

## **Part Three**

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# **MAJOR FISCAL ISSUES FACING THE LEGISLATURE**

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*Revenue Issues*

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*Expenditure Issues*

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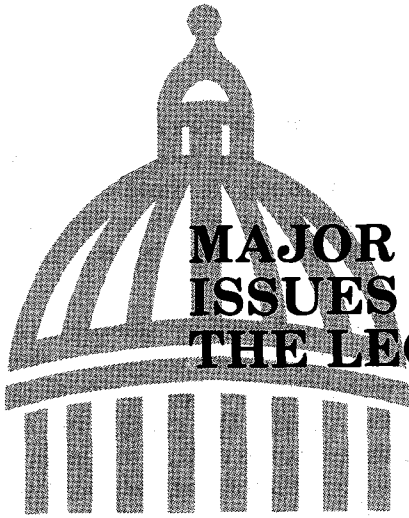
*Local Government*

*Finance Issues*

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*Legislative Control  
of the Budget*

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# MAJOR FISCAL ISSUES FACING THE LEGISLATURE

This part discusses some of the broader issues facing the Legislature in 1984. Many of these issues are closely linked to proposals contained in the Governor's Budget for 1984-85. Others are more long range in nature and will, in all probability, persist for many years beyond 1984. Even in these cases, however, legislative action during 1984 is desirable because the Legislature generally will have a wider range of options for addressing these issues in 1984 than it will have in subsequent years.

We have grouped the issues discussed in this part into four major sections.

***State Revenue Issues.*** The first section identifies issues related to state revenues. Specifically, we discuss options for increasing legislative oversight of *tax expenditures*—an increasingly significant portion of the state budget. We also discuss the *tax burden* in California, and analyze how the level of taxation in California compares with the levels in other states.

***State Expenditure Issues.*** The second section identifies issues related to state expenditures. Here, we discuss the allocation of funds for *cost-of-living adjustments*, the effect of the Governor's proposed *staffing reductions* on state programs and operations, the state's "rainy day" fund

which is formally known as the *reserve for economic uncertainties*, the proposed *realignment of state/county responsibilities* in four health and welfare areas, funding for benefits provided through the state's various *retirement systems*, and ways the Legislature can improve the effectiveness and coordination of the state's *hazardous substances* control programs.

**Local Government Finance Issues.** The third section identifies issues related to local government finance. In this section, we discuss the Governor's *local government finance proposal*. We also discuss the ways in which the Legislature can help counties control the rising costs of operating the *trial courts*. In addition, we discuss issues related to funding for *state-mandated local programs*, *community redevelopment projects*, and the new *supplemental property tax program*.

**Legislative Control of the Budget.** The fourth section identifies issues that involve the Legislature's ability to monitor and control state spending. One of these issues concerns the Legislature's role under those state laws that grant to state employees the right to bargain collectively over the terms and conditions of their employment. Other issues discussed in this section involve the availability, comprehensiveness and reliability of data on revenues and expenditures, and the effect of adverse court decisions on the state's General Fund.

In addition to the issues discussed in this part, a number of major policy and funding issues are discussed in the *Analysis*.

## ***Revenue Issues***

### **TAX EXPENDITURES**

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#### ***How Can The Legislature Ensure That its Priorities are Addressed by Tax Expenditure Programs?***

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This section examines ways in which the Legislature might improve its ability to review the state's multitude of tax expenditure programs. Annual review of the costs and benefits associated with tax expenditure programs is justified on the very same basis that annual review of direct expenditure programs is—namely, that these programs represent a commitment of state resources to achieve state objectives, and the priorities associated with these different objectives change over time.

#### **Tax Expenditures Defined**

The term tax expenditures refers to a number of tax exclusions, exemptions, preferential tax rates, credits, and deferrals, which reduce the amount of revenue collected from the state's basic tax structure.

The Legislature has enacted tax expenditure programs for a variety of reasons. First, tax expenditures provide taxpayers with *incentives* to alter their behavior in certain ways which further the goals of state policy in areas such as economic and industrial development, housing, transportation, energy and resources development, health and education. For example, the income tax deduction for mortgage interest is intended to encourage homeownership and promote the development of the housing industry. Tax credits for solar energy systems are designed to promote the growth of a new industry, reduce consumption of energy from traditional sources, and foster technological innovation. Tax expenditures also provide tax *relief or aid* to particular groups or classes of individuals, in order to further the goals of the state's social policies. For example, the sales tax exemption for prescription medicines is intended to lessen the financial burden on those who must purchase medication.

Because tax expenditures are described in terms of revenues *foregone*, some who oppose the use of the concept claim that it implies that all income belongs to the government, and that therefore all income *not* collected by the government is a tax expenditure. The problem with these critics' reasoning is that tax expenditures are not measured against a base of *all income*, but rather against the revenues which would have been collected under the basic system. Consequently, use of the term "tax expenditure" does not imply that "all income belongs to the government."

As instruments of state policy, tax expenditure programs differ from *direct* expenditure programs only in that they are "funded" through

provisions of the tax code instead of through the annual Budget Act. The "costs" of tax expenditure programs are measured in terms of revenue losses, instead of budget expenditures. The revenue losses associated with existing tax expenditure programs are sufficiently large to constitute a substantial portion of the state's total spending plan.

Table 57 compares direct expenditures with major tax expenditures for the period 1981-82 through 1983-84. The table shows that the "cost" of tax expenditures has risen 22 percent since 1981-82, while the cost of direct expenditure programs has risen 4 percent during the same period. The relatively low rate of growth in direct expenditures, of course, was a direct consequence of the recent recession and the devastating impact it had on revenues. As Table 57 indicates, tax expenditure programs in no way bore a comparable share of the burden imposed on the General Fund by the recession. Instead, these programs continued to grow—and grow rapidly—throughout the period.

**Table 57**  
**Major General Fund**  
**Tax Expenditure Costs and**  
**Direct Expenditure Costs**  
**1981-82 through 1983-84**  
**(in millions)**

	1981-82	1982-83	1983-84	Change 1981-82 to 1983-84	
				Amount	Percent
Tax expenditures:					
Personal income tax .....	\$4,600	\$5,443	\$5,732	\$1,132	24.6%
Sales and use tax .....	2,300	2,566	2,724	424	18.4
Bank and corporation tax .....	200	222	229	29	14.5
Totals .....	\$7,100	\$8,231	\$8,685 <sup>a</sup>	\$1,585	22.3%
Direct expenditures:					
General Fund .....	\$21,695	\$21,755	\$22,641	\$946	4.4%

<sup>a</sup> Source: 1983-84 Governor's Budget, adjusted for 1983 legislation.

### The Need for Legislative Oversight

Tax expenditure programs can be an appropriate means of accomplishing legislative objectives. In certain circumstances, they may even be superior to alternative direct expenditure programs because they are relatively simple to administer. Nevertheless, the Legislature needs to monitor these programs closely, for three major reasons.

First, *tax expenditures may not be effective in influencing taxpayer behavior*. This may be due to the fact that the incentive provided by certain tax expenditures is too small to make a difference or is overwhelmed by other incentives facing those whose behavior is intended to be influenced. For example, several sales and use tax exemptions have been established as a means of encouraging new businesses to locate or

stay in California. In many of these cases, however, other factors, such as access to markets, skilled labor, transportation, or raw materials, may be much more important to firms making location decisions than the relatively small amount of tax relief provided by a sales tax exemption.

Second, *compared to most direct expenditure programs, tax expenditure programs are relatively uncontrollable*. Once a tax expenditure has been established in law, expenditures—that is, revenue losses—occur automatically. Unlike direct expenditure programs, for which funds must be appropriated annually, tax expenditures are not subject to annual legislative review or approval. Also, tax expenditures resemble entitlement programs, in that there is no limit on the number of individuals who can claim a benefit or on the total amount of the “expenditure.” In short, once a tax expenditure is enacted, the Legislature—as a practical matter—loses control over the total amount of state resources devoted to the accomplishment of the particular objective. This makes it extremely difficult for the Legislature to alter the allocation of existing resources to reflect changing priorities, as may be particularly necessary during times of fiscal constraint.

Finally, *excessive use of tax expenditures may have an adverse impact on the tax system*. The proliferation of exemptions, credits, and exclusions is one of the primary reasons why taxpayers are confronted with such a complicated tax system. Adding another line or one more form to a tax return has little impact, but the cumulative burden carried by the tax system from all tax expenditures is heavy.

#### **Better Information is Prerequisite for the Review Process**

*We recommend that the Legislature enact legislation requiring the Department of Finance to present specific information on tax expenditures as part of the annual budget.*

Since 1975–76, the Department of Finance (DOF) has each year provided a brief presentation on tax expenditures in the budget’s introductory (or ‘A’) pages. This presentation has included background information and a fiscal summary of the major identifiable tax expenditures. Ch 575/76 requires the department, in odd-numbered years, to include a detailed analysis and set of recommendations regarding these “costs” in the Governor’s Budget.

The Governor’s Budget for 1983–84 included a review of changes in tax expenditure programs which either had been recommended by the department in prior tax expenditure reports or were recommended for termination in 1983 (the Solar and Energy Tax Credit programs). In addition, the budget proposed that the tax expenditure report requirement be discontinued, on the basis that the report did not have sufficient impact to warrant the effort that went into it. The Legislature did not consider

discontinuation of the report requirement.

In contrast to past years, the Governor's Budget for 1984-85 contains no information on the estimated cost of tax expenditure programs for the current and budget years. This is the first budget since 1975-76 in which the department has failed to provide the Legislature with any information on this subject.

In our judgment, information on tax expenditures is too important for the Legislature to do without. If anything, the Legislature's need for information on tax expenditures is greater today than it was in 1976 when the requirement for a biennial report was imposed on the department. As state and local resources are constrained by a sagging economy or voter-approved restraints on taxing powers, the Legislature finds it more difficult to maintain expenditures for what it deems high priority programs. In looking for ways to shore up funding for these programs, the Legislature needs a comprehensive picture of where funds are being spent and how effectively they are being used, regardless of whether the expenditures occur through the budget or through the tax code. Without information on the projected revenue loss from existing tax expenditure programs in the budget year, a substantial portion of the state's total spending plan is beyond the Legislature's effective review or control.

We conclude that the Legislature needs information on tax expenditures annually, not every other year. Moreover, to facilitate legislative review of tax expenditure programs, this information should include:

- ***A Comprehensive List of Tax Expenditures.*** The department's reports in the past have included only "major identifiable" tax expenditures, rather than a complete list of state tax expenditures. As a result, the listings have generally excluded those tax provisions for which the revenue loss may be significant but is difficult to estimate.
- ***More Detailed Information on Individual Categories of Tax Expenditures.*** Past tax expenditure reports have provided only fiscal estimates for aggregated categories of tax expenditures (for example, the revenue loss from mortgage and nonmortgage interest deductions combined) in a single year. In order to facilitate legislative review, the department should include, for each tax expenditure, at least the following: (1) the authorizing section of the Revenue and Taxation Code, (2) a brief description, (3) the sunset date, if any, and (4) the estimated annual revenue loss.
- ***Historical Information.*** The Governor's Budget for 1983-84 included, for the first time, a chronology of tax expenditures enacted and repealed since 1977. The department should continue to provide this type of information, in order to facilitate the Legislature's evaluation of changes to the tax expenditure budget.

Accordingly, we recommend that the Legislature enact the following

statutory language in the *companion* legislation to the Budget Bill:

"The Department of Finance shall provide an annual report to the Legislature on tax expenditures, including (1) a comprehensive list of tax expenditures, (2) additional detail on individual categories of tax expenditures, and (3) historical information on the enactment and repeal of tax expenditures."

#### **Procedural Options for Legislative Review and Oversight**

*We recommend that the Legislature consider establishing a formal process for review and oversight of tax expenditure programs.*

Despite the large volume of legislation on and the high level of interest in tax expenditure programs, the Legislature does not have a formal process for considering the level of resources devoted to these programs on an ongoing basis. Given that a substantial amount of resources are devoted to tax expenditure programs in order to achieve the Legislature's policy objectives, and that these resources would otherwise be available for direct expenditures or broad based tax relief, there is no reason why they should not receive the same oversight as direct expenditures.

If the Legislature wishes to establish a formal review process for tax expenditures, it could consider the following options:

- Establish a budget subcommittee in each house whose sole function would be to review tax expenditures.
- Delegate to the existing budget subcommittees the responsibility for reviewing tax expenditures falling within their jurisdiction, in conjunction with their review of the Governor's Budget. For example, the resources subcommittees would review solar energy tax credits, and the health and welfare subcommittees would review the medical expense deduction.
- Require the Governor to submit a "Tax Expenditure Budget" to the Legislature. This budget would identify all tax expenditure programs and center the Governor's recommendations on those that warrant special legislative review. This proposal is somewhat similar to AB 1894 (Bates), which has already passed the Assembly. That measure goes one step further and requires the Legislature to repeal or modify specific tax expenditures if the projected growth rate for all programs exceeds an allowable rate.
- Make tax expenditure control a part of the existing budgetary process. In Canada, for example, direct and tax expenditures relating to each program function are analyzed in the same light and subjected to the same spending limitations. Under this so-called "envelope system," budget subcommittees are constrained by a ceiling on the sum of direct and tax expenditures.

In our opinion, a formal legislative process for reviewing and overseeing

tax expenditure programs should be based on the ongoing need to evaluate whether these programs are meeting state objectives and legislative priorities.

### **An Agenda for Review is Critical**

*We recommend that the Legislature assign to the Legislative Analyst the ongoing responsibility to prepare in-depth reviews of selected tax expenditure programs.*

Whatever process the Legislature may choose to enact, it is clear that not all tax expenditure programs need annual review. Some programs, such as the income tax deduction for local property tax payments, are so widely applicable and so ingrained in the tax structure that they may need legislative attention on a relatively infrequent basis. Other tax expenditure programs, however, may warrant more frequent or more thorough review. In particular, legislative review should focus on tax expenditure programs which can be shown to:

- Provide windfall benefits to individuals or groups whose behavior is unaffected by the tax incentive,
- Work contrary to the objectives of other state programs or other tax expenditures, and
- Have less priority to the Legislature than they did when originally enacted.

***The 1983 Tax Expenditure Agenda.*** In 1983, the Legislature's fiscal committees considered 31 pieces of legislation affecting some 42 separate tax expenditure programs. Action on these bills resulted in increased state resources amounting to approximately \$174 million. The changes in tax expenditure programs made in 1983 reflect the Legislature's *overall* priorities for these programs, relative to direct spending programs, as well as the Legislature's priorities among different tax expenditure programs.

The Legislature's deliberations on tax expenditure priorities during the last session was greatly facilitated by the existence of an *agenda for reductions*. This agenda, which was offered by the Governor, sought to "free up" General Fund resources for other uses.

***Setting the Agenda After 1984.*** Information on the costs and benefits of individual tax expenditure programs should constitute the basis for legislative review of these programs on an annual basis, independent of the state's overall fiscal condition. Unfortunately, the Legislature currently does not have an ongoing procedure which establishes an agenda for reviewing tax expenditure programs at the outset of each legislative session, and provides information on those programs that appear on the agenda. Instead, the Legislature's agenda is usually a function of sunset dates attached to various programs when they are enacted. The number of programs with sunset dates, however, is relatively small, and these

programs may not necessarily be the ones that are most deserving of legislative scrutiny. We believe that the Legislature needs a more flexible procedure for establishing its agenda for reviewing tax expenditure programs, and for assuring that analysis of these programs is available to it on a timely basis.

In order to ensure that the Legislature has adequate and timely information on which to base a review of tax expenditure programs in future years, we recommend that the Legislature assign an ongoing responsibility for the preparation of in-depth reviews covering selected programs to the Legislative Analyst. The selection of items for review in the upcoming year could be determined annually in the course of the regular budget process, or left to the discretion of the Legislative Analyst. These reviews would be presented to the Legislature in December of each year. They would then be available to the Legislature during budget hearings regardless of the process it selects to review the programs.

## **THE LEVEL OF TAXATION IN CALIFORNIA**

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***Does the Legislature Need to Worry That the "Tax Burden" in California is "Too High" Relative to the Tax Burden in Other States, and Therefore a Threat to the Well-Being of the State's Economy and Its Citizens?***

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The level of taxes collected by California's state and local governments from individuals and businesses has been the subject of considerable discussion in recent years. Some have argued that California's taxes are high relative to other states and that, because of this, the state's business climate, and therefore its economic performance, have suffered. Recent ballot initiatives calling for tax reductions have been defended, in part, on the basis that California's taxes are "too high." These initiatives have provided for reductions in local property taxes (Proposition 13, approved in June 1978), reductions in state income tax rates (Proposition 9, defeated in June 1980), full indexing of the income tax (Proposition 7, approved in June 1983), and elimination of inheritance and gift taxation (Propositions 5 and 6, approved in June 1982).

The discussion below presents an overview of tax levels in California, focusing on four main questions:

1. What is the level of taxes collected by California's state and local governments, and how does this level compare to those imposed by other states?
2. How has the level of taxes in California changed over time?
3. What are the major tax relief programs that have caused the level of taxes in California to drop in recent years?

4. What are the economic implications of California's tax burden and of interstate differences in tax levels?

### 1. Tax Levels in California and the Nation

Table 58 shows the amount of taxes collected by state and local governments in California and in the nation as a whole in 1982-83. The table indicates that in 1982-83:

- State and local government tax collections in California amounted to nearly \$33.6 billion. Of this amount, nearly \$22.3 billion (66 percent) represented state taxes and \$11.3 billion (34 percent) represented local taxes.
- Taxes per capita in California were \$1,358, including \$901 in state taxes and \$457 in local taxes. By comparison, state and local taxes per capita for the nation as a whole were \$1,226, including \$738 in state taxes and \$487 in local taxes.
- Taxes per \$1,000 of personal income in California, were \$108, including \$72 in state taxes and \$36 in local taxes. By comparison, state and local taxes per \$1,000 of personal income nationally were \$110, including \$66 in state taxes and \$44 in local taxes.

**Table 58**  
**Comparative Data on State and Local Tax Collections in 1982-83<sup>a</sup>**  
**California and the Nation as a Whole**

	<i>State Government Tax Collections</i>	<i>Local Government Tax Collections</i>	<i>Combined State and Local Government Tax Collections</i>
<b>A. Amount of Taxes Collected</b>			
1. California (millions) .....	\$22,265	\$11,300	\$33,565
2. All states (millions) .....	170,936	112,830	283,766
<b>B. Taxes Per Capita</b>			
1. California .....	\$901	\$457	\$1,358
2. All states .....	738	487	1,226
<b>C. Taxes Per \$1,000 Personal Income</b>			
1. California .....	\$72	\$36	\$108
2. All states .....	66	44	110
<b>D. California's Tax Rank Relative to Other States<sup>b</sup></b>			
1. Amount of taxes .....	1st	2nd	2nd
2. Taxes per capita			
—Measure 1 .....	9th	22nd	11th
—Measure 2 .....	9th	19th	10th
3. Taxes per \$1,000 personal income			
—Measure 1 .....	21st	32nd	23rd
—Measure 2 .....	21st	29th	21st

<sup>a</sup> Figures based on data from various publications of the U.S. Department of Commerce, Bureau of the Census. Details may not add to totals due to rounding.

<sup>b</sup> Rankings reflect estimates by Legislative Analyst's Office of 1982-83 local tax collections, based upon preliminary U.S. Department of Commerce information for selected tax levies. Measure 1 assumes that 1982-83 local tax collections for individual states equal the same percentage of their respective state tax collections as in 1981-82. Measure 2 assumes that 1982-83 preliminary property tax collections estimates for major population areas in individual states are the same proportion relative to their respective statewide local tax collections as in 1981-82.

Table 58 also shows that California ranked first in the dollar amount of state tax collections, and second (to New York) in both local tax collections and combined state and local tax collections. This high ranking, for the most part, reflects California's population and income base, both of which are the largest in the nation. When interstate differences in population and personal income are adjusted for, California's tax ranking is much lower. Specifically, Table 58 shows that:

- In terms of *taxes per \$1,000 of personal income*—which we believe is probably the best single broad measure to use in making interstate tax level comparisons (because it partially compensates for interstate differences in such factors as income levels and living standards)—California ranked only 21st for state taxes, between 29th and 32nd for local taxes, and between 21st and 23rd for combined state and local taxes.
- In terms of *taxes per capita*, California ranked 9th for state taxes, between 19th and 22nd for local taxes, and either 10th or 11th for combined state and local taxes.

Given these rankings, California's overall tax level does not appear to be unusually high relative to many other states. It is true that the state-local tax *mix* in California differs somewhat from the nation's—66 percent of all California collections represent state taxes, compared to only 60 percent nationally (prior to Proposition 13, state taxes were relatively *less* important in California than they were nationally). Nevertheless, California's share of total state and local taxes (11.8 percent) was actually below its share of total national personal income (12.8 percent) in 1982–83. Furthermore, the dollar differences separating California from some of the states ranked lower in terms of tax burden are not all that great. For example, the state's ranking in terms of total taxes per \$1,000 of personal income would drop from the low 20's to 30th with only a \$4 (3.7 percent) decline in this measure of tax burden. Thus, it would appear that the current level of taxes in California relative to the levels in other states can be best characterized as "relatively moderate."

This characterization is supported by a recent study of state tax burdens (see *1981 Tax Capacity of the Fifty States, September 1983*) conducted by the Advisory Commission on Intergovernmental Relations (ACIR). The approach which ACIR used to measure tax burdens was to first develop an index of relative *tax capacity* for each state, which measures the amount of taxes per capita which would be raised in each state if a nationally uniform set of tax rates for 26 commonly-used state and local taxes were applied to the various components of each state's tax base. The commission then developed an index of relative *tax effort* for each state, which measures each state's actual tax collections relative to its tax capacity.

The ACIR study found that while California's relative *tax capacity* ranked 8th and was 15 percent above the national average, its relative *tax effort* ranked only 19th and equalled the national average. Thus, the ACIR's findings are consistent with the view that California's tax burden is "middle-of-the road." The ACIR study also reported that California was one of only 15 states whose tax effort index fell between 1977 and 1981, and the magnitude of California's tax effort decline (14 percent) was the second largest of any state.

**Table 59**  
**Historical Trends in State and Local Government Tax Burdens**  
**1972-73 through 1982-83**

**A. "Real" Taxes Per Capita <sup>a</sup>**

Fiscal Year	<i>Total State and Local Taxes</i>		<i>State Taxes</i>		<i>Local Taxes</i>	
	<i>California</i>	<i>All States</i>	<i>California</i>	<i>All States</i>	<i>California</i>	<i>All States</i>
1972-73 .....	\$740	\$579	\$356	\$325	\$384	\$253
1973-74 .....	706	571	353	324	353	247
1974-75 .....	723	552	376	313	347	239
1975-76 .....	742	560	385	319	357	241
1976-77 .....	785	584	415	336	371	248
1977-78 .....	823	593	452	347	372	246
1978-79 .....	653	574	444	349	208	225
1979-80 .....	675	563	471	346	204	218
1980-81 .....	648	556	446	340	203	215
1981-82 .....	643	556	432	340	211	217
1982-83 .....	610 <sup>b</sup>	551	405	332	205 <sup>b</sup>	219

**B. Taxes Per \$1,000 of Personal Income**

Fiscal Year	<i>Total State and Local Taxes</i>		<i>State Taxes</i>		<i>Local Taxes</i>	
	<i>California</i>	<i>All States</i>	<i>California</i>	<i>All States</i>	<i>California</i>	<i>All States</i>
1972-73 .....	\$146	\$128	\$70	\$72	\$76	\$56
1973-74 .....	139	123	70	70	69	53
1974-75 .....	144	122	75	69	69	53
1975-76 .....	147	125	76	71	71	54
1976-77 .....	152	127	80	73	72	54
1977-78 .....	156	126	85	74	70	52
1978-79 .....	120	119	82	72	38	47
1979-80 .....	121	115	84	71	37	44
1980-81 .....	115	113	79	69	36	44
1981-82 .....	111	110	75	67	37	43
1982-83 .....	108 <sup>b</sup>	110	72	66	36 <sup>b</sup>	44

<sup>a</sup> Per capita taxes adjusted for inflation, using the U.S. State and Local Government GNP Deflator and measured in 1972-73 dollars.

<sup>b</sup> Legislative Analyst's Office estimate.

**2. Changes in Tax Levels Over Time**

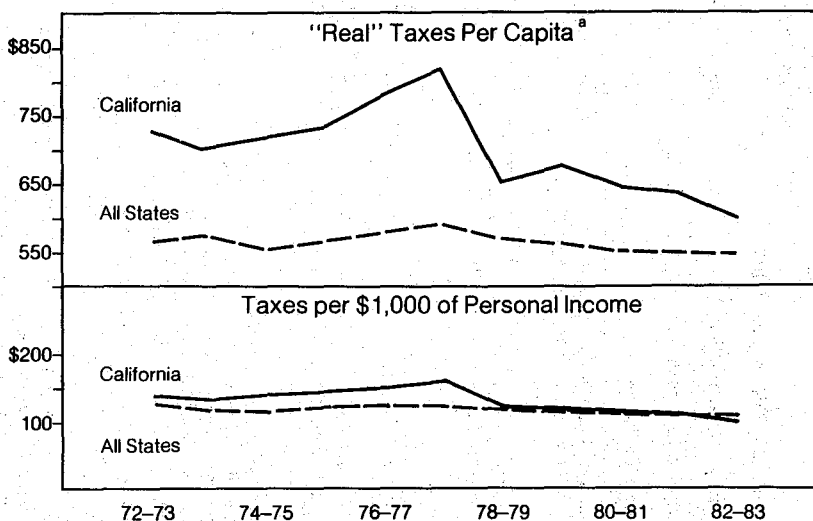
Table 59 and Chart 22 show what the trends in tax collections were during the 1972-73 through 1982-83 period, both for California and for all

state and local tax collections nationally. Two alternative tax measures are presented to illustrate these trends—taxes per \$1,000 of personal income, and “real” (that is, inflation adjusted) taxes per capita. As shown in the table and chart, state taxes and combined state-local taxes in California rose from 1973–74 through 1977–78 regardless of which measure is used to indicate the tax burden. The rise, moreover, was considerably sharper than the rise in state and state-local taxes nationally.

Beginning in 1978, however, a number of tax-reducing measures were implemented in California, including a one-time personal income tax cut in 1978, income tax indexing, reductions in and eventually repeal of the inheritance and gift taxes, and, of course, property tax reductions. As a result, taxes per capita and per \$1,000 of personal income fell in 1978–79 at both the state level and for California’s local governments. By 1982–83, the tax burdens within the state had fallen even lower. Although tax burdens for the nation as a whole also fell during the past 5 years, the drop in California was relatively greater. As a consequence, California’s tax ranking has improved (that is, dropped back from the high end of the spectrum) in recent years.

**Chart 22**

**Historical Trends in State and Local Government Tax Burdens  
1972–73 through 1982–83**



<sup>a</sup> Per capita taxes adjusted for inflation, measured in 1972–73 dollars.

**Table 60**  
**State and Local Tax Relief Benefits**  
**1977-78 Through 1984-85**  
**(in millions) <sup>a</sup>**

	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	Totals
<b>A. Tax Relief Measures Adopted Prior to June 6, 1978</b>									
1. <i>Local Relief</i>									
Homeowner's Property Tax Exemption.....	\$759	\$337	\$328	\$334	\$335	\$334	\$334	\$335	\$3,096
Senior Citizen's Property Tax Relief.....	98	78	74	73	68	59	52	48	550
Inventory Property Tax Exemption <sup>b</sup> .....	418	211	224	288	292	292	284	282	2,291
2. <i>State Relief</i>									
Low Income Income Tax Credit .....	23	25	15	5	2	1	1	1	73
Renter's Tax Credit.....	127	134	155	152	160	166	174	174	1,242
Subtotal, Measures Adopted Prior to June 6, 1978 .....	\$1,425	\$785	\$796	\$852	\$857	\$852	\$845	\$840	\$7,252
<b>B. Tax Relief Measures Adopted On or After June 6, 1978</b>									
1. <i>Local Relief</i>									
Proposition 13 .....	—	\$6,600	\$7,300	\$8,200	\$9,000	\$9,700	\$11,000	\$11,800	\$63,600
Inventory Property Tax Exemption <sup>b</sup> .....	—	—	—	209	219	225	218	220	1,091
Senior Citizen's Property Tax and Renter's Relief .....	—	—	—	—	—	—	—	2	2
2. <i>State Relief</i>									
Personal Income Tax:									
—Indexing .....	—	\$260	\$688	\$1,826	\$2,323	\$3,035	\$3,012	\$3,880	\$15,024
—One-time 1978 Credit .....	—	720	—	—	—	—	—	—	720
—Elderly Tax Credit.....	—	8	8	8	8	8	8	10	58
—Sale of Home Exemption.....	—	25	25	25	25	25	25	25	175
Subtotal, Personal Income Tax .....	—	\$1,013	\$721	\$1,859	\$2,356	\$3,068	\$3,045	\$3,915	\$15,977
Renter's Tax Credit.....	—	—	\$203	\$253	\$265	\$256	\$257	\$273	\$1,507
All other:									
—Unitary Treatment of In-state Businesses .....	—	—	—	14	16	18	20	68	136
—Inheritance and Gift Tax Phase-out .....	—	—	9	7	109	348	680	842	1,995
—Disability Insurance Provisions.....	—	—	354	48	9	1	1	1	414
—Unemployment Insurance Provisions .....	—	—	—	—	—	330	540	540	1,410
Subtotal, All Other.....	—	—	\$363	\$69	\$134	\$697	\$1,241	\$1,451	\$3,955
Subtotal, Measures Adopted On or After June 6, 1978.....	—	\$7,613	\$8,587	\$10,590	\$11,974	\$13,946	\$15,761	\$17,661	\$86,132
Totals <sup>c</sup> .....	\$1,425	\$8,398	\$9,383	\$11,442	\$12,831	\$14,798	\$16,606	\$18,501	\$93,384

<sup>a</sup> Estimates by Legislative Analyst's Office and California Department of Finance.

<sup>b</sup> Offset by increase in bank and corporation tax.

<sup>c</sup> Totals reflect the sum of individual program costs; however, the cost of individual programs may be affected by changes in other programs. For example, enactment of Proposition 13 reduced the cost of homeowner's property tax relief by reducing the property tax rate.

### 3. Tax Relief Measures

Table 60 shows the major tax relief measures which have been implemented in recent years and which are responsible for the decline in California's combined state and local tax burden. The table shows that from 1978-79 through 1982-83, the cumulative value of these measures totaled \$52.7 billion, including \$13.9 billion in 1982-83 alone. The single largest tax relief measure has been Proposition 13, accounting for a local property tax reduction of \$9.7 billion in 1982-83 and \$40.8 billion over the entire five-year period.

Table 60 also shows that the cost of California's Proposition 13-era tax relief programs will total an estimated \$15.8 billion in the current year and \$17.7 billion in the budget year. Thus, total tax relief provided from June 6, 1978 through 1984-85 is projected to reach \$86.1 billion. Of this amount, \$64.7 billion (75 percent) represents local tax relief.

### 4. Implications of Interstate Differentials in Tax Burdens

Although the tax burden data presented above provide a useful picture of the *level* of taxation in California relative to levels in other states, these data do *not*, contrary to what is often claimed, necessarily imply anything about the social and economic well-being of a state's residents and its economy. In drawing conclusions from the data, the following should be kept in mind.

- A state's ranking in terms of per capita taxes or taxes as a percent of personal income does *not* necessarily say anything about the relative well-being of taxpayers in that state. This is because such rankings do not compare the quality of the public services in different states which are paid for by taxes. Thus, it is possible that taxpayers in a state which ranks very high in terms of taxes collected could be much better off than taxpayers in other states *if* their tax payments provide high-quality public services like roads, schools, and sanitation facilities which they value very highly. What *is* important is that a state's citizens receive whatever amount of public services they are willing to pay for, and that these services are provided as efficiently as possible.
- Tax burden measurements and rankings also obscure important differences between states in the relative tax treatment of different taxpayers, such as individuals versus businesses and high-income taxpayers versus low-income taxpayers. California personal income taxpayers at different income levels, for example, fare very differently when compared to comparable taxpayers in other states. According to one recent analysis, estimated California personal income taxes for a family of four in 1983 rank 38th among all states when income is \$15,000, 34th when income is \$25,000, and 26th when income is \$50,000. This variation occurs because California's personal income tax

structure has a fairly high income threshold which must be reached before *any* tax liability is due, and a highly progressive marginal tax rate structure thereafter.

- Most business location studies have not been able to provide any solid quantitative evidence that interstate tax levels per se are a significant determinant of business locational decisions. State and local tax levels can influence locational choices if interstate differences in other important determinants of business location are absent. Normally, however, this is not the case, and as a result, business locational decisions depend primarily on factors such as proximity to output markets, resource costs and availability, labor costs, and transportation requirements.

Given the above, care should be taken when drawing conclusions from tax collections measures and tax rankings regarding the effects of interstate differences in tax burdens on the relative well-being of taxpayers and on the general health of a state's economy.

## ***Expenditure Issues***

### **COST-OF-LIVING ADJUSTMENTS (COLAs)**

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#### ***How Should the Legislature Budget for Cost-of-Living and Inflation Adjustments?***

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Each year, the Governor's Budget typically includes funds for various cost-of-living adjustments, commonly referred to as COLAs. These adjustments generally have a common objective: to compensate for the effects of inflation on the purchasing power of the previous year's funding level.

#### **Discretionary and Statutory COLAs**

Existing law authorizes *automatic* COLAs for 20 different programs, most of them in the health, education and welfare areas. These adjustments generally are referred to as statutory COLAs. Many other local assistance programs traditionally have received COLAs on a *discretionary* (or nonstatutory) basis, through the budget process.

In 1984-85, statutory COLAs will range from 2 percent (Medi-Cal long-term care facilities) to 10 percent (Medi-Cal noncontract hospitals). Those statutory COLAs with the largest costs are for K-12 apportionments (\$456 million), SSI/SSP grants (\$97 million) and AFDC grants (\$90 million). If fully funded, statutory COLAs would increase current General Fund expenditures by \$884 million in 1984-85.

#### **Governor's Budget Proposal**

The budget proposes a total of \$1,020 million from the General Fund for COLAs in 1984-85, including \$428 million for statutory COLAs and \$592 million for discretionary COLAs, including price adjustments for state operating expenses, as shown in Table 61. The amount requested for statutory COLAs is \$456 million, or 52 percent, less than what would be needed to provide full increases for all programs with statutory COLAs.

Table 61 shows that only 5 of the 20 statutory COLAs are fully funded in the Governor's Budget. These include four components of the Medi-Cal program (noncontract hospitals; prepaid health plans and related nonhospital services; long-term care facilities; and drug ingredients) and the portion of the state's contribution to the State Teachers' Retirement System's unfunded liability that is adjusted annually by the change in California's Consumer Price Index. For the remaining 15 programs, the governor has sponsored provisions of SB 1379 and AB 2314 (the budget trailer bills) which would suspend the operation of statutory COLAs in 1984-85. In lieu of the statutory COLAs, the budget proposes a 2 percent increase for health and welfare programs and a 3 percent increase for K-12 education programs.

Two budget components would receive a discretionary COLA of approximately 10 percent—the Student Aid Commission’s Cal grants and state employee compensation. Specifically, the budget reflects a total increase of 10 percent for student aid award programs operated by the commission. In addition, the budget includes funds for salary increases and improved fringe benefits for all state employees. According to the budget, sufficient funds are requested to increase state employee compensation as follows:

- University of California (UC) faculty ..... 13%
- California State University (CSU) faculty ..... 10%
- Other state employees (including  
nonacademic employees of UC and CSU) ..... 10%

The budget does not request funds to provide COLAs for programs which traditionally have received discretionary COLAs. Specifically, as detailed in Table 61, no COLAs are proposed for the following four health and welfare programs: medically indigent services, Medi-Cal contract hospitals, Medi-Cal county administration, and welfare county administration. With regard to the county administration items, the Governor has proposed to reverse a three-year legislative policy aimed at limiting the cost of administering welfare and welfare-related programs. Specifically, the budget proposes that in lieu of a COLA for county administration in the budget year, \$17.7 million be provided from the General Fund to fund cost-of-living increases granted by *counties* in excess of the increases that the Legislature agreed to pay for in the last three budget acts. Of this amount, \$10.9 million is linked to administration of the AFDC program and \$6.8 million is linked to Medi-Cal. Generally, the Legislature sought to limit the state’s share of county-granted COLAs to an amount corresponding to the salary increase granted to state employees. Many counties granted salary increases well in excess of what the Legislature granted to state employees, and the budget proposes that the state pick-up a share of the costs attributable to the excess.

When the COLAs for county administration are included, the total amount proposed from the General Fund for COLAs in the budget year totals \$1,038 million, or 4.1 percent of proposed General Fund expenditures.

**Budgeting Errors.** As a result of technical budgeting errors, the budget proposes more than a 3 percent increase for the summer school and California Children’s Services programs, and less than a 2 percent increase for the In-Home Supportive Services and Primary Care Clinics programs. Moreover, our review indicates that the Governor’s county administration proposal is overbudgeted by \$1.6 million for Medi-Cal and underbudgeted by \$2.3 million for AFDC (a difference of \$700,000 which would have to be added to the budget if the Legislature decides to ap-

prove the Governor's proposal). Finally, the Governor proposes a \$1.2 million COLA for the *supplemental* summer school program that will begin initial operations in July 1984 and therefore has experienced no purchasing power losses that need to be compensated for in the budget year. We discuss these issues under the appropriate budget items in the *Analysis*.

**Table 61**  
**General Fund Cost-of-Living Increases**  
**1983-84 and 1984-85**  
**(dollars in thousands)**

Department/Program	1983-84		1984-85			
	Budgeted Percent Increase	1% Dollar Increase <sup>a</sup>	Statutory Percent Increase	Dollar Increase	Budget Percent Increase	Budget as Proposed
<b>HEALTH AND WELFARE</b>						
Alcohol and Drug Realignment Health Services	—	\$626	—	—	2.0%	\$1,252
County Health (AB 8) .....	0.53%	3,689	5.55%	\$20,475	2.0	7,378
Medically Indigent Services ....	3.0	4,774	—	—	—	—
Public Health .....	—	1,022	—	—	2.0	2,038
Medi-Cal						
Contract Hospitals .....	—	524	—	—	—	—
Noncontract Hospitals (in- cluding PHPs and RHF)	8.2	909	10.0	9,086	10.0	9,086
PHPs, CDS, and RHF (non- hospital services) .....	10.0	1,321	2.0 <sup>b</sup>	2,642	2.0	2,642
Long-Term Care Facilities, including state hospitals	1.9 <sup>c</sup>	4,273	2.0 <sup>d</sup>	8,546	2.0	8,546
Providers, all others .....	—	3,964	—	—	2.0	7,928
Beneficiary ("Spin-off") .....	4.0	2,347 <sup>e</sup>	5.5	14,041	2.0	5,396
Drug Ingredients .....	8.0	435	7.4	3,216	7.4	3,216
County Administration .....	—	580	—	—	—	—
Developmental Services						
Regional Centers .....	—	3,328	—	—	2.0	6,656
State Hospital Education Programs .....	—	42	—	—	2.0	85
Local Mental Health Programs ..	—	3,172	—	—	2.0	6,344
Social Services						
SSI/SSP .....	4.0 <sup>f</sup>	17,647	5.5	97,066	2.0	35,297
AFDC .....	4.0	16,362	5.5	89,861	2.0	32,723
IHSS—Statutory .....	4.0	170	5.5	912	2.0	326
IHSS—Nonstatutory .....	3.0	2,738	—	—	2.0	5,143 <sup>g</sup>
Community Care Licens- ing—Local Assistance	—	75	—	—	2.0	150
County Administration ....	—	1,291	—	—	—	—
Social Services—Other .....	—	1,902	—	—	2.0	3,804
Department of Rehabilitation ....	—	446	—	—	2.0	893
<b>YOUTH AUTHORITY</b>						
County Justice System .....	—	628	<sup>h</sup>	—	2.0	1,256
<b>EDUCATION</b>						
Apportionments:						
K-12—Districts .....	8.0	82,833	5.5	455,580	3.0	250,880
Meals for Needy Pupils .....	6.0	201	6.0	1,209	3.0	604
Summer School—Base .....	8.0	176	5.5	966	3.0	527
Summer School—Supplement	—	410	—	—	3.0	1,231
Apprentice Programs .....	6.0	41	—	—	3.0	123
Small School District Transpor- tation .....	6.0	186	—	—	3.0	557
Transportation .....	6.0	2,472	—	—	3.0	7,415

K-12—County Offices of Education .....	8.0	1,636	5.5	8,996	3.0	4,907
Regional Occupational Centers/Programs.....	6.0	1,650	—	—	3.0	4,949
Child Nutrition .....	6.0	268	4.1	1,099	3.0	804
American Indian Education Centers .....	6.0	8	—	—	3.0	24
Native American Indian Education .....	6.0	3	—	—	3.0	10
Child Care Program.....	6.0	2,313	—	—	3.0	6,939
Special Education .....	8.0	12,328	5.5	67,805	3.0	36,985
Staff Development .....	6.0	108	—	—	3.0	325
Preschool .....	6.0	322	—	—	3.0	965
Libraries .....	—	70	—	—	3.0	210
Meade Aid.....	6.0	96	—	—	3.0	289
Urban Impact Aid.....	6.0	615	—	—	3.0	1,844
Gifted and Talented.....	6.0	178	6.0	1,070	3.0	535
Instructional Materials (K-8) .....	—	590	3.3	1,948	3.0	1,769
Instructional Materials (9-12) .....	—	178	—	—	3.0	535
Demonstration Programs in Reading and Math .....	6.0	38	—	—	3.0	113
Educational Technology .....	6.0	12	—	—	3.0	35
Economic Impact Aid .....	6.0	1,820	—	—	3.0	5,461
Adult Education .....	6.0	1,627	6.0	9,761	3.0	4,881
Adults in Correctional Facilities .....	6.0	13	—	—	3.0	38
Foster Youth Services .....	6.0	8	—	—	3.0	23
School Improvement Program ..	6.0	1,725	—	—	3.0	5,174
Miller-Unruh Reading Program ..	6.0	172	—	—	3.0	515
Board of Governors, California Community Colleges						
Apportionments.....	—	14,119 <sup>i</sup>	5.7	77,828	j	9,961 <sup>j</sup>
Handicapped Student Services ..	3.0	219	—	—	3.0	656
EOPS .....	3.0	249	—	—	3.0	747
Student Aid Commission—						
Awards <sup>k</sup> .....	3.0	746	—	—	10.1	7,750
CSU-EOPS .....	—	69	—	—	3.0	207
ALL OTHERS						
State Contribution to STRS .....	—	2,097	5.5	11,523	5.5	11,523
Employee Compensation <sup>l</sup> .....	5.0 <sup>m</sup>	40,758	—	—	10.7	434,772
Civil Service and Related .....	—	(20,330)	—	—	(10.8)	(220,331)
University of California .....	—	(10,455)	—	—	(10.9)	(113,670)
California State University .....	—	(9,895)	—	—	(10.1)	(99,961)
Hastings College of Law .....	—	(78)	—	—	(10.4)	(810)
Price Adjustment (state support)	N/A	N/A	—	—	—	75,583 <sup>n</sup>
TOTALS .....	—	\$242,619	—	\$883,630	—	\$1,020,025

<sup>a</sup> Figures have been rounded.

<sup>b</sup> Rates will be based on actuarial studies.

<sup>c</sup> Composite increase consisting of 2.9 percent for skilled nursing facilities and 1.1 percent for all other.

<sup>d</sup> Rates will be set on basis of rate studies.

<sup>e</sup> Approximate. COLA cannot be determined simply on a 1 percent basis.

<sup>f</sup> Annualized increase over the year.

<sup>g</sup> We estimate that the proposed two percent COLA is underfunded by \$332,000 from the General Fund.

<sup>h</sup> Current law requires annual adjustment by same percentage given other local assistance programs receiving a discretionary COLA.

<sup>i</sup> One percent of revised 1983-84 base budget, per Ch 1xx/84 (AB 1xx).

<sup>j</sup> Due to enactment of Ch 1xx/84 (AB 1xx), proposed budget is no longer applicable.

<sup>k</sup> Reflects total increase in awards for all programs.

<sup>l</sup> Percentage increases reflect the level of salary and salary-driven benefits (such as social security) which could be provided by the budgeted amounts. Collective bargaining negotiations will determine final amounts.

<sup>m</sup> Total compensation package, including salary and benefits.

<sup>n</sup> Department of Finance planning estimates.

### **Purpose of COLAs**

Most discussions of COLAs typically focus only on those programs listed in Table 61. Generally, these COLAs are 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 service providers (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), and (2) student grant levels provided under the California State University Educational Opportunity Program.

### **"COLAs" for State Operations**

Any COLA discussion also should take account of COLA-type adjustments that are provided for the state operations portion of the budget.

Budget items which are classified as state operations can receive an adjustment to compensate for inflation using one of two methods. The first involves applying an across-the-board percentage increase to funding for operating expenses. This year a 6 percent increase in operating expenses was allowed by the Department of Finance. The second method involves providing specific percentage increases identified in the Department of General Services' Price Book for particular items of expense, and a fixed percentage increase for all other items that are not specifically identified (4 percent in 1984-85).

### **Need for a Consistent Policy in Awarding COLAs**

The practice of awarding COLAs to different programs has developed in a piecemeal, haphazard manner. The result is that there is no consistent policy—either in the executive branch or in the legislative branch—for deciding which programs get how much or for what purposes. Below we summarize some of the major inconsistencies in the ways in which COLAs currently are determined.

*There Is No Rationale for the Wide Variations in Statutory COLAs.* Statutory COLAs in 1984-85 range from a low of 2 percent to a high of 10 percent. This is due to differences in the base years and indices used in calculating the adjustment. For example, some statutory COLAs are tied to a particular inflation index, such as the U.S. or California Consumer Price Index. Most welfare programs use a specially constructed California Necessities Index (CNI). Other programs are provided statutorily speci-

fied increases, which may be based on such measures as the manufacturers' direct list prices (Medi-Cal drug ingredients) or administratively determined "reasonable cost" guidelines (work activity services administered by the Department of Rehabilitation).

In past issues of the *Analysis*, we have noted that, although some variation in COLAs was warranted, we could find no analytic justification for the wide variations in statutory adjustments that currently exist. As a result, we have recommended that the Legislature use the Gross National Product (GNP) personal consumption expenditures deflator and the GNP deflator for state and local government purchases as the bases for judging how inflation affects the purchasing power of private citizens and state and local governments, respectively. In addition, we concluded 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.

***There Is No Rationale for the Variation in Discretionary Local Assistance COLAs.*** The Governor's Budget includes discretionary COLAs of 2 percent for 11 health, welfare, and correctional programs and 3 percent adjustments for 24 education programs. If these adjustments have a common objective, as stated earlier, of compensating for the effects of inflation on the purchasing power of the previous year's funding level, we know of no analytical reason to provide different COLAs to these local assistance programs.

***Variations in COLAs Often Reflect Budget Accounting Concepts, Rather than Policy Considerations.*** The Governor's Budget for 1984-85 proposes that many of the programs categorized in the budget as local assistance receive either a 2 percent or 3 percent COLA, while programs categorized as state operations are recommended for a 6 percent (or larger) increase. Yet, there seems to be no analytic justification for awarding different increases to these two groups of state-funded programs. In most cases, the funding adjustment is proposed for the same purpose—that is, to maintain purchasing power at current-year levels. In addition, many spending items classified as local assistance are similar to state administrative activities, and some spending items classified as state operations actually are used to fund local programs. The result is that budgeting procedures, rather than policy considerations, determine which programs receive larger COLAs. Some examples of the haphazard treatment given by the budget to similar programs follow:

- The proposed budget for the *Department of Social Services* provides a 6 percent discretionary COLA for support of state-operated adoptions and community care licensing programs which are budgeted as state operations. Yet, the budget provides only a 2 percent COLA to the same programs operated by the counties on behalf of the state, which are budgeted as local assistance.

- The budget proposes a 2 percent COLA for *regional centers* for the developmentally disabled, which is categorized as a local assistance item. Regional center staff are used, in part, to review regional center client utilization of services. Staff in the Department of Health Services perform a similar utilization review function for *Medi-Cal* clients, yet the budget proposes that department staff receive a 10.7 percent COLA for employee compensation, and a price letter adjustment (maximum of 6 percent) for operating expenses, because these costs are classified as state operations.
- The Department of Health Services' budget proposes that *county health services* funded under the provisions of AB 8 and categorized as local assistance receive a 2 percent COLA. Yet, the funding proposed for health services which the state provides directly, under contract with small counties, includes a 10.7 percent increase for employee compensation and a price letter adjustment (maximum of 6 percent) for operating expenses, because it is categorized as state operations.

**County Administration COLA Proposal Raises Equity Questions.** As discussed earlier, the Governor proposes to fund COLAs provided by *counties* to their welfare department employees in excess of the percentage increases specified by the Legislature in the Budget Acts for 1981-82, 1982-83, and 1983-84. Our review of this proposal (please see *Analysis*, Item 4260-101-001 (Medi-Cal) and Item 5180-141-001 (AFDC) for a detailed discussion) indicates that it would reward counties that chose not to support the Legislature's efforts to limit costs and penalize counties that attempted in good faith, to keep their salary and benefit increases within the limit set by the Legislature. Specifically, the Governor's proposal would (1) provide *no* additional funds for a county that limited salary increases for its employees to the legislatively established percentage (generally, the percentage increase granted to state employees), and (2) fund a portion of the increase granted by another county that was as much as 23 percentage points larger than the legislatively established limit.

There is another drawback to the Governor's proposal beyond the differential treatment of counties. Approval of the proposal would place the state in the position of paying for salary increases to *county* employees that exceed—often greatly exceed—the increases provided to its own *state* employees.

## Conclusion

In order to ensure that the amounts of COLAs provided to individual programs are determined in a rational, equitable, and consistent manner that reflects the Legislature's priorities, we recommend that the Legislature establish at the outset of budget hearings a formal policy governing cost-of-living and inflation adjustments. This policy should call for the size of any COLAs awarded to be based on the extent to which a COLA is

needed to protect and maintain the purchasing power of a program or activity, after giving due recognition to the options available to the recipient for improving productivity or reducing costs. The Legislature will want to adjust this basic policy from time to time to reflect changing legislative priorities and program needs. *Any variations in the level of COLAs awarded to different programs, however, should reflect specific legislative objectives, rather than historical spending differences or how the program is categorized in the budget.*

## STATE WORKFORCE REDUCTION PROPOSAL

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### *What Effect Will the Governor's Proposed Staffing Reductions Have on State Programs and Activities? How Much Money Will it Save?*

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As discussed in detail in Part Two, the Governor's Budget proposes a state government workforce of 229,540 personnel-years in 1984-85. This is a reduction of 4,880 personnel-years from what the budget estimates the current-year level to be, and a reduction of 3,520 personnel-years from the staffing level reflected in the 1983 Budget Act. The budget indicates that following a strictly enforced hiring freeze, a management review has found that these personnel-years can be eliminated due to "increased efficiencies." This section analyzes the Governor's staffing reduction proposal in an effort to evaluate its effect on state operations and expenditures.

### Background

Since the passage of Proposition 13 in 1978, the state has operated under some type of hiring freeze almost continually, as shown in Table 62. Despite these restrictions, the state's workforce grew by 9,959 personnel-years between 1978-79 and 1982-83, the last year for which data on *actual* staffing levels are available. If the budget's estimate of the current-year staffing level is used, the increase in the state's workforce since 1978-79 is even larger—15,890. In other words, the budget indicates that there has been an *increase of 5,931 personnel-years* in the state's workforce since 1982-83 (which ended last June 30).

Table 62 shows that a hiring freeze in and of itself does not necessarily cause personnel-years to go down. For example, although hiring freezes were in effect during all of 1979-80 and 1980-81, the state's workforce actually grew by 1,663 personnel-years the first year and by 5,374 personnel-years the second year. Even in the current year, despite the freezes instituted by the administration, the workforce is estimated to be 2,026 personnel-years *larger* than what the *administration proposed* in the budget for 1983-84, and 5,931 personnel-years larger than what the workforce actually was in 1982-83. The increase in personnel-years shown for 1983-84 in the Governor's Budget represents the largest year-to-year increase, both in absolute and percentage terms, since Proposition 13.

**Table 62**  
**State Personnel-Years**  
**1977-78 through 1984-85**

	<i>Proposed in Governor's Budget</i>	<i>Actual</i>	<i>Difference Proposed/Actual</i>	<i>Change in Actual From Prior Year</i>	<i>Number of Hiring Freeze Months</i>
1977-78.....	215,796	221,251	5,455	—	—
1978-79.....	224,337	218,530	-5,807	-2,721	12
1979-80.....	218,619	220,193	1,574	1,663	12
1980-81.....	221,118	225,567	4,449	5,374	12
1981-82.....	226,743	228,813	2,070	3,246	4
1982-83.....	231,375	228,489	-2,886	-324	6
1983-84.....	232,394	234,420 <sup>a</sup>	2,026	5,931 <sup>a</sup>	12 <sup>b</sup>
1984-85.....	229,540 <sup>c</sup>	—	—	4,880 <sup>c</sup>	—

<sup>a</sup> Estimated.

<sup>b</sup> Beginning August 1, hiring limited to state layoff lists. Beginning January 31, departments can obtain freeze exemptions upon Department of Finance approval of a personnel management plan.

<sup>c</sup> Proposed.

There are a number of reasons why staffing levels can rise in the face of hiring freezes. For example, public safety, 24-hour care, and revenue raising activities usually are exempt from hiring freezes. In addition, exemptions from the freeze have often been allowed at the discretion of an agency secretary or the Department of Finance. This is not to suggest that such exemptions are inappropriate. In fact, quite the opposite is often true—staffing increases are needed to protect the public interest. What the trends shown in Table 62 do suggest is that the official policy toward staffing levels—for example, a hiring freeze—may not provide an accurate indication of what is happening “to the numbers”—that is, to the size of the workforce.

The reverse can also be true. A change “in the numbers” may not give an accurate indication of which direction state policy is actually heading, or what the implications are for state programs and expenditures. Such seems to be the case with respect to the staffing numbers contained in the Governor’s Budget, and what has been said about the meaning of these numbers.

In the balance of this section, we consider the claims made in the Governor’s Budget from five different perspectives:

1. What did the hiring freeze in 1982-83 accomplish?
2. How valid is the base against which the number of *personnel-years* proposed for 1984-85 is compared?
3. What changes in *positions* are proposed by the administration?

4. To what extent are personnel-year reductions the result of "increased efficiencies"?
5. How much has been saved as a result of the proposed reductions?

#### **What Did the Freeze in 1982-83 Accomplish?**

In the introductory ("A") pages to the 1984-85 Governor's Budget, the administration indicates that due to a strictly enforced freeze on new hiring, "approximately 6,700 personnel-years were vacant as of July 1983."

Our review indicates that no single state agency has comprehensive data on personnel-year savings attributable to the hiring freeze. This is because personnel data generally are kept for other purposes. Thus, although the State Controller's payroll-related data are extensive for most (but not all) state agencies and can identify the number of positions that did not receive a paycheck in June 1983, the data cannot identify *why* the positions were vacant. Similarly, although the State Personnel Board gathers statistics on state employees, not all employees are covered by these statistics nor are the data compiled on the basis of authorized positions.

***Freeze Savings Unclear.*** While the administration's premise is sound that the state should employ no more staff than it really needs, our analysis indicates that the amount of staff savings attributable to the freeze at the end of 1982-83 is very unclear.

Because data cannot be obtained from any single state agency indicating the savings from or vacancies that can be attributed to the hiring freeze, the Department of Finance had to make an estimate of these variables. It did so relying primarily on data from the State Controller's office, and adjusting the data for various factors.

We have been unable to replicate the department's methodology because the 1982-83 payroll data on which it was based were purged in the fall of 1983. Through discussions with the department, however, we have identified a key assumption made by the administration that we believe casts considerable doubt on the reliability of the department's estimate of freeze-related vacancies and savings. Specifically, the department assumed that *the number of state employees working in June 1983 represented the staffing level for the state as a whole throughout 1982-83.*

We question the validity of assuming that the number of positions vacant in June is representative of vacancies throughout the year. This is because departments may be forced to hold more positions open in the last month of the fiscal year than at other times, particularly in a tight budget year, in order to live within their budgeted levels.

Moreover, the department failed to compare its estimate of vacancies in June 1983 with the normal vacancy rate at the end of a fiscal year. Only this incremental amount—vacancies in excess of the normal vacancy fac-

tor—can properly be attributed to the administration's hiring freeze.

For these reasons, we question whether the state's hiring freeze actually resulted in 6,700 personnel-year vacancies at the end of 1982-83.

### **How Valid Is the Base Against Which the Number of Personnel-Years Proposed for 1984-85 Is Compared?**

The budget states that due to "increased efficiencies" the administration determined that 5,900 personnel-years could be abolished. The administration proposes to transfer 1,000 of these personnel-years to high priority programs (including prisons, highway patrol, and Caltrans), for a net savings of 4,880 personnel-years in 1984-85, compared to current-year staffing estimates. It is the basis for this comparison—the current-year staffing estimate—to which we now turn.

As noted earlier (and as Table 62 shows) when the *current-year* staffing level shown in the Governor's Budget is compared to the *actual* staffing level in 1982-83, we find the largest year-to-year *increase* since the voters approved Proposition 13—5,931 personnel-years. Our analysis indicates that an understanding of the 1983-84 staffing level estimated in the budget is crucial to understanding and evaluating the Governor's staffing proposal for the budget year.

Table 63 summarizes how the staffing levels for 1983-84 have changed since the Governor's Budget for that year was submitted to the Legislature in January 1983. It shows that *the administration has administratively established 2,213.2 new positions in the current year*. This is almost twice the number of positions eliminated from the 1983 Budget Act by gubernatorial vetoes. Because of increased salary savings, however, the net change between the budget as enacted and the revised midyear estimate is an increase of only 1,360.2 personnel-years.

**Table 63**  
**Changes in Personnel-Years for 1983-84, Between**  
**January 10, 1983 and January 10, 1984**

Governor's Budget (January 10, 1983) .....	232,393.7	
Staffing added by Finance Letters .....	+951.1	
Governor's Budget (revised) .....	233,344.8	
Legislative changes .....	+847.6	
Staffing included in Budget Bill, as passed by the Legislature .....	234,192.4	
Staffing vetoed by the Governor .....	-1,132.6	
Staffing included in 1983 Budget Act, as chaptered .....	233,059.8	
Positions added by the administration <i>after</i> the budget was chaptered ....		2,213.2
Increase in estimated salary savings .....		-853.0
Net personnel-years added by the administration <i>after</i> the budget was chaptered .....		(1,360.2)
Revised estimate of personnel-years (January 10, 1984) .....	234,420.0	

Thus, by significantly increasing the number of positions in the current

year (approximately 2,200 more than indicated in the 1983 Budget Act) the administration is able to take credit for "saving" positions that were never formally authorized by the Legislature. (We have not been able to resolve the apparent discrepancy between the administration's need to *add* significant numbers of staff in the current year after the budget was enacted and its proposal to reduce total staffing by 4,880 personnel-years in the budget year.)

#### What Changes in Positions Are Proposed for the Budget Year?

After examining how the base personnel level is adjusted, the next factor to consider is the changes in staffing levels that are proposed for 1984-85. To analyze these changes, two approaches can be followed. One looks at *positions*—what is happening to the number of "slots" (filled or unfilled) in state government? The other approach looks at *personnel-years*—how many years of staffing (filled positions) does the administration propose to "buy"?

While most of the data on the state's workforce is kept in terms of personnel-years, it is possible to estimate the change in positions proposed by the administration. To do this, we totaled the negative and positive position adjustments shown for each budget item in the Governor's Budget for 1984-85, *after* the adjustments which were made to the base and *before* salary savings were subtracted. Table 64 shows the results of these proposed changes. It indicates that rather than eliminating positions in the budget year, the budget actually proposes a net *increase of 588 positions*. (An unknown portion of the total positions added includes re-establishment of limited-term positions and continuation of administratively established positions.)

**Table 64**  
**Proposed Position Changes**  
**Negative and Positive Adjustments, Excluding**  
**Base Adjustments and Salary Savings**  
**1984-85**

	<i>Positive Adjustments</i>	<i>Negative Adjustments</i>	<i>Difference</i>
Legislative, Judicial, and Executive .....	381.0	-74.7	306.3
State and Consumer Services .....	286.0	-303.0	-17.0
Business, Transportation, and Housing.....	997.8	-1,367.1	-369.3
Resources .....	411.5	-527.2	-115.7
Health and Welfare.....	778.7	-2,105.6	-1,326.9
Youth and Adult Correctional Agency.....	2,889.9	-753.2	2,136.7
Education.....	726.3	-1,172.2	-445.9
Other.....	538.9	-119.3	419.6
Totals.....	7,010.1	-6,422.3	587.8

### **To What Extent Are the Proposed Personnel-Year Reductions the Result of "Increased Efficiencies"?**

Our analysis has found that while "increased efficiencies" will indeed enable the state to reduce staffing levels in 1984-85, the overwhelming majority of the reduction in personnel-years proposed by the administration for 1984-85 reflects other factors. Some of the more important of these factors are discussed below.

***Positions Administratively Established Inflate Savings.*** State regulations require that administratively established positions cannot be continued beyond the year in which they are established unless authorization to do so is given by the Legislature. Thus, to the extent any of the 2,213 positions that were established administratively in 1983-84 (see Table 63) are among the 4,880 *proposed* for elimination, the proposal is redundant. That is to say, these positions would have been eliminated anyway. For example, the Department of Transportation (Caltrans) administratively established 244 personnel-years in 1983-84 to supplement its highway design and engineering staff over the level authorized by the Legislature in the 1983 Budget Act. The Governor then reduced the department's 1984-85 baseline level of operations by 250 personnel-years, as part of his program to reduce the number of state employees. Our review indicates that the department's "savings" of 494 personnel-years in the budget year is in fact only a reduction of 250 personnel-years compared to legislatively authorized levels, the difference being, the positions added by the administration in the current year.

***Termination of Limited-Term Positions Not Due to Efficiencies.*** Similarly, when building the budget for 1984-85, the administration has to make adjustments for decreases in so-called "limited-term" positions that have been authorized by the Legislature for a specified length of time and are scheduled to expire at the end of the current year. Our analysis indicates that the number of authorized positions was reduced by approximately 600 between the current and budget years as a result of the expiration of limited-term positions in 1983-84. These positions, however, are counted by the administration as among the "savings" resulting from increased efficiencies. For example, the Department of Justice eliminated 81.5 limited-term positions because the project to automate the department's name index files will be finished at the end of the current year. Similarly, the Departments of Health Services, Mental Health, and Social Services combined eliminated 144.9 limited-term positions whose authority expires at the end of the current year.

***Salary Savings Inflated.*** As noted earlier, personnel-years are different from positions authorized by the Legislature in that the former reflect the time that positions are expected to be vacant, due to such factors as staff turnover and delays in hiring. The difference between positions and

personnel-years is known as "salary savings."

The administration estimates that 8,908.7 personnel-years will be saved as a result of position vacancies in the budget year. This is an increase of 1,177 personnel-years, or 15 percent, over estimated salary savings in 1983-84. This difference reflects an *increase* in the percentage of total positions that, on average, will be vacant during the year. Specifically, the administration expects this percentage to rise from 3.2 in 1983-84 to 3.7 in 1984-85.

Assuming that the state is no longer operating under a hiring freeze, it is unclear to us why the anticipated vacancy rate should be *higher* in the budget year. If the same salary savings rate used in 1983-84 were assumed for 1984-85, an estimated 7,613.4 personnel-years would be saved. Thus, 1,295.3 personnel-years of the 4,880 personnel-years to be eliminated are due to the assumed increase in *salary savings* in the budget year.

***Personnel Reductions in Individual Program Areas Are Explained by Other Factors.*** Our review of the position reductions claimed in specific program areas indicates that, in many cases, the reductions are due to factors other than "increased efficiencies." For example, of the proposed reductions in personnel-years,

- 919.6 are in the *Employment Development Department* (EDD). The majority of these reductions (863.7), however, are due to anticipated decreases in *workload* for unemployment insurance claims processing caused by the expected decline in the rate of unemployment. The other 55.9 personnel-years are eliminated due to the termination of the federal Comprehensive Employment and Training Act (CETA) program.
  - 442.7 are in the *Department of Motor Vehicles*. These reductions are due to increased automation, and were first identified in 1980 when the department's automation project began.
  - 147.3 are in the *Department of Education*. In part, these reductions reflect the implementation of an unallocated reduction made in the 1983 Budget Act.
  - 327.2 are in the *Prison Industries Authority*. This reduction is attributable to legislative action in Ch 956/83 (AB 436) which exempted this ongoing program from annual Budget Act appropriations. The positions are still there; they are just not counted in the totals for 1984-85.
  - 1,116 are in the *University of California*. The largest component of the decrease, 957 personnel-years, was made in the teaching hospitals. A large portion of these reductions, however, were anticipated two years ago when the Legislature enacted Medi-Cal reform legislation.
- Position Control Lacking.*** We note that 23 percent of the administration's total proposed savings in personnel-years occurs in the University of California. The state, however, does not have position control over the University. This means that the University is able to

make position adjustments on its own during the course of the year without the approval of the applicable control agencies, principally the Department of Finance. Thus, if the teaching hospitals decide that some or all of the 957 personnel-years to be eliminated are needed, and sufficient funds are available to support them, the hospitals would be able to reestablish these positions administratively. This is true not only of the teaching hospitals, but for the University as a whole. As a result, the savings reported for the University may be more of a hope than a certainty.

In summary, our analysis of the Governor's personnel-year reduction proposal indicates that the administration has taken credit for "increased efficiencies" that simply do not exist. Statewide totals mask many of the changes that would have occurred regardless of administrative actions, as well as the effect that the Governor's addition of positions in the current year has on "savings" in the budget year.

Our review indicates that from the time the budget is enacted to the time that final staffing level data are available, such wide variations occur as to make statewide personnel totals, particularly midyear estimates, almost meaningless. From the Legislature's perspective, this necessitates a function-by-function review to ascertain whether an adequate staffing complement is available to carry out the program priorities of the legislative branch.

#### **How Much Has Been Saved as a Result of the Proposed Reductions?**

The Governor's Budget indicates (Schedule 4) that net salary and wages (that is, adjusted for salary savings) for state employees will increase from \$5.7 billion in 1983-84 to \$6.2 billion in the budget year, an increase of \$534 million, despite the projected decrease of 4,880 personnel-years. The net average annual salary for a personnel-year in 1983-84 is \$24,203. Assuming that the 4,880 personnel-years earned the average amount, the administration's staffing changes should have resulted in a net salaries and wages savings of approximately \$118 million. Did they?

In order to evaluate the fiscal effect of the Governor's proposal, we derived a base level of salary expenditures by adjusting the net total salaries and wages figures reflected in the budget for both the current and budget years. Specifically, we subtracted from both figures the following factors: (1) unallocated employee compensation amounts, (2) the 6 percent salary increase provided effective January 1, 1984, and (3) special salary adjustments. Table 65 shows that when adjusted for these factors, "base" salary and wages are only \$17 million *lower* in the budget year than the current-year level, or approximately \$101 million less than the potential savings we derived assuming an average salary level.

In summary, despite projected staffing reductions in the budget year,

we have been unable to identify dollar savings that in any way are commensurate with the personnel changes indicated in the budget.

**Table 65**  
**Adjusted Net Salaries and Wages**  
**1983-84 and 1984-85**  
**(in thousands)**

	1983-84	1984-85
Salaries and wages .....	\$5,842,680	\$6,403,080
Salary savings .....	-168,945	-195,800
Net totals .....	\$5,673,735	\$6,207,280
Adjustments:		
Unallocated employee compensation .....	-96,849	-444,885 <sup>a</sup>
Six percent salary increase .....	-176,671	-354,327
Special salary adjustments .....	-12,856	-37,977
Base salaries and wages: .....	\$5,387,359	\$5,370,091
Difference: .....	-\$17,268	

<sup>a</sup> Does not include higher education because amount has not been included in total salaries and wages.

### **Some Proposed Staffing Reductions are not Warranted on a Workload Basis**

Our program review of personnel-year reductions reflected in the budget suggests that many of the staffing changes were made without a thorough review of what "inputs" are required in order to produce the "outputs" envisioned by the Legislature when the program was established. For example, in the budget year the administration is proposing to *reduce* positions in the Department of Industrial Relations' Division of Occupational Safety and Health at a time when programs within the division are experiencing serious backlog problems. Specifically,

- Approximately 13,600, or 40 percent, of the elevators in the state currently are overdue for the annual inspection required by law.
- At the present time, 2,255, or 7.5 percent, of the liquified petroleum gas (LPG) tanks in the state and 1,052, or 44 percent, of the boilers which are used to generate steam pressure are past due for inspection.

In view of these serious backlogs, it is unclear to us why staffing reductions have been made in this division. Moreover, as discussed in more detail in the *Analysis* (see Item 8350), these inspection programs are supported entirely by fee collections—thus, any "savings" to the state only result from fewer fees being collected.

### **Governor's Alternative to Using State Employees May be More Costly**

It appears that there are a number of instances, such as the Department of Industrial Relations, where personnel-years have been reduced primarily for the sake of getting the staffing total down, rather than to reduce costs, because dollar savings commensurate with the reductions cannot be identified. In fact, in some instances, the budget proposes to spend *more* on contractual services to perform a function previously carried out by

department staff than it would have cost to continue the existing program structure.

***Some Proposed Contracts More Expensive Than the Staff They Would Replace.*** There are several instances in which the administration is proposing to replace departmental staff with outside staff at an increased cost to the taxpayers. For example, Caltrans proposes to rehabilitate 16 commuter rail stations between San Francisco and San Jose during the budget year. The department proposes to contract with the Office of State Architect in the Department of General Services for project design and construction engineering, at a cost of \$1,625,000. Our analysis indicates that if departmental staff performed the same work, it could be completed for \$1,121,000, for a savings of \$504,000 or 31 percent.

Similarly, Caltrans is proposing to increase significantly the amount of highway maintenance work performed on a contract basis rather than by state staff. The budget for 1984-85 includes \$2.9 million in additional contract funds for this purpose. The department advises that the amount requested for contracted work is calculated first by estimating the personnel-year equivalent and cost of the work if it were performed by department staff, *then multiplying by 1.25*. This increases the cost of contracting for the proposed maintenance work by \$1.1 million in 1984-85.

We acknowledge that in many cases it is possible to reduce the cost of state programs by contracting with the private sector, and we have long recommended that greater use be made of private sector resources where doing so will result in savings to the state. However, contracting makes sense *only* if it is the more economical and cost-effective alternative, or if there are special circumstances such as a lack of expertise in a department to handle the particular task. The administration does not appear to have kept such factors in mind in some of its contract proposals. (For further discussion of these issues, please see the *Analysis*—Item 2660 [Caltrans], Item 3540 [Department of Forestry] and Item 1710 [State Fire Marshal].)

## **Conclusion**

Our review of the administration's workforce reduction proposal found that:

- The administration's assertion that 6,700 personnel-years were vacant as a result of a strictly enforced freeze in 1982-83 cannot be substantiated;
- The administration's 1984-85 personnel-year savings are overstated as a result of significant personnel additions which have occurred since the enactment of the 1983 Budget as well as an increase in the salary savings rate assumed for 1984-85;
- The administration's personnel reductions attributable to "increased efficiencies" is overstated because many of the reductions would have

occurred in the absence of administrative actions or have been anticipated for several years;

- Dollar savings commensurate with the proposed staffing reduction cannot be identified; and
- In some instances, the administration is proposing to contract for ongoing state activities at a greater expense than continued use of state employees.

## **THE RESERVE FOR ECONOMIC UNCERTAINTIES**

### ***How Large Should the Reserve for Economic Uncertainties Be?***

Beginning with the 1980 Budget Act, the Legislature established a Reserve for Economic Uncertainties within the General Fund. The purpose of this reserve is to provide a source of funds to meet state General Fund spending obligations in the event of an unexpected decline in revenues or an unanticipated increase in expenditures.

The establishment of this reserve by the Legislature was a wise move. Just as a household needs to keep some funds in its bank account at all times so that it can cope with an unforeseen financial emergency, the state needs to keep funds in *its* bank account.

In maintaining the Reserve for Economic Uncertainties, the most difficult question that the Legislature must answer is: How large should the state's reserve be? If the reserve is "too small," it may not be sufficient to protect the state's ability to provide needed governmental services to the people of California during periods of unanticipated revenue declines or program cost increases. On the other hand, if the reserve is "too large," expenditures for needed public services may be unnecessarily restricted or, alternatively, taxpayers may come to believe that they are giving up more of their income to pay taxes than is necessary.

### **Factors Affecting the Optimal Size of the Reserve**

There is no simple formula for determining the "right" size of the reserve for uncertainties. There are, however, two general factors which the Legislature should consider in deciding how much of the state's revenues to earmark for the reserve.

- First, it should consider the potential effect of a downturn in the economy on revenues. As Table 31 in Part Two shows, General Fund revenues experienced shortfalls of well over 5 percent in both 1981-82 and 1982-83, due to weaker-than-expected economic performance.
- Second, it should consider the extent to which other means are available to help bridge an unanticipated gap between revenues and expenditures, such as increasing the amount of tax revenues collected or transferring monies from special funds to the General Fund.

These two considerations will indicate the magnitude of the "fiscal cushion" that might be needed in the event that the fiscal assumptions on which the state's expenditures and revenue estimates are based fail to come true.

### How Fiscal Crises Have Been Dealt With in Recent Years

During the past three years, the state has managed to survive its fiscal problems in spite of *not* having a healthy reserve for uncertainties. In large part, it was able to do so by enacting legislation to enhance revenue collections.

Two primary methods have been used to enhance revenues when deficits in the state General Fund materialize:

1. The transfer of monies from special funds (primarily tidelands oil revenues and vehicle license fee collections) to the General Fund; and
2. Revising the due dates and delinquent penalties for tax payments, so as to accelerate revenue collections.

Table 66 shows that these steps, which are discussed in detail in the revenue section of Part Two, raised revenues by a total of over \$950 million in 1981-82, nearly \$1.4 billion in 1982-83, and about \$760 million in 1983-84, or nearly \$3.1 billion during the three years combined. While the absence of an adequate reserve to "lean on" during this three-year period made it necessary for the Legislature to reduce expenditures for many state programs when a deficit threatened the General Fund, the required cut-backs might have been much larger had these revenue enhancements not been available.

Clearly, the greater the potential availability of revenue enhancing mechanisms, the smaller the reserve that is necessary to deal with any particular fiscal emergency. The converse, however, is also true—namely, the more limited the set of revenue-enhancing opportunities available, the larger the reserve that is necessary to adequately protect the state from unanticipated fiscal problems.

**Table 66**  
**Primary Revenue Enhancement Methods**  
**1981-82 through 1983-84**  
**(in millions)**

	1981-82	1982-83	1983-84	Totals
1. Revenue accelerations.....	\$405	\$620	\$140	\$1,165
2. Transfers from special funds to General Fund	550	750	619	1,919
Totals.....	\$955	\$1,370	\$759	\$3,084

### The Reserve in 1984-85 and Thereafter

Unfortunately, the converse would seem to prevail as the state Legislature begins work on the Governor's Budget. Because of the heavy reliance placed on tax accelerations in combatting recession-induced revenue shortfalls in recent years, there is little more to be "milked" from these "revenue enhancements." Moreover, unless the Legislature decides to continue to use, for General Fund purposes, monies which traditionally have supported activities financed from special funds, "transfers" may not prove to be a reliable part of the state's "fiscal cushion" in the future. These considerations, coupled with the increasing volatility of the nation's economy, convince us that a substantial balance should be kept in the economic uncertainties reserve for the foreseeable future.

**Size of the Reserve.** As for the size of this "substantial balance," we repeat that there is no analytical basis for specifying a precise amount. In our judgment, however, we believe that a cushion equal to about 5 percent of planned expenditures makes sense. For 1984-85, a cushion of this magnitude would amount to about \$1.25 billion, or \$300 million more than the \$950 million reserve (3.8 percent of planned expenditures) provided for in the Governor's Budget. Based on recent history, a 5 percent reserve will give the state an "insurance policy" against a mild economic downturn, such as occurred in 1981-82 when revenues were about 6 percent below the original budget estimate. It will provide only partial protection against a more severe downturn such as that which caused 1982-83 revenues to come in 11 percent below budget estimates. Even under these circumstances, a 5 percent reserve can fulfill its "insurance policy" function by "buying time" for the Governor and the Legislature to seek and adopt other alternatives for keeping the budget in balance.

Providing for such a reserve in 1984-85 seems especially prudent in light of two factors:

- First, there is great uncertainty regarding how strong the economy will be by late 1984 and 1985. Should the economy weaken during 1984-85 due to the negative effects of such factors as large federal budget deficits and high interest rates, a 5 percent "fiscal cushion" could prove to be extremely valuable. As Table 41 in Part Two shows, General Fund revenues for 1983-84 and 1984-85 combined would fall short of the budget estimates by \$2.2 billion if the Department of Finance's "low" economic and revenue scenarios occur, leaving the General Fund with a large deficit at the end of 1984-85.
- Second, if economic expansion continues through 1984-85, the revenues that the state's economy will yield would make it easier to establish an adequate cushion on which the state could fall back in subsequent years, when the business cycle turns down. In other words, while we believe that there is reason enough *in* the budget year to

want an adequate reserve, the Legislature should also look *beyond* the budget year. Recognizing that over the longer-term there will be "good times" alternating with "bad times", the Legislature should take the opportunity presented by periods of economic prosperity to make provisions for the economic downturns to come, even though these downturns may be several years away.

In summary, our review indicates that a substantial balance should be established and maintained in the Reserve for Economic Uncertainties. For the budget year, we believe that this balance should be *at least* as much as that proposed by the Governor (\$951 million, or 3.8 percent of proposed expenditures) and preferably \$300 million larger.

### **PROPOSED STATE PROGRAM REALIGNMENTS**

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#### ***Should the Legislature Alter Program Administration Responsibilities for Four Health and Welfare Programs in Order to Give Local Government More Flexibility?***

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In the budget for 1983-84, the Governor proposed three state block grants—the Alcohol and Drug Block Grant, the Public Health Block Grant and the State Education Block Grant. The Legislature did not approve the administration's proposals and restored most state positions that had been designated for elimination in anticipation of these block grants.

In 1984-85, the administration is proposing to reduce state administrative staff and transfer various state responsibilities to the local level through four state/county program realignments. These realignments are proposed for the following areas: mental health, family planning, public health, and alcohol/drug programs. (For a detailed discussion of each of these proposals, see the following item discussions in the *Analysis*: Item 4440—Department of Mental Health, Item 4260—Department of Health Services, and Item 4200—Department of Alcohol and Drug Programs.) The administration's proposals will be embodied in five separate bills. Three of the five bills were in print when this was written; the remaining two—one each for alcohol and drug programs—will be introduced in the spring of 1984. The three pending bills are as follows:

1. AB 2381 (Mojonnier) which would implement the mental health initiative;
2. SB 1450 (Seymour) which would implement the new family planning grant program; and
3. AB 2450 (Stirling) which would implement the proposed Public Health Enhancement Program (PHEP).

### Programmatic and Fiscal Overview of Proposals

The Governor's proposals and the programs they include are shown in Table 67. In total, 13 existing programs are included in the four program realignments.

**Table 67**  
**Program Realignments**  
**1984-85**

<i>Proposal</i>	<i>Administering Department</i>	<i>Consolidated/Transferred Programs</i>
Mental Health Initiative	Department of Mental Health	• Local Mental Health Programs
Family Planning Grant Program	Department of Health Services	• Family Planning
Public Health Enhancement Program	Department of Health Services	• Preventive Health Care for the Aging
		• Dental Health
		• Immunization Assistance
		• Infant Dispatch
		• Perinatal Access
		• High-Risk Infant Follow-up
		• Perinatal Health Services
		• Maternal and Child Health Grants
		• Child Health Disability Prevention
Alcohol and Drug Program Realignment	Department of Alcohol and Drug Programs	• Alcohol Programs
		• Drug Programs

Table 68 summarizes the proposed savings and transfers which are estimated to result from adoption of the four proposals in 1984-85 and 1985-86. Full-year effects would not be experienced until 1985-86, due to the phase-in of the proposals during the first six months of 1984-85. Thus, in the budget year, state savings in state operations would total approximately \$9 million. Of this amount, \$6.7 million is proposed for transfer to local assistance. Similarly, in 1985-86, the administration projects state operations savings of \$20.6 million, of which \$14.1 million would be transferred to local government.

The bulk of the savings in state operations is due to the elimination of 604 positions. Of the total proposed reduction, 415.9 positions, or 69 percent, are from the Department of Mental Health. Of this amount, 299 are proposed for transfer to 18 specified counties. Similar positions have been transferred in the past to the state's 40 other counties.

Table 69 puts the proposed savings into perspective. It identifies the state operations and local assistance budgets for the programs affected by the realignments. It shows that in 1984-85 state operations expenditures

for these programs are proposed to *decrease* by \$8.8 million and local assistance expenditures are proposed to *increase* by \$51 million, compared to the current year. The differences in proposed savings and expenditures shown in the two tables are partially attributable to portions of the existing program which are not directly affected by the realignment proposal.

**Table 68**  
**Proposed Program Realignment Savings and Transfers (All Funds)**  
**1984-85 and 1985-86**  
**(in thousands)**

	1984-85 (Six Months)	1985-86 (Full Year)
<i>State Operations—Savings</i>		
Mental Health .....	-\$6,200	-\$14,300
Family Planning .....	-445	-890
PHEP .....	-1,354	-3,381
Alcohol/Drug .....	-993	-1,986
Totals .....	-\$8,992	-\$20,557
<i>Transfers to Local Assistance</i>		
Mental Health .....	\$5,100	\$10,200
Family Planning .....	445	890
PHEP .....	822	2,318
Alcohol/Drug .....	324	648
Totals .....	\$6,691	\$14,056
Net Effect on All Funds .....	-\$2,301	-\$6,501
<i>Positions<sup>a</sup></i>		
Mental Health .....	—	-415.9
Family Planning .....	—	-24.5
PHEP .....	—	-83.2
Alcohol/Drug .....	—	-80.0
Subtotals .....	—	-603.6

<sup>a</sup> Positions are phased out in 1984-85 resulting in full position savings in 1985-86.

**Table 69**  
**Proposed Funding Levels in Realigned Programs (All Funds)**  
**1983-84 and 1984-85**  
**(in thousands)**

	1983-84 Estimated	1984-85 Proposed	Change	
			Amount	Percent
<i>State Operations</i>				
Mental Health .....	\$25,301	\$19,498	-\$5,803	-22.9%
Family Planning .....	1,002	603	-399	-39.8
PHEP .....	6,012	4,571	-1,441	-24.0
Alcohol/Drug .....	9,442	8,259	-1,183	-12.5
Subtotals .....	\$41,757	\$32,931	-\$8,826	-21.1%
<i>Local Assistance</i>				
Mental Health .....	\$317,152	\$364,568	\$47,416	15.0%
Family Planning .....	28,138	29,155 <sup>a</sup>	1,017	3.6
PHEP .....	26,772	28,473 <sup>a</sup>	1,701	6.4
Alcohol/Drug .....	93,864	94,682	818	0.9
Subtotals .....	\$465,926	\$516,878	\$50,952	10.9%
Totals .....	\$507,683	\$549,809	\$42,126	8.3%

<sup>a</sup> Represents half-year funding.

***Incentive Funding.*** The Governor's Budget indicates (p. 31) that funding augmentations will be included in four of the five implementing bills "to provide local government with the ability to expand in areas of high need." Specifically, separate augmentations, totaling \$11 million, are proposed as follows: (1) PHEP—\$1.25 million, (2) Family Planning—\$4.75 million, and (3) Alcohol and Drug Programs—\$5 million (divided equally between the two programs). These incentive funds are not reflected in the funding totals included in the Governor's Budget, but instead will be incorporated in separate legislation. To the extent that incentive funding is provided, the administration's realignment proposal will result in a net cost, instead of a net savings, to the state.

### **Analysis of the Realignment Proposals**

Our analysis indicates that the concept of program realignment for these particular programs has merit. Such proposals allow local governments increased flexibility in designing and funding local programs to meet local needs. Moreover, program realignment allows counties to integrate these programs more effectively with other local programs serving similar populations and/or clients. The realignment proposals generally have the advantage of increasing accountability by giving the level of government which spends the taxpayers' funds, in this instance, the counties, the greatest responsibility for program administration.

Despite these advantages, our analysis has identified various problems with each of the proposals. These crosscutting problems are summarized below and discussed in more detail in the individual item write-ups in the *Analysis*.

***Potential Service Reductions.*** Our review has identified several instances where the proposals may result in service reductions to program clients. For example, the mental health initiative would eliminate existing county matching requirements (currently \$30.8 million) for locally provided mental health services. Our review indicates that without effective maintenance of effort requirements, counties could replace county funds with state funds or reduce mental health services. In the case of both the family planning and PHEP proposals, it is unclear to us whether counties would experience increased costs to administer the grant program (negotiate contracts, establish claims payment systems, etc.), leaving less money available for services.

***Audit Inconsistencies.*** One problem that we have identified in each of the administration's proposals has to do with the way that audits of state funds would be conducted. The administration has offered several alternatives ranging from no audit of state funds (alcohol and drug programs) to an independent audit arranged for by the county and subsequently for-

warded to the state (mental health). Our review indicates that audits of state funds should continue on some sort of uniform basis.

***Impact of Differential Standards.*** State-administered programs often offer the advantage of a consistent minimum service standard and consistent eligibility requirements. Our review indicates that the realignment proposals, because of increased flexibility at the local level, may have the unintended consequence of different minimum service and eligibility standards between counties. For example, because family planning services may be unpopular in some counties, more restrictive eligibility requirements may be imposed in these counties compared to the current state standard. Similarly, in alcohol programs, delegation of program review, approval and reapproval for the drinking driver program to the counties may result in inconsistent application of state standards for the program. In addition, it is unclear whether the delegation of responsibility to the counties for assuring the quality of alcohol and drug treatment and recovery programs may make it more difficult for these programs to receive reimbursement from insurance carriers and other so-called "third-party" payers, because of differential service quality standards from one county to another.

***Funding Proposal Diminishes Local Control.*** Of the four proposals, two appear to contain aspects that diminish, rather than enhance, local control and thus run counter to the thrust of the proposals themselves. Specifically, the alcohol and drug program realignment requires counties to spend at least 35 percent of their combined alcohol and drug funds on alcohol programs and 35 percent on drug programs. The remaining 30 percent of the funds would be distributed on a discretionary basis between alcohol and drug programs. Our analysis indicates that five counties would experience funding shifts in their current programs if the 35/35/30 allocation process were adopted. Three counties would have to shift funds from drug programs to alcohol programs and two counties would have to shift funds from alcohol to drug programs.

In the case of the mental health initiative, the administration is proposing to transfer state staff who arrange essential community services for mentally disordered individuals released from state and local psychiatric hospitals to 18 counties who have been unwilling or unable to accept responsibility for these staff in the past.

## **Conclusion**

At the time this review was prepared, specific legislation implementing the administration's proposals was being developed. In addition, in many instances, sufficient information was not available outlining the mechanics of the programs' operations. This information is needed before the Legislature can assess the specific merits of these realignment proposals.

## FUNDING OF BENEFITS FOR STATE RETIREMENT SYSTEMS

### *How Should the Legislature Address Funding Shortfalls in State Retirement Systems?*

#### Background

Currently, retirement benefits of state and many local government employees are provided through one of the following state pension programs: the Public Employees' Retirement System (PERS), the State Teachers' Retirement System (STRS), the Judges' Retirement System (JRS), the Legislators' Retirement System (LRS), and the University of California Retirement System (UCRS). The state actually *manages* all but one (the UCRS) of these systems, and it provides—directly or indirectly—a major portion of the funding for *all* of them.

Table 70 shows that in 1984–85, the state is expected to pay almost \$1.5 billion *specifically* to finance retirement benefits provided by these systems. Of that amount, the state pays \$560 million in “normal cost” contributions and \$907 million toward financing unfunded liabilities (the terms “normal costs” and “unfunded liabilities” are discussed below). Table 70 also shows that in 1984–85 school districts and superintendents of schools are expected to pay \$305 million in employers' PERS contributions for their nonteaching employees and \$616 million in STRS contributions for their certificated (teaching) employees. A major portion of these contributions will be paid by the state indirectly, through apportionment aid to local school districts.

**Table 70**  
**State Retirement Systems**  
**Selected Information**  
**1984–85 (dollars in millions)**

Retirement Systems	Proposed 1984–85 State Contributions <sup>a</sup>				Size of the Unfunded Liability <sup>b</sup>
	Current Membership	Toward the Normal Costs	Toward the Unfunded Liability	Total Contributions	
Legislators' .....	400	\$0.3	\$0.4	\$0.7	\$25
Judges' .....	1,700	7.0	10.4	17.4	450
Public Employees'					
State members .....	264,000	485.0	331.3 <sup>c</sup>	816.3	6,000
School members .....	236,000	(208.0) <sup>d</sup>	(97.0) <sup>d</sup>	(305.0) <sup>d</sup>	1,500
State Teachers' .....	400,000	(616.0) <sup>d</sup>	555.4 <sup>e</sup>	555.4 <sup>e</sup>	13,200
University of California .....	85,000	73.4 <sup>f</sup>	9.5 <sup>f</sup>	82.9 <sup>f</sup>	395
Totals .....	987,100	\$565.7	\$907.0	\$1,472.7	\$21,570

<sup>a</sup> Based on current contribution rates and projected 1984–85 payrolls.

<sup>b</sup> As determined by the latest available actuarial valuation for each system.

<sup>c</sup> This amount includes \$8.3 million in local mandate reimbursements.

<sup>d</sup> Amounts of total contributions paid by local school employers. A major portion of each of these amounts is indirectly financed by the state, in the form of apportionment aid to school districts and superintendents of schools.

<sup>e</sup> Includes: (1) \$211 million in state contributions approved by the Legislature but vetoed by the Governor from the 1983 Budget Act, and (2) \$43.4 million in local mandate reimbursements.

<sup>f</sup> Represents only the state's share of contributions (about 42 percent of total contributions) for UC employees whose salaries and benefits are paid from state funds. The balance of contributions comes from federal and private sources.

### **The Components of Retirement Costs**

The state's contributions to retirement systems are used to pay one of two cost components associated with retirement benefits: (1) normal costs and (2) unfunded liabilities.

**Normal Costs** are the costs of financing the retirement benefits which are *being* earned in a given year. These costs are expressed in terms of a fixed percentage of an employee's salary that has to be paid annually over the employee's career, in order to fund his or her retirement benefits. For example, the normal cost of the Judges' Retirement System is 34 percent of payroll (please see Table 3, page 24, of the 1984-85 *Analysis*). This means that, as of the 1980 valuation date, annual payments equal to 34 percent of judicial payroll (or about \$30 million in 1984-85) would be required to fully fund the retirement benefits being earned by active judges in a given 12-month period. (As noted below, current contributions total 30.3 percent, which is insufficient to fund the annual normal costs of the system.)

Normal costs are estimated in each actuarial valuation, based on the actuarial experience of the membership and specific assumptions about long-term salary increases and investment yields. These valuations usually are conducted at 2-4 year intervals for state systems.

**Unfunded Liability Costs**, on the other hand, are those obligations to pay retirement benefits earned in *prior* years which are not funded by current assets. These costs are also based on actuarial estimates, made at a given point in time. Unfunded liabilities exist because, in past years, normal costs were not covered by employee and employer contributions. Again, using the Judges' Retirement System as an example, it would take annual contributions equal to 42 percent of judicial payroll (or about \$37 million in 1984-85) to amortize the \$450 million accumulated unfunded liability of the system over a 30-year funding period (please see the *Analysis*, Item 0390, Table 3).

### **The Legislature Should Fully Fund Normal Costs**

In past years, most of the discussion concerning the funding problems of individual state retirement systems has centered on unfunded liabilities. These liabilities, indeed, constitute a fiscal problem, particularly if (1) they are very large when compared to a retirement system's assets, and/or (2) they are growing rapidly.

In our judgment, however, the Legislature should look upon a shortfall in funding normal costs of state retirement systems as a more immediate and serious concern. It is this type of shortfall, after all, which brings about

an unfunded liability and causes its continued growth.

Table 71 shows: (1) the current normal costs of the five state retirement systems, (2) the amounts of total contributions (from all sources) toward normal costs, and (3) the existing shortfall (if any) in funding these costs, expressed both in absolute terms for 1984-85 and as a percent of payroll.

As the table shows, there are normal cost shortfalls in three of the retirement systems—namely, the LRS, the JRS, and the STRS. A funding augmentation of \$249.3 million would be required to eliminate these shortfalls.

**Table 71**  
**State Retirement Systems**  
**Funding Requirements for Normal Costs<sup>a</sup>**  
**1984-85**

<i>Retirement Systems</i>	<i>Normal Costs<sup>b</sup></i>	<i>Current Contributions Toward Normal Costs<sup>b</sup></i>	<i>Funding Shortfall</i>	
			<i>Percent<sup>b</sup></i>	<i>1984-85 Costs<sup>b</sup> (millions)</i>
Legislators' .....	21.3%	18.8%	2.5%	\$0.1
Judges' .....	34.0	30.3	3.7	3.2
Public Employees'				
State Members .....	16.0	16.0	—	—
School Members .....	15.5 <sup>c</sup>	15.5 <sup>c</sup>	—	—
State Teachers' .....	19.2	16.0	3.2	246.0
University of California <sup>d</sup> .....	14.1	14.1	—	—

<sup>a</sup> As determined by the latest available actuarial valuation.

<sup>b</sup> Expressed as a percent of payroll of the respective systems, as indicated in the latest available actuarial valuation.

<sup>c</sup> A major portion of these costs are indirectly financed by the state through apportionment aid to school districts and superintendents of schools.

<sup>d</sup> This system is administered by the Regents, rather than by the state. It is shown here because about 42 percent of the system's total employer contributions is provided by the state.

Our review indicates that funding of normal costs should be the first step in addressing the funding problem of state retirement systems. Therefore, in our detailed analysis of the legislators', judges' and teachers' retirement systems (please see the *Analysis*, Items 0110-0150, 0390, and 6300, respectively), we are recommending that the Legislature place its highest priority on fully funding the normal cost shortfalls of these systems.

### **Total Compensation: A Guide to Selecting Funding Options**

If the Legislature decides to eliminate the existing shortfalls in funding for normal costs of state retirement systems, it will need a basis for choosing among the various options for achieving this objective. These options involve: the employers' contribution toward benefits, the employees' contribution, the level of benefits themselves, and, where the state is not the employer (STRS), the state's contribution toward benefits.

When deciding what actions the *state* should take in eliminating any shortfall, we recommend that the Legislature base its decision on an analy-

sis of the *total compensation* provided to employees. That is, the state's contributions toward funding employees' retirement benefits should be viewed as just *one* aspect of the employees' overall compensation—along with salary, other fringe benefits, and the general working environment. In the case of state contributions toward the JRS, for instance, we recommend that the Legislature consider this annual payment as part of the total compensation provided each year to judges.

If, in considering the various options for fully funding normal costs, the Legislature concludes that the level of total compensation for a particular employee (such as a judge or a state worker) is *not* adequate, the state would want to pick up part or all of the normal cost shortfall in that particular retirement system. If, on the other hand, the Legislature determines that the current level of total compensation *is* adequate, it would want to have the shortfall financed through increased employees' contribution rates, or through a reduction—on a prospective basis—of retirement benefits.

### **The Unfunded Liability Issue**

Table 70 shows that state-administered systems have collective unfunded liabilities in excess of \$21 billion, based on the latest available actuarial estimates. The magnitude of these liabilities is a problem which should not be ignored. The existence of this debt can harm the state's credit rating, and it certainly causes anxiety among existing employees as to the security of their future retirement benefits.

We find it difficult at this time, however, to make a recommendation as to how the Legislature should deal with the unfunded liability problem, for several reasons.

- **Funding Responsibility.** While the state has already assumed a role in funding unfunded liabilities, the Legislature may wish to reassess how that responsibility might be shared among employers, employees and the state, based on total compensation for current employees (or, in the case of the STRS, based on the adequacy of state contributions towards the cost of education at the local level).
- **Intergenerational Equity.** We can find no analytical basis for requiring one generation of taxpayers (such as the *current* one) to bear a greater burden in paying off an unfunded liability not of its own making, rather than requiring some other generation of taxpayers (that is, *future* ones) to do so. Therefore, it is impossible for us to recommend a level of contributions that the state *should* pay in any one year to help amortize this unfunded liability.
- **Other Legislative Decisions Could Affect Contribution Level.** Any decision the Legislature makes on other related compensation issues might affect how it would want to address the issue of unfunded liabilities. For instance, if the Legislature decides to provide for the

full funding of the STRS's normal cost, it would not be necessary to continue state contributions toward the unfunded liability of that system at the level proposed in the Governor's Budget.

### Conclusion

In summary, we recommend that the Legislature (1) act first to fund the shortfalls in normal costs of state retirement systems; (2) use the concept of total employee compensation in determining what the state's role in eliminating such shortfalls should be; and (3) address the issue of unfunded liabilities by considering a collective funding approach, and by taking into account its decisions on related compensation issues, such as financing for normal costs.

## HAZARDOUS SUBSTANCES CONTROL PROGRAMS

### *How Can the Legislature Improve the Effectiveness and Coordination of the State's Hazardous Substances Control Programs?*

The budget proposes \$105.7 million and 776 personnel-years in 12 state agencies for a wide range of regulatory functions related to hazardous substances. This is an increase of \$6.3 million, or 6.3 percent, above estimated current-year expenditures, and an increase of 123 personnel-years, or 19 percent, above current-year staffing levels. The Department of Health Services accounts for 61 percent of the total funds budgeted for hazardous substance control, and the Department of Food and Agriculture's pesticide program represents an additional 19 percent of the total.

Table 72 provides an overview of hazardous substances control activities in state government. It briefly describes each program and shows estimated current-year and proposed budget-year expenditures, fund sources, and personnel-years.

**Table 72**  
**Hazardous Substances Control Expenditures,**  
**Fund Sources, and Staffing**  
**1983-84 and 1984-85**

Item	Program	Fund	Amount (in thousands)		Personnel- Years	
			Estimated 1983-84	Proposed 1984-85	1983-84	1984-85
0650	Office of Planning and Research					
	1. Hazardous Waste Management Council siting plan	Reimbursements	\$225	—	5.0	—
0690	Office of Emergency Services					
	1. Hazardous material incident contingency plan	General, Reimbursements	\$113	\$118	3.0	3.0
0860	Board of Equalization					
	1. Collection of HWCA fees and HSA taxes	Reimbursements	\$331	\$346	8.1	8.1

2660	Department of Transportation					
1.	Highway cleanup including toxic and non-toxic spills	SHA	\$657 <sup>a,b</sup>	696 <sup>a,b</sup>	13.2	13.2
2720	California Highway Patrol					
1.	Inspection related to transportation of hazardous materials	MVA, STF	\$2,820	\$2,874	60.1	60.1
2.	Hazardous materials response training and equipment	Reimbursements	313	—	2.6	—
	Subtotals .....		\$3,133	\$2,874	62.7	60.1
3400	Air Resources Board					
1.	Research and support	MVA, General, APCF	\$1,501	\$2,480	17.5	22.5
2.	Stationary source	MVA, General, APCF	616	1,001	12.9	13.9
	Subtotals .....		\$2,117	\$3,481	30.4	36.4
3600	Department of Fish and Game					
1.	Wildlife protection and management, and environmental services	Various	\$626 <sup>b</sup>	\$664 <sup>b</sup>	N/A	N/A
3940	State Water Resources Control Board					
1.	Water quality regulatory activities, studies, and regional board assistance	General, CWBF	\$3,724	\$3,730	45.9	48.5
2.	Hazardous waste permitting, enforcement, and site closure	HWCA, RCRA, Reimbursements	1,233	1,208	20.8	20.8
3.	Underground tanks	General, UTS, UCIA	—	2,539	—	52.2
4.	Underground injection control	Federal	258	114	4.3	—
	Subtotals .....		\$5,215	\$7,591	71.0	121.5
4260	Department of Health Services					
1.	Hazardous waste management	HWCA, RCRA, ERF	\$8,436	\$11,584	136.8	193.6
2.	Superfund	HSA, HSCA, CERCLA, RP	49,600	48,100	45.5	62.5
3.	Epidemiology, toxicology, and laboratory services	General, HWCA, RCRA, Reimbursements	5,034	5,118	67.2	69.4
	Subtotals .....		\$63,070	\$64,802	249.5	325.5
8350	Department of Industrial Relations					
1.	Cal-OSHA inspections and other support functions (includes both toxics- and non-toxics-related activities)	General, Federal	\$8,000 <sup>a</sup>	\$7,586 <sup>a</sup>	N/A	N/A

**Table 72—Continued**  
**Hazardous Substances Control Expenditures,**  
**Fund Sources, and Staffing**  
**1983-84 and 1984-85**

Item	Program	Fund	Amount (in thousands)		Personnel- Years	
			Estimated 1983-84	Proposed 1984-85	1983-84	1984-85
8570	Department of Food and Agriculture					
	1. Pesticide registration	General, Ag	\$2,414	\$2,563	72.4	72.4
	2. Pesticide use enforcement and worker health and safety	General, Ag, Federal	14,062	14,378	93.5	89.5
	3. Environmental monitoring	General, Ag, Reimbursements	2,623	3,264	42.8	44.9
	Subtotals .....		\$19,099	\$20,205	208.7	206.8
8700	Board of Control					
	1. Victims' compensation program	Reimbursements	\$355	\$355	1.0	1.0
	Totals .....		\$102,941	\$108,718	652.6	775.6
	Less reimbursements ..		3,490	2,996		
	Net totals .....		\$99,451	\$105,722		
	<i>State funds:</i>					
	Agriculture Fund (Ag) .....		\$9,279	\$9,622		
	Air Pollution Control Fund (APCF) .....		106	174		
	Clean Water Bond Fund (CWBF) .....		1,335	1,129		
	Energy and Resources Fund (ERF) .....		439	—		
	General Fund .....		18,327	20,221		
	Hazardous Substances Account (state Superfund—HSA) .....		11,145	9,645		
	Hazardous Substances Compensation Account (HSCA) .....		355	355		
	Hazardous Waste Control Account (HWCA) .....		7,175	10,508		
	Motor Vehicle Account (MVA) .....		4,407	5,485		
	State Highway Account (SHA) .....		657	696		
	Underground Tank Storage, Underground Container Inventory Accounts (UTS, UCIA) .....		—	1,428		
	Other .....		267	283		
	Subtotals .....		\$53,492	\$59,546		
	<i>Federal funds:</i>					
	Comprehensive Environmental Response Compensation, and Liability Act (federal Superfund—CERCLA) .....		16,900 <sup>c</sup>	16,900 <sup>c</sup>		
	Resource Conservation and Recovery Act (RCRA) .....		3,135	3,703		
	Other .....		4,724	4,373		
	Subtotals .....		\$24,759	\$24,976		
	<i>External sources:</i>					
	Responsible parties (RP) <sup>d</sup> .....		\$21,200 <sup>c</sup>	\$21,200 <sup>c</sup>		

<sup>a</sup> Includes some proportion of nonhazardous substances activities.

<sup>b</sup> Estimate based on actual 1982-83 costs.

<sup>c</sup> These amounts probably exceed the amount that will actually be received.

<sup>d</sup> Responsible parties are private companies or individuals that reimburse the state for the cost of cleaning up hazardous waste sites.

### **Summary of Budget Changes**

Below we summarize the amounts budgeted for those six departments accounting for 99 percent of hazardous substance control expenditures, as well as the major changes proposed for 1984-85.

1. ***Department of Health Services.*** The budget proposes \$64.8 million for hazardous substances control functions performed by the department. The department's functions include (a) regulating hazardous waste management, cleaning up contaminated sites, and supporting the development of alternative technologies and (b) studying health effects, setting scientific standards, and consulting with other departments and local agencies. The budget proposes a net increase of \$1 million and 73.8 personnel-years for hazardous substances control in 1984-85. This primarily reflects an increase of \$2.6 million and 62 positions for permitting and inspecting hazardous waste facilities and a decrease of \$1.5 million appropriated on a one-time basis for a site cleanup in the current year.

2. ***Department of Food and Agriculture.*** The budget includes \$20.2 million and 207 personnel-years for the department's pesticide regulatory program, which includes pesticide registration, research on pesticide use, and monitoring exposure of persons handling pesticides. This is an increase of \$1.1 million and a net decrease of 2 personnel-years from the current-year levels. The most significant change in the budget for this program in 1984-85 is the request for \$334,000 and five positions to determine the dispersal of pesticides and their impact on the environment and agricultural productivity.

3. ***State Water Resources Control Board.*** The budget proposes \$7.6 million and 121.5 personnel-years for hazardous substance control-related activities of the board in 1984-85. These funds will be used to (a) monitor ground water quality, (b) permit, inspect, and enforce waste discharge requirements, and (c) regulate underground tanks. The requested amount is \$2.4 million (40 percent) above current-year levels, and will provide for 50.5 new positions (71 percent). Most of the increase is to implement new programs to identify, permit, and monitor underground tanks and to begin cleaning up leaks from these tanks.

4. **Department of Industrial Relations.** The budget includes \$7.6 million for hazardous substance control-related workplace health and safety activities to be conducted by the department in 1984-85. This is a 5.1 percent reduction from estimated current-year expenditures. Most of the \$7.6 million is for activities related to hazardous substances. These activities include workplace inspections, various research projects, enforcement of worker right-to-know laws, and the Hazard Evaluation System and Information Service (HESIS).

5. **Air Resources Board.** The budget proposes \$3.5 million and 36.4 personnel-years for related activities to be conducted by the board in 1984-85. These funds will be used primarily to develop controls or standards for toxic air contaminants emitted by stationary (nonvehicular) sources. The requested amount is \$1.4 million above the current-year level, and will fund six additional personnel-years, as well as increased extramural research and expanded sampling of ambient air and emissions.

6. **California Highway Patrol.** The budget proposes \$2.9 million and 60.1 personnel-years for the patrol to use in inspecting and enforcing federal and state regulations for containers and vehicles carrying hazardous materials or wastes during the budget year. This is not a significant change from current-year expenditure and staffing levels.

#### **Review of Hazardous Substances Control Programs**

In the *Analysis*, we discuss numerous issues concerning individual hazardous substances programs in connection with our review of the departments' operating hazardous substances control programs. In this section, we review the current status of the state's program for controlling hazardous substances as a whole.

Our analysis indicates that the current mechanisms for planning and coordinating activities of the 12 departments operating hazardous substance control programs are not adequate. In the detailed analysis that follows, we (1) recommend immediate legislative action to strengthen the planning and coordinating functions of the existing system and (2) describe options for making further changes in the program.

**Problems of Overlapping Authority and Coordination.** Recognizing the need for greater control of hazardous substances, the Legislature has enacted numerous statutes to establish new hazardous substances control programs or expand existing authority. As a consequence, the number of statutes and hazardous substances control programs has increased tremendously since passage of the Hazardous Waste Control Act in 1972. In 1983, the Legislature established new programs to (1) identify and inspect underground tanks storing hazardous substances and (2) increase the

monitoring of drinking water to detect contamination.

Some of the new laws enacted during the last 12 years have resulted in overlapping responsibilities among agencies. This has led to conflicts between agencies in regulatory development, standard-setting, and enforcement. For example, both the Department of Health Services (DHS) and the State Water Resources Control Board (SWRCB) regulate and issue permits to hazardous waste facilities. The board regulates hazardous waste disposal facilities that discharge waste to surface or ground water. The department regulates all hazardous waste disposal facilities, including facilities that generate, store, or treat hazardous wastes. Draft regulations developed separately by the two agencies in 1983 contained conflicting standards. Also in 1983, the department filed legal charges against wood treatment facilities that were negotiating with regional water boards to clean up contamination on a voluntary basis.

In addition, the proliferation of hazardous substances control programs in different departments has made it more difficult for the administration to coordinate plans and budgets for these programs. As a result, we have observed inconsistencies between budget requests for different agencies. For example, the budget proposes an increase of \$889,000 and 5.7 personnel-years in the Air Resources Board (ARB) for improved regulation of toxic air contaminants. The statute authorizing these activities requires the DHS to analyze standards proposed by the ARB for their impact on public health. Although the ARB budget proposes a significant increase in staffing and workload that would presumably result in a larger number of proposed standards, the budget did not contain additional funds for the department to handle this additional workload.

***Previous Efforts to Improve Coordination Between Agencies.*** The problems we identify have been recognized for several years, and efforts have been made on several occasions to improve interagency coordination. Our review indicates that at least three organizations have been established for this purpose over the years. They are as follows:

1. ***Toxic Substances Coordinating Council.*** In 1980, the Governor established, by executive order, the Toxic Substances Coordinating Council (TSCC), consisting of representatives from seven state agencies and departments that regulated hazardous substances. The Governor charged the council with developing policy recommendations, promoting consistency in regulations, encouraging cooperation between agencies, and coordinating research. The council's activities resulted in the development of numerous legislative initiatives and budgetary proposals. Our review indicates, however, that the council did not successfully address the problems of coordinating regulatory activities, planning, and budgeting in the state agencies involved with hazardous substances control.

2. **Hazardous Waste Management Council.** In 1982, the Legislature established the Hazardous Waste Management Council (HWMC) on a limited-term basis (until July 1984) to develop a plan for facility siting and permitting, and to make recommendations for legislative and administrative changes needed to improve hazardous waste management. The 16-member council is composed of key department heads, legislators, and representatives of local government, industry, and environmental organizations.

The draft *Hazardous Waste Management Plan*, issued by the council in January 1984, makes 79 specific recommendations for new legislation as well as changes in state and local government operating procedures, including some recommendations aimed at improving coordination between state agencies and between state and local agencies. The primary focus of the report, however, is on the facility siting process. The report recommends establishing a state appeals board to review certain local government decisions on facility siting requests. The council's report is the most comprehensive report produced to date that reviews state hazardous substances programs. We will be able to comment further on the report and the recommendations it contains at budget hearings.

3. **Hazardous Substances Task Force.** In April 1983, the Governor abolished the Toxic Substances Coordinating Council and created the Hazardous Substances Task Force (HSTF). The executive order creating the new task force charges it to "identify and address issues relating to radioactive, toxic, and other hazardous substances and have overall responsibility to formulate and oversee the implementation of a comprehensive program" through existing statutory authority. The Governor designated the Secretary of Environmental Affairs as task force chairperson. The membership of the task force is drawn from 16 state departments and agencies.

The task force is conducting a three-phase review to (a) identify issues, (b) adopt goals and priorities, and (c) develop specific implementation proposals. Staffing for the task force is provided through the Office of the Secretary of Environmental Affairs and through the loan of personnel from other departments. The task force hopes to complete its review by the end of 1984.

In October 1983, the task force issued a draft report, *An Identification of Issues*, that provides an overview of existing programs and examples of current coordination problems. The report does not identify priorities among the issues cited nor does it make recommendations to correct the problems. The task force indicates that priorities and recommendations will be covered in later reports. Although our review indicates that the task force is performing needed coordination, we identified a number of shortcomings, which are discussed below.

### **A Permanent Effort with Expanded Authority is Needed**

*We recommend that the Legislature enact legislation to establish the task force on a permanent basis and expand its responsibilities to include (1) the development of recommendations for legislation and organizational changes, (2) oversight of budgetary decisions involving hazardous substances control, and (3) reporting to the Legislature on a regular basis.*

The Governor has established the Hazardous Substances Task Force (HSTF) to coordinate regulatory activities related to hazardous substances within the framework provided by existing law. The initial efforts of the task force have been aimed at identifying issues. In the future, the task force intends to establish priorities and plans for improving the state's hazardous substance control activities.

We see several shortcomings in the task force approach. Specifically, the task force (1) has no statutory authority and is therefore not accountable to the Legislature, (2) is not charged with reviewing existing statutes and organizational structures, (3) does not review budget proposals to insure that they are internally consistent, (4) has no line authority to resolve conflicts or direct departments to take specific actions, and (5) is not required to report to the Legislature or the public.

We believe that the enactment of legislation to establish the task force on a permanent basis would strengthen the efforts initiated by the Governor and, at the same time, improve legislative involvement in priority-setting for the hazardous substances control programs. The primary problems facing the state in coordinating its activities in this area are not likely to go away any time soon. In fact, we believe that a coordinating body of some sort will be needed as long as responsibilities in this area are shared by different agencies. From an organizational perspective, ad-hoc bodies established by executive order do not lend themselves to the same legislative review as similar organizations that have been established in statute. For this reason, we recommend that the Legislature enact legislation formally establishing and charging the task force (or some comparable body) with ongoing responsibilities in the hazardous substance control area. Specifically, this legislation should:

1. *Expand the task force's scope* to include the review of existing statutory provisions and organizational structures. The limitation on the task force's efforts imposed by the executive order's—acceptance of the existing statutes as immutable—is inappropriate because the state's efforts to control hazardous substances are still developing. Members of the task force are familiar with the existing statutes and should be encouraged to recommend changes where such changes will strengthen program performance.

2. *Expand the role of the task force chairperson* to include reviewing budget proposals in the hazardous substance control area. The current

budget development process does not ensure consistent decisions on related activities undertaken by different agencies. An effective way to ensure consistency would be to refer all budget requests to the task force and require the chairperson to submit written comments to the Department of Finance before these proposals are included in the budget. A unified presentation of the hazardous substance control program should be included annually in the introduction to the Governor's Budget.

3. *Require the task force to develop a comprehensive state plan for the control of hazardous substances and to report annually to the Legislature on the administration's progress in fulfilling the plan's objectives.* A comprehensive plan would represent a commitment by the administration to the Legislature to achieve concrete objectives and allow the Legislature to make changes in the priorities as necessary. The annual progress reports would form the basis for ongoing legislative oversight as well as for efforts by the public to hold the administration responsible for meeting the plan's commitments. The task force should solicit public input on the plan through hearings, workshops, or advisory committees.

Our analysis of the state's current efforts in the hazardous substance control area has identified two other program components that need immediate attention. These components involve data systems and scientific standard-setting. In the following sections, we discuss the problems in these areas that our analysis has uncovered and recommend supplemental report language requiring the administration to establish technical working groups to coordinate efforts in these areas.

### **Improved Data Systems Needed**

*We recommend that the Legislature adopt supplemental report language requiring the Hazardous Substances Task Force to establish a technical working group to review and coordinate data collection efforts and to recommend changes in current data collection efforts as appropriate.*

Over the years, the departments regulating hazardous substances independently of one another, have developed mechanisms to collect data from the regulated industries and to use that data to monitor compliance with the law. Different data systems on hazardous waste generation currently are operated by the Department of Health Services (DHS), the Board of Equalization (BOE), and the State Water Resources Control Board (SWRCB). In addition, the Department of Food and Agriculture collects data on pesticide usage. These systems produce contradictory conclusions as to the amounts and types of hazardous wastes generated because of differences in definitions and methodology.

The draft report of the Hazardous Substances Task Force (HSTF) and the draft plan of the Hazardous Waste Management Council (HWMC) identify the lack of a statewide coordinated data base as a significant

problem. The lack of data (1) impedes monitoring of compliance with permit requirements, (2) reduces the state's ability to encourage recycling and other alternatives to land disposal, (3) hinders program planning and facility siting decisions, and (4) makes evaluation of program effectiveness more difficult. The Hazardous Waste Management Council (HWMC) recommends that DHS (1) take the lead in coordinating and consolidating data and (2) provide data to counties to assist them in planning for facilities.

Our analysis confirms that the existing data systems are inadequate and uncoordinated, and that immediate steps are needed to improve these systems. We do not agree with the council's recommendation, however, that the Department of Health Services is the entity best able to design and operate a comprehensive data system. As we discuss in our analysis of the DHS budget (Item 4260 of the *Analysis*), implementation of the department's Hazardous Waste Information System is significantly behind schedule. In fact, the department currently is reviewing the system to identify changes in its design and operation that will allow full implementation. Given the problems that the department is having already, we do not believe it would be prudent to assign to it additional data management responsibilities.

We recommend instead that the HSTF establish a technical working group of staff currently responsible for collecting and managing hazardous substances data to (1) analyze existing data bases, (2) identify duplication or gaps in the information collected, (3) recommend system changes, and (4) estimate the cost of making these changes. Because of the importance of a functional data system to statewide hazardous waste management, we recommend that the Legislature adopt the following supplemental report language:

"The Hazardous Substances Task Force (HSTF) shall establish a technical working group to review the existing hazardous substances data systems and to recommend improvements. The group shall include representatives from the departments operating the existing systems and technical consultants experienced in electronic data processing. The working group should perform an inventory of existing data bases, identify duplication or gaps in the information collected, and make recommendations for system changes. The system changes may consist of alterations to existing systems or consolidating the systems into one. It shall also develop a feasibility study, an implementation schedule, and cost estimates for implementing the system changes. The HSTF shall submit a preliminary report of the working group's findings and recommendations to the chairpersons of the fiscal committees and the Joint Legislative Budget Committee by December 31, 1984, and a final report by March 31, 1985."

### **Standard-Setting and Risk Assessment**

*We recommend that the Legislature adopt supplemental report language requiring the Hazardous Substances Task Force to establish a working group of departmental scientists to (1) coordinate current activities, (2) analyze ongoing risk assessment needs, (3) establish priorities among specific substances to be reviewed, and (4) recommend changes in funding, organizational structures, or statutory authority as appropriate.*

The development of health effect standards is a major component of state hazardous substances regulatory activities. Current law authorizes at least five departments to develop and enforce exposure standards. The Department of Health Services (DHS) (1) sets and enforces standards for food and drinking water, (2) sets and enforces standards for hazardous waste disposal, (3) conducts studies of specific populations to determine health effects of hazardous substances, and (4) advises other departments on the medical and toxicological aspects of proposed standards. The Air Resources Board (ARB), State Water Resources Control Board (SWRCB), Department of Food and Agriculture (DFA), and Department of Industrial Relations (DIR) set and enforce standards for specific substances closely related to their program responsibilities.

The process of scientific standard-setting can be separated into two components: risk assessment and risk management. Risk assessment uses factual data to determine the effects of exposure to specific hazardous substances on the health of populations and individuals. Risk management develops regulatory standards using the information from the health risk assessment and other technical engineering and economic concerns.

Risk assessment has two phases (1) reviewing available scientific literature and conducting new studies to determine if a material poses a health risk and, if so, the total amount of exposure that is harmful and (2) applying that knowledge to the specific environmental medium or population covered by the particular department's jurisdiction. For example, acceptable exposure levels for ethylene dibromide (EDB) are different for drinking water, food products, and worksite exposure because the amount of the substance absorbed through each medium is different.

Differences in standards caused by the nature of the environmental medium are appropriate. Other differences in the risk assessment stage occur when the agencies use different approaches in determining whether a substance poses a risk and the total amount of exposure that is harmful. At worst, these inconsistencies in risk assessment can lead to conflicting state standards for the same chemical being set by the different departments. At best, where similar approaches are used by the different departments, the first phase of risk assessment, involving the basic scientific review, is duplicated in up to five departments. With the current backlog of substances suspected of being a threat to public health for

which enforceable exposure standards have not been developed, the state cannot afford to waste scientific effort in duplicative activities.

Our analysis indicates that the state's current method of scientific standard-setting needs immediate improvement. We have identified two alternatives to addressing the problem: (1) consolidating all risk assessment functions in the Department of Health Services and (2) improving coordination between the departments.

***Consolidation in the Department.*** In the past, before the other regulatory agencies were created, the department was responsible for all public health issues regardless of the type of exposure or environmental medium involved. Consolidation of scientific risk assessment into one organizational unit would tend to insulate the technical, scientific assessment of human health risk from the decisions of the regulatory agency managers, which must take into account political, economic, and technical considerations in addition to the potential effect on public health. The National Academy of Sciences recently recommended that the two functions of risk assessment and risk management be clearly separated.

***Improve Coordination.*** At this time, we recommend that the Legislature opt for the improvement of coordination between the existing departments, rather than consolidation. Before a reorganization is contemplated, we believe that a technical working group of scientists from various departments should be established by the task force to coordinate activities, analyze ongoing risk assessment needs, and identify problems in existing organizational structures and funding. We further recommend that the working group specifically evaluate the advantages and disadvantages of consolidating risk assessment into one department.

Accordingly, we recommend that the Legislature adopt the following supplemental report language:

"The Hazardous Substances Task Force (HSTF) shall establish a technical working group of scientists representing the appropriate regulatory agencies to (1) coordinate current hazardous substances activities, (2) analyze ongoing risk assessment needs, (3) establish priorities among specific substances to be reviewed, and (4) identify problems in funding, organizational structures, or statutory authority as appropriate. The working group shall evaluate the advantages and disadvantages of consolidating all risk assessment activities into one department. Scientists employed outside of the state regulatory agencies should be consulted as needed. The HSTF shall submit a preliminary report and plan by December 31, 1984, and a final report by March 31, 1985."

### **Possible Organizational Changes**

Our review indicates that the Legislature and the administration may wish to consider moving the hazardous waste regulatory activities current-

ly located in the Department of Health Services (DHS) to the Environmental Affairs Agency. Under this option, other DHS functions related to hazardous substances—health effects studies, toxicology, and laboratory services—would remain in the department's Health Protection Division.

The majority of the state's hazardous waste management activities currently are performed by the Toxic Substances Control Division (TSCD) in the DHS. A portion of the activities of SWRCB and the ARB are also related to hazardous waste. Many of the coordination problems regarding data collection, regulations, permitting, and enforcement are between the department and SWRCB.

Our review indicates that the TSCD has more in common with the SWRCB than with other units in the department or in the Health and Welfare Agency. The division's personnel are primarily engineers or waste management specialists, classifications that are found in large numbers at the board but not frequently in the rest of the department.

Past evaluations conducted by the Auditor General, the Environmental Protection Agency, and the Legislative Analyst have criticized the department's management of the hazardous waste programs. One of the reasons for the department's poor performance in the past is the relative small size of the division compared to the department as a whole. In the budget year, the division's proposed expenditures of \$58.1 million are 1 percent of the department's total expenditures of \$5.6 billion. The division's 245.5 positions represent 6 percent of the 4,135 positions proposed for the department. Within such a large department, it takes more time to make decisions and to process administrative paperwork. In our analysis of the division's Superfund program, for example, we criticize the long time needed to develop and process contracts for remedial action. Each contract currently must pass through 45 steps of development or approval handled by 16 different units, of which 13 are in the department.

The advantages of establishing a separate Department of Hazardous Waste Management in the same agency as the SWRCB and the ARB are (1) the three major government units regulating hazardous waste would report to one agency secretary, thereby increasing cooperation and improving communications, (2) the number of layers of bureaucracy would be reduced, thereby speeding decision-making, (3) administrative staff would no longer be shared with other programs, and (4) administrative procedures would be tailored to the hazardous substances program's needs rather than those of other programs such as Medi-Cal or local assistance grants.

The disadvantages of such a proposal are that (1) the program may be less sensitive to public health concerns, (2) administrative disruptions and delays often occur during major reorganizations, and (3) a new department would increase, rather than decrease, the number of agencies in-

volved in hazardous substances control because the DHS would continue to perform laboratory analyses and health effect studies. The Legislature needs more information before determining that reorganization is the best method of improving the performance of the state's hazardous substance control programs.

## **Local Government Finance Issues**

### **THE GOVERNOR'S PROPOSAL FOR FINANCING LOCAL GOVERNMENTS**

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***What Effect Will the Governor's Proposal for Financing Local Governments Have on the Ability of Local Agencies to Respond to the Needs of Those They Serve?***

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The voters' approval of Proposition 13 in 1978 brought about a distinct change in the way local government agencies operate. Prior to 1978, local governments had the ability to raise funds to maintain or expand local services, to add to their stock of capital facilities, and to provide in other ways for the needs of those residing within their boundaries. They were able to do this by increasing their property tax rates. Proposition 13, however, took away this ability, leaving most local agencies more dependent upon state aid to finance their programs. Furthermore, due to revenue shortages at all levels of government, local agencies have had to fund the growth in some programs by cutting back funding for other traditional services. Local governments contend that during the last five and one half years, they have lost a large part of their fiscal independence and fiscal stability.

#### **The Governor's Proposal**

The Governor's Budget proposes to restore, through the enactment of various statutory and constitutional changes, some of the fiscal stability which local governments enjoyed prior to Proposition 13. Specifically, the Governor proposes to:

- Repeal the AB 8 deflator;
- Repeal all statutory provisions for determining fiscal relief;
- Constitutionally guarantee vehicle license fee and cigarette tax subventions;
- Allocate the state's share of vehicle license fee revenues (18.75 percent of total collections, or \$210 million) to *counties* (\$208 million) and to the 31 "no property tax" *cities* (\$2 million);
- Apportion the supplemental property tax proceeds (estimated at \$422 million) among all local agencies, instead of only to K-12 schools, beginning in 1984-85 rather than in 1985-86 as provided by current law;
- Repeal the subvention for personal property tax relief (business inventories);
- Require counties to pay 20 percent of the estimated \$5 million in costs arising under the Indigent Defense and Homicide Trials programs. (This proposal is discussed in greater detail in Items 8160 and 8180 of the *Analysis*);

- Restore local governments' access to the general obligation bond market by relaxing (through a constitutional amendment) the one percent limitation on the property tax rate;
- Provide additional unspecified revenues for counties;
- Make specified changes relating to state-mandated local programs. (This proposal is discussed in greater detail later in this part and in Item 9680 of the *Analysis*.)

### Revenue Shifts

The Governor proposes to eliminate the personal property tax relief subvention for local agencies other than school districts. This would reduce state subventions to cities, counties and special districts by a total of \$320 million in 1984-85. Schools would not be affected because business inventory subventions were folded into the regular school apportionments system beginning in 1983-84. In order to offset a portion of the revenue loss that local agencies would experience as a result of eliminating the subvention, the Governor also proposes to advance by one year, from 1985-86 to 1984-85, the date on which these agencies will begin to share in the proceeds of the supplemental property tax. Under existing law, all of the proceeds from this tax are allocated to K-12 school districts in 1983-84 and 1984-85. If the Governor's proposal is approved, cities, counties, and special districts would gain about \$262 million from supplemental property taxes in 1984-85. K-12 schools would not be affected by the property tax shift because General Fund apportionments would increase automatically to offset any property tax revenue losses that they experience.

The Governor also proposes to allocate an additional portion of vehicle license fee (VLF) collections to counties. Under current law, 18.75 percent of these collections (an estimated \$210 million in the budget year) are deposited in the state General Fund; the remaining 81.25 percent is apportioned among cities and counties on the basis of population. Under the Governor's proposal, most of the 18.75 percent designated for the state would be redirected to counties; a small portion (\$2.1 million) would be allocated to the so-called "no property tax" cities—cities that existed but did not levy a property tax prior to the passage of Proposition 13. The \$2.1 million is intended to restore the revenue loss incurred by these cities when three small subventions were repealed in 1981-82.

**Fiscal Effect in 1984-85.** Table 73 illustrates the effect of the individual components of the Governor's financing plan (other than the repeal of the deflator) in 1984-85. This table indicates that, overall, *counties* would fare the best under the Governor's proposal, as they would receive an estimated net increase in revenues of \$191 million in 1984-85. Most of this increase is attributable to the additional vehicle license fee collections that would be redirected from the state to the counties.

*Special districts* would also fare well initially under the Governor's proposal, as they would receive an estimated \$12 million increase in revenue in 1984-85. *Cities*, however, would experience a net loss of approximately \$9 million, because they would lose more in revenue from the repeal of the business inventory subvention than they would gain in the form of supplemental property tax roll revenues. *Redevelopment agencies* would lose an estimated \$43 million in revenue during 1984-85. This loss is attributable entirely to the repeal of the business inventory subvention.

*Local school districts* would experience no net change in revenue as a result of the Governor's proposal. This is because the state generally "guarantees" a specific level of funding (the "revenue limit") for all K-12 school districts. Consequently, the \$284 million reduction in revenue to K-12 schools resulting from the revenue shifts would be offset by an increase in state General Fund apportionments. Similarly, the budget proposes to offset the \$22 million revenue gain to community colleges by an equivalent reduction in General Fund apportionments.

**Table 73**  
**Fiscal Effect of Governor's Proposal<sup>a</sup>**  
**by Revenue Source**  
**1984-85**  
**(in millions)**

<i>Revenue Source</i>	<i>State</i>	<i>Counties</i>	<i>Cities</i>	<i>Special Districts</i>	<i>RDAs<sup>b</sup></i>
Vehicle License Fees .....	-\$210	\$208	\$2	—	—
Property Taxes—Supplemental Roll .....	—	165	61	\$36	—
Offset to School Apportionments .....	-262	—	—	—	—
Business Inventory Subventions .....	+320	-181	-72	-24	-\$43
Other <sup>c</sup> .....	+1	-1	—	—	—
Totals .....	-\$151	\$191	-\$9	\$12	-\$43

<sup>a</sup> Does not reflect proposal to repeal deflator.

<sup>b</sup> Redevelopment agencies.

<sup>c</sup> Reflects counties' assumption of 20% of specified judicial programs.

As Table 73 indicates, the state would sustain a net loss of \$151 million in the budget year as a result of the Governor's proposal.

The budget assumes that revenues from the supplemental property tax will total \$422 million in 1984-85. As shown in Table 73, we estimate that if this assumption proves to be accurate, \$262 million in additional property tax revenues would be allocated among cities, counties, and special districts. There is considerable doubt, however, as to whether the estimate of these property taxes contained in the budget is accurate. If it is not accurate, the net fiscal effect of the Governor's proposals on local governments will differ from what is shown in the table.

In this regard, we note that data compiled by the Board of Equalization from information submitted by the counties indicates that the level of

supplemental property tax revenue in 1983-84 will be significantly less than what is anticipated by the Department of Finance. If the county estimates prove to be more accurate, the property tax estimates for 1984-85 probably are overstated as well. If that occurs, counties and special districts will not realize the full amount of the gains shown in Table 73, and cities will experience even greater net losses than those shown.

***Fiscal Effect on Individual Local Agencies in 1984-85.*** The data in Table 73 display the fiscal effect of the Governor's proposal on the four categories of local agencies. The data, however, are not necessarily representative of how individual agencies within each category would fare. For example, Table 73 indicates that, overall, cities will sustain a loss of \$9 million in the budget year. This \$9 million loss, however, will not be spread evenly among cities. Some will come out ahead; others will lose a disproportionate amount.

***Cities.*** The fiscal effect of the Governor's proposal on individual cities will depend on the relationship between each city's business inventory subventions (BIE) and what the city can expect to receive from the supplemental property tax. The amount of BIE received by any particular city depends on the value of business inventories located within that city's boundaries in 1979-80, and the city's share of the 1 percent Proposition 13 property tax rate. The amount of supplemental roll revenue that would be allocated to a given city would depend on assessed value within the city and, again, its share of the 1 percent Proposition 13 property tax rate.

The amount of business inventory value as a percent of total assessed value varies widely among cities, so that some cities would receive more in BIE than they would receive in proceeds from the supplemental property tax. Conversely, cities with a relatively small amount of BIE would probably realize a net gain in revenues.

***Special Districts.*** Table 73 also indicates that, overall, special districts would realize increased revenues of \$12 million. Again, this does not necessarily mean that each special district would come out ahead as a result of the Governor's proposal; some would and others would not.

***Counties.*** No county would lose revenues as a result of the Governor's proposal, due to the way in which the increase in vehicle license fee subventions would be allocated. First, funds would be allocated to each county in an amount sufficient to replace the loss of business inventory funding. The remaining vehicle license fee funds (about \$27 million) would be allocated to each county in proportion to its population.

***Redevelopment Agencies.*** All redevelopment agencies would sustain a loss of revenue under the proposal. We estimate that these agencies would lose approximately \$43 million, although the actual losses could be higher. Our estimate reflects the amount of the BIE subvention allocated to these agencies by county auditors. Current law, however, requires that

an adjustment to the assessed value of redevelopment agencies be made to increase their property tax revenue, in lieu of allocating to them any of the proceeds from the BIE subvention. The Governor proposes to repeal this adjustment, and no information is available on what the fiscal effect of doing so would be.

**Fiscal Effect After 1984-85.** A significant feature of the Governor's proposal for 1984-85 is the transfer of supplemental property tax revenues from K-12 schools to other local agencies. Under current law, this transfer would occur in 1985-86. Consequently, the additional revenue that local agencies would receive from the supplemental property tax in 1984-85 as a result of the Governor's proposal represents a *one-time only* revenue gain. Table 74 displays the estimated effect of the Governor's proposal in 1985-86.

**Table 74**  
**Fiscal Effect of Governor's Proposal**  
**by Revenue Source**  
**1985-86**  
**(in millions)**

<i>Revenue Source</i>	<i>State</i>	<i>Counties</i>	<i>Cities</i>	<i>Special Districts</i>	<i>RDAs<sup>a</sup></i>
Vehicle License Fees <sup>b</sup> .....	-\$230	\$228	\$2	—	—
Property Taxes—Supplemental Roll.....	—	—	—	—	—
Business Inventory Subventions .....	320	-181	-72	-\$24	-\$43
Other <sup>c</sup> .....	1	-1	—	—	—
Totals .....	\$91	\$46	-\$70	-\$24	-\$43

<sup>a</sup> Redevelopment Agencies

<sup>b</sup> Assumes 10 percent growth in revenue.

<sup>c</sup> Reflects counties' assumption of 20% of specified judicial programs.

Table 74 indicates that under the Governor's proposal, the state and counties would realize net revenue increases in 1985-86 of \$91 million and \$46 million, respectively. Cities, special districts and redevelopment agencies, on the other hand, would sustain net revenue losses of \$70 million, \$24 million and \$43 million, respectively.

### **Governor Proposes to Repeal the Deflator**

At the same time that the Legislature committed itself to a permanent program of fiscal relief for local agencies, it also established a mechanism, commonly known as the "AB 8 deflator", that reduces the amount of this relief *automatically* in times when state revenues are not adequate to maintain the ongoing "baseline" level of state expenditures. (A more detailed discussion of fiscal relief appears in Part Two—Expenditures: Local Assistance).

The deflator becomes activated when projected state revenues fall below an inflation-adjusted base level of state expenditures. When the deflator is activated, the State Controller is required to reduce motor vehicle

in-lieu subventions, cigarette tax subventions, and business inventory reimbursement subventions by an amount sufficient to make up one-half of the difference described above. Until recently, the other one-half would have come from apportionments to K-12 schools and community colleges. Ch 498/83, however, repealed the deflator for local education agencies.

**Deflator in Effect for 1984-85.** Based upon the most recent revenue and expenditure forecasts by the Department of Finance, the AB 8 deflator mechanism will be "triggered" for the 1984-85 fiscal year, and will require reductions of \$364 million in aid to cities, counties and special districts. These reductions would be made in proportion to each local agency's share of the three subventions specified above.

The governor proposes that the deflator mechanism, which was suspended in 1981-82, 1982-83, and 1983-84, be repealed for 1984-85 and thereafter. Table 75 shows the effect that activation of the deflator would have in 1984-85, by type of agency;

**Table 75**  
**Effect of the AB 8 Deflator**  
**Under Current Law**  
**1984-85**  
**(in millions)**

	<i>Counties</i>	<i>Cities</i>	<i>Special Districts</i>	<i>RDAs<sup>a</sup></i>	<i>Totals</i>
Vehicle License Fee Subvention .....	-\$128	-\$128	—	—	-\$256
Cigarette Tax Subvention .....	-4	-17	—	—	-21
Business Inventory Subvention .....	-49	-20	-\$6	-\$12	-87
Totals.....	-\$181	-\$165	-\$6	-\$12	-\$364

<sup>a</sup> Redevelopment agencies

### **Proposed Program Realignments Would Affect Local Agencies**

In addition to the Governor's proposal for financing local government, the budget includes several other proposals which would significantly alter the existing relationship between the state and county governments. As discussed earlier in "Expenditure Issues", the five proposed program realignments generally would shift existing health-related responsibilities in community-based mental health services, public health, family planning, and alcohol and drug programs from the state to the counties. Local governments would be provided \$53 million in additional revenues when these program responsibilities are transferred in 1984-85. This \$53 million includes approximately (1) \$7 million in existing state funds that would be "saved" as a result of transferring administrative responsibilities to the counties, (2) \$11 million in new funds to be appropriated in the legislation introduced to accomplish the program transfers (these funds are *not* included in the budget), and (3) \$35 million in new mental health services funds contained in the Governor's Budget.

### **Would the Governor's Proposal Increase the Fiscal Stability of Local Agencies?**

The primary objective of the Governor's local government financing proposal is to restore fiscal stability at the local level. According to the budget, local governments do not enjoy fiscal stability at the present time because a large part of their basic revenue structure is vulnerable to change at the state level shortly before—or even during—the fiscal year to which the change applies. Thus, by eliminating the automatic annual adjustments *required* by the AB 8 deflator, by providing a constitutional guarantee for most shared revenues, and by redistributing certain other revenue sources between the state and local agencies, the Governor maintains that fiscal stability can be restored.

This section examines the major components of the Governor's local government financing proposal to determine whether, and to what extent, each would contribute to achievement of the Governor's stated objective.

***Repeal of the AB 8 Deflator.*** The Governor's proposal to repeal the AB 8 deflator would, indeed, remove a major "threat" that each year confronts local governments as they prepare their budgets. If, for example, the Legislature allowed the deflator to take hold in 1984-85, as would occur *automatically* in the absence of legislative action, the deflator would reduce state aid to local governments by \$364 million. This "threat," however, is more of a tactical, than a strategic, problem to local governments. The deflator has existed since 1979, but it has never been allowed to go into effect. Even last year, when the state faced fiscal problems of an unprecedented magnitude, other mechanisms were used to reduce fiscal relief in order to help balance the state's General Fund budget. The elimination of the deflator, therefore, would contribute to local governments' fiscal stability only by putting them in a better bargaining position in the event a deficit in the General Fund looms once again.

***Constitutional Guarantee for VLF and Cigarette Tax Subventions.*** If a proposal to guarantee these subventions is approved by the voters in November 1984, cities and counties would have assurance, beginning in 1985-86, that *these* subventions could not be reduced by the state in the event of a prospective General Fund deficit. There can be no question that these subventions are particularly vulnerable to reduction. During the last three years, the state has reduced VLF subventions by significant amounts (39 percent in the current year) in order to help balance the state budget. Thus, this part of the Governor's program would indeed stabilize these particular revenue sources, by making the yield from them more predictable.

Here again, however, the advantage that would be gained by local governments is more tactical than strategic. Enactment of the Governor's

proposal would in no way preclude the state from making changes in other local government revenue sources to achieve the same end as a reduction in the VLF would achieve. For example, the state is empowered to alter the distribution of property tax revenues between local agencies, and this could be used as a means of shifting resources from local agencies to the state.

***Restoration of Local Governments' Access to the General Obligation Bond Market.*** Restoring the ability of local governments to issue general obligation bonds, which we have recommended since 1979, would provide important fiscal benefits to these governments. This change, however, would enhance local fiscal independence, rather than increase fiscal stability.

***Revenue Shifts.*** As discussed earlier, counties would be net gainers from the revenue shifts proposed by the Governor. In the first year (1984-85), these gains could be as much as \$191 million; by the second year, the increase would be reduced to \$46 million. This feature of the Governor's proposal would add stability to county finances by removing the funding for BIE subventions from state control. It would also contribute to county fiscal independence in 1984-85 by increasing the level of resources available to counties. After the first year, however, the net revenue gain would be so small—less than 1 percent of county general purpose revenue—that the impact would not be very significant.

Both cities and special districts, after the first year, would be net losers under this part of the proposal. Relative to their general purpose revenue, however, the magnitude of the net losses in each case would be minor.

***Conclusion.*** The Governor's proposal would improve the fiscal stability of local governments, but not in any fundamental or dramatic fashion. From a local perspective, the main attributes of the proposal are: (1) the increase in county revenues that would occur on a one-time basis in 1984-85, (2) the enhanced fiscal independence that would come from restored access to the general obligation bond market, and (3) the partial protection of the local revenue base if the voters approve the VLF and cigarette tax subvention guarantees. However, the proposal would *not* preclude the state from making adjustments in other local sources of funds, so local agencies would still be vulnerable to state-initiated, potentially abrupt changes in their revenues.

#### **Issues Not Resolved by the Governor's Program**

The Governor's program alludes to, but does not directly address, the other main concern of local governments (beside fiscal stability)—the ability to adjust local revenues to meet local needs. To us, this is the heart of the fiscal independence issue.

The budget mentions that the administration will work with the Legisla-

ture and local governments to review revenue alternatives for *county* governments. No details are given as to the types of alternatives which might be acceptable, nor is there any mention of a similar need for greater fiscal independence on the part of other types of local agencies. This section provides background on existing local revenue sources, and suggests ways in which the adequacy of local resources can be improved.

### Review of Local Resources

Table 76 presents information on the total revenues received by local agencies in 1981-82, the last year for which actual data are available. These data indicate that 31 percent of total city revenues are derived from tax proceeds, while counties take in only 23 percent of their total revenues from this source. Special district tax proceeds amount to 32 percent of their total revenue. The table also indicates that state aid is relatively less important to cities and special districts than it is to counties, in terms of its contribution to *total* revenues. This reflects the large amounts of state aid provided for county-operated health and welfare programs.

**Table 76**  
**Local Government Revenues, By Source**  
**1981-82<sup>a</sup>**  
**(in millions)**

	<i>Cities</i>		<i>Counties</i>		<i>Non-Enterprise Special Districts</i>	
	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>
General taxes .....	\$3,222	31%	\$2,994	23%	\$619	32%
Charges for services .....	3,951	38	2,584	20	150	8
Aid from other government agencies:						
State .....	600	6	3,584	27	85	4
Federal .....	901	9	2,746	21	207	11
Other .....	99	1	59	<sup>b</sup>	117	6
Other sources .....	1,522	15	1,107	8	744	39
Totals .....	\$10,297	100%	\$13,073	100%	\$1,920	100%

<sup>a</sup> Source: State Controller. City and county data include enterprise activities. San Francisco is reflected as a county. County charges for services include state Medi-Cal funds. Details may not add to totals due to rounding.

<sup>b</sup> Less than 1 percent.

The data shown in Table 76 relate to total revenues, however, and these data do not provide a very definitive picture of the local resources that are available for local general purposes. This is because total revenues include revenues from sources, such as the gasoline tax and user charges, that must be used for *specific* purposes.

Table 77 presents information on the level of revenues available to local agencies for general purposes between 1981-82 and 1984-85. The data for 1984-85 reflect the effects of the Governor's proposal. These revenues exclude receipts over which local agencies have no control, and conse-

quently these revenues provide a better (but by no means a precise) indicator of the relative extent to which local agencies can address local needs for services. The data in this table show that:

- Over the last three years, taxes have accounted for almost 74 percent of city general purpose revenue, and 63 percent of county general purpose revenue. Thus, the growth in total general purpose revenue for both types of agencies primarily depends on growth in tax revenues.
- Federal aid and other sources of both city and county revenue have been virtually static over the entire period.
- Cities experienced a modest increase (4.2 percent) in total revenues during 1982-83, reflecting the reduction in state vehicle license fee subventions. In the current year, the growth rate (8.9 percent) is more robust because higher tax receipts were not offset by significant increases in the amount of subventions withheld by the state. In the budget year, the restoration of "normal" VLF funding would raise state aid by 83 percent, which in turn would lead to a 14 percent increase in general purpose income.
- Counties also experienced modest revenue increases during 1982-83 (6.1 percent) and 1983-84 (6.1 percent). The Governor's proposal to shift additional VLF revenues to counties in the budget year would increase state aid by 23 percent, and contribute to a general purpose revenue increase of over 12 percent.

**Table 77**  
**General Purpose Revenues of Cities and Counties<sup>a</sup>**  
**1981-82 through 1984-85**  
**(in millions)**

	1981-82	1982-83	1983-84	1984-85 <sup>b</sup>	Percentage Change 1983-84 to 1984-85
<i>Cities</i>					
Taxes .....	\$3,229	\$3,484	\$3,899	\$4,359	11.8%
State aid .....	389	318	319	583	82.8
Federal aid.....	258	254	254	254	—
Other sources .....	640	648	651	657	0.1
Total .....	\$4,516	\$4,704	\$5,123	\$5,853	14.2%
<i>Counties</i>					
Taxes .....	\$2,737	\$3,020	\$3,256	\$3,710	13.9%
State aid .....	621	642	673	827	22.9
Federal aid.....	268	257	257	257	—
Other sources .....	895	880	903	930	3.0
Totals.....	\$4,521	\$4,799	\$5,089	\$5,724	12.5%

<sup>a</sup> Source: 1981-82 data for cities and counties, and 1982-83 data for counties, is from State Controller's Annual Report on Financial Transactions. All other data represent Legislative Analyst's Office estimates.

<sup>b</sup> Reflects Governor's local government finance proposal.

### **Adequacy of Local Revenue Base.**

Even though it has been five and one-half years since Proposition 13 was approved by the voters, no consensus has formed regarding what constitutes an adequate local revenue base. Obviously, average trends in revenue growth do not reflect the experience of *every* city and county. Some communities have greater needs; others have more resources to draw on. As a result, estimates of general purpose revenues for cities and counties as a group illustrate broad trends in the fiscal health of local agencies, but they are not nearly precise enough to highlight the fiscal health of individual local entities.

If the Legislature wishes to increase the fiscal independence of local governments, it can do so in three ways:

- *Authorize local agencies to impose additional local taxes.* Cities presently have fairly broad authority to raise or levy virtually any type of tax not precluded by state law or city charter. County governments and special districts, however, do not have the same flexibility. There would appear to be little reason why the state would want to deny the voters of any local jurisdiction the right to tax *themselves* in order to maintain services in accordance with local priorities.
- *Extend to local agencies a greater degree of flexibility in administering state-controlled programs.* This can be done by eliminating unnecessary program requirements that are not closely related to program outputs. To the extent the state limits the options available to local agencies in carrying out their program responsibilities, it may prevent them from taking advantage of changes in technology which could result in the more efficient provision of public services.
- *Provide additional funding to local governments whenever new program requirements are imposed by the state.* Whenever the state mandates new or increased duties on local agencies and does not provide the necessary funding for these duties, it in effect requires local governments to redirect funds from existing local programs to the new state program. If local officials are to be held accountable by those they serve for how local resources are used, the state should fund the new requirements it imposes on local governments.

### **TRIAL COURT COSTS**

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#### ***How Can the Legislature Help the Counties Control Trial Court Costs?***

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The responsibility for the administration and financing of California's trial court system currently is shared between the state and local governments. State laws, and the rules of court adopted by the state Judicial Council, establish programs, procedures, and guidelines for the operation of these courts. Responsibility for the day-to-day administration of the trial

courts, however, lies with the counties and the courts themselves.

California has three types of trial courts—superior, municipal, and justice courts. Superior courts are supported primarily by the counties, although the state (1) pays about 90 percent of each judge's salary, (2) provides an annual \$60,000 block grant to offset a portion of county costs for certain judgeships, and (3) provides health and retirement benefits for judges. Municipal and justice courts are also financed primarily by the counties, except that the state provides retirement benefits for municipal court judges. In addition, the state reimburses counties for the costs of certain trial court activities, such as defending indigents in capital cases.

### **Trial Court Expenditures Increasing**

Table 78 details the increase in state and county trial court expenditures from 1978–79 through 1982–83. It shows that during this period, state expenditures have been increasing at a rate of over 15 percent a year, while county expenditures rose at an annual rate of about 14 percent. During this five-year period, state trial court costs rose about 76 percent, and county costs rose about 68 percent. The actual increases in expenditures during this period were \$32 million for the state and \$218 million for the counties.

**Table 78**  
**Estimated State and County Trial Court Expenditures**  
**1978–79 through 1982–83**  
**(in millions)**

Year	State		County		Total Trial Court Costs	
	Amount	Percent	Amount	Percent	Amount	Percent
1978–79.....	\$42.3	—	\$322.1	—	\$364.4	—
1979–80.....	51.1	20.8%	370.5	15.0%	421.6	15.7%
1980–81.....	63.0	23.3	418.1	12.8	481.1	14.1
1981–82.....	62.7	–0.5	472.3	13.0	535.0	11.2
1982–83.....	74.5	18.8	540.4	14.4	614.9	14.9
Total Increase from 1978–79 to 1982–83	\$32.2	76.1%	\$218.3	67.8%	\$250.5	68.7%
Average Annual Increase.....	—	15.2%	—	13.8%	—	14.0%

Sources: Governor's Budgets and the State Controller's office.

County expenditures for the trial courts rose at a rate significantly faster than overall county costs during the 1978–79 through 1982–83 period. As shown in Table 79, total county expenditures increased by an average of 8 percent annually between 1978–79 and 1982–83. Because trial court expenditures increased at an average annual rate of nearly 14 percent, these expenditures rose from 4.2 percent of county budgets in 1978–79 to 5.2 percent in 1982–83—a 24 percent increase. The data in Table 79 also demonstrate that state costs for the trial courts are rising faster than total state General Fund expenditures, although they still represent a very small percentage of the state's General Fund budget.

**Table 79**  
**Growth in County and State Expenditures**  
**1978-79 through 1982-83**  
**(in millions)**

Year	Counties		State General Fund	
	Amount	Percent	Amount	Percent
1978-79 .....	\$7,618.7	—	\$16,250.8	—
1979-80 .....	8,148.4	7.0%	18,534.1	14.0%
1980-81 .....	9,385.4	15.2	21,104.9	13.9
1981-82 .....	9,783.7	4.2	21,692.8	2.8
1982-83 .....	10,305.3	5.3	21,751.4	0.3
Total Increase, 1978-79 through 1982-83 .....	\$2,686.6	35.3%	\$5,500.6	33.8%
Average Annual Increase .....	—	7.8%	—	7.6%

Sources: Governor's Budgets and the State Controller's office.

County representatives have expressed concern over the rapid rate of growth in trial court costs. Due to the restrictions imposed by Proposition 13 in 1978, counties generally are not able to increase taxes in order to cover the rising costs of providing government services. Because trial court costs are rising faster than the costs of other county services, counties are having to finance rising court costs by reducing expenditures for other programs which they believe to be of higher priority.

#### **Legislature's Role in Controlling Court Costs**

The largest component of *state* trial court expenses is the cost of salaries and retirement benefits for judges. Legislative attempts in recent years to control these costs have been frustrated by a series of court decisions which have ruled that limitations on salary increases or pensions may not be implemented during a judge's term in office. As a result, the Legislature's ability to control the state's share of trial court costs is limited, for the most part, to restricting the number of new judgeships authorized for the courts.

There are, however, a number of ways the Legislature can assist counties in controlling their costs. This is because, in many instances, *state law currently limits county flexibility to operate the trial courts in such a way as to control or reduce trial court costs*. Below, we identify several ways the Legislature can give counties more flexibility to administer the trial courts in a more cost-effective manner, or to impose more of the costs of providing court services on the users of those services. Each of these alternatives would require a change in state law.

#### **Process Serving**

*In order to increase county control over the costs of serving civil process, we recommend that legislation be enacted to permit counties to (1) assess fees to cover their actual costs of serving process and (2) contract with private firms to serve process.*

One way the Legislature can assist counties is to modify laws that limit local flexibility in utilizing court-related personnel. For example, counties use sheriff's and marshal's officers to serve civil process (such as a notification of a pending court action against a person). Private firms may also serve process except in specified instances (they may not serve certain writs). State law limits the ability of counties to control costs for process serving by setting a maximum fee counties may charge for this service, and by restricting counties from contracting with private firms, in lieu of using more expensive county personnel, to serve process.

Specifically, under Section 26721 of the Government Code, when a person decides to use a sheriff or marshal to serve process, the county may not charge the individual more than \$14 for the service. The counties' actual costs for performing these duties often are significantly higher than the maximum allowable fee. This limit on fees makes it necessary for local taxpayers to subsidize users of public process servers. Los Angeles County estimates that its costs for process serving exceed fee revenues by about \$9 million annually.

In addition, when individuals request counties to serve process for them, or when specified types of process must be served, the Government Code (Sections 26608, 71264, 71265) requires sheriff's or marshal's officers *themselves* to serve the process. As a result, a county generally may not contract with a private firm to serve process on the county's behalf, even where it would be cost-effective to do so. Because sheriff's and marshal's officers are trained and compensated as peace officers, a county's cost to serve process may be significantly higher than that of a private firm which does not use peace officer personnel for the task. San Diego County estimates that it could save \$1 million annually by contracting with private firms for process serving.

By allowing counties to recover their actual costs in serving process, the Legislature would enable counties to shift the costs of providing these services from the general taxpayers to the users of the services. In addition, by allowing counties to contract with private firms to serve process, the Legislature would enable counties to reduce their costs.

### **Electronic Recording of Court Proceedings**

*In order to increase county control over the costs of court proceedings, we recommend that the Legislature enact legislation to permit counties to use electronic recording as an alternative to shorthand reporting when they determine it would be appropriate and cost-effective.*

Various studies in recent years have found that major savings could be achieved by modernizing the method by which court and administrative proceedings are recorded and transcribed. In June 1982, the United States General Accounting Office (GAO) recommended increasing the use of

electronic recording in the federal courts, as an alternative to shorthand court reporters. The GAO estimated that the annual savings from doing so would be about \$10 million. In February 1982, the state Auditor General's office found that the Workers' Compensation Appeals Board, which conducts administrative hearings, could save about \$1 million annually by using electronic recording. The studies also concluded that transcripts produced from electronic recordings could be as accurate, or more accurate, than shorthand reporters' transcripts.

Currently, many state agencies which conduct administrative hearings, such as the Public Employees' Relations Board and the Department of Motor Vehicles, rely on electronic recording devices in lieu of shorthand reporters. Moreover, the Office of Administrative Hearings indicates that the electronically recorded transcripts consistently have been accepted by the courts when decisions made by these agencies are appealed.

Despite strong indications that electronic recording devices can be as accurate as—and often significantly less expensive than—shorthand reporters, state law generally prohibits trial courts from using these devices or even experimenting with them to determine their usefulness. The Code of Civil Procedure (Sections 269 and 274c) *requires* superior, municipal, and justice courts to use shorthand reporters for court proceedings. The only exception to this requirement is that municipal and justice courts may use electronic recording devices for certain proceedings, in accordance with Judicial Council rules, if no reporter is available. Municipal courts in several counties currently employ these devices successfully when no reporter is available.

The Los Angeles County Superior Court Executive Officer estimates that the use of electronic recording in the 5–10 percent of the proceedings where it would be *most* cost-effective (for example, in certain family law hearings), would save the county over \$400,000 annually. If the Legislature modified current law to give the counties more flexibility to use electronic recording devices in the trial courts, counties could reduce trial court costs by utilizing electronic reporting in those proceedings where it would be appropriate and cost-effective.

#### **Fees for Civil Trials**

*In order to tie litigants' costs more closely to the costs they impose on the trial courts, we recommend the enactment of legislation to authorize all counties to assess litigants for the costs of court reporters in civil trials.*

Courts traditionally have assessed fees to cover a portion of their operating costs. In recent years, the Legislature has authorized counties to offset rising costs by increasing fees charged to litigants in civil cases. As a result, court fee revenues were about \$63 million, or 139 percent, higher in 1982–83 than in 1978–79. This represents an average annual increase of

about 24 percent during the five-year period. As Table 80 demonstrates, because court fees rose faster than court costs during the period, the portion of costs covered by fees also increased. Nevertheless, fees still cover only about 20 percent of *total* county court costs.

It is important to note that this total includes costs for criminal, as well as civil actions. While no statewide data are available which separate the costs of these activities, two counties have performed studies indicating that costs for civil matters comprise about 50 percent of their total superior court costs. Based on these estimates, fee revenues may offset about 40 percent of county costs for civil matters handled by trial courts.

**Table 80**  
**County Trial Court Fee Revenues**  
**1978-79 through 1982-83**  
**(in millions)**

<i>Year</i>	<i>Fee Revenues</i>		<i>Costs</i>		<i>Fees As A Percentage of Costs</i>
	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>	
1978-79 .....	\$45.4	—	\$322.1	—	14.1%
1979-80 .....	46.3	2.0%	370.5	15.0%	12.5
1980-81 .....	65.9	42.3	418.1	12.8	15.8
1981-82 .....	87.2	32.3	472.3	13.0	18.5
1982-83 .....	108.3	24.2	540.4	14.4	20.0
Total Increase, 1978-79 through 1982-83 ....	\$62.9	138.6%	\$218.3	67.8%	—
Average Annual Increase .....	—	24.3%	—	13.8%	—

Source: State Controller's office.

Although much of the recent growth in court fee revenue has resulted from increases in filing fees, initial processing of filings is a relatively small proportion of total court costs. The costs of conducting trials accounts for a far greater portion of county court expenditures. Yet, in most counties, litigants must pay only a small share of county trial costs.

Counties currently have limited statutory authority to charge litigants for the costs of trials, which primarily result from the salaries and benefits of the court reporters, bailiffs, and clerks that attend trials. According to the Judicial Council, litigants in municipal and justice courts generally pay the full costs of court reporters. However, Government Code Section 269 prohibits superior courts from assessing litigants for a county's costs to retain a court reporter during a trial. The Legislature made exceptions to this provision in nine counties where the courts may charge litigants requesting trials for the costs of court reporters.

Our review suggests that the policy of allowing counties to charge litigants requesting trials for the costs of court reporters should be extended to the superior courts in all 58 counties. By enacting legislation to give counties the flexibility to charge civil litigants for an increased share of the costs of trials, the Legislature would tie the costs borne by litigants more

closely to the costs they impose on county governments. While this approach clearly would shift more of the costs of the court system to litigants, it would not necessarily increase the financial burden on low or moderate income persons. This is because the California Rules of Court generally require courts to waive fees for persons who are not able to afford them.

### **Summary**

The statutes discussed above are only several examples of the laws that the Legislature could modify in order to give counties more flexibility to cope with rising trial court costs. Elimination of such restrictions would enhance the ability of the counties to respond to the other demands for public services placed upon them by their residents. Accordingly, we recommend enactment of legislation to permit counties to: (1) assess fees to cover their actual costs of serving process, (2) contract with private firms to serve process, (3) use electronic recording as an alternative to shorthand reporting when the counties determine it would be appropriate and cost-effective, and (4) assess litigants for the costs of court reporters in civil trials.

## **FUNDING FOR STATE-MANDATED LOCAL PROGRAMS**

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### ***Does the Legislature Need to Consider Changes in the Reimbursement Process?***

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Current statutory law (Chapter 3, Pt. 4, Div. 1, Revenue and Taxation Code), familiarly known as "SB 90", *requires* the state, under certain circumstances, to reimburse local governments for the costs of state-mandated programs. Article XIII B of the State Constitution (Proposition 4 on the November 1979 ballot) also requires the state to reimburse local governments for the costs of state-mandated programs. State reimbursement of these costs represents a significant annual expenditure. This section examines issues relating to the state's procedures for funding state-mandated local programs.

### **State Procedures for Reimbursing Mandated Costs**

Under the existing reimbursement process, a local government may submit a claim to the State Board of Control in an attempt to obtain reimbursement for the state-mandated local costs associated with unfunded legislation. This first claim, known as a "test claim," forms the basis for the board's review. After a series of hearings and a review of documents submitted by local and state agencies, the board determines (1) if a mandate exists, (2) if the mandate is eligible for reimbursement, and (3) the amount of funding required to reimburse all local agencies for the costs incurred as a result of the mandate.

The amount of funding so determined reflects the costs incurred by all

local agencies from the operative date of the mandate through the current year, which is usually a period of several years. The cost determination is based on "parameters and guidelines" developed by the board which delineate the types of costs which are eligible for reimbursement. Once adopted by the board, a report summarizing the board's findings is presented to the Legislature and a bill, known as a "claims bill," is introduced which appropriates funds sufficient to pay all claims approved by the board.

After the Legislature completes its deliberations on the claims bill and the bill is chaptered, local agencies then file "reimbursement claims" with the State Controller. The Controller disburses the funds appropriated by the Legislature to each claimant, after its claim is reviewed for consistency with the parameters and guidelines adopted by the Board of Control. In succeeding years, an appropriation for the ongoing costs associated with mandates initially funded in this manner is included in the Governor's Budget.

#### **Legislative Action on Claims Bills**

During the 1983 session, the Legislature considered two bills seeking appropriations to reimburse local governments for costs associated with what the Board of Control has deemed to be a reimbursible mandate. These bills, together with amendments requested by the board but not agreed to by the Legislature, would have provided a total of \$219.7 million in funding for costs incurred by local agencies under 34 separate statutes.

As of this writing, one of these bills—SB 1274—has been chaptered. This act appropriated \$157,800 for payment of claims relating to two statutes. The other claims bill, AB 504 (Vasconcellos), is still pending before the Legislature. In its current form (as amended February 13, 1984), the bill would appropriate a total of \$52 million from the General Fund for payment of claims relating to 18 separate statutes.

#### **Growth of State Mandates**

Since 1975, when the state began keeping records on state-mandated local costs, approximately 2,800 bills have been enacted which contain a mandated local program. According to the Department of Finance, 108 of these bills contained an appropriation in the enabling legislation to pay for the mandated costs. In addition to the 108 bills which contained appropriations, the Board of Control has to date determined that another 52 statutes require reimbursement by the state. To date, 15 of these statutes have been funded by the Legislature.

Annual state General Fund expenditures for state-mandated costs have grown from \$3.5 million in 1973-74 to an estimated \$225 million in 1983-84. Table 81 details the total cost of state-mandated local programs from the inception of the program.

**Table 81**  
**State-Mandated Local Programs**  
**Total General Fund Costs<sup>a</sup>**  
**1973-74 through 1984-85**  
**(in thousands)**

	<i>Appropriations Contained in Mandate Legislation</i>	<i>Expenditures From Budget Act Appropriations</i>	<i>Claims Bills</i>	<i>Total</i>
1973-74 .....	\$3,538	—	—	\$3,538
1974-75 .....	2,655	\$14,943	—	17,598
1975-76 .....	1,376	17,963	—	19,339
1976-77 .....	20,226	18,356	\$523	39,105
1977-78 .....	4,007	52,623	—	56,630
1978-79 .....	21,443	54,434	1,203	77,080
1979-80 .....	12,013	75,565	12,202	99,780
1980-81 .....	9,947	105,377	7,572	122,896
1981-82 .....	—	101,942	33,980	135,922
1982-83 .....	610	92,886	24,183	117,679
1983-84 .....	10,000	73,362	141,424 <sup>b</sup>	224,786
1984-85 <sup>c</sup> .....	—	82,042	29,550 <sup>d</sup>	111,592
Totals .....	\$85,815	\$689,493	\$250,637	\$1,025,945

<sup>a</sup> Includes funding from the Restitution/Indemnity Fund in 1982-83 through 1984-85 for Ch 1123/77.

<sup>b</sup> \$157,800 of this amount has been approved by the Legislature, the remainder is pending. Does not reflect pending approval of \$30 million for Ch 360/77 (liability limits).

<sup>c</sup> Department of Finance estimates.

<sup>d</sup> Pending approval by the Legislature.

### **Governor's Funding Proposals**

**Current Year.** The Governor's Budget estimates that *General Fund* expenditures to reimburse local governments for mandated costs will be approximately \$225 million in the current year, which includes: (1) \$10 million to pay the costs of the first claims bill introduced in 1984, (2) \$31 million in deficiencies from prior-year budget appropriations for mandated costs, (3) \$84 million for reimbursement of the ongoing costs associated with existing mandates, and (4) \$100 million for reimbursement of specific outstanding claims. This latter amount includes: (1) \$21 million for AB 504, and (2) \$79 million to fund two of the 13 claims which originally were recommended for payment by the Board of Control but were deleted from the bill in the Assembly. The Governor's Budget is silent regarding the \$30 million appropriation in AB 504 for Ch 360/77. Assuming, however, that the administration would consent to the appropriation of these funds, approximately \$130 million, or 60 percent of the \$220 million originally requested by the Board of Control in 1983-84 may ultimately be provided.

**Budget Year.** The Governor proposes General Fund expenditures of approximately \$112 million for reimbursement of mandate-related costs in the budget year. This includes: (1) \$82 million for reimbursement of the continuing costs associated with existing mandates, and (2) \$30 million to provide reimbursement for the ongoing costs of statutes funded for the first time in AB 504.

Expenditures for the budget year, however, could be significantly higher than the \$112 million identified in the Governor's Budget, for two reasons. First, an unknown but probably major amount of funding will be required to reimburse local governments with respect to claims presently pending before the Board of Control. The board will introduce two claims bills during the 1984-85 fiscal year, one in July of 1984, and the other in January of 1985. No estimate of the amount of funds to be requested by the board in these claims bills is currently available. Second, the state could also incur additional funding liability for "prior year deficiencies." These deficiencies arise when the funding level provided for a mandate is insufficient, and an additional appropriation is needed to reimburse all local agencies with valid claims.

### **Governor's Proposal to Reform the Reimbursement Process**

The Governor's Budget proposes two changes to the existing system for reimbursing approved state-mandated local costs. Specifically, the Governor proposes that legislation be enacted to (1) provide that mandates which are not accompanied by an appropriation shall be implemented only at the *discretion* of local agencies, and (2) allow the Controller to allocate funds to local agencies on a formula or "uniform allocation" basis, rather than on the basis of individual claims submitted by local agencies. The language to accomplish these changes is to be included in the budget companion bill, but as of this writing it was not available. Each of these proposals is discussed in more detail below.

**Discretionary Mandates.** The Governor's Budget proposes that legislation be enacted which provides that compliance with legislation which imposes new duties on local agencies without making an appropriation to fund the cost of carrying out those duties *shall be voluntary*. In contrast, the administration's local government finance package (SB 1300, Marks) provides that if the legislation imposes a mandate but does not appropriate an amount at least equal to the Department of Finance's statewide cost estimate, then the mandate *shall not be operative*.

Regardless of how the inconsistency between the two proposals is resolved, our analysis indicates that neither would accomplish its stated objective.

Specifically, according to Legislative Counsel, mandates cannot be made inoperative or discretionary in the manner suggested in either one of the administration's proposals. This is because the actions of one Legislature do not bind the actions of succeeding Legislatures. Any statute enacted *after* a statute making compliance with an unfunded mandate voluntary would not be bound by the earlier statute. Thus, if a subsequent bill placed a new requirement on local government but did not contain an

appropriation to reimburse local government for these costs, local governments would be legally obligated to comply with the new statute, notwithstanding the previous statute making compliance voluntary.

**Block Grant Funding.** The Governor's Budget proposes that funding for most ongoing mandate programs be provided on a block grant basis. This would only apply to mandates which have been funded through the Budget Act for a period of several consecutive years. Presumably, this would result in funds for *individual* mandate programs being provided on an allocation formula or uniform allowance basis. The Department of Finance indicates, however, that this proposal is still being developed, and that the program ultimately proposed could be substantially different from that which is indicated by the language in the 1984 Budget Bill.

Our analysis indicates that the existing process for reimbursement of these mandates is, indeed, in need of revision. As the Governor points out, the process of developing complex procedures for computing the amount of allowable reimbursement, determining the actual amounts of costs eligible for reimbursement, and then verifying that the claimed amounts are appropriate, requires more effort than it is worth. The resources devoted to these unproductive activities could be better utilized in the delivery of services to the public at both the state and local levels. Accordingly, we endorse the thrust of the Governor's proposal and suggest that the Legislature and the administration work together to produce a new system for reimbursing local governments for such costs.

Payment options available to the Legislature range from the uniform allowance or allocation formula approach now in use for four mandates, to a broader "block grant" approach. Under the latter type of approach, all reimbursement funds for a particular type of agency might be "folded together," and allocated on the basis of population or some other variable. For example, each school district's revenue limit could be increased by the amount of its reimbursement under each of the 20 mandate programs currently funded for school districts.

In the *Analysis* (Item 9680, State-Mandated Local Programs), we recommend that the Department of Finance submit a detailed proposal for changing the funding of mandated local programs prior to the time of budget hearings, and address certain key administrative and policy issues associated with this suggested block grant approach.

### **Court Challenges to the Reimbursement Process**

Within the past few years, several suits have been filed by local agencies against the state challenging various aspects of the existing mandated cost reimbursement process. These cases generally fall into one of two categories: (1) those challenging the authority of the Board of Control, and (2) those challenging the adequacy of the funding level provided. Several of

these cases provide the courts the opportunity to significantly restructure the reimbursement process, and restrict the Legislature's ability to impose enforceable mandates. Following is a discussion of several of the cases which currently are pending and their potential impact on the reimbursement process.

**Board of Control Authority.** The County Supervisors Association and 38 counties have sued the state, alleging that the state has enacted 15 unfunded mandates in violation of Section 6, Article XIII B of the California Constitution. One of the more important issues in this case is whether the existing Board of Control reimbursement process provides an adequate administrative remedy for legislative mandates which are imposed without explicit provision for reimbursement. The counties contend that under Article XIII B, they may go directly to the courts to seek a remedy when mandates are imposed but reimbursement is not provided. The counties argue that the Board of Control does not have the authority to grant any relief from alleged violations of Article XIII B, and therefore it is not an administrative remedy that must be exhausted, per statutory law, prior to seeking judicial relief. A finding in favor of the counties would, in effect, shift from the Board of Control to the judicial system the responsibility for arbitrating disputes over funding for mandates. The case is currently pending in the Sacramento County Superior Court.

There have been at least four additional cases relating to 11 different statutes filed since March, 1983 which challenge the procedures used by the Board of Control when reviewing initial claims to determine if a mandate exists. Existing case law, commonly referred to as the "Topanga test," requires that findings of adjudicating boards must bridge an analytical gap between the evidence presented at an administrative hearing and the resulting decision or order of the board. In other words, the decision rendered by a board must bear a reasonable relationship to the facts and issues which were presented during the hearing. Compliance with the "Topanga test" serves several functions. Specifically, it (1) enables a reviewing court to trace and examine the decision-making board's analysis, (2) enables parties to the administrative decision to determine whether and on what basis to seek judicial review, and (3) demonstrates that the administrative decision is careful, reasoned and equitable.

In each of the 11 statutes cited in the four cases, the board found that no mandate existed. The local agencies subsequently filed suit alleging that the board's decision-making process did not meet the "Topanga test." The court found in favor of the local agencies and remanded each of the statutes to the Board of Control to be reheard.

As a result of the court's finding, the board implemented more formalized procedures, beginning at its December 1983 meeting. Specifically, the board revised its internal procedures to include sworn testimony,

detailed written findings and a formal recording of all proceedings as documented by a court reporter. These changes were implemented too recently to know if they will meet the criteria of the "Topanga test." Further, it is unknown what effect, if any, these changes will have on the overall claim process. For example, the amount of time required to arrive at a determination could be increased, or these more formal proceedings could actually promote, rather than dispel, future litigation.

The significance of the court's decision, however, is not that it caused the board to change its procedures for hearing initial claims. Rather, the decision demonstrates that the court considers the board to be an adjudicating, rather than advisory body, thereby clarifying that the board's decisions are subject to judicial review.

**Adequacy of Funding Level.** On November 14, 1983, the City of Los Angeles filed an omnibus suit which, among other things, seeks to compel the state to pay the full costs, *as determined and approved by the Board of Control*, associated with reimbursable mandates. In this case, which relates to vocational rehabilitation (Ch 1435/74), the board found that a mandate existed, and fixed the level of reimbursement. The Legislature, however, did not provide the requested level of reimbursement. The city's suit seeks to compel the state to provide full reimbursement as determined by the board. The case raises the question as to how significant Board of Control findings are, and whether these findings can be used in court to force specific legislative action. Specifically, this case could allow the court to determine whether, through Article XIII B of the Constitution, the state can be compelled to provide funding for mandated local costs and whether the Legislature has any discretion over the level provided. This case is presently pending in the Sacramento County Superior Court.

In another case, the Sacramento County Superintendent of Schools, 84 other superintendents and the California School Boards' Association have filed a suit alleging that the Legislature has not provided a level of reimbursement sufficient to cover the full costs incurred by schools in complying with mandates relating to special education and bilingual/bicultural education. The significance of this case, again, is in the remedy being sought. The superintendents are not seeking full funding reimbursement. Instead, they are seeking a judicial declaration that absent (full) funding, a local agency need not comply with a mandate.

A finding in favor of the superintendents could reduce legislative control over the reimbursement process in two ways. First, it could establish the court's authority to determine exactly what constitutes "full" funding. Second, it could allow the court to determine what obligation, if any, there is for local agencies to comply with mandates for which full funding is not provided. The case is pending trial in Superior Court.

### **Recommended Changes to the Reimbursement Process**

*We recommend that the Legislature consider establishing a new adjudicative body to replace the State Board of Control for all matters relating to state-mandated local programs.*

Our review of the existing system for reimbursing state-mandated local costs, along with our review of the number and breadth of reimbursement-related cases currently pending in court, indicates that the existing system needs to be altered. The Board of Control has functioned, since the time it was assigned its responsibility for SB 90 matters in 1979, as an *advisory* body. Its role has been to report to the Legislature its determinations as to which mandates qualify for reimbursement, and the amount of funding necessary to reimburse local agencies for carrying out these requirements. The board's approach to decision-making has not been constrained by the strict interpretation of legal issues which now appears to be necessary.

Our analysis indicates that the advisory role is no longer appropriate. Recent judicial decisions indicate that the courts will hold the board accountable to a *judicial* standard. Further, we believe that an adjudicative body's decisions would provide a better basis for legislative determinations as to its ultimate liability for reimbursement of mandates not currently funded and those not yet enacted. Such a body would, in the course of its operations, clarify many of the ambiguities which now exist as to what constitutes a mandate, and the circumstances under which reimbursement may be disclaimed. Finally, the creation of such a body might prevent the judicial system from subsuming the resolution of state-mandated local program issues within its ever-spreading jurisdiction. Accordingly, we recommend that the Legislature consider establishing an adjudicative body, along the lines of the Workers' Compensation Appeals Board, to replace the State Board of Control in all matters relating to state-mandated local programs.

### **FINANCING COMMUNITY REDEVELOPMENT PROJECTS**

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*How Can the Legislature Assure that the Expenditure of State Funds for Redevelopment is Consistent with State Objectives?*

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Community redevelopment agencies are special districts established by local agencies, usually cities, to redevelop a community's blighted areas. Blighted areas are defined as property which suffers from economic dislocation or disuse due to faulty planning, inadequate public facilities, a high incidence of depreciated property values, impaired investments or social and economic maladjustment. Although local legislative bodies may ap-

point the members of the redevelopment agency's governing board, it is more common for the legislative body itself (usually a city council) to serve as the agency's governing board.

By 1981-82, local governments had created 160 redevelopment agencies, which constituted 3.2 percent of the state's 5,000 special districts. The relatively small number of redevelopment agencies, however, belies the size and scope of their financial operations. In 1981-82, redevelopment agency revenues exceeded \$1.1 billion, which was 14 percent of all special district revenues. In the same year, redevelopment agencies spent over \$885 million, which was slightly less than 14 percent of all special district expenditures.

As discussed in more detail below, redevelopment agencies derive most of their funding from the property taxes attributable to the *increase* in assessed valuation within project areas. Consequently, one might conclude that these agencies are supported entirely by local revenue sources. Such, however, is not the case. The state, through its General Fund, provides considerable financial support for redevelopment activities—albeit indirectly. The amount of this support, moreover, has increased rapidly in recent years. Because this support is provided indirectly, the amount of this support and the way it is used are not determined through the annual state budget process. Consequently, the Legislature should consider taking action to ensure that the amount and use of these funds are consistent with Legislative priorities.

### **Agency Funding Sources**

Redevelopment agencies have five primary sources of revenue—tax increment revenues, bonds, other forms of long-term debt (usually loans), interest earnings and federal grants. Redevelopment agencies had been authorized to levy a 1 percent sales tax, but the statute authorizing this tax recently may have been invalidated by the First District Court of Appeals (*Huntington Park Redevelopment Agency vs. Martin*, 149 Cal. App. 3d 82). Table 82 summarizes redevelopment agencies' proceeds from each of these revenue sources and the major categories in which their expenditures fall, from 1976-77 through 1981-82.

As Table 82 indicates, not only is the scope of redevelopment agencies' activities broad; the level of these activities has grown rapidly. From 1976-77 to 1981-82, redevelopment agencies' gross revenues grew at an average annual rate of 13 percent. Tax increment revenues and interest earnings—which are redevelopment agencies' two primary sources of *operating* revenues—grew at annual rates of 21 percent and 35 percent, respectively. Gross expenditures over the same period grew at an annual rate of over 16 percent, while expenditures on current operations—project improvements, real estate purchases, administration and other operating expenses—grew at an annual rate of nearly 21 percent.

**Table 82**  
**Redevelopment Agencies**  
**Revenue Sources and Objects of Expenditure**  
**1976-77 through 1981-82**  
**(in millions)**

	<i>Actual</i>				<i>Average Annual Change 1976-77 to 1981-82</i>
<i>Revenues</i>	<i>1976-77</i>	<i>1979-80</i>	<i>1980-81</i>	<i>1981-82</i>	
Property Tax Increment .....	\$106.6	\$149.3	\$205.1	\$271.3	20.5%
Proceeds of Long-Term Debt .....	99.0	156.7	170.4	251.5	20.5
Sale of Bonds .....	229.2	445.5	66.1	237.8	0.7
Interest .....	34.0	119.6	119.2	153.2	35.1
Federal Grants .....	73.2	47.6	63.8	60.6	-3.2
Other .....	61.4	114.0	119.4	138.5	17.7
Totals .....	\$603.4	\$1,032.7	\$744.0	\$1,112.9	13.0%
<i>Expenditures</i>					
Debt Principal .....	\$156.6	\$181.2	\$124.1	\$222.6	7.3%
Project Improvement .....	67.5	315.8	162.8	150.3	17.4
Real Estate Purchases .....	58.7	79.9	104.5	199.7	27.7
Debt Interest .....	50.6	119.9	116.9	133.2	21.4
Administration .....	31.1	49.4	52.4	65.0	15.9
Other .....	49.7	59.7	107.0	116.1	18.5
Totals .....	\$414.2	\$805.9	\$667.7	\$886.9	16.4%
<i>Net Income</i> .....	\$189.2	\$226.8	\$76.3	\$226.0	3.6%

Source: State Controller's office

### Tax Increment Financing

The most common form of funding for redevelopment agencies is property tax increment financing. After an agency is formed, the other taxing jurisdictions within the redevelopment project area (the county, cities, school districts, and other special districts) generally receive property tax revenue only from the amount of assessed valuation that existed within the project area at the time the agency was established. Property tax revenue attributable to any increase in assessed valuation subsequent to the agency's formation can be allocated to the redevelopment agency. These so-called property tax increment revenues are allocated to the redevelopment agency up to its level of certified debt, which can include bonded indebtedness, contractual agreements, payments to other agencies, or virtually any other form of financial obligation.

Although tax increment revenues constitute only about 25 percent of redevelopment agencies' revenues, these funds are far more important to the agencies. This is because the funds are used to leverage virtually all of the agencies' other revenues. Tax increment revenues are pledged to the retirement of tax allocation bonds, loans, and other debt instruments issued by the agency. This debt financing is used to support real estate acquisition, construction of public facilities, and other activities related to the redevelopment project. In 1981-82, the value of all outstanding debt issued by redevelopment agencies was nearly \$2.2 billion, which repre-

sented over 20 percent of the debt issued by all special districts. Proceeds from bonds are also invested by redevelopment agencies. The yield from these investments has become a major source of operating funds for the agencies—now over \$150 million per year.

### **State Bears Major Burden of Tax Increment**

Except for a limited number of grants, the state does not support redevelopment agencies directly. The state, however, indirectly finances redevelopment activities through the K-14 school district revenue limit apportionment mechanism. Under this mechanism, the state makes up the difference between what districts are authorized to spend by the revenue limit and what they receive in property tax revenues. Because the school districts' share of whatever growth in property taxes occurs within an agency's boundaries is allocated to the redevelopment agency, rather than to the districts, the state must allocate additional apportionment funds to the school districts to replace these foregone revenues. We estimate that in 1982-83, the state spent *\$87.8 million* to replace the school districts' share of tax increment revenues.

Redevelopment agencies have argued that the state would have had to pay this amount anyway, because the assessed valuation growth that occurs in redevelopment project areas results primarily from the agencies' activities. This is partially true, because redevelopment agencies are indeed directly responsible for considerable growth in assessed valuation within project areas. Some of this growth, however, is due to inflationary adjustments and reassessments triggered by changes in ownership, which would have occurred even in the absence of a redevelopment project. Hence, the indirect cost to the state of supporting redevelopment agencies is equal to the school districts' share of tax increment revenues associated with assessed valuation growth that would have occurred without redevelopment activities. While we do not know what this amount is, it clearly is a substantial sum.

Table 83 shows that tax increment revenues received by redevelopment agencies more than doubled in the three years between 1979-80 and 1982-83, as did the school districts' share of the tax increment. This rapid rate of growth (over 30 percent annually) is not unexpected, because redevelopment agencies receive *all* of the property tax growth that occurs within existing project areas, and because they have usually been able to expand project areas by amending their redevelopment plans.

**Table 83**  
**Growth in Tax Increment Revenues**  
**1979-80 through 1982-83**  
**(in millions)**

	1979-80	1980-81	1981-82	1982-83 <sup>a</sup>
Total revenues .....	\$149.3	\$205.1	\$271.3	\$329.0
K-14 districts' share .....	39.7	54.6	72.2	87.8

Source: State Controller's office, Board of Equalization.

<sup>a</sup> The figures for 1979-80 through 1981-82 are actual revenues. The figure for 1982-83 is tax increment levies only. Levies exclude interest, penalties, delinquencies, and allocations from prior year levies. The 1982-83 figure probably understates by a considerable margin actual tax increment revenues.

### **Tax Increment Burden On Local Agencies**

The balance of the tax increment financing, in effect, comes from cities, counties, and special districts. Cities, however, are the major direct beneficiary of redevelopment activity. These benefits come in the form of increased employment and retail trade within the project area, as well as the effect that the improved overall attractiveness and utility of the project area has on business and commerce in other areas of the city.

Redevelopment law has established two mechanisms to alleviate the financial burden caused by tax increment financing on local agencies:

1. Proposed redevelopment plans must be submitted to a fiscal review committee for review and comment. The committee consists of representatives from each of the local taxing jurisdictions affected by the proposal to establish tax increment financing.

2. Redevelopment agencies are authorized to make payments to local agencies to alleviate the effect of serious "financial detriment," as determined by the fiscal review committee, due to tax increment financing. The term "financial detriment" is not defined in current law.

It is not clear, however, how effective these mechanisms are in alleviating the burden that tax increment financing places on all affected entities. On the one hand, the structure of the fiscal committees does not appear to provide counties and special districts with much leverage on the development of redevelopment project plans. Committee members only have the power to advise the redevelopment agency of the detrimental effects that a proposed project would have, and they generally do not have sufficient information to adequately assess these effects. Counties and special districts have no authority to seek changes in a plan to ameliorate detrimental effects or to address other unmet needs. Fiscal review committees also have no authority to review proposed amendments to existing redevelopment plans, even though the amendments often are as significant as the proposals to adopt new plans.

On the other hand, while the financial detriment payments may alleviate the burden for some affected entities, they may *increase* the burden on others. To the extent, for example, that a payment is made to the county (perhaps as part of a negotiated settlement calling for the county to discontinue its efforts to block the establishment of a new agency or the expansion of an existing one), it increases the redevelopment agency's level of certified debt and consequently allows it to increase the amount of the tax increment it may claim. This will work to the further financial detriment of school districts—and therefore, to the state.

### **Use of Tax Increment Revenues for Purposes Other Than Redevelopment**

The rehabilitation of blighted urban areas is an objective that serves both state and local interests. In recent years, however, some redevelopment agencies have served essentially as agencies of city governments, providing services that traditionally have been considered city responsibilities and providing capital that traditionally has been raised through the issuance of general obligation bonds.

For example, some redevelopment agencies have used tax increment revenues to secure indebtedness issued for the purpose of developing vacant and agricultural land, instead of rehabilitating blighted developed property. In certain extreme examples, redevelopment project areas consist almost exclusively of vacant property. In other cases, redevelopment agencies are using tax increment revenues to build freeway interchanges and support the ongoing maintenance and operation of *existing* public facilities, including buildings and even roads.

Cities concede that certain redevelopment activities do not serve the original objective which the agencies were created to achieve. They argue, however, that their existing general purpose revenues are inadequate to support the operation and maintenance of existing municipal facilities, necessitating the use of tax increment revenues for such purposes. They also argue that redevelopment projects are the only practical means available to cities to finance needed public facilities, infrastructure and maintenance, given the restrictions imposed by Proposition 13.

### **Legislature Needs to Reform Redevelopment System**

*We recommend that the Legislature enact legislation to reform the redevelopment plan adoption process, restrict the uses of tax increment revenues and limit the state's contribution to redevelopment projects.*

We acknowledge the difficulties involved in issuing general obligation bonds, given Proposition 13's restrictions, and elsewhere in these pages we recommend that the voters be asked to approve a constitutional amendment relaxing these restrictions. Nevertheless, we see two defects in the cities' rationale for extending the use of tax increment financing beyond the traditional—and legitimate—use of rehabilitating blighted areas. First, it ignores the fact that both charter and general law cities are authorized by state law and the constitution to impose general purpose taxes with a simple majority vote of their legislative bodies. Given this flexibility, it seems inappropriate for cities to use tax increment revenues for operation and maintenance of existing facilities, especially when the activities are not directly related to the redevelopment of blighted areas.

Second, and more importantly, the current structure and operation of redevelopment agencies, in effect, requires the state to contribute major

sums of *state* funds to achieve *local* objectives other than those which they originally were set up to achieve. In addition, redevelopment agencies, through tax increment financing, can dictate the amount of support provided by the state.

In order to assure that the state's interest is protected, we recommend enactment of legislation that would reform the redevelopment plan adoption process, restrict the uses of tax increment revenues, and limit the state's contribution. Specifically, this legislation should:

- Strengthen and clarify the responsibilities of the fiscal review committees;
- Prohibit the use of tax increment revenues to support traditional city services not directly related to the rehabilitation of blighted neighborhoods;
- Place limitations on the duration of redevelopment projects;
- Restrict the inclusion of vacant land in redevelopment project areas; and
- Limit the amount of tax increment available to redevelopment agencies to the growth in property tax revenues directly attributable to redevelopment project activities. At a minimum, legislation should require school districts, rather than redevelopment agencies, to receive their share of the assessed valuation growth resulting from the 2 percent inflationary adjustment allowed under Proposition 13.

## **THE SUPPLEMENTAL PROPERTY TAX**

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### ***Should the Legislature Take Steps to Improve the Administration of the Supplemental Property Tax?***

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The cost of the various education reform programs enacted in SB 813 (Ch 498/83) was supported in part by the establishment of a supplemental property tax administered by county governments. The purpose of the supplemental tax program is to accelerate the collection of property tax increases caused by changes in ownership that occur, or new construction that is completed, on or after July 1, 1983.

At the time that SB 813 was enacted, it was estimated that this acceleration would yield additional property tax revenues of \$272 million in 1983-84 and \$444 million in 1984-85. SB 813 allocated all of these revenues, (also referred to as "floating lien date" funds) to K-12 school districts in 1983-84 and 1984-85, thereby reducing the General Fund cost of state aid provided to those districts by the amount of the supplemental property tax revenues. Beginning in 1985-86, the act provides that the supplemental revenues will be allocated to all local governments through the regular property tax allocation mechanism.

Following the passage of SB 813, the Legislature enacted AB 399 (Ch

1102/83), which made a variety of technical changes to SB 813 and established a mechanism to fund the counties' costs of administering the supplemental property tax program.

The supplemental property tax has a prominent role in the Governor's proposal for restructuring local government finance. Specifically, the Governor has proposed to allocate the supplemental property tax through the regular property tax mechanism in 1984-85 (one year earlier than required under current law), and to replace the schools' revenue losses in the budget year with increased General Fund aid.

Obviously, the attractiveness of this proposal to local governments and its fiscal impact on the state depend on how much revenue counties can be expected to collect in 1984-85. After reviewing the counties' progress in implementing the supplemental property tax, we have reached the following conclusions:

- Counties estimate that 1983-84 supplemental property tax *levies* will be about \$50 million less than the amount assumed in the Governor's Budget;
- Supplemental property tax *collections* in 1983-84 probably will be substantially less than the amount assumed in the budget, resulting in a major unfunded current-year deficit in state aid to K-12 schools;
- If the counties' estimate of 1983-84 supplemental revenues is reliable, then the Governor's Budget probably overestimates 1984-85 revenues from this source by a significant amount.
- The Legislature needs to clarify whether redevelopment agencies are entitled to a share of supplemental property tax revenues.
- The amount of potentially reimbursable costs that counties will incur for administering the supplemental property tax is probably more than the amount of funds made available in AB 399 to cover those costs.

### **Property Tax Provisions of SB 813 and AB 399**

#### **Reassessment Prior to SB 813**

Under the provisions of Proposition 13 (June 1978), increases in assessed valuation generally are restricted to increases in the cost of living, not to exceed 2 percent annually. Property which is newly constructed or changes ownership, however, is reassessed at its full market value as of the date the property is completed or transferred. Prior to SB 813, the county assessor did not conduct the reassessment until the first lien date (March 1) following the transfer or completion of construction. The new assessed valuation became effective on the first day of the fiscal year following the lien date (July 1). Hence, under prior law, properties were subject to higher assessments no sooner than 4 months and as much as 16 months after the event which triggered the reassessment occurred.

### **How the Supplemental Property Tax Works**

SB 813 established a "floating lien date" for reassessing property. Except for builders' inventories, property is now reassessed on the first day of the month following the date on which a transfer occurs or new construction is completed. The supplemental property tax has four major components: (1) making supplemental assessments, (2) determining supplemental tax liabilities, (3) billing and collecting taxes, and (4) allocating revenues to local agencies.

**Step 1: Supplemental Assessments.** SB 813 requires county assessors to prepare two supplemental assessment rolls in addition to the regular assessment roll—one for the current fiscal year and one for the upcoming fiscal year. Properties which change ownership or are newly constructed between March 1 and May 31 are placed on *both* supplemental rolls, because these transfers "missed" the lien date for the upcoming fiscal year. The first supplemental assessment equals the difference between the property's full market value as of the date of transfer or completion and the assessed value entered on the current roll. The second supplemental assessment equals the difference between full market value and the value entered on the roll being prepared. Properties which change ownership or are newly constructed between June 1 and February 28 are placed on the supplemental roll for the *current* year only. The supplemental assessment on these properties equals the difference between full market value as of the date of transfer or completion and the value entered on the current roll.

**Step 2: Calculating Supplemental Tax Bills.** After the deadline for claiming an exemption has expired (30 days after the assessor notifies the property owner that a supplemental assessment has been made), the assessor turns over the supplemental assessment rolls to the county auditor, who prepares the supplemental tax rolls. The tax liability on the supplemental assessment for the upcoming fiscal year equals the supplemental assessment for that year times the tax rate for the upcoming fiscal year. The tax liability on the supplemental assessment roll for the current year equals the supplemental assessment for that year, times the current tax rate, times a proration factor based on the number of months remaining in the fiscal year.

**Step 3: Billing and Collecting Taxes.** After preparing the supplemental tax roll, the auditor gives it to the county tax collector, who prepares and sends supplemental tax bills to the property owner. Supplemental bills for the current year are sent immediately, while supplemental bills for the upcoming fiscal year are combined with the property owner's regular tax bill.

**Step 4: Allocating Revenues.** After the tax collector receives payments on the supplemental tax bills, the county auditor deducts from the

portion of the revenue attributable to the regular (1 percent) property tax levy an amount to cover the county's administrative costs. Under current law, the balance is allocated in 1983-84 and 1984-85 to each K-12 school district in the county in proportion to the district's average daily attendance. After 1984-85, these funds will be allocated through the regular property tax apportionment process. (That portion of the revenues attributable to the tax rate above 1 percent is allocated to various accounts used to retire voter-approved debt.)

### **Reimbursement of County Administrative Costs**

SB 813 imposes major costs on county assessors, auditors, tax collectors and data processing departments to implement and administer the supplemental property tax. SB 813 itself provided no funds for county administrative costs. AB 399, however, authorized each county, prior to allocating revenues to school districts and debt accounts, to deduct from the supplemental property tax revenues it collects in 1983-84 and 1984-85 an amount to cover its administrative costs, not to exceed 5 percent of all the revenues collected, including debt levies. AB 399 also appropriated \$10 million from the General Fund to reimburse counties for administrative costs in 1983-84 that exceed the amount that can be funded from the counties' share of the supplemental property tax.

### **Implementation Progress to Date**

#### **County Progress Varies Considerably**

Shortly after SB 813 was enacted, forty-two county assessors filed suit against the state in San Francisco Superior Court (*Shafer v. State Board of Equalization*). The assessors have asked the court to invalidate the supplemental property tax primarily on constitutional grounds. First, the assessors have asserted that the supplemental property tax is a new ad valorem tax on real property which violates the prohibition on such taxes added to the constitution by Proposition 13. Second, the assessors have argued that the provisions of SB 813 exempting builders' inventories and trade fixtures from supplemental assessment are unconstitutional because classes of property may be exempted from property taxation only by constitutional provisions, not by statute. (A third cause of action—that SB 813 imposed an unfunded mandated program on counties, in violation of Article XIII B, Section 6—was dropped when AB 399 provided a funding source to defray the counties' costs for administering the tax.) As of February 1, 1984, the case had not yet been heard in court.

In spite of the lawsuit, it appears that every county has taken some steps toward implementing the tax. The progress made by individual counties to date, however, varies considerably.

By February 1, 1984, approximately one-half of the counties had sent out notices of supplemental assessment to owners of property that had

debt accounts. The amount that would be allocated to school districts is \$53.2 million less than the amount indicated in the budget. Any shortfall in such revenues would be reflected as an unfunded current-year deficit in state aid for K-12 school districts.

***Collections Are Expected to Lag Behind Estimates.*** All of the figures displayed in Table 84 are estimates of *accrued revenues*—that is, taxes owed because of events that occur in each fiscal year. Because it is difficult to predict when counties will send out tax bills, there are no reliable estimates of actual *tax collections* in 1983-84. Collections probably will be *substantially less* than accrued revenues, because of the delays that counties have experienced in making supplemental assessments and collecting supplemental taxes. We estimate that actual collections could be as much as \$150 to \$200 million less than the estimate of accrued revenues contained in the budget. Because state aid to K-12 districts is calculated on the basis of property taxes *actually allocated* to school districts, a delay in collecting supplemental property taxes beyond June 30, 1984 would result in *increased* state aid to schools in 1983-84 and *decreased* state aid in 1984-85.

The budget estimates that these accrued revenues in 1984-85 will total approximately \$500 million. Of this amount, \$444 million would be allocated to various local agencies and the remaining \$56 million would be allocated to debt accounts, as indicated in Table 84. Counties have not yet prepared their own estimate of 1984-85 revenues. If the counties' estimate of 1983-84 revenues is reliable, however, then the budget probably overestimates 1984-85 revenues.

Supplemental property tax *collections* in 1984-85 will be less than tax *levies*, because of delinquencies and delays in making assessments, billing taxpayers and collecting taxes. The shortfall in collections, however, will probably be less than the shortfall in the current year. This is because counties will be processing supplemental assessments and tax bills more quickly in 1984-85 than in the current year.

#### **County Administrative Costs Could Exceed AB 399 Funding**

On January 15, 1984, 47 counties submitted claims to the Board of Equalization for reimbursement of 1983-84 administrative costs which exceed 5 percent of 1983-84 supplemental tax revenues. These counties estimated total 1983-84 administrative costs of approximately \$17.9 million. Based on discussions with Los Angeles, Santa Clara and San Francisco Counties, which did not file claims, we estimate that total county administrative costs will be about \$22 million in the current year. This amounts to 7.1 percent of the 1983-84 supplemental revenues estimated by the Board of Equalization, and 8.8 percent of the revenues estimated by counties. About one-half of this amount will be funded from the 5 percent property tax allocation.

Under the claiming guidelines developed by the Department of Finance, the 47 counties will be required to support \$10.9 million of these costs from the proceeds of the supplemental property tax. The remaining \$11.1 million would be supported by funds appropriated in AB 399. Since the act appropriated only \$10 million for this purpose, available funds probably will be prorated among certified claims. AB 399, however, permits counties to charge unpaid 1983-84 claims against 1984-85 supplemental property tax revenues.

In 1984-85, administrative costs for most counties will decline relative to supplemental tax revenues. This is because most counties will no longer incur one-time implementation costs, especially for modification of their data processing systems, and because 1984-85 supplemental tax levies will be larger than 1983-84 levies. There will be some exceptions, however. Several counties have deferred major modifications of their data processing systems until 1984-85 and will incur higher costs than they are incurring in 1983-84.

Even though counties' administrative costs will decline relative to supplemental tax revenues in 1984-85, it appears that the costs incurred by many smaller counties will exceed the funding currently available under AB 399. For example, in the current year, 18 counties have reported administrative costs in excess of 20 percent of tax levies. Although these counties' costs probably will decline in 1984-85 relative to tax revenues, their costs will exceed 5 percent of revenues in most cases. Any costs not supported by the counties' share of supplemental property tax revenues are potentially state-reimbursable.

Under the Governor's proposal, counties would receive, in addition to 5 percent of supplemental tax revenues, a portion of the remainder based on the regular property tax apportionment formulas. These funds could be used to support any county costs that exceed the amount available from AB 399.

#### **Redevelopment Role Needs Clarification**

*We recommend that the Legislature clarify whether redevelopment agencies are entitled to a share of supplemental property tax revenues.*

When a redevelopment agency is formed under current law, the other taxing jurisdictions within the redevelopment project area receive property tax revenue only from the amount of assessed valuation that existed in the project area prior to the agency's formation. Subsequent property tax revenue growth is allocated to the redevelopment agency.

The language of SB 813 is not sufficiently clear on the question of whether redevelopment agencies are entitled to the supplemental property tax levied on property within redevelopment project areas. Although current law does not distinguish supplemental property taxes from ordi-

nary tax increment revenues, the Governor's Budget assumes that redevelopment agencies will *not* receive any supplemental revenues. This may not be a reasonable assumption. County auditors might be compelled to allocate to redevelopment agencies their share of the supplemental revenues. If all redevelopment agencies received these revenues, the amount remaining for allocation to all other agencies would be reduced by \$19 million in 1983-84 and by \$31 million in 1984-85.

Because of the magnitude of this potential revenue shift and because the ambiguity in SB 813 may result in different policies among the counties, the law should be clarified. We therefore recommend that the Legislature enact legislation specifying the allocation of supplemental property taxes levied in redevelopment project areas.

## ***Legislative Control of the Budget***

### **COLLECTIVE BARGAINING FOR STATE EMPLOYEES**

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#### ***What Role Does the Legislature Wish to Play in the Collective Bargaining Process?***

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##### **Background**

In 1983–84, the second round of collective bargaining negotiations took place within the framework established by the State Employer-Employee Relations Act (SEERA) and the Higher Education Employer-Employee Relations Act (HEERA).

In our *Analysis of the 1982–83 Budget Bill* (page B-44) and *The 1983–84 Budget: Perspectives and Issues* (page 185), we provided: (1) a detailed description of the bargaining process for state employees, (2) an analysis of what happened during the first year of collective bargaining, and (3) a number of recommendations intended to help the Legislature play a more meaningful role in the collective bargaining system. This year, our discussion of collective bargaining focuses on:

- The current status of collective bargaining within state government (1983–84), including the status of employees falling under SEERA and HEERA;
- The results of the second round of negotiations; and
- The Legislature's role in the collective bargaining process.

##### **Employees Affected by Collective Bargaining**

As Table 85 shows, most state civil service and related employees are now represented in collective bargaining with regard to the terms and conditions of their employment. Over 82 percent, or 112,890, of the state's 136,988 full-time employees have been assigned to bargaining units. The remaining 24,098 employees are not subject to collective bargaining, due to: (1) their responsibilities as managerial, supervisory or confidential employees, or (2) specific exemptions granted by law to (a) the staff of those state agencies with a direct role in the collective bargaining process, such as the Public Employment Relations Board (PERB) and the Department of Personnel Administration (DPA), and (b) statutory officers whose salaries are set directly by the Legislature.

Decisions regarding the terms and conditions of employment for those employees who are not covered by a collective bargaining agreement are made as follows:

- The Governor, through the DPA, proposes changes in existing conditions of employment for nonrepresented civil service and related employees.

**Table 85**  
**State Civil Service and Related Employees**  
**Status Under the State Employer-Employee Relations Act (SEERA)**  
**1983-84**

<i>Category</i>	<i>Estimated Personnel-Years (As of July 1, 1983)</i>	
	<i>Number</i>	<i>Percent</i>
Employees in bargaining units .....	112,890	82.4%
Employees not subject to bargaining:		
Managerial and supervisory .....	19,216	14.0
Confidential .....	1,356	1.0
Excluded specifically by SEERA .....	1,933	1.4
Statutory officers and exempt employees not in bargaining units .....	1,593	1.2
Total (excluding legislative staff) .....	136,988	100.0%

- The University of California (UC) Regents and California State University (CSU) Trustees propose such changes for UC and CSU non-represented employees, respectively.
- The Legislature then acts on the proposals, either:
  - Through the normal budget bill process (for provisions which require an appropriation), or
  - By enacting a separate bill (for provisions which require changes to existing law).

Neither the provisions of the SEERA, nor the salary-setting procedure for non-covered employees apply to employees of the Legislature. Compensation increases for these employees are set by the Legislature, outside of the process established by SEERA.

***State Employees Covered Under SEERA.*** The PERB has designated 20 separate bargaining units for state civil service and related employees. The exclusive bargaining representatives of these units have negotiated agreements on behalf of their members for each of the past two years. Table 86 shows the distribution of state civil service employees among bargaining units and the status of the memorandum of understanding (MOU) covering each unit. The table shows that:

- The vast majority of MOUs (17 out of 20) will expire at the end of 1983-84. Of the remaining three MOUs, two (units 8 and 18) will be operative until the end of 1984-85, and one (unit 13) will be in effect until the end of 1985-86.
- Almost one-half of the state civil service and related employees in bargaining units are part of either the administrative, financial and staff services group (unit 1) or the office and allied occupational group (unit 4).
- Ten of the 20 bargaining units, which cover two-thirds of those employees subject to bargaining, have the California State Employees' Association (CSEA) as their exclusive representative.

**Table 86**  
**Distribution of State Civil Service and Related Employees**  
**Among Bargaining Units and Current MOU Status**  
**1983-84**

Unit Number	Occupational Group	Estimated Personnel-Years As of July 1983		Exclusive Representative	Term of Current MOU
		Number	Percent		
1	Administrative, Financial and Staff Services .....	22,132	19.6%	California State Employees' Association (CSEA)	7-1-82 to 6-30-84
2	Attorney & Hearing Officer .....	1,858	1.6	Association of California State Attorneys, Inc.	7-1-82 to 6-30-84
3	Education and Library ..	2,044	1.8	CSEA	7-1-82 to 6-30-84
4	Office and Allied .....	29,770	26.4	CSEA	7-1-82 to 6-30-84
5	Highway Patrol .....	4,469	4.0	California Association of Highway Patrolmen	7-1-83 to 6-30-84
6	Corrections .....	7,271	6.4	California Correctional Officers Association	7-1-83 to 6-30-84
7	Protective Services and Public Safety .....	4,424	3.9	Coalition of Associations and Unions of State Employees	7-1-82 to 6-30-84
8	Firefighter .....	2,795	2.5	California Department of Forestry, Employees' Association	7-1-83 to 6-30-85
9	Professional Engineer ....	4,630	4.1	Professional Engineers in California Government	7-1-83 to 6-30-84
10	Professional Scientific ....	1,462	1.3	CSEA	7-1-82 to 6-30-84
11	Engineering and Scientific Technicians .....	2,731	2.4	CSEA	7-1-82 to 6-30-84
12	Craft and Maintenance ..	9,018	8.0	CSEA	7-1-82 to 6-30-84
13	Stationary Engineer .....	512	0.5	International Union of Operating Engineers, Stationary Engineers' Division	7-1-83 to 6-30-86
14	Printing Trades .....	685	0.6	CSEA	7-1-82 to 6-30-84
15	Custodial and Services ..	5,452	4.8	CSEA	7-1-82 to 6-30-84
16	Physician, Dentist and Podiatrist .....	802	0.7	Union of American Physicians and Dentists	5-1-83 to 6-30-84
17	Registered Nurse .....	1,570	1.4	CSEA	7-1-82 to 6-30-84
18	Psychiatric Technicians	7,000	6.2	Communication Workers of America, Psych Tech Union	7-1-82 to 6-30-85
19	Health and Social Services/Professional .....	3,000	2.7	American Federation of State County and Municipal Employees	7-1-82 to 6-30-84
20	Medical and Social Services/Support .....	1,265	1.1	CSEA	7-1-82 to 6-30-84
Totals .....		112,890	100.0%		

**California State University.** The PERB has designated nine separate bargaining units for CSU employees. Exclusive representatives have been selected for each of these units. Table 87 shows the distribution of CSU employees among bargaining units and the effective period for each unit's current MOU. The table indicates that seven agreements cover both the current and budget years, while the remaining two agreements (for units 1 and 3) will expire at the end of 1985-86.

**Table 87**  
**Distribution of CSU Employees Among Bargaining Units**  
**and Current MOU Status**  
**1983-84**

Unit Number	Occupational Group	Employees		Exclusive Representative	Term of Current MOU
		Number <sup>a</sup>	Percent		
1	Physicians .....	139	0.4%	Union of American Physicians and Dentists	7-1-83 to 6-30-86
2	Health Care Support ....	399	1.2	California State Employees' Association (CSEA)	7-1-83 to 6-30-85
3	Faculty .....	19,690	58.0	Congress of Faculty Association	8-16-83 to 6-30-86 <sup>b</sup>
4	Academic Support.....	1,357	4.0	United Professors of California	9-16-83 to 6-30-85 <sup>b</sup>
5	Operations Support Services .....	1,966	5.8	CSEA	7-1-83 to 6-30-85
6	Skilled Crafts .....	782	2.3	State Employees Trades Council	7-1-83 to 6-30-85
7	Clerical Support.....	7,162	21.1	CSEA	7-1-83 to 6-30-85
8	Police .....	183	0.5	State University Police Association	9-16-83 to 6-30-85 <sup>b</sup>
9	Technical Support Services .....	2,271	6.7	CSEA	7-1-83 to 6-30-85
TOTALS .....		33,949	100.0%		

<sup>a</sup> Source: California State University

<sup>b</sup> Salary and benefit provisions effective July 1, 1983

**University of California.** Table 88 highlights the status of collective bargaining for UC employees. The table indicates that there are 26 bargaining units for UC employees, structured as follows: 8 are systemwide, 10 are confined to individual campuses, 4 are lab units, 3 are health-care units, and 1 unit (number 7) consists of printing trade employees working at three printing plants in the UC system. UC has filed a lawsuit challenging in the court the designation of unit 26, the house staff employees. UC questions whether the hospital interns and residents that comprise this unit qualify as employees under HEERA.

Contrary to the status of collective bargaining in state civil service and within the CSU system, exclusive representatives for 15 of these units were just selected during the past year, and most units are either just starting or still in the midst of negotiations with UC management regarding the terms of the initial MOUs. Eight of the 26 units have opted for no representation, and the question of representation for one unit is, as yet, undecided.

The HEERA provides that faculty units can be formed on either a single statewide basis or divisional units of the academic senate. The faculty employees at UC Berkeley and UCLA each voted for *no* representation in elections conducted by PERB. The only UC faculty that has opted for representation is one consisting of 267 members at the Santa Cruz campus. UC faculty employees at other campuses, estimated to number about 3,500, have not petitioned the PERB for an election.

#### **Fiscal Impact of the MOUs In Effect During 1983-84**

In order to identify the fiscal impact of the MOUs in effect during the current year, we asked the DPA and CSU to provide us with (1) a detailed cost accounting of all provisions of the MOUs to which they are a party and (2) detailed information on the cost of each new benefit provided to employees *not* covered by the collective bargaining process in 1983-84. We also asked DPA and CSU to designate whether each benefit required a new appropriation of funds or was considered "absorbable" within existing appropriations. Finally, we asked UC officials to provide us with information on what employee compensation adjustments were provided to their employees.

Based on our review of the information submitted by the Department of Finance (DOF), the DPA, CSU, and UC, we believe that 1983-84 employee compensation provisions can be divided into three fiscal categories:

- Provisions which received direct appropriations within the 1983 Budget Act;
- Provisions which will require *additional* (or incremental) funding from the 1984-85 budget; and
- Provisions considered by the administration to be *absorbable* within the current-year appropriations.

***Provisions Having a Direct Fiscal Effect.*** In the 1983 Budget Act, the Legislature appropriated \$338.8 million from all funds (\$212.1 million from the General Fund) to finance employee compensation increases in 1983-84. The major provisions in this category provide for:

- A 6 percent salary increase, effective January 1, 1984.
- Continuation for six months of the \$50 (or \$100) reduction in the employee's contribution to the Public Employees' Retirement System (PERS) and the University of California Retirement System (UCRS).

**Table 88**  
**Distribution of UC Employees Among Bargaining Units**  
**And MOU Status**  
**1983-84**

<i>Unit Number</i>	<i>Type</i>	<i>Occupational Group</i>	<i>Employees As of July 1, 1983</i>		<i>Exclusive Representative</i>	<i>MOU Status</i>
			<i>Number</i>	<i>Percent</i>		
1	Systemwide .....	Police	192	0.4%	Statewide University Police Associations	Currently in Negotiations
2	Campus .....	Faculty (Santa Cruz)	267	0.6	Faculty Association UC Santa Cruz	Effective July 1, 1983 to June 30, 1984
3	Lab .....	Lawrence Livermore National Laboratory (LLNL) Skilled Crafts	261	0.5	No Representation	Not Applicable
4	Campus .....	UC Berkeley/Lawrence Berkeley Skilled Crafts	222	0.5	Alameda County Building Trades Council	Currently in Negotiations
5	Campus .....	UC San Francisco Skilled Crafts	71	0.1	San Francisco Building Trades Council	Currently in Negotiations
6	Campus .....	UCLA Skilled Crafts	309	0.6	International Union of Operating Engineers (IUOE), Local 501	Currently in Negotiations
7	Printing Plants.....	Printing Trades	100	0.2	Printing Trades Alliance	Currently in Negotiations
8	Lab .....	LLNL Technical	1,653	3.5	No Representation	Not Applicable
9	Systemwide .....	Technical	4,083	8.5	No Representation	Not Applicable
10	Lab .....	LLNL Service	494	1.0	No Representation	Not Applicable
11	Systemwide .....	Service	6,320	13.2	American Federation of State, County and Municipal Employees (AFSCME)	Currently in Negotiations

12	Systemwide .....	Clerical and Allied Services	18,538	38.7	AFSCME	Currently in Negotiations
13	Health Care .....	Patient Care—Technical	3,914	8.2	AFSCME	Currently in Negotiations
14	Health Care .....	Residual Patient Care—Professional	1,462	3.1	No Representation	Not Applicable
15	Health Care .....	Registered Nurses	4,005	8.4	California Nurses Association	Currently in Negotiations
16	Lab .....	LLNL Professional Scientists and Engineers	3,205	6.7	No Representation	Not Applicable
17	Systemwide .....	Professional Librarians	381	0.8	American Federation of Teachers (AFT)	Currently in Negotiations
18	Systemwide .....	Nonacademic Senate Instructional	1,877	3.9	(AFT)	Currently in Negotiations
19	Systemwide .....	Research and Allied Professionals	Undetermined	—	Undecided	Not Applicable
20	Campus .....	UC Riverside Skilled Crafts	39	0.1	IUOE, Local 501	Currently in Negotiations
21	Campus .....	UC Irvine Skilled Crafts	81	0.2	IUOE, Local 501	Currently in Negotiations
22	Campus .....	UC Santa Barbara Skilled Crafts	49	0.1	IUOE, Local 501	Currently in Negotiations
23	Campus .....	UC Davis Skilled Crafts	205	0.4	No Representation	Not Applicable
24	Campus .....	UC San Diego Skilled Crafts	126	0.3	IUOE, Local 501	Currently in Negotiations
25	Campus .....	UC Santa Cruz Skilled Crafts	23	— <sup>a</sup>	AFSCME	Currently in Negotiations
26	Systemwide .....	House Staff Employees	Undetermined	—	No Representation	Not Applicable
	Total .....		47,877 <sup>b</sup>	100.0%		

<sup>a</sup> Less than 0.05 percent.

<sup>b</sup> Does not include employees of either: Unit 19, whose membership would probably total less than 8,000 employees; or the employees of 8 faculty units (all campuses except for Santa Cruz), comprised of approximately 7,000 employees, which either have opted for no representation or have not petitioned the PERB for an election.

**Table 89**  
**1983-84 Employee Compensation Cost Provisions**  
**1983-84 and 1984-85 Fiscal Impacts**  
**All Funds**  
**(in thousands)**

<i>Provisions</i>	<i>Civil Service and Related</i>			<i>California State University</i>			<i>University of California</i>			<i>Total, All Employees</i>		
	<i>1983-84</i>	<i>1984-85</i>	<i>1984-85</i>	<i>1983-84</i>	<i>1984-85</i>	<i>1984-85</i>	<i>1983-84</i>	<i>1984-85</i>	<i>1984-85</i>	<i>1983-84</i>	<i>1984-85</i>	<i>1984-85</i>
	<i>Costs</i>	<i>Costs</i>	<i>Increment</i>	<i>Costs</i>	<i>Costs</i>	<i>Increment</i>	<i>Costs</i>	<i>Costs</i>	<i>Increment</i>	<i>Costs</i>	<i>Costs</i>	<i>Increment</i>
General salary increase (6%) .....	\$119,807	\$239,614	\$119,807	\$27,415	\$55,815	\$28,400	\$29,449	\$58,898	\$29,449	\$176,671	\$354,327	\$177,656
Retirement offset .....	36,853	—	-36,853	7,521	—	-7,521	4,678	—	-4,678	49,052	—	-49,052
Special salary adjustments .....	7,161	28,645	21,484	1,350	2,400	1,050	1,333	5,332	3,999	9,844	36,377	26,533
Health insurance .....	44,480	44,480	—	3,386	3,386	—	12,140	13,870	1,730	60,006	61,736	1,730
Dental insurance .....	7,120	7,120	—	1,690	1,690	—	2,000	2,000	—	10,810	10,810	—
Shift differential .....	193	193	—	—	—	—	—	—	—	193	193	—
Work week group modification .....	800	1,600	800	—	—	—	—	—	—	800	1,600	800
Professional proficiency compensation .....	2,212	—	-2,212	—	—	—	—	—	—	2,212	—	-2,212
Health and welfare .....	300	300	—	—	—	—	—	—	—	300	300	—
Life insurance .....	177	707	530	—	—	—	—	—	—	177	707	530
Unfunded merit salary adjustments and faculty promotions .....	—	—	—	4,250 <sup>a</sup>	4,250 <sup>a</sup>	—	—	—	—	4,250	4,250	—
Other benefits .....	1,500	—	-1,500	1,911 <sup>a</sup>	1,349 <sup>a</sup>	-562	—	—	—	3,411	1,349	-2,062
Totals .....	\$220,603	\$322,659	\$102,056	\$47,523	\$68,890	\$21,367	\$49,600	\$80,100	\$30,500	\$317,726	\$471,649	\$153,923

<sup>a</sup> The 1983-84 costs of the (1) "Unfunded MSAs and Faculty Promotions" and (2) "Other Benefits" total \$6.2 million. The 1984-85 cost of these two 1983-84 provisions is \$5.6 million. Of the \$5.6 million, the Governor proposes to fund only \$1.1 million, leaving \$4.5 million in unfunded costs for 1984-85.

- Special salary realignments and adjustments for specified classes of employees.
- An increase to maintain the state's percentage contributions toward the cost of employee health insurance premiums.
- An increase in the state's contributions for the employee dental care program.

Table 89 summarizes the fiscal impact of the employee compensation package in 1983-84, by type of employee. The table shows that the provisions will cost \$317.7 million in 1983-84, which is \$21.1 million, or 6.2 percent, less than the amount provided in the 1983 Budget Act. DOF officials maintain that the \$317.7 million in identified expenditures represents the department's best estimate of the costs of the employee compensation package for civil service, UC, and CSU employees. Further adjustments may be needed, since the cost estimates are being refined.

***Additional Costs of 1983-84 Provisions.*** Our review of the 1983-84 MOUs and cost estimates provided by the DPA, Department of Finance, UC, and CSU indicates that *the full-year cost of 1983-84 employee compensation increases is far greater than the amount allocated from the 1983 Budget Act appropriations.* These costs will be fully reflected in the 1984-85 budget. Costs will increase in the budget year because many salary and benefit increases provided in 1983-84 became effective *after* the start of the fiscal year. Thus, the *annualized* costs of these benefit increases greatly exceed current-year funding requirements.

For example, most state employees received a 6 percent salary increase, effective January 1, 1984. The total state cost of this provision in *1983-84*, as shown in Table 89, is \$176.7 million. The full-year or annualized cost of this increase, as reflected in the budget for 1984-85, will be \$354.3 million—double the amount provided in 1983-84. This annualized cost is shown in Table 89 in the column labeled "1984-85 Costs". The *additional* 1984-85 cost of providing the 6 percent salary increase is \$177.7 million, as shown in Table 89 under "1984-85 Increment".

Table 89 shows that the cost of *all* 1983-84 provisions in fiscal year 1984-85 (that is, the "annualized" costs) will total \$472 million. This is \$154 million more than the amount allocated for employee compensation in 1983-84. Our review of the Governor's Budget for 1984-85 reveals that virtually all of the funds needed to cover the annualized costs of the 1983-84 employee compensation provisions have been included in the 1984-85 *baseline budgets* of departments. As a result, the additional incremental costs of these provisions are somewhat hidden from legislative review. We discuss the fiscal impact of "annualization" in greater detail in our review of the Governor's employee compensation proposal (See Item 9800 of the *Analysis*).

***Provisions Considered Absorbable Within Existing Appropriations.***

As we pointed out in last year's *Perspectives and Issues* (p. 191), no money is specifically appropriated by the Legislature or allocated by the administration to fund those provisions of the employee compensation packages that impose costs which are considered to be "absorbable." The determination of what is and what is not "absorbable" is made by the administration through the fund allocation process.

The fact that a cost is deemed to be absorbable, however, does not mean that it is negligible or minor. It simply means that funding for the cost will not be provided to the department or agency. The department or agency, however, *will* have to find a way to fund the cost. Generally, it does so by redirecting funds from other activities, perhaps including those specifically approved by the Legislature, in order to finance the expenditure required by the MOU.

Our review of the employee compensation packages indicates that various provisions of the 1983 agreements will require the expenditure of \$33.9 million in 1983-84 to cover costs for which no funds were specifically appropriated. This \$33.9 million is on top of the \$317.7 million in expenditures that *were* funded in the 1983 Budget Act.

Table 90 summarizes these "absorbable" costs for civil service and related employees, as identified by the DPA and the Department of Finance. CSU officials maintain that their employee compensation packages contain no provisions which will result in identifiable "absorbable" costs. (UC has completed only one MOU to date, and this MOU has no provisions with *fiscal* impact.) As Table 90 indicates, the employee benefit provision that results in the greatest "absorbable" costs is the one requiring merit salary adjustments (\$28.8 million).

**Table 90**  
**Employee Compensation Costs**  
**"Absorbed" by State Agencies in 1983-84**  
**Civil Service and Related Employees**  
**(in thousands)**

<i>Provisions</i>	<i>Covered by MOUs</i>	<i>Not Covered by MOUs</i>	<i>Totals</i>
Merit salary adjustments .....	\$24,014	\$4,736	\$28,750
Realignments .....	1,576	—	1,576
Adjustment of vacation accruals .....	947	—	947
Work week changes .....	556	—	556
Training .....	500	—	500
Professional fees .....	345	137	482
Uniform allowances .....	275	—	275
Safety equipment .....	213	—	213
Special pay .....	158	—	158
Pay differential .....	149	—	149
Increase in mileage rate .....	75	—	75
Bereavement leave .....	65	—	65
Special programs .....	60	—	60
Overtime .....	40	—	40
Counseling .....	29	—	29
Miscellaneous .....	57	—	57
Totals .....	\$29,059	\$4,873	\$33,932

**1983-84 Fiscal Effect Summary.** Our analysis indicates that collective bargaining agreements signed in 1983-84, along with the compensation package for noncovered employees, resulted in ongoing costs of approximately \$505.5 million (all funds)—\$317.7 million in 1983-84 costs covered by a Budget Act appropriation, \$153.9 million in 1984-85 incremental costs due to "annualization," and \$33.9 million in "absorbable" costs (where the administration provided no allocations to fund the provisions).

### **Role of the Legislature in Collective Bargaining Under SEERA**

At the present time, the Legislature has three main functions relevant to the process for setting the terms and conditions of state employment. First, the Legislature has an *oversight* role with regard to SEERA. As it gains experience with the act, the Legislature may choose to make changes in the law in order to increase its effectiveness.

Second, the Legislature considers legislation which affects the terms and conditions of state employment. In some cases, this legislation is needed to implement the provisions of a negotiated agreement (for example, under SEERA, the Legislature must implement any negotiated changes in retirement benefits). In other cases, the legislation may make *unilateral* changes in employee benefits, wages, and working conditions, even though these issues are bargainable and could be left to the parties to resolve at the bargaining table.

Finally, and most importantly, under SEERA, the Legislature must approve those provisions of MOUs that require the expenditure of funds. This responsibility was written into SEERA by the Legislature, presumably to maintain its control over expenditures, even while it delegates to the Governor the responsibility for reaching agreements with the exclusive representatives of state workers.

### **Legislative Review of MOU Provisions to Date**

During the first two years in which bargaining took place under SEERA—1982 and 1983—the Legislature was not given an opportunity to conduct a meaningful review of MOUs prior to approving them. In fact, not one of the MOUs signed in either year was available to the Legislature or its staff for review prior to when the Legislature had to grant its approval in order for the agreements to take effect as scheduled. In some cases, MOUs were approved on the basis of a one-page summary of what the administration maintained were the major fiscal provisions.

Under these circumstances, the Legislature's ability to maintain control over state expenditures, as well as over the terms and conditions of state

employment, is a far cry from what may have been intended by the Legislature when it enacted SEERA. In short, the approval of MOU provisions, as required by SEERA, has become a pro forma exercise.

To the extent the Legislature is *not* able to undertake a meaningful review of the MOUs, it will encounter a number of problems in performing its oversight and control functions. Specifically, without adequate legislative review:

- ***The Full Costs of the MOUs May Not Be Identified.*** For example, subsequent to legislative approval of the current contract covering the California Department of Forestry Employees' Association, we found that the contract provides for more than 1000 California Department of Forestry employees to receive a 7.5 percent salary increase during *nonfire* mission periods. Despite its \$800,000 price tag in 1983-84, this provision was *never brought* to the Legislature's attention before the MOU was approved. Full implementation of this provision in 1984-85 will cost \$1,600,000.
- ***"Absorbable" Costs May Be Funded At The Expense of Legislative Priorities.*** As mentioned earlier, state agencies were required to "absorb" \$34 million in costs resulting from MOUs negotiated for the 1983-84 fiscal year. MOUs negotiated for 1982-83 required state agencies to absorb \$61 million in costs. Clearly, costs of this magnitude cannot be "absorbed" without cutting back agency activities in other areas. Consequently, it is likely that in order to absorb these costs, some agencies were forced to reduce activities *below* the levels funded by the Legislature. In other words, the benefits agreed to by the administration may come at the expense of *legislative* priorities.
- ***The Legislature Will Have No Opportunity to Compare the Provisions of MOUs for Consistency.*** To the extent the MOUs approved by the Legislature provide some employees with benefits that are not provided to employees in other units, state programs may be disrupted and the Legislature may find itself the target of criticism from the employees who come up short.
- ***The Legislature Will Have No Chance to Review Long-term Commitments Which It Will Be Expected to Fund in Future Years.*** Without copies of the MOUs and enough time to complete an adequate review, the Legislature has been asked to approve (and has approved) contracts which call for special adjustments to base salaries paid some employees costing more than \$150 million, beginning in the *second* year of the contract.
- ***Finally, and Most Obviously, the Legislature Will Not Be Able to Confirm That the Costs of MOUs Fall Within the Amount Appropriated for Employee Compensation.*** During the past two years, the Legislature could assess the consistency of MOUs with the amount appropriated for employee compensation only *after-the-fact*.

### **What Role Does the Legislature Want to Play in the Bargaining Process?**

These problems, and others like them, will continue to arise year-after-year if the Legislature's opportunity to review—not just approve—MOUs is cut short. These problems can be overcome or minimized if the Legislature wishes. Before addressing these problems, however, we believe the Legislature needs to make a basic policy decision as to what role it wants to play in the collective bargaining process.

The Legislature may wish to limit its role simply to controlling total expenditures in the budget year. If this is the role it wishes to play, the employee compensation item in the Budget Bill provides a reasonably effective means for doing so. This does not mean, however, that the Legislature should not consider making some changes in the existing collective bargaining process at the margin. If the Legislature chooses to play a more limited role in the process, it could, for instance, eliminate the requirement in SEERA that it approve *specific* provisions of MOUs.

If, instead, the Legislature wishes either to approve the *specific* provisions of MOUs—the role apparently envisioned at the time SEERA was enacted—or to control total expenditures *beyond* the budget year, far more dramatic changes in the existing process will have to be made. The current structure simply does not provide the Legislature with an opportunity to exercise these powers in a meaningful way.

This is a basic policy decision that the Legislature will have to make and it depends on:

- The confidence the Legislature has in this and future administrations to perform the role delegated to the Governor in an acceptable manner;
- The time the Legislature is willing to devote to the negotiating process;
- The extent to which the Legislature wants to be involved with the specific features of negotiated settlements; and
- The Legislature's willingness to set deadlines for the completion of negotiations and make them stick.

### **Alternatives to the Current Process**

If the Legislature wishes to play a more active role in the bargaining process or address some of the problems identified above, there are a number of alternatives to the current system that it can consider. These alternatives can be divided into two categories: (1) those that retain the existing system, and (2) those that would make major changes in the existing system. None of these approaches, however, represents an absolute solution to the problems which have been identified.

First, these are several options which simply modify the *existing* collective bargaining process:

- ***Legislative Monitoring of Negotiations.*** The leaders of the Legislature could designate representatives to attend negotiations involving state employees. This would prevent last-minute surprises when the MOUs are presented to the Legislature.
- ***Require MOUs to Be Submitted by May 15.*** The Legislature, of course, would have a greater opportunity to consider and act upon the provisions of MOUs if they were available for review as part of the budget process. As the experience of other states has demonstrated, however, it is difficult to compel the parties to conclude negotiations by a fixed date if "late" decisions will still be considered by the Legislature. In the case of a May 15 deadline, the parties undoubtedly would recognize that most important budgetary decisions are made by the budget conference committee at a later date.
- ***Require MOUs to Be Submitted by June 30, and Become Effective October 1.*** If this alternative were adopted, legislative staff would have time to review the agreements during the summer recess and the Legislature could then consider and approve them in late August or September. Again, however, the problem of compelling compliance with an arbitrary deadline would remain.
- ***Provide Legislative Guidance at an Earlier Date.*** A joint committee could—through a resolution—provide the parties with a sense of legislative priorities on personnel needs and personnel policy for the upcoming year.

If, however, the legislature feels that the problems with the process are more serious, it could consider the following major changes to the collective bargaining structure:

- ***Delay the Onset of Bargaining Until the Amount Available for Enhancing Employees Wages, Benefits, and Working Conditions Has Been Decided.*** In this case, negotiations would occur during the fall—after an amount for employee compensation has been determined. The effective date of the new MOUs would also be delayed, giving the Legislature an opportunity to review and approve the MOUs when it reconvenes in January.
- ***Require Bargaining to Begin in the Fall and Conclude Before the Budget Process Begins.*** In this case, the amount of funds needed to implement the agreements could be included in the Governor's Budget in January. This would allow full legislative review and approval of the MOUs prior to the start of the new fiscal year.
- ***Fund MOUs Through Special Legislation.*** This alternative would enable the use of legislative committees to review the terms of negotiated settlements. The specific terms, however, would have to be available for legislative review. The legislatures in New York and Massachusetts use this approach.
- ***Create a Special Joint Committee.*** The committee would moni-

tor negotiations and/or review and approve MOUs. This approach, which would probably require the most legislative involvement in the bargaining process, is similar to that taken by the legislatures in Wisconsin and Minnesota.

In summary, our review of the Legislature's experience with collective bargaining during the first two rounds of negotiations has convinced us that the Legislature currently has the worst of all worlds. It has the statutory duty to approve the individual provisions of MOUs but does not have either the information or time needed to make the approval process meaningful. As a result, the Legislature is unable to exercise the control and oversight functions apparently envisioned by the drafters of SEERA, yet it may find itself held accountable for the specific features of individual MOUs that it has "approved".

While the Legislature has various alternatives for extricating itself from this bind, the first step must be to decide what kind of a role it wants to play in collective bargaining.

## **THE NEED FOR BETTER BUDGET INFORMATION**

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### ***How can the Legislature Improve the Fiscal Information on Which it Depends for Making Informed Decisions on the Budget?***

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Our review of the fiscal information which traditionally has been presented to the Legislature indicates that certain improvements are needed in the timing, accuracy and comprehensiveness of this information. The Legislature must have good information on the state's economy, state revenues, and state expenditures in order to do an effective job in exercising its control of the state's budget. Our analysis indicates that these improvements are most needed in the area of fiscal forecasting, and can be achieved without a significant increase in cost.

#### **Improvements in Fiscal Forecasts**

*We recommend that the Legislature enact legislation requiring the Department of Finance to include specific information in its fiscal forecasts and to present these forecasts at specified points in time during each fiscal year.*

It is important that the Legislature have the most *current* and *accurate* picture possible of the state's fiscal situation in order to manage the budget in an effective manner. In last year's *Perspectives and Issues*, we identified a number of deficiencies in the state's current approach to fiscal forecasting, and recommended that certain statutory reporting requirements be enacted in order to remove these deficiencies. To date, no action has been taken either by the Legislature or the Department of Finance (DOF) in response to these recommendations.

Accordingly, we again recommend the enactment of legislation requiring the DOF, which has the leadership role in the budget process, to provide specified fiscal data to the Legislature. Specifically, we recommend that the DOF be statutorily required to do the following:

- ***Submit Periodic Fiscal Updates.*** The DOF should be required to provide estimates of General Fund revenues, expenditures, and surplus, at those points in time when updated information is needed for purposes of legislative decision-making or fiscal planning. Specifically, we believe updates should be submitted in January (Governor's Budget), March/April, May/June (May Revision), August, and November. These updates should also include revisions to the revenue estimates for the major sources of *special fund revenue* (such as vehicle-related fees and tidelands oil and gas revenues). Each update should reflect any significant fiscal developments which have occurred since the preceeding update such as changed economic conditions, legislation, court decisions, federal budget decisions, revised case load assumptions, and technical reestimates.
- ***Provide Explanations for Revisions in Fiscal Forecasts.*** The DOF should be required to itemize all factors responsible for significant changes in its estimate of the General Fund surplus, including economic factors, cash-flow factors, legislation, court cases, and so forth. It should also publish in the Governor's Budget each year a reconciliation table which documents the changes in the estimate of prior and current year General Fund surplus which have occurred since the previous year's budget.
- ***Indicate the Degree of Uncertainty Surrounding Fiscal Estimates.*** The DOF should be required to publish information on the degree of uncertainty surrounding its estimates of General Fund revenues, expenditures, and surplus, taking into account both economic forecasting uncertainties and error margins associated with statistical estimating techniques.
- ***Provide Alternative Fiscal Forecasts.*** The DOF should be required to publish, along with its regular fiscal estimates, fiscal estimates for alternative economic scenarios which the department and other economic forecasters feel have a reasonable likelihood of occurring.
- ***Publish Long-Term Fiscal Projections.*** The DOF should be required to publish, at least twice each year (in January and May), a projection of General Fund revenues, expenditures and surplus, and of special fund revenues, for *four years beyond* the budget year.

A detailed discussion of the basis for these recommended reporting requirements may be found on pages 204 through 206 of our 1983-84 *Perspectives and Issues*.

The reason why legislation to improve fiscal reporting is desirable is not

that the DOF is unwilling to improve the fiscal information which it produces; indeed, the DOF has, itself, initiated a number of improvements in recent years. However, in the absence of a statutory obligation to upgrade the quality and frequency of its fiscal reports, there is no assurance that the DOF will adequately address all of the existing deficiencies on a continuing basis. Consider, for example, what happened during 1983:

- In April, the DOF revised downward its General Fund revenue estimates for 1982-83 and 1983-84 by a combined total of about \$185 million. These reestimates, however, were *not* reflected in the DOF April General Fund surplus estimates.
- In October, the State Controller issued his preliminary estimate of the ending General Fund balance for 1982-83. This estimate—which had the effect of increasing the projected end-of-year surplus by several hundred million dollars—subsequently was published by the State Treasurer in October. The Legislature, however, was not formally notified of this significant change in the state's fiscal outlook until mid-December, when the DOF's report on 1983 financial legislation was published.
- Although the DOF stated in July 1981 that it would provide a complete fiscal forecast revision each November which would, among other things, take account of changed economic conditions (plus other factors) affecting revenues and expenditures, the department's revision for November 1983 was never released to the Legislature. Instead the department's reports to the Legislature continued to reflect the economic assumptions adopted in June 1983 right up to the publication of the Governor's Budget for 1984-85, even though these assumptions were over half-a-year old.
- The department also stated in July 1981 that it would provide, each year in the Governor's Budget, a projection of total and major categories of revenues and expenditures for two years beyond the budget year. This was done in 1982-83. These projections are absent, however, from both the 1983-84 and 1984-85 Governor's Budgets.
- Until 1984-85, the Governor's Budget has always included a table (labeled Schedule 1-A) which reconciles changes between the current and prior budget estimates of the General Fund's prior and current year surplus position. The 1984-85 Governor's Budget does not include this information.

To avoid situations such as these in the future, we believe it would be in the Legislature's best interest to require, through the enactment of legislation, any improvements it desires in the fiscal forecasting process.

#### **Bank and Corporation Tax Forecasting Needs Study**

*We recommend that the Legislature adopt supplemental language directing the Department of Finance to conduct a thorough review of the*

*procedures which it uses to forecast bank and corporation tax revenues, and that it report the findings of this review to the Legislature by October 1, 1984.*

Probably the single most difficult state revenue source to predict accurately is the bank and corporation tax. This is due to a variety of factors, including the inherent volatility of corporate profits, the complex prepayment patterns which firms use to remit funds to the state, the lengthy time lags before actual data on corporate profits become available, and recent federal law changes which have distorted the historical relationships between U.S. and California profits.

In forecasting California taxable profits, the Department of Finance utilizes several approaches. The first approach is to survey California's corporations to determine their profits in the most recent calendar year—in this case the 1983 calendar year. This is done because actual data on California profits in 1983 will not be available until later in 1984, when tax return data are available. The second approach involves the use of statistical multiple regression relationships between the past behavior of California profits and certain economic variables such as national corporate profits, state personal income and state taxable sales. These relationships are then applied to the forecast for these variables in order to project taxable profits in 1983, 1984, and 1985. Because each of these two procedures gives a different estimate of corporate profits for 1983, the department has to reconcile the two results and decide upon a single figure. It then uses the regression-based results to predict profits for 1984 and 1985, working from the 1983 figures selected as a base.

We believe that the department needs to conduct a thorough review of the procedures it uses to forecast the bank and corporation tax. There are several reasons why this should be done.

- *First*, the profit survey approach needs to be thoroughly evaluated in order to assess its usefulness and to identify how it might be improved. During the past several years, a number of problems regarding the sample have come to light. Although the department has gotten a relatively good response rate, the coverage of the survey is too small to provide a reliable measure of corporate profits in California. Moreover, the department has never "tracked" the actual profit performance of responding companies in order to determine how accurate the predictions of these companies are. Our review indicates that the survey responses need to be "validated." The department also needs to reevaluate the manner in which it conducts the survey, giving special attention to how firms are selected for the sample, and how much weight should be given to different categories of firms by industry type and firm size. The department may find that there are ways to improve the survey and its usefulness in forecasting revenue, or

alternatively, that the resources spent conducting the survey could be better utilized in other ways.

- *Second*, the department has found that the data on California profits published by the Franchise Tax Board (FTB) are not always consistent with the level of profits implied by the actual bank and corporation tax collections. This is a potentially serious problem, because the FTB profits data provide the historical data used in the department's forecasting equations. If the data are wrong, then the resulting profits forecasts also will be wrong. In our judgment, the department needs to determine whether steps can be taken to reconcile these two types of data.
- *Third*, the relationship between U.S. profits and California profits has changed in recent years, due to the federal tax law changes cited earlier. Because the level of national profits is an important variable used in forecasting California profits (especially in light of unitary taxation), the department needs to review and restructure its state-national profits equations.

We believe that the department's review of its bank and corporation tax forecasting methodology should be conducted as a part of its normal fiscal forecasting responsibilities, utilizing existing resources. Accordingly, we recommend adoption of the following supplemental report language:

"The Department of Finance shall conduct a review of the methodology it uses to project bank and corporation tax revenues and report its findings to the Legislature by October 1, 1984. This review shall include (1) an analysis of the department's annual corporate profits survey, including its statistical reliability, steps which can be taken to improve the survey, and whether the costs of conducting the survey are justified, (2) an analysis and reconciliation of the differences between the profit data collected by the Franchise Tax Board and the profit data implied by actual cash revenue collections, and (3) an analysis of how the historical relationship between national and state profits has changed due to federal law changes, and how this change can best be incorporated into the department's revenue estimating models."

## **COURT RULINGS OVERTURN STATE BUDGET DECISIONS**

### ***What is the Impact of Recent Court Rulings on Policy and Funding Decisions Made by the Legislature?***

A number of major court decisions issued since legislative action on the 1983 Budget Act was completed have had an adverse impact on the budget. These court decisions, and others like them in previous years, have two important implications for legislative control and priority setting. First, these decisions highlight the difficulties that the Legislature has

in setting priorities through the budget and making these priorities stick during the course of the fiscal year. Second, these decisions make it difficult—sometimes very difficult—for the Legislature to control overall state expenditures.

The two problems tend to reinforce each other. To the extent the courts do not allow the Legislature to cut what it considers to be low-priority expenditures, the Legislature may have to reduce higher priority expenditures or, in some cases, raise taxes.

### Recent Court Decisions Have Increased State Costs

Our review indicates that court decisions handed down since legislative action on the 1983 Budget Act was completed have increased General Fund costs by \$42.1 million in 1983–84, and will further increase General Fund costs by \$64.1 million in 1984–85. Table 91 displays the impact of these decisions.

**Table 91**  
**Increased General Fund Costs**  
**Due to Court Decisions and Settlements**  
**1983–84 and 1984–85**  
**(in millions)**

	1983–84	1984–85
<i>I. Medi-Cal</i>		
1. <i>Committee to Defend Reproductive Rights v. Rank</i> —payment for abortions .....	\$15.7	—
2. <i>Beltran v. Myers</i> —property transfers .....	4.1	\$7.6
3. <i>Lynch v. Rank</i> —effect of Social Security increases .....	1.5	1.3
4. <i>Lopez v. Heckler</i> —disability determinations on eligibility .....	0.7	4.3
Subtotal, Medi-Cal .....	\$22.0	\$13.2
<i>II. Welfare</i>		
1. <i>Lopez v. Heckler</i> —SSI/SSP disability determination .....	\$0.8	\$4.2
2. <i>Wright v. Woods</i> —AFDC retroactive supplemental benefits .....	—	20.4
3. <i>Wood v. Woods</i> —AFDC stepparent income .....	—	7.9
4. <i>Zapata v. Woods</i> —AFDC eligibility to children on SSI/SSP .....	5.8	1.3
5. <i>Miller v. Deukmejian</i> —AFDC emergency regulations .....	4.2	—
6. <i>Community Services for the Disabled v. Woods</i> —IHSS protective supervision by housemates .....	8.8	16.6
7. <i>Angus v. Woods</i> —AFDC collection of overpayments .....	—	0.5
Subtotal, Welfare .....	\$19.6	\$50.9
<i>III. Judicial</i>		
1. <i>Olson v. Cory</i> —interest on judges' back pay .....	\$0.5	—
Totals .....	\$42.1	\$64.1

Excluded from the figures in Table 91 are the costs of those decisions which (1) find the state liable for personal injuries or property damage; (2) award attorney fees; (3) became final prior to July 1, 1983, even though these decisions also resulted in ongoing General Fund costs; (4) are under appeal; or (5) result in costs the magnitude of which is unknown (although possibly substantial).

**Medi-Cal.** The program area most affected by court decisions dur-

ing the *current year* is Medi-Cal. A series of court decisions will increase General Fund costs under the Medi-Cal program by \$22.0 million in 1983-84, and by \$13.2 million in 1984-85.

These decisions (1) required the state to fund abortions for Medi-Cal recipients, despite limitations on these expenditures adopted by the Legislature in the 1983 Budget Act (*Committee v. Rank*); (2) ordered the state to reimburse Medi-Cal recipients who were penalized for transferring property to other individuals in order to qualify for Medi-Cal (*Beltran v. Myers*); (3) required the state to identify individuals disqualified from SSI/SSP because of social security benefit increases, and notify them that they may continue to be eligible for Medi-Cal benefits (*Lynch v. Rank*).

The court's decision in the *Lopez v. Heckler* case has increased General Fund costs under both the SSI/SSP program and Medi-Cal. This ruling prohibited the federal government from discontinuing payments to SSI/SSP recipients as a result of changes in disability criteria used in the program. Because SSI/SSP recipients are automatically eligible for Medi-Cal, the ruling also restores Medi-Cal benefits for these individuals. The decision will increase General Fund costs for both programs by a total of \$1.5 million in 1983-84 and \$8.5 million in 1984-85.

**Welfare.** Six other decisions affecting the AFDC, SSI/SSP, and In-Home Supportive Services programs will increase General Fund costs by \$18.8 million in the current year and by \$46.7 million in the budget year. In these cases, the courts (1) required the state to reimburse certain AFDC recipients denied supplemental payments between 1976 and 1981 (*Wright v. Woods*); (2) prohibited the state from automatically including stepparent income as part of the welfare family's income, without regard to other factors, in determining eligibility (*Wood v. Woods*); (3) required the state to provide AFDC benefits to needy parents or other relatives who are caring for children receiving SSI/SSP payments (*Zapata v. Woods*); (4) delayed implementation of emergency regulations affecting the beginning date for AFDC payments (*Miller v. Deukmejian*); (5) required the state to pay housemates for protective supervision they provide to aged, blind, or disabled individuals, regardless of their relationship to the individuals (*Community Services for the Disabled v. Woods*); and (6) required the state to consider the financial circumstances of AFDC recipients when reducing grants in order to collect previous overpayments. The decision further required the state to pay retroactive benefits to persons whose payments were reduced between 1977 and 1981 (*Angus v. Woods*).

**Judicial.** On December 30, 1983, the state Supreme Court ordered the state to pay judges elected before 1980, interest on the back pay they were awarded by the 1980 *Olson v. Cory* decision. (Chapter 1183, Statutes of 1976, limited judges' annual cost-of-living increases to 5 percent. The

1980 decision declared Chapter 1183 unconstitutional, and ordered the state to pay those judges back wages.)

### **Court Decisions Reduce the Legislature's Control Over State Spending**

In summary, court rulings can have a significant effect on the policy and funding decisions made by the Legislature. As we indicated in last year's *Perspectives and Issues* (p. 203), decisions handed down after enactment of the 1982 Budget Bill imposed a net cost of \$431.1 million on the General Fund in 1982-83. The second-year effect of many of those cases, plus the decisions handed down after the 1983 Budget Act was chaptered, have increased 1983-84 expenditures by an estimated \$98 million. Clearly, these decisions not only reduce the Legislature's control over state spending but constrain its ability to achieve its priorities in the budget process.