governor Barbara Roberts faced a large structural deficit. Roberts decided to address the problem by having a "Conversation with Oregon." She first spoke with 10,000 Oregon voters in small group settings through video conferencing. After announcing a plan to save money by streamlining the state government, she then went on two tours of the state to continue to receive feedback from Oregonians. After her "Conversation," however, Roberts went behind closed doors and consulted with advisers. The result was a tax package that she planned to put before voters. The state legislature then rejected the referendum, citing the cost of holding a new election. Their more important objection was to Roberts' decision to craft a tax plan without their participation.

Since then, the Oregon Progress Board (OPB), an independent agency, has overseen development of the state's benchmarks, which are indicators of state economic, social, and environmental conditions. A large task force of community, business, and government leaders selected the benchmarks, which were then pared down from 259 to 92 to make them more relevant and significant. Public input was solicited through citizen meetings and surveys.

The Oregon Progress Board web site is at: http://egov.oregon.gov/DAS/OPB/index.shtml. In 2003, a student and I found that many measures for Maryland comparable to those used in Oregon could be obtained with little effort from the State Data Center of Maryland's Department of Planning and from other public and private sources.

Washington[18]

In 2002, Washington's Democratic governor, Gary Locke, faced the challenge of closing a $2.1 billion shortfall. With only ten weeks to address this deficit, Governor Locke brought in a consulting firm, Public Strategies Group (PSG), co-led by David Osborne of "reinventing government" fame.

PSG emphasized that Locke had to be concerned with the results of programs rather than their funding levels. Locke created a "Guidance Team" made up of his senior policy advisors and several business and think tank leaders and a "Staff Team" of experts from the Office of Financial Management. These two groups created a list of the ten "Priorities of Government" (POG) that they saw as most essential. The teams then decided what percentage of the budget should be allocated to each POG. Next, a "Results Team" made up of agency officials relevant to each POG created a list of the programs most important to achieving that goal.

The Guidance Team had already determined that tax increases were politically infeasible, so the total spending level was set based on the anticipated amount of revenue from current sources. That money was split among the ten POGs based on the percentages determined by the Guidance and Staff teams. Within each POG, the Results Team ranked programs based on their importance and simply drew a line at the point at which funding ran out.

While the POG approach ostensibly relied on performance measurement, there was insufficient analysis of budget cuts that would affect millions of people. The teams spent too little time determining the percentages of the budget that should be devoted to each priority, and prioritized programs without sufficient data to conclude that their chosen programs were the best means of achieving their goals. Nor did they review tax preferences.

Washington's approach did help the Governor reduce a large structural deficit through program eliminations, but the process was insufficiently inclusive. Democrats in the legislature felt their priorities were abandoned, captured by the joke made by a Republican leader who noted the similarity between "POG" and "GOP." The current Democratic Governor, Christine Gregoire, has used citizen outreach and a CitiStat-like system to repair the damage.

Recommendations

A transition to better performance budgeting and priority-setting cannot be completed in just a few months. It takes time to develop data systems and to hire more analysts. Even more critical, but also likely to take time, is recognition by elected officials that they can meet their political goals by shifting their attention toward program performance, reporting on the state's condition, and citizen participation.

But deciding now to adopt these approaches could still help the state deal with its structural deficit over the next few years. The Governor and General Assembly should convene a task force to study the priority-setting practices used by leading states, with the goal of quickly proposing a process for Maryland implementation in calendar year 2008. That process could inform citizens and the state's leaders during the inevitable, high-stakes debate over tax increases.

The Governor and the General Assembly should also promise to improve the reliability and relevance of MFR data and to rely on these data when making major budget decisions at the program level. It could do so by phasing in a transparent and open PART system that would eventually provide critical information on program effectiveness, thus complementing StateStat.

Who We Are

The University of Maryland, Baltimore County (UMBC) is a major research university in the Baltimore-Washington area. The Department of Public Policy offers a master's and a Ph.D. degree, and advanced graduate certificates. Our mission is to provide superior education for a diverse range of high quality students with aspirations and career goals related to public policy. Our interdisciplinary program prepares students for senior administration, policy analysis, research, consulting, and teaching. Our major areas of focus include evaluation and analytical techniques, health policy, public management, social policy, and urban policy. For more information, visit our Web site, **www.umbc.edu/pubpol**, or call **410-455-3202**.

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