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Assembly
California Legislature

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Agenda

April 15, 2010

Upon Adjournment of Session in Room 4202

Vote-Only Items:

Amend Budget Vehicles

AB 1610	AB 1617	AB 1624	AB 1631
AB 1611	AB 1618	AB 1625	AB 1632
AB 1612	AB 1619	AB 1626	AB 1633
AB 1613	AB 1620	AB 1627	AB 1634
AB 1614	AB 1621	AB 1628	AB 1635
AB 1615	AB 1622	AB 1629	AB 1636
AB 1616	AB 1623	AB 1630	AB 1637

Items to Be Heard:

- California Forward Proposal—(Issues 1-3 in California Forward Reform Agenda Packet and attachments)
    - ACA 4 (Feuer)
    - AB 2591 (Feuer)

OVERVIEW OF CALIFORNIA FORWARD REFORM PROPOSAL

AB 2591 (FEUER)
ACA 4 (FEUER)

Introduction

The following packet details state finance and budget provisions of the California Forward Reform Proposal, which is contained in both ACA 4 (Feuer) and AB 2591 (Feuer). The intent of this packet is to facilitate committee discussion on the multiple elements of the proposal in a focused and organized manner, to allow a full, complete, and detailed vetting of the proposal in a timely process.

If adopted, the California Forward Proposal would fundamentally change California's budget process. One of the better known elements of the proposal is the change to the vote threshold to adopt a budget, which has been discussed before in the Committee. However, other components have not been discussed as much, like instituting performance based budget.

This packet focuses on the state budget issues contained in the reform proposals and does not address a portion of the proposal that address local government finance and decision making. It is the intent of the Committee to defer discussion of these items to the appropriate policy committee.

Over the last few months, the California Forward language has evolved due to input from stakeholders and the public. The Committee will consider the latest version of the California Forward Proposal.

California Forward Organization

California Forward is an organization that was created in March 2008 by California Common Cause, the Center for Governmental Studies, the New California Network, and the Commonwealth Club of California's Voices for Reform Project. The organization's main goal is to contribute to improving the quality of life for all Californians by creating a more responsive, representative, and cost-effective government. This organization is funded by the following foundations: the California Endowment, the Evelyn and Walter Haas Jr. Fund, the William and Flora Hewlett Foundation, the James Irvine Foundation, and the David and Lucile Packard Foundation.

In 2008, *California Forward* started a process of consultation and engagement with the public and community leaders regarding a government reform agenda. They have made hundreds of presentations, consulted with hundreds of community leaders, conducted focus groups and public opinion research in the development of a reform agenda that includes budget process reform and local government reform. California Forward was submitted to the Attorney General Ballot initiatives to implement the reform aimed at the November 2010 ballot.

Elements of California Forward Proposal

Vote thresholds
Lowers the vote to pass budget and most trailer bills to a simple majority. Increases the vote to 2/3 in the limited circumstances where a fee is imposed to replace a tax within two years.

Mid-year budget powers for Governor
Allows the Governor to reduce budget act spending if the Legislature fails to pass a bill to address a Prop 58 fiscal emergency within 45 days. The Legislature has sole power to determine whether a bill "addresses" the fiscal emergency.

Late budgets/Budget Schedule
Requires the budget and trailer bills to be referred to a budget Conference Committee before May 1st of each year. Extends budget deadline to June 25, or Legislature forfeits salaries and per diem if budget is not passed by a majority vote by that deadline.

Budget information from the Governor
Requires the Governor to submit, along with the budget, projections of non-recurring revenues, 5-year projections of expenditures and revenues, and "long-term impacts" of proposals.

"Non-recurring" revenues
Limits use of non-recurring revenues to specific one-time purposes. "Non-recurring revenues" as defined in the California Constitution, is LAO's "April Surprise" proposal from 2008.

"Pay-As-You-Go"
Requires bills to identify funding sources (new revenues, spending cuts) for any proposal of $25 million or more.

Performance-Based budgeting
Requires the Legislature to use performance-based budgeting beginning in 2014-15. Budget decisions are to be based on explicit missions and goals; and, performance metrics that reflect desired outcomes from state programs.

Program evaluation
Requires the Legislature to establish performance standards for state programs and to evaluate all state programs using those standards at least once every decade. The result of the evaluations will be used to develop legislation to improve or terminate the programs.

Preliminary Schedule for Discussion

The following schedule is anticipated to allow discussion of all of the elements of the California Forward Proposal; however, it may change as discussion begins:

Thursday, April 15	Introduction, Performance-Based Budgeting, Program Evaluation, Budget Information from the Governor, and other Committee items (AB 1645 and AB 2564).
Monday, April 19	Vote Thresholds, and Non-reoccurring Revenues.
Monday, April 26	"Pay-As-You Go", Late Budgets/Budget Schedule, and Mid-year Budget Powers for Governor.
Monday, May 3	Final Hearing, Follow Up, and Adopt Amendments.

General Questions to Consider in the Discussion of California Forward Proposal:

- How do the mechanisms identified in the proposal work with the realities of California's budget deadlines and the availability of revenue and expenditure data?
- Should specific and prescriptive processes be stipulated in the Constitutional components of the proposal or should they be included in the statutory provisions instead?
- The proposal dramatically expands the amount of information that must accompany the Governor's January 10 Budget Proposal. Are there too many deliverables at the same time to develop the budget within existing resources?

ISSUE 1: PERFORMANCE-BASED BUDGETING

Section 4 of AB 2591
Sixth (Section 12 (g) of Article IV) of ACA 4

SUMMARY OF PROVISION

ACA 4 requires the Legislature to establish an oversight process based upon performance standards.

AB 2591 requires the use of performance-based budgeting, beginning in 2014-15. The bill defines a performance-based budget as including:

- The mission and goals of the agency;
- The activities and programs for achieving these goals;
- Performance metrics that reflect the desired outcomes and targeted performance measurements;
- Prior-year performance data and an explanation for any deviation from previous year's targets; and,
- Proposed changes in statute.

In 2012-13, the Governor would be required to include performance measures and standards for all agencies in the 2014-15 budget, with the Legislative Analyst required to review these measures as part of the overall budget review. The Legislature may amend performance standards.

The bill also establishes a task force consisting of the Director of Finance, the Controller, and the Chairs and Vice Chairs of the Budget Committees to establish guidelines to establish performance-based budgeting and to review the plan to train executive staff to begin using the performance-based budget process.

AB 2591 requires a summary of mission, goals, performance, and objectives for each agency on the Governor's Web site.

STAFF COMMENT

The current budget process does use performance measures in the evaluation of expenditures, but the use is ad hoc and situational. AB 2591 would establish a systematic and permanent performance measurement process across all areas of the budget.

Other States use performance measures to a varying degree as part of their budget process. A 2008 National Conference of State Legislators Report (see attachment A) includes the feedback from a survey of state legislators about the use of performance measures and a summary of each state's use of these measures in their budget process.

The use of performance data is critical to fully evaluate the effectiveness of a program, if the appropriate data is available. The bill allows significant lead time to allow time to develop measurements.

The use of performance data can only be successful if the right performance and outcome measurements are developed. Outcome reporting examples have been successfully implemented in state government. For example in 2001, AB 636 (Steinberg) developed a comprehensive performance measurement system for Californian's foster care and child welfare systems. These measurements focused on key outcomes to help diagnose and improve California's program to serve youth and have been credited with focusing policy management and policymaking in this program area.

However, performance-based budgeting can have weaknesses. The use of performance measures can narrow the focus and objectives of departments too much on the measurable performance, resulting in a loss of focus in other areas that are important, but not measured.

In addition, by making these performance measures part of the state budget, the bill adds more deliverables and information to a three-part document that is already nearly 1,500 pages long, thus potentially diminishing the impact of the information. Crafting and measuring performance measures requires significant staff time; and, adds more deliverables to a process that must meet a January 10th deadline.

In the early 1990's, California piloted the use of Performance-Based Budgeting in three departments, an effort that was ultimately abandoned. Attached (see attachments B and C pages 1-8) are two LAO reports that reflect the Analyst's thinking at two points in that pilot that help explain why this effort did not succeed. The Committee may wish to revisit this pilot in attempting to insure that the state does not repeat the same mistakes in adopting a new system.

In the *California Forward* framework, there is more investment in the framing and guidelines for performance measures, which should help avoid some of these problems. In addition, since the framework is included in the AB 2591 statutory provisions, it provides the Legislature flexibility to fine tune as time and experience inform the discussion.

It appears the Legislature can change the performance standards, but only the Governor can choose which measures to include or ignore in the budget itself.

POSSIBLE QUESTIONS

Why does AB 2591 prescribe what performance measurements and information must be listed on the Governor's Web site, as opposed to allowing the Administration discretion about where to post this data on the various state Web sites?

ISSUE 2: PROGRAM EVALUATION

Section 1 of AB 2591
Sixth (Section 12 (g) of Article IV) of ACA 4

SUMMARY OF PROVISIONS

ACA 4 Requires the Legislature to establish an oversight process based upon performance standards. It also requires the review of every state-funded program at least every ten years.

AB 2591 requires the Legislature to designate or create a Joint Committee that would review the performance of every area of the budget. The bill requires that all areas of the budget be reviewed at least once every ten years, but requires that at least one-third of all expenditures be reviewed by 2015, and that two-thirds of all expenditures are reviewed by 2018. The Legislature is required to adopt a schedule for the reviews, including deadlines, within one year of enactment of the bill.

The reviews include all expenditures, but would also include tax expenditures, deductions and credits.

Each review is designed to take six months to complete. The process envisioned in AB 2591 is as follows:

- Joint Committee develops an "initial review" document that must be submitted to the appropriate policy committee for consideration. Six months prior to the deadline.

- The policy committee must make recommendations back to the Joint Committee, within 90 days of the deadline.

- The Joint Committee makes its final recommendation.

- Proposed legislation from the Joint Committee would be referred to the appropriate policy committee.

In preparing proposed legislation for a program that is being reviewed, the Joint Committee shall propose one of the following:

- Changes to the program to reduce costs;

- Change to the program to improve outcomes; or,

- Termination of the program.

STAFF COMMENT

As crafted, the language provides the Legislature with some latitude to schedule the performance reviews, but it does limit the process that the Legislature can use to undertake these reviews. This flexibility allows the Legislature to develop a workable plan that will complement the existing legislative and budget processes.

POSSIBLE QUESTIONS

Why does this process use a Joint Committee, rather than allowing two parallel processes in each house?

Does the ten-year cycle for review make sense or should a different time period be considered?

ISSUE 3: BUDGET INFORMATION PROVIDED BY GOVERNOR

Sixth (Section 12 of Article IV) of ACA 4

SUMMARY OF PROVISION

ACA 4 requires the Governor to submit a budget for both the budget year and the succeeding fiscal year. The budget must contain provisional language, performance measurement standards, a projection of anticipated State revenues, including nonrecurring revenues. The budget must also contain a projection of State expenditures and revenues for the three fiscal years following the fiscal year succeeding the budget year and budget plans for those three fiscal years. This constitutional amendment also requires the trailer bill language accompanying the Governor's budget to be introduced in bill form immediately in each house.

The provision also requires that if, for the budget year and the succeeding fiscal year, recommended expenditures exceed estimated revenues, the Governor shall recommend reductions in expenditures or the sources from which the additional revenues should be provided, or both. The recommendations must include an estimate of the long-term impact that expenditure reductions or additional revenues will have on the economy of California. Together with the budget, the Governor shall submit to the Legislature any legislation necessary to implement appropriations contained in the budget, together with a five-year capital infrastructure and strategic growth plan, as specified by statute.

The provision also stipulates that if the Governor's budget proposes to create a new state program or agency, or to expand the scope of an existing state program or agency, as defined by statute, which would result in a net increase in state costs during the budget year or the succeeding fiscal year, or proposes to reduce a state tax, which would result in a net decrease in state revenue in the budget year or the succeeding fiscal year, the proposal shall be accompanied by a statement identifying state program reductions or sources of additional state revenue, or both, in an amount that is equal to or greater than the net increase in state costs or net decrease in state revenue.

The budget must update these projections on May 15th, after the Legislature's budget Conference Committee recommendations are adopted, and on October 15th of each year.

ACA 4 also requires that all proposed trailer bills that accompany the Governor's Budget be introduced in bill form immediately in both houses.

STAFF COMMENT

Current information regarding out-year deficits is already included in the Governor's budget submission (see attachment D) and is also the focus of the Legislative Analyst's Fiscal Impact Report. However, this Constitutional provision updates this information throughout the budget process and adds a new date of October 15th for providing this information.

The reporting requirement does not require an update of budget information after the final budget package is chaptered. The committee may wish to consider substituting the October 15th deadline with one that is tied to the final chaptering of the Governor's budget.

The Administration currently provides trailer bill language to the Legislature after the submission of the budget bill, but not immediately upon the issuance of the budget. This year, most of the language was available by February 1st. The Committee may consider if accelerating this date to January 10th is necessary.

ISSUE 4: VOTE THRESHOLDS

Third (Sections 9 of Article II) of ACA 4
Fourth (Section 8 of Article IV) of ACA 4
Sixth (Section 12 of Article IV) of ACA 4
Tenth (Section 3 of Article XIII A) of ACA 4

SUMMARY OF PROVISION

Budget Bills
ACA 4 exempts appropriations made in budget bills from the two-thirds vote requirement. Revenue increases would still require a two-thirds vote.

The provision defines a budget bill as: "a bill that makes appropriations for the support of the government of the State for an entire fiscal year, including a bill that contains only provisions amending or augmenting an enacted bill that made appropriations for the support of the government of the State for an entire fiscal year."

Trailer Bills
ACA 4 also allows budget implementation bill (commonly referred to as "trailer bills") to go into effect immediately without an urgency clause. It does not change the vote threshold for the bills, but removal of the urgency clause requirement, in effect, makes most trailer bills majority vote. Trailer bills must be identified in the budget bill. The provision also excludes trailer bills from the referendum process.

ACA 4 also defines a budget implementation bill as a bill enacted by a statute that is identified in the budget bill as containing only changes in law necessary to implement a specific provision of the budget bill.

Fees
ACA 4 requires that any bill that imposes a fee be passed by two-thirds of each house if revenue from the fee would be used to fund a program or activity that was previously funded by revenue from a tax that is repealed or reduced in the same fiscal year or in a prior fiscal year.

STAFF COMMENT

There are only eight states that have supermajority vote requirements for the passage of the State budget. All other states require only a majority vote for passage of the State budget. The other states that have supermajority vote requirements for the budget each have different systems as detailed below:

- **Arkansas.** Three-fourths majority is required on all appropriations except education, highways, and paying down state debt.

- **Connecticut.** Three-fifths majority is required for appropriations only if the General Fund expenditure ceiling is reached. Otherwise, appropriations require a simple majority.

- **Hawaii.** Two-thirds majority is required for appropriations only if the General Fund expenditure ceiling is reached. Otherwise, appropriations require a simple majority.

- **Illinois.** A simple majority vote is required for appropriations until June 1, after such time a three-fifths majority is required to pass the budget.

- **Maine.** A simple majority vote is required for all legislation that is non-urgency. Urgency legislation requires a two–thirds vote. Therefore, the budget must be passed by April 1 if it is to be implemented with a majority vote.

- **Nebraska.** Nebraska's system is similar to Maine's.

- **Rhode Island.** Appropriations require a two-thirds majority vote.

In 2009, the Legislature twice adopted reductions to budgets that were already enacted. The mechanism to make these changes was colloquially referred to as "Budget Bill Jr." because the bill made the reductions by chaptering out sections of an adopted budget and so the bill looked very much like a budget. The Committee may wish to consider including "reduce" to the definition of a budget bill, so it applies to bills that reduce the budget.

ISSUE 5: NON-REOCCURRING REVENUES

Eleventh (Section 21 or Article XVI) of ACA 4
Twelfth (Section 3.5 of Article XVIII) of ACA 4

SUMMARY OF PROVISION

ACA 4 would require the Director of Finance on or before May 31 to estimate General Fund revenues for the current fiscal year, the General Fund impact of tax legislation adopted subsequent to the enactment of the budget bill, and the amount of the General Fund reserve for economic uncertainty as of June 30 of the current fiscal year. This constitutional amendment would define unanticipated revenues as the lesser of the following: (1) the estimate of General Fund revenues reported on May 31 minus the estimate of General Fund revenues for the current fiscal year set for in the January 10 Governor's budget; or, (2) the estimate of the General Fund reserve for economic uncertainty as of June 30 of the current fiscal year.

This constitutional amendment would limit unanticipated State revenues from being expended except to satisfy any additional obligation created by Proposition 98, resulting from the unanticipated revenues. After this obligation is met, the remaining unanticipated revenues shall be transferred to the Budget Stabilization Account up to $8 billion.

If there are any remaining unanticipated revenues, this constitutional amendment would require that these revenues be used to retire outstanding budgetary indebtedness, including unfunded prior year obligations under Proposition 98, a repayment obligation created by the suspension of Proposition 1A (2004), a repayment obligation created by the suspension of Proposition 58 (2004) and the transfer of motor vehicle fuel sales tax to the State Transportation Improvement Program, unfunded state mandate obligations, and repayment of bonded indebtedness as a result of Proposition 58 (2004).

STAFF COMMENT

The structure for capturing unanticipated revenue outlined in ACA 4 is based upon the LAO recommendation for an "April Surprise" strategy that was included in the 2008 budget analysis. The original analysis is attached with the April Surprise detailed on (see attachment E page 154 of report).

Proposition 1A of 2009 offered a slightly different approach in determining the amount of one-time revenue. Proposition 1A established a process to determine which revenues are "unanticipated." The measure generally defines unanticipated revenues to mean those that exceed the amount expected based on the revenues received by the state over the past ten years. The ten-year trend would have been adjusted to exclude the impact of shorter-term tax changes. Beginning in 2010-11, any extra revenues would have been directed to the following purposes (in priority order):

- Meet funding obligations under the Constitution for K-14 education not already paid. (An existing formula established by Proposition 98 determines how much of higher revenues go to education);

- Transfer to the Budget Stabilization Fund to fill the reserve up to its target; and,

- Pay off any budgetary borrowing and debt, such as certain loans and Economic Recover Bonds.

Once all of these types of payments were made, any other extra revenues could have been spent on a variety of purposes, including further building up of the BSF, paying for infrastructure (such as constructing roads, schools, or state buildings), providing one-time tax relief, or paying off unfunded health care liabilities for state employees.

ISSUE 6: PAY-AS-YOU-GO

Section 2 and 3 of AB 2591
Second (Section 8 of Article II) of ACA 4
Fourth (Section 8 or Article IV) of ACA 4

SUMMARY OF PROVISION

Pay-As-You-Go Applied
This constitutional amendment would make any new statute or constitutional amendment void that costs in excess of $25 million unless it also contains provisions with program reductions or revenue increases in an amount equal or greater than the costs of the statute. The budget bills are excluded from this requirement, as are appropriations for school funding. This constitutional amendment also requires that any Governor's budget proposal to expand or create a new program be accompanied by a statement identifying State program reductions or additional revenues that are equal or greater than the net increase in the State costs of the new or expanded program.

ACA 4 requires any initiative measure to provide for additional revenues in an amount that meets or exceeds the net increase in costs, other than costs attributable to bonds. The initiative measure may not be submitted to the electors until the Legislative Analyst's Office (LAO) and Department of Finance (DOF) jointly determine that the initiative measure provides for additional revenues in an amount that meets or exceeds the net increase in costs.

Process for assessing cost
AB 2591 requires the fiscal committee of each house to determine whether a bill or measure should be reviewed by the LAO to make determination of whether the statute is restricted by the new constitutional "Pay-As-You-Go" provisions (contained in ACA 4) that require that any statute or measure that has "qualified state costs" of more than $25 million must have offsetting program reductions or revenue increases of an equal or greater amount.

The bill also allows the Legislature to override the LAO's determination of constitutionality by a two-thirds vote in each house. This bill authorizes the LAO to consider impacts to other programs and establish a time period in making determinations in this section. The Legislative Counsel digest shall reflect the determination made by the LAO before a measure is read for a third time if the LAO determines that the bill has qualified state costs of $25 million or more.

Pay-As-You-Go Definitions and Exclusions
AB 2591 defines "qualified state costs" to exclude: general obligation bond debt; restoration of funding that was reduced in a prior fiscal year, to balance the budget to address a forecasted deficit; one-time increases in the budget bill or a budget trailer bill; COLAs or other workload increases, including increases in Memorandums of Understanding (MOUs) approved by the Legislature; and local mandates. This bill

defines "a net increase in qualified costs" to mean ongoing expenditures and does not include one-time expenditures. This bill defines "additional revenue" to mean a sustained increase as determined by the state agency responsible for collecting the revenue.

In addition, AB 2591 waives the requirements of the new "Pay-As-You-Go" constitutional amendment if the State is in a structural surplus, and the net increase in costs or net decrease in revenues does not exceed the amount by which state revenues exceed state expenditure obligations in any given year, over a five-year period starting with the prior fiscal year.

STAFF COMMENT

California must adopt a balanced budget every year, so absent the Pay-As-You-Go provisions any unfunded program would have to be considered and addressed in the budget process of the subsequence year.

This Pay-As-You-Go provision does not apply to bonds.

ISSUE 7: LATE BUDGET/BUDGET SCHEDULE

Sixth (Section 12 of Article IV) of ACA 4

SUMMARY OF PROVISION

Budget Schedule
On or before May 1st, appropriate committees in each house of the Legislature should consider the budget bill and implementing budget bills and refer them to the Joint Committee. The Joint Committee shall report recommendations to each house no later than June 20th of each year. The legislature shall pass the budget no later than June 25th of each year.

ACA 4 also requires the Governor to submit revenue and expenditures projections on May 15th, immediately following the report of recommendations by the Joint Committee, and October 15th.

Legislator's Pay
ACA 4 requires that if the budget bill is not passed by the Legislature by midnight on June 25th, Members of the Legislature shall forfeit any salary or per diem until the budget bill is passed. No salary or per diem shall be paid retroactively.

STAFF COMMENT

The requirement to refer budget deliberations to a Joint Committee on May 1st could hamper the ability of the public and the members of the Legislature to participate in budget discussion. This Joint Committee would convene prior to the Governor's issuance of the May Revision proposal (prior to May 15th), and, historically there have been major policy and fiscal changes at that time. With the exception of 2009, the May Revision is normally considered first by Subcommittees and then each house adopts a different version of the budget that is considered by a Budget Conference Committee.

ACA 4's Joint Committee structure does recognize that the Budget Conference Committee discussion is not truly focused on the technical purpose of a Conference Committee, working out the differences between the Assembly and Senate versions of the budget, and is instead an opportunity for public high-level discussions between the four caucuses and the Administration.

This Committee may wish to consider whether the Joint Committee milestone dates of May 1st and June 20th are necessary to stipulate in California Constitution, or if the deadline for the final budget vote of June 25th is sufficient.

ACA 4 stipulates that all Trailer Bills must be passed by June 25th, but historically some Trailer Bills have been passed after the main budget item.

ISSUE 8: MIDYEAR BUDGET POWER FOR GOVERNOR

Fifth (Section 10 if Article IV) of ACA 4

SUMMARY OF PROVISION

Mid-Year Cut Authority
ACA 4 expands the mid-year powers provided to the Governor in Proposition 58 of 2004. ACA 4 allows the Governor to reduce or eliminate unexpended appropriations in the budget act if the Legislature fails to act prior to the 45th day of a fiscal emergency. The Legislature can override the veto with a two-thirds vote of the membership of each house concurring.

ACA 4 also requires the Governor to identify the size of the budget discrepancy in the emergency declaration—the expanded powers to reduce or eliminate appropriations cannot exceed the amount of this discrepancy.

Proposition 58 requires that the State enact a balanced budget and provides for mid-year actions in the event that the budget falls out of balance. Proposition 58 also established a special budget reserve called the Budget Stabilization Account and prohibited borrowing to cover budget deficits. The proposition also authorizes the Governor to call a fiscal emergency and special legislative session to address such an emergency. This year, the Governor used this power on January 10th to call the Legislature into special session to address the state's budget problems. In such a case, if the Legislature fails to pass legislation to address the budget problem within 45 days, it would be prohibited from (1) acting on any other bills, or (2) adjourning in joint recess until such legislation is passed.

STAFF COMMENT

The Committee may wish to reflect on recent history regarding the use of Proposition 58 fiscal emergency declarations over the last three years in considering this proposal.

ATTACHMENTS

Attachment A

- National Conference of State Legislatures: *Legislative Performance Budgeting, September 2008*

Attachment B

- Legislative Analyst's Office: *Performance Budgeting: Reshaping the State's Budget Process, October 25, 1993*

Attachment C

- Legislative Analyst's Office: *1996-97 Budget Analysis: Statewide Administration Crosscutting Issues*

Attachment D

- *Excel Document: General Fund Multi-Year Projection at 2010-11 Governor's Budget*

Attachment E

- Legislative Analyst's Office: *Alternatives to the Governor's Budgetary Reforms, 2008*

Attachment A

National Conference of State Legislatures: *Legislative Performance Budgeting, September 2008*

Legislative Performance Budgeting

September 2008

The broad effort frequently referred to as performance management is occurring at all levels of government. The hallmarks of performance management include establishing strategic plans, setting agency goals and objectives, identifying ways to meet them, and measuring how well they are accomplished over time. Performance measures are maintained in most states. Regular performance reporting to the legislature occurs in some.

In nearly all cases, the executive branch maintains the performance measures. Legislative and executive branches may collaborate on determining measures (Oregon), while the legislature reviews key, but not all, measures (New Mexico, Texas). Legislative staff may review key measures to identify areas of legislative concern and bring them to legislators' attention (Arizona, Missouri, New Mexico, Texas).

NCSL surveys have found that legislators and staff agree that results-based government requires:

- Permanent institutional commitment from the governor, legislature, and agency administrators (Louisiana, Texas, and Washington are examples),
- A statutory base,
- Adequate staff resources,
- Existence of an oversight agency,
- Investment in data management; and
- Recognition that fundamental change requires time.

Legislative Use of Performance Information

Legislators and staff suggest that agencies are most likely to heed indicators when the linkage to funding is explicit. In 22 states, performance information is used at some point in the legislative budget process, although legislative performance budgeting—the actual linking of results information to legislative decision-making—is uncommon. The legislatures in these states are similar with respect to the types of performance information they use but they differ in when and where the information comes into play and how it appears. A number of states require that measures be used in development of agency budget requests and some also include this information in agency budgets. A handful include performance information in their appropriations bills.

What goals do legislators have as they consider performance measures?

- Better understanding of state programs
- State program effectiveness (outcomes)
- State program efficiency (costs and benefits)

- Potential savings
- Other purposes

Reasons for legislative use of performance information include these:

- Performance data can provide newly elected legislators with helpful background on the purposes of state-funded programs and the results they achieve.
- Performance information can help explain the results of previous legislative funding decisions.
- Performance indicators can help with estimating and justifying the potential consequences of new funding decisions.
- Regular review of performance measures before and during budget deliberations can encourage deeper legislative understanding of agency activities and may even garner support for them.
- Performance information has the potential to communicate what is received in return for the investment of tax dollars.
- Instead of focusing on the preservation of existing programs and associated spending levels, both agency personnel and policymakers may gain understanding of program effectiveness.

Legislative hearings provide an opportunity for legislators to learn about agency performance, whether during the interim, at pre-session budget hearings, or in some states, during legislative session. The attached pocket guide lists questions for use in hearings. Missouri's appropriations staffs have incorporated similar information into reports for legislator review. Performance information can help show the effects of reductions on different programs and can support difficult decisions to reduce funding where the effects will be least detrimental. Louisiana's House Appropriations chairman led a successful effort to adopt performance budgeting, with legislative fiscal staff closely involved in the determination of measures and indicators. When the governor introduced a number of new initiatives in higher education and economic development for FY 2004 while reducing funding for a number of health care programs, the Legislature was able to use performance data to demonstrate the effects of the cuts on service delivery and health outcomes, to question the feasibility of implementing the administration's proposal, and to justify reorganizing priorities to restore health care funding.

Performance Reporting to Legislators

Legislators and legislative staff over time have raised numerous issues about the choice of agency and program performance indicators and reports of performance. The most frequently heard complaints are that:

- Indicators are not well-chosen to reflect legislators' concerns;
- Too much information is reported;
- Presentation is not well-planned;
- Reported information is unreliable.

Legislators' concerns
It is important for legislators to make clear the kinds of measures they care about and how they want results information presented to them. Legislators have to be involved in selecting performance indicators to make sure the indicators are relevant to legislators' concerns. Indicators were more useful to legislators in Florida and Texas, where legislators reviewed them, than in Minnesota, where they didn't have that opportunity. A reasonable number of key indicators (selected from a larger list maintained by the agency) are likely to be of greatest use. Legislative approval of these key measures will help ensure that they will be used.

Agency personnel and legislators may have different ideas about what is important about an agency's work. Administrators' performance indicators are likely to focus on management factors--FTEs, caseloads, staff productivity, reports processed, for example. When these types of management indicators appear in reports to legislators, they may have the unintended consequence of shifting legislative attention to executive branch responsibilities and away from policy results. Examples of measures especially relevant to policy makers and their constituents include items such as highway accident rates, occurrences of child abuse in foster care, unemployment rates, college completion rates, graduate in-state job placement rates--items and issues that are the subject of policy discussions and decisions.

Information overload
The number of indicators available is large because of the size of state government, the variety of its activities, and the different interests of different legislators and other stakeholders. The Utah Office of the Legislative Fiscal Analyst in 2003 surveyed performance measures in just eight states--Alaska, Arkansas, Florida, Louisiana, New Mexico, Oregon, Texas, and Virginia--and identified 5,303 measures in its final report.

Oversight agencies and state budget offices deal with this issue by prioritizing indicators and using a relatively small number of them in budget recommendations and legislation. Legislative staff responsibilities in Florida, Louisiana, New Mexico, and Texas include tracking agency performance and reporting strong or weak performance in relation to specific expectations of legislators. Texas legislators asked whether the numbers of performance measures and targets in the appropriations act and the performance-based budgeting system were appropriate indicated an interest in either fewer, better defined, or better prioritized indicators. New Mexico legislators have said they prefer to review 12-15 key measures per agency or program.

Minnesota legislators repealed the requirement for separate agency performance reports in part because of the bulkiness of the reports they were given. The legislative auditors' staff in Minnesota reported that performance reports were too long to be assessed biennially.

Presentation
Key results indicators, limited to a few per program, agency or department, can direct legislative attention to the policy outcomes of greatest interest and importance to citizens and highlight important agency performance. When reports provide brief staff analyses and graphics to explain results, they can be even more helpful.

Louisiana legislators review two-page performance variance reports prepared by legislative staff to identify trends, compare performance to standards, and notify legislators of potential problems. In New Mexico, quarterly performance reports provide ratings of "red, yellow, green" to highlight areas of potential concern regarding measures. The Utah Legislature has developed reports that focus on budget changes called "Building Blocks." The reports show past and current funding sources and amounts along with a short description of the reasons for the appropriations.

Reliability
Suggestions about data and verification from legislators in states that were consulted for *Making Results-Based State Government Work* included the following:

- Establish a system of verification of the reported data, technical assistance on the construction of performance measures, and evaluation of the validity of measures, and spend money on information and data systems (Florida).

- Make sure to note the limitations of any measurement data and link activities being measured to some desired outcome (Oregon).

The recommendation to link indicators to appropriations has been made by legislators and staff in a number of states, yet efforts to do so have been a struggle. Legislative budget review tends to focus on changes in funding rather than on the base (the amount appropriated for the previous budget cycle). Specifying the changes in agency performance that could be expected to result from a change in funding would provide legislators with relevant and pertinent information of immediate use in policy making decisions. Agencies can specify in their budget requests and reports how any additional funds they request would affect their output and outcome measures.

Legislators and staff generally support the use of incentives and disincentives to improve agency performance, but developing an effective way to do so has been difficult. Reducing funding for programs that do not meet performance goals may not be an effective course; agency failures could be the result of inadequate funding and reduced funding could make the matter worse. Agencies that perform well can be rewarded with additional funding or additional flexibility in the use of their funds. However, such rewards have to be weighed against the needs of other agencies, and funding is not necessarily available to serve as a reward. Incentive awards for individual employees have been suggested in some states, but state personnel laws and union agreements (where they exist) have made this a less useful tool in the public sector than in the private sector.

Laws in Florida, Louisiana and Texas allow the use of incentives and disincentives, but actual use has been very limited. Louisiana imposes stricter reporting standards on agencies that fail significantly in meeting performance goals. It appears in practice that requiring reports and the use of praise and admonition may be the most effective incentives and disincentives that policy makers can use.

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Appendix

Performance Budgeting in the States

Even though most legislatures don't classify their predominant budget approach as "performance-based," quite a few call their approach a "combination." Legislative use of performance information appears to have increased somewhat since 1997, when three states defined their budget approach as "performance-based," and 17 reported the use of performance measures in the budget process.

A 2007 survey of legislative fiscal offices for this report found that 22 states, the District of Columbia, Guam and the Northern Mariana Islands now indicate use of performance measures in the legislative budget process. States such as Arkansas, Maine and Michigan that indicated adoption of performance budgeting procedures in 1997, however, have since moved away from the approach, and it is also endangered in Florida and Tennessee. Legislative responses to questions about their state's "predominant budget approach" and the use of performance information in 2007 follow:

- Arizona — The General Appropriation Act includes performance measure targets that may be used by legislators to evaluate requests.
- California — The Legislature's review of departments' performance is done on a case-by-case basis.
- Colorado — The General Assembly has entered into performance-based memoranda of understanding with certain departments or agencies.
- Connecticut — In 2007, Connecticut concluded a two-year pilot program applying Results Based Accountability (RBA) to programs involving multiple agencies delivering services to pre-school kids. In addition, RBA has been used to evaluate two programs in the Department of Environmental Protection: clean water and parks. Connecticut will expand RBA to new and expanded programs and integrate the analysis, discussion and funding into the legislative appropriations process.
- Delaware — Starts with a zero-based budget, but combines this with performance and traditional approaches. Performance measures are used (seldom) for program questioning during JFC [Joint Finance Committee] hearings but are a required field in agency budget requests.
- District of Columbia — The District of Columbia (DC) uses performance-based budgeting. Performance measures are listed for each program and are monitored by the DC Council through its oversight of the budget.
- Florida — The Florida Legislature created a performance-based program budgeting (PB2) process in 1994 to link funding to agency products or services and results. The 1994 Government Performance and Accountability Act required the governor to submit performance-based program budgets for the executive agencies to the Legislature. During the early years, the Legislature was very active in selecting and monitoring the performance measures and results. Now the process is used more by agency supervisors for internal management, although the Legislature retains a key role. In 2006, the Legislature passed Chapter 2006-122, Laws of Florida, which created § 216.1827, Florida Statutes, to separate the approval of performance measures and standards from the legislative appropriations process. Agencies now provide information on their legislatively approved performance measures and

standards in their long-range program plans. To delete or amend these measures and standards, agencies must obtain approval from the Office of the Governor and the Legislative Budget Commission.

- Georgia — Georgia uses program budgeting. Officials hope to start bringing performance into the process, but there is currently almost no review of performance measure in the legislative process.

- Guam — Guam is moving toward performance-based budgeting.

- Hawaii — Performance measures or program goals are a standard part of the budget submittals from the executive and judicial branches. They are included annually along with the budget request. In addition to the budget documents, state law requires the submittal of "variance reports." These reports detail the variations to performance goals and provide explanations for those differences.

- Iowa — Statute requires a modified zero-based approach. Performance measures are available in agency budgets for legislative review.

- Kansas — Although still largely based on traditional methods, performance measures are requested of agencies and reviewed by the governor and Legislature in formulating the budget.

- Kentucky — Kentucky has adopted through legislation some components of performance based budgeting. KRS 48.810 requires each program cabinet to develop and submit a four-year strategic plan and to provide periodic progress reports. KRS 48.810 also requires agencies to submit the Strategic Plan with their biennial agency budget requests. The uniform set of budget instructions and forms to be used by agencies in the budget request submission process includes a form that requires the agency to discuss program performance and provide output and outcome measures where available. Agencies must use quantitative data and other information to explain the program's purpose and justification for expenditures. This information can be used by legislators in their deliberations when appropriating funds.

- Louisiana — Act 1465 of 1997 mandates performance budgeting. Performance data are reviewed during the appropriations process.

- Maryland — Performance measurement data are reported in conjunction with the budget and considered as the budget committees deliberate on agency level funding changes.

- Mississippi — In 1997 the Legislature began including performance targets in the appropriations of 21 agencies accounting for approximately 85 percent of the state's general fund appropriations. There are no statutory penalties for not attaining these targeted goals. All agencies are required to include performance measurement information in their annual budget request submissions. Agencies also report semi-annually on attainment of performance targets.

- Missouri — Missouri incorporates a variety of approaches in its budgeting process, including the requirement of performance measures and outcomes, traditional/incremental budgeting and a core review of agency budget requests that is zero-based in its approach. Also, during the interim, both Senate and House appropriations committee staff have a statutory requirement to conduct a review of performance measures for purposes of analyzing the usefulness of these measures in agency performance reviews.

- Montana — Montana is making a major effort to incorporate more performance measures into budgeting.

- New Mexico — New Mexico uses a combination traditional/incremental and performance-based budget approach in the appropriation process. Agency appropriations are made by program with the program name appearing first, then the purpose of the program, appropriations by category and performance measures with proposed targets for the ensuing fiscal year. The Accountability in Government Act requires all state agencies to submit performance-based budget requests and "key agencies" to submit quarterly performance reports comparing actual performance with targeted performance for the reporting period to the Department of Finance and Administration and the Legislative Finance Committee. During the appropriation process, both the House Appropriations and Finance Committee and the Senate Finance Committee review and adopt performance measures and targets for the agency for the ensuing fiscal year.

- North Carolina — In the 2006 session, North Carolina adopted a major rewrite of the state's core budget law. The new state budget act took effect July 1, 2007. It leaves the governor free to select a budget format without specifying the styles to be applied. But it requires that, whatever format is chosen, line-item information be made available within each program. For the 2007 session, following that theme, the Office of State Budget and Management revised the governor's budget presentation to begin including program descriptions and rudimentary output/outcome measures along with line-item detail.

- Oklahoma — As part of a move from incremental budgeting to program budgeting, the state has begun to move toward program-based budgeting, with mixed results. Oklahoma has been using performance-based budgeting since about 1999.

- Oregon — While the budget process is predominantly traditional [incremental], there are elements of performance-based (agency key performance measures approved by the legislature), program-based (sub-agency or program level identification), and zero-based (discussion of 10 percent to 20 percent reduction options). There has been more of an emphasis on the performance-based elements over the last two budget cycles. The legislature, through the Joint Committee on Ways and Means, reviews and approves a series of key performance measures (including targets) for each state agency as a component of the biennial budget process. Before increases to programs can be considered, agencies must identify the impact on their key performance measures. State agencies are required to provide annual reports to the legislature and public on their key performance measures.

- South Carolina — Legislators frequently use Agency Accountability Reports as supplemental information in budget policy making.

- Tennessee — Defined by statute, budgeting is zero-based. However, the state practices a continuation of required programs plus essential improvements. The traditional/incremental approach is still used but Tennessee incorporated performance measures into the budget request process in 2002. The Legislature has authority to review and comment on all performance measures that are reported. In

2007, the Administration proposed eliminating many of the performance-based initiatives but the change was deferred until 2008.

- Texas — Texas reports itself as a performance-based budgeting state. The staff of the Legislative Budget Board are responsible for tracking the performance measures and making sure that key measures are brought to the attention of legislators. Texas legislators can see reports submitted by state agencies that show planned and actual performance in terms of outcome and explanatory measures (reported annually) and output and efficiency measures (reported quarterly).

- Vermont — A combination of traditional and performance-based budgeting is used.

- Northern Mariana Islands — Traditional budgeting is used when departments do not submit information on zero-based budgeting.

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Attachment B

Legislative Analyst's Office: *Performance Budgeting: Reshaping the State's Budget Process, October 25, 1993*

Making Government Work Better

First in an Occasional Series

Performance Budgeting:
Reshaping the State's Budget Process

The Clinton Administration recently released its *Report of the National Performance Review*, which proposes ways to improve the operations of the federal government. The idea of restructuring governmental operations is equally applicable at the state level.

This is the first in an occasional series of papers discussing opportunities to make California government work better.

Legislative Analyst's Office
October 25, 1993

BACKGROUND

It is hard for most people to get excited about the state budget process with its mountain of numbers, intricate details, and endless jargon. It is a fact of life, however, that the budget process determines who gets what services and who pays for them. The Governor's 1993-94 Budget proposed to change the state's budgeting process by pilot testing performance budgeting in four state departments because the state's traditional budget process "has become seriously dysfunctional."

FINDINGS

We have reviewed the use of performance budgeting in other states and the Governor's proposal for California. We conclude that nine months after being proposed by the administration, the pilot project still lacks sufficient details and its schedule has slipped. Nevertheless, we believe that performance budgeting has merit and is worth pilot testing. This is because it focuses on program results, thereby offering the potential of improving the delivery of services.

RECOMMENDATIONS

If the potential benefits of performance budgeting are to be realized, the Legislature will need to "break the mold" in how it appropriates funds for the pilot departments and conducts legislative oversight. It will have to focus on longer-term program goals and outcomes, rather than immediate process and service demands. Accordingly, we recommend the establishment of a joint legislative committee—including representation from the fiscal and policy committees of both houses—to oversee the pilot project and review the performance and budgets of the pilot project departments.

"Performance budgeting differs from the traditional approach to budgeting in that it focuses on outcomes rather that inputs or processes..."

BACKGROUND

What Is Performance Budgeting?

Stated simply, performance budgeting is the allocation of resources based on an expectation of performance levels, where performance is measured in specific, meaningful terms. It differs from the traditional approach to budgeting in that it focuses on *outcomes* rather than *inputs* or *processes* when deciding how to allocate resources. For example, under the traditional budgeting approach, the number of parks managed by the Department of Parks and Recreation and the number of state park employees are *input* factors that help determine the department's budget. Under performance budgeting, the level of satisfaction expressed by visitors to state parks would be one of a number of *outcome* measures. Visitor satisfaction could be determined by a simple survey of park-goers, with the results providing an indication as to how well the department was carrying out its responsibilities. This measure of performance could be used in evaluating a budget request.

Performance budgeting is not a new concept. The City of Los Angeles implemented a version of it in the early 1950s. Recently, however, there has been renewed interest in this budgeting approach at the state and federal levels. For example, the National Conference of State Legislatures identifies 23 states that are involved to some degree with performance budgeting.

The federal government has recently shown interest in the use of performance measures, a key component of performance budgeting. For example, in February 1993 the U.S. General Accounting Office (GAO) released a report on the uses and limitations of performance budgeting in selected states. A primary objective of the GAO study was to gather information on the implications of state experiences for federal performance budgeting efforts. In July 1993, Congress passed the Governmental Performance and Results Act, which provides for three-year pilot projects that will embody many of the components of performance budgeting. The National Performance Review, a six-month study of the federal government requested by President Clinton, resulted in a report issued by the Vice President in early September 1993, which likewise embraces aspects of performance budgeting.

What Has Been the Experience in Other States?

In its review of performance budgeting, the GAO focused on five states (Connecticut, Hawaii, Iowa, Louisiana, and North Carolina) that had the following characteristics:

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

Results Have Been Mixed. As Figure 1 shows, the GAO concluded that performance budgeting produced mixed results in the five states reviewed. In addition, the GAO pointed out that performance measures—a key component of performance budgeting—took time to develop and implement.

As Figure 1 suggests, while performance budgeting may offer promise, states have had difficulty realizing that promise. Part of the problem has been the reluctance of executives to change their budget decision-making from one based on policy and political considerations to one based on performance. In addition, Legislatures,

Figure 1

States Experienced Mixed Results From Performance Budgeting

- It provided helpful budgetary decision-making information, but did not fundamentally change the budget process (see Figure 2 for details).
- It was not the "final arbiter" of funding decisions given the political nature of the budget process.
- It gave managers greater decision-making flexibility.

"...while performance budgeting may offer promise, states have had difficulty realizing that promise."

used to considerable control in approving budgets through emphasis on process and procedure, have had difficulty embracing the fundamentally different approach of performance budgeting, which stresses program missions, goals, and outcomes.

Figure 2 summarizes the specific reasons why performance budgeting has not fundamentally changed the budget process in the five states reviewed by the GAO.

Other States Continue to See Promise. While results were mixed in the states the GAO chose to examine, many other states, including California, have decided to pursue performance budgeting, believing that there will be net benefits.

Figure 2

Why Performance Budgeting Did Not Fundamentally Change the Budget Process in Other States

- ☑ Time, resources, and data constraints limited the use of performance information by the legislative and executive branches.
- ☑ Legislative and executive budget decision makers were dissatisfied with and questioned the reliability of performance measures.
- ☑ Performance budgeting complicated the budget process by highlighting trade-offs among programs competing for limited resources.

WHAT IS CALIFORNIA PROPOSING?

How the Administration Describes Performance Budgeting

The Governor proposed in January 1993, as part of his 1993-94 budget, to pilot test performance budgeting in four departments. According to the administration, performance budgeting, along with quality improvement pilot projects, offers the potential for substantial savings, improved program performance, enhanced

"...the Legislature has not been provided sufficient details regarding the administration's performance budgeting project."

How the Pilot Departments Were Selected. The administration has listed the following characteristics of "ideal" candidates for pilot departments:

- Department must be committed to all aspects of the project.
- Department must be well managed currently.
- Department must be prepared to initiate strategic planning activities.
- Department must be medium-sized.
- Pilot departments should include both internal service agencies and public service agencies.

Based on these criteria, the Department of Finance (DOF), which has been given responsibility for the performance budgeting pilot project, selected the following four departments to participate in the pilot test: the Departments of Consumer Affairs, General Services, and Parks and Recreation, and the Stephen P. Teale Data Center.

Legislature Has Shown Interest in Performance Budgeting

In addition to the administration's interest in performance budgeting, similar interest has been expressed by the Legislature. Specifically, the Legislature passed SB 500 (Hill), the Performance and Results Act of 1993, which embodies several aspects of the administration's pilot project. A primary difference, however, is that SB 500 (Ch 641/93) establishes a specific timetable for the project and requires the DOF to evaluate project results and report its findings to the Legislature by January 1, 1996.

LAO Assessment of the Pilot Project

In preparing this issue paper, we reviewed available documentation concerning the administration's performance budgeting proposal and discussed the status of the pilot project with pilot departments and also the DOF. We also reviewed literature on performance budgeting, focusing on recent experiences and current initiatives. Our assessment of the administration's pilot project to date is summarized in Figure 4 and discussed in greater detail below.

Definition Lacking

At the time the Governor's Budget was released in January 1993, the administration had not developed the details of the performance budgeting pilot citizen satisfaction, and greater accountability in the delivery of state services.

In the administration's view, performance budgeting has seven essential elements, as listed in Figure 3.

Figure 3

Elements of Administration's Performance Budgeting Proposal

- ☑ Annual budgetary contracts between legislative budget writers and the administration.
- ☑ Operational flexibility, which could include relief from statutory requirements.
- ☑ Incentives for performance and efficiency, including the ability to reinvest 50 percent of any savings into discretionary activities.
- ☑ An emphasis on long-term strategic planning.
- ☑ Development of performance measures.
- ☑ Benchmarks for measuring operational efficiency.
- ☑ A commitment to quality improvement.

Figure 4

LAO Assessment of the Pilot Project

- ☑ Pilot project lacks sufficient definition.
- ☑ Despite project schedule slippage, implementation should not be rushed.
- ☑ Participating departments are only partially representative of the range of departments in state government.
- ☑ Implementation costs will occur, and should be budgeted for.
- ☑ Performance needs to be verified independently.
- ☑ Sanctions for poor performance should be considered.
- ☑ Departments may need additional motivation to ensure a fair test of performance budgeting.

project. To date, the Legislature has not been provided sufficient details regarding the administration's performance budgeting project. Specifically, the Legislature has not been provided the following information:

- A detailed implementation schedule showing major tasks and milestones.
- How the administration and the Legislature will be involved in developing performance measures.
- How the actual performance of a pilot department will be evaluated.
- The form budget contracts will take and how they will be submitted to the Legislature.
- An estimate of the cost to implement performance budgeting and a proposal on how it will be funded.

"Some of the delay (of the pilot) may be appropriate, if it reflects a cautionary approach to getting the pilot done right."

We recommend that the administration provide this information to the Legislature as soon as possible, but no later than the submission of the 1994-95 budget.

Project Schedule Has Slipped

The administration initially indicated that the pilot project would be implemented in the current fiscal year through budget "contracts" with the Legislature. The administration advised that the contracts would probably be in the form of a letter to the Legislature, in which the administration would commit to certain results in exchange for an approved budget.

At this time, however, the DOF has no budget contracts planned for the current fiscal year. Senate Bill 500 requires implementation of such contracts in 1994-95.

As noted above, the DOF's schedule has slipped. In part, this is due to the fact that the department had not developed the type of up-front planning that it should have. Some of the delay, however, may be appropriate, if it reflects a cautionary approach to getting the pilot done right.

Pilot Departments Could Be More Diverse

The four pilot departments selected by the administration are only partially representative of the range of departments in state government.

Two of the four pilot departments, General Services and the Stephen P. Teale Data Center, are primarily departments that serve other state departments. Of the remaining two, only Parks and Recreation has a significant General Fund allocation (approximately $44 million), which is relatively small when compared to many other state departments. Given the continuing difficulties with the General Fund, it would seem desirable to include in the performance budgeting pilot project a department with a more significant General Fund allocation (for example, the Department of Justice). Alternatively, the Legislature could consider adding a department that is a traditional caseload budget (for example, the Department of Rehabilitation).

Only Up-Front Costs Are Certain

Experience in other states and a review of the DOF's proposal for California indicates that, while significant benefits are typically anticipated, the only certainty is that there will be costs to implement the pilot project. These costs reflect:

"Performance budgeting, like many approaches to reinventing government, is neither new nor a panacea for addressing all the ills of government."

- Staff time devoted to establishing and maintaining performance budgeting.

- The development and maintenance of strategic plans.

- The development and maintenance of management information systems to collect, monitor, and evaluate performance.

- The implementation and maintenance of new programs designed to continuously improve the quality of work performed.

The administration's pilot project proposal mentions activities for which there will have to be an expenditure of resources, but the proposal does not indicate whether project costs will be budgeted or are to be absorbed by participating departments. Such costs could be significant.

Proposal Should Include Independent Verification

With respect to verifying the results of the performance budgeting pilot, the administration has not yet spelled out how this is to occur. Much of the literature on performance budgeting notes the problems associated with the credibility of performance reports. The difficulty with credibility has occurred in other states primarily in the legislative branches, where there has been reluctance to accept performance assessments made by departments. This is because legislative staff generally have not had the time or resources to assess the reliability of the reported results. In order to avoid this situation, we believe that verification should be performed by an independent entity, such as the Bureau of State Audits.

Sanctions For Poor Performance Should Be Considered

The administration's proposed pilot project includes rewards as incentives for participating departments to do a good job. In addition to being able to retain and redirect to other "discretionary" activities 50 percent of any savings achieved during the year, pilot departments would be freed from certain external controls.

Despite these incentives, it is possible that a department may not deliver the promised results. Indeed, increasing managerial flexibility carries with it a potential for increased failure. In such instances where this may occur, and depending on the magnitude and reasons for failure, it may be appropriate to apply sanctions. We think that such sanctions should not take the form of budgetary or administrative constraints, which could have an adverse impact on departmental programs, but be more in the nature of sanctions applicable to those making the promises and those possessing the authority to fulfill them (for example, not granting a pay increase or, in extreme cases, removal from a position).

Additional Motivators and Longer-Term Commitments May Be Needed

As noted above, the administration proposes to allow participating departments to reinvest 50 percent of their savings into discretionary activities. It is not clear whether such discretionary activities would allow employees to share monetarily in the savings (for example, through a program similar to existing state programs that allow monetary awards for exemplary work). If such sharing were contemplated, this would likely provide additional motivation, and a greater level of commitment to performance budgeting.

While managers may be motivated simply by the relaxation of external controls, unless certain controls are relaxed on a longer-term basis, the level of commitment by managers may be short-lived. For example, if, pilot participants are provided an exemption from Department of Personnel Administration (DPA) requirements governing organizational structure, what will happen to a department that which has reorganized in a manner not consistent with the DPA's rules once the pilot project is over? This is an important consideration, given that managerial classification and pay levels are based generally on current organizational models. Therefore, if the pilot test is to be as meaningful as possible in terms of demonstrating the potential of performance budgeting, consideration will have to be given to extending some exemptions for some period of time beyond the termination of the pilot project.

Some Cautionary Observations

Solid Foundation Is Important

As we have noted earlier, an adequate test of performance budgeting will require several years and therefore could span a couple of administrations. Given the necessity for both gubernatorial appointees and other high-level managers to buy into the pilot program, a solid foundation is required in order to ensure the appropriate level of commitment from current and future administrations. A well-defined pilot program, with administration and legislative roles clearly agreed upon, would provide such a foundation.

Performance Budgeting Is Not a Panacea

Performance budgeting, like many approaches to reinventing government, is neither new nor a panacea for addressing all the ills of government. Thus, the Legislature needs to be realistic about this approach to changing governmental operations. While this approach helps the administration and Legislature to focus on the results of programs, it does not guarantee that departments will improve. There may be other important changes needed before a department can improve its performance. For example, performance budgeting will have limited success if the department has poor managers, inadequately trained staff, problems filling key job classifica tions, or conflicting objectives.

THE LEGISLATURE'S ROLE IN PERFORMANCE BUDGETING

A Change In Perspective Is Needed

Despite the limited progress to date and the cautionary notes discussed above, we believe that performance budgeting has merit and is worth pilot testing. This is because it offers the potential of improving the delivery of services by focusing on program results. In order to realize these potential improvements, however, we believe the Legislature will need to change its general perspective toward the budget process, as shown in Figure 5.

Figure 5

Performance Budgeting Will Require A Change In the Legislature's Perspective Towards the Budget Process

- ☑ It needs to be willing to relinquish some controls over departments and programs.
- ☑ It needs to focus on program mission, goals, and outcomes, not on inputs and processes.
- ☑ It must be willing to accept a longer-term view of implementation and results.

"...it's important that the Legislature 'breaks the mold' in the way that it appropriates funds for the pilot departments."

In short, the steps shown in the figure indicate that the Legislature has to give up the traditional type of budgetary control it exercises over departments. It would relinquish the more detailed short-term control it now has over the resources given an agency, hopefully in return for more longer-term control over the mission, direction, and outcomes of the agency. This is not an easy task, as has been shown in those states which have implemented performance budgeting. However, these changes are a necessary precondition if performance budgeting is to have a chance of success.

Figure 6

A Joint Legislative Committee Should Be Formed to:

- ☑ Obtain more specific information from the administration on its plans to implement performance budgeting.
- ☑ Review and approve performance measures.
- ☑ Review proposals to exempt pilot departments from statutes.
- ☑ Review proposed budget contracts.
- ☑ Consider whether sanctions should be included in the pilot project.
- ☑ Consider adding to the pilot project other state departments.

Different Approach Needed to Implement Performance Budgeting

A changed perspective on the budget process alone may not be enough to ensure successful implementation of performance budgeting. This is because performance budgeting is such a significant departure from the way the state has budgeted resources in the past. As a result, we recommend that the Legislature consider a completely different method to budget resources for the pilot departments. For instance, it is critical that both houses provide uniform direction to the pilot departments. In addition, it's important that the Legislature "breaks the mold" in the way that it appropriates funds for the pilot departments. In order to address these unique concerns, we recommend the establishment of a joint legislative committee to oversee the pilot project and review the budgets of the pilot project departments. The joint committee would include representation from the fiscal committees and relevant policy committees of both houses. Figure 6 lists the specific activities we recommend the committee carry out.

One of the key functions of the committee would be to review and approve the performance measures. Figure 7 identifies key ingredients for designing the performance measures.

Figure 7

Key Ingredients for Designing Performance Measures

- ✔ Measures need to focus on *outcomes* not process.
- ✔ Measures must be *relevant* to the performance being measured.
- ✔ Measures should be *customized* to fit specific programs.
- ✔ *Multiple measures* should be developed to capture the complexity of programs.
- ✔ Measures must be *reliable*—that is, produce accurate and verifiable information.

This joint committee would be acting *in lieu* of the normal budgeting process. As noted above, this is a significant departure from current practice. In making such a recommendation, we are attempting to offer a possible alternative that still meets the Legislature's needs for input and involvement from the membership.

CONCLUSION

The Governor's proposal to pilot test performance budgeting provides an opportunity to demonstrate improved governmental effectiveness through a new approach to developing and managing budgets. In order to provide the most meaningful test of the Governor's proposal, both the executive and legislative branches will need to cooperate in specific ways throughout the pilot test. Both branches also will need to be willing to change the manner in which they have traditionally dealt with budgets. In order to enable a cooperative relationship between the executive and legislative branches to work well, the administration needs to provide considerably more detail concerning its plans for performance budgeting. The joint legislative oversight committee which we recommend, based on the desire to ensure a meaningful test of performance budgeting, would provide the forum for a discussion of the administration's plans, and facilitate the Legislature's participation in the pilot project.

This report was prepared by Bob Dell'Agostino, under the supervision of Craig Cornett. For additional copies, contact the Legislative Analyst's Office, State of California, 925 L Street, Suite 1000, Sacramento, CA 95814, (916) 445-2375.

Attachment C

Legislative Analyst's Office: *1996-97 Budget Analysis: Statewide Administration Crosscutting*

1996-97 Budget Analysis: Statewide Administration Crosscutting Issues

PERFORMANCE BUDGETING: WILL IT CHANGE THE BUDGET PROCESS?

The Governor's Performance Budgeting Pilot Program, now in its third year of implementation, has not materially changed the budget process and it is not clear that it will. At the same time, most of the participating departments indicate that the program has helped them to do a better job of managing their programs. Other state departments can benefit from the lessons learned from the pilot project, and the administration should institutionalize those aspects which can improve the performance of state programs.

In this section, we provide an update on the performance budgeting pilot program and discuss the common themes and issues which have emerged as the administration has implemented this program. We conclude with recommendations that we believe can help to make the pilot program more effective.

BACKGROUND

What Is Performance Budgeting? Performance budgeting differs from the traditional approach to budgeting in that it attempts to determine whether a program is achieving its goals by focusing on outcomes, rather than processes or inputs. For example, instead of focusing on the number of parks and employees managed by the Department of Parks and Recreation, performance budgeting would review an array of performance measures including customer satisfaction with the park system, the extent to which the department is protecting wildlife habitat, and the degree to which the department has increased access to parks.

In order to implement performance budgeting, departments must identify performance *goals*, or outcomes, and the performance *measures* that will be used to determine whether progress is being made toward achieving the desired outcomes. Resources are then allocated to departments in order to achieve specific goals.

Governor Initiates Pilot Project. In January 1993, the Governor proposed to change the state's budgeting process by pilot testing performance budgeting in four state departments. According to the Governor's Budget, the pilot program was being proposed because the state's traditional budget process was "seriously dysfunctional." The administration indicated that performance budgeting, along with quality improvement, offered the potential for substantial savings, improved performance, enhanced citizen satisfaction, and greater accountability in the delivery of state services.

The Legislature responded to the Governor's initiative by enacting Ch 641/93--the Performance and Results Act of 1993 (SB 500, Hill)--which established the program, required budget "contracts" between pilot departments and the Legislature, and set January 1, 1996 as the completion date of the pilot project. Budget contracts are supposed to require departments to deliver specified outcomes for a specified level of funding. They must identify criteria for evaluating outcomes and specify provisions for reinvesting savings resulting from performance budgeting.

Chapter 672, Statutes of 1994 (SB 1609, Hill) requires that a draft budget contract be submitted to the fiscal subcommittees of the Legislature by January 31 if the contract is proposed to be effective in the ensuing fiscal year.

Finally, the Legislature enacted Ch 779/94 (AB 2711, Valerie Brown)--the State Government Strategic Planning and Performance Review Act--which (1) requires the Department of Finance (DOF) to identify state agencies which should either develop a strategic plan or update an existing one, and (2) requires those agencies to report annually to the Legislature on steps being taken to develop performance measures that could be used for performance budgeting or performance review.

Legislative Analyst Office's Initial Assessment of Performance Budget and Pilot Project. In October 1993 we released a report on performance budgeting, including an assessment of the Governor's pilot program to that date. Figure 4 summarizes the key findings from that report, which apply broadly to performance budgeting as it had been tried in several states and localities.

Figure 4 **Performance Budgeting** **Key Findings From Other States and Localities** **LAO 1993 Report**

	✔	The manner in which performance budgeting is applied and the results it produces vary widely among the states	
	✔	In most instances, performance budgeting has *not* fundamentally changed the budget process	
	✔	Implementation costs are significant	
	✔	Performance measures need to focus on *outcomes*, not process	
	✔	Performance needs to be verified independently	
	✔	Performance budgeting requires a change in the Legislature's perspective towards the budget process	
	✔	The Legislature must be willing to accept a longer-term view of implementation and results	

We noted in our report that the foundation of the Governor's pilot program--reshaping the state's budget process--would not be easy to accomplish because performance budgeting is a complex undertaking. Recognizing the important role the Legislature would have to play to ensure success of the project, we recommended the establishment of a joint legislative committee to oversee the pilot project and review the budgets of the pilot departments.

Current Project Status

The DOF is responsible for administering the performance budgeting pilot program which currently includes four departments:

- California Conservation Corps.
- Department of Consumer Affairs.
- Department of General Services.
- Department of Parks and Recreation.

The Departments of General Services, Consumer Affairs, and Parks and Recreation were among the original four departments selected to participate in the pilot. The fourth department--the Stephen P. Teale Data Center--is no longer a participant. The California Conservation Corps and the Department of Toxic Substances Control were added in 1994; however, the latter department dropped out in 1995.

Some Departments Are Ahead of Others. Not surprisingly, the rate of progress in implementing performance budgeting has varied among the participating departments. As noted above, establishing a performance budgeting system is complicated, and some of the pilot departments are larger and more complex than others. Other factors contributing to a variation in progress include:

- Whether a department already had a strategic plan in place.
- The difficulty in determining appropriate performance measures.
- Negotiations with the control agencies (DOF, State Personnel Board, and Departments of Personnel Administration and General Services) to increase administrative flexibility.

- The learning curve each department has had to undergo to get an idea of the magnitude of the effort and what a budget contract would actually look like.

Despite these factors, and although much remains to be accomplished, departments have completed most of the preliminary tasks to implement performance budgeting, such as developing a strategic plan and defining performance measures; however, most of the departments have not established the computer-based systems which are required to collect and maintain performance data and generate reports of actual performance.

COMMON THEMES

Several common themes have emerged during the implementation of the pilot project as displayed in Figure 5.

Figure 5
Common Themes of the Performance Budgeting Pilot Program

	☑	Performance Impacts	
		• Program has reoriented departmental management to focus on department's purpose, develop supporting business plans, and manage to achieve outcomes	
		• Participating departments have generally been energized by the pilot program and have been sincere in their efforts to improve performance	
		• In gathering data to measure performance, departments have discovered in many instances that such data do not exist	
	☑	Fiscal and Budgetary Impacts	
		• A significant investment of resources has been made	
		• Anticipated savings available for redirection have not materialized	
	☑	Administrative Impacts	
		• Many administrative flexibilities provided by current budget contracts appear to be relatively minor and nonquantifiable	
		• Other than the use of budget contracts, there has been no significant change in the budget process	
		• Controls on administrative flexibility have been identified which have questionable value	

Departments Have Refocused on Their Purposes and Goals. Pilot departments have exerted a considerable amount of effort to redefine their organizations, update their mission statements, adopt strategic plans (along with performance measures and goals), and manage in accordance with those plans. Consequently, the pilot departments are focusing on performance *management*, which they believe is proving to be valuable to them and the programs they administer. Most of the mechanisms that have been put in place in pilot departments--strategic plans, goals, performance measures, and the means to capture and report progress--are viewed as basic and fundamental to a business enterprise. Consequently, these are practices which state departments should have been following all along. Nevertheless, if the pilot program goes no further than fostering performance management in state departments, and that management emphasis is maintained, the pilot program will have served a useful purpose.

Departments Energized. It is clear that a very real and positive result of the performance budgeting pilot program has been the enthusiasm observed in most of the pilot departments. In some departments we have observed that the enthusiasm permeates throughout the organization. This enthusiasm has in many cases been channeled into department-wide efforts to determine what's important, and to whom, and to develop plans and strategies to keep the focus on important goals and manage to achieve them. Whether the benefits of this enthusiasm will be lasting will depend on the extent to which departments are able to keep focused on their goals, maintain their plans and strategies, and manage effectively. This in turn depends on the extent to which department staff at all levels remain committed and involved.

Measuring Performance and Tying It to Budgets Is Difficult. In a number of instances, departments have discovered that there is little or no baseline performance data against which to measure improvement. Where this occurs, departments must establish a means of collecting the baseline data that will enable the periodic assessments of improvement which are at the heart of performance management.

Those pilot departments which have progressed to the point of attempting to present budgets in a performance-based format have indicated difficulty accomplishing this task. For example, the Department of Parks and Recreation, which had previously indicated that its 1996-97 budget would be presented in a performance-based format, has instead provided a *sample* format in the Governor's Budget and has postponed until 1997-98 presenting its budget in a new display. Similarly, the California Conservation Corps has experienced difficulties in its attempt to develop a new budget format which ties requested budget allocations to specific performance areas and outcomes.

Significant Resources Have Been Invested. In our October 1993 report we noted that the cost to implement the pilot project would be significant; and, in the *Analysis of the 1994-95 Budget Bill,* we recommended that the DOF advise the Legislature as to its estimate of costs and benefits associated with the administration's performance budgeting plans. To date, no such estimate has been provided. Because departments are absorbing the costs to implement performance budgeting, the costs are not apparent. However, several pilot departments have acknowledged that there has been a substantial investment in staff time alone, and some departments have contracted for consultants to help in the development of strategic plans.

In last year's *Analysis,* we estimated that the state's total investment in the pilot project would be about $5 million by the end of the current year. We have not updated this cost estimate for the budget year because departments are not uniformly accounting for their expenditures for performance budgeting. In addition, some of them argue that they would incur similar costs regardless of performance budgeting. This latter point is arguable, as it seems apparent that participation in the performance budgeting pilot program has caused departments to embark on planning and other activities they would not have otherwise undertaken.

"Redirected Savings" Have Not Occurred. One of the "carrots" made available to departments volunteering to participate in the pilot program is the ability to redirect 50 percent of savings resulting from performance budgeting. Chapter 641 requires that such "gainsharing" be specified in annual budget contracts. To date, none of the current budget contracts provide for gainsharing. We do not know whether any budget contract for 1996-97 will provide for gainsharing. This is because none of the departments had submitted proposed contracts at the time this analysis was prepared.

Increased Administrative Flexibility. A long-standing and frequent complaint of state managers at all levels has been the inability to get the job done effectively because of a myriad of controls on their ability to administer programs. One of the more attractive features of the performance budgeting pilot project to departments is the prospect of being provided additional administrative flexibility. Although the 1995-96 budgets for the pilot departments reflect a relaxation of certain administrative controls, it can be argued that much of this flexibility is relatively minor and should have been provided regardless of the pilot program. For example, the Director of General Services is authorized to augment the budget by up to 10 percent, without DOF approval, in order to cover unanticipated service requests from customer departments.

On the other hand, the number of specific administrative flexibilities provided pilot departments in 1995-96 budget contracts increased significantly from those provided in 1994-95. Moreover, some of the flexibilities are significant. For example, the current budget contract for the Department of General Services (DGS) provides administrative flexibility in 12 areas. The flexibility provided the DGS ranges from the specific exemption from requirements to purchase goods from the Prison Industry Authority, to the ability to obtain a waiver of specific provisions of civil service law, with the agreement of the State Personnel Board, except for provisions relating to discrimination, unlawful employment, or applicant fraud, or where a waiver would conflict with the merit principles of the California Constitution.

Results of Flexibilities Generally Nonquantifiable. For the most part, pilot departments are unable to quantify the benefits of the administrative flexibilities which they have been provided. While it is not clear whether these flexibilities will have a marked impact on departmental performance, it does not make sense to subject departments to controls which add cost unless they also add policy value and further important oversight. Eliminating such controls should help departments to better focus on fulfilling their missions.

Controls of Questionable Value Should Be Eliminated. It is important to distinguish between controls which are in place for good executive or legislative oversight purposes and those that do not add value to government programs but rather get in the way of departmental attempts to focus on their primary missions. Some of the flexibilities granted to the DGS in the current year, while not minor, still reflect reasonable changes which should help the department to better focus its resources on fulfilling its various program requirements. We believe that the pilot program has identified a number of controls which add little or no value to state government. For example, limiting to 60 working days the length of time for which an emergency appointment may be made without the approval of the State Personnel Board. (The California Conservation Corps was authorized under the pilot to make such appointments for up to nine months.) In our judgment, relief from administrative controls is always desirable where the value to the control agency is relatively minor compared to the workload or delay the control imposes on departments.

WHERE IS PERFORMANCE BUDGETING GOING?

We recommend that the Department of Finance (DOF) and the performance budgeting pilot departments, advise the Legislature, during budget hearings, as to their evaluation of the pilot program and plans for performance budgeting in the future, including sharing with all state agencies lessons learned from the pilot program and the extent to which the DOF plans to relieve other departments of administrative controls found to be unnecessary as the result of the pilot program. We further recommend that any plans to expand elements of the pilot program to other departments include standards and guidelines to ensure that there is no unwarranted duplication of effort.

Program Expectations Still to Be Met. In initiating the performance budgeting pilot project in 1993, the Governor identified a number of potential benefits to this budgeting approach. These benefits, and our assessment of the extent to which they have been realized, are shown in Figure 6. To date, performance budgeting has not realized the fundamental benefits initially envisioned by the administration, as shown in the figure.

Figure 6
Have Performance Budgeting Benefits Been Achieved?

Benefit	Met?	Comment
Change fundamentally the budget process	No	Only difference is budget contracts
Produce substantial cost savings	No	Unclear as to whether substantial savings will result
Improve program performance	Unclear	Not yet apparent
Enhance citizen satisfaction	Unclear	Has not been measured
Produce greater accountability	Unclear	A measure of accountability is expected under budget contracts

We believe that there are several reasons for this lack of significant results to date. First, significant improvements in performance do not occur "overnight" and tend to take some time. Second, the experiences of other states and local governments suggest that it takes time to radically change long-standing budget processes. In order to achieve such changes, it requires the commitment of both the administration and the Legislature to shed their old approaches to the budget. Third, the program got off to a slow start and has suffered to some extent because it has been implemented in the absence of a definitive plan, with the result that each of the pilot departments has been left to its own devices to define the program as it applies to them.

Progress May Have to Be Incremental. Given the administration's experiences to date with performance budgeting, it may be that the only way the state can attain a better budget system is to make incremental changes. That is why we believe it is important to identify successful elements of the pilot program experience, institutionalize them, and keep expectations realistic and clear as to how the pilot program can improve the overall budget system. In our judgment, the administration should determine what incremental steps should be taken statewide, because it is has the current experience with the pilot program to draw upon, and it has been assigned responsibility by the Legislature to work toward changing the budget process.

Evaluation of Pilot Program May Help Shed Light. In this regard, the DOF is required by Chapter 641 to report its evaluation of the pilot program. The report, which was due January 1, 1996, is required to address (1) the extent to which performance budgeting results in a more cost-effective and innovative provision of government services, (2) gainsharing rewards to each department in the program, and (3) the specific innovations which brought about gainsharing savings. The report had not been released at the time this analysis was prepared; however the DOF advises that the report will be available in time for budget hearings. The report may shed some light on the administration's plans for performance budgeting beyond the four pilot departments.

Standard Approaches Lacking. In last year's *Analysis* we noted that as a result of the independent approach to performance budgeting occurring in the pilot departments, there was no assurance that information technology systems necessary to make performance budgeting work would be developed in a manner which would prevent duplication of effort and the development of redundant computer applications. We also noted that without guidelines, the Legislature would not be assured that performance reports submitted by the pilot departments would be in a consistent, easy to read format. Consequently, the Legislature adopted supplemental report language requiring the DOF to develop guidelines for information technology systems and reporting formats. The guidelines had not been developed as of the preparation of this analysis.

Lessons Should Be Shared. As noted above, the pilot departments will have invested, by the end of the current year, approximately $5 million related to the performance budgeting pilot department. For the most part, the pilot departments believe that the performance management benefits have warranted this investment. Although two of the pilot departments recently agreed to collaborate to produce a performance budgeting newsletter, it is not clear as to the extent to which the lessons learned by the pilot departments will be shared with other departments which could benefit from improving their management practices, or when or how such sharing will occur. Given the state's significant investment in performance budgeting, it makes sense to share with *all* state agencies the important findings and recommendations developed by the DOF and the pilot departments as a result of their experience with the pilot program. This is important even if the official pilot program is not extended, because there is nothing to prevent other departments from independently implementing performance budgeting.

Analyst's Recommendation. In our review of the DOF, we recommend that the department provide the Legislature a status report on the pilot program at the time of budget hearings. In that regard, we believe there is merit in having a broader *administration* perspective on performance budgeting--one which reflects pilot department views as well as those of the DOF. This is because the pilot departments have learned much about what works, and what doesn't work in attempting to implement performance budgeting. Also, the pilot departments have supported one another in their mutual efforts to improve program performance through participation in the pilot program and have developed a core competency in management reform which can be useful to other state agencies.

Consequently, we recommend that the DOF and the performance budget pilot departments advise the Legislature, during budget hearings, as to their evaluation of the pilot program, and plans for performance budgeting in the future, including sharing with all state agencies lessons learned from the pilot program and the extent to which the DOF plans to relieve other departments of administrative controls found to be unnecessary as the result of the pilot program. We further recommend that any plans to expand elements of the pilot program to other departments include standards and guidelines to ensure that there is no unwarranted duplication of effort.

Attachment D

Excel Document: General Fund Multi-Year Projection at 2010-11 Governor's Budget

GENERAL FUND MULTI-YEAR PROJECTION at 2010-11 GOVERNOR'S BUDGET

(Dollars In Millions)

	2009-10	2010-11	2011-12	2012-13	2013-14
RESOURCES:					
Prior Year Balance	-$5,855	-$3,863	$2,558	-$3,145	-$9,130
Revenues/Transfers (absent BSA transfer)	88,084	89,322	85,611	93,223	99,276
Transfer from Revenue Stabilization Fund	(0)	(0)	(0)	(0)	(0)
Repayment of Loans from Special Funds	(-83)	(-625)	(-495)	(-355)	(-120)
Tideland Oil	(258)	(160)	(193)	(196)	(659)
Tribal Gaming Revenues	(370)	(365)	(355)	(363)	(371)
Leveraging State Assets	0	(289)	(296)	(109)	(0)
Prop 58 Transfer to the Budget Stabilization Account (for rainy day)	0	0	0	0	0
Total Resources	$82,229	$85,459	$88,169	$90,078	$90,146
EXPENDITURES:					
Proposition 98 guarantee	$34,660	$36,090	$35,016	$38,524	$40,466
Proposition 98 Suspension	$0				
Above/Under Guarantee	$0	$0	$0	$0	
Proposition 98 Suspension Settle-up	0 [1]	(450) [1]	450 [1]	450 [1]	450 [1]
Total Proposition 98	$34,660 [2]	$36,090	$35,466	$38,974	$40,916
Transfer to Prop. 42 (Transportation Investment Fund) [3]	1,506	83	83	83	83
Other Non-Proposition 98	49,926	46,728	55,765	60,151	62,036
Prop 58 Transfer to the Budget Stabilization Account (to retire ERBs) [4]	0	0	0	0	0
Total Non-Proposition 98 [5]	$51,432	$46,811	$55,848	$60,234	$62,119
Total Expenditures	$86,092	$82,901	$91,314	$99,208	$103,035
FUND BALANCES:	-$3,863	$2,558	-$3,145	-$9,130	-$12,889
Reserve for Encumbrances	$1,537	$1,537	$1,537	$1,537	$1,537
Special Fund for Economic Uncertainties (Reserve)	-$5,400	$1,021	-$4,682	-$10,667	-$14,426
Budget Stabilization Account	$0	$0	$0	$0	$0
Total Reserve (SFEU and BSA)	**-$5,400**	**$1,021**	**-$4,682**	**-$10,667**	**-$14,426**
Operating Deficit(-)/Surplus [6]	$1,992	$6,421	-$5,703	-$5,985	-$3,759

[1] The amount reflected is proposed to be appropriated to fund prior-year Prop 98 commitments. Since this amount is attributable to prior year obligations, the actual expenditure is reflected as a Prior Year Adjustment to the beginning General Fund balance once the amount is proposed to be appropriated in the Governor's Budget for that year. However, for 09-10, the amount will be paid as part of the 09-10 appropriation, therefore, it is not reflected as a prior year adjustment.

[2] Prop 98's true program costs in 2009-10 are $35.510 billion. The amount displayed incorporates an -$850m offset from Prop 1A/RDA.

[3] This reflects the base forecast levels, plus an increase due to the temporary 1.0 percent sales tax increase.

[4] This portion will be used to redeem Economic Recovery Bonds.

[5] See page 2 for back-up detail.

[6] Operating deficit excludes the effect of BSA transfer for rainy day purposes.

Attachment E

Legislative Analyst's Office: *Alternatives to the Governor's Budgetary Reforms, 2008*

ALTERNATIVES TO THE GOVERNOR'S BUDGETARY REFORMS

What Budgetary Reforms Does the Governor Propose? How Would the Proposed Changes Affect the Legislature's Budgetary Authority? What Alternatives Could the Legislature Consider?

Summary

The Governor proposes that a constitutional amendment be put before the state's voters related to the state's budgeting process. The Governor has identified two problems with the state's current system:

- *The state does not save enough during good economic times and is, therefore, ill–prepared for swift deteriorations in revenues.*
- *Spending formulas make it too difficult to slow spending during bad economic times.*

The administration proposes to limit the amount of revenues that the General Fund could receive in any year. In addition, the Governor proposes a system by which the administration could trigger across-the-board reductions if the state's budget situation declined.

Although the measure would help even out the state's revenues from year to year, it would also be inflexible to legislative decision making on a year-to-year basis. The proposed across-the-board reductions would fail to prioritize state spending and represent a serious diminution of the Legislature's authority. Consequently, we recommend that the Legislature reject the proposed changes. We provide, instead, some alternatives it could consider which build upon the positive aspects of the Governor's proposal.

The Governor proposes that a constitutional amendment be put before the state's voters related to the state's budgeting process. In this piece, we describe the budgetary changes that were implemented in 2004 and the Governor's proposed reforms. Then, we provide an analysis of the proposal and alternatives that the Legislature could consider.

Budgetary Reforms Under Proposition 58

Proposition 58 was approved by the voters in March of 2004. Passed in conjunction with Proposition 57, which authorized the sale of up to $15 billion in deficit-financing bonds, Proposition 58 amended the State Constitution and made a number of changes to the state's budgeting practices. These reforms were intended to help prevent the state from reaching the same level of budgetary problems that led to the issuance of the bonds. Proposition 58's key changes are described below.

Balanced Budget. The Constitution has long required the Governor to *propose* a balanced budget. Proposition 58 also requires the Legislature to *pass* a balanced budget (expenditures do not exceed estimated available revenues).

Mid-Year Adjustments. The proposition also authorizes the Governor to call a fiscal emergency and special legislative session to address such an emergency. This year, the Governor used this power on January 10 to call the Legislature into special session to address the state's budget problems. In such a case, if the Legislature fails to pass legislation to address the budget problem within 45 days, it would be prohibited from (1) acting on any other bills or (2) adjourning in joint recess until such legislation is passed.

New Reserve. Proposition 58 creates a second reserve called the Budget Stabilization Account (BSA), in addition to the state's traditional Special Fund for Economic Uncertainties (SFEU). The Constitution now requires 3 percent of annual General Fund revenues be transferred to the BSA (smaller percentages were required in earlier years). The Governor is authorized to suspend this transfer through an executive order, which the Governor proposes to do for 2008-09. The annual BSA transfer has two components:

- ***Accelerated Payoff of Deficit-Financing Bonds.*** One-half of revenues transferred into the BSA are used to provide supplementary debt payments on the state's deficit-financing bonds. These supplementary payments stop when the bonds are paid off or total BSA supplementary payments total $5 billion. Through the current year, $1.5 billion in supplementary debt payments have been made.

- ***Budgetary Reserve.*** Funds not used for supplementary debt payments stay in the BSA as a budgetary reserve. Transfers into the BSA are required until the reserve equals the greater of $8 billion or 5 percent of General Fund revenues (currently about $5 billion).

Transfers Out of the BSA. The Legislature can transfer funds out of the BSA for any purpose through statute. The *2007-08 Budget Act* (Control Section 35.60) authorizes the Department of Finance (DOF) to transfer funds out of the BSA if needed to cover state expenses. Earlier this year, DOF transferred the entire balance of the BSA—$1.5 billion—to the SFEU to help close the state's budget shortfall.

Not Much Time to Work. Under Proposition 58, transfers into the BSA began in 2006-07. With the state's worsening fiscal situation in the current year, the balance of the BSA has already been depleted. As such, the Proposition 58 changes intended to build up the state's budgetary reserve have not yet had an opportunity to fully function.

Components of the Governor's Reforms

At the time this analysis was prepared, the administration had not yet provided the actual text of its proposed measure. Instead, in preparing this analysis, we have relied on the general characterizations of the measure that the administration provided us. Many of the details of how specific provisions would work in practice, therefore, are still unknown. We describe the key components of the Governor's reforms below. The administration aims to have the measure placed on the November 2008 general election ballot, with an effective date of February 1, 2009.

Problem Definition

The Governor has identified two problems with the state's current system:

- The state does not save enough during good economic times and is, therefore, ill-prepared for swift deteriorations in revenues.
- Spending formulas make it too difficult to slow spending during bad economic times.

Limit on General Fund Revenues Forces Reserve Build-Up

Ten-Year Revenue Growth Rate. The administration proposes to limit the amount of revenues that the General Fund could receive in any year.

Specifically, the amount would be limited by the average growth rate of General Fund tax revenues over the prior ten years. For instance, the administration estimates that tax revenues have grown by 6 percent between 1998-99 and 2007-08. If the proposal was in effect for 2008-09, therefore, General Fund tax revenues available for expenditure could grow by no more than 6 percent. The limit on revenues would be adjusted to allow for any new revenues from a General Fund tax increase.

Deposits Into New Reserve. In any year in which General Fund revenues were expected to grow by more than the ten-year average (based on a DOF forecast), the "excess" revenues would be deposited into a new reserve called the Revenue Stabilization Fund (RSF). The RSF would be in addition to the state's two existing reserves, the SFEU and BSA. The administration intends to abolish the BSA once the state's deficit-financing bonds are paid off (currently expected in 2012-13).

Transfers Out of the RSF. Unlike the state's current reserves, the Legislature could not generally access the funds in the RSF, including in cases of fiscal emergencies. Instead, funds could only be transferred from the RSF to the General Fund in years in which General Fund revenues were forecasted to grow less than the ten-year average growth rate. In those years, the Legislature could transfer some or all of the RSF balance—up to the ten-year average growth rate—to the General Fund through a two-thirds vote of each house.

Building Up Reserve Balance

The aim of the Governor's proposal is to build up a substantial amount of funds in the RSF—up to 15 percent of annual General Fund revenues (about $15 billion in today's dollars). After this amount was met, the measure would require the Legislature to spend any additional funds on a variety of "one-time" purposes:

- *K-14 Education.* Forty percent could be spent on one-time K-14 education purposes. This spending would be outside of the Proposition 98 minimum guarantee.
- *Other Purposes.* The remaining 60 percent could be spent on any combination of tax relief, infrastructure, or general obligation bond debt service.

Automatic Mid-Year Budget Reductions

The measure would also establish a system by which the administration could trigger across-the-board reductions if the state's budget situation declined. The DOF would estimate the state's revenues and expenditures three times a year—in November, January, and May. If the state's current-year budget was projected to have a negative reserve, then the administration would trigger reductions. The amount of the reductions would depend upon the severity of the budget shortfall. If the negative reserve was projected to be less than 1 percent of expenditures, then the reductions would be implemented to achieve a 2 percent reduction in spending on an annualized basis. If, however, the negative reserve was more than 1 percent, then the reductions would be implemented to achieve a 5 percent reduction on an annualized basis.

Types of Reductions. If passed, the constitutional measure would give the Governor the authority to achieve the specified percentage reductions in different ways, depending on the type of program.

- *Preauthorizations for Entitlement Reductions.* The measure would require the Legislature to enact contingency laws for entitlement programs—where spending is driven by requirements in existing law—such as Medi-Cal and the California Work Opportunity and Responsibility to Kids (CalWORKs). These contingency laws would have to specify how reductions would be implemented to achieve 2 percent or 5 percent reductions if triggered. For any programs for which the Legislature failed to enact contingency laws but was required to do so, the Governor would be given the authority to waive any state law in order to achieve the reduction target.
- *Other Programs, Including Proposition 98.* For other types of programs, the measure would provide the administration the authority to reduce statutory or budget act appropriations. This would include Proposition 98 revenue limit payments to schools, local assistance grants, and prison spending. In the case of Proposition 98, the administration would have the authority to reduce appropriations but not suspend the minimum guarantee. If these reductions resulted in spending below the minimum guarantee, the state would either incur a settle-up obligation or the Legislature would have to suspend the guarantee (with the existing vote requirements).
- *Programs Exempt From Reductions.* Finally, some areas of the budget would be exempt from reductions—when a certain level of spending is mandated by federal law, or constitutionally or contractually protected (such as debt service). The administration would determine which programs met these criteria.

Turning Off the Reductions. Any reductions would remain in place until turned off by the passage of a new budget or other law.

Implications of the Governor's Reforms

Changes Would Help Level Out Revenues and Increase Reserves...

The administration shared with us some of its modeling of how the measure would have worked if it had been in effect in earlier years. Under the administration's projections, the state's budget problems from the recent past might have been lessened, but not eliminated, if the measure had been in effect. Since we have not reviewed the specific proposed language, we have not attempted to perform our own modeling. It is clear though—by limiting the appropriation of any revenues over the recent average growth rate—annual General Fund revenues would be leveled out under the measure. Budgetary reserves would be built up during good times and available to lessen the effect of revenue downturns.

...But With Potentially Difficult Results

Possible Pitfalls. Formulas, by their nature, cannot predict all future circumstances. As a result, they tend to limit, rather than increase, future policy makers' options to craft budgets. For instance, as the state comes out of an economic downtown, it may experience above average revenue growth. This growth, however, would be off a lowered base. In such an instance, a portion of revenues would still be transferred to the RSF—despite state spending being at a significantly lower level compared to spending before the downtown. Restoring programs to their pre-downturn service levels could be impossible under the measure (unless taxes were raised).

Measure Could Lock in Structural Imbalance. As we discuss in "Part I" of this publication, the state would continue to face a structural gap between its revenues and spending—even if the Legislature approved all of the Governor's budget proposals. If the state did not permanently bring its revenue and spending lines into alignment *prior* to the passage of the administration's measure, it is possible the measure would permanently lock in this imbalance. That is because the measure would prevent the availability of any funds from higher-than-average revenue growth years from being used to close the gap. Absent the administration's measure, such a year with healthy revenue growth could allow the state to pay off additional budgetary debt and finally gets its fiscal house in order.

Too Inflexible. For these reasons, we conclude that the proposed ten-year average formula would be too inflexible on a year-to-year basis. Without the ability to adjust to unexpected circumstances, the Legislature would be unnecessarily restricted in the tools available to balance the state budget.

Does the State Need Three Reserves?

Under the administration's proposal, the state would have three reserves—the SFEU, BSA, and RSF. As part of its proposal, the administration would eliminate the BSA once the state's deficit-financing bonds are paid off (scheduled for 2012-13). Yet, there is little reason to make the state's budgeting even more complicated by instituting three reserves—even in the short term. If the Legislature chooses to make changes regarding its budgetary reserves, we recommend modifying, rather than supplementing, the state's existing two reserves.

Across-the-Board Approach Ill-Advised and Contrary to Balance of Powers

Limited Effort to Set Priorities. Throughout this publication, we critique the administration's across-the-board reductions approach to the 2008-09 budget. The administration's budget reductions reflect little effort to prioritize and determine which state programs provide essential services or are most critical to California's future. Under the administration's constitutional measure, this across-the-board reduction approach would become the default for any future state budget problems. All state programs (except those determined to be exempt by the administration) would be subject to the 2 percent or 5 percent reductions. The Legislature could determine *how* those levels of reductions were achieved in a particular program through the passage of a contingency law. The Legislature, however, could not prioritize and determine whether some programs should be protected from any reductions or whether others should experience greater reductions.

Legislature Should Maintain Its Appropriation Authority. The proposed changes also represent a serious diminution of the Legislature's authority. Under the State Constitution, only the Legislature can appropriate funds and make mid-year reductions to those appropriations. Under the administration's proposal, however, the Governor would have the authority to determine when across–the–board reductions would occur. Moreover, if the Legislature did not pass the contingency laws envisioned by the measure, the Governor would have the authority to waive state laws affecting the state's core programs.

Existing Process for Mid-Year Reductions. The administration has not made it clear why the existing process to make mid-year reductions is not sufficient. For past mid-year budget problems, the administration has submitted specific reduction proposals to the Legislature. The Legislature is then given the opportunity to adopt the Governor's proposals or substitute other alternatives. Proposition 58 formalized this process by authorizing the Governor to declare a fiscal emergency and call the Legislature into special session, as he has done this year. This new process has the added component of the 45-day schedule described earlier to help ensure timely action. While the across-the-board mechanism envisioned by the administration could implement some reductions a few weeks earlier, it does so by denying the Legislature the opportunity to review the impacts of any proposals prior to their adoption.

Building on the Positive Aspects of the Proposal

Based upon the inherent flaws in the Governor's proposal discussed above, we recommend that the Legislature reject the administration's approach. The Legislature should not pursue budget changes which take away its appropriation authority or hamstring future budget decisions through a formula. Yet, if the Legislature wishes to pursue alternative budgetary changes, it could build upon the positive aspects of the Governor's proposal—namely, seeking to build up additional reserves during good times and avoiding formulas driving state budgeting. We discuss some alternatives to the Governor's approach for both of these areas below.

Strengthening Proposition 58's Provisions

Determining when and how much money should be transferred to a reserve always involves an inherent tension between the demands for current services and an attempt to prudently save for a rainy day. To encourage additional saving in the future, we believe the Legislature could build upon Proposition 58's framework. As noted above, due to the state's financial cycle, the measure has not yet had an opportunity to fully function. Yet, it is apparent that the measure could be strengthened to better meet its original goals.

Increase Total Amount of Reserve. Currently, the BSA has a maximum balance of $8 billion. Building up to this level will take a number of years, particularly until the state pays off its deficit-financing bonds. Even so, with the state's volatile revenue structure—where multibillion dollar swings in annual revenue forecasts are common—the Legislature should consider increasing the BSA's maximum balance. Targeting 10 percent of annual General Fund spending as a *long-term* goal for building up the reserve (currently $10 billion but growing over time) would give the state a greater cushion from economic downturns.

Harder to Access Funds. Currently, the Constitution specifies that BSA funds may be accessed through any statute. The 2007-08 budget provided the authority for DOF to access the BSA balance. In the future, if the BSA funds were more difficult to access, the state might make more conservative budgetary decisions to guard against financially overcommitting the state. For instance, requiring the passage of a separate bill (outside of the budget bill) to access the BSA would make it more difficult to count on using BSA reserve funds in a budget plan.

Mechanism to Increase Transfers in Really Good Years. We appreciate the administration's effort to transfer excess revenues to a reserve. The problem is determining what revenues are excess in any year and locking that definition into the Constitution. By driving off of the average growth rate, the administration's proposal would transfer funds to the RSF in roughly half of the years. As an alternative, the Legislature could develop a higher threshold when revenues are considered excess. The Legislature could particularly focus on those years when there is an "April surprise"—personal income tax receipts which surge well beyond the amounts predicted in the budget. When revenues are received in April (which is nearly the end of the fiscal year), we think it would be reasonable to consider them as excess and automatically transfer them to the BSA. (This is in contrast to budget-year revenue forecasts when the Legislature and Governor have the regular budget process to debate how any new funds should be used.) We would suggest limiting such transfers to those years in which the updated revenue *total* for the year exceeds the budget's forecast. (This would not require the transfer of revenues that simply catch the state up from earlier soft revenue months.)

Rethinking the State's Budgetary Formulas

The Governor also identified the large number of formulas driving state budgeting as a key problem. We agree that the state's budget has become increasingly complicated and confusing—partially as a result of the number of formulas affecting state spending. Yet, even with these formulas, the Governor's own budget proves that virtually all aspects of the state budget are controllable. Many of the formulas can be, and have been, amended or suspended by the Legislature and/or Governor when necessary.

Difficult Choices. While the Governor proposes formula changes in a couple of instances (regarding reductions to Proposition 49's afterschool funding and K-12 education cost-of-living adjustments [COLAs]), the administration has not put forward a comprehensive set of proposed changes to budgetary formulas. We believe that engaging in a comprehensive review of state formulas would be a worthwhile effort for the Legislature. The Legislature could systemically review the formulas to determine if they are still needed and continue to reflect today's priorities. If it chose to "unlock" the state budget by repealing these types of formulas, it would gain a great deal of flexibility in crafting the budget on a year-to-year basis. Such changes, however, would potentially affect the funding of numerous key state program areas, as well as require asking the voters to reverse a number of previously approved propositions. We discuss below the types of propositions and statutory measures which restrict state budgeting. Figure 1 summarizes recent propositions with major General Fund effects in this regard.

Dedicated Tax Revenues. In recent years, there have been a number of approved propositions which raised tax revenues historically used for general purposes but instead dedicated them to specific purposes. As such, these measures restrict the Legislature's authority to prioritize spending among programs in any particular year.

Locked in General Fund Spending. Other ballot measures have guaranteed that a certain portion of General Fund spending be dedicated to a specific purpose. These measures restrict the Legislature's ability to alter the relative shares of General Fund spending provided to program areas in any given year.

Statutory Cost Drivers. In addition to the propositions described above, the Legislature has also enacted a variety of statutory formulas and other measures which create cost pressures or increase General Fund spending from year to year.

- The state has a variety of "entitlement" programs laid out in state law—guaranteeing benefits to any individual who is eligible for a program. These include Medi-Cal, a number of social services direct assistance programs, and a portion of the state's CalGrant financial aid program.
- The state also has a number of statutory COLAs which provide increased funding each year to compensate for the adverse effects of inflation on the purchasing power of the previous year's funding level. These include most Proposition 98 programs, trial court funding, some portions of Medi-Cal, CalWORKs, and Supplemental Security Income/State Supplementary Program.
- The state offers "defined benefit" retirement programs to its employees, both in the form of pensions and retiree health services. These programs guarantee that employees will receive specific benefits in the future, regardless of the level of state's costs necessary to provide the services.

Conclusion

The Governor's proposed budgetary reforms would make future budgeting even more complicated and represent a loss of legislative authority. In putting forward its proposal, however, the administration does raise some legitimate questions about how to better build up the state's reserves in good times and maximize budgetary flexibility.

Figure 1

Major Propositions Affecting the State General Fund

Date	Measure	Description
Dedicated Tax Revenues		
November 1988	Proposition 99	Provides a 25 cent per pack tax on cigarettes and dedicates the more than $300 million annually to tobacco education and health care services for low-income persons.
November 1993	Proposition 172	Raises the statewide sales tax rate by one-half cent and dedicates the $3 billion in annual funds to local public safety purposes.
November 1998	Proposition 10	Provides a 50 cent per pack tax on cigarettes and dedicates the roughly $600 million annually to early childhood development programs.
November 2004	Proposition 63	Enacts a state personal income tax surcharge of 1 percent that applies to taxpayers with annual taxable incomes of more than $1 million. The proceeds of the tax surcharge (about $1.6 billion annually) are earmarked to finance an expansion of community mental health programs.
Locked in State Spending		
November 1988	Proposition 98	Provides for a minimum level of total spending (General Fund and local property taxes combined) on K-14 education in any given year. The required General Fund contribution is roughly 40 percent of the state's budget.
March 2002	Proposition 42	Directs $1.5 billion in sales taxes on gasoline to transportation purposes. (Reflected as General Fund spending.)
November 2002	Proposition 49	Requires that the state spend a certain amount (currently $550 million) on after-school programs.
November 2004	Proposition 1A	Restricts the Legislature from altering local government revenues in many cases. In prior years, the state took such actions which helped the state's General Fund.
November 2006	Proposition 1A	Restricts the circumstances in which the Legislature could suspend the Proposition 42 transfer for transportation.

Analysis

ACA 4 (Feuer)

AB 2591 (Feuer)

Date of Hearing: April 15, 2010

ASSEMBLY COMMITTEE ON BUDGET
Bob Blumenfield, Chair
ACA 4 (Feuer) – As Amended: April 12, 2010

SUBJECT: Process, Legislative Process, and Local Government Finance

SUMMARY: This proposed Constitutional Amendment is the *California Forward* organization's proposed changes to the state budget and legislative processes. Specifically, this bill:

1) Implements a pay as you go system for the majority of legislation, the Governor's Budget, and initiatives;

2) Limits how one-time revenues could be expended;

3) Requires the Legislature to review state programs once every ten years;

4) Lowers the vote threshold for the budget to a majority;

5) Increases the vote threshold for fees when they are being used to fund a program, service, or activity that was previously funded by revenue from a tax to two-thirds;

6) Forfeits legislator pay, after June 25th, if the Legislature has not passed a budget;

7) Provides the Governor with mid-year cut authority if the Legislature does not act prior to the 45th day of a fiscal emergency;

8) Eliminates the ability of the state to redirect local property tax to schools;

9) Prohibits the state from reallocating any locally-imposed non-ad valorem tax or an assessment levied or imposed by a county, city, city and county, any special district, or any other local or regional governmental entity; and,

10) Defines a Countywide Strategic Action Plan as a plan developed by local agencies within a county to effectively use existing and new revenue to accelerate progress toward community goals. In a county where a plan is approved, this Constitutional Amendment would allow a county to increase the sales and use tax by up to 1-cent with a majority vote of the electorate.

FISCAL EFFECT: This Constitutional Amendment would likely require new state spending in the tens of millions of dollars annually to develop and implement new performance standards. Specifically, new information technology expenditures could result to address the new requirements.

In years when the budget bill is not passed by June 25, legislators would forfeit any salary or reimbursement for living and travel expenses. In any year that the Legislature does not pass a bill by June 25, the measure could reduce state costs by around $50,000 per day until the passage of a budget.

COMMENTS: This Constitutional Amendment, proposed by the *California Forward* organization, is a bipartisan proposal to improve California's Budget and fiscal processes based upon best practices in other states and over two years of engagement with citizens and organizations across California. One of the goals of this package of reforms is to provide balanced solutions to improve the accountability, effectiveness, and timeliness of the state budget process.

There are only eight states that have supermajority vote requirements for the passage of the state budget. All other states require only a majority vote for passage of the State budget. The other states that have a supermajority vote requirements for the budget each have different systems as detailed below:

1) Arkansas: Three-fourths majority is required on all appropriations except education, highways, and paying down state debt.

2) Connecticut: Three-fifths majority is required for appropriations only if the General Fund expenditure ceiling is reached. Otherwise, appropriations require a simple majority.

3) Hawaii: Two-thirds majority is required for appropriations only if the General Fund expenditure ceiling is reached. Otherwise, appropriations require a simple majority.

4) Illinois: A simple majority vote is required for appropriations until June 1, after such time a three-fifths majority is required to pass the budget.

5) Maine: A simple majority vote is required for all legislation that is non-urgency. Urgency legislation requires a two–thirds vote. Therefore, the budget must be passed by April 1 if it is to be implemented with a majority vote.

6) Nebraska: Nebraska's system is similar to Maine's.

7) Rhode Island: Appropriations require a two-thirds majority vote.

Reducing the vote threshold for the state budget could improve accountability by placing the responsibility of governance solely on the majority party and the Governor. However, without the authority to raise revenues by majority vote, the majority party and Governor would be limited to reducing state expenditures or reprioritizing existing expenditures. Therefore, this measure would not provide all the tools needed to fully address priorities and govern the state.

Legislative pay provisions of this measure have the potential to significantly reduce legislator pay. This could have the consequence of reducing the diversity of candidates seeking legislative office, as these reductions may eliminate candidates that are not independently wealthy and those that cannot afford to risk a significant reduction in income.

Many of the provisions in this Constitutional Amendment reduce the overall flexibility of the Governor and the Legislature to modify funding to address priorities. Specifically, this measure reduces how the Governor and Legislature may use one-time revenues. It also eliminates the ability to substitute fees for taxes without a supermajority vote. Reducing the flexibility of state resources ultimately reduces the Governor and Legislature's ability to set priorities for the state.

The new restrictions on state redirection of local revenues would eliminate state budget tools that generated about $3.6 billion in 2009-10 budget relief. The 2009 Budget Act suspended Proposition 1A to effectively borrow $1.9 billion in local property tax revenue and shifted $1.7 billion in Redevelopment funds. These new restrictions would create more stability and predictability for local governments, but would further reduce budget options for the state.

The new tax authority in this proposed Constitutional Amendment would make it easier for county voters to approve an increase in the sales tax compared to the existing two-thirds vote requirement in the Constitution for special taxes. The Legislative Analyst examined 2004 local sales tax measures and found that voters approved one-third of them. If the voter approval threshold for these taxes had been 50%, instead of 67%, another one-third would have been approved. Based on past behavior of local governments and local voters, it is unlikely the tax increase would be implemented in all counties, and where implemented, it might not be set at the maximum one-cent level. New local tax revenue might be expected to be more in the range of $1 billion instead of the maximum of $5 billion.

REGISTERED SUPPORT / OPPOSITION:

Support

AARP
State Building and Construction Trades Council of California
Sierra Business Council
Monterey County Business Council
San Joaquin County Business Council
Fresno Business Council
Contra Costa Council
San Francisco Chamber of Commerce
Greenlining Institute
California Church IMPACT
Yolo County Board of Supervisors
California La Raza Lawyers Association
San Gabriel Valley Economic Partnership
California Alliance of Child and Family Services
Kern County Taxpayers Association
Progressive Christians Uniting
The Campaign for College Opportunity (SCA 19 and SB 844)
WELL Network
Town of Paradise
Inland Empire Economic Partnership
San Carlos Chamber of Commerce
Valley Industry and Commerce Association

Opposition

Cal-Tax

Analysis Prepared by: Christian Griffith / BUDGET / (916) 319-2099

Date of Hearing: April 15, 2010

ASSEMBLY COMMITTEE ON BUDGET
Bob Blumenfield, Chair
AB 2591 (Feuer) – As Amended: April 8, 2010

SUBJECT: State Budget and Legislative Reform

SUMMARY: This bill would amend statute to fully implement the budget reform provisions of ACA 4 (Feuer). This bill and ACA 4 constitute a state government reform package that is sponsored by the organization *California Forward.* Specifically, this bill:

1) Provides a statutory framework for the implementation of performance-based budgeting;

2) Creates the systematic program performance review by the Legislature; and,

3) Makes operational "pay-as-you-go" provisions contained in ACA 4.

FISCAL EFFECT: This bill, if implemented with ACA 19 (Feuer), is likely to require new state spending in the tens of millions of dollars annually to develop and implement new performance standards. This includes additional resources for the DOF and the LAO given their expanded roles under this bill. In addition, new information technology expenditures could result to address the new requirements.

COMMENTS: AB 2591 is a companion to ACA 4 (Feuer) which is a Constitutional Amendment proposed by the *California Forward* organization. *California Forward* created a bipartisan plan to improve California's budget and fiscal processes based upon best practices in other states and over two years of engagement with citizens and organizations across California. One of the goal of this package of reforms is to provide balanced solutions to improve the accountability, effectiveness, and timeliness of the state budget process.

AB 2591 establishes the statutory provisions that are referenced in ACA 4, to make the California Forward proposal full operational.

AB 2591 requires the use of performance-based budgeting, beginning in 2014-15. The bill defines a performance-based budget as including:

1) The mission and goals of the agency;

2) The activities and programs for achieving these goals;

3) Performance metrics that reflect the desired outcomes and targeted performance measurements;

4) Prior-year performance data and an explanation for any deviation from previous year's targets; and,

5) Proposed changes in statute.

In 2012-13, the Governor would be required to include performance measures and standards for all agencies in the 2014-15 budget, with the Legislative Analyst required to review these measures as part of the overall budget review. The Legislature may amend performance standards.

The bill also establishes a task force of the Director of Finance, the Controller, and the Chairs and Vice Chairs of the Budget Committees to establish guidelines to establish performance-based budgeting and to review the plan to train executive staff to begin using the performance-based budget process.

AB 2591 requires a summary of mission, goals, performance, and objectives for each agency on the Governor's web site.

AB 2591 requires the Legislature to designate or create a joint committee that would review the performance of ever area of the budget. The bill requires that all areas of the budget are reviewed at least once every ten years, but requires that at least one-third of all expenditures be reviewed by 2015 and that two-thirds of all expenditures are reviewed by 2018. The Legislature is required to adopt a schedule for the reviews, including deadlines, within one year of enactment of the bill.

The reviews include all expenditures, but would also include tax expenditures, deductions and credits.

Each review is designed to take six months to complete. The process envisioned in AB 2591 is as follows:

1) The joint committee develops an "initial review" document and must submit it to the appropriate policy committee for consideration, this occurs six months prior to the deadline;

2) The policy committee must make recommendations back to the joint committee within 90 days of the deadline;

3) The committee makes it final recommendation; and,

4) Proposed legislation from the joint committee would be referred to the appropriate policy committee.

In preparing proposed legislation for a program that is reviews, the joint committee shall propose one of the following:

1) Changes to the program to reduce costs;

2) Change to the program to improve outcomes; or,

3) Termination of the program.

AB 2591 requires the fiscal committee of each house to determine whether a bill or measure should be reviewed by the Legislative Analyst's Office (LAO) to make determination of whether the statute is restricted by the new constitutional "pay as you go" provisions (contained in ACA 4) that require that any statute or measure that has "qualified state costs" of more than $25 million must have offsetting program reductions or revenue increases of an equal or greater amount.

The bill also allows the Legislature to override the LAO's determination of constitutionality by a two-thirds vote in each house. This bill authorizes the LAO to consider impacts to other programs and establish a time period in making determinations in this section. The Legislative Counsel digest shall reflect the determination made by the LAO before a measure is read for a third time if the LAO determines that the bill has qualified state costs of $25 million or more.

AB 2591 defines "qualified state costs" to exclude: general obligation bond debt; restoration of funding that was reduced in a prior fiscal year, to balance the budget to address a forecasted deficit; one-time increases in the budget bill or a budget trailer bill; COLAs or other workload increases, including increases in Memorandums of Understanding (MOUs) approved by the Legislature; and, local mandates. This bill defines "a net increase in qualified costs" to mean ongoing expenditures and does not include one-time expenditures. This bill defines "additional revenue" to mean a sustained increase as determined by the state agency responsible for collecting the revenue.

In addition, AB 2591 waives the requirements of the new "pay-as-you-go" Constitutional Amendment if the state is in a structural surplus, and the net increase in costs or net decrease in revenues does not exceed the amount by which state revenues exceed state expenditure obligations in any given year, over a five year period starting with the prior fiscal year.

REGISTERED SUPPORT / OPPOSITION:

Support

AARP
State Building and Construction Trades Council of California
Sierra Business Council
Monterey County Business Council
San Joaquin County Business Council
Fresno Business Council
Contra Costa Council
San Francisco Chamber of Commerce
Greenlining Institute
California Church IMPACT
Yolo County Board of Supervisors
California La Raza Lawyers Association
San Gabriel Valley Economic Partnership
California Alliance of Child and Family Services
Kern County Taxpayers Association
Progressive Christians Uniting
The Campaign for College Opportunity (SCA 19 and SB 844)
WELL Network

Town of Paradise
Inland Empire Economic Partnership
San Carlos Chamber of Commerce
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Opposition

Cal-Tax

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