

Making Government Work Better

First in an Occasional Series

Performance Budgeting: Reshaping the State's Budget Process

The Clinton Administration recently released its *Report of the National Performance Review*, which proposes ways to improve the operations of the federal government. The idea of restructuring governmental operations is equally applicable at the state level.

This is the first in an occasional series of papers discussing opportunities to make California government work better.



Legislative Analyst's Office

October 25, 1993

■ BACKGROUND

It is hard for most people to get excited about the state budget process with its mountain of numbers, intricate details, and endless jargon. It is a fact of life, however, that the budget process determines who gets what services and who pays for them. The Governor's 1993-94 Budget proposed to change the state's budgeting process by pilot testing performance budgeting in four state departments because the state's traditional budget process "has become seriously dysfunctional."

■ FINDINGS

We have reviewed the use of performance budgeting in other states and the Governor's proposal for California. We conclude that nine months after being proposed by the administration, the pilot project still lacks sufficient details and its schedule has slipped. Nevertheless, we believe that performance budgeting has merit and is worth pilot testing. This is because it focuses on program results, thereby offering the potential of improving the delivery of services.

■ RECOMMENDATIONS

If the potential benefits of performance budgeting are to be realized, the Legislature will need to "break the mold" in how it appropriates funds for the pilot departments and conducts legislative oversight. It will have to focus on longer-term program goals and outcomes, rather than immediate process and service demands. Accordingly, we recommend the establishment of a joint legislative committee—including representation from the fiscal and policy committees of both houses—to oversee the pilot project and review the performance and budgets of the pilot project departments.

"Performance budgeting differs from the traditional approach to budgeting in that it focuses on outcomes rather than inputs or processes..."

BACKGROUND

What Is Performance Budgeting?

Stated simply, performance 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. For example, under the traditional budgeting approach, the number of parks managed by the Department of Parks and Recreation and the number of state park employees are *input* factors that help determine the department's budget. Under performance budgeting, the level of satisfaction expressed by visitors to state parks would be one of a number of *outcome* measures. Visitor satisfaction could be determined by a simple survey of park-goers, with the results providing an indication as to how well the department was carrying out its responsibilities. This measure of performance could be used in evaluating a budget request.

Performance budgeting is not a new concept. The City of Los Angeles implemented a version of it in the early 1950s. Recently, however, there has been re-

newed interest in this budgeting approach at the state and federal levels. For example, the National Conference of State Legislatures identifies 23 states that are involved to some degree with performance budgeting.

The federal government has recently shown interest in the use of performance measures, a key component of performance budgeting. For example, in February 1993 the U.S. General Accounting Office (GAO) released a report on the uses and limitations of performance budgeting in selected states. A primary objective of the GAO study was to gather information on the implications of state experiences for federal performance budgeting efforts. In July 1993, Congress passed the Governmental Performance and Results Act, which provides for three-year pilot projects that will embody many of the components of performance budgeting. The National Performance Review, a six-month study of the federal government requested by President Clinton, resulted in a report issued by the Vice President in early September 1993, which likewise embraces aspects of performance budgeting.

What Has Been the Experience in Other States?

In its review of performance budgeting, the GAO focused on five states (Connecticut, Hawaii, Iowa, Louisiana, and North Carolina) that had the following characteristics:

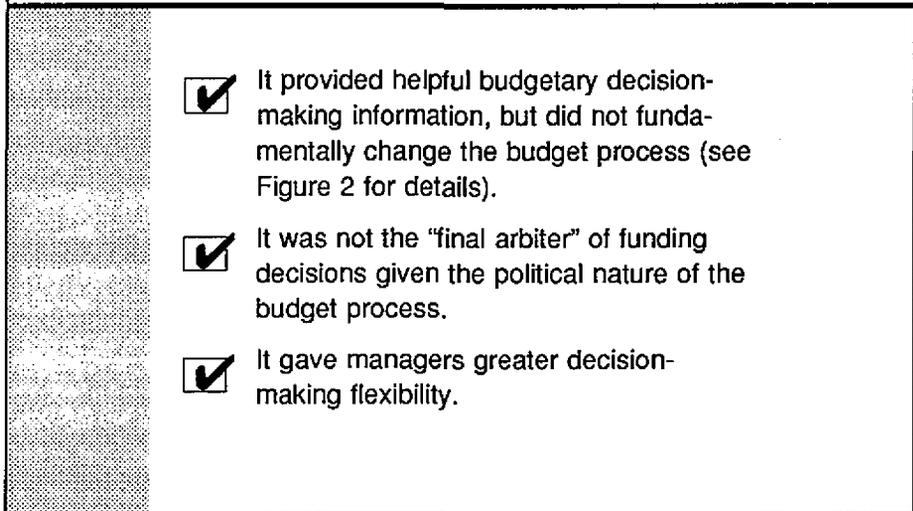
- Each regularly published performance measures in its budget documents.
- Each reported using a variety of performance measures, including effectiveness and productivity measures.
- Each had used performance measures through at least two budget cycles.

Results Have Been Mixed. As Figure 1 shows, the GAO concluded that performance budgeting produced mixed results in the five states reviewed. In addition, the GAO pointed out that performance measures—a key component of performance budgeting—took time to develop and implement.

As Figure 1 suggests, while performance budgeting may offer promise, states have had difficulty realizing that promise. Part of the problem has been the reluctance of executives to change their budget decision-making from one based on policy and political considerations to one based on performance. In addition, Legislatures,

Figure 1

States Experienced Mixed Results From Performance Budgeting



"...while performance budgeting may offer promise, states have had difficulty realizing that promise."

used to considerable control in approving budgets through emphasis on process and procedure, have had difficulty embracing the fundamentally different approach of performance budgeting, which stresses program missions, goals, and outcomes.

changed the budget process in the five states reviewed by the GAO.

Other States Continue to See Promise. While results were mixed in the states the GAO chose to examine, many other states, including California, have decided to pursue performance budgeting, believing that there will be net benefits.

Figure 2 summarizes the specific reasons why performance budgeting has not fundamentally

Figure 2

Why Performance Budgeting Did Not Fundamentally Change the Budget Process in Other States

- Time, resources, and data constraints limited the use of performance information by the legislative and executive branches.
- Legislative and executive budget decision makers were dissatisfied with and questioned the reliability of performance measures.
- Performance budgeting complicated the budget process by highlighting trade-offs among programs competing for limited resources.

WHAT IS CALIFORNIA PROPOSING?

How the Administration Describes Performance Budgeting

The Governor proposed in January 1993, as part of his 1993-94

budget, to pilot test performance budgeting in four departments. According to the administration, performance budgeting, along with quality improvement pilot projects, offers the potential for substantial savings, improved program performance, enhanced

"...the Legislature has not been provided sufficient details regarding the administration's performance budgeting project."

How the Pilot Departments Were Selected. The administration has listed the following characteristics of "ideal" candidates for pilot departments:

- Department must be committed to all aspects of the project.
- Department must be well managed currently.
- Department must be prepared to initiate strategic planning activities.
- Department must be medium-sized.
- Pilot departments should include both internal service agencies and public service agencies.

Based on these criteria, the Department of Finance (DOF), which has been given responsibility for the performance budgeting pilot project, selected the following four departments to participate in the pilot test: the Departments of Consumer Affairs, General Services, and Parks and Recreation, and the Stephen P. Teale Data Center.

Legislature Has Shown Interest in Performance Budgeting

In addition to the administration's interest in performance budgeting, similar

interest has been expressed by the Legislature. Specifically, the Legislature passed SB 500 (Hill), the Performance and Results Act of 1993, which embodies several aspects of the administration's pilot project. A primary difference, however, is that SB 500 (Ch 641/93) establishes a specific timetable for the project and requires the DOF to evaluate project results and report its findings to the Legislature by January 1, 1996.

LAO ASSESSMENT OF THE PILOT PROJECT

In preparing this issue paper, we reviewed available documentation concerning the administration's performance budgeting proposal and discussed the status of the pilot project with pilot departments and also the DOF. We also reviewed literature on performance budgeting, focusing on recent experiences and current initiatives. Our assessment of the administration's pilot project to date is summarized in Figure 4 and discussed in greater detail below.

Definition Lacking

At the time the Governor's Budget was released in January 1993, the administration had not developed the details of the performance budgeting pilot

citizen satisfaction, and greater accountability in the delivery of state services.

In the administration's view, performance budgeting has seven essential elements, as listed in Figure 3.

Figure 3

Elements of Administration's Performance Budgeting Proposal

- Annual budgetary contracts between legislative budget writers and the administration.
- Operational flexibility, which could include relief from statutory requirements.
- Incentives for performance and efficiency, including the ability to reinvest 50 percent of any savings into discretionary activities.
- An emphasis on long-term strategic planning.
- Development of performance measures.
- Benchmarks for measuring operational efficiency.
- A commitment to quality improvement.

Figure 4

LAO Assessment of the Pilot Project

- Pilot project lacks sufficient definition.
- Despite project schedule slippage, implementation should not be rushed.
- Participating departments are only partially representative of the range of departments in state government.
- Implementation costs will occur, and should be budgeted for.
- Performance needs to be verified independently.
- Sanctions for poor performance should be considered.
- Departments may need additional motivation to ensure a fair test of performance budgeting.

project. To date, the Legislature has not been provided sufficient details regarding the administration's performance budgeting project. Specifically, the Legislature has not been provided the following information:

- A detailed implementation schedule showing major tasks and milestones.
- How the administration and the Legislature will be involved in developing performance measures.
- How the actual performance of a pilot department will be evaluated.
- The form budget contracts will take and how they will be submitted to the Legislature.
- An estimate of the cost to implement performance budgeting and a proposal on how it will be funded.

“Some of the delay (of the pilot) may be appropriate, if it reflects a cautionary approach to getting the pilot done right.”

We recommend that the administration provide this information to the Legislature as soon as possible, but no later than the submission of the 1994-95 budget.

Project Schedule Has Slipped

The administration initially indicated that the pilot project would be implemented in the current fiscal year through budget “contracts” with the Legislature. The administration advised that the contracts would probably be in the form of a letter to the Legislature, in which the administration would commit to certain results in exchange for an approved budget.

At this time, however, the DOF has no budget contracts planned for the current fiscal year. Senate Bill 500 requires implementation of such contracts in 1994-95.

As noted above, the DOF's schedule has slipped. In part, this is due to the fact that the department had not developed the type of up-front planning that it should have. Some of the delay, however, may be appropriate, if it reflects a cautionary approach to getting the pilot done right.

Pilot Departments Could Be More Diverse

The four pilot departments selected by the administration are

only partially representative of the range of departments in state government.

Two of the four pilot departments, General Services and the Stephen P. Teale Data Center, are primarily departments that serve other state departments. Of the remaining two, only Parks and Recreation has a significant General Fund allocation (approximately \$44 million), which is relatively small when compared to many other state departments. Given the continuing difficulties with the General Fund, it would seem desirable to include in the performance budgeting pilot project a department with a more significant General Fund allocation (for example, the Department of Justice). Alternatively, the Legislature could consider adding a department that is a traditional caseload budget (for example, the Department of Rehabilitation).

Only Up-Front Costs Are Certain

Experience in other states and a review of the DOF's proposal for California indicates that, while significant benefits are typically anticipated, the only certainty is that there will be costs to implement the pilot project. These costs reflect:

“Performance budgeting, like many approaches to reinventing government, is neither new nor a panacea for addressing all the ills of government.”

- Staff time devoted to establishing and maintaining performance budgeting.
- The development and maintenance of strategic plans.
- The development and maintenance of management information systems to collect, monitor, and evaluate performance.
- The implementation and maintenance of new programs designed to continuously improve the quality of work performed.

The administration’s pilot project proposal mentions activities for which there will have to be an expenditure of resources, but the proposal does not indicate whether project costs will be budgeted or are to be absorbed by participating departments. Such costs could be significant.

Proposal Should Include Independent Verification

With respect to verifying the results of the performance budgeting pilot, the administration has not yet spelled out how this is to occur. Much of the literature on performance budgeting notes the problems associated with the credibility of performance reports. The difficulty with credibility has occurred in other states primarily

in the legislative branches, where there has been reluctance to accept performance assessments made by departments. This is because legislative staff generally have not had the time or resources to assess the reliability of the reported results. In order to avoid this situation, we believe that verification should be performed by an independent entity, such as the Bureau of State Audits.

Sanctions For Poor Performance Should Be Considered

The administration’s proposed pilot project includes rewards as incentives for participating departments to do a good job. In addition to being able to retain and redirect to other “discretionary” activities 50 percent of any savings achieved during the year, pilot departments would be freed from certain external controls.

Despite these incentives, it is possible that a department may not deliver the promised results. Indeed, increasing managerial flexibility carries with it a potential for increased failure. In such instances where this may occur, and depending on the magnitude and reasons for failure, it may be appropriate to apply sanctions. We think that such sanctions should not take the form of budgetary or administrative constraints, which could

have an adverse impact on departmental programs, but be more in the nature of sanctions applicable to those making the promises and those possessing the authority to fulfill them (for example, not granting a pay increase or, in extreme cases, removal from a position).

Additional Motivators and Longer-Term Commitments May Be Needed

As noted above, the administration proposes to allow participating departments to reinvest 50 percent of their savings into discretionary activities. It is not clear whether such discretionary activities would allow employees to share monetarily in the savings (for example, through a program similar to existing state programs that allow monetary awards for exemplary work). If such sharing were contemplated, this would likely provide additional motivation, and a greater level of commitment to performance budgeting.

While managers may be motivated simply by the relaxation of external controls, unless certain controls are relaxed on a longer-term basis, the level of commitment by managers may be short-lived. For example, if pilot participants are provided an exemption from Department of Personnel Administration

(DPA) requirements governing organizational structure, what will happen to a department that which has reorganized in a manner not consistent with the DPA's rules once the pilot project is over? This is an important consideration, given that managerial classification and pay levels are based generally on current organizational models. Therefore, if the pilot test is to be as meaningful as possible in terms of demonstrating the potential of performance budgeting, consideration will have to be given to extending some exemptions for some period of time beyond the termination of the pilot project.

SOME CAUTIONARY OBSERVATIONS

Solid Foundation Is Important

As we have noted earlier, an adequate test of performance budgeting will require several years and therefore could span a couple of administrations. Given the necessity for both gubernatorial appointees and other high-level managers to buy into the pilot program, a solid foundation is required in order to ensure the appropriate level of commitment from current and future administrations. A well-defined pilot program, with administration and legislative roles

clearly agreed upon, would provide such a foundation.

lems filling key job classifications, or conflicting objectives.

Performance Budgeting Is Not a Panacea

Performance budgeting, like many approaches to reinventing government, is neither new nor a panacea for addressing all the ills of government. Thus, the Legislature needs to be realistic about this approach to changing governmental operations. 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, prob

THE LEGISLATURE'S ROLE IN PERFORMANCE BUDGETING

A Change In Perspective Is Needed

Despite the limited progress to date and the cautionary notes discussed above, we believe that performance budgeting has merit and is worth pilot testing. This is because it offers the potential of improving the delivery of services by focusing on program results. In order to realize these potential improvements, however, we believe the Legislature will need to change its general perspective toward the budget process, as shown in Figure 5.

Figure 5

Performance Budgeting Will Require A Change In the Legislature's Perspective Towards the Budget Process

- It needs to be willing to relinquish some controls over departments and programs.
- It needs to focus on program mission, goals, and outcomes, not on inputs and processes.
- It must be willing to accept a longer-term view of implementation and results.

"...it's important that the Legislature 'breaks the mold' in the way that it appropriates funds for the pilot departments."

In short, the steps shown in the figure indicate that the Legislature has to give up the traditional type of budgetary control it exercises over departments. It would relinquish the more detailed short-term control it now has over the resources given an agency, hopefully in return for more longer-term control over

the mission, direction, and outcomes of the agency. This is not an easy task, as has been shown in those states which have implemented performance budgeting. However, these changes are a necessary precondition if performance budgeting is to have a chance of success.

Figure 6

A Joint Legislative Committee Should Be Formed to:

- Obtain more specific information from the administration on its plans to implement performance budgeting.
- Review and approve performance measures.
- Review proposals to exempt pilot departments from statutes.
- Review proposed budget contracts.
- Consider whether sanctions should be included in the pilot project.
- Consider adding to the pilot project other state departments.

Different Approach Needed to Implement Performance Budgeting

A changed perspective on the budget process alone may not be enough to ensure successful implementation of performance budgeting. This is because performance budgeting is such a significant departure from the way the state has budgeted resources in the past. As a result, we recommend that the Legislature consider a completely different method to budget resources for the pilot departments. For instance, it is critical that both houses provide uniform direction to the pilot departments. In addition, it's important that the Legislature "breaks the mold" in the way

that it appropriates funds for the pilot departments. In order to address these unique concerns, we recommend the establishment of a joint legislative committee to oversee the pilot project and review the budgets of the pilot project departments. The joint committee would include representation from the fiscal committees and relevant policy committees of both houses. Figure 6 lists the specific activities we recommend the committee carry out.

One of the key functions of the committee would be to review and approve the performance measures. Figure 7 identifies key ingredients for designing the performance measures.

Figure 7

Key Ingredients for Designing Performance Measures

- 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.

This joint committee would be acting *in lieu* of the normal budgeting process. As noted above, this is a significant departure from current practice. In making such a recommendation, we are attempting to offer a possible alternative that still meets the Legislature's needs for input and involvement from the membership.

CONCLUSION

The Governor's proposal to pilot test performance budgeting provides an opportunity to demonstrate improved governmental effectiveness through a new approach to developing and managing budgets. In order to provide the most meaningful test of the Governor's proposal, both the executive and legisla-

tive branches will need to cooperate in specific ways throughout the pilot test. Both branches also will need to be willing to change the manner in which they have traditionally dealt with budgets. In order to enable a cooperative relationship between the executive and legislative branches to work well, the administration needs to provide considerably more detail concerning its plans for performance budgeting. The joint legislative oversight committee, which we recommend, based on the desire to ensure a meaningful test of performance budgeting, would provide the forum for a discussion of the administration's plans, and facilitate the Legislature's participation in the pilot project.