AN ANALYSIS OF THE BUDGETARY AND FISCAL ANALYSIS PROPOSALS OF THE CALIFORNIA PERFORMANCE REVIEW

Prepared Statement for the Little Hoover Commission
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Today I will confine my comments to two topics: what we as academics know about major attempts at government reorganization such as the California Performance Review (CPR) and how you should think about and analyze the pros and cons of the CPR's recommendation to create a new Governor's Office of Management and Budget that would largely merge the budgeting and management staff functions.

I base my comments on three decades of writing on organizational design and public budgeting and a decade as a budget practitioner for the Congress of the United States. My practical experience goes back to the 1970s when as a junior staff member of the Congressional Budget Office (CBO) I was charged with creating the CBO methodology that we would use to estimate the cost savings of then President Jimmy Carter's proposed federal reorganization. My experience also includes CBO's effort (in partnership with the GAO) to estimate the cost savings of the Grace Commission during President Reagan's tenure. I hope this experience has not made me too cynical of the positive effects of large-scale reorganizations.

I. GOVERNMENT REORGANIZATION: THE GREAT & LARGELY UNREALIZED HOPE.

Here are four points that I believe you should keep in mind as you analyze the California Performance Review (CPR).

(1) Few Major Public Sector Reorganizations Are Actually Enacted and Implemented: The first, and perhaps the most important fact about large-scale reorganizations in American government is that very few have been enacted and even fewer successfully implemented. Thus, the classic history of federal reorganizations – Peri E. Arnold's Making the Managerial Presidency (Arnold 1998) – is basically a story of the substance and non-adoption of proposals rather than a history of the effects of reorganizations.

(2) Reorganizations Are Mostly About the Reallocation of Power: The second basic fact of governmental reorganization in the US is that although traditionally advocated on efficiency grounds, in the end what reorganizations tend to be all about is the allocation and reallocation of power. There is a long history of progressive reformers of American government, going back at least as far as Woodrow Wilson and his first academic article on "The Study of Administration" in 1887, desiring to make government more businesslike (Wilson 1887). The general thrust of many reorganization plans has been to rationalize organizational structure to reduce redundancy, establish clear lines of authority and thereby achieve greater accountability and economies of expenditure. Even more recent reorganization efforts, which rightly stress the advantages of creating a more customer-oriented management culture in which managers are to be judged by whether they achieve agreed upon policy goals, end up being sold on the grounds that they will reduce the size of government. If you do not believe this just review the history of the Clinton Administration's reinventing government initiative.

As indicated, in practice, major reorganization efforts involve the reallocation of power. Moreover as Professor Jeffrey Pfeffer of Stanford's Graduate School of Business points out this is equally true for private firms as well as the public sector organizations (Pfeffer 1994)

Even the classic federal reorganization effort – the First Hoover Commission – while initiated as an effort to reduce the size of government ended up advocating reforms that increased the power of the presidency. As such, it ended up creating tools that presidents would later use to increase the size and scope of federal activity. Peri E. Arnold (Arnold 1976) describes how the staff of the First Hoover Commission exploited ex-President Herbert Hoover's belief in a strong executive to divert Hoover from his initial goal of using the Commission to roll back the New Deal to a final report that by advocating greater executive power created the managerial conditions for a stronger presidency which later Democratic presidents used to increase the size of government.

This tradeoff between achieving a smaller more efficient government and reallocating power toward the executive is important when considering the proposals of the California Performance Review (CPR). The CPR seems to contain two classes of proposals. There are many suggestions of programmatic changes that the CPR claims will reduce state expenditures, increase state revenues and thereby help close the State's structural deficit. But the CPR is also a document that seeks to increase the power of the Governor.

My experience in costing out the claimed savings of the Grace Commission lead me to be wary of the savings claimed by the CPR. But even more important I have the feeling that what the CPR is really all about is increasing the power of the California Governor.

The passage of Proposition 140 (term limits) has led to a decline in the power of the California Legislature. We now have a strong activist governor and a fully term-limited Legislature. It is not surprising, therefore, that such a governor would seek a reorganization that shifts power from the Legislature and other units of state government into her or his own hands. But in analyzing the CPR you should think beyond this particular governor to how the new powers of the chief executive will be used by future governors with different policy agendas.

(3) Reorganizations Rarely Lead to Lower Levels of Spending Through Efficiencies: One might argue that even if they are mostly about reallocating power reorganizations can still lead to efficiencies. But unless the reorganization involves real policy choices what data we have indicates that reorganizations rarely if ever lead to lower levels of expenditures or fewer personnel. For example, in one of the few empirical studies that we have of state reorganizations Kenneth J. Meier analyzed 16 state level reorganizations that were successfully implemented between 1965 and 1980. He found that, "Of the 16 reorganized states, only three showed a statistically significant long-term decline in employment while none showed a significant short-term decrease. None of the short- or long-term reductions in expenditures were statistically significant." (Meier, 1980, pp. 410)

This is not to say that reorganizations cannot lead to reductions in the size of Government, but rather that such reductions come from and require positive policy changes rather than simple managerial efficiencies. And these policy changes lead to real changes in the amount of goods and services provided by government. As such they do not automatically occur through "painless efficiencies" but require political support for the provision of fewer goods and services.

As in many things involving political economy the ultimate evaluation comes from Franklin D. Roosevelt, "We have to get over the notion that the purpose of reorganization is economy…I had that out with Al Smith in New York….The reason for reorganization is good management." (quoted on page 12 of Seidman1998).

(4) Reorganizations Are More Likely to be Successful When There is Agreement on the Purposes and Goals of the Reorganization: As you know, and as the testimony of the other members of today's panel make clear, modern reorganizations (particularly those in private firms) are about much more than simply moving the boxes around. Today, most organizational theorists do not believe there is one right way to manage or one right way to structure an organization. Instead most scholars of organizations have adopted a contingency model of organization design. In short, "it all depends."

This being the case, one might ask, "What is the correct organizational design?" One answer is that the key to a good organizational design is to have the various components of an organization – its goals, its tasks, its strategy, its structure, its personnel, its incentive structures, its information systems, etc. – reinforce each other rather than undercut each other. (See for example: Gailbraith, et. al. (2002)) It follows from this approach that the necessary requirement for a successful reorganizational effort is widespread agreement on the goals, values and policies of the organization.

This, in turn, explains why successful reorganizations are less likely to occur in the public sector than in private firms since by definition politics – and thus disagreements over values -- is at the heart of public sector activity. It also explains why Frederick C. Mosher found that public sector reorganizations were more likely to succeed when they focused on a narrow administrative problem than when they involved a change in an agency's mission (particularly if that change was imposed from outside) (Mosher 1967).

II. COMMENTS ON THE CPR'S PROPOSED CREATION OF AN OFFICE OF MANAGEMENT AND BUDGET FOR CALIFORNIA

As you know the California Performance Review proposes the creation of a Governor's Office of Management and Budget that would bring together a wide variety of staff functions. I think this would be a mistake primarily because it would create an agency with a wide variety of cultures (based on the very different professional norms of the wide variety of staff that will be needed to carry out the long list of functions). Think about the mess that is the US Department of Homeland Security.

On the other hand given that budgeting is inherently an executive function, as Roger Noll has argued, it makes sense to increase the governor's power over the preparation and execution of the budget (Noll 1995). Noll's recommendation, which I would support, is to eliminate the elected offices of Board of Equalization, the State Treasurer and the Secretary of State (as well as an independently elected Superintendent of Public Instruction). The governor should be solely responsible for the executive budget functions (preparation and execution). Only the Comptroller, who acts as a check on possible executive branch malfeasance, should be independently elected.

(1) What Functions Should Be Included in the New Office of Management and Budget? The proposed OMB includes a wide variety of functions ranging from those that are clearly budgetary and fiscal to those that relate to personnel and those that relate to information technology. In general these can be grouped into budgetary and management functions.

If the federal government experience is any guide I would predict that in practice the budgetary function will drive out the other functions, which will become little offspring of the agency. For years, for example, public administrators have advocated increasing the power of the "M" in the federal OMB. But the management function will always be driven out by the budgetary function since one *has* to make budgetary decisions each year while management changes *can or cannot* be made.

(2) Will The New Structure and Procedures Solve California's Fiscal Problems? I do not believe that the reforms proposed by the CPR will solve California's budget problems since they to not address the source of those budget problems – the super majority vote requirements for raising taxes and enacting the budget.

Today, California has a structural shortfall (defined as a shortfall that will not disappear via realistically expected rates of economic growth) of somewhere around $10 billion per year. The reason for the shortfall is that during the dot-com bubble the State brought in about $10 to $12 billion in additional revenues from taxes on stock options and capital gains. After several years the then Governor and the then Legislature decided to increase permanent (as against one-time) spending – primarily on K to 12 education, medical care and tax relief. When the dot.com bubble burst and the bubble revenue evaporated the state had several options – increase taxes to make up for the lost revenues, reduce expenditures, or some combination of these two actions. If the super majority voting requirements were not in the California Constitution the State would not have undergone a fiscal crisis. The Democrats controlled the Governorship and both chambers of the Legislature and as a result would have closed the gap largely through the enactment of higher taxes. The voters would have then judged their actions.

But the super-majority voting requirement prevented this solution and the Democrats were unwilling to make the spending reductions (and the resulting reduction in the provision of goods and services – such as California once again being ranked 47th in the country in spending per K-12 pupil) that would be required to close the shortfall through spending cuts.

Thus, California's problem is a political problem not a budget process problem. From my conversations with the state rating agencies, moreover, it is clear that California's low bond rating is a result of those agencies making a judgement about California's political process rather than its economic health. All the rating agencies judge is the likelihood that the bondholders will get their money. Their current judgment is that California's political deadlock increases the likelihood that the state will default.

(3) Is Performance Budgeting the Solution to California's Budget Problems?

Performance budgeting is the current rage among budget reformers. And there is no doubt that it makes sense to establish outcome (and output) goals and then prepare budgets based on these priorities and then evaluate programs based on whether or the degree to which they actually achieve those priorities. The CPR recommends that a priority setting process be institutionalized and places it in the new OMB.

But there is a fly in the ointment – the very process of creating the rank order of priorities is a political process and as such is subject to the same forces that currently underpin California's budget deadlock. Periodically performance budgeting works and one frequently cited example is Governor Gary Locke's goal-setting effort in Washington State (Osborne and Hutchinson 2004). But for every success there are failures such as the collapse of Oregon's priority setting system and prior attempts to determine priorities in pilot California state agencies.

Moreover, the CPR recommends that priority budgeting be institutionalized, in effect, as a planning process. The danger here is that the State will create a planning bureaucracy that will create plans that are never used. A recent example of such a planning effort is The Government Performance and Results Act of 1993 (GPRA) that required all federal agencies create plans that set out specific goals by which those agencies would be judged in the budget process. After ten years agencies are still creating plans but there is little evidence that they are being held accountable for the content of those plans (Barr 2004). What do planners know how to do? – plan. What is needed in California? – political skill and political courage.

Many years ago, the founder of my School, Aaron Wildavsky, wrote an essay on how important is was to save analysis from systems (in his time the PPB System of the 1960s) (Wildavsky 1969). I would argue that the same is true today.

Rather than a new "system" I would recommend that the governor – and the legislature – be given increased analytic power. The goal here would be to provide information to decision makers so that they know the consequences of alternative actions and to provide citizens with information so that they can hold their elected officials accountable. Given the current structure of many government programs this information has to be presented in a multi-year framework.

Such a system is not perfect. Many seek to bias the decision making process by providing protections for certain types of activity (such as K to 12 spending) or making it more difficult to undertake certain types of actions (such as raising taxes). I am against all such biases. I would follow the classic budgeting norm that all activities should be equally susceptible to adoption or rejection. (The classic norms of budgeting are set out in Ellwood 1995.)

But under category of fair disclosure I must tell you that eliminating the super-majorities that currently govern the California budget process would lead to a larger state government – about 8 percent larger by one econometric estimate (Besley and Case 2003).

I can live with such a result. Can you?

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