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NO SUCH THING AS A QUICK FIX

Key problems: *The costs of operating state programs are growing faster than the revenue base that supports them. The revenue system is highly sensitive to changes in the economy, producing volatility. The single-year budgeting horizon encourages short-term fixes, rather than long-term solutions. The budget does not take a strategic approach to ensure a return on public investments and there is a lack of public and legislative review of how money is spent.*

The bottom line: *The common good would best be served by controlling costs, managing volatile revenue and taking a long-term investment approach. Through a strategic budget process, policy-makers can set priorities, redirect funds to better solutions to difficult problems, and make steady improvement toward public goals. A reformed budget process would enable the Legislature to do better oversight and has the potential to increase public trust.*

State budget process crippled by chronic shortsightedness

By Leon E. Panetta and Thomas McKernan - Special to The Bee
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Ask any cardiologist: By the time you are buckled over with chest pain – you think your heart is about to explode and you are terrified of dropping dead on the spot – it's too late for diet and exercise. When that moment arrives, your only choices are painful and expensive – and if you survive, recovery will take time.

Our state's fiscal pains are no different. We have long ignored the budget versions of "diet and exercise," and elected officials face painful budget surgery and politically lethal tax increases. Given the role of ballot initiatives and the churning caused by term limits, today's legislators for the most part inherited the difficult choices that confront them. And ironically, the most significant reforms they could make will benefit their successors much more than themselves. But that is the immediate peril of leadership and the delayed gratification of legacy.

In a Capitol where deficits have become routine and partisanship is a virtue, it is hard to see how a deal will be struck before the state runs out of cash in September. But history tells us that there is a deal to be had – and the question is which programs will be cut, who's taxes will be raised and how much will be added to the growing tab being left for the next generation of Californians.

What is less certain is whether California's leaders will do anything as part of that budget deal that will begin to put the state on the road to a healthy recovery. Even an honestly balanced budget, by itself, will not address the causes of chronic budget deficits, growing dissatisfaction with the performance of essential public programs and increasing distrust of government. Just as bypass surgery only buys time, unless long-term reforms are enacted, California's fiscal ills will quickly return.

Diagnosing the state's fiscal problems is not difficult. In recent years there have been more than a dozen thoughtful critiques of the dysfunctional fiscal relationship between the state and the thousands of local governments, of the volatile and antiquated state tax system, and the increasingly obscure process for allocating more than \$140 billion each year through the state budget.

To begin a public dialogue on fiscal reforms, California Forward, a bipartisan organization, distilled the analyses of the budget process into a set of problems and principles. Those concepts were refined by examining the best practices in other states, then informed and validated by conversations with scores of community leaders and daylong meetings with randomly selected Californians.

Through this process, we identified five overarching issues:

- **Out of control costs:** The costs of operating state programs are growing faster than the revenue base supporting them. State leaders need better ways to identify and control costs and make sure the state doesn't commit to programs it cannot support.
- **Volatile revenues:** The revenue system is highly sensitive to changes in the economy, producing significant volatility. The state needs to better manage that revenue to stabilize budgets and make the tax systems more reliable.
- **Short-term fixes:** The single-year budgeting horizon encourages short-term fixes rather than long-term solutions. Multiyear planning can help ensure that policy choices are sound and programs are managed to reduce costs and deliver results.
- **No performance standards:** The budget does not take a strategic approach to ensure a return on public investments. Setting priorities and goals can focus the public and policy-makers on how the money gets spent, not just how much more will be spent than the year before.
- **Little oversight:** There is a lack of public and legislative review of how money is spent. Both legislators and the public think there should be a more thorough and consistent review of how effectively dollars are spent.

For each one of these problems, we identified conceptual solutions that have been recommended or implemented by other governments – from a "Pay-Go system" to make sure new programs don't run up future deficits, to multiyear fiscal plans that

make sure budget deals really pencil out. Many of these reforms have been endorsed or enacted elsewhere by bipartisan organizations or through bipartisan agreements.

The assessment of California Forward's own bipartisan Leadership Council is that some of these solutions may be favored by Republicans or Democrats, but together a package of reforms with these elements would improve fiscal stability, the performance and accountability of public programs, and the public's understanding of how their money is spent. No one should disagree with those goals, and so we have no time to lose getting to work on the details.

It might help our besieged leaders to know that these are reforms that Californians would like to see. It is easy, by looking at the polling and listening to the interest groups, to see why elected officials have difficulty reaching a deal. Few Californians want to raise their own taxes or see cuts to the programs they cherish.

But from six daylong dialogues with Californians throughout the state, we know that there is broad belief that the budget process is irrational and – accurately or not – that poor decisions are being made about where their money gets spent. Making the budget process more rational and more responsive to the state's needs is clearly a top priority of Californians.

The participants supported taking two concrete reform steps as soon as possible to restore public trust in the system:

- First, they want to be able to see where their money is going and whether programs are working.
- And second, they want to get off this roller coaster of boom-and-bust budget cycles. They acknowledge the weakness of our current system, where budget decisions are made in a single year and revenue volatility makes spending decisions exponentially more painful every year. But they want long-term budgeting and planning, where the system is flexible enough to respond to changing circumstances. They want the government to explain the impacts of their budget decisions beyond the current year and make visible improvements for future generations.

California Forward heard similar concerns from community leaders in regional forums last winter and spring. In Los Angeles and Fresno, San Jose and San Francisco, community leaders argued less about the size of government and emphasized instead the effectiveness of government. Business leaders in particular seemed perplexed that state leaders don't set priorities or goals when allocating billions of dollars, or track results. Some local government leaders – such as in San Mateo and San Diego – have been doing this for years and are waiting for the state to get on board.

These are changes our Legislature and governor can implement this year. To the extent that new revenue will be used to balance the budget, these reforms could bring comfort to Republicans that the money will be better spent. To the extent that Democrats want to protect vulnerable Californians, stable and steady improvement in outcomes is a far better strategy than boom and bust.

That was part of the deal that was struck in Virginia, which consistently receives high marks from the Government Performance Project of the Pew Center on the States. Virginia's state budget does not focus on how much money will be spent, but what the state is doing with the money. A view of progress toward goals is readily available.

By comparison, in California we have long-running debates about whether we can even fairly track performance – as if we don't have to do a better job every year.

We know that putting these types of improvements in place will be difficult. Any change that will limit the influence of interest groups or increase the public scrutiny of public programs will have opponents concentrated in the Capitol, while the beneficiaries – taxpayers, parents, clients and patients – will be distributed in neighborhoods around the state.

For more than a generation, California's fiscal systems have continued to devolve into a complex mess under which it is difficult for officials to make good decisions and for the public to know whether their money is well spent.

In the 1990s, our country faced serious financial challenges, and the government's money problems were being felt on Wall Street and Main Street. At the federal level, we were running huge deficits and debt mounted during relative peace and prosperity. Fiscal decisions were not based on what was in the nation's long-term best interest, and we committed ourselves to making the public interest our lodestar. We entered into negotiations, Congress and the White House, Democrats and Republicans. We agreed to put everything on the table – and nothing was agreed to until everything was agreed to. When we were finished, we had brought the federal budget into balance, and established a "Pay-Go" policy that required elected leaders to make difficult decisions rather than push debt onto the next Congress and the next generation.

For just as long, smart Californians have recommended similar solutions, but reforms have not been put in place.

California Forward was created in part to make it easier for elected officials to take on the politically dangerous task of putting in place public-interest reforms. The budget principles were assembled to start a bipartisan discussion – and when we agree on the principles, we can work on the details. The more Californians are involved, the easier it will be for their elected representatives to find principled compromises.

We know that these types of reforms can find bipartisan support. They are a step in the right direction, and California Forward wants to contribute to their adoption and success. It will be challenging, but for California to achieve its economic, social and environmental goals, our leaders must make these comprehensive changes to how key decisions are made. The state has had enough of fiscal crisis. It is time for leadership.

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Principles for improving state fiscal decisions

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In recent decades, California's fiscal system has evolved in ways that have made it difficult for state and local agencies to consistently provide high-quality services and proficiently respond to complex problems. The fiscal system does not suffer from a single ailment, and many of its infirmities are the unintended consequences of previous efforts to "fix" the system or respond to the imperative of the moment.

For California to achieve its economic, social and environmental goals, government agencies must manage revenues to continuously improve the quality and efficiency of education, transportation, public safety and other programs. This will require comprehensive changes to the fiscal system and how key decisions are made.

The significant gap between revenues and spending is a symptom of this dysfunction. Given the size and complexity of the issues, strategic and incremental changes are more likely to succeed. A logical first step is to improve the state's annual budget process – the central venue for fiscal choices that then ripple through the thousands of public agencies statewide. Five major problems and principles for solutions follow.

Problem: The state's spending obligations grow faster, on average, than revenue.

Solution: • Control escalating costs. The state needs to systematically scrutinize fast-growing expenditures to control costs or get the job done in a different way.

- Pay as we go. New programs and major expansions of existing programs should have an identified funding source as a condition of approval.

- Analyze the impact of tax breaks on the budget. Incentives in the tax system should be analyzed periodically to determine if they are effective.

Problem: California's volatile revenue system requires better fiscal management to ensure reliable public services through good times and bad times.

Solution: • Manage one-time revenue. Major "spikes" in revenue should be used to maintain a significant reserve and one-time purposes, such as infrastructure investment or tax rebates.

- Manage midyear shortfalls. The state needs a joint executive and legislative response to declining revenue during the budget year.

- Modify the tax system. One ingredient to long-term fiscal balance is to adjust the tax system to reflect the contemporary economy.

Problem: The one-year lifespan of the state budget puts too much emphasis on matching revenue and spending in a single year rather than strategically investing public dollars to meet critical needs over the long-term.

Solution: • Consider long-term impacts. When making fiscal decisions, policy-makers and the public should understand the long-term fiscal impacts of choices to better control costs and improve the return on investment over time.

- Evaluate long-term impacts of budget decisions. Increase public awareness of long-term commitments.

Problem: While the budget appropriates more than \$140 billion a year, it does not set clear priorities or ensure that dollars are allocated in the best way to achieve results.

Solution: • Focus on results. The governor's proposed budget and the budget act should be developed and discussed with a focus on improving results.

- Publish the results. Californians and their elected leaders should have information on the quality of public services and the impact of those services on individuals and communities.

Problem: Elected officials spend more time debating incremental changes in state spending than whether money is well spent – and how it can be better spent in the future.

Solution: • Seek agreement on goals. The Legislature should organize its fiscal activities to achieve broader agreement on the state's goals and the fiscal choices that will best advance those goals.

- Conduct better oversight. The Legislature should systematically review the performance of programs and their contribution to the state's goals and objectives, and encourage expert and public comment on how public funds could be better used to achieve objectives.

Source: California Forward
