Part Three

# MAJOR FISCAL ISSUES FACING THE LEGISLATURE

## *Revenue Issues*

- California's Income Tax System
- Shortfall in the Motor Vehicle Account

## *Expenditure Issues*

- The State's Appropriations Limit
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- Prison Support Costs
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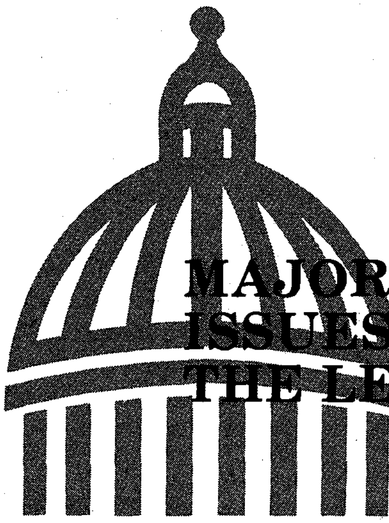
- Financing School Facilities
- California's Community-Based Long-Term Care System
- Hazardous Waste Site Cleanup Strategy
- Transportation Programming
- The Increasing Costs of Tort Liability
- State Telecommunications Management

# Part Three



# MAJOR FISCAL ISSUES FACING THE LEGISLATURE

This part discusses some of the broader issues facing the Legislature in 1986. Many of these issues are closely linked to funding requests contained in the Governor's Budget for 1986–87. Others are more long-range in nature and will, in all probability, persist for many years beyond 1986. Even in these cases, however, legislative action during 1986 is warranted since the Legislature generally will have a wider range of options for addressing these issues in 1986 than it will have in subsequent years.

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

***State Revenue Issues.*** The first section identifies issues related to state revenues. Specifically, we discuss California's *income tax* system and whether it is in need of major reform. We also discuss the shortfall in the *Motor Vehicle Account* and the options available to the Legislature for ensuring that adequate resources are available from the account to support the state's vehicle regulation and law enforcement programs.

***State Expenditure Issues.*** The second section identifies issues related to state expenditures. Here, we discuss the effect of the *state's appropriations limit* on the state's ability to provide services in 1986–87, the options available to the Legislature for accommodating or reducing the *ward population* committed to the Department of the Youth Authority, the rising cost of operating the state's *correctional system*, and an alternative process for authorizing new *prison construction* which would facilitate completion of projects on a more timely basis and provide for a reasonable level of legislative control. In this section, we also identify a new method for financing the construction of local *school facilities*, ways in which the state could provide community-based *long-term care services* in a more efficient and effective manner, a *hazadous waste site* cleanup strategy which would maximize public health protection, ways that the Legislature could make the *State Transportation Improvement Program* more effective, the factors contributing to the increasing costs of *tort liability* and possible alternatives for addressing this problem, and ways to make the state's management of its *telecommunications system* more effective.

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

# Revenue Issues

## CALIFORNIA'S INCOME TAX SYSTEM

### *Is the State's Personal Income Tax in Need of Major Reform?*

California's personal income tax (PIT) is the state's largest single source of revenue. In 1986–87, the amount of state income taxes paid by almost 13 million taxpayers will total $12.5 billion, or 40 percent of total General Fund revenues.

The state income tax is based on the same principles as the federal income tax. Given this, it is not surprising that the recent attention paid to federal tax reform—including the discussion of changes needed to improve the system's fairness, efficiency, and effectiveness—has led many to raise similar questions about the state's income tax. Several major tax reform proposals have been introduced in the Legislature during the 1985–86 session. Assembly Bill 540, for example, proposes to broaden the tax base and reduce tax rates. Similarly, the Governor's Tax Reform Advisory Commission has recommended that the state conform to the federal definition of adjusted gross income and levy a flat rate tax, with a special "surcharge" to be paid by high-income taxpayers.

This section examines whether or not the state's personal income tax is in need of major reform. We begin this analysis by evaluating the factors that ought to be considered in judging the effectiveness and fairness of the current system. Based on this review, we then consider the potential costs and benefits of major tax reform.

#### The Current System: Is Reform Needed?

Proponents of tax reform in California say that it would reduce the complexity of the tax, produce a more equitable distribution of the tax burden, and enable the state to adopt a more efficient and less costly administrative structure. These are widely accepted goals for *any* tax system. Unfortunately, they are not always compatible with one another. Indeed, the system we have today is the product of many past decisions involving complex tradeoffs which the Legislature has made over the years.

Is the state personal income tax in need of major reform? In order to answer this question, four basic issues regarding the *current* system first need to be resolved:

- ***Tax equity:*** Is the present system unfair? If so, in what ways is it unfair?
- ***Compliance burdens and enforcement:*** Does it take too much time, money, and energy for taxpayers to understand and comply with state

income tax laws, and for the state to enforce them?

- ***Administrative costs:*** Does the state spend an unreasonable amount to collect the income tax?
- ***Tax policy and efficiency:*** Are state policy objectives addressed efficiently and effectively through the income tax?

The answers to these four questions may provide some assistance to the Legislature in determining whether tax reform is needed, and if so, the form it should take and what tradeoffs should be made to achieve it. These tradeoffs involve having to accept less of one thing as the price of obtaining more of something else. For example, if the Legislature chooses to make the tax system simpler, does it have to give up some deductions or exclusions that also have a high priority? Or, is simplicity less important than a tax system which encourages taxpayers to engage in certain activities that are desirable from the state's perspective?

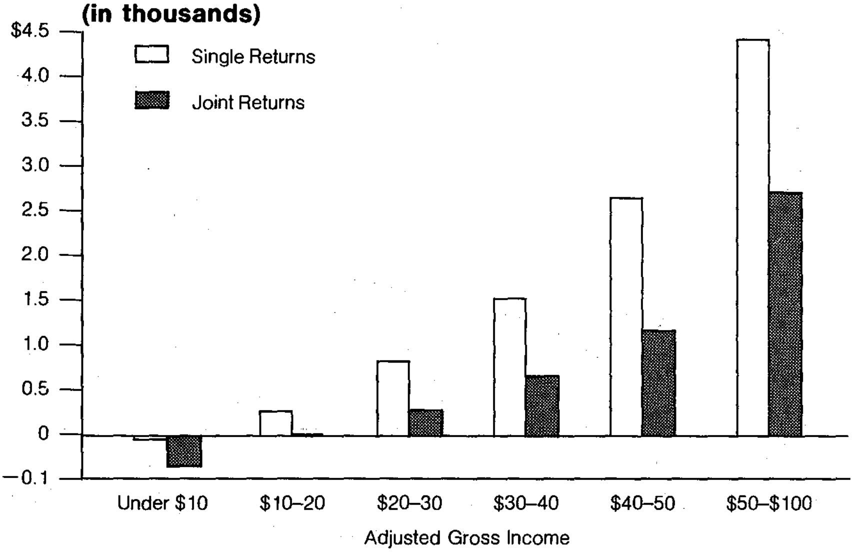
***Tax Equity—How Fair is the Current System?*** The answer to this question depends on how "fairness" is defined. In terms of the income tax, fairness can be viewed in two separate ways. The first view of fairness involves "vertical equity," which focuses on the *distribution* of the tax burden *amongst* income classes. The second view involves "horizontal equity," which represents the extent to which taxpayers in *similar situations* end up paying the *same* amount of taxes.

The current system's definition of *vertical equity* holds that the *more* income a taxpayer has, the *more* he or she should be taxed in order to finance the public services that society as a whole needs. This is accomplished through the use of progressive tax rates, which require taxpayers with higher incomes to pay not only a *larger dollar amount* but also a *larger proportion* of their income in state taxes than those with lower incomes have to pay.

Evidence from the Franchise Tax Board (FTB), which administers the state income tax, suggests that the current system *is* fairly progressive, when the tax burdens are measured in both absolute dollar and percent-of-income terms. For example:

- Taxpayers with lower levels of adjusted gross income (AGI) pay a significantly lower dollar amount of taxes than others with higher levels of AGI. This is shown in Chart 20, for both single and joint return taxpayers. For example, the average tax for a single taxpayer with between $20,000 and $30,000 of AGI ($925) is only about one third the amount paid by a single taxpayer with $40,000 to $50,000 of AGI ($2,600). The chart also shows that the average tax for taxpayers with less than $10,000 of AGI is *negative*—in other words, no taxes are due from these taxpayers. This is largely because of the state exemption credits ($42 for a single return, $84 for a joint return, plus $13 for each dependent), which completely offset the relatively small amount of tax assessed on low-income taxpayers.

**Chart 20**
**Average State Personal Income Tax Liability By Income Class and Type of Return[a] (in thousands)**



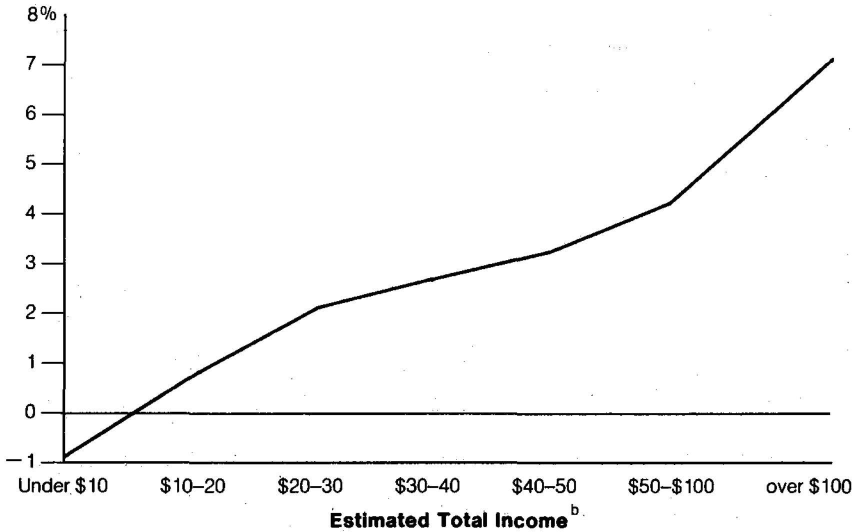

[a] Source: Franchise Tax Board. Data are estimates for the 1985 tax year. Scale for negative tax liability adjusted to indicate actual amounts.

- State income taxes also become a *larger percentage* of a taxpayer's income as his or her level of income increases. For example, Chart 21 shows that for taxpayers with estimated total incomes of between $10,000 and $20,000, the average tax rate is slightly less than 1 percent. In contrast, the rate is nearly 3 percent for taxpayers with incomes of $30,000 to $40,000, and 4.5 percent for taxpayers with incomes of $50,000 to $100,000. (The true progressivity of the present state income tax is less, however, than it appears in Chart 21 because of the *federal* tax deduction for state taxes paid. For example, while Chart 21 shows that taxpayers with incomes of over $100,000 pay an average tax of 7 percent, the federal deduction reduces the rate they actually pay to approximately 4.5 percent, assuming that the taxpayer is in the 45 percent federal tax bracket.)

The extent to which taxpayers in the *same* general economic situation pay a *similar* amount of tax is referred to as *horizontal equity.* Using this criterion, it is possible to reach a different conclusion about the fairness of the current system. This is because various tax exemptions, deductions, and credits often result in sharply *different* tax liabilities for taxpayers with the same income. Certain provisions even have enabled some high-income taxpayers to avoid paying any taxes at all.

**Chart 21**

**State Personal Income Tax Liability As a Percent of Income[a] (dollars in thousands)**

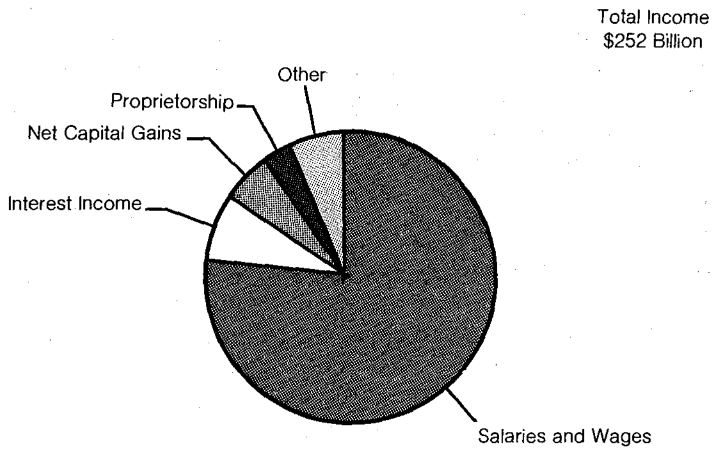



[a] Source: Franchise Tax Board. Data are estimates for the 1985 tax year.
[b] "Estimated Total Income" is adjusted gross income plus all preference income and adjustments to income.

Consider, for example, the inequities which could arise because different types of income are treated differently for tax purposes. As Chart 22 shows, over three-quarters of the income tax base is accounted for by the salaries and wages that taxpayers earn. Earnings from savings and investments (interest and capital gains) account for most of the remaining sources of income subject to tax. What the chart does *not* show, however, are the types of income which are *not* taxable. Among these, the most significant are employee fringe benefits, such as employer contributions to pension programs and health plans. Taxpayers whose employers do not provide retirement and health benefits are required to pay for them out of their wage and salary income, which is taxed before they can begin to spend it. In contrast, taxpayers whose *employers* provide these benefits are not required to report the dollar value of the benefits as taxable income, even though they represent an important part of the employees' total compensation. Thus, these employees have some of their "income" spent on their behalf, but do not pay taxes on it.

**Chart 22**

**Major Sources of State Income Subject to Tax** [a]




[a] Source: Franchise Tax Board. Data represent estimates for the 1985 income year.

The current system also treats differently those taxpayers who have similar *monetary incomes* from the same sources, but whose incomes may differ in *real terms* when the effects of inflation are taken into account. This is illustrated by the tax treatment of income from capital gains. Consider, for example, the case of two taxpayers who have the same amount of capital gains from the sale of common stock. Suppose that taxpayer "A's" gain is only enough to offset the effects of inflation during the period in which he owned the stock. In contrast, suppose that taxpayer "B" owned the stock for a shorter period, and that the appreciation in its value is several times more than what is necessary to offset inflation.

Clearly, "B's" ability to pay has increased, while "A's" has not changed. The state's tax system, however, makes no allowance for this and taxes both taxpayers the same.

Inequities amongst taxpayers also arise from the various *deductions* and *credits* allowed by the tax law for certain types of expenditures. Consider the case of two taxpayers who both earn the same amount of income and are identical in every other respect except one: taxpayer "A" owns his home while taxpayer "B" occupies an identical dwelling that he rents from another person. Because mortgage interest payments and property taxes are deductible expenses for income tax purposes, taxpayer "A's" liability is likely to be significantly *lower* than taxpayer "B's."

In fact, the mortgage interest deduction, which is the single largest itemized deduction ($18 billion, or 40 percent of total itemized deductions in California), provides a useful illustration of how a tax provision can result in serious inequities among taxpayers. The deduction usually is justified on the grounds that it encourages home ownership by reducing the costs of housing. Whatever the merits of this argument, the deduction introduces inequities into the tax system. This is because the deduction provides significant tax savings only to those taxpayers who can afford to own, as opposed to rent, a home.

Even among homeowners, the deduction only pays off if the total dollar amount of annual mortgage interest payments *and* other deductions is larger than the amount of the standard deduction. (In fact, only about 30 percent of all taxpayers claim the deduction for mortgage interest.) Large disparities also can exist among those who claim the deduction, because taxpayers who bought expensive homes are likely to receive a *larger* tax subsidy than those who chose to buy lower-cost housing. Moreover, those with higher levels of income also benefit more than those with lower levels of income from this deduction.

Finally, certain tax preferences often enable *high-income taxpayers* to pay little or no state tax. According to FTB, in 1983 there were 84 taxpayers with incomes of $200,000 or more who did not pay any personal income tax. In 65 of these cases, the taxpayer was able to avoid paying taxes by investing in windmills, which qualify for the state solar credit.

Clearly, the overall equity of the tax system cannot be judged on the basis of these 65 taxpayers, or even the many more who pay less because they own their homes. Nonetheless, these examples show how the provisions of existing law which "narrow" the tax base end up introducing important disparities into the distribution of the tax burden, even if it is considered to be reasonably fair in the aggregate.

***Compliance and Enforcement—How Difficult Is It to Comply With and Enforce the State's Tax Laws?*** The present tax system imposes costs and burdens on taxpayers because they must complete and file their tax returns (or pay someone else to do it). It also requires that the state engage in enforcement activities to ensure that taxpayers' self-assessments comply with the law.

From the viewpoint of many *taxpayers*, the state personal income tax law probably appears lengthy and complicated. California's income tax provides for 11 tax brackets, and it allows over 15 specific exemptions from gross income, over 30 separate tax deductions, and 14 tax credits. A taxpayer who itemizes must fill out a minimum of three pages of tax information, and most likely will also have to submit separate forms for such items as capital gains, employee business expenses, and various tax credits.

However, despite the law's complexity, the compliance burden probably is a lot less than first appears to be the case. In 1983, 6.6 million taxpayers (60 percent of the total) claimed the standard deduction, and of these, about one-half (3.5 million) were able to use the short form (540A). Further, many of the items that require lengthy calculations—for example, adding up wages, interest income and expenses, and charitable contributions—are already required of the taxpayer, because the identical information is needed for federal tax purposes. In fact, the overwhelming majority of taxpayers fill out their federal return first, and then just copy most of the same figures onto their state return. Thus, the amount of time and effort expended to file a state return is probably a lot less than the amount needed to file a federal return.

From the *state's* perspective, the Legislature also must be concerned about how effectively the tax laws are enforced. The FTB's proposed budget includes nearly *$60 million* for audit, filing enforcement, and collections activities, which eventually will produce over $700 million in revenue. Nonetheless, certain types of taxpayers may be successful in avoiding income taxes. For instance, a contractor may be able to avoid reporting income by accepting *cash* payments for work done on someone's home. In addition, a large number of individuals have claimed a false number of exemptions for withholding purposes and then deliberately failed to file a tax return, thereby avoiding the payment of any taxes.

The state and the federal Internal Revenue Service (IRS) have taken steps to prevent such abuses. Most recently, the Legislature enacted stronger enforcement tools as part of the 1984 tax amnesty legislation (Ch 1490/84, AB 3230). It also has sought to provide the tax agencies with more resources through the budget process to deal with the enforcement problem.

***Costs—Does the State Spend an Unreasonable Amount to Administer the Income Tax?*** This question can be addressed by comparing PIT collection costs with the cost of collecting other state taxes and the federal income tax.

Currently, it costs the state a total of $106 million to collect the tax. This includes $85 million spent by the FTB for return processing, taxpayer assistance, collections, and audits, plus $21 million spent by the Employment Development Department to administer the withholding program. Stated another way, these costs amount to approximately $9.40 for every $1,000 in PIT revenue collected.

There is no obvious basis for concluding whether this amount is "too much," but it is within the same range as the collection costs for other taxes. For example, the cost to collect the bank and corporation tax is about $9.10 per $1,000 collected, and the cost to collect the sales and use tax is about $7.30 per $1,000 in collections.

The state's PIT collection costs also compare favorably to the costs of collecting the *federal* income tax. While data from federal sources suggest that it costs about the same to collect $1,000 in income taxes at the state and federal levels, a more meaningful comparison involves the cost per return processed. This is because the higher federal tax rates generate more income per return. The state's cost per return is about $8.40, which appears to be about one-half of what it costs the IRS to process each federal return.

***Tax Policy—Does the Tax Mechanism Offer an Effective and Efficient Means to Promote State Policy Objectives?*** Clearly, the fundamental purpose of the income tax is to raise revenue for funding state programs. However, the tax system also is often used as a mechanism for implementing *government policies.* Many special provisions, which are commonly known as "tax expenditures," have been added to the state tax code in order to provide financial relief to certain individuals or to encourage certain forms of social or economic behavior.

In evaluating the "tax policy" provisions of the current system, an important distinction needs to be drawn between two different types of policy objectives—those involving the distribution of the tax burden, and those which provide incentives for certain types of behavior.

With respect to the *distribution of the tax burden*, policy choices can be implemented in a relatively straightforward manner. For example, by allowing a special credit or deduction for certain types of income or expenditures, the state achieves some control over who will bear more—or less—of the income tax burden. The present state tax code is filled with many provisions which reflect the effects of legislative policy choices of this type. For example, under the tax code:

- Low-income persons are required to pay little or no tax, due to the combination of low tax rates and the low income and personal exemption tax credits;
- Homeowners receive preferential tax treatment compared to renters, because home mortgage interest and property taxes are deductible from income;
- In contrast to federal law, only taxpayers whose employers *do not* provide for a retirement plan are allowed to deduct contributions to an individual retirement arrangement (IRA) account; and
- Families who have to obtain child care assistance in order to work may qualify for tax relief through the child care credit.

The second set of objectives that tax policy may seek to achieve involves using the income tax system to encourage a *particular type of behavior.* The Legislature, for example, has enacted special tax credits and deductions to encourage investments in energy conservation, ridesharing, and political contributions.

There is widespread disagreement, however, over the desirability and effectiveness of many tax expenditure provisions. It often is argued that state tax incentives are *inefficient*. This is because many taxpayers whose behavior is unaffected by the provisions qualify for the benefit anyway, and therefore receive a "windfall". It is also argued that state tax incentives are *ineffective*. This is because (1) taxes are only one factor in economic decisionmaking, and (2) because of federal deductibility, the value of state tax incentives is automatically diluted. On the other hand, it is reasonably clear that the solar and energy credits have had a significant effect on the level of investment in these types of equipment, largely because the credits are so large (a state credit of up to 25 percent of the cost of qualifying investments).

**What Does Tax Reform Have to Offer?**

Our analysis indicates that tax reform does offer some potential benefits to California in terms of making the system more equitable, more simple, and less costly to comply with and administer. To obtain these benefits, however, the state may be required to give up some control over tax policy.

***Fairness and Equity.*** Proponents claim that tax reform would bring about a more equitable distribution of the income tax burden. The validity of this claim depends upon the types of reform being promoted.

One of the most important aspects of any reform proposal is the extent to which it would *broaden* the tax base—that is, expand the portion of the total income base which is subject to taxation. Base-broadening would promote greater fairness among taxpayers in the same economic situation ("horizontal equity"). This is because, with fewer tax preferences available, there would be less disparities among similar taxpayers based on such factors as whether they owned or rented their home or received employer-paid health insurance.

An important feature of base-broadening is that it does *not* preclude the use of a progressive rate structure, which is a useful tool for making sure that the tax system achieves vertical equity. Clearly, a progressive rate structure could be applied to a broad as well as to a narrow taxable income base.

***Tax Simplification.*** Tax simplification always has been one of the arguments in favor of tax reform. The degree of simplification depends on the specific features of a reform option. For example, a measure could be enacted that simply required taxpayers to pay, as their state tax, a set portion of their federal tax. This change could reduce the state tax form to just a couple of lines. The state could also "piggyback" onto the federal tax, and have the IRS collect the tax for the state, for a potentially significant savings.

***Administrative Cost Savings.*** Tax reform *does* offer the potential for reduced administrative costs. Savings could be realized in taxpayer assistance, return processing, and the printing of forms and instructions. For example, given a higher standard deduction, as proposed by AB 540 and the Governor's Tax Reform Advisory Commission, fewer returns would need to be filed, and the returns probably would be shorter in length and easier to process. Thus, the state would realize some savings from not having to print, distribute, and process as many tax returns as it does under current law.

The magnitude of these potential savings is unknown, but it is likely that for every 10 percent fewer returns, the ongoing cost reduction would be in the range of $4 million. One-time implementation costs, such as the costs to revise the FTB's data processing systems and retrain personnel, would offset some of these savings in the short run. However, we believe that sizeable net savings could be realized on an ongoing basis.

***The Tax System as a Tool for Implementing Public Policies.*** Tax reform would tend to limit the use of the tax system as a policy tool—both for distributing the tax burden and for encouraging certain types of social and economic activities.

If the goal of tax reform is simplification, the Legislature would be required to give up some of its ability to determine who bears the tax burden. For example, if tax simplification is looked upon as *full* federal conformity, the state would *completely* give up its control over tax policy to the U.S. Congress and the IRS. Thus, the state would be required implicitly to adopt federal positions on such key policy issues as the taxation of social security benefits, capital gains, and contributions to IRA accounts. The tax reform proposals that would make the state tax a given percent of the federal tax also implicitly ask the Legislature to approve the same degree of progressivity for California as that provided for by the current or future federal tax rates.

Proponents of tax reform also question the need for tax policies to encourage certain behavior. In fact, it often is said that the incentives provided in the tax code amount to nothing more than "loopholes" that benefit mainly special interest groups. However, what appears to be a tax loophole to one person may be viewed as a very legitimate incentive by another. The issue which the Legislature must decide in considering how far to go with tax reform is the extent to which there are means other than the tax system, such as the budget process, for accomplishing specific state policy objectives.

In moving towards tax simplification, the state would set a policy—at least initially—that the income tax system *not* be used to reallocate resources or to provide special economic incentives. In theory, this would make the system "neutral" with regard to personal and business decisions. This would produce a more efficient allocation of society's resources.

In practice, however, these gains from *state* tax reform may not be very significant, given the lack of evidence that state tax incentives exert much influence over economic decisionmaking. Also, given the reliance of the present *federal* income tax on a multitude of incentive programs, significant distortions in the allocation of resources still would occur in the state's economy, regardless of whether the state's incentives were retained or removed. Thus, the major benefit from eliminating state tax expenditure programs would be the savings made possible by eliminating "windfall benefits" to certain taxpayers.

On the other hand, it must be remembered that the Legislature has enacted many of the state's current tax provisions because it wants to use the tax system as a policy tool. While we have been critical of many tax expenditure programs in terms of their effectiveness, we recognize that the mechanism *can* offer significant administrative advantages. Most important, by adding one form—or sometimes even one line—to the tax return, the Legislature can implement through the tax system what it would take many state employees to administer through a direct expenditure program.

**Conclusions**

Both state and federal income taxes are the focus of significant pressures for reform. This is evident from the amount of attention paid to the subject of tax reform by legislative bodies, executive agencies, and special study commissions. The key issues underlying any meaningful discussion of tax reform—fairness, efficiency, and simplicity—are very similar at both the state and federal levels. However, a careful analysis of these issues could lead to conclusions regarding the need for reform of the *state* income tax that differ from the conclusions that one reaches by analyzing the need for reform of the *federal* income tax.

***State Action Should Await Federal Tax Reform.*** Given the possibility that significant changes for the federal income tax may be in the works, we recommend that the Legislature *defer action* on state income tax reform. We suggest that the Legislature await action on the pending federal income tax reform proposals by the Congress, for the time being. Should the state move closer to a system (the federal government's) that is then changed dramatically, the resulting confusion could nullify the simplification and compliance benefits that the state reforms originally were intended to achieve.

***Are State Reforms Needed Anyway?*** Absent significant actions on federal tax reform, we believe that the current state income tax is *not* in need of wholesale change. This conclusion is based on the following considerations:

- Given the high degree of conformity between the state income tax and the current federal income tax, we find that the compliance burden is not likely to be significant for most taxpayers;

- The state's administrative cost for collecting the personal income tax is not unreasonable;
- The current system appears to be fair, from the standpoint of "vertical equity"; and
- The current system gives the Legislature the option of implementing state policy objectives through tax provisions.

Although the current structure is workable, the Legislature can still make many improvements to the state income tax. Most important, we believe that the system could be improved through base-broadening, thereby achieving more "horizontal equity" in the distribution of the tax burden. Some other possible changes that the Legislature should consider include:

- Placing limits on the deduction for mortgage and non-mortgage interest expenses;
- Allowing inflation-indexing of capital gains, so as to ensure that only "real" gains are taxed;
- Changing tax deductions to tax credits, so as to ensure that the actual value of a tax deduction is not dependent upon a taxpayer's marginal tax bracket; and
- Requiring a certain amount of employee fringe benefits to be included as taxable income.

In our view, changes to the tax system along these lines would help ensure that individuals pay an equitable share of the costs of providing state programs and services.

## SHORTFALL IN THE MOTOR VEHICLE ACCOUNT

***What Options Are Available to the Legislature for Ensuring That the State's Vehicle Regulation and Law Enforcement Activities Are Adequately Funded in the Years Ahead?***

### Motor Vehicle Account Funded by User Fees

California finances the regulation and licensing of vehicles and drivers, the enforcement of traffic and highway safety laws, and the implementation of vehicle exhaust emission standards, using funds derived from "user fees" imposed upon the state's motorists. These fees include (1) the motor vehicle registration fees (currently $23), (2) the drivers license fees (currently $10), and (3) and a portion of the motor vehicle weight fees.

The user fees are deposited in the Motor Vehicle Account (MVA) in the State Transportation Fund. The vast majority of these revenues—95 percent in 1986–87—are used to support the activities of the Department of

Motor Vehicles (DMV), the California Highway Patrol (CHP) and the Air Resources Board (ARB).

**Motor Vehicle Account Is Slipping Into The Red**

Last year, in *The 1985–86 Budget: Perspectives and Issues* (Part Three), we indicated that if additional revenues were not made available to the Motor Vehicle Account, the account would soon slip into the red during 1987–88. We also indicated that with no increase in revenues, the account was heading for a cumulative funding shortfall of $327 million during the five-year period from 1985–86 to 1989–90.

The outlook for the account today is worse, not better. Our projections of MVA revenues and expenditures now indicate that the account will run a deficit of just under $50 million in 1986–87—one year earlier than we anticipated a year ago. Within another four years, the cumulative revenue shortfall in the account will be somewhere between $676 million and $1 billion (depending on the rate of growth in expenditures).

The reason for the more pessimistic outlook is clear: the budgets for the DMV, CHP and ARB call for MVA expenditures in the current and budget years that are nearly $100 million higher than what we projected one year ago.

Table 45 details our projections of MVA revenues and expenditures during the next five years. In making these projections, we have assumed that revenues will grow at an average annual rate of 4.6 percent. This rate is consistent with the *actual* growth rate since 1982–83 and the growth rate expected for 1985–86 and 1986–87 as presented in the Governor's Budget. On this basis, we project that MVA revenues will grow from $697 million in 1986–87 to $834 million in 1990–91.

**Table 45**
**Motor Vehicle Account**
**Fund Condition**
**1986–87 through 1990–91**
**(dollars in thousands)** [a]

| | *1986–87* | *1987–88* | *1988–89* | *1989–90* | *1990–91* | *Totals* |
|---|---|---|---|---|---|---|
| Total revenue and transfers [b] | $697,044 [c] | $729,108 | $762,647 | $797,729 | $834,424 | $3,820,952 |
| Fund surplus carried over | 44,559 | — | — | — | — | 44,559 |
| Total resources | 741,603 [d] | 729,108 | 762,647 | 797,729 | 834,424 | 3,865,511 |
| Total expenditures [e] | 789,813 | 845,100 | 904,257 | 967,555 | 1,035,284 | 4,542,008 |
| Annual operating deficit | –$48,210 | –$115,992 | –$141,610 | –$169,826 | –$200,859 | –$676,497 |

[a] Details may not add to totals due to rounding.

[b] Legislative Analyst office's estimates based on straight line projections of actual revenues for 1982–83 through 1984–85 and Department of Finance estimates for 1985–86 and 1986–87. Average growth per year—4.6 percent.

[c] Includes $7 million in one-time revenues resulting from the Registration Amnesty Program, Ch 1126/85 (AB 2000), as assumed by the Department of Finance. The deficit in the budget year may increase to the extent that these revenues do not materialize as expected.

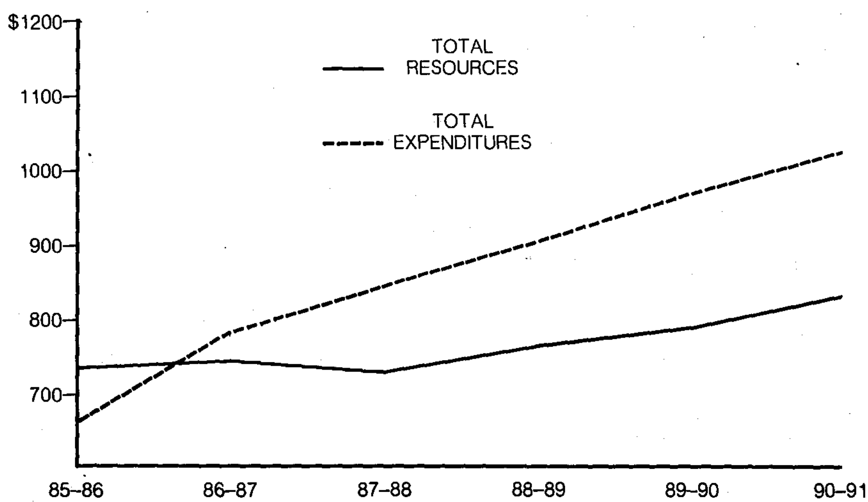
[d] Excludes proposed $65.7 million transfer from the State Highway Account to the Motor Vehicle Account assumed in the Governor's Budget.

[e] Legislative Analyst office's estimates based on 1986–87 proposed expenditures and assuming an average annual growth rate of 7 percent (5 percent inflation plus 2 percent program growth) thereafter.

In projecting expenditures, we have assumed an average annual growth rate of 7 percent beyond 1986–87. This would be sufficient to compensate for a 5 percent rate of inflation and a 2 percent increase in workload growth. In our judgment, this is the *lowest* rate of growth in expenditures that can reasonably be expected in the years ahead. In effect, a 7 percent growth rate assumes that (1) the DMV field office automation project essentially will be completed early in 1987–88, (2) the CHP will not require a significant increase in the number of traffic officers over the next five years, and (3) MVA support for ARB programs will be reduced significantly in the budget year and replaced with support from the General Fund. (In *The Analysis of the 1986–87 Budget Bill* (Item 3400), we recommend that the source of funding for $20 million in ARB activities be shifted from the MVA to the General Fund because under the Constitution, the MVA cannot be used to fund activities which are unrelated to motor vehicles or their environmental effects.)

Chart 23 graphically displays the huge gap that will open up between MVA expenditures and revenues over the next five years if our projection of expenditures holds. If expenditures continue to grow at the current rate, the cumulative gap in 1990–91 would widen from $676 million to $1 billion.

**Chart 23**
**Motor Vehicle Account Fund Condition[a]**
**1985–86 through 1990–91 (in millions)**




[a] Source: Legislative Analyst's office. Assumes that revenues grow at an average annual rate of 4.6 percent and expenditures increase at an annual rate of 7 percent.

**Causes of the Shortfall**

Our analysis indicates that several factors are causing the growing revenue shortfall in the MVA. The most important of these are as follows:

1. ***Program Expenditures Are Increasing Rapidly.*** For the five-year period ending with 1986–87, the average annual rate of growth in MVA-financed expenditures was about 10 percent. (In contrast, General Fund expenditures during this period have risen at an average annual rate of 7.2 percent.) All three agencies supported by the account have contributed to the upsurge in expenditures. By 1986–87, the CHP's annual expenditures will have increased by $166 million, or 54 percent, while DMV expenditures will have increased by $81 million, or 52 percent. The ARB's MVA-funded expenditures will have grown even more rapidly—by $22 million, or 94 percent.

The primary reasons for the significant increases in expenditures from the MVA are: (1) the significant increase in the number of CHP traffic officers; (2) the increased costs of DMV's field office automation project; and (3) the increased costs of ARB's acid rain and toxic air contaminant research programs.

Our analysis indicates that the rate of growth in expenditures by the CHP, DMV and ARB probably will decline beyond 1986–87. Still, our conservative projections show total MVA program expenditures increasing by 31 percent during the four years following the budget year—from $790 million in 1986–87 to over $1 billion in 1990–91.

2. ***The Current Fee Structure Does Not Produce Sufficient Revenues to Match the Growth in Program Expenditures.*** The registration and license fees, which are the MVA's primary revenue sources, are fixed in dollar terms. As a result, inflation tends to reduce the purchasing power of these fee rates over time. In contrast, ad valorem taxes, such as the sales tax, generally permit revenues to keep pace with increases in the price level, thereby maintaining the purchasing power of the tax. Because they are not ad valorem, the registration and license fees generate more revenue only to the extent there is growth in the numbers of vehicles and drivers. As a rule, this is not sufficient to cover the growing costs of vehicle regulatory activities and safety management services.

Based on the projected growth in the number of vehicles and drivers, we estimate that the resources available to the MVA will grow by only 13 percent during the next four years—from $742 million to $834 million. When this increase is compared to a projected growth of 31 percent in expenditures over the same period, it becomes evident that the current fee structure will not be able to support current state programs that depend on the MVA.

3. ***More Vehicle Owners Refusing to Comply with Registration Laws.*** Another major cause of the revenue shortfall is that drivers, in increasing numbers, are failing to register their cars. Since 1982–83, the rate of vehicle registration renewals has dropped from 95 percent to 91 percent—a 4 percent drop in just two years. The Department of Motor Vehicles attributes this decline to a number of factors, including the high costs associated with registration fees, in-lieu property taxes, use taxes, smog certifications and mandatory liability insurance. These costs are making drivers increasingly resistant to registering their vehicles.

Table 46 compares the costs to register and insure a typical three-year-old car in a metropolitan area with the related costs of purchasing a similar model used car. It shows that reregistration alone costs a driver $742 annually, largely due to the cost of mandatory liability insurance. Total costs, however, are even higher for the driver who buys a similar model used car. These costs average $1,182 per year—59 percent more than the reregistration costs of $742.

**Table 46**
**Registration and Mandatory Liability Insurance Costs for a Three-Year-Old Car**
**1986**

| | *Reregistration* | *Purchase of Used Car* |
|---|---|---|
| State use tax | — | $437 [a] |
| Change of ownership | — | 3 |
| Registration fee | $23 | 23 [b] |
| In-lieu property tax | 94 | 94 |
| Smog inspection and related repairs | 70 | 70 |
| Mandatory liability insurance (annual premium) | 555 | 555 [c] |
| Totals | $742 | $1,182 |

[a] Six percent tax, purchase price $6,725.
[b] If registration expires within 60 days of purchase, reregistration is required.
[c] Source: Southern California Automobile Association (for San Jose area).

According to DMV, this resistance on the part of drivers to paying the increased costs of car ownership has resulted in about 2.1 million vehicles —about 10 percent of the state's vehicles—being driven on California's roads and highways without a valid registration. Because of this, the MVA will lose about $48 million in registration fees in the current year.

The DMV is unable to estimate the revenue loss to the General Fund and local governments resulting from the failure of drivers to pay the state use tax and in-lieu property tax. We believe, however, the General Fund and local governments are being deprived of more than $100 million in revenues during the current year.

Recognizing the seriousness of this problem, the Legislature recently enacted Ch 1126/85 (AB 2000) establishing the Registration Amnesty Program. This program allows motorists to register or reregister their vehicles without penalties during a three-month period starting January 1, 1986. The Department of Finance estimates that as a result of the AB 2000 program, $8 million of registration fees, or 15 percent of the amount outstanding, will be collected during the three-month period, and that an additional $7 million will be collected in 1986–87 as a result of drivers reregistering their vehicles.

The AB 2000 program may indeed reduce the number of vehicles without valid registrations. Unless, however, there is increased emphasis on *enforcement* of state vehicle registration laws, there is no reason to believe that many drivers will change their ways.

***Insufficient Enforcement of Vehicle Registration Laws.*** Given the increase in the number of cars being driven without a valid registration, it is evident that the combined efforts of DMV, CHP and local police departments have *not* been very effective in enforcing the state's vehicle registration laws. This has come about despite the fact that the Legislature has substantially increased the number of CHP patrol officers on the roads and highways, and has provided DMV with one of the state's largest computer networks.

**Governor Fails to Address the Cause of the Deficit**

The Governor's Budget for 1986–87 does not contain any proposal to address the *cause* of the deficit in the Motor Vehicle Account—the growing imbalance between account revenues and account expenditures. The budget proposes no increase in revenues to the account. Nor does it propose any slowdown in the growth of expenditures. In fact, the budget proposes increases in MVA support of (1) 14 percent for the CHP, (2) 10 percent for the DMV, and (3) 15 percent for the ARB. If these rates were to continue in succeeding years, we estimate that the deficit in the MVA would exceed $1 billion by 1990–91.

In summary, the Governor's Budget pretends that the structural imbalance between revenues and expenditures in the Motor Vehicle Account doesn't exist.

***Budget Proposes Transfer of Funds from the State Highway Account to Temporarily Close Deficit in the Budget Year.*** The Governor's Budget attempts to gloss over the $48 million revenue shortfall in the Motor Vehicle Account during 1986–87 by proposing a $65.7 million transfer from the State Highway Account (SHA) to the MVA. This transfer, if approved by the Legislature, would provide a contingency reserve of $17.5 million in the Motor Vehicle Account and a one-year stopgap solution to the growing funding crisis in the MVA.

Rather than request that the Legislature approve the transfer in the Budget Bill, the Department of Finance indicates that it will authorize the transfer *administratively* under Section 42275 of the Vehicle Code. This provision allows a transfer of highway funds to the MVA to cover program costs.

Our analysis indicates that there are two flaws with the proposed transfer. *First*, it leaves untouched the *cause* of the deficit—a serious imbalance between MVA expenditures and MVA revenues. *Second*, the transfer could result in or enlarge a potential revenue shortfall in the State Highway Account during 1986–87. We estimate that the shortfall in the SHA could be as high as $104 million if the transfer takes place. Accordingly, in our *Analysis of the 1986–87 Budget Bill* (Item 2740), we recommend the Legislature adopt budget bill language to prohibit the transfer.

**Options for Eliminating the Imbalance of Revenues and Expenditures**

Given the funding shortfall projected for the MVA during the next five years, the Legislature has two distinct options available for avoiding a deficit in the account: (1) it can reduce expenditures—and therefore services—below current levels, or (2) it can increase revenues above the projected levels.

***Reduce Growth in MVA Expenditures.*** To eliminate the shortfall without increasing revenues, the Legislature would have to reduce expenditures below the "current service level" by $48 million in 1986–87. In addition, further incremental reductions of $68 million in 1987–88, $25 million in 1988–89, $29 million in 1989–90, and $31 million in 1990–91 would have to be made. This would certainly mean (1) sharp cuts in the number of CHP traffic officers assigned to the field, (2) major reductions of DMV field offices and computer systems, resulting in longer customer waiting lines, and (3) sizable reductions in ARB's air pollution research and control programs. The construction of new CHP and DMV field offices also would have to be discontinued or drastically cut back.

Such major program cutbacks would not be consistent with the Legislature's long-term goals of (1) providing for effective regulation of the state's vehicles and drivers, (2) providing for effective management and enforcement of the state's traffic laws and driving safety programs, and (3) improving services to the motoring public.

***Increase MVA Revenues.*** To eliminate the shortfall without cutting current program levels would require the Legislature to increase the registration fee by about $7, or 30 percent, if the growth in expenditures is held to 7 percent per year. If, however, expenditures continue to grow at the current rate of 10 percent per year, an increase of $10, or 44 percent, would be needed to eliminate the shortfall. Alternatively, the $10 drivers license fee, which drivers pay every two-to-four years, could be increased in order to hold down the size of the increase in registration fees.

*Do Both.* Obviously, these are not mutually exclusive options. The Legislature could eliminate the MVA shortfall by (1) holding the growth in program expenditures to less than 7 percent per year *and* (2) increasing user fee revenues.

**Funding Imbalance Must Be Addressed**

***We recommend that the Legislature (1) direct the California Highway Patrol to establish a task force with the Department of Motor Vehicles and local law enforcement agencies to increase compliance with the state's vehicle registration laws and (2) transfer $20 million in costs for the Air Resources Board from the MVA to the General Fund. We further recommend that the Legislature enact legislation to increase the vehicle registration fee by $6 (to $29) and the drivers license fee by $4 (to $14), effective January 1, 1987.***

Our analysis indicates that the Legislature should take a three-step approach to eliminating the imbalance between MVA expenditures and revenues. *First,* it needs to increase compliance with the state's vehicle registration laws. *Second,* it should shift the source of funds for the ARB's stationary source pollution activities from the MVA to the General Fund. *Third* (and unavoidably), it must increase user fees so as to balance account revenues with expenditures.

1. ***Increase Compliance With the State's Vehicle Registration Laws.*** Given the increase in the number of cars being driven on California's roads and highways without a valid registration, we believe that the CHP must be more aggressive in its enforcement of vehicle registration laws. With this in mind, we recommend in *The Analysis of the 1986–87 Budget Bill* (Item 2720), that the Legislature direct the California Highway Patrol to form a task force which includes representatives of the Department of Motor Vehicles and local enforcement agencies for the purpose of developing and implementing a plan for increased enforcement of the state's vehicle registration laws.

2. ***Shift the Source of Funds for Air Resources Board Programs.*** As discussed earlier, a significant amount of Air Resources Board activities which are unrelated to motor vehicles or their environmental effects are funded from the MVA. Consequently, in *The Analysis of the 1986–87 Budget Bill* (Item 3400), we recommend that the source of funding for $20 million in ARB activities be shifted from the MVA to the General Fund. These activities do not appear to qualify for MVA support under the State Constitution.

3. ***Increase MVA Revenues.*** We believe the Legislature must increase MVA user fee revenues if it is to maintain current levels of service to motorists. Specifically, we recommend the Legislature enact legislation

to increase the vehicle registration fee by $6 and the drivers license fee by $4, effective January 1, 1987. A $6 increase in the vehicle registration fee (from $23 to $29) would raise about $120 million each year, or $575 million during the five-year period. A $4 increase in the drivers license fee (from $10 to $14), would raise about $20 million each year, or $100 million over the five-year period. Together, these increases would generate the $675 million needed to eliminate the shortfall and restore a balance between expenditures and revenues during the next five years.

**Conclusion**

This three-step approach we recommend will keep revenues and expenditures in balance during the next five years, *assuming* the growth in expenditures from the MVA is held to a conservative 7 percent annually. This, however, would leave no funds available for legislative initiatives to expand DMV, CHP, or ARB program activities. If the Legislature and the Governor wish to increase the current level of services provided by these agencies, further increases in MVA user fees beyond those we recommend would be necessary.

# Expenditure Issues

## THE STATE'S APPROPRIATIONS LIMIT

### *How Will the Constitutional Limit on State Appropriations Affect the State's Ability to Provide Services?*

As discussed in Part Two of this document, the Governor's Budget proposes that the state's constitutional appropriations limit for the 1986–87 fiscal year be established at $24.2 billion. According to the Department of Finance, the proposed limit is only $100 million more than the level of appropriations subject to limitation proposed by the Governor.

We estimate that the level of appropriations proposed in the budget actually *exceeds* the state's appropriations limit.

Regardless of whose conclusion is correct, the implications are the same: the limitation on appropriations which the voters approved seven years ago has suddenly become an important factor which the Legislature must take into account in putting together a budget for California.

This section provides some background on the appropriations limit imposed by Article XIII B of the California Constitution. It also reviews the legislation which implemented this provision of the Constitution, and discusses the reasons why the state has not encountered the limit in previous years. In addition, this section analyzes where the state stands in relation to the limit, given the spending plan presented in the Governor's Budget and the requirements of current law. Finally, this section presents our conclusions regarding the likely effects of the limit during the two years beyond the budget year.

#### Background

Article XIII B was added to the State Constitution when the voters approved Proposition 4 on the November 1979 Special Election ballot. The article does three things:

- It limits the level of tax-funded appropriations which can be made by the state and individual local governments in any given year. The limit for each year is equal to the limit for the prior year, adjusted for changes in the cost-of-living and population, with certain exceptions as discussed below.
- It requires that state and local governments return to the taxpayers any moneys collected or on hand that exceed the amount which can be appropriated in a given fiscal year.
- It requires that the state reimburse local governments and school districts for the cost of complying with state mandates.

This section will consider only the appropriations limit and refunding requirements of the measure.

As noted above, the limit applies only to appropriations financed from the "proceeds of taxes." The article defines this term to include:

- All tax revenues to the General Fund and special funds, including those carried over from a prior year;
- Any proceeds from the investment of tax revenues, such as interest earnings; and
- Any revenues from a regulatory license fee or user charge that exceed the amount needed to cover the reasonable cost of providing the regulation, product or service.

Appropriations financed by other sources of revenue, such as tidelands oil and gas revenues, federal funds, bond funds, traffic fines and user fees based on reasonable costs, are not subject to the appropriations limit.

Nor does the appropriations limit for the state government apply to certain specific categories of appropriations, even though these appropriations may be financed by tax proceeds. These exempt categories include:

- "State subventions" to local governments and school districts (the appropriation of these funds is subject to limitation at the *local* level);
- Payments to beneficiaries from retirement, disability insurance and unemployment insurance funds;
- Payments for interest and redemption charges on state debt existing as of January 1, 1979, or payments on bonded indebtedness approved by the voters after that date; and
- Appropriations needed to pay the state's cost of complying with mandates imposed by federal laws and regulations or court orders.

Article XIII B established the 1978–79 fiscal year as the "base year" for purposes of computing the initial appropriations limit, and specified that the initial appropriations limit first apply to appropriations made in the 1980–81 fiscal year.

The initial appropriations limit was computed by calculating the total amount of "appropriations subject to limitation" in the base year, and then adjusting this amount to reflect cost-of-living and population changes, as well as transfers of financial responsibility, in order to arrive at the appropriations limit for 1980–81.

"Transfers of financial responsibility" occur when one level of government assumes the burden of financing a service from another level of government, or when the source of program financing is shifted from tax proceeds to *fees* or other nontax proceeds. The appropriations limit of each entity which is a party to a service transfer must be adjusted by a corresponding amount, so that in the aggregate, the total amount of their appropriations limits is *no larger after the transfer than it was before.* In the case of a transfer involving the source of financing, the appropriations limit must be *reduced* by the amount of nontax revenue used to finance the service.

In years after 1980–81, the appropriations limit is equal to the limit for the prior year, regardless of how much was actually appropriated, adjusted to reflect cost-of-living changes, population changes, and any transfers of financial responsibility.

***Implementing Legislation.*** Because several of Article XIII B's provisions are ambiguous, and appear to work at cross-purposes, it is not a simple matter to determine the state's initial appropriations limit. In order to develop a workable set of definitions and procedures that can be used to calculate the initial limit, one must interpret a large number of the measure's provisions—a task that requires the use of assumptions regarding what the proponents of the measure intended and how the courts would interpret the various provisions. (Once the initial limit is determined, the task of adjusting it for subsequent years is considerably easier.)

Using opinions supplied by the Legislative Counsel, staff in the Legislative Analyst's office and in the Department of Finance developed the methodology needed to establish the appropriations limit for 1980–81.

Before this methodology could be used, however, it was necessary for the Legislature to give meaning to some of the terms in Article XIII B. For example, the term "average daily attendance" (ADA), as it applies to school districts, could refer to one of several numbers that stand for "ADA" in the course of the year. (ADA ultimately was defined as average daily attendance computed for the second annual apportionment of state school funds.) Accordingly, the Legislature enacted SB 1352 (Ch 1205/80) to clarify the meaning of the terms used in the measure.

Senate Bill 1352 defines state subventions to local governments as meaning only that money received by a local agency from the state which is *unrestricted* as to the purposes for which it can be used. As a result, only about $1.9 billion of the $11-plus billion which the state will turn over to cities, counties, and special districts in 1986–87 is considered to be "state subventions." This $1.9 billion consists primarily of the Motor Vehicle License Fee subvention and the reimbursement from the state for the revenue loss associated with the Homeowner's Property Tax Exemption.

With respect to K–12 school districts, SB 1352 defines state subventions as that portion of a district's revenue limit apportionments necessary to fund the "foundation program," after taking into account local tax revenues. The "foundation program" represents a computed value which generally is less than the revenue limit amount. The balance of the regular apportionment, as well as apportionments for categorical programs, are *not* considered to be subventions. State subventions for Community College districts and County Superintendents are determined using a similar formula.

As a result, approximately $7.4 billion of the $12.7 billion that the state will turn over to local school districts in 1986–87 is considered to be "state subventions" and therefore exempt from the appropriations limit. Table 47 illustrates how state aid for local school districts is allocated between the state and local appropriations limits.

**Table 47**
**Amount of State Aid for Education Included in State and Local Appropriations Limits**
**1986–87**
**(dollars in millions)**

| *Program* | *State Limit* | *Local Limit* |
|---|---|---|
| K–12 Education: | | |
| Revenue Limits | $2,045 | $6,125 |
| Categorical Aids | 3,282 | — |
| County Offices of Education | — | 102 |
| Community Colleges | 71 | 1,193 |

***The Initial Appropriations Limit.*** The Legislature officially acted to set the state's initial appropriations limit when it passed the 1981 Budget Bill. Control Section 12.2 of the bill set the limits for both 1980–81 and 1981–82.

In establishing these limits, the Legislature included in the computation of the 1978–79 "appropriations subject to limitation" certain appropriations financed by revenue sources which technically were not tax proceeds. Article XIII B states that "proceeds of taxes shall include, but not be restricted to..." specified items. Given the apparent flexibility accorded by this language, the Legislature opted to count toward the appropriations limit appropriations financed by revenues from the sale of state property, moneys received under the unclaimed property law, and certain other miscellaneous revenues. The inclusion of these appropriations in the base was expected to add to the Legislature's flexibility in later years, since these revenue sources were expected to grow more slowly than the appropriations limit itself. Appropriations from other, larger sources of nontax revenues, such as tidelands oil revenues, were excluded in calculating the initial limit because these revenue sources were expected to show higher rates of growth.

In summary, the operation of the state's appropriations limit is actually controlled by three factors: the State Constitution (Article XIII B), the implementing legislation (Ch 1205/80), and the past practices of the Legislature in establishing the state's limit.

### Limit Not Relevant in Past Years

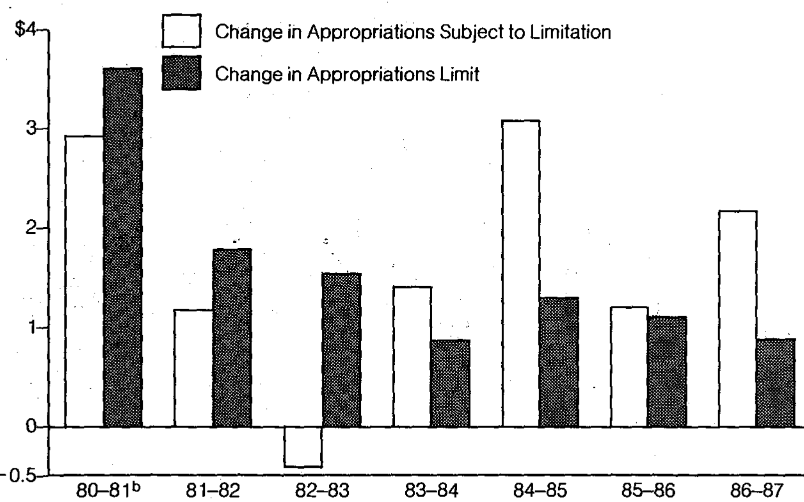
Chart 24 graphically illustrates the estimated change in the state's appropriations limit and in the amount of appropriations subject to limitation for each year since the limit became effective in 1980–81. Chart 25 displays the amount of *unused* appropriations limit for the same period.

As the data indicate, the "room" between the limit and the amount of appropriations subject to the limit increased significantly during the first three years in which the limit was in effect. These increases, in part, reflected the restraining influence on state revenues of the economic recession that occurred during this period. Because tax revenues grew slowly, the state did not have enough money to support appropriations that could fully utilize the room within the limit. Probably more important in explaining the trend during the first three years of the limit's existence was the high rate of inflation that characterized this period. Because the limit is adjusted for the increase in population and the lower of either the increase in the U.S. Consumer Price Index or per capita personal income, the limit increased by almost 21 percent between 1980–81 and 1982–83.

**Chart 24**

**Annual Changes in the State Appropriations Limit and Appropriations Subject to Limitation** [a]

**1980–81 through 1986–87 (in billions)**



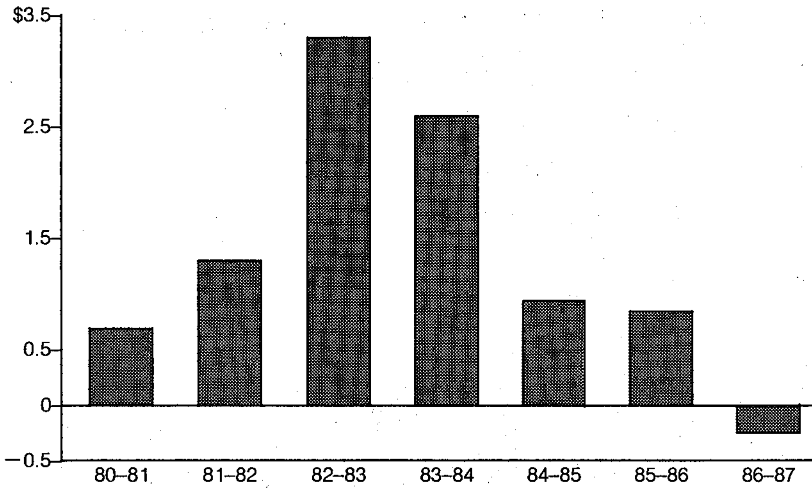

[a] Source: Governor's Budget. Data for 1986–87 fiscal year represent Legislative Analyst office's estimates, based on Governor's Budget as proposed.
[b] Represents change for two-year period between 1978–79 and 1980–81.

In 1983–84, the gap between the limit and appropriations subject to the limit began to narrow, as the state's economy recovered from the recession and began to generate tax revenues that could be used to increase appropriations. These tax revenues, in turn, were used to expand programs, particularly in the area of education. This is evidenced by the fact that appropriations subject to the limit grew by over 9 percent in 1983–84. At the same time, the rate of growth in inflation and per capita personal income sank to record lows, causing the limit to grow by only 4.4 percent.

In 1984–85, the amount of unused "room" within the limit fell dramatically, as appropriations subject to the limit climbed by more than $3 billion. This increase reflected the dramatic improvement in the condition of the General Fund brought about by a healthy economy. Fiscal year 1984–85 also marked the second straight year that the inflation rate remained below 5 percent, causing the state's limit to grow at a rate less than one-half the rate of growth in appropriations subject to the limit.

**Chart 25**

**Amount of Unused Appropriations Limit[a]**
**1980–81 through 1986–87 (in billions)**




[a] Source: Governor's Budget. Data for 1986–87 represent Legislative Analyst Office's estimates, based on Governor's Budget as proposed.

The Governor's Budget estimates that in the current year, the amount of unused "room" within the limit will remain at about what it was in 1984–85. That is, the rate of growth in both appropriations and the limit will largely parallel each other.

This estimate, however, gives a false signal as to the underlying trends. This is because over $500 million in 1985–86 spending is not included in the amount of "appropriations subject to limitation" because it is being financed from the Special Fund for Economic Uncertainties. Article XIII B specifies that appropriations *into* this reserve account are subject to the limit, but appropriations *from* the account are not. If current revenues had been available to finance this spending, "appropriations subject to limitation" in 1985–86 would have been $500 million higher than what is shown in the budget document.

**The 1986–87 Predicament**

As noted earlier, the budget indicates that the amount of "appropriations subject to limitation" proposed by the Governor will be $100 million less than the "appropriations limit" for 1986–87. Our analysis leads us to a different conclusion—that the appropriations proposed in the Governor's Budget actually *exceed* the allowable amount by $238 million. Two factors account for this conclusion.

***The Appropriations Limit Reflected in the Budget is Too High.*** The Governor's Budget for 1986–87 *estimates* that the limit for 1986–87 will be $24.2 billion. We emphasize the word "estimates" because the data needed to determine the limit for 1986–87 will not become available until May. Furthermore, the limit will have to be "administratively adjusted" during the course of the year in order to reflect any transfers of financial responsibility that take place after the budget is adopted.

Nevertheless, given the information that is now available, we find that the Governor's Budget overstates the limit by approximately $70 million. This is because the Department of Finance has chosen to raise the limit by more than what inflation and population changes would warrant. The department has done so citing several "transfers of financial responsibility" that occurred in 1985.

The events which the department refers to do not appear to involve any such transfers. For example, the department has raised the state's limit by $50 million to reflect the additional state funding provided in the 1985 Budget Act for the Medically Indigent Services program. This augmentation, however, reflects no underlying change in either the counties' or state's responsibility toward program beneficiaries. The increase was provided merely to ensure that the state's reimbursement for the costs mandated on counties by this program did not continue to lag behind the growth in program costs. More importantly, since the state *already* is 100 percent responsible for financing the costs of this state-mandated local program, there is no way to justify an increase in the limit by claiming that the state "increased" its share of responsibility for the program's cost.

The other adjustments to the limit proposed by the department present similar problems.

***The Appropriations Called for in the Budget are Understated.*** In order to compute the total amount of "appropriations subject to limitation," it is necessary to first count all appropriations from those state funds which derive their revenue in whole or in part from the "proceeds of taxes." The total of these appropriations is then reduced by the amount of appropriations financed by fee revenues, revenues from state-imposed penalties, tidelands oil revenues, and certain other non-tax revenues. Finally, the amount of unrestricted state subventions to local governments and school districts, and the cost of voter-approved debt service, are subtracted. Here again, it is important to recognize that many of the figures used in making this computation are only *estimates* of the amount to be expended, and are subject to significant revision.

Our review of the Department of Finance's calculations uncovered several discrepancies which, when corrected, raise the total amount of "appropriations subject to limitation" by approximately $267 million. One item accounts for most of the increase. In computing the total amount of appropriations proposed for 1986–87, the department omitted a $200 million "reserve for additional expenditures" in the State Highway Account (State Transportation Fund). Although the Budget Bill does not propose the appropriation of these funds, the department intends to seek legislation appropriating the funds for new projects. Even if it chose not to seek such an appropriation, however, under the provisions of existing law the funds would be appropriated automatically on June 30, 1987. Most of the remaining difference relates to the exclusion of $50 million in statutory appropriations financed by the Universal Telephone Service tax.

To summarize, our analysis indicates that the budget proposed by the Governor calls for appropriations that exceed by approximately $238 million the limit imposed by Article XIII B of the State Constitution. Assuming no changes in either the revenues or the expenditures reflected in the budget (a most unrealistic assumption to be sure), this amount would have to be eliminated from the proposed spending plan and returned to taxpayers before June 30, 1989. In the next section we discuss some of the ways in which these estimates may change, and the options that are available to the Legislature for producing a different outcome.

***Is a Violation of Article XIII B Inevitable in 1986–87?*** As noted earlier, all of the calculations regarding Article XIII B are based on *estimates*. Some of these involve the amount that will be *spent* in 1986–87 under various "open-ended" programs, so that it will not be possible to ascertain the exact degree of compliance with the article's requirements until well after the 1986–87 fiscal year is completed.

The state's position relative to the appropriations limit can change markedly if some of the more important assumptions underlying the initial calculation change. For example, if the actual CPI adjustment differs from the projected adjustment by one percentage point, the appropriations limit for 1986–87 will be $230 million higher or lower. Similarly, changes in General Fund revenue from what is projected in the budget for 1986–87 will increase or decrease "appropriations subject to limitation" on a dollar-for-dollar basis. This is because these changes will raise or lower the amount available for appropriation to the Special Fund for Economic Uncertainties.

In what direction are these changes likely to go? At this point, there is no reason to believe that the estimates of revenues and CPI adjustment are either too high or too low. There is one factor in the equation, however, that *is* likely to put the state even further above its limit. This factor involves voter-approved debt service.

The budget's estimate of expenditures for voter-approved debt service in 1986–87 obviously is too high. As we explain in Part Two of this volume, moreover, the uncertainty surrounding federal tax reform and its effects on tax-exempt debt is likely to keep debt-service payments well below the budget estimate. Under existing law, the amount saved as a result of the shortfall is automatically appropriated to the Special Fund for Economic Uncertainties unless it is appropriated for some other purpose. This would increase "appropriations subject to limitation" because appropriations for voter-approved debt service are exempt from the limit, while appropriations to the special fund or for program expansions are not.

If the CPI adjustment is *lower* than estimated, it will pose a special problem for the Legislature because of the way "state subventions" is defined. To the extent that the CPI adjustment is lower than 3.4 percent (the adjustment assumed in the budget), the amount of state aid included within local school districts' limits is automatically lower as well. This means more state school aid will be subject to the appropriations limit at the state level, *even if the total amount of state aid is unchanged*. This "additional" state aid, moreover, would have to be accommodated within a state appropriations limit that is *lower* because of the smaller CPI increase—a double whammy. If the CPI adjustment is higher than estimated, on the other hand, the amount of state aid subject to the local limit increases, as does the local limit, and less state aid remains to be accommodated within a higher state limit.

The Legislature also will have an opportunity to change the relationship between appropriations subject to the limit and the limit itself. It can bring about such a change:

- By increasing expenditures for "state subventions" to local government;
- By enacting new "tax expenditure" or tax refund programs;
- By increasing appropriations for General Fund debt service (provided that the voters approve additional bond authorizations at the June 1986 election); or
- By appropriating more funds to comply with court orders (assuming the amounts necessary to comply with such orders can be identified).

Each of these actions would reduce appropriations subject to limitation by the Constitution. If not accompanied by actions to reduce spending for other categories of expenditure, however, the additional room within the appropriations limit would come at the expense of the state's contingency reserve.

Thus, it is clear that the state's accommodation to the constraints imposed by Article XIII B in 1986–87 is but one part of a complex budgetary equation that must be solved by the Legislature and the Governor.

Article XIII B also provides two methods by which the appropriations limit may be exceeded. First, the limit may be exceeded in the event of an emergency, provided that the appropriations limit for the succeeding three years is reduced to prevent an aggregate increase in appropriations over the four-year period. Second, the limit may be changed by a majority popular vote, but any such change could only remain in effect for a four-year period.

### The Long-Range Outlook

Given that the state has used up the breathing room it once had within its appropriations limit, the limit can be expected to constrain state spending so long as the economy remains strong and inflation remains moderate.

In the event there is a significant slowdown in the state's economy, state revenues might not grow fast enough to keep pace with the limit. This, in fact, is what occurred in 1981–82 and 1982–83, thereby opening up the large gap between the limit and the amount appropriated in those years. The consensus of business economists indicates that a recession will begin sometime before 1988.

As we discuss in Part One of this volume, the long-range forecast offered by the administration includes no provision for an economic slow-down. If this forecast proves correct, the economy will produce revenues well in excess of the amount needed to maintain expenditures at a constant "real" per capita level, making it necessary for the state to refund the excess tax in the future.

## POPULATION GROWTH IN THE YOUTH AUTHORITY

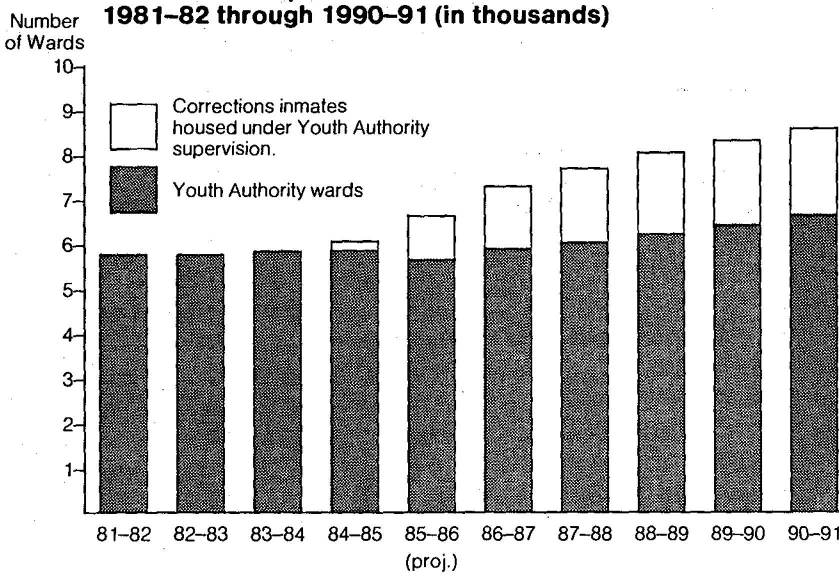
### *What Options Does the Legislature Have to Alleviate Overcrowding in Youth Authority Facilities?*

The institutional population of the Department of the Youth Authority is increasing rapidly. The department's current-year support budget is based on a low-growth assumption that the ward population will increase from 6,440 on June 30, 1985, to 6,575 on June 30, 1986. By January 1, 1986, however, the number of wards in the department's institutions and camps already had reached 7,100—a higher level than had been predicted for the end of the year. Moreover, the department's revised population projections now indicate the need to house 7,300 wards by the end of the current year and 7,700 wards by the end of the budget year.

Given the design capacity of the department's existing institutions and camps (5,915), the Youth Authority will be overcrowded by 1,785 wards at the end of the budget year. Thus, it will be operating at about 130 percent of capacity.

Chart 26 depicts the historical and projected growth in ward population from 1981–82 through 1990–91.

Chart 26
**Department of the Youth Authority Institutional Population 1981–82 through 1990–91 (in thousands)**




**Nature of the Youth Authority Population Problem**

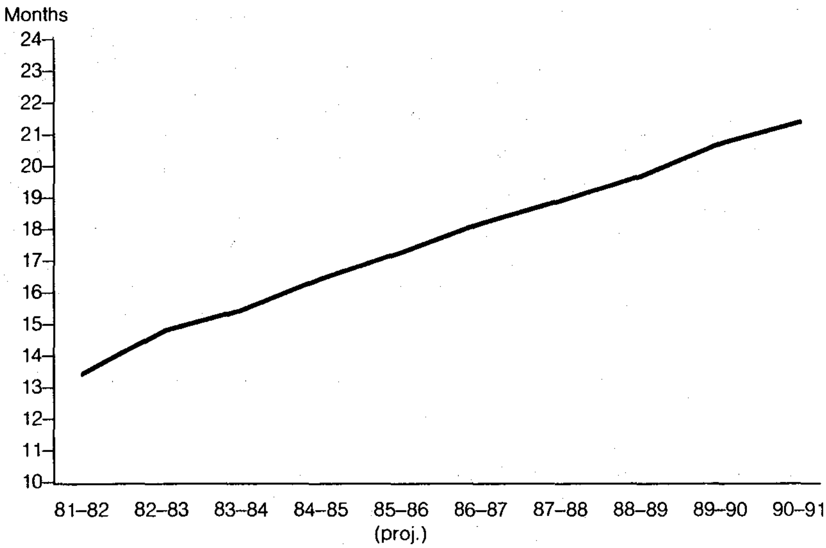
The increase in ward population is *not* primarily the result of an increase in juvenile and criminal court commitments to the Youth Authority. Since 1981–82, first commitments from juvenile court have remained relatively stable and criminal court first commitments have declined by 74 percent.

In part, the rapid increase in population in the current and budget years is due to a heavy intake of correctional inmates committed under the provisions of Ch 701/83 (SB 821). This measure specifies that in sentencing a person under the age of 21 to serve time in state prison, the court may order that person transferred to the custody of the Youth Authority to serve all or a portion of his or her confinement time. At the beginning of 1984–85, a total of 206 SB 821 inmates were housed in the Youth Authority. One year later, a total of 973 such inmates were housed in its facilities. Chart 26 also shows how these inmates will affect the growth in Youth Authority population in future years.

Although SB 821 transfers have increased dramatically, the department's population projections do not anticipate an increase in the *rate* of such transfers during the next five years. Similarly, the department projects that minors committed by both juvenile and criminal courts will remain stable. The *primary* reason why the Youth Authority ward population is projected to continue increasing is because of a dramatic rise in the length of time that wards are expected to stay in Youth Authority institutions. Chart 27 depicts the actual increase in average ward length-of-stay since 1981–82, as well as what the department projects through 1990–91.

Chart 27

**Department of the Youth Authority Ward Average Length of Stay 1981–82 through 1990–91**




As Chart 27 indicates, ward length-of-stay has increased 3.7 months since 1981–82, and the department expects it to increase by an additional 4.2 months by 1990–91. Simply explained, an increase in a ward's length-of-stay contributes to institutional overcrowding by delaying his or her departure from Youth Authority facilities. Even if the number of first admissions remains unchanged, the institutions become more crowded as each ward stays in the institutions longer.

For example, in 1981–82, total first admissions to the Youth Authority (including both juvenile and criminal court commitments as well as persons returned to the institutions due to parole violations) totaled 4,643. In the same year, about the same number of wards—4,646—were paroled or transferred out of departmental facilities. This resulted in a net decrease of three wards in the institutional population by the end of the year.

By 1984–85, however, the number of wards committed to the Youth Authority in that year exceeded by 597, or about 14 percent, the number of wards released from department institutions. Clearly, as Youth Authority wards spend more time within institutions, overcrowding problems will continue.

**Reasons for Increasing Length-of-Stay.**

There are various explanations for why the average length-of-stay has increased. For the most part, however, length-of-stay is affected by two major factors: (1) the parole consideration date established for each ward and (2) the "time cuts" granted for good behavior and "time adds" imposed for poor progress within the institution.

***Parole Consideration Dates.*** When a ward is first committed to the Youth Authority, the Youthful Offender Parole Board (YOPB) must establish a parole consideration date (PCD) for the ward. The PCD represents the interval of time which the board believes the ward should stay in a Youth Authority institution before he or she is ready for parole. The YOPB employs a classification system for determining a ward's parole consideration date that is based on the seriousness of the commitment offense and the degree of danger which the ward poses to the public.

**Table 48**
**Historical Changes in Parole Consideration Dates (PCDs) for Selected Commitment Offenses**

| *Commitment Offense* | *PCDs Prior to June 1, 1978*[a] | *Current PCDs 1985–86* | *PCDs Proposed by Youthful Offender Parole Board*[b] |
|---|---|---|---|
| Murder, 1st and 2nd degree | 3 years | 6 years | 7 years |
| Voluntary manslaughter | 3 years | 3 years | 4 years |
| Assault with deadly weapon or force | 1 year | 1.3 years | 1.5 years |
| Robbery | 1 year | 1 year | 1.5 years |
| Burglary, 1st degree | 1 year | 1 year | 1.5 years |
| Sale of narcotics | 1 year | 1.3 years | 2 years |
| Grand theft-person | 1 year | 1 year | 1.5 years |
| Attempted murder | 1 year | 2 years | 4 years |
| Forcible rape | 1 year | 2 years | 3 years |
| Battery with injury | 1 year | 1.3 years | 1.5 years |

[a] The Youthful Offender Parole Board (YOPB) adopted a new ward classification system in 1978.
[b] Proposed policy changes to parole consideration dates approved by the YOPB in November 1985. These changes have not yet been approved by the Office of Administrative Law.

In recent years, parole consideration dates have risen steadily, as shown in Table 48. For instance, a ward committed to the Youth Authority for murder before 1978 received a parole consideration date of three years from the date of commitment. Under current board policies, the parole consideration date for this offense has increased to six years. Under the proposed parole consideration date changes recently approved by the board, the PCD for murder would increase to seven years. Such increases have contributed to the rise in the average length-of-stay and, thus, to overcrowding in department institutions. We discuss these proposed changes in more detail later in this analysis.

*"Time Adds and Time Cuts."* The second factor which determines how long a ward spends within the Youth Authority institutional system is the "time adds" and "time cuts" granted by the YOPB. These actions extend or reduce a ward's parole consideration date, respectively. Depending upon a ward's progress within the institution, the YOPB has the ability to grant reductions in commitment time to reward positive behavior, and to increase commitment time for negative actions.

Over the past several years, there has been a change in the pattern of time adds and time cuts granted by the board. For example, during the last nine months of fiscal year 1981–82, time adds and time cuts occurred at a rate which, in total, *reduced* approximately two weeks from the average length-of-stay. The department's most recent projections, however, indicate that time adds and time cuts will occur at a rate which will *add* more than four and one-half months to the average ward's length-of-stay. This change clearly adds to the department's overcrowding problem.

According to the Youth Authority, two principal factors have contributed to the increase in time additions. First, incidents resulting in time adds are more common in many overcrowded institutions, as wards become more difficult to manage. Second, the board is making a greater number of decisions at the time of a ward's first parole release hearing which increase the amount of time that the ward must remain committed to the Youth Authority. The department suggests that many of these decisions are based on a ward's failure to complete a substance abuse treatment program.

**Alternatives to Alleviate Institutional Overcrowding**

Developing solutions to the Department of the Youth Authority's overcrowding problem will pose a major challenge for the state in 1986. In the discussion which follows, we present some of the alternatives the Legislature may wish to consider for alleviating overcrowding in Youth Authority facilities.

1. ***Early Release of Juvenile Offenders.*** One alternative would be to establish an early release system for juvenile offenders. The State of Washington has adopted this approach. Its early release system specifies that when the population of the state's juvenile institutions exceeds 105 percent of the rated bed capacity, the secretary of the state Department of Social and Health Services may recommend population reductions to the Governor. The secretary then has the authority to release a sufficient number of juvenile offenders to reduce the ward population to 100 percent of rated bed capacity.

Under the Washington law, the secretary must first release those juveniles who have served the greatest proportion of their sentence, and must notify each member of the Legislature and the committing court when a juvenile has been released. In no event, may juveniles who have committed *serious* crimes participate in the early release program. Moreover, all juvenile offenders who are released must be assigned to the department's parole program. In a recent study, the Washington State Department of Juvenile Rehabilitation determined that in order to bring the population of its juvenile facilities to their rated bed capacity, the commitment time for all wards would have to be reduced by an average of 18 days.

Establishing an early release policy would provide a swift mechanism for reducing overcrowding in the short term. In addition, such a policy would produce savings to the General Fund because the average per capita cost of housing a ward within an institution or camp ($30,800 in 1986–87) is over six times greater than the average per capita cost of providing parole services for the same ward ($4,700 in 1986–87). Any early release program, however, must be based on decisions regarding the ability of individual wards to function successfully in the community once released, as well as on public safety considerations.

2. ***Special Programs to Reduce Ward Length-of-Stay.*** A second alternative would be to expand the number of special programs designed to reduce ward length-of-stay. The Youth Authority currently operates two "Planned Reentry" or "PREP" programs which provide intensive rehabilitative services within a shorter treatment period, with the goal of reducing the length-of-stay. A third program is targeted at parolees who are returned to the department's institutions for technical violations of their parole conditions. The purpose of this program is to make these violators ready for return to their community in a shorter period of time by focusing on the reasons why the individual ward failed on parole, as well as on the basic life skills which are needed for success on parole.

Another type of special program is designed to address specialized treatment recommendations made by the YOPB. According to the Youth Authority, an increasing number of time additions are imposed by the board because wards have failed to complete a recommended specialized treatment program, such as for substance abuse. Although the Youth Authority currently operates several substance abuse treatment programs, there is a significant backlog of wards waiting for placement and some treatment programs have not been recognized formally by the YOPB.

Special programs generally require higher staffing levels or other resources which cause them to be more costly. To the extent that such programs are successful, however, the programs may generate long-range savings by reducing a ward's institutional stay or the probability that he or she will be recommitted. The Legislature may, therefore, wish to consider directing the department to establish additional programs of this type in order to help alleviate institutional overcrowding.

3. ***Modify Parole Consideration Dates.*** A third option would involve legislative intervention in the determination of parole consideration dates for juvenile offenders. Currently, the YOPB has sole authority for establishing parole consideration dates.

As noted above, these dates have increased substantially over the past eight years. In addition, the YOPB has proposed amendments to Title 15 of the California Administrative Code which, if approved by the Office of Administrative Law, would further increase parole consideration dates for many commitment offenses. If these changes are adopted, the YOPB indicates that the average ward length-of-stay will increase by approximately two months. The board also estimates that if the proposed amendments are adopted, they will *increase* the Youth Authority's institutional population by *531 wards,* once the full effect of the change has occurred (1990–91). The board states that such an increase will require additional institutional bed space, *at an estimated General Fund cost of $58.8 million.*

Clearly, the question of how long a juvenile offender should be institutionalized is a major policy issue. Answers to this question must rest on judgments regarding the effect that length-of-stay has on the ability of a ward to function successfully in the community once released, as well as on public safety considerations. The Legislature has largely delegated the responsibility for making these decisions to the YOPB. Given the current overcrowding problem in Youth Authority institutions, the Legislature may wish to reduce or prevent further increases in, ward length-of-stay at this time. (Please see our discussion of the YOPB budget in the *Analysis* —Item 5450.)

4. ***Expand Bed Capacity.*** Another option for alleviating Youth Authority institutional overcrowding involves the construction of additional institutional bed space.

The Youth Authority's population management plan relies heavily on continued overcrowding of institutions and camps until additional bed space can be provided through the capital outlay process. This plan will result in major short-term capital outlay and long-term operating costs. In fact, the department estimates that its five-year capital outlay plan (which proposes the construction of five new 600-bed institutions) would require one-time expenditures of about $400 million for capital outlay and equipment, and additional expenditures for operations of $92 million per year. A discussion of this option appears in the capital outlay portion of the *Analysis* (Item 5460-301).

**Alternatives to Building New Institutions Warrant Consideration**

***We recommend that the Department of the Youth Authority prepare a report which evaluates options for alleviating overcrowding in Youth Authority facilities, and submit its findings to the Legislature by November 1, 1986.***

The department's population management plan places minimal emphasis on alternatives to building new institutions. This is in sharp contrast to the Youth Authority's position as recently as 1981–82, when it proposed to limit the institutional ward population by reducing length-of-stay through (1) early referral of wards for parole and (2) asking the YOPB not to add time for minor disciplinary infractions. The 1986–87 budget, however, reflects no such proposals.

In order for the Legislature to assess the adequacy of the department's population management plan, we recommend that the Department of the Youth Authority prepare and submit to the Legislature a report which evaluates the potential for alleviating institutional overcrowding through the use of options such as those discussed above. At a minimum, the department's report should address in a comprehensive fashion:

- The impact of each option on ward rehabilitation and public safety.
- The potential costs and benefits of each option.
- The effect each option could have on the need to provide additional bed space through the capital outlay process.

We further recommend that the department submit this report to the Legislature by November 1, 1986.

## PRISON SUPPORT COSTS

### *How Can the Legislature Control Expenditures for the State's Correctional System?*

During recent years, expenditures for the state's prison system have increased dramatically. In fact, the cost to the General Fund of the state's correctional system is likely to grow at a faster rate than state revenues. As Table 49 shows, the rate of growth in these expenditures has been nearly twice the growth rate for General Fund revenues during the past 10 years.

**Table 49**
**Prison Costs Grow Faster than General Fund Revenues**
**1977–78 through 1986–87**
**(dollars in millions)**

| | | | Percent Change From Previous Year | |
|---|---|---|---|---|
| *Year* | *General Fund Revenues and Transfers* | *Department of Corrections' General Fund Budget* | *General Fund* | *Department of Corrections* |
| 1977–78 | $13,732.4 | $253.8 | 20.4% | 13.7% |
| 1978–79 | 15,217.4 | 256.3 | 10.8 | 1.0 |
| 1979–80 | 18,042.8 | 302.1 | 18.6 | 17.9 |
| 1980–81 | 19,047.5 | 370.7 | 5.6 | 22.7 |
| 1981–82 | 20,920.6 | 426.5 | 9.8 | 15.1 |
| 1982–83 | 21,231.1 | 486.8 | 1.5 | 14.1 |
| 1983–84 | 23,822.1 | 594.3 | 12.2 | 22.1 |
| 1984–85 | 26,605.9 | 766.6 | 11.9 | 29.0 |
| 1985–86 [a] | 28,186.6 | 983.5 | 6.2 | 28.3 |
| 1986–87 [b] | 31,023.6 | 1,184.5 | 10.1 | 20.4 |
| Average annual change over the 10-year period | | | 9.5% | 18.7% |

[a] Estimated
[b] Proposed

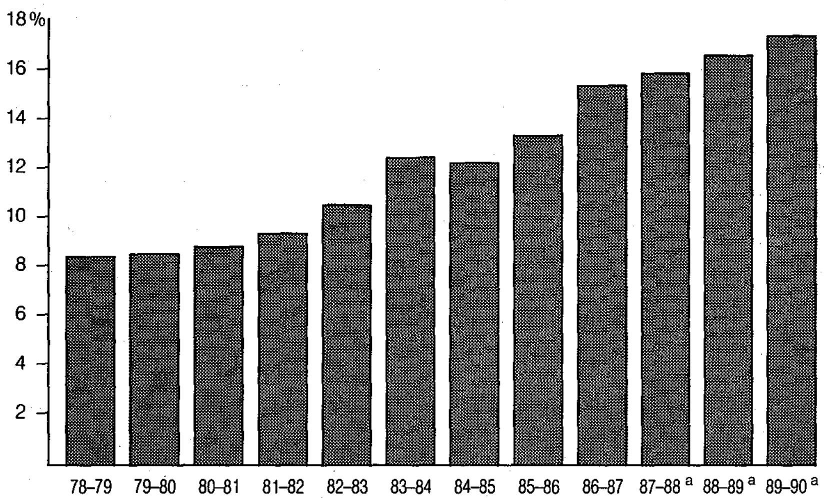
The upward trend in correctional expenditures will continue for many years. The costs associated with the rapid rise in the prison population, coupled with the major costs imposed by numerous court orders and the activation of new prisons that are more costly to operate than existing facilities, will continue to place a heavy burden on the General Fund demanding a larger and larger share of the available resources. As the cost of operating the correctional system outpaces the growth in General Fund revenues, the Legislature will face a series of difficult policy choices regarding how the burgeoning prison system should be financed. Unless the Legislature takes action to raise taxes or limit the growth in prison support costs, funds will have to be diverted from other General Fund programs. Those programs that are most vulnerable are those that receive the largest amounts of General Fund support—education, health, or welfare.

**Growth in Corrections' Costs**

In the past, the Legislature has funded more than 97 percent of the Department of Corrections' (CDC) support budget from the General Fund. The Governor's Budget for 1986–87 requests a General Fund appropriation of approximately $1.2 billion for CDC support—*20 percent above* estimated expenditures in the current year.

Since 1977–78, General Fund support for CDC has increased by 431 percent. During the same period, *total* General Fund expenditures have increased 223 percent. As a result, CDC's share of the General Fund budget for state operations has nearly doubled in eight years, from 8.3 percent in 1978–79 to 15 percent in 1986–87. We estimate that by 1990, the cost to the General Fund of operating the prisons will exceed $1.7 billion, or more than 17 percent of projected General Fund costs for state operations. Chart 28 shows the growth in CDC's share of General Fund state operations costs, which we have projected through 1989–1990.

Chart 28
**Prison System Takes Increasing Share of General Fund Budget for State Operations[a] 1978–79 through 1989–90**




[a] Estimated by Legislative Analyst's Office based on Governor's Budget and Department of Corrections' projections.

### Comparisons with Other States

California is not unique among the states in having to devote a larger share of available funds to maintaining its correctional system. The National Conference of State Legislatures (NCSL) recently reported that from 1979 to 1983, spending for corrections among states increased by an average of 79 percent, while aggregate state spending rose 48 percent. In fact, NCSL indicates that spending for corrections was the fastest growing expenditure category in state government during the four-year period, exceeding the growth in spending for education, health, welfare, and transportation.

### Growth in Inmate Population

Obviously, the major reason for the increased costs of the prison system is that the inmate population has increased sharply. Tougher laws, coupled with a stronger law enforcement climate and a larger state population, have brought about the growth in the inmate population. Table 50 shows the inmate population over the past 10 years and what CDC expects it to be for the remainder of the decade.

**Table 50**
**State Prison Population Growth**
**1976 through 1990[a]**

| *Year (As of June 30)* | *Inmate Population* |
|---|---|
| 1976 | 20,345 |
| 1977 | 21,525 |
| 1978 | 20,629 |
| 1979 | 22,534 |
| 1980 | 23,511 |
| 1981 | 26,768 |
| 1982 | 32,127 |
| 1983 | 37,228 |
| 1984 | 42,130 |
| 1985 | 47,075 |
| 1986 (projected) | 52,525 |
| 1987 (projected) | 58,060 |
| 1988 (projected) | 62,095 |
| 1989 (projected) | 65,555 |
| 1990 (projected) | 68,370 |

[a] Source: Department of Corrections

Increases in the prison admission rate and length of prison sentences have been the primary factors causing the inmate population to swell. The prison admission rate has doubled in less than 10 years. In 1977–78, approximately 72 persons were admitted to prison per 100,000 population; by 1984–85, the number had increased to almost 136. The CDC projects that the admission rate will reach approximately 157 per 100,000 in 1986–87.

During the 1970s and early 1980s, the Legislature enacted a number of statutes and the public approved several ballot initiatives that, together, have resulted in longer prison sentences. In 1981, the average sentence for males and females in CDC institutions was approximately 3.7 years and 2.7 years, respectively. By 1985, the average sentence had increased to 4.1 years for males and 3.1 years for females.

**Impact of the New Prison Construction Program on Prison Operating Costs**

Although growth in the state's inmate population is the major reason for the increase in state correctional costs, the department's new prison construction program is a contributing factor as well. The CDC is in the midst of what is the largest new prison construction program in the nation. During 1986–87, the department plans to open five new prisons and activate more than 8,500 new beds. The department is authorized to construct another four prisons that will provide an additional 7,400 beds beyond the budget year.

The new prison construction program will increase prison costs for several reasons. First, as new prisons are activated, the level of prison overcrowding will decline significantly. Because crowded prisons generally are less expensive to operate on a per capita basis, transferring inmates from crowded to new prisons will increase per capita costs.

Second, the new prison facilities generally will have smaller housing units that are more staff-intensive than existing facilities. For example, two recently activated prisons, the California Medical Facility-South at Vacaville and the Southern Maximum Security Complex at Tehachapi, have the lowest inmate-to-staff ratios of any California institutions other than San Quentin State Prison (which houses the state's most dangerous felons and is under restrictive court orders). The lower inmate-to-staff ratio greatly increases per capita costs.

Third, the current prison system does not provide work or educational program activities for all inmates, although it is the department's goal to provide greater programming at the new institutions. As the department provides more of these program activities, per capita costs will increase. This is because more personnel are needed to supervise inmates in small work crews or classrooms than to supervise them in large groups (for example, in a prison recreation yard). These additional costs would be offset to some degree, however, because inmates can reduce their time served in prison by participating in a work or educational program.

**Costs Driven by Courts**

For the most part, prison support costs are linked to legislative policies, such as sentence length and programming requirements. Some costs, however, are outside the Legislature's control—those imposed by courts. In recent years, a number of court decisions have increased prison operating costs. One decision, *Toussaint v. McCarthy,* has forced the department to (1) reduce its inmate population at maximum security institutions, (2) add large numbers of additional staff, and (3) make major modifications to the facilities. In 1985, the department added 191 positions, at a cost of $5.2 million, to meet staffing requirements specified by the court monitor in the *Toussaint* case. The department's projections suggest that full-year funding for these positions will cost the state approximately *$9 million annually,* beginning in 1986–87. This amount does not include the multimillion dollar costs of either capital improvements or attorney fees.

Many lawsuits that are still being litigated have increased prison operating costs as well. The department indicates that *Durggan v. McCarthy* was a major factor in its request for $4.5 million in 1985–86 to upgrade prison hospitals for licensure by the state Department of Health Services. That proposal will result in ongoing costs of more than *$10 million annually.*

Court decisions such as these not only reduce the Legislature's control over state spending but constrain its ability to achieve its priorities through the budget process.

**Options for Controlling Rising Prison Support Costs**

In order to reduce the pressure to cut back other state programs or raise taxes in order to finance the rising costs of the prison system, the Legislature may wish to consider a number of options for controlling these costs. These options, which we discuss below, fall into one of two basic categories: (1) options that reduce the inmate population and (2) options that reduce the cost of inmate care once an inmate is in the prison system.

*Options to Reduce the Inmate Population*

The first three options would reduce General Fund costs by reducing the number of inmates in prison.

1. ***Selectively Reduce Prison Terms.*** The simplest way to reduce the ongoing cost of the state prison system is to reduce prison terms for selected offenses, thus incarcerating inmates for shorter periods of time. Although this option probably would yield greater savings and more relief to prison overcrowding than any other option, it goes counter to the trend of recent legislation.

Under current law, all persons convicted of crimes other than murder are sentenced to fixed or *"determinate"* prison terms. The actual length of an inmate's stay in prison, however, typically is not equal to the length of his or her sentence, since the amount of time an inmate serves can be reduced through a system of credits. Inmates can earn a sentence reduction of up to one-half by participating in prison work programs and other approved assignments. Consequently, although full-year per capita support costs for one inmate currently are $16,932, each statute that adds one year to an inmate's sentence results in additional incarceration costs of between $8,466 per year (*all* sentence reduction credits) and $16,932 (*no* sentence reduction credits). Inmates also earn "preconfinement credits" for time served in county jail prior to when they are admitted to prison.

Table 51 shows the average length of determinate prison sentences received by inmates admitted to state prison in 1984–85, along with the estimated average incarceration cost for each. These figures reflect estimated preconfinement and work/training credits. As the table shows, the average sentence is approximately four years, while the estimated cost of incarcerating an inmate over the length of his or her stay in prison is, on average, slightly greater than $40,000 (in 1986–87 dollars).

**Table 51**
**Average Sentence Length and Prison Costs for Inmates with Determinate Sentences**

| *Offense* | *Total Admissions* [a] | *Average Sentence (Years)* | *Estimated Time to Serve in Prison* [b] *(Years)* | *Estimated Prison Costs Per Inmate 1986–87* [c] |
|---|---|---|---|---|
| Robbery | 2,823 | 5.07 | 3.02 | $51,082 |
| Assault | 1,625 | 4.20 | 2.50 | 42,338 |
| Burglary | 5,283 | 3.55 | 2.11 | 35,787 |
| Forgery/Theft | 4,562 | 2.16 | 1.29 | 21,807 |
| Rape | 484 | 11.51 | 6.85 | 115,996 |
| Other Sex Offenses | 1,295 | 8.44 | 5.02 | 85,011 |
| Narcotics | 3,601 | 2.65 | 1.58 | 26,744 |
| Manslaughter | 395 | 7.13 | 4.24 | 71,865 |
| Life Attempts[d] | 183 | 11.92 | 7.09 | 120,042 |
| Other Offenses | 2,607 | 3.99 | 2.37 | 40,206 |
| Totals | 22,858 | 3.99 | 2.38 | $40,216 |

[a] New prison admissions and parole violators with new terms, 1984–85 (most recent data available).
[b] Includes estimated work/training and preconfinement credits.
[c] Based on 1986–87 per capita costs ($16,932/year).
[d] Includes attempted murder, attempted kidnapping, attempted train wrecking, and attempted aggravated assault by a life prisoner.

Only the crimes of first and second degree murder are punishable by *indeterminate* prison sentences. Table 52 shows the number of persons receiving indeterminate sentences in 1984–85 (so-called "lifers"). Although the number of "lifers" admitted to prison on an annual basis is much lower than the number of persons sentenced to determinate terms, the potential cost of these inmates obviously is much greater. An inmate who spends 12.5 years in prison for first degree murder, for example, will cost the state at least $211,650 (in 1986–87 dollars); if the same inmate were to serve 25 years in prison for the same crime, the state's costs for incarceration would be at least $423,300 (in 1986–87 dollars).

**Table 52**
**Prison Costs for Inmates with Indeterminate Sentences**

| *Offense* | *Total Admissions* [a] | *Minimum Time to Serve (Years)* [b] | *Minimum Prison Costs Per Inmate 1986–87* [c] |
|---|---|---|---|
| Murder, First Degree | 291 | | |
| Death Penalty | (20) | — | — |
| Life Without Parole | (54) | — | — |
| 25 Years to Life | (217) | 12.5 | $211,650 |
| Murder, Second Degree | | | |
| 15 Years to Life | 313 | 7.5 | $126,990 |
| Total | 604 | | |

[a] Preliminary data for 1984–85 (most recent data available).
[b] Data on preconfinement credits not available.
[c] Based on 1986–87 per capita costs ($16,932/year).

2. ***Early Release.*** One option that has been used effectively in other states to reduce the number of inmates in the prison system and limit overcrowding is to release some inmates prior to the end of their terms. Such a program could, for example, allow the Department of Corrections to release on parole certain nonviolent inmates 30, 60, or 90 days in advance of their scheduled parole dates. Early release could be tied to overcrowding levels and could be used under limited circumstances—such as when the prison system reaches a certain level of overcrowding, or when the release is authorized by emergency proclamation of the Governor or resolution by the Legislature.

If, for example, the Department of Corrections had released 1,500 of the 24,711 inmates released in 1984 60 days in advance of their parole dates, the department could have saved approximately $4 million.

Prior to determinate sentencing, the Board of Prison Terms had the ability to increase the number of parolees without specific statutory authorization because prisoners were not sentenced to legislatively fixed terms. The Board of Prison Terms indicates that this was done routinely to relieve prison overcrowding.

The major advantage of this option is that it provides a swift mechanism for reducing costs and overcrowding at the same time. In addition, it can be used selectively to address specific problems, such as court orders to reduce crowding at a specific institution. On the other hand, early release is a departure from the Legislature's policy of determinate sentencing. Early release also provides only a short-term solution to increasing costs and overcrowding. In addition, any plan to release inmates on parole prior to their normal parole date has to be weighed against questions of public safety.

3. ***Modify Conditions for Parole Violators.*** The number of male felon parole violators returning to prison has increased substantially, from 5,560 for the first half of fiscal year 1984–85, to 7,278 for the second half of the year. Many of these parolees are arrested for a new offense and returned to prison to complete their original sentence as well as to serve a new term, thereby increasing the institution population. Many parolees, however, are returned to custody for offenses that probably would not subject them to prosecution or for violating parole conditions in some other way—such as failing to report to a parole officer as required, or failing urine tests for marijuana usage. The CDC's data indicate that of the 19,761 parolees taken into custody in 1984–85, more than 10,000 were for technical violations of parole that were not necessarily related to a new criminal offense.

Although the Board of Prison Terms is responsible for determining which parole violators are returned to prison, the conditions of parole that can lead to a violation generally are established by the Department of Corrections. Consequently, modifying the conditions of parole can result in fewer parolees returning to custody, thereby reducing the prison population and saving incarceration costs. As with early release, however, any program to modify conditions of parole has to take into account the interests of public safety.

### *Options to Reduce Costs for Inmate Care While in Prison*

We have identified four options that would reduce inmate support costs.

1. ***Increase the Number of Inmate Work Assignments.*** The Inmate Work/Training Incentive Program established by Ch 1234/82, allows inmates who work or participate in an educational program full-time to reduce their sentences by one month for every month of such participation. Consequently, the program can reduce incarceration costs dramatically by reducing the time each inmate serves in prison. In addition, it can reduce unproductive idleness and provide valuable work and training experience, perhaps cutting down recidivism later on.

Although the department has made significant advances in providing work and education to inmates, a large number of inmates still are without jobs or education assignments. As of September 30, 1985, about 67 percent of all inmates were involved in a full-time work or training program. Another 24 percent were temporarily unassigned because of their housing or movement status, while less than 2 percent chose not to participate. The remaining 7 percent were unassigned because the department lacked a sufficient number of jobs or education assignments. Because these inmates are unassigned involuntarily, they generally earn sentence credits under the credit system that was in place prior to Ch 1234/82, which automatically reduces their sentences by one-third, rather than one-half.

If the department could provide a job or an educational assignment to an inmate unassigned involuntarily, the department could save approximately $2,822 per inmate, per year, since the inmate would spend less time in prison. Although these savings would be partially offset by the increased cost of supervising inmates during their work assignments, giving these unassigned inmates jobs is one means by which the department could realize major annual savings.

It is unlikely that the department will provide significant numbers of new jobs in the near future, however, given the continued overcrowding at existing prisons and the department's slow progress in bringing new beds on-line. In fact, the department is modifying many institutions to provide additional inmate housing at the expense of space previously used as classrooms or work areas for work/training assignments. Ironically, this effort to accommodate overcrowding only makes overcrowding worse in the future, because the reduction in job and educational opportunities will result in inmates earning fewer work credits and, thus, spending more time in prison.

2. ***Revision of the Classification System.*** Another way to reduce the

costs of inmate care once inmates are part of the prison system is to classify them at the lowest possible security level. Currently, CDC assigns a score to each inmate, based on points given for sentence length, personal characteristics, prior record, and prior behavior while incarcerated. Inmates are then divided into four security groups according to their classification scores, with level IV inmates presenting the greatest security risk, and level I inmates offering the lowest security risk.

The department uses the classification scores when it assigns inmates to particular institutions. For example, level IV inmates generally are assigned to Folsom or San Quentin Prisons or the Southern Maximum Security Complex at Tehachapi, which are the state's three maximum security institutions.

The security level of an institution is one of the major factors in determining the cost of supporting the institution. The cost for caring for an inmate at San Quentin, a level IV institution, is approximately $27,503 per inmate per year, while at the California Conservation Center at Susanville, which houses mostly level I and level II inmates, the cost is $13,655 annually. The lower costs are due primarily to the lower staffing requirements for supervising level I and level II inmates. Although the differences between costs at other institutions are not this dramatic, it clearly is much cheaper to house inmates at the lowest possible security level, given safety constraints.

In the past, we have noted that the current classification system appears to overclassify inmates—that is, place inmates in higher security groups than they require. The department has recognized this problem and currently is completing an exhaustive study of the classification system that is likely to reduce the security classification of many inmates.

3. ***Increase Use of Community Beds.*** Another method for reducing prison costs is to place more inmates in community correctional facilities. These include work furlough programs in which inmates work in the community but spend the rest of each day at a facility, and mother/infant programs, which allow female inmates to live in a facility with their young children. Currently, more than 1,000 of these beds are available through contracts with private or nonprofit entities, while 140 beds are available in state-operated facilities.

The Governor's Budget indicates that community correctional facilities currently cost approximately $37 per inmate, per day. This is substantially lower than the average cost of housing an inmate in prison—approximately $46 per day. In addition, such facilities allow gradual re-entry of selected inmates and parolees into the community, while reducing overcrowding in the prison system (every person housed in a community facility frees up a bed in prison).

The Legislature has expressed its intent that CDC make maximum use of community correctional facilities. The department, however, has been unsuccessful in adding significant numbers of additional beds. The department has planned to place 2,000 inmates in community beds annually since 1981, but has yet to reach that goal. CDC currently is using approximately 1,400 community beds, and the budget indicates that approximately 1,600 beds will be filled during the budget year. The department indicates that the major factor responsible for the delay in adding community beds has been the objections of community residents to the placement of facilities in their neighborhoods.

4. ***Privatization of Correctional Services.*** One option that might reduce correctional costs is contracting with the private sector for correctional services. Contracting can allow the department to acquire certain specialized services at less cost than if the services are provided with additional departmental staff. In addition, contracting for inmate housing can relieve prison overcrowding and possibly reduce costs. Several states currently are exploring contracting for the management of entire prison facilities.

The link between corrections and the private sector in California has already been established. The private sector currently provides the Department of Corrections with a number of services. As indicated above, many work furlough and community correctional facilities are operated by private companies. In addition, CDC contracts with private companies for a variety of inmate services, such as medical care. During 1986 the department plans to contract with two private companies to provide housing for 200 parole violators who are returned to custody for up to one year. The private sector will provide the facilities, support services, and staff, while the department maintains on-site representatives and some security personnel. The department has not, however, made attempts to contract with the private sector for management of a major correctional facility.

The idea of reducing correctional costs by contracting with the private sector is appealing at first glance. There are, however, many concerns and issues that must be considered in assessing this option. First among these is the concept's feasibility. Although several correctional facilities in other states currently are run by the private sector, most are specialized facilities, such as immigration or youth detention centers. Private companies have no track record in running major prisons, although several states currently are considering contracting out management of such institutions. In addition, the concept raises a number of difficult issues such as the following:

- ***Use of Force.*** Is it proper for private employees to use deadly force to maintain order in prisons?
- ***Liability.*** How can the state protect itself from liability when it is not managing the facility?

- ***Cancellation of the Contract.*** Once the state places reliance on a private contractor to run a prison, how can it protect itself against the possibility that the contract will be canceled or the private company will declare bankruptcy?
- ***Accountability.*** Are facilities run by the private sector likely to be less accountable to legislative concerns?
- ***Source of Savings.*** Are the cost advantages of privately run facilities attributable to reduced services to inmates or reduced security?

We have not found any data which substantiates the claims that private management of a major prison would be less costly than management by the state. Still, the Legislature should monitor closely the experience of other states with contracting out prison management and continue to explore ways in which the skills and resources of the private sector can be tapped.

#### Conclusion

The Legislature has a number of options for limiting the growth in the costs of operating the state's correctional system. Several of the options discussed above—selectively reducing prison terms, early release, or privatization of an entire prison—would require major policy changes and statutory authorization. The other options—modifying conditions for parole violators, increasing the number of inmate work assignments, revising the classification system, and increasing the use of community beds—however, could be implemented through the annual budget process.

### NEW PRISON CONSTRUCTION

***How Can the Legislature Accelerate New Prison Construction and at the Same Time Maintain Control of the Program?***

#### Background

Since 1980, the Legislature has authorized construction of more than 24,000 new prison beds. Eleven major new prison complexes currently are planned or being developed at various locations in the state. Nearly $1.2 billion has been provided for the planning and construction of these facilities.

The Legislature has recognized the need to accelerate construction of new prison beds in order to accommodate a rapidly growing inmate population. As a result, it has exempted prison construction from various legal requirements that apply to most other capital outlay projects. Recently, the Legislature broadened these exemptions by waiving the requirements of the California Environmental Quality Act for several projects and the formal state selection process for appointment of professional consultants. In giving the administration unprecedented authority and flexibility to carry out the prison construction program, the Legislature has given up much of its ability to control the funding and policy decisions that are being made under the program.

Despite the flexibility extended to the administration regarding how more than $1 billion will be spent, most of the authorized projects have not proceeded as planned. For this reason, we believe that the Legislature needs to reassess its policies toward prison construction with a view toward improving legislative input and overcoming obstacles that have delayed completion of these needed projects.

It is not too late to conduct such a reassessment. The need for additional prison beds will not end when the 11 complexes currently on the drawing boards are completed. On the basis of the Department of Corrections' latest population projections, California will need an additional 15 new 500-bed prisons to accommodate the inmate population in 1990.

This section analyzes the shortcomings of the process now used to authorize and fund new prison construction and offers an alternative process that we believe would accomplish two key objectives: (1) facilitate the completion of new prison projects on a more timely basis, and (2) provide for a reasonable level of legislative control over a rapidly expanding portion of the state's budget.

**Current Legislative Oversight of Prison Construction**

Under existing law, the Department of Corrections (CDC) is required to submit staffing plans, inmate work programs and preliminary plans for each proposed new prison to the Joint Legislative Prison Committee and the two fiscal committees, before it takes the project to the State Public Works Board for approval. The committees have 30 days to review the information provided by the department. The department's plans are deemed to be approved by the committees unless they take specific action to revise or disapprove them.

This time-limited, automatic approval procedure has been substituted for the normal capital outlay budget process which requires agencies to submit specific proposals and justification to the Legislature for review, approval, and funding. The latter process provides the Legislature with an opportunity to influence, in a meaningful way, the major policy and funding decisions related to capital outlay projects. The former process provides no such opportunity. The following discussion identifies some of the problems the Legislature faces in attempting to fulfill its control and oversight responsibilities toward prison projects.

***Inadequate Planning Information.*** Any major construction program requires a master plan. The main objective of the master plan is to establish the link between the program's policies and objectives and individual capital projects. Thus, the master plan gives policymakers the opportunity to assess and establish overall policies and objectives for the program and to determine how individual projects fit within the policy framework.

The current prison construction process does not allow the Legislature to reap the benefits from the master plan. The department's plan, which is issued annually, neither addresses policies and objectives nor provides a comprehensive framework for meeting the state's prison needs. Instead, the department's master plan is nothing more than a *status* report—one that frequently is out-of-date.

Specifically, the Department of Corrections' master plan lacks:

- A framework of policies and objectives.
- Specific proposals for meeting anticipated requirements, given population projections.
- A description of how requirements, such as specialized facilities for medical/psychiatric and reception center services, are to be met.
- A time frame for authorization, planning and construction of new projects.
- An assessment of what projects and/or actions would be needed in the event the underlying assumptions, such as projected population, change over time.

Without this information, the Legislature is unable to assess the policy and cost implications of the individual projects or determine how these projects relate to one another. As a result, the Legislature finds itself in the position of having to approve the individual projects which the department submits, regardless of their policy and fiscal implications, or leave itself open to charges that it is delaying expansion of the prison system and therefore contributing to a critical overcrowding situation.

***Piecemeal Submittal of Project Information.*** Generally, the department submits only *partial* preliminary plans for individual prisons to the legislative committees for approval. Consequently, the Legislature lacks the information needed to determine:

- The implications of the partial plans on facility operating cost factors such as inmate programs, staffing or security.
- The estimated cost of the total project relative to the amounts appropriated for it.

***Review Period Afforded the Legislature Is Not Adequate.*** Under the provisions of the Penal Code, the Department of Corrections must submit specific information to the legislative committees at least 30 days prior to when a project is brought before the Public Works Board. The Legislature established this timetable in an attempt to expedite the projects while still maintaining a degree of legislative oversight.

In most instances, the 30-day period is inadequate for meaningful review. The period is too short and the issues involved with a new prison—

staffing, academic/vocational programs, work programs, security, housing, etc.—are too complex for the process to be anything more than pro forma.

*No Schedules for Some Prisons.* The Legislature has appropriated funds for acquisition, planning and construction of new prison projects based on the department's contention that the funds were needed to implement the projects on a timely basis. The department, however, has yet to implement an approved project on schedule. In fact, in the case of the new prisons authorized for Los Angeles, Riverside and San Bernardino Counties, the department has *no schedule.* When these prisons were authorized by the Legislature, the department insisted that funds be appropriated so that the San Bernardino prison could be completed by May 1986 and the Los Angeles and Riverside prisons could be finished by December 1986.

**The Legislature Can Expedite Prison Projects Without Foregoing Its Ability to Oversee These Projects**

***We recommend that the Legislature enact legislation establishing a new process for review of new prison capital outlay projects.***

The Legislature can establish a framework in which new prisons can be completed on an expedited basis without having to give up its control and oversight of prison construction. It can do so by (1) directing the department to prepare and submit a meaningful master plan for legislative approval, and (2) holding the department accountable for the costs and schedules of projects approved by the Legislature.

Legislative oversight and control of individual projects can be achieved most easily by gearing decisions to three major milestones in the development and implementation of proposed projects. These milestones would occur when the Legislature receives:

1. A new prison proposal.
2. A request to purchase a proposed site.
3. Completed preliminary plans and cost estimates for the entire complex.

Here is how the alternative process would work.

*(1) Conceptual Approval of New Prison.* As the department refines its population projections, it must update the statewide facilities master plan to identify the projects that are needed to accommodate the projected number of inmates. Once the plan has been updated, the department must develop conceptual plans for providing the needed facilities. This would take the form of proposals for construction of new facilities in various areas of the state, consistent with programmatic and geographic needs.

The department would send its conceptual plans to the Legislature in support of its request for the authorization of one or more new prison facilities. The department would specify the number of beds to be provided, the security level or mission of the facility, and the general location and estimated costs of the complex. Based on the master plan and the specific proposal, the Legislature could then appropriate funds for options-to-purchase up to three sites, environmental studies, a physical master plan for each proposed site, and a pre-architectural program. By funding options for three sites rather than one, both the Legislature and the department would have alternative sites available if the preferred site proved to be unacceptable.

After these funds are appropriated, the department would be responsible, *within a specific time frame,* for securing purchase options for the potential sites and preparing the environmental/planning documents for the new prison.

***(2) Approval of Site Acquisition.*** After the department completes these tasks, it would present the Legislature with a preferred site together with environmental documents, site master plans, a pre-architectural program and an analysis of the advantages/disadvantages of each site for which the department has secured purchase options. Based on its review of this information, the Legislature could appropriate funds for (a) acquisition of a specific site for the prison, (b) preliminary plans for the prison complex, and (c) working drawings and construction of basic site development and utilities for the complex.

The department would then be responsible, *within a specified time frame,* for (a) site acquisition, (b) preparation of preliminary plans and costs estimates for the entire project and (c) design *and* construction of basic site development and utility work.

***(3) Design/Cost Approval.*** The final milestone would be reached when the department submitted preliminary plans/cost estimates for legislative approval. At this point, the Legislature would fund working drawings and construction *for the entire complex, and establish a specific completion date for the facility.* No further legislative review of the project would be required as long as the department implemented the project consistent with legislatively approved plans and costs. Thus, construction could occur in phases, using "fast track" techniques or other methods to expedite completion of the project.

***Potential Time Line With New Procedures.*** If this procedure were in place:

- the Legislature would be given sufficient time to review the plans developed by the department at each milestone, and
- the department would be expected to implement the approved phases on schedule and within approved costs.

Our analysis indicates that no more than 18 months should elapse between conceptual approval and approval of funds for working drawings and construction. Assuming the department utilizes techniques that are available to expedite construction, there is no reason why an entire complex could not be completed within 24 months after final approval by the Legislature. Thus, the total time between authorization for a conceptual plan and occupancy would be approximately 42 months. Table 53 shows the various tasks to be accomplished in bringing a prison from the conceptual stage to occupancy and the estimated time needed for each step in the process.

**Table 53**
**Planning for New Prison Construction Projects**
**Estimated Time Frames for Tasks**

I. CDC Implements Legislative Authorization for New Prison (6 months)
  A. Performs Site Search
  B. Prepares Environmental Documents on Potential Sites
  C. Secures Options-to-Purchase for Selected Sites
  D. Submits to the Legislature:
    1. Completed Pre-architectural Program
    2. Request for Acquisition of Site Preferred by CDC
    3. Site Master Plan
    4. Site Costs
    5. Environmental Documents on Sites
II. Legislative Review/Approval (3 months)
  A. Legislature Reviews Site Information; If Approved, Appropriates Funds for:
    1. Site Acquisition
    2. Preliminary Plans for Complex
    3. Working Drawings and Construction of Site Development
III. CDC Implements (6 months)
  A. Exercises Purchase Option for Selected Site
  B. Begins Construction of Site Development
  C. Prepares Preliminary Plans and Cost Estimate on Complex
  D. Submits Completed Preliminary Plans and Estimates
IV. Legislative Review/Approval (3 months)
  A. Legislature Reviews Design and Costs; If Approved, Appropriates:
    1. Working Drawings and Construction for Complex
V. CDC Implements (24 months)
  A. Completes Working Drawings and Construction
  B. Occupies Facility

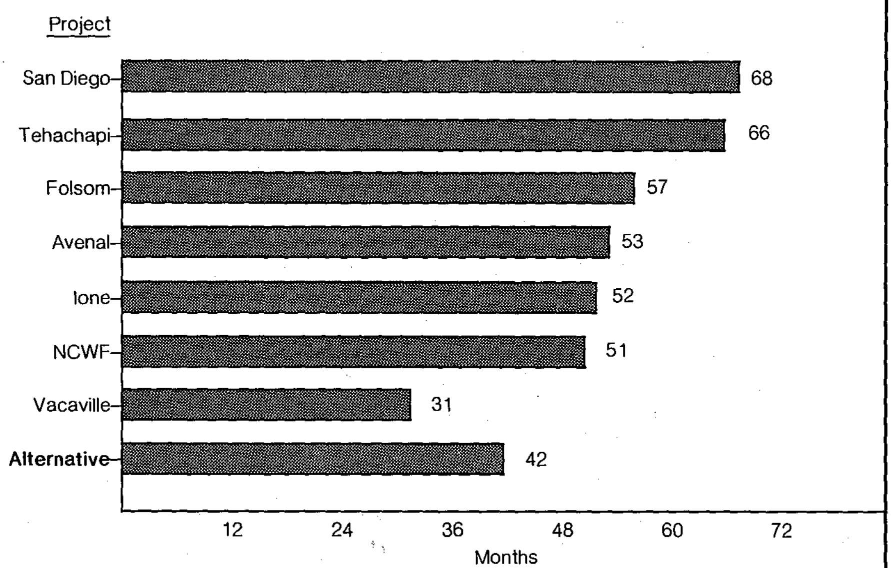
***Time Line For Alternative Procedure Compared With Existing Procedure.*** Chart 29 compares the time required for prison development using the alternative procedure with the time required to develop projects which have already been authorized by the Legislature using the existing procedure. Where previously authorized projects have not been completed, we have relied on the Department of Corrections' latest project schedule for completion dates.

The chart indicates that except for the Vacaville project, all of the other previously authorized projects have been or will be occupied between nine months and 26 months after they would have been if the alternative procedure had been used. (It should be noted that the schedule for the alternative procedure assumes that a site must be acquired. In the case of the Tehachapi, Folsom, Northern California Women's Facility (NCWF) and Vacaville projects, however, the state already owned the site.)

It may be argued that this comparison puts a hypothetical timeline against a real-world timeline reflecting delays that are beyond the state's control. Obviously, delays caused by property owners, local governments and interested citizens will arise if the Legislature chooses to develop prisons using the alternative procedure. The alternative procedure, however, will be able to respond to the cause of these delays much more effectively by providing the Legislature with an opportunity to assess the problems and take corrective action at an earlier stage. As a consequence, projects will be completed more quickly than they are being completed using the existing process.

**Chart 29**

**New Prison Construction Projects Authorization to Occupancy CDC Schedule and Alternative Schedule**




### Advantages of the Alternative Process

The alternative process for providing legislative review of new prison construction projects offers several advantages. These advantages include the following:

- The process would place key policy and decisionmaking with the elected officials of the state, rather than with department officials.
- The process would clearly establish legislative intent for each project with respect to scope, cost and schedule for implementation.
- The Legislature would place the responsibility for project implementation squarely on the administration.
- If the department could not meet the specific time frames for submission of information, the Legislature would have the opportunity to reassess its policies regarding prison size, location and security level and, if necessary, modify these policies to shorten the delays in providing needed prison beds.
- The process would allow projects to be completed sooner.

**Conclusion**

The Legislature's efforts to expedite construction of new prison capacity by appropriating funds before plans are developed has been unsuccessful. Meanwhile, the Legislature has given up meaningful control of the policy direction for this massive program. Clearly, there is a need for new procedures that will allow the Legislature to participate in setting policy direction and, at the same time, establish accountability for the department to implement the legislatively approved projects in a timely manner.

Based on the Department of Corrections' December 1985 population projections, the state will need approximately 9,000 additional prison beds in 1990—enough to justify 15 new 500-bed prisons—in order to accommodate the inmates that will be committed to the correctional system without excessive overcrowding. We believe the alternative process for authorizing and funding new prisons discussed above would reestablish the Legislature's ability to influence the direction of the prison expansion program as it moves into its next phase, while allowing for completion of individual projects on a more timely basis.

## FINANCING SCHOOL FACILITIES

***What is the Best Method of Meeting the Long-Term Financing Needs for the Construction and Reconstruction of Local School Facilities?***

Since the passage of Proposition 13 in 1978, the burden of providing funding for local school facilities construction and reconstruction has shifted to the state. In the intervening years, the voters have approved two statewide bond issues totaling $950 million and the Legislature has appropriated a total of $450 million in tidelands oil revenues for school facilities. Yet, despite these expenditures, the amount of state revenues available falls at least $465 million short of meeting local demand for school facilities financing.

Given the limitations on state spending imposed by Article XIII B of the California Constitution (the state appropriations limit), it is not clear how long the state can continue to be the primary source of funds for school facilities financing. Moreover, we find that the current system for allocating state school facilities aid to local school districts is ill-equipped either to determine the extent of districts' needs for such funds or to assign priorities among districts.

For these reasons, we believe that the best long-term solution to financing the construction and reconstruction of local school facilities is to return the primary responsibility for raising revenues to the local school districts themselves. In this section, we discuss how this can be accomplished, while conforming to the principles of equity in school finance enunciated by the California Supreme Court in *Serrano v. Priest.*

**Funding for School Construction**

***Pre-Proposition 13 Funding.*** Prior to the passage of Proposition 13, local school districts financed the construction of elementary and secondary school facilities either by issuing local school construction bonds, or by obtaining a loan from the state under the State School Building Aid program. In either case, district voters first had to approve the borrowing by a two-thirds vote.

Funds borrowed by the districts were repaid from property tax revenues. In order to provide adequate security for the bonds or loans, the district-borrower had to levy an additional property tax.

Proposition 13 eliminated the ability of local school districts to levy additional special property tax rates of the type previously used to pay off indebtedness. Consequently, school districts can no longer issue construction bonds or participate in the State School Building Aid program.

***Post-Proposition 13 Funding.*** Because of this, the Legislature revised the State School Building Lease-Purchase Act so that districts could continue to receive state aid for financing needed school facilities. Under the revised act, the state no longer provides loans to school districts; instead, it provides "quasi-grants". Specifically, the state funds the construction of new school facilities and rents them for a nominal fee to local school districts under a long-term, lease-purchase agreement that calls for title to the facility to be transferred to the district no later than 40 years after the rental agreement is executed. In most cases, the rent paid to the state consists of $1 per year, plus any interest earned on state funds deposited in the county's school lease-purchase fund. Because this amount usually is nominal in comparison to the amount of state aid provided, the state essentially is providing school districts with a grant for school construction, rather than a loan.

***Allocation of Grants.*** The State Allocation Board (SAB) is the agency responsible for receiving applications for state funding from local school districts. Review and processing of an application, which can take up to five years, passes back and forth among four different state agencies (the SAB, the Office of State Architect, the Office of Local Assistance in the Department of General Services and the School Facilities Planning Unit in the Department of Education), with no single agency having overall responsibility. The SAB, however, is the agency which ultimately allocates the funds on a project-by-project basis to the local school districts.

***Funding Sources.*** Funding for the State School Building Lease-Purchase Fund is provided through three major statutory appropriations, each of which is available for expenditure without regard to fiscal year. These fund sources, which are displayed in Table 54, are composed of:

- ***School district "excess" repayments***—that is, the amount by which school district principal and interest payments on State School Building Aid loans exceed debt service requirements for state school construction bonds. These funds, estimated at $93.9 million in the current year, are used principally to fund school district deferred maintenance projects. The balance of funds, if any, is used to fund new construction.

- ***Tidelands oil revenues***—current law appropriates $150 million of these revenues annually through 1988–89. These funds are used principally for new school construction. The Governor, however, is proposing to defer the 1986–87 appropriation until 1989–90. This would require a change in law.

- ***Proceeds from bond sales***—the voters have authorized the state to raise funds for school facilities by approving the State School Building Lease-Purchase Bond Acts of 1982 (Proposition 1) and 1984 (Proposition 26). Proposition 1 of 1982 authorized the sale of $500 million in bonds—$350 million for the construction of new school facilities and $150 million for reconstruction and rehabilitation of facilities constructed over 30 years ago. These funds have been fully allocated.

Proposition 26 of 1984 authorized the sale of $450 million in additional bonds, of which at least $250 million is available for construction of new school facilities. Of the total authorization, $165 million has been apportioned to date, leaving $285 million available for future apportionments. The SAB estimates that this balance will be fully apportioned during the current year.

***Funding Authorized.*** The funding available from each of these sources for allocation by the SAB in the past, current and budget years is displayed in Table 54.

**Table 54**
**K-12 Education**
**Revenues Authorized for School Facilities Aid [a]**
**Under Current Law**
**1984–85 through 1986–87**
**(dollars in millions)**

| | *Actual 1984–85* | *Est. 1985–86* | *Est. 1986–87* |
|---|---|---|---|
| State School Building Lease-Purchase Program (Construction and Reconstruction): | | | |
| Tidelands Oil Revenues | — | $285.0 [b] | $142.5 |
| State School Building Lease-Purchase Bond Act of 1982 (Proposition 1) | $190.0 | — | — |
| State School Building Lease-Purchase Bond Act of 1984 (Proposition 26) | — | 450.0 [c] | — |
| School Building Aid Bonds (Ch 764/84) | — | — | 40.0 |
| Lease-Purchase Rental Revenues | 3.8 | 3.8 | 3.9 |
| Federal Funds [d] | — | 28.5 | — |
| Subtotals | $193.8 | $767.3 | $186.4 |
| Deferred Maintenance (excess repayments) [e] | $89.2 | $93.9 | $89.9 |
| Emergency Classroom Program [f] | 7.5 | 7.5 | 7.5 |
| Asbestos Abatement Program | — | 19.9 | — |
| Portable/Relocatable Classrooms | 5.2 | 2.8 | 2.9 |
| Federal Funds: [d] | | | |
| Child Care Facilities | — | 36.5 | — |
| Child Care Capital Outlay | — | 7.3 | — |
| Air Conditioning | — | 13.5 | — |
| Totals | $295.7 | $948.7 | $286.7 |

[a] This table illustrates only the revenue sources provided by current statutes. This is not a fund condition statement and, accordingly, does not include any beginning balances for each school facilities program.
[b] Includes $142.5 million which was not spent in 1984–85 and was carried over to 1985–86.
[c] Assumes that all funds from Proposition 26 bonds will be committed in 1985–86.
[d] Settlement funds to be received pursuant to Section 8(g) Outer Continental Shelf Lands Act.
[e] School districts receive apportionments from the State School Deferred Maintenance Fund to match district expenditures up to one-half of 1 percent of the district's General Fund budget. The fund balance not used for deferred maintenance is transferred to the State School Building Lease-Purchase Fund.
[f] Up to 5 percent of tidelands oil revenues to the State School Building Lease-Purchase Fund during fiscal years 1984–85 to 1988–89 may be used for the Emergency Classroom Program (pursuant to Section 6217f(2) of the Public Resources Code).

The table shows that, during the three-year period 1984–85 to 1986–87, approximately $1.5 billion is authorized for commitment under the school facilities aid program. Of this amount, $680 million results from statewide bond sales, $450 million comes from tidelands oil revenues, $273 million is from excess repayments, $85 million is from the one-time expenditure of federal funds and $42 million comes from other sources.

### School Construction Need

There are no reliable estimates available of the *need* for school facilities funding on a statewide basis. Recognizing this problem, the Legislature enacted Ch 1680/84 (AB 2743), which directs the State Allocation Board to develop and maintain an automated school facilities inventory that can

(1) indicate the degree of facility utilization and (2) project school facilities needs five years in advance. Board staff indicate that a feasibility study for the automated school facilities inventory is underway. The entire system is expected to be complete and fully operational by July 1987.

Although the data needed to estimate the need for school facilities financing is not available, we can provide data on the volume of school facilities funding requests that are pending before the SAB. It is important to note, however, that statistics on funding requests are not necessarily valid indicators of need per se.

As of January 23, 1986, 339 applications from school districts were on file with the State Allocation Board, requesting $902 million for *new* construction. Of this amount, $825.3 million is for projects that are still in the planning stage, and the balance ($76.7 million) is for projects awaiting final approval and construction. In addition, 901 applications were on file with the board requesting approximately $798 million for *reconstruction* of school facilities. Of this amount, approximately $274 million is for reconstruction projects that have been approved and are ready to be started.

Thus, districts with applications currently on file with the board are requesting $1.7 billion for school facilities. In comparison, an estimated $1.2 billion is authorized to be available in 1985–86 and 1986–87 to fund these requests. Consequently, even if no additional applications are filed and all available revenues are used, the SAB will not be able to fund projects estimated to cost $465 million.

To the extent that (1) school districts file additional requests for aid with the SAB between January 23, 1986 and the end of 1986–87 and/or (2) the Legislature approves the Governor's proposal to defer the appropriation of $150 million in tidelands oil revenues, the gap between available funds and the demand on those funds will widen. On the other hand, authorization of additional bond sales, such as Senate Bill 1133 (Bergeson) seeks, would narrow the gap.

**Problems with the Current Process for Allocating Revenues**

Our review identifies four major problems with the existing system for allocating state funds to local school districts.

***The Process is Slow.*** *First,* it takes several years—and frequently as long as five years—to review, process and allocate funds for a single school construction project. Construction, which can take an additional one to two years, generally does not begin until the funds have been allocated. An allocation system with a lag period of up to seven years is neither an effective nor efficient solution for a school district with an identified need for a new or reconstructed facility.

***No Priorities.*** *Second,* there are virtually no priorities for allocating the state funds, once a district's basic eligibility for state aid has been established. To qualify for *new* construction funds, districts are required to meet a minimum threshold of 10 percent overcrowding. For districts meeting the threshold, however, funds are provided on a first-come first-served basis, without regard to need, ability to finance through other alternatives, or severity of problem.

***Old, Inflexible Standards Used.*** *Third,* there appears to be universal dissatisfaction with the classroom utilization standards that, by regulation, the SAB requires local school districts building facilities with state funds to meet. These standards, which have not changed since 1955, do not reflect changes in facilities usage patterns resulting from educational changes (such as the proliferation of special-purpose, categorical programs) that have occurred over the last 30 years. Further, by having a single standard with which all schools must comply, local communities are unable to build the type of facility that best meets local needs.

***Fragmented Responsibility.*** *Fourth,* with four state agencies involved with processing the applications, no single agency is responsible for shepherding an application through the entire system. Consequently, school districts are unable to track or expedite the progress of an application.

### Alternative Method for Financing School Construction

***We recommend that the Legislature enact legislation, contingent upon voter approval of ACA 55 on the June 1986 ballot, to establish a "guaranteed yield schedule" under which every school district levying a given tax rate to amortize school facilities bonds would be guaranteed the same minimum revenue yield per pupil housed.***

Because current methods of funding school construction (1) fail to provide sufficient funds to meet district needs in a timely manner and (2) fail to distribute equitably the burden of paying for new school facilities, we recommended in both the *Analysis of the 1983–84 Budget Bill* and the *Analysis of the 1984–85 Budget Bill* that the option of raising funds through temporary property tax increases be reestablished for local school districts. We continue to recommend that this be done.

*ACA 55.* The Legislature has taken the first step towards restoring school districts' revenue-raising abilities by approving ACA 55. This measure, which will appear on the June 1986 ballot, provides that local governments may—with the approval of two-thirds of district voters—incur bonded indebtedness for site acquisition and capital outlay, and pay off the bonds by temporarily increasing the property tax rate.

One potential drawback of this proposal, however, is that it could violate the principles on which the Supreme Court's decision in the *Serrano v. Priest* case was based. This is a legitimate concern. School districts with considerable property tax wealth could raise large amounts for school facilities by imposing a very low tax rate, while school districts with less property tax wealth would not be able to raise sufficient funds even with a very high tax rate.

***Companion Legislation for ACA 55 Needed.*** For this reason, we recommend that the Legislature take a second step in order to make the mechanism authorized by ACA 55 more equitable. Specifically, we recommend that the Legislature enact legislation, contingent upon voter approval of ACA 55, guaranteeing every school district a certain revenue yield from a given tax rate. The funding source for this guarantee would be the revenues from (1) school construction bonds issued by the state and (2) tidelands oil and gas operations.

***How the Guarantee Works.*** In broad outline, this new funding mechanism would work as follows:

- A school district would submit information on its need for new school facilities to the SAB, which, in turn, would certify the accuracy of the district's estimates regarding the number of students to be housed in the new facility.
- The district would then consult a schedule showing the amount of revenue per pupil housed which it could raise from a given tax rate. This basic schedule would be the same for all districts throughout the state, even though the actual amount of revenue raised by each tax rate would vary considerably from place to place. Such a schedule could include "adjustment factors" to reflect local differences in the costs of site acquisition and construction.
- Based upon the cost of the facility per pupil housed, the district would choose a tax rate from the guarantee schedule and submit this rate to the local voters for their approval.
- If the voters approved the measure, the district then would be authorized to levy the new tax rate. If the revenues raised by the tax were less than the amount guaranteed by the state schedule, the state would make up the difference.

***Advantages of Proposal.*** In short, the state school construction aid program would be changed from one that allocates grant funds to districts with no matching contribution required, to a program providing grants based on a *variable* matching rate. Under the new program, districts with a low property tax base would have a lower local matching requirement than districts with a high property tax base.

Specifically, under a guaranteed yield program such as we recommend, the ability of all school districts to raise a given amount of revenue for a given level of tax effort would be *equalized.* At the same time, the program would allow local discretion in determining the exact amount of revenue to be raised.

By carefully designing the guarantee schedule, the Legislature can provide strong fiscal incentives for school districts to construct facilities at a "standard" level of costs per pupil housed, while still allowing local communities to tax themselves at somewhat higher rates in order to provide either more space per pupil or a higher quality of construction.

***Sample Guaranteed Yield Schedule.*** Table 55 shows a sample guaranteed yield tax schedule that incorporates these features.

**Table 55**
**Sample Guaranteed Yield Schedule**

| *Tax Rate (Per $100 of Assessed Value)* | *Guaranteed Yield per Pupil Housed* |
|---|---|
| $0.00 | — |
| 0.01 | — |
| 0.02 | — |
| 0.03 | — |
| 0.04 | — |
| 0.05 | — |
| 0.06 | $200 |
| 0.07 | 400 |
| 0.08 | 600 |
| 0.09 | 800 |
| 0.10 | 1,000 |
| 0.11 | 1,050 |
| 0.12 | 1,100 |
| 0.13 | 1,150 |
| 0.14 and above | 1,200 |

Under the sample schedule shown in the table, the voters in a school district would be required to levy an additional tax rate of at least $0.06 per $100 of assessed value in order to receive any state school facilities aid. If they did so, they would be guaranteed a total yield of at least $200 per pupil housed. That is, the district would receive from the state the difference (if any) between (a) $200 per pupil housed and (b) the amount of revenue actually raised by the $0.06 rate. For every $0.01 increase in the tax rate, the district's guaranteed yield would increase by $200 per pupil housed—up to a level of $1,000 per pupil housed (reached at a tax rate of $0.10).

For tax rates above $0.10, the marginal increase in guaranteed yield would be less—for every increase in the tax rate of $0.01, the district's guaranteed yield would increase by only $50 per pupil housed (up to a maximum of $1,200 per pupil housed). At tax rates beyond $0.14, the guaranteed yield would remain unchanged at $1,200 per pupil housed.

Thus, school districts would have a strong fiscal incentive to construct their facilities at a cost of $1,000 per pupil housed (where the overall state matching rate is greatest). At the same time, districts which chose to do so *could* construct facilities at a higher cost per pupil housed, but with a lower marginal state contribution. No school district, however, would receive state aid to construct a facility costing in excess of $1,200 per pupil housed.

**Examples Using Three Hypothetical Districts**

Table 56 shows how the sample guaranteed yield schedule would work for three hypothetical school districts—a "poor" district, an "average" district, and a "wealthy" district—each needing to house 1,000 students. (In our proposal, school district wealth is measured by the district's assessed value per pupil needing to be housed.) As the table shows, each district would be guaranteed the same *total* amount of revenues for a given tax rate. For any given tax rate, however, the "poor" district would have a larger share of its guarantee paid for by the state than would the "wealthy" district.

The following discussion illustrates the choices that these districts might face, and shows how their decisions could be influenced by the guaranteed yield schedule.

**Table 56**
**Revenues Raised by Three Hypothetical School Districts Needing to House 1,000 Students Under a Sample Guaranteed Yield Schedule**

| | *"Poor" District* | | *"Average" District* | | *"Wealthy" District* | |
|---|---|---|---|---|---|---|
| *Tax Rate* [a] | *Local Contribution* | *State Contribution* | *Local Contribution* | *State Contribution* | *Local Contribution* | *State Contribution* |
| $0.01 | $10,000 | — | $25,000 | — | $75,000 | — |
| 0.02 | 20,000 | — | 50,000 | — | 150,000 | — |
| 0.03 | 30,000 | — | 75,000 | — | 225,000 | — |
| 0.04 | 40,000 | — | 100,000 | — | 300,000 | — |
| 0.05 | 50,000 | — | 125,000 | — | 375,000 | — |
| 0.06 | 60,000 | $140,000 | 150,000 | $50,000 | 450,000 | — |
| 0.07 | 70,000 | 330,000 | 175,000 | 225,000 | 525,000 | — |
| 0.08 | 80,000 | 520,000 | 200,000 | 400,000 | 600,000 | — |
| 0.09 | 90,000 | 710,000 | 225,000 | 575,000 | 675,000 | $125,000 |
| 0.10 | 100,000 | 900,000 | 250,000 | 750,000 | 750,000 | 250,000 |
| 0.11 | 110,000 | 940,000 | 275,000 | 775,000 | 825,000 | 225,000 |
| 0.12 | 120,000 | 980,000 | 300,000 | 800,000 | 900,000 | 200,000 |
| 0.13 | 130,000 | 1,020,000 | 325,000 | 825,000 | 975,000 | 175,000 |
| 0.14 | 140,000 | 1,060,000 | 350,000 | 850,000 | 1,050,000 | 150,000 |
| 0.15 | 150,000 | 1,050,000 | 375,000 | 825,000 | 1,125,000 | 75,000 |
| 0.16 | 160,000 | 1,040,000 | 400,000 | 800,000 | 1,200,000 | — |
| 0.17 | 170,000 | 1,030,000 | 425,000 | 775,000 | 1,275,000 | — |
| 0.18 | 180,000 | 1,020,000 | 450,000 | 750,000 | 1,350,000 | — |
| 0.19 | 190,000 | 1,010,000 | 475,000 | 725,000 | 1,425,000 | — |
| 0.20 | 200,000 | 1,000,000 | 500,000 | 700,000 | 1,500,000 | — |

[a] Per $100 of assessed value.

***"Poor" School District.*** This district is considering two alternatives for housing its 1,000 students. First, it could construct an "adequate" facility at a cost of $1 million. Second, it could construct a more spacious facility at a cost of $1.2 million.

Consulting the state guaranteed yield schedule (see Table 56), the district's school board finds that:

- A tax rate of $0.10 per $100 assessed value would be needed in order to raise $1 million. If the voters approved this rate, the district would raise $100,000 locally and would receive $900,000 in state aid (a matching rate of 9 to 1).
- A tax rate of $0.14 per $100 of assessed value would be needed in order to raise $1.2 million. If the voters approved this rate, the district would raise $140,000 locally, and would receive $1,060,000 in state aid (a state matching rate of roughly 7.6 to 1).

Knowing that the local community has strongly supported education in the past, the school board decides to try for the higher tax rate of $0.14. The board believes the voters can be persuaded that the quality of the more expensive facility, plus the generous state matching rate, justifies the higher tax effort.

***"Average" School District.*** This district is considering three alternatives. The first alternative, providing an "adequate" amount of space per student and standard quality of construction, costs $800,000. The second alternative, providing more generous amounts of space per student, costs $1 million. The third alternative, providing the greatest amount of space and the best quality of construction, costs $1.2 million.

Consulting the state guaranteed yield schedule, this school board finds that:

- A tax rate of $0.09 per $100 assessed value would be needed in order to raise $800,000. If the voters approved this rate, the district would raise $225,000 locally, and would receive $575,000 in state aid (a state matching rate of roughly 2.6 to 1).
- A tax rate of $0.10 per $100 of assessed value would be needed in order to raise $1 million. If the voters approved this rate, the district would raise $250,000 locally, and would receive $750,000 in state aid (a state matching rate of 3 to 1).
- A tax rate of $0.14 per $100 of assessed value would be needed in order to raise $1.2 million. If the voters approved this rate, the district would raise $350,000 locally, and would receive $850,000 in state aid (a state matching rate of roughly 2.4 to 1).

Based on these alternatives, the school board decides to go for the most generous matching rate and proposes a tax increase of $0.10 per $100 of assessed value.

***"Wealthy" School District.*** This district is considering only two alternatives. First, it could build a new facility at a cost of $1 million. Second, it could reconstruct an existing facility at a cost of $300,000.

Consulting the state guaranteed yield schedule, this school board finds that:

- A tax rate of $0.10 per $100 of assessed value would be needed in order to raise $1 million. If the voters approved this rate, the district would raise $750,000 locally, and would receive $250,000 in state aid (a state matching rate of roughly 0.3 to 1).

- A tax rate of $0.04 per $100 of assessed value would be needed in order to raise $300,000. If the voters approved this rate, the district would raise the full $300,000 locally, receiving no state aid.

Based on these alternatives, the school board believes that the state matching rate is not sufficiently generous to persuade local voters to tax themselves at the higher rate of $0.10. Accordingly, the board proposes the lower rate of $0.04 in order to reconstruct the existing facility.

**Conclusion**

In sum, the method we recommend for financing the construction and reconstruction of local school facilities offers the following advantages over the current system:

- It would increase incentives for each school district to choose the most cost-effective solutions for its school facilities needs, because the beneficiaries of school construction projects would be required to pay at least a portion of project costs.
- It would enhance local control by enabling local school districts to develop their projects based on local, rather than state, priorities.
- It would provide local school districts with an opportunity to raise substantial amounts of money for new construction within a shorter period of time, because the role of the state in reviewing and approving applications would be substantially reduced.
- It would provide districts with greater flexibility and the opportunity to conduct long-range planning, by allowing them either to construct new facilities or rehabilitate existing facilities, depending upon the costs and benefits of each alternative.
- It would make local school districts more accountable to those they serve, because voter approval would be necessary before bonds could be sold.

## CALIFORNIA'S COMMUNITY-BASED LONG-TERM CARE SYSTEM

### *Can the State Provide Community-Based Long-Term Care Services in a More Effective and Efficient Manner?*

During the last couple of years, the Legislature has shown increased interest in shaping California's long-term care system. This interest springs primarily from three concerns:

- ***Demographic Changes.*** The number of Californians who are 65 years of age or older is growing rapidly, thus expanding the need for health and social services.

- ***Increasing Health Costs.*** The cost of long-term care—mostly Medicare and Medicaid expenditures—is rising rapidly, due in part to increased utilization by the elderly of acute care hospitals and nursing homes.
- ***Limited Long-Term Care Alternatives.*** The most widely available long-term care alternative is nursing home care. Many people perceive this alternative as less desirable when compared to receiving services at home.

In order to address these concerns, the Legislature recently enacted measures which provide for the incremental development of a long-term care delivery system which includes expanding existing long-term care programs and developing new programs.

In general, long-term care consists of two components: (1) institutional care (for example, nursing home care) and (2) community-based services which assist individuals to remain in their home instead of being placed in a nursing home.

This analysis addresses the following two questions concerning long-term care programs in California:

- What long-term care services are available for older Californians?
- Has the state organized and managed its *community-based* long-term care system in the most efficient and effective way?

**What Long-Term Care Services Are Available in California?**

In general, California law defines long-term care as a coordinated continuum of care that:

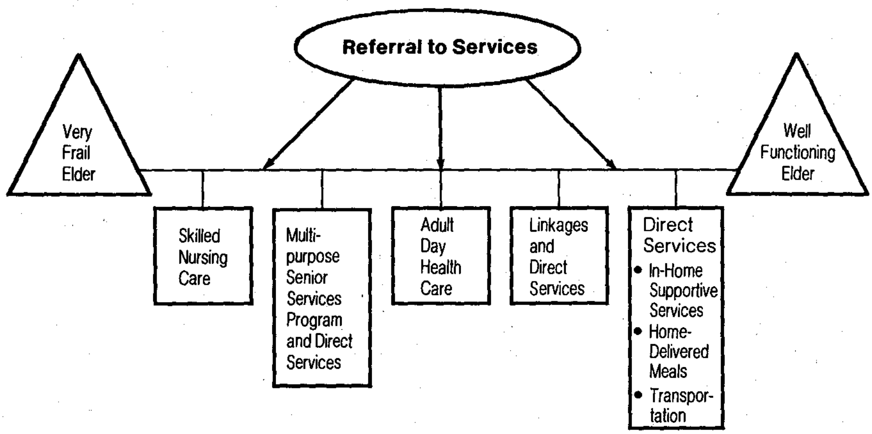
- Addresses the individual's health, social, and personal needs, and
- Maximizes the individual's ability to function independently, especially outside of an institution.

California's definition of long-term care is so broad as to include any service that is needed to maximize an individual's independence. For example, this definition would include a service such as housing assistance, that normally might not be associated with long-term care.

In *theory,* the range of services available to elders in California follows a continuum based on how well the person functions and the extent of his or her informal support system. Chart 30 generally illustrates this continuum of care.

At one end of the continuum are the most frail elders who need institutional services because they have little family support at home and are physically or mentally unable to care for themselves. At the other end of the continuum are the least frail elders who simply need some direct services, such as In-Home Supportive Services (IHSS). Between these two ends of the continuum are various case management programs which help put together a package of services which assists the elderly person to remain at home.

**Chart 30**
**California's Continuum of Care for the Elderly**




In *reality,* the long-term care options available to most older Californians are not as neatly organized as shown in Chart 30.

Table 57 summarizes the major long-term care services provided in California. These services are discussed in more detail in the *Analysis* (Item 4170). The table does not provide a complete picture of all available services because it excludes programs which do not receive funding from governmental sources.

Table 57 demonstrates several important points regarding California's current system of long-term care:

- ***Nursing Home Care Accounts for the Bulk of Long-Term Care Expenditures.*** California will spend approximately $1.7 billion (all funds) for long-term care services in 1985–86. Of this amount, about 62 percent will be spent for skilled nursing care and intermediate care services and the remaining 38 percent will be spent for community-based care services.
- ***Sources of Funding Influence the Use of Residential Care Services.***

The Medi-Cal program is the single largest funding source for long-term care programs, accounting for over $1.0 billion in nursing home funds. Because the Medi-Cal program does not reimburse most of the costs of community-based care, it tends to encourage the use of institutional care over community-based care.

- ***The IHSS Program and Home Health Care Services are the Largest Community-Based Services.*** Of the community-based services, the IHSS program serves the largest number of people residing in the community (116,000) and has the largest amount of state and federal funding ($413 million in 1985–86). Home health care providers serve more people than IHSS (140,000). Table 57 significantly understates the costs of the home health services, because it does not include the share of costs which are paid by clients.
- ***The State's New Long-Term Care Programs are Relatively Small.*** The new long-term care programs which provide case management and direct services—Multipurpose Senior Services Program (MSSP), Linkages, Adult Day Health Care (ADHC), and Alzheimers—serve relatively few people and receive relatively little funding compared to residential care services and the IHSS program. These four new programs together receive $32 million and serve 10,000 clients, while residential care and IHSS receive $1.4 billion and serve approximately 320,000 clients.
- ***Long-Term Care Administrative Agencies are Fragmented.*** Long-term care services, both residential and community-based, are managed by a number of different public and private entities. This may make it difficult to direct a person to the most appropriate type of care.
- ***Area Agencies on Aging (AAAs) Serve the Frail Elderly.*** The AAAs generally are viewed as serving the relatively well-functioning elderly. Among the services for which AAAs contract, however, are four that frail elders utilize extensively—case management, in-home services, home-delivered meals, and transportation.

### What Do We Know About the Effectiveness and Efficiency of Providing Community-Based Long-Term Care Services?

***Nationwide Research Projects.*** During the last 10 to 15 years, the federal government has sponsored a number of different long-term care demonstration projects across the country. In general, the purpose of these projects was to determine the impact of community-based long-term care services on the cost and quality of care provided to the elderly. Because many of these demonstration projects are still in process, research findings published to date are either incomplete or preliminary. Even where projects have been completed, the research findings regarding cost and quality of care are inconclusive.

## Table 57
## Long-Term Care Services in California
## 1985–86
## (dollars in thousands)

| Type of Service | Administrative Agency[a] | Number of Providers | Number of People Served | Funding | | | |
|---|---|---|---|---|---|---|---|
| | | | | General | Federal | Local | Total[b] |
| Residential Care | | | | | | | |
| • Skilled nursing care and intermediate care[c] | Private | 1,200 | 135,600 | $517,435 | $510,003 | — | $1,027,438 |
| • Board and care | Private | 3,400 | 71,300[d] | Unknown | Unknown | Unknown | Unknown |
| Community-Based Care | | | | | | | |
| Case Management | | | | | | | |
| • Multipurpose Senior Services Program | CDA | 22 | 5,400 | 9,790 | 9,551 | — | 19,341 |
| • Linkages | CDA | 13 | 1,800 | 3,808 | — | — | 3,808 |
| • Title IIIB—case management[e] | AAAs | 65 | 11,800 | 86 | 1,303 | $647 | 2,036 |
| Direct Services | | | | | | | |
| • In-Home Supportive Services | County Welfare Departments | 96,850[f] | 116,000 | 90,034 | 303,221 | 19,947 | 413,202 |
| • Title IIIB[e]—in-home services | AAAs | 124 | 38,300 | 81 | 2,743 | 1,511 | 4,335 |
| • Home health care[g] | Private | 479 | 140,000 | 3,233 | 149,109 | Unknown | 152,342 |
| • Adult day health care (ADHC) | CDA | 60 | 2,550 | 4,356 | 3,522 | Unknown | 7,878 |
| • Adult social day care[h] | Private | 90 | 4,590 | Unknown | Unknown | Unknown | Unknown |
| • Alzheimer's day care resource centers | CDA | 8 | 185 | 467 | — | 75 | 542 |
| • Home-delivered meals[e] | AAAs | 168 | 45,400 | 6,014 | 9,378 | 3,937 | 19,329 |
| • Transportation[e] | AAAs | 203 | 55,300 | 530 | 4,855 | 3,218 | 8,603 |
| • Adult protective services | Counties | Unknown | Unknown | Unknown | — | Unknown | Unknown |
| • Housing[i] | AAAs, HCD | — | 9,733 | 550 | 5,580 | Unknown | 6,130 |
| Subtotals—community-based care | | | | $118,949 | $489,262 | $29,335 | $637,546 |
| Totals—residential and community-based care | | | | $636,384 | $999,265 | $29,335 | $1,664,984 |

[a] CDA = California Department of Aging; AAAs = Area Agencies on Aging; HCD = Department of Housing and Community Development.
[b] These totals do not include client-share of cost where required.
[c] November 1985 Medi-Cal estimate only, includes some facilities for developmentally disabled.
[d] Number of *beds licensed* as residential facilities for the elderly.
[e] 1984–85 California Department of Aging Management Information System and cost report data.
[f] Estimated 1983.
[g] 1983 Medicare fiscal data; 1985–86 Medi-Cal fiscal estimate.
[h] Estimated number of elderly providers and slots among those licensed for adult day care.
[i] These are estimates of seniors served and associated expenditures under eight different programs provided through AAAs and HCD. It does not encompass all housing programs.

***The Multipurpose Senior Services Program (MSSP).*** One of the major research projects on community-based long-term care services for the elderly—MSSP—was conducted in California. The purpose of the MSSP research was to test the effectiveness of delivering services to the elderly using case managers. Case managers operate in teams made up of health and social workers, in order to assess and coordinate the delivery of services to individuals.

It is important to understand the findings from this research project because it has become the model in California for the delivery of community-based services to individuals who are most at-risk of institutionalization. The findings of the research project are summarized below:

- ***Cost of Services.*** The demonstration project found that, contrary to conventional wisdom, it is *more expensive* to maintain an elderly person in the community with MSSP services than it is to provide services to that person in an institution. In 1983–84, for example, it cost $106 more a month to keep an elderly person in the community with MSSP services ($1,669) than to provide institutional care to that individual ($1,563). One reason for the higher cost is the case management and research cost of the MSSP. In 1983–84, these costs accounted for approximately $277 per month, per person, or about 23 percent of an MSSP client's average monthly cost of care. The research costs alone account for about $110 per month, or 11 percent of the cost of care. Another explanation for the higher cost is that MSSP does not directly control the utilization of services by its clients. For example, Medicare accounts for almost 50 percent of an MSSP client's average monthly costs. These are largely acute care hospital costs, over which MSSP has no direct utilization control.
- ***Effectiveness of Services.*** The results from MSSP regarding program effectiveness are mixed. On the positive side, MSSP clients spend less time in hospitals and skilled nursing homes and live slightly longer than would have been the case had they not received the service. On the other hand, MSSP had no significant effect on the physical or mental functioning level of the typical client.
- ***Targeting of Services.*** The MSSP research suggests that it is important to target services to those individuals who will benefit from these services the most. Specifically, the research found that MSSP was most beneficial for the frailest elderly. That is, for the most frail elderly, MSSP saves more hospital days, more nursing home days, and more days of life, at less cost per person.

In summary, the MSSP research indicates that an individual's quality of life (in terms of fewer days spent in institutions) may be improved by the program, but such improvement results in expenditures which exceed the cost of institutional care. If research costs are excluded, the cost of keeping a person in the community is almost the same as the cost of institutional care.

Preliminary data since 1983–84 indicate that although the cost per client has not changed significantly, the distribution of those costs has changed. Administrative costs per client are decreasing because the same costs are spread across more clients. Service costs per client, however, are increasing. We discuss these cost issues further in Item 4170 of the *Analysis.*

**Has the State Organized and Managed its Community-Based Long-Term Care System in the Most Efficient and Effective Way?**

Some of the issues facing California's community-based long-term care system stem from policies and actions of the federal government and the Legislature's ability to address these issues is limited. For example, if the Legislature decides on a model of care that relies on federal funding, it probably would have to obtain federal waivers of Medicare and Medicaid regulations, and could not simply provide for implementation of the system by a state agency. Because it is difficult to secure these waivers, the Legislature is limited in the extent to which it can change the long-term care system.

The issues discussed below involve those aspects of the community-based long-term care system which the Legislature *can* affect directly.

**Improved Methods For Targeting Long-Term Care Services Are Needed**

***We recommend that the Legislature adopt supplemental report language which requires the Department of Aging to submit a report by December 1, 1986, which describes the costs and benefits of various targeting mechanisms for the Multipurpose Senior Services Program, as well as other case management programs.***

One of the major conclusions yielded by the MSSP research is that it is important to target community-based long-term care services to specific groups of individuals. Specifically, the research shows that case management services, such as those provided by MSSP, are most cost-effective when targeted to the frailest elderly. In an attempt to target services on the most frail elderly, the MSSP currently serves only those individuals who are "certifiable" for intermediate or skilled nursing home care. The experience of MSSP shows, however, that simply serving individuals who are "certifiable" does not result in only the *most* frail elderly receiving services. This is because certifiability is a broadly defined term which can be applied to any person who, as a result of a medical condition, needs an out-of-home protective living arrangement in order to stop the deterioration of health. Thus, certifiability is a fairly arbitrary line which, in practice, does little to help distinguish among the functional levels of various clients.

Currently, there are two projects underway in the state which are attempting to develop better targeting mechanisms.

- The California Department of Aging (CDA), in conjunction with the University of California, is developing a computer-assisted targeting system for use by the MSSP sites. Because this system has not yet been tested, the department does not know if it will be effective in identifying those individuals who would benefit most from community-based services.
- Another way to improve targeting would be to expand the Gatekeeper program statewide, as required by Ch 1600/84 (AB 2226). This would enable MSSP and other community-based long-term care programs to serve those individuals who have actually applied for admission to a nursing home, and thus are very likely to be quite frail. We discuss this issue further in Item 4260 of the *Analysis.*

In order for the Legislature to evaluate the potential targeting mechanisms for MSSP and other case management programs, we recommend the adoption of supplemental report language requiring the CDA to submit a report to the Legislature that presents targeting alternatives for the MSSP program. The report should not be limited solely to the targeting systems described above, but also should examine the costs and benefits of other alternatives as well. The following language is consistent with this recommendation:

"The Department of Aging shall submit a report to the Legislature by December 1, 1986, which describes the costs and benefits of various targeting mechanisms for case management programs, particularly the Multipurpose Senior Services Program. This report shall include, but not be limited to computer-assisted targeting, as well as targeting through such referral mechanisms as the Gatekeeper program."

**Client Assessment for Services Needs to Be Done More Efficiently**

***We recommend that the Legislature adopt supplemental report languge which requires the Departments of Aging and Social Services to submit a plan for consolidating assessments for community-based long-term care programs.***

Currently, many individuals receive community-based long-term care services from more than one program. For example, it is not unusual for a person to receive services from MSSP, ADHC, and IHSS all at the same time. All of these programs use different assessment tools to determine the amount and type of services their clients need in order to remain in their own homes. Thus, a client could be assessed three different times, once by each program, prior to receiving each of these services. Although some of these assessments are more extensive than others, each contains many of the same elements, such as a medical history and an evaluation of the person's ability to function in the home. These multiple assessments not only result in duplication of effort, but can be both draining and confusing for a frail elderly person.

Because there are many efficiencies to be gained from consolidating assessments, we recommend that the Legislature adopt supplemental report language which requires the CDA and the DSS to submit a plan to the Legislature for consolidating the assessment process for community-based long-term care programs. The following language is consistent with our recommendation:

"The Departments of Aging and Social Services shall submit a plan to the Legislature by December 1, 1986, for consolidating assessments for services from community-based long-term care programs. The consolidation plan should include, but not be limited to MSSP, Linkages, Alzheimer's Day Care Resource Centers, ADHCs, and IHSS. This plan should have a beginning implementation date no later than July 1, 1987."

**Local Organizational Structures May Affect Coordination of Services**

***We recommend that the Departments of Aging and Social Services submit a report to the Legislature by December 1, 1986, regarding consolidation of community-based long-term care systems at the local level.***

A large number of agencies provide long-term care services to the elderly at the local level. These agencies include county welfare departments, area agencies on aging, and local long-term care programs (for example, MSSP) sponsored by the CDA. There are also many private organizations, such as home health agencies, which provide these services. This fragmentation may make it difficult to provide services in the most efficient way, on two different levels:

- From a systemwide standpoint, having several different agencies providing services makes it difficult to target services to individuals. This is because no one agency is responsible for determining which services are most appropriate for a given individual.
- From an individual's standpoint, having several local agencies providing services makes it difficult for a person to make the transition from one service to another.

Several counties have attempted to minimize this fragmentation by combining into one agency those local entities which provide community-based long-term care services. Based on our review, these types of structures appear to be a more efficient way of providing community-based long-term care services. Because one agency has responsibility for determining the appropriate level of care for all those seeking services, it is easier to determine one individual's needs relative to another's when allocating existing services. Moreover, from the client's standpoint, it is easier to find services when one agency in the community provides them.

Because these consolidated structures appear to be more efficient in delivering long-term care services, we recommend that the Legislature adopt supplemental report language which requires the CDA and the DSS to submit a report which examines the benefits of this type of organization at the local level. In addition, the report should include a plan to provide assistance to counties that have not yet consolidated their organizations for delivering community-based long-term care services. The following language is consistent with this recommendation:

"The Departments of Aging and Social Services shall, by December 1, 1986, submit a report to the Legislature listing the counties which have consolidated long-term care service delivery systems, and examining the benefits and limitations of such systems. The report also shall include a plan for providing assistance to those counties who have not yet developed such a consolidated system."

### The CDA Should Specify the Need for Community-Based Long-Term Care Services

***We recommend that the CDA include in its annual report on long-term care specified information which will better enable the Legislature to do long-range planning for community-based long-term care services.***

During the last few years, the number of community-based long-term care programs has increased significantly. For example, the number of MSSP sites more than doubled, from 8 to 22, between 1984–85 and 1986–87. In addition, the number of ADHC sites has increased from 35 in 1984–85 to a projected 80 in 1986–87. In general, expansion of these and other community-based programs has been incremental, with each program's expansion considered separately from the others. In other words, expansion has not been based on estimates of the particular types of services that are most appropriate for those who will need community-based long-term care.

There are two negative implications of expanding services without this information. First, by incrementally expanding programs without taking into consideration the needs of older Californians, individuals may not be receiving the services they need, or they may be mismatched with available services. Second, a haphazard matching of elders to services may result in a service system which is not cost-effective. This is particularly important because many of these community-based programs have the potential for significant cost increases due to their broad eligibility guidelines.

One example of how the need for services can be estimated statewide is contained in CDA's report "MSSP: Impact Analysis, 1983–84". The department estimated, by frailty level, the number of potential MSSP recipients in each county of the state. This estimate could be compared to the actual number of people served by MSSP statewide in order to determine the percentage of need being addressed by this program throughout the state. (MSSP, however, has not used this particular formula on which to base its expansion requests. Instead, it has used the formula required by its federal waiver.)

Similarly, CDA could estimate the need for *all* long-term care programs using particular characteristics of the elderly targeted in other long-term care programs. For example, if the department can estimate the potential number of MSSP clients statewide based on the number of "most frail" Medi-Cal recipients, presumably the department can estimate the number of potential ADHC and other community-based long-term care services clients using a "medium" level of frailty. These estimates of need for particular programs could be combined county-by-county in order to determine the total need for long-term care services in the state, and what proportion of that need is being met in each county through existing services. This information would enable the Legislature not only to use estimated need as a basis for expanding programs, but also to expand them on a priority basis.

In order to most appropriately match need with long-term care services, we recommend that the Legislature adopt the following supplemental report language requiring the CDA to include in its annual long-term care report, projections of the number of elderly in the state, their functional levels, type of informal support systems, and any other information which enables the Legislature to determine unmet need for community-based long-term care services.

> "The Department of Aging shall include in its long-term care plan due annually by December 1, an estimate of the number of elderly in the state, their functional levels, and any other information which enables the Legislature to determine unmet need for community-based long-term care services, including MSSP, Linkages, ADHC, and IHSS."

## HAZARDOUS WASTE SITE CLEANUP STRATEGY

### *Do the State's Current Hazardous Waste Cleanup Procedures and Priorities Maximize Public Health Protection?*

Current law assigns responsibility for the cleanup of hazardous waste sites in California to the Department of Health Services. With the approval of the $100 million bond act in 1984, the voters provided the department with the means to begin permanently cleaning up many hazardous waste sites. While Ch 1439/85 (AB 129), establishes general program procedures, responsibility for determining how the cleanup process works and setting program priorities rests largely with the Department of Health Services (DHS).

This section reviews the program's process and priorities for cleaning hazardous waste sites and makes recommendations to ensure that the department maximizes the impact of cleanup activities on protection of public health and the environment.

### Current Cleanup Process

The current cleanup process involves five distinct stages or phases of planning and remediation.

- ***Site Discovery.*** In this phase, the Department of Health Services discovers that a site has hazardous wastes posing a public health threat. Sites may be discovered through public complaints or the department's program to systematically search for abandoned hazardous wastes.
- ***Site Development.*** Once a site is discovered, the department takes steps to determine the general extent of contamination and the magnitude of the public health threat. The department may undertake a number of formal actions at this point, such as (1) reducing the immediate public health threat by removing potentially explosive drums or erecting fences around the site, or (2) calculating the site's priority ranking, which determines whether immediate cleanup action is appropriate or whether higher priority sites should be cleaned up before attention is given to the site in question. Efforts to identify responsible parties may also begin at this time.
- ***Site Characterization.*** Permanent cleanup activity begins with site characterization, which involves an in-depth assessment of the contamination problem. The department characterizes only the highest priority sites for which there is no responsible party or an identified responsible party will not agree to a cleanup plan.
- ***Development of a Remedial Action Plan.*** At this stage, DHS develops a cleanup plan that sets cleanup standards based on (1) a public health risk assessment established for each toxic material and (2) the ability of current technology to eliminate contamination from the site.
- ***Remediation of the Site.*** Once the remedial action plan is approved, cleanup of the site begins. The typical site requires one to two years to clean up. Complicated sites may take up to five or more years to remediate, with ongoing operating and maintenance costs continuing for many more years. The state initiates and pays for cleanup actions when the responsible party cannot fund the cleanup costs or will not take appropriate action. In some cases, the state cleans up only sites for which no responsible party or parties exist.

### Current Cleanup Strategy Does Not Maximize Public Health Protection

***We recommend enactment of legislation establishing a policy that requires interim cleanup activities at hazardous waste sites in order to quickly reduce threats to the public and the environment. We further recom-***

***mend that this legislation specify general criteria under which interim measures would be applied.***

Our analysis indicates that there are normally two categories of problems at hazardous waste sites: short-term and long-term threats to public health and the environment. The *short-term* threat exists when (1) the potential for fire, explosion, or public contact with toxic substances creates a public health hazard or (2) the continuing escape of toxic materials into water or air results in damage to the environment. The *long-term* threat is any public health or environmental danger that cannot be eliminated by interim measures. Because the danger from fire, explosion, and public contact often can be greatly reduced by relatively simple remedies, environmental contamination usually constitutes the major long-term threat. This threat continues so long as a site is not permanently cleaned up.

Actions to reduce short-term threats are relatively straight forward. Potentially explosive drums can be removed. Contaminated areas can be fenced-off in order to reduce public contact with the toxic substances. Further spread of contaminants into the environment can be inhibited by covering the site with impermeable clay, thereby (1) reducing the filtration of rainwater through contaminated soil into the groundwater and (2) reducing the contamination of rainwater that ultimately runs into surface streams and rivers.

Actions to eliminate long-term threats are usually more complicated and costly. Contaminated dirt can be removed and possibly treated or disposed in a licensed waste disposal site. Contaminated groundwater can be pumped out of the ground and treated or disposed.

Current state policies generally do not result in action to reduce the short-term threat posed by a site. According to the department, sites occasionally are fenced in order to reduce public contact; the department may initiate action at a site in order to reduce fire and explosion threats. Our review indicates, however, that there is no consistent policy governing actions to reduce short-term threats. If a site is not among the top-priority sites or is not on the federal site list, the department is unlikely to take the steps needed to reduce the immediate danger. Moreover, a high ranking on the state priority list is no guarantee that any intermediate remedial steps will occur.

The result of this policy is that DHS cleanup actions focus on a limited number of high-priority sites; the remaining sites receive little or no attention, even though the ongoing health and environmental effects may be significant. Currently, there are 222 sites on the state priority list. Of these sites, cleanup actions are targeted for 117 sites (37 sites with state bond act funds, 53 with federal Superfund monies, and 27 with support from responsible parties). This means, however, that the department has no immediate plans to take any action at 105 sites. Unless the DHS takes action to reduce the threat to health and the environment at these 105 sites, they will continue to present a danger to the public. Indeed, the threat posed by these sites may even increase if continued deterioration of sites permits contaminants to enter air and water at increasing rates.

While a policy of taking no action at low-priority sites does not adequately protect the public health, an across-the-board policy of fencing or capping all sites does not make sense either. The cost of interim action at some sites could approach the cost of permanently eliminating the toxic hazard. In these cases, interim actions probably should not be taken. If permanent action is years away, however, intermediate steps may stabilize a site and, therefore, reduce future cleanup costs. Thus, interim action may be justified, even if it is relatively expensive.

Interim cleanup measures should be taken when:

1. Interim action could prevent or substantially limit contamination of underground or surface water and continued inaction would result in substantially greater cleanup costs at a later time.

2. Continued inaction poses a substantial threat of death, serious injury, or illness.

3. Interim action is relatively inexpensive in relation to the cost of permanently cleaning up the site with presently available technology.

With these considerations in mind, we recommend enactment of legislation establishing a hazardous waste cleanup policy that generally requires interim cleanup activities at hazardous waste sites. We further recommend that this legislation specify broad parameters under which interim measures would be applied.

### State Priority List Does Not Adequately Reflect Costs and Benefits

***We recommend enactment of legislation requiring the Department of Health Services to revise its site cleanup priorities based on the net costs and benefits that result from cleaning up a hazardous waste site. We also recommend that this legislation require the department to update a site's priority whenever new data indicate that the danger posed by the site has changed significantly.***

The state priorities list reflects the department's assessment of which sites should be cleaned up first. Clearly, the department cannot permanently clean up all 222 sites in California at one time. As a result, the DHS needs an objective method of setting priorities as a way to focus its resources. One way to set priorities—the method chosen by the federal government—is to first clean up the worst sites—those sites presenting the most severe threat to public health and the environment. State law, however, requires the department to also consider cleanup costs when setting priorities.

***Priorities Are Not Updated to Reflect New Information.*** The priority calculation devised by the department is a modified cost-benefit calculation—the public health benefit is divided by the estimated cost of cleaning up the site. The department first determines a score representing the severity of the three threats to society—environmental, public contact, and fire and explosion. These scores are summed to attain the "cleanup benefit" of remediating each site. The benefit number is then divided by a "cost factor" that represents the estimated cost of cleaning up the site. The resulting health index determines a site's program priority.

Our review of the department's methodology for establishing a site ranking list indicates that it has the following deficiencies:

- ***The site priority list is not reassessed after interim actions have reduced site hazard.*** As we discussed earlier, the department sometimes takes interim action at some sites. The department does not, however, recalculate a site's priority ranking to reflect the reduction in the threat to the public. Instead, the site is ranked as if no interim action occurred. As a result, the state priority list tends to overestimate the true hazard posed by some sites.
- ***Cleanup costs and site priorities are estimated with questionable data.*** The department determines a site's priority ranking before a site is characterized (step three in the five-step cleanup process). Priority rankings are based on initial estimates of each site's condition and cleanup costs. The first in-depth assessment of a site's hazardous waste problem, however, does not occur until site characterization. While Chapter 1439 requires a site to be characterized before it can be included on the cleanup list, the department plans to characterize only those sites that receive a top priority based on preliminary data. As a result, the characterization required by Chapter 1439 will not affect the order in which sites are cleaned up. Because of the department's policy to characterize a few sites at a time, site priorities are based on data that may be incomplete or inaccurate because (1) the data were collected years earlier and, therefore, do not represent the current situation at a site or (2) preliminary testing did not provide a comprehensive assessment of the environmental/health threat or projected cleanup cost. Therefore, cost estimates and priority rankings may be derived from data of questionable validity.

***Site Priority Does Not Accurately Reflect the Relative Costs and Benefits of Cleaning Up Hazardous Waste Sites.*** Currently, the estimated cost of permanent cleanup plays a major role in determining whether a site receives a high or low priority; the threat to public health and the environment plays an important, but secondary, role. The 10 sites having the top priority on the state list, for instance, are expected to be relatively inexpensive to clean up—less than $300,000 each. Sites that represent a more severe health and environmental danger but are also relatively expensive to clean up tend to receive a much lower priority. For example, McColl is ranked number 108, Stringfellow is number 111, and Iron Mountain Mine is number 157. These sites receive a low priority primarily because the estimated cleanup costs are high.

Table 58 displays the department's ranking methodology for three fictional sites. Eliminating the health risk posed by a particular site is considered the benefit of the cost/benefit calculation. Sites that pose the greatest public health and environmental risks are those with the highest risk factor numbers.

The department estimates health factors by totaling the scores for environmental, direct contact, and fire and explosion dangers posed by each site. Next, cleanup costs are grouped into one of six cost categories: estimated cleanup costs of less than $300,000 are assigned a cost factor of one, costs totaling more than $300,000 but less than $1 million have a cost factor of two, and so on. Finally, the health risk factor for the site is divided by the site's cost factor to produce a "health index." The health index determines site priority.

Cleaning up Site A, for instance, would eliminate a health risk of 100 at a cost of $285,000 (a cost factor of one). Therefore, Site A is assigned a health index of 100. Since Site A has a higher health index number than either of the other two sites in Table 58, it would be the first site to be cleaned up.

**Table 58**
**Department of Health Services**
**Methodology for Calculating Site Priorities**

| *Site* | *Health Risk Factor* | *Estimated Cleanup Cost* | *Cost Factor* | *Health Index* | *Site Rank* |
|---|---|---|---|---|---|
| A | 100 | $285,000 | 1 | 100 (100/1) | 1 |
| B | 120 | 310,000 | 2 | 60 (120/2) | 2 |
| C | 175 | 2,850,000 | 3 | 58 (175/3) | 3 |

Our review of the department's cost/benefit equation indicates that the department's methodology does not accurately reflect costs and benefits of cleaning up hazardous waste sites. This is because the "cost factors" do not correspond closely to actual cleanup costs. Table 58 shows how the cost factor can distort the assigned health index number and therefore the ultimate priority ranking. The estimated cost of cleaning up Site A, for instance, is $285,000. Site B is estimated to cost $310,000, which is $25,000, or 8.8 percent, more than Site A. Because Site B costs more than $300,000, it is assigned a cost factor of two; even though actual costs are only 8.8 percent higher than Site A, Site B's cost factor results in a cost "difference" of 200 percent for the purposes of the cost/benefit calculation. For this reason, Site B's health index is much smaller than Site A's and, on a list with many sites, Site B would receive a much lower priority.

On the other hand, cost factors can *understate* the actual cost differences between sites. Site C is estimated to cost $2.85 million, which is 10 times more expensive to clean up than Site A. Site C's cost factor, however, is only three times larger than Site A's. On a list with many sites, Site C's health index—and its priority—would be much higher than its relative cost would dictate. As a result of the distortions introduced by the use of the cost factors, the department's priorities do not accurately reflect the relative costs and benefits of different sites.

***Net Benefit Calculation Balances Benefits and Cost.*** Our analysis suggests that a net benefit calculation would provide a more balanced approach to ranking sites than the department's methodology. A net benefit calculation subtracts total costs from total benefits. A positive net benefit indicates that a site is worth cleaning up. A negative net benefit suggests that a site should not be cleaned up.

Net benefit calculations require that total costs and benefits be converted into dollars. The net benefit calculations *assume* that each unit of hazardous waste cleaned up has a dollar value, such as $10,000, $100,000, or $1,000,000 per unit. The site with the greatest net benefit is ranked number one, the site with the second greatest net benefit is ranked number two, and so on.

The net benefit calculation provides a system for establishing cleanup priorities in which the assumptions are explicit. Placing a low dollar value on the benefit derived from eliminating health risk implies that costs would play a greater role in establishing priorities; a high value indicates a preference for eliminating the worst health risks. Site ranking is important because, at any point in time, there is only a limited amount of money available to use for site cleanup. By using the net benefit approach, the state can determine site priorities in a way that explicitly recognizes the relative importance of costs and benefits associated with site cleanup.

Table 59 displays total cleanup benefits, cleanup costs, and the results of three net benefit calculations for the 10 sites in California that pose the worst public health and environmental threat (as determined by the DHS). The public benefit of cleaning up the Chevron Refinery, for example, would be valued at $21.4 million if cleaning up a unit of hazardous waste risk is worth $100,000. This is calculated by multiplying the site's health risk factor (213.65 units) by $100,000. If the cost of cleaning up the Chevron Refinery site were $30 million, then the cost exceeds the benefits by $8.6 million; under these assumptions, the site would not be worth cleaning up. Similarly, if the benefit of cleaning up hazardous waste risk is pegged at $1 million a unit, then the benefit of cleaning up the Chevron site would total $213.6 million and the *net benefit* of cleaning up the site would be $183.7 million.

**Table 59**
**Department of Health Services**
**Alternative Priorities for the 10**
**Worst Public Health and Environmental Threats**
**(costs and net benefits in thousands)**

| Site | Health Risk Factor | Total Cleanup Costs | Net Benefits Assuming Each Unit of Benefit is Worth | | |
|---|---|---|---|---|---|
| | | | $10,000 | $100,000 | $1,000,000 |
| Chevron Refinery | 213.65 | $29,950 | –$27,634 | –$8,585 | $183,700 |
| Thomas Ranch | 156.67 | 1,745 | –178 | 13,922 | 154,925 |
| Hugo Neu Proler | 144.50 | 3,400 | –1,955 | 11,050 | 141,100 |
| Space Ordinance | 133.56 | 6,100 | –4,764 | 7,526 | 127,460 |
| Waste Disposal, Inc | 131.70 | 10,350 | –9,033 | 2,820 | 121,350 |
| Alviso Area | 129.68 | 6,500 | –5,203 | 6,468 | 123,180 |
| Custom Chrome | 124.09 | 285 | 955 | 12,124 | 123,805 |
| Flex Multilayer | 123.83 | 165 | 1,073 | 12,218 | 123,665 |
| Bray Oil | 118.62 | 2,120 | –934 | 9,742 | 116,500 |
| Aerojet General | 115.45 | 3,000 | –1,846 | 8,545 | 112,450 |

***Net Benefits Can Help Reveal Preferences.*** Examining various net benefits can provide insight into how different assumptions regarding the relative value of costs and benefits results in different strategies for cleaning up hazardous waste sites. If cleanup funds are extremely limited, for example, the net benefit calculation can indicate which sites yield the largest reduction in danger for a minimum cost. This is done by setting the value of cleanup benefits at a relatively low figure. Table 59 shows that valuing benefits at $10,000 a unit implies that only two inexpensive sites are worth cleaning up. If few cleanup funds were available, these two sites would be the first sites to be remediated. On the other hand, if unlimited funds were available, the net benefit calculation can indicate which sites should receive attention first. In Table 59, when health risks are valued at $1 million a unit, all 10 sites have a positive net benefit figure—all sites are worth cleaning up if the most important factor is reducing health risks.

**Table 60**
**Department of Health Services**
**Alternative Rankings for the 10 Worst**
**Public Health and Environmental Hazardous Waste Sites**

| Site | Site Priorities Based on | | | |
|---|---|---|---|---|
| | DHS Ranking System | Net Benefit Assuming Each Unit of Benefit is Worth $10,000 | Net Benefit Assuming Each Unit of Benefit is Worth $1,000,000 | DHS Health Risk Factor |
| Chevron Refinery | 6 | 10 | 1 | 1 |
| Thomas Ranch | 3 | 3 | 2 | 2 |
| Hugo Neu Proler | 5 | 6 | 3 | 3 |
| Space Ordinance | 7 | 7 | 4 | 4 |
| Waste Disposal, Inc | 9 | 9 | 8 | 5 |
| Alviso Area | 8 | 8 | 7 | 6 |
| Custom Chrome | 1 | 2 | 5 | 7 |
| Flex Multilayer | 2 | 1 | 6 | 8 |
| Bray Oil | 4 | 4 | 9 | 9 |
| Aerojet General | 10 | 5 | 10 | 10 |

If we know what value to place on cleanup benefits, we can use each site's net dollar benefit to determine the order in which sites should be cleaned up. Table 60 converts the net benefits for the 10 sites that pose the worst public health threats into priority rankings, with the number 1 site having the highest priority ranking. Table 60 shows that when benefits are valued at $1 million per unit, rankings generally equate to the site's total health risk. The relationship is not exact, however, because the estimated cleanup costs still play a role in determining site ranking. If benefits were valued at $100 million a unit, sites would be ranked only by their health risk. In the same way, the lower the value placed on a unit of cleanup benefit, the more that site priorities are influenced by cleanup costs. This is because the lower the value assigned to a given reduction in health risk, the greater the role of cleanup costs in setting priorities. If we assume that all sites, including the major costly sites, should be cleaned up, it implies that society values the benefits of cleanup at somewhere between $100,000 and $1 million per unit. Table 60 suggests that in contrast, the DHS priority equation values benefits at approximately $10,000 a unit under a cost/benefit method of prioritizing site cleanup.

No particular dollar amount is the analytically "correct" value to place on a unit of cleanup benefit. Ultimately, this is a decision that elected officials must make. We think the net benefit approach offers the Legislature a straight forward way of making this decision and thereby setting priorities for cleaning up hazardous waste sites.

When calculating priorities using the net benefit approach, it is essential that the department use accurate up-to-date data on contaminated sites. Without meaningful data, the process of establishing site prioritization loses much of its value. As noted earlier in this section, the data currently used by the department are neither consistently accurate nor up-to-date.

Based on the analysis presented above, we recommend that the Legislature enact legislation requiring the department to revise its site cleanup priority list based on the net costs and benefits that result from cleaning up a hazardous waste site. We also recommend that this legislation require the department to update a site's priorities whenever new data indicate that the danger posed by the site has changed significantly.

These two recommendations—that the Legislature require more interim cleanup activities and require a change in the way site priorities are determined—would, if approved, shift the program focus toward reducing the public health risk. It would do so as follows:

- ***Emphasize Interim Remedial Actions.*** Instead of limiting its cleanup efforts to a few sites, the toxics program would provide interim remedial actions at many more sites, in order to reduce the threat posed by these sites to public health and the environment. An up-to-date assessment of these threats would provide state officials with the data needed to decide what action is appropriate based on the cost of interim and permanent action and the extent to which interim remedies reduce the danger to public health and the environment. In addition, the assessment would generate the quality information needed for determining each site's priority.

- ***Revise the Way Priorities for Site Cleanup Are Determined.*** Under our recommended system, site priorities would be recalculated after interim measures were applied at a site so that the priority list accurately reflected the current danger posed by each site. If interim measures were applied at many sites, the priorities list would be composed of smaller sites (where interim action was not cost-effective) and larger, more complicated sites (where groundwater contamination constitutes the principal remaining threat). The net benefits of cleaning up sites would determine cleanup order and achieve a reasonable balance between costs and benefits.

Adoption of our recommendations would signal a significant departure from current DHS operations. For this reason, we further recommend that legislation permit the department to maintain its current efforts to clean up the 17 sites where remedial action is imminent. To curtail action on these sites would needlessly sacrifice a significant amount of the resources already expended by the department. In addition, the department will gain valuable information on (1) cleanup methods, (2) the use of zone contracts and task orders, and (3) recovery of cleanup costs from responsible parties. These lessons will be useful in planning future cleanup measures.

## TRANSPORTATION PROGRAMMING

### *What Can Be Done to Make the State Transportation Improvement Program More Effective?*

Chapter 1106, Statutes of 1977 (AB 402), requires the California Transportation Commission (CTC) to adopt and submit annually, to the Legislature and the Governor, a five-year State Transportation Improvement Program (STIP).

#### The State Transportation Improvement Program (STIP)

The STIP is the basic plan for all state- and federally-funded transportation projects in California, including improvements in the state highway system, state-operated toll bridges, mass transportation, and aeronautics programs. The STIP provides:

- An annual and five-year estimate of all state and federal funds *reasonably* expected to be available for transportation purposes, and any associated funding constraints.

- A schedule of all major projects to be funded from state transportation funds in each of the five years covered by the plan.
- An estimate of the amount of funds to be allocated by the commission during the five-year period.
- An estimate of the residual amount that will be needed for any highway projects which will not be completed within the five-year period, by funding source, as well as the project's completion date.
- A summary of expenditures for minor projects to be funded through allocations by the commission during the period.

***Annual Planning Process.*** Each year the commission establishes guidelines for the Department of Transportation to use in preparing the STIP for the following year. Regional transportation improvement programs also are submitted to the commission. After considering the existing STIP, the proposed state program submitted by the department, and the regional improvement programs, the commission adopts a new five-year STIP.

### The STIP Has Serious Deficiencies Which the Legislature Should Address

The STIP has provided a structured process for planning, funding and implementing transportation projects and programs. Nevertheless, it has serious deficiencies which must be corrected if the process is to be made more effective. The specific problems with the current STIP process include:

- A predisposition toward overprogramming of transportation projects;
- A tendency to generate unrealistic expectations regarding the completion of projects;
- An inability to effectively use the STIP for budgeting and control purposes.

### The STIP Is Overprogrammed

The Department of Transportation annually prepares a "Fund Estimate," using a methodology adopted by the CTC. Most of the assumptions on which the estimate is based are presented by the department to the commission and discussed at various commission meetings.

The Fund Estimate provides the basis for programming and scheduling individual capital outlay projects for construction and funding during the five-year period. It shows (1) the projected amount of federal highway funds available, (2) the anticipated level of state transportation revenues from various sources, (3) projected levels of support expenditures (including expenditures on capital outlay design, highway maintenance and operations, local assistance, and administration of state agencies), (4) the amount committed for capital outlay expenditures in previous STIPs, and (5) any remaining resources that will be available for programming and funding additional projects during the five-year period.

In the past, the Fund Estimate has assumed that California will receive the *maximum* amount of federal funds apportioned to the state, including both future apportionments and past unexpended apportionments. Beginning with the 1986 STIP, however, the Fund Estimate will include only future apportionments.

***Optimistic Projections Result in Overprogramming.*** By projecting the maximum amount of federal funds that the state could receive, the Fund Estimate encourages the commission to include in the STIP an overly optimistic schedule of capital expenditures. In fact, about 20 percent of the projects programmed in past STIPs could not be funded within the five-year period. Thus, the STIP is more of a *six*-year plan masquerading as a five-year plan.

The 1984 and 1985 STIPs provide a good illustration of the problem. In each of these years, the amount of federal funds which the state is authorized to expend (known as obligational authority) has been significantly *less* than the amount called for by the apportionment formula. In 1984–85, for example, California initially received about 93 percent of its apportionment. Subsequently, the state received an additional 5 percent in discretionary funds, bringing the total to 98 percent of the apportionment level. For 1985–86, the state's obligational authority is expected to be approximately 83 percent of the apportionment level, and the actual amount could be even lower if the federal Gramm-Rudman-Hollings Budget Amendment is implemented. Thus, the state's authority to expend federal dollars is certain to be far below the statutory apportionment level.

Our review finds that the 1986 STIP Fund Estimate also uses unrealistic estimates of federal funds for the five-year period covered by the plan. This will result in a 1986 STIP which, in all probability, will not be fully funded. (Please see Item 2660 of the *Analysis.*)

Table 61 shows what happens to project funding when federal obligational authority falls below the level assumed in the STIP. We estimate that, under a best-case scenario, about $176.3 million of highway projects would not be funded in the current year as a result of the shortfall. Similarly, if the state gets 90 percent of its statutory apportionment (about $1 billion) in 1986–87, the STIP would be overprogrammed by approximately $102 million, including about $89 million for state projects and $13 million for local projects. Over a five-year period, this mismatch could leave the STIP overprogrammed in terms of state projects by $500 million. If the obligational level declines to 80 percent of the statutory apportionment for the five-year period, the amount of overprogramming would be twice that amount, or $1 billion.

**Table 61**
**Impact of Obligational Authority Shortfalls on Highway Projects and Activities**
**1984–85 through 1986–87**
**(dollars in millions)**

| | *Apportionment*[a] | *Estimated Obligational Authority (OA)* | *Unfunded Amounts* |
|---|---|---|---|
| 1984–85 (actual) | $968 | $944.2 | $23.8 |
| 1985–86 | 1,037 | 860.7 | 176.3 |
| 1986–87 | 1,019 | | |
| 90% OA | | 917.1 | 101.9 |
| 80% OA | | 815.2 | 203.8 |

[a] Includes only fund categories subject to obligational authority limits.

In sum, by basing the Fund Estimate on formula-based apportionments, rather than on the amounts which the state will be authorized to spend, the commission builds into the STIP a significant number of projects which realistically cannot be funded.

**The STIP Generates Unrealistic Expectations**

Typically, the STIP programs approximately 2,000 projects, with an average of 400 projects per year. Projects are programmed by various categories of funds, such as interstate completion, interstate rehabilitation, and primary systems, with the date projects are to be advertised for construction shown for each. Not surprisingly, the adopted STIP tends to be viewed by the Legislature and local agencies as a *commitment* on the CTC's part to fund and implement specified projects. Such a view, however, is not realistic given the inherent overprogramming of the STIP. There simply is not sufficient money to fund all projects within the STIP's time frame.

For example, the realization that federal funding would be much lower than anticipated during the 1985 STIP period led the commission to defer about $650 million in projects *beyond* the five-year 1985 STIP period and about $1.2 billion in projects *within* the period. When this happens, the usefulness of the document for project identification, scheduling and delivery is diminished.

The problem of unmet expectations is compounded further by the fact that there is no mechanism for determining which projects to defer when a funding shortfall materializes. STIP projects are not ranked and funded in priority order. Instead, funds are allocated to projects as projects become ready to be advertised for bid. Project readiness, however, may not reflect relative priority. Consequently, when projects must be deferred because the STIP is overprogrammed, there is no guarantee that the highest priority projects will be the ones to proceed.

**The STIP Cannot Be Effectively Used For Budgeting Purposes**

Our review finds that the STIP is not useful for budgeting and control purposes, for the following reasons:

1. ***Capital Outlay Expenditures in the Budget Are Exaggerated.*** The STIP is supposed to provide the basis on which the Department of Transportation formulates its annual *capital outlay* budget request. Thus, when the STIP is overprogrammed, the department's capital outlay request is overbudgeted.

2. ***Realistic Staffing Level Cannot Be Identified.*** The department budgets its *support* staff for project design and development at the level needed to "deliver" the STIP. Because STIP funding levels are overstated, the staffing level requested in the budget is larger than what is needed to get *fundable* projects ready for advertising and construction.

Given the complexity of transportation project scheduling, the department needs some staffing flexibility to ensure that "shelf" projects can be brought to bid in the event additional funding becomes available. The current STIP display and methodology, however, does not permit the Legislature to identify the amount of staff resources available to work on these projects in a given year. As a result, the Legislature does not have the information it needs to review the staffing level proposed for the department.

3. ***Monitoring and Evaluation of Project Delivery Are Difficult.*** The department indicates that, in any one year, bids are advertised and awarded for approximately 80 percent of the projects scheduled in the STIP for that year. This means that about 20 percent of the scheduled projects are not delivered as planned. This, coupled with the fact that a large number of projects will not be funded due to overprogramming, makes it very difficult for the Legislature to monitor and evaluate the department's effectiveness in delivering projects. This is further complicated by the fact that project scopes and costs are constantly being changed and revised.

Monitoring the performance of the department and the commission is also difficult because the STIP does not contain information on either current-year activities or past-year accomplishments. The commission reports on past and current fund allocations for projects separately, in its annual report to the Legislature. Consequently, the Legislature is not able to monitor the cost and status of projects in individual STIPs without going through a difficult and time consuming process.

4. ***Program Performance Is Measured by Dollars Expended—Not Projects Delivered.*** Unlike most other state agencies which are required to itemize projects in the Budget Bill, the Department of Transportation requests and receives capital outlay appropriations in a lump sum. The appropriations are then used to fund the projects subsequently adopted in the STIP. The department, however, does not measure its perform-

ance in terms of whether it has advertised specific projects for construction on schedule, as set forth in the STIP. Instead, the department measures its capital outlay performance by the dollar amount of construction contracted for in a given year.

**The STIP Can Be Made More Effective**

***We recommend that the Legislature enact legislation to enhance the effectiveness of the STIP process and document by:***

1. ***Establishing more explicit guidelines for adoption of a reasonable Fund Estimate.***
2. ***Requiring the STIP and Fund Estimate documents to include a list of all major assumptions used in fund projections.***
3. ***Requiring the commission to adopt a STIP which reflects separately: (a) the group of projects for which the state will be able to obligate federal dollars, and (b) additional "shelf" projects which could be undertaken if more optimistic funding projections hold true.***
4. ***Requiring the STIP to include comparative information on (a) past year project accomplishments—actual costs, delivery dates, and explanations of delivery schedule variances, and (b) current-year activities information.***
5. ***Requiring the department to submit to the commission quarterly progress reports on the delivery of the STIP, including major changes from adopted STIP delivery schedules.***

Our review indicates that the STIP process is a useful means for establishing the state's transportation program. We believe, however, that the STIP should be modified in order to correct the deficiencies noted above and enhance its effectiveness as a program, budget, and fund allocation document.

Since the STIP Fund Estimate defines the size of the state's transportation programs, it is paramount that the annual Fund Estimate be as accurate as possible. Given the commission's track record to date, it is clear that the approach it is using to prepare the estimate is inadequate. Accordingly, we recommend that the Legislature enact legislation setting forth general guidelines for the CTC to use in adopting the STIP Fund Estimate. In addition, we recommend that all of the major assumptions on which the Fund Estimate is based be spelled out in the Fund Estimate and STIP document.

In the past, we have discussed the pros and cons of overprogramming projects for delivery in the STIP (please see Item 2660, *Analysis of the 1984–85 Budget Bill,* pages 404–406). We believe it is possible to avoid the adverse consequences that inevitably result from an overprogrammed STIP without having to give up the flexibility needed in the event that unanticipated funds become available. Accordingly, we recommend that the Legislature enact legislation directing the CTC to revise the STIP document in order to program two groups of projects: (1) projects which can be delivered within the limits of obligational authority, and (2) "shelf" projects which are of lower priority, and would be funded if additional funds become available. The department would be authorized to pursue project development and design work for these latter projects in order to provide for program flexibility.

In our view, differentiating projects in this way would assist in establishing project priorities, and produce a STIP which states more realistically the magnitude of capital projects that can be constructed during the five-year period. In addition, when the department requests capital outlay support staff to deliver STIP projects, the Legislature could better evaluate what is needed to deliver those projects which can be financed within the obligational authority, and what amount of staff is needed to produce "shelf" projects.

In our judgment, it also is possible to make the STIP document more useful in monitoring and evaluating the department's effectiveness in delivering projects, and managing the expenditure of capital outlay dollars. This can be done by requiring the commission to include in the STIP not only information on what is proposed to be achieved, but also what has been accomplished in the recent past. Thus, we recommend that the commission be required to include in the STIP a progress report on projects scheduled for delivery in the past and current year, as well as a reconciliation of what has actually been achieved.

Finally, we recommend that the Legislature require the department to submit quarterly progress reports to the commission on the delivery of projects, including any major variances from adopted STIP delivery schedules. This would provide an early warning to the commission of potential delays in project delivery, and their causes.

## THE INCREASING COSTS OF TORT LIABILITY

### *What Can the Legislature Do to Curb the Rising Cost of Tort Liability?*

In recent years, state and local government officials have expressed great concern over the rising cost of tort liability claims and the dramatic increases in the cost of tort liability insurance policies. These concerns are voiced by many others as well, including operators of day-care centers, small businesses, and private education agencies.

In this section, we review the information that is available on the magnitude of the problem in the public sector. We also try to identify some of the factors that account for the upward trend in the cost of tort liability claims and insurance. Finally, we discuss some of the alternatives that are available to the Legislature for curbing the rise in tort liability costs to the state and local governments.

**Are Tort Liability Costs Increasing?**

Our analysis of the available data on claims and insurance premiums confirms what the conventional wisdom holds: tort liability costs to both the state and local governments have increased sharply in recent years.

It is difficult to measure the magnitude of the increase on a statewide basis because governments pay for these costs in different ways. Some buy insurance, some self-insure, and others rely on a combination of self-insurance and commercial insurance policies. The costs incurred by a self-insured agency cannot be compared easily with the costs borne by an agency that relies on commercial insurance for the payment of claims. Despite the absence of comprehensive and consistent data, however, it is clear that the tort liability component of state and local government budgets is rising rapidly.

***Increases in Tort Claims Paid by the State.*** The Board of Control is the primary agency responsible for managing tort claims against the state. It refers claims dealing with the Department of Transportation—about one-half of all claims—to the department for investigation and litigation. All other claims are referred to the Attorney General. In addition, the Department of General Services administers the state's Motor Vehicle Liability Self-Insurance Program.

Since 1978, the state has maintained a policy of self-insurance for tort claims.

A review of tort liability claims against the state reveals that the amount paid for claims over the last five years has more than doubled. As Table 62 shows, claims payments increased from $11.7 million in 1980–81 to $25.7

**Table 62**
**State of California**
**Tort Liability Claims Paid [a]**
**1980–81 through 1984–85**
**(dollars in thousands)**

| | *1980–81* | *1981–82* | *1982–83* | *1983–84* | *1984–85* |
|---|---|---|---|---|---|
| Department of Justice [b] | $2,802 | $2,188 | $1,293 | $4,931 | $5,521 |
| Department of Transportation | 6,869 | 7,127 | 5,685 | 7,223 | 15,701 |
| Department of General Services | 2,038 | 2,775 | 3,120 | 5,920 | 4,463 |
| Totals | $11,709 | $12,090 | $10,098 | $18,074 | $25,685 |
| Change from prior year: | | | | | |
| Amount | $3,208 | $381 | –$1,992 | $7,976 | $7,611 |
| Percent | 38% | 3% | –16% | 79% | 42% |
| Average annual increase over the five-year period | | | | | 21.7% |

[a] Based on the Governor's Budget, adjusted to include amounts appropriated in the annual claims bills.
[b] Includes amounts paid from appropriations in the Budget Acts, annual claims bills, and other special legislation.

million in 1984–85. The largest increases occured in 1983–84 (79 percent) and in 1984–85 (42 percent). Thus, during this two-year period, tort liability claims paid by the state rose at an average annual rate of nearly 60 percent!

Table 62 also shows that the amount of total claims payments can fluctuate from year-to-year. The Department of Transportation advises that these fluctuations tend to reflect the timing of a few unusually large claims.

***Increases in Insurance Premiums Paid by Local Governments.*** Comprehensive data on claims paid by local governments is not readily available. This is because in the past, most local governments have relied heavily on insurance companies to pay their claims. There is, however, enough data available to confirm that insurance *premiums* have increased dramatically in the last year.

- The County Supervisors Association of California (CSAC) advises that the total cost of insurance premiums to 47 California counties *increased by 186 percent* during the past year—from $6,278,000 in 1984–85 to $17,943,000 in 1985–86. This increase, however, greatly *understates* the rise in the cost of insurance. This is because $17.9 million in 1985–86 bought considerably less insurance than $6.3 million bought in 1984–85. The data provided by CSAC shows that the 47 counties covered by its survey saw their insurance coverage fall by 35 percent and their deductibles (the dollar amounts below which the counties must pay the cost of tort claims) increased by 62 percent. Thus, counties are paying significantly more for significantly less insurance coverage, at the same time their out-of-pocket costs for uninsured claims (that is, claims subject to deductibles as well as claims which exceed the policy limits) are increasing.
- The League of California Cities provided information on 12 insurance contracts covering 46 cities which shows that between 1984 and 1985, the average premium *increased by 248 percent.*
- The Southern California Rapid Transit District advises that during 1985–86, the costs of its insurance *increased by 4,600 percent!* In 1982–83, the transit district purchased a three-year policy providing $28.5 million of insurance coverage with a $1.5 million deductible, at an average annual cost of $67,000. The current policy provides slightly less coverage ($26 million) and a higher deductible ($4 million), at a cost of $3.2 million in 1985–86.

**What Are the Reasons for the Increase?**

There are many theories about why tort liability costs have risen so dramatically in recent years. While most observers agree that several factors have played some role in pushing up these costs, there is no consensus on the *relative* importance of these factors. Among the reasons most frequently cited as contributors to the recent rise in tort liability costs are the following:

1. ***Insurance Companies Have Raised Rates and Reduced Coverage to Compensate for Price-Cutting in Prior Years.*** One of the most commonly cited explanations for the recent trend is that when interest rates were high in the late 1970s and early 1980s, insurance companies engaged in competitive rate-cutting to attract clients. This enabled them to earn higher investment income from the additional premiums. According to a representative of a major insurance brokerage firm, when the prime rate was at 21 percent, in the early 1980s, a casualty insurance company could just about double its original investment before the company would ever be required to pay claims.

When interest rates and the return on investments dropped, however, investment income could no longer cover the difference between the claims paid and the premiums charged. This led insurance companies to, in effect, concentrate the premium increases for a number of years into just one or two years, thereby accounting for the sharp increase in insurance rates.

2. ***Government's "Deep Pockets" Lead to Larger Claims and Awards.*** The rule of joint and several liability is another frequently cited cause of the dramatic increase in state and local government costs for tort damages. Under this rule (which was established by the courts themselves, rather than by the Legislature and the Governor), defendants are *jointly* liable for fully compensating a plaintiff for damages awarded by the court. Thus, if one of the responsible parties cannot pay his or her share of the award, the other parties will be held responsible for paying it. Thus, a governmental entity responsible for only 1 percent of the loss to the plaintiff may have to pay 100 percent of the damages awarded by the court.

This arrangement is sometimes called the "deep-pocket" rule because the party with the most money, or "the deepest pocket," often has to pay more than his or her share.

Since "government" is rarely in a position where it cannot pay its full share of the award, and generally is regarded as having the "deepest pockets," the rule of joint and several liability is a costly rule from government's standpoint. The rule works to government's fiscal disadvantage in two ways. First, it often causes government to pay more than its share of fault would warrant. Second, the rule undoubtedly encourages plaintiffs to sue government entities in order to make their "deep-pockets" subject to an award.

The Attorney General's office has provided us with examples of major tort settlements and verdicts against the state covering the last three years (1983 through 1985). These settlements are summarized in Table 63. The table compares the state's share of damages in each case with the state's share of liability, as estimated by the Attorney General's office. It shows that in 15 cases, the state was responsible for *all* of the damages even though its share of fault was 30 percent or less. The most striking example of the "deep pocket" rule at work is the 1983 Clemente claim. In this case, *the state was held responsible for all of the damages—$3.1 million—even though its estimated degree of fault was only 1 percent.*

(The Attorney General's office advises that the state's liability, as shown in Table 63, reflects its best estimate. The office suggests that the plaintiffs' counsel probably would put the state's liability at a higher percentage.)

Another example of this trend is provided by the results from a February 1985 survey conducted by the League of California Cities. This survey requested data from cities covering only those cases where the cities believed they had little or no liability. Slightly more than one-third of the cities in the state (162 cities) reported paying deep-pocket claims of $5.1 million in 1981–82, $18.2 million in 1982–83, and $19.1 million in 1983–84.

**Table 63**
**Major Tort Settlements and Verdicts Against the State**
**State's Share of Damage Payments Versus the State's Share of Liability [a]**
**1983 through 1985**

| | *Verdict or Settlement Amount* | *State Share of Damages Amount* | *State Share of Damages Percent* | *Estimated State Liability Percent* |
|---|---|---|---|---|
| *1983* | | | | |
| 1. Carvello v. Kazabos | $100,000 | $100,000 | 100% | 10% |
| 2. Coca v. State | 4,000,000 | 2,250,000 | 56 | 56 |
| 3. Perez v. State | 175,000 | 175,000 | 100 | 25 |
| 4. Clemente v. State | 3,100,000 | 3,100,000 | 100 | 1 |
| 5. Tryk v. Earll | 140,000 | 140,000 | 100 | 5–10 |
| 6. Pettijohn v. State | 265,000 | 265,000 | 100 | 20 |
| 7. Crabtree v. State | 75,000 | 25,000 | 33 | 1 |
| 8. Chavez v. State | 50,000 | 50,000 | 100 | 20 |
| 9. Tillman v. Mt. Baldy | 35,000 | 35,000 | 100 | 20 |
| 10. Robinson v. State | 400,000 | 49,950 | 12 | 20 |
| *1984* | | | | |
| 1. Chang v. State | $47,500 | $47,500 | 100% | 25% |
| 2. Silvera v. State | 45,000 | 45,000 | 100 | 20 |
| 3. Swafford v. State | 50,000 | 50,000 | 100 | 10 |
| 4. Rhodes v. State | 415,000 | 415,000 | 100 | 20 |
| 5. Talbert v. State | 475,000 | 50,000 | 11 | 10 |
| 6. Thomsen v. Messer | 350,000 | 200,000 | 57 | 40 |
| 7. Solis v. Yen | 198,000 | 110,000 | 56 | 55 |
| 8. Yi v. State | 725,000 | 725,000 | 100 | 20 |
| *1985* | | | | |
| 1. Mulligan v. State | $150,000 | $150,000 | 100% | 20% |
| 2. Reich v. State | 165,000 | 100,000 | 61 | 20 |
| 3. Killacken v. State | 85,000 | 35,000 | 41 | 33 |
| 4. Davidson v. State | 292,500 | 70,000 | 24 | 20 |
| 5. Campos v. State | 70,000 | 70,000 | 100 | 30 |
| 6. Matilla v. Monterey | 135,000 | 45,000 | 33 | 33 |
| 7. Smith v. State | 30,000 | 30,000 | 100 | 20 |

[a] Source: Attorney General's office

3. ***Government is Becoming More Vulnerable to Lawsuits.*** Current law provides government with general immunity from liability for damages unless liability is specifically provided for by statute. Another general rule, however, provides that government is liable for injuries caused when it does not perform duties that it is required to perform. Some claim that the immunity of public entities is rapidly being eroded because the courts, through the decisions they hand down, are imposing additional duties on government and, therefore, increasing government's exposure to liability for damages.

One example of how government is becoming more vulnerable to lawsuits is provided by the court's decision in a case involving the California Highway Patrol (CHP). Existing law specifically exempts public entities from liability for failure to provide police protection and imposes no obligation on law enforcement officers to control the conduct of others or to warn those who might be harmed by it. Nevertheless, the court has ruled that once a CHP officer chooses to investigate an incident involving motorists stranded on a freeway, he or she has created a special relationship with those persons and has a special duty to protect them from the actions of others.

In this case (which was decided in 1977), the court implied that the traffic officer's "legal duties" could include instructing motorists to get in their vehicles and avoid standing between the stalled cars, providing protective flares, using a rearward-facing flashing light, or positioning the patrol car behind the stranded car as a protective device. The court held that the officer (and his or her employer—in this case, the state) may be liable if this duty to protect the individuals is not performed.

In another, more-recent case, the court decided that the Los Angeles Police Department had a special duty to care for a shopkeeper after it promised the shopkeeper increased protection. As a result, the court found the city liable for damages to the shopkeeper when he was subsequently robbed and injured. (The case has been returned to the trial court to determine how much the city will be required to pay.) City officials believe that this decision by the court erodes the city's immunity under the law, and will serve to encourage the filing of additional lawsuits against governments.

Obviously, court decisions such as these directly increase tort liability costs to self-insured government entities. They indirectly increase costs to all other governments since government's expanded vulnerability to lawsuits is reflected in the insurance premiums that each entity must pay. Furthermore, as insurers find it increasingly difficult to predict what the courts will hold to be a duty of government, they become more and more reluctant to assume the risks of insuring government.

**Various Proposals for Curbing Tort Liability Costs**

Many alternatives have been proposed for relieving the financial burden that rising tort liability costs have placed on the state and local governments. These proposals are as different from one another as are the explanations for what is *the* primary cause of the tort liability cost increases.

***State Review of Insurance Premiums.*** Under this approach, all private insurers selling tort insurance in California would be required to seek and justify proposed rate increases before a state agency, such as the Department of Insurance—much as a regulated private utility must do. This alternative is premised on the belief that insurance premiums are higher than the insurers' actuarial experience would warrant.

There are, however, fundamental differences between utilities and insurance firms:

- Utilities usually have a legal monopoly over the provision of an essential service; insurance companies do not.
- Insurance firms are much more mobile than utilities, and could refuse to sell insurance in California under these conditions if they are not able to charge satisfactory (from their standpoint) rates. By contrast, most of a utility's assets are fixed in California, making these firms much more susceptible to state regulation.
- Public utility rates are predicated on a rate of return for each company that may be calculated based on known revenues and costs. It would be difficult, however, for a state agency to judge the reasonableness of proposed insurance rate increases, due to varying opinions on the reserves necessary to cover future claims.

***State Pool for Local Governments.*** Under this approach, the state would create and operate an insurance program which would allow local governments to obtain private insurance on better terms by spreading risks. This approach would offer the most benefit to the small jurisdiction which is at a competitive disadvantage in dealing with insurance firms. Its viability would depend upon whether most local governments would become members of the pool—thereby sharing risks and costs. It is likely, however, that the members of the pool (be they many or few) would exert strong pressures on the state to subsidize costs, in order to keep premiums within the "affordability range."

***Modify Joint and Several Liability Doctrine.*** A number of states have attempted to address the growth in tort liability costs by abolishing the joint and several liability, or so called "deep-pocket", rule. Proponents of this approach argue that the most simple and equitable way to allocate the responsibility for paying damages among several parties is to base each defendant's share of damages on the defendant's share of negligence or fault.

There are a number of ways to modify the joint and several rule which would *reduce,* rather than eliminate, the liability of "deep-pocket" defendants, such as the state and local governments, for damages exceeding their share of fault. For example, the state could impose a *fault threshold,* so that defendants whose fault was minor (such as the state's in the Clemente case mentioned earlier) would be treated differently than those defendants that are primarily responsible for the damages.

Alternatively, the Legislature could place a *limit on the amount or type of damages* that defendants must pay. Such an approach has already been taken with respect to medical malpractice liability, where the Legislature placed a statutory cap on the amount that doctors are required to pay for certain types of damages. A similar cap could be established for tort claims generally.

The fiscal impact of the different alternatives for modifying the joint and several rule would depend, of course, on the specific change made to the rule. The greatest savings to state and local governments would be achieved if the joint and several rule were eliminated entirely. This would also yield savings to "deep-pocket" *private* entities. More-limited proposals to reduce or restrict the "deep-pocket" rule would result in less, but still significant, savings to both public and private defendants.

***Reduce Governments' Liability.*** The tort liability of governments could be clarified—and perhaps restricted—by enacting new laws which specify those activities which expose government to a tort claim. For instance, the Legislature could clarify the duties and responsibilities of police officers. The Legislature also could strengthen existing governmental immunities in such areas as highway and building design.

### The Legislature's Alternatives

There is a vast array of actions that the Legislature could take to curb the rising cost of tort liability to the state and local governments. Those described above are merely illustrative of the options that exist. It is clear, however, that there is no simple or immediate solution to this multidimensional problem. Implementation of changes to reduce government's liability exposure are more likely to yield savings over the long term rather than to have an immediate impact on today's costs.

The Legislature may wish to consider a combination of approaches which address both the short-term problem of local governments that cannot afford insurance coverage and the more fundamental problem of government vulnerability to tort claims. The latter problem almost surely will require some modification to the many statutes and court rulings that affect the degree to which the state and local governments are held liable for tort damages.

## *Is the State Taking Full Advantage of the Opportunities Now Available to Apply Telecommunications Technology to Its Program Operations?*

### Background

Since the divestiture of the American Telephone and Telegraph Corporation (AT&T) in January 1984, the Legislature has spent considerable time evaluating and addressing the state's "telecommunications" needs. Although defined in different ways, "telecommunications" generally refers to the transmission of voice, data, and video images between locations through the use of electronic switching systems (such as the one used to place a local telephone call).

The popular perception of telecommunications seems to focus on the process of carrying voices from one place to another through the use of a telephone system. While state agencies have significant voice transmission needs, these entities also rely to a great extent on the transmission of *data* between facilities as part of operating their programs. Moreover, it soon may become both feasible and cost-effective for state agencies to use systems which transmit *video images* for the purpose of conducting long-distance meetings and interviews.

The Legislature's efforts to assess the extent to which the state is taking full advantage of available telecommunications goods and services are timely, for several reasons:

- First, since the AT&T divestiture, the state has assumed management responsibilities formerly handled by regulated telecommunications companies;
- Second, technological progress in the telecommunications industry continues to provide the state with a broad range of goods and services for use in the operation of state programs;
- Third, telecommunications activities are a major expense item in most state agency budgets;
- Finally, telecommunications goods and services offer the state many opportunities to reduce program costs and improve the delivery of public services.

### The State's Telecommunications Network

Currently, the state is the *largest* consumer of telecommunications goods and services in California, and it is among the five largest *public* telecommunications consumers nationwide. Table 64 provides a summary of the estimated annual costs of certain elements of the state's telecommunications network. It shows that state telecommunications costs are projected to be almost $54 million in 1986–87, which is $2.4 million less than estimated current-year expenditures. This reduction reflects the expectation that ongoing telephone lease expenses will decline in 1986–87 as more telephone equipment is purchased by state agencies.

**Table 64**
**State Telecommunications Network**
**Summary of Annual Costs**
**1984–85 through 1986–87**
**(dollars in thousands)**

| *Network Element* | *Actual 1984–85* | *Estimated 1985–86* | *Projected 1986–87* | *Change From 1985–86* | |
|---|---|---|---|---|---|
| | | | | *Amount* | *Percent* |
| Telephone systems | $19,693 | $16,906 | $12,745 | –$4,161 | –24.6% |
| Local exchange switches: | | | | | |
| Centrex lines | 18,500 | 19,400 | 20,300 | 900 | 4.6 |
| Long-distance services: | | | | | |
| ATSS lines | 19,200 | 20,000 | 20,900 | 900 | 4.5 |
| Totals | $57,393 | $56,306 | $53,945 | –$2,361 | –4.2% |

Source: Department of General Services, Telecommunications Division

The amounts shown in Table 64, however, greatly *underestimate* the actual costs incurred by the state for telecommunications goods and services. This is because the staff of the Telecommunications Division (TD) in the Department of General Services (DGS) lacks complete information about the telecommunications resources used by state agencies. For example, the table reflects only the ongoing costs of leasing telephone equipment and using dedicated local and long-distance transmission lines for voice transmissions. The TD staff does not know, and thus has not reported, the cost of purchasing and maintaining various telephone equipment, the expenses incurred for calls not routed on the dedicated transmission lines, and the cost of transmitting data between state facilities. According to the TD staff, total annual state telecommunications costs may, in fact, be *double* what is being reported.

Table 65 provides a selected inventory of the major elements in the state's telecommunications network for the three-year period ending in 1986–87. The table indicates that, at the end of 1984–85, the state owned only about 65,000, or 27 percent, of its telephones. As of January 1986, the TD estimated that the state owned about 30 percent of its telephones, and that this percentage would increase to 48 percent and 65 percent by the end of the current and budget years, respectively.

The table also indicates that the state relies almost entirely on leased "Centrex" lines, rather than on private branch exchanges (essentially, in-house computerized "switchboards"), for its local telephone services. These Centrex services: (1) allow state personnel in the same general area to make calls by dialing five, rather than seven, numbers, and (2) provide state agencies with local calling services at lower rates than what other "businesses" are usually charged.

**Table 65**
**State Telecommunications Network**
**Selected Inventory**
**1984–85 through 1986–87**

| *Network Element* | *Actual 1984–85* | *Estimated 1985–86* | *Projected 1986–87* |
|---|---|---|---|
| Equipment: | | | |
| Leased telephones | 172,500 | 124,060 | 104,300 |
| Owned telephones | 64,872 | 116,612 | 191,612 |
| Percent owned | 27.3% | 48.5% | 64.8% |
| Local exchange switches: | | | |
| Centrex lines (leased) | 110,058 | 115,319 | 120,831 |
| Private branch exchanges (owned) | 66 | 75 | 86 |
| Long-distance services: | | | |
| ATSS lines (leased) | 5,739 | 5,989 | 6,249 |

Source: Department of General Services, Telecommunications Division

### The State's Telecommunications "Control" Agencies

In Management Memorandum 84-24, the administration designated the Telecommunications Division as the *lead* agency for the "overall management of telecommunications and telecommunications planning within state government." The TD currently has a six-person policy and planning unit which is responsible for: (1) developing short-range and long-range telecommunications plans, (2) keeping abreast of developments in the telecommunications industry, and (3) monitoring regulatory and legislative proceedings on behalf of the state.

The Office of Information Technology (OIT) in the Department of Finance is responsible for assisting the TD in the development of state telecommunications policy. The office carries out this responsibility with a two-person telecommunications unit, which also reviews state agency telecommunications projects involving the use of information technology (primarily computers).

In contrast, several state agencies currently manage their telecommunications networks *without* being subject to the jurisdiction of these two agencies. These entities include:

- The University of California, which is authorized by existing law to conduct all of its procurement, contracting, and network management activities independently;
- The California State University, which has authority (until January 1, 1987) to manage its telecommunications network independently; and
- The California State Lottery Commission, which also is independent of the control agencies, and which currently is planning the operation of a statewide network linking up to 12,000 lottery terminals to several mainframe computers.

### The State's Current Telecommunications Performance

Our assessment of the state's general performance in managing its telecommunications activities reveals that there are both areas of accomplishment and areas in which the Legislature should expect more. These are discussed in greater detail below.

#### Areas of Accomplishment

The state appears to be doing a reasonably *good* job of managing its telecommunications activities in two particular areas: (1) arranging for the cost-effective provision of local exchange services on behalf of state agencies, and (2) managing the state's long-distance network.

*Local Exchange Services.* For most state agencies, Centrex services continue to offer the most economical local exchange telephone services. This is because in 1985, the state negotiated a three-year, fixed-rate agreement with the local telephone utilities for the provision of Centrex services to agencies located in the state's metropolitan areas. During the life of that agreement, the TD plans to perform a cost-benefit analysis of the two primary means of obtaining local switching capability: Centrex services and private branch exchanges. This analysis, which would involve contracting for the expertise of a private telecommunications consultant, is expected to be completed in 1986–87.

*Long-Distance Network.* Most of the state's long-distance voice transmissions are carried by the Automatic Telecommunications Switching System (commonly known as ATSS). This system offers the state the greatest volume discounts on calls between local areas in California and on most out-of-state calls. The system also reduces the number of digits that need to be dialed for calls between state facilities located in different local areas. Given the limited number of companies capable of offering economical long-distance transmission services at the level of activity required by the state, it appears that in the short term at least, the use of the ATSS network is prudent.

#### Areas of Concern for the Legislature

***We recommend that the Legislature enact legislation which: (1) designates the Department of General Services as the state's sole telecommunications control agency, and (2) revises the department's telecommunications mission to include an advocacy role.***

***We further recommend that Item 1760-001-666 be augmented by $314,-000 in order to provide the resources needed to double the size of the current telecommunications planning unit in the Department of General Services.***

Our analysis indicates that there are at least four areas in which the state could improve its telecommunications management. These are: (1) the division of authority between the state's telecommunications control agencies, (2) the mission of the control agencies, (3) the level of effort devoted to telecommunications planning activities, and (4) the extent to which the state leases telephone equipment.

***Division of Authority Between the Control Agencies.*** In the *Analysis of the 1985–86 Budget Bill* (please see pages 195–196), we discussed the rather confusing arrangement whereby two agencies are involved in the establishment of the state's telecommunications policies. The administration maintains that its two control agencies—the TD and the Office of Information Technology—have a coordinated approach to telecommunications oversight. It is not clear to us, however, what specific role the OIT currently plays in the overall process of telecommunications planning; nor can we find any basis for concluding that the office should be involved in this process.

We continue to believe that it makes greater sense administratively for a *single* agency to have both overall management authority in telecommunications and operational responsibilities to carry out daily tasks. It appears that the Department of General Services, which is involved extensively with telecommunications vendors, user agencies, regulatory bodies, and state control agencies on a daily basis, is best suited for the responsibility of planning for the state's use of telecommunications goods and services.

Accordingly, we recommend that the Legislature enact legislation designating the DGS as the *sole* entity in state government responsible for the development and implementation of telecommunications plans and policies.

***Mission of the Control Agencies.*** Of all the responsibilities that telecommunications control agencies should be expected to perform, the one which appears to have eluded them is advocating and promoting the application of telecommunications technology to state government operations. Traditionally, the TD has played a *reactive* role with respect to state agency telecommunications needs. In practice, this role generally involves responding to state agency requests for technical assistance in completing a communications project that has been conceived and designed by the agency. The TD expects state agencies to be responsible for proposing conceptual telecommunications solutions to their own management problems.

This passive approach is in part responsible for the dispersed and seemingly uncoordinated efforts throughout state government to pursue innovative ways to improve program operations through telecommunications. For example, we are aware of at least two network projects with great potential that are being explored and developed *without* much involvement from the TD. These projects include: (1) a "telecommuting" pilot program, which would involve state employees working at home through the use of a microcomputer linked by telephone wires to state agency offices, and (2) an electronic mail feasibility study, which would explore the value of allowing state employees in different facilities to communicate electronically with each other by sending data through local telephone lines.

We believe that it makes little sense to rely on individual state agencies to promote the most cost-beneficial use of telecommunications goods and services. This is because: (1) state agencies do not have a specific charge to use telecommunications technology in their operations, and (2) state managers are not always familiar with the ways that telecommunications can solve their management problems.

In order to ensure that state agencies pursue the opportunities available to reduce costs or improve services through the use of telecommunications, we recommend that the Legislature enact legislation revising the DGS' telecommunications mission, so that it includes an *advocacy* role as well as the department's traditional role of serving as a technical resource to state agencies.

***Level of Planning Effort.*** In the *Analysis of the 1985–86 Budget Bill* (please see pages 196–197), we questioned the extent to which the TD could carry out all of its relatively new planning-related responsibilities without additional resources. Currently, the TD has a six-person policy and planning unit, which is supplemented by $620,000 in funds for consultant services. For 1986–87, the budget proposes no change in the unit's level of staffing, nor does the budget include any funds for telecommunications consultants.

We continue to question whether the TD has been allocated sufficient resources for planning-related activities. The current funding level has, in our judgment, made it difficult for the division to: (1) develop a complete statewide inventory of telecommunications equipment, (2) estimate with precision the costs incurred by state agencies for various telecommunications goods and services, and (3) monitor and participate on behalf of the state in legislative and regulatory activities conducted at the state and federal levels. Moreover, our survey of other large public organizations (primarily state governments) suggests that comparatively speaking, the state has *not* allocated sufficient resources for developing telecommunications policies and implementing operational plans.

In order to provide the division with the resources it needs to carry out its responsibilities, we recommend that the TD's policy and planning unit be doubled in size. Accordingly, we recommend that the Legislature augment the DGS budget for 1986–87 by $314,000 from the Service Revolving Fund (Item 1760-001-666), so that the Telecommunications Division can increase its policy and planning unit from six to 12 positions.

***Telephone Equipment Ownership.*** The state currently uses approximately 240,000 telephones. In the *Analysis of the 1985–86 Budget Bill* (please see pages 197–198), we reported that the state was *leasing* about 85 percent of these telephones, despite the fact that the state potentially could save several million dollars annually by purchasing this equipment. This is because telephone purchase costs generally can be recouped within a period of months through the savings in lease payments which otherwise would continue indefinitely.

In response to our recommendation that the DGS expedite the purchase of leased telephones, the Legislature augmented the department's spending authority from the Service Revolving Fund by $4.6 million (1985 Budget Act, Item 1760-001-666), and directed the department to use these funds as needed to provide agencies with *loans* to finance the purchase of telephone equipment.

In this year's *Analysis* (please see Item 1760), we conclude that the state is moving too slowly in terms of *reducing* the number of telephones leased by state agencies. At the time the *Analysis* was prepared (in January 1986), the state owned only *30 percent* of the telephones used by state agencies. In order to realize *major* savings in state communications costs, we believe the DGS must play a *stronger* role in the telephone equipment acquisition process.

To accomplish this objective, we recommend in the *Analysis* that the Legislature direct the department in the Budget Act to unilaterally purchase telephone equipment on behalf of those state agencies which fail to initiate this action themselves. We also recommend that the spending authority of the DGS budget be increased by $5 million in 1986–87, in order to provide the department with the financial resources it may need to conduct a more centralized and expedited telephone purchase program.

## Conclusion

While the state's management of its telecommunications activities appears to be commendable in the areas of local exchange and long-distance transmission services, more needs to be done in other areas. In two of these areas, the role and mission of the state's telecommunications control agencies, we recommend that the Legislature enact legislation which: (1) designates the Department of General Services as the state's sole telecommunications control agency, and (2) revises the department's telecommunications mission to include an advocacy role. In order to increase the department's effort related to telecommunications planning, we further recommend that the department's 1986–87 budget be augmented by $314,000, in order to provide the resources needed to double the size of its existing telecommunications planning unit. With regard to telephone equipment leased by state agencies, we make recommendations in the *Analysis* that, if adopted, would expedite the state's purchase of this equipment.

85—80961

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