Performance-Based Budgeting in California State Government:
A Blueprint for Effective Reform

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Introduction

Performance-based budgeting (PBB) has been implemented by federal, state, and local governments in recent years with mixed results. The resurgence of interest in performance-based reforms during the 1990s is merely the latest incarnation of a decades-old effort to link resources with outcomes. California flirted with PBB in the mid-1990s, but a pilot program implemented on the heels of the 1990-91 recession failed to produce significant cost savings or improve service delivery. As the state seeks to extricate itself from another severe economic downturn, it may once again turn to PBB as a means of improving resource allocation. A revisiting of PBB appears even more likely given that the state's newly-elected governor has surrounded himself with PBB advocates and has appointed a PBB expert to lead his audit of state government.

This paper reviews the concept of performance-based budgeting and how it has been applied at the federal and state levels. It briefly surveys the PBB literature and provides an overview of California's experiment with PBB, including the history of the enacting statutes and the results of the pilot program. Finally, the paper incorporates lessons learned from California's PBB effort with empirical research and best practices from other PBB initiatives into a set of recommendations for the new administration.

What Is Performance-Based Budgeting And Why Is It Important?

Although PBB has been implemented by the federal government, virtually every state and numerous localities, there is no common definition of the term. The National Conference of State Legislatures, for example, defines PBB in the following way:

> Performance budgets use statements of missions, goals and objectives to explain why the money is being spent…[It is a way to allocate] resources to achieve specific objectives based on program goals and measured results… Performance budgeting differs from traditional approaches because it focuses on spending results rather than the money spent - on what the money buys rather than the amount that is made available.[1]

The Reason Public Policy Institute (RPPI), on the other hand, offers a more formal definition that is perhaps more accessible to accountants and budget analysts:

> Performance budgeting is an exercise that "costs out" various activities that attempt to achieve an end outcome. It enables the correlation of results to expenditures. There are three components of performance budgeting: the result (end outcome), the strategy (ways to achieve the end outcome), and activity/outputs (what is actually done in order to achieve the end outcome). Performance budgeting establishes a link between the rationales for specific activities and the end outcome results. Note that the result is not costed out, but individual activities or outputs are. This information enables policymakers to determine what activities are cost-effective in reaching their end outcome.[2]

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[1] K. Carter, "The Performance Budget Revisited: A Report on State Budget Reform," Legislative Finance Paper #91, Denver, National Conference of State Legislatures, pp. 2-3 as cited in Richard D. Young, "Performance-Based Budget Systems," *Public Policy & Practice*, January 2003, p. 12, www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.

[2] Geoffrey Segal and Adam Summers, *Citizens' Budget Reports: Improving Performance and Accountability in Government*, Reason Public Policy Institute, Policy Study No. 292, March 2002, p. 4.

Finally, Joyce and Sieg view PBB as "a continuum that involves the availability and use of performance information at each of the various stages of the budget process – budget preparation, budget approval, budget execution, and audit and evaluation."[3] This definition is somewhat broader than the first two, emphasizing the importance of information *availability and use* throughout a very fluid budget process.

While there is no single definition of PBB, most experts agree that, in the broadest sense of the term, "PBB is the allocation of funds to achieve programmatic goals and objectives as well as some indication or measurement of work, efficiency, and/or effectiveness."[4] There are several characteristics common to PBB, including the following:

1) PBB sets a goal, or a set of goals, to which monies are "connected" (i.e. allocated). From these goals, specific objectives are delineated and funds are then subdivided among them.
2) PBB provides information and data on past performance and thereby proceeds to allow for meaningful comparisons between "expected" and "actual" progress.
3) Adjustments to programs are made either at this point or during a future budget preparation cycle to close any performance gaps that may exist.
4) PBB provides an opportunity for regular or special (ad hoc) program evaluations. When utilized, these evaluations are valuable in that they give independent and verifiable information to budget decision-makers and program managers alike.[5]

According to California's Legislative Analyst, performance budgeting differs from the traditional approach to budgeting in that it attempts to determine whether a program is achieving its goals by focusing on outcomes, rather than processes or inputs. In order to implement performance budgeting, departments must identify performance *goals*, or outcomes, and the performance *measures* that will be used to determine whether progress is being made toward achieving the desired outcomes. Resources are then allocated to departments in order to achieve specific goals."[6]

PBB is important to governments for a number of reasons, including the following:

- Provides accountability to the public.
- Drives redesign of programs (focuses on improvements).
- Helps rationalize budget allocations (uses performance information as a basis of evidence).
- Improves understanding of crosscutting programs in government.
- Helps agencies link their daily activities to overall government outcomes and similar activities of other agencies.
- Compares cost effectiveness between programs.

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[3] Philip G. Joyce and Susan Sieg, *Using Performance Information for Budgeting: Clarifying the Framework and Investigating Recent State Experience*, unpublished paper prepared for the 2000 Symposium of the Center for Accountability and Performance of the American Society for Public Administration.
[4] Richard D. Young, "Performance-Based Budget Systems," *Public Policy & Practice*, January 2003, p. 12, www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.
[5] Ibid.
[6] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process?" *1996-97 Budget Analysis: Statewide Administration Crosscutting Issues*, www.lao.ca.gov/analysis_1996/a96hcc.html.

- Helps align government spending with overall goals.[7]

State governments can use performance measurement as a guide for decisions to fund or cut programs, for budget presentation and justification, to assess efficiency of programs, to determine service costs, to streamline program and budget structures, to curb departmental flexibility regarding fund transfers, and to eliminate or sunset programs illustrated by the measures as poorly performing.[8]

The Federal Effort To Implement Performance-Based Budgeting

The federal government began its effort to implement PBB just over a decade ago. In 1993, President Clinton signed into law the Government Performance and Results Act (GRPA), which shifted performance measures from inputs and process to results. Specifically, GRPA required federal agencies to develop five-year strategic plans with results-oriented goals, prepare annual performance plans, and generate annual performance reports that review the agency's success in achieving its performance goals. The Act provided for a series of pilot projects so the agencies could gain experience with its provisions and provide lessons before government-wide implementation began in 1997.[9]

The Office of Management and Budget (OMB) reinforced the GRPA by creating new resource management offices to formulate and review budget requests, assess program effectiveness, conduct mid- and long-range policy and program analysis, and implement government-wide management policy and program evaluation. In addition, the GRPA was further reinforced through oversight by the General Accounting Office (GAO) and Congressional committee staff. Despite these reinforcements, additional effort is needed to clearly describe the relationship between performance expectations, requested funding and consumed resources.[10]

GRPA has succeeded due to its statutory framework, strategic plans and emphasis on measuring results. GRPA's phased, iterative implementation framework allowed agencies to identify where implementation did not meet expectations and make adjustments and revisions as needed. Strategic planning has extended agencies' time horizons to a longer five- to six-year view, rather than the annual nature of the budget process. Finally, agencies have demonstrated continued improvement in planning and performance and produced useful baselines from which to assess future program performance.[11]

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[7] www.performance.napawash.org/mainfiles/TTbudgets.htm.

[8] Katherine G. Willoughby, *Performance Measurement Importance to State Budget Process and Deliberation*, unpublished paper presented at the annual meeting of the Association of Budgeting and Financial Management of ASPA, January 17-19, 2002, p. 10, www.abfm.org/pdf_2001_conf/willoughby2.pdf.

[9] Jonathan D. Breul, "The Government Performance and Results Act – Ten Years Later," *Journal of Government Financial Management*, Spring 2003, pp. 58-64.

[10] Ibid.

[11] Ibid.

Unfortunately, GRPA has not fared as well with respect to the PBB pilots. The pilots, which were supposed to link anticipated results to alternative spending levels, were scrapped after agencies spent an inordinate amount of time and effort ensuring that strategic and annual plans would be useful documents that met the GRPA requirements. Systematic integration of performance information into budget decision-making has yet to occur. In order to accomplish this, OMB will have to produce a government-wide architecture for relating budget and performance data and create a portal for collecting and sharing this information. The architecture must ensure that the information satisfies program policy review needs, is comparable across programs, and can be shared with the government's central budget and financial systems.[12]

According to Breul, four challenges lie ahead for the federal government – integration, performance budgeting, program evaluation and congressional buy-in.

1) ***Integration***: Management improvement initiatives must be integrated into agencies' day-to-day operations and program decision-making.
2) ***Performance Budgeting***: Planning and evaluation must be integrated into the budget process and documents. The alignment of budget accounts should be reviewed so that the budget can readily relate resources used to the results produced. Accounts and activities should be budgeted the full annual cost of the resources used.
3) ***Program Evaluation***: Sustaining a credible performance-based focus in budgeting will require significant improvements in evaluation capacities and information across federal agencies as well as third parties that implement federal programs.
4) ***Congressional Buy-In***: This is critical to sustain any major management reform, but even more so for performance budgeting.[13]

State Efforts To Implement Performance-Based Budgeting

In 1998, Melkers and Willoughby conducted a comprehensive survey of PBB efforts in the United States. They found that 31 states, including California, had enacted legislation requiring implementation of PBB. In addition, sixteen states had some form of PBB instituted by administrative requirements. Only Arkansas, Massachusetts, and New York lacked either type of mandate to conduct PBB.[14] The authors drew the following conclusions from their research:

- Most states have adopted a formal requirement for performance-based budgeting.
- There does not seem to be a major difference between legislatively or administratively initiated reforms.
- A number of states have created oversight bodies with responsibilities once the purview of the central budget office.
- There is a commitment to continued development of performance measures and a willingness to revise the use of PBB systems given their place within the larger efforts of strategic planning and benchmarking activities.
- States see the importance of clearly defining the producers and consumers of information and providing an appropriate incentive strategy for the use of performance-based information, particularly by recognizing the role of the public in assessing agency performance.
- Some states have established formal incentive programs to support enhanced agency performance.

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[12] Ibid.
[13] Ibid.
[14] Julia Melkers and Katherine G. Willoughby, "Performance Based Budgeting Requirements in State Governments," Policy Brief, frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html.

- States recognize the importance of involvement from agency personnel and outside sources concerning the development of performance measures.
- Ultimately, the effects on appropriations and influence on programs and activities is the real test of the success of PBB in the states.[15]

In her 2002 study of state performance budgeting efforts, Willoughby found that performance measurement initiatives had their greatest impact on improving communication and understanding among budget players internal to the government, while such initiatives were *not* effective in changing legislative budget deliberations, influencing spending decisions that might pit different programs against each other, and changing appropriation levels.[16] Her findings reinforce her earlier research with Melkers in that performance budgeting does not change the budget process despite significant implementation costs. PBB has its greatest use in day-to-day agency management decisions and is most important from a budgetary standpoint for decision-making in the early stages of budget development.[17]

Moreover, while state performance measurement projects are often established in the context of saving state resources by streamlining operations and improving service delivery, state performance measurement programs were considered to be least effective in eliminating duplicative services, reducing or eliminating ineffective services and programs and generating cost savings.[18] Willoughby's findings do not bode well for state PBB efforts given the finding by Melkers and Willoughby that, "ultimately, the effects on appropriations and influence on programs and activities is the real test of the success of PBB in the states."[19]

In attempting to explain why performance information is generally not used in resource allocation, Willoughby cites ambivalence on the part of legislative and executive budget officers regarding the effectiveness of PBB. According to Willoughby:

> Some explained that their state remains 'very much' political and that economic and fiscal environments that constrain governments serve as intervening variables to effectiveness. Past survey research shows that just one third (33 percent) of executive and legislative budget officers consider their performance based budgeting system to be effective or very effective in improving decision making, while only seven percent believe the same regarding influencing appropriations levels. And, while there is great faith in the positive aspects of implementing a performance measurement system (85 percent believe the reform is better than nothing) most budgeters (81 percent) point out that lack of legislative interest is problematic to usefulness when appropriations are being discussed. Similar reasoning for lack of use of performance measurement systems has been indicated by state auditors."[20]

In a 1993 report, California's Legislative Analyst (LAO) cited several shortcomings of PBB efforts in various states and localities. Her findings presaged those of Willoughby

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[15] Melkers and Willoughby, frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html.
[16] Willoughby, p. 10, www.abfm.org/pdf_2001_conf/willoughby2.pdf.
[17] Willoughby, p. 3.
[18] Willoughby, p. 9.
[19] Melkers and Willoughby, frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html.
[20] Willoughby, pp. 5-6 www.abfm.org/pdf_2001_conf/willoughby2.pdf.

in that she concluded PBB "had not fundamentally changed the budget process" in most states. Specifically, she found that:

- The manner in which performance budgeting was applied and the results it produced varied widely among the states.
- In most instances, performance budgeting had not fundamentally changed the budget process.
- Implementation costs were significant.
- Performance measures must focus on outcomes, not process.
- Performance needs to be verified independently.
- Performance budgeting requires a change in the Legislature's perspective towards the budget.
- The Legislature must be willing to accept a longer-term view of implementation and results.[21]

In 2000, Joyce and Sieg conducted another analysis of state PBB efforts, focusing on the availability and use of performance information at all stages of the budget process. They suggest there are at least four prerequisites to successful implementation of PBB:

- Public entities need to know what they are supposed to accomplish.
- Valid measures of performance need to exist.
- Accurate measures of cost need to be developed.
- Cost and performance information need to be brought together for budgeting decisions.[22]

Joyce and Sieg argue that, by defining PBB too narrowly, scholars have oversimplified a very complex system. Instead of asking "To what extent are the Governor and/or the Legislature using performance information to make budget decisions?" they believe scholars should be asking "To what extent is performance information *available and used* at each stage of the budget process – budget preparation, budget approval, budget execution, and audit and evaluation?"[23] They go on to argue that:

> performance-based budgeting is not just (as sometimes seems to be suggested) about whether the chief executive or legislature stops engaging in pork barreling behavior, instead allocating resources in a more "rational" manner. It is also about (to name two) whether agencies use performance information in managing their budgets, and whether auditors ask performance questions in evaluating programs. If we do not embrace this broader set of questions, we run the risk of prematurely stifling progress if (as some of the previous studies have suggested) the most important evidence of increasing use of performance measures in the budget process is found at the budget execution and evaluation stage.[24]

They find that in only four states does the central budget office actually use performance information in macro-budget decision-making. Moreover, only in Louisiana does there appear to be extensive legislative use of performance information. Joyce and Sieg conclude that performance information is not used by legislators because they believe the process of measuring performance is still too new to be relied on for resource allocation, they are unwilling to forego parochial interests to make allocation decisions on performance alone, and performance information is of interest only when legislators need

[21] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process?" www.lao.ca.gov/analysis_1996/a96hcc.html.
[22] Joyce and Sieg, p. 12.
[23] Joyce and Sieg, p. 14.
[24] Joyce and Sieg, p. 16.

to report accomplishments to their constituents at home. In addition, they report that legislators expressed concerns about data quality and were skeptical of measures because they had no input in the process that created the measures. According to Joyce and Sieg, states generally believe the highest and best use of performance measures is for management decision-making in the agencies, which supports the findings of both Willoughby and the LAO.[25]

Wendland addresses legislators' reluctance to embrace PBB, citing their need to control as a major obstacle to successful implementation of PBB. Specifically, he points to several reasons why legislators prefer the incrementalist approach to budgeting:

1) The calculations are easy because they are not comprehensive.
2) The present activities are tied to a known past rather than an unknown future.
3) Traditional budgeting does not require analysis of policy. Line-item budgets are policy-neutral, thereby lessening conflict.
4) Traditional budgeting lives on because it is easier, simpler and reduces conflict.
5) Many portions of the current budget cannot be altered, including categorical grant programs (which require adherence to strict rules and regulations), education accounts (which are politically untouchable), and interest payments and employee benefits (which are mandatory).
6) The cost of auditing performance reports could be very high.[26]

In 2001, Reck examined the relationship between performance information and resource allocation at the municipal level. She found that while non-financial information is used by budget officers to evaluate unit performance, it is not used in resource allocation. According to Reck, "the results indicate that the addition of non-financial measures did not add incremental value to budget allocation decisions, contrary to the perceived usefulness of such information. This does not mean that non-financial information is unimportant, however, since non-financial performance measures were used to assess the overall performance of the department." Reck's findings seem to support the aforementioned studies of statewide PBB that indicate non-financial measures have little impact on resource allocation.[27]

Finally, O'Roark argues that the fiscal impact of state PBB efforts strongly depends on the particular set of institutional rules selected. He suggests that PBB systems implemented by executive order exert a greater impact on spending restraint (at least in the short run) than PBBs established by statute. Further, he finds that public accountability and publication of results reinforce this fiscal impact in executive order states, while monitoring of performance targets reinforces the fiscal benefit in states where PBB is implemented by statute.[28]

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[25] Joyce and Sieg, pp. 26-27.
[26] Timothy A Wendland., "Measuring Governmental Performance – The Accountants Weigh In," *Journal of Government Financial Management*, Fall 2003, pp. 56-60.
[27] Jacqueline L. Reck, "The Usefulness of Financial and Non-Financial Performance Information in Resource Allocation Decisions," *Journal of Accounting and Public Policy*, 2001, 20, pp. 45-71.
[28] J. Brian O'Roark, *Performance-Based Budgeting: An Empirical Analysis at the State Level*, unpublished paper, February 2000, www.gmu.edu/departments/economics/ candidates/O'RoarkPaper.doc.

To be sure, PBB results in the states have been mixed. It is clear that further research will be necessary to determine the extent to which PBB can help states improve resource allocation. According to Joyce and Sieg:

> The overwhelming conclusion is that performance measurement is gaining in popularity, but its usefulness is still in question. Most scholars suggest that performance information may be best suited for support of managerial decision-making. These studies underscore the rather preliminary nature of state performance-based budgeting efforts. Further, they tend to support a notion that there is still a great deal of variation among the states in the presence of performance information and the use of this information for budgeting.[29]

Efforts To Implement Performance-Based Budgeting In California

California is one of the 31 states that has implemented PBB *in statute*, enacting legislation that specifies the use of benchmarking and gain sharing, among other provisions. In January 1993, Governor Wilson proposed to pilot test PBB in four state departments, including the Departments of Consumer Affairs (DCA), General Services (DGS), Parks and Recreation (DPR), and the Stepen P. Teale Data Center. The administration indicated that PBB, along with quality improvement, offered the potential for substantial savings, improved performance, enhanced citizen satisfaction, and greater accountability in the delivery of state services.[30]

In response to the Governor's proposal and Congressional interest in the use of performance measures at the federal level, the Legislature enacted the Performance and Results Act of 1993 (Chapter 641, Stats. of 1993) to authorize the pilot program.[31] Senator Hill, the author of the bill (SB 500), argued that this legislation was necessary because:

> the current budget process does not reward innovation, service efficiency, or other actions which can improve delivery of government services. The current funding process is based on the prior year's budget with adjustments for workload and inflation. In brief, if a department program does not exhaust all its funds, it may lose them to other programs within the department and, most assuredly, it will have its funding reduced in the next budget cycle... Conversely, programs which are inefficient and build up workloads, may be rewarded with more funding in the next budget cycle.[32]

Specifically, the legislation required the Department of Finance (DOF) to develop a performance budgeting pilot project in accordance with the following principles:

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[29] Joyce and Sieg, p. 9.
[30] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process? www.lao.ca.gov/analysis_1996/a96hcc.html.
[31] Legislative Analyst, State of California, "Mixed Success in Implementing Performance Budgeting," *Resources Crosscutting Issues*, February 22, 1995, www.lao.ca.gov/analysis_1995/chapb-1.html and Senate Floor Analysis of SB 500, June 8, 1993, www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_500_cfa_930608_110440_sen_floor.
[32] Assembly Consumer Protection, Government Efficiency, and Economic Development Committee Analysis of SB 500, July 12, 1993, www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_500_cfa_930712_104613_asm_comm.

- 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.[33]

The legislation required DOF to evaluate the pilot program and submit a report to the Joint Legislative Budget Committee on or before January 1, 1996 regarding the gain-sharing awards and "the extent to which performance budgeting results in a more cost-effective and innovative provision of government services."[34] An earlier version of the bill sought to require:

> a specific comparison of the effect of performance budgeting on program performance and the implementation of innovations of the four departments in the pilot program with four comparable state departments whose resources are budgeted and managed in the traditional manner. The evaluation also shall list the savings achieved by each department in the program and the specified innovation which brought about the savings.[35]

However, this provision was removed in the Assembly. The final version of this legislation was approved unanimously by policy and fiscal committees in both the Senate and Assembly. It was also approved unanimously by the entire Assembly and passed the full Senate by a vote of 35-2, reflecting broad bipartisan support for PBB in the Legislature.[36]

Bill proponents argued that enactment of SB 500 would yield the following benefits:

- Departments could benefit by delegating to them additional authority to manage personnel.
- Departments could benefit by providing them with the flexibility to obtain services and products outside of the Department of General Services.
- Departments could benefit by receiving waivers from the review and approval of specified requirements. Additionally, departments could propose certain statutory changes to be addressed in their budget contracts, as well as propose modifications to the structure of budget bill appropriations, to allow additional flexibility in the use of funds.[37]

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[33] Text of SB 500 as chaptered, www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_500_bill_931001_chaptered.

[34] Text of SB 500 as chaptered.

[35] Text of SB 500 as amended June 8, 1993, www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_500_bill_930608_amended_sen.

[36] SB 500 legislative history, www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_500_bill_history.

[37] Assembly Consumer Protection, Government Efficiency, and Economic Development Committee Analysis of SB 500, July 12, 1993, www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_500_cfa_930712_104613_asm_comm.

Later, the California Conservation Corps (CCC) and Department of Toxic Substances Control (DTSC) were added to the SB 500 pilot program. The Department of Finance was responsible for administering the program, which included four departments in its final incarnation (CCC, DCA, DGS, and DPR) after DTSC and the Teale Data Center dropped out due to management and personnel changes.[38] The CCC was added by AB 202 (Chapter 894, Stats. of 1993), which:

> requests the Governor to issue an executive order establishing performance goals for the corps, by which the Legislature may evaluate a proposed corps contract, and that the executive order includes such goals as increasing the number of corpsmembers, increasing the number of corpsmember hours dedicated to public service, conservation work and emergency response, and developing specific and quantifiable measures of the corps' success.[39]

An earlier version of AB 202 contained much more specific performance measures. In fact, the Legislature would have been directed to consider whether a proposed contract would have contributed to the following:

- An increase in the corpsmember population of 5 percent per year for a total growth of 25 percent.
- A decrease in reliance on the General Fund of 5 percent per year until the Corps' total budget is not more than 25 percent General Fund money.
- An increase in the number of eligible corpsmembers who enroll in high school diploma programs of 2 percent per year for a total growth of 10 percent.
- An increase in the retention rate of corpsmembers of 2 percent per year for a total growth of 10 percent.[40]

These measures were later modified and eventually stripped from the bill in its final form.

Finally, the Legislature enacted the State Government Strategic Planning and Performance Review Act (Chapter 779, Stats. of 1994), which was sponsored by State Controller Gray Davis. Citing a Texas performance audit that identified $4.8 billion in potential savings in 1992, the Controller argued that performance reviews of every state agency would uncover costly duplications and inefficiencies. As originally passed by the Assembly, this legislation (AB 2711) would have required DOF, the Controller and the Bureau of State Audits to jointly develop a plan for conducting performance reviews of all state agencies and to immediately initiate such reviews beginning with three agencies determined to be of highest priority. It would have also required reviewed agencies to report to the Legislature regarding recommendations which had and had not been implemented.[41] However, due to DOF opposition, the Senate removed the language implementing performance reviews and instead required DOF to *survey* state agencies to

[38] Legislative Analyst, State of California, "Mixed Success in Implementing Performance Budgeting," www.lao.ca.gov/analysis_1995/chapb-1.html.
[39] Text of AB 202 as chaptered, www.leginfo.ca.gov/pub/93-94/bill/asm/ab_0201-0250/ab_202_bill_931008_chaptered.
[40] Text of AB 202 as amended August 17, 1993, www.leginfo.ca.gov/pub/93-94/bill/asm/ab_0201-0250/ab_202_bill_930817_amended_sen.
[41] Assembly Floor Analysis of AB 2711, August 27, 1994, www.leginfo.ca.gov/pub/93-94/bill/asm/ab_2701-2750/ab_2711_cfa_940827_142118_sen_floor.

obtain specified information concerning strategic plans.[42] Those agencies were required to report annually to the Legislature on steps being taken to develop performance measures that could be used for performance budgeting or performance review.[43]

Results Of California's Performance-Based Budgeting Pilot Program

The LAO concluded in 1996 that, "to date performance budgeting has not realized the fundamental benefits initially envisioned by the administration."[44] Specifically, it failed to fundamentally change the budget process or produce substantial cost savings in state operations. In evaluating the pilot program, the LAO identified the following common themes:

- The program reoriented departmental management to focus on the department's purpose, develop supporting business plans, and manage to achieve outcomes.
- Participating departments were energized by the pilot program and were sincere in their efforts to improve performance.
- In gathering data to measure performance, departments discovered in many instances that such data do not exist.
- A significant investment of resources was made.
- Anticipated savings available for redirection did not materialize.
- Many administrative flexibilities provided by budget contracts appeared to be relatively minor and non-quantifiable.
- Other than the use of budget contracts, there were no significant changes in the budget process.
- Controls on administrative flexibility were identified which had questionable value.[45]

While some progress was made toward program goals such as improving program performance, enhancing citizen satisfaction and producing greater accountability, the pilot program was considered by many to be a failure because it did not result "in a more cost-effective and innovative provision of government services" as the enabling legislation intended.[46] As one LAO official put it, the pilot program "required a lot of effort and commitment, but didn't do much."[47] The LAO attributed the lack of significant results to the following factors:

- Significant improvements in performance do not occur "overnight" and tend to take some time.
- The experiences of other states and local governments suggest that it takes time to radically change long-standing budget processes.
- The program got off to a slow start and suffered to some extent because it was implemented in the absence of a definitive plan, with the result that each of the pilot departments was left to its own devices to define the program as it applied to them.[48]

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[42] Ibid.
[43] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process?" www.lao.ca.gov/analysis_1996/a96hcc.html.
[44] Ibid.
[45] Ibid.
[46] Ibid. @ www.lao.ca.gov/analysis_1996/a96hcc.html and Craig Cornett, "California's Performance Budgeting Pilot Project: A View from the Legislature," *Cal-Tax Digest*, February 1998, www.caltax.org/MEMBER/digest/feb98/feb98-6.htm.
[47] Interview with senior official in the Office of the Legislative Analyst, October 21, 2003.
[48] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process?" www.lao.ca.gov/analysis_1996/a96hcc.html.

The last of these points is particularly instructive in explaining why the pilot project failed. The American Society of Public Administration (ASPA) recommends that governments implementing PBB should "make strategic planning the PBB point of departure," because it "embraces all the requisite mechanisms that are essential to initiating successfully a PBB approach."[49] Young suggests that strategic planning is important because it allows a state to assess where it is presently, ascertain the challenges and opportunities that present themselves, and determine what destination is most desirable and how to get there, while PBB adds or emphasizes the critical, additional step of measuring progress. Furthermore, he argues that a strategic plan indicates "to state leaders – more lucidly - what is state government's (or more particularly an agency's) overall mission, its goals and objectives, its strategic or programmatic initiatives, and its resources (people, monies, technologies, facilities, etc.)"[50]

While the text of SB 500 (which launched the pilot program) emphasized that "strategic planning is central," the final version of AB 2711 (which promulgated the state's strategic plan) was enacted nearly a year after SB 500. Thus, the pilot departments had no strategic plan upon which to base their PBB efforts for a year after SB 500 was enacted and thus were left to their own devices to define the program as it applied to them.[51] Moreover, by the time the strategic plan was eventually enacted, it had been watered down substantially due to DOF's concerns.

The Performance Institute, a private think tank that serves as the nation's authority and repository on performance-based management practices for government organizations, cites the bureaucracy, the legislature's cultural resistance to performance and accountability, and poor implementation as the reasons for the pilots' failure. Specifically, the Institute concluded that:

> The performance measures selected to track performance were not results-oriented, and instead measured meaningless process, activity, and effort levels. Even worse, the pilots failed to link their resources to performance goals through activity-based costing. Instead, pilots lumped their entire program budget into a single justification – providing very little useful information to allocate resources on activities that had a greater impact on performance.[52]

Craig Cornett of the Legislative Analyst's Office describes the pilots as worthwhile from a government management perspective, but cautioned that, "as with other budgeting methods that have been introduced in the public sector over the years – 'planning-programming-budgeting' in the 1960s to 'zero-based budgeting' in the 1970s and 1980s - a budgeting method is not a panacea. As the pilot departments can attest, implementing a performance budgeting system and making fundamental changes to the way business is conducted takes a great deal of effort."[53]

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[49] Young, p. 22, www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.
[50] Young, pp. 17-18, www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.
[51] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process?" www.lao.ca.gov/analysis_1996/a96hcc.html.
[52] The Performance Institute, *Citizens' Budget 2003-05*, Part Three: Spending Reductions, www.performanceweb.org/pi/research/california/partthree.htm.
[53] Craig Cornett, "California's Performance Budgeting Pilot Project: A View from the Legislature," *Cal-Tax Digest*, February 1998, www.caltax.org/MEMBER/digest/feb98/feb98-6.htm.

In the end, LAO recommended that DOF, together with the pilot departments, provide the Legislature a status report on the pilot program at the time of budget hearings. In addition, they were encouraged to advise the Legislature "as to their evaluation of the pilot program and plans for performance budgeting in the future, including sharing with all state agencies lessons learned from the pilot program and the extent to which the DOF plans to relieve other departments of administrative controls found to be unnecessary as a result of the pilot program." Finally, LAO recommended that "any plans to expand elements of the pilot program to other departments include standards and guidelines to ensure that there is not unwarranted duplication of effort."[54]

Renewed Performance-Based Budgeting Efforts In California

In 2003, the Senate's President Pro Tempore and Minority Floor Leader jointly introduced a budget trailer bill requiring DOF to develop a performance budgeting pilot project under which the budgets of at least four departments in specified fiscal years would be analyzed by specified criteria. The legislation was introduced toward the end of budget negotiations as a concession to Republican legislators seeking to streamline state operations. While approved unanimously by the Senate, SB 1082 was removed from the budget package by the Assembly. However, it could be revisited during the next legislative session, particularly in light of the Republicans' pending control of the Governor's office.

Appendix A outlines the key provisions of SB 1082. Consistent with efforts to reduce the current budget deficit, it declares that "performance budgeting can provide a useful tool to help determine where to make targeted spending reductions without sacrificing vital services."[55] The bill text was drafted by the Reason Public Policy Institute (RPPI), a think tank promoting choice, competition, and a dynamic market economy. However, RPPI contends that California is well past the point of a "pilot project" for performance-based budgeting as proposed by SB 1082. In its *Roadmap for Reform*, RPPI argues that "while recent movement toward adopting a performance-based budgeting pilot program as part of the budget deal is positive, a flawed implementation of this pilot, as has occurred in the past, would render the effort meaningless. California must adopt a formal performance-based budgeting law that uses results-oriented performance measures and is aligned to high quality financial information drawn on activity-based costing."[56]

While it is unclear at this point whether the newly-elected Governor is prepared to introduce such a sweeping reform, he has promised to "open the books" in order to eliminate duplicative processes and inefficiencies in state government. To help him accomplish this task, he has hired Donna Arduin, Director of the State of Florida's Office of Policy and Budget as his Director of Independent Audit. In her capacity as Director of

[54] Legislative Analyst, State of California, "Performance Budgeting: Will It Change the Budget Process?" www.lao.ca.gov/analysis_1996/a96hcc.html.

[55] Current text of SB 1082, www.leginfo.ca.gov/pub/bill/sen/sb_1051-1100/sb_1082_bill_20030727_introduced.pdf.

[56] Carl DeMaio and George Passantino, *A Roadmap to Reform: Seven Principles for Fundamentally Reforming California State Government*, The Reason Foundation and The Performance Institute, August 2003, www.rppi.org/californiaroadmap.shtml.

Florida's Office of Policy and Budget, Arduin oversaw the implementation of one of the most ambitious PBB systems in the country.[57] If the Governor-elect pursues PBB, he may seek enactment of SB 1082 or introduce his own PBB initiative (either as legislation or administratively).

Recommendations

In implementing any PBB initiative, the new Governor will want to avoid the pitfalls that befell the Wilson Administration's efforts and incorporate the best practices employed by other states in their PBB systems. To do so, he should consider the following:

1) ***Adopt a comprehensive strategic plan for all state agencies prior to implementation of PBB.***
   As described above, a comprehensive strategic plan is essential to successful PBB efforts because it lays out the government's mission, goals and objectives, which are prerequisites to adoption of formal performance measures. The plan should require DOF to immediately initiate performance reviews of *all* state agencies and report their findings to the Legislature.[58] The plan should be accompanied by a PBB "framework," which includes how the PBB process works and a calendar that clearly states when milestones, target dates, and so forth, should occur.[59] Only after this process has been completed should PBB be implemented. While AB 2711 served as a strategic plan for the Wilson Administration's PBB initiative, it was developed *after* the PBB pilots had already begun. Moreover, although an earlier version of AB 2711 mandated performance reviews of all state agencies, the final plan merely required DOF to *survey* state agencies.

2) ***Implement the strategic plan and PBB by Executive Order.***
   Given the tendency of the Legislature to water down PBB efforts (as evidenced by SB 500, AB 202, and AB 2711) and O'Roark's finding that PBB systems implemented by executive order exert a greater impact on spending restraint than those enacted by statute, the Governor should implement PBB via executive order. This assumes that he can get buy-in from DOF (which may be difficult) and that his plan is integrated with the aforementioned strategic plan. If possible, he should seek to implement the strategic plan as part of the executive order creating PBB. However, he may find that legislators are reluctant to embrace any PBB effort unless they play a significant role in its development. Thus, he should include legislators in the development of the PBB plan and associated performance measures even if he pursues the initiative administratively. In addition, he should emphasize public accountability and

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[57] Florida's Government Performance and Accountability Act legislated that PBB be piloted in several agencies, with all agencies participating by the year 2002. The law creates several bodies to support PBB in the state, contains numerous performance incentives and disincentives, includes benchmarking provisions, and makes reference to the strategic plan. Melkers and Willoughby, "Performance Based Budgeting Requirements in State Governments," frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html.

[58] Assuming it is implemented during prosperous times and ample funds are available for such reviews – see Recommendation 8 below.

[59] The National Performance Review recommended such a "framework." See Young, p. 21, www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.

publication of PBB results if the system is created by executive order, while emphasizing monitoring of performance targets if it is enacted by statute.[60]

3) ***Link resources to performance measures using activity-based costing.*** Joyce and Sieg suggest that "connecting resources with results implies knowing how much it costs to deliver a given level of outcome. Most public agencies cannot even tell you how much it costs to deliver an output, in particular because of the problems with allocating indirect costs."[61] They go on to point out that, while activity-based costing "is a more sophisticated mechanism that attempts to measure the full cost of resources consumed in the delivery of a particular service, including allocations for fringe benefits and overhead costs as well as allocations for other indirect costs," no state has implemented activity-based costing (or anything like it) statewide. The states that are most accomplished are still in the pilot stages.[62] Furthermore, Lee indicates that states have not developed accounting systems that track the costs of providing services or performing work, noting that states have identified few incentives to devise such systems.[63] Thus, California will need to devote substantial time and resources to the adoption of activity-based costing and create incentives to encourage such costing procedures. This is particularly important since development of new accounting procedures was a significant obstacle to successful implementation of the Wilson pilots. Because the pilot departments had very little data against which to measure improvement, they had to establish a means of collecting data in order to make ongoing assessments of improvement. They also had to devise new budget formats that tied requested budget allocations to specific performance areas and outcomes, which was difficult and time consuming.[64]

4) ***Ensure that performance measures are results-oriented.*** Many of the performance measures selected to track performance in the Wilson PBB initiative measured process, activity, and effort levels rather than results. For example, one of DPR's proposed performance measures was to establish a new motorcycle safety training program. Another was to develop a plan for reducing visitor dissatisfaction with the department's camping reservation system. As the Legislative Analyst points out, more meaningful performance measures would have been those that determined the extent to which motorcycle injuries had been reduced and camper satisfaction increased.[65] The new administration must ensure that performance measures focus on outcomes rather than processes. Furthermore, they should focus only on vital performance measures. Too much superfluous information and data will overload the system and frustrate decision-makers.[66]

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[60] This is consistent with O'Roark's findings.
[61] Joyce and Sieg, p. 12.
[62] Joyce and Sieg, pp. 23-24.
[63] R. D. Lee, Jr., "A Quarter Century of State Budgeting Practices," *Public Administration Review*, 57 (2), 1997, pp. 133-140, as cited in Joyce and Sieg.
[64] Cornett, www.caltax.org/MEMBER/digest/feb98/feb98-6.htm.
[65] Legislative Analyst, State of California, "Mixed Success in Implementing Performance Budgeting," www.lao.ca.gov/analysis_1995/chapb-1.html
[66] Young, p. 22, www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf

5) ***Include performance incentives, benchmarking, and oversight provisions.*** California was one of only seven states to implement a gain sharing provision and one of only six to establish benchmarking as part of its PBB effort.[67] However, since no savings were identified from the Wilson pilots, it is unclear whether up to half the savings resulting from performance budgeting would actually have been shared with the pilot departments as stipulated by SB 500. Any new PBB effort should include gain sharing or similar incentives for agencies to perform as well as disincentives for agencies that perform poorly.[68] In addition, it should include benchmarking and appropriate oversight provisions. According to Willoughby, legislators cited benchmarks as useful in decision-making.[69] To ensure adequate oversight, several states have created offices to assist in the performance measurement process.[70] Similarly, the Office of Management and Budget (OMB) created resource management offices to help administer the federal PBB effort and delegated additional oversight responsibility to the General Accounting Office (GAO) and Congress. California may want to pursue a similar policy, which would not only improve the state's oversight capability, but might also allay some of DOF's concerns about managing the program with limited resources.

6) ***Communicate results to participating agencies, the Legislature, and the public.*** Communicating the results of any PBB initiative to legislators, state agencies, and the public is extremely important, particularly if it is implemented via executive order.[71] Prospective readers of budget information indicated in focus groups that they prefer a wide range of information – some financial and some not. They wanted to see outcome measures, customer preferences and cost-related information (including efficiency and tax burden). In addition, they wanted the information placed into context with comparisons among governmental units (e.g. benchmarking state vs. state).[72]

7) ***Expand the PBB implementation time frame.*** Joyce and Sieg suggest that, in many cases, "reforms are not permitted to germinate and bear fruit before they are prematurely declared to be failures. Seen in this context, we would argue that it is crucial to view performance-based budgeting reforms through a wide, rather than a narrow lens. If we focus only on centralized institutions – such as the central budget office and legislative bodies – as our

[67] Melkers and Willoughby, frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html.
[68] Incentives established by other states include increased budget, personnel flexibility, retention of unencumbered appropriations, employee bonuses, resource improvements, public commendation, exemptions from reporting requirements, increased funding transferability, and financial rewards to employees (non management), among others. Disincentives include mandatory quarterly reports on progress, restriction or reduction of positions and funding, and transferring functional responsibility to another entity, among others. Melkers and Willoughby, frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html.
[69] Willoughby, p. 10.
[70] Melkers and Willoughby, frp.aysps.gsu.edu/frp/frpreports/policybriefs/policy_brief6.html
[71] As indicated above, O'Roark finds that publication of results reinforces the fiscal impact of PBB initiatives established by executive order.
[72] Wendland, pp. 56-60.

barometers of success, we may miss a lot of potentially encouraging developments."[73] The LAO also emphasized the importance of a much longer PBB implementation window, suggesting that "the Legislature must be willing to accept a longer-term view of implementation and results." Of course, it will be quite difficult to convince term-limited legislators that they should support PBB if they will not be in office to realize the benefits associated with its implementation.

8) ***To the extent possible, implement PBB during a sustained economic expansion to ensure sufficient resources are available to fund the effort.***
As Young points out, "adequate resources (sufficient staff, equipment, and funds) are essential to PBB success, second only perhaps to the requirement of 'good and sustained leadership.'"[74] Unfortunately, the state tends to focus on performance budgeting during fiscal crises, which are the most difficult times to initiate performance audits or establish pilot programs due to the cost of such programs and the relative lack of human capital, administrative support and managerial commitment available to the state. Any effort to implement PBB at all state agencies would cost considerably more than the $5 million or so expended on the Wilson pilots. There would also be substantial costs in terms of staff time and commitment to the project. While PBB would ostensibly reduce government spending in the long run by improving resource allocation, it is unclear if DOF would be willing and able to support such an initiative during an economic crisis. Implementation during economic prosperity is not only more feasible, but also more likely to generate buy-in among state agencies, which would have substantially more flexibility to devote time and resources to the project. At the same time, however, the public may not support reforming the budget process unless they feel the economy was moving in the wrong direction or that the government was doing a poor job of fiscal stewardship. Given the new Governor's popular mandate, it may be an appropriate time to establish a separate fund dedicated to adoption of activity-based costing, statewide performance audits and full implementation of PBB.

9) ***DOF should coordinate PBB for the state.***
According to Young, "PBB systems are most successful when they are coordinated and assisted by a government's central administrative unit. This approach lends itself to consistency, coherence, and uniformity of PBB processes among several and variant governmental entities. It also facilitates in providing on-demand, or 'timely,' technical expertise or assistance to individual agencies at critical stages during PBB implementation."[75] Thus, DOF should administer the program, perhaps with the assistance of the Controller, the Bureau of State Audits, or an inter-departmental entity. However, it is important that the oversight function be delegated to LAO and the Legislature. This is consistent with successful state PBB efforts as well as the federal effort (in which OMB administers the program under GAO and Congressional oversight).

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[73] Joyce and Sieg, p. 30.
[74] Young, p. 22 www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.
[75] Ibid., www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf.

Conclusions

While the above recommendations may provide some general guidance for the new administration should it decide to implement PBB, they do not assist in determining whether or not California *should* revisit PBB. Based on the state's prior experience and the consensus among researchers that PBB has not generated significant cost savings or improved service delivery, one might be tempted to dismiss PBB entirely. However, as virtually all researchers point out, PBB takes time to yield results – much longer than the Wilson pilots were given to produce them. Moreover, time may reveal process-related benefits in addition to those specifically related to outcomes. This argues for giving PBB a second chance, albeit with a greatly expanded time frame.

Of course, time is a luxury that most of today's policymakers cannot afford. In the absence of tangible results that can be produced relatively quickly, legislators are unlikely to embrace PBB, particularly if it could adversely impact a pet program or project. The central problem confronting PBB advocates remains changing the Legislature's perspective on budgeting and convincing policymakers that implementation of PBB is worth their time and warrants expenditure of substantial state resources. Certainly, researchers recognize the importance of this issue to the success or failure of PBB. The LAO, for example, argues that "the Legislature must be willing to accept a longer-term view of implementation and results" and "performance budgeting requires a change in the Legislature's perspective towards the budget." Similarly, the Performance Institute cites "the Legislature's cultural resistance to performance and accountability" as an obstacle to PBB's success. These obstacles become even more problematic in an environment where term limits have compressed the window for producing results and staff has assumed a much more prominent role in the budget process.

While authors such as Wendland highlight reasons for the Legislature's reluctance to cede some of its control over resource allocation in adopting PBB, no suggestions are offered for actually *changing* the Legislature's current perspective. In fact, the only solution to this problem incorporated into the above recommendations is to *circumvent* the Legislature whenever possible. However, this is likely to cause political problems that could adversely impact the success of PBB over the long term.

Clearly, further research is required to determine how to "sell" PBB to legislators. In addition, researchers may want to consider how to generate support for PBB among budget agencies, since they appear to enjoy substantial power in shaping PBB initiatives (as evidenced by DOF's "watering down" of PBB legislation with the Legislature's complicity). While researchers explore these and other issues related to PBB implementation, states will undoubtedly continue to make strides toward improving service delivery by linking performance information to resource allocation in a variety of ways.

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Appendix A
Key Provisions of SB 1082 (Burton and Brulte)

If enacted, DOF would be directed to analyze pilot department expenditures based on:

1) The extent to which the pilot department's programs are relevant with respect to all of the following:
   a. Whether the program addresses a specific interest, problem, or need that is clearly identified and immediately necessary.
   b. Whether the program represents a critical essential role for state government.
   c. Whether the elimination of the program would result in other parties mitigating the loss of the program wholly or in part.
   d. Whether the program is designed to make a unique contribution that is not duplicative of other federal, state, local government programs or private and non-profit programs.
   e. Whether the program's budget has grown over the past ten years in a manner consistent with the growth in the need it is designed to address.

2) The extent to which the department's performance measures demonstrate an impact, as described in all of the following:
   a. Whether the program has specific, long-term performance measures focusing on outcomes
   b. Whether the program has a limited number of annual performance measures demonstrating progress toward long-term goals.
   c. Whether the program actually meets the impacts described in paragraphs (1) and (2).
   d. Whether the program delivers quality performance in comparison to similar program activities in other governments, the private sector and non-profits.
   e. Whether the program collects timely and credible performance information that can be verified and validated.

3) The extent to which the department avoids internal inefficiencies and poor resource allocation, as specified in all of the following:
   a. Whether the program can provide a compelling cost-per-unit of service.
   b. Whether employees are held accountable for performance standards and trained and managed to produce optimal results.
   c. Whether information technology and other processes have improved performance and cost-efficiencies of the program.
   d. Whether the program uses partnerships, grants and contracts to improve the efficiency of operations and service delivery.
   e. Whether the program has strong internal controls that reduce waste, fraud and errors in its payment and financial management system.[76]

[76] Current text of SB 1082, www.leginfo.ca.gov/pub/bill/sen/sb_1051-1100/sb_1082_bill_20030727_introduced.pdf.