

# HOW CAN MARYLAND'S BUDGET PROCESS BE IMPROVED?

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## **SUMMARY AND RECOMMENDATIONS**

Maryland's budget process is widely considered to be a good one. Budgets are enacted on time, and are prudent enough to earn the state the highest available bond rating. However, with the executive and legislative branches controlled by different parties for the first time in over thirty years, and the fact that divided governments often arrive at gridlock, there is reason to doubt that Maryland can effectively confront the large deficits that are projected for the coming years. To assist the state with this problem, this paper focuses on two areas of concern: the balance of budgetary powers between the executive and legislative branches, and the processes for setting budgetary targets and choosing budgetary priorities.

### The Balance of Powers

In 1916, Maryland also faced a large deficit, which was attributed to legislative irresponsibility. Reformers responded by amending Maryland's Constitution. In their "executive budget" system, they gave the Governor more power than is now permitted by any other state in the nation. In particular, the legislature cannot add items or amounts to the Governor's operating budget request for the executive branch; it can only cut from that request. The Governor cannot veto the legislatively-enacted operating budget, but after the legislature adjourns, and with the permission of the Board of Public Works, the Governor can cut spending by up to 25% of an allotted appropriations. Legislators can add items to the capital budget, but the Governor can item veto these additions.

Although reform of legislatures early in the twentieth century was thought to be a hopeless cause, we now know that this assumption was false. In Maryland, the General

Assembly has an admired record of fiscal responsibility due to its Spending Affordability process, which sends strong signals to the credit markets and the Governor that spending should be capped at a prudent level. Since the legislature's power of the purse is a distinctive element of American government, the resilience of the Governor's extraordinary budgetary powers, even after the General Assembly has improved its capacity, is somewhat surprising.

On the other hand, that the Governor has retained his strong power can be explained by the general difficulty of amending constitutions. In addition, over time both the executive and legislative branches have both adjusted to and bent the constitutional rules. The General Assembly has exercised its right under the Constitution to increase spending that is supported by dedicated revenues, and has also mandated expenditures for future years. Governors have used supplemental budgets—which under the Constitution are to be used only for limited purposes—to negotiate with legislators on a wide range of matters.

Unfortunately, while these adjustments have allowed the branches to accommodate each other, they have had several undesirable effects. An accumulation of dedicated revenues and mandates has helped reduce the flexibility of the budget. Nor is the budget as transparent as it should be. Since supplemental bills cannot be considered before passage of the regular budget, the spending included in them does not receive the technical analysis and public scrutiny given to other spending. Similarly, when Governors use post-session cuts to assert their priorities after the legislature has stopped sitting, those cuts cannot be reviewed by the legislature.

When legislators and the public have such limited opportunities to participate in budgeting, they can respond in undesirable ways. A public that lacks knowledge of budget realities tends to demand the “free lunch” of high services and low taxes. Legislators focus more

on obtaining targeted funds for their districts than on improving programs. And although the advocates of the 1916 reform might have believed that these problems would be avoided by making Governors so responsible for budgeting that this visibility would force Governors to act responsibly, Governors also have the electoral incentive and bully-pulpit ability to shift some blame for their actions away from them. The past year's budget process shows much evidence of each branch blaming the other for the failure of legislation to legalize slots, the veto of corporate tax increases, and for spending cuts.

With separated branches of government and competing parties, some conflict is inevitable and even desirable. Nevertheless, we believe that the spending powers should be rebalanced. This would permit the General Assembly to fulfill the roles for which it is best suited—serving as a sounding board for the public's concerns and as a source of ideas. Given more responsibility, legislators would be more likely to help educate their constituents about budgetary realities.

We therefore recommend that Maryland adopt a constitutional amendment giving the General Assembly the power to add spending to the operating budget, and giving the Governor the right to veto either items added to the budget bill or the entire bill. The General Assembly should be allowed to propose more spending than the Governor requests, as long as the proposed amount does not exceed available revenues. Legislative rules should require that additions to the budget be proposed early in the legislative session, which would allow more time for analysis and discussion.

A possible drawback of this approach would be that the deadline for completing the budget would have to be extended by several weeks. However, the General Assembly session

length is now a comparatively short 90 days, and since there are two months from the end of the session to the beginning of the fiscal year, there is sufficient time to allow a small expansion of the session's length. Current constitutional rules have been effective in requiring that the budget be the sole order of legislative business in order to meet the budget completion deadline.

### Budgetary Targets and Priorities

Like other states, Maryland relies heavily on a balanced budget rule to promote fiscal discipline. But the recent economic cycle of boom-and-bust illustrates that the balanced budget rule provides only limited guidance for devising intelligent budgets. During the boom, the state cut income taxes and then mandated a large spending increase for elementary and secondary education, commonly known as "Thornton." The bust now threatens Maryland's ability to adequately finance Thornton, as well as other programs that have suffered large cuts in the past two fiscal years.

Unlike some other states, Maryland has a good record in minimizing the use of accounting gimmicks during tough times. For example, it recently declined the opportunity to securitize receipts from the tobacco litigation settlement, which in effect would have been an extremely costly method of borrowing. Instead, the state transferred moneys into the general fund—the focus of balanced budget rule—from special funds like the Transportation Fund and from the Rainy Day Fund.

Drawing down the Transportation Fund did reduce financing available for meeting the state's transportation goals. This stimulated complaints that Maryland was breaking faith with automobile drivers who expected their gas taxes and motor vehicle fees to support roads and the

Motor Vehicle Administration. However, the Transportation Fund should not be completely separated from the rest of the state's finances. It receives funds from a wide variety of sources and likewise spends on many programs that have close connections to programs financed through the general fund.

Recent Governmental Accounting Standards Board statements require states to report on their activities using a government-wide focus rather than featuring the general fund. This is consistent with one of the principles of good budgeting: use a comprehensive view of the government's finances. The Spending Affordability Committee approaches this ideal by including special funds in its target calculation. It also has taken a strong position on protecting the state's AAA bond rating by maintaining large balances in the Rainy Day Fund. But the most recent revenue decline, which was very sharp, suggests that Maryland might be better off now had it built up the Rainy Day Fund to an even larger amount during the period of strong economic growth. The cost of doing this would have been reduced funding during the boom for operating programs and for capital spending financed by current revenues—so-called “PAYGO” spending. The benefit would be that these programs would not have had to suffer such large cuts in the past two fiscal years, assuming that the state would draw down the larger Rainy Day Fund during periods of weak or negative growth.

We also believe that the Spending Affordability process should annually consider whether to recommend explicit targets for revenue changes—for growth when structural deficits cannot be solved through spending cuts alone, and for cuts when taxes produce undesirably large surpluses or are uncompetitive. The Spending Affordability Committee now avoids this topic to focus on spending targets. Maryland similarly fails to produce regular analyses of its tax

structure. Yet the state's tax structure has serious problems. With the changing economy, its yield is declining, particularly in the sales and corporate tax areas due to narrow bases and evasion. The distribution of the tax burden is clearly regressive, but the state rarely analyzes such issues of incidence. Business interests routinely argue that aspects of the state's tax structure make the state's economy uncompetitive. Intelligent budgeting requires the harmonization of spending, borrowing, and taxing policies, and Maryland's process needs a more structured way of considering tax issues.

The Spending Affordability process, and budgeting in the state more generally, would also be improved if Maryland were to produce and draw from the findings of an annual report on Maryland's condition. Other states—most notably Oregon—have experimented with planning processes that consider information about the social, economic, and environmental conditions in their states. The states discuss their strategic goals, such as improving education, and then tie these goals to benchmarks that show how the states are changing from year to year and how they compare to other states. Maryland already has much information like this, but it is not aggregated into a useful form, perhaps because the state planning process has been concentrating on “smart growth.”

If Maryland were to adopt a consensus/benchmark planning approach, and if the General Assembly were to consider revenues as well as spending in its Spending Affordability process, that process could be renamed the “Budget Targets” process. It would be a better focus for interbranch budgetary discussions than the current backdoor negotiations about which projects might be included in the supplemental.

It would also provide an impetus to improve the generation of information about the

effects of spending. Like many other states, Maryland has been engaged in performance reporting, and some agencies have worked hard at what is a very difficult task. However, in our opinion—which we know is widely shared in state government—the effort has not shown much success. One reason is that elected officials have not sent strong signals that they will use performance information to make budget decisions. Instead, much like Maryland’s early-twentieth century approach to the balance of budgetary powers, the state makes decisions that are reminiscent of the budget-cutting methods of those days, which focused on objects-of-expense rather than on program effectiveness. When Maryland cuts personnel across-the-board rather than terminating weak programs, it is deciding to do everything poorly rather than some things well.

We therefore recommend that Maryland should make a sustained effort to improve Managing for Results measures and to integrate them with the processes of budget preparation, enactment, execution, and audit. Since tax preferences are often similar to spending, the state should also improve the technical quality of tax expenditure estimates and integrate review of tax preferences into the budget process.

### Conclusion

If Maryland were to adopt our recommendations, it would be providing its citizens with more information about budgetary choices and more opportunity to participate in how these choices are made. In an era when the United States is advocating across the world skillful public management and greater public involvement, Maryland should replace a system that attempts to restrict budgeting to a closed executive branch with one that is more consistent with American



ideals. For a detailed presentation of the points made in this summary, see the full paper.

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## I. INTRODUCTION

*After many years of Democratic governors, Maryland is led by a Republican Governor. The new Governor faces a General Assembly populated largely by Democrats, and a serious budget deficit, caused in part by a weak economy. To balance the budget, the Governor cuts agency operating budgets, neglects funding some long-term obligations, and transfers transportation revenues to the general fund. Among the issues disputed by the executive and legislature is whether to legalize gambling in order to increase revenues.*

Although the previous paragraph describes today's situation in Maryland, it is written in italics to hint that the description was for an earlier period (it is drawn from Miles, 1942). Specifically, four-term Governor and Democrat Albert Ritchie was defeated by Republican Harry Nice in 1934, when "weak" would be a ridiculously generous description of the economy's condition. Nice proposed a budget that failed to eliminate the state's deficit, apparently to shift that political burden to the legislature. The legislature responded by enacting an emergency gross receipts tax and by then negotiating with the Governor a supplemental budget that substituted new borrowing for some of the Governor's initial spending cuts. The Governor then proposed a sales tax, which the legislature quickly killed. The historical similarity to today is obviously breaking down, but not entirely--by 1937, among the revenue options enacted to fund relief for the needy were taxes on pin-ball and "claw" machines, approval of additional days of racing, and even legalized--and thus taxed--bookmaking. Quick and massive public opposition to open bookies convinced the Governor to veto that bill. (Miles, pp. 28-57; Brugger, 1988)

While history has not repeated itself exactly, in 2003 Maryland is again confronted with

significant budget challenges--to the point that the state was even the subject of a hilarious article in the satiric weekly The Onion, which recounted how the state was going to “close down” in response to the budget deficit (2003). Medium-term projections now show the general fund deficit around \$600 million in fiscal year 2005 and \$1.5 billion in fiscal year 2007. The executive and legislative branches, being controlled by different parties, have serious disagreements about how to deal with this problem. Given this context, this paper addresses the question: how can Maryland’s budget process be improved?

This question may be surprising, for Maryland’s budget process is widely considered to be a good one, particularly for its prudence. The Department of Legislative Services (DLS), in its Legislative Handbook volume on “Maryland’s Budget Process,” writes:

As the reader considers the State’s budget process, it is also important to be aware that a cautious fiscal culture has evolved in Maryland. Having earned a AAA bond rating, the State makes few important decisions without considering the potential impact on that treasured status. (p. 2)

Neutral observers also tend to appreciate Maryland’s budget process. For example, the Government Performance Project of Syracuse University graded Maryland’s financial management at A-, including the following praise:

. . . one of the best fiscal note processes in the country to guarantee the soundness of new ventures. Program and project analysis is performed by a nonpartisan and professional legislative staff. . . virtually everything Maryland’s finance office does is done well. . . (2001).

Maryland also has an admirable record for timely passage of the budget by the end of the legislative session (which precedes the start of the fiscal year by two months).

Given such positive evaluations of Maryland’s budgeting, it is not surprising that the question asked by this paper is unfamiliar. In 2002, however, the Commission on Maryland’s

Fiscal Structure, informally known as the Puddester Commission after its chair, was charged to review and make recommendations for changes to the State budget process, Spending Affordability process, and Capital Debt Affordability process that would allow for more effective development and enactment of the annual State budget.

Unfortunately, the Puddester Commission did not complete this task. Although the Commission was created by passage of the 2002 session's House Bill 1--the low number indicated the bill's high priority with the leadership--the Commission was abolished in the 2003 session. The Commission did conduct informative hearings on the state's fiscal situation, and also proposed a long list of budgetary options for eliminating the deficit. This focus was presumably due to the gravity of the state's budget problems. As a former director of the Congressional Budget Office, Rudolph Penner, used to say about the federal budget deficits of the 1980s, "The process is not the problem; the problem is the problem." For Maryland, this aphorism should mean that the state's deficit can only be eliminated by adopting specific policies that will reduce spending and/or increase revenues. It would be fiscally dangerous to think only about the budget process and thus defer consideration of such policy options.

Nevertheless, we believe that the state should still evaluate its budget process, and we have written this paper to stimulate and inform such a conversation. This paper focuses selectively on two features of the process: the balance of power between the executive and legislative branches, and the setting of budget targets and priorities.

This paper is based on reviews of many primary documents and secondary sources, and on interviews with budget process participants. We have also consulted sources on so-called "best practices" of budgeting, including the National Advisory Council on State and Local Government Budgeting Practice (1998; State Treasurer Kopp was the co-chair; see also Meyers,

1996). Our recommendations are non-partisan.

## **II. THE BALANCE OF EXECUTIVE AND LEGISLATIVE BUDGETARY POWERS**

For the first time since 1968, Maryland has a “divided government”—the executive and legislative branches are controlled by different parties. Across the states, divided government helps cause delays and conflicts in budget decision-making (e.g., see Alt and Lowry, 1994; Poterba, 1994). Many of the interbranch conflicts of the past year suggest that Maryland risks a dynamic of partisan blame generation that could lead to the “gridlock” and “train wrecks” that have been common in states such as New York and California and in the national government (Gold, 1995; Meyers, 1997).

Yet it can also be argued that the constitutional structure of Maryland will prevent such a crisis. In 1916, the state Constitution was amended to give Maryland’s Governor more authority over budgets than is held by any of the other forty-nine states’ Governors. Distrust of the legislature and its tendency to overspend was epidemic, and the chosen remedy was giving the Governor the power to propose budgets that the legislature could only reduce. The theory was simple—far simpler than the Madisonian system of “separated institutions sharing powers” that is the essential idea of American constitutions. Empowering the Governor would ensure prudent budgets. He could act more quickly, being one person in charge rather than many, and his actions would be visible to voters, allowing them to easily fix blame for unbalanced budgets.

As the historical example that opened this paper shows, this theory was not only simple, it was also simplistic. Faced by the fiscal crisis of the Depression, Governor Nice didn’t do everything that was necessary to eliminate the deficit, which forced the legislature to act. Political scientists call this strategy “blame avoidance” (Weaver, 1986). More generally, since even those Governors who lack the extraordinary powers held by Maryland’s Governor are

nevertheless the elected officials most closely identified with their state's budget policies, Governors are most at risk of losing re-election bids because of the decisions they must make (Hansen, 1999; Kone and Winters, 1993; Beyle, 1992). Their chances of survival are enhanced when they can shift some of the blame for tax increases and spending cuts to legislatures.

On the other side of the relationship, while legislators may be wary of being pinned with this tale, they also would rather not cede to the Governor their authority over the budget. The budget is too meaningful a tool to allow that. But since Maryland's Constitution effectively constrains the legislature from directly and openly affecting the budget's contents, the legislature has resorted to indirect and opaque means. This is the hidden story of Maryland's "strong executive budget," and the results have been mixed. To be able to confront the Governor, the General Assembly has typically chosen very effective and strong leaders. In some years of the past two decades, those leaders have negotiated effectively with the Governor through the Spending Affordability process. On the other hand, since legislators can more easily change the budget by using means that substantially reduce the budget's flexibility, the strong executive budget system ironically has made budgeting more difficult.

Frustration is the natural result in both branches. For example, in 2001, one of the state's most highly-respected budget experts, Senator Robert Neall,

decried the process as "an insidious force that is eroding the independence of this body." Neall, an Anne Arundel Democrat, went on to ask Senate President Thomas V. Mike Miller to remove him from the budget committee because the process is so staked against the legislature. "I will not continue to work under these conditions," said Neall. (Waldron, 2001; see also Office of Policy Analysis, 2002)

From the perspective of the executive branch, legislative challenges to its authority over the budget may justify actions that take advantage of the Governor's constitutional powers. For



example, some legislators have argued that Governor Ehrlich was so frustrated by opposition to his bill to permit slot machine gambling that he took an uncompromising position on tax increases during the session, and then waited until adjournment of the legislature to cut appropriations.

While investigating the effects of Maryland's current budget process, we have adopted the perspective of two law professors who organized a collection of articles on "constitutional stupidities and tragedies." They wrote:

There is nothing about our project that requires any disrespect for the Constitution or its framers; smart people can create rules that over the long term become stupid. For most of our authors, it is their respect and even awe for the Constitution's success that drives their interest in understanding its limitations. (Eskridge and Levinson, 1998, p. 3)

We therefore ask readers to keep an open mind, and to suspect a claim that any change to Maryland's budgetary process would inevitably cause damage—for example, that it could cause the loss of Maryland's AAA bond rating. We think the suggestions in this paper would be more likely to protect than threaten that rating, but we also want to emphasize that this rating is not the only measure of the quality of Maryland's budgetary process. After all, bond raters only assess the risk that Maryland will run out of cash to pay debt service. They do not evaluate whether Maryland's process is responsive to its citizens.

## ORIGINS OF THE EXECUTIVE BUDGET

The "executive budget" was ushered into Maryland in 1916 through ratification of a constitutional amendment. It had been proposed by the "Goodnow Commission," after its chair Frank Goodnow, President of Johns Hopkins University and a leading political scientist. Formally the "Commission on Efficiency and Economy," it was the state namesake of the

influential federal commission of 1912 created by President Taft.

The need for this new system had become apparent after accumulation of a large general fund budget deficit in 1915. During the pre-executive budget era in Maryland, appropriations were made by the legislature one at a time without regard to other demands on the treasury. This lack of coordination allowed spending to exceed current revenues, which forced emergency responses. Cash was also held by agencies rather than consolidated into a general fund, enabling corrupt diversions (see Chase, 1916). To stop this fiscal irresponsibility, the executive budget process required agencies to formally request spending authority through the Governor. This allowed a comprehensive comparison and ranking of competing uses for limited funds. (See Cleveland, 1915, for arguments favoring the executive budget; and for a skeptical history, see Webber and Wildavsky, 1986.)

The executive budgets adopted by the states varied in the extent to which they concentrated power within the chief executive's hands. Maryland picked the Taft conservative pro-concentration end of this dimension, allowing the legislature only the power to cut from the Governor's operating budget request. (On the adoption and early history of Maryland's executive budget, see Rohr, 1932; see also Abernethy, 1959).

It is largely forgotten now that some influential reformers strongly opposed Maryland's approach, notably William H. Allen, a former colleague of Goodnow and Cleveland who was a Progressive leader in reforming New York government. Budget expert Irene Rubin summarizes his views:

Allen objected to the Maryland constitutional revisions because they imposed only a casual burden on the Governor to explain the budget, because they impeded the ability of the legislature to respond to legitimate public demands to expand services, and because they did not allow for public participation in budgetary decision making at every step.

(1994, p. 235)

Box 1 excerpts some of Allen's criticisms.

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Box 1: ALLEN'S "SERIOUS DEFECTS OF MARYLAND'S BUDGET LAW"

When Frederick A. Cleveland, the designer of Maryland's executive budget, attempted to convince other states to adopt Maryland's extremely strong grant of power to the Governor, his opponent William H. Allen wrote a pamphlet that raised numerous objections to Maryland's new law (1917). Following are relevant excerpts from that pamphlet, with introductions to relevant sections in normal type and Allen's comments in italics.

On presenting supplementals only after passage of the regular budget:

*This is loaded with TNT and detonators. In some states this would mean that the executive would put in his bills bite by bite or bait by bait, and at no time until the bill is finally voted would legislators, newspapers, taxpayers, or administrative officers see the whole of the governor's proposal. . . . The Maryland plan would inevitably encourage log-rolling by all parties to budget-making, whereas intelligent budget making requires that all cards be on the table and left there in full public view long enough so that no surprises can be sprung and no favors denied or granted by the people's representatives.*

*Should not the governor's change of mind run the gauntlet of special analysis before, not after, the executive budget is passed just as the Maryland law prescribes for supplementary bills originating with the people, with state departments or with the legislature? (p. 7)*

On the inability of the legislature to propose increases to the Governor's budget:

*The insane are notoriously neglected in New York State; twice an executive budget has failed to make additional provisions necessary for decencies and mere humanity. The Maryland law not only fails to give a hearing to those who know these facts about the insane, but prevents even the introduction of a supplementary bill until after the executive budget bill has been voted. This will in most legislatures be the last week if not the last hour of the session.*

*Practically, as well as legally, this Maryland law uses and muzzles the legislative branch, administrative officers who know of needs not provided for by the governor, and the public.*

*Conceding that it is important not to confuse the governor's program with anybody else's program and that it is desirable to fix squarely upon the executive's shoulders responsibility for his recommendations, it still remains possible to foster discussion and to use legislators for promoting public welfare. . .*

*Nothing could be more unscientific and more absurd than to ask legislators to deal intelligently or honestly with executive proposals if the constitution prohibits them from considering at the same time evidence existing anywhere in the state that the governor's proposals are inadequate. (pp. 8-9)*

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## CURRENT BUDGETARY POWERS

The current balance of budgetary powers is not exactly the same as that enacted in 1916. Before we discuss how current powers evolved, we first describe them. (Department of Legislative Services, 2002, 2001. For specific language, see particularly Article III, § 52 of the Maryland Constitution.)

The budget is a detailed statement of projected and proposed revenues and expenditures, and it is presented in a format that is partially prescribed by law and partially up to the Governor's discretion. An integral part of the budget is a bill presented by the Governor that makes the appropriations listed in the budget. The budget and corresponding budget bill are submitted to the General Assembly on the third Wednesday in January, or in the case of a first-term Governor by the tenth day of the legislative session. Prior to submission of the budget, the Spending Affordability Committee of the General Assembly recommends a level of growth for the budget. The Governor is not bound by this recommendation, but if it is violated the Governor must explain why.

The Governor's budget must be balanced at the time of presentation; similarly, appropriations in the budget bill cannot exceed estimated revenues. The balance requirement applies only to the general fund, on a cash basis, including use of carryover and transferred funds. The Constitution requires the Governor to provide funding for debt service, maintenance of effort for public schools, and the salaries of constitutional officers. The Governor must also fund annually those programs that have been statutorily mandated by the General Assembly.

The legislature's main role is to delete or reduce appropriations made by the Governor. The Constitution prohibits the General Assembly from adding new items or increasing spending

for items in the operating budget for the executive branch. In contrast, appropriations for the legislative and judicial branches can be increased. One method of cutting funds is to add language to the budget bill that would make spending contingent or conditional or would restrict how funds could be applied. Reductions cannot be made to the appropriations for debt service, constitutionally-mandated public school expenditures, or the salaries of constitutional officers. The General Assembly must complete action on the budget by the 83<sup>rd</sup> day of the 90-day session and cannot consider any other appropriations measure until the budget has been approved. Once the operating budget is approved, it becomes the law and is not subject to a veto by the Governor. Supplementing the bill is the Joint Chairmen’s Report, which though it does not have the force of law, includes detailed directives to agencies that the agencies usually treat as law.

The Governor can also submit “supplemental” budgets after submission of the budget bill. Although the Constitution requires that supplementals be used only to correct technical errors or omissions in the original budget, actual practice is much more lenient.

“Supplementary” appropriation bills resemble supplemental budgets in name, but are different mechanisms. With these bills, the legislature can propose that additional revenues be dedicated to finance specific expenditures. Unlike the budget bill, supplementaries are subject to the Governor’s veto.

The Governor also proposes the capital budget, after receiving the advice of the Debt Affordability Committee, which consists of the Treasurer, Comptroller, Secretary of Budget and Management, Secretary of Transportation, and a public member appointed by the Governor. The legislature has a more active role in the capital budget process—it may add items and amounts to the bond bill that finances most capital spending. The remainder is financed

from current revenues, and is called “PAYGO” spending. However, the Governor can veto this bill in whole or in part (i.e., use an item veto), and the bond bill can only be considered after the operating budget is passed.

After the budget is signed into law, the Governor has the power--with a majority vote of the Board of Public Works (the Governor, the Comptroller, and the Treasurer)-- to cut up to 25 percent of an appropriation. The Governor can also withhold allocations, a power typically granted in budget bill language.

## THE EVOLUTION OF BUDGETARY POWERS

In 1968, Alan Rosenthal, who is now the nation’s leading expert on state legislatures, wrote about the constitutional restrictions on Maryland’s General Assembly:

At first glance these provisions. . . would seem to be ones few legislatures would tolerate. . . . But formal requirements can be misleading. In fact, the General Assembly can exert practically as much influence over the executive sections of the budget as it chooses. (p. 119 ; see also Rosenthal works from 1990 and 1998, and a forthcoming book covering Maryland and four other states)

Though we believe that the legislature can be more influential when it wants to cut the budget than when it wants to increase it, we agree with his central point: the legislature is not impotent.

We first discuss two legal disputes that illustrate some bounds of formal powers: mandated spending and post-session cuts. We then turn to other means of legislative influence:

negotiations over supplementals and the recommendations of the Spending Affordability Committee. In addition, Box 2 describes some constitutional amendments regarding the budget that were enacted after 1916.

## Box 2: Selected Post-1916 Constitutional Amendments on the Budget Process

1948: Legislative sessions and budgets were biennial until an amendment provided for annual sessions.

The “Sherbow Commission” had concluded that a biennial budget cycle was too long to make accurate predictions for the fiscal health of the state; extraordinary sessions had been required to make up for budget shortfalls. The new sessions were then structured so that the legislature met for 90 days in odd-numbered years and 30 days in even-numbered years, with the 30-day sessions being vaguely limited to fiscal matters.

1952: Maryland’s traditional budget format was the highly detailed line-item style. Along the lines of the federal Hoover Commission, the “Sobeloff-Stockbridge Commission” recommended that the state instead use a program budget (Commission on Administrative Organization, 1951). The amendment of 1952 left budget format up to the Governor except that which is prescribed by statute, and a program budget was then prescribed by statute.

1971: The length of the annual legislative session was extended to 90 days, which gave the legislature more time to consider the budget. In 1967, a constitutional convention had proposed, among other provisions that would further strengthen the Governor, that the Governor’s budget be enacted automatically after 50 days of legislative session. The legislature rejected this threat to legislative authority, and in 1968—a bad year in which to argue for centralizing power--the voters rejected the proposed new Constitution. During the subsequent Mandel administration, significant parts of the draft Constitution were ratified piecemeal, including the session-lengthening amendment.

1974: An informal principle of the executive budget system since its conception was a balanced budget. This principle was explicitly added to the Constitution.

## Mandated Expenditures

In 1974, administration of care for foster children was divided between the Social Services Administration and the Juvenile Services Administration. The former managed payments to foster parents for those children who were “neglected or dependent,” and the latter made payments to foster parents on behalf of those children committed by juvenile courts to foster homes. The General Assembly became disturbed that payments made by the Social Services Administration were often less than those made by the Juvenile Services Administration, so it passed a law which required that the payments made to foster parents by the Social Services Administration be no less than the rate paid by the Juvenile Services Administration, and that this rate could not be below that paid in FY 1975. Governor Mandel signed the law, but his budget for FY 1976 did not provide sufficient funding for the Social Services Administration to meet this statutory mandate.

The Court of Appeals of Maryland ruled on the constitutionality of this funding requirement in a 1977 case entitled *Maryland Action for Foster Children v. State of Maryland* (279 Md. 133). In a 4-3 decision, the Court held that the Governor could not be forced to make such appropriations. In a rigid interpretation of the Maryland Constitution, the Court noted that there are clearly only two ways for the state to make an appropriation: solely by the Governor in the budget bill, or by the General Assembly in a supplementary appropriation bill. The law did not dedicate funding, and was not proposed by the Governor as the budget bill, so it was an unconstitutional appropriation.

The dissenters in the case felt that the majority opinion seriously disturbed the balance of power between the executive and the legislature, and that once the power of the veto was not



exercised on the bill, then the spending limit contained within it should have been mandated. Not surprisingly, the legislature agreed with the dissenters, and in 1978 passed a constitutional amendment that required the Governor to fund programs enacted by the General Assembly at no less than the levels prescribed by law. This amendment was ratified by the voters in November 1978.

The General Assembly has used mandates frequently to advocate for new spending commitments, both large and small. One reason, of course, is that since the legislature can not simply add to the Governor's budget, it often must resort to the mandate alternative. Another reason is that interest groups and agencies know that mandated spending may eliminate their annual challenge to acquire what they consider to be sufficient and stable funding. And in some cases of mandated spending, other factors have also been important. For example, the Bridge to Excellence Act of 2002 (informally known as "Thornton," after the chair of the commission which pushed for the bill) was in part a response to the state's legal exposure for failing to meet the Constitution's requirement that the state provide a "thorough and efficient" education.

While we do not argue against funding Thornton, we note that it illustrates one of the major problems associated with mandated spending. Thornton required a very large increase in spending (by 6 years after enactment, about 80 percent higher), but did not provide funding after the first year. While it did provide a possible escape clause—a vote by the 50<sup>th</sup> day of the 2004 legislative session which could reduce obligated spending to a level nicknamed "Thornton Lite"—the Attorney General has informally questioned the constitutionality of this procedure. This mandate was added to a budget that already featured large amounts of rapidly growing and difficult to control spending, such as Medicaid.

Mandates can be useful--when the government puts up lots of money over a long period to reach a goal, it can entice commitments from others to support that effort (e.g., see Patashnik, 2000). Thornton could have this effect if the prospect of higher lifetime pay is convincing enough to increase the quantity and quality of elementary and secondary teachers, and if other conditions for educational effectiveness are put in place. On the other hand, mandates have long been worrisome to budget experts, because in combination multiple mandates risk long-term insolvency (for a recent review, see Roberts, 2002). They also reduce the government's flexibility to deal with short-term revenue declines, placing excessive burdens on unprotected accounts. Finally, mandates can complicate the budget's structure, making it harder to understand and manage (see, for example, the Cigarette Restitution Fund).

#### Post-Session Cuts

A balanced general fund budget has always been an expectation under the executive budget system. Unexpected deficits are now handled through a process that is set out in §7-213 of the State Finance and Procurement Article. This provision authorizes the Governor, with the approval of the Board of Public Works, to reduce by not more than 25 percent any appropriation that the Governor deems "unnecessary." In 1992, Governor William Donald Schaefer used this power by submitting a plan for cuts to the Board of Public Works that among other things reduced by \$30.8 million the appropriation to the Department of Health and Mental Hygiene. This reduction meant the elimination of health care coverage under the grant for Medical Assistance State Only (MASO), which was targeted on indigent individuals.

The ability of the Governor to authorize such a reduction was considered in the 1992

Court of Appeals of Maryland case *Judy v. Schaefer* (331 Md. 239). The Court decided that §7-213 was a ‘necessary and proper’ statute, as it allowed the Governor to adjust the budget throughout the budget year in order to forestall a deficit. However, the Court also said that this decision was not “administrative,” which would have enabled the Court to overturn it as being arbitrary, capricious and unsupported by substantial evidence. Instead, such reductions by the Governor and Board of Public Works are quasi-legislative actions. Finally, the Court held that the elimination of the MASO spending did not exceed the 25 percent limitation. This program was only a small percentage of the funds listed by the Governor in the budget bill under the title “Medical Care Provider Reimbursement.”

This decision appears to have been a slam dunk for Governors, but recent repetition appears to have at least weakened the backboard. To set the scene, we point out that the 2002 campaign platforms of both major party gubernatorial candidates avoided confronting the looming deficit, following the legislature’s similar behavior in the 2002 session. It might be naive to expect otherwise, but after the election, the victors must deal with the fiscal realities. The Governor and the General Assembly did not agree on how to do that during the 2003 session. That fact may be the only thing on which they would now agree, for each side is quick to blame the other for acting in bad faith. Their relationship can be described simply as a game of “chicken”—along the lines of: “I dare you to oppose slots” versus “We dare you to veto a tax bill.” Both dares were accepted. The Governor’s strong budget powers were not sufficient to make the legislature back down from its position, and the session ended in gridlock. Absent a special session, spending cuts of the Governor’s choice became inevitable, as the legislature had warned with the so-called “doomsday” and “super doomsday” lists that circulated during the

session.

The Governor's power for post-session cuts is limited by the requirement to act through the Board of Public Works (BPW). During its history, the BPW has served as a partial check on the Governor (though this role was unintended by its creators, Wilner, 1984, pp. x, 124). Perhaps because of uncertainty about his ability to gain a second vote on the BPW, Governor Ehrlich first ordered the Comptroller to temporarily impound ten percent of each agency's appropriated funds. This reduced allotment was justified as a method of helping agencies "adjust" to permanently lower levels of spending. The Governor's use of this technique will likely lead the legislature to withdraw this statutory authority next year, for some legislators blamed the Governor for "unilateral" and "gunslinger" tactics (Montgomery, 2003).

We are reluctant to blame only the Governor for the post-session cuts. Just as when there is gridlock in Washington, we believe that the responsibility for the current situation in Annapolis is widely shared. Some of that responsibility should be borne by the designers of the strong executive budget. Just as the current balance of budgetary powers can inspire the legislature to mandate spending, it similarly may encourage the Governor to postpone action until the legislature gets out of Dodge.

On July 30, 2003, the Governor announced \$208 million in cuts. At the BPW meeting that ratified these cuts, Treasurer Kopp suggested that the public and/or the General Assembly should be allowed to comment on such cuts before BPW action.

### Supplementals and Transparency

"Chicken" isn't a game that is easy to play over and over. In Maryland, as in other systems

where the branches share powers, executives and legislators have learned that they must work together. Each branch can punish the other by refusing to cooperate on items of high priority to the other branch.

Under the Constitution, supplementals are meant to be limited to extraordinary and unanticipated needs. In practice they are often used to reallocate funds deleted by the General Assembly or to reward or punish legislators based on their levels of support of the Governor's agenda. The magnitude and importance of supplementals is often not appreciated outside of the halls of Annapolis. In part, this is because legislators often use the Governor's strong budget powers as an explanation of why they cannot support constituent requests for more spending. Their civics lesson is simple: "Under the Constitution, the legislature can only cut from the Governor's proposed budget. Sorry, I would love to help, but I can't."

This stance is misleading. Consider House Bill 120 of 1999, which Governor Glendening proposed as Supplemental Budget #3 for Fiscal Year 2000. Among the funds provided by the bill were \$121.3 million in "anticipated legislative reductions" to earlier budgets, and among the appropriations were \$152.6 million from the general fund, split into numerous items. The Washington Post reported on the process of constructing this bill:

Governors traditionally have withheld most pet projects from the big budget proposals presented at the annual 90-day legislative session and have included them in the supplemental budget as rewards for compliant allies in the House and Senate. In keeping with that tradition, Glendening has been dangling projects in front of legislators as incentives and rewards for their votes on his General Assembly agenda. . .

As Glendening's budget secretary, Fred Puddester, outlined the proposals to the Senate budget committee yesterday, Chairman Barbara A. Hoffman (D.-Baltimore) said, "we could actually put names {of legislators} next to these" projects. Puddester leaned into his microphone and said, "We have." (LeDuc, 2000; see also Wheeler and Thompson)

The ability of Governors to purchase legislative support like this has helped many of Maryland's Governors be strong voices for government innovation and expansion (Burdette, 1983). As is the case in other legislatures, such earmarks (aka "pork barrel") also often improve the reelection chances of Maryland legislators, particularly when legislators can claim credit in their districts for acquiring funds. However, such visibility in the district is not matched by visibility in the budget process, because very little time is available for analysis of supplementals.

The unfortunate outcome of this form of executive-legislative cooperation is less public knowledge about and involvement in budgeting than would otherwise be the case. This lack of transparency starts at the beginning, during budget formulation. The Maryland's Legislative Handbook reports that:

During July and August, each agency prepares its budget request indicating the source of funding for the expenditures for each program. Since the General Assembly may not add to the Governor's recommended allowance, this is the time period when legislators and advocacy groups attempt to get departments or agencies to include in the original budget request funding for particular projects of interest to them. (p. 16)

After the budget is sent to the General Assembly, many legislators are then likely to stay relatively quiet, lest they lose the chance that their pet projects will be accepted by the Governor. If one adopts a pessimistic view of legislatures, then this behavior may be the best that can be expected of the General Assembly.

On the other hand, if legislators were allowed to propose options other than those included in the Governor's budget, then perhaps they would jointly spend more time on the fundamental issues facing Maryland. At the very least, those who wanted to increase spending would be expected to say this openly at the beginning of the process, which would expose their

claims on the state's limited resources to a fairer competition.

Defenders of the current process might argue in return that this approach will only encourage legislators to call for more pork barrel. Instead, they would let the legislators loose in the "rabbit garden" of the supplemental, and hope that the executive will use the closed budget process to dampen down public pressure for more spending. The problem with this approach is that when the public feels that it cannot be involved, it doesn't bother to educate itself about the realities of the state's budget. Much research shows that an ignorant public is more likely to demand a "free lunch" from government. To prevent this, some governments have educated citizens about the real choices that they face and invited them to participate in budgetary decision-making. (For research on relatively successful approaches, see Simonsen and Robbins, 2000 on Eugene, Oregon, and Abers, 2000, on the impressive case of Porto Allegre, Brazil). While such an approach might be desirable over the long-run, here we suggest that basic representative government could improve public understanding of the budget. Since the public would know that every legislator has budgeting responsibility, legislators would be more likely to discuss budget policies with their constituents rather than just pass the buck to the Governor.

### The Spending Affordability Process

In some contrast to the previous conclusion, the Spending Affordability process provides an example of the General Assembly's ability to participate as a quasi-equal partner in budgeting. This process was informally established in 1981 and then statutorily required in 1982 as a substitute for a tax limitation proposal that had been stimulated by California's Proposition 13. It now functions not only to limit spending growth and protect Maryland's high bond rating (in

conjunction with the Debt Affordability process), but also as an opportunity for the legislature to bargain with the Governor about the contents of his budget request.

The membership of the Spending Affordability Committee consists of the General Assembly's leaders of the parties and of the standing fiscal committees, and an advisory committee of citizens. The Committee issues a report in the late fall which comments on the projections of the Board of Revenue Estimates and recommends targets for aggregate spending and debt. The Committee's reports typically claim that the legislature has usually succeeded in holding gubernatorial requests and subsequent legislative actions to these targets, particularly during periods of rapid revenue growth (see also Deschenaux, 1997). A qualifier to this claim is that each year, different types and amounts of spending have been excluded from the Spending Affordability calculations.

In the next section of this paper, we question whether this process uses the best approach for establishing budget targets, particularly in light of unpredictable revenue cycles. Here, we don't question the potential utility of the process to the legislature for sending several signals. By setting a cap on spending, the General Assembly formally signals the public that the legislature, just as much as the Governor, desires fiscal prudence. Its informal signal may be as important. Before setting a top line in public, the legislative leadership can communicate in private with the Governor and his budget staff in an attempt to negotiate the major contents of the budget request. Their discussions can identify which items the legislature wants protected in the budget, in return for a promise to shield the Governor's priorities from legislative reduction. In other words, though the spending affordability documents are written as if the selection of a spending ceiling is a technical matter dependent primarily on the state's growth in personal



income, the process can obscure tentative and private bargains between the branches.

“Potential” is the most important word in the previous paragraph, for the process isn’t guaranteed to smooth executive-legislative relations. Though both branches have been controlled by the same party from the inception of spending affordability until late 2002, fiscal stress and the personalities of leaders have often prevented successful negotiations (e.g., see Smith, 1999; Rascovar, 1998).

#### POSSIBLE EFFECTS OF SHIFTING THE BALANCE OF POWERS

Over the past few decades, several legislators have introduced constitutional amendments that would reduce the Governor’s budgetary powers. Bills advocated first by Delegate Marilyn Goldwater and then by Senator Laurence Levitan were rejected in committee. In recent years, this cause has been led by Senator Patrick Hogan, who with 23 cosponsors, put forward Senate Bill 476 in 2002. The bill proposed a constitutional amendment that would give the General Assembly the power to increase amounts and add items to the operating budget for executive branch agencies. However, the total appropriation for the executive branch as approved by the General Assembly could not exceed the total allowance that was originally submitted by the Governor. Hogan’s bill also provided for the enacted budget to be presented to the Governor for consent or veto. That veto was limited to a line item veto that applied only to those amounts or items that the General Assembly had increased or added to the executive branch. If the Governor should use this veto authority (which would revert amounts to the Governor’s proposed levels), then the legislature would have the option to reconvene and override each vetoed item by a three-fifths vote of each house. The Speaker of the House and President of the

Senate would jointly issue a date on which to reconvene in extraordinary session, and this session would be limited to considering whether to override the vetoed items within the budget bill.

The defeat of this bill by a vote of 27-19 (a majority lower than the 3/5ths requirement for passage of constitutional amendments) was in part due to opposition from the Governor, and to legislators' fears of gubernatorial retribution if they were to support passage. Another reason for the bill's defeat was that some members worried that the legislature would be unable to take on this responsibility without falling to the temptation of adding a great deal of spending to the budget. Concerns were also raised about the potential of this approach to increase the power of legislative leaders, including committee chairs, vis-a-vis regular Delegates and Senators. Ironically, some leaders worried in turn that a new process would reduce their power (Libit, 2001).

That this amendment failed because of positions that are logically contradictory illustrates that future consideration of this amendment, or others that would shift budgetary powers, will feature a significant amount of uncertainty about projected effects. Political considerations would also complicate passage. Since constitutions are very difficult to change, it can be tempting to leave well enough alone. In addition, the Hogan amendment would likely be portrayed by some as a partisan challenge by legislative Democrats to a Republican Governor, even though the proposal had been proposed by Democratic legislators operating under Democratic Governors in the past. Another reason to accept the current balance of powers is a hope that the warring branches and parties can learn how to negotiate more fruitfully, just as they have put forward a unified position to bond raters.

On the other hand, our description of the current system and its effects may suggest that a rebalancing of budgetary powers is in order. Rather than having stood the test of time, the strong executive budget in Maryland could be an anomaly that has survived longer than it should. To illustrate this, we will briefly compare Maryland's system to budgeting in California. Because of California's huge deficit, The Economist recently wrote "If California really were independent, the IMF would have been called in by now" (2003). While it is fashionable and not unreasonable to blame the state's leadership for this situation, also at fault is the state's system of initiative and referendum, which has been used to foist irresponsible and uncoordinated spending and revenue policies on the state (Ellwood, 2003).

California's approach was adopted in 1911. Knowing that businesses had a stranglehold on elected officials, the Progressives attempted to replace representative democracy with direct democracy. They could not have imagined the spectacle of this year's gubernatorial recall. Reformers in Maryland were also skeptical about representative democracy, but they went in the other direction. Ostrogorski described how they viewed legislatures:

Their improvement being considered hopeless, attempts were made. . .to limit their powers, to leave them as few opportunities of legislating as possible (1910, p. 359).

Maryland's executive budget thus abandoned the core belief of the colonial, revolutionary, and U.S. constitutional systems that the legislature should have the "power of the purse." Instead, Frederick Cleveland, the main proponent of the executive budget, argued that "Responsibility should be attached to one man, who can be continued or retired as one man" (1915, p. 9).

Just as California should reconsider the theory of and rules for direct democracy, given how direct democracy is actually practiced, Maryland should ask whether Cleveland's recommendation makes sense nearly nine decades later, particularly when compared to the

vision espoused by the framers of the U.S. Constitution in 1789 and the framers of the other 49 state constitutions. For Maryland is that much of an outlier regarding the budgetary powers of the Governor—there are no other states in which only the Governor can directly add items or amounts to the executive branch operating budget; nor do we know of states that have given the Governor this power but then moved back to the standard balance (though the trend in recent decades has strengthened legislative powers, Abney and Lauth, 1998). That is, the term “executive budget” is often applied to states that have different institutional characteristics—in some states executive budget means that the Governor is charged with preparing a comprehensive budget, in other states the Governor also has item veto authority, and then there’s Maryland.

Political scientists and others have done a good job of describing the extent of this institutional variation (see, e.g., Clynch and Lauth, 1991; NASBO, 2002). However, though some quantitative research has analyzed the effects of characteristics such as divided government and selected fiscal rules on budgetary outcomes, this research has not tested for the effects of differences in or changes to the gubernatorial-legislative balance of budgetary powers (e.g., see Lowry, Alt and Ferree, 1998; Knight and Levinson, 2000). This restricts us to reasoning by analogy, which can ignore important factors and produce conflicting conclusions. In some states—for example, in Mississippi, Utah, and Texas--the legislatures are more powerful on the budget than are the Governors, but have produced budgets that spend less than does Maryland’s. In addition, Utah has long had bond ratings as strong as Maryland’s. In contrast, in New York’s “executive budget” the Governor lacks the powers held by Maryland’s Governor; perhaps this helped cause that state’s difficulties (see Kerker 1994)?

We won't attempt to weigh the merits of such contrasting arguments; rather, we would like to address head-on the assumption that grounds Maryland's system. If the expectation of legislatures nearly a century ago was that "their improvement {was} considered hopeless," by now we now know this expectation was in great error. Particularly during the 1960s and 1970s, many state legislatures, including Maryland's, substantially increased their capacity by hiring professional staff and by attracting more capable legislators. Maryland's Spending Affordability process, though it could be improved, is strong proof that the General Assembly has a collective desire to be fiscally responsible. And while in recent years, the General Assembly has by no means been free of corruption scandals, any problems it presents now are minimal compared to the era of the executive budget's creation. Nor have Maryland's modern Governors been immune to comparable accusations about corruption (see, e.g., Jacobs, 1984).

Recent work in political science suggests that it is especially useful to analyze who has veto power and the related power to propose bills (Tsebelis, 2002; Cameron, 2000; Krehbiel, 1998). The more veto players and proposers there are, and the farther apart they are from each other on policy, the less likely it is that change will take place. This framework can be used to predict—with caution—one way the Hogan bill could change the budgetary process in Annapolis. Giving the legislature the opportunity to propose spending increases and new items adds two other players to the mix, increasing the potential for disagreement and inaction. But in reality, the Hogan bill does not change the process very much. It requires the legislature to stay within the executive's operating budget total; if the Governor proposes a low number, the legislature can do nothing but resort to supplementary bills or mandates for later years. It also applies to the operating budget those rules that are already applied to the capital budget. This is not an entirely

attractive option, because the capital budget, and the supplemental bill that resembles it, are often loaded down with “pork.”

However, the Governor would now also have the opportunity to use the item veto on operating budget proposals from the legislature. Evidence on the effects of the item veto is voluminous (see, e.g., Fisher, 1997; Carter and Schap, 1990; Nice, 1988; Abney and Lauth, 1985). In brief, the item veto usually does not constrain overall spending, but does give the Governor the ability to maintain his or her position on details. Because of this latter effect, legislatures often phrase budget language in hopes of protecting their favorite items. This inevitably attracts lawyers, who go to court to clarify differing interpretations of the item veto power.

An alternative to this result would be to give the legislature the right to exceed the Governor’s proposed budget total, but also allow the Governor to veto the entire budget bill. If the legislature wanted to spend more than the Governor, it would take the risk of being blamed for this by the Governor, or the Governor’s veto could block this additional spending, absent an override. This model is similar to the national government’s, which raises the specter of large deficits and long delays before budget enactment. But Maryland already has a healthy respect for the penalties placed by credit markets on states that delay in dealing with deficits. A new legislative procedure could also limit this risk—any member of the General Assembly could be permitted to raise a point of order if the total budget exceeded available revenues.

With the opportunity to propose increases to the operating budget, the legislature would likely rely less on mandating and on attempting to convince the Governor in private to include these increases in his proposed budget or supplemental. In other words, the Hogan approach

would encourage more simplicity and openness, or as it is often called by budget experts, “transparency.” Though it may be easier for elected officials to identify budget cuts through private discussions, this is not a sufficient reason to discourage transparency, which we regard as a central element of good government. The executive doesn’t have a monopoly on good ideas or on the ability to analyze them. Allowing legislators to propose increases to the regular budget would also extend the time available to scrutinize these ideas, rather than rushing them through the General Assembly at the end of the session in the supplemental and capital budget. This could be ensured by requiring that all proposed increases to the budget be proposed by a date no later than, say, 45 days into the session, with a tightly construed waiver process for emergencies and technical corrections.

### **III. SETTING BUDGETARY TARGETS AND CHOOSING BUDGETARY PRIORITIES**

To the superstitious, Maryland's recent budgetary history could indicate that the state has been cursed with the phrase "May you live in interesting times." During the latter 1990s, revenues expanded rapidly, allowing the state to afford extensive PAYGO projects and to cut income taxes by 10 percent. Though a recession then stopped revenue growth, the state adopted a plan to greatly expand primary and secondary education spending. As the magnitude of the revenue decline increased, the state set a tight spending affordability ceiling, adopted significant transfers and spending cuts in the Budget Reconciliation and Financing Act (BRFA) and the budget, and subtracted more in post-session cuts.

It is sometimes argued that a boom-and-bust cycle helps a government make decisions that it would not otherwise make. Apparently flush with cash, a state can afford to take big steps, such as with Thornton; in desperate need of cash, a state can make tough choices that it previously would avoid, such as terminating ineffective employees who are ordinarily protected by inflexible civil service procedures. However, the disadvantages from boom-and-bust may be significant. Will Thornton turn out to be a false promise because of insufficient revenue? Are some of the recent savings actually counterproductive—will they reduce rather than increase effectiveness, efficiency, and equity?

While we are unable to give definitive answers to these questions, we believe that the state's citizens could avoid having to ask similar questions time and time again if Maryland were to change the way it sets budgetary targets and chooses budgetary priorities. We make this case by first discussing how the state budgets by mixing rules with discretion. We then argue that the state's spending affordability process should extend its perspective to the medium term, attempt



to balance the budget over the business cycle while expanding the focus beyond the general fund, and correspondingly strengthen the rainy day fund. Maryland should also analyze and address problems in its revenue structure, and set budget targets and choose budget priorities using more information about social conditions and the effects of spending.

## RULES, DISCRETION, AND THE BUDGETARY PROCESS

A useful simplification for understanding the fiscal challenges facing state governments is to imagine opposite trends for their financial resources--tax revenues and proceeds of borrowing. Increasing taxes risks a tax revolt, and heavy borrowing might lead a state to acquire more debt than it could repay. On the other hand, a big decline in resources could prevent a state from purchasing the services necessary to make it a desirable place to live.

Should leaders deal with these challenges by exercising discretion, or should they be hemmed in by rules? Those who argue for rules often assert that politicians and their constituents tend to care only about the short-term. Rules, in theory, can be used to prevent current decision-makers from pushing bad consequences onto their successors. In practice, Maryland has adopted several rules with this intent, but as we have already noted, rules can also produce bad consequences as people avoid them.

Like many other states, Maryland has a balanced budget rule in its Constitution. The Constitution also requires payment of debt service and sets a quasi-floor for education spending. However, unlike some other states, Maryland has not set formal caps on its debt or revenues; it uses the debt and spending affordability processes to make these decisions each year with discretion.

Though balanced budget rules are often considered to be inherently good, in reality they result in benefits and costs. The primary benefit of a balanced budget rule is that it sets a conventional target for the budget—don't spend more than you take in. Since Americans have long found this balancing principle to be rational on its face, governments need not debate each year whether to run a deficit or surplus (Savage, 1988).

However, the apparent simplicity of the balanced budget rule is to a significant degree a ruse, for the state must still define what part of the budget should be balanced, and for what time period (Caiden, 1999). In Maryland, the practice is to attempt to balance the general fund from current revenues. The remaining spending is segregated in special and federal funds and financed with a mix of dedicated revenues, charges, grants, and proceeds from borrowing. We used the verb “attempt” because the state need not finance general fund spending with revenues received only during that fiscal year. It can also transfer money from special funds, substitute federal funds, and draw on the “Rainy Day Fund” that was established to help the state deal with unexpected and/or prolonged revenue declines. The Rainy Day Fund is financed by general fund surpluses saved in previous years.

Given the balanced budget rule's limited scope, Maryland must also use its discretion to set prudent budgetary policies, particularly because of the watchful eye of the credit markets. Above, we praised Maryland's Spending Affordability process for its signalling functions. In Annapolis, its sponsors stated their goals for the process in the 2002 report

The committee's primary responsibility is to recommend to the Governor and the General Assembly a level of spending for the state operating budget that is reflective of the current and prospective condition of the state's economy. Consideration is given to constraining disproportionate growth in the state-funded expenditures in any fiscal year which might necessitate or “build in” unsupportable levels of spending in future years. Thus, especially during periods of strong economic growth, the committee has attempted

to exert a “smoothing effect” on spending. (Spending Affordability Committee, 2002)

This claim appears reasonable for the 1990s, when state personal income growth exceeded spending growth--as calculated by the committee, which sometimes has excluded significant amounts of spending. However, the trend is towards a more comprehensive definition of the ceiling; the process now includes special and higher education funds and current revenue financed-capital projects not listed in the capital plan.

The 2002 committee also recommended the following:

appropriations subject to the spending affordability limit be no more than 2.5% over appropriations approved in the previous year, which was below the 4.4% forecast for personal income growth;

“that future sustainability be a primary consideration in the development of the fiscal 2004 general fund budget and that the imbalance between revenues and expenditures be erased entirely by fiscal 2005;” and

that the state withdraw funds from the Rainy Day Fund only if all other available cash balances are exhausted and if there is a statutory commitment to replenish the fund.

## COUNTER-CYCLICAL POLICY AND THE SCOPE OF THE BUDGET

Maryland has a good revenue estimating record, due to its skillful staff and a consensus-oriented approach. But revenue cycles are unavoidable, as is uncertainty about the shape of these cycles. During the late 1990s, if revenue estimators thought that an investment bubble was artificially inflating revenues, they couldn't expect to predict with confidence when the bubble would burst, and by how much revenues would decline in response. They have since said that the revenue decline over the last several years has been the largest and steepest since the Great Depression.

States have several methods of coping with this uncertainty (Wolkoff, 1999). One is to rely on accounting gimmicks, or to put it another way, adopt policies that generate reported cash

now at the unreported cost of losing cash later. An example of how irresponsible states can be in this regard is provided by Illinois, which recently sold taxable pension obligation bonds in a risky attempt to profit by investing some of the proceeds in equities. Thankfully Maryland hasn't relied heavily on gimmicks—for example, it recently decided not to securitize tobacco settlement receipts, which would be a much costlier method of borrowing than issuing general obligation bonds.

Like many other states, Maryland often uses the alternative option of adopting pessimistic revenue estimates. If the pessimism comes true, then states avoid having to cut spending predicated on higher revenues. As the last revenue decline was precipitated by a burst investment bubble, this strategy obviously has some limits. It also requires that the public be kept in the dark about the best point estimate of revenues.

A third option is to redesign taxes and spending to minimize their sensitivity to the business cycle. For example, sales and income tax revenues can be replaced by property tax revenues, or entitlement spending can be rationed rather than expanded during downturns. The impact of this approach is typically regressive. It also increases the destabilization of the state's economy—that is, it is procyclical. For these reasons, and for national macroeconomic stabilization as well, it would make great sense for the states to lobby for the redesign of selected federal policies, such as automatically triggering more generous Medicaid reimbursement rates during recessions. Lacking that—or a conception of Maryland's fiscal position that is wider than balancing the general fund—the state's medically needy and its economy suffer. For example, the Governor's July 30th cut of \$34 million to general fund spending for Medicaid “actually results in a \$68 million cut in health services received by Marylanders,” because of the foregone federal

match (Maryland Budget and Tax Policy Institute, 2003, p. 5).

Given these drawbacks, many states have adopted a fourth approach: saving during good years and spending hoarded funds during bad years; in other words, balancing over the medium-term rather than every year. This budget stabilization approach has the potential of minimizing a state government's fiscal drag on the economy, if done with sufficient magnitude and with the right timing (Gramlich, 1974). Those are big ifs. States must decide how much they should save, and when to allow how much of a drawdown. These decisions are political as well as technical—elected officials are always pressured by advocacy groups to spend rather than to save, and voters are often skeptical about large budget surpluses, viewing them as indicators of predatory tax rates.

For many years, state budget experts used a rule of thumb for the “optimal” fund balance for budget stabilization funds: 5 percent of current revenues. Nice round numbers like that should make people wary—the drop in Maryland's current revenues from fiscal year 2001 to 2002 was 4.6 percent, which would nearly wipe out, in one year, a fund at its supposed optimal size. Academic budget experts have argued that desirable levels for state budget stabilization funds should instead vary along with the volatilities of states' revenue and expenditure structures (Joyce, 2001). Joyce roughly calculated that Maryland fell within the middle of the range of volatility, and when compared to other states, Maryland's balance in the budget stabilization fund was relatively high. This is consistent with our early observation about Maryland's prudent fiscal culture, but it still begs the question: did Maryland save enough?

The question should not be answered without acknowledging some complications. First, Maryland has long used current revenues to finance some of its capital spending; this “PAYGO”

approach saves debt capacity. During much of the Glendening administration, PAYGO spending expanded, and not to universal acclaim. Some doubted that the projects it financed were necessary, and others questioned the priority these projects received over operating budget increases for programs serving needy populations. In response, Governor Glendening argued he was trying to avoid an overexpansion of the operating budget, though this was not entirely credible since many PAYGO projects implied future operating budget commitments. Without settling this dispute, we will observe that in the recent downturn, the state has temporarily eliminated PAYGO financing and shifted surviving projects into the capital budget.

In other words, PAYGO was a bit of a buffer against revenue shocks, just as the Rainy Day Fund has been. In terms of timing, it has been an earlier buffer. In terms of both timing and magnitude, transferred balances from over 25 other funds, such as the Transportation Fund, were a much larger buffer than the Rainy Day Fund was.

One argument against these transfers is that they delayed the hard choices necessary to deal with the “real problem.” If the “real problem” is that the state will face a structural deficit after a return to normal economic growth, then that argument makes some sense. But if the structural deficit is not that large, then it is unnecessary to act as if the state does not have any surplus cash to pay its general fund bills.

The other argument against transfers is that special funds should be inviolate because they receive dedicated revenues. This case is strongest when the state has a fiduciary obligation to spend reserved funds in the future, such as when employee compensation included a strong promise to pay pension benefits. In contrast, the connections between spending and the dedicated revenues used to finance this spending are much more tenuous. There is no question,

for example, that transferring money from the Transportation Fund (TTF) reduced the ability of the state to meet its ambitious transportation goals, and the Maryland Department of Transportation (MDOT) was required by law to adjust its long-term plan when this happened. Some have argued that this breaks faith with drivers who expected that their gasoline taxes would be used to build and maintain roads or to finance other transportation approaches that provide mobility. But it is unrealistic to think that this fund should be immune from such adjustments simply because it is treated in the budget as a special fund rather than as part of the general fund. The TTF receives funds from a wide variety of sources and likewise spends on many programs that have close connections in their policy effects to programs financed through the general fund. If it is good process to budget out of a big pot for all the state's modes of transportation, then it should also be the case that the state's transportation budget should be connected to the rest of the budget.

Comptroller Schaefer made this argument well on his web page, when he commented about opposition to cuts in Program Open Space (a program that we happen to support strongly):

Someone will point out that the open space program is funded by a separate source of revenue—for example, the transfer tax for open space. But open space does not mean open spending. The fact is: it's all one budget. We can't spend in one place without taking from another. There is only so much money. (Schaefer, 2003)

Several years ago, the Governmental Accounting Standards Board (GASB) agreed with this perspective when it adopted new standards for state and local government accounting, known as Statements 34 and 35 (for a tutorial on the requirements of Statement 34, see Mead, 2000). GASB continues to allow governments to use fund accounting to distinguish between governmental, proprietary (that is, “business-like services”) and fiduciary (usually pensions) activities. But it also requires that accountants “provide a clear picture of the government as a

single, unified entity,” according to Maryland’s 2002 Comprehensive Annual Financial Report, which was prepared in conformance with the new standard (p. 27). One can look on pp. 50-51 of that report and see a comprehensive and reasonably comprehensible description of Maryland’s operations. However, anyone trying to do that with the budget documents of the Governor or the General Assembly would fail because of the convoluted fund structure and the budget’s focus on the general fund.

In this discussion, we have just scratched the surface of some complicated and interrelated issues, so our main recommendation is that the state study them in more detail. First, the state should consider how to adopt the government-wide focus required by modern accounting standards to its budget, consistent with relatively comprehensive scope of the Spending Affordability process. (A related issue that we do not discuss here, but which is also worthy of consideration, is the application of strong accrual accounting concepts to the spending side of the budget.) Second, the state should consider how to put more dollars into the Rainy Day Fund during periods of strong economic growth, and under what conditions of weak or negative growth these moneys should be used.

## REVENUE STRUCTURE AND TARGETS

When states suffer steep revenue declines, they cut spending, and then often raise taxes. But the “T word” hasn’t been spoken often or loudly in Maryland in the past several years. General Assembly Democrats spurned the request of their party’s Governor to postpone the last year of a scheduled income tax cut, and Republicans ran on their usual anti-tax platform, claiming a mandate for this position after Governor Ehrlich’s victory. But elected officials from both sides



of the aisle and both branches have made strong commitments to dramatically increase elementary and secondary education spending, worry about the ability to finance very expensive current and potential future transportation projects, and recognize the high likelihood of continued double-digit annual growth rates in Medicaid. Since “efficiency” cuts are highly unlikely to be of such magnitude that they can fully finance these spending wishes, we are confident that revenue options will be considered in the next few years.

While we would never argue against the right of elected officials to oppose excessive taxation, we do believe that Maryland should no longer shun analysis of tax issues, as if such analyses would promote a contagious and deadly disease. While the Board of Revenue Estimates’ reports have remarkable detail on economic and business conditions and on the different revenue sources, this information does not appear to receive sustained attention by the Governor or General Assembly. Nor do these elected officials receive regular analyses of the incidence (that is, who bears the burden) of the state’s tax system. For example, this subject is absent from the otherwise helpful DLS Legislative Handbook volume on Maryland’s revenue structure.

Yet Maryland’s tax system, like state tax systems in general, is far from perfect (see Brunori, 1998, 2001; Governing, 2003). It is less regressive than most, but it is still regressive. Income taxes are modeled on the dreadfully complicated federal system. Maryland recently attempted to decouple partially from it, allowing a one-year delay in Maryland’s acceptance of changes to the federal tax base, but the administrative feasibility of this approach is not clear. The corporate tax is increasingly prone to avoidance and evasion. Electronic commerce has added to the narrowing of the sales tax base, which applies to goods and not services; the state is

also potentially exposed to changes proposed by the Streamlined Sales Tax Project.

From the legislative session of 1995 to that of 2001, the state reduced taxes by over \$2.6 billion (using 5-year estimates of revenue losses made contemporaneously at the times of adoption). But while the state has some fine tax analysts, it made these choices without a procedural framework for considering tax policy choices or integrating them into the budget process. The last time the state's revenue structure was studied comprehensively was 1990, by the "Linowes Commission" (Maryland Commission on State Taxes and Tax Structure). Appointed by Governor Schaefer in a bid to generate more revenues and devote them to poor communities, the legislature appreciated the technical analysis but balked at the policy proposals. Maryland should aspire towards replicating such analysis on a more frequent basis. With this information, it can better ask fundamental questions, such as: Are revenue yields sufficient to finance desired services? Are tax rates so high that they reduce Maryland's economic competitiveness? Is the distribution of the tax burden fair? Can the tax system be simplified?

Facing a large deficit over the medium term, the revenue yield question should be paramount. Looking over the Spending Affordability Committee's reports, we found frequent references to looming budget problems. Yet the spending affordability process treats only spending as a policy choice; revenues are treated as a fixed constraint. We recommend instead that the Spending Affordability process annually consider whether to recommend explicit targets for revenue changes—for growth when structural deficits cannot be solved through spending cuts alone, and for cuts when taxes make the state uncompetitive or produce undesirably large surpluses. If the legislature were to do this, it could rename the "Spending Affordability"

process the “Budget Targets” process. Old hands will caution that this is politically unrealistic, for few legislators want to be seen as having proposed tax increases. But to recycle some Clinton-era rhetoric, this is a case of “with rights come responsibilities.” If the legislature is to have the power to add to the budget, it should also share the onus for raising necessary funds.

## TAX EXPENDITURES

At the nexus between revenue structure and spending priorities are “tax expenditures,” the revenue costs from special provisions in the tax code. The Department of Budget and Management (DBM) is required by law to produce a report that estimates the costs of tax expenditures; the most recent report was issued in February 2003. Though the title says the report was “presented to the Governor and General Assembly,” it is hard to find evidence of any impact—the report’s contents are not integrated into the Governor’s budget, nor did they receive serious consideration by the General Assembly. The full report is also not shown on the DBM’s web site. One possible explanation is that the report fails to produce quality estimates of many tax expenditures—we calculate that for over 40 percent of the provisions, DBM confessed that it could not produce reliable estimates.

While quality tax expenditure estimates can be prepared only after wrestling with conceptual difficulties and acquiring reliable data, these challenges have been overcome in selected states (a survey and analysis can be found in Mikesell, 2002). The magnitude of these tax expenditures is significant; DBM calculated that the FY2004 revenue loss exceeded \$2.3 billion, using its most limited definition of tax expenditures—so-called “categorical expenditures.” While for technical reasons, summing individual tax expenditures can produce an

overestimate of the real revenue loss, remember that this \$2.3 billion only counts the less than 60 percent of categorical tax expenditures for which DBM has reliable estimates.

Greater transparency of tax expenditures can help the state both improve its revenue structure and deal with the deficit. Tax codes tend to become cluttered with special provisions; the costs are inequities, higher compliance burdens, and increased marginal tax rates to protect tax yields. We suggest that if tax expenditures were more transparent, and then were compared to spending programs, the state would choose to simplify the tax code by eliminating some of these expenditures.

#### A BUDGET TARGETS PROCESS

Above we described the Spending Affordability process as one that was too narrowly focused on spending levels, and recommended that it expand to consider alternative revenue targets. Here we argue for an even broader expansion—one that would recast it from a process that functions primarily to protect Maryland's strong bond rating to one that would also help the Governor and the General Assembly set priorities.

This Budget Targets process would demand more information about the state than does the Spending Affordability process. It is an exaggeration, but not much of one, to say that the Spending Affordability Committee's recommendations are based on a quite simple and apparently arbitrary calculation: project income growth (e.g., 3 percent), and then multiply by a percentage (e.g., 90 percent) to arrive at the maximum increase in spending. (In 2002, the Committee also made recommendations on the Rainy Day Fund, debt policies, and a hiring freeze.) Is this enough information to go on for determining the major budgetary goals for the state?

“If we don’t know where we’ve been, are now, and want to go, we will never get to our goals.” This quote is from a report of the Oregon Progress Board (2003, p. i). Oregon is one of the states (others include Minnesota, Florida, Utah, and North Carolina) that have experimented with consensus-based planning processes to inform budgeting, and it now has over a decade of experience doing so. The state has settled on three strategic goals: quality jobs for all Oregonians; safe, caring, and engaged communities; and healthy, sustainable surroundings. Attached to each of these goals are from three to seven objectives, such as “More Oregon companies will export higher-valued products” and “All aspects of society will encourage responsible parenting and adult mentoring of children.” The state also collects and reports annually on ninety benchmarks which are related to these goals and objectives, such as state rank in new companies, the high school dropout rate, and substantiated cases of child abuse or neglect. (Oregon Progress Board, 2003)

While the design and implementation of Oregon’s system has not been trouble-free, we think it is well worthy of emulation (Spicer, 1994; Varley, 1999). To show that collecting and distributing similar data would not be much of a burden for Maryland, we have prepared a table (available with links at: <http://userpages.umbc.edu/~meyers/MD Benchmark Example.pdf>) which shows Oregon’s benchmarks and what appear to be the most recent, publicly available data for Maryland on these benchmarks. Please note that the data in this table are rough, and in some cases are likely not to be the best available—but that is all the more reason to charge the experts in the Maryland Department of Planning and related agencies with the duty to prepare an annual report that does tell us where we are and where we may be going. (Note also that the Department of Planning’s web page has a Maryland State Data Center that could serve as the

starting point for this report, at: <http://www.op.state.md.us/MSDC/>.) We are confident that many of Oregon's measures would be of great interest to Marylanders; for example, we couldn't imagine that Maryland's report would drop "traffic congestion" from Oregon's list. Maryland would also want to develop indicators for some problems endemic to the state and region; for example, the condition of the Chesapeake Bay.

When academics and others propose that states adopt an approach like this, opponents typically raise several objections. One objection is that merely by reporting on conditions in the state, with the possibility that this information could be used in setting budgetary targets, there is an inevitable pressure to spend more money. We believe that this criticism is wrong in two respects. First, verified data often refutes claims that conditions are terribly bad, which can lessen demands for spending. Second, when verified data substantiates claims of terrible conditions, shouldn't we want to know that? As Oregon's Progress Board argues

Although there is no pat formula on how to use benchmark data, the practical value of understanding the factual context of issues that Oregonians care about is fundamental to the challenges facing Oregon's legislators today. Without this perspective, our leaders are handicapped in their ability to make the most clear-headed choices possible. (pp. 5-6)

Another typical objection to the planning approach is that it would replace the regular process of setting the state's agenda through gubernatorial and legislative leadership with a technocratic and bureaucratic method that would be unrepresentative. In our opinion, this is a frail straw man, for Maryland's elected officials would be in charge of the process. If they want to set explicit goals for the child poverty rate, for new businesses created in the state, or for improvements to the quality of the Bay, they can do that. Alternatively, they can use Maryland's data just as informal indicators of problems.

## FIXING “MANAGING FOR RESULTS”

The irony of that last objection is that Maryland has already set many hundreds of goals in its “Managing for Results” (MFR) process. The Government Performance Project awarded Maryland a B for “Managing for Results,” but we are convinced that this grade was a generous gift. For our harsh assessment is that though Maryland adopted a program budgeting format over fifty years ago, it has yet to learn how to use it (see also Schick, 1971, pp. 70-75).

We do not mean to discount the good efforts of many Maryland agencies and the progress they have made so far; performance budgeting and management improvement are difficult tasks (Kelly and Rivenbark, 2003; Joyce and Tompkins, 2002; Melkers and Willoughby, 1998; Broom and McGuire, 1995). But we believe our judgment is widely shared in Annapolis, based on conversations with state officials, and our review of DBM’s MFR web page and of published budget documents for two agencies—the Department of Business and Economic Development (DBED) and the Department of Juvenile Justice (DJJ). (DJJ was recently renamed the Department of Juvenile Services on the initiative of Governor Ehrlich; because these documents were produced before that act, we will refer to the agency as DJJ.)

Reading through Governor Ehrlich’s first budget (the MFR portion of which he inherited from Governor Glendening), it is clear that performance measures are more numerous than in previous years, but often repetitive. Too many of them are either “can’t miss” or “impossible to make” targets, or too far removed from the stated missions of the agencies, and we had little to no sense of how measures related to each other or to program strategy. And then there was the problem of data quality. DLS audited DBED’s MFRs and

concluded that the department was not providing accurate and reliable data . . . The department did not disclose that the reported results represented projections rather than

actual performance. (pp. 3, 32)

This is especially problematic for a policy area in which inflated claims of effectiveness are routine, and for an agency that does not present transparent budgetary accounts.

DLS's critique of DJJ's MFRs was even more biting.

It was noted during last year's budget deliberations that DJJ's MFR was long on service delivery and short on outcomes. . . Outcomes, in the form of a variety of recidivism measures, for example, do begin to appear this year, but in an inconsistent format. . . For all the funding that has been poured into the agency in the past several years, systematic data collection and analysis remains a core weakness. Ultimately, until this situation is resolved, any claims of improvement or otherwise will remain difficult to substantiate. The department has indicated that it understands this problem and hopes to begin to address it in fiscal 2004. . . There has been a tendency in recent years in DJJ to pile programming upon programming because the need is apparent. What is absent is effective evaluation of programming. In fiscal 2002 when funding for community-based services was significantly increased, the legislature insisted that 5 percent of any awarded funds be used for independent evaluations. However, no evaluations appear to have been done. Certainly none are available. (pp. 13, 23)

The DLS analysis of DJJ was an exemplary, probing one. This policy area is one of the most difficult facing state governments, and the previous administration had major problems with it. DLS identified personnel as one problem—high turnover and vacancy rates were interpreted not as opportunity for savings, but as indicators of needed reforms. The analysis also found three of what it called “holes” in the budget—that is, underfunding. Of course, the General Assembly was powerless to add increases for these areas into the operating budget, though it could “recommend” transfers to them.

Agencies appear to be taking MFRs somewhat seriously—as a motivational tool and/or because there is a risk that MFRs may eventually be taken seriously by elected officials. This is threatened in DBM's budget preparation guidelines:

several of the ways that Managing for Results information will be used in the budget process:



to set priorities to facilitate necessary budget reductions and efficiencies

MFR goals, strategies, and results data will be discussed in analyses of agency budgets and in budget hearings.

If targets are not attained, questions may be raised as to the strategies being used to attain agency goals.

To identify poorly performing programs.

But that kind of language, with its emphasis on cuts, sets off alarms among experts who have studied performance budgeting and previous systems that attempted to connect budgets to management and program evaluation. There's nothing wrong with demanding accountability from those who spend government funds. But if the system is designed primarily to threaten, and does not also provide positive support for management improvements, then it engenders resistance that dooms data conceptualization and reporting.

Finally, it is unrealistic to expect a big improvement in the supply of budget-relevant performance information if the demand for it is half-hearted. What agencies and citizens deserve are strong signals that elected officials will use performance information to make budget decisions. If one looks at how the state has cut budgets to deal with the deficit over the past two years, one's eyesight can be strained trying to see just one signal cloud with this message on the horizon. In fact, consistent with the argument made in the first part of this paper that the state is stuck with an early-1900s method of making budget decisions, the decisions themselves are reminiscent of the budget-cutting methods of those days, which focused on objects-of-expense rather than on program effectiveness.

A quick summary of the budget policy of the past two years would be: entitlement spending increased, state aid to localities was kept level, but funding for state operations was cut

dramatically. Those cuts started—and almost ended—with personnel. Unlike the DLS analysis of DJJ that viewed quality personnel as a critical input to program success, personnel in Maryland deficit reduction plans are usually just a big target—the largest object-of-expense that is cut before all else. The Spending Affordability Committee sets a personnel ceiling, budgets cut personnel across-the-board, agencies’ turnover and vacancy rates are tightly controlled, and salaries are frozen or effectively reduced. Given the nature of operating budgets, savings from abolished vacant positions are translated into cuts in other objects-of-expense, adding to explicit cuts to selected objects such as communications.

This approach is reminiscent of the downsizing that is popular in the private sector; at times it is unavoidable, and with strong leadership, may improve efficiency. But it is not a be-all and end-all escape valve for budgetary pressures, and it is particularly antithetical to the premise in performance management that agencies that must report on their results should also be given more flexibility to control inputs.

When cuts to personnel are matched with an abhorrence of selecting weak programs for termination, even good programs suffer. Rather than doing some things well, the state risks doing everything poorly.

The administration portrayed the July 30 cuts as streamlining.

For the most part, the cuts are being accomplished without reducing programs that serve the public, said Budget Secretary James C. “Chip” DiPaula Jr. About \$57 million, or 27 percent, comes from administrative savings and efficiencies, DiPaula said. (Garland, 2003)

Others differed in their assessment. For example,

City officials say the latest round of budget cuts will hurt some of Baltimore’s neediest residents, including pregnant women and infants, families living on minimum-wage jobs and drug addicts awaiting treatment. Dr. Peter Beilenson, the city health commissioner,

said the Health Department has decided to eliminate a new program that provides prenatal care and counseling to chronically ill or drug-addicted women. . . The cuts proposed by Gov. Robert L. Ehrlich, Jr. and approved by the Board of Public Works on Wednesday are “without question penny-wise but extremely pound-foolish,” Beilenson said. (Dewar, 2003; see also Maryland Budget and Tax Policy Institute, 2003)

We cannot resolve this dispute here. Nor can we tell what the programmatic effects of the July 30 cuts to DBED and DJJ (now DJS) might be, or how they relate to their MFRs. (DBED cuts included 10 positions, less advertising, and reduced funds for two programs; DJS cuts included reduced contractual service expenditures for unspecified poorly performing programs and postponed contracts for services and evaluation.) The Governor’s budget documents and press releases do not present enough information to weigh the contrasting arguments.

One approach to improving the demand for this information is to add to DBM’s analytical staff. DBM could also adopt an approach recently used by the Bush Administration which has the potential to increase substantially public understanding of programs. Known as Program Assessment Rating Tools, or PARTs, they make accessible to the public information about how evaluations have judged the effectiveness of agency approaches (OMB, 2003). In the General Assembly, the legislators could decide to curb their desire to micromanage programs, and instead insist on quality reporting and evaluation from agencies.

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