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Changing the Rules of the Game:  
Comprehensive Changes to  
California's Fiscal System and  
Decision-Making

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The summer of 2009 will be remembered as the year the governor and legislature took long-standing priority programs apart. As a state we must begin to focus on reviving California state and local government by establishing a framework for realigning state and local government responsibilities—on the revenue and expenditure side of the policy agenda.

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For the past year, *California Forward*—a bipartisan and public interest governance reform effort—has been consulting with Californians about better ways of making fiscal decisions. Based on these discussions and the rapidly degrading economy, we believe the promise of substantive budget process reform is essential to successfully persuading voters to support a new and more effective budget making process.

Our budget-related conversations with Californians have focused on five problems:

**1. Short-term fixes:** The single-year budgeting horizon encourages short-term fixes rather than long-term solutions. Multiyear planning can help ensure that policy

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choices are sound and programs are managed to reduce costs and deliver results.

**2. 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. California's dependence on a highly progressive personal income tax results in General Fund revenues that are more volatile than in most states. Since 1990 revenues have fluctuated from a decrease of 5% to an increase of 23%. That volatility in revenue makes it difficult for state leaders to plan and effectively manage public resources. When revenues are growing faster than the base budget, policymakers strive to lock in those new dollars to new initiatives, or to expand existing programs. Program advocates then strive to fend off cuts when revenues return to normal or decline. Program performance ultimately suffers from false starts, budget uncertainty, and ultimately unanticipated cuts.

**3. 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 policymakers on how the money gets spent, not just how much more will be spent than the year before. Even during the good times, state leaders grappled with growing costs and disappointing outcomes in essential public programs.

**4. Uncontrolled costs:** The costs of operating state programs are growing faster than the revenue base supporting them. State leaders need better ways to identify efficiencies and avoid making commitments they cannot keep. Policymakers find it easier to create new programs rather than improve existing ones, and there is no incentive to eliminate ineffective programs or those that are no longer a priority. Policymakers are encouraged to create small programs, with the hope that they will grow over time. In good years, base spending is ramped up, which sets up a conflict among these programs and their advocates when revenue declines. Similarly, tax cuts are imposed without offsetting decreases in spending or reliable increases in other sources of revenue. As the structural deficit has grown, state policymakers have shifted liabilities to other governments or into the future.

**5. 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. 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.

The assessment of *California Forward*'s own bipartisan Leadership Council is that fiscal system reforms can find favor with Republicans and Democrats, and that together a package of provisions 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.

Based on the best budget practices in other states and after consulting with thousands of Californians, it is clear—to address those five problems—we must do the following:

**1. Look to the future.** A multiyear budgeting system would focus fiscal choices on long-term implications and discourage short-term solutions that push liabilities and difficult decisions into the future.

**2. Focus on priorities and outcomes.** A results-based process for making budget decisions would enable leaders to assess whether to increase, continue, or alter policies and programs, rather than letting budgets grow on autopilot, regardless of whether services are, in fact, having a positive impact on the lives of Californians.

**3. Create a culture of accountability.** The legislature does not dedicate adequate time to reviewing whether programs are achieving their goals and what must change for them to improve. Budget decisions should be guided by what programs are trying to achieve and what must change to achieve those goals.

**4. Pay our own way.** Create a process so that any policy change that increases costs must also contain a provision that identifies where the money will come from, whether new revenue or expenditure reductions elsewhere.

**5. Create stability.** A new budget process would identify nonrecurring revenue and hold it for times when economic downturns reduce tax revenue. Since 1990, revenues have fluctuated wildly—from a decrease of 5% to an increase of 23%, which makes it difficult for state leaders to effectively manage resources.

These reforms will not close the budget gap, but had these reforms been in place we would be dealing today only with the problems associated with the recession—and not the chronic fiscal problems that have stifled steady progress in education, health care, environmental protection, and public safety.

These reforms have the promise of more stability and the potential to get past the partisanship that has come to define the Capitol in good times and in bad. Making the state budget system more accountable over the long term will help pave the way for further attention given to government realignment reforms.