PART 2

MAJOR FISCAL ISSUES FACING THE LEGISLATURE

This section contains a discussion of some of the broader issues facing the Legislature as it begins its deliberations on the Governor's Budget for 1982–83. We have grouped these issues into five major categories.

State Revenue Issues. The first category of issues relates to state revenues. Specifically, we discuss a number of tax policy issues, including tax expenditures and tax simplification procedures. We also present alternatives for increasing state revenues from existing sources, including tax increases, user charges, and transfers from special funds. Finally, we examine the existing system for earmarking the distribution of tidelands oil revenues, and explain how this system limits legislative flexibility.

State Expenditure Issues. The second largest category of issues relates to state expenditures. Here, we discuss the effects of the reduced rate of growth in federal aid to California, and the implications of shifting federal support for a number of program areas from a categorical to a block grant basis. In addition, we identify a number of issues relating to the allocation of funds for cost-of-living adjustments.

We also examine the Governor's proposals for reducing state operations budgets by 5 percent, controlling toxic substances, and the Investment in People Initiative. Finally, we discuss in this category various capital outlay issues, including those related to new prison facilities.

Fiscal Relief Issues. The third category of issues involves fiscal relief to local governments. Specifically, we analyze the Governor's proposed fiscal relief package which provides for a $503 million reduction in aid to cities and counties, as well as the proposal that would allow counties to recoup some of the loss by implementing a new procedure for reassessing property. We compare these proposed reductions with those that would occur under the AB 8 deflator, and identify other options for allocating reductions among local governments.

We also analyze the Governor's proposal for reforming procedures for reimbursing local agencies for state mandated programs, and recommend other options for evaluating the effectiveness of existing mandated programs.

Broad Fiscal Issues. The fourth category of issues involves broad fiscal trends. Here, we examine the ability of existing revenue sources to finance a "workload" budget in 1983–84. We also include a discussion of the Reserve for Economic Uncertainties, and point out the need to increase this reserve, if possible.

Collective Bargaining Issues. The fifth and last category consists of the issues the Legislature will face in implementing and funding the first collective bargaining contracts with state employees.

I. REVENUE ISSUES

A. Tax Policy Issues

The primary focus of our analysis of the Governor's Budget is on the direct expenditures which support both new and existing programs of state government. In addition, we attempt to identify various expenditure-related issues which may not involve specific funding requests at present, but which could be important from either a fiscal or policy perspective in the near future.

In acting on the Governor's Budget, however, the Legislature also needs to consider the "other half" of the administration's fiscal plan—the revenue side of the budget. By far the largest component of revenues is tax collections. Because the state's overall fiscal balance is dependent on *both* expenditures *and* revenues, the revenue side of the budget, in theory, should receive the same regular review as does the direct expenditure side. This review should include an evaluation of existing tax policies, as well as an identification of tax-related issues which have significant fiscal and/or policy implications.

In this section, we discuss several major issues regarding the tax revenue side of the budget. These are

1. "Tax expenditures," which are already embedded within the state's tax laws;
2. Tax simplification; and
3. Other taxation issues, including unitary apportionment, urban enterprise zones, windfall profits taxation, and indexing income taxes for inflation.

Tax Expenditures

The Governor's Budget for 1982–83 proposes an increase in General Fund expenditures that is just a little more than 5 percent above estimated current-year expenditures. That same budget, however, reveals a 24 percent increase in another "spending" category: General Fund *tax expenditures.*

The term tax expenditures refers to various tax exclusions, exemptions, preferential tax rates, credits, and deferrals, which reduce the amount of revenue collected from the basic tax structure. Although there are several reasons why tax expenditures may be enacted, the principal ones are: (1) to provide incentives for taxpayers to alter their behavior in certain ways (for example, tax deductions for mortgage interest is intended to encourage homeownership), and (2) to exempt certain types of income from taxation. The tax expenditure concept is used not to suggest that all income "belongs" to the government, but as a systematic means for identifying those revenues foregone by the state for policy reasons, in order that the "costs" of these policy decisions may be compared to the results.

In 1981–82, identifiable tax expenditures were estimated at $7.9 billion. For the budget year, however, the corresponding amount is $9.8 billion, or 24 percent more than the current-year level. This growth is explained in part by the large increase in tax expenditures through the inheritance and gift tax program which resulted from recent changes in law, and in part by rapidly increasing mortgage interest deductions by homeowners. As a result of the increase, total tax expenditures in 1982–83 are expected to be 41 percent of estimated General Fund expenditures in that year.

Although tax expenditures are an appropriate means of accomplishing legislative objectives, there are two basic reasons why their use needs to be closely monitored. First, tax expenditures may not be effective tools in influencing taxpayer behavior. For example, because California's income tax rates are low relative to federal tax rates, certain deductions allowed by California law do not result in large tax savings to individuals. It is doubtful that those state tax expenditures which provide a relatively moderate amount of tax relief per return have much impact on taxpayer behavior. These types of tax expenditures, however, can result in significant amounts of foregone revenue.

Second, tax expenditures weaken the Legislature's control of the budget. Once a tax expenditure has been established in law, the revenue loss occurs automatically thereafter. Unlike regular expenditure programs, funds for which must be appropriated annually in the Budget Act, tax expenditures need not come under annual legislative review.

Furthermore, tax expenditures are like entitlements in that there is no limit on the number of persons who can claim the corresponding benefits. While the Legislature can place a maximum "cap" on an otherwise open-ended appropriation, tax expenditures cannot be controlled in this fashion. In short, once a tax expenditure is enacted, the Legislature—for all practical purposes—loses control over the amount of state resources allocated to the accomplishment of the particular objective. In this regard, the unlimited deduction of mortgage interest payments is not unlike a direct housing subsidy program that provides grants to as many homeowners as file for them.

Reevaluation of Tax Expenditures. Because of the state's present fiscal condition, expenditure programs financed from the General Fund are undergoing a much more careful scrutiny than they have in the past. There are several reasons why the Legislature might also wish to give a more careful scrutiny to tax expenditures.

a. ***Windfall Benefits.*** Many tax expenditures provide benefits to taxpayers whose behavior is unaffected by the tax incentive. For instance, it is highly unlikely that the *state* tax deduction for charitable contributions affects many taxpayers' decisions on charitable donations, yet *everyone* claiming the deduction receives the benefits from the tax expenditure.

b. ***Tax Expenditures Contrary to Other State Goals.*** Some tax expenditures appear to be contrary to the objectives of other state programs. For example, the Legislature has made clear its intent to encourage energy conservation through both tax and regular expenditure programs. At the same time, the state continues to provide a partial subsidy to *consumers* of energy through the income tax deduction for gasoline taxes.

c. ***Tax Expenditures at Cross-Purposes.*** Some tax expenditures work at cross-purposes with each other. For instance, the state provides an income tax deduction for interest paid on consumer debt, which in effect subsidizes consumer *spending*. On the other hand, the state provides an income tax exemption for individual retirement accounts, which is intended to encourage *savings*.

d. ***Changed Priorities.*** Given the state's current fiscal condition, many tax expenditures may not have the same priority to the Legislature that they had when enacted. In this regard, the Legislature might want to consider eliminating such tax expenditures as:

- The sales tax exemptions for candy and periodicals.
- The income tax exclusion of up to $1,000 for military pay.
- The percentage depletion allowance under the income taxes (the state allows a flat percentage allowance, rather than a depletion allowance based on cost).

In addition to eliminating low-priority tax expenditures, the Legislature might also wish to limit certain tax expenditures. For instance, it is estimated that the tax expenditures for energy credits will cost the state in foregone revenues approximately $100 million in 1982–83. This cost could be reduced substantially by: (1) reducing the percentage credit allowed, (2) allowing a state credit only for expenditures *not* eligible for the federal credits, or (3) disallowing the credit for the purchase of those items which the taxpayer *already* has a strong economic incentive to purchase. The revenue loss from most tax expenditures can be reduced in similar ways.

Tax Simplification

One method of simplifying the state's tax structure is to make it conform with federal law. At present, state and federal income tax laws are generally comparable; however, there are still literally hundreds of differences between the two.

In past years, the Legislature has pursued conformity on a *selective* basis. That is, the Legislature has acted to conform specific provisions of state law with federal law. For instance, this past November the Senate and Assembly Revenue and Taxation Committees evaluated the extent to which the state should conform with the individual federal income tax changes made by the Economic Recovery Tax Act of 1981.

The Legislature, however, also has considered measures that would provide for *total* conformity with federal income tax laws. SCA 14 of the current session, for instance, would allow the state to bring its tax laws into conformity with federal laws on a prospective basis (that is, it would provide for *automatic* changes in state tax laws whenever federal tax laws change).

The advantages of either limited or widespread conformity are (1) reduced taxpayer compliance costs (in time and money) and (2) lower costs to the state for administering tax programs.

On the other hand, there are two major disadvantages to automatic conformity. First, with automatic conformity, the state loses control over its tax policy. In effect, the state must accept the federal government's judgment as to what is an equitable and efficient tax base. Second, the state may lose control over income tax revenues in the short run. For instance, had there been automatic conformity to the provisions of the Economic Recovery Tax Act of 1981, California would have lost hundreds of millions of dollars in 1981–82 unless an offsetting increase in the tax *rates* was enacted. The short-term loss of control can be a particular problem when the state is experiencing difficulties in balancing its budget.

Specific Tax Issues

In addition to questions involving tax expenditures and tax simplification, there are several specific tax policy issues which the Legislature is likely to face in the coming year.

a. ***Unitary Apportionment.*** In applying the bank and corporation tax to multinational firms, the Franchise Tax Board (FTB) allocates income to California through a unitary method of apportionment. This method uses three factors—sales, payroll and property—as a measure of a firm's California business activity relative to its total business activity. During the current session of the Legislature, several bills have been introduced which would prohibit FTB from applying unitary apportionment to *foreign-based* multinationals. In addition, a bill pending in the United States Congress would prohibit the application of unitary apportionment to *any* foreign operations.

b. ***Urban Enterprise Zones.*** The Reagan Administration has proposed the establishment of urban enterprise zones within economically depressed areas. Within these zones, various federal tax incentives would be provided in order to stimulate business development. State legislation providing comparable tax incentives has also been introduced during the current legislative session (AB 416).

c. ***Windfall Profits Tax.*** The state's existing Bank and Corporation Tax Law allows firms to deduct certain taxes (such as sales and property taxes) but not others (such as federal income taxes) in determining their taxable income. The Franchise Tax Board has issued a preliminary opinion holding that firms are permitted to deduct the federal windfall profits tax from income on their state returns. The administration has proposed legislation (AB 2361 and SB 1326) which would prohibit the deductibility of windfall profits taxes.

d. ***Indexing.*** The Legislature has provided for automatic annual adjustments to personal income tax brackets to offset the effects of inflation for increases in the California Consumer Price Index exceeding 3 percent. There remain, however, three major policy issues involving indexing which are still subject to legislative debate:

- What is the appropriate index to use for adjusting tax brackets—the California Consumer Price Index? the U.S. Consumer Price Index? the Wages and Salary Index? etc.
- Should the brackets be fully or partially adjusted to offset the effects of inflation?
- Should certain elements of the tax base (such as capital investments) also be indexed to avoid state taxation of inflation-induced gains that are not income in a real sense?

B. Alternatives for Increasing State Revenues

Given the uncertainty about the path of the economy in 1982 and 1983, it is possible that 1982–83 revenues could differ significantly from the budget's projections. To the extent revenues exceed the projections, additional funds would be available to (1) replenish the Reserve for Economic Uncertainties, (2) maintain existing service levels under various state programs, (3) fund new or expand existing programs, or provide additional tax relief. It is, of course, possible that actual revenues will exceed the forecast, as occurred in the middle and late 1970's.

On the other hand, should a revenue shortfall occur, the state would have to either reduce expenditures or augment its revenues in order to avoid a General Fund deficit.

There are several approaches the Legislature could consider if it is faced with the prospect of having to augment budget year revenues. For example:

The Legislature Could Enact a General Tax Increase

A general tax increase could be applied to one or more of the state's three major revenue producers—the sales and use tax, the personal income tax, and the bank and corporation tax. In most years, these taxes account for over 85 percent of total General Fund revenues.

The simplest way of implementing and administering a general tax increase would be to increase existing tax rates. For example:

- A quarter-cent increase in the state sales and use tax rate—currently 4¾ cents—would generate over $450 million in 1982–83.
- A one percentage point increase in the bank and corporation tax rate—currently 9.6 percent—would generate about $360 million in 1982–83.
- A 5 percent surcharge on marginal personal income tax rates—which presently range from 1 percent to 11 percent—would generate about $430 million in 1982–83.

It should be noted that the net cost to most California taxpayers from such revenue-raising measures would be *less* than the amounts of additional revenue received by the state, because state tax payments can be deducted when computing federal income tax liabilities.

The Legislature Could Increase Selective Excise Tax Rates

The state currently levies a variety of excise taxes, including taxes on cigarettes, horse racing wagering, and alcoholic beverages. In 1982–83, revenues from these items are projected to be over $530 million.

In last year's *Analysis* (pages A-85 through A-87) and in a subsequent report entitled *The Taxation of Cigarettes, Alcoholic Beverages and Horse Racing Activity in California* (Report 81-18, October 1981), we indicated that there are several reasons why the Legislature might wish to consider increasing these taxes. One reason is to adjust the tax rates to reflect inflation that has occurred, since these rates were last changed. Most of these rates have not been changed for many years. In the case of the taxes on alcoholic beverages and cigarettes, which are levied on a physical-unit basis, the passage of time effectively reduces the tax rate because inflation causes it to represent a smaller and smaller percentage of the taxed items' selling price.

SIN TAXES

Should the Legislature decide to increase these selective excise tax rates, the revenue gain would depend on the size of the increase. The potential yield from an increase in these taxes can be seen in the following examples:

- If these excise tax rates were increased to the average rates levied by other states, maximum additional revenues would total about $280 million.
- If these excise tax rates were adjusted for inflation since 1970–71, maximum additional revenues would total over $250 million.

Actual revenues could be somewhat less than these amounts if consumers reduced consumption of the taxed items in response to higher prices caused by the higher taxes.

The Legislature Could Increase User Charges

A third alternative for increasing revenues is to transfer the responsibility for supporting the cost of certain government services from the General Fund to those who benefit most directly from those services. For example, the administration has proposed to:

1. Extend the concept of user funding to all utilities under the jurisdiction of the California Public Utilities Commission (PUC). The 1982–83 budget indicates that the PUC will seek legislative approval to authorize assessments to offset the costs of regulating gas, electrical, water and sewer, and communication activities. These assessments, which would increase revenues by $24 million, are included in the budget's revenue estimates.
2. Save the General Fund approximately $27 million by shifting certain units in the Department of Industrial Relations to a self-funding reimbursement basis.

UC* CSU ?

Our analysis indicates that several other changes of this type are warranted, including the following:

- In our analysis of the Department of Forestry, we have recommended (a) that a system of graduated permit fees be used to finance the Forest Practice Act, and (b) that the Fire Protection program be made partially self-supporting through a system of landowner assessments. In addition, we have recommended that the Department of Fish and Game make its streambed alteration permit program self-supporting by levying fees. These three recommendations could save the General Fund close to *$35 million.*

- The Department of Food and Agriculture currently provides funds to cover county costs for issuing pesticides permits, for the operation of state veterinary labs, and for state inspection of fruits, nuts, and vegetables. General Fund support for these programs in 1982–83 will amount to over $9 million. Some portion of these costs could be offset by user fees and charges.
- The California Department of Transportation currently spends over $15 million for the operation and administration of inter-city rail service. Part of these costs, which presently are paid for by General Fund sales and use tax revenues transferred into the Transportation Planning and Development (TP&D) Account, could be offset by user charges.

The Legislature Could Transfer Special Fund Balances to the General Fund

In the 1981 Budget Act, over $700 million in special fund balances were transferred on a one-time basis to the General Fund, to help balance the current-year budget. Most of this money represented tidelands oil revenues.

In 1982–83, the Governor proposes a one-time transfer of over $450 million from special funds to the General Fund. This primarily represents monies in the Motor Vehicle License Fee Account. The budget, however, still shows special fund revenues totaling $3.4 billion in 1982–83, including $510 million in oil and gas revenue from state lands that would be spent through various special funds established in 1980.

In many cases, depositing revenues into special funds is desirable, particularly when these monies are collected to support specific programs, as they are in the case of most licensing and regulatory programs. In other cases, however, depositing monies into special purpose funds, though appropriate from a policy standpoint, tends to complicate the Legislature's review of state expenditures and narrow the Legislature's options in allocating state resources.

The Legislature may wish to consider transferring to the General Fund special fund balances that were not raised for the express purpose of financing specific activities. A prime candidate for such a transfer, should a 1982–83 revenue shortfall arise, is tideland oil revenue.

C. Allocating Tidelands Oil Revenues

Allocation Priorities Under Current Law

Chapter 899, Statutes of 1980, provided for the redistribution of tidelands oil and gas revenue that under prior law would have been deposited in the Capital Outlay Fund for Public Higher Education (COFPHE).

Prior to 1980–81, California received approximately $110 million in tidelands oil revenue annually. About $70 million of that amount went to the COFPHE. Unprecedented increases in the price of oil, however, resulted in an almost five fold increase in tidelands oil revenues. Thus, in 1982–83, California will receive approximately $510 million in new revenues from this source.

In enacting Chapter 899, the Legislature established a priority sequence for the distribution of tidelands oil revenues. Under this measure, six special funds are recognized as eligible to receive the funds. Rather than distribute a fixed amount or a fixed percentage of available money to each of these six special funds, Chapter 899 arranges the funds in descending order of priority and establishes a target funding level for each. Under this arrangement, no fund gets *any* allocation of tidelands oil revenues until all funds having a higher priority get their *full* target amounts. Put another way, a shortfall in revenues is not appportioned among all six funds, but instead is borne by one or more funds at the bottom of the list. The existing priority sequence and the target distributions for each fund are shown below.

- $125 million—COFPHE
- $200 million—State School Building Lease/Purchase Fund
- $120 million—Energy and Resources Fund (ERF)
- $35 million—State Parks and Recreation Fund
- $25 million—Transportation, Planning and Development Fund
- Remaining Balance—Special Account for Capital Outlay

In the case of the COFPHE and ERF, any unused balances remaining in the fund from the prior year are deducted from the target amount. In the case of the other funds, however, no such deductions are made. Thus, for example, the State School Building Lease/Purchase Fund may have available more than $200 million in any year, if balances are carried over from the previous year.

Legislative Flexibility Restricted

From an analytical standpoint, tidelands oil revenues are indistinguishable from General Fund revenues. They are not raised for a particular function of state government, and may be used for any public purpose. Depositing tidelands oil revenue into special purpose funds tends to limit the Legislature's options in allocating available state resources among state-supported programs and activities. Our analysis suggests that there are two major weaknesses in the existing distribution of these revenues:

1. The priority sequence arrangement implies that the *lowest* priority capital outlay project funded in any one of the top five tiers is needed more than the highest priority project in the next lower tier. Thus, for example, the logic of the allocation mechanism implies that the lowest priority at, say, the community colleges, is more important than the energy and resources project offering the most dramatic energy savings to the state. Similarly, the energy and resources project with the lowest pay-off is given a higher priority than fire, life safety and environmental improvements at a state hospital.

2. Capital outlay projects financed from tidelands revenues are given a higher priority than all other state programs because they are funded from dedicated revenues, and need not compete for funding with these other programs. In contrast, state operations and local assistance must compete with each other for funding.

The Legislature recognized these problems in acting on the 1981 Budget Act and provided for the transfer of balances from the tidelands oil special funds to the General Fund. The Governor proposes to make a much smaller transfer in the 1982–83 Budget Bill.

While such transfers offer a way of overcoming the weaknesses in the existing distribution of tidelands oil revenues, they are not easily accomplished once specific projects are proposed for funding from individual special purpose funds.

To improve the Legislature's fiscal flexibility in responding to the fiscal problems facing the General Fund, we recommend that either:

1. Tidelands revenues be deposited directly into the General Fund, or

2. These revenues be deposited into a single capital outlay fund from which all capital outlay needs would be funded on a statewide-priority basis.

Governor's Proposed Distribution of Tidelands Revenue

Table 1 shows the distribution of tidelands oil revenue under existing law, as well as the distribution proposed in the Governor's Budget. Implementation of the Governor's proposal is provided for in Section 90 of AB 2361 and SB 1326.

Table 1
Distribution of Tidelands Oil Revenue
Existing Law Compared to Governor's Budget
(in thousands)

	1982–83	
	Existing Law	*Governor's Budget*
Revenues:		
Current estimate	$510,000	$510,000
Distribution:		
State Lands Commission and refunds to local governments	8,050	8,050
Water Fund	25,000	14,710
Central Valley Water Project	5,000	—
Sea Grants	500	475
Capital Outlay Fund for Public Higher Education (COFPHE)	125,000	116,000
State School Building Lease-Purchase Fund	247,200 [a]	100,000 [a]
Energy and Resources Fund (ERF)	98,250 [b]	120,000
State Parks and Recreation Fund (SPRF)	— [c]	11,000
Transportation Planning and Development Account (TPDA)	— [c]	—
Special Account for Capital Outlay (SAFCO)	— [d]	78,000
Off-Highway Vehicle Account	1,000 [e]	—
Reimbursement to General Fund for Energy Tax Credits	— [f]	61,740

[a] Includes repayment of $47.2 million loan pursuant to Ch 998/81.

[b] Based on Governor's Budget, this fund has a balance of $3,957,000 June 30, 1982. Thus, under existing law $116,043,000 would be deposited if there were sufficient tidelands oil revenues. Revenues, however, coupled with other commitments would leave $98,250 available for the Energy and Resources Fund.

[c] Revenues will not be sufficient to provide the $35 million and $25 million prescribed by existing law for the SPRF and TPDA, respectively.

[d] SAFCO receives balance of revenues not deposited in the other funds. Estimated revenues in 1981–82 are not sufficient to reach the SAFCO.

[e] Repayment of loan pursuant to Ch 998/81.

[f] Under existing law, reimbursements of up to $42 million and $3 million are to be made from the SAFCO and from the ERF, respectively, not from undistributed tidelands oil revenue.

As shown in Table 1, under the Governor's proposal the ERF, SPRF, and SAFCO would receive tidelands oil revenue at the expense of the state water projects, K–12 school construction, higher education, and transportation. The ERF, however, is the only fund that would receive *more* tidelands oil revenue than existing law would provide. This reflects the priority which the administration places on energy and resource conservation capital outlay projects. In fact, the Governor's Budget also includes $3.7 million from the COFPHE and $10.9 million from the SAFCO for energy conservation projects, in addition to the $103.7 million proposed from the Energy and Resources Fund for these projects. Thus, a total of $118.2 million is budgeted for energy/resource conservation projects in 1982–83. If transportation funds and bond funds are excluded, this amounts to 51 percent of the $233.1 million proposed in the Governor's capital outlay program.

Table 2 summarizes the appropriations from the tidelands oil special funds proposed in the Governor's Budget, and the balances that would be available in each fund on June 30, 1983 if the budget were approved as submitted.

Table 2
Appropriations and Amounts Available
Special Funds Receiving Tidelands Oil Revenues
As Proposed in Governor's Budget
(in thousands)

	1982–83
Capital Outlay Fund for Public Higher Education (COFPHE):	
Carry-over from previous year	—
Tideland oil revenue	$116,000
Budget Bill appropriations	−114,180
Balance available for appropriation	$1,820
State School Building Lease-Purchase Fund (SSBLPF):	
Carry-over from previous year	$1,000
Tideland oil revenue	100,000
Balance available (continuously appropriated)	$101,000
Energy and Resources Fund (ERF):	
Carry-over from previous year	$3,957
Tideland oil revenue	120,000
Budget Bill appropriations	−103,654
Balance available for appropriation	$20,303
State Parks and Recreation Fund (SPRF):	
Carry-over from previous year	$607
Tideland oil revenue	11,000
State Park System Revenues	7,500
Transfer from Highway Users Account, State Transportation Fund	1,500
Budget Bill appropriations	−19,937
Balance available for appropriation	$670
Transportation Planning and Development Account:	
Carry-over from previous year	$13,205
Retail Sales and Use Tax	155,000
Surplus Money Investment	17,200
Transfers	4,970
Budget Bill appropriations	−191,122
Reserve for Unified Trans Fund (locals)	−13,000
Balance available *(deficit)*	*−$13,747*
Special Account for Capital Outlay (SAFCO):	
Carry-over from previous year	$23,954
Tidelands oil revenue	78,000
Budget Bill appropriations	−72,712
Balance available for appropriation	$29,242

The distribution of funds proposed by the budget bill may cause the SAFCO to be oversubscribed. There are two reasons for this.

SAFCO Funds May be Needed for New Prison Construction. The budget includes $161.8 million for the Department of Corrections' New Prison Construction Program. These funds, however, will be available *only* if the voters at the June 1982 election approve the New Prison Construction Bond Act of 1981. The Budget Bill contains language specifying that, if this bond program is not approved, $69.3 million for a new prison at Tehachapi is to "be recognized as a priority project and shall be available from the Special Account for Capital Outlay." Should these funds have to be used for the Tehachapi prison, the capital outlay program proposed to be supported from the Special Account for Capital Outlay would be virtually eliminated, since the entire program funded from the SAFCO totals only $72.7 million—$3.4 million more than the cost of the prison.

Problems With Energy Tax Credit Funding. A further complication resulting from the distribution of tidelands oil revenue proposed by the Governor has to do with energy tax credits. The budget proposes to transfer $61.7 million in tidelands oil revenues *directly* to the General Fund for reimbursement of solar and other energy tax credits which are estimated to cost $100 million in 1982–83. Existing law (Ch 904/80), however, requires $42 million to be transferred *from SAFCO* to the General Fund as a reimbursement for energy conservation tax credits. As AB 2361 is drafted, the $61.7 million would be in addition to the statutory allocation of $42 million. Thus, the entire estimated cost for solar and other energy tax credits would be paid from tidelands oil revenue if AB 2361 is approved as introduced. (It is possible that the budget may have intended that $61.7 million come from the SAFCO.)

Taking both of these factors into consideration, the budget envisions commitments of $184 million against the SAFCO. According to the Governor's Budget, however, the SAFCO has a balance available of $101.9 million—$82.1 million less than the maximum potential commitment.

Legislative Priorities

We recommend that the Legislature make an early decision regarding the relative priority of the various claims on tidelands oil revenues. In lieu of the allocation of tidelands oil revenues proposed in the budget, the Legislature may chose to (1) redirect a larger portion of these revenues to the General Fund where they would be available to fund legislative priorities in all program areas, or (2) place a higher priority on capital outlay in such areas as state office buildings, higher education, or K–12 school construction. In any case, we urge the Legislature to make a decision on the allocation of these funds at the outset of the budget process so that (1) individual capital outlay projects proposed in the budget and other statewide needs can be evaluated on a consistent basis during budget hearings, and (2) funds are not committed to individual projects before the overall needs of the state are identified.

In our analysis of the various departmental capital outlay programs, we have divided those projects funded from tidelands oil revenues, which our analysis indicates are justified, into seven descriptive categories. These categories are provided as an aid to the Legislature in evaluating capital projects in the event (1) the Tehachapi project must be funded from SAFCO and the balance of the state capital outlay program must be reduced significantly, or (2) the Legislature decides to restructure the priorities for tidelands oil revenue, either by increasing the transfer to the General Fund or by modifying the emphasis on the type of capital outlay projects funded.

In addition, wherever we have recommended reductions to capital outlay programs funded with tidelands oil revenue, we have recommended that the resulting savings be transferred to the General Fund. We have made this recommendation with the intent of increasing the Legislature's fiscal options. Any unappropriated balance remaining in the tidelands oil special funds would be available only to finance programs and projects of a specific nature. By transferring these balances to the General Fund, the Legislature would broaden its options in meeting high-priority statewide needs.

II. EXPENDITURE ISSUES

A. Federal Budget Reductions

During recent years, the task of preparing a budget for the state has become increasingly difficult because of the uncertainties regarding fiscal and economic policy at the federal level. The state's experience in adopting and implementing a budget for the current year is a case in point.

Uncertainties Surrounding the Federal Budget for 1982

The Governor's Budget for 1981–82 was prepared in the fall of 1980 and submitted to the Legislature on January 10, 1981. The Legislature enacted the budget on June 15, 1981, and it became law on June 28. This budget assumed that the amount of federal aid provided to California would be at a certain level.

Six weeks later, however, major changes in federal expenditures and revenues were signed into law by President Reagan. These changes invalidated a number of key assumptions underlying the state's budget for 1981–82.

The Omnibus Budget Reconciliation Act of 1981 revised maximum authorizations for a large number of federal programs in 1982, 1983, and 1984, and provided for spending cuts in many of these programs. These cuts were made in response to President Reagan's economic plan. The President's original economic plan proposed to reduce the rate of growth of total federal spending over the next five years, and to shift federal priorities from nondefense to defense-related spending. The President's plan proposed net spending reductions of $270 billion during the five-year period 1981 to 1984. A portion of these reductions would be offset by spending increases, for a net reduction of $201 billion.

Spending decreases were spread across a variety of programs, but tended to fall disproportionately in a few areas—particularly federal grants to state and local governments.

The Omnibus Reconcilation Act established revised authorization levels for most programs in 1982, 1983, and 1984. These authorization levels, however, do not make funds available for distribution to the states. They merely establish the *maximum* amount that may be appropriated for a particular program in a given year. The Congress must then pass specific appropriation bills to determine the level of funds that will be available to programs within the maximum authorization.

Because Congress failed to enact appropriation bills by the beginning of federal fiscal year (FFY) 1982, it passed a series of continuing resolutions—on October 1, 1981, November 21, 1981, and December 11, 1981—to provide short-term funding for federal programs and activities. Continuing resolutions authorize spending for specific programs, pending enactment of an appropriation measure, at one of the following levels: (a) the level authorized in the previous fiscal year, (b) the level authorized in the Reconciliation Act, or (c) the level in the appropriation bill being considered by each house of Congress—whichever is lower. The effect of the latest continuing resolution was to make further reductions in program spending levels, bringing them below the levels authorized by the Reconciliation Act. Once an appropriation bill is enacted, the funding level it contains supersedes that provided for in the continuing resolution, retroactive to the beginning of the federal fiscal year.

Since October 1981, 10 of the 13 appropriation bills have been signed into law. The three appropriation bills which remain to be approved, however, account for a significant portion of the federal budget, and well over half of the money provided by the federal government to the state. These three bills include funding for labor, health, human services, and education programs; state, justice, and commerce activities; and treasury and postal service operations.

The current continuing resolution expires March 31, 1982, with six months left in FFY 82. We are unable to predict whether Congress will pass the three remaining appropriation bills by that time or whether a fourth continuing resolution will be needed. Nor are we able to predict what the spending levels authorized in those measures will be. As a result, the level of federal spending for many programs in FFY 82 still remains uncertain. Since approximately 75 percent of federal aid provided in FFY 82 will be allocated by the state during its current fiscal year (which ends June 30, 1982), the difficulties presented by these uncertainties are easy to see.

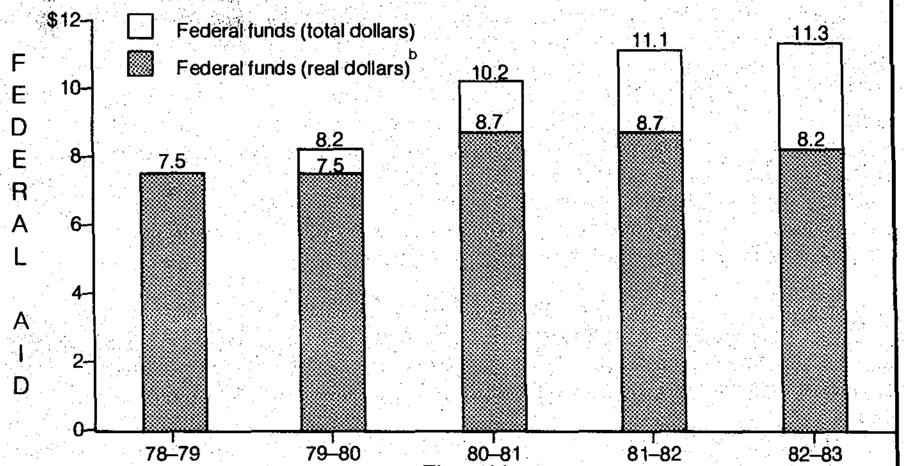
Recent Trends in Federal Aid to California

Chart 1 identifies the changes in total federal aid to California during the period 1978–79 through 1982–83. The amounts in this chart are based on estimates presented in the Governor's Budget for 1982–83. Because the budget in some cases assumes that federal funding will be provided at the

Chart 1

Expenditures of Federal Aid Granted to the State of California

1978–79 through 1982–83 (in billions)[a]



[a] Source: Governor's Budgets.
[b] "Real" federal dollars equal total federal dollars deflated to 1978–79 dollars using the Gross National Product price deflator for state and local purchases of goods and services.

levels authorized in the Omnibus Reconciliation Act, rather than at the lower levels provided for in the continuing resolutions, the levels of aid shown in the chart for 1981–82 and 1982–83 are likely to be optimistic.

A review of this chart indicates two things:

1. The rate of growth in federal aid to California is expected to be minimal in the budget year.

2. In terms of purchasing power, there has been relatively little growth in federal aid since 1978–79.

The chart shows expenditures in total actual dollars as well as in "real" dollars (that is, actual dollars deflated to reflect changes in purchasing power). In terms of total actual dollars, federal expenditures have grown from nearly $7.5 billion in 1978–79 to $11.3 billion in 1982–83. During the first two years of that four-year period, total federal expenditures grew at an average annual rate of 16.9 percent. During 1981–82 and 1982–83, however, total federal expenditures are expected to grow at an average annual rate of only 5.3 percent.

In terms of "real" or deflated dollars, federal expenditures have grown from $7.5 billion in 1978–79 to $8.2 billion in 1982–83. Real federal expenditures grew at an average annual rate of 8.8 percent during the two-year period 1978–79 to 1980–81. During 1981–82 and 1982–83, however, they are expected to *decrease* by 3.1 percent.

The Prospects for Federal Aid in the Future

State and local governments can expect further cutbacks in federal aid in the years ahead. The spending reductions proposed by the President and enacted by the Congress cannot be viewed as one-time occurrences. Nor is it likely that federal grants to state and local governments will begin rising once again in the near future. The Omnibus Reconciliation Act proposed spending reductions of $38 billion in FFY 82 and $105 billion in FFY 83 and FFY 84, for a total of $143 billion during the five-year period from 1981 to 1984. This still leaves an additional $127 billion in spending reductions which must be implemented if the President wishes to achieve his goal of $270 billion in total reductions by 1984.

Furthermore, the Economic Recovery Tax Act of 1981 will all but force further spending reductions to be made. We estimate that this act will reduce total federal tax revenues by $38 billion in FFY 82, $93 billion in FFY 83, and $150 billion in FFY 84, for a total revenue reduction of $282 billion over the entire 1981 to 1984 period.

Most of the growth in federal expenditures which may occur in the future is likely to be absorbed by the entitlement programs and, to a lesser extent, by the federal defense budget. Any growth in federal grants to state and local governments, however, is likely to fall far short of the amount needed to offset the effects of inflation.

B. Federal Block Grants

The Omnibus Budget Reconciliation Act of 1981 (PL 97-35), in conjunction with the Education Consolidation and Improvement Act of 1981, collapsed 57 federal categorical programs into the following nine block grants.

1. Title XX Social Services—includes social services, day care, and related training.

2. Low-Income Home Energy Assistance (LIHEA)—restructures the low-income energy assistance program.

3. Alcohol, Drug Abuse, and Mental Health—combines alcohol abuse and drug abuse categorical programs with the community mental health centers program.

4. Community Services—restructures the community action program which provides anti-poverty services.

5. Maternal and Child Health (MCH)—combines the maternal and child health, crippled and disabled children, lead-based paint poisoning prevention, sudden infant death syndrome, hemophilia, adolescent pregnancy, and genetic disease programs.

6. Preventive Health Services—combines the health incentive grants, risk reduction and health education, rodent control, fluoridation and hypertension, home health services, rape crisis services, and emergency medical services programs.

7. Primary Care Services—restructures the community health centers program.

8. Community Development—restructures the existing small cities community development block grant program.

9. Education—consolidates 31 educational programs authorized in six separate federal acts.

Federal Requirements

Federal law established procedures that states must follow in order to assume responsibility for administering block grants. Federal law also identifies matching requirements for program and administrative funding (if any), formulas for distributing funds to various states, restrictions on the use of funds, and provisions for the transfer of funds from one block grant to another.

In most cases, federal law establishes a transition period during which responsibility for the administration of block grants is to be shifted from the federal government to the states. States, however, were required to assume administrative responsibility for the Social Services and LIHEA block grants by October 1, 1981. They are required to take over the following block grants not later than October 1, 1982, or forego federal funding: Alcohol, Drug Abuse, and Mental Health; Community Services; MCH; and Preventive Health. Federal law regarding the education block grant becomes effective October 1, 1982, but requires the states to assume responsibility for that block grant retroactive to July 1, 1982, when payment of federal funds would begin. Finally, federal law *permits* but does not require states to assume responsibility for the Community Development block grant in FFY 82 and the Primary Care block grant in FFY 83. In the event the state chooses not to directly administer either of these block grants, the federal government is authorized to continue direct administration of the programs.

Federal Funding Impact

Table 3 identifies the impact of the federal funding changes that accompanied the switch from categorical to block grants. This table is based on information presented in the A-pages of the Governor's Budget.

As the table indicates, program funding under the federal block grant arrangement in 1981–82 will be 9.3 percent below what was anticipated before the federal reductions were made. The federal level will be *further reduced* by 7.9 percent in 1982–83.

4—75056

Table 3
Federal Funding Changes For Block Grant Programs 1981–82 and 1982–83[a] (in thousands)

Funding Level	*Dollars*	*Percent Change*
A. 1981–82—anticipated before federal reductions	$634,136	—
B. 1981–82—anticipated following federal reductions		
1. Community provider share	134,392	
2. State share	440,820	
3. Subtotal	$575,212	–9.3%
C. 1982–83	$529,817	–7.9%

[a] Source: 1982–83 Governor's Budget.

Table 3 identifies general trends in funding under the block grants. Funding levels for individual block grants, however, should be viewed with a great deal of caution. In our discussions of the individual block grants later in this *Analysis,* we point out a number of errors or overly-optimistic assumptions reflected in the amounts estimated for the block grants in the Governor's Budget. For example:

- The amount of funds proposed for the Maternal and Child Health, Preventive Health Services, and Alcohol, Drug Abuse and Mental Health block grants for 1982–83 is based on the amounts *authorized* in the Omnibus Budget Reconciliation Act. The most recent continuing resolution, however, *appropriated* from 6.8 percent to 15.1 percent less money for these programs than the amounts authorized in the Reconciliation Act. As a result, the level of anticipated federal funding shown in the budget may be too optimistic.
- The administration counted a portion of block grant funds for Preventive Health twice, thus overstating the total level of federal funds available to the state by more than $1 million.
- The amount of funds budgeted for the Maternal and Child Health block grant fails to take into account the fact that the act allows the federal government to "set aside" up to 15 percent of total funds available nationwide to support special projects. The Governor's Budget anticipates receiving these funds for continuing activities which may not meet the federal criteria for special projects. As a result, the amount of funds budgeted for the Maternal and Child Health block grant in 1982–83 may be overstated by as much as $2.5 million.
- The Low Income Home Energy Assistance block grant amount includes $600,000 which will be allocated directly by the federal government to Indian tribes, rather than to the state, thus overstating the amount of funds actually available for direct state expenditure.

We also note several instances in which the information contained in the budget on block grant funding levels is either contradictory or incomplete:

- In the case of the Preventive Health, Maternal and Child Health, and Social Services block grants, the budget presents conflicting detail on the amount of block grant funding in its A-pages, the budget narrative, and individual back-up budget detail.
- The administration was unable to verify how it had estimated the amount of funding proposed in the Governor's Budget for the Mental Health block grant portion.

State Enabling Legislation

Chapter 1186, Statutes of 1981 (AB 2185), which became effective January 1, 1982, establishes provisions for state administration of the federal block grants during 1981–82 and subsequent years. It directs the state to assume administrative responsibility for the LIHEA and Social Services block grants during 1981–82. It also states that the following six block grant programs "shall not be assumed by the state until July 1, 1982": Preventive Health; MCH; Primary Care; Alcohol, Drug Abuse and Mental Health; Community Services; and Community Development. Another provision of Chapter 1186 requires the Governor to submit information for "all federal programs to be administered by the state as of July 1, 1982."

Because of the language contained in Chapter 1186, there is some confusion regarding when the six block grants must be taken over by the state.

Table 4
Implementation Dates for State Administration of Block Grant Programs, As Specified by Federal and State Law and the Governor's Budget

Block Grant Program	*Federal Law*	*State Law (Ch 1186/81)*	*Governor's Budget*
1. Social Services—Department of Social Services	10/1/81	1981–82	10/1/81
2. LIHEA—Office of Economic Opportunity	10/1/81	1981–82	10/1/81
3. Alcohol, Drug Abuse and Mental Health—Departments of Mental Health and Alcohol and Drug Abuse	No later than 10/1/82	7/1/82 [a]	10/1/82
4. Community Services—Office of Economic Opportunity	No later than 10/1/82	7/1/82 [a]	10/1/82
5. Maternal and Child Health—Department of Health Services	No later than 10/1/82	7/1/82 [a]	10/1/82
6. Preventive Health Services—Department of Health Services and Emergency Medical Services Authority	No later than 10/1/82	7/1/82 [a]	10/1/82
7. Primary Care	FFY 83 [b]	7/1/82 [a]	Allow federal government to continue to administer
8. Community Development—Department of Housing and Community Development	FFY 82 [b]	7/1/82 [a]	10/1/82
9. Education—Department of Education	7/1/82 [c]	Does not specify	10/1/82

[a] Legislative Analyst's assumption. We are awaiting an opinion from Legislative Counsel regarding the requirements of Chapter 1186.

[b] Federal law permits the federal government to continue to administer the Primary Care and Community Development block grants if the state opts not to assume direct administrative responsibility for them.

[c] Federal law becomes effective October 1, 1982, but its provisions regarding the payment of federal funds to the states are retroactive to July 1, 1982.

The administration is interpreting the provisions of Chapter 1186 to mean that the state must assume administrative responsibility for these block grants *no sooner than* July 1, 1982, rather than *on* July 1, 1982. As a result, the Governor's Budget proposes to let the federal government continue to administer the Primary Care block grant and to have the state take over the remaining five block grants on October 1, 1982. We have requested a legal opinion from the Legislative Counsel to clarify this issue.

Table 4 compares the implementation dates for state administration of block grants under federal law, Chapter 1186 (assuming a July 1, 1982 implementation date for the six block grants), and the Governor's Budget.

Chapter 1186 does not specify the date on which the state must assume responsibility for administration of the education block grant. It does, however, require that a Governor-appointed advisory committee make recommendations on the allocation of education block grant funds by May 1, 1982. It also requires the Superintendent of Public Instruction and the State Board of Education to make recommendations by July 1, 1982.

Budget Reporting Requirements

Chapter 1186 requires all affected departments to report to the Legislature no later than October 15, 1981 on the new block grant programs. These reports are to include a summary of programs, funding levels, contracting progress, clients affected by funding reductions during 1981–82, and a description of transition programs.

The Department of Finance has indicated that because of federal delays and uncertainty regarding the federal budget for 1982, most departments do not have sufficient information to prepare the required reports. As a result, the Department of Finance has instructed individual departments to submit this information to the Legislature as it becomes available. The information will be submitted in the form of a letter prepared under the provisions of Section 28 of the Budget Act of 1981.

As of February 1, 1982, one Section 28 letter—covering the Social Services block grant—had been submitted by the Department of Finance to the Legislature. That letter addressed some, but not all, of the reporting requirements identified in Chapter 1186.

Chapter 1186 also requires the Governor to submit, as part of his proposed 1982–83 budget, the following information related to block grants: program identification, estimates and descriptions of clients affected, estimates of federal funding levels, and a proposal for the structural and administrative organization of block grant programs to be administered by the state as of July 1, 1982. The Governor's Budget acknowledges that due to uncertainties regarding federal funding and delays in federal rules and regulations governing the block grants, several of the proposals included in the budget are incomplete. The budget states that more specific information will be provided before or during budget hearings.

Below, we summarize our findings regarding the adequacy of information submitted in the Governor's Budget regarding the block grants, and our recommendations for requiring the submission of additional information. Detailed discussions of each recommendation are found in our analysis of individual budget items.

1. The administration is proposing to spend less than the full amount of the Community Services block grant allocation for the budget year. Because this will result in a reduction in available funds from prior year

levels, we recommend that the administration report on how funding priorities will be established and whether it will reduce the level or number of awards to local agencies.

2. Carry-over funds from Community Services block grant awards made in prior fiscal years are available to the state in the budget year. As a result, we recommend that the administration report on both the block grant amount as well as any carry-over amount available in the budget year to ensure legislative control over the expenditure of *all* block grant funds.

3. The administration has failed to meet many of the reporting requirements identified in Ch 1186/81 for the Preventive Health Services, Maternal and Child Health, and Alcohol, Drug Abuse and Mental Health block grants. As a result, we recommend that the administration submit the required information, including (a) a description of programs and clients affected, and (b) proposals for administering the block grants, including expenditure plans, staffing requirements, and a discussion of options for integrating federal and state programs.

4. The budget does not include adequate information on staffing requirements for the administration of (a) preventive health service funds by the Emergency Medical Services Authority, (b) community mental health centers funds by the Department of Mental Health, and (c) small cities community development grants by the Department of Housing and Community Development. In each case, California has not previously had a role in the administration of these funds.

The budgets for the Emergency Medical Services Authority and the Department of Mental Health do not explain how necessary staff and administrative resources will be provided. In addition, the budget for the Department of Housing and Community Development proposes $652,000 in state and federal funds for 15 positions to administer the block grants, but the department has been unable to provide workload estimates or other materials to justify the requested amount. In each case, we recommend that the necessary material be provided so that the Legislature can assure that adequate resources will be available to administer these new state programs.

5. Federal Funds for the education block grant are expected to be 35.4 percent *less* than funds for programs consolidated into the block grant. Yet the budget proposes a $1.6 million *increase* in funding for state operations. We recommend that the Legislature withhold action on total proposed funding for state operations, pending receipt of adequate justification from the administration and final action on allocations by the special advisory committee.

C. Cost-of-Living Adjustments

We recommend that the Legislature:

1. ***Repeal statutory COLAs and provide inflation adjustments through the budget process to all programs that warrant such adjustments.***

2. ***Base state employee salary adjustments for those employees not covered by memorandums of understanding on pay levels for comparable occupational groups in nonstate employment, rather than on changes in the cost-of-living indices.***

3. ***Use the two GNP price deflators, with certain exceptions, as a basis for judging how inflation is affecting private citizens generally and state and local governments.***

4. ***Give highest priority to programs which can demonstrate that a re-***

duction in state funding will lead to a direct and proportionate reduction in essential services.

5. ***Require that each program administrator identify (a) how COLAs will be used and (b) what program adjustments will be made if the COLA provided is not sufficient to maintain current services.***

Discretionary and Statutory COLAs

Existing law authorizes automatic cost-of-living adjustments (COLAs) for 17 different programs, most of them in the health, education, and welfare areas. These adjustments generally are referred to as *statutory* COLAs. In 1982–83, statutory COLAs will range from 4.6 percent (Medi-Cal drug ingredients) to 13.95 percent (teachers' retirement). Those COLAs with the largest costs are K–12 apportionments ($520 million), SSI/SSP ($170 million) and AFDC ($130 million). If fully funded, statutory COLAs would increase General Fund expenditures by $1.3 billion in 1982–83.

Many other local assistance programs generally have received COLAs on a *discretionary* basis, through the budget process. If these programs are provided increases sufficient to maintain service levels provided in the current year, General Fund expenditures would increase by an additional $0.7 billion in 1982–83.

Governor's Budget Proposal

The budget proposes full statutory COLAs for SSI/SSP, AFDC, In-Home Supportive Services, and apportionments for K–12 education, county offices of education, master plan for special education, and community colleges. The Governor has sponsored provisions of AB 2361 and SB 1326 that would suspend the operation of all other statutory COLAs in 1982–83.

The budget proposes to provide an increase of 5 percent to most of the remaining programs which have received statutory or discretionary COLAs in past years. The one exception is that the budget proposes no COLA for Medi-Cal hospital inpatient services, drug ingredients, and other Medi-Cal providers.

The budget proposes a total of $1.5 billion from the General Fund for COLAs. This is $523 million, or 26 percent, less than what would be needed to provide full increases for all programs with statutory COLAs and to maintain current services in programs which traditionally have received discretionary COLAs.

Legislative Issues Regarding Determination of COLAs.

There are a number of issues which the Legislature may wish to consider in deciding how much of a COLA to provide for individual programs.

1. ***Should COLAs be established by statute or through the budget process?*** Statutory COLAs are intended to give program recipients some degree of certainty regarding the level of state funds they will receive in a given year. In providing this assurance to certain groups, however, the Legislature necessarily reduces its ability to allocate funds to reflect its program priorities and available resources. During the last two budget cycles, the Budget Act has funded COLAs for many programs at less than the level authorized by statute. The result is that statutory COLAs have not provided the level of certainty intended. In order to preserve legislative budget options and flexibility, we continue to recommend that statutory COLAs be repealed and that inflation adjustments be provided to all programs that warrant such adjustments through the budget process. Such

adjustments should be based on program needs and the availability of funds to finance these needs.

2. ***Should the salaries of state employees be based on comparable salaries or cost-of-living considerations?*** In providing salary increases to those state employees not covered by memorandums of understanding, the Legislature may choose to base the increases on one of two primary standards: (a) salaries paid by the private sector or other governmental agencies or (b) changes in the cost-of-living.

In those years when private sector salaries fail to keep up with inflation, choosing between these goals will have significant cost implications. It will also have significant policy implications, since it raises the question of whether state employees should be protected against inflation to a greater extent than (a) the taxpayers who supply the funds to pay their salaries, (b) local government employees, or (c) other recipients of state funds such as medical providers or welfare recipients.

We continue to recommend that the Legislature base salary adjustments for state employees not covered by memorandums of understanding on pay levels for comparable occupational groups in nonstate employment, rather than on inflationary considerations.

3. ***What indices should be used in adjusting for the effects of inflation?*** Existing statutory COLAs range from a low of 4.6 percent to a high of 13.95 percent. We can find no analytic justification for such a wide variation in the adjustments provided to different programs. Many statutory COLAs are tied to a particular inflationary index such as the U.S. or California Consumer Price Index (CPI). Most welfare programs use a specially constructed California Necessities Index (CNI). Other programs are provided statutorily specified increases based on such measures as the manufacturers' direct list prices for Medi-Cal drug ingredients, administratively determined "reasonable cost" guidelines for Medi-Cal inpatient reimbursements, or legislatively established revenue limits for K–12 apportionments.

In last year's *Analysis,* we discussed five of the more commonly used indices: the U.S. CPI, the California CPI, the Gross National Product (GNP) personal consumption deflator, the GNP state and local government deflator, and the CNI. For each index, we identified its measure of the inflation rate over the last decade and some of its strengths and weaknesses.

Based on the measuring deficiencies in the CPI, we continue to recommend that the Legislature use the two GNP deflators as a basis for judging how inflation affects private citizens generally and state and local governments. In addition, we continue to believe that the CNI may prove to be a good measure of inflation's effect on welfare recipients if refinements in certain spending subcategories can be made.

4. ***How does the Legislature intend that COLA funds be used?*** Funds for COLAs generally are added to a program's total funding and may be used for any of the purposes for which program funds are provided. As a result, it is extremely difficult to track how such funds have been used in prior fiscal years, or to project how they will be used in the budget year. Our analysis indicates, however, that COLA funds will be used in one of four primary ways: (1) to increase salaries and operating expenses for employees of counties, schools and community college districts; (2) to increase the maximum grants paid to welfare recipients; (3) to provide rate increases for providers who contract with the state or counties to provide specified services (mostly in the health and welfare areas); and

(4) to provide salary increases for state employees.

In addition, COLAs are used to maintain the real value of (1) the state's contribution to the State Teachers' Retirement System (STRS) to offset a portion of the system's unfunded liability, (2) reimbursements to offset local property tax relief revenue losses, and (3) student grant levels provided under the Equal Opportunity Program.

Occasionally, programs have used COLA funds to finance one-time expenditures including capital improvements (alcohol and drug abuse programs), to increase service hours (in-home supportive services), and to provide additional service grants (youth authority county justice system).

Generally, it is the funding recipient who decides how the COLA funds will be used. These include county boards of supervisors, school district boards, private providers, and individual recipients. State agencies have placed very few administrative constraints on the use of COLA funds. A number of legislative constraints, however, have been placed on the use of COLA funds in specific programs. For example, budget act language or statutory provisions have been used to:

- set specific rate increases for different types of providers funded through the Medi-Cal program and regional centers,
- prohibit state payment for county employee salary adjustments which exceed the percent increase specifically authorized by the Legislature for county Medi-Cal and welfare program administration, and
- prohibit salary and benefit increases to regional center employees and providers which exceed 5 percent.

In addition, language in the 1982 Budget Act proposes a cap on COLAs for provider reimbursement rates in the Department of Rehabilitation's work activity program.

Generally, the Legislature does not have adequate information to indicate how programs will respond if they do not receive a COLA sufficient to maintain current service levels. As a result, it also is difficult to identify what effect such adjustments will have on the level and quality of services provided and the achievement of stated program goals.

Some recipients have a variety of options available to them if they do not receive a full COLA. For example, a program administrator may be able to increase workload or extend workload backlogs, increase fees, reduce the number of clients served, extend waiting lists, substitute alternative funds, defer certain projects or acquisitions, reduce or eliminate optional programs, lay-off staff, or freeze salaries and wages. Some agencies, because of the nature of the programs they administer, have few options. The STRS program, for example, has only one option when the state's contribution fails to keep pace with inflation—watch the unfunded liability grow. Still other programs are prohibited from taking certain action.

In order to assure that funds provided for COLAs are used in the most cost-effective manner, we recommend that the Legislature assign the highest priority to programs which can demonstrate that a reduction in state funding will lead to a direct and proportionate reduction in essential services. This includes programs or recipients which have few alternative means for adjusting the level of their expenditures or substituting alternative sources of funding. The programs which most clearly meet these criteria are the AFDC and SSI/SSP programs. Welfare recipients, for example, cannot make a fixed amount of money "go further" by increasing productivity or deferring certain purchases.

We further recommend that, in considering the level of COLAs provided to other programs, the Legislature require that such programs identify (a) how COLAs will be used and (b) what program adjustment will be made if the COLA provided is not sufficient to maintain current services. In certain cases, the Legislature may wish to add clarifying language to the Budget Bill to ensure that actual program expenditures or reductions are consistent with legislative program priorities.

D. Five Percent Reductions in State Operations Budgets

The Governor directed most state agencies and departments to reduce the General Fund portion of their 1982–83 baseline budgets for state operations budget by 5 percent. These reductions were not supposed to require a change in statute or regulation. In addition, the reductions were not to include savings in programs already scheduled for reduction or elimination.

The administration exempted all 24-hour facilities from the 5 percent reduction. This included state correctional facilities, the Veterans' Home, state hospitals, state special schools for the disabled, and the work activity program for the developmentally disabled. It also exempted all local assistance programs and all state operations financed with special fund revenues.

According to information provided in the A-Pages of the budget, 1982–83 General Fund reductions achieved as a result of this directive totaled $115.1 million. Our analysis, however, indicates that this total inappropriately includes reductions of $2.8 million for the Board of Equalization and $4.3 million for the Franchise Tax Board. Because the Department of Finance subsequently restored both these reductions, they should not have been counted in the total. Adjusting the total budget reduction to *exclude* these amounts leaves a revised total reduction of $108 million.

The Governor's Budget also exempted the Legislature from any reduction. The Legislature, however, independently adjusted its budget to reflect $5.1 million in unallocated reductions. These reductions are not included in the $108 million total.

Table 5 breaks out the General Fund 5 percent reductions by spending category. Each of these categories is described below.

Table 5
Governor's Budget
Five Percent General Fund Reductions
By Spending Category
(in millions)

Category	*Amount*	*Percent of Total*
1. Personal services	$18.8	17.4%
2. Operating expenses and equipment (not related to personal services)	22.5	20.8
3. State programs	9.0	8.3
4. Unallocated reductions	21.6	20.0
a. By program	(0.5)	(0.5)
b. By department	(21.1)	(19.5)
5. Reductions achieved by transferring costs to other funding sources	36.1	33.5
a. User fees	(30.2)	(28.0)
b. Federal funds	(4.9)	(4.5)
c. Reimbursements from other departments	(0.5)	(0.5)
d. Bond funds	(0.4)	(0.4)
e. Other state funding sources	(0.1)	(0.1)
Totals	$108.0	100.0%
Personnel-years—503		

1. Personal Services—includes reductions in authorized positions, staff benefits, and related operating expenses and equipment. It also includes reductions in temporary help, overtime, and savings resulting from holding current positions vacant (salary savings).

2. Operating Expenses and Equipment (OE&E)—includes OE&E reductions not specifically related to the elimination of positions. It contains such items of expenditure as general office expenses, travel, facilities operations, consulting and professional services, and training.

3. State Programs—includes reductions in programs directly administered by state agencies.

4. Unallocated Reductions—consists of two components. The first includes reductions which are assigned to a specific program within a department or agency but which are unallocated within that specific program. The second includes reductions which are unallocated within a department or agency.

5. Reductions Achieved by Transferring Costs to Other Funding Sources—consists of General Fund reductions which are achieved by transferring the cost of an activity to (a) user fees, (b) federal funds, (c) reimbursements from other departments, (d) bond funds, or (e) other state funding sources.

Findings. Below, we describe our findings regarding how the 5 percent reductions were achieved by the individual departments and agencies.

1. ***The administration gave individual departments discretion in identifying which activities were to be reduced. As a result, there is no consistent pattern as to how the various departments applied these reductions.*** For example, the extent to which departments eliminated positions in order to achieve their budget reductions varies widely. Some departments, such as the Departments of Social Services and Justice, opted to take the majority of their reductions in authorized positions. Others, such as the Departments of Health Services and Education and the University of California, chose to take few or no position reductions, and instead achieved their reductions in other areas.

In one case, the administration allowed a department to apply a reduction to the local assistance portion of its budget. Specifically, the Department of Housing and Community Development reduced local assistance support for housing development loans to local agencies by $210,000.

2. ***The administration did not consistently apply the 5 percent reduction to all departments and agencies. In most cases, we are unable to identify the analytical basis for excluding certain departments from the full 5 percent reduction and not excluding others.*** The administration completely exempted the budgets of the Judiciary, the Department of Industrial Relations, and the California Conservation Corps. In other cases, the administration agreed to a reduction of less than 5 percent. Those departments receiving less than a full 5 percent reduction include the University of California (2.5 percent), the California State University (2.5 percent), the Department of Justice (3.7 percent), and the Department of Forestry (1.8 percent), among others.

In several cases, the administration rejected a department's proposal for achieving the intended reduction as programmatically unacceptable. Rather than requiring the department to submit an alternative proposal, however, the administration instead simply exempted the department from the reduction.

3. ***The budget reductions penalize those departments which rely heavily on General Fund support.*** For example, the State Personnel Board, which is supported almost entirely from the General Fund, was required to sustain substantial reductions. The Public Employees' Retirement System, on the other hand, is supported entirely by special funds and therefore was not subject to any reductions. In our judgment, decisions regarding budget reductions should be based on whether an activity or function is needed, rather than on whether or not it is supported from the General Fund.

4. ***The budget reductions penalize those activities or functions which are categorized as "state operations" rather than "local assistance." In many cases, we can identify little or no analytic difference among activities included in these two categories.*** A number of activities categorized as state operations actually provide funds to local governments and organizations or individuals. Examples include arts grants to local organizations provided by the Arts Council, grants to local youth employment programs provided by the Employment Development Department, recycling grants provided to local organizations by the State Solid Waste Management Board, grants to local agencies provided by the Emergency Medical Services Authority, and student grants awarded by the Student Aid Commission. Because these activities are budgeted as state operations, the agencies were permitted to reduce them in achieving the required 5 percent reductions.

On the other hand, items of spending classified as local assistance often include administrative operations comparable to those budgeted as state operations. An example is the review of client utilization rates which is performed both by staff in regional centers for the developmentally disabled and by Medi-Cal staff. Because support for regional center staff is budgeted as local assistance, it was exempted from the 5 percent reduction, whereas support for Medi-Cal staff was not exempted. Our analysis indicates that decisions regarding budget reductions should be based on the necessity of the function, rather than on how the function is identified in budget spending categories.

5. ***The total General Fund reduction of $108 million reflects only a $72 million reduction in the level of state government. One-third, or $36 million, of the reductions were achieved by shifting the cost of activities to other funding sources.*** A number of agencies maintained existing services but shifted the cost of these services to user fees. For example, the California State University achieved $13.1 million, or 52 percent, of its reduction by increasing student fees. Similarly, the Department of Parks and Recreation identified a reduction of $3.7 million but was able to offset this reduction and actually increase its baseline spending by 5 percent by increasing user fees and concession rental revenues at state parks for a total net increase of $2.3 million.

In most cases, we believe it is appropriate to require those who are the direct beneficiaries of state services to pay for these services when they are able. Allowing agencies to count those General Fund reductions which were offset by increased user fees, however, gives these agencies an advantage over other agencies which are unable to tap alternative revenue sources and thus must take "real" budget cuts.

In some cases, agencies merely transferred the cost of certain activities from the General Fund to other state funding sources. For example, the

Department of Justice achieved a $96,000 reduction by increasing its reimbursements from special fund departments. The Controller's Office achieved a $420,000 reduction by imposing a fee on other state agencies for processing certain payroll documents. The Water Resources Control Board achieved a $252,000 reduction by transferring the cost of contracts for toxic monitoring to the Clean Water Bond Fund, even though the General Fund ultimately is responsible for repaying the principal and interest on the bonds.

6. ***In a few cases, the administration included, as part of its special 5 percent reductions, those reductions which should have been incorporated as part of the normal budget preparation process.*** For example, the State Treasurer's reduction included $144,000 from increased reimbursements charged to various bond commissions and authorities, even though these reimbursements are required under provisions of existing law. Similarly, the Postsecondary Education Commission included a reduction of $64,000 achieved by eliminating a state match for a federal program which was terminated in FFY 81.

7. ***The budget fails to identify how almost $22 million in General Fund budget reductions will be achieved.*** For example, the budget for the California State University contains $12.1 million in unallocated reductions and the University of California's budget contains $8.7 million in unallocated reductions. Several other departments have identified reductions for specific programs but have not identified how these reductions will be achieved. The most significant of these is the Department of General Services, which has identified $354,000 in reductions for maintenance of the Capitol Complex but has not specified what activities will be reduced. In some cases, the budget indicates a spending plan for unallocated reductions will be provided prior to budget hearings. Without this information, the Legislature will be unable to determine how total funds for a department or program will be spent.

Summary of Recommendations. In our analysis of individual budget items, we identify the specific reductions applied to each department. In those items where our analysis indicates that funds requested in the Governor's Budget are less than the amount needed to accomplish the budget's stated objectives, we point this out. We also recommend that the administration be prepared to explain how it expects to carry out the program within the amount proposed. Where reductions are unallocated within departments or programs, we recommend that a spending plan be submitted to the Legislature prior to budget hearings. In several cases, we conclude that a program scheduled for elimination or reduction is performing a worthwhile or cost-saving activity and therefore recommend that the program be continued using an alternative funding source.

E. Governor's Proposal for Controlling Toxic Substances

For the past two years, the budget has proposed major increases in state efforts to control toxic substances, including hazardous wastes.

For 1982–83, the budget provides 773.8 positions and $47.6 million from various funds for toxic substances control activities in 11 state agencies. This is an increase of 204.9 positions, or 36 percent, above current-year authorized positions, and $18.2 million, or 62.2 percent, above estimated current-year expenditures. The increase consists of $24.5 million in new proposals, offset by $6.3 million in reductions to reflect one-time expenditures in the current year.

Table 6 provides an overview of the Governor's Toxic Substance Control program for 1982–83. It shows for each component of the program, funding source, estimated current-year expenditures, proposed budget changes, and our recommendations regarding the funding request. Each of these recommendations is discussed in our analysis of the individual budget items.

The three major proposals contained in the budget are as follows:

1. ***Superfund.*** The budget requests $10 million to implement Ch 756/81 (SB 618) for hazardous waste site clean-up and emergency response. Our analysis indicates that the proposed activities lack coordination and that the implementation schedule for a major portion of the proposal is unrealistic. Moreover, the detailed expenditure plan prepared by the Department of Health Services exceeds the $10 million available from the Hazardous Substances Account.

2. ***Polychlorinated Biphenyls (PCBs).*** PCBs are substances used in the manufacture of electrical equipment in past years which recently have been found to be highly toxic. The budget proposes the removal of equipment leaking PCBs in state-owned buildings, at a cost of $5.8 million. We recommend deletion of the funds because (a) the Department of General Services has not acted expeditiously to expend funds appropriated in the 1981 Budget Act for this purpose, (b) the expenditures should be supported by special funds, not the General Fund, and (c) a portion of the proposed expenditures is not adequately justified.

3. ***Occupational Health.*** The budget proposes 88 new positions and over $4 million in the Department of Industrial Relations to establish regulations, increase worksite inspections and develop voluntary compliance programs. We withhold recommendation on 12 of the proposed positions due to inadequate justification.

F. Governor's "Investment In People Initiative"

The Governor's Budget proposes to allocate a total of $49 million from the General Fund among six educational and employment-related activities as part of his "Investment in People" initiative. As summarized in Table 7, these proposals address (1) deficiencies in the training of math and science teachers and the relevance of the instructional materials provided for classroom use, (2) the adequacy of funding for engineering education in both the University of California and the State University system, (3) promotion of technical job training programs and establishment of grants for training programs in high technology fields, (4) training for welfare recipients, (5) assistance to displaced workers, and (6) strengthening the relationship between vocational education councils and the business community.

Conceptually, we believe that the Investment in People proposals represent a first step in identifying issues which merit the serious consideration of both the executive and legislative branches. We find, however, that many of the proposals, particularly those in the education area, are so lacking in program and budgetary detail that we have no basis for determining either their feasibility or the need for additional resources. Other proposals in the employment area would expand existing pilot projects begun on July 1, 1981, even though current law makes program expansions contingent on the demonstrated cost-effectiveness of these projects.

Accordingly, except in the case of two components—the Department of

Table 6
An Overview of Toxic Substances Programs [a]
Estimated and Proposed Expenditures
1981–82 and 1982–83
(dollars in thousands)

					1982–83			
			Estimated 1981–82		Proposed Change [a]		Recommended Reductions	
Item	Agency	Fund	Amount	Staff	Amount	Staff	Amount	Staff
0650	Office of Planning and Research	Reimb.	($473)	8.0	($132)	3.0	—	—
0690	Office of Emergency Services	General	108	1.5	—	—	—	—
		Reimb.	—	—	(83)	2.5	(−$30)	−1
0860	Board of Equalization	Reimb.	(357)	16.7	(−5)	−6.5	—	—
1710	Office of State Fire Marshal	General	200	1.0	−160	—	−37	−1
1760	Department of General Services	SAFCO	3,647	—	2,153	5.0	−5,310 [b]	−5
2720	California Highway Patrol	MVA	835	18.8	852	21.0	—	—
		Reimb.	(80)	1.0	(212)	1.5	Withhold	
3400	Air Resources Board	General	202	23.4 [c]	—	—	—	—
		MVA	891	N/A	287	7.0	—	—
		APCF	—	—	60	—	—	—
		ELPF	92	N/A	21	—	—	—
		Federal	101	N/A	—	—	—	—
3940	Water Resources Control Board	Various	4,380	74.5	−216	−8.1	Withhold	
4260	Department of Health Services							
	(1) Superfund Cleanup and Emergency Response	HSA	—	—	10,000	47.5	Withhold	
		General	2,000	10.0	−2,576 [d]	−10.0	—	—
	(2) Hazardous Waste Management	HWCA	2,909	67.0	2,358	31.0	Withhold	
		Federal	2,568	53.0	251	—	—	—
	(3) Siting and Abandoned Site Search	ERF	1,499	33.0	−363	−10.0	—	—
	(4) Laboratories, Epidemiology Studies, Occupational Hazards, and Research	General	1,628	40.0	1,408	17.0	—	—
		Reimb.	(3,473)	66.0	(398)	13.0	—	—

8250	Department of Industrial Relations	General	4,131	77.5	4,061	84.0	Withhold	
		Federal	4,131	77.5	—	—	—	—
		Reimb.	—	—	(157)	4.0	Withhold	
8710	Board of Control	General	—	—	6	—	−6	—
		Reimb.	—	—	89	3.0	(6)	—
	Totals	All	$29,322	568.9	$18,231	204.9	−$5,353	−7
	Totals, proposed budget, 1982–83				$47,553	773.8		

Fund Abbreviations:

MVA—Motor Vehicle Account
Reimb.—Reimbursements
SAFCO—Special Account for Capital Outlay
APCF—Air Pollution Control Fund
ERF—Energy and Resources Fund
HSA—Hazardous Substances Account
HWCA—Hazardous Waste Control Account
ELPF—Environmental License Plate Fund

[a] Change includes proposed new activities and the elimination of current-year, limited-term projects.
[b] Withhold recommendation on $490,000.
[c] The board was unable to identify positions by fund.
[d] Includes repayment of General Fund loan.
[e] Amounts in parentheses represent reimbursements from other state departments.

Employment Development Training for Welfare Recipients and Aid to Displaced Workers—for which we recommend limited approval, we are recommending that funding for the Investment in People Initiative be deleted from the budget. Each of the components is more fully discussed in our analysis of the respective budget items cited in Table 7. We will advise the fiscal committees if additional information becomes available before the budget hearings that would warrant a change in our recommendations.

Table 7
Investment in People Initiative
Proposed 1982–83 Expenditures
(in millions)

Item	*Agency and Program*	*General Fund Expenditure*[1]	
6100-189-001	*Department of Education*		
	1. Training for Math and Science Teachers—K–12		$19.6
	Replace and supplement instructional materials (math and science textbooks)	$8.6	
	Augment resource centers to upgrade the teaching skills of secondary math and science teachers	3.4	
	Staff development for secondary math and science teachers	7.6	
6440-001-001	*University of California (UC)*		
6610-001-001	*California State University System (CSU)*		
	2. Funding for Engineering Education		7.0
	UC: Research and education in engineering, computer sciences, and related basic sciences	4.0	
	CSU: Science and engineering enhancement	3.0	
6870-101-001	*Community Colleges*		
8350-001-001	*Department of Industrial Relations*		
	3. Technical Job-based Training		11.2
	Community Colleges: employment-based job training	7.5	
	Community Colleges: Institutes in high-technology jobs	2.5	
	Department of Industrial Relations: promote employment-based training	1.2	
5100-001-001	*Employment Development Department*		
	4. Training for Welfare Recipients		8.0
	Employment Preparation Program	6.5	
	Training for Welfare Recipients	1.5	
5100-001-001	*Employment Development Department*		
	5. Aid to Displaced Workers	2.0	2.0
5100-001-001	*Employment Development Department*		
	6. Strengthen Relations Between Vocational Education Councils and the Business Community	1.0	1.0
	Total Expenditure		$49.0

[1] Components do not add to total due to rounding.

G. Capital Outlay Issues

The capital outlay proposals in the Budget Bill raise the following major issues which the Legislature will need to consider.

Prison Facilities. The budget contains $161.8 million to continue planning for new prisons, to complete construction of the Tehachapi project and to construct temporary prison facilities. The budgeted amount is to be funded from the new Prison Construction Bond Act of 1981 that will be submitted to the voters for their approval in June 1982.

The administration proposes that 11,900 additional beds be constructed over the next five years to alleviate overcrowding in the prison system. It would cost about $800 million to finance these added facilities. The bond act would finance $495 million of this amount. The administration has not, however, identified a funding source for the remaining $305 million.

Moreover, the department estimates that even with these 11,900 new beds, the inmate population in 1987 will still be 6,800 above the system's designed capacity. It could cost an additional $640 million to eliminate this deficit. Thus, if the bond issue *is* approved by the voters and the Legislature decides to provide enough beds to eliminate overcrowding by 1987, the state will need to provide nearly $1 billion for prison construction *on top of* the $495 million proposed in the 1981 bond act. This estimate, moreover, *makes no allowance for the impact of pending legislation on the prison population* in 1987 or later years.

The Budget Bill indicates that in the event the bond measure is not approved by the voters, the Tehachapi project—$69.3 million—is to be considered a priority project and funding shall be available from the Special Account for Capital Outlay. Thus, the Tehachapi project, which provides 1,000 maximum-security beds, could proceed using tidelands oil revenues in the SAFCO (although it would proceed at the expense of virtually all other projects proposed for funding from the SAFCO in 1982–83). The other prison projects, however, could not proceed within the budgeted amounts, and the Legislature would be faced with funding new prison construction using additional tidelands oil revenue or the General Fund. The only other alternatives to proceeding with the state's prison construction program would be to (1) increase the number of inmates double-celled (two inmates in a cell designed for one inmate) or (2) commit fewer people to prison.

Cogeneration Facilities. The budget contains several appropriations to develop cogeneration utility facilities at a number of state-owned locations. Chapter 102, Statutes of 1981, states that:

> "It is the policy of this state to use available resources at state facilities which can substitute for traditional energy supplies or produce electricity at its facilities when use or production will reduce long-term energy expenditures. Criteria used in analysis of proposed actions shall include life-cycle cost evaluation, benefit to taxpayers, reduced fossil fuel and improved efficiency. Energy facilities at state-owned sites shall be scaled to produce optimal system efficiency and best economic advantage to the state. Energy produced in excess of state facility needs may be sold to nonstate purchasers."

Our review of the feasibilty studies submitted for proposed cogeneration facilities as part of the 1982–83 budget indicates that the policy established by the Legislature in Ch 102/81 has not been followed on a consistent basis. Most of these studies concentrate on *technical* feasibility, and place relatively little emphasis on the *economic advantage* to the state. Our analysis indicates that a more systematic approach to the evaluation of projects is needed. In order to ensure that the most cost-efficient cogeneration system is funded, the following information should be available to the Legislature before it is asked to appropriate funds beyond the preliminary planning stage:

- A reassessment and reconfirmation of the conclusions contained in the initial feasibility study should be performed by a consulting engineer.
- Each state facility where cogeneration is proposed should be the

subject of a comprehensive energy conservation plan to reduce overall energy consumption prior to the installation of a cogeneration facility.
- The cost-benefit analysis should be based on completed negotiations with the utility district.

Department of Energy (DOE) Consent Order Proceeds Account. In July 1981, the U.S. Department of Energy (DOE) and a major oil company entered into a proposed consent order concerning compliance with the federal petroleum and allocation statutes/regulations for the period January 1, 1973 through January 27, 1981. Under one provision of the consent order, the oil company agreed to pay $25 million to states and territories, based on the volume of products sold in those areas during 1980. California's share of this amount is $6.6 million. Under the consent order guidelines, the funds may be used for any of the following projects:

- Highway and bridge maintenance and repair.
- Ridesharing programs.
- Public transportation projects.
- Residential or commercial building energy audits.
- Grants or loan projects for energy conservation weatherization and equipment.
- Energy assistance programs.
- Airport maintenance or improvements.
- Reductions in airport user fees.
- Energy conservation or energy research offices and administration.

The Governor's Budget proposes to spend these funds for energy conservation projects in the Department of Developmental Services ($219,000) and cogeneration projects at two California State University campuses ($6.5 million). In view of the fiscal constraints facing the Legislature, there may be unmet needs which the Legislature may wish to fund from this source in lieu of the energy projects proposed by the administration. It would appear that a considerable amount could be reallocated from these projects to other program areas, particularly in view of the fact that (1) the Energy and Resources Fund is the only tidelands oil revenue fund which is budgeted to receive more than the amount allocated to it by current law, and (2) an additional $14.6 million in energy projects are to be funded from the Capital Outlay Fund for Public Higher Education and the Special Account for Capital Outlay.

III. LOCAL FISCAL RELIEF ISSUES

A. Alternatives for Reducing Local Fiscal Relief and Other Local Aid

Governor's Proposal

The budget proposes to reduce local fiscal relief and other local aid by a total of $569 million in 1982–83. To offset a portion of these reductions, the Governor is also proposing an optional program of selective property tax increases and a "speed-up" of sales tax collections, which the budget states could add $355 million in city, county, and special district revenues. Were this to happen, the net change in fiscal relief and other local aid would be a reduction of $214 million for local governments other than schools.

The reductions consist of:

- A $450 million reduction in vehicle license fee (VLF) subventions to cities and counties, on a per capita basis. Cities would lose $250 million, while counties would lose $200 million.

- A $16.1 million reduction in business inventory payments to cities, counties and special districts. This would be achieved by reducing the COLA from the 10.0 percent statutory level to the 5 percent budgeted level.
- A $53 million reduction in funding for County Health Services, relative to the amount which otherwise would be provided under current law.
- A $50 million reduction in Medi-Cal reimbursements to county hospitals as a result of the proposed limit on hospital inpatient reimbursements.

The increases consists of:

- A $275 million increase in local property taxes (schools would receive an additional $205 million) to be implemented on an optional basis by county boards of supervisors. The increase would be achieved by changing the date on which property that is newly constructed or changes ownership is reassessed, so that additional revenue can be collected (this proposal is discussed more fully in the next section).
- An $80 million increase in sales tax receipts to cities, counties and transit districts resulting from an acceleration of sales tax collections from retailers.

The distribution of these reductions and increases among the different types of local agencies (excluding schools) is illustrated in Table 8.

Table 8
Proposed Changes in Local Fiscal Relief and Other Local Aid
1982–83
(in millions)

Reductions	*Cities*	*Counties*	*Special Districts*	*Total*
Fiscal Relief:				
Vehicle license fee subvention	–$250	–$200	—	–$450
County health services subventions	—	–53	—	–53
Subtotal, Fiscal Relief	–$250	–$253	—	–$503
Other Local Aid:				
Business inventory subvention	–$5	–$9	–$2	–$16
Medi-Cal hospital reimbursements	—	–50	—	–50
Subtotal, Other Local Aid	–$5	–$59	–$2	–$66
Totals, Reductions	–$255	–$312	–$2	–$569
Increases				
Property Tax Increase	$66	$179	$30	$275
Sales Tax Speed-up	51	13	16	80
Totals, Increases	$117	$192	$46	$355
Net Change in Local Resources	–$138	–$120	$44	–$214

As the table shows, the reduction experienced by cities and counties would be $258 million. Under the Governor's proposal, special districts would receive an additional $44 million. Thus, the net change for all three types of local governments is a reduction of $214 million. Under existing law, the Department of Finance estimates that county "discretionary revenues" will grow by 11.0 percent in 1982–83, while the "discretionary revenues" of cities will grow by 13.1 percent. According to the budget, the combined effect of the reductions and increases proposed by the Governor will be to reduce these growth rates to 10.5 percent for counties and 10.8 percent for cities. These estimates assume that all counties will adopt the proposed property tax reassessment procedure.

Offsetting Revenue Gains Unlikely to Materialize

Our analysis indicates that the property tax reassessment proposal and the proposed speedup may have little impact on local agencies in the budget year. This is because Legislative Counsel has indicated that the property tax proposal may be unconstitutional, and because it may not be administratively feasible for the Board of Equalization to transmit the sales tax funds to local agencies prior to July 1, 1983. Presently, the transmittal of sales taxes to local agencies occurs approximately one month after collections are received by the board.

AB 8 Deflator

Table 9 compares reductions in local government fiscal relief (excluding schools) that would occur under the Governor's proposal and those that would result from the AB 8 deflator.

Based upon the most recent revenue and expenditure forecasts by the Department of Finance, the AB 8 deflator mechanism will be "triggered" for the 1982–83 fiscal year. This mechanism, which was suspended for 1981–82, would require reductions of $793 million in aid to local agencies and school districts. Half of this amount ($396 million) would be taken from K–14 school district apportionments. The other half would be taken from cities, counties and special districts, in proportion to their share of four specific subventions.

Table 9
Changes in AB 8 Fiscal Relief:
Comparison of Governor's Proposal and AB 8 Deflator
1982–83
(in millions)

		Governor's Proposal		*AB8 Deflator*	
	Fiscal Relief Current Law	*Reduction*	*Percent Change*	*Reduction*	*Percent Change*
Cities	$319	–$250	–78.4%	–$181	–56.7%
Counties	2,452	–253	–10.3	–207	–8.4
Special Districts	309	—	—	–8	–2.6
Total	$3,080	–$503	–16.3%	–$396	–12.9%

The magnitude of the deflator reduction for 1982–83 will increase to the extent that (a) the Governor's proposals for increases in state revenues are not adopted, (b) the economy fails to perform as well as expected, (c) current year expenditures exceed estimated levels, and (d) the income tax indexing and inheritance tax initiatives on the June 1982 ballot are approved. The Commission on State Finance will make the final determination on the size of the deflator reduction on June 10, 1982.

In last year's *Analysis,* we recommended that the deflator mechanism be repealed. We continue to make this recommendation because our analysis suggests that the deflator restricts, rather than enhances, the Legislature's flexibility in responding to the problem of financing California government. Moreover, in its current form, the deflator would spread any reductions proportionately among local jurisdictions without taking into account the relative ability of local agencies to bear these reductions.

The Governor's proposal to reduce Vehicle License Fees (VLF) on a per capita basis has the same general shortcoming as the deflator, although this is mitigated to some extent by an exemption for low-growth agencies. We believe that many other options for reducing state aid to local governments are available that are preferable to either the deflator or the VLF reduction.

Factors the Legislature Should Consider in Providing Local Fiscal Relief

In considering the Governor's proposed reductions in fiscal relief, the Legislature needs to consider first the extent to which it wishes to establish priorities for expenditure in the *combined* state and local government sector. The answer to this question will, to a large extent, determine the best course of action for the Legislature to take.

Several other factors need to be considered in determining the level of fiscal relief for 1982–83. Specifically, the Legislature needs to consider:

- *The impact of reductions on essential local services.* In past years, service reductions have been made in police and fire protection services, although these reductions may be attributable to changes in local priorities rather than to a lack of resources available to support these services.
- *The extent to which local agencies can bail themselves out* through new local taxes or elimination of less essential services. The state is becoming the primary source of funding for more and more local programs. At some point, local taxpayers must be asked to support those local programs which they feel are worthwhile.
- *The extent to which reductions can be offset through elimination of unnecessary mandates on local agencies.* (See discussion of mandated programs on page (B-40).

The Legislature also needs to make decisions as to how the reductions are to be allocated among the different *types* of local agencies, and whether the mechanism selected for allocating the reductions among types of local agencies should take into account the relative ability of the local agencies to absorb these reductions.

Reductions in 1981–82 fiscal relief were made in proportion to the amount of property taxes transferred from schools to cities and counties in 1979–80. Because of the way this amount was determined, several county governments were exempt from the reductions, even though some of these counties were in better condition than counties which took reductions. We know of no analytical basis for allocating the cuts in this fashion. The Governor's proposal also ignores differences in local fiscal condition, except in the case of those cities and counties expecting less than 5 percent growth in their discretionary revenues.

From our perspective, the best measure of relative fiscal conditions (although a flawed one to be sure) is discretionary revenue growth. This measure excludes from consideration those receipts tied to programs over which local agencies have no control, and provides an indication of the relative extent to which local agencies are able to address local needs for services. In the case of county governments, the measure should be adjusted to account for the local resources which must be allocated to the major state mandated health and welfare programs, since these expenditures vary widely from county to county.

B. Governor's Property Tax Reassessment Proposal

The budget proposes to partially offset the $503 million reduction in local government fiscal relief by allowing counties to implement a new procedure for reassessing property which is newly constructed or changes ownership. Essentially, owners of such property would have their assessments and property taxes increased one year earlier than under existing law. The budget proposes to effect this change through the establishment of two supplemental property tax rolls. Legislative authority for the proposed change is contained in the companion bills (AB 2361 and SB 1326) to the Budget Bill.

Under existing law, property taxes are based on the assessed values established on the March 1 lien date. The taxes become a lien on the property as of that date, although the exact amount of taxes is not known until the tax rate is set by the county board of supervisors on or before September 1. The California Constitution, as amended by Proposition 13, provides that all property which changes ownership or is newly constructed during the year preceding the March 1 lien date shall be assessed at its full market value. Newly constructed property which is only partially completed as of the March 1 lien date is assessed at the full market value of the construction actually completed as of that date. All other real property is assessed at its value as recorded on the assessment roll for the *preceding* year, plus an inflationary adjustment not to exceed 2 percent.

The budget proposes giving local boards of supervisors authority to approve the preparation of two supplemental property tax rolls. The first of these rolls, which would be prepared after July 1, would consist of all properties which changed ownership or were newly constructed between March 1 and June 30. These properties would be enrolled at their respective full market values as of June 30. In the case of properties which were also included on the previous (March 1) roll, the new values would *supplant* their previously enrolled values.

The second supplemental roll, prepared after January 1, would consist of all properties which changed ownership or were newly constructed between July 1 and December 31. Properties on this roll would be valued in either of two ways: (1) those which changed ownership would be enrolled at 50 percent of the difference between their previously recorded assessed values and their full market values as of December 31, and (2) properties which were newly constructed would be enrolled at 50 percent of their full market values as of December 31. Values on this second supplemental roll would be in addition to, and not instead of, values already recorded on the previous rolls.

New construction which is only partially completed on either June 30 or December 31 would not appear on either supplemental roll. Instead, such property would continue to be enrolled only on the March 1 uniform lien date, the same as under existing law.

The budget estimates that *if all counties were to implement these changes,* the additional property tax revenues would total $480 million in 1982–83. Cities, counties and special districts would receive $275 million from these increased revenues, and schools would receive the remaining $205 million. Under existing law, increased property tax revenues for schools would be offset by an equal reduction in state school apportionments. Therefore, there would be no net increase in revenues for schools. The budget also proposes that counties be allowed to retain up to 2 percent of the additional property tax revenues for purposes of funding county assessors' costs of preparing two supplemental assessment rolls.

The budget estimates this amount to be almost $10 million.

Our examination of the Governor's property tax proposal identifies three major concerns.

1. Proposal May Be Unconstitutional

The Governor's proposal leaves the adoption of the reassessment changes to the discretion of county boards of supervisors. Thus, if some counties were to adopt the proposal, while others did not, identical types of property within the state could be assessed according to two different standards, depending on where they were located. The Legislative Counsel has advised us in a written opinion (# 599) that such assessment practices would be unconstitutional, as Article XIII, Section I of the California Constitution has been consistently interpreted to mandate the uniform assessment of property. Counsel also advises us that this proposal would be constitutional if it were applied uniformly throughout the state.

2. Budget Overestimates Potential State Cost Savings

Our analysis indicates that the budget estimates of the net additional revenues attributable to this proposal in 1982–83 are overly optimistic, for three reasons. First, the estimates assume that all counties will be willing and able to enact ordinances requiring their assessors to prepare the supplemental tax rolls. Given the differences in revenue sources and political climate among California's 58 counties, it is unlikely that all counties would opt for the Governor's proposal.

Second, the budget estimates implicitly assume that the total assessed value of California property will grow by 15.2 percent from March 1982 through February 1983, and that this growth will be spread relatively evenly over that period. This assumption is probably overly optimistic. Assessed values grew by 13. 4 percent between March of 1979 and the 1980 lien date, and by 13.6 percent in the 12 months preceding the 1981 lien date. Assessed values are estimated to increase by another 12 percent by the March , 1982 lien date. While some increase in the rate of assessed value growth during the period March 1, 1982 through February 1983 is possible, it is unlikely, given the current depressed state of the California real estate market, that the growth in assessed values will accelerate sufficiently to *average* more than 15 percent during this time period.

Finally, the budget estimate assumes that approximately $205 million (43 percent) of the increased local property tax revenues will be used to fund K–12 schools and community colleges, and that state apportionments for schools would be reduced by a corresponding amount. Our analysis indicates that the reduction in school apportionments is more likely to be only $150 million, as the actual proportion of existing property tax revenues devoted to school purposes is only 37 percent statewide.

Table 10 compares our estimate of the 1982–83 fiscal impact of the Governor's property tax proposal with the estimate presented in the budget. In developing our estimate, we have assumed that (1) assessed values will grow an average of 13 percent in 1982–83, and (2) the reduction in school apportionments would equal 37 percent of the increased property tax collections, not 43 percent as indicated in the budget.

3. Administrative Problems

The original reason for assessing property on the March 1 lien date and preparing the property tax bills several months later was to allow local governments time to calculate their respective tax rates based on a known amount of assessed value. The need for this time lag has largely disap-

Table 10
Estimated Impact of Governor's Property Tax Proposal
1982–83
(in millions)

Revenues	*Governor's Budget Estimate*	*Legislative Analyst Estimate*	*Difference*
Local government:			
Increased property tax collections	$480	$410	−$70
Decreased school apportionments	−205	−150	55
Totals	$275	$260	−$15
Costs			
State government:			
Decreased school apportionments	−$205	−$150	$55
Increased cost of homeowners' exemptions	—	4	4
Totals	−$205	−$146	$59
Local government:			
Assessors' administrative costs	$10	$8	−$2
Totals	$10	$8	−$2
Net Fiscal Impact, State and Local	$470	$398	−$72

peared as a result of the passage of Proposition 13. This is because most counties now levy the $1.00 maximum tax rate. Local governments, however, still rely on the known amount of assessed value to compute their tax rates for voter-approved debt. These rates, which will average about $0.125 per $100 of assessed value in 1982–83, vary significantly among local governments.

The enrollment of additional assessed value via the supplemental property tax rolls would greatly complicate the setting of tax rates for debt service. Under the Governor's proposal, local governments would face three choices. First, they could opt to tax property on the supplemental rolls at only the $1.00 basic rate, levying no tax for debt service on these properties. While this solution would be the easiest administratively, the taxation of identically situated properties at different rates may be unconstitutional. Second, the counties could opt to tax all property on the primary and supplemental rolls according to a debt tax rate based on the property values on the primary roll only. This approach, however, would result in local governments raising up to $50 million *more* than actually needed for debt repayment. Finally, counties could base the debt tax rate on the amount of assessed value on the primary assessment roll *plus* an estimate of the amount of assessed value expected to be added via the supplemental rolls. If the assessed value actually enrolled on the supplemental rolls turned out to be lower than anticipated, however, local governments could be forced to divert revenues earmarked for other operations to debt service.

C. Governor's Proposal to Reform Reimbursement Process for State Mandated Local Programs

Chapter 1406, Statutes of 1972 (SB 90), authorized the reimbursement of local governments for state mandated costs and lost sales and property tax revenues. Under Chapter 1406, local governments could submit claims for reimbursement only in cases where the mandating statute acknowledged an obligation on the state's part to cover the increased costs (or revenue loss) resulting from the mandate.

Chapter 1135, Statutes of 1977, significantly broadened the reimbursement program authorized by Chapter 1406. It allows local governments to appeal to the Board of Control for reimbursement where (1) legislation contains a section disclaiming any state obligation to reimburse mandate costs or (2) legislation does not disclaim the state's obligation to reimburse but fails to provide an appropriation.

Chapter 100 (AB 777), Statutes of 1981, further broadens the reimbursement program. It provides that costs mandated on school districts by the courts, federal government, and voter-approved initatives are also reimbursable through the Board of Control process.

The Governor's Budget is proposing several changes to this reimbursement process, all of which require the enactment of legislation.

Minor Cost Legislation

Currently, the state does not provide funding for most mandated local programs which impose relatively minor costs on local government. Legislation of this type typically includes a disclaimer recognizing that if local agencies incur additional minor costs, they may seek reimbursement through the Board of Control process. In 1980, 51 chaptered measures included disclaimers of this type.

The administration is proposing in the companion bills to the budget (AB 2361 and SB 1326) that minor cost bills be identified and that an estimate of their costs be made during the legislative review process. This identification would serve as the basis for a *statewide* annual cost estimate to be included in legislation introduced at the request of the Department of Finance. If an appropriation is made by the Legislature for this purpose, local agencies would be reimbursed on a predetermined formula basis.

The expense involved in preparing and submitting to the Board of Control minor cost claims, coupled with the uncertainty that reimbursement will be approved by the board or appropriated by the Legislature probably discourages many local agencies from filing claims. To the extent that such minor claims are submitted, it is doubtful that the cost of processing, auditing, and issuing the warants for reimbursements are justified by financial benefits to local agencies. Most of the resources devoted to accounting for and verifying these minor cost claims could probably be more productively used to meet other public needs. This conclusion would seem to apply equally to the reimbursements for sales and property tax revenue losses (Item 9100-101-001 (g)), which are budgeted at $3.2 million for 1982–83.

Crimes and Infractions Legislation

Section 2253.2 of the Revenue and Taxation Code specifies eight conditions under which mandated costs are not reimbursable. One of these conditions is when a chaptered bill creates, eliminates, or changes the penalty for a new crime or infraction. In 1981, over 100 bills were enacted which recognized additional costs associated with the mandate but disclaimed funding responsibility through a "crimes and infractions" disclaimer.

The budget proposes that the state recognize the impact of such legislation and provide funding to offset these costs. Specifically, it proposes that *any* measure which increases total local law enforcement costs by more than 5 percent of prior year expenditures be funded by the state. The most recently available expenditure data show that in 1979–80, cities and counties expended $2.9 billion for law enforcement activities. Table 11 identifies the components of these expenditures.

Table 11
1979–80 Local Agencies
Law Enforcement Expenditures
(in millions)

Program	*Amount*
Counties:	
Judicial	$566.5
Police protection	557.7
Detention and correction	510.8
Cities:	
Police protection [a]	1,299.1
Totals	$2,934.1

[a] Includes the cost of city detention facilities.

Using this amount as a base, a bill would have to raise expenditures by over $146 million (5 percent) statewide in order to qualify for state funding under the budget proposal. It is not likely that this proposal, as drafted, would result in the disbursement of any funds to local agencies.

Legislative Action on Claims Bills

Under the existing reimbursement process, the Board of Control reviews claims from local agencies which allege that chaptered legislation contains a state mandate. If the Board of Control determines that a mandate exists, it must develop parameters and guidelines which delineate allowable costs for which local agencies may claim reimbursement. Once adopted by the board, the approved claims are presented to the Legislature in a claims bill for an appropriation. In past claims bills, the Legislature has deleted some claims which were submitted for payment.

The administration is proposing legislation which would require that the Legislature issue a specific finding when deleting claims. This finding would have to indicate either that (1) the enabling legislation did *not* constitute a state mandate or (2) there are no reimbursable costs associated with the mandate. In the absence of such a finding, local agencies would not be required to continue to comply with these unfunded state mandates.

D. Procedures for Reevaluating Effectiveness of Existing State Mandated Local Programs

In 1972, the Legislature enacted Chapter 1406, which required the state to reimburse local governments for the cost of state mandated local programs. Since 1975, when the state began keeping records, almost 2,000 bills have been enacted which contained a state mandated local program. Only 111 of the bills, however, contained an appropriation to pay for the mandated costs.

In many of these cases, the state appropriately disclaimed responsibility for reimbursement. For example, where the statute also provided savings in an amount sufficient to offset the costs, there were no net increased costs to the local agency warranting reimbursement. In the bulk of these cases, however, we simply do not know whether any increased costs were incurred, or whether the statutes ever met their intended objectives. This is because, once a disclaimed state mandated program is enacted, its efficacy is usually not subject to review by the Legislature. The Legislature may have an opportunity to review some of these programs again, when local agencies seek to obtain reimbursement through the Board of Control. However, the number of such programs is limited relative to the number of outstanding mandated programs.

The Legislature has recognized the need for some review of these mandates. On two occasions, legislation has directed our office to examine specific state mandated local programs and make recommendations to the Legislature as to whether they need modification or should be repealed. In addition, our office has been given an ongoing responsibility to review annually all state mandated programs which receive state funding through the Board of Control process each year.

In our most recent report, "An Analysis of 21 State-Mandated Local Programs" (January 1982), we recommended that 12 of the 21 mandates examined be repealed or modified, in order to achieve a more efficient use of state and local funds. The specific mandates that we recommended be repealed or modified are as follows:

Statute or Regulation	*Analyst Recommendation*
• In-Home Supportive Services Regulations: MSW Requirement	Repeal
• Guardianship and Conservatorship	Modify
• Voter Registration Purge	Modify
• Voter Registration by Mail	Modify
• High School Proficiency Assessments	Modify
• Law Enforcement Records	Modify
• General Relief	Modify
• Benefits in Lieu of Temporary Disability for Safety Officers	Repeal
• Presumption of Work-Related Disability	Repeal
• Civic Center Act	Repeal
• Single Session Kindergarten Classes	Repeal
• Administrator-Teacher Ratio	Repeal

Some of these recommendations would increase state and local costs, and others would reduce costs. On balance, however, we believe the combined savings to the state and local governments would significantly exceed the costs.

From our perspective, the identification and repeal of existing state mandated local programs which are no longer justified can significantly reduce government expenditures at all levels. At the present time, however, there is no process for accomplishing such a review. The state is not in a good position to identify those mandates that are unnecessary or not constructive because it does not administer the programs or observe their results. Although local governments frequently testify on the problems caused by the imposition of these mandates, they generally refrain from offering any evaluations of *specific* mandates or presenting a case for eliminating them.

For this reason, we recommend that a process be established whereby the state and local governments, in a cooperative effort, seek to identify unnecessary mandates. This could be implemented by assigning this subject to a legislative committee with the responsibility for receiving evaluations of existing mandates from local agencies. This committee could review these evaluations and make recommendations to the Legislature as a whole. In this way, local governments could identify those programs with low priorities or inadequate accomplishments, and present a case for modification or repeal. Since, for the most part, these programs are currently financed by local governments, it should be in their interest to make recommendations for changes so the savings generated through this process could be put to other local purposes having a higher priority.

IV. GENERAL FUND CONDITION, PRESENT AND FUTURE

A. Avoiding a Deficit

Fiscal Year 1981–82

Last July, after the 1981–82 budget was adopted, we estimated that the General Fund would have a surplus (uncommitted reserves) of about $475 million. In the intervening seven months, the condition of the General Fund has deteriorated markedly because:

- Revenue estimates for the current year have been revised downward by over $800 million—the largest downward adjustment in history.
- Expenditures are up over $300 million from the level estimated last July.

In the previous sections of this *Analysis*, we have described the actions proposed by the administration to keep the General Fund solvent during the current fiscal year. At the time this analysis was written, the Legislature was considering other alternatives, such as AB 7x and AB 8x which would increase current year resources by raising revenues or reducing expenditures. The fate of the state's General Fund during the current year depends upon what actions are taken by the Legislature to address the pending deficit, and especially what happens to revenue collections during the next five months.

Fiscal Year 1982–83

The Governor's proposed budget for 1982–83 will be in balance if the economy has a normal upturn from the current recession, and if several other assumptions, such as those regarding the voters' decisions at the June 1982 primary election, are borne out.

The principal fiscal problem facing the state in the budget year, as in the current year, is a sluggish economy. If the economic assumptions made in May 1981 had held up, General Fund revenues (under existing law) in 1982–83 would be $1.5 billion higher than currently estimated. This level of revenues would have provided funding that was almost sufficient to continue the original 1981–82 level of services into the budget year. The recession, however, has reduced revenues to the point where expenditures in terms of real purchasing power will be about 2.9 percent *lower* than those for the current year, assuming the Governor's revenue enhancements are approved. This decline in the level of services will be even larger if the voters in June 1982 approve the Jarvis full income tax indexing measure and repeal the inheritance and gift taxes.

Fiscal Year 1983–84

The budget estimates that General Fund revenues will be $26.3 billion in 1983–84—$2.7 billion, or 11.4 percent, over the estimated level for the budget year. Our analysis indicates that this is a reasonable figure, given what many private economists are predicting for the economy in 1982 and 1983, *provided* the ballot measures mentioned above are not approved by the voters.

We estimate that the levels of service proposed for the budget year could be financed in 1983–84 within the $26.3 billion projected to be available.

In summary, the condition of the General Fund and its ability to sustain current service levels depends primarily on:

1. what happens to the California economy, and
2. the voters' decision on three revenue measures on the June ballot.

Revenues are much more sensitive than expenditures to changes in economic conditions. If the expected upturn in the economy materializes, then the task of balancing the budget should be easier in the future.

B. Reserve for Economic Uncertainties

The Reserve for Economic Uncertainties was established in the 1980 Budget Act. It was designed to be an "insurance policy" to protect the solvency of the General Fund against declines in revenues and unanticipated increases in expenditures. This reserve was established at a *minimum* of 3 percent of total General Fund appropriations, with a goal of 5 percent.

In 1980–81, the reserve began the year with $620 million (3 percent of appropriations), but almost half of this amount was needed by the General Fund during the year to sustain the approved expenditure program. This was due to a decline in revenues, and some unanticipated increases in expenditures. The ending balance in the reserve was only $349 million.

In 1981–82, the reserve began the year with a balance of $658 million. Shortly after the budget was adopted, however, the reserve fell to $475 million because $183 million was needed to fund the expenditures in the budget and companion legislation. Without any action by the administration, this reserve would have been fully depleted during the current year because estimated revenues are down by over $800 million from the level estimated last May, and expenditures are up over $300 million. This $1.1 billion decrease in the resources available to the General Fund was more than double the size of the reserve after the adoption of the budget and its companion bills.

The administration's program for solving this funding problem consists of three parts.

1. Current-year expenditures would be reduced by $419 million, by cutting most General Fund-supported state operations budgets by 2 percent, and by freezing certain capital outlay appropriations.
2. Revenues would be accelerated by $338 million during the current year, and
3. The remaining reserve would be reduced to $116 million. This represents a total reduction of $542 million from the beginning balance.

Two important lessons can be learned from this year's experiences:

1. The solvency of the General Fund can be hurt more by a shortfall in revenues than from unanticipated increases in expenditures, and
2. A 3 percent reserve is only a *partial* "insurance policy." A 5 percent reserve (the ultimate goal of the 1980 and 1981 Budget Acts) would have been needed to absorb the $1.1 billion decline in General Fund resources.

In 1982–83, the budget proposes to restore the reserve to $500 million, or 2.16 percent of General Fund expenditures. This is *lower* than the 3 percent minimum target established by the Legislature in years past, and lower than the ratio at the beginning of either 1980–81 or 1981–82. This amount, moreover, would have to do double duty in 1982–83. Not only would it have to protect the General Fund against declines in revenue under existing law and increases in regular expenditures; it would also have to protect the General Fund against the following three unique contingencies which the budget assumes will *not* materialize.

1. The voters approve the Jarvis income tax indexing initiative on the June 1982 ballot (General Fund revenue loss of $230 million in 1982–83).

2. The voters approve one of the initiatives on the June 1982 ballot which repeals the inheritance and gift taxes (General Fund revenue loss of $130 million in 1982–83).

3. The voters reject the prison bond issue on the June 1982 ballot, which would eliminate $162 million in 1982–83 funding, which the budget anticipates will be available.

If all three of these contingencies materialize, the adverse affect on the budget would be $522 million, or more than the $500 million reserve.

We recommend the Legislature give high priority to increasing this reserve to the same ratio as existed in the prior two fiscal years, namely 3 percent. That would result in a starting balance of $700 million for 1982–83.

V. COLLECTIVE BARGAINING FOR STATE EMPLOYEES

New Collective Bargaining Provisions

In 1982–83, compensation increases for state employees will, for the first time, be subject to collective bargaining.

Collective negotiations over state employee compensation increases and other terms and conditions of employment were initiated during the current year under provisions of:

- The State Employer-Employee Relations Act (SEERA), which the Legislature enacted in 1977.
- The Higher Education Employer-Employee Relations Act (HEERA), which the Legislature enacted in 1978.

The SEERA provides for a formal, bilateral employee relations system for most state civil service employees. Under its provisions, the Governor or his designee is required to "meet and confer in good faith" with employee organizations which have been selected by a majority of employees within individual bargaining units in an effort to reach agreement relative to "wages, hours and other terms and conditions of employment." Such agreements are to be formalized in memorandums of understanding (MOU's). Any provision in such a memorandum requiring the expenditure of funds (for example, negotiated salary or benefit increases) is subject to approval by the Legislature. Mediation is required if the parties are unable to reach agreement.

The HEERA provides for a similar system with respect to both academic and nonacademic employees of the University of California (UC) and California State University (CSU).

Traditionally, state civil service salaries and benefits have been adjusted on the basis of (1) State Personnel Board (SPB) surveys of salaries and benefits received in nonstate employment, (2) salary and benefit increase recommendations contained in the board's annual report to the Governor and Legislature, (3) action by the Legislature and Governor on the Budget Act, and (4) SPB allocation of funds appropriated for salary increases, among occupational classes. (As we note in our analysis of the Department of Personnel Administration (DPA), all SPB functions involving salary administration and various other "nonmerit aspects" of personnel administration were transferred to the DPA effective July 1, 1981, pursuant to Governor's Reorganization Plan No. 1 of 1981.)

Under the prevailing rate system, salaries and benefits of academic employees of the UC and CSU were adjusted on the basis of (1) a report submitted to the Legislature by the California Postsecondary Education Commission (CPEC) comparing California faculty salaries to those in two groups of postsecondary education institutions that are comparable to the two California segments, and (2) action by the Legislature and Governor on the Budget Act.

In order to treat nonacademic employees of the UC and CSU equally, the Legislature traditionally has appropriated funds to provide the same salary increases for UC and CSU nonacademic employees as those received by civil service employees in comparable job classes.

Employees Not Covered by Collective Bargaining

Both the SEERA and HEERA exclude the following categories of employees from collective bargaining:

- ***Managerial employees,*** who are defined as those employees having significant responsibilities for formulating or administering policies or programs or for administering agencies.
- ***Supervisory employees,*** who are defined as those employees having the authority to hire, transfer, suspend, lay off, recall, promote, discharge, assign, reward, or discipline other employees, or responsibility to direct them or adjust their grievances, or effectively recommend such action.
- ***Confidential employees,*** who are defined as those employees required to develop or present management positions regarding employer-employee relations, or whose duties require access to confidential information contributing significantly to the development of management positions.

In addition to these categories, the SEERA also specifically excludes the following from collective bargaining:

- Employees of the Public Employment Relations Board.
- Employees of the Legislative Counsel Bureau.
- Nonclerical employees of the SPB engaged in technical or analytical personnel functions.
- Conciliators employed by the State Conciliation Service in the Department of Industrial Relations.

Also excluded are all statutory officers whose salaries are set by the Legislature and those employees in positions exempt from civil service who are not specifically designated by SEERA as being covered.

The total number of civil service and related personnel is estimated at 140,846 (full-time equivalent). Of the total, 118,570 employees, or 84.2 percent, have been assigned to specific bargaining units. This leaves 22,276, or 15.8 percent, of the employees not subject to collective bargaining. This is shown in Table 12, which displays the number and percent of employees in the categories not subject to collective bargaining.

The 18,222 managerial and supervisory employees group includes a variety of positions encompassing a wide range of salary levels and responsibilities. In many instances, an employee designated as a supervisor is excluded from bargaining while a higher salaried employee working in the same program area, in the same department, is subject to bargaining.

Table 12
State Civil Service and Related Employees Covered by State Employer-Employee Relations Act (SEERA)

Category	*Estimated Personnel (Full-Time Equivalent)* *Number*	*Percent*
Employees in bargaining units	118,570	84.2%
Employees not subject to bargaining:		
Managerial and supervisory	18,222	12.9
Confidential	833	0.6
Excluded specifically by SEERA	1,457	1.0
Statutory officers and exempt employees not in bargaining units	1,764	1.3
Total Personnel	140,846	100.0%

It should be noted that the totals in Table 12 do not include staff employed by the Legislature. Salaries and benefits of these employees will continue to be set by the Legislature outside the process established by the SEERA. The Legislature, however, may choose to coordinate its salary and benefit decisions for legislative staff with the decisions resulting from the collective bargaining process.

Issues Subject to Negotiation

The SEERA and HEERA both provide for collective bargaining over wages, hours and other terms and conditions of employment.

As a practical matter, virtually all conditions of employment are subject to collective bargaining. For example, the SEERA, identifies numerous negotiable issues which we have grouped in the nine major catgegories identified below:

1. Holidays, Vacation, Sick Leave, Leaves of Absence, Time Off.

- designated state holidays;
- the employee's personal holiday;
- the amount of vacation time which may be accumulated, and methods by which employees moving from one state agency to another may be compensated for, or otherwise receive credit for, their accumulated vacation privileges;
- the rate at which employees accumulate vacation credit;
- provisions for taking vacation time;
- the rate at which sick leave is accumulated;
- the amount of sick leave which may be accumulated;
- the provision of sick leave without pay for employees who have used all of the sick leave to which they are entitled;
- leaves of absence with pay for pregnancy, childbirth, or the recovery therefrom;
- authority of agency heads to grant educational leave with pay under specified conditions to state civil employees in positions requiring teaching certification qualifications;
- leaves of absence without pay;
- leaves of absence for jury duty;
- time off allowed during working hours to qualified employees for taking state civil service examinations.

2. Salaries, Compensation Levels, and Allowances and Payments for Work-Related Expenses

- salary increases including merit salary increases;
- compensation levels when the employee is paid a fixed amount per unit of work;
- payment above the minimum step of a salary range to meet recruitment problems, obtain employees of extraordinary qualifications or correct salary inequities;
- frequency of payments to state employees;
- intermediate steps within salary ranges;
- minimum and maximum salary limits for laborers, workers, and mechanics employed on an hourly or per diem basis;
- payment of a salary above the maximum of a range to employees moved to lower positions due to managment-initiated changes;
- provision of lump-sum payments upon separation for accumulated vacation or for compensating time off for previous overtime worked;
- payment for moving, traveling, lodging and meal expenses due to a required change in work location;
- payment of travel expenses of job applicants to fill positions for which there is a shortage of qualified applicants, and payment of moving expenses to persons accepting such positions;
- allowances paid to employees while traveling on state business;
- allowances provided to the employee for purchasing uniforms;
- the furnishing of work clothes to employees;
- the furnishing of safety equipment and police protective equipment to employees when such equipment is required by the employing agency;
- the replacement of employees' tools or equipment when stolen from the jobsite;
- the value of maintenance, living quarters, housing, lodging, board, meals, food, household supplies, fuel, laundry, domestic servants, and other services furnished by the state as an employer to its employees.

3. Overtime

- the designation of workweek groups and conditions for paying overtime for work performed after the normal scheduled workweek;
- the extent to which, and method by which, overtime work is compensated;
- the granting of compensating time off in lieu of cash for overtime;
- compensation provided to employees who are required to report back to work after completing the normal workday, workweek, or when otherwise off duty;
- payment to the employee of actual and necessary expenses when the employee is required to work overtime.

4. Health Insurance and Benefits, Life Insurance, Disability Benefits, and Rehabilitation Services

- the nature and extent of health insurance coverage for employees and their dependents;
- state's contribution toward employee health insurance;
- state payments into a private fund to provide health and welfare benefits to nonpermanent employees;
- health and safety programs for state employees;

5—75056

- the nature and amount of life insurance coverage provided for state employees;
- the nature, amount and conditions of nonindustrial disability coverage;
- the nature, amount, and conditions of industrial disability coverage;
- extension of benefits to a fireman who at the time of his injury, death, or disability is performing duties as a fireman, but not acting under the immediate direction of his employer;
- provisions requiring the DPA and Department of Rehabilitation to jointly formulate procedures for selecting and referring disabled state employees who can benefit from rehabilitation services and might be retrained for other appropriate positions in state service.

5. Employee Training

- provisions requiring the DPA to devise plans for, and cooperate with officials of the various agencies in training employees;
- conditions under which employees may be assigned to take out-service training;
- conditions under which employees may be reimbursed for tuition fees and other necessary expenses in connection with out-service training;
- conditions under which the employee may be required to reimburse the state for the cost of out-service training in the event the employee fails to remain in state service for a reasonable time after receiving the training;
- provisions requiring agency heads to arrange for counseling and training of employees in order to place them in other state civil service positions when their positions are to be changed substantially or eliminated by automation, technological changes, or other management-initiated changes;
- authority of the Commandant of the Veterans' Home of California to permit members of the medical staff to attend with pay medical and scientific meetings and medical and refresher courses under specified conditions.

6. Appointments, Transfers, Separations, Resignations, Reinstatements

- DPA's authority to temporarily restrict the methods of appointment available to the various agencies when necessary in order to place in other state civil service positions employees whose jobs have been substantially changed or eliminated;
- limited term appointments to education classifications to facilitate professional development of educators;
- authority of agency heads to transfer employees under various specified conditions;
- various provisions relative to separations from state service;
- the policy that when employees are separated from state service because of management-initiated changes, steps should be taken on an interdepartmental basis to assist such employees in locating, preparing to qualify for, and being placed in other state civil service positions;
- the provision that absence without leave for five consecutive working days constitutes an automatic resignation from state service;
- conditions under which an employee who formerly resigned from state service must be reinstated to his former position and paid his salary from the date of resignation;
- provisions under which an employee may be reinstated but *not* be

paid his salary from the date of resignation;
- DPA's authority to (1) establish a clerical pool in any location where the demand for temporary clerical help warrants it and (2) assign persons from the pool to agencies where they are needed.

7. Employee Performance Review
- employee performance standards and systems for rating employees' performance;
- rules under which unsatisfactory performance may lead to demotions or removal from service.

8. Retirement and Deferred Compensation
- the nature and extent of retirement benefits under the Public Employees' Retirement System (PERS);
- the state's contribution toward employee retirement benefits under the PERS;
- criteria for determining the application of the state safety category of membership in the PERS;
- DPA's authority to establish a deferred compensation plan and employees' authority to have deductions made from their wages in order to participate in such a plan.

9. Other Conditions of Employment
- credit for prior service;
- systems for adjusting employee grievances;
- provisions relative to prohibiting an employee from engaging in activities which are inconsistent, incompatible, or in conflict with his duties.

Issues Not Subject to Collective Bargaining

The SEERA and the HEERA both exclude from collective bargaining the basic functions of the employer—the merits, necessity, or organization of any service or activity provided by law.

The HEERA also excludes from the scope of bargaining (1) specified fees which are not a condition of employment; (2) admission requirements for students, conditions for awarding certificates and degrees to students, and the content and conduct of courses, curricula, and research programs; and (3) methods to be used for the appointment, promotion and tenure of academic employees.

Functions of the Executive Branch and the Legislature Under Collective Bargaining

Executive Branch Functions Under the SEERA. The Governor, or his representative, is to meet and confer in good faith regarding wages, hours and other terms and conditions of employment with representatives of recognized employee organizations, and consider fully presentations made by such organizations on behalf of their members. The parties are to attempt to reach agreement on matters within the scope of bargaining before the final state budget is adopted for the ensuing year. The negotiated agreements are to be formalized in MOU's and submitted "to the Legislature for determination."

Executive Branch Functions Under the HEERA. The "higher education employer" is defined as the (1) regents with respect to the UC, (2) Directors in the case of Hastings College of Law and (3) trustees in the case of the CSU.

The higher education employers, or their representatives, are to meet and confer with the employee organizations selected as exclusive representatives of the appropriate units of employees in all matters within the scope of representation. The negotiated agreements are to be prepared jointly by representatives of the higher education employers and the exclusive representatives and presented to the higher education employers for concurrence.

The higher education employer is to maintain close liaison with the Department of Finance and the Legislature in meeting and conferring on provisions which have fiscal ramifications. Following the execution of MOU's, the employer is to forward to the Legislature and the Governor or other funding agencies a request for funding for all state-funded employees or necessary proposed legislation.

If the Legislature or Governor fails to fund fully a MOU or take the necessary action, the entire MOU is to be referred back to the parties for further meeting and conferring. In that case, the parties may agree to provisions of the MOU which are nonbudgetary and do not require funding.

With respect to the CSU, the HEERA:

- Requires the Governor to appoint one representative to attend the meeting and conferring, including the impass procedure, to advise the Governor on matters requiring an appropriation or legislative action.
- Authorizes the Speaker of the Assembly and Senate Rules Committee each to appoint one representative to attend the meeting and conferring to advise the parties on the views of the Legislature on matters which would require an appropriation or legislative action.

Functions of the Legislature Under Collective Bargaining. Under both the SEERA and HEERA, the Legislature must approve MOU provisions which require either (1) the expenditure of funds or (2) a change in the law, before these provisions can be implemented.

As noted above, the HEERA specifically provides that if the Legislature or Governor does not fully fund a MOU, the *entire MOU* is to be referred back to the parties for further meeting and conferring.

Compensation Increases for Employees Not Covered by Collective Bargaining

It is our understanding that the procedure for providing compensation increases for state employees not covered by collective bargaining will probably operate as follows:

- The Governor, through the DPA, will propose increases for nonrepresented civil service and related employees, and the UC Regents and CSU Trustees will propose such increases for UC and CSU nonrepresented employees, respectively.
- The Legislature and Governor will act on such proposed increases through the normal Budget Bill process.

Implementing the Bargaining Process

The Public Employment Relations Board (PERB) is responsible, under the SEERA and HEERA, for:

- Determining appropriate bargaining units (that is, designating the specific job classes which are to be combined within separate units for representation by individual employee organizations).

- Conducting elections to determine which, if any, of the competing employee organizations will serve as the exclusive bargaining agent for each such unit.

Status of Implementing Collective Bargaining Under the SEERA. The PERB completed the bargaining unit determination process in November 1979 and designated a total of 20 separate bargaining units. Implementation of the SEERA was delayed to some extent by litigation testing its constitutionality. The California Supreme Court, however, has ruled that there is no basic conflict between the SEERA and the California Constitution.

Table 13

Distribution of State Civil Service and Related Employees Among Bargaining Units Created Under Provisions of the State Employer-Employee Relations Act (SEERA)

Bargaining Unit		*Estimated Personnel (Full-Time Equivalent*		
Unit Number	*Occupational Group*	*Number*	*Percent*	*Exclusive Representative*
1	Administrative, Financial and Staff Services	23,192	19.6%	California State Employees' Association (CSEA)
2	Attorney and Hearing Officer	1,842	1.5	Undecided
3	Education and Library	2,155	1.8	CSEA
4	Office and Allied	32,848	27.7	CSEA
5	Highway Patrol	4,179	3.5	California Association of Highway Patrolmen
6	Corrections	6,533	5.5	California Correctional Officers Association
7	Protective Services and Public Safety	4,492	3.8	Coalition of Associations and Unions of State Employees
8	Firefighter	3,150	2.7	California Department of Forestry Employees' Association
9	Professional Engineer	4,795	4.0	Professional Engineers in California Government
10	Professional Scientific	1,327	1.1	CSEA
11	Engineering and Scientific Technicians	3,092	2.6	CSEA
12	Craft and Maintenance	9,449	8.0	CSEA
13	Stationary Engineer	472	0.4	International Union of Operating Engineers, Stationary Engineers Division
14	Printing Trades	856	0.7	CSEA
15	Custodial and Services	5,690	4.8	CSEA
16	Physician, Dentist and Podiatrist	890	.7	Union of American Physicians and Dentists
17	Registered Nurse	1,608	1.4	CSEA
18	Psychiatric Technician	7,426	6.3	Communication Workers of America, Psych Tech Union
19	Health and Social Services/Professional	2,962	2.5	American Federation of State, County and Municipal Employees
20	Medical and Social Services Support	1,612	1.4	CSEA
	Total Employees	118,570	100.0%	

During June 1981, the PERB conducted unit elections, providing all eligible employees the opportunity to vote for the exclusive bargaining agent, if any, of their choice. At the time this analysis was written, 19 of the 20 units had selected an exclusive representative. The only unit remaining undecided with respect to exclusive representation was one consisting of attorneys and hearing officers which represents 1,842, or 1.5 percent, of the 118,570 civil service and related employees covered by collective bargaining. Therefore in the budget year, compensation increases for employees in 19—and possibly all—of the 20 bargaining units will be subject to the collective bargaining process.

Approximately 84 percent of state civil service and related employees are covered by collective bargaining under the SEERA. Table 13 indicates the distribution of these employees among the 20 bargaining units.

Steps Taken by the Administration to Prepare for Collective Bargaining. The Office of Employee Relations (OER) was established in the Governor's Office by Executive Order B7-75 to represent the administation in all matters concerning employer-employee relations. Pursuant to Governor's Reorganization Plan No. 1 of 1981, the OER was eliminated and its functions were transferred to the new Department of Personnel Administration (DPA). The new department, in addition to representing the administration in employer-employee relations, is responsible for managing the nonmerit aspects of the state personnel system.

Activities undertaken by the OER (now DPA) to prepare state management for collective bargaining include:

- Issuing guidelines to managers and supervisors for complying with the SEERA so that they may avoid committing unfair labor practices. (The guidelines cover such items as rights of employees and employee organizations, and procedures for complying with bilateral decisions.)
- Issuing to employees designated as "managers," "supervisors," and "confidential employees" information regarding their rights and role in the state management process.
- Issuing periodic reports informing state managers and supervisors of state plans for implementing collective bargaining under the SEERA.
- Conducting formal training for managers and supervisors in subjects such as grievance procedures and the administration of contracts executed pursuant to the collective bargaining process.
- Establishing a Management Relations Division to deal specifically with personnel issues related to those employees not covered by collective bargaining.
- Establishing steering committees consisting of departmental managers to assist the DPA in preparing for collective negotiations.

Status of Implementing Collective Bargaining for UC Employees. Faculty employees at UC Berkeley and UCLA each voted for no representation in the elections conducted by the PERB under the provisions of the HEERA. Therefore, at least for the budget year, those employees will *not* be covered by collective bargaining. Employees in two other UC bargaining units, however, have selected an exclusive bargaining agent, to represent them in collective negotiations in PERB-sponsored elections:

- A unit consisting of 295 faculty members at the Santa Cruz campus.
- A statewide university police unit consisting of approximately 200 employees.

Compensation and working conditions for these employees in 1982–83 will be subject to collective bargaining.

At the time this analysis was written, the unit determination process had not been completed for the balance of the UC employees and, therefore, it does not seem likely that the 1982–83 compensation increases for these employees will be determined by collective bargaining.

Status of Implementing Collective Bargaining for CSU Employees. The PERB designated a total of eight separate bargaining units for CSU employees. Each unit is structured on a statewide basis. At the time this analysis was written only the unit composed of university police (representing 185, or 0.5 percent of CSU employees covered by collective bargaining) had selected an exclusive bargaining representative. In the budget year, compensation increases and other terms and conditions of employment for these employees will be subject to collective bargaining.

Employees in the other seven units were in the process of voting to determine which, if any, of the competing employee organizations would represent them as their exclusive agents in collective bargaining negotiations. At this time it is uncertain whether or not compensation increases for employees in any or all of these seven units will be determined for the budget year through the collective bargaining process.

Table 14 shows the distribution of CSU employees among the eight bargaining units.

Table 14

Distribution of CSU Employees Among Bargaining Units Created Under Provisions of the Higher Education Employer-Employee Relations Act (HEERA)

Bargaining Unit		*Estimated Personnel (Full-time Equivalent)*		
Unit Number	*Occupational Group*	*Number*	*Percent*	*Exclusive Representative*
1	Physicians	140	0.5%	Undecided (election in progress)
2	Health Care Support	280	0.9	Undecided (election in progress)
3	Faculty	19,330	62.6	Undecided (election in progress)
4	Academic Support	1,335	4.3	Undecided (election in progress)
5	Operations Support Services	2,110	6.8	Undecided (election in progress)
6	Skilled Crafts	815	2.7	Undecided (election in progress)
7	Clerical Support	6,680	21.6	Undecided (election in progress)
8	Police	185	0.6	Statewide University Police Association
	Total Employees	30,875	100.0%	

Problems the Legislature Will Face as a Result of Collective Bargaining

Because 1982–83 compensation increases for many state employees will be subject to the collective bargaining process, the Legislature will face a number of new and perplexing problems. These problems will be particularly acute in this, the first year of bargaining because of uncertainty as to:

- Whether employees in certain bargaining units will be covered by collective bargaining.
- Whether negotiations in all of the bargaining units will be completed in time for the funding implications of the MOU's to be considered by the Legislature in acting on the 1982 Budget Bill.
- The procedure the Legislature will use in receiving, considering and acting on MOU's.
- The availability of adequate criteria and reliable cost data for evaluating MOU's.

Moreover, it is likely that the Legislature will have only a short time in which to act on MOU's, because employee compensation proposals probably will be submitted late in the 1982–83 budget process.

In the following pages we (1) identify and discuss some of these problems and (2) make recommendations for addressing them.

Problem No. 1: A Legislative Procedure Needs to be Established for Receiving, Considering, and Acting on MOU's.

Collective Bargaining Issues. There are essentially four types of issues which will arise out of collective bargaining: (1) direct fiscal issues involving such items as salaries, wages, and fringe benefits, (2) indirect fiscal issues involving working conditions, (3) issues requiring changes in existing law, and (4) issues which require neither legislative funding nor statutory changes. The latter category are those issues which either fall entirely within the discretion of management (including a wide range of working conditions) or are allowed to take precedent over specified sections of law, as permitted by both the SEERA and the HEERA. This category of issues does not require legislative approval.

Direct Fiscal Issues. The Legislature will have to act on any collective bargaining provision that requires the appropriation of state funds for employee salary, wages, or benefits. These provisions may be submitted to it in one of three ways. First, the Department of Finance may submit budget change letters to provide funding for MOU's. This is likely to be the case in 1982–83, due to delays in implementing the new collective bargaining process.

Second, funding for MOU's covering fiscal years beyond 1982–83 may be included in the Governor's Budget, if they are completed on time.

Third, where a MOU is agreed to after enactment of the Budget Bill, special legislation may be introduced to fund the direct fiscal provisions of these agreements. In all three cases, the Legislature could use the same hearing procedures that it uses in examining other fiscal issues.

Indirect Fiscal Issues. Negotiated changes in working conditions or other terms of employment could have an indirect fiscal impact. For example, a MOU might provide for changing employee workshifts from an 8-hour day, 5-day week to a 10-hour day, 4-day week. Such change could require additional staff resources if the normal workweek coverage is to be maintained. Ideally, such indirect costs should be identified in the MOU's and highlighted for legislative consideration in the same way as direct fiscal issues.

It is possible, however, that such indirect issues may not be raised at the time a MOU is submitted, particularly if the agency has not determined the full impact of the MOU on its operating requirements. If these indirect costs are not identified and highlighted for the Legislature, they could be overlooked, only to appear in future years in the form of Budget Change Proposals or baseline budget adjustments.

Statutory Changes. MOU's requiring changes in existing law will be presented to the Legislature in the form of special legislation. Here again, the Legislature could direct these measures through the regular policy committee/fiscal committee/floor route that other proposed fiscal measures must follow.

Most state legislatures have not found it necessary to establish special committees or procedures for dealing with collective bargaining issues. (One exception is Wisconsin, which we discuss below.) We believe that most collective bargaining issues can be handled within existing legislative organizational arrangements.

Accordingly, *we recommend that the existing committee structure which the Legislature uses for hearing budget items and bills be used for considering and acting on both MOU's and proposed increases submitted by the administration for employees not covered by collective bargaining.*

The Wisconsin Model. Although the Legislature probably does not need to establish any special committee structures for dealing with collective bargaining matters, the Wisconsin Model is an alternative that the Legislature may want to consider. Wisconsin is one of two states which has established a special committee structure for dealing with collective bargaining issues. Its Joint Committee on Employment Relations deals with all state-related collective bargaining matters. The committee is composed of the Speaker of the Assembly, the President of the Senate, the majority and minority leaders of both houses, and the chairpersons of the fiscal committees. The committee is authorized to meet with the Governor's negotiating team in executive session prior to the commencement of negotiations to help develop negotiation strategies, and to determine the budgetary amounts which can be made available to implement MOU's. The committee also holds hearings to approve or reject MOU's after they have been negotiated. Formal actions of this committee go directly to the floor of each house for final approval or disapproval.

Minnesota has recently enacted legislation creating a committee structure similar to the Wisconsin Model.

Problem No. 2 Criteria and Data Are Needed to Evaluate Proposed Compensation Increases

In the past, prevailing rates in nonstate employment have provided an objective basis for evaluating proposed compensation increases. In establishing collective bargaining in lieu of the prevailing rate system, the Legislature implicitly recognized that factors other than comparable pay are permissible standards for determining state employee compensation levels. While this opens up the wage-determination process to other considerations, it makes the Legislature's task in acting on MOU's that much more difficult, since the objective basis for evaluating increases (pay levels in comparable nonstate employment) is no longer definitive.

As a result, the Legislature must determine what criteria to use in evaluating compensation increases (a) negotiated by the administration and (b) proposed by the DPA for employees not represented in the collective bargaining process.

Negotiated Increases. Criteria which might be used for evaluating negotiated increases include:

- Prevailing salary rates in comparable nonstate employment.

- Increases in the GNP Personal Consumption Deflator (price index), the California Consumer Price Index (CCPI) or other indexes that measure inflation.
- Recruitment and retention problems which exist for individual state classifications.
- Cost-of-living increases granted by the state to other programs where a major share of the funding is used for salaries of local government employees.

Non-negotiated Increases. The DPA will be responsible for adjusting salaries of management, supervisory, and confidential employees as well as employees in units not represented by exclusive bargaining agents. Criteria which might be used by the Legislature for evaluating these proposals would be similar to those used to evaluate negotiated increases. For confidential employees and nonrepresented employees, an additional criterion would be the level of increases received by represented employees in comparable classes. For management and supervisory employees, an additional criterion might be the amount of increase required to maintain the same average percentage differential between their salaries and the salaries of the employees they supervise.

The information needed by the Legislature for evaluating compensation increase proposals will depend on which criteria the Legislature chooses to apply. Submission of this information to the Legislature in time to allow adequate review and evaluation is critical if the employee compensation proposals are to be coordinated with the 1982–83 Budget.

In order for the Legislature to have a basis for (a) evaluating negotiated increases for employees covered by collective negotiations and (b) determining appropriate increases for other state employees, *we recommend that the Department of Personnel Administration provide the following information to the Legislature by May 15 relative to each MOU or other proposed increase:*

A. *The projected percentage difference, as of the following July 1, between salaries of major state occupation groups and salaries paid in comparable nonstate employment. (In the case of managers and supervisors who are exempt from collective bargaining, the information should indicate the average percentage difference which would result between salaries of supervisors and managers and the salaries of those they supervise, assuming that all MOU's and proposed compensation increases are approved by the Legislature.)*

B. *The nature and extent of any significant recruitment and retention problems.*

Other Data

Another problem the Legislature will face will be evaluating one MOU against another. For instance, one unit may bargain for lower salary increases in favor of higher benefits or better working conditions, while another unit may bargain for higher salary increases with lower benefits. Some of the employee benefit provisions, such as retirement benefit changes, could have a significant future cost impact without affecting budget year costs.

To assist the Legislature in evaluating the total compensation package provided by each MOU, *we recommend that each MOU, or other proposed increase submitted to the Legislature be accompanied by information indicating the total cost expressed in terms of a percentage salary* *increase. This information should include long-range cost estimates for changes, such as increased retirement benefits, which would have a deferred cost impact.*

Problem No. 3 The Need for Reliable and Coordinated Cost Estimates

In order to determine the total amount of funds required for employee compensation and other employment related costs, the Legislature will need reliable and comprehensive cost estimates for each of the MOU's and other compensation proposals. Because the Legislature will be receiving numerous proposals from various sources (for example, the DPA, CSU, UC, and Hastings College of Law), it may be difficult for the Legislature to assess the accuracy and reliability of these estimates.

As noted above, MOU's also can have a substantial cost impact in ways other than straight-forward increases in salaries and benefits. For example, changes in work shifts, the definition of "overtime," productivity standards, and frequency of payments to state employees can have significant cost implications. As we noted earlier, (a) specific approval by the Legislature is needed to implement MOU provisions which require the expenditure of funds and (b) *virtually all conditions of employment are subject to negotiation.*

The reliability of the cost estimates for individual MOU's is particularly important for changes in benefits and working conditions because these costs are more difficult to estimate than salary increases. For instance, a proposal to add a new state holiday would add additional state costs for two reasons. First, there would be additional overtime relating to the staffing of functions that require 24-hour coverage, such as the state hospitals. Second, there would be a loss in productivity for those employees who are not replaced because they work one less day a year. The loss in productive time is difficult to measure objectively, and could result in a substantial variance in estimates between, say, DPA and CSU.

The Legislature needs to assure itself that the cost estimates submitted by the administration are complete, accurate and reliable. These estimates should be reviewed and coordinated by one central agency before being transmitted to the Legislature. The Department of Finance would be the logical agency to do this because it is designated by statute as having general supervisory responsibilities over all fiscal affairs of the state. Therefore, *we recommend that:*

(a) *The Department of Finance submit to the Legislature by May 15, 1982 a comprehensive cost summary of proposed and negotiated changes in compensation and working conditions for all civil service and related employees and employees of the UC and CSU. The summary should include long-range cost estimates for changes in benefits and working conditions, such as increased retirement benefits, which would have a deferred cost impact.*

(b) *The Department of Finance, in future years, include such a summary in the Governor's Budget.*

Problem No. 4: The Need to Treat Various Categories of Employees Equitably

Collective bargaining will make it more difficult to provide compensation increases in a consistent manner among the various classes and categories of state employees for the following reasons:

- Compensation increases contained in MOU's for the various bargaining units will be negotiated independently of one another.
- MOU's probably will be submitted to the Legislature at separate times.

- The magnitude of increases negotiated or proposed for nonfaculty employees of the UC and the *same classes* of nonfaculty employees at the CSU may differ significantly from one another and both may differ from increases negotiated for the same classes of civil service employees. Thus, it is possible that senior stenographers, for example, could be paid at different rates by the UC, CSU and the various state agencies.
- The magnitude of increases (a) negotiated for UC faculty employees in different units and (b) proposed for such employees who choose not to be covered under collective bargaining may differ significantly from one another.
- Disproportionate differences may result between (a) increases negotiated for represented employees and (b) increases proposed for the managers and supervisors to whom they report.

To enable the Legislature to act on negotiated and proposed increases in a consistent manner so that the various categories of employees are treated as equitably as possible, *we recommend that:*

A. *The administration submit to the Legislature a comprehensive summary showing the nature and amount of compensation increases negotiated or proposed for all categories of employees. Information on different units containing the same or similar classes of employees (UC faculty employees, for example) should be grouped together for comparative purposes.*

B. *The Legislature consider and act at one time on all compensation increases negotiated and proposed for all categories of employees.*

Problem No. 5: Need to Incorporate Employee Salary Provisions into the Budget Without Delaying the Budget Process

There are two main ways collective bargaining could delay the budget process:

- *Late submission of MOU's for consideration by the Legislature* due to the negotiating parties' failure to (a) commence negotiations sufficiently in advance of the budget hearing process, or (b) complete negotiations in a timely manner.
- *Negotiated increases might cost more than the amount the Legislature is willing to authorize.* It is important to note that MOU's submitted under the HEERA which are not approved by the Legislature must be returned to the parties for further meeting and conferring. The SEERA, however, is silent as to what the Legislature's options are with respect to MOU's it does not approve.

Under the HEERA, the Speaker of the Assembly and the Senate Rules Committee are each authorized to appoint a representative to attend negotiation sessions of the CSU. The SEERA, however, contains no similar provisions for such communication links between the Governor's negotiators and the Legislature.

In order to prevent collective bargaining from delaying enactment of the budget, we recommend that:

A. *The DPA, UC and CSU submit to the Legislature by May 15, 1982 all MOU's and other proposals for compensation increases for 1982–83.* This will provide time for the Legislature to consider and act on such proposed increases for 1982–83 as part of the regular budget process.

B. *Legislation be adopted to require that all MOU's and other proposals* *for compensation increases in future years be submitted to the Legislature by January 10, along with the Governor's budget. (Proposed compensation increases also should be submitted in situations where impasses have not been resolved.)* This would allow the amount of funds required to implement all employee compensation increases negotiated or proposed by the executive branch to be included in the Governor's Budget. This will enable the Legislature, in future years, to consider and act on employee compensation increases in the regular budget process.

C. *Legislation be adopted amending the SEERA and HEERA to designate November 15 as the date by which an impasse will be deemed to have been reached if the parties have not completed their negotiations.* This will give mediators and factfinders until early January to effect resolution of impasses and allow funding for the negotiated increases to be included in the Governor's Budget. (In order to *ensure* that impasses are resolved, the Legislature may want to adopt legislation to modify the SEERA and HEERA to provide for a final, binding arbitration procedure, whereby the last position proposed by either of the two parties is selected.)

D. *Legislation be adopted amending the SEERA to authorize the Speaker of the Assembly and the Senate Rules Committee to each appoint a representative to attend negotiation sessions relative to civil service and related employees.* This would allow for communication links between the Governor's negotiators and the Legislature, thereby increasing the likelihood that the types and amounts of increases negotiated would be within limits acceptable to the Legislature.

E. *Legislation be adopted amending the SEERA and HEERA to provide that if the Legislature disapproves an MOU because of the amount of funds required, it designate the amount of funds to be provided and return the MOU to the parties for meeting and conferring as to how the funds are to be allocated.* This will enable the Legislature to determine the amount of funds to be appropriated for compensation increases without interfering with the bilateral negotiations on how the funds are to be allocated. It will also avoid delaying completion of the final budget.

Problem No. 6. The Danger that the Negotiating Parties will Attempt to Circumvent the Collective Bargaining Process by Sponsoring Special Legislation

Collective bargaining considerations will be a primary concern for those legislative staff who prepare analyses of proposed legislation and budget requests for the various committees. Under the new collective bargaining policy, the Legislature has delegated the responsibility for determining "salaries, wages, working conditions, and other terms and conditions of employment" to the Governor and the two state university systems and appropriate employee organizations. Under the HEERA, the Legislature has retained the right only to approve or disapprove provisions of MOU's which require funding or statutory modifications.

It is likely that some of the parties involved in the meet and confer process will attempt to circumvent the collective bargaining process by sponsoring legislation which would *unilaterally* change provisions relative to employee wages, benefits, and working conditions.

The fiscal implications of granting some employee benefits through the collective bargaining process, and at the same time granting or taking away other benefits through the legislative process could be significant. This might make it difficult for the Legislature to evaluate the costs of salary and benefit improvements granted each year. Moreover, legislative proposals which unilaterally change employee wages, benefits, and working conditions could have the effect of undermining the collective negotiations process.