



Making the most of the economic downturn:

Seven steps states can take today

The economic downturn offers an opportunity to address long-standing challenges.

After years of prosperity, tough times have returned for state budgets. Revenue growth is slowing, leaving more than half the states in the nation to cope with projected budget shortfalls in fiscal 2009, according to the Center on Budget and Policy Priorities. The center estimates that states collectively will take in nearly \$50 billion less than they expected in the upcoming fiscal year.

In many states, tax revenues are weakening as citizens and businesses react to rising energy prices, a staggering real estate market, and other economic forces. Unlike earlier downturns, the current slump's impact is uneven. States involved in the housing bust are taking some of the biggest hits, while agricultural and energy producing states are doing quite well. But the pain is real, and it's likely to get worse – and more widespread – before it gets better.

This means public officials throughout the nation must confront stark choices for closing the revenue gap while maintaining essential government services and protecting their state's economic competitiveness. Some will be tempted to enact stiff across-the-board cuts for agencies and programs. Others may seek to borrow their way through the revenue crisis.

But there is another option: Today's downturn presents an opportunity to attack both the current crisis and the long-standing structural problems that hobble government operations. Instead of producing "quick fixes," tough times should be a catalyst for deeper changes that improve long-term prosperity and withstand unpredictable budget cycles and shifting demographics.

Rethinking government infrastructure and business processes can deliver significant savings and promote efficiency, ultimately delivering better value and service to taxpayers. And there's often no better time for transformation than during an economic downturn.

"In times of crisis, your mettle is really tested and your leadership is really required," said former Pennsylvania Gov. Tom Ridge, now a senior advisor to Deloitte. "And leadership often means that you cannot do the same thing as you've done it in the past. It gives you an opportunity to think boldly."

With that thought in mind, the following are considerations as you cope with the current economic slowdown in ways that can benefit your state and its citizens long after today's headlines fade.



1. Cut smartly

Declining revenue usually creates pressure to spread budget cuts evenly across agencies and programs. But that's not necessarily the most effective course of action, especially in areas such as information technology, which can be used to boost efficiency and effectiveness.



Instead of ordering across-the-board cuts of 5 or 10 percent, take a surgical approach. Examine departmental programs with an eye toward innovation. How can services be delivered differently? Where can duplication be reduced? Look for opportunities to automate manual processes and implement Web-based transactions that reduce the need for physical offices. This may mean you shield technology programs from harsh cuts because they ultimately should help reduce the cost of operating critical programs and services.

In addition, smart investments in technology can deliver information that helps state officials make sound strategic decisions. Real-time budgeting information, performance management tools and digital dashboards help state leaders understand the true cost and effectiveness of programs.

But remember, although these improvements involve technology, they're not about technology. Serious process changes need to accompany automation. Take a hard look at how you conduct business, change where necessary, and enable those changes with technology.

For governors, now is the time to lean on your cabinet leaders. Ask them to dig into programs and provide you with a true understanding of what's needed. Look for changes that deliver immediate benefits, but that also fit into a strategy of long-term structural reform — especially in big-ticket items like Medicaid, public pensions, and other entitlement programs.

2. Consider consolidation

Over the past 20 years, government programs proliferated, and they drove a corresponding increase in the technological equipment needed to support them. It's time to root out the redundancy.



"I consolidated multiple data centers because having those separate facilities didn't make sense from an efficiency point of view," Ridge said. "I also consolidated several small programs and blended two cabinet agencies into one. So there are opportunities to affect organizational change that I think generate savings, and if you do it the right way you'll have even better outcomes. But that's tough work. It involves people looking very carefully and very critically — in a constructive way — at how you're delivering services today."

There are a number of methods for reducing costs in a strategic fashion while simultaneously improving services. Strategic sourcing is a powerful procurement tool from the commercial world that is rapidly being adopted in government. It's a time-tested approach that can deliver excellent results.

Another innovative concept — shared services — makes it practical to support the needs of multiple agencies through a single resource. For instance, most forms of state licenses can now be processed by a central service, even though those licenses are issued through numerous agencies and departments.

Shared services can help eliminate redundant functions, and they can facilitate the building of state centers of excellence that use effective practices and help employees develop additional capabilities. The result can be better efficiency, better service and the ability to confront future workforce shortages.

These consolidation and standardization strategies also tend to help pull separate agencies closer together, enabling government to act more like a single enterprise and less like a loose collection of parts. As traditional government silos are eliminated, officials can gain more power to lead statewide initiatives designed to manage costs and improve performance.

"Government leaders seeking to drive major change programs need to approach the task just like a Fortune 200 CEO would — through an enterprise approach to management and customer service," said Robert Campbell, vice chairman and U.S. state government services leader for Deloitte LLP. "You can't do that with a confederation of separate, siloed agencies."

3. Think differently

For many states, solving the current revenue crisis will demand a combination of economic growth incentives, revenue enhancement, and strategic cost reduction. Decisions in some of these areas will be controversial, but it's time for bold leadership. Crisis both demands and enables innovation. Now is your opportunity to enact structural changes that won't stand a chance when the economic climate improves.



A growing number of states are trying to boost revenue instead of simply cutting back services. Some innovative techniques under consideration are long-term leasing of roadways, creation of toll roads, implementation of congestion pricing, and legalization of gaming. Admittedly, these moves can be polarizing, especially when hastily enacted. But challenges can be reduced by tailoring the changes to specific situations. States have fundamentally different business objectives for considering such initiatives, as well as different philosophies on outsourcing and privatization. Designing initiatives around these nuances can ease opposition.

Furthermore, don't be afraid to borrow good ideas. States throughout the nation are grappling with similar challenges and coming up with innovative solutions. Pay attention to what other agencies are doing and keep an eye on the private sector, too. You may see strategies that fit your needs. And the search shouldn't stop at the U.S. borders. Other countries may offer fresh approaches that respond to today's challenges in ways you hadn't considered.

"Many innovative programs have been conducted in New Zealand, London, Australia, and other countries," said Christina Dorffhuber, U.S. Public Sector Strategy and Operations Leader, Deloitte Consulting LLP. "Even though some of those ideas weren't created to solve a fiscal crisis, they produce a fiscal benefit for the jurisdictions that tried them."

4. Communicate realistically

As you deal with the revenue downturn, avoid the temptation to sugar-coat the news to citizens. The sky isn't falling, but the situation is serious, and the changes may not be painless. Convey that message honestly and directly.

"I think there's a tendency among some political figures to underestimate citizens' capacity to understand the reality they're dealing with," said Ridge. "From reading the headlines and probably from their own personal experiences, almost everyone understands that the economy is chugging along marginally and is potentially more troubled down the road."

As you develop a broad approach for addressing the economic downturn, your public communication can make or break your plan. Thoughtful and consistent messaging about how government is tightening its belt and attempting to provide services in a different way can help prepare citizens for the changes ahead.

5. Plan for economic ups and downs

The current economic downturn illustrates the value of so-called rainy day funds. States that had the foresight to establish reserve or budget stabilization funds during good economic times are better equipped to ride out the storm today.



The 2007 Fiscal Survey of the States, produced jointly by the National Governor's Association and the National Association of State Budget Officers, found that states had a total of \$63 billion – or about 9.6 percent of their total expenditures — in reserve funds last year. Based on fiscal 2008 enacted budgets, states will have about \$46 billion in

reserve this year. But these funds aren't evenly distributed, and states with "money in the bank," can now tap those reserves to ease budget shortfalls.

The lesson here is that economies are cyclical, and you need to plan for ups and downs. It's too late to save for the current downturn, but prosperity will return, and your actions then may determine how well you ride out the next slowdown.

Create a reserve fund and resist the urge to enact politically popular — but structurally unsound — measures when state coffers are full. To some extent, states confronting revenue shortfalls today undertook significant program expansions and reduced taxes or cut fees during the economic boom a few years ago. Those actions make the current slowdown even more challenging to address.

"In the period of strong economic growth after 2001, we had a number of states that undertook significant program expansions and tax reductions," Campbell said. "These moves were politically popular, but they have, to some extent, made the situation more difficult for states that are struggling to keep up with expenditure growth."



6. Take action

Visionary public officials must weave these ideas into a fabric of transformation that makes sense for their particular state or locality. And these initiatives must be backed by strong business cases, sound evaluation metrics, and appropriate program management capabilities.

Consider targeted investments in technology to automate processes and reduce the number of transactions that are conducted face-to-face. But remember that fundamental changes in business processes must drive automation initiatives. Don't be handcuffed by tradition. Question normal procedures and investigate unconventional approaches.

Think strategically, and look for opportunities to consolidate resources and facilities. Implement enterprise-wide standards and practices that enable top officials to function as CEOs of their organizations.

7. It's all about execution

Ultimately, your success in implementing crucial changes hinges on execution. A big part of that equation is executive leadership. But you'll also need solid management information and the ability to hold individuals accountable for results.

Develop meaningful performance metrics and

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implement processes to capture and report them. Without a strong accountability trail, even great ideas tend to lose steam. Identify appropriate benchmarks and track progress toward them. Create incentives that promote the outcomes you want, and give your team the tools they need to reach them.

“You need to encourage the right kinds of behavior across the state,” said Mark Price, principal, finance and administration services, Deloitte Consulting LLP. “For example, asking department heads to take an enterprise approach may save money overall, but it might reduce individual budgets. Look for opportunities to let agencies reinvest some of that savings into program improvements.”

Clearly, the current downturn presents states with tough choices, but it also offers a real chance for meaningful change and overdue reform. Fiscal hardship, though unpleasant, can open the door to innovation that would rarely happen during times of prosperity. Seize the opportunity to tackle long-standing structural problems that leave state budgets vulnerable to economic swings and shortchange both taxpayers and benefit recipients.

What’s more, today’s economy is more volatile than ever before. In the past, states often had a year or two to plan for economic changes, thanks to the fiscal lag involved in tax collection. Now, with the global economy, financial forces are more complex and intertwined. And a greater amount of tax collections are done in real time. These factors drastically cut reaction time for governments, putting a premium on developing a firmer financial footing.

The cost of inaction on these issues is simply too high to ignore. It’s time for strategies that address today’s financial pressures while positioning your jurisdiction for long-term prosperity that withstands inevitable economic fluctuations.

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