The Performance Institute

PREPARED REMARKS

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The California Little Hoover Commission
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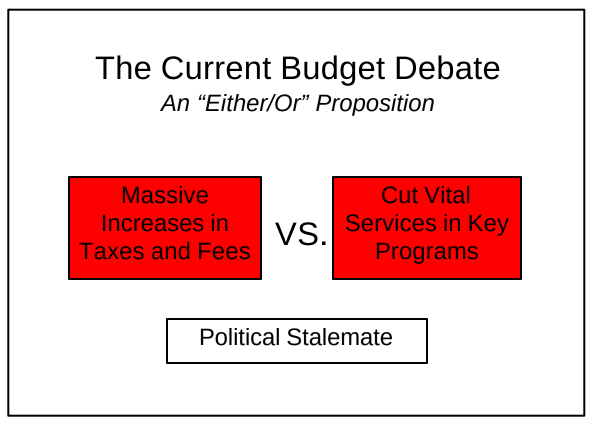
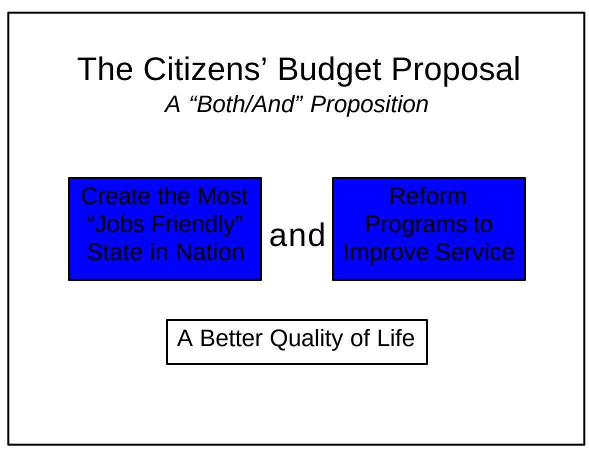
The gravity of California's fiscal crisis requires bold and immediate action. We have a unique opportunity to change several flaws in California's system of governance if we act immediately. That is why I am pleased to join the Little Hoover Commission this morning as it considers fundamental reforms to address the current crisis and ensure similar crises do not occur in the future.





At the Performance Institute and the Reason Foundation, I led a team of experts through a six month review of state finances during the last budget cycle. The product of our work—the **California Citizens' Budget Plan**—was released in May of this year. The **Citizens' Budget** fundamentally rejects the two extremes being presented by Sacramento on the budget. On one side, Republicans oppose tax increases they say would further dampen the economy and cost hundreds of thousands of jobs across the state. On the other side, Democrats reject cuts to programs they say would result in loss of vital services to the poor, women, and children. And in the middle of these two extremes, some suggest a "balanced" approach would mix tax increases with cuts in services; or, worse, some say we can avoid tax increases and cuts in services through deficit financing bonds.

Neither the extremes nor the middle were accepted by the **Citizens' Budget** plan. As a result, the **Citizens' Budget** provides comprehensive strategies for restructuring the state government using a 10 point plan of reform. In August, I was joined by a bipartisan group of former state elected officials—including Kathleen Connell and Matt Fong—as we released our **"Roadmap to Reform"** report, which recommended a restructuring

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commission be created to implement the **Citizens' Budget** plan.

DEFINING THE PROBLEM AND ROOT CAUSES

Before California can begin to explore solutions to the crisis, we must first define the problem facing the state as well as identify root causes. We define California's problem on three levels: A Spending Problem; a Performance Problem; and a Revenue Problem. Regardless of the methodology one uses, it is clear that state spending has far outpaced population and inflation growth for the past five years. Our budget analysis found little to substantiate massive increases in budget authority for many programs. State programs suffer from myriad performance problems—including waste, duplication, fraud, errors, and low service levels. The state's public health, social service, and education systems are broken—delivering lower performance results than programs in other states.

Finally, the state indeed suffers from a problem of revenue—but this cannot be solved with higher taxes. Revenues are the symptom, and the disease is California's job unfriendliness and propensity to enter into feast-famine cycles. Too often the debate focuses on raising taxes or cutting services when it should be first and foremost focused on jobs. As for the feast-famine cycles, the state ratcheted up its spending in 2000 when it collected one-time revenue from capital gains from the dot-com boom. When the stock market fell and those funds dried up, the state did not correct its spending. Reckless spending overextended the state, resulting in our current budget crisis.

In examining the root causes of these problems, we identify ten factors that must be addressed:

1. **Flawed Leadership and Inaction:** The previous Governor and the Legislature failed to act in 2001 when the crisis first emerged. Instead of devising and passing legitimate budgets, the budgets in FY 2001-2002; 2002-2003, and 2003-2004 were filled with accounting gimmicks rather than tough choices and fundamental reform.
2. **Constitutional Flaws:** The State's Constitution no longer contains an effective spending limit (originally provided by the Gann Limit) and instead ties the hands of legislators by putting nearly half of the state budget on auto pilot by mandating education spending levels.
3. **Fragmented and Duplicative Structure:** The state government organizational structure is fragmented and duplicative—leading to misallocation of resources and the inability to coordinate services to the taxpayer.
4. **No Performance Information:** State programs do not provide performance information to justify their budget requests, which prevents evaluations of the effectiveness of their programs. Without evaluating performance results, we are left only to assume benefits are being provided.
5. **No Transparency of Costs:** State programs do not provide "cost-per-unit" information on the cost of government services. Without measuring costs, we cannot manage costs.
6. **No Competitive Service Delivery:** State programs are not subjected to regular competition studies where other government agencies, non-profits, and private vendors are able to "bid" against the state agency for the opportunity to provide the service at a lower cost and with better performance.
7. **Poor Workforce Management:** The state does not engage in regular workforce planning assessments to recruit, retain, and deploy the right workforce; instead, the workforce has mushroomed without strategic direction. Moreover, employee unions have not only negotiated unsustainable pay and benefits packages, but prevent employee performance evaluation and management in most agencies.
8. **Poor Legislative and Executive Oversight**: The Legislature rarely engages in meaningful oversight of state programs and oversight assistance is fragmented among a number of

support agencies. Moreover, the management oversight functions in the Executive branch relating to finances, personnel, procurement, technology, logistical support, etc. are equally fragmented and little priority has been placed on management improvement initiatives.

9. **Tendency to Bond everything… and then Raid Bond Funds**: An external factor to the Legislature and Executive branch is the proclivity of the California voter to support bonds for virtually every program category. Unfortunately, as has been seen in this budget crisis, the state has raided bond programs by supporting general fund initiatives with bond funds and special trust funds.
10. **Loss of Economic Competitiveness**: State tax and regulatory policy has contributed to the loss of jobs in California—from Sinclair fees to lack of constructive action on the state budget, worker's compensation reform, and health care reform. Moreover, lack of progress on workforce investment, education, and transportation/infrastructure contribute to undermining California's competitiveness in the eyes of business. Businesses are leaving the state in droves—not because consumers are not spending, but because the price of operating in California has skyrocketed due to higher costs for energy, worker's compensation insurance, and regulation. Mismanagement of the state's finances only contributes to a growing sense of uncertainty for businesses. In a sick cycle, as more jobs leave the state, the deficit gets worse with fewer and fewer taxpayers contributing. If every Californian who *wanted* a job could *get* a job, the state would actually face a budget surplus this year.

THREE PROPOSED REFORMS

Constitutional Tax and Expenditure Limit:
The State should adopt a constitutional amendment limiting the growth in state spending to population and inflation. Growth in revenues should also be tied to this benchmark to prevent the legislature from pursuing a tax policy to intentionally "over-collect" revenue above the spending limit (thus triggering mandatory spending provisions in the state constitution). To limit the level of state debt, the Constitution should limit interest and principal payments on state debt to a set percentage of the general fund—say five to six percent. By adopting these limits, state government will be forced to live within its means—and implement a process for continual reform and performance improvement.

Performance Budgeting Process:
The state should overhaul its entire budget process to improve the transparency of performance and cost in state programs. Towards this end, the state's budget process should require the submission of strategic plans, performance measures, and full cost accounting for each state program.

Furthermore, the state should move to a two-year budget cycle where the legislature spends year one engaged in oversight of agency strategic plans, performance goals, and costs—while using year two for appropriations. No legislation making an appropriation or resulting in an appropriation at the state or local level would be permitted during year one of the biennial budget cycle. To support expanded oversight, all state audit functions should be integrated under a Chief State Auditor who would review the coordination and relevance of agency performance information and certify the accuracy of program cost data. Finally, the Governor should be given authority to make mid-year budget corrections when revenues or expenditures do not match those anticipated or authorized in the Budget Act. Should the Legislature disagree with the Governor's proposed mid-year corrections, a simple majority vote can suspend the Governor's proposal and the Legislature would then have to consider and pass legislation (subject to the two-thirds vote) making corrections on its own.

Restructuring Commission:
Fundamental reform sometimes cannot occur within traditional political structures. Nowhere can this be seen better than with the military base closures process used in the wake of the end of the Cold War. Borrowing from that experience, California should create a Reform Commission to propose reforms in state government STRUCTURE, as well as reforms in the SYSTEMS for health, social services, education, and transportation. The Commission should be given nine months to develop a reform package, which would be automatically submitted to the voter for approval on the November 2004 ballot. Members of the Commission would be appointed by the Governor and the Legislature—and purposely designed to have equal representation of both political parties.

Thank for your time and consideration. The Performance Institute's California Government Accountability Council and I look forward to working more closely with the Little Hoover Commission.

The Performance Institute *is a private think tank that serves as the nation's leading authority and repository on performance-based management practices for government agencies. Our mission is to identify, study and disseminate the leading management innovations pioneered by 'best-in-class' public-sector organizations. Through national conferences on pressing issues, interactive executive training programs, best practice research and strategic consulting services, the Institute provides cutting-edge expertise in the design, implementation and evaluation of strategies to solve operational challenges, improve customer service and enhance organizational performance.*

The California Government Accountability Council *serves as California's leading voice for government reform and improving the quality of life of every Californian. To do this, we serve as the state's leading "watchdog" of state and local government in California. The Council combats waste, fraud, abuse and inefficiencies in government and promotes greater accountability for results. As the leading voice for fundamental reform of state and local government, the Council applies the principles of performance, transparency, competition and accountability to state and local government as the best way of safeguarding the quality of life and interests of taxpayers in California.*