Perspectives on the 1990-91 Budget: Expenditures

II

Part II

Perspectives on the 1990-91 Budget: Expenditures

This part provides an overview of historical state spending trends and the spending plan proposed in the *1990-91 Governor's Budget*. It discusses the level of proposed expenditures and the factors which determine this level, the major components of the budget, the priorities reflected in the budget, and the major program changes proposed for 1990-91. It also compares the levels of funding provided for different programs with the amounts that would be required to maintain the current levels of service in those programs.

The major findings of this part include:

- The increase in General Fund expenditures in 1990-91 is restrained to 6.2 percent by: (1) the need to allocate $345 million of the increased revenue anticipated for 1990-91 to fund the *existing* level of state expenditures (because current-year expenditures are expected to exceed current-year revenues), and (2) the proposed allocation of $489 million to the Special Fund for Economic Uncertainties.
- The General Fund cost of maintaining current levels of service, including the restoration of the reserve to the 3-percent-of-expenditures level, would amount to $4.5 billion. Because the amount of General Fund revenue available for spending increases in 1990-91 is projected to be only $2.6 billion, this leaves a *$1.9 billion funding gap.*

- The budget provides $1.5 billion for workload growth, $1.3 billion for K-14 education pursuant to the provisions of Proposition 98, $400 million for cost-of-living adjustments (including salary increases), and $210 million for increased federal requirements. These costs are partially offset by reductions in a variety of program areas.
- The Legislature's options for reducing expenditures through actions taken in the Budget Bill are relatively limited. They exist mostly in the areas of higher education, health, resources and general government. Constitutional funding guarantees place most of K-14 education off limits, while a combination of state laws and federal regulations predetermine the funding levels that must be provided for many welfare programs and Medi-Cal. Thus, significant expenditure reductions would inevitably be dependent upon the enactment of legislation.

Expenditures in 1990-91

HISTORICAL CONTEXT OF BUDGET EXPENDITURES

Figure 1 shows state expenditures for the last 10 years from the General Fund and special funds in both "current dollars" (amounts as they appear in the budget) and "constant dollars" (current dollars adjusted for the effect of inflation since 1981-82). This adjustment relies upon the Gross National Product (GNP) implicit price deflator for state and local purchases of goods and services. The GNP deflator is a good general measure of the price increases faced by state and local governments, and allows us to make comparisons of the "purchasing power" of state resource allocations over time. (Unless otherwise noted, all inflation adjustments in this part have been made using this GNP deflator.)

Figure 1

Total State Spending
Current and Constant Dollars

1981-82 through 1990-91

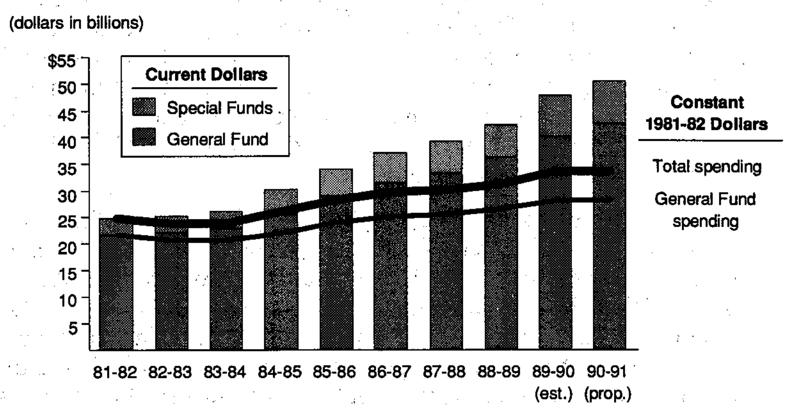


Figure 1 shows that state spending (in current dollars) from all state funds has increased from $24.7 billion in 1981-82 to a proposed level of $50.5 billion in 1990-91. This amounts to an average annual increase of 8.3 percent. Figure 1 also shows that in constant dollars, total state expenditures have grown less rapidly, increasing at an average annual rate of 3.5 percent over the 10-year period.

Over the last 10 years there has been a gradual but steady increase in the share of state expenditures financed by special funds. For example, in 1981-82, special fund expenditures represented approximately 12 percent of total state expenditures. In the 1990-91 proposed budget, however, special fund expenditures represent nearly 16 percent of total spending. This reflects both the relatively higher growth for certain special fund revenues, such as motor vehicle license fees, and the adoption of new user charges and taxes for specific activities, such as hazardous waste site cleanup.

THE 1990-91 BUDGET

This section provides an overview of the spending proposed in the 1990-91 budget. It discusses state spending by program area and identifies the cost pressures faced by the state in building a budget for 1990-91.

State Spending by Program Area

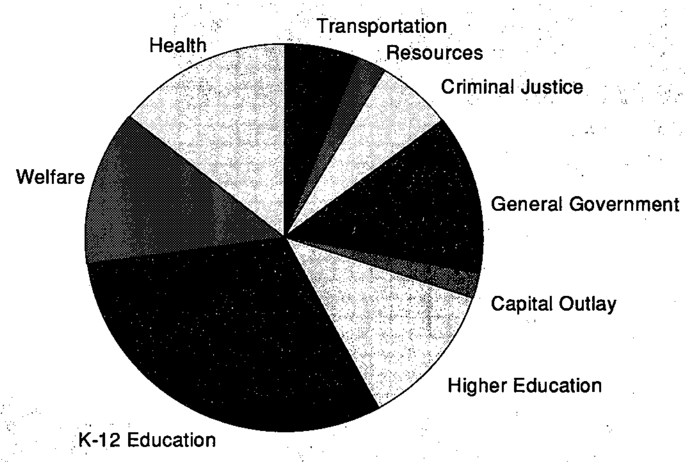
Figure 2 shows the distribution of proposed 1990-91 expenditures from all state funds among different program areas. We have included both General Fund and state special fund expenditures here to provide some perspective on total state spending on different programs. In some program areas (for example, resources), the exclusion of special fund expenditures from discussions of program changes would not permit a meaningful evaluation of funding and policy changes.

The program area groupings used in Figure 2 differ in three ways from the traditional groupings used in the Governor's Budget. Specifically, the criminal justice category includes both the traditional Youth and Adult Corrections category as well as state expenditures for the judicial system, in order to recognize the linkage between these programs. The general government category includes not only most of the programs that traditionally are shown as general government in the Governor's Budget, but also includes all of the administrative functions traditionally included in the Legislative, Judicial, and Executive; State and Consumer Services; and Business, Transportation, and Housing categories. This provides a better perspective as to the costs of running state government. Finally, the capital outlay category

Figure 2

Total State Spending By Major Program

Proposed for 1990-91



includes all of the direct capital outlay expenditures made from the General and special funds, as well as state general obligation bond debt service, payments associated with lease-revenue bonds, and the costs of the school facilities aid program. This treatment allows a consolidated perspective as to the impact on the budget of the state's expenditures for the acquisition of capital assets.

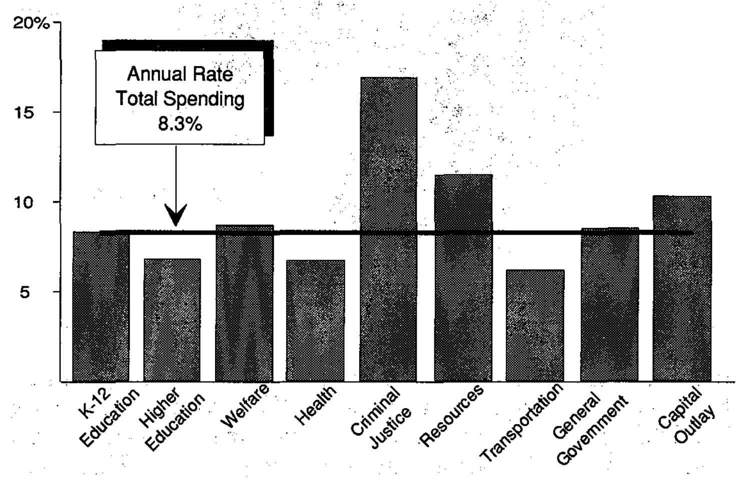
Figure 2 shows that slightly more than 40 percent of all expenditures from state funds is proposed for educational programs, and nearly one-third for health and welfare programs. The remaining expenditures are in the areas of general government (14 percent) criminal justice (6.3 percent), transportation (6.0 percent), resources (2.4 percent) and capital outlay (2.1 percent).

Figure 3 compares the average annual growth rate for each program area during the 1980s with the overall growth in state spending from all state funds. It shows that criminal justice, resources and capital outlay expenditures have grown significantly faster than the budget as a whole. Taken together, these programs represent 11 percent of all state expenditures in 1990-91. Expenditures on K-12 education, welfare, and general government programs, which together make up over 54 percent of the total state budget, have been growing at essentially the same rate as the budget as a whole. Finally, health, transportation and higher education programs have been growing significantly slower than total spending.

Figure 3

Comparison of Annual Average Growth Rates for Major Program Areas

All State Funds
1981-82 through 1990-91



How Are Spending Levels Determined?

The proposed spending levels described above reflect a multitude of decisions made in the preparation of the budget. One of the most significant constraints on spending decisions is the level of revenue available. We estimate that, after accounting for the need to finance the gap between current-year expenditures and revenues and for the budget's proposal to allocate $489 million of the new revenue to increase the state's reserve, there is only about $2.6 billion (equivalent to an increase of 6.7 percent in revenues) available to fund increases in state programs. In addition, given the Department of Finance's estimate that the state has less than $150 million in room under its appropriations limit in 1990-91, the Legislature and the administration have limited flexibility to provide for additional expenditures by proposing revenue increases.

On the expenditure side, most of the proposed spending reflects the "baseline" costs of maintaining existing state programs. Thus, most of the decisions made in the course of the normal budget process are focused on how *additional* resources will be allocated. This year's budget, however, also reflects a number of decisions to reduce baseline expenditures in order to make ends meet.

In distributing these additional resources among individual programs, the Legislature and the Governor must consider a variety of factors. These factors include state and federal requirements which necessitate higher expenditures, as well as policy decisions to maintain, expand or cut back existing levels of state services. While new priorities may be established each year, one way to gain perspective on the budget is to examine what would be required to maintain current service levels in existing programs, comply with existing state and federal requirements for the expansion of certain programs, and restore the state's reserve to the 3-percent-of-expenditures level. We estimate that approximately $4.5 billion in additional resources would be needed for these purposes in 1990-91. Figure 4 summarizes these budget-year funding requirements.

As the amount of General Fund revenues available for new spending in the budget year is estimated to be $2.6 billion, the state is left with a $1.9 billion "funding gap" relative to the amount of resources that would be needed to maintain current service levels.

Figure 4

General Fund Current-Service Level Funding Requirements

1990-91
(dollars in millions)

Program	Amount
Workload changes	$1,700
Proposition 98	1,270
COLAs:	
Statutory	450
Other	580[a]
Special Fund for Economic Uncertainties (SFEU)	330[b]
Increased federal requirements	210
Total	$4,540

[a] Includes funding for salary increase commitments.
[b] Amount required to bring SFEU balance to 3 percent of General Fund expenditures (in addition to amount proposed in the Governor's Budget).

The rest of this section discusses this year's budget from a program-area perspective. For each program area, we discuss historical funding patterns in both current- and constant-dollar terms, describe the Governor's proposal for 1990-91, and identify how the Governor's proposed allocations compare with funding levels that would be required to maintain current service levels. In addition, because the Legislature must begin this year's budget deliberations focused on how to address the $1.9 billion funding gap described above, each program area discussion addresses the question of how much flexibility the Legislature has to reduce state costs through the Budget Act.

K-12 Education

Funding for K-12 education represents 36 percent of General Fund expenditures proposed in 1990-91 and 30 percent of proposed expenditures from *all* state funds. Figure 5 shows spending trends over the last nine years and as proposed in the budget. The average annual increase in General Fund spending for K-12 education over this period is 8.4 percent, or slightly higher than the rate of increase in *total* General Fund spending (7.8 percent). The figure also shows that General Fund expenditures for K-12 education have been relatively stable, ranging from a low of 34 percent (1981-82) to a high of 37 percent (1984-85). The proposed level of expenditures in 1990-91 would fall about in the middle of this range. This percentage differs from the commonly cited 41 percent used for Proposition 98 purposes because it excludes community college expenditures. In addition, the Proposition 98 percentage is based only on General Fund *tax* revenues, as opposed to total General Fund expenditures.

Figure 5

K-12 Education Expenditures Current and Constant Dollars

General Fund 1981-82 through 1990-91

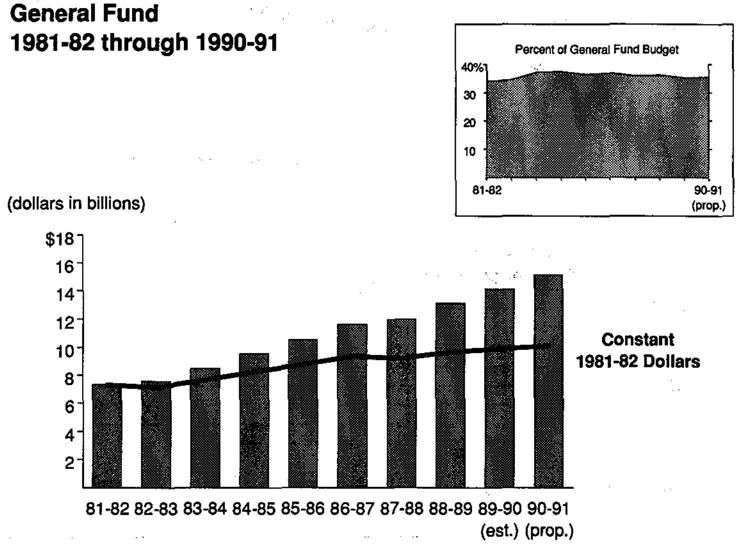


Figure 5 also displays the rate of increase for K-12 expenditures as adjusted for declines in state purchasing power. As the figure shows, expenditures in "constant" dollars also have increased significantly (37 percent) over the period.

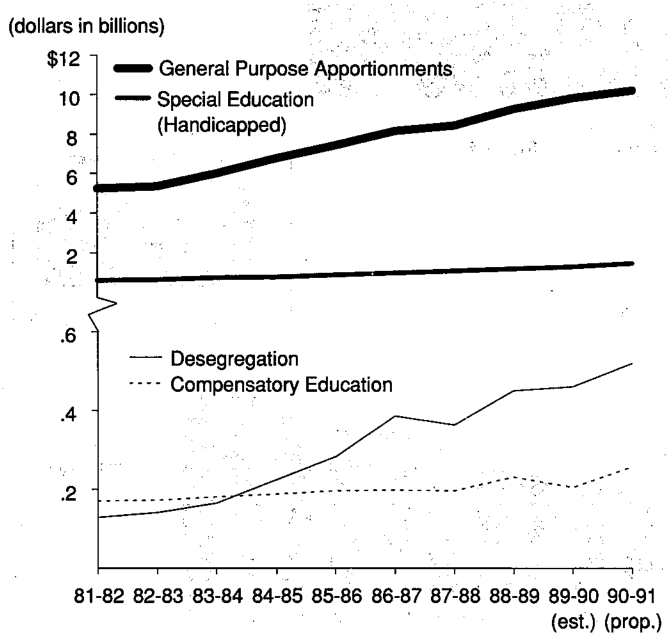
Figure 6 shows the relative growth of four of the largest programs in K-12 education: (1) general-purpose school apportionments, (2) special education for handicapped pupils, (3) desegregation programs, and (4) compensatory education (Economic Impact Aid). These four programs account for over 80 percent of total state funding for K-12 education.

As the figure shows, these programs have grown at very different rates over the period 1981-82 through 1990-91. Specifically, funding for general-purpose apportionments has increased by 96 percent, while funding for special education has increased by 136 percent. Funding for compensatory education, in contrast,

Figure 6

K-12 Education Expenditures By Major Program

General Fund
1981-82 through 1990-91



has grown by only 50 percent. Finally, funding for desegregation programs has *quadrupled* over this same period.

OVERVIEW OF THE BUDGET

The budget for 1990-91 proposes an increase of $1,033 million (7.3 percent) from the General Fund. We estimate that the General Fund increase needed to meet the requirements of Proposition 98 and thereby fund the current level of services is approximately $1,078 million, including $183 million for workload increases and $895 million for statutorily required inflation adjustments. This is $45 million above the amount proposed by the Governor.

The budget contains the following major policy proposals, which account for the $45 million difference just noted:

- ***Cost-of-Living Adjustments ($321 Million Net Reduction).*** The budget proposes to provide *statutory* COLAs at 3.0 percent, in lieu of the 4.95 percent required by current law. Partially offsetting this reduction is the budget's proposal to provide *discretionary* COLAs at 3.0 percent for other programs.
- ***Class Size Reduction ($110 Million Augmentation).*** The budget proposes additional funds for the first year of an eight-year program to (1) reduce class sizes in grades 9 to 12 and (2) implement a language arts enrichment program in grades 1 to 3, as authorized by Ch 1147/89 (SB 666, Morgan).
- ***Adult Education ($44 Million Reduction).*** The budget proposes to reduce funding for K-12 school apportionments by tightening eligibility standards and funding rates for (1) K-12 students concurrently enrolled in adult education and (2) adults enrolled in K-12 independent study programs.
- ***Proposition 98 Reserve ($210 Million Augmentation).*** The budget proposes to continue the current-year practice of maintaining a reserve, in order to avoid potentially appropriating to K-12 education more than the amount required by Proposition 98.

Although the budget is $45 million short of funding the current service level for K-12, it does fund the Proposition 98 requirements. This is because the budget proposes two actions which, taken together, reduce the amount of the Proposition 98 guarantee that would otherwise be available for K-12 purposes. These are: (1) shifting to the K-12 budget funding for certain noninstructional services required by special education pupils, and (2) increasing funding for drug education programs administered by the Office of Criminal Justice Planning.

Figure 7 shows the major funding changes proposed for each of the K-12 program areas in 1990-91.

Figure 7

K-12 Education Programs
Proposed Major Changes for 1990-91

General Purpose Apportionments	Requested: $15 billion Increase: $852 million (6%)
+	$476 million for enrollment growth
+	$441 million for cost-of-living increase
−	$55 million for adult education services
Special Education	**Requested: $1.6 billion Increase: $163 million (11%)**
+	$74 million for enrollment growth
+	$65 million for cost-of-living increase
+	$41 million for noninstructional services
Desegregation	**Requested: $519 million Increase: $58 million (13%)**
+	$23 million for program expansions
+	$20 million for enrollment growth
+	$15 million for cost-of-living increase
Compensatory Education	**Requested: $659 million Increase: $47 million (7.7%)**
+	$35 million to continue funding appropriated in 1988-89, but received in 1989-90
+	$9 million for enrollment growth
+	$7 million for cost-of-living increase

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

Due to the enactment of Proposition 98, the Legislature has virtually no ability to control the overall level of General Fund support provided to K-12 education. This is because this measure provides K-12 schools and community colleges a constitutionally guaranteed minimum funding level. Of the $15.1 billion in total General Fund support proposed for K-12 education in 1990-91, $15 billion (99.4 percent) counts towards meeting Proposition 98 requirements.

The Legislature, however, has considerably more ability to control the growth of costs *within* the overall Proposition 98 guarantee. For example, in contrast to other areas of the budget, the Legislature has the ability to provide lower cost-of-living adjustments for K-12 education than those required by statute. (As noted, the Governor's Budget proposes K-12 COLAs of 3.0 percent, rather than the statutorily required 4.95 percent; this action reduces the costs of these programs by $353 million.)

The Legislature also has a limited number of options (discussed in greater detail in the *Analysis of the 1990-91 Budget Bill, Item 6110)* for bringing the rapidly increasing costs of desegregation programs under control, including (1) imposing stricter eligibility standards and cost controls and/or (2) increasing the required local cost share above the current 20 percent level. A third option would be to combine all or part of the existing funding for desegregation with that provided for compensatory education, and require that school districts' first priority for the use of such funds be to support the costs of desegregation programs. Our review indicates that the adoption of any of these options could assist in bringing the costs of desegregation programs under control, while being sensitive to legitimate program needs, and could ultimately lead to a more equitable distribution of state funds among all school districts impacted by high concentrations of minority populations.

Higher Education

Funding for higher education programs represents 8.1 percent of expenditures from all state funds and 14 percent of General Fund expenditures proposed in 1990-91. As shown in Figure 8, higher education expenditures have declined steadily as a percentage of General Fund expenditures since 1981-82. The figure also shows that expenditures for this program area have increased from about $3.4 billion in 1981-82 to almost $6 billion as proposed for 1990-91, which represents an average annual increase of 6.7 percent.

Figure 8 also presents the spending trend for higher education as adjusted for declines in purchasing power. On this basis, higher education expenditures have increased at an average annual rate of 2 percent. (This rate drops below 1 percent on a per-student basis.)

Figure 8

Higher Education Expenditures Current and Constant Dollars

General Fund 1981-82 through 1990-91

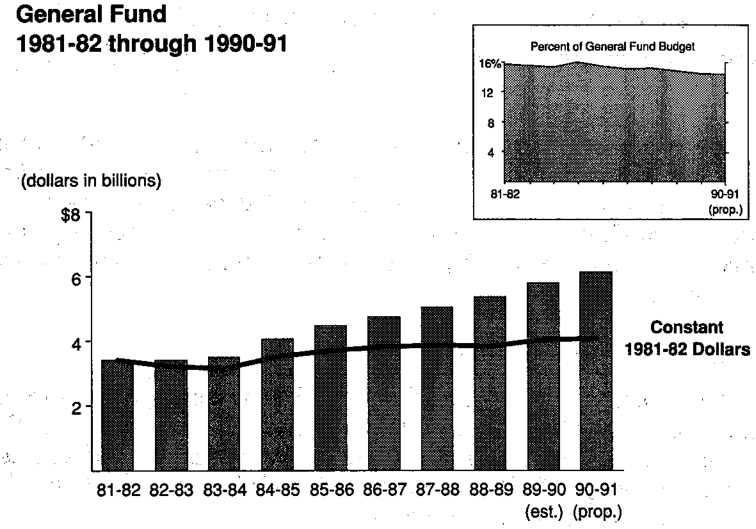


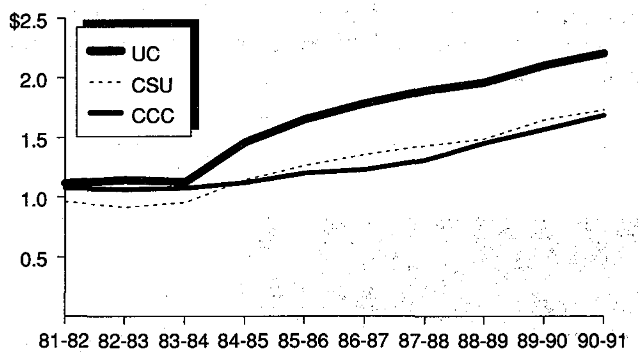
Figure 9 shows the trend in state support since 1981-82 for each of the three segments of higher education. It shows that the University of California (UC) has experienced a greater rate of growth than has the California State University (CSU) or the Community Colleges (CCC). This is partially explained by the greater full-time enrollment (FTE) increase at UC compared to CSU and the CCCs.

Figure 9

Higher Education Expenditures[a] By Segment

General Fund
1981-82 through 1990-91

(dollars in billions)



[a] Excludes CSU appropriated fee revenue.

Figure 10 presents estimates of the average annual rate of growth in state funds *per student,* and compares these rates to the average annual change in the prices of government services. These data show that expenditures per student in each segment have increased at a slightly higher rate than has the government services index.

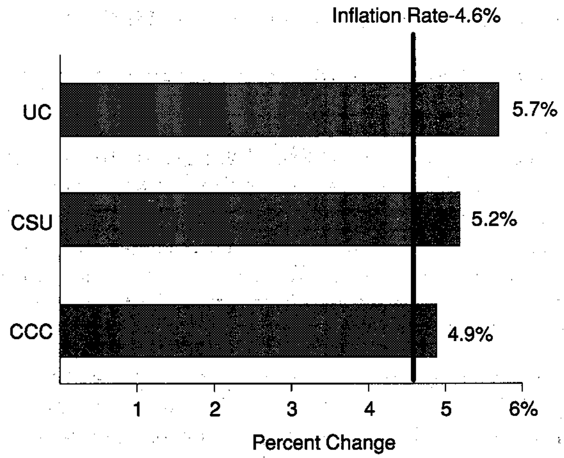
OVERVIEW OF THE BUDGET

The budget proposes a General Fund increase for higher education of $352 million, or 6.1 percent. We estimate that the General Fund increase needed to fund the current level of services is approximately $506 million. This is $154 million above the amount proposed by the Governor.

Figure 10

Average Annual Growth in Per Student Spending in the Higher Education Segments Compared to the Average Annual Change in Prices[a]

1981-82 to 1990-91



[a] Change in prices as measured by the implicit price deflator for purchases of goods and services by state and local governments.

The CCC budget is funded at the current service level, largely because of the funding requirements of Proposition 98. The primary difference between the the proposed budget and the current services level funding occurs in the UC and CSU budgets. The major items reflected in the funding shortfall are:

- ***Merit Salary Adjustments (MSAs).*** The budget does not fund the anticipated $24 million cost of staff MSAs that will be provided in 1990-91.
- ***Price Increases.*** UC and CSU anticipate increased costs of $30 million for a variety of price increases that are not addressed in the budget.
- ***Instructional Equipment Formula.*** The budget underfunds the normal level of funding for instructional equipment by $16 million, according to the formula traditionally used for this purpose.

- ***CSU Unallocated Reduction.*** The budget proposes an unallocated reduction of $14 million for CSU.
- ***Retirement Contributions.*** The budget also proposes to delay the state's contribution of $55.6 million to the University of California Retirement Plan until the 1991-92 fiscal year.

Figure 11 shows the major funding changes for higher education reflected in the proposed budget for 1990-91.

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

The Legislature has a great deal of ability to control the expenditures of the UC and CSU through the budget process. This is because most of the higher education budget is based on agreed-upon formulas that can be changed on a year-to-year basis rather than on statutory obligations. Generally, however, cost controls in higher education represent difficult choices because they either affect access of students or they affect the level of educational services provided.

Access. As mentioned, the budget proposes to serve an additional 7,120 FTE in the CSU and 1,888 FTE in the UC at costs of $34 million and $11 million, respectively. These enrollment increases are the primary cost drivers in the higher education systems and they are under control of the Legislature to adjust. To do so, however, creates a policy problem of reducing the access of qualified students to these institutions.

Likewise, the budget proposes the opening of a new CSU campus at San Marcos. This is a significant General Fund expense of approximately $6 million to serve just 250 FTE students in the first year of operation. While the Legislature could choose to forego this expense by delaying the opening of the campus, the trade off would again be reduced access for some students to higher education.

In addition, the Legislature can control the fees charged to students. Thus, if resident student fees were set to increase by 10 percent rather than the approximately 4.7 percent proposed, an additional $24 million in revenue could be generated. This action, even if accompanied by additional financial aid support, could negatively affect access for some lower-income students.

Level of Service. Other cost control measures within the jurisdiction of the Legislature involve changing the level of service provided. Such changes could range from increasing the amount of space cleaned by janitors to the number of students taught by the faculty. Thus, currently we budget UC faculty at an agreed-

Figure 11

Higher Education Segments
Proposed Major Changes for 1990-91

Community Colleges — Requested: $1.7 billion; Increase: $124 million (7.9%)

- + $120 million for cost-of-living increases
- + $41 million for statutory and preferential enrollment growth
- + $11 million for equalization of revenue limits
- + $10 million for a reserve

California State University — Requested: $2.1 billion; Increase: $114 million (5.8%)

- + $58 million for 1990-91 salary increases
- + $43 million for annualization of 1989-90 salary increases
- + $34 million for enrollment growth
- + $6 million for expansion at the new San Marcos campus
- + $5 million for revenue bond payments
- − $20 million to correct for one-time adjustments
- − $14 million unallocated cut

University of California — Requested: $2.2 billion; Increase: $114 million (5.5%)

- + $53 million for 1990-91 salary increases
- + $46 million for annualization of 1989-90 salary increases
- + $17 million for faculty merit salary increases
- + $11 million for enrollment growth
- + $8 million for workload related to maintenance of new buildings
- − $14 million to the General Fund to reflect additional UC revenues
- − $5 million reduction in the teaching hospital subsidy

upon student/faculty ratio of 17.6/1. There is no statutory requirement to do this, merely budget practice. It is within the jurisdiction of the Legislature to adjust this ratio upwards to achieve some measure of cost control in the instruction program. To make changes in many of these previously agreed-to budgeting practices could result in service level reductions.

Due to the enactment of Proposition 98 in 1988, the Legislature, however, has virtually no ability to control the overall level of General Fund support to K-14 education. It can, however, allocate costs within the overall Proposition 98 guarantee to affect the allocation to the CCCs. The budget proposes an allocation of 9.9 percent to the CCCs from the Proposition 98 guarantee—the same as in the current year.

Welfare and Social Services

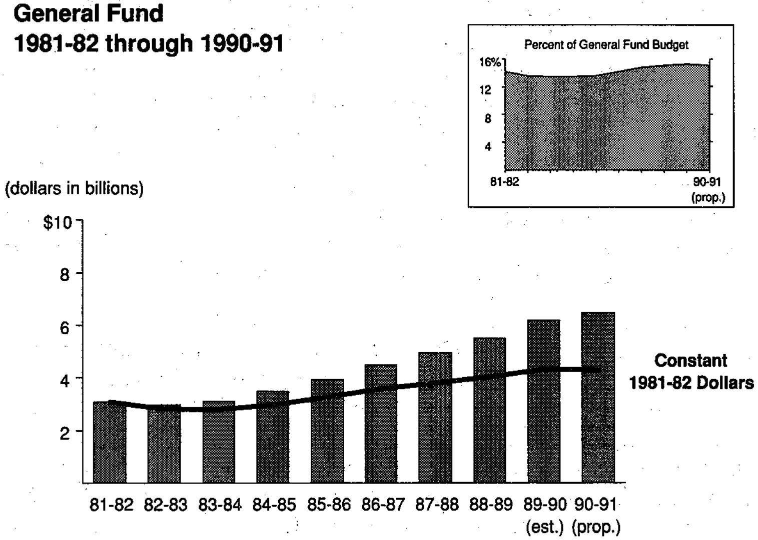
Funding for welfare and social services programs represents 13 percent of state expenditures from all state funds and 15 percent of expenditures from the General Fund as proposed in the budget for 1990-91. Figure 12 displays spending trends in this area over the last nine years and as proposed in the budget. As the figure shows, General Fund expenditures for these programs have increased steadily since 1982-83, and have more than doubled over the entire period. The figure also shows that welfare and social services programs have accounted for a slightly increasing share of all General Fund expenditures since 1983-84.

Figure 12 also displays the spending for these programs adjusted for declines in the purchasing power of the dollar. On this

Figure 12

Welfare and Social Services Expenditures Current and Constant Dollars

General Fund
1981-82 through 1990-91



basis, expenditures still increased by 41 percent from 1981-82 to the current year, which represents an average annual rate of increase of 4.4 percent. The amount proposed in the budget, which would require several statutory changes to implement, would actually represent a slight decline (less than half a percentage point) in purchasing power as compared with estimated current-year expenditures, resulting in the first drop in real expenditures for these programs since 1983-84.

The inflation index that we used in preparing Figure 12 is the GNP implicit price deflator for state and local government purchases, which is a good indicator of the general price increases faced by state and local governments nationwide. The California Necessities Index (CNI), which is designed to estimate inflation in the prices of the goods that California's poor need to survive—food, clothing, shelter, and transportation—provides an alternative approach to estimating changes in the purchasing power of California's welfare programs. Using the CNI to adjust the welfare portion of total program expenditures, we estimate that real expenditures still grew by almost 4 percent per year during the 1980s. To put this increase in perspective, the *populations* that are targeted by welfare and social services programs—the poor, the aged, and children—grew at annual rates of 4.8 percent, 3.1 percent, and 2.1 percent, respectively, during this period. These data would tend to indicate that real expenditures in this program area have essentially kept pace with expansions in service populations.

Figure 13 displays General Fund expenditures for the five major welfare and social services programs. The figure shows that the two major welfare programs, AFDC and SSI/SSP, have grown steadily since 1983-84. The budget's proposal to suspend the statutory COLAs for these programs would result in a flattening of the rate of growth in SSI/SSP costs. While the budget also proposes to suspend the COLA for the AFDC program, the other pressures on costs in this program are so substantial that they more than offset the proposed savings, with the result that proposed 1990-91 expenditures continue the steady increases reflected in the graph over the past several years.

The figure also shows that General Fund costs for county administration (of the AFDC and Food Stamps programs) and for the two major social services programs—Child Welfare Services (CWS) and In-Home Supportive Services (IHSS)—have increased substantially over this period. The rather substantial decline in the IHSS program between 1984-85 and 1985-86 is due more to the switch in federal funding between the CWS and the IHSS programs, which occurred in 1985-86, than to the rather modest reduction in total program costs that occurred at the same time.

Figure 13

Welfare and Social Services Expenditures By Major Program

General Fund
1981-82 through 1990-91

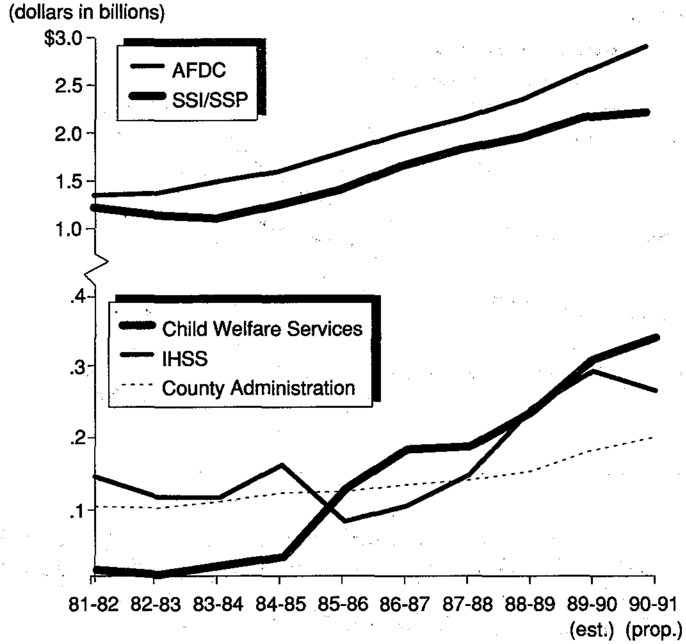


Figure 14 provides a better view of IHSS costs because it includes federal as well as state funds. As the figure shows, the combined state and federal costs of all three of these programs have grown substantially since 1981-82. By far the most dramatic increase among these programs has been the 530 percent increase in funding for the CWS program that occurred between 1981-82 and 1989-90. This reflects an increasing number of abused children that require services as well as the state's expanded financial participation in the program.

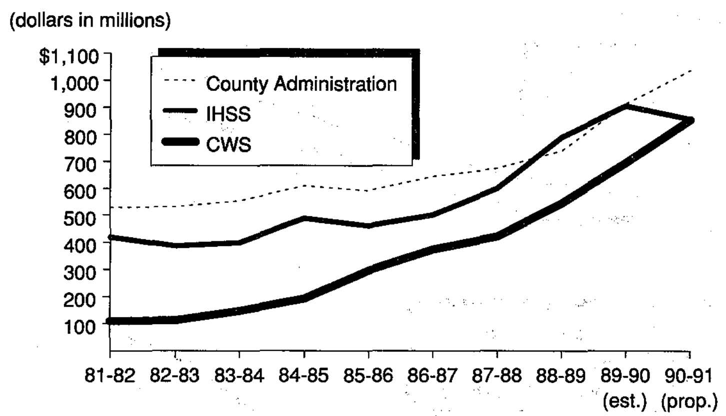
OVERVIEW OF THE BUDGET

The budget proposes *increases* of $300 million from the General Fund for all programs in the welfare and social services area. The General Fund increase represents a 4.9 percent increase over

Figure 14

Welfare and Social Services Expenditures from State and Federal Funds

1981-82 through 1990-91



estimated General Fund expenditures in the current year. We estimate that the General Fund amount needed to fund the current level of services would be approximately $6.9 billion, or $463 million more than is proposed in the budget.

The major proposals in the welfare and social services portion of the budget are for *reductions* in costs. The budget does contain one major new program in 1990-91, the new transitional child care program to reimburse AFDC recipients who take a job and leave welfare for the child care costs they incur during their first 12 months off welfare. This proposal, however, simply implements a new federal requirement. The major cost-cutting proposals contained in the budget are:

- ***Suspension of Statutory Welfare COLAs ($253 Million General Fund Savings).*** The budget proposes to suspend the provisions of state law that require increases in AFDC and SSI/SSP grants based on the change in the CNI. Under existing law, AFDC grants will receive an estimated 4.62 percent increase effective July 1, 1990. As a result, the grant for a family of three will increase from the current \$694 per month to \$726. SSI/SSP grants will receive the same percentage increase effective January 1, 1991, so that the grant for an aged couple will increase from \$1,167 to \$1,221. The proposed suspension of the COLAs, which requires legislation to implement, would result in savings of \$388 million (\$253 million General Fund, \$121 million federal funds, and \$14 million county funds).

- ***Greater Avenues for Independence—GAIN (Net General Fund Reduction of \$67 Million).*** The 1989 Budget Act included funds to serve 100 percent of the caseload that was anticipated to go through the GAIN program in the current year. Since the GAIN program is relatively new—it is still being phased in by all 58 counties—the Department of Social Services (DSS) anticipates that the number of individuals served by the program would be substantially higher in 1990-91 than in 1989-90. In addition, the estimated costs of serving each client have increased substantially, based on counties' actual experiences. The budget proposes to scale back the number of new cases that counties will be allowed to serve in 1990-91, for a General Fund savings to the GAIN program of \$96 million. These savings would be partially offset by increased General Fund costs to the AFDC program of \$29 million, because the GAIN program will generate less savings.
- ***IHSS Program (\$71 Million General Fund Reduction).*** The budget proposes legislation to eliminate IHSS program eligibility for recipients whose physical ability to take care of their everyday needs has been assessed as being somewhat greater than most other recipients. Additional restrictions would apply for individuals whose service providers are their own relatives. The DSS estimates that this proposal would reduce eligibility by 42,000 persons.
- ***Child Welfare Services (\$24 Million General Fund Reduction).*** The budget proposes \$339 million from the General Fund for the Child Welfare Services program, which is \$24 million less than the DSS estimates would be needed to provide enough social workers to serve the entire anticipated child welfare services caseload. The budget does *not* indicate how county welfare departments would be expected to accommodate this shortfall.

Figure 15 displays the major funding changes proposed for the welfare and social services program areas in 1990-91.

Figure 15

Welfare and Social Services Programs
Proposed Major Changes for 1990-91

AFDC — Requested: $2.9 billion; Increase: $273 million (10%)

- \+ $158 million for caseload increases
- \+ $84 million increase for legislation enacted in 1989 and to offset reduced federal funding for refugees
- − $112 million reduction due to suspension of COLA
- − $26 million for transfer of funding for foster care costs of severely emotionally disturbed children from DSS to SDE

SSI/SSP — Requested: $2.2 billion; Increase: $51 million (2.4%)

- \+ $138 million to fund the full-year cost of the COLA that recipients were granted effective January 1, 1990
- \+ $79 million for caseload increases
- − $172 million reduction due to savings resulting from increases in the federal share of the grant
- − $141 million reduction due to suspension of COLA

Child Welfare Services — Requested: $339 million; Increase: $31 million (10%)

- \+ $51 million for caseload increases
- − $24 million program reduction

In-Home Supportive Services — Requested: $265 million; Decrease: $28 million (9.5%)

- \+ $55 million for caseload increases
- − $71 million program reduction

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

The Legislature has limited ability to control the costs of most of the welfare and social services programs through the budget without also making statutory changes. This fact is reflected in the budget itself, in that most of the cost-cutting measures proposed in the budget would require legislation to implement.

The two exceptions are the proposal to scale back the GAIN program and the program reduction proposed for Child Welfare Services. With respect to the Child Welfare Services program, however, there are practical limits to the amount of cost control that it is possible to achieve without statutory change. This is because existing law is very specific as to how counties must serve abused and neglected children and their families. While it might be possible for some counties to make some modest staffing reductions and still provide all the required services, a substantial cutback would require them to reduce services below the levels required by law. Should this occur, it is likely that the budget cuts would face legal challenges from the counties and from client groups.

The Legislature, however, has broad discretion to control costs in welfare and social services programs through statutory changes. There are three basic approaches that the Legislature could use in designing legislation to effect reductions in welfare and social services costs: generalized reductions in program benefits, targeted reductions, and elimination of lower priority programs. The budget includes examples of how the administration proposes to use each of these approaches.

General Reductions in Benefits. The proposed suspension of welfare COLAs is a general reduction in benefits. Such reductions are generally allowable under federal rules, have the potential to yield large savings, and are administratively simple to implement. On the other hand, this approach does *not* distinguish between recipients based on their individual circumstances and therefore may place some unknown number of recipients at substantial risk. For example, recipients in rural communities with lower housing costs might be able to forego the statutory COLA for 1990-91 with less difficulty than recipients in urban areas, where high housing costs already place some recipients at risk of becoming homeless.

Targeted Reductions. The major example of a targeted reduction in the welfare and social services part of the budget is the proposed IHSS "program reduction." This approach attempts to "soften" the adverse effects of budgetary reductions by placing the burden of the cuts on individuals who are theoretically best able to handle them. In the case of the proposed IHSS reduction, recipients would no longer be eligible for benefits if their physical ability to take care of their own everyday needs is assessed as being relatively high. While this type of targeted approach can yield fairly large savings, it can be extremely difficult to design and implement. For example, the budget proposal for IHSS program reductions is flawed because it bases the targeting on the recipients' *average* scores on a complex assessment of their physical ability to take care of a variety of their own personal care needs. Since the average can mask significant variations in an individual's ability to handle specific self-care tasks, it is quite possible that many of those targeted by the proposal are *not* actually able to take care of all of their essential daily needs, and would therefore be placed at significant risk under the proposed reduction.

Elimination of Lower-Priority Programs or Program Components. To the extent that it is possible to identify programs of lower priority, this approach makes the most sense analytically. The problem is in determining which programs are of lower priority. The programs proposed for elimination in the welfare and social services portion of the budget, however, are in areas of historically high priority to the Legislature such as child abuse prevention, job placement for the disadvantaged, and the licensing of family day care.

Another criterion the Legislature could use in assessing its priorities is program effectiveness. Often, however, there is not compelling quantitative evidence of either program effectiveness or ineffectiveness. In the case of the proposal to save $10 million by eliminating the Child Abuse Prevention Training Act Program, for example, there are no reliable studies that assess the program's success in preventing abuse.

Health

Funding for health programs represents 14 percent of expenditures from all state funds and 15 percent of General Fund expenditures proposed in the budget for 1990-91. Figure 16 shows spending trends over the last nine years and as proposed in the budget. The average annual increase in General Fund spending for health programs over the last 10 years is 5.5 percent. Including the recent increase in cigarette tax funding and other special funds pushes the rate of annual increase up to 6.7 percent.

Figure 16 shows that expenditures from all funds for health programs have increased every year since 1983-84, except for a decline in 1990-91, due to the elimination of one-time Proposition 99 (Cigarette and Tobacco Products Surtax Fund—C&T) funds carried over from 1989-90. Expenditures from the General Fund have increased every year since 1983-84.

Figure 16

Health Expenditures
Current and Constant Dollars

All State Funds
1981-82 through 1990-91

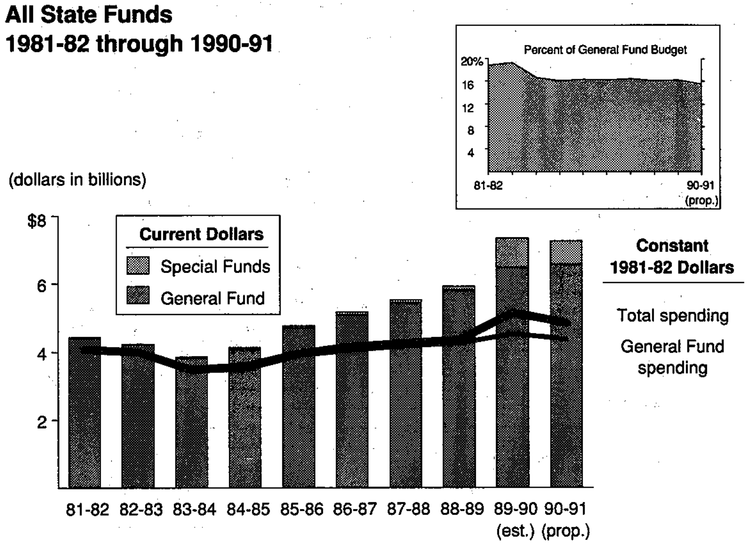


Figure 16 also displays the rate of increase for health programs as adjusted for declines in state purchasing power. As the figure shows, spending on the adjusted basis has increased only slightly over the last 10 years. The average annual increase in adjusted spending from the General Fund amounts to 0.9 percent; including the special funds raises this increase to 1.9 percent.

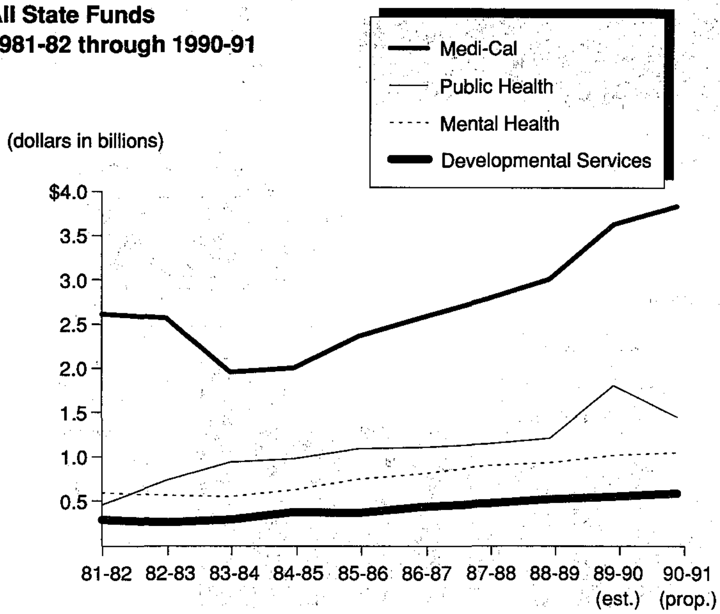
Figure 17 shows spending from all funds by major program. For Medi-Cal, the largest program, the figure shows a significant reduction in 1983-84 due to reforms in the program, followed by a steady increase since then. The program shows an accelerated rate of growth between 1988-89 and 1989-90 primarily as a result of new federal requirements and the delay in payment of certain expenditures from 1988-89.

Spending for public health programs has increased significantly over the past nine years, primarily due to (1) establishment of the Medically Indigent Services Program (MISP) in 1983 to

Figure 17

Health Expenditures By Major Program

All State Funds
1981-82 through 1990-91



assist counties to care for former Medi-Cal eligibles and (2) the infusion of C&T funds in the current year.

OVERVIEW OF THE BUDGET

The budget for 1990-91 proposes a reduction of $76 million (1 percent) from all state funds and an increase of $98 million (1.5 percent) from the General Fund for health programs. We estimate that the General Fund increase needed to fund the current level of services is approximately $556 million, consisting of $444 million for workload increases and $192 million for cost increases, offset by a net savings of $80 million due to other factors. This is $458 million above the amount proposed by the Governor.

The budget contains the following major policy proposals:

- ***Reduction in AB 8 County Health Services ($150 Million General Fund).*** The budget proposes to reduce funding for this program based on the premise that a major cause of recent increases in state Medi-Cal spending is that counties are receiving additional Medi-Cal reimbursements for services provided to aliens as a result of federally mandated changes in Medi-Cal. This premise is probably accurate to some extent; however, the exact level of additional Medi-Cal funding received by counties for services to aliens is unknown.
- ***Medi-Cal Savings Proposals ($98 Million General Fund).*** The budget proposes to implement various savings proposals in the Medi-Cal program. The largest single proposal is to eliminate six health care benefits not required by the federal government ($36 million). The others involve rate reductions for incontinence supplies ($28 million), drug cost containment ($24 million), and restructuring of physician reimbursement rates ($10 million).
- ***Regional Center Fees ($34 Million General Fund).*** The budget proposes to impose fees on regional center clients. The Department of Developmental Services estimates that actual fee collections would be $5 million. The remaining savings would occur because instituting fees would enable the state to claim federal funding through the Medi-Cal program for case management services.
- ***MISP Reduction ($25 Million General Fund).*** The budget proposes to reduce funding for the MISP. According to the budget, the General Fund reduction will be offset by an increased appropriation for the program next year—1991-92.

- ***Special Education Pupils Shift ($15 Million General Fund).*** The budget proposes to transfer responsibility for mental health services to special education pupils to the State Department of Education.
- ***Suspend Statutory COLAs ($29 Million General Fund).*** The budget proposes to suspend statutory COLAs for cash assistance beneficiaries. This affects expenditures in several health programs.

The policy changes listed above account for $351 million of the difference between the proposed General Fund budget and current services level funding. The remaining difference is due primarily to the budget's failure to fund cost increases in some programs ($146 million General Fund).

The budget also reflects a decrease of $174 million, or 20 percent, in special funds. This is primarily due to elimination of one-time Proposition 99 funds that were available in the current year.

Figure 18 shows the major changes in funding proposed for health programs in 1990-91.

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

The Legislature has limited ability to control health program costs through the budget process. This is because in many of the major programs, eligibility requirements, benefits, provider reimbursement methods, and/or funding levels are set in statute. In addition, for many programs, federal requirements limit the Legislature's flexibility to make changes in statute. Some of the major factors affecting costs are:

Caseload. Eligibility requirements for the Medi-Cal program are set in statute and generally are based on eligibility requirements for the state's cash assistance programs—SSI/SSP and AFDC. Thus, the Legislature cannot control caseload growth through the budget. To reduce Medi-Cal costs, the Legislature could enact statutory changes to revise eligibility requirements for the cash assistance programs or eliminate or curtail coverage of some limited categories of Medi-Cal eligibles who do not receive cash assistance. However, any reduction in Medi-Cal costs would be at least partially offset by increased costs to counties, as the counties are "the providers of last resort."

The budgets for several public health programs (amounting to approximately $110 million from the General Fund in 1990-91), the Department of Developmental Services, and a portion of the state hospitals in the Department of Mental Health, also are

Figure 18

Health Programs
Proposed Major Changes for 1990-91

Medi-Cal Local Assistance	Requested: $3.8 billion Increase: $211 million (5.8%)

- + $198 million for new federal requirements
- + $126 million for changes in caseload, utilization, and other factors
- + $62 million for current- and budget-year cost-of-living adjustments
- − $98 million for six cost-saving proposals
- − $14 million to delete funding for Medi-Cal abortions

Public Health Local Assistance	Requested: $1.4 billion Decrease: $349 million (19%)

- − $173 net reduction in C&T funds available
- − $150 million reduction in the AB 8 county health services program
- − $25 million program reduction in the MISP

Mental Health	Requested: $1 billion Increase: $29 million (2.8%)

- + $21 million to reduce the salary savings level at the state hospitals and to fund other cost increases
- + $10 million from the C&T Fund for program expansion
- − $15 million savings to transfer responsibility for providing services to special education pupils to the SDE

Developmental Services	Requested: $584 million Increase: $45 million (8.3%)

- + $27 million for implementation of the Alternative Residential Model rate-setting system
- + $19 million to reduce the salary savings level at the developmental centers and to fund other cost increases
- − $34 million savings as a result of imposing fees on regional center clients

caseload-driven, based on statute. The caseload increases in these programs are not subject to control through the budget.

Benefits. Like eligibility levels, the benefits available through many programs are set in statute and are influenced by federal requirements. The Legislature cannot control these through the budget process. The Legislature can reduce the benefits available, however, through statutory changes. Again, such reductions could result in some offsetting costs: (1) to the state, in the form of higher-cost Medi-Cal services or (2) to counties, as the providers of last resort.

Costs of Services. Many of the programs operate by reimbursing private providers according to rate schedules set by statute or regulations. The Legislature has varying amounts of control over reimbursement rates through the budget process. For example, the Legislature can choose whether to grant COLAs to some categories of Medi-Cal providers, such as physicians. Other categories of providers, such as noncontract hospitals and nursing facilities, receive automatic COLAs under federal rules and state law.

For programs operating by reimbursing providers through *rate schedules,* another factor affecting costs is the mix of services billed. The Legislature can institute some controls through the budget process, for example, by increasing prior authorization staffing, but cannot implement any major changes in the criteria for approving services in this manner.

Reimbursement levels and the mix of services billed are influenced by underlying trends in the costs of medical care. Costs of these programs have increased despite cost containment measures, in part because medical care costs have increased more rapidly than the costs of other goods and services.

Some programs operate through *contracts* or *agreements*. In some of these programs, the Legislature has very little control over the contract arrangements and costs through the budget process. For example, although the regional centers operate under contract, they have considerable autonomy under the Lanterman Act to approve services for clients. In contrast, the Legislature can control the level of spending on local mental health programs and many public health programs by setting the appropriation in the annual budget.

The state itself operates the state mental hospitals and developmental centers. The costs of these services can be controlled to a limited degree through the budget process by setting staffing levels or funding community alternatives. However, requirements imposed by the federal government limit the Legislature's staffing flexibility, and community alternatives can be as costly as state institutional care.

Statutory Funding Levels. The funding level for the AB 8 County Health Services Program is set in statute based on the level of spending in 1977-78, adjusted for inflation and population changes. Thus, statutory changes are required to affect spending levels for this program.

Criminal Justice

Funding for criminal justice programs represents 6.3 percent of expenditures from all state funds proposed in 1990-91 and 7.5 percent of General Fund expenditures proposed in 1990-91. As shown in Figure 19, criminal justice program expenditures have almost tripled over the last 10 years, increasing at an average annual rate of 17 percent (General Fund). The figure also shows that criminal justice expenditures have increased steadily and rapidly as a share of the General Fund budget over the 10-year period. In fact, criminal justice is the only expenditure category that has increased its share of General Fund expenditures in *every* year since 1981-82. Figure 19 also displays the spending trend as adjusted for declines in state purchasing power. On this basis, criminal justice expenditures have increased at an average annual rate of 12 percent.

Figure 19

Criminal Justice Expenditures Current and Constant Dollars

General Fund 1981-82 through 1990-91

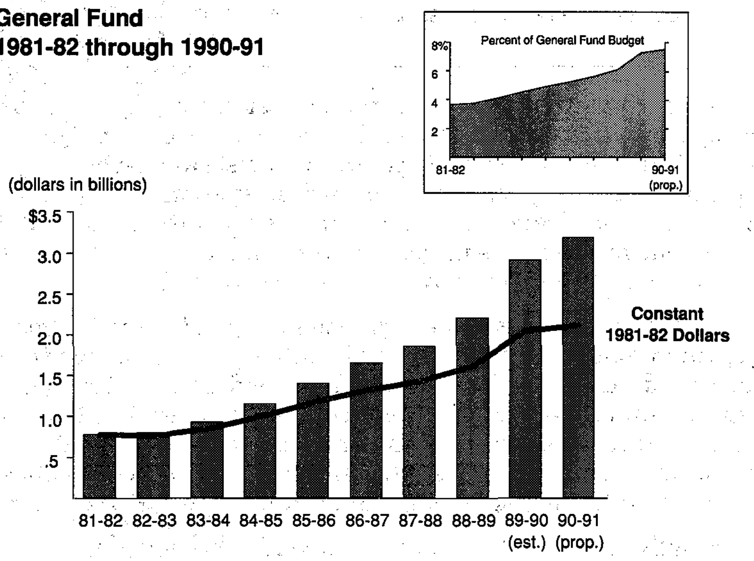
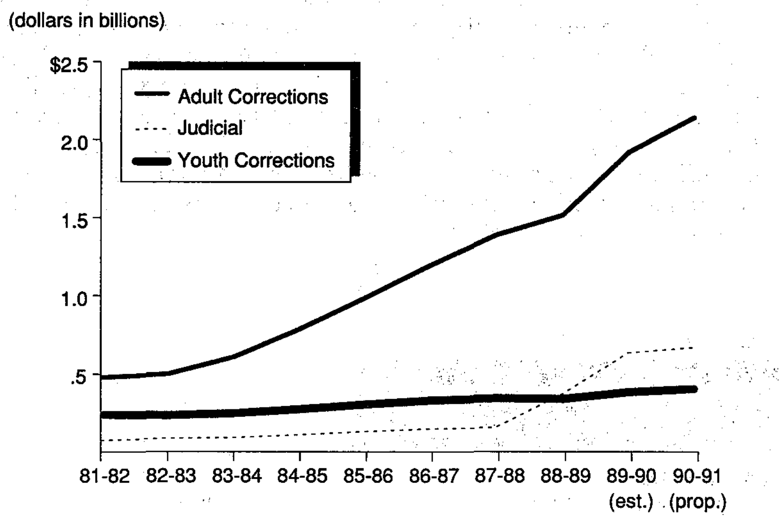


Figure 20 shows how each of the major programs in this area have grown since 1981-82. These data indicate that the rates have differed substantially.

Figure 20

Criminal Justice Expenditures By Major Program

General Fund
1981-82 through 1990-91



Adult corrections is, by far, the largest criminal justice program, accounting for about two-thirds of proposed criminal justice expenditures in 1990-91. This program consists almost entirely of expenditures to support the state prison system. The primary reason for the dramatic rise in state expenditures for adult corrections has been the increase in the number of adults sent to state prison—295 percent over the 10-year period.

As Figure 20 shows, the increase in expenditures for youth corrections has been relatively small, although it has doubled over the period. The number of youthful offenders incarcerated in Department of Youth Authority facilities, however, has risen 51 percent since 1981-82. The major factor contributing to this population increase has been the length of stay, which is subject to administrative decisions of the Youthful Offender Parole Board.

Finally, Figure 20 shows that expenditures for judicial programs accounted for a small portion of criminal justice expenditures until a sharp rise in 1988-89. This is attributable to implementation of the Trial Court Funding Program, which provided for the state to assume primary responsibility for funding the operations of the trial courts in counties that chose to participate.

OVERVIEW OF THE BUDGET

As shown in Figure 19, the budget for 1990-91 proposes increases of $278 million (9.5 percent) for criminal justice programs. These programs are financed almost completely from the General Fund. We estimate that the General Fund increase needed to fund the current level of services is approximately $269 million, consisting of $191 million for workload increases and $78 million for costs increases. The Governor's Budget proposes spending about $9 million above this amount.

The Governor's Budget contains no major policy proposals for criminal justice programs.

Figure 21 displays the major funding changes proposed for program in the criminal justice area for 1990-91.

Figure 21

Criminal Justice Programs
Proposed Major Changes for 1990-91

Adult Corrections — Requested: $2.1 billion; Increase: $214 million (11%)

+ $167 million for increased caseload
+ $41 million for cost adjustments
− $21 million unallocated reduction

Youth Corrections — Requested: $402 million; Increase: $22 million (5.7%)

+ $11 million for increased caseload
+ $11 million for cost adjustments

Judicial — Requested: $667 million; Increase: $39 million (6.2%)

+ $23 million for cost and workload adjustments in state-financed local court programs
+ $16 million for increases in state judicial programs

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

The Legislature's ability to control costs of criminal justice programs, especially in the short run, is severely limited. This is because most of the factors that determine workload in this area, such as the length of criminal penalties, are set in statute. Most changes in statute that could reduce expenditures would be unlikely to have an impact for one or more years. In addition, changes in this area could result in significant trade-offs that would help control costs at the state level, but result in increased costs at the local level.

Given that adult corrections comprise two-thirds of criminal justice expenditures, the Legislature would probably need to focus attention in this area in order to have any significant effect on expenditures. However, California's criminal sentencing structure makes it extremely difficult for the Legislature to control costs of adult corrections in the short-run, because any changes in sentences would apply only prospectively.

In order to have a significant impact on expenditures, the Legislature would have to seek reductions in the inmate and parole populations. The options that would control expenditures most quickly include selectively reducing prison terms, releasing some inmates from prison prior to the end of their terms, or making changes in methods of parole supervision to reduce the number of parole violators returned to prison. These options generally run counter to trends in recent legislation.

The Legislature also could reduce expenditures for support of the existing adult corrections programs, such as reducing the number of custody, support, or program staff in state prisons (staff services comprise just over two-thirds of the costs of adult and youth corrections programs). Reductions of custody staff, however, would have obvious public safety trade-offs. Reductions in support or program staff could actually make the fiscal situation worse, since most programming in state prison is intended to reduce the time inmates spend in institutions or decrease their likelihood of returning.

Youth corrections comprise only about 12 percent of criminal justice expenditures and, as Figure 20 shows, have been relatively stable over the past 10 years. Consequently, changes to control costs in this area would not result in as significant a change in state costs as would be available in the corrections area. Most of the options outlined above would apply to these programs as well.

Changes in judicial programs would likely require statutory changes and may be of little benefit to the Legislature when attempting to control costs. For example, the Legislature could modify the Trial Court Funding Program (which accounts for about 70 percent of judicial program expenditures) to reduce block grants to counties. Such an option would have little benefit, however, because modifications would require an increase in the appropriations limits of counties and a decrease in the appropriations limit of the state. Thus, the state might not have sufficient room under its limit to spend the funds that were saved as a result of the transfer.

Resources

Funding for resources programs represents only a small share (2.4 percent) of expenditures from state funds proposed by the Governor's Budget in 1990-91. In total, the budget proposes $1.2 billion from all state funds for support of resource program operations and local assistance in the budget year. Nearly 60 percent ($724 million) of state support for resources programs will come from special funds, including the Environmental License Plate Fund, the Motor Vehicle Account, the Public Resources Account (Proposition 99), and funds generated by fees for support of specific regulatory activities. The remainder—$503 million—is proposed from the General Fund. As Figure 22 demonstrates, the share of the General Fund budget allocated for resources programs has declined steadily for the last five years, and special funds have now surpassed the General Fund as the primary source of support for resources programs.

Figure 22

Resources Expenditures Current and Constant Dollars

All State Funds 1981-82 through 1990-91

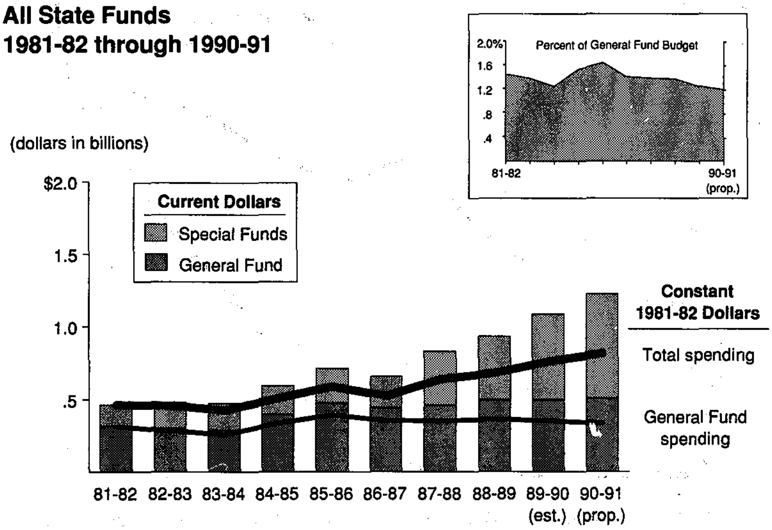


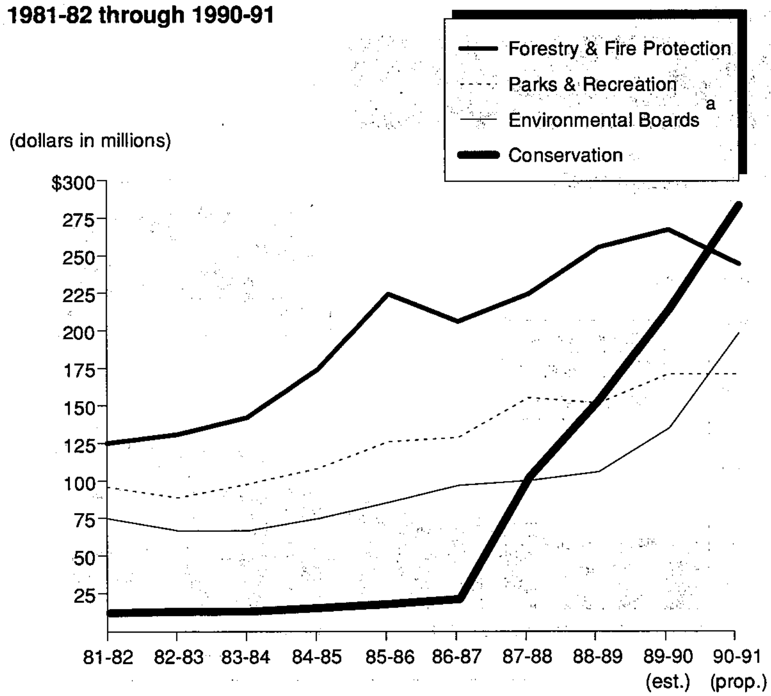
Figure 22 shows state spending trends for resources programs over the last 10 years. As this figure demonstrates, General Fund expenditures have increased by nearly $200 million in the last 10 years. When these expenditures are adjusted for declines in purchasing power, however, the growth in General Fund spending for support of resource programs has increased only slightly. Figure 22 also demonstrates that special fund expenditures for resources programs have increased markedly—from $150 million in 1981-82 to $724 million proposed in 1990-91. Adjusting for declining purchasing power, *total* state expenditures for resources programs grew at an average annual rate of 6.5 percent during the last 10 years.

Figure 23 illustrates expenditure trends for the four largest state-funded program areas within the resources area: the De-

Figure 23

Resources Expenditures By Major Program

All State Funds 1981-82 through 1990-91



[a] Includes State Water Resources Control Board, Air Resources Board, and the Integrated Waste Management Board.

partments of Conservation (DOC), Forestry and Fire Protection (CDFFP), and Parks and Recreation (DPR), and the Environmental Affairs Agency boards with responsibility for water quality, air quality, and waste management. As the figure shows, the most marked increase in expenditures began in 1987-88 when the Department of Conservation grew from a relatively small department ($21 million in state funds) to become the largest single department within the Resources Agency ($283 million proposed in 1990-91). This rapid growth resulted from the implementation of a statewide beverage container recycling program.

OVERVIEW OF THE BUDGET

As shown in Figure 22, the budget for 1990-91 proposes increases of $140 million (13 percent) from all state funds and $6 million (1.2 percent) from the General Fund. We estimate that the General Fund increase needed to fund the current level of services is approximately $35 million. This is $29 million above the amount proposed by the Governor. The failure of the budget to plan for emergency fire suppression costs (approximately $24 million) explains most of the discrepancy in funding for the current services level. The remaining amount is due primarily to a reduced level of support for local assistance grants and programs and the failure to fund cost increases in various departments.

Figure 24 shows the major funding changes for resources programs proposed for 1990-91.

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

The ability of the Legislature to control resource program costs are constrained by several factors. First, costs determined by natural events, or by the need to plan for natural phenomena contribute significantly to the overall cost of resources programs. Among other things, these costs include expenditures for fighting forest fires and helping local governments build flood control projects. Second, the pressure to preserve open space and outdoor recreational opportunities for an increasingly urban society, and to protect wildlife habitat from environmental pressures caused by population growth ultimately increases state costs to operate, maintain, and police acquired lands. Third, the state must comply with various federal requirements regarding environmental quality. Finally, statutory initiatives passed by the electorate often require regulatory action by state agencies, as in the case of Proposition 65. (Proposition 65 imposed new requirements for discharges of toxic chemicals and for warnings about exposure to toxic chemicals.) Environmental initiatives currently circulating for the June and November 1990 ballots could significantly

Figure 24

Resources Programs
Proposed Major Changes for 1990-91

Conservation	Requested: $283 million Increase: $68 million (32%)

+ $68 million for implementation of the state's new Beverage Container Recycling Program

Forestry and Fire Protection	Requested: $244 million Decrease: $21 million (8.6%)

− $24 million reduction for emergency fire suppression costs

Environmental Boards	Requested: $198 million Increase: $63 million (47%)

+ $43 million to expand integrated waste management activities

+ $21 million to expand programs relating to storage tanks

increase state costs to protect habitat and regulate forest practices.

Despite these constraints, the Legislature has several tools available to it to control costs—especially General Fund costs—of many resources and environmental programs. These tools include:

Shifting Costs to the Regulated Community and Program Beneficiaries. In recent years, the Legislature has frequently used special fees assessed on regulated industries to support the costs of environmental programs. Examples include (1) fees assessed on owners and operators of petroleum storage tanks to cover the State Water Resources Control Board's (SWRCB) costs to regulate tank operation, maintenance and cleanup, and (2) new fees implemented in the current year to cover the full costs of the Integrated Waste Management Board. However, there are other areas traditionally supported by the General Fund that also could be shifted to fees, including: (1) the state's costs for reviewing Timber Harvest Plans, (2) the SWRCB's costs of issuing water rights permits and of regulating waste discharges, and (3) the costs to operate the state park system.

Accepting Greater Risk; Doing Less. Federal and state requirements in many areas of environmental regulation result in the state implementing inspection and enforcement programs to ensure that the regulated community is complying with legal requirements. Implicit in the level of resources approved for these activities is an assessment of risk that the state has made concerning the costs to the state to enforce the regulations versus the cost to the environment of a violation of the requirements. In many areas, it may be that the state has been more risk-averse than current law minimally requires by providing resources for optional inspections and reviews. As a cost-control measure, the Legislature could choose to allocate fewer enforcement resources for environmental programs, thereby accepting a greater risk that violations resulting in environmental damage will happen. This would be contrary, however, to recent legislative trends in this area.

Transportation

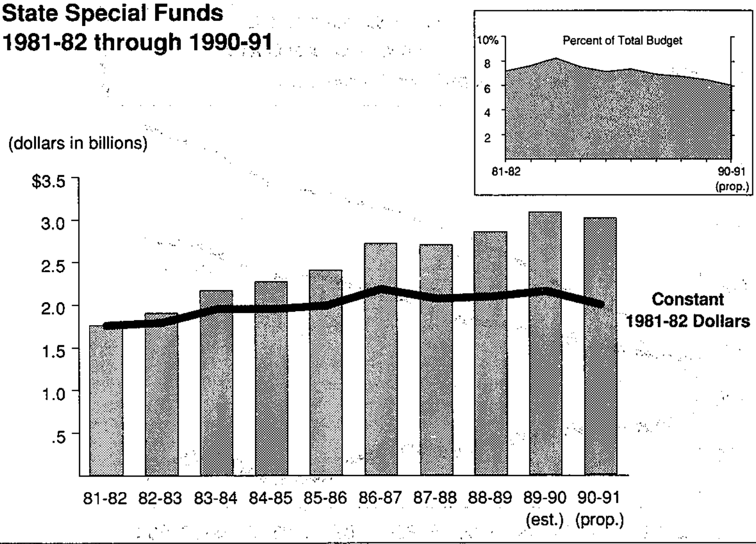
Funding for transportation programs represents 6 percent of expenditures from all state funds proposed in 1990-91. State funds for transportation programs are provided almost entirely from state excise taxes on gasoline and diesel fuel, truck weight fees, and vehicle registration and drivers' license fees. Only minimal amounts of General Fund money are used for the state's transportation programs.

Figure 25 shows spending trends over the last 10 years. The average annual increase in spending from all state funds for transportation programs over the decade was 6.1 percent. The figure also shows that expenditures for transportation programs have been declining steadily as a share of expenditures from all state funds since 1982-83. Figure 25 also shows the rate of increase in state spending as adjusted for declines in state purchasing power. On this basis, transportation spending's annual

Figure 25

Transportation Expenditures Current and Constant Dollars

State Special Funds 1981-82 through 1990-91



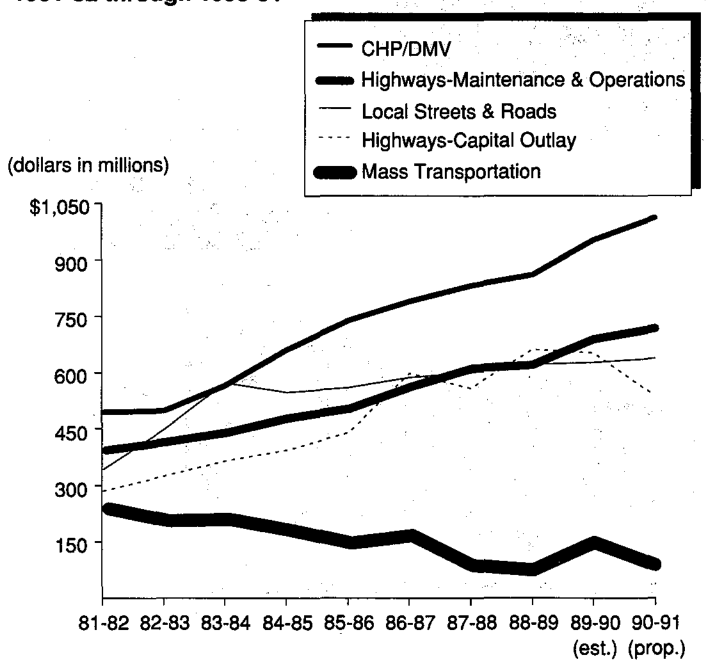
rate of increase was about 2.3 percent through 1989-90, but would decline in 1990-91.

Figure 26 shows spending for the five major transportation-related programs since 1981-82. It indicates that state expenditures for licensing and registering California drivers and vehicles, as well as for traffic enforcement—by the Department of Motor Vehicles (DMV) and the California Highway Patrol (CHP), respectively—have increased significantly over the last 10 years, at an average annual rate of 8.3 percent. Expenditures to operate and maintain the state's highway system have also expanded significantly, although at a lower average annual rate of 6.9 percent. State-funded expenditures for highway capital outlay (including design, engineering and construction) show a relatively rapid rate of growth through 1989-90 (about 11 percent per year). However, as shown in Figure 26, these capital outlay

Figure 26

Transportation Expenditures By Major Program

State Special Funds 1981-82 through 1990-91



expenditures are projected to decrease dramatically in the budget year.

In contrast, the figure shows that expenditures on mass transportation activities have declined consistently since 1981-82, at an average annual rate of almost 11 percent. In 1990-91, expenditures for mass transportation are proposed at $88 million, compared to expenditures of $238 million in 1981-82.

OVERVIEW OF THE BUDGET

As shown in Figure 25, the budget for 1990-91 proposes $3 billion in state funds for transportation programs. This is a net decrease of $75 million (2.4 percent) from the current-year estimated level.

The Governor's Budget identifies a $533 million deficit in state funds necessary to restore base reductions made in the current year in highway maintenance and operations, and to carry out previously planned highway capital outlay activities. In order to minimize the necessary cutbacks in the highway capital outlay program, the budget contains the following major policy proposals:

- ***Highway Capital Outlay ($185 Million Reduction).*** The budget proposes to eliminate all state-funded highway capital outlay projects, except for seismic retrofit, safety, and earthquake-related rehabilitation work.
- ***Engineering Service Contracts ($104 Million Reduction).*** The budget proposes to eliminate state funding of engineering services contracts and to rely only on state engineering staff to design and develop highway projects.
- ***Transit Programs ($118 Million Reduction).*** The budget proposes to eliminate State Transportation Assistance (STA) and transit guideway funding, and to reduce Transit Capital Improvement program funding. As a result, the state will not be able to honor about $85 million worth of prior funding commitments in 1990-91. These funds would be used for highway transportation purposes instead.

While highway capital outlay and mass transportation expenditures are proposed for reduction, the budget would increase state funding of the traffic licensing and enforcement programs above the current level. Specifically, the budget provides funding for additional CHP traffic officers and additional staff at the DMV for increased workload and to implement new programs. To pay for the higher service levels and to avoid a potential deficit in the Motor Vehicle Account (MVA), the budget proposes to increase various fees charged to drivers and for vehicle registration (if the fee increases are not implemented, the MVA could run a deficit of at least $60 million in 1990-91). In addition, the budget proposes to fund part of the retirement expenditures for CHP staff from surplus employer contributions to the Public Employees' Retirement Fund.

Figure 27 displays the major funding changes proposed for transportation programs in 1990-91.

Figure 27

Transportation Programs
Proposed Major Changes for 1990-91

Highway Operations and Maintenance — Requested: $717 million; Increase: $30 million (4.3%)

+ $30 million to restore reductions in highway maintenance expenditures made in the current year

Highway Capital Outlay — Requested: $538 million; Decrease: $114 million (18%)

− $114 million reduction as a result of insufficient state funds for highway activities

Local Streets and Roads — Requested: $637 million; Increase: $11 million (1.7%)

+ $11 million in subventions for local streets and roads

Mass Transportation — Requested: $88 million; Decrease: $61 million (41%)

− $61 million reduction from eliminating funds for state transit assistance programs and transit guideway projects

Traffic Enforcement — Requested: $1 billion; Increase: $59 million (6.2%)

+ $27 million for 150 new CHP officers and for other cost and workload increases

+ $33 million for increased workload and to implement new legislation at DMV

IMPACT OF SENATE CONSTITUTIONAL AMENDMENT 1 (SCA 1)

The Governor's Budget proposal for transportation expenditures was prepared based on current law. In the June 1990 election, voters will be asked to approve SCA 1 (Garamendi). If approved, this measure would trigger increases in gasoline and diesel excise taxes, and in truck weight fees, beginning in August 1990. These increased revenues would have a significant impact on the budget for transportation programs.

If SCA 1 is approved by the voters, an additional $925 million in state revenues would be received in 1990-91 for highway transportation, local streets and roads, and mass transportation purposes. In that event, the Legislature would need to determine whether to restore all the base adjustments and reductions proposed in the Governor's Budget, and what amount of the additional funds ought to be directed for highway and mass transportation activities.

However, if SCA 1 is not approved, the Legislature would need to determine the appropriate level of highway capital outlay activities to be sustained, given limited state resources, and how best to adjust to the lower program level. In addition, the Legislature would need to determine the extent to which state funds ought to be used for mass transportation purposes, and how to accommodate the state's demand for transportation services from the available combination of state, federal, local and private funds.

General Government

Funding for general government programs represents about 14 percent of expenditures from all state funds and approximately 8.4 percent of General Fund expenditures in 1990-91. These general government expenditures include: state administrative expenses, regulatory programs, tax relief, local government aid, and the costs of state-mandated local programs.

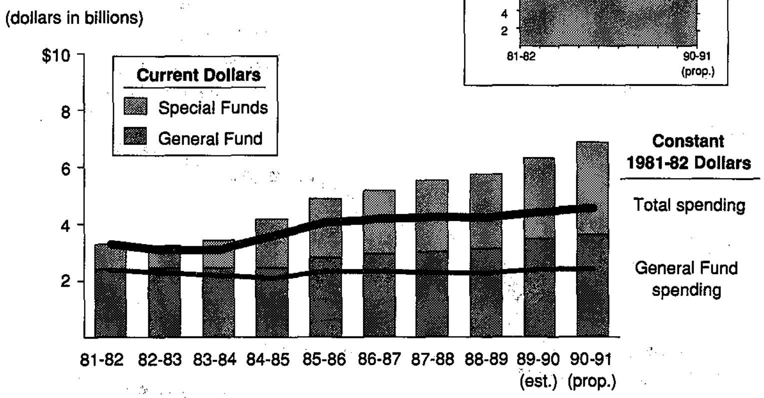
Figure 28 shows that general government expenditures from all state funds have increased from $3.3 billion in 1981-82 to a proposed level of $6.8 billion in 1990-91, an average annual increase of 8.5 percent. Spending for these programs from the General Fund has increased at a much-less-rapid average annual rate of 4.7 percent. As a result, special funds now support almost one-half of expenditures in this program area.

Accounting for declines in state purchasing power, Figure 28 shows that general government expenditures from all funds have

Figure 28

General Government Expenditures Current and Constant Dollars

All State Funds 1981-82 through 1990-91



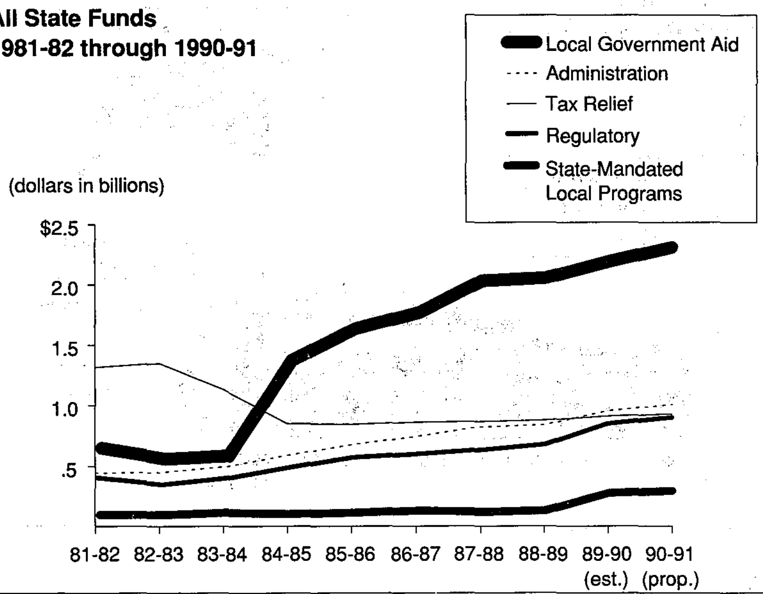
grown at an average annual rate of 3.7 percent between 1981-82 and 1990-91. General Fund expenditures, in contrast, show no increase over the 10-year period when adjusted for purchasing power declines.

Figure 29 shows funding for general government expenditures, by major program, for the last 10 years. The largest program over much of the last 10 years has been aid to local governments. This aid, which is funded primarily by motor vehicle license fees (VLF) and is apportioned to cities and counties for general purposes according to population, has been growing at an annual average rate of 9.1 percent since 1984-85. In the 1981-82 through 1983-84 period, the state reduced VLF subventions as part of its overall budget-balancing strategy. The decline in state funding for tax relief between 1982-83 and 1984-85 shown in Figure 29 reflects the repeal of the Business Inventory subvention in 1983-84. Tax relief expenditures have been relatively stable ever since. Finally, Figure 29 also shows that although state-mandated local programs are a relatively small portion of expenditures for general government programs, they have more than doubled over the last two years.

Figure 29

General Government Expenditures By Major Program

All State Funds
1981-82 through 1990-91



OVERVIEW OF THE BUDGET

The Governor's Budget proposes general government expenditures of $6.8 billion from all state funds ($3.6 billion General Fund) in 1990-91. This represents an increase of 8.6 percent, (5 percent for General Fund spending) over estimated 1989-90 expenditures. With two exceptions, the Governor's Budget proposes to fund programs in the general government area at the level required to maintain current service levels.

First, the budget, consistent with its practice in recent years, does not provide funding for merit salary increases and certain other cost increases in most departments. The second exception is that the budget proposes to eliminate the funding for certain state-mandated local programs.

Figure 30 shows the major funding changes proposed for general government programs in 1990-91.

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

While the Legislature has some limited flexibility to reduce costs in general government programs, there can be significant costs to making certain types of reductions. For example, while state administrative programs are not generally protected through statute or the State Constitution, significant reductions could actually worsen the state's current fiscal situation. For instance, reductions made in the budgets of the Franchise Tax Board or the Board of Equalization could result in decreased revenue collections for the state. Similarly, significant reductions in the State Treasurer's office might result in reduced investment yields or higher interest expenses. In general, some minimum level of state funding is required for these programs and significant reductions in this area could affect the efficiency and effectiveness of state government.

In the area of regulation, much of the funding comes from special funds, which obtain their revenue from the industries they regulate. In this case, expansions in regulated industries result in both increased costs and increased revenues. In addition, spending on regulatory programs is generally intended to protect California citizens. Thus, while reductions in the level of regulation might be made, to do so could expose the citizens of the state to increased problems with currently regulated industries. In terms of General Fund costs for regulation, the largest portion goes for programs in the Department of Industrial Relations (DIR). While the level of funding for DIR programs is generally discretionary, reductions in those programs could result in decreased worker safety in the state.

Figure 30

**General Government Programs
Proposed Major Changes for 1990-91**

Administration	**Requested: $1 billion** **Increase: $49 million (5%)**

+ $20 million for workload increases

Regulatory	**Requested: $898 million** **Increase: $51 million (6.2%)**

+ $22 million to implement the workers' compensation reform legislation

Tax Relief	**Requested: $925 million** **Increase: $13 million (1.4%)**

+ $13 million for normal program growth

Local Government Aid	**Requested: $2.3 billion** **Increase: $120 million (5.5%)**

+ $120 million for normal program growth

State-Mandated Local Programs	**Requested: $289 million** **Increase: $17 million (6.2%)**

+ $82 million for additional mandated program reimbursements

− $28 million reduction due to proposal to eliminate 10 state-mandated local programs

In the other major general government program areas (tax relief, local government aid and state-mandated local programs), the Legislature has limited flexibility to make spending reductions through the budget process. This is because a significant portion of the costs of those programs are protected through statute and the state Constitution.

Thus, a significant portion of general government expenditures are essentially uncontrollable by the Legislature through the budget process. In the areas in which the Legislature does have some discretion, however, it is not clear how deep reductions could be made and still allow state government to function reasonably efficiently and effectively.

Capital Outlay

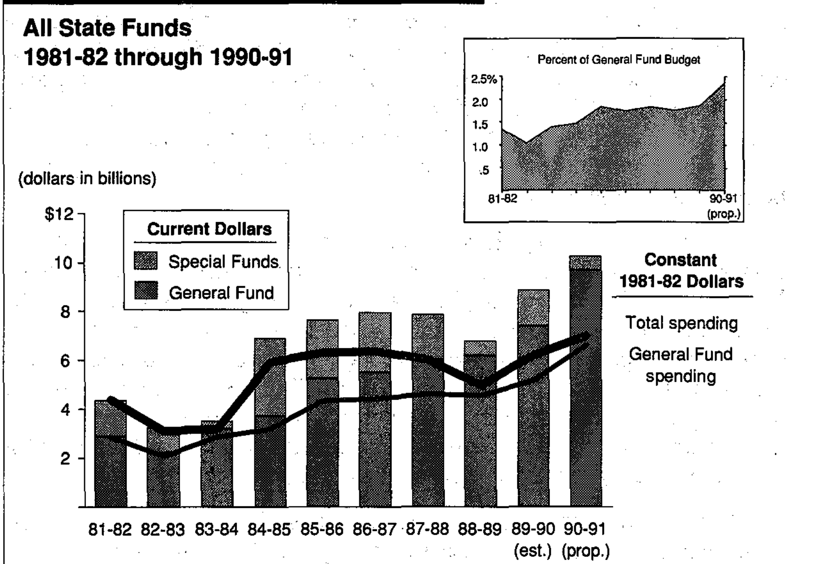
Funding for capital outlay expenditures represents about 2.1 percent of expenditures from all state funds proposed for 1990-91 and about 2.3 percent of the General Fund budget. These expenditures reflect the state's current *payments* for capital programs in each year (through "pay-as-you-go" spending or debt service payments), as opposed to the total amount of *outlays* (such as a bond expenditure which is "paid for" over a period of many years). As shown in Figure 31, expenditures for capital outlay programs have increased significantly over the past 10 years, and the increase is attributable to increased General Fund spending. The average annual increase in General Fund expenditures over the 10-year period amounts to 15 percent.

Figure 31 also displays the spending trend as adjusted for declines in the purchasing power of the dollar. On this basis,

Figure 31

Capital Outlay Expenditures Current and Constant Dollars

All State Funds 1981-82 through 1990-91



spending for capital outlay expenditures have increased at an average annual rate of 5.4 percent (all state funds) over the 10-year period, while state General Fund expenditures have increased at an average annual rate of 9.6 percent.

Until 1987-88, state expenditures were about evenly divided between special fund expenditures for capital outlays (basically "pay-as-you-go" spending from tidelands oil revenues) and General Fund expenditures for payment of debt service on funds borrowed through the sale of general obligation bonds. Since 1987-88, however, the state has relied almost exclusively on borrowed funds for its capital outlay programs, either through general obligation bonds approved by the electorate or through lease-revenue bonds approved by the Legislature and the administration. These methods of financing have been used mainly for two reasons. First, there was a substantial decline beginning in 1987-88 in the state's tidelands oil royalties—the traditional revenue source for financing capital outlay. Second, the magnitude of the expansion of the state prison system, coupled with an increased emphasis on construction in education, made it impossible to finance these costs on a pay-as-you-go basis.

Figure 32 shows the past 10-year trend for capital outlay expenditures in four governmental areas: (1) Youth and Correctional Agency (YACA), (2) K-12 education, (3) higher education and (4) resources. These four areas represent between 75 and 90 percent of the annual expenditures in each of the 10 years covered by Figure 32. Other than the resources area, which experienced a steady upward trend in expenditures through 1989-90, state expenditures in these governmental areas have varied significantly over the 10-year period. The most significant increase has been in the area of YACA, where new outlays for prison construction in the early 1980s caused a dramatic increase in expenditures beginning in 1984-85.

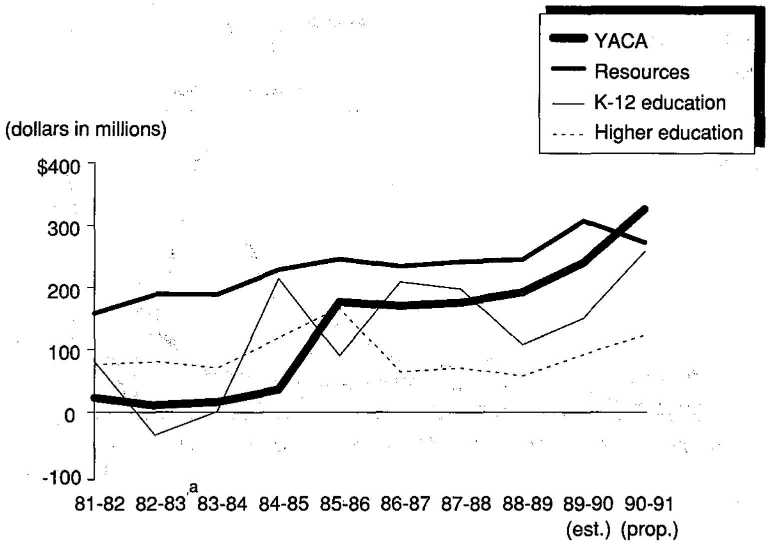
As noted earlier, these expenditures do not represent the actual level of capital improvements undertaken in each year. Instead, most of the expenditures reflect payments to retire the debt incurred through the use of bond financing. For example, debt service payments represent 88 percent of the capital outlay expenditures from state funds in 1988-89. However, some of this debt payment is for general obligation bonds that were authorized as long ago as 1955. Debt service payments generally continue for a period of 20 years after each bond sale.

Figure 33 shows the annual amount of state outlays for the acquisition of capital assets in each year, for the four program areas described above. In general, these outlays represent capital improvements actually accomplished or committed to construc-

Figure 32

Capital Outlay Expenditures By Program Area

All State Funds
1981-82 through 1990-91



[a] Negative expenditure for K-12 education in 1982-83 represents excess bond repayments by local school districts.

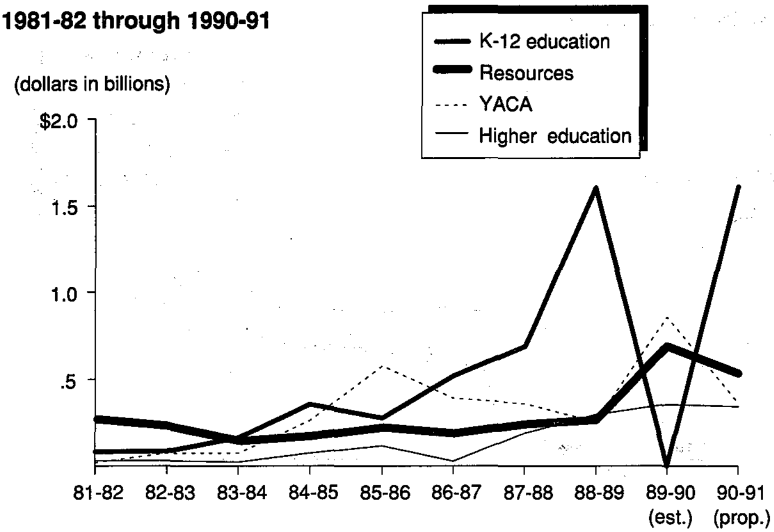
tion in the particular year. An exception to this is in the area of K-12 education, where the expenditures represent allocations to local districts. Since 1988-89, the full amount of new bond authorizations are allocated to school districts in the year the authorizations are approved by the voters. These commitments are then reflected as expenditures for accounting purposes. This change explains the large swings in capital outlays for K-12 education between 1988-89 and 1990-91. The actual disbursement of the funds, and the commencement of construction activities, may not occur for several years after the allocations are made.

Figure 33 shows that one of the most significant changes in annual capital outlay activities occurred in 1984-85, when major expansion of the state's prison system began. Another rapid increase is evident in 1987-88, when expenditures are shown for the first of a series of bond issues for higher education.

Figure 33

Annual Outlays for Acquisition of Capital Assets By Program Area

All State Funds
1981-82 through 1990-91



OVERVIEW OF THE BUDGET

The Governor's 1990-91 Budget includes over $2.9 billion of proposed capital *outlays*, exclusive of transportation-related capital outlays. This reflects outlays of $747 million for state-level facilities, and $2.2 billion in state assistance for capital facilities to be constructed by local governments and school districts. Of the $2.9 billion in total outlays, almost all ($2.8 billion) would be paid from bond funds.

The Governor's Budget indicates support for six new general obligation bond issues totaling $4.65 billion for the June and November 1990 statewide ballots. These bonds would finance capital outlay programs in education (K-12 and higher education), prisons, transportation and earthquake safety upgrading for state buildings. Not all of these measures had been placed on the ballot at the time this analysis was prepared. In addition, a voter initiative calling for $1.99 billion of general obligation bonds for passenger rail facilities has qualified for the June ballot.

Of the $2.8 billion in proposed outlays from bond funds (discussed above), about $2 billion is proposed to be funded from the general obligation bond issues that the budget assumes will be approved by the voters at the June and November 1990 elections. Thus, depending on voter approval of the bond issues finally approved by the Legislature and the administration, the state will continue to finance a large share of its capital outlay program by borrowing money through general obligation bonds.

FUNDING BY PROGRAM

State-Level Capital Outlays. The major thrust of the state-level capital outlay program in the Governor's Budget is in higher education. About $344 million is for expenditures in this area. Expenditures for already authorized correctional facilities ($154 million) and for state parks projects ($121 million) make up most of the remainder. The budget as submitted to the Legislature *does not include any proposals for new prisons.* This omission has been the administration's practice in recent years. Rather than give the Legislature a clear picture of total needs in the state budget—including needs for new prisons—the administration has chosen to propose individual new prisons in separate legislation. Consequently, Figure 33 does not reflect any proposed outlays for new prisons in 1990-91.

Local-Level Capital Outlay Assistance. As in past years, the major emphasis of the local-level expenditure program is K-12 school construction. About $1.6 billion in allocations to school districts are planned for 1990-91, which is the full amount of the general obligation bond issues currently proposed for the 1990 elections. The budget also reflects an allocation of $200 million for county correctional facilities, and about $150 million in grants for local park projects.

ABILITY OF THE LEGISLATURE TO CONTROL COSTS

The Legislature has almost no flexibility to reduce the impact of capital outlay expenditures on the budget, because—as noted earlier—most of the state's current budget expenditures are for debt service on past capital outlay projects. Only a small amount of state funds—primarily tidelands oil revenues—are used for pay-as-you-go capital outlays.

Conclusion

This part has described past spending trends for state expenditures, summarized the proposed budget for 1990-91, and discussed the Legislature's ability to control state expenditures through the budget process. As this review indicates, the preparation of a balanced budget for 1990-91 will not be an easy task, given the fiscal conditions facing the state. Rather, it will be one that requires the reevaluation of past policy choices and funding decisions.

The prospects that a significant windfall in state revenues will change the nature of this year's budget deliberations are small. As we discuss in Part Three of this document, the administration's economic forecast is already on the high end, relative to the consensus of other economic forecasters, and the risks to the revenue forecast are generally on the down side. Further, the state's appropriations limit places a cap on the amount of additional tax revenues that could be absorbed or raised through legislative action, at least as it stands today. Thus, the Legislature must begin the 1990 budget process by examining its options for reducing state expenditures to the level of available revenues.

As we have discussed throughout this part, the Legislature's options for reducing expenditures *through actions taken in the Budget Bill are relatively limited.* They exist mostly in the areas of higher education, health, resources and general government. Constitutional funding guarantees place most of the budget for K-14 education off-limits, while a combination of state laws and federal regulations predetermine the funding levels that must be provided for many welfare programs and Medi-Cal.

The Legislature has considerably more flexibility to control expenditures through enactment of legislation changing the service-level requirements for state programs. If *all* state programs are to be subject to the *same level of scrutiny* in terms of their priority for the receipt of state funds in 1990-91, then it will be necessary to consider statutory changes along with budgetary actions. Some of the available statutory changes, such as the suspension of COLAs, could provide significant short-term savings without requiring complex program adjustments. In some program areas, program restructuring would probably be required in order to realize significant savings. In any event, the magnitude of the savings required to balance the budget will force the state to reduce the level of services it provides.