LITTLE HOOVER COMMISSION

BUDGET REFORM: PUTTING PERFORMANCE FIRST

October 1995

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October 11, 1995

The Honorable Pete Wilson
Governor of California

The Honorable Bill Lockyer
President Pro Tempore of the Senate
and Members of the Senate

The Honorable Rob Hurtt
Senate Republican Floor Leader

The Honorable Brian Setencich
Speaker of the Assembly
and Members of the Assembly

The Honorable Willie L. Brown Jr.
Assembly Democratic Floor Leader

Dear Governor and Members of the Legislature:

No single reform can banish California's many problems or make the choices faced by its policy makers any easier to resolve. But the State can take steps to emulate successful private-sector companies that have made great strides in efficiency and effectiveness. Such steps hold out hope that government performance will meet the expectations and demands of citizens.

In previous reports, the Little Hoover Commission has advocated overhauling the State's procurement practices and civil service procedures. In the report that accompanies this transmittal letter, the Commission examines the State's budgeting mechanism and finds work in progress on innovative reforms -- but a lack of the type of support that can foster and spread success. The State's experiment with performance-based budgeting is warmly embraced by the departments involved but has generated little enthusiasm in the Legislature and in the remainder of the Executive Branch.

The key advantage of the performance measurement approach to budgeting is that the allocation of funding is linked to what a program is able to accomplish. This differs from traditional budgeting, which focuses on increasing line items of expenditures -- personnel, equipment, supplies, etc. -- when caseloads grow, regardless of a program's ability to meet goals. After reviewing the State's progress and examining the experience of other government jurisdictions throughout the country and in other nations, the Commission has concluded that performance-based budgeting is a valuable mechanism with winners on all sides:

Milton Marks Commission on California State Government Organization and Economy

660 J Street, Suite 260 ▪ Sacramento, CA 95814 ▪ *tel* (916)445-2125 ▪ *fax* (916)322-7709

- ***Policy makers*** gain clear information about the impact of varying levels of expenditures that allows them to make informed choices. The result of policy decisions becomes evident as performance is measured and trends are established. The process for insuring accountability shifts from blanket restrictions that stifle innovation to documented outcomes. And policy makers can shift their attention from process to goals.

- ***Program managers*** work within well-defined expectations and have the flexibility to reform processes and increase efficiency as long as goals are met. Innovation and superior performance are rewarded.

- ***The public*** can see a clear connection between tax dollars expended and services provided. Programs become customer-focused, enhancing the prospects of government successfully meeting the needs of a diverse constituency.

Despite the potential benefits of performance-based budgeting, the Commission recognizes that it is only a tool. The dual duties of setting appropriate goals for government and achieving a consensus on priorities for funding still face policy makers, regardless of the format that is used for budget information. Tough choices may become easier when relevant information is available to all parties -- but the choices still must be made.

Nonetheless, the Commission believes that it is important for state government to continue on the path of reform by extending and better supporting the performance-based budgeting pilot program. Like most experiments, the results may be mixed or unclear for some time, but the dividends should be large if policy makers have the patience to nurture this promising reform.

Sincerely,

Chairman Richard Terzian

Budget Reform:

Putting Performance First

October 1995

Table of Contents

Section	Page
Executive Summary	i
Introduction	1
Background	7
Finding 1: Flawed Process	25
Finding 2: Measuring Up	45
Finding 3: Costly Controls	57
Conclusion	67
Appendix	73
Endnotes	77

Table of Sidebars

Title	Page
Pressures on State Government	4
The Power of Measuring	10
1949 Hoover Report Excerpt	12
The Waves of Reform	13
Palo Alto's New Paradigm	18
California's Nine Principles	20
Departments: Go For It	22
California Conservation Corps Budget	29
Backers of Budget Reform	31
Sunnyvale Solid Waste Disposal	33
The Texas Tornado	35
Indianapolis Parks and Recreation	37
Palo Alto Public Works	38
United Kingdom Commitments	49
Oregon's Benchmarks	50
California Department of Parks and Recreation	51
Department of Consumer Affairs	52
California Conservation Corps	53
Little Hoover Reports	62
Parks and Recreation Cost Avoidance	63

Executive Summary

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.

Introduction

Introduction

When private-sector companies ignore their customers and their market environment, they fail financially. When governments do the same thing, they earn the disdain of taxpayers and face restrictions at the ballot box that affect their ability to provide services.

In the 1980s and '90s, the private sector has moved dramatically to sharpen efforts and refocus strategies in the new highly competitive marketplace so that fulfilling customer expectations is the top priority. Continuous improvement, employee empowerment, right-sizing, just-in-time delivery -- the buzzwords and fads are many but the changes and results are tangible.

At a much slower pace -- indeed, in fits and starts -- governments are also beginning to change, largely driven by overt public dissatisfaction and dwindling resources. Policy makers and bureaucrats are examining ways to take successful private-sector concepts and fit them into government operations without sacrificing the public trust.

At the heart of the transformation of government across the nation is the struggle to measure the outcome of programs and forge a connection between budgetary decisions and the proven ability to create desirable results. Two dozen states and the federal government are in various stages of using an analytical, performance measurement approach to budgeting. They range from Texas, which in one two-year budget cycle completely overhauled its budgeting mechanism, to California, which is inching into reform with a limited pilot program in four departments.

Linking program performance with funding decisions is not a new concept, as those who have seen wave after wave of budget reforms in the past 50 years can attest. But the circumstances facing government today have combined to make reform imperative. Among those circumstances in California are:

- ***California's economy.*** Economists may differ on the details, but all agree that the State has been through a long and difficult recession that has restricted the revenues available to government. Military base closures, deteriorating infrastructure and other factors are expected to continue to suppress the State's economic growth for the near future. Even the most rosy predictions do not forecast a return any time soon to the type of economic expansion that allowed California government to grow non-stop throughout the post-World War II years. As a result, governments at all levels in the State continue to find their resources constrained.

- ***Population pressures.*** California continues to grow, both through immigration and birthrates that outstrip deaths. State statistics make it clear that the growth is coupled with disproportionate increases in the demands for services, largely because of the specific demographics of the growth (largely the very old, the very young and the very new to America). From the social safety net programs like Medi-Cal and Aid to Families with Dependent Children (AFDC), to the general service programs, such as schools, the number of clients for state services is increasing at a far greater rate than the population itself. As a result, government must strain to provide

Pressures on State Government

Among the indicators of stress on state programs:

✓ **Declining revenues.** Spurred by a large tax increase, California's revenues peaked at $42.03 billion in 1991-92, but then dropped to $40.95 billion in 1992-93 and $40.10 billion in 1993-94. The increase in 1994-95 -- to $42.35 -- signaled an improving economy but did not allow the State to recoup ground lost to inflation.

✓ **Growing caseloads.** While the State's population grew 9.4 percent between 1990-91 and 1995-96, the AFDC caseload grew 40 percent and the number of SSI/SSP clients grew 26 percent. In the mid-1980s, one in nine Californians was on Medi-Cal. The rate is one in six today.

✓ **Low voter turnout.** Only 60.5 percent of registered voters went to the polls in the 1994 gubernatorial election compared to 79.2 percent in 1966's gubernatorial race.

✓ **High public distrust of government.** In 1983, only 28 percent of those polled felt the California Legislature was doing a poor job compared to 39 percent in 1994 -- an improvement from 1992 's 50 percent disapproval rating. During the same period, public disapproval of Congress rose from 43 percent to 73 percent.

✓ **Increasing diversity.** In 1980, California's population was 67.0 percent white, 19.2 percent Hispanic, 7.5 percent African American and 5.2 percent Asian. By 1990, the picture had changed, with only 57.2 percent white. Hispanics were 25.8 percent of the population, African Americans 7 percent and Asians 9.1 percent.

Sources: Budget Summaries, Governor's Budget Summary 1995-96. Secretary of State's Office, Field Poll, Gallup Poll, Department of Finance

more services even as resources diminish.

- ***Public distrust.*** The public's belief in government as a positive force has steadily eroded, as reflected in opinion polls and voter turnout. Hand-in-hand with this growing distrust have come a series of ballot-box measures meant to tie government's hands: Proposition 13, Proposition 4 and Proposition 98 -- each of which restricted government's ability to raise revenues or determine how to spend funds -- are just a few examples. As a result, policy makers are faced with limited options and are increasingly unwilling to make tough choices, preferring inaction and short-term fixes over long-term reforms that may prove unpopular.

- ***Increasing diversity.*** Amid the clamor of single-issue groups and other special interests, it is difficult for policy makers to focus on the needs and desires of the general public. In addition, as California has become less homogeneous, it has become more difficult to identify a single common good that is easily agreed on by the diverse groups constituting California's population. As a result, prioritizing needs and making decisions about the relative value of various possible expenditures becomes a zero-sum game of balancing conflicting demands rather than a reasoned dispassionate approach to investing government resources in services that have proven value.

These factors could be formidable forces on state government to do a better job, but institutional inertia and turf-protecting instincts are immense barriers to change. It is within this environment of warring pressures that California began a performance-based budgeting pilot project in 1993. While the pilot project has yet to run its course, mid-way assessments by the Legislative Analyst's Office and legislative staff have been cautious, if not negative.

The Little Hoover Commission turned its attention to the pilot project as a natural progression from other studies it has conducted on the mechanics of government. In prior reports on how the State oversees its real property assets, how the State procures goods and services and how the State manages its work force, the Commission has advocated reforms that echo private-sector practices in an effort to make government more effective and efficient. The Commission, therefore, had an interest in examining performance-based budgeting as a concept that would help the State focus on the bottom line of wisely spending scarce resources.

Study Methodology

To carry out its study, the Commission gathered information from experts across the nation, as well as examined the experience of other states, the federal government and other nations. The Commission conducted a public hearing in Sacramento, bringing together some of

those experts and the state department heads involved in the pilot project (see **Appendix A** for a list of hearing participants). Finally, the Commission intensively studied the experience of Oregon and Texas, the two states that appear to have made the most progress in perfecting performance-based budgeting.

The result is the following report, which focuses on the concept of performance-based budgeting rather than on an evaluation of the pilot project process in California. The Commission believes that the specifics of the pilot project implementation are less important to the eventual success of the experiment than the steps that need to be taken, as demonstrated in other jurisdictions, to build consensus and support for change.

The report begins with an Executive Summary and this introduction, followed by a background section and three separate findings with associated recommendations for each. The report ends with a conclusion, appendices and endnotes.

Background

- *Performance-based budgeting is an approach to allocating funds that links measured results with policy decisions.*

- *Traditional budgeting focuses on line-item costs for personnel, equipment and supplies; performance-based budgeting focuses on outcomes.*

- *Sunnyvale's successful budgetary process includes a 20-year strategic plan, a 10-year financial plan, a two-year performance budget, annual evaluations and performance-based compensation.*

- *Twenty-four states are trying performance-based budgeting to some degree, ranging from the wholesale adoption in Texas to Florida's projected, gradual conversion department by department.*

- *California's experiment includes four departments: Parks and Recreation, General Services, Consumer Affairs and the California Conservation Corps.*

Background

In an era of recession-reduced revenues and increasing demands for services, national, state and local governments are seeking ways to improve delivery of effective services at the lowest possible cost. California is no exception. In 1993, the State began a pilot program to test performance-based budgeting, a complex process of strategic planning and outcome evaluation that seeks to ensure that programs are funded according to their ability to produce positive results.

The State's first steps in this direction come at a time when many other states have taken major strides to reform their budgeting mechanisms. The federal government is embarking on a massive pilot project and foreign governments are well immersed in linking evaluations to budgetary decisions.

While California is not a leader in the movement toward performance-based budgeting, it long ago incorporated many of the elements in its own budgeting process that other states are just now adopting -- concepts such as delineating funding by program functions and providing key program indicators within the budget document. Thus, the State has not felt the same pressure for change that policy makers in other states have who are frustrated by cryptic, enigmatic budget documents. By comparison, California's budget, as introduced by governors each January, is a treasure trove of information about how much specific programs cost, how many people are employed to operate them and, often, how much service is delivered. Nonetheless, the budget falls far

short of providing a picture of how successful state government is in reaching the policy goals represented by the commitment of funding.

Nationally and in California, the move to performance-based budgeting is but the latest in a long line of attempts to improve the way governments allocate funds and provide accountability. Understanding what has come before and why other reform efforts have failed is important for those who seek to make the new budgeting overhaul successful. In addition to explaining the performance-based budgeting concept, this background section provides a historical context for budget reform, summarizes the experience of other government jurisdictions and reviews the pilot project in progress in California.

A Definition

Performance-based budgeting is an approach to allocating funds that attempts to link measured results with policy decisions. This method stresses holding departments accountable for outcomes, prioritizing spending based on a program's ability to successfully reach goals, and providing comparative data on how much value is received when dollars are allocated in different ways.

As the Legislative Analyst's Office defines it, performance-based 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.*[1]

For instance, rather than funding a job-training program based on the number of clients needing services and the number of caseworkers that are required to meet that need, a performance-based budget would offer policy makers a grid of expected results that would be verified over time. An investment of one level of dollars would have the potential of achieving a 10 percent reduction in unemployment, while a greater investment may bring a 20 percent reduction.

The Power of Measuring

The book *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* describes the power of performance measurement:

- ✓ What gets measured gets done.
- ✓ If you don't measure results, you can't tell success from failure.
- ✓ If you can't see success, you can't reward it.
- ✓ If you can't reward success, you're probably rewarding failure.
- ✓ If you can't see success, you can't learn from it.
- ✓ If you can't recognize failure, you can't correct it.
- ✓ If you can demonstrate results, you can win public support.

The contrast between performance-based budgeting and the more-traditional line-item budgeting is clear because the perspectives are quite different, according to a report by the National Conference of State Legislatures:

> *The traditional approach to government budgeting focuses on incremental changes in detailed categories of expenses called line items. More money is appropriated for specific expenses like personnel, equipment or rent as demand for an agency's service expands or new program responsibilities are added over time.*
>
> *Performance budgeting differs from this traditional approach because it focuses on spending results rather than the money spent -- on what the money buys rather than the amount that is made available.*[2]

The report identified the following characteristics of a performance-based budget:

- A statement of the goal in allocating funds for a particular program and a set of measurable objectives.
- A report on past performance and the use of a common cost factor that allows direct comparisons between disparate types of programs.
- Flexibility for managers to redirect funds as needed, along with rewards for success and sanctions for failure.
- Data on program evaluation that is reliable, credible and capable of being independently verified.[3]

The Governor's Budget Summary of 1993-94 provided a similar but expanded list of "essential elements" for the performance-based budgeting pilot project in California. The elements include:

- The creation of long-term strategic plans, with the State identifying missions for each program and strategies for carrying out the missions.
- The development of performance measures to be used in a department's program and financial planning process.
- The establishment of benchmarks by which to measure progress toward more efficient and effective operation.
- The development of annual budgetary contracts that specify the level of resources provided to a program, the level of performance expected, accountability measures and flexibility granted to managers.

- The provision of flexibility to managers to enhance program performance through relief from control mechanisms involving procurement, personnel and other requirements

- The incentive of retaining 50 percent of any savings within a department to encourage program efficiency and innovation.

- The commitment to quality improvement, with a focus on customer service, constant redesign of processes and employee empowerment.[4]

The Governor's Budget Summary emphasized the potential that performance-based budgeting holds for increasing efficiency: "The development of a performance budget requires budget writers and program managers to determine the best method to maximize program performance and enhance service delivery, given a realistic level of available funding."[5]

As will be examined in more detail in Finding 1, performance-based budgeting offers policy makers the opportunity to make program evaluation part of the budget process, to provide managers with flexibility while maximizing accountability for results and to encourage cost-effective streamlining of programs. None of these are new goals, as a review of more than four decades of budgeting reforms indicates.

1949 Hoover Report Excerpt

The federal Hoover Commission recommended overhauling the nation's budget process in a report that said:

> *In order to produce a simpler, more understandable and more satisfactory budget plan for congressmen, newspaper reporters and the general public, the present ponderous budget document needs to be completely recast along the lines of work programs. This is known as the program or performance budget, which analyzes the work of governmental departments and agencies according to their major functions, activities or projects. It thus concentrates upon the general character and relative importance of the work to be done or the service to be rendered by the departments and agencies, rather than the things to be acquired by the departments and agencies, such as personnel services, contractual services, supplies, materials, equipment and so on. The latter things are only means to an end. The all-important consideration in budgeting is the work or service to be accomplished.*

Source: Hoover Commission's Task Force Report on Fiscal Budgeting and Accounting Activities, 1949

Historical Context

Officials have long struggled to make dry and complex budget documents more understandable and relevant to those who must use them to make decisions. The federal Commission on the Organization of the Executive Branch of Government, more commonly known as the Hoover Commission, in 1949 recommended that the federal government reshape its budget to focus on functions, activities and projects rather than agencies and departments. The Commission used the term "program budget" to describe the new concept, which was touted as a simpler, more understandable way of presenting the

budget with an emphasis on "the general character and relative importance of the work to be done" rather than on things (personnel, equipment, supplies, etc.) to be acquired by departments. The Commission's report included a nod to the State of California for already using programmatic themes in its budget.

The federal government adopted program budgeting in 1951, but this proved to be only a single change in a succession of reforms. Budgets were now formatted by programs, but expenditure categories were still driven by "things" rather than by work output.

In 1961, Secretary of Defense Robert McNamara implemented Planning-Programming-Budgeting-Systems (PPBS) in the department, which was followed by a presidential order in 1965 that all federal departments adopt the new system. This system was designed to provide macro-analysis of broad policy decisions and desired outcomes rather than focusing on the details of planning and implementation. According to one national researcher, PPBS was intended to "provide a systematic process to identify trade-offs among programs aimed at similar objectives, to analyze the performance and impact of programs and to connect these objectives to the current year's budget."[6]

Despite goals that were very similar to those expressed by the federal Hoover Commission, the new system was no more successful than the old in driving decisions toward proven results. In the late 1960s, witnesses told congressional committees that across the federal system there had been no apparent change in the decision-making process and the budgets being produced.[7]

The Waves of Reform

The federal government has not hesitated to tinker with its approach to budgeting. Key reforms include:

- ✓ **Program Budgeting, 1951:** Laying out expenditure information by program category rather than by agency or department..
- ✓ **Planning-Programming-Budgeting Systems, 1965:** Focusing on broad policy objectives and program performance rather than implementation details.
- ✓ **Zero-Base Budgeting, 1976:** Starting from scratch each year, with all programs competing for limited funding based on performance and priorities rather than on prior years' funding.
- ✓ **Performance-Based Budgeting, 1993 (pilot):** Basing budgetary decisions on outcome data and long-range strategic planning.

President Carter brought Zero-Base Budgeting to the federal government after implementing it as governor of Georgia in 1971. This approach tackles the problem of programs becoming entrenched and receiving funding long after their usefulness has diminished or their aims have become a lower priority for policy makers. Under Zero-Base Budgeting, each year's budget is supposed to be designed fresh without relying on prior years' totals. Each program is theoretically begun with a zero budget and is funded after competing with all other programs for available resources. Directors are required to identify, evaluate and rank

in order of importance each function and operation to be performed by a department so that program value can be compared across all sectors of government.[8]

Zero-Base Budgeting met much the same fate as PPBS: Departments quickly learned the rituals that needed to be performed, but actual decision-making remained largely unaffected by the new system, according to many observers.

By the 1980s, a national trend toward performance-based budgeting was emerging, with the California community of Sunnyvale leading the way. The 1993 publication and runaway success of *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* put the catchwords mission-driven, results-oriented and customer-focused on the agenda of every progressive policy maker. Cautious observers, however, wonder if performance-based budgeting will prove to be just one more new exercise that fails to change decision-making in any fundamental way. This perspective gained credence when the United States General Accounting Office examined performance-based budgeting in five states and concluded that the system has yet to influence state budget decisions. Instead, allocations continued to be driven by traditional budgeting practices.[9]

Advocates are firm in the belief that the performance-based budgeting approach holds the key to making government efficient and responsive. And the track record of at least some of the jurisdictions using performance criteria to mold their budgets demonstrates that the system has vast potential when used well.

Success Stories

Sunnyvale, a city of 120,000 people just south of San Francisco, has become internationally renowned for its performance-based budgeting. Under a federal Office of Management and Budget (OMB) grant in the mid-1970s, Sunnyvale began to experiment with an approach that it calls the Planning and Management System (PAMS). By May 1991, OMB was impressed enough with the results to tell a Senate committee that Sunnyvale's system:

> *...stands out as the single best example of a comprehensive approach to performance measurement that we have found in the United States...One underlying reason for the success achieved in Sunnyvale is the fact that every program manager uses the system to plan, manage and assess progress on a day-to-day basis.*[10]

The elements of the system include a 20-year strategic plan, a 10-year financial plan, a two-year performance budget, annual evaluations and performance-based compensation.[11] Rather than formatting its budget along departmental lines, Sunnyvale matches its allocations to the seven

topics in its 20-year strategic plan: transportation, community development, environmental management, public safety, socio-economics, cultural and planning and management. The budget allocates funding for tasks rather than for personnel, equipment or supplies, with quantifiable objectives that are expected to be achieved with the funding.[12]

The proof of Sunnyvale's success with the system comes not just in the kudos it receives in books such as *Reinventing Government* and in international forums, but in the statistics it can provide. Compared to fiscal year 1984-85, Sunnyvale reported in 1993-94 that there was a 44 percent improvement in worker productivity and a 38 percent improvement (in constant dollar terms) in the cost of providing city services.[13]

The City of Indianapolis for several years has produced what it calls a "popular budget" for several major departments, including parks and recreation and public safety. The budget provides mission statements, allocations by outcome objectives and comparative performance measures. An introductory statement that is specific to the parks and recreation department captures the flavor of what the city is attempting to achieve with its popular budget:

> *This agency is under a major transformation that represents a dramatic departure from traditional government approaches. Indy Parks hopes to communicate to the public and to its constituencies that parks and recreation are a necessity. With today's frantic lifestyles, Indy Parks will strive to provide enticing recreational opportunities so that people are healthier and more productive. With every action that Indy Parks takes, it will do so with the end customer in mind. Considering the customer's wants and needs will continue to be important at every phase of implementation.*[14]

The successful implementation of performance-based budgeting has not been limited to this country. The Organization for Economic Cooperation and Development, based in Paris, has promoted results-oriented approaches to governmental service for the past five years. The United Kingdom, Australia and New Zealand have been at the forefront of making government more responsible and accountable through performance measurements.[15] Australia is particularly well known for its system of strategic planning, annual work plans, performance reporting and program evaluation. The government each year publishes a 19-volume set of detailed program performance statements relating funding to accomplishments.[16]

In 1991, the United Kingdom began a 10-year program called the Citizen's Charter to improve public services. The program aims to make clear what standard of service people can expect and what they can do about it if service falls short. A 1994 report on the effort produced by the prime minister documented improvements in services in 24 different

areas of government, ranging from health and education to the post office, defense, agriculture, planning and housing. In each area, the report delineated with specific objectives and data what had been promised, what was achieved and what future steps were planned. The United Kingdom's efforts have been widely acknowledged as successful, prompting other countries to study the model.[17]

Closer to home, most efforts in the United States are too fresh for any definitive analysis of the results. But performance-based budgeting, either whole or in part, is spreading rapidly.

The National Experience

Twenty-four states have tried performance-based budgeting to some extent. Eighteen are in various stages of modifying their budget procedures: Arizona, California, Connecticut, Florida, Georgia, Idaho, Massachusetts, Minnesota, Mississippi, North Carolina, New Mexico, Oklahoma, Oregon, South Carolina, Texas, Virginia, Washington and Wyoming. Another six are emphasizing long-range strategic planning but are expected to reform budget processes as a next step: Alabama, Arkansas, Missouri, Utah, Vermont and West Virginia. Eight states may join the performance-based budgeting ranks in 1995: Alaska, Kansas, Louisiana, Maryland, Nebraska, New York, North Dakota and Pennsylvania.[18]

The National Conference of State Legislatures identifies three types of performance reforms that are emerging. The broadest type rethinks what role government should play, extends beyond single budget cycles and looks at the highest levels of program outcome. Oregon, Minnesota and Utah are involved in this type of reform. "An unspoken expectation in these states is that once long-range goals are hammered out, these objectives will limit budget debate, structure program activity and establish spending priorities for years to come."[19]

The second type of reform focuses on efficiency and effectiveness of current services, moving into the new budgetary system quickly and with little advance discussion. Texas fits into this category.

The third type focuses on managerial aspects, giving departments freedom from budgetary line-item control in exchange for promised levels of performance. California, Massachusetts and Mississippi are working on this concept.[20]

The degree of involvement in performance-based budgeting varies. The following summarizes the experiences of several states that are considered on the leading edge of the movement:

- ***Texas:*** In a single, biennial budget cycle, Texas converted its entire funding process to a performance-based budgeting system. Beginning with a top-down strategic planning process, Texas

policy makers defined a vision statement for state government and directed all agencies to develop mission statements that fit within the vision. Agencies were required to develop six-year strategic plans and performance measurements, identifying outcomes and outputs. The 1993-95 budget had more than 3,000 key performance targets that agencies were expected to be held accountable for achieving. A senior analyst told the Little Hoover Commission that, by and large, the system has worked well, especially for those agencies that have taken the process seriously.[21]

- ***Oregon:*** Working from the bottom up, Oregon began conducting a series of statewide public hearings in 1988 that culminated in a strategic plan and mission statement entitled *Oregon Shines.* The Legislature created the Oregon Progress Board in 1989 with the mandate to develop measurements and criteria for holding government programs accountable. The result was *Oregon Benchmarks: Standards for Measuring Statewide Progress and Government Performance*, a document with almost 300 achievement goals that is regularly updated and subject to extensive public review. By the 1993-95 biennial budget, all state agencies were directed to use performance measurements linked to the benchmarks in developing budget requests. A state coordinator for the program estimates that only about 25 percent of the agencies have produced effective measurement systems, but others continue to make progress.[22]

- ***Florida:*** Moving on a slower track, Florida has set up a gradual schedule of conversion to performance-based budgeting that is expected to encompass all agencies by 2002. Unlike many states where part of the goal is to deflect micro-management by policy makers, Florida's reform effort came from frustration with a budget that gave no program information and left agencies free to shift funds away from activities that the Legislature set as priorities. A half dozen agencies are expected to be added to the process each year.[23]

- ***North Carolina:*** Driven by a $1.2 billion shortfall in revenues for 1991-92, North Carolina created a State Government Audit Committee with legislators and private-sector representatives. In 1993, the legislature enacted many of the committee's recommendations, including a mandate to develop a performance-based budgeting system that focuses on results rather than line items and a new personnel classification system that would allow greater management flexibility and reward performance.[24]

- ***Minnesota:*** In 1993, 20 agencies were directed to produce annual performance reports on which the 1994-95 budget could be based, with all other agencies to follow by the 1996-97 budget. The reports are required to answer three questions: What is the agency's mission? What are the expected results of

agency programs? What are the actual results? The reports were to be used by the Legislature during the budget deliberation process. [25] But a report by the state's auditor indicates that the first set of performance reports had very little impact on the discussion and decisions by executive and legislative branches for the 1994-95 budget.[26]

- ***Pennsylvania:*** Focusing on the development of a solid measurement system first, Pennsylvania requires all departments to form five-year strategic plans and annual performance plans. Based on three years' experience with projections and actual results, the Budget Office is expected to recommend the best way to implement a performance-based budgeting system by late 1998.[27]

- ***Washington:*** The Washington Performance Partnership is a multi-year plan by the state's leaders to refocus state government programs on meeting the needs of citizens. Using focus groups, citizen input and surveys, the state's leaders have put together a strategic statement for Washington government and is directing the implementation of performance measurements throughout state agencies. The biennial 1997-99 budget is expected to be based on performance measures and strategic visions.[28]

- ***Virginia:*** The state's 1992 budget act required all new programs to be set up with performance measures. Existing programs were to be moved into performance-based budgeting on a pilot basis in future years.[29]

Palo Alto's New Paradigm

In addition to states and the federal government, municipal governments are also embracing performance-based budgeting. For instance, the May 9, 1995 presentation of the city manager's budget proposal to the City of Palo Alto begins by trumpeting the city's move to a "mission-driven budget" system. The transmittal letter explains:

> *The basic approach and philosophy of the budgeting system is to present the financial spending plan in a logical and clear format that is easy to read, presenting the services in a clear, understandable manner and displaying the impacts of the services, along with the costs of the services. This, we believe, makes the budget a powerful tool and a logical method to use in deciding what services the City will provide and at what level to fund them for years to come....This budget presents the costs of services to you rather than an organizational structure. The focus is not on how departments are organized and how much each organizational piece costs, but on what the Council and community deserve to know. That is what we are providing to the community -- how much it costs and how do we measure the impact.*

Although the Palo Alto has chosen to call its process mission-driven, the budget document adheres closely to the elements of performance-based budgeting: clear statements of purpose, measurable objectives and allocations by activity rather than by personnel, equipment and supplies.

Source: City of Palo Alto 1995-96 Proposed Budget, May 9, 1995

The federal government is also moving in the direction of performance-based budgeting. In 1993, the National Performance Review recommended that future budgets be based on outcomes, finding that

the current budgeting process is both messy and costly. The panel's report described the lengthy negotiations and their effect:

> *Until the end, agency officials troop back and forth to [the Office of Management and Budget] and to the Hill to make their case. States and localities, organizations and advocates seek time to argue their cause. Budget staffs work non-stop, preparing estimates and projections on how this or that change will affect revenues or spending. All this work is focused on making a budget -- not planning or delivering programs....*
>
> *The process is devoid of the most useful information. We do not know what last year's money, or that of the year before, actually accomplished. Agency officials devise their funding requests based on what they got before, not on whether it produced results.*
>
> *In sum, the budget process is characterized by fictional requests and promises, an obsession with inputs rather than outcomes, and a shortage of debate about critical national needs.*[30]

The same year the report was issued, the Government Performance and Results Act was enacted. It required at least 10 federal pilot projects to test strategic planning, annual performance plans and measurable outcomes. To date, more than 75 agencies are involved. The same act required all agencies beginning in 1997 to submit five-year strategic plans, to be updated each three years, and annual performance plans.[31]

The fact that all levels of government are experimenting with budgeting techniques reflects the shared need to improve and streamline programs. With widespread interest both in the United States and around the world in reforming budgeting techniques, it is not surprising that California would become involved. What is notable, however, is that the State -- with a history of being an aggressive leader, if not innovator, in reform movements -- has taken a cautious, small-step-at-a-time approach.

California

Enacted by both Executive Order of the Governor and statute in 1993, California has a performance-based budget pilot project that currently involves four departments: the Department of General Services, the Department of Parks and Recreation, the Department of Consumer Affairs and the California Conservation Corps. The Department of Finance provides oversight for the pilot project and is required to report to the Legislature on January 1, 1996 on the extent to which performance-based budgeting results in more cost-effective and innovative programs and services.

The departments in the pilot project are diverse in many respects, including size, areas of responsibility and types of programs. For

instance, the California Conservation Corps, with 415 employees and a $56.7 million budget, is tiny compared to the Department of General Services, with 3,740 employees and a $503.1 million budget. The Department of Consumer Affairs deals extensively with "clients" outside of state government (the people it regulates and the State's consumers), while the Department of General Services' activities are directed toward other state agencies. The Department of Parks and Recreation manages natural resources, while the California Conservation Corps focuses on training youths for productive lives.

The goal of the pilot project is to find more cost-effective ways to deliver government services through strategic planning, performance measurement and the budgetary decision-making process. The statute creating the pilot project lists nine elements that in general outline a program where departments will be given flexibility but in turn will be held accountable for results that are delineated in a contract each year between the Legislature and the department.

Each department has followed a fairly similar path of strategic planning (developing mission and goal statements), identifying measurable objectives and linking budgetary needs to program activities. As of mid-1995, each department had a strategic plan in place, as well as mechanisms for updating and revising the plans; each had established performance measurements and baseline data, although some were still being revised; and each had completed a budget contract with the Legislature. The contracts, however, focused on the flexibility that managers would be allowed and the achievements that would be pursued. The actual budgets adopted for each department for the 1995-96 fiscal year continued to reflect the line-item format used for all state departments.

Managers told the Little Hoover Commission that a lack of guidance from the Department of Finance, particularly in terms of standardized

California's Nine Principles

California's performance-based budgeting pilot program is guided by nine principles. As delineated in the Performance and Results Act of 1993 (Chapter 641), these are:

- ✓ Strategic planning is central.
- ✓ Outcome measures are the primary focus of management accountability
- ✓ Productivity benchmarks measure progress toward strategic goals.
- ✓ Performance budgeting may work in conjunction with total quality management, which emphasizes an orientation toward customer service and quality improvement.
- ✓ Budget contracts between the Legislature and the executive branch require departments to deliver specified outcomes for a specified level of resources.
- ✓ Budget contracts shall include evaluation criteria, and shall specify "gainsharing" provisions, in which 50 percent of savings resulting from innovation are reinvested in the program.
- ✓ Managers are provided sufficient operational flexibility to achieve stated outcomes.
- ✓ Legislative involvement is critical and is appropriately focused on strategic planning and performance outcomes.
- ✓ Innovation is rewarded, not punished.

processes and explicit expectations, has forced each department to struggle with a steep learning curve. The Legislative Analyst's Office particularly noted that there were no guidelines to help departments determine how to conduct budget negotiations with the Legislature, and that no common reporting formats or computer application standards had been set to facilitate the shift to a performance-based budget document.[32]

The Department of Finance, however, has maintained that since each department is so different an important part of the pilot project process is to allow each to develop separately with little constraint. In sharp contrast to enthusiastic advocates of performance-based budgeting who testified to the Commission and the leaders of state departments in the pilot project who uniformly said they saw positive changes in their operations, the Department of Finance sees performance-based budgeting as one in a long line of attempted reforms that has only limited applicability to state government. The Chief Deputy Director of the Department of Finance told the Commission:

> *We continue to believe that not all agencies are well suited to performance-based budgeting. Our focus should remain on those agencies whose services mirror the private sector and which have identifiable measures of performance. Some agencies administer programs for the federal government; they operate under rules that we do not control in California. Other agencies have mandated responsibilities that are not amenable to the level of discretion necessary for performance-based budgeting to succeed.*[33]

An expert from Texas, however, told the Commission that his state's overnight conversion to performance-based budgeting in all agencies has worked well for the most part. He said the factor that seems to determine whether the method will work for an agency is not the agency's mission or program constraints, but the degree of seriousness with which the agency approaches the process of strategic planning and measurement development.[34]

Similarly, the U.S. Senate counsel most closely connected to the federal experiment (and a former mayor of Sunnyvale) said that performance-based budgeting can work with any level of government and any type of program. He said an appropriate analogy is the difference between a 747 jet and a small single-engine plane; both fly under the same general principles of aerodynamics but each is designed and constructed differently.[35]

Both the Department of Finance and the Legislative Analyst's Office agree that the State has seen little tangible results from the pilot project so far, although departments have reported improved customer sensitivity. Departments have spent more than $5 million on the process of creating strategic plans and identifying performance measures, although some of that cost involves staff time that would

have been spent on budgeting activities regardless of the pilot project. Cost savings are not expected to accrue until departments have been able to implement the program fully -- and that is not expected to be before the January 1, 1996 reporting deadline.

While the results of the pilot project have yet to be assessed, policy makers have taken several actions to set the stage for the method's eventual expansion to other agencies.

In 1994, the State Government Strategic Planning and Performance Review Act (AB 2711, Chapter 799, Statutes of 1994) said that "strategic planning is a prerequisite for effective performance reviews and effective performance budgeting." The act requires the Department of Finance to survey annually state agencies regarding the status of their strategic plans and to recommend which ones should develop or update a plan. The act also requires the Controller, the Department of Finance and the Bureau of State Audits, in consultation with the Legislative Analyst, to develop a plan for conducting performance reviews of all state agencies.

In addition, executive orders and statutes have focused on total quality management programs and results-oriented processes. A total of 27 "Pioneer Projects" have brought total quality management techniques to state agencies under a 1993 executive order. A 1993 statute (SB 1082; Chapter 418, Statutes of 1993) requires Cal-EPA to develop a model quality program and to begin in 1998 submitting a yearly progress report on the achievement of performance objectives as part of the budget process.

Departments: Go For It

Although the Department of Finance does not see performance-based budgeting working for every agency, the departments in the pilot project have a different perspective. They told the Commission:

✓ **Department of Parks and Recreation:** *The Department of Parks and Recreation has complex programs...with numerous funding sources. It is our assessment that if the pilot is successful for [us], it can be used with all state departments.*

✓ **Department of Consumer Affairs:** *[We believe] that all state departments should be allowed to participate in performance-based budgeting once the pilots are complete. In fact, the process by which each department must develop performance and outcome measures may lead each department to examine the reason for its existence. Any process that requires government to refocus on its activities and the necessity for its existence is worthwhile in its application.*

✓ **California Conservation Corps:** *Regardless of whether the California pilot project is successful in changing the emphasis of budgeting from line-item expenditure control to the allocation of resources based on program goals and measured results, the CCC is evidence of how government departments can improve management by focusing on results and efficiency.*

✓ **Department of General Services:** *Performance budgeting offers a new way to achieve program accountability by replacing bureaucratic controls with documented accomplishments. Performance budgeting offers opportunities to show that public expenditures result in measurable benefits. Our experience to date suggests that successful performance budgeting requires the following capabilities and characteristics: leadership, project goals and evaluation criteria, resources, standards and rational consequences.*

Regardless of the eventual assessment of the performance-based budgeting pilot project, California clearly is moving away from traditional

top-down, command-and-control mechanisms for delivering state services. The following three chapters of findings examine the experience of those most familiar with the necessary steps to re-engineer government effectively and provide recommendations designed to speed the process and avoid missteps in California.

Flawed Process

- *California's line-item budget encourages policy makers to make automatic cuts or increases, rather than focusing on the quality of a program or the desirable level of service.*

- *Performance-based budgeting is particularly helpful in three ways:*

  - *Data comes in a format that makes it easier to re-assess priorities as conditions change.*

  - *It is a system that focuses on available revenue rather than on the funding gaps created when demands outstrip resources.*

  - *Program expectations are clearly stated and performance becomes the key factor in funding decisions.*

- *No system will make tough decisions automatically -- policy makers simply have more information on which to base choices in a performance system.*

Flawed Process

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.

Government budgeting experts agree that no system can make difficult choices on behalf of policy makers. Decisions must be made about how to meet the competing demands on state government, regardless of how data is presented and tracked. No system provides an "automatic pilot" for arriving at the proper balance of public expenditures. But it is widely acknowledged that some systems enhance the ability of policy makers to focus on pertinent data and make sound comparisons between programs, including their effectiveness and efficiency.

Most governmental entities use a budgeting system referred to interchangeably as line-item, baseline, current services or workload. The budget for a department under this system lists personnel, equipment, supplies, travel, training and other well-defined categories for how money is to be spent. An unrefined version of this type of budget makes no reference to the separate programs that may be operated by a department, the source of funding, the operational goals, the number of clients served or other information that sheds light on how money is used in a broad sense. Instead, it merely describes how money is spent.

California's Budget

California's budget has a long history of being more informative than a straightforward line-item budget. The 1949 federal Hoover Commission report acknowledged California as a leader in describing expenditures in terms of programs rather than departments.[36] This allows people to tell how much is being spent on specific groups of services rather than lumping the many operations of a single department together.

In the late 1970s, the push by "tax revolt" proponents to cut government waste prompted the Legislature to improve budget oversight and require more information on which to base decisions. One major bill, Chapter 1284 of the Statutes of 1978, put into place most of the recommendations from a study by Deloitte Haskins & Sells on the State's fiscal management. Among other things, the law required:

- The Department of Finance to operate an accounting system with expenditures by program, item, organization and fund source.
- The Governor to propose his budget in terms of programs rather than simply by department.
- Federal allocations to be incorporated in the budget as a source of funds by program.
- The Department of Finance to develop an online California Fiscal Information System to monitor the budget, forecast revenues and allow comparison of the affect of different spending choices -- and to provide access to the information to both the Legislature and the Administration.
- The Department of Finance to develop departmental performance measures for each state agency.[37]

Although several of the requirements were later modified, the statute substantially affected how the State's annual budget was presented. The box on the next page, which contains in abridged form all of the elements in the 1995-96 Governor's Budget for the California Conservation Corps, shows the range of information in the budget.

California Conservation Corps Budget
(Abridged Version from 1995-96 Governor's Budget)

The California Conservation Corps (CCC) assists federal, State and local agencies and nonprofit entities in conserving and improving California's natural resources while providing employment, training and educational opportunities for young men and women.

The CCC performs over 3 million hours of conservation work each year. In addition to tree planting, stream clearance, trail building, park development, landscaping, energy conservation, forest improvements, maintaining a native plant nursery and wildlife habitat restoration, the CCC responds to emergencies caused by fires, floods, earthquakes and other natural disasters. The annualized corps member population for 1995-96 is estimated to be 1,800.

Authority: Public Resources Code Section 14000

Summary of Program Requirements

	93-94	94-95	95-96
Personnel Equivalent Years	377.3	396.3	415.6
TOTALS	$54,230	$58,879	$56,702
General Fund	$26,938	$30,212	$27,503
Public Resources Account	226	234	234
Energy Resources Account	5,429	5,607	5,607
Collins-Dugan Fund	2,352	6,244	--
Petroleum Violation Account	--	--	2,088
Federal Trust Funds	1,160	1,892	1,000
Reimbursements	18,125	14,690	20,270

Program Objective and Description

The CCC hires California youth primarily between 18 and 23 years old who reflect the diversity of the State's population. The age range varies with grants and specially funded programs. As a general rule, the youth hired are not on probation or parole and are paid minimum wage. The mission of the CCC is to develop youth and enhance the State's natural resources. This is done through fostering an appreciation for the value of hard work and the importance of education. The work is varied, meaningful and productive. Statewide, there are 13 residential service districts, 1 nonresidential service district and more than 30 nonresidential satellites in urban and rural areas.

Major Budget Adjustments Included for 1994-95

- $264,000 from the Collins-Dugan Fund and three positions for the Northern California Bootstraps program.
- $3,345,000 to fund youth national service and learning programs (Americorps).
- $2,709,000 General Fund to provide funding for the CCC's settlement of a Fair Labor Standards Act lawsuit.
- $250,000 Federal Trust Fund increase to allow completion of three federal grant projects.

Major Budget Adjustments Proposed for 1995-96

- $2,088,000 from the Petroleum Violation Escrow Account, $706,000 in additional reimbursements and 18.5 positions for an expanded Southern California Energy, Water and Housing Center in Compton.
- Continuation of $3,345,000 from Americorps.
- $306,000 in reimbursements from the California Youth Authority to continue the Bootstraps program.

Program Budget Detail

Shows funding from separate sources for different programs

Summary by Object

Shows spending on personnel, operating expenses and equipment

Reconciliation with Appropriations

Shows a reconciliation of the appropriations by funding source

* ***All figures in thousands of dollars***

The elements in the budget include:

- An introductory paragraph about the department, followed by the statutory citation that provides authority for the program.

- A summary that tells how many people work for the department, how much money is spent and where the money comes from. All figures in the budget -- expressed in thousands of dollars -- are compared across three years: the actual prior year, the anticipated current year and the proposed next year.

- A statement about the program's objective and a description of how it operates.

- A listing of the major budget adjustments for the current year and those that would affect the proposed year.

- A detailed budget showing the total funding coming from separate sources and the different programs within the department that funding will be spent on, by source.

- A summary for the whole department showing how much will be spent on personnel salaries and benefits, operating expenses and equipment.

- A reconciliation of the appropriations by funding source.

California's budget, then, displays a broad range of information. But all of it is information relating to what a program is expected to do -- not what it has actually accomplished. It is full of "inputs" (number of personnel, amounts to be spent on salaries, benefits, equipment, etc.) and not "outcomes."

In addition, like all line-item budgets, it encourages policy makers to make automatic cuts or increases -- rather than focusing on the quality or level of service being funded -- since there is no information that would allow such a judgment. The Governor's Budget Summary for 1993-94 described the exercise the administration goes through to propose the next year's budget:

> *The Executive Branch phase of this process begins by developing a workload budget for each program for the upcoming fiscal year. The workload budget is calculated by adjusting the program's authorized level of spending in the current fiscal year for one-time costs, increases in the cost of operations, implementation of new legislation and for additional workload anticipated under current law.*[38]

None of this exercise involves determining how well a program has performed and making some assessment of whether the program should continue. In writing about the problems with traditional budgeting, the

National Conference of State Legislatures agreed that the focus on line items leads to an incremental approach.

> *Incremental budgeting assumes that past decisions remain appropriate and would not typically be subject to major revision. Incremental budgeting does not easily allow a state to shift large sums of money from existing programs to more pressing needs.*[39]

In testimony to the Commission, the Department of Finance said that such an approach to budgeting works when revenues are growing but:

...it fails when revenues are shrinking because it builds false expectations by calculating a program's "entitlement" and then failing to fund the program to that level. The result is to create "funding gaps" which pit one program against another to see which program can fill more of its gap. The losers are the people of California. In the environment of today's realities, we need a new budget process that shifts from a focus on expenditures to a focus on available revenues. In this new budget paradigm, the most important question becomes, "What is the best program I can deliver for the funds that are available?"[40]

Because the current process builds on prior budgets, new and innovative programs often get squeezed out with little consideration. The revenues that exist beyond that needed to cover workload increases in existing programs are the only source of funding for new concepts. When resources are not expanding, earmarking funding for one program, either new or old, often means cutting another. Competition among programs for limited dollars creates countervailing pressures on policy makers that are easiest to avoid by across-the-board cuts that ignore issues like performance, quality and need.

Backers of Budget Reform

Many groups outside of government recognize the value of revamping California's budgeting mechanism:

✓ **California Business-Higher Education Forum:** *State and local governments should expand their use of performance budgeting, working to establish goals and benchmarks consistent with an evaluation of the outputs of government rather than the traditional focus on inputs. ...Budgeting based on performance results is a much tighter coupling of program success and budget allocation than is possible when using the traditional line-item budget process.*

✓ **California Taxpayers Association:** *Moving a political mountain is what we are talking about in discussing priority budgeting and trashing the traditional current services approach. Call it a priority budget if you like, or a resources budget, because growth is determined by a limited amount of revenue divided among priority programs.*

✓ **California Policy Seminar:** *The state needs to refocus policy development and evaluation on outcomes....Even if we can't guarantee that we have precise performance measures, we should rely on the current state-of-the-art to enhance that approach....Clearing up lines of responsibility tied to outcome performance measures would help to restore public confidence in government.*

Summing up the problems with the workload budget concept, the Governor's Budget Summary for 1993-94 said:

> *The process of developing a workload budget has created unrealistic expectations among department managers and employees, elected officials and program recipients that the current level of service is an entitlement that can be continued without regard to the State's fiscal condition. It makes no allowance at all for productivity or quality improvements. It places too much emphasis on the level of funding promised to each program, and too little emphasis on program performance. Finally, it has relegated the development of the budget to a technical calculation of desired levels of funding, when the budget should instead be a tool for improving program management.*[41]

Frustration with the current system goes beyond the state bureaucrats and policy makers struggling to make it work. The California Business-Higher Education Forum, the California Taxpayer's Association and the California Policy Seminar have all issued statements backing the performance-based budgeting concepts.[42]

In addition, experts from other governmental jurisdictions that are at various stages of making performance-based budgeting work uniformly praise it as a much-needed improvement over traditional budgeting. The following sections provide their observations and advice, as well as samples of their budgeting techniques.

Sunnyvale

Sunnyvale's budget document is rich in information, ranging from past trends in performance to current statistics on the unit cost of different activities and targets for future performance. Organized by function rather than department (for instance, solid waste disposal rather than the Department of Public Works), the budget reflects increased productivity over time and captures the return on innovative program management.

Perhaps the most striking aspect of the city's budget is the long list of performance indicators -- the measurements that tell what is being achieved by the city's programs and services. The ones in the box on the next page deal with solid waste disposal, but there are many other examples: having fewer than 10 complaints about telephone information services; repairing damage from vandalism within three days; successfully assisting on library information requests 95 percent of the time; responding to police emergency calls in 5.6 minutes or less 90 percent of the time; maintaining files so they can be retrieved within five minutes 85 percent of the time; and getting positive survey results from recreational customers 90 percent of the time.[43]

If such measurements are rare in most governments, they are the heart of Sunnyvale's intensively monitored system. It is a system that has allowed the city to focus on its goals even in times of declining

revenues. The Sunnyvale city manager says that performance-based budgeting allows government to accomplish three things:

- A clear articulation of the purpose for which funds are appropriated, which in turn assures that the funds are being spent for the "right thing."
- The enhanced ability to provide oversight and proper management of services.
- An improvement in the quality and efficiency of service delivery.

By focusing on outcomes and desirable objectives, policy makers not only give better guidance to those who are managing the programs but they also free themselves from being concerned about issues that are irrelevant to their goals. The city manager told the Commission:

Traditional approaches to governmental budgeting often are criticized for being micro-managed, with policy leaders involved in day-to-day administration, establishing numerous prescriptive rules as to how to get the job done. In the case of Sunnyvale, those deterrents to the provision of economic and quality services have largely been done away with. We have found that when policy leaders know that they are responsible for the clear articulation of the level and quality of services to be provided and when they receive frequent feedback on what was actually accomplished, that they no longer feel the necessity of micromanaging, and as a result responsible

Sunnyvale Solid Waste Disposal

This partial listing from Sunnyvale's budget for its solid waste disposal system shows the type of information the budget provides.

Solid Waste Disposal System

To ensure safe and effective collection and disposal of all Class 3 solid wastes generated within the city.

Program-wide objective: Collect and dispose of 175,800 tons of solid waste at a cost of $83.31 per ton. Also collect and process recyclable materials from 28,000 houses at a cost of $11.81 per unit.

Objective: Provide recycling collection to 28,000 homes on a weekly basis at least 99% of the time.

Number of pickups	350,000
Unit cost	.74
Hours	10,125
Cost	$257,449

Objective: Process all incoming recyclable materials within 5 working days of receipt 90% of the time.

Tons processed	7,100
Unit cost	5.68
Hours	1,575
Cost	$40,304

Objective: Perform administrative and support services.

Work hours	5,981
Unit cost	30.67
Cost	$183,434

Performance Indicator Statement

Percent of collections performed as scheduled	100%
Percent of time recyclables processed in 5 days	100%
Gallons of motor oil collected per week	588
Pounds of newspaper collected per week	127,648

Budget Program Totals by Account

Salaries	$242,353
Contracts	209,584
General supplies	11,440
Postage	11,837
Taxes and licenses	258,336
Refuse collection	7,422,540
Franchise fees	371,125
Payments to landfills	1,975,449
Consulting services	579,020
Fleet rental	93,154
Other (detailed in budget)	285,747
TOTAL	$11,460,576

management and line personnel have greater freedom to focus on results.[44]

One key aspect of the Sunnyvale system that is atypical of government is that management is on a pay-for-performance system. Managers are evaluated based on their ability to meet the goals set in the budget document. Those who succeed earn bonuses of up to 10 percent while those who fail may face a reduction of 5 percent in their pay (and this sanction has been used, according to the city manager, although managers with a pattern of under-performing usually do not stay with the city). Because Sunnyvale emphasizes achieving specified levels of service more efficiently, managers are rewarded more for meeting the objective at a lower cost than for exceeding the objective at the budgeted amount.

Another aspect of the Sunnyvale system is the constant accountability. Managers receive monthly reports on performance in relationship to goals. The city manager told the Commission that such constant reminders that performance is expected is alien to many people in public service and that some have a tough time adjusting. But many flower in an atmosphere that not only allows them to be creative but also rewards them for innovation and success. Because of the city's commitment to training and shifting employees to new areas rather than laying them off when changes are made, employees and their unions in general are supportive of the system.

Even with a system that is being lauded and studied internationally, Sunnyvale is not content to rest on its laurels. The city manager told the Commission that the city is now evolving into a system that focuses on "high-level outcomes." For instance, instead of measuring the time it takes to respond to police calls, the city is exploring ways to objectively measure activities that lead to reduction in crime.

> *There seems to be a trend emerging at higher levels of government to focus on overall outcomes as opposed to the details of defining specific services, which are often output based. The City of Sunnyvale, recognizing the value of high-level, but still measurable, outcome statements, is now moving to a major refinement of its historical performance budgeting approach to the development of high-level outcomes. In spite of the success we have enjoyed under the past framework, we are finding new opportunities to better focus scarce resources, as well as to clarify what results government should be attempting to accomplish.*[45]

Thus, Sunnyvale is committed to continuing to refine its process and, if necessary, move in new directions -- even after more than 15 years of performance-based budgeting. The city manager said the one lesson the city has learned is that change takes time, but patience as the system evolves is critical.

> *Performance-based budgeting and management takes time. It is not a quick fix. Its results evolve over time. It should be viewed as a framework and theoretical construct rather than a new fad, and therefore requires perseverance at both the political and executive level so that its full capabilities are allowed to grow and emerge rather than any expectation that it will be judged an instantaneous success or failure.*[46]

The need for patience has also been stressed by others with experience in performance-based budgeting, including those who are running the system in a governmental jurisdiction that far surpasses Sunnyvale in size and complexity: Texas.

Texas

Unlike California, which is edging into performance-based budgeting with a largely unstructured pilot project, Texas has whole-heartedly embraced the new system, taking a top-down approach. While Sunnyvale's emphasis is on performance indicators and well-defined unit costs, Texas has concentrated on strategic planning. In 1992, the then-Governor published *Texas Tomorrow*, laying out the statewide vision, philosophy and mission that would become the foundation for the marching orders to individual state agencies to define their own missions, philosophies, goals, objectives and strategies.

The state's vision, philosophy and mission read:

We envision a Texas where all people have the skills and opportunities they need to achieve their individual dreams; a Texas where people enjoy good health, are safe and secure from

The Texas Tornado

Texas has a strategic planning template shaped like an inverted pyramid -- colloquially known as the Texas Tornado. The state sets the overall vision and functional goals. Agencies set their own missions, philosophies, goals, objectives and measures. The following is an excerpt from a budget request by the Department of Environmental Quality:

***Goal* | Objective** | Strategy

Improve air quality in Texas	
Reduce air pollutants to fed standards by 1988	
Implement EPA ozone policy	$11,125,000
Enforce local air quality programs	250,000
Reduce toxic emissions by 40% 1990-1998	
Implement comprehensive program	5,000,000
By 1998, analyze 90% of potential cases of toxic chemical exposure through air pollution	
Conduct studies of exposure	1,200,000
TOTAL GOAL 1	$17,575,000

Improve air quality in Texas	
Reduce air pollutants to fed standards by 1988	
Percent of Texans where standards met	77%
Reduce toxic emissions by 40% 1990-1998	
Percent reduction from 1990 levels	13%
By 1988, analyze 90% of potential cases of toxic chemical exposure through air pollution	
Percent of cases analyzed	37%

Administrative and Support Cost for Whole Department	
Central Admin (personnel, operating, capital)	1,500,000
Financial and Personnel Services	296,000
Information Resource Technologies	1,300,000
Operating/Support	780,000
TOTAL	3,876,000
Administrative/Support Cost by Strategy	
Implement EPA ozone policy	$1,642,040
Enforce local air quality programs	37,760
Implement air toxics program	566,400
Conduct studies of toxic exposure	75,520
TOTAL admin/support for GOAL 1	2,321,720

harm and share a quality standard of living; a Texas where we and future generations can enjoy our bountiful natural beauty and resources.

Public service is a public trust. As public servants we take pride in the service we provide for our fellow citizens. We will be open, ethical, responsive, accountable and dedicated to the public we serve -- providing legendary customer service. We will foster a working environment free of bias and respectful of the individual. We will operate efficiently and spend the public's money wisely.

The mission of Texas state government is:

- *to provide educational opportunities for all its people;*
- *to protect and enhance the health, well-being and productivity of all Texans;*
- *to preserve the state's environment, and ensure wise, productive use of the state's natural resources;*
- *to build a solid foundation for social and economic prosperity; and*
- *to ensure the safety of our communities.*[47]

Each of the mission statements has several goals, each of which is accompanied by a list of key indicators of success. For instance, one of the goals for the mission of building a solid foundation for social and economic prosperity is: "The Texas economy will be diversified and healthy, creating and retaining the jobs needed for a prosperous Texas." Key indicators for success under this goal include: the Texas employment rate, median household income, net number of new jobs created, net number of start-up businesses, and economic diversity as measured by the percentage of jobs outside of the state's five largest industries.

Another goal under the same mission is: "Our communities will be socially prosperous." Key indicators of success include: percentage of Texans with access to affordable housing, home and auto insurance cost as a percentage of median household income, percentage of Texans with access to public transportation, number of civil rights/harassment violations per 10,000 Texans, and percentage of state professional licensee population without documented complaints.[48]

Working within these state-set missions and goals, each Texas department determines a set of objectives and outcome measurements and then puts in place a strategy to meet the measurement levels specified in the budget. For instance, the Texas Commission for the Blind has several objectives, including increasing by 6 percent by 1995 the number of blind people who meet their independent living goals and to increase by 7 percent the number of children who reach their habilitative goals. Related strategies are to provide a statewide program for developing independent living skills and to provide services to all blind and visually impaired children.

A senior budget analyst for Texas told the Commission the system is holding up well as the state moves into the second two-year budget cycle using performance measures. Policy makers who scoffed at the concept that the new system could make a difference are now converts to the process, he said. Among the lessons he identified that Texas has learned and can share with others are:

- Involve everyone, instilling a sense of ownership through orientation, training, information sharing and active solicitation of ideas. "Everyone" includes elected officials, department heads, managers, line employees, service populations, non-profits, community groups, local units of government, business, labor and the media.

- Be flexible and patient. "The job is never done. This is a long-term (10 years?) iterative process centered around continuous learning and continuous improvement."

- Create incentives, not just disincentives. Reward genuine participation by departments with additional operational flexibility, public recognition and relief from reporting requirements. In the long run, rewards should include increased appropriations and pay for performance.

- Report, regularly and publicly, about the results with easy-to-read formats.

- "Think of this as not just another system or a new process, but rather as a revolution in thinking, attitudes and emphasis."[49]

Indianapolis Parks and Recreation

Indy Parks has three missions: providing quality programs, providing leisure opportunities and developing park resources. Excerpts from their budget:

Budget summary by external outcome	
Provide quality programs	$12,160,189
Provide leisure opportunities	6,124,965
Develop park resources	4,733,861
TOTAL for whole department	$23,019,015

Policy Goal: Strong neighborhoods
External Outcome: Provide quality park facilities and areas
The quality of Indianapolis neighborhoods is enhanced by well-built and maintained parks and facilities. A pleasant environment increases the attendance and adds to overall positive experiences.

Regional Attractions	$4,282,691
Non-tax revenue per $1 expended	.80
Percent prime-time use	75%
Percent non-prime-time use	50%
Percent of surveys showing satisfaction or better	86%
Percent of critical indicators met	90%
Number of active partnerships	20
Percent reduction in vandalism incidents	25%
Average time in minutes for ranger response	15
Magnet Parks	$4,217,832
Neighborhood Parks	$3,659,666
TOTAL for providing quality programs	$12,160,189

Operating Budget for Providing Quality Parks	
Personal Services	$6,708,491
Supplies	926,327
Other	4,381,452
Capital	143,919
TOTAL for providing quality programs	$12,160,189

Indianapolis, Palo Alto

Examples of budgets on this page and the next from Indianapolis and Palo Alto demonstrate again the level of information that a

performance-based system provides. The Indianapolis budget -- a document that the mid-western city uses more for public information sharing than for policy decisions -- concentrates on missions, policy goals and external outcomes that demonstrate the goals are being met. Appropriations are delineated according to both mission and operating expenses.

Palo Alto's new budget, which is an initial, untested system for the San Francisco Bay Area city, divides up departments by function and describes the major activities related to each function. The impact measures set the goals for performance and, once baseline data is established, will demonstrate the trends over time. Other portions of the budget not shown here detail the numbers and type of personnel involved in each activity and provide a summary of the reasons for proposed funding changes.

Benefits and Pitfalls

The message from those who have studied performance-based budgeting and those who are using it is that it is particularly useful in at least three ways for policy makers:

- It provides data in a format that makes it easier to re-assess priorities as conditions change instead of merely duplicating the past.
- It is a system that focuses on available revenue and how to divide those funds rather than on "funding gaps" that are created when allowing automatic program growth causes demands to outstrip expected resources.
- It makes performance a key factor in funding decisions and provides a clear statement of program expectations.

Palo Alto Public Works

Excerpts from the City of Palo Alto's new mission-drive budget for the Department of Public Works:

Department Summary	
Streets	$3,198,697
Sidewalks	496,047
Trees	1,520,010
Structures & Grounds	3,691,203
Private Development	406,764
TOTAL EXPENDITURES	$9,312,720
FULL-TIME POSITIONS	76.88
TOTAL DEPARTMENT REVENUE	$1,867,276
Major Activity: Streets -- In-House Maintenance	
To maximize the useful life of streets through effective repairs	
Salaries, benefits	$366,680
Non-salaries	230,514
Allocated expenses	758,519
TOTAL EXPENDITURES	$1,355,713
FULL-TIME POSITIONS	6.43
Impact measures	
Repair potholes within 5 working days	85%
Respond to bicycle path maintenance requests within 5 days	95%
Major Activity: Trees -- In-House Maintenance	
To provide for healthy trees and public safety through quality and specialty activities, including ornamental trimming, watering, etc.	
Salaries, benefits	$407,368
Non-salaries	135,800
Allocated expenses	225,219
TOTAL EXPENDITURES	$768,387
FULL-TIME POSITIONS	8.00
Impact measures	
Annually trim, prune City trees	10%
Respond to emergency requests within 8 hours	80%
Contain controllable infestations within 90 days	80%

Converting to a performance-based budgeting system, however, is not easy. Among the potential pitfalls outlined by experts are:

- ***Delayed gratification:*** As noted by Commission witnesses from Sunnyvale and Texas, perfecting a performance-based budgeting system takes time and missteps are likely to occur along the way. The department managers in California's pilot project are already aware of the pressures they face to produce results. The Department of Parks and Recreation told the Commission, "Results have been expected on a time frame which is difficult to produce considering the rather monumental undertaking of changing California's budgetary process. It will not be the failure of the pilot, but the failure of government to accept or allow the pilot's success that will be the ultimate barrier to the project."[50]

- ***Silver-bullet syndrome:*** Those who believe a new system will fix government funding crises will be disappointed in performance-based budgeting because it is not a silver bullet that can perform miracles. Said one experienced analyst from Mississippi: "Budget reform will not prevent revenue shortfalls. It will not eliminate budget cuts. It will not allow more spending. And it will not totally eliminate structural deficit problems. What it will do is greatly improve preparations for revenue shortfalls."[51] Another expert wrote, "Performance budgets, program budgets and zero-base budgets all try to increase the rationality of budget choices. None provide the complete solution to the budget problem -- it is wrong to expect any system to provide judgments that must be made by people."[52] Tough decisions still will need to be made, but they can be made with more information than before with a performance-based system.

  In addition, simply setting performance goals does not mean departments will be able to achieve them. Wrote California's Legislative Analyst, "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 classifications, or conflicting objectives."[53]

- ***Lack of consensus:*** There are many key players who can make the budgeting process work -- or turn it into a futile paper exercise. These include the elected officials who propose the budget, the policy makers who adopt it and the bureaucrats who use it daily. Failure on the part of any one of these players to embrace performance-based budgeting diminishes the value of the new system. This has been particularly evident in Florida, where legislators over a several-year span have created audit units, evaluation committees and requirements for agency

strategic plans -- but lack of follow-through and funding have kept these reforms from being effective.[54]

Support outside of government is important, too, for maintaining consensus once it is achieved; one Texas expert told the Commission that getting the media to understand the system and write about it knowledgeably is important.[55]

Summing up its review of six states, the U.S. General Accounting Office found that achieving consensus is critical: "The experiences of the state reforms that we examined as part of this review continued to underscore the importance of the executive and legislative branch officials working together and the damage to performance budgeting reforms when strong working relationships were not established."[56]

- ***Turf concerns:*** Change does not come easily to organizations, especially when power has been shaped and institutionalized over time. Performance-based budgeting does not allow business as usual. When implemented properly, it forces policy makers to let go of line-item control in return for promised results in meeting specific goals; it holds bureaucrats accountable for outcomes, not simply for spending money in specific categories; and it pushes politics and ideology to one side by assuring that everyone has the same base of credible facts about actual performance on which to make decisions.

  Few are comfortable with the wholesale changes needed in such a reform. Most experts recognize that strong, effective, visible and committed leadership from the top is critical whenever an organization seeks cultural change in the way it does business. This is no less true in government than in the private sector -- and in fact becomes more important because there is no profit motive to help drive change.

Setting Up for Success

Avoiding the potential pitfalls is not easy. California's past experience with budget reforms demonstrates that lack of follow-through and institutional resistance can sidetrack the most well-intended reforms -- and patience has never been a hallmark of the State's political process.

One example of prior failed reforms is the State's brush with zero-based budgeting. Chapter 503 of the Statutes of 1979 established a form of zero-based budgeting, requiring a review of all department budgets over a four-year period. The implementation, however, was first delayed and then eventually sidetracked by incorporating it into a simple paperwork process that had little effect on legislative decision-making. Assessing the impact of the law, a Senate analyst wrote, "[The Department of Finance] has been able to impair a thorough review of the budget base

by essentially going through a minimal paperwork effort to meet the minimum requirements of law."[57]

Similarly the major reforms of 1978 discussed earlier (the development of an on-line computer information system, performance measures, etc.) were never fully implemented. In the midst of what was supposed to be a 7- to 10-year implementation schedule, policy makers decided that the law's goals were being met and -- at the request of the Department of Finance -- enacted Chapter 1286 of the Statutes of 1984 to change some of the original requirements. Among other things, the new law deleted the requirement for the development of performance measures and said that using a program format for the budget was no longer mandatory. A Senate overview of the budget process concluded:

> *While the bulk of the budget was retained on a program basis, the authority of the Legislature was seriously weakened. What began as a serious effort to improve the budget capabilities of the Legislature was usurped by the Executive [Branch]. Ironically, the administration made the greatest use of this effort by improving its own internal operations. The Legislature did not maintain proper oversight and lost this opportunity to produce an integrated, on-line fiscal information system.*[58]

The same overview found that the Legislature does not spend enough time determining the effectiveness of current programs, instead concentrating on writing new laws.

Writing about the performance-based budgeting pilot project, the Legislative Analyst said that the Legislature will need to change its general perspective if reform is to be productive. Her report said that the Legislature will need to relinquish some controls over departments and programs, will need to focus on program mission, goals and outcomes rather than inputs and processes, and must be willing to accept long-term views of implementation and results. The offsetting benefit the Legislature can expect to reap is greater control through being in charge of policy rather than process.[59]

If the Legislature needs to change, the need is no less so in the Executive Branch. The tentative nature of support and lack of helpful guidelines from the Department of Finance has slowed the pilot project's progress, according to the participants. The Department of General Services produced for the Commission a laundry list of prerequisites for success if performance-based budgeting is to spread throughout all state agencies. The list included the need for functional guidelines (as opposed to "cookie-cutter requirements") for setting benchmarks and objectives, creating strategic plans, and reporting accomplishments. The Department also said the pilot project itself should be subject to well-defined measurable goals and criteria for evaluating its success or failure.[60]

The history of past reform efforts in California and elsewhere is not encouraging except in the lessons that may be learned. Minnesota's legislative auditor could have been writing about California when he concluded, "For the most part, these reforms did not outlive the administrations that proposed them. Their failures demonstrate that, for budget reforms to succeed, there must be a shared commitment to the objectives of budget reform within the executive branch and between the executive and legislative branches."[61]

California's start in the direction of performance-based budgeting has been slow, but the prognosis for successful budget reform can be influenced by the combined efforts of leaders, policy makers and program managers to make the new system work.

Recommendations

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.

In addition, the Legislature is well positioned to make the benefits of the new system available to the public. At a time when the public continues to demand more services while refusing to pay higher taxes, it is critical that citizens be made aware of exactly what their tax dollars are purchasing. Shifting to results-oriented accountability for government programs can be a powerful tool for restoring public confidence in the public sector's ability to provide quality service. The Legislature can play a key role in ensuring that performance results are made public in an understandable and useful way.

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.

In addition, when the Governor presents his proposed 1996-97 budget in January 1996, the pilot project department budgets should be in a performance-based format, such as that used by Texas or Sunnyvale, rather than the traditional format used for all agencies. This will help make the progress already made by pilot project departments toward accountability and measured achievements evident to the policy makers and the public.

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.

Measuring Up

- *It is easy to count the number of employees working on a program, the amount of paper they use and the square footage they occupy -- these are inputs.*

- *It is not much harder to count the number of people served, the number of applications processed and the number of hours spent on a task -- these are outputs.*

- *Measuring outcomes is valuable but tricky. Pick the wrong thing to measure and efforts will be focused in the wrong direction. Results may be too far into the future or too non-concrete to quantify.*

- *Setting overall goals -- or benchmarks, as Oregon calls them -- is a first step to identifying what needs to be measured.*

  - *Oregon set its goals with a bottom-up approach of public meetings and grass-roots involvement.*

  - *Texas set its goals with a top-down approach in a directive from the Governor and the Legislature.*

  - *California is letting each department set its own goals independently.*

Measuring Up

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.

Government, of course, already measures many things. As the authors of *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* write:

> *People in government are always counting something or churning out some statistical report. But most of this counting is focused on inputs: how much is spent, how many people are served, what service each person received. Very seldom does it focus on outcomes, on results.*
>
> *This is true in part because measuring is so difficult. Measuring profit in business is fairly straightforward. Measuring results in government is not. Normally it takes years to develop adequate measures; an agency's first attempt often falls woefully short. It may measure only outputs, not outcomes. It may define outcomes too narrowly, driving employees to concentrate on only a few of the results the organization actually wants to achieve. It may develop so many measures that employees can't tell what to concentrate on.*[62]

The following sections of this finding discuss the types of measurements that are needed for performance-based budgeting to work, summarize the difficulties that may arise as departments seek to identify the correct measurements and highlight the value that adequate measuring brings to government programs. Boxes on the following pages give examples of measurements and targets being used by different levels of government, including three of the four California pilot project departments.

Definitions

Experts on performance-based budgeting generally use four terms to define different types of measurements:

- ***Inputs*** are the elements that go into a program. They include the number of staff, the amount of supplies, the hours worked, etc. Typically, traditional budgeting defines allocations by inputs.

- ***Outputs*** are the volume of work produced. This includes things like how many applications are processed, how many hours of service are delivered and how many miles of road are repaired. Although not part of traditional budgeting usually, these factors are often easily counted and the information may be supplied to policy makers outside of the budget document.

- ***Outcomes*** are a higher-level of assessment that looks at the quality or effectiveness of what is produced. Included are questions like did the training result in a person obtaining a permanent job, did the service help the disadvantaged person live independently longer than he would have otherwise, and did the creation of summer recreation programs reduce juvenile crime.

- ***Efficiency*** measures tell what the cost per unit of output or the cost to achieve a specific outcome is. Even when a program is

having the desired outcome, it is desirable that it still improve its performance by increasing efficiency and lowering cost.[63]

Although outcomes are the key focus of budget reform enthusiasts, there is some level of academic debate about what needs to be measured -- and the answer appears to be a mix of each type of data. Critics of input-measuring systems argue that service providers become caught up in the processes of a program rather than in what is actually provided to people. But those who question the outcome-only approach to measuring worry that process will be completely ignored in the rush to count positive outcomes, which may result in more difficult cases being ignored. A report on the best way to provide job training identified a middle ground:

A third view is that neither of these two approaches works well alone. Advocates of this position argue that outcome-based accountability is the single most important mechanism for improving quality and efficiency in service delivery, but that higher level outcomes cannot be achieved without a concurrent emphasis on promoting continuous improvement in the way all service delivery and support processes are carried out throughout the system. They urge implementing outcome-based accountability systems in which there are real consequences for poor performance and using more traditional input-driven processes to promote the adoption of continuous quality improvement processes.[64]

United Kingdom Commitments

Under the Citizen's Charter, the United Kingdom has been committed to a 10-year program to improve government service since 1991. The government regularly publishes an update on what it has promised, what has been accomplished and what future steps will be taken. Excerpts of some of the promises and achievements:

Promised	Achieved
90.5% next-day mail delivery	91.9%
96% of customers to be served in 5 minutes	96%
Benefits Agency to achieve an 85% customer satisfaction rating	82%
Inland Revenue to see callers within 15 minutes	93%
Inland Revenue to answer letters within 28 days	99%
Customs and Excise to reply to written requests within 10 days	90%
Prosecution witnesses should be called to testify within two hours	42%
Witness expenses to be paid within 5-10 days	79%
Weather forecasters to achieve 83% accuracy in 24-hour forecasts	84%
Search and Rescue to respond promptly 95% of the time	95%

A mixture of types of measurements is evident in most of the jurisdictions using performance measuring. The United Kingdom, for instance, publishes a varied list of goals and accomplishments that include outputs, outcomes and efficiency measures.

Regardless of what is being measured, it is important to carefully design the instrument that is used. California's Legislative Analyst identified five key ingredients for designing performance measures that will work well:

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.[65]

The Texas list for what makes a good measure also covers relevance, reliability and ability to capture complexity -- and adds "cost effective:" The data must be of sufficient value to justify the cost of producing and tracking it. A Texas report added:

Performance measures can neither resolve program difficulties nor ensure program success, but can indicate whether either condition is occurring. They cannot account for the impact of all factors affecting program outcomes but do reflect the composite effects of external and internal influences.[66]

The neutrality of measurements is most evident in *Oregon Benchmarks*, a publication that is nationally acknowledged as a leader in setting standards and measurement criteria. The document contains no strategies for achieving goals, no prescription for changing the conditions described, no reasons for the existence of the problems quantified. Instead, it is a compilation of data about existing conditions and targets for what government programs should achieve in a variety of quality-of-life areas. Oregon's state departments are expected to design their programs and their own accountability measurements around the expectations set in *Oregon Benchmarks*. The benchmarks are derived from community meetings and policy maker input by a permanent state commission.

Oregon's Benchmarks

Each two years, Oregon updates its set of benchmarks, a well-defined list of what the state wants to accomplish to provide a high quality of life for its citizens. State departments are expected to gear their efforts toward making the benchmark targets a reality. Among the 272 benchmarks set by the state are:

	1992	2000	2010
Pregnancy per 1,000 females 10-17	19.3	8.0	8.0
Babies born drug-free	n/a	99%	100%
Teens drug-free previous month	80%	98%	99%
Child care facilities meeting basic standards	23%	100%	100%
Oregonians with economic access to health care	85%	100%	100%
Oregonians living where air meets fed standards	50%	100%	100%
Homeowners spending less than 30% on housing	49%	84%	92%
Reincarceration rate for parolees within 3 years of release	41%	20%	15%
Hate crimes per 100,000 people	19.2	2	0
11th graders proficient in math, reading	66%	n/a	99%
Areas where wild salmon and steelhead are increasing	25%	88%	100%
% who think Oregon is doing a good job providing service	32%	75%	90%

As many managers have discovered, the difficult part is not setting targets but in knowing what data to capture to achieve relevant measures. A Florida analyst writes:

Developing good performance measures that actually assess whether a program is achieving the desired outcome is difficult in any environment, but is even more demanding in the public sector where many activities are not susceptible to quantification. There is also a danger that the adoption of a performance measurement system will provide agencies with the perverse incentive of measuring those activities that the agency can easily achieve while neglecting measurement of meaningful activities that promote the agency's mission. Agency staff may also resist a performance measurement system due to fear that the system will hold them accountable for outcomes that are beyond their ability to control or subject only to limited control.[67]

These are not the only hurdles to building a performance-based system. Some of the stumbling blocks include difficulty in deciding what to measure, unintended consequences from picking certain measures, at what level standards should be set and how many measurements are needed.

Difficult Decisions

It is easy to count the number of employees working on a program, the amount of paper they use annually and the volume of applications they process (inputs). It is not much more difficult to determine the number of people they provide service to and the number of hours spent in providing service (outputs). However, if a program is narrow in function but has broad policy goals it may be difficult to determine how to measure the outcome. For instance, providing eligible families with vouchers to pay security deposits on rental units is a specific function with the broad policy goal of reducing homelessness. But the outcome of the program may not be

California Department of Parks and Recreation

The Department of Parks and Recreation has set up a hierarchy of goals (customer service, resource preservation, financial responsibility and organizational efficiency), each with its own set of strategies and measurements. Some examples:

Goal: Customer Service

Strategy: Establish high-quality visitor facilities

Indicator of Success: Maintain 918 miles of surface roads at a rating of 70 on the repairs index

95-96 Target: Maintain 918 miles of surface roads at a rating of 61.7 on the repairs index under proposed funding level

Equipment	$ 250,000
Cat I	950,000
Cat II	2,200,000
TOTAL	$3,400,000

Goal: Resource preservation

Strategy: Protect resources from threats

Indicator of Success: Reintroduction of fire into natural ecological processes

95-96 Target: Prescribed burning will be applied to 3,500 acres of parklands and a cost-per-acre baseline structure for future outcome measures will be developed

Goal: Financial Responsibility

Strategy: Establish revenue generating opportunities

Indicator of Success: Increase revenue from leases

95-96 Target: Generate an increase of 3% on gross sales from 94-95 total of $52.35 million for an additional $1.5 million in revenue from leases

clear until the family has avoided homelessness for an undetermined length of time.

The problem of what to measure becomes more difficult with programs that defy quantification. Government programs that involve research often yield results sporadically or only over long periods of time. Emergency readiness programs, such as the Office of Emergency Services, may show low measures of achievement except when the need arises for the specific services. The consulting firm Price Waterhouse says it is important to avoid thinking that:

> *If it can't be counted, then it doesn't count. Due to the complex nature of many programs and organizations, developing quantitative performance measures is challenging, if not impossible. An over-emphasis on quantification often drives out important qualitative measures of effectiveness.*[68]

Osborne and Gaebler agree in *Reinventing Government* that some valuable results are impossible to quantify. They advocate doing both quantitative and qualitative analysis, adding that over-reliance on numbers may prompt employees to "game" the numbers. Price Waterhouse puts it bluntly: If the numbers do not look good, there may be a tendency to simply change the numbers. For instance, if an agency is held accountable for how many complaint cases it closes, it may go to any lengths to close a case regardless of the quality of the outcome. Or if an application must be processed within a certain amount of time, then applications are rejected as incomplete for minor errors so that the time clock can start again when the person reapplies.

Department of Consumer Affairs

The Department of Consumer Affairs has created a grid that addresses four functions -- licensing, consumer information, mediation and enforcement -- with three sets of measurements. The measurements are speed/volume, quality and cost. An excerpt from the grid:

	Licensing
Speed/Volume	Average time to process new license
	Average time to process renewal
Quality	Customer satisfaction
	Percent of applicants denied license
	Exam pass rate
Cost	Average cost to process new license
	Average cost to process renewal
	Mediation
Speed/Volume	Average time to mediate complaint
	Number of complaints received
	Complaints referred to enforcement
Quality	Customer satisfaction
	% of cases resulting in compensation
	Complaints resolved as a % of closed
Cost	Average cost per complaint closed

The unintended consequences that can arise from choosing measurements can skew the results of a program. Osborne and Gaebler present the example of job training programs that concentrated on placing well-qualified people in jobs because it was easier and allowed them to meet their contractual obligations. It did not, however, do much for the unqualified people who needed the job training services the most.[69] Another example the authors use is the FBI improving their

fugitive apprehension figures by concentrating on catching military deserters, who were comparatively easier to find than dangerous criminals.

Another problem with numbers arises when targets are set for improving measurements. If the targets are set too low, the agency will easily reach them and look successful, even if a higher level of performance was possible. If the targets are set too high, management may be blamed for failing to reach an impossible goal. And targets may be set and reached without any consideration for efficiency; successfully reaching a target does not necessarily mean an agency used the most cost-effective means and streamlined approach.

Finally, it is easy to fall into the trap of measuring far too many things. Both the Department of General Services and the Department of Consumer Affairs told the Commission their initial attempts at identifying measurements produced too many standards to deal with and monitor. Some will be kept as internal management indicators rather than as measurements to be used in budget negotiations. The cost can be high for tracking data that is interesting but not critical for evaluating performance. In addition, there is the danger of shifting a program's emphasis from process to outcome only to become focused instead on measurement as an end to itself.

State agencies differ dramatically in mission and objectives so it is impossible to direct the adoption of specific measurement standards from above. But with the many government jurisdictions rushing to embrace performance-based budgeting, there is a substantial pool of experience that could assist agencies in fixing on relevant and reliable measurements of performance.

California Conservation Corps

The California Conservation Corps has two goals (building capable and skilled youth and filling important environmental and community needs), four desirable outcomes for each goal and a total of 21 performance measures. An excerpt:

Goal: To build capable and skilled youth

Outcome: Employable youth

- Increase to 100% those who complete Career Development course
- Train 350 annually on oil spill cleanup
- Train six wildlife firefighting crews

Outcome: Literate corpsmembers

- Increase by 10% corpsmembers who earn GED or high school diploma

Goal: To fill important environmental and community needs

Outcome: Corpsmember hours dedicated to public

- Increase crews trained to fight fires
- Maintain 200 corpsmembers trained for oil spills

Outcome: Efficient, high quality programs

- Decrease workers' comp costs by 2%
- Reduce General Fund cost-per-person by 5%
- Increase efficiency through information technology in all district offices

Finding the Right Ones

One consulting firm has a five-step approach that it advises agencies to take in identifying performance measures. The steps include:

- ***Taking aim:*** Begin by assessing what the program is supposed to do and what strategies it will take to accomplish goals.

- ***Taking inventory:*** Identify all the potential ways of measuring the program's performance.

- ***Taking the best:*** Settle on the best set of measurements that will be reliable, relevant and cost-effective to capture.

- ***Taking action:*** Put the measurement systems in place so they can begin to drive change.

- ***Taking another look:*** Reassess measurements over time and refine them to develop the best, clear picture of program results.[70]

Another method is determining what other similar agencies who are recognized as good performers are doing to see if it can be replicated. In the private sector, this practice is known as benchmarking. With two dozen states, many cities and several other countries engaged in performance measuring, there are many different role models to investigate and emulate.

A key to ensuring that performance measurements will provide a solid foundation for performance-based budgeting is not just picking the right indicators but building the consensus that the correct things are being measured. Experts agree that performance measures do little good if they are not both usable by the agencies for management purposes and relevant to the concerns of legislators who must make budgetary decisions. Reaching such a consensus requires the active involvement of legislators as state departments develop their strategies, goals and objectives.

Managers of departments in California's pilot project told the Commission that one of the biggest barriers to their success has been the lack of involvement by the Legislature. The director of the California Conservation Corps said:

> *The CCC has had a difficult time persuading the Legislature to change the way they view and control a department's budget. Because legislators only receive input-related information regarding department operations, there is only limited focus on the impact of appropriations. Even though legislators seem to desire more control, and more information should theoretically lead to more control, there are indications that members feel that performance data will be inaccessible and unreliable. Legislators and their staff may be afraid that information will be too hard to understand, too overwhelming and require too much work.*[71]

Other department managers agreed that it is difficult to forge ahead with a new system when the intended beneficiaries -- legislative policy

makers -- are either not supportive or not interested in the reforms taking place. Because measurements are the critical component of the performance-based budgeting system, obtaining high-level agreement on what should be measured in each department is a vital step to making the system a credible source of information on which to base budgetary decisions.

While measuring government services does not necessarily mean improvements will follow, they are unlikely to occur in the absence of meaningful measurements. As one consulting firms summarized:

> *While performance measures are powerful tools, they are only tools. They are no more likely to guarantee good government than an accurate speedometer is likely to prevent speeding tickets. If properly developed and used, they can reveal problems, point to solutions and be a check on the effectiveness of solutions once implemented.*[72]

Recommendations

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.

Costly Controls

- *Control systems are an automatic response to costly mistakes and intentional wrongdoing -- but they often constrain options, drive up costs and slow down production.*

- *Each of the departments in the performance-based budgeting pilot program has sought relief from the same four control systems:*

  - *The overlapping authority of the State Personnel Board and the Department of Personnel Administration.*

  - *The standard procurement process.*

  - *The property leasing oversight and design services.*

  - *The use of the Prison Industry Authority as the sole source for the goods and services offered.*

Costly Controls

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.

Traditional government operations are set up to be consistent and rigid, removing the chance for error and misstep -- but also removing the flexibility needed to meet changing challenges and evolving conditions. Private-sector experts on improving performance recognize that one key is to have the person closest to a situation -- the person with the most hands-on experience and knowledge about conditions -- making decisions. Under this concept, known as employee empowerment, management takes on the role of coach and supporter for front-line workers, supplying information and guidelines rather than issuing orders and restricting options. Greater accountability for outcome balances with the greater freedom of action. This shift in roles is not easy to make in the public sector.

The Sunnyvale city manager told the Little Hoover Commission that one of the largest barriers to performance-based budgeting implementation is the structure of government itself:

> *Most governmental organizational structures are designed on command-and-control principles around a traditionally defined way of providing services. Performance budgeting and management, however, requires as much authority and flexibility as possible for the direct delivery of services to be pushed to the lowest possible level. Control is around results, not how things get done. This requires a significant change in thinking and behavior by both policy leaders and executive management.*[73]

He added that much of the infrastructure developed in governmental organizations is in conflict with the environment necessary for performance management.

> *Civil service systems, governmental pay systems, prescriptive rules and regulations, training systems, etc., were developed over a many year period of time with multiple purposes. When they are not aligned with one another and in support of a performance approach, they often serve to provide a contradictory and confusing set of signals to employees. In a sense, an organization is being asked to go in two (or multiple) directions at the same time with one direction being the accomplishment of a specific results area and the other to meet a prescriptive set of standards that do not support the results orientation, but rather some other standard.*[74]

Osborne and Gaebler write that government's control systems emerged as a reaction to the scandals at the turn of the 20th Century when figures like Boss Tweed ran programs for their own benefit. The new reforms cleaned up government but, in doing so, they created their own problems. "In attempting to control virtually everything, we became so obsessed with dictating how things should be done -- regulating the process, controlling the inputs -- that we ignored the outcomes, the results."[75]

The tendency to over-prescribe solutions when a disaster, wrong-doing or mistake occurs is reinforced by a system that protects those who made the error but demands action from those at the top. Thus, when an agency wastes millions of dollars on a computer system that will not work, the managers involved are not held accountable for their actions -- but policy makers demand control systems that will ensure that nothing similar happens again. Write Osborne and Gaebler:

> *To this day, whenever things go wrong, politicians respond with a blizzard of new rules. A business would fire the individuals responsible, but governments keep the offenders on and punish everyone else by wrapping them in red tape. They close the barn door after the horse has escaped -- locking in all the cowhands.*

> *We embrace our rules and red tape to prevent bad things from happening, of course. But those same rules prevent good things from happening. They slow government to a snail's pace. They make it impossible to respond to rapidly changing environments. They build wasted time and effort into the very fabric of the organization.*[76]

In addition to setting up control systems, policy makers often move toward centralization to solve perceived problems. If something goes wrong, then clearly the system was lacking someone high enough up with the proper power and knowledge to make the right decision. Current management philosophy, however, backs decentralization -- pushing the decision-making and responsibility down to the lowest possible levels of an organization so that action can take place swiftly and changing conditions can be dealt with by those most familiar with what is needed.

While the control systems and centralization process are sometimes prescribed in statute, the budgeting process itself is often used by policy makers to dictate conditions. The extensive use of line items to describe how each dollar should be spent often leads to the charge that policy makers are micromanaging programs, but the prospect of yielding line-item control leaves many policy makers feeling that agencies will run wild. A balance between accountability and detailed direction is difficult to reach. In discussing the proper role of the budgeting process in California, a Senate analyst wrote:

> *There should be adequate budget controls to insure that each dollar budgeted is expended for the authorized purpose. The budget control mechanisms should provide enough flexibility to meet unanticipated and emergency needs. The institutional budget arrangements should provide adequate checks and balances without detracting from management capacity for creativity and ingenuity.*[77]

That said, the analyst went on to characterize the State's existing budget process as one of control rather than one of management or planning.

Since government as it exists is a hostile environment for performance-based budgeting techniques, implementing the system reform requires a give-and-take that is atypical of government. Policy makers typically grant agencies relief from control systems in return for commitments that targets for performance will be met. Testifying to the U.S. Senate Committee on Governmental Affairs, one expert said that governments in states and countries that adopt performance-based budgeting typically grant managers greater freedom from civil service constraints; allow them to arrange multiple-year budgets and retain efficiency savings for redirected spending; and streamline acquisition processes, including the ability to privatize services when advantageous.[78]

Implications for California

California's system of governance is replete with command-and-control mechanisms. Much of the centralized oversight for financial decisions comes from the Department of Finance, while control of daily operational processes is often vested in the Department of General Services. In addition, departments face multiple constraints on choices because of statutes that require government business to be conducted in a certain fashion. Printing, for instance, is done by the State Printer. And Prison Industry Authority products must be purchased in lieu of comparative shopping for the best value in the private sector. Many of the pitfalls of some of these systems of control have been described by the Little Hoover Commission in prior reports that have called for streamlining processes and increasing efficient operation of internal government programs.

It is no surprise, then, that the four departments involved in the performance-based budgeting pilot project have negotiated to escape the heavy hand of the State's many control systems. The relief from control systems sought and obtained by the four pilot project departments has been strikingly similar. Each sought the ability to:

- Attend to civil service matters by going directly to the State Personnel Board, skipping the review process by the Department of Personnel Administration.
- Procure goods and services outside of the control system established by the Department of General Services.
- Lease office space without the oversight and design services of the Department of General Services.
- Use the Prison Industry Authority as a competitive bidder rather than as the sole source for goods and services.

The California Conservation Corps' list of exemptions reached further, covering 22 separate relief measures. Among those was the ability to make budget changes without going through the Department of Finance

Little Hoover Reports

The Little Hoover Commission has long advocated removing costly controls and streamlining internal governmental processes. Prior reports that focus on the same areas that pilot project departments are avoiding include:

✓ ***Too Many Agencies, Too Many Rules:*** The Commission noted the overlapping authority and duplicative processes that make the civil service process slow and costly for departments.

✓ ***California's $4 Billion Bottom-Line:*** This report found that the State's centralized procurement system involves costly delays and intensive paperwork. The same report exposed the Prison Industry Authority as a poor buy for departments because products are high priced, delivery is delayed and quality is poor.

✓ ***Moving Beyond the Role of Caretaker:*** The Commission continued its push for more effective property management techniques, increasing both speed and flexibility for departments.

processes; travel outside of the state without special permission; make some hiring decisions without going through the State Personnel Board; and hire above minimum salaries without specific approval.[79]

While any state department manager would recognize that these exemptions from control systems are invaluable in terms of avoiding time-consuming paperwork, delayed action and other headaches, there is an actual cost-savings as well. The Department of Parks and Recreation built into its performance-based budget for 1995-96 the expectation of saving more than $660,000 in a single year from avoiding the procedures of control agencies.[80]

Other incentives

Relief from controls is a large incentive for departments to want to make difficult changes and revamp the way they conduct business. But performance-based budgeting systems typically involve other incentives as well. As has been mentioned in prior findings, governments like Sunnyvale's provide direct rewards (and sanctions) to managers who successfully meet goals by linking compensation to performance. While pay for performance is a concept alien to the set salaries of civil service systems, it is close kin to a merit system of pay increases -- if the merit raises are actually based on evaluation of performance rather than automatically given to anyone who comes to work regularly.

Parks and Recreation Cost Avoidance

By obtaining relief from various control agency mechanisms, the Department of Parks and Recreation plans to save more than $660,000 in 1995-96.

Anticipated Savings	
Contract Administration	$ 61,970
Records Management	5,800
Procurement	137,000
Land Acquisition	300,000
Development	158,000
TOTAL	$662,770

While a pay-for-performance system offers individual incentives, organizational incentives along the same lines are also sometimes part of performance-based budgeting. The expert from Texas told the Commission that state departments that are meeting their targets are more likely to receive increased funding or extra allocations for special projects. Conversely, departments that do poorly may find policy makers less receptive at budget time.[81] This area is controversial, however, because the correct response to poor performance may not be to cut a department's appropriation. If a program is performing poorly because there were not enough resources to meet goals despite exemplary management, then cutting funding further will not resolve the situation. Instead, despite its counter-intuitive feel, the proper response to a poorly performing program may be to increase allocations.

In addition to the above incentives, performance-based budgeting systems often address a lingering, perverse incentive that is built into traditional, incremental forms of budgeting. Under current budgeting

systems, departments lose any funding they do not spend by the end of the fiscal year. Worse than that, if they do not spend all of their appropriation, they endanger their future years' budgets because policy makers may see the leftover funds as a sign that less money is needed to conduct operations. In essence, efficient departments are punished by having their funding endangered while inefficient departments are rewarded with increased appropriations. A legislator from Texas summarized the inherent problem:

> *Our method of budgeting makes no sense. It removes incentives from agencies and employees to conserve and save because they don't get any benefit from it. We reward lethargy. An agency that spends more and more money and claims it needs more and more money to do increased work, as opposed to being more efficient, is going to be rewarded. We give them more money. And efficient organizations? We take their money away. It's insane.*[82]

An incentive typically offered under performance-based budgeting is that a department may retain at least some portion of the savings created by innovative efficiency measures over multiple fiscal years and redirect the funding to internal projects.

Finally, performance-based budgeting is built on the concept of long-range planning and tracking performance over time. This requires a stability of funding decisions that is difficult to achieve when budgets are adopted annually and the budgetary implications of spending decisions are not calculated out over several years. Some 20 states use biennial budgets and many governmental jurisdictions incorporate long-term projections in their budgets.[83] California, however, has a single year budget and does not provide long-term projections as part of the budget document.

As California's pilot project is expected to demonstrate and the Little Hoover Commission has frequently noted in previous reports, departments that are given the latitude to control their own operations can improve their programs and services without becoming less accountable. The spread of latitude to other departments similar to that given to pilot project participants has the potential of yielding dramatically improved government performance.

Recommendations

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.

Conclusion

Conclusion

Inherent in the nature of institutions are mechanisms to avoid change and preserve the status quo. But governments at all levels are facing immense pressures to reform their processes and procedures. Only by improving performance can government restore the confidence the public once had in the ability of the public sector to serve many needs, and serve them well.

Experts on systems management believe government has gone astray by focusing on processes rather than results, by concentrating on efficiency without regard to effect, and by failing to re-evaluate the continued need for programs as times and conditions change.[84] The failure results in part from a lack of consensus about the primary functions of government. One commission charged with identifying the principles that should guide government in Florida developed the following list:

- Government should be catalytic, steering hundreds of different organizations in delivering services rather than being a centralized service provider.

- Government should be community-oriented, empowering localities to come up with their own solutions to problems.

- Government should be customer-driven, giving its constituents the choices they desire for delivery of services.

- Government should be value-oriented, focusing on preventative measures rather than immediate fixes.

- Government should be results-focused, funding outcomes rather than inputs.

- Government should be market-oriented, using competition rather than using public monopolies.[85]

Few governments live up to these or similar principles. But performance-based budgeting offers a promising venue for governments to change and improve. By providing comparative information, performance-based budgets can give policy makers the tools they need to make informed decisions. At the same time, it is a system that increases accountability, both between managers and policy makers and between government and the public. With clear and compelling data easily accessible to everyone, policy discussions can focus on realities rather than ideologies.

Change is very difficult, however. As one Florida analyst wrote:

> *Reinventing government is not only harder than it sounds, it takes a long time to make even small gains. For each bloated bureaucracy and each set of convoluted rules, there is a constituency that demanded it and a constituency that will defend it. Additional obstacles include the sheer complexity of the endeavor, a bureaucratic culture which is risk intolerant and acclimated to following cumbersome rules and regulations rather than searching for the best way to obtain quality results for customers, and a legislature that guards its prerogative to dictate in detail how agencies spend their funds.*[86]

Despite these barriers, many in California recognize the need for change. With a pilot project that involves four departments, California has made tentative steps toward adopting performance-based budgeting. But those involved in the project and those who are assessing its progress have noted a lack of the necessary support and leadership that may make the difference between failure and success. In addition, with no single point person among policy makers to champion the continuation of reform, there is a real danger that the process will peter out and become just one more passing fad.

The departments involved believe they have made substantial improvements in their operations and have created an atmosphere where excellence can thrive. The continuation of their effort and its spread to other state departments holds the promise of increasing the capacity of state government to provide services in an effective and efficient manner.

The experience of other governmental jurisdictions using performance-based budgeting points to the need for patience and long-term commitment to reform. Neither is an evident pattern in California's

political process. Nonetheless, the recommendations in this report are designed to improve the chances that reform will succeed in California and that the partial benefits already reaped by departments in the pilot project can be extended to other agencies. With the demands and constraints facing California, policy makers need to be aggressive about finding ways to reshape and improve government programs. Performance-based budgeting offers them that opportunity.

Appendix

APPENDIX
Witnesses Appearing at
Little Hoover Commission
Perfomanced-Based Budgeting
Public Hearing

July 26, 1995, Sacramento

Kathleen Connell,
State Controller

Thomas Lewcock,
City Manager of Sunnyvale

Ara Merjanian, Texas

Bob Dell' Agostino,
Legislative Analyst's Office

Stan Stancell,
Department of Finance

Steve Olsen,
Department of General Services

Donald Murphy,
Department of Parks and Recreation

Marjorie Berte,
Department of Consumer Affairs

Al Aramburu,
California Conservation Corps

Endnotes

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LITTLE HOOVER COMMISSION FACT SHEET

The Little Hoover Commission, formally known as the Milton Marks Commission on California State Government Organization and Economy, is an independent state oversight agency that was created in 1962. The Commission's mission is to investigate state government operations and -- through reports, and recommendations and legislative proposals -- promote efficiency, economy and improved service.

By statute, the Commission is a balanced bipartisan board composed of five citizen members appointed by the Governor, four citizen members appointed by the Legislature, two Senators and two Assembly members.

The Commission holds hearings on topics that come to its attention from citizens, legislators and other sources. But the hearings are only a small part of a long and thorough process:

* Two or three months of preliminary investigations and preparations come before a hearing is conducted.

* Hearings are constructed in such a way to explore identified issues and raise new areas for investigation.

* Two to six months of intensive fieldwork is undertaken before a report -- including findings and recommendations -- is written, adopted and released.

* Legislation to implement recommendations is sponsored and lobbied through the legislative system.

* New hearings are held and progress reports issued in the years following the initial report until the Commission's recommendations have been enacted or its concerns have been addressed.

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