

Executive Summary

As the demands on California to provide services increase and resources remain limited, it is critical that the State move to equip its agencies and programs with the flexibility to perform efficiently and effectively. It is no less critical that policy makers be provided with information that will allow them to make informed choices among competing interests. Performance-based budgeting -- while not a panacea that will produce balanced spending plans without painful choices -- is a promising tool for managers and policy makers alike.

Performance-based budgeting links measured results with allocations of funding. Departments are held accountable for outcomes, spending is prioritized based on a program's ability to successfully reach goals, and comparative data allows policy makers to understand the array of results that can be accomplished through different levels of spending. This system differs sharply from traditional budgeting, which focuses on line-item expenses -- personnel, equipment, supplies, etc. Under the traditional system, spending increases as demand for a program grows rather than as a program proves itself successful in reaching desirable outcomes.

Many states, the federal government and other nations have adopted performance-based budgeting to some degree. In California, several departments are participating in a performance-based budgeting pilot project. The Little Hoover Commission examined California's experiment with the performance-based budgeting format and reviewed the

experience of other government jurisdictions. The result is the Commission's report, which contains three findings and nine recommendations.

Finding 1: The current process for allocating funds and setting program priorities is not a framework that encourages the best policy decisions, especially in times of economic contraction.

The traditional line-item budget invites policy makers to add funds automatically to existing programs each year to take care of caseload growth. In years when resources are growing, such reflexive action is possible even as new layers of programs are added. But when resources fail to keep pace with demands, policy makers would be better served by a system that helps them make rational choices. Such a system would quantify outcomes that will be achieved by various levels of spending. Informed decisions about how to get the most value out of limited resources to meet competing needs could then be made. The focus could shift to reaching consensus about priorities rather than on battling to protect existing programs, regardless of performance.

Recommendation 1-A: The Legislature should play a major role in bringing performance-based budgeting to California, providing support and oversight for the current pilot project.

The Legislature needs to designate a point person or committee for ensuring that the performance-based budgeting pilot project is proceeding in a direction that can win legislative support and consensus. This could be either a special budget subcommittee in each house that would be in charge of the budgets for the departments in the pilot program, or it could be a special, joint committee of the two houses.

Since the system envisions the policy makers yielding substantial power to department managers on line-item management and programmatic details, it is imperative that legislators understand the benefits that they can expect to gain in terms of accountability and improved real-world information. Such an educational process will only occur if there is a strong point of support for the new system within the Legislature.

Recommendation 1-B: The Executive Branch should renew its commitment to the performance-based budgeting concept by providing the logistical support departments need to make the system work.

The Administration can assist pilot project departments by providing them with the guidance and standardized approaches needed to gain Executive Branch consensus on the performance-based budgeting process. This should include strong support from the Department of Finance, which has been placed in an oversight capacity for the pilot project. The Department of Finance should play a lead role in gathering information from other governments using performance-based budgeting, providing parameters for departments to use in negotiating budget contracts and reporting performance measures, and setting up formats for information sharing between departments and the Legislature.

The experience of other states, the federal government and other nations does not support the Department of Finance's viewpoint that the system must be limited to certain departments and functions. Such pre-judgment may hamper the success of much-needed reform in the long run.

Recommendation 1-C: The Governor and the Legislature should express their long-term commitment to budgetary reform by adopting legislation to extend the timeline for the performance-based budgeting pilot project and to encourage its expansion as appropriate.

There is an intensive investment of time and resources in developing strategic plans, identifying appropriate performance measures and tracking data. Many of these processes may not work well the first, or even the second, time. But for reform to be successful, the commitment to change the budgeting process cannot evaporate at the first sign of failure.

In addition, performance-based budgeting contains many elements that allow for improved program management rather than just improved budgetary decision making. The Governor and the Legislature should encourage departments whose leadership is capable and open to change to adopt techniques and processes now under development by the pilot project departments rather than waiting for a final evaluation of the project.

Finding 2: Reliable and relevant performance measures are difficult to identify and may be costly to track but they are a critical component for a valid performance-based budgeting system.

Some things in government programs are easy to measure: How many pieces of paper are processed in a certain amount of time, how many hours of service are provided, how much money is spent for postage. But other things are more difficult to quantify: Does a person who

receives services have an improved life, is a specific training program sufficient to help someone obtain a permanent job, does the provision of a certain recreation program reduce juvenile crime? Performance-based budgeting seeks to capture the latter kind of information so that policy makers can make informed choices about how to spend funds. But picking the right thing to measure -- and then measuring it accurately -- can be a difficult process. Pick the wrong thing to measure and performance "improvements" will tilt in undesirable directions or have unintended consequences.

Recommendation 2-A: The Legislature should establish general criteria for the types of performance measurements it would find useful and require departments to submit their proposed performance measures for approval before budget hearings.

The Legislature should direct departments that are moving into performance-based budgeting to measure the things that policy makers are interested in using to craft budgetary decisions. While the Legislature should allow departments the ability to develop accountability systems that meet their needs and programs, the departments would benefit from general parameters and indications of what the Legislature would find most useful. The further step of having the Legislature specifically approve performance measurements before budget time would focus policy makers' attention on their own needs and give departments time to reshape measuring systems as necessary before budget deliberations.

Recommendation 2-B: The Governor and the Legislature should approve legislation directing the Department of Finance to ensure that departments have access to adequate training and outside expertise to develop effective measuring systems.

Each department knows its own culture, programs and needs best. But the movement toward performance-based government and results-oriented programming is so extensive that there is a large base of experience with developing measurements. Departments should make the most of others' experiences as they put their measurement systems into place. The most efficient way of gathering the relevant information is to have the oversight agency, the Department of Finance, contract with experts and act as a clearinghouse for data. In addition, the Department of Finance should take the lead in ensuring that department directors and managers have adequate training to make performance-based budgeting work in a meaningful way.

Finding 3: Achieving accountability through bureaucratic controls increases the cost of government programs and decreases the flexibility needed to make them successful.

Whenever something goes wrong in government, the reaction is to set up control systems that will preclude a repeat occurrence. The protective systems become paperwork burdens on programs, increasing costs without adding value, creating frustration and shifting employee focus away from meeting program goals. Accountability, however, is the key to operating government effectively, efficiently and credibly. Performance-based budgeting retains accountability but shifts it away from command-and-control structures and toward concrete outcome and output measurements.

Recommendation 3-A: The Governor and the Legislature should examine and revise control systems for all agencies to eliminate unnecessary and costly processes.

The Little Hoover Commission has identified many procedural barriers to government efficiency in several prior reports. Chief among the systems that should be revised, according to these reports and the experience of the pilot project departments, are the civil service system, the procurement system, leasing oversight and the mandatory use of Prison Industry Authority products. The prior Commission reports contain specific recommendations for increasing efficiency without eliminating accountability.

Recommendation 3-B: The Governor should negotiate and the Legislature should approve a pay-for-performance system that rewards success and sanctions failure.

Whether it is called a merit system or a pay-for-performance system, government should have the ability to provide managers and employees incentives for doing a good job. The "fairness" of a system that pays everyone assigned the same type of work the same amount regardless of their ability and effort can and should be disputed. Organizations that recognize achievement are most likely to encourage it.

Recommendation 3-C: The Governor and the Legislature should allow departments that achieve budgetary savings through increased efficiency to retain and redirect part of the savings.

The perverse incentives in the current budgeting process encourage departments to spend every penny in each year's budget. Allowing a program manager to retain funds into a new budget year when they have been earned through efficiency would change that spending incentive and encourage innovation. The redirection of the savings could be restricted to certain expenditures approved by the Legislature or managers could be given broad discretion as long as the spending contributed to the mission and objectives of the department's programs.

Recommendation 3-D: The Governor and the Legislature should adopt a multi-year approach to budgeting.

Performance-based budgeting yields data about long-range trends and performance. But to take advantage of this information, policy makers need to look beyond the next year and understand the implications of their decisions. This can be achieved by building multi-year projections into the budget process and exploring the potential, including any necessary constitutional changes, for adopting budgets that span more than one year.