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Assembly
California Legislature

ASSEMBLY COMMITTEE ON BUDGET

BOB BLUMENFIELD, CHAIR
ASSEMBLYMEMBER, FORTIETH DISTRICT

Agenda

April 26, 2010

3:00 p.m. – State Capitol Room 4202

ITEMS TO BE HEARD

CALIFORNIA FORWARD REFORM PROPOSAL: AS CONTAINED IN ACA 4 (FEUER) AND AB 2591 (FEUER)

Overview of California Forward Reform Proposal

April 26, 2010

3:00 p.m. - State Capitol Room 4202

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.