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2009-10 Budget Analysis Series

Resources and Environmental Protection

CONTENTS

EXECUTIVE SUMMARY

The Governor's budget proposes $7.1 billion from the General Fund, various special funds, and bond funds for resources and environmental protection programs in the budget year. Apart from a proposal to phase out the California Conservation Corps (CCC), the budget proposes few program reductions. New spending proposals include the Governor's Emergency Response Initiative (ERI) and a proposal to modify the funding of recreational uses of the State Water Project (SWP).

Balancing the 2009-10 Budget

Governor's Proposals—Mainly More Borrowing

The Governor's budget proposes only one significant budget-balancing solution in the resources and environmental protection areas—$350 million of loans over the current and budget years from various special funds to the General Fund. The budget also proposes to phase out CCC and realign some of its functions to the local level, for a General Fund savings of $24 million once the Corps is completely eliminated, and shift $11 million of funding for the Department of Parks and Recreation (DPR) from the General Fund to bond funds. We generally recommend approval of these proposals, although we propose modifications to the budget proposal to eliminate CCC in a way that creates additional budgetary savings.

LAO Recommendations for Fee-Related Budget Solutions

We offer a number of recommendations for achieving General Fund savings by shifting funding for the support of certain resources and environmental protection programs from the General Fund to new or increased fees. Fees are an appropriate funding source in these cases, in our view, because the state is either providing a service directly to beneficiaries (such as wildland fire protection) or administering a pollution control program that should be funded on a "polluter pays" basis (such as a water quality regulatory program).

Our fee proposals include: (1) enacting a new fee on property owners with structures in areas of the state benefiting directly from the state's wildland fire protection services; (2) increasing Department Fish and Game (DFG) regulatory fees to fully pay for two regulatory programs; (3) expanding the fee base of State Water Resources Control Board (SWRCB) so that a larger group of water polluters pay regulatory fees; and (4) shifting the cost of the scientific support activities of the Office of Environmental Health Hazard Assessment (OEHHA) that support regulatory programs in other state agencies to regulatory fees.

LAO Recommendations for CalFire General Fund Reductions

We recommend a package of program reductions and expenditure deferrals in the California Department of Forestry and Fire Protection's (CalFire) fire protection budget to create General Fund savings of $55 million in 2009-10, with $28 million of ongoing savings. These include eliminating funding for a DC-10 aircraft contract, closing lower-priority fire stations, and deferring vehicle replacements and a capital outlay project to a later year.

Other Issues

Recommend Rejection of Governor's ERI. We recommend rejection of the Governor's proposal to levy a new surcharge on property insurance policy premiums statewide. The resulting revenues are proposed to expand emergency response activities, mainly within CalFire, including for information technology (IT) upgrades and a permanent expansion of staffing on fire engines statewide. We find that the proposed surcharge (which would be a tax) is not an appropriate funding source for the activities in question, and we separately reject most of the proposed program augmentations on the basis that they do not address a critical and immediate fire protection need.

Davis-Dolwig Act Requires Major Reform. The Governor's budget proposes $39 million ostensibly for recreation and fish and wildlife enhancements in SWP under the terms of the statute, known as the Davis-Dolwig Act, that governs the development and funding of this aspect of SWP. The administration also proposes statutory changes to the law. We recommend that the budget request be denied on the basis that the proposed expenditures would result in few recreation or fish and wildlife benefits. We recommend an alternative to the Governor's proposed statutory changes because the Governor's proposal fails to address fundamental problems that we have identified with the way the act is being implemented by the state Department of Water Resources (DWR).

State Water Project Staffing Not Justified. We recommend the rejection of most of the 111 requested new positions (that would be added to 1,509 existing positions) for SWP, as the request lacks sufficient justification. We again recommend bringing the SWP "on budget" to improve legislative oversight of this sizable program.

Major Delta Policy Issues Facing State. Several recent reports all concur that the Delta is "broken," but offer differing fixes to the problems. There is common agreement that an alternative to the current approach of conveying water solely through the Delta is needed if the state is going to meet its environmental and economic goals for the Delta. We evaluate the administration's approach on the conveyance issue, finding that the analysis being conducted by the administration is too narrow to fully inform the Legislature of the costs, benefits, risks, and tradeoffs of the various conveyance alternatives. We also discuss the information that the Legislature should obtain to establish a sound and sustainable policy for the Delta.

New Funding Framework Needed for Resources and Environmental Protection Programs. We find that there has been an increasing reliance on a plethora of narrowly prescribed special and bond funds to support resources and environmental protection programs. The structure of these funding sources has constrained the Legislature's ability to respond to new funding needs and legislative priorities as they arise. In other words, spending is often driven by available resources, as opposed to programmatic needs. We make a number of recommendations to move the state towards a simpler, more flexible funding structure in these program areas.

BACKGROUND

Governor's Spending Proposal

Total Spending Down by 27 Percent. Expenditures for resources and environmental protection programs from the General Fund, various special funds, and bond funds are proposed to total $7.1 billion in 2009-10, which is about 5 percent of all state-funded expenditures proposed for the budget year. This level is a decrease of $2.6 billion, or 27 percent, below estimated expenditures for the current year. The proposed reduction is almost entirely from bond funds. Specifically, the budget proposes bond expenditures totaling about $1.8 billion in 2009-10—a decrease of $2.4 billion, or 58 percent, below estimated bond expenditures in the current year.

The budget also includes a net reduction of $113 million (5 percent) in General Fund spending, reflecting both proposed spending decreases and increases. On the decrease side, the budget includes a reduction of $248 million for emergency fire suppression, reflecting an estimated lower level of resources in the budget year after the current year's particularly severe fire season drove up spending on firefighting activities far beyond the amounts initially budgeted. Still, even with this decrease, the $189 million from the General Fund proposed for emergency fire suppression in 2009-10 is by far the largest amount ever initially proposed in the Governor's budget plan. This amount is based on the most recent five-year average of these costs. On the increase side, the budget proposes to add $181 million to pay for resources-related bond debt service costs, an increase of 33 percent above estimated current-year expenditures for this purpose.

Multiple Funding Sources; Special Funds Still Predominate. As in the current-year budget, the largest proportion of state funding for resources and environmental protection programs—about $3.3 billion (or 47 percent)—would come from various special funds. These special funds include the Environmental License Plate Fund, the Fish and Game Preservation Fund, funds generated by beverage container recycling deposits and fees, an "insurance fund" for the cleanup of leaking underground storage tanks, and a relatively new electronic waste recycling fee. Of the remaining expenditures, $2 billion would come from the General Fund (28 percent of total expenditures) and $1.8 billion from bond funds (25 percent of total expenditures).

Summary of Resource Spending Proposals. Figure 1 (see next page) shows spending for major *resources* programs—that is, those programs within the jurisdiction of the Secretary for Natural Resources and the Natural Resources Agency. As the figure shows, the General Fund provides a significant amount of the funding for a number of resources departments, with minor increases in some departments, and more significant decreases in others. We discuss the extent to which the General Fund is used to support particular resources (as well as environmental protection) programs in greater depth later in this analysis.

While the figure shows decreased bond expenditures in most resources departments, there is a significant *increase* proposed in DPR, due to a major proposed infusion of bond funds for local parks. In addition, while the budget proposes a net reduction in DWR bond spending of almost $1.3 billion, that number reflects a major new proposal to spend $685 million in bond funds (from Propositions 84 and 1E) for flood control projects and levee improvements in the state's Delta and Central Valley regions. The budget also proposes $38 million (mainly bond

Figure 1

Resources Budget Summary
Selected Funding Sources

(Dollars in Millions)

Department	Actual 2007-08	Estimated 2008-09	Proposed 2009-10	Change From 2008-09	
				Amount	Percent
Resources Secretary					
Bond funds	$90.6	$108.8	$61.0	-$47.8	-43.9%
Other funds	10.7	38.1	26.6	-11.5	-30.2
Totals	**$101.3**	**$146.9**	**$87.6**	**-$59.3**	**-40.4%**
Conservation					
General Fund	$5.0	$11.6	$15.5	$3.9	33.6%
Recycling funds	1,215.7	1,235.4	1,232.1	-3.3	-0.3
Other funds	59.8	78.4	73.9	-0.9	-1.2
Totals	**$1,280.5**	**$1,321.8**	**$1,321.5**	**-$0.3**	**—[a]**
Forestry and Fire Protection (CalFire)					
General Fund	$930.0	$1,026.0	$790.2	-$235.8	-23.0%
Other funds	480.5	467.8	1,011.8	544.0	116.3
Totals	**$1,410.5**	**$1,493.8**	**$1,802.0**	**$308.2**	**20.6%**
Fish and Game					
General Fund	$83.6	$85.1	$75.8	-$9.3	-10.9%
Fish and Game Fund	82.4	90.2	99.1	8.9	9.9
Bond funds	74.5	142.0	109.9	-32.1	-22.6
Other funds	143.7	157.8	177.7	19.9	12.6
Totals	**$384.2**	**$475.1**	**$462.5**	**-$12.6**	**-2.7%**
Parks and Recreation					
General Fund	$157.2	$141.9	$145.0	$3.1	2.2%
Parks and Recreation Fund	121.6	124.6	125.9	1.3	1.0
Bond funds	65.5	161.1	379.2	218.1	135.4
Other funds	119.2	274.3	192.3	-82.0	-29.9
Totals	**$463.5**	**$701.9**	**$842.4**	**$140.5**	**20.0%**
Water Resources					
General Fund	$166.9	$161.3	$129.6	-$31.7	-19.7%
State Water Project funds	1,339.1	987.8	1,030.5	42.7	4.3
Bond funds	630.7	2,025.8	764.3	-1,261.5	-62.3
Electric Power Fund	5,048.8	4,601.4	4,271.6	-329.8	-7.2
Other funds	59.4	113.8	99.2	-14.6	-12.8
Totals	**$7,244.9**	**$7,890.1**	**$6,295.2**	**-$1,594.9**	**-20.2%**

[a] Less than 0.05 percent.

funds, but also including special funds) for recreation and fish and wildlife enhancements at SWP facilities, and proposes reform of related statutes, including the Davis-Dolwig Act enacted in 1961. (We provide an update on the bond resources available for resources and environmental protection programs later in this section.)

Finally, the budget proposes the ERI, to be implemented together by CalFire, the California Emergency Management Agency (CalEMA), and the Military Department. The ERI is intended to enhance the state's emergency response capabilities, and would be funded by a 2.8 percent surcharge on all residential and commercial property insurance premiums statewide. As far as CalFire is concerned, the budget proposes that ERI special fund revenues in 2009-10 be used to augment CalFire's budget by about $42 million. These revenues would mostly fund four-person staffing on fire engines during peak and transition fire seasons statewide and support an emergency response-related IT upgrade. Unlike a similar ERI proposal proposed by the administration last January, this new proposal does not create budget-year General Fund savings.

Summary of Environmental Protection Spending Proposals. Similar to Figure 1, Figure 2 (see next page) shows spending and fund source information for major *environmental protection* programs—those programs within the jurisdiction of the Secretary for Environmental Protection and the California Environmental Protection Agency (Cal-EPA). As the figure shows, the budget proposes relatively stable spending for Cal-EPA departments, with the exception of the SWRCB, which would receive a significant budget reduction. Most of the 25 percent reduction for SWRCB reflects an anticipated decrease in bond-funded local assistance.

Governor's Proposed Budget-Balancing Solutions

Largest Budget Solution Involves More Borrowing. The budget proposes only one significant General Fund budget-balancing solution in the resources and environmental protection area—special fund loans. The budget proposes about $350 million in loans from various resources special funds, to be made in either the current or budget years. The repayment dates range from as early as 2009-10 to as late as 2012-13. Most of these reflect new loans, although about $30 million reflects proposals to delay repayment of existing loans. Two other proposed budget solutions are:

- ***Elimination of CCC.*** The budget proposes to phase out CCC (with complete elimination by 2010-11) and "realign" some of its current functions to the local level. In future years, grant funding to the existing 12 certified non-profit local conservation corps would be increased. The budget assumes General Fund savings of $17 million in 2009-10 and $24 million annually beginning in 2010-11 from this proposal.

- ***Fund Shift to Bonds.*** The budget proposes to shift funding for Americans with Disabilities Act compliance in DPR from the General Fund to Proposition 84 bond funds, for a savings of $11 million in the current year and $8 million in the budget year. This proposal creates ongoing General Fund savings of varying amounts through 2015-16.

Governor's Intent to Pursue Effectiveness/Efficiency Measures

In addition to the proposal to eliminate and realign CCC (which is reflected in the budget), the Governor has stated his intent to submit a number of other legislative proposals to further improve governmental efficiency. These proposals are largely based on recommendations of the

Figure 2

Environmental Protection Budget Summary Selected Funding Sources

(Dollars in Millions)

Department/Board	Actual 2007-08	Estimated 2008-09	Proposed 2009-10	Change From 2008-09	
				Amount	Percent
Air Resources					
Motor Vehicle Account	$117.8	$126.9	$119.4	-$7.5	-5.9%
Air Pollution Control Fund	155.1	169.0	170.6	1.6	1.0
Bond funds	441.6	251.2	253.5	2.3	0.9
Other funds	29.0	84.8	85.8	1.0	1.2
Totals	**$743.5**	**$631.9**	**$629.3**	**-$2.6**	**-0.4%**
Waste Management					
Integrated Waste Account	$45.1	$52.9	$48.9	-$4.0	-7.6%
Electronic Recycling Account	100.3	112.9	135.5	22.6	20.0
Other funds	70.2	69.6	72.9	3.3	4.7
Totals	**$215.6**	**$235.4**	**$257.3**	**$21.9**	**9.3%**
Pesticide Regulation					
Pesticide Regulation Fund	$63.7	$69.5	$70.4	$0.9	1.3%
Other funds	3.2	3.2	3.1	-0.1	-3.1
Totals	**$66.9**	**$72.7**	**$73.5**	**$0.8**	**1.1%**
Water Resources Control					
General Fund	$41.2	$40.3	$40.6	$0.3	0.7%
Underground Tank Cleanup	269.0	236.8	268.1	31.3	13.2
Bond funds	297.6	223.4	10.5	-212.9	-95.3
Waste Discharge Fund	73.0	81.5	78.8	-2.7	-3.3
Other funds	178.5	195.4	201.3	5.9	3.0
Totals	**$859.3**	**$777.4**	**$599.3**	**-$178.1**	**-22.9%**
Toxic Substances Control					
General Fund	$22.5	$25.5	$22.3	-$3.2	-12.6%
Hazardous Waste Control	51.7	55.3	50.3	-5.0	-9.0
Toxic Substances Control	46.0	52.4	54.2	1.8	3.4
Other funds	48.8	66.4	71.1	4.7	7.1
Totals	**$169.0**	**$199.6**	**$197.9**	**-$1.7**	**-0.9%**
Environmental Health Hazard Assessment					
General Fund	$8.8	$8.3	$8.3	—	—
Other funds	8.2	9.9	11.5	$1.6	16.2%
Totals	**$17.0**	**$18.2**	**$19.8**	**$1.6**	**8.8%**

administration's California Performance Review conducted in 2004. Implementation of these proposals is not reflected in the *2009-10 Governor's Budget*, meaning that the budget reflects "business as usual." Few details on these proposals have been made available for our review.

Of these proposals, a number relate specifically to the resources area:

- Strengthening and streamlining energy functions now performed by nine entities;
- Consolidation of waste and recycling functions, including elimination of the California Integrated Waste Management Board (CIWMB);
- Elimination of the Department of Boating and Waterways (DBW), with its functions transferred to DPR;
- Consolidation of the Board of Geologists and Geophysicists into the State Mining and Geology Board (in the Department of Conservation [DOC]); and
- Moving the California Accidental Release Prevention Program from the Office of Emergency Services (now CalEMA) to the Department of Toxic Substances Control (DTSC).

Later in this report under "Other Issues," we provide more details of these proposals and reference our previous analyses that generally affect the same programs and agencies as the administration's proposals.

Cost Drivers for Resources and Environmental Protection Programs

Cost Drivers for Resources Programs. The costs of resources departments are driven by a diverse set of factors:

- For a number of resources departments, the expenditure levels are driven mainly by the availability of bond funds for purposes of fulfilling their statutory missions. These include departments in which the main activity is the acquisition of land for restoration and conservation purposes as well as departments that administer grant and loan programs for various resources activities.
- For other departments that rely heavily on fees, their expenditure levels are affected by the amount of fees collected.
- Some resources departments own and operate public facilities, such as state parks and boating facilities. The number and nature of such facilities drive operations and maintenance expenditures for these departments.
- In addition, the state's resources programs include a number of regulatory programs. The cost drivers for these programs include the number and complexity of regulatory standards that are required to be enforced and the related composition of the entities which are regulated.
- Finally, some resources activities that have a public safety purpose are driven by emergency response costs that can vary substantially from year to year depending upon events. These include CalFire's emergency fire suppression activities and the emergency flood response actions of DWR.

Cost Drivers for Environmental Protection Programs. A core activity of departments and boards under Cal-EPA is the administration of regulatory programs that implement federal and state environmental quality standards. These regulatory programs generally involve permitting, inspection, and enforcement activities. The main cost drivers for environmental protection programs are the number and complexity of environmental standards that are required to be enforced, which dictate the extent of the parties regulated by the departments and therefore the regulatory workload. In addition, a number of Cal-EPA departments administer grant and loan programs. The expenditure level for grant and loan programs, and the staffing requirements to implement them, are driven largely by the availability of bond funds or fee-based special funds to support them.

Resources Bond Fund Status Report

$22 Billion in Resources-Related Bonds Approved Since 1996. Between 1996 and 2006, voters have approved seven resources bonds totaling $20.6 billion (Propositions 204, 12, 13, 40, 50, 84, and 1E), as well as $1.2 billion for air quality purposes in the Proposition 1B transportation bond and $200 million for local parks in the Proposition 1C housing bond.

$4.3 Billion Remains Available for Future Appropriations. As shown in Figures 3 and 4, about $4.3 billion is projected to remain available under the Governor's budget plan from these various bond measures at the end of 2009-10 for appropriation in future years. Figure 3 shows the status of available funds by bond measure, while Figure 4 shows similar information by program area.

The Role of General Fund in Resources And Environmental Protection Programs

Where Does the $2 Billion Go? As mentioned above, the budget proposes about $2 bil-

Figure 3

Resources General Obligation Bonds, 1996 to Present

(In Millions)

Bond	Year	Total Authorization	Previous Appropriations[a]	Proposed Appropriations[b]	Balance (July 2010)
Proposition 204[c]	1996	$870	$827	$22	$21
Proposition 12	2000	2,100	2,072	10	18
Proposition 13[c]	2000	2,095	1,892	87	116
Proposition 40	2002	2,600	2,574	14	12
Proposition 50	2002	3,440	3,381	10	49
Proposition 1B[d]	2006	1,200	735	254	212
Proposition 1C[e]	2006	200	7	11	182
Proposition 1E	2006	4,090	1,514	563	2,013
Proposition 84	2006	5,388	2,949	795	1,644
Totals		**$21,983**	**$15,953**	**$1,764**	**$4,266**

a Includes funds previously appropriated, statewide bond costs, future-year obligations, and reversions.

b As proposed in the *2009-10 Governor's Budget.*

c $125 million was transferred from Proposition 204 to Proposition 13 accounts.

d Primarily a transportation bond, this includes sections that have funds for air quality.

e Primarily a housing bond, this includes funds dedicated for housing-related parks.

lion from the General Fund for resources and environmental protection purposes, including for general obligation bond debt service. Over the last ten years, the level of General Fund support for these purposes has been highly variable—reaching a peak of about $2.6 billion in 2000-01 (when the state's General Fund condition was particularly healthy), and a trough of about $1 billion in 2003-04. Figure 5 (see next page) shows the departments that are the major recipients of General Fund monies in the resources and environmental protection area, and the corresponding percentage of their budgets that are funded from the General Fund. Shown separately in the figure is the General Fund expenditure for resources-related general obligation debt service—accounting for $722 million (36 percent) of the $2 billion. Accordingly, roughly $1.3 billion of the $2 billion from the General Fund directly supports program budgets.

$1.3 Billion General Fund Proposed for Programs Largely Reflects Fire Protection Costs. As shown in Figure 5 (see next page), the largest General Fund programmatic expenditure by far in the resources area is for CalFire. The General Fund supports CalFire's (1) core fire protection program ($754 million), (2) the forest resource management program ($33 million, of which about $12 million is for timber harvest plan [THP] review), and (3) the Office of the State Fire Marshal ($3 million). The General Fund supports 44 percent of the department's total budget, and almost 70 percent of its state operations (that is, excluding capital outlay). The $790 million General Fund budget proposed for CalFire for 2009-10 is 83 percent ($359 million) higher than 2000-01 expenditures. There are a number of factors that have driven the department's fire protection costs upwards so significantly, including increasing labor costs, the growing population in

Figure 4

Resources General Obligation Bonds, 1996 to Present[a] by Program Area

(In Millions)

	Allocation	Previous Appropriations[b]	Proposed Appropriations[c]	Balance (July 2010)
Parks and recreation				
State parks	$1,094	$913	$71	$110
Local parks	2,412	1,838	206	369
Historic and cultural resources	240	236	1	3
Nature education	100	6	94	—
Subtotals	($3,846)	($2,993)	($371)	($481)
Water quality	$3,647	$2,582	$138	$927
Water management	6,843	4,063	638	2,142
Conservation, restoration, and land acquisition	4,711	3,972	312	427
CalFed/Delta related	1,686	1,557	52	77
Air quality	1,250	784	254	212
Totals	**$21,983**	**$15,953**	**$1,764**	**$4,266**

a Includes Propositions 204, 12, 13, 40, 50, 1B, 1C, 1E, and 84.

b Includes funds previously appropriated, statewide bond costs, future-year obligations, and reversions.

c As proposed in the *2009-10 Governor's Budget.*

and around wildland areas, and unhealthy forest conditions (particularly in Southern California).

Apart from its support for fire protection, the General Fund generally supports resources and environmental protection programs at levels that are lower than in 2000-01. For example, from a 2000-01 peak, General Fund support for DPR, DWR, and SWRCB has declined by 38 percent, 69 percent, and 60 percent, respectively. For the most part, these declines in General Fund support are not reflected in reduced program levels. Rather, for resources departments, these declines have been largely offset by newly available bond funds and in some cases by increased fees (such as state park fees). For Cal-EPA regulatory departments, the decline in General Fund support mostly reflects the shifting of funding from the General Fund to regulatory fees.

In spite of the declines in the level of General Fund support for these programs, the General Fund still provides significant support in a number of resources and environmental protection departments outside of CalFire. The $145 million proposed for DPR is all for state park operations. The $130 million proposed for DWR largely goes for flood management purposes, of which about $60 million is for financing of a flood-related lawsuit settlement. For DFG, the $76 million proposed from the General Fund is for a wide variety of activities, including enforcement ($27 million), habitat conservation planning ($25 million), and sport fishing and hunting programs ($13 million). For SWRCB, the $40 million proposed from the General Fund (1) supplements fee-based funding in the board's core water quality and

Figure 5

Governor's Proposed General Fund Expenditures—Resources and Environmental Protection

(Dollars in Millions)

	General Fund Amount	As Percentage of Total Departmental Budget
Departmental Budgets		
CalFire	$790.2	44%
Parks and Recreation	145.0	17
Department of Water Resources	129.6	6[a]
Fish and Game	75.9	16
State Water Resources Control	40.6	7
Toxic Substances Control	22.3	11
California Conservation Corps	18.0	40
Department of Conservation	15.5	—[b]
Coastal Commission	11.3	63
State Lands Commission	9.4	32
Environmental Health Hazard Assessment	8.3	42
Secretary for Natural Resources	5.7	7
San Francisco Bay Conservation	4.1	71
Secretary for Environmental Protection	1.9	13
Native American Heritage Commission	0.7	99
Tahoe Conservancy	0.2	3
Air Resources	0.2	—[b]
Subtotals	($1,278.9)	
Agencywide General Obligation Bond Debt Service	$721.9	
Total General Fund Expenditures	**$2,000.8**	

[a] Reflects percentage of total departmental budget excluding California Energy Resources Scheduling division.

[b] Less than 0.05 percent.

water rights regulatory programs ($12 million), (2) supports a number of water quality management activities, including basin planning ($21 million), and (3) supports general cleanup programs ($7 million).

While relatively small in absolute dollar terms, the General Fund continues to be the *primary* means of support for a number of resources and environmental protection departments outside of CalFire, including the Coastal Commission, OEHHA, and CCC (proposed for elimination by the Governor).

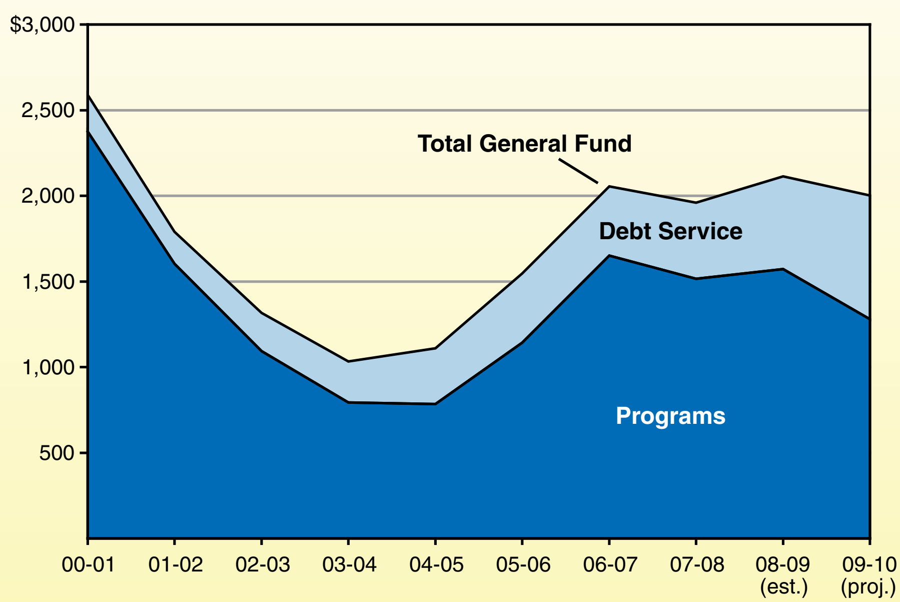
General Fund Bond Debt Service Has Increased Substantially Over Time. General Fund expenditures for resources-related general obligation debt service have increased exponentially over the last ten years, reflecting voter approval of several, increasingly larger bond measures. (We discuss the status of funds remaining available for future appropriation from these bond measures in the section that follows.) Figure 6 shows the General Fund expenditures for debt service over the last ten years, in the context of total resources and environmental expenditures from the General Fund.

Summary. While General Fund support for resources and environmental protection programs are declining overall under the Governor's proposed spending plan, our analysis indicates that there are nonetheless additional opportunities to help the state address its significant General Fund problems. In the "Balancing the 2009-10 Budget" section of this report that follows, we offer a number of specific recommendations for achieving General Fund savings. These reflect both program reductions and opportunities to shift funding from the General Fund to new or increased fees.

Figure 6

Resources and Environmental Protection General Fund Expenditures

(In Millions)



BALANCING THE 2009-10 BUDGET

In this section, we report on the Governor's proposals to create General Fund savings in the budgets for resources and environmental protection and offer a number of our own recommendations to achieve additional savings. The Governor's 2009-10 budget proposes only one significant General Fund budget-balancing solution in these areas of the budget—special fund loans to the General Fund. Other solutions include the elimination of CCC and a funding shift to bonds in DPR. Our additional savings proposals include several recommendations to (1) shift funding from the General Fund to fees and to (2) reduce or defer program expenditures in CalFire.

Governor's Proposed Special Fund Loans

The Governor proposes a number of loans from special funds established for resources and environmental protection programs and deferrals of special fund loan repayments, to create a one-time General Fund benefit of about $350 million over the current and budget years (see Figure 7). The Governor proposes budget bill or trailer bill language specifying the final repayment date of these loans and requiring that repayment be made so as to ensure that the programs supported by the special fund are not adversely affected by the loan.

We find that the condition of the various special funds can accommodate the loans at the proposed amounts and that the General Fund benefit assumed in the budget is achievable.

Governor's Proposal to Eliminate The California Conservation Corps

Background

The CCC provides young people between the ages of 18 and 23 work experience and educational opportunities. The program participants, referred to as corpsmembers, work on projects that conserve and improve the environment, such as tree planting, trail building, and brush clearance. Corpsmembers also provide assistance during natural disasters, such as filling sandbags during floods. Work projects are sponsored by various governmental and nongovernmental agencies that reimburse CCC for the work performed by corpsmembers.

The CCC receives the majority of its funding from the General Fund (about 60 percent in the current year), with most of the balance coming from reimbursement revenues. When CCC corpsmembers work on projects for other public agencies or private entities, CCC is reimbursed for the labor provided. This reimbursement revenue is used to support the corpsmembers' salaries and benefits as well as department-wide administrative and operational costs. The CCC sets a statewide reimbursement rate target (currently $18.77 per hour for corpsmember labor) and staff in the field use this target rate when negotiating contracts with client agencies.

The CCC estimates about 4,000 men and women (the equivalent of about 1,200 full-time positions) will participate in the program during the current year. Corpsmembers earn minimum wage and are assigned to work approximately 40 hours per week. On average, corpsmembers stay in the program for a little over seven months. The current annual cost of the program per corpsmember is in the range of $40,000 to $45,000 per full-time equivalent. The current-year budget provides funding for seven residential and 15 nonresidential facilities throughout the state.

Governor Proposes to Eliminate Corps, Shifts Some Funds to Locals

Budget Reflects Phase-Out of CCC Beginning in 2009-10. The budget requests about $44.6 million in total spending for CCC in 2009-10, of which $17.9 million is for state operations and $26.7 million is for capital outlay. This is a reduction of about $64 million—or 59 percent—below expenditures in the current year. The budget-year spending amount reflects the budget's proposal to begin phasing out CCC in 2009-10, with its complete elimination in 2010-11, at which time some CCC activities would be realigned to the local level. Reflecting the proposed realignment, the CCC's proposed state operations budget for 2009-10 includes $7 million for personnel and operating expenses as operations are wound down, $5.9 million for lease-revenue bond debt expenditures, and

Figure 7

Governor's Proposed Special Fund Loans—Resources and Environmental Protection Special Funds

(Dollars in Millions)

Special Fund	Amount of Loan	Year of Loan	Repayment Date
California Beverage Container Recycling Fund	$99.4	2009-10	2012-13
Off-Highway Vehicle Trust Fund	90.0	2008-09	2012-13 (partial payments beginning in 2010-11)
School Land Bank Fund	61.0	2008-09	2012-13
Fish and Game Preservation Fund, Non-dedicated Account	30.0	2008-09	2012-13
Harbors and Watercraft Revolving Fund	29.0	2008-09	2012-13 (partial payments beginning in 2010-11)
California Tire Recycling Management Fund	17.1	Deferral of repayment of 2003-04 loan, initially budgeted in 2008-09	2011-12
California Tire Recycling Management Fund	10.0	2008-09	2010-11
California Teleconnect Fund Administrative Committee Fund	5.0	Deferral of partial repayment of 2003-04 loan, initially budgeted in 2008-09	2010-11
Integrated Waste Management Account	4.8	Deferral of repayment of 2003-04 loan, initially budgeted in 2008-09	2009-10
Recycling Market Development Revolving Loan Subaccount	1.9	Deferral of repayment of 2003-04 loan, initially budgeted in 2008-09	2011-12
Total	**$348.2**		

$5 million for a new grant program to local non-profit conservation corps.

Proposed Corps Realignment Intended to Create General Fund Savings. The budget proposes to eliminate CCC and redirect a portion of the Corps' funding to 12 Local Conservation Corps (LCC) programs. This proposal creates net budget-year savings of $17 million to the General Fund and $26.4 million to other funds (mostly the Collins-Dugan Reimbursement Account). The net General Fund savings would increase to $24 million annually beginning in 2010-11 when the CCC would be completely eliminated. Under the proposed realignment, the Natural Resources Agency would assume responsibility for specified ongoing CCC obligations, including bond grant administration. The agency would also administer a proposed grant program to LCCs of $10 million annually beginning in 2010-11. The budget proposes a related $5 million grant program in the budget year, administered by agency.

Budget Reflects Continuing Capital Outlay Expenditures. The budget proposes $26.7 million (Public Buildings Construction Fund) for capital outlay expenditures in 2009-10 for construction of the Delta Service Center, a facility to include dormitories, and education and recreation buildings. While design and working drawings have been completed, construction has not begun on the site.

Evaluation of Governor's Proposal

In evaluating the Governor's proposal to eliminate CCC, the Legislature should consider various issues. These include (1) the CCC's current capacity to meet its statutory mission, (2) the impact that the CCC's elimination may have on other state agencies that utilize corpsmember labor, (3) the administration's plans to divest the CCC of its capital projects and pay off related debt, and (4) the details of the proposed grant program. We discuss each of these in turn.

CCC Mission Erosion. One of the key legislative goals for CCC is to provide work training and education for corpsmembers. Over the years, this mission has been addressed by education-focused activities, including direct schooling through the certified charter high school, and through work training such as backcountry trail construction, emergency response assistance, and job preparedness guidance sessions. In recent years, this primary mission has eroded, with significant reductions in the amount of time spent on training and the number of corpsmembers receiving their high school graduation equivalent. General Fund reductions have shifted the focus of CCC to those activities generating reimbursement revenues, many of which are not education- or training-oriented.

Increasing Reliance on Reimbursable Work Projects. As part of CCC training, corpsmembers conduct reimbursable work for public and private sector entities. The $33.9 million in activities supported from the General Fund in the current year are matched by about $30 million in reimbursable activities from such agencies as the Department of Transportation ($4.7 million), CalFire ($4.1 million), DPR ($1.7 million), and DWR ($1.2 million). Approximately 55 public and private-sector entities contracted with CCC for as little as $1,000 and as much as $5 million. The activities range from picking up trash on highways to staffing fire camps during emergencies.

CCC Labor Not Necessarily Low-Cost. The loss of CCC as staffing for CalFire camps has been raised as an example of a potential loss of a low-cost source of labor to the state, and thus a potential cost of the Governor's proposal that needs to be weighed when it is evaluated.

However, CalFire estimates that it may be able to *reduce* its costs for labor formerly provided by CCC corpsmembers by shifting to local labor contractors. For example, each corpsmember is reimbursed at $18.77 per hour (with no payment for overtime), and each supervisor is reimbursed at $18.77 per hour or at a rate of $34.84 for overtime. (Overtime is generally necessary for staffing fire camps.) CalFire estimates that shifting to a local labor contractor would cost between $8 and $10 for normal working hours, and $12 to $15 for overtime. The rates for supervisors range from $12 for normal working hours to $20 for overtime. A second option involves contracting with local governments using an existing contract at a flat reimbursement rate of $11.14 per hour. Therefore, options clearly exist which are significantly less expensive than using CCC labor.

Budget Proposal Includes Minimal Plans for Divestment of Capital Assets. The CCC currently maintains 22 facilities, of which 5 are owned by the state and the remainder are leased. There are also four capital projects which are in various stages of development: three in the design phase (including the Delta Service Center project referenced earlier) and one in the construction phase (the Camarillo Satellite Relocation project, scheduled for completion in June 2009). The administration budget proposal to phase out CCC includes few details on the administration's plans to divest this operation of its capital assets. As regards the Camarillo Satellite project, the budget assumes that this facility will be transferred to another state agency (not yet identified) in order that revenue bonds can be issued to pay off $18 million of interim financing on this project. However, there is no specific plan for such a transfer.

New Local Grant Program Proposal Lacks Definition. In order to offset the programmatic impact of the CCC elimination, the administration has proposed legislation to start a new program to provide grants to LCCs. The proposal appropriates $5 million in the budget year and $10 million in subsequent years (General Fund) to the Natural Resources Agency for a yet-to-be-defined grant program to LCCs. The administration proposal claims LCCs will be able to use the funds to absorb corpsmembers who would otherwise have joined the state CCC. It is not clear, however, that LCCs actually have the capacity to do so. The budget plan broadly proposes to direct the grant funding to education, operations, job training and emergency response, though it does not have specific details as to which of these would be the highest priority, nor how the grants would be distributed.

Proposed Grant Program Proposal Raises Issues for Legislative Consideration. While the Governor's proposal to create a new local grant program may have merit, we think that the proposal raises significant policy issues that should be addressed to ensure a smooth transition from the state-operated CCC to a local grant program. The proposal, which is intended to mitigate the elimination of CCC programs, does not include details about how the funds would be disbursed. The proposal is also a substantial increase in General Fund support of the LCCs—from $337,000 in the current year, to $5 million in the budget year and ultimately $10 million in future years. We are concerned that the LCCs may not have the capacity to absorb so many additional corpsmembers, and they may not consider the administration's proposal to shift CCC activities to them as a fit with their current program priorities.

Recommendations

Recommend CCC Elimination, but Deny Grant Program. In light of the significant General Fund budget shortfall, and the ongoing erosion of CCC's core activities over time, we recommend approval of the proposal to eliminate CCC. However, we propose some modifications to the Governor's budget plan as described below.

In particular, we think that the Governor's proposed realignment of CCC functions to the local level warrants further legislative policy review. We therefore recommend that the Legislature not proceed with this component of the Governor's proposal at this time to achieve $5 million in General Fund savings of this amount in 2009-10.

Capital Projects Should Be Halted. Our review found several capital outlay projects in process. These include the Delta Service Center, the Sierra-Placer Water Connection, and the Tahoe Base Center relocation project, all currently in the design phase. We recommend that work be halted on these projects that are in the early stages of development. If the Legislature approves the proposed phase-out of CCC operations, we see no reason why the Delta Service Center project should advance to the construction phase and be funded for such construction in the budget year. We therefore recommend reducing the CCC's capital outlay appropriation by $26.7 million to reflect the halt of this project.

Capital Asset Divestment Plan Required. We recommend the administration prepare a specific plan for the divestment of CCC's existing and developing capital projects, and submit this plan to the Legislature for its review at budget hearings. We are concerned that the $5.9 million from the General Fund proposed to be set aside to retire existing lease-revenue bond debt on CCC facilities—including those under development—may not be enough to pay down these debts. In addition, we are concerned about the budget's assumption that the nearly constructed Camarillo project will be transferred to another state agency so that revenue bonds can be issued to repay interim financing costs of $18 million. There is no plan currently in place, however, that guarantees this result, meaning that there could be additional one-time General Fund costs in the budget year because the General Fund, rather than revenue bonds, would be called upon to pay off this interim financing.

LAO's Fee-Based Recommendations

Basis for Recommendations

In this section, we offer a number of recommendations for achieving General Fund savings by shifting funding for an activity from the General Fund to new or increased fees. While the resulting General Fund savings are clearly a benefit from adopting these recommendations, we have offered these kinds of recommendations in both good and bad fiscal times. Our analysis finds that these fees are the appropriate funding source, as a matter of policy, for the activities in question, either because the state is providing a service directly to beneficiaries (such as wildland fire protection), or administering a pollution control program that could be funded on a polluter pays basis (such as the SWRCB's water quality regulatory program).

It is important to note that the application of the "beneficiary pays" funding principle does not imply that fees will necessarily cover the full cost of an activity. Rather, some activities—take the state's wildland fire protection, for example—provide benefits to the public at-large (such as by providing habitat protection) as well as directly to identifiable individuals (such as property owners in or near wildland areas). In such cases, we recommend that fees be assessed to cover the portion of the costs that can reasonably be allocated to the activity's direct beneficiaries, with state General Fund resources being used to pay for its broad public benefits.

As we have presented each of these recommendations outlined below in previous analyses, we refer the reader to the document where the prior analyses can be found for a more in-depth discussion of the recommendation.

New Wildland Fire Protection Fee

State Is Responsible for Wildland Fire Protection. Under existing statute, the state is responsible for providing *wildland* fire protection in "State Responsibility Areas" (SRAs). These SRAs encompass about 31 million acres of the state, primarily *privately owned* timberlands, rangelands, and watershed areas. There are an estimated 860,000 homes in SRAs. Initially, CalFire's mission was the prevention and suppression of wildland fires in undeveloped areas. Over time, however, there has been considerable "mission creep" and the department now spends considerable time and resources protecting homes in SRA from wildfire, as well as responding to medical emergencies and other non-wildfire calls.

Costs of State Fire Protection Have Increased Dramatically. Today, the state's largest General Fund expenditure in the natural resources area is for fire protection. Over the last ten years, the cost to provide fire protection in SRAs has increased substantially. In the 1998-99, the General Fund cost for fire protection (including both the base budget and Emergency Fund expenditures) was $307 million. In the current year, estimated General fund fire protection expenditures are $967 million—a tripling of these costs.

Recommend a New Wildland Fire Protection Fee in SRAs. Property owners in an SRA directly benefit from the protection of their property provided by CalFire. Therefore, we believe it is appropriate that property owners in an SRA pay *a portion* of the state's cost for fire protection. Since housing development has been a key driver of increasing CalFire expenditures, we believe it is appropriate that homeowners in an SRA pay most of the cost of a new fire protection fee. Because the department provides fire protection for natural resources of statewide significance—such as watersheds that provide drinking water for much of the state—it is also appropriate that the state as a whole pay for a portion of the cost of fire protection. Therefore, we consider it reasonable that the state's cost of providing fire protection in an SRA be shared between the direct beneficiaries and the state's taxpayers as a whole.

We recommend that the Legislature enact a fee on the owners of structures in SRA that would be generally proportional to the additional costs imposed on the state as a result of the presence of those structures. When determining the level of such a fee for structures in a given area, the Legislature may wish to consider actual expenditures made by the department in that area, the local fire risk, and the adequacy of fire protection provided by local governments. We recommend that the Board of Equalization (BOE) be authorized to collect such a fee.

Because our recommendation would create a new fee, there will be a significant amount of one-time administrative work by CalFire and BOE to set up the fee-collection mechanism and make the initial determinations of who must pay the fee. It is likely this work would take several months. It may be possible to generate revenues beginning as early as the budget year if the Legislature were to enact our fee recommendation soon. Otherwise, revenues from the new fee would most likely begin accruing in 2010-11.

As we discuss below, the Governor has proposed a different approach that involves levying a surcharge on property insurance premiums in the state to initially fund the *expansion* of emergency response activities, primarily wildland fire protection. In contrast, our proposal is designed to generate *General Fund savings* as soon as the fee revenues become available. We also note that the Governor's proposed insurance premium surcharge would be considered a tax. This would increase the state's funding obligations under Proposition 98, a constitutional provision mandating a set portion of the proceeds of state taxes be used to provide specified minimum funding levels for public schools and community colleges. In contrast, our proposed funding mechanism would be structured as a fee and thus would not add to the state's funding obligations under Proposition 98.

For a more detailed discussion of our SRA fee proposal, please see our *Analysis of the 2008-09 Budget Bill,* page B-47.

Increased Fish and Game Regulatory Fees

Regulatory Programs Supported by the General Fund Could Be Funded by Fees. The DFG administers various regulatory programs to protect public resources, including fish and wildlife. These programs are generally supported by fees charged to the regulated community. However, there are some cases when the General Fund lends significant support for a regulatory program. We recommend that General Fund support be shifted to regulatory fees in such cases, which are highlighted below:

- ***California Endangered Species Act Review.*** The department reviews projects that may impact endangered species under state law. Currently, this program is supported primarily by the General Fund, with additional support from various special funds. We recommend the enactment of legislation to create a new regulatory fee to fully fund this program, saving the General Fund about $1.9 million and potentially $800,000 in special funds.

- ***Natural Communities Conservation Planning Review.*** The Natural Communities Conservation Planning Act is an alternative regulatory program to the Endangered Species Act. Currently, this program is supported by the General Fund, as well as various bond, special, and federal funds. Current law allows a fee to be assessed by the department to recover its costs. We recommend that the Legislature eliminate the General Fund support for this program and direct the department to raise fees sufficient to cover its costs, as state law allows it to do—yielding General Fund savings of about $850,000 and potential additional savings to the other fund sources currently supporting the program.

For more detailed information on these DFG-related fee recommendations, please see our *Analysis of the 2008-09 Budget Bill*, page B-58.

Increased Water Board Regulatory Fees and New Water Quality Fee

Background. The SWRCB, in conjunction with nine semiautonomous regional boards, regulates water quality in the state. The state and regional boards issue and enforce permits that regulate the discharge of pollution into the state's waters. The state board also administers water rights in the state, by issuing and enforcing permits and licenses to applicants who wish to take water from the state's streams, rivers, and lakes. The board's proposed budget for 2009-10 includes $40.3 million from the General Fund, an increase of about $1.6 million (4 percent) above current-year expenditures.

As we discussed in our *Analysis of the 2008-09 Budget Bill*, page B-100, we recommend applying the polluter pays funding principle more fully to the board's core water quality and water rights programs by expanding regulatory fees to fully fund water quality management programs. We discuss each of our two specific recommendations in turn.

Recommend Fully Funding Core Regulatory Programs From Fees. Core regulatory programs include water quality permitting activities (pollution discharge permitting program), the agricultural waiver program, THP reviews, and water rights activities. While these programs receive much of their funding from fees, the proposed budget includes about $11.6 million for these core programs, of which $4.7 million is for THP review.

As a general principle, we recommend that the core regulatory programs at the water boards be fully funded by fees, based on the polluter pays funding principle. Shifting the funding of the balance of the water boards' core regulatory activities from the General Fund to fees (except for THP review) would save the General Fund $6.9 million in the budget year. As a legislative policy review of the state's multiagency THP review process is pending, we withhold making a recommendation at this time on the board's THP funding component.

Recommend Creation of New Water Quality Fee. In our *2008-09 Analysis*, we recommended that the bulk of the board's General Fund-supported programs outside of the core regulatory programs be funded by a new water quality fee. These are water quality management programs that assess the state's water quality and develop water quality plans and standards, which ultimately form the basis for the board's permitting and enforcement activities. These program activities—which include the Total Maximum Daily Load program, basin and groundwater planning, and non-point source pollution programs—are proposed to receive General Fund support of about $21.6 million, a 10 percent increase over current-year expenditures.

Currently, there are about 20,000 entities that pay one or more of several categories of the board's water quality regulatory fees. We recommend expanding this fee base to include, to the extent feasible and administratively efficient, a larger number of parties who, while impacting water quality and creating regulatory program workload on the state and regional boards, currently pay no, or minimal, fees to support these programs. There are a number of issues for the Legislature to consider in structuring such a fee. These include determining (1) who should pay the fee, (2) what the fee rates should be, and (3) how the fees might vary, based on factors such as differences in regional water quality problems and costs imposed on the water boards by pollution type, and accounting for whether or not the fee payer currently pays a water-quality related fee. Any legislative concerns about the impact of such a fee on economically disadvantaged communities could be addressed in the fee structure design, such as by including exemptions from the fee.

Increased Watermaster Fees

Recommend Fully Funding DWRs' Watermaster Program From Fees. The Watermaster Program administered by DWR ensures that water is allocated according to established water rights as determined by court adjudications or agreements, by an unbiased party, in an attempt to reduce water rights-related lawsuits and law enforcement. The program encompasses watermaster service areas for a number of Northern California stream systems and for two Southern California groundwater basins. The budget proposes to continue baseline General Fund support of $1.2 million for this program. In contrast, most groundwater-related watermaster programs, administered mainly at the local level, are fully supported by program beneficiaries within the watermaster service area. We recommend funding the Watermaster Program from fees, resulting in General Fund savings of $1.2 million.

Office of Environmental Health Hazard Assessment—Fee-Based Funding Shifts

Office Provides Scientific Support for Regulatory Programs. The OEHHA identifies and quantifies the health risks of chemicals in the environment. It provides these assessments, along with its recommendations for pollutant standards and health and safety regulations, to the boards and departments in Cal-EPA and to other state and local agencies. The OEHHA also provides scientific support to environmental regulatory agencies.

The OEHHA's Funding a Mix of General and Special Funds. The budget requests total funding of $19.8 million for support of OEHHA in 2009-10. The General Fund support requested is $8.3 million, with the remaining $11.5 million requested from fee-based special funds and reimbursements.

Figure 8 shows the 11 OEHHA programs that have at least some level of General Fund support. In addition to these programs, there are several other programs within OEHHA funded entirely by special funds.

Regulatory Support Activities Should Be Funded by Fee-Based Special Funds. In our *Analysis of the 2005-06 Budget Bill*, page B-92, we reported on the potential for alternative funding sources for many of OEHHA's activities currently funded from the General Fund, namely environmental protection and public health regulatory programs benefiting directly from OEHHA's technical expertise. We have found that where OEHHA provides services (in the form of assessments and recommendations) to regulatory programs administered by other state agencies, it is appropriate to fund these services from regulatory program fees.

On the other hand, some of OEHHA's activities have more of a broad-based public health focus—such as those related to children's health and Proposition 65, a 1986 initiative measure that requires the state to annually publish a list of cancer-causing chemicals and inform citizens about exposures to these chemicals. These activities cannot be reasonably or easily connected with discrete regulatory programs. The General Fund, in our view, continues to be the appropriate primary funding source for these activities. After accounting for such activities, we have concluded that there is the potential to shift up to about $5 million of OEHHA's funding from the General Fund to fees.

As shown in Figure 8, many of OEHHA's regulatory program support activities receiving General Fund support are already partially funded with fee-based special funds. We recommend going further where such a special fund is available to assume the General Fund's current funding contribution. Examples of potential funding shifts include transferring support for pesticide regularity programs to the Department of Pesticide Regulation Fund and for toxic air contaminant programs to the Air Pollution Control Account and/or the Motor Vehicle Account.

Accommodating the Funding Shifts May Require Statutory Changes or Fee Increases. We note that for the budget year, a number of the special funds to which OEHHA's General Fund support could be shifted have reserves that could support the funding shift. In other cases, an increase in fees or redirection of monies from other activities may be required to accommodate the funding shift. In yet other cases, a statutory change may be required to specify that OEHHA's activities are an eligible use of the special fund in question.

Figure 8

Office of Environmental Health Hazard Assessment—Programs With General Fund Support

(In Thousands)

	Proposed Expenditures			
Program	General Fund	Other Funds	Totals	Current Source(s) of Non-General Fund Support
Proposition 65 Implementation/ Science Advisory Board	$191	$200	$391	Waste Discharge Permit Fund
Pesticides	482	813	1,295	Department of Pesticide Regulation Fund
Drinking water	1,390	—	1,390	—
Fish	305	564	869	Fish and Game Preservation Fund, Environmental License Plate Fund
Fuels	313	490	803	Air Pollution Control Fund, Environmental License Plate Fund
School sites	403	—	403	—
Proposition 65	2,051	1,016	3,067	Waste Discharge Permit Fund
Children's health	171	—	171	—
Criteria air pollutants	454	371	825	Air Pollution Control Fund, Motor Vehicle Account
Toxic air contaminants	675	809	1,484	Air Pollution Control Fund, Motor Vehicle Account
Green chemistry	135	272	407	Used Oil Recycling Fund
Executive and administration	1,770	1,762	3,532	Various
Totals	**$8,340**	**$6,297**	**$14,637**	

CalFire General Fund Reductions and Deferrals

Increasing Fire Protection Costs and Mission Creep. CalFire's fire protection budget can be divided between the base budget and the Emergency Fund. The base budget pays for everyday firefighting operations of the department, including salaries, facility maintenance, and other regularly scheduled costs. The Emergency Fund is used to fund unanticipated firefighting costs usually associated with large fire events, including overtime costs for CalFire employees, costs to rent equipment from outside vendors, and costs to reimburse local fire agencies for helping to fight large wildfires. As was mentioned above, CalFire's total General Fund expenditures for fire protection (both the base budget and Emergency Fund, but excluding capital outlay) have more than tripled in ten years—rising from $307 million in 1998-99 to $967 million in the current year. Over the same time period, the General Fund base budget alone has increased from $267 million to more than $530 million—an increase of almost 100 percent in that same decade.

Our analysis indicates that CalFire's budget for its core mission of fighting wildland fires has increased so substantially due to the occurrence of larger fires, increased labor costs, and the development of more housing in fire-prone areas. In addition, CalFire spends considerable time and effort responding to non-wildland fire emergencies. Because the department's accounting system does not track the costs for these non-wildland fire calls, we cannot quantify the cost of these noncore mission activities. However, in 2006, department personnel spent about 30 percent of their response time on calls not related to wildland fires. We are concerned that the costs of expanding the mission of CalFire—a phenomenon often referred to as mission creep—are significant.

Proposed General Fund Reductions to Fire Protection Budget. Due to the size of the fire protection budget and its dramatic increases in recent years, we believe it is critical to address the spiraling costs of fire protection as one strategy for balancing the 2009-10 budget. In order to do so, we recommend the Legislature reduce the department's General Fund budget for fire protection by $55.1 million in 2009-10 (with $16.8 million in ongoing savings), as follows:

- ***Eliminate Funding for DC-10 Aircraft Contract—$6.8 Million Ongoing Savings.*** CalFire contracts with the owners of a DC-10 jet aircraft that has been converted for use in fire fighting. The department has used the DC-10 to supplement its existing air fleet, rather than to replace existing aviation assets. In 2008, the cost of this contract was $6.8 million. While the addition of this resource has added to CalFire's fire protection capabilities, the department has not shown that the use of this asset has improved its fire protection response capability in a cost-effective manner.

- ***Delay Vehicle Replacements in the Budget Year—$17 Million One-Time Savings.*** The proposed budget includes $10.8 million from the General Fund for fire engine replacements and $6.2 million from the General Fund for replacement of other vehicles. We recommend the Legislature eliminate this funding *in the budget year*, and that these expenditures be delayed for one year. As vehicles age, the cost of maintaining them increases and the amount of time they are unavailable due to maintenance needs increases. Ultimately, CalFire will have to resume its vehicle replacement program. However, given the state's very difficult budget situation, we recommend that this replacement program be delayed by one year. We think this can be done without significantly impacting the department's emergency response capability.

- ***Close Low-Priority Fire Stations and Other Facilities—$10 Million Ongoing Savings.*** We recommend the Legislature reduce CalFire's base General Fund fire protection budget by $10 million and direct the department to close the fire stations that are a lower priority to keep open for wildland fire protection, in order to achieve this level of savings. The department has identified a list of such lower-priority stations, based on criteria including the number of calls to those stations, the frequency of large fires in the surrounding areas, and other factors. While our recommendation would reduce the level of fire protection service provided by the department, we note that it reflects a reduction of only 2 percent to the proposed budget and would leave the department with a General Fund base budget approximately equal to the enacted 2008-09 budget.

- ***Capital Outlay Deferral—$21.3 Million One-Time Savings.*** The Governor's budget proposes to spend $21.3 million from the General Fund in 2009-10 on a capital outlay project to replace the Hemet-Ryan Air Attack Base. This deteriorating facility ultimately will need to be replaced. However, we find that the department can continue to use this facility in the near term (albeit with increasing maintenance costs). We recommend the Legislature defer the project until a later year.

Figure 9

LAO Proposed General Fund Reductions to CalFire Budget

(In Millions)

State Operations	2009-10	2010-11
DC-10 Aircraft contract[a]	$6.8	$6.8
Vehicle replacements		
Fire engines	10.8	—
Other vehicles	6.2	—
Close low-priority fire stations	10.0	10.0
Subtotals	($33.8)	($16.8)
Capital outlay		
Hemet-Ryan Air Attack Base replacement	$21.3	—
Totals	**$55.1**	**$16.8**

[a] There may be a penalty for canceling the existing contract, which could reduce savings in the budget year.

We summarize our proposed reductions in Figure 9.

Potential Impacts to the Emergency Fund. CalFire is unusual in state government, in that the budget act allows the Director of Finance to augment CalFire's budget during the course of the budget year, as needed, to pay for additional, unanticipated costs of fire protection. Due to the nature of wildland fire protection, it is possible that reductions such as we have proposed to the department's base budget may increase the incidence of large fires, thus increasing Emergency Fund expenditures.

When the state needs additional resources to battle wildland fires, it calls on federal and local fire agencies for assistance. The state generally reimburses these other fire agencies for the cost of their assistance. However, we believe this is a wise budget trade-off. The cost to use those resources—only when needed—should be less than the cost to keep that capacity in place throughout the fire season. Thus, while additional Emergency Fund expenditures due to the proposed reductions are possible, we would expect that any additional costs would only partially offset the General Fund savings created by our proposal.

OTHER ISSUES

Governor's Emergency Response Initiative

The Governor's budget includes the ERI—a proposal to levy a new surcharge on property insurance policy premiums statewide and to use the resulting revenues to support emergency response activities in several departments, but primarily within CalFire. Below, we separately address the proposed source of funds and the uses of these funds, as we believe that the Legislature should independently weigh how to fund emergency response and what program activities should be funded in this area of the budget.

New Insurance Surcharge Proposed To Fund Emergency Response

New Surcharge Proposal. The Governor proposes to levy a surcharge on all residential and commercial property insurance policies in the state. The surcharge rate would be 2.8 percent of the premium and would raise an estimated $70 million in the budget year and $278 million annually thereafter. Revenues from the proposed surcharge would be spent by several departments, as shown in Figure 10.

Surcharge Is a Tax. Based upon our discussions with staff at Legislative Counsel, we believe that this proposal would be considered a state tax. Legislative Counsel staff have also advised us that if this proposal were to be enacted, it would increase the state's funding obligations under Proposition 98, a constitutional provision mandating a set portion of the proceeds of state taxes be used to provide specified minimum funding levels for public

Figure 10

Uses of Governor's Proposed Insurance Surcharge

(In Millions)

	2009-10	2010-11[a]
Program Expansions		
CalFire	$41.6	$65.0
California Emergency Management Agency	16.2	16.9
Military Department	2.2	4.9
Deposited into Reserve[b]	9.5	191.0
Total Revenues	**$69.5**	**$277.8**

a Reflects full-year surcharge revenues.

b The proposal would deposit revenues above planned expenditures into a reserve to be used to pay for unanticipated disaster costs.

schools and community colleges. The Governor's budget proposal does not reflect this increased obligation under Proposition 98. Therefore, if the Legislature were to approve the Governor's proposal, it would increase the Proposition 98 obligation beyond what is projected in the budget.

Recommend Rejection of the Surcharge Proposal. While the Governor's proposal is described as an emergency response measure, in practice much of the revenues generated would be used for wildland fire protection. We do not think it is good policy to raise additional general tax revenues for specific uses that benefit a defined population. Instead, we believe the specific beneficiaries of these expenditures should pay for them. Therefore we recommend against enacting the proposed surcharge.

Instead, as we discuss earlier under "Balancing the 2009-10 Budget," we recommend that the Legislature assess a fee on landowners in areas threatened by wildfire to pay for a portion of the state's cost for providing wildland fire protection that directly benefits those landowners.

Governor Proposes CalFire Augmentations Funded From New Surcharge

The Governor's budget proposes to spend revenues from the proposed insurance surcharge in several state agencies—including CalFire, the Military Department, and CalEMA. We discuss the spending proposals for CalFire below. We will discuss the spending proposals for the Military Department and the California Emergency Management Agency in our separate "General Government" budget analysis document.

Total budget-year expenditures from the ERI in CalFire would be about $42 million. It is important to note that expenditures for some of the components of the proposal would not begin in the budget year. With its budget proposal, the administration has presented a multiyear spending plan showing additional program augmentations in future years when the proposed insurance surcharge would be fully operational. If the Legislature approves the budget proposal without specifying otherwise, the administration interprets this as authorizing the entire proposal, so that future-year spending (totaling about $67 million in a typical year) would be included in the department's future base budget.

The Governor's budget proposes the following program augmentations to CalFire's budget, to be funded by the proposed insurance surcharge:

- ***Aviation Asset Coordinator.*** During significant fire events, CalFire works with the Military Department and federal military agencies to respond with firefighting aircraft. The budget proposes to add 1.5 positions at a cost of $265,000 to better coordinate these activities between CalFire and other agencies.

- ***Wide Area Network Upgrade.*** Many of CalFire's facilities are located in rural areas with limited communications infrastructure. As a consequence, personnel in the field have limited access to the department's IT system. The budget proposes to begin implementation of an IT project to connect most of CalFire's facilities to a wide area network. The cost for this proposal would be $11.4 million in the budget year and about $3 million per year thereafter, with additional, periodic upgrades of equipment in future years.

- ***Four-Person Staffing.*** CalFire's current practice is to staff fire engines with three personnel. In recent years, the department—under executive order—has increased staffing on fire engines to four personnel in targeted areas during peak fire season. The budget proposes to extend this additional staffing level to all fire engines throughout the state, during peak and transition fire seasons. This would entail hiring about 1,100 additional seasonal firefighters (230 personnel-years). While the cost to augment staffing as needed (under the executive order) has been about $13 million annually in recent years, this proposal would cost about $43 million per year, or $30 million more than the current-year level of expenditures.

- ***Automatic Vehicle Locators.*** CalFire's current dispatch and communications system relies on fire engine or aircraft crews to report their location to the dispatch center. If the department loses contact with a crew, it has to rely on information from the crew's last report to determine where the vehicle or aircraft is located. The administration proposes to upgrade all vehicles and aircraft with a system that will allow the department to automatically determine a vehicle or aircraft's location at all times—allowing help to be dispatched if contact with a crew is lost. First-year costs for this element of the proposal would be about $4.9 million in 2010-11 and would rise to an ongoing cost of about $6.4 million per year.

- ***Helicopter Replacements.*** The department's helicopter fleet is composed of UH–1H helicopters procured from the federal Department of Defense in the early 1990s. This class of helicopter was first produced in the 1960s. While the department keeps up with all Federal Aviation Administration-required and manufacturer-recommended maintenance, over time the cost of replacing increasingly rare spare parts will grow. In addition, the department's helicopters are not equipped for night flight. The administration proposes to begin acquiring new helicopters in 2010-11. The cost of this proposal is about $28 million per year over five years, which includes costs for related facility upgrades.

Recommend Against Funding Most of the Proposed Augmentations. Given the state's dire fiscal situation, we believe it is important for the Legislature to only authorize augmentations when there is a critical and immediate need. While many of the elements of this proposal have merit and could likely improve the protection of life, property, and state resources, we recommend that most of these augmentations be rejected in the budget year. Our comments on the particular budget requests are below.

- ***Approve Aviation Asset Coordinator.*** We find that this is a worthwhile proposal to better leverage state and federal aviation assets at a relatively low cost. However, since we recommend the rejection of the proposed insurance surcharge, we recommend that the cost of this proposal be paid for from the General Fund initially, to be offset with revenues from our recommended wildland fire protection fee when these revenues become available.

- ***Reject Wide Area Network Upgrade.*** We find that this proposal is not justified at this time because the administration did not sufficiently consider alternative means of improving the IT system at a lower cost. In particular, the growing penetration of high-speed Internet access in the state may make it possible to achieve many of the goals of this proposal in the near future without the costly investment in new IT infrastructure. While this proposal would likely improve CalFire's operational efficiency, the department has been able to fulfill its mission with the current system.

- ***Reject Four-Person Staffing.*** The department has not been able to justify why the increased staffing level is cost-effective and needed throughout the state and in all years, rather than targeted to areas of high fire risk or during fire seasons of unusual danger. It is also important to note that the department has not estimated the impact from the proposed staffing expansion on its facility costs and capital outlay requirements. The department plans to house the additional firefighters in existing facilities, but most are at, or near full, capacity. The costs to create additional capacity in the department's facilities are unknown but could result in substantial increases in the department's capital outlay budget in future years. Finally, we note that the Governor still has the authority used in the last several years to implement four-person staffing in targeted areas and times through executive order.

- ***Reject Vehicle Locators.*** We find that the proposal to upgrade CalFire's dispatch system to provide additional safety to its employees has merit. However, the department has not completed a feasibility study report for this project, which would provide information on alternative ways to meet the project goals, potentially at lower costs. Since the department does not intend to implement this upgrade until 2010-11, we recommend the Legislature reject the proposal at this time, and direct the department to examine whether there is a more cost-effective way to implement this project in future years.

- ***Reject Helicopter Replacements.*** Maintenance costs for the existing helicopter fleet will increase in the coming years. However, the department has not presented a cost-benefit analysis demonstrating that this increase in maintenance costs justifies the replacement of the department's entire fleet over the next few years. Additionally, the department has provided very little detail on the type of helicopters to be purchased, their capabilities, or their cost. The limited information provided thus far indicates that the department would purchase helicopters with features such as night flight capability and dual engines that may be useful but that are not necessarily essential to their mission. Because the department does not intend to begin replacement of the fleet in the budget year, we recommend that the Legislature reject this proposal at this time and direct the department to report back next year with a more detailed proposal.

Conclusion

Taken together, our recommendations on the ERI would provide $265,000 in additional funding to improve the state's emergency response capabilities but reduce the 2009-10 level of spending proposed under the administration's budget plan by $41.3 million in the budget year. Our proposal would result in a modest General Fund increase for aviation coordination because fee revenues from our SRA fee recommendation may not materialize until 2010-11. In future years, the cost of this small augmentation could be offset by new fee revenues.

Additionally, our recommendation to reject the Governor's insurance surcharge proposal would avoid additional General Fund costs due to the state's Proposition 98 minimum funding guarantee. These costs are not recognized in the Governor's budget plan.

The Davis-Dolwig Act: Fundamental Reform Required

The Governor's budget proposes $38.5 million in bond and special funds for fish and wildlife enhancements and recreation in SWP. This funding is proposed in connection with the state's 47-year old state law, the Davis-Dolwig Act, which states the intent of the Legislature that such activities be included in the development of the statewide water system. The budget also proposes a number of statutory reforms to the act, in part to provide a dedicated funding source for its implementation. We find that the Governor's proposal does not address a number of major problems with the implementation of the act that we have identified, and that the administration's approach improperly limits the Legislature's oversight role. We recommend that the budget request be denied, and we offer the Legislature an alternative package of statutory reforms to the act.

The Davis-Dolwig Act: Original Intent and Practical Implementation

The SWP. The SWP is the state's main water conveyance system—mostly from Northern California to parts of the San Francisco Bay Area, the Central Valley, and Southern California. Users of the water system ("SWP contractors") fund most of SWP's capital and operational costs through water user fees. The DWR is responsible for the overall operations of SWP. Other sources of funding for the project include federal funding (mainly for flood control), state general obligation bonds (mainly for environmental programs), and the General Fund combined with user fees (recreation and fish and wildlife programs). The project was initiated by legislation in 1959 under the Burns-Porter Act, with voters ratifying in November 1960 the $1.75 billion bond for the project authorized in the act.

Davis-Dolwig Enacted in 1961. Chapter 867, Statutes of 1961 (AB 261, Davis)—the Davis-Dolwig Act—states the broad intent of the Legislature that SWP facilities be constructed "in a manner consistent with the full utilization of their potential for the enhancement of fish and wildlife and to meet recreational needs." The DWR is charged with implementing the act as part of planning for construction of SWP facilities. The Davis-Dolwig Act does not provide criteria specifying what kinds of recreation facilities or fish and wildlife enhancements are to be developed, nor does it require legislative review or approval of such facilities or enhancements that DWR chooses to develop in the course of implementing the law.

The Davis-Dolwig Act states that the cost of fish and wildlife enhancements and recreation is a *non-reimbursable cost* to SWP contractors. That is, under the act, DWR is not to include costs of fish and wildlife enhancements and recreation in charges levied on the SWP contractors. The act states the *intent* of the Legislature that such costs be paid for by an annual appropriation from the General Fund. The act, however, did not actually appropriate any General Fund monies to pay for Davis-Dolwig costs. Since one Legislature cannot bind another Legislature to a future action, and the State Constitution prohibits the Legislature from creating certain debts or liabilities without voter approval, we are advised that the legislative intent language of Davis-Dolwig does not create a legal obligation for the General Fund to cover the costs of these fish and wildlife enhancements or recreation. It is up to the Legislature, at its complete discretion, whether to provide funding in accordance with the act.

How Davis-Dolwig Is Implemented by DWR. The DWR has been responsible for implementing Davis-Dolwig since 1961. State law, as we noted earlier, is silent on what specific projects and costs are eligible under Davis-Dolwig. Thus, DWR determines what share of the costs of SWP facilities relate to fish and wildlife enhancements and recreation and are Davis-Dolwig costs not subject to reimbursement by state water contractors. In practice, most Davis-Dolwig costs are related to recreation. Most fish and wildlife costs are classified as being related to "preservation" of these species, rather than the "enhancement" of fish and wildlife, and therefore are not usually attributed to Davis-Dolwig.

Most Davis-Dolwig Costs Are an Allocation of Total SWP Costs. There are two main costs that DWR considers eligible Davis-Dolwig costs. First is the capital cost of the creation of recreation facilities when the SWP was constructed (such as the purchase of additional land for hiking trails and camping). The second is an allocation to recreation of the total annual budget of the overall SWP. (The allocation, on a statewide basis, averages about 3 percent for operations and 6 percent for capital spending.) This allocation means that every SWP facility has a recreation cost assigned to it, even if the facility has no direct recreation use. For example, 3.1 percent of the annual operational costs of the Edmonston Pumping Plant—a facility closed to the public—is allocated to recreation. As the capital costs for the creation of the recreation facilities have been paid off, the annual total cost that has been assigned to Davis-Dolwig by DWR in recent years is mainly comprised of this allocation of total SWP costs to recreation. In 2006-07, of a total of $12 million of costs described as Davis-Dolwig costs by DWR, $10.3 million were an allocation of total SWP costs.

Operation or Improvement of Recreation Facilities Generally Not a Davis-Dolwig Cost. The costs to operate, maintain, and improve most recreation facilities in SWP are *not* included in DWR's calculation of Davis-Dolwig costs. Recreation facilities in SWP are operated by a mix of federal (National Forest Service), state (DPR), and local agencies (for example, Los Angeles County). Generally, the day-to-day costs of operations and maintenance (for example, operating campgrounds and stationing rangers at parks) are borne by the operating entity, such as DPR.

However, the DWR has chosen to pay some operating costs of recreation at two SWP facilities—Lake Oroville and Lake Perris. Since 1996, the DWR has paid some of the costs of campgrounds and park rangers at Lake Oroville in Butte County that are provided by DPR. At Lake Perris in Riverside County, DWR has paid for some improvements to the recreation facilities (such as replenishing beach sand) since 2007. Both Lake Perris and Lake Oroville are State Recreation Areas and, as such, DPR funds provide the majority of funding support for the recreation operations at these sites. In 2006-07, of a total of $12 million of costs described as Davis-Dolwig costs by DWR, about $1.4 million related to the direct operating costs at Lake Oroville.

Some SWP Facilities Defined by DWR as Having Mainly a Recreation Purpose. There are a small number of facilities in SWP where DWR assigns more than 75 percent of costs to recreation, meaning that the main purpose of the facility is for recreation. In the extreme, a 100 percent allocation of costs to recreation at a particular facility means that the facility would not have been included in the SWP except for its use for recreation.

DWR's Decision Making on Davis-Dolwig Done "Off Budget." There has been no opportunity for legislative input into DWR decisions to allocate certain costs to Davis-Dolwig. That is, DWR alone determines what costs are to be charged to the SWP contractors and what costs are potentially to be borne by the state. That is largely because these and other budget decisions affecting the SWP are made largely outside of the annual legislative budget process.

Although the department must obtain authorization from the Legislature to create new staff positions, the allocation of SWP funds to support SWP operations and capital outlay expenditures is not subject to appropriation in the annual budget bill. Existing statute provides DWR with the authority to spend SWP funds without legislative approval for these purposes. As an example, DWR is moving ahead with a $350 million capital improvement project to make seismic safety retrofits to the dam at Lake Perris without legislative oversight—even though a portion of costs will be allocated to Davis-Dolwig and could be viewed as an obligation of the state. The SWP contractors have raised concerned with the portion of costs that they will be required to pay for Lake Perris, as they feel that there is limited water supply benefit and a more cost-effective alternative to the capital improvement project exists.

LAO Findings and Issues for Legislative Consideration

Our review has found that DWR has interpreted the provisions of Davis-Dolwig broadly, given the lack of any requirement for legislative ratification of its actions in the budget process and the off-budget status of SWP. As a consequence, we have identified a number of problems relating to DWR's implementation of the act that impact SWP operations and contractors, some with potential fiscal implications for the state. We discuss each of these issues below.

Over-Allocation of Total SWP Costs to Recreation. As noted above, the majority of the approximately $10 million per year in Davis-Dolwig costs are based on an allocation by DWR of total SWP costs. This allocation, as we discussed earlier, represents DWR's assessment of the benefit to the state's recreation facilities of the existence of SWP as a whole. However, these monies do not go directly for the construction or operation of recreation facilities (except as noted earlier). For this reason, we have concluded that DWR's allocation approach overstates the benefits to recreation from the operation of SWP and therefore overstates the appropriate public funding share of SWP costs for recreation.

Some Operational Costs at Recreation Incurred Without Legislative Review. The DWR is continuing to incur new recreation costs at SWP facilities without identifying a state funding source to pay for them or considering legislative priorities for spending for recreation programs. For example, DWR has spent SWP funds for the recreation facilities at Lake Perris without any consideration of what may be higher-priority projects in other state parks or any legislative review of its spending for this purpose.

Regulatory Compliance Costs Are Being Allocated by DWR to Davis-Dolwig. In order to continue to operate the hydroelectric facility at Lake Oroville, DWR must renew its license from the Federal Energy Regulatory Commission. Part of the licensing requirements is the provision of additional recreation facilities. The DWR has allocated a portion of the added costs of these facilities to Davis-Dolwig and the state, rather than including them in charges to SWP contractors, even though these costs are the result of regulatory requirements that must be met to operate the hydroelectric plant. Currently, these regulatory-related costs for providing recreation at Lake Oroville amount to approximately $1.5 million annually. However, DWR has estimated that these regulatory-related costs could increase to $11.5 million per year, for a period of 50 years. The DWR has chosen to allocate these costs to the state under Davis-Dolwig.

This approach raises significant policy concerns. In the past, the Legislature has stated its intent that regulatory compliance costs such as these are not appropriately funded by state funds, but rather should be paid by the regulated party—in this case, the SWP contractors.

New Revenue Bonds for SWP Construction Are on Hold. The DWR's approach to the implementation of Davis-Dolwig has led to another major problem—an inability for DWR to sell revenue bonds to finance current and future SWP projects. In the past, the DWR has relied on the issuance of revenue bonds to fund a number of SWP construction projects. The debt retirement costs of these revenue bonds are generally paid off with revenues from charges to SWP contractors. Under DWR's cost allocation methodology, the SWP contractors were only to be charged 94 percent of SWP total capital costs, with the remainder (6 percent) being allocated to the state as a Davis-Dolwig cost.

Until recently, the 6 percent Davis-Dolwig cost was "fronted" by SWP contractors, with the anticipation of repayment by the state. However, in 2006, a formal protest by a SWP contractor halted this practice. As a result, SWP contractors now can only be charged for their 94 percent of the cost of capital projects—the costs remaining once the 6 percent allocation to Davis-Dolwig has been taken into account.

In order to sell revenue bonds, DWR must show that it has a revenue source to cover 100 percent of the debt service, including the 6 percent share allocated to Davis-Dolwig. Because no source of funding has been dedicated to pay these costs, DWR is currently unable to sell new revenue bonds, placing current and future SWP capital projects in jeopardy, or at least on hold. For example, the department has advised us that the seismic work at Lake Perris has been delayed.

SWP Contractors Have Fronted Monies for Davis-Dolwig Costs. Since 1961, DWR has allocated over $464 million of SWP costs to Davis-Dolwig. Of this amount, $107 million has been paid from a combination of tidelands oil revenue ($90 million) and the General Fund ($17 million). A further $202 million in Davis-Dolwig costs fronted by SWP contractors was offset with monies owed by them to the state, which had fronted the costs for SWP construction projects. The remaining $155 million allocated by DWR for Davis-Dolwig recreation costs has been paid for, on an interim basis, by SWP contractors. (These costs were covered in the rates they paid over time.)

Notably, the DWR did not submit any budget request to the Legislature for payment of Davis-Dolwig costs between 1996 and 2007. The Governor's 2008-09 budget request did include $3.9 million for Davis-Dolwig costs related to capital projects. However, this request was rejected by the Legislature because of concerns that the administration had not provided a comprehensive solution to the implementation problems related to the Davis-Dolwig Act. The Legislature did not want to approve an interim solution that only addressed certain portions of a greater funding problem.

Governor's Proposal to Address Davis-Dolwig Problems

Governor's Proposal. The Governor's 2009-10 budget proposes to address some of the problems that have resulted from the way that DWR has been implementing Davis-Dolwig. Specifically, the budget attempts to address the problem with revenue bond issuance and the broader problem of the lack of a funding source for costs allocated to the state under Davis-Dolwig by DWR. The Governor's plan has three main components:

- An appropriation of $31 million of Proposition 84 bond funds to pay a portion of the costs of nine SWP capital projects. These projects are not recreation facilities. Rather they are improvements to the SWP, such as an upgrade to SWP communication systems and an upgrade to the Santa Ana pipeline. The $31 million represents DWR's allocation of a portion of the costs of these projects to recreation under Davis-Dolwig.

- A statutory change to provide an ongoing, annual appropriation of $7.5 million from the Harbors and Watercraft Revolving Fund (mainly funded from boating-related fees and gas-tax revenues) to DWR for Davis-Dolwig costs. Under the administration's proposed approach, the expenditure of these monies would not be subject to annual review and appropriation by the Legislature in the annual budget act.

- A statutory clarification to declare in statute that there is no obligation for contractors to be reimbursed from the state General Fund for costs previously allocated by DWR to the state under Davis-Dolwig.

We agree with the administration that it makes sense to resolve the problems stemming from the implementation of Davis-Dolwig. There are some benefits, at least in theory, to the administration's proposal, in that it provides a continuing funding source to pay for Davis-Dolwig costs that potentially would allow revenue bonds for construction projects to be sold. However, we have several concerns with the Governor's proposal that we discuss below.

Some Fundamental Problems Not Addressed. The administration's proposal does not address most of the problems with the ongoing implementation of Davis-Dolwig by DWR that we have identified, and in our view, compounds some of the problems. Specifically, the budget proposal does not propose any statutory clarification of what is an eligible Davis-Dolwig cost. Accordingly, it fails to address what we consider to be an overallocation of SWP project costs to recreation, the incurring of recreational operating costs by DWR outside of legislative review, and the inappropriate allocation of regulatory compliance costs to the state under Davis-Dolwig.

Proposed Expenditures Would Have Few Physical Recreation Benefits. As noted above, the $38.5 million proposed in the budget to pay for costs related to Davis-Dolwig is to be used to fund the portion of SWP projects allocated by DWR to recreation. As such, very few physical recreation facilities (for example, campgrounds) would actually be provided with these funds. Under the administration's approach, there is no guarantee of any physical recreation facilities being built with these state funds in future years. This could compound the problem of DWR's past overallocation of Davis-Dolwig costs for recreation to the state.

Legislative Oversight Lacking. We are concerned about the proposal to provide ongoing appropriations of funding from the Harbors and Watercraft Revolving Fund without annual review of expenditure proposals by the Legislature. This approach means that there would continue to be insufficient oversight of the Davis-Dolwig commitments made by DWR and how funds are spent for these purposes. Under the administration's approach, DWR could continue to incur large new obligations for the state under Davis-Dolwig, and could use the funds it receives for these purpose in a manner that potentially conflicts with legislative priorities.

Dismissal of Historical Obligations Presents Policy Issues. As noted earlier, the administration proposes to clarify state law to state, in effect, that no historical state-funding obligation exists for Davis-Dolwig. This declaration in statute cites a provision in the State Constitution that prohibits the creation of state debt without voter approval. The administration has advised us that it intends to rely on the proposed statutory language as the basis for its plan *not* to make any state payments at any time in the future in respect of costs that DWR has allocated to Davis-Dolwig since the mid-1990s.

Based on our discussions with staff at Legislative Counsel, the administration appears to be legally correct in its view that the Davis-Dolwig statute does not create a legally binding obligation of the General Fund. However, we think that any decision by the state to not recognize these unfunded Davis-Dolwig costs could have significant legal and policy implications. We note that the SWP contractors have raised several objections to this course of action. From a policy perspective, the Legislature should consider how it wishes to balance equity to SWP contractors who have fronted these past costs with the state's very difficult fiscal situation.

Funding Source Has Structural Deficit. Our analysis indicates that there are technical problems with the Governor's proposal to use funding from the Harbors and Watercraft Revolving Fund to pay Davis-Dolwig costs. This fund would have a structural deficit (with expenditures exceeding revenues on an annual basis) if it were used for this purpose. In the budget year, the proposed $7.5 million appropriation to DWR to pay Davis-Dolwig costs would leave the Harbors and Watercraft Revolving Fund with a fund balance of only $796,000. If the Governor's proposal were adopted, the Department of Boating Waterways estimates that expenditures from the fund on existing programs would be need to be reduced beginning in 2010-11 to avoid a fund deficit, unless revenues to the fund were increased.

The administration's proposal also complicates another component of the Governor's budget plan. The Governor has proposed a loan of $29 million to the General Fund from the Harbors and Watercraft Revolving Fund in the current year that was to be repaid by 2012-13. A commitment of $7.5 million annually from the fund to pay Davis-Dolwig costs would accelerate the date when this loan would have to be repaid from the General Fund.

LAO Recommendations on the Budget Request. Because of the problems we have identified above with the administration's approach, we recommend that the Legislature deny the request for Davis-Dolwig funding in the budget year and reject the proposed statutory change to provide an ongoing appropriation from the Harbors and Watercraft Revolving Fund to pay Davis-Dolwig costs. We further recommend that the Legislature carefully evaluate the policy and legal implications for the state before adopting the administration's proposal to modify state law to declare that no historical state funding obligation exists for Davis-Dolwig costs. However, we recommend that the Legislature act now to address Davis-Dolwig issues. In the section that follows, we present an alternative to the Governor's proposal to address this issue.

LAO's Recommended Reform of Davis-Dolwig

We propose reforming the Davis-Dolwig Act to clarify the state's funding obligations while improving legislative oversight of spending related to recreation for the SWP. Our objective in developing these recommendations is to clearly define eligible Davis-Dolwig costs and funding responsibilities of the state (versus those of SWP contractors) for recreation at SWP facilities, and to provide legislative budgetary oversight of SWP expenditures for recreation purposes. If our proposals were adopted as a package, the state would not incur any Davis-Dolwig costs in the budget year.

Figure 11 compares the Governor's proposal to address the problems with the Davis-Dolwig Act with the LAO's proposals, which are outlined below.

Specify What Costs Are Eligible for Davis-Dolwig. As current law does not specify what costs are eligible to be funded by the state under Davis-Dolwig, DWR has interpreted the act broadly, leading to what we view as the inclusion of inappropriate costs to the state under Davis-Dolwig. We propose several steps to address this situation:

- First, we recommend that Davis-Dolwig be amended to specify that only costs related to construction of recreation facilities at *new* SWP facilities are to be paid for by the state under Davis-Dolwig. The Legislature should specify that there is to be no allocation of total SWP costs to recreation. The recreation cost component of SWP capital projects would be removed, presumably allowing revenue bonds to be sold and construction to continue on pending SWP projects.

- Second, we recommend that the Legislature specify that SWP is no longer to incur operational and maintenance costs for state recreation areas, or use SWP funds for these purposes. These costs should be considered for funding alongside any other budget requests for the state park system, and be subject to legislative review and approval in the annual budget process. In particular, DWR should not incur any further costs related to the operation of the State Recreation Area at Lake Perris.

- Third, we also recommend that the Legislature specify that any SWP recreation facilities that are to be developed or improved under a regulatory requirement shall not be considered eligible state costs under Davis-Dolwig. This approach is consistent with legislative policy on how regulatory compliance costs are to be funded. If this recreation spending is required by a federal, state, or local regulatory agency as a condition of approving the construction or operation of an SWP facility, these regulatory costs should be considered a project cost and paid for by SWP contractors.

If the Legislature decides to include recreation facilities at the time that the construction of new SWP facilities is authorized, we would concur with the current policy approach contained in Davis-Dolwig. In these circumstances, we believe it is reasonable that the costs for these recreation facilities not be charged to SWP contractors. The Legislature should amend the state law, however, to specify that no discretionary spending for such recreation facilities is to be incurred without prior legislative approval and a prior legislative budget appropriation to cover the entire cost of the project.

Figure 11

Governor's Versus LAO's Proposals for Davis-Dolwig Act Reform

Issue	Governor	LAO
• Addresses over-allocation of total State Water Project (SWP) costs to recreation?	No proposal.	Limits Davis-Dolwig costs to construction of recreational facilities at new SWP facilities.
• Addresses Department of Water Resources (DWR) incurring some operational costs at recreational facilities, without legislative review?	Limited legislative oversight (only for spending in excess of $7.5 million per year).	Specifies that DWR cannot incur recreation operational costs. Requires an appropriation in the budget act for all recreation operational costs through budget of Department of Parks and Recreation.
• Prevents regulatory costs being passed to the state?	No proposal.	Specifies that regulatory compliance costs are to be paid by the SWP contractors.
• Allows revenue bonds to be sold?	Provides funding for costs allocated to recreation. Administration states that this will remove impediment to revenue bond issuance.	Removes the recreation component of cost allocation and hence the impediment to revenue bond issuance.

The DWR Should Evaluate Potential Divestment of SWP Facilities Mainly Used for Recreation. As we noted earlier, some SWP facilities have little or no water supply benefits. Recreation is their sole or primary benefit. In our view, this means it would be inappropriate for SWP contractors to subsidize the costs of operation for these state recreation facilities on an ongoing basis.

Therefore, we recommend that the Legislature direct DWR to evaluate the potential to divest SWP of these facilities and to shift them to other state, local, or federal agencies whose mission is to operate recreational facilities. The DWR should report to the Legislature by December 2009 with the findings from this evaluation, including a discussion of the costs and benefits and any legal impediments to such a divestment. The report should also provide a plan for such divestment, to the extent it is determined to be a legally and fiscally feasible course of action.

Recommend the Legislature Provide Clear Policy Direction on Status of Costs Previously Allocated by DWR to Davis-Dolwig. As discussed above, the budget proposes to clarify in statute that no historical obligation exists for unfunded Davis-Dolwig costs. As we discussed earlier, this approach has significant legal and policy implications. We do concur with the concept that, after it has reviewed these issues, the Legislature should clarify in statute its position regarding the payment of these unfunded costs. If the Legislature chooses to have the state assume some of the historical costs of recreation, it should direct the Department of Finance (DOF) to develop an implementation plan by December 2009 to carry out the Legislature's policy direction in this area.

Delta Issues and the CALFED Bay-Delta Program

In the analysis that follows, we discuss the key findings of a number of recently released reports on how to fix water-related problems in the Delta, summarize the CALFED Bay-Delta Program (CALFED) budget proposal, and provide a framework for the Legislature to apply in evaluating the Governor's budget proposals for CALFED. We then offer our recommendations regarding new budget requests and recommend reductions in CALFED's base program that would result in General Fund savings. Finally, we discuss key issues for the Legislature to consider in adopting a policy to enable the state to move forward in solving the Delta's problems.

Reports Agree That Delta Is Broken, Differ on Fixes

Over the past year, several reports have been published that discuss the crisis in the Delta and offer recommendations regarding how the state should proceed to fix the problems. These reports include the strategic plan of the Governor's Delta Vision Blue Ribbon Task Force (made up of seven gubernatorial appointees) that was released in October 2008, as well as a related January 2009 report of the Delta Vision Committee (consisting of five cabinet secretaries). (The administration is statutorily required to develop a strategic vision for a "sustainable" Delta, including sustainable ecosystems; land-use patterns; flood management strategies; and transportation, water supply, utility, and recreation uses.) There have been several other reports conducted by others outside of the administration—including reports by the Public Policy Institute of California (PPIC) and environmental advocacy organizations.

Generally, there is common agreement among these various reports that a business-as-usual approach, relying on the current means of conveying (moving) water through the Delta, will not enable the state to achieve its environmental and economic-related goals for Delta water use. The reports differ, however, in their recommended solutions, with the debate squarely focused on the issue of the preferred means of water conveyance and the fundamental policy trade-offs that parties are willing to accept. We briefly summarize the findings and recommendations of some of these key reports below.

Delta Vision Strategic Plan. The Delta Vision Blue Ribbon Task Force recommended an amendment to the State Constitution to establish that the Delta must be managed according to the two coequal goals of restoring the Delta ecosystem and creating a more reliable water supply for the state. The task force recommended that a new system of "dual water conveyance" through and around the Delta be developed. (This is the concept of building both a separate canal to convey water around the Delta as well as improvements to better enable water to be channeled through the Delta.) The task force had specific recommendations for revamping Delta governance, including the creation of a new California Delta Ecosystem and Water Council (a policy making, regulatory, planning, and oversight body) and a new Delta Conservancy (to coordinate ecosystem restoration projects in the Delta).

Delta Vision Committee Implementation Report. Based on its review of the Delta Vision Blue Ribbon Task Force's Strategic Plan, the Delta Vision Committee for the most part accepted the recommendations in the Delta Vision Strategic Plan, including a dual-conveyance approach. It recommended that the Legislature and Governor defer making a decision at this time on the specifics of a long-term governance structure, although it agreed that Delta governance needed to be improved.

PPIC Report. The PPIC report concluded that a peripheral canal conveying water around the Delta was the best long-term strategy to balance the twin objectives of maintaining a reliable, high-quality water supply and improving conditions for fish and wildlife. The PPIC viewed this option as more cost-effective than the dual-conveyance approach. The report evaluated four main options for the Delta, including the option of ending Delta water exports altogether. The report explicitly recognized that there are risks and trade-offs, and thus policy choices to be made, with each option. For example, the report found that while ending water exports altogether was the best option from the perspective of fish and wildlife protection, it was the most costly option from the perspective of its economic impact. The PPIC report also recognized the need for a more centralized, coordinated governance system to address Delta issues.

Governor's CALFED Budget Proposal

The CALFED Bay-Delta Program. The CALFED encompasses multiple state and federal agencies that have regulatory authority over water and resource management responsibilities in the Bay-Delta region. The objectives of the program are to provide good water quality for all uses, improve fish and wildlife habitat, reduce the gap between water supplies and projected demand, and reduce the risks from deteriorating levees. The Secretary for Natural Resources is the main state agency that administers the program, with responsibility for the overall program planning, performance, and tracking.

Expenditure Summary. The budget proposes $314.9 million of state funds across eight state agencies for CALFED in 2009-10. This is a decrease of $507.4 million, or 62 percent, below estimated current-year expenditures. This decrease is primarily due to a decrease in available bond funds. Figure 12 shows the breakdown of CALFED expenditures in the current year and as proposed for 2009-10, including how they are distributed among the program's 13 elements.

Off-Budget CALFED Expenditures Are Increasingly Driving the Program. As Figure 12 indicates, CALFED expenditures are proposed in eight state departments. Most of this funding would go to DWR and DFG, with proposed expenditures of $263.9 million and $32.9 million, respectively, in 2009-10. As can also be seen in Figure 12, the state funding in the budget year is proposed to come largely from two sources—various bond funds (totaling $183.6 million) and SWP funds ($114.4 million). The SWP funds originate from payments of charges by SWP water contractors. It is important to note that SWP expenditures are off budget, meaning that they are not subject to legislative appropriation in the annual budget bill. (Please see our write-up on the SWP staffing request

Figure 12

CALFED Expenditures—State Funds Only

(In Millions)

	2008-09	2009-10
Expenditures by Program Element		
Bay Delta Conservation Plan	$9.2	$9.2
Conveyance	119.7	116.8
Delta Vision	2.0	—
Ecosystem restoration	61.2	45.8
Environmental Water Account	25.4	—
Levee system integrity	309.1	51.8
Oversight and coordination	7.1	7.2
Science	35.7	9.7
Storage	15.8	—
Water quality	185.6	37.1
Water supply reliability	2.4	4.9
Water use efficiency	43.9	26.8
Watershed management	5.2	5.6
Totals	**$822.3**	**$314.9**
Expenditures by Department		
Water Resources	$682.6	$263.9
Fish and Game	25.9	32.9
Secretary for Resources	23.6	6.6
Public Health	80.1	4.2
State Water Resources Control Board	4.1	0.9
Conservation	4.4	4.8
CalFire	1.5	1.5
San Francisco Bay Conservation	0.1	0.1
Totals	**$822.3**	**$314.9**
Expenditures by Fund Source		
General Fund	$14.1	$14.0
Proposition 204 (1996)	1.7	1.6
Proposition 13 (2000)	89.3	65.6
Proposition 50 (2002)	186.9	40.2
Proposition 1E (2006)	134.0	38.5
Proposition 84 (2006)	297.6	37.7
State Water Project Funds	95.9	114.4
Other state funds	2.8	2.9
Totals	**$822.3**	**$314.9**

elsewhere in this report for further discussion of this issue.) The largest single proposed CALFED program expenditure by far—$116.8 million for conveyance—is largely funded by SWP funds.

Evaluation of CALFED Budget Proposals

Budget Reflects $157 Million of New CALFED Spending Proposals. Of the $315 million of state-funded CALFED expenditures proposed for 2009-10, $157 million reflects new spending for which budget change proposals have been submitted for legislative review. To a large degree, the new spending reflects the second year of funding for bond-funded projects and programs appropriated by the Legislature on a one-time basis in the current year. The remainder is for ongoing projects and programs that have been previously approved by the Legislature.

Approach for Evaluating CALFED Budget Proposals. We recommend that the Legislature evaluate CALFED budget proposals based on a number of criteria, including clear objectives, established funding priorities, and use of the beneficiary pays funding principle. Specifically, we recommend that budget proposals:

- Not prejudge or bias the outcome of various ongoing Delta-related planning efforts, including the Delta Vision, Bay Delta Conservation Plan (BDCP), and Delta Risk Management Strategy (DRMS) processes. (We discuss these various planning processes in greater detail in our *Analysis of the 2008-09 Budget Bill*, page B-18.)
- Be focused so as to provide timely information that serves to inform various Delta-related planning efforts.
- Tie to clear objectives and established funding priorities for the program.
- Reflect the application of the beneficiary pays funding principle, as adopted in the long-term plan for the CALFED program and by the Delta Vision Blue Ribbon Task Force.
- Minimize growth of the CALFED program until the Legislature's policy for the Delta is established, redirecting funding from lower- to higher-priority activities as necessary to minimize expenditure growth.
- Reserve General Fund expenditures only for those activities, such as program oversight, for which an alternative eligible funding source is not available.

Applying the above criteria, our recommendations on a number of the CALFED budget proposals follow.

Bay-Delta Modeling Should Be Funded From Existing Resources. The budget requests five positions and $936,000 (off-budget SWP funds) for increased support of an existing IT-based modeling program being used to determine historic water flow patterns in the Delta. The department has said this modeling activity is increasingly important to its work. However, we note that there is no proposal to redirect funding to this activity from other programs to reflect its higher-priority status. Over the past several years, the division which carries out this modeling work has increased by 19 staff and $80 million. While this activity may have merit in concept, we recommend that the department fund these activities out of existing resources by redirecting funding from lower-priority activities. We therefore recommend that the budget request be denied.

South Delta Improvement Program Funded Inappropriately. The budget proposes $29.4 million in bond funds (Propositions 13 and 50) for final design and construction costs for a capital project under the South Delta Improvements Program. The total cost of the project is projected to be about $105 million. This project directly benefits water users of both the federal Central Valley Project (CVP) and SWP by improving water flow conditions near the pumping plants at Tracy and therefore the reliability of water supplies. However, the budget proposal does not include any funding contribution from the state and federal water project contractors. The proposal acknowledges that a federal cost-sharing agreement has not been secured and that the project, while accomplishing program goals, will "result in a disproportionate level of cost to the state." As this project is now moving into the construction phase, we think that cost-sharing agreements with the project's water-user beneficiaries are long overdue. Accordingly, we recommend that the funding proposal be rejected, on that grounds that it is inappropriately funded from state funds rather than by the project's direct beneficiaries.

Pumping Plant Fish Protection Activity Funded Inappropriately. The budget requests $180,000 in Proposition 13 bond funds for the CALFED conveyance program to support the South Delta Fish Facility Improvement Projects. Two new limited-term positions would be responsible for evaluating the impact of Delta pumping on fish populations and protection of fish at the pumping plants. The activities proposed for funding directly benefit both the CVP and SWP water contractors, as they are part of a larger conservation planning effort intended to provide greater regulatory certainty to water exporters and thus greater reliability of water supplies. We recommend that this funding request be rejected, on the basis that the activity's direct beneficiaries—the state and federal water contractors—should pay for the activity, rather than state funds.

Franks Tract Project Premature. The budget proposes $27 million in Proposition 13 and Proposition 50 bond funds for part of the state's share of costs for the Franks Tract Project—a $130 million project designed to improve Central Delta water quality. Other funding sources to make up the balance of the project's costs have yet to be determined, but the department suggests that it would seek a "local cost share" from SWP funds, Proposition 84 bond funds, or local agency funds.

This proposal is problematic in two ways. First, we have concluded that the costs, benefits, and underlying rationale for this project are integrally tied to the state's yet-to-be-finalized decision on the future of Delta water conveyance. For example, an alternative means of conveyance under consideration by the department would relocate the current South Delta pumping plants, which would substantially affect the relevance and benefits of the Franks Tract Project. Until a decision is made on whether or how to build new conveyance facilities at the Delta, it is premature to begin construction on such a significant capital project. Second, it is premature, in our view, to proceed with spending state funds on this project until the cost-sharing agreements are in place.

Ecosystem Restoration Proposals Premature, Benefits Uncertain. The budget requests $22 million in Proposition 84 bond funds in the 2009-10 budget for DFG for CALFED ecosystem restoration projects. To date, the department has identified only one project to be funded from the proposed appropriation—the restoration of Dutch Slough Tidal Marsh—at a cost of $5.9 million.

As was the case last year, we recommend that the Legislature reject the budget proposal for new ecosystem restoration projects until the Legislature has had an opportunity to consider the long-term uses and configurations of the Delta as both an ecosystem and a water supply system. The result of those deliberations may be significant changes to the way in which the state uses the Delta. We believe it would be premature to fund restoration projects before those decisions are made, since fundamental changes to the Delta may make the proposed projects unsustainable in the long term.

In addition, the "End of Stage One Report"—the administration's review of the CALFED program's performance between 2000 and 2007—found that in-Delta ecosystem restoration projects have made little progress in improving the Delta's natural environment, as evidenced by the dramatic decline in fish species such as the Delta smelt. Further, the CALFED program has not yet developed performance measures for monitoring and evaluating project outcomes. Until such performance measures are developed, we believe it would be fiscally imprudent to continue to fund restoration projects whose benefits are uncertain and will not be verifiable.

Natural Community Conservation Planning Proposal Funded Inappropriately. The budget requests $8.9 million in Proposition 84 bond funds for DFG to develop a natural community conservation plan (NCCP) in the Delta. (An NCCP is a regulatory tool used to ensure compliance with the California Endangered Species Act.) The requested funds would be granted to federal wildlife agencies to pay for their participation in the NCCP development process.

We recommend that the Legislature reject this budget proposal. The administration is developing an NCCP for the Delta to ensure that SWP has sufficient regulatory authority to continue exporting water from the Delta. Because the SWP contractors are the regulated party in this case, and thus will directly benefit from the authority to continue exports, we believe it is appropriate that they pay the full cost of developing the NCCP. In addition, while Proposition 84 *allows* up to $20 million to be used for NCCP development, it does not *require* that this be done. These Proposition 84 funds could be used instead for other Delta and coastal fishery restoration projects for which alternative funding sources may not be available.

Reduction Should Be Made to CALFED's General Fund Expenditure Base

Proposed General Fund Expenditures for CALFED. As shown in Figure 13 (see next page), the budget proposes a total of $14 million from the General Fund for CALFED in 2009-10. All of this funding supports expenditures in CALFED's base budget. Of this amount, about one-half—$7.2 million—is for CALFED program oversight of various state agencies. The majority of the remaining funding is allocated to DWR for a variety of specific CALFED programs. As shown in Figure 13 (see next page), the General Fund contribution in each of these DWR-administered programs is a small fraction of the total state funds (including bond funds and SWP funds) that are spent on these programs.

Recommend Baseline General Fund Reduction of $5.9 Million. Our analysis indicates that the CALFED programs in DWR proposed to receive General Fund support may have merit and work towards achieving CALFED's goals. Most of the programs proposed for General Fund support, such as the Delta levees subventions program, have existed in some form or another prior to the creation of CALFED. In the intervening years since these programs began, however, multiple funding sources in addition to the General Fund have become available to support them. This includes substantial increases in available bond funds, many of which are allocated specifically to CALFED. Now, the General Fund contributes less than 3 percent overall to these CALFED programs.

However, in light of the magnitude of the state's General Fund fiscal problems, we think that it is a good time for the Legislature to reconsider whether DWR's CALFED activities warrant continued General Fund support. We believe such a reassessment of priorities is reasonable, given the level of support available to CALFED from other funding sources. We therefore recommend that CALFED's base General Fund budget be reduced by $5.9 million by reducing or eliminating General Fund support in two programs:

- ***Delta Levees—$4.9 Million General Fund Savings.*** The budget would allocate $4.9 million from the General Fund for levee maintenance and repairs within the Delta. This program pertains to levees outside of the state's Central Valley flood control system, mainly Delta islands, that are operated by local reclamation districts. While improving these levees has some merit, the need to continue to stabilize levees on many islands in the Delta is currently being assessed as the department evaluates alternatives for Delta conveyance. Therefore, it is uncertain whether preserving these levees will remain a priority for state funding. The availability of other fund sources (mainly bond funds) means that General Fund support can be eliminated without significantly impacting the program.

- ***Water Use Efficiency—$1 Million General Fund Savings.*** The General Fund provides $1.4 million of the nearly $27 million budgeted for CALFED water use efficiency programs, mostly from bond funds. Of the $1.4 million, about $1 million is allocated to the California

Figure 13

CALFED Bay-Delta Program—Programs With General Fund Support Governor's Proposed 2009-10 Budget

(Dollars in Thousands)

CALFED Program[a]	Expenditures: General Fund	Other Funds	Totals	General Fund Percentage of Total Support
Water use efficiency	$1,358	$25,443	$26,801	5.0%
Drinking water quality	78	37,205	37,103	0.2
Levees	4,871	46,923	51,794	9.0
Conveyance	589	116,238	116,827	1.0
Totals	**$6,896**	**$225,629**	**$232,525**	**3.0%**

[a] Administered by Department of Water Resources.

Irrigation Management Information System (CIMIS), a program operated jointly with the University of California, Davis, intended to assist irrigators in managing their water resources efficiently. We are concerned that the original purpose of the program—agricultural water efficiency—has been changed. In fact, many of the 6,000 registered users of the system are not irrigators, but are water agencies, researchers, educators, and water consultants. In our view, General Fund support for the water use efficiency program can be reduced by $1 million without significantly impacting the original program scope. We would recommend this reduction until the Legislature has evaluated the revised scope of the CIMIS program to determine whether it remains a priority to receive General Fund support. (The remaining $350,000 of the General Fund support is used for review of urban water conservation plans, a high-priority activity for which an alternative funding source is not likely to be available.)

Moving Forward to Address Delta Issues

Recommend Legislature Adopt Its Policy for the Delta. The findings and outcomes of the various Delta-related state planning efforts—Delta Vision, DRMS, and BDCP (discussed below)—have major policy implications for the state. As we have recommended in previous analyses, once the Legislature has reviewed the various work products stemming from these efforts, some of which are not yet complete, the Legislature should enact legislation establishing its Delta policy. This legislation would establish the Legislature's policies for the future of the Delta and its objectives and funding priorities for CALFED and other Delta-related programs. This would enable evaluation of future budget proposals for consistency with legislative policy priorities.

Choice of a Delta Conveyance Alternative a Key Component of a Delta Policy. In our *California's Water: an LAO Primer* (page 70), we call attention to the need for the Legislature to address the current problems with conveyance of water through the Delta. Solving these problems as soon as possible is necessary if the state's environmental and economic objectives for the Delta are to be met. (Economic objectives include, for example, increasing the reliability of Delta water supplies.) We have recommended that the state prioritize the selection of an alternative to the current business-as-usual conveyance approach in which water is conveyed solely through the Delta.

How Is the Administration Proceeding on the Conveyance Issue? The budget proposes funding ($2.6 million, SWP funds) for DWR to support planning, environmental, right of way, engineering, and construction activities related to making a decision on Delta conveyance alternatives. The administration's process, known as BDCP, involves conservation planning and an environmental permitting process authorized under federal and state law with both conservation and water supply objectives. (The budget plan assumes that at least an additional $9 million will be provided in support of the BDCP process overall from SWP funds.) The intended result of the process is (1) the issuance of federal and state endangered species permits necessary to continue the current SWP operations in the Delta, thereby increasing the reliability of water supplies, and (2) habitat conservation improvements that will go beyond those necessary to mitigate the impacts of Delta conveyance operations.

At the core of the BDCP process is an effort to change the current means of conveying water through the Delta. The BDCP is proceeding on the basis that dual conveyance is the preferred conveyance alternative. The budget request includes funding for the statutorily required environmental impact documentation that is required to back up the selection of dual conveyance as the preferred alternative. The department will be evaluating various alternative conveyance approaches under this framework.

Analysis Too Narrowly Focused. While the process described above will provide useful information to inform the Legislature on the conveyance issue, we think that its focus is too narrow to fully inform the Legislature on this issue. That is because the BDCP process is essentially a regulatory process intended to result in permit issuance for SWP operations. As such, the focus of the process is not as broad as the one that considers and balances issues from a statewide perspective.

For example, DWR has indicated that the economic component of its analysis has focused on the potential fiscal impact of various Delta alternatives on state water contractors. While this is an important concern, this focus is too narrow, in our view, and does not appear to be giving adequate consideration to the economic impact of the chosen solution on third parties (such as Delta farmers) or to the fiscal impact of the various alternatives on state finances. Some alternatives, we noted, could result in significantly greater long-term costs to the state for maintaining levees, roads, and other public facilities.

Ongoing Role Recommended for the Delta Vision Committee. Although the administration has stated publicly on a number of occasions that it will not begin construction of a new conveyance system for the Delta without legislative involvement, we are concerned that the administration is not conducting analyses that will provide the Legislature with the information it will ultimately need to make a wise decision on the conveyance issue. Therefore, we recommend that the Delta Vision Committee be directed to report to the Legislature, prior to its moving forward with construction of a new conveyance system, with the following information on each conveyance alternative evaluated by the administration:

- Costs, including direct costs for construction.
- Potential adverse economic impacts or benefits for third parties. These would include, for example, societal impacts such as impacts on users of the state's drinking water and impacts on sectors of the economy, such as Delta agriculture.
- Potential costs to state and local government agencies.
- Benefits, in terms of the state's ecosystem restoration objectives.
- Benefits, in terms of water supply reliability.
- A clear articulation of the risks and tradeoffs of the alternative, and the policy choices that it involves.
- A clear articulation of the critical assumptions underlying the above findings, and how the findings would change under a different, yet still reasonable, set of assumptions.

As the Legislature proceeds with its search for a Delta solution, it will be important that it be made fully aware of the tradeoffs that it is being asked to accept, so as to ensure that the implemented conveyance solution is consistent with its policy priorities. We think that the provision of the information outlined above is necessary to enable the Legislature to establish a sound and sustainable policy for the Delta.

State Water Project Staffing Request Not Fully Justified

Department of Water Resources Budget Issues. We discuss budget issues relating to DWR in three places in this report. Earlier in this section, we discussed (1) the Governor's DWR budget proposal to provide funding for, and make statutory reforms to, the Davis-Dolwig Act, and (2) various Delta-related budget proposals, many of which pertain to DWR, including the SWP. In this analysis, we focus on the budget request for 111 new staff positions for the SWP.

SWP Background. The DWR protects and manages California's water resources. In this capacity, the department maintains the SWP, which is the nation's largest state-built water conveyance system, providing water to 23 million Californians and 755,000 acres of agriculture. The project conveys (moves) water mostly from Northern California and through the Sacramento-San Joaquin Delta to parts of the San Francisco Bay Area, the Central Valley, and Southern California. The project was initiated with a voter-approved bond in November 1960. The project is mainly funded by users of the water system (often referred to as SWP contractors). These user revenues are commonly referred to as SWP funds. However, there are other significant sources of funding related to SWP. Specifically, the federal government provides a share of the costs for flood control projects related to SWP, the General Fund has supported related recreation and fish and wildlife programs, and state general obligation bond funds have supported several related environmental programs, including CALFED.

SWP Staffing Request. The budget requests 111 new positions for SWP to be funded from SWP funds. This is an increase of 7 percent above the current-year number of positions—1,509. Over the past three years, SWP has added 195 positions mainly for administration, environmental compliance, and legal support. The proposed positions include:

- 60 positions for management, various state operations, and activities related to addressing global climate change and energy-related activities.
- 26 positions for overall support of DWR administration.
- 25 positions for Bay-Delta programs, including support for a new conveyance program and modeling of water flow and water quality in the Bay-Delta.

We provide our recommendations on the requested positions below.

Recommend Denial of 60 Positions for Management, State Operations, and Energy Activities. Below, we describe the requested positions in more detail, and the basis for our recommendation to reject them.

- ***Reject Positions for Program Management Group.*** Of the 60 new SWP positions, nine are program management positions, costing about $1.5 million, that would be used to establish a centralized point within DWR to initiate, track, account for, allocate, and bill costs of SWP projects. However, we note that at least 17 positions related to SWP administration, legal review, and protest resolution have been added to the existing base budget for these activities in the past three years. Moreover, it is unclear why the 50-year old program requires at this time a *new* central program management group. As the budget request has not been justified, we recommend that it be denied.

- ***Reject Positions for Expanded Operating Programs.*** The SWP requests 42 of the 60 new positions, which would cost about $5.9 million, for a broad spectrum of SWP programs, including licensing of energy facilities, protection of endangered species, and asset management. The majority of the positions added over the past three years were added for similar purposes, including positions for energy license implementation and environmental compliance. We do not find that the additional requested positions are justified at this time, and therefore recommend that this component of the staffing request be denied.

- ***Reject Positions for Climate Change Energy Activities.*** The SWP requests nine new positions at a cost of $1.7 million to help SWP shift to a more renewable energy-focused portfolio in meeting its energy requirements. The proposal to increase the use of renewable energy in SWP has merit. The budget proposal, however, has not justified why *existing* SWP staff working on energy-related matters could not be utilized for this proposal by redirecting their focus to increasing SWP's use of renewable energy. Consequently, we recommend deletion of these positions.

Recommend Denial of 26 Positions for Support of DWR Administration. The budget requests 26 new positions and $3.4 million, of which $2.7 million would come from SWP funds, to increase administrative capacity to handle workload created by these previous position increases. However, SWP has already received additional administrative positions in recent years. We find that the request for further additional administrative positions has not been justified, and therefore recommend denying this component of the budget request.

Recommend Denial of Four Positions for Delta Monitoring. Below, we describe 4 of the 25 total positions requested by SWP for Delta activities. We address the remaining 21 positions in our write-up on Delta issues. The department proposes to transfer 16 water flow monitoring stations from the United States Geological Survey (USGS) to the department when a current contract with the federal government ends in 2009. Four SWP staff would be added to take over these contract activities. Currently, these stations are operated by the USGS for water flow modeling, biological studies, water quality studies, as well as SWP-related activities. We recommend that this proposal be rejected, because we think there is merit to maintaining independent monitoring by USGS of water quality and flow monitoring stations in the Delta. As the state's Delta policy continues to evolve over the next few years, potentially fundamentally affecting SWP operations, having independent monitoring could become increasingly important. We therefore recommend that the Legislature direct the department to extend its current contract with USGS to provide this information.

Off-Budget Process No Longer Appropriate for SWP

Broad Spending Authority Provided to Department for SWP Activities. The DWR's requests to the Legislature for the authority to establish new SWP positions, such as those discussed above, are budgeted in a different manner than for most state agencies. While DWR must seek approval from the Legislature to establish permanent new positions, it does not need additional legislative approval for the funding to support them. That is because the expenditure authority for these positions is already provided off budget. This term means that the funds to support these positions, as well as all other operating costs and capital outlay for the SWP, are not appropriated in the annual budget bill. Instead, DWR has "continuous appropriation" authority to spend the revenues.

Because of this broad and ongoing grant of expenditure authority, the department is not required to submit funding requests in conjunction with position requests. Consequently, this complicates the Legislature's ability to fully evaluate these position requests in the context of the SWP's total current-year staffing of 1,509 positions.

SWP's Budget Development Lacks Checks and Balances. There are other aspects of SWP budgeting that we believe are problematic. We are concerned that the process DWR follows to develop SWP budgets lacks checks and balances that would help ensure accountability. For example, while the SWP seeks and receives some advice from SWP water contractors, it does not actually review its budget with the contractors prior to the submission of departmental requests for additional positions to the Legislature. Review of the now $900 million budget takes place internally at DWR, with ultimate approval coming from within the department and DOF. At no point is the budget vetted and approved in a public setting, nor do ratepayers—those affected most by spending decisions—have an opportunity to review the budget prior to approval, as is the general practice at other state agencies.

The only public review of the SWP spending plan takes place at legislative budget hearings, and only then in the context of specific requests for position authority. This relative lack of budgetary oversight also applies to SWP's capital projects, although there is some limited oversight provided by DOF and the bonding agencies in cases in which the SWP issues revenue bonds to finance the construction costs of its projects.

Lack of Transparency in SWP Budget Process Has Led to Problems. The lack of transparency in the development of the SWP budget appears to have triggered increasing billing protests from SWP contractors. This, in turn, has led to increases in staffing and increased costs to handle the billing protests, which are ultimately passed on to water ratepayers. This upward expenditure cycle is due in part to the lack of effective budgetary oversight of the SWP.

Previous Recommendation to Bring SWP on Budget More Timely Than Ever. In our *2007-08 Analysis* (page B-129), we recommended SWP be brought on budget and that its expenditures be subject to ongoing review and approval in the annual budget act. As we noted in our prior analysis, we are concerned that the role of SWP has changed substantially from its inception in 1960.

In the past, SWP operated as a discrete, self-contained program with sufficient fiscal oversight provided by SWP contractors who pay most of the project's costs. However, this situation has changed. Specifically, we found that SWP had developed increasing fiscal and programmatic ties to other state on-budget programs, such as CALFED, that we believe justify placing this program under regular legislative budget scrutiny along with requests for additional positions. Our analysis has led us to conclude that the Legislature has the authority to do so.

Since publication of our *2007-08 Analysis*, we believe the case for putting SWP on budget has grown stronger. We have found that, not only is SWP integrally linked to other programs, but its operation has created significant liabilities for other programs and funding sources, including the General Fund, without any legislative oversight. (For example, please see our discussion in this report on the Davis-Dolwig Act.) There is also growing recognition of SWP's role in contributing both to the causes of, and the potential solutions to, water-related problems in the Delta. This has major policy and fiscal implications for a number of state programs.

For these reasons, we continue to recommend the enactment of legislation that would make SWP subject in all respects to the annual legislative budget process.

Oil Severance Tax Administration Should Shift to Tax Agency

The Governor's budget includes a request for $10.6 million in the budget year from the General Fund for DOC for an additional 83 positions to administer a proposed oil severance tax. The oil severance tax would be 9.9 percent of the gross value of each barrel of oil extracted in California. Below, we discuss how the oil severance tax should be administered, and at what funding level, should the Legislature enact such a tax.

DOC Currently Regulates Oil and Gas Production in the State. The Division of Oil, Gas, and Geothermal Resources (DOGGR) within DOC regulates oil, gas, and geothermal well operations throughout the state. The division issues production permits and oversees the drilling, operation, maintenance, as well as the plugging and abandonment of wells. The DOGGR also provides detailed production reports on oil and gas output in the state.

Proposed Legislation Tasks DOC With Administration of the Oil Severance Tax. The Governor's budget plan includes proposed changes in statute that would assign DOC with the task of administering the oil severance tax. The proposed legislation gives DOC the authority to develop regulations, hire staff, and certify which oil-producing wells are to be exempted from the tax. The statutory language appropriates $6.8 million from the General Fund to DOC in the current year for these administrative costs. Funding for these costs in 2009-10 would be appropriated in the annual budget act.

Governor's Budget-Year Proposal for Oil Severance Tax Administration. The budget requests 83 new positions for a new oil severance tax administration unit within DOGGR, of which 42 positions would be permanent and 41 would be three-year, limited-term positions, at a total cost in 2009-10 of $10.6 million from the General Fund.

The DOC proposal was developed, and its costs estimated, based upon past work by DOC in administering its beverage container recycling program and DOGGR's experience in working with oil producers. In developing its budget request, however, DOC did not consult with BOE, a body that administers a large number of special fees and taxes on behalf of various state agencies. In our view, BOE would have been a reasonable alternative agency for the administration to have considered in evaluating how the tax should be administered and the costs and staffing required for such an endeavor. This is because of BOE's longstanding focus on, and technical expertise in, tax administration, and because of the potential efficiencies from consolidating activities for collection of a new tax with similar processes already in place at BOE.

DOC's Funding Request Substantially Higher Than BOE's Estimates to Do the Job. The BOE provided us with an updated estimate for its costs to administer an oil severance tax proposal very similar to the one proposed by the Governor—one proposed in Proposition 87, an unsuccessful voter initiative on the November 2006 ballot. The updated BOE estimate is that its costs to administer such a tax would be $4.2 million in the first year, with an ongoing cost of $2.9 million. The ongoing funding level is $7.7 million below DOC's budget-year request for funding to administer the Governor's proposed tax.

Reject DOC Request for Additional Positions. Given the substantial savings that could be achieved by having BOE administer the oil severance tax, we recommend that the Legislature choose this option if it decides to enact an oil severance tax. Accordingly, we recommend that the Legislature reject DOC's request for additional positions and General Fund support. The funding level (and related position authority) for BOE's administration should be set at a level to reflect BOE's lower costs. We also note that the Governor's proposed legislation specifies that the costs to administer the oil severance tax are to be funded from the oil severance tax revenues. A budget appropriation for the administrative costs should be consistent with any such statutory direction.

Governor's Reorganization Proposals

As mentioned previously in the "Background" section, the Governor has stated his intent to submit five legislative proposals to reorganize programs in the resources and environmental protection area to improve governmental efficiency. (These are in addition to the proposal, reflected in the budget plan, to eliminate and realign the CCC.) In the following section, we summarize these proposals and provide our initial comments on them. We note that, at the time this analysis was prepared, the administration had provided only limited information to the Legislature about these reorganization proposals.

State Energy Agencies

Current Structure of State's Energy Agencies. The formulation of energy policy, the regulation of energy markets, and the implementation of energy-related programs are spread across several state commissions, boards, departments, and an independent nonprofit entity. In the past, we have found that this system of governance has created problems for the formulation and execution of state energy policy. For example, energy policy-making is diffused throughout state government, impeding accountability to the Governor and the Legislature.

Governor's Proposal. The administration has indicated its intent to pursue a reorganization of the various state agencies with energy-related responsibilities. Under the Governor's proposal, a consolidated Department of Energy would be created which would assume many of the energy-related responsibilities of nine existing state agencies—including certain regulatory powers currently held by the California Public Utilities Commission (CPUC) related to permitting of large renewable generation and transmission infrastructure. The California Energy Commission (CEC) would be eliminated, with all of its current functions assumed by the proposed consolidated department.

LAO Comments. We have previously recommended that the state reorganize its various energy-related agencies to improve accountability and reduce redundancies. For a detailed discussion of our reorganization proposal, please see *The 2006-07 Budget: Perspectives and Issues*, page 199.

As with the Governor's broadly outlined proposal, we recommend the creation of a consolidated Department of Energy that would be headed by a single department head or cabinet secretary. The new department would perform the duties of the CEC as well as certain programs currently operated by other state agencies. Such a department would have responsibility for policy-making, some regulatory functions, and the implementation of energy-related programs. Under our proposal, electricity ratemaking functions would remain with CPUC. While there would be some administrative cost savings from our reorganization proposal, the purpose is largely to improve the state's formulation and implementation of energy policy and accountability for such policy-making.

Waste and Recycling Functions

Current Structure of the State's Waste and Recycling Functions. The following departments have responsibility for the state's recycling and waste functions:

- CIWMB—for reduction, recycling (non-beverage container), and reuse of solid waste generated in the state.
- The DOC's Division of Recycling—for beverage container recycling.
- DTSC—for regulation of the generation, treatment, and disposal of hazardous waste.

Governor's Proposal. The administration has indicated its intent to pursue a reorganization of the various state agencies with waste and recycling-related responsibilities. Under the Governor's proposal, the Division of Recycling within DOC would assume responsibility for the recycling of all materials, DTSC would assume responsibility for the remaining (nonrecyling) solid waste management functions of CIWMB, and CIWMB would be eliminated. The Governor estimates ongoing, annual savings of between about $2 million to $3 million from this proposal.

LAO Comments. We have previously recommended that the state reorganize its recycling and waste management functions (see our *Analysis of the 2005-06 Budget Bill*, page B-17), including eliminating CIWMB and combining recycling functions within a single department. As such, we believe that the general concept proposed by the Governor has merit. However, two issues with the Governor's proposal warrant further consideration by the Legislature:

- ***Location of Waste Management and Recycling Functions.*** The Governor's proposal splits recycling and waste management functions between the Natural Resources Agency (recycling) and

Cal-EPA (waste management). As recycling is closely related to other waste prevention functions, we have previously stated that there are benefits from having a single agency responsible for both recycling and waste management. Thus, we have recommended that Cal-EPA would be the most appropriate location for both waste management and recycling functions—the current location for the bulk of these two functions.

- ***Should There Be a DOC?*** The Governor's proposal expands the scope of DOC by adding additional recycling-related responsibilities. However, we have previously recommended that recycling program consolidation be achieved by moving the recycling function *from* DOC to a Cal-EPA department. We think that this would open the door to an evaluation of the role for a DOC in state government and whether its functions could be assumed by other state entities. As noted in our previous analysis, DOC currently has several roles and responsibilities that overlap with a number of other state agencies, including the State Lands Commission. Prior to expanding the scope of DOC through consolidation of recycling efforts, we recommend that the Legislature consider the overall role for DOC and opportunities to transfer various components of DOC to other state agencies to improve program effectiveness and efficiency.

Department of Boating and Waterways and Department of Parks and Recreation

Current Role of DBW. The DBW funds, plans, and develops boating facilities on waterways (both public and private facilities), provides financial aid and training to local law enforcement, and licenses yacht and ship brokers. Other activities include a wave and ocean data program, weed eradication in the Delta, and beach erosion and replacement programs. The budget proposes $71 million in expenditures for 2009-10, mainly from special funds and federal funds for state operations, local assistance, and capital outlay.

Governor's Proposal. The administration has indicated its intent to pursue the elimination of DBW and consolidate its functions into DPR, allowing for better coordination and management of projects and grants relating to boating access and safety programs. The Governor estimates ongoing, annual savings of $600,000 from this proposal.

LAO Comments. The administration has indicated that the overall goal of its proposal is to eliminate redundancy and reduce costs. We concur that opportunities for efficiencies and savings exist from reorganizing DBW's current functions. We see no reason why another agency, such as DPR, would not be capable of administering DBW's ongoing grant and loan programs and overseeing its capital outlay activity. By coordinating such activities with similar activities in another agency, efficiencies should result. As such, we think the Governor's proposal has merit and recommend in principle that it be adopted. However, as discussed below, we think that the Legislature could go further than the Governor's proposal, creating additional savings.

In 1996, the administration proposed a similar elimination of DBW, with the majority of programs to be shifted to DPR. The proposal also included the elimination of certain DBW programs, with no other state agency assuming them. We think that this aspect of the 1996 proposal has merit, and we recommend that the Legislature, in evaluating the Governor's proposal, consider going further to eliminate unnecessary or lower priority state programs currently implemented by DBW, including:

- ***Licensing of Yacht and Ship Brokers.*** In past years, we have recommended eliminating various licensing boards and commissions based on criteria to assess whether the state should license a particular occupation to include: (1) potential risk to public health and safety, (2) risk of financial harm to consumers, and (3) federal mandate requirements. Based on these criteria, ending the state's role (currently implemented by DBW) in licensing yacht brokers appears to have merit.

- ***Private Marina and Small Craft Harbor Loan Programs.*** These loans have typically been made for the planning, design, and construction of public small craft harbors facilities and private recreational marina facilities. Eliminating these programs would leave the lending function to the private sector. We recommend that the Legislature consider whether these loan programs continue to be a state funding priority.

Board for Geologists and Geophysicists And State Mining and Geology Board

Governor's Proposal. The administration has indicated its intent to pursue consolidation of the Board for Geologists and Geophysicists (the licensing and regulatory body for geologists and geophysicists), currently under the Department of Consumer Affairs (DCA), with the State Mining and Geology Board, an entity currently under DOC. The Governor estimates ongoing, annual savings of up to $714,000 from this proposal.

LAO Comments. As we discuss in our *2009-10 Budget Analysis Series General Government* document, we have concluded that the Governor's proposal to pursue the elimination of a number of DCA boards, bureaus, and committees through program consolidations and eliminations has merit and should be adopted.

However, prior to consolidating the two particular boards in question here, we recommend the Legislature consider potential opportunities to go further than the Governor's proposal. Specifically, we note that the Governor's proposal would retain the licensing and certification of geologists and geophysicists with a state board. We recommend the Legislature consider whether licensing of these professionals by the state is a necessary state function. We also question whether a state board structure is the most appropriate and cost-effective way to oversee mining and geology within the state.

California Accidental Release Prevention Program

Roles of the CalARP Program and DTSC. The California Accidental Release Prevention Program (CalARP) currently resides within CalEMA (formerly Office of Emergency Services). The program encompasses planning activities related to the prevention of accidental releases of hazardous substances and cleanup activities should a spill occur. The DTSC regulates hazardous waste management, oversees contaminated hazardous substance site cleanups, and implements pollution prevention programs.

Governor's Proposal. The administration has indicated its intent to move CalARP from CalEMA to DTSC, for purposes of improving consistency and efficiency.

LAO Comments. This proposal appears consistent with past legislative action to consolidate the implementation of various hazardous materials management programs previously administered by multiple state and local entities. This action has reduced fragmentation in program implementation and improved program effectiveness. We find that the proposal has merit and recommend that it be adopted.

Miscellaneous Budget Proposals Not Justified

Based on our review of the Governor's budget, we find the following budget proposals in various departments are not justified for the reasons specified. Therefore, we recommend the Legislature reject these proposals, which would result in the savings noted.

CalFire

Implementation of Assembly Bill 2917—$270,000 General Fund, $40,000 Reimbursements. The department proposes an augmentation of $310,000 to comply with Chapter 274, Statutes of 2008 (Assembly Bill 2917, Torrico), which requires criminal history background checks for emergency medical technicians in the state. While the department is required to comply with this legislation, we find that it has proposed a relatively costly method to do so. Specifically, the department proposes to hire an outside medical director to oversee compliance. We recommend that the Legislature reject this proposal, and direct the department to resubmit its proposal after finding a more cost-effective way to comply with the law.

Public Utilities Commission

Implementation of Higher Renewables Portfolio Standard (RPS)—$322,000 Special Funds. State law currently requires investor-owned utilities to comply with an RPS requiring 20 percent of their electricity supplies to come from renewable energy sources by 2010. The Scoping Plan developed by the Air Resources Board to meet the state's greenhouse gas emission reduction goals under Chapter 488, Statutes of 2006 (Assembly Bill 32, Núñez), recommends that the state increase the RPS goal to 33 percent by 2020. While changes to the current RPS have not been enacted in law, the budget requests additional resources for CPUC to begin the process of implementing a 33 percent RPS in anticipation of enabling legislation. While this proposal may have merit, we recommend the Legislature deny it on the grounds that it is premature, pending enactment of the enabling legislation.

Department of Boating and Waterways

Monitoring and Prediction of Waves and Shoreline Change—$250,000 Special Funds. The Coastal Data Information Program is administered jointly by DBW and federal agencies through the Scripps Institute of Oceanography. The program currently receives $500,000 from the Harbors and Watercraft Fund, which the budget proposes to augment by $250,000 on an ongoing basis. Federal funding from the Army Corps of Engineers is proposed to remain at approximately $1 million. The budget proposal suggests that, without increased state funding, additional federal funds may be lost. However, a proposal to receive increased federal funding to match the additional state funds has not been proposed in the budget plan. While this program may have merit, we do not find the increase in state funding to be justified at this time and we recommend rejection of the budget proposal.

A Funding Framework for Natural Resources and Environmental Protection Programs

In our *Analysis of the 1992-93 Budget Bill* (see page IV-19), we addressed the subject of the state's overall strategy for funding resources and environmental protection programs. In that analysis, we described several ways that these program areas could be funded. In general, we recommended that (1) when state programs provide benefits to identifiable parties, or (2) when they address the negative environmental impacts of activities undertaken by specific parties, it is appropriate for those parties to pay for the costs of the related programs.

Since the time of our *1992-93 Analysis*, the funding mix used to support natural resources and environmental protection programs has evolved, with greater reliance on a large number of special funds and bond funds with narrowly tailored uses. In the following analysis, we review the current funding structure for resources and environmental protection programs in light of these changes. We also make general recommendations for ways to restructure the current funding system to allow more effective spending of state funds and to provide greater spending flexibility to meet legislative funding priorities.

Funding Natural Resources and Environmental Protection. In the areas of natural resources and environmental protection, there are different means the state can use to fund its programs. When deciding what the appropriate fund source for a program should be, it is important to consider both the purpose of the program and the groups or individuals that are connected to the program. (For example, the parties connected to a program may be beneficiaries of a state service or those regulated by the state.) In general terms, there are two basic ways to fund these programs.

The first way to fund programs is through the use of general revenue sources. There are many program areas that benefit the state as a whole, such as programs to protect wildlife habitat or watersheds which provide water supplies to much of the state. In cases where the benefits of a state program accrue to most or all of the state's residents, we believe that it is appropriate to use general revenue sources to fund those programs. The most obvious example of a general revenue source is the state's General Fund—to which almost all state residents make some contribution. Also included in general revenue sources are general obligation bond funds that are repaid using the state's General Fund.

The second way to fund programs is based on fees or other charges levied on specific parties. In some cases there are direct, identifiable beneficiaries of state programs. Because these individuals or groups derive a direct benefit from a state service or access to a public resource, we contend that it is good policy for those parties to pay for the benefits they receive. This is commonly referred to as the beneficiary pays principle. For example, hunters and fisherman pay licensing fees to the state. In this case, the beneficiaries of a state program pay for the state's cost to protect existing populations of fish and wildlife as well as programs to provide additional hunting and fishing opportunities.

On the other hand, there are cases where individuals or groups directly impact a public resource in a negative way. To the extent those polluters are identifiable, the state may impose regulatory fees on them to pay for both the costs to prevent or control pollution and to clean up pollution. This is commonly referred to as the polluter pays principle. For example, the state collects fees on oil imported into the state to support the regulation of oil imports and to support a trust fund for cleaning up oil spills when the actual polluter cannot be identified or is unable to pay the costs. In this case, industry supports the cost of regulation and the potential cleanup of oil spills.

Of course, a mixture of general revenues and fees can be used to fund a state program and this reflects current practice. For example, the state park system is supported, in part, by the General Fund because the system protects natural and historic resources that belong to the residents of the state as a whole. The state park system also derives considerable funding support from user fees charged to visitors because those visitors derive a direct benefit from access to parks.

Funding Sources Are Subject to Different Legal Constraints. In addition to the policy reasons for using certain types of funding sources for programs, there are differing legal constraints between fund sources that affect the Legislature's ability to raise and spend revenues from those fund sources. There are different legal parameters for the General Fund, fee-based special funds, and general obligation bond funds.

General Fund monies are collected broadly from taxpayers and are available by legislative appropriation for broad purposes. Relative to other fund sources, the Legislature has a great deal of flexibility regarding what programs can be funded from the General Fund. A General Fund tax increase can only be enacted with a two-thirds vote of the Legislature and revenues from such tax increases generally can be appropriated only with a two-thirds vote of the Legislature.

In addition to the major sources of General Fund tax revenues, the state collects a wide variety of other revenues which are deposited in special funds. As mentioned above, the state often assesses fees under the beneficiary pays or polluter pays principles. A fee may be enacted by the Legislature on a majority vote, provided there is sufficient "nexus" between the universe of fee payers and the programmatic activity for which the fee revenues are used. Typically, these revenues are deposited into a special fund and may be appropriated by the Legislature on a majority vote.

It is important to note that just because revenues are deposited in a special fund, it does not legally make them fee revenues. For example, the Governor's budget includes a proposal to assess a surcharge on property insurance premiums to pay for state emergency response costs. Revenues from this surcharge would be deposited into a special fund. However, based on our discussions with staff at Legislative Counsel, we believe these revenues would be considered tax revenues. This characterization has several implications for these funds—including the vote requirements for enactment of the surcharge and appropriation of the funds, the creation of an additional state funding requirement for education under Proposition 98, and the potential use of these revenues for other purposes unrelated to emergency response.

Under the State Constitution, the voters may authorize the sale of state general obligation bonds with a majority vote. Unless otherwise specified in the measure, general obligation bonds are repaid using the state's General Fund. While there are general requirements in the Government Code for the use of such bond funds (including a general requirement that they be used for capital purposes), the bond measure itself largely determines how the funds are to be spent. In some cases, bond measures provide very detailed allocations of funding to different programs. In other cases, bond measures allow the Legislature wide latitude in appropriating the funds.

Most state funds are subject to legislative appropriation, meaning that before they can be spent, they must be appropriated by the Legislature in the annual budget act or other legislation. In some cases, either a piece of legislation or a bond measure provides the appropriation authority to the administration to spend funds without any further action by the Legislature. We generally recommend that funds be subject to annual legislative appropriation so that the Legislature can exercise oversight over the expenditures of funds.

Shift in Funding Sources to Bonds and Narrowly Constrained Special Funds. In recent years, special funds have generally provided the largest source of funding for resources and environmental protection programs, followed by general obligation bond funds, the General Fund, and then other fund sources, as shown in Figure 14. While special funds have historically played a major role in funding resources programs, over the last 15 years the relative importance of the General Fund has declined, while bond funds have become a much larger share of total spending.

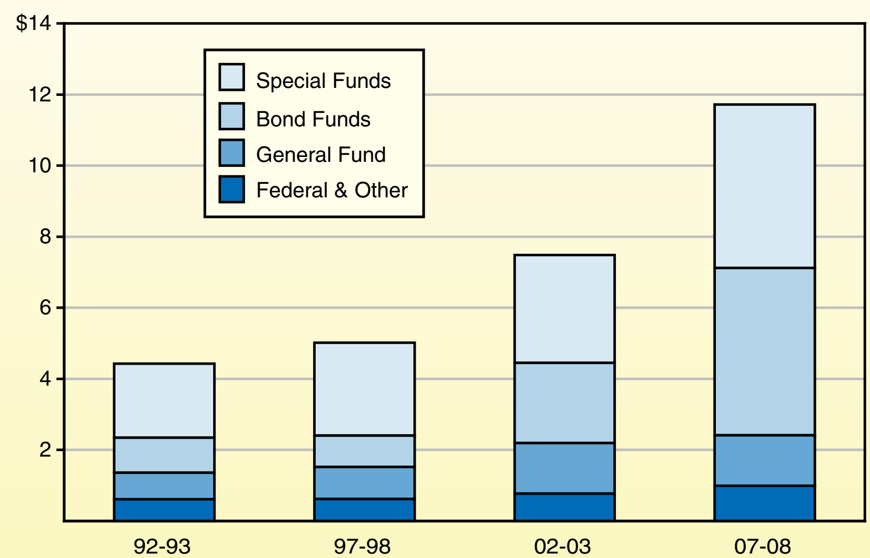
Trends in Structure of Bond Measures and Special Funds. Since 1996, the voters have approved about $22 billion in general obligation bonds for resources and environmental protection programs. These bond measures have included both legislative measures and voter initiatives. As the state's reliance on bond funds has increased, the make-up of those general obligation bonds has become a key driver of resources-related spending.

Typically, bond measures specifically allocate funding among many program areas, while

Figure 14

Special Funds and Bonds A Growing Source of Program Support

Inflation-Adjusted Expenditures[a], by Fund Type (In Billions)



[a]Excludes general obligation bond debt service.

leaving some or all of the authority to appropriate the bond funds to the Legislature. For example, Proposition 84, a voter initiative enacted in 2006, allocates $5.4 billion among about 70 different uses. While most of Proposition 84 is subject to legislative appropriation, the Legislature is not allowed to reallocate funds among the various uses specified in the bond measure. On the other hand, some recent legislative bond measures—such as Propositions 1B and 1E—allocate funds to a handful of general program areas and authorize the Legislature to appropriate those funds within the general requirements of the bond measure.

Another trend over the last two decades is a greater reliance on special funds that are only available for very narrowly defined uses. A good example is the Fish and Game Preservation Fund. This fund has almost two-dozen individual accounts dedicated to very specific uses as well as a large "nondedicated" account for broader purposes. While all the funds in the Fish and Game Preservation Fund are generally used for the protection of the state's natural resources, each individual subaccount has strict statutory constraints on its use. In practice, this system of very specific accounts creates administrative costs for the state and limits the Legislature's ability to direct funding from low-priority activities to high-priority activities without making statutory changes.

On the other hand, there are special funds which can be used for a relatively broad range of purposes within a programmatic area. For example, the Toxic Substances Control Account—which is supported by regulatory fees, cost recoveries, and penalties relating to hazardous substances—is generally available for expenditures relating to the prevention, regulation, and cleanup of hazardous substances.

Based on our review of the various special funds that have been used to support programs in the natural resources and environmental protection areas of the state budget, we find an increasing amount of funding is narrowly constrained. In 1992-93, we estimate that 69 percent of special fund expenditures came from funds that can be characterized as narrowly focused. By 2007-08, narrowly constrained funds made up 83 percent of such expenditures.

Consequences of Current Funding Structure. The funding structure that has evolved over the last two decades has implications for the state's ability to allocate funding to priority programs.

- ***Funding May Not Change as Priorities Do.*** Because much of the funding for resources and environmental protection come from special funds and narrowly constrained bond funds, the Legislature's ability to react to evolving funding needs is constrained. If new funding needs arise, it is difficult to reprogram existing funds from lower-priority areas of the budget to higher-priority areas. This is particularly true of bond funds. The bond measures approved by the voters in recent years have been very large and consequently have been spent over many years. As new challenges arise, the Legislature does not have the authority to reprioritize expenditures from existing bond funds. Instead, the Legislature must choose between shifting General Fund monies from other areas of the budget, creating new revenue sources, or not funding new priorities.

- ***Spending Is Often Driven by Available Revenues, Not Needs.*** For many programs supported by smaller and/or more narrowly constrained special funds, annual budgeting is largely based on the fee revenues that are available, rather than on an evaluation of the funding required to meet statutory requirements. In addition, because there are so many small programs with individual funding sources, it is difficult for the Legislature to provide effective oversight of these many programs within the time constraints of the budget process. Thus, many programs continue year after year with relatively little consideration as to whether they continue to meet state priorities for funding.

- ***Use of Bond Funds Creates Debt Service Costs.*** Because bond funds are borrowed money, the state is obligated to pay them back with interest, generally over 30 years. In general, for every million dollars borrowed, the state pays back $1.2 million (after accounting for inflation). As the state has come to rely on bonds more and more in recent years, debt service has become a major General Fund cost in the resources area. In the budget year, debt service is projected to cost more than $720 million in the resources and environmental protection areas. This is second only to fire protection as a use of General Fund support in this part of the budget. Consequently, General Fund support for other priority programs is limited by the necessity to repay general obligation bond costs.

Recommend the State Move Towards Simpler and More Flexible Funding. The following are some general approaches we recommend the Legislature rely upon in the coming years to improve budgeting in the resources and environmental protection area. We believe these principles can be applied in the future to evaluate proposals for funding resource programs, potential statutory changes, and proposed bond measures.

- ***Where Appropriate, Consolidate Funds.*** There are opportunities for the Legislature to consolidate existing special funds while adhering to the general purposes for which those funds were created. This would allow the Legislature greater flexibility in setting funding priorities *within programs,* while still supporting the general goals of the program. For example, the many separate accounts in the Fish and Game Preservation Fund could be consolidated into a single account which would still be used to support fish and game activities, but with greater flexibility and lower administrative costs.

- ***Tie Fee Revenues to the Budget Act.*** In general, we recommend the Legislature make statutory changes that would tie fee levels to budget act appropriations for a program. During the budget process, state agencies and DOF would inform the Legislature of the fee levels needed to support proposed appropriations, and subsequently set fee levels such that they would generate revenues sufficient to support the approved appropriations. Thus, if new program needs arose, they could be addressed in the budget process without having to make statutory changes each time. Similarly, if program expenditures were lower than fee revenues and fund balances built up, fee levels would be reduced correspondingly.

- ***Rely Less on Bond Funding, Particularly Constrained Bond Funds.*** As the Legislature considers future bond measures, we recommend that only those programmatic activities that will yield long-term benefits should be supported with borrowed money. There may be areas of the budget—for example, programs to increase the efficiency of water use—that can be funded on a "pay-as-you-go" basis with new or existing funds, thereby reducing the need for borrowed money. Also, we recommend that future bond measures allocate funds to a few general areas—such as water quality or wildlife habitat restoration—rather than narrowly prescribing how funds must be allocated. This would allow future Legislatures the flexibility to appropriate funds to meet evolving state priorities. Finally, we recommend that all the funds provided in future bond measures be subject to annual appropriation to allow legislative oversight of these expenditures.

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