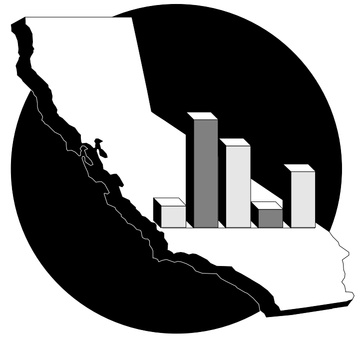


AN OVERVIEW OF STATE EXPENDITURES

PROPOSED CURRENT- AND BUDGET-YEAR SPENDING

The Governor's Budget proposes spending $52.5 billion from the General Fund and state special funds in 1994-95, as shown in Figure 1. This expenditure level is only slightly more than estimated current-year spending of $52.3 billion—an increase of $228 million, or 0.4 percent. General Fund spending shown in the budget declines by 1.4 percent, while spending from special funds increases by 6.1 percent. However, as we discuss in greater detail later in this part, this reflects a shift in how programs are financed rather than a change in program spending priorities or in underlying revenue trends. This shift in financing results from the Governor's state-county restructuring proposal.

Figure 1 also includes two adjustments that we have made to the spending totals shown in the budget in order to better reflect actual state spending levels, and to make spending amounts more comparable from year to year. The first adjustment recognizes a net $596 million of off-budget education spending in the current year (a current-year off-budget loan of $786 million to K-12 schools and community colleges against their future Proposition 98 state funding entitlements less $190 million to repay a prior loan).

The second adjustment adds spending from the Local Public Safety Fund (LPSF) established by Proposition 172, which was approved at the

November 1993 election. Proposition 172 made permanent, as of January 1, 1994, a temporary half-cent increase in the state sales tax that had been enacted in 1991-92 to provide General Fund revenue. The proposition, however, dedicated this revenue to the LPSF for allocation to counties and cities. These LPSF allocations, in effect, offset some of the local revenue loss from property taxes that were shifted to schools in order to reduce state education funding obligations as part of the 1993-94 budget agreement. The budget treats the LPSF as a trust fund and excludes it from spending totals. We disagree with the budget's treatment of LPSF funds because the LPSF consists of state tax revenues which are expended for public purposes. Furthermore, the LPSF is not fundamentally different from other dedicated state funds, such as the Motor Vehicle License Fee Account (also constitutionally dedicated to local governments) and the Cigarette and Tobacco Products Surtax Fund (Proposition 99) which *are* included in budget spending totals.

Figure 1

Governor's Budget
Proposed and Adjusted Spending Changes
1993-94 and 1994-95

(Dollars in Millions)

			Change From 1993-94	
	1993-94	1994-95	Amount	Percent
Budgeted Spending:				
General Fund	$39,347	$38,788	-$559	-1.4%
Special funds	12,972	13,760	787	6.1
Totals shown in budget	$52,320	$52,548	$228	0.4%
Adjustments				
Add net Proposition 98 loan	596	—		
Add Local Public Safety Fund	686	1,450		
Adjusted totals	$53,602	$53,997	$396	0.7%

Including these adjustments adds approximately $1.3 billion to the budget spending totals in 1993-94 and $1.5 billion in 1994-95, raising them to $53.6 billion and $54.0 billion, respectively. We use these adjusted figures in our discussions below.

Spending from Federal Funds and Bond Proceeds

Federal Funds. The budget proposes to spend a total of $30.7 billion of federal funds in 1994-95. Most of these federal funds are for federal contributions to health and welfare programs ($20.9 billion), education ($6.5 billion), and transportation ($2.4 billion). Although the budget relies on $3.1 billion of additional federal funds to resolve most of the 1994-95 budget gap, expenditures of federal funds actually decline by $1 billion in 1994-95 compared with estimated spending in 1993-94. The main reason for this apparent discrepancy is that the budget treats $2 billion of the additional 1994-95 federal funds as General Fund *revenues* rather than expenditures. Projected reductions of $2.1 billion in federal funds for ongoing programs such as unemployment benefits, transportation projects, and sewage projects more than offset the remaining $1.1 billion of new federal funds for health and welfare costs that the budget assumes.

Bond Proceeds. Debt service on general obligation bonds and lease-payment bonds is included in spending from the General Fund and special funds within the appropriate program areas, as are direct expenditures on capital outlay projects. Spending from bond proceeds has *not* been included in these figures, however. Instead, the cost of bond programs is reflected when the debt-service payments are made.

The budget estimates that the state will spend $2.8 billion of general obligation bond proceeds in 1994-95. Half of these bond fund expenditures ($1.4 billion) are to finance local K-12 school facilities, with funding provided by a proposed 1994 school facilities bond act. The budget also proposes to spend $488 million of general obligation bond proceeds for higher education facilities, which would be financed primarily from a new 1994 bond act. Other major uses of general obligation bonds would be for transportation projects ($367 million); flood control, drinking water and water conservation projects ($220 million), and prisons and correctional facilities ($193 million).

Spending for earthquake safety projects could increase bond fund expenditures above the amount shown in the budget. Approximately $195 million of authorized general obligation bonds for earthquake safety projects remain available and were not proposed for expenditure in the budget, which was released prior to the Northridge earthquake.

In addition to general obligation bonds, the state also uses lease-payment bonds (supported almost entirely from the General Fund) to finance some facilities. In 1994-95, the budget indicates that the state will spend about $500 million of lease-payment bond proceeds, primarily to build prisons.

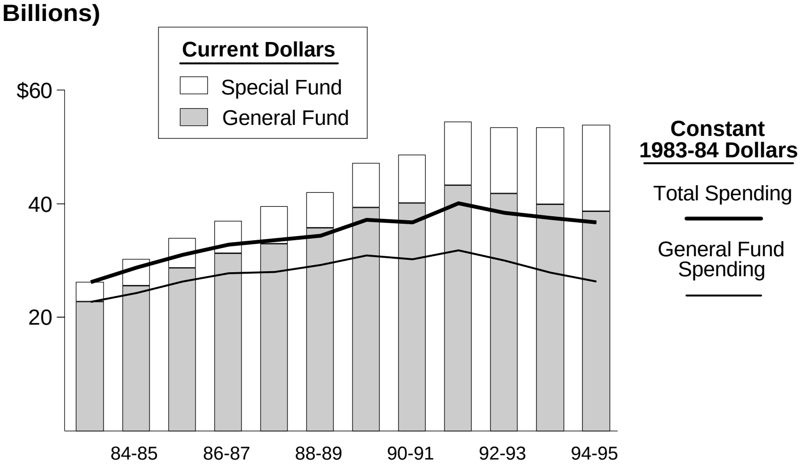
STATE SPENDING SINCE 1983-84

Figure 2 illustrates the trend in state General Fund and special fund expenditures from 1983-84 through 1994-95. The figure shows expenditures in both "current dollars" (amounts as they appear in the budget) and "constant dollars" (current dollars adjusted for the effects of inflation). Using constant dollars allows comparisons of the "purchasing power" of state spending over time.

Figure 2

State Spending[a]
Current and Constant Dollars
1983-84 Through 1994-95

(In Billions)



[a] Excludes bond funds and federal funds.

Recession Puts Brakes on State Spending Growth

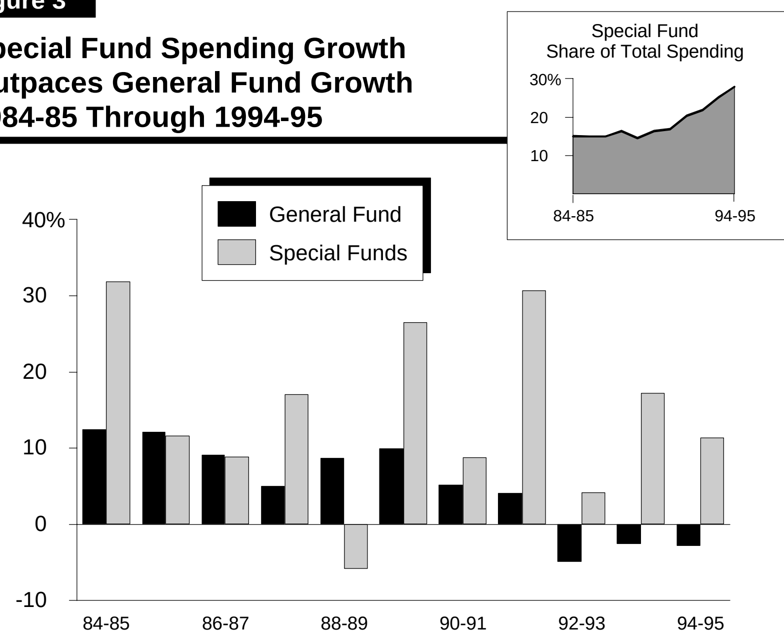
Spending grew at an annual rate of more than 9 percent between 1983-84 and 1991-92, when spending peaked at $54.5 billion (a one-time accounting change in Medi-Cal exaggerates this spending peak by $1 billion). After adjusting for inflation, spending still grew at annual rate of 5.4 percent during this period, which was more than twice the rate of population growth. After 1991-92, however, state spending declined and has remained essentially flat since then. This spending decline and stagnation is unprecedented in the post-World War II period, and reflects the depth and stubbornness of the current recession in California. The budget would carry this flat spending trend into 1994-95. As Figure 2 shows, flat spending means declining purchasing power after adjusting for inflation. In constant dollars, proposed spending in 1994-95 is 8.3 percent less than spending in 1991-92. On a per-capita basis, the decline in constant-dollar spending will be even greater—13 percent.

State-County Realignment Shifts Spending From General Fund to Special Funds

Spending from special funds accounts for a growing share of state spending, as shown in Figure 2. Figure 3 illustrates this rapid growth in special fund spending. In 1983-84, spending from special funds was about 13 percent of total spending, but will reach 28 percent in 1994-95.

Figure 3

Special Fund Spending Growth Outpaces General Fund Growth 1984-85 Through 1994-95



Prior to 1991-92, most special fund spending consisted of transportation funds and fees used to support a wide variety of programs. Growth in special fund spending during that time largely reflected enactment of new fee-based environmental and recycling programs and approval of Propositions 99 and 111 in 1988 and 1990. Proposition 99 enacted a cigarette and tobacco products surtax and placed the revenue in a special fund dedicated primarily to augmenting health-care programs, while Proposition 111 activated a schedule of gasoline tax increases and increased truck weight fees to enhance transportation funding. Thus, special fund spending growth during this period was based on special sources of dedicated revenues that were used for programs that had not been General Fund responsibilities.

The 1991-92 Realignment and Subsequent Actions. Beginning in 1991-92, however, growth in special fund spending primarily reflects a shift of General Fund costs and state sales tax revenues to new special funds that are allocated to local governments (mainly counties). The realignment of state and county health and welfare responsibilities enacted in 1991-92 included a half-cent increase in the state sales tax that was placed in a special fund for distribution to county governments to offset a portion of the General Fund costs that were shifted to them. The state budget agreement for the current year (and Proposition 172) dedicated an additional half-cent of the state sales tax to the new Local Public Safety Fund to partially offset the loss of property tax revenue shifted to public schools and community colleges in order to reduce state General Fund spending. For 1994-95, the budget proposes to shift an additional half-cent of the state sales tax to counties as part of a second realignment of state and county responsibilities for health and welfare programs. As a result, $4.3 billion (28 percent) of proposed special fund spending in 1994-95 consists of state sales tax revenue that will be allocated to county governments to directly or indirectly offset former state General Fund costs that have been shifted to them.

Vehicle license fee (VLF) revenues have been another growing source of special fund financing for state costs shifted to local governments. The VLF is a tax levied on the value of motor vehicles, similar to a property tax. The state collects the tax as a special fund revenue and allocates it to cities and counties, as required by the California Constitution. As part of the 1991-92 state-county program realignment, the Legislature increased vehicle license fees, so that in combination with realignment sales tax revenues, local governments received additional revenues approximately equal to the costs that the state shifted to them. For 1994-95, the Governor's Budget estimates that the state will distribute $2.1 billion of regular VLF revenues and $741 million of additional VLF realignment funding to cities and counties.

Two categories of spending account for more than two-thirds of the total $15.2 billion in projected spending from special funds in 1994-95. Local government allocations from sales tax and VLF total $7.2 billion, and transportation spending (including local transportation subventions) totals $3.8 billion. A wide variety of special funds financed by special fees and taxes make up the remainder of special fund spending . Among the largest of these are California State University student fees and income ($517 million), the Beverage Container Recycling Fund ($356 million) and Proposition 99 cigarette and tobacco surtax funds ($445 million).

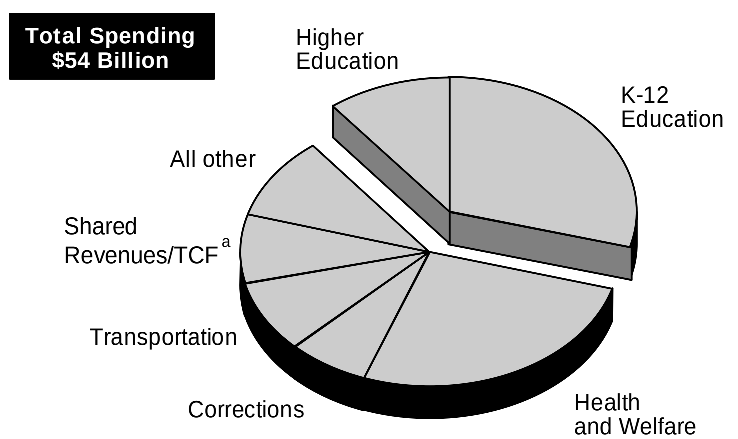
PROPOSED SPENDING BY PROGRAM AREA

Figure 4 shows the distribution of the proposed $54 billion of state spending in 1994-95 among the state's major program areas. The figure includes both General Fund and special fund expenditures in order to provide a meaningful comparison of program areas that have different mixes of General Fund and special fund support.

As Figure 4 shows, education receives the largest share of proposed state spending from all funds—a total of 40 percent (29 percent for K-12 education and 11 percent for higher education). Health and welfare programs (including state-county realignment funds) receive the next largest share of state spending—26 percent.

Figure 4

Total State Spending by Major Program 1994-95



[a] Includes VLF, Local Public Safety Fund and Trial Court Funding Block Grants.

PROGRAM SUPPORT TRENDS OVER TIME

Year-to-year changes in budget spending by program (that is, amounts shown in the budget) have become less meaningful over time and now are misleading in some cases. This is because spending adjustments and shifts—adopted in the last few years, as well as new funding shifts and program restructuring changes proposed in the budget—mean that changes in state spending from one year to another do not necessarily translate into similar changes in *program support levels*. By program support level, we mean the *total funding* provided for a program through state actions, not just the amount of state funding shown in the budget. It should be noted that most of the state budget is used, in one way or another, to support locally administered programs. In addition, program support levels take into account amounts provided through funding shifts to local governments, the federal government or to the future (using loans) and treat the total as a package.

Education funding provides an example of how program support levels are a more meaningful measure of funding than budget spending. State spending for K-12 education increases by 11 percent from 1993-94 to 1994-95 based on the figures that appear in the Governor's Budget, yet schools will realize only a 1.7 percent increase in their support level funding. This is because the increased state funding merely offsets two funding reductions that are not reflected in the budget's education spending totals. First, $1.1 billion of state spending replaces local property tax revenue that the Governor's state-county restructuring plan shifts from K-12 schools back to counties (where they offset state health and welfare costs shifted to the counties). Second, a net increase of $419 million is needed to replace the K-12 portion of the off-budget Proposition 98 loan provided in the current year.

In order to compare program support trends, we have calculated program support levels using the methodology shown in Figure 5 for major program areas in 1993-94 and 1994-95.

The support levels that we have derived only reflect funding provided by the state or (as in the case of property tax shifts) resulting from state budget actions. They do not include any effects of changes in local spending (outside of realignment and restructuring) or in federal funding (other than amounts used to offset state costs).

Figure 6 shows the proposed percentage changes in funding support level by program for 1994-95 and compares them with the average annual growth rate in support for each program during the past decade. Total program support has grown at an annual rate of 7.4 percent over the last decade, but the overall growth rate proposed for 1994-95 is much smaller—2.6 percent. Furthermore, the growth rate in 1994-95 is lower than in the past decade for every major program, although there are sharp differences among program areas in the magnitude of the change. Only a small portion of the slowdown in support growth can

Figure 5

Program Support Levels State Funding Plus Cost Shifts Adjustments by Program Area 1993-94 and 1994-95

K-12 Education and Community Colleges

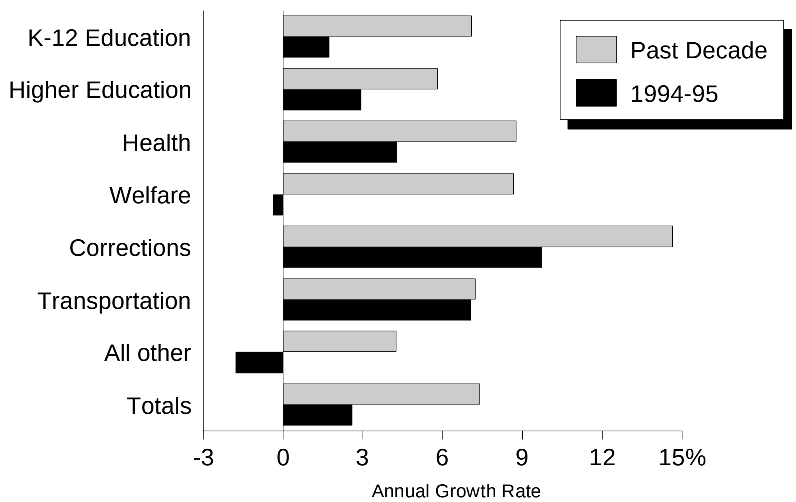
- Include funding provided by property tax shifts enacted as part of the 1992-93 and 1993-94 budget agreements and as proposed in the budget for 1994-95.
- Include spending financed by off-budget Proposition 98 loans in 1993-94 and exclude on-budget spending for repayment of prior loan.

Health and Welfare

- Allocate state/county realignment and restructuring funds among health and welfare programs.
- Include the indirect state funding that is proposed as part of the state-county restructuring plan in 1994-95. These funds consist of property tax revenue shifted back to counties from schools and increased trial court funding that would be provided to free up county resources for health and welfare costs.
- Include federal immigration funding and increased federal aid that the budget assumes for 1994-95.

Figure 6

Growth in Program Support Levels
1983-84 Through 1993-94/Proposed for 1994-95



be attributed to lower rates of inflation and population growth compared with the last decade. From 1983-84 to 1993-94, an annual growth rate of 6 percent was needed to keep pace with inflation and population growth, while for 1994-95, the anticipated increase is 4.6 percent. Thus, overall support levels for state programs will not keep pace with inflation and population growth based on the budget proposal.

Corrections

Youth and Adult Corrections will continue to experience the most rapid growth of any of the major program areas. Over the last decade, corrections support increased at an annual rate of 14.7 percent, and the budget proposes an increase of 9.7 percent in 1994-95. The budget estimates a 6.9 percent growth in the inmate population in 1994-95. Additional funding is proposed to open and staff several new prisons and make payments on bonds used to finance prison and jail construction.

Health and Welfare

Over the last decade, state support for health and welfare programs has grown by 8.7 percent annually. They have been the most rapidly growing programs after corrections. Support for health and welfare programs during this period includes state-county realignment funding, federal State Legalization Impact Assistance Grant (SLIAG) funds and Proposition 99 funding from the cigarette surtax. For 1994-95, however, the budget proposes to reduce the growth rate of health program support to 4.7 percent and support for welfare programs would decline slightly (1.1 percent).

The slowdown in health support growth reflects the elimination of some optional benefits and other proposed Medi-Cal savings that partially offset continued growth in caseload and medical costs. It also reflects a steady decline in Proposition 99 funding. Welfare support would fall slightly in 1994-95, despite increasing caseloads, as a result of substantial AFDC grant reductions proposed in the budget. Health and welfare support levels in 1994-95 include proposed funding from state-county restructuring and $1.1 billion of assumed additional federal funds, primarily for costs related to immigrants, but also due to a proposed increase in the federal match percentage for Medi-Cal and AFDC.

Education

Support for K-12 schools will grow by 1.7 percent in 1994-95, based on the budget proposal, compared with an annual growth rate of 7.1 percent over the past decade. These figures include the effects of property tax shifts and Proposition 98 loans. (Program support growth differs from the growth in Proposition 98 cash support because the latter includes local revenue changes in base property taxes and excludes non-Proposition 98 K-12 spending, such as debt service on state school bonds.) The level of support provided in 1994-95 primarily reflects anticipated enrollment growth with a flat level of per-pupil support.

Support for higher education increases by 2.9 percent in 1994-95 (including the effects of property tax shifts and Proposition 98 loans on community college resources). The proposed growth is about half of the annual growth rate during the last decade. The 1994-95 increase primarily reflects funding to cover a portion of cost and salary increases, additional student financial aid , and funding to make up for a shortfall in property tax revenues at the community colleges.

Transportation

Support for transportation, including subventions to cities and counties for streets and highways, has grown at essentially the same rate as overall state support for all programs during the last decade, and the budget proposes to continue growth in transportation support at a similar pace (7.1 percent) in 1994-95. Because transportation spending is financed by its own revenue sources, such as the gasoline tax, it has been less subject to the funding pressures that have affected other programs due to the ongoing General Fund budget problem.

Other Programs

Support for all other programs declines slightly (by 1.8 percent) in 1994-95, compared with an annual growth rate of 4.3 percent over the last decade. The decrease is somewhat misleading, however, because it reflects the budgeting practice of including in this category various statewide savings proposals (such as the reduction in middle managers) that are not allocated among the individual program areas.

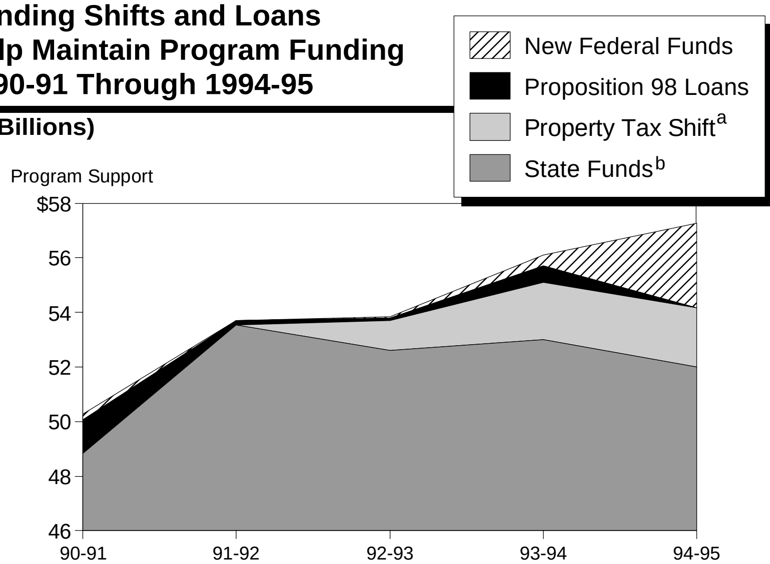
Funding Shifts Have Maintained Program Support

As the discussion above points out, growth in program support levels has slowed considerably compared with the last decade, but the budget still continues to provide some growth for most programs. In fact, since 1990-91, when the current fiscal crisis began in earnest, total state program support levels have increased by 17 percent, despite a series of massive revenue shortfalls. Figure 7 examines how the state has managed to finance growth in program support during a time when its revenue base has been shrinking.

Figure 7

Funding Shifts and Loans Help Maintain Program Funding 1990-91 Through 1994-95

(In Billions)



[a] Net of revenue from Local Public Safety Fund.

[b] Includes Local Public Safety Fund; excludes $1 billion Medi-Cal accounting change in 1991-92.

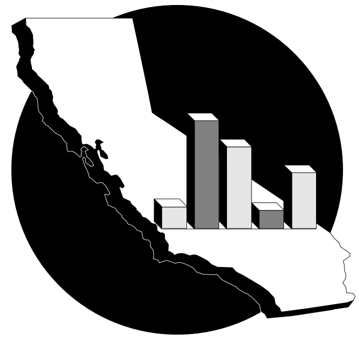
The lower area in the figure represents spending shown in the budget for each year from the General Fund and special funds for all state programs, including those administered at the local level. We have also included allocations to local governments from the Local Public Safety Fund (LPSF) in 1993-94 and 1994-95 (since these are state sales tax revenues).

The top three components in the figure represent the major funding shifts that the state has used. Property tax shifts from local governments to schools have maintained school funding while reducing state costs. Off-budget Proposition 98 loans to schools and community colleges during this period shift funding between years and also provide current funding while shifting recognition of that spending to future years. Federal funds used to offset state costs include SLIAG grants and the additional $3.1 billion of federal funds assumed in the budget for 1994-95 ($2 billion as General Fund revenues and $1.1 billion as federal funds expenditures which have the effect of reducing General Fund expenditures.

As Figure 7 shows, spending from the state's own revenues increased sharply in 1991-92 and financed a substantial increase in program support. This resulted from tax increases totaling about $7 billion that were enacted that year. Since then, however, funding shifts and off-budget loans have played an increasing role in maintaining state program support levels. These shifts and loans contribute $3.1 billion in the current year and they will contribute $5.3 billion in 1994-95 under the Governor's budget proposal.

The large net increase in 1994-95 shown in Figure 7 results from the budget's assumption that the federal government will take over $3.1 billion of existing state costs. Based on the Governor's Budget, these funding shifts will allow program support levels to grow by 5.3 percent from 1991-92 to 1994-95 even though spending from current state resources declines by 4.6 percent during the same period.

What does Figure 7 say about service level trends? First, a caveat: Our analysis addresses only *state* program levels—that is, programs funded by the state but operated by different levels of government. It does not, for example, take into account the declines in local government program levels that resulted from the 1992-93 and 1993-94 property tax shifts. With respect to state programs, however, an approximation of the ability to provide services can be derived by adjusting for the effects of inflation and population growth. When this is done, per-capita support levels decline—by 4.8 percent—since 1990-91. The decline is somewhat greater—7.9 percent—using 1991-92 as the base year. Thus, the funding shifts have not enabled the state to completely maintain the per-capita purchasing power of its programs, but they have avoided the reductions in state-financed programs that would otherwise have been required.



MAJOR EXPENDITURE PROPOSALS IN THE 1994-95 BUDGET

In this section, we discuss several of the most significant spending proposals in the budget. For more information on these spending proposals and our findings and recommendations concerning them, please see our analysis of the appropriate department or program in the *Analysis of the 1994-95 Budget Bill*.

Few Major Changes Proposed by Budget

As discussed in Part One, the Governor's Budget proposal relies on federal budget actions and a favorable decision by the U.S. Supreme Court to provide $3.7 billion of additional resources to balance the budget. Because of its assumption of additional funding, the budget makes few proposals for program reductions, except in welfare (AFDC) and health (Medi-Cal) programs. Generally, the budget continues programs at approximately current funding levels adjusted for caseload changes. Thus, outside the health and welfare area, the budget itself does not present the Legislature with many major proposals to change spending priorities or existing levels of program support. The budget's plan for restructuring state and county health and welfare responsibilities (which we discuss in detail in Part Five) would make significant revisions in the division of responsibilities between the state and the counties, but it is proposed to be fiscally neutral and does not change existing program priorities.

Figure 8

Summary of Major Budget Balancing Proposals In the 1994-95 Governor's Budget

(In Millions)

Proposal	Legislation Required?	Federal Action Required?	Assumed Effective Date	Savings 1993-94	Savings 1994-95
Increased Federal Funding					
Reimbursement for K-12 undocumented students	No	Yes	10/1/94	—	$1,700
Reimbursements for undocumented felons	No	Yes	10/1/94	—	300
Pay full Medi-Cal costs for undocumented immigrants	No	Yes	10/1/94	—	300
Pay three years health and welfare costs of refugees	No	Yes	10/1/94	—	114
Increase federal health and welfare match (FMAP)	No	Yes	10/1/94	—	599
Expand coverage of IHSS Personal Care	No	Yes	10/1/94	—	46
Eliminate SSI/SSP administrative charge	No	Yes	10/1/94	—	43
Welfare Reductions					
AFDC grant reductions and reforms	Yes	Yes	7/1/94	—	460
Medi-Cal					
Eliminate some optional benefits	Yes	No	7/1/94	—	154
Eliminate prenatal services for undocumented immigrant women	Yes	No	2/1/94	$14	92
Implement pharmacy contracting	Yes	No	1/1/95	—	34
Property Tax Shift (Proposition 98)					
Correct calculation methodology to realize full shift	Yes	No	6/30/94	200	210
Other Proposition 98					
Increase community college fees	Yes	No	7/1/94	—	35
State Administration					
Reduce managers by 10 percent	No	No	7/1/94	—	75
Natural Resources					
Shift flood control costs to bonds	Yes	No	7/1/94	—	135

Proposals that Require Legislation or Federal Action

Figure 8 lists the major budget-balancing proposals in the budget and indicates whether legislation or federal action is needed to implement them, as well as the timing assumed by the budget.

INCREASED FEDERAL FUNDING

Federal Immigration Funding

Immigration policy and enforcement is the responsibility of the federal government. The federal government also determines the eligibility of immigrants for health and welfare benefits under programs such as Medicaid (Medi-Cal in California), AFDC, and SSI/SSP, which are supported jointly by state and federal funds. In addition, the U.S. Supreme Court has determined that the federal Constitution entitles immigrant children to public education, regardless of their legal status.

Proposal

The Administration is seeking a total of $2.4 billion of additional federal funds for services related to undocumented immigrants ($2.3 billion) and refugees ($114 million). Of this amount, $2.0 billion is budgeted as revenue to the General Fund from federal reimbursements and the remaining $0.4 billion offsets state costs directly.

Education of Undocumented Immigrant Children. The budget assumes receipt of $1.7 billion in federal funds as reimbursement for the costs of providing K-12 education to undocumented immigrant children, based on the administration's estimate of the number of undocumented immigrant children in the state's public schools. In a decision on a Texas case (*Plyler v. Doe*), the U.S. Supreme Court determined that the equal protection clause of the federal Constitution prohibits states and localities from excluding undocumented children from public schools. The budget counts the $1.7 billion as an addition to General Fund revenues, rather than as a spending offset because Proposition 98 does not permit the use of federal funds in lieu of state funds in meeting the state's funding requirements. In other words, the federal funds were budgeted as revenue in order to improve the state's General Fund condition.

Incarceration Costs. The budget assumes that the state will receive $300 million in federal funds (also budgeted as General Fund revenues) for the cost of incarcerating and supervising the parole of undocumented immigrants who have been convicted of a felony in California. The federal Immigration

Reform and Control Act of 1986 (IRCA) authorizes federal reimbursements—subject to annual appropriation—for these state costs. However, Congress has never appropriated any funds for this purpose.

Medi-Cal Costs of Emergency Care. The budget includes $300 million of federal funds for the state costs of providing emergency medical care (including labor and delivery services for pregnant women) to undocumented immigrants in 1994-95. The federal Omnibus Budget Reconciliation Act (OBRA) of 1986 requires states to provide emergency medical services to undocumented immigrants who, aside from their legal status, would otherwise qualify for the Medicaid (Medi-Cal) program. The additional federal funds would replace the state's share of these costs (and the county share under the Governor's restructuring plan), so that the federal government would cover 100 percent of these Medi-Cal expenses.

Services to Refugees. The federal Refugee Act of 1980 entitles refugees to a full range of health and welfare services. The budget includes $114 million in federal funds to provide 100 percent federal funding for these AFDC, SSI/SSP and Medi-Cal services during the first 36 months of residence by refugees, as required by the act. Federal funding for this purpose has been declining since 1986 and the state received no funds for this purpose in 1993-94.

Increase in the Federal Medical Assistance Percentage (FMAP)

The FMAP is the percentage that the federal government pays of the cost of most services provided through the Medicaid (Medi-Cal) program and welfare grants and services provided in the AFDC program. The percentage varies by state according to a formula based on a state's per-capita personal income—with the federal share increasing as the per-capita personal income declines relative to the national average. California, which has a relatively large number of high-income individuals, receives an FMAP of 50 percent—the lowest possible share under the current formula.

Proposal

The budget includes a General Fund savings of almost $600 million due to an increase in the FMAP effective October 1, 1994. Most of the savings would be in the Medi-Cal program ($408 million) and the AFDC program ($170 million), with some savings also occurring in the IHSS Personal Care program. The savings assume that Congress adopts one of the options that the U.S. General Accounting Office (GAO) recommended for revising the FMAP formula. The GAO found that the existing formula does not adequately measure each state's relative need for federal funds or its ability to pay for services. Instead, the GAO recommended that Congress enact one of several alternatives that rely on the relative number of persons in each state living in poverty (to reflect need) and each state's relative tax base (to reflect ability to pay). California's FMAP would increase under any of the GAO alternatives, with the minimum increase raising the FMAP from the current 50 percent to 54.4 percent.

Issues for Legislative Consideration

Backup Plan Needed. California has joined with a number of other states that have experienced substantial immigration, such as Florida, to seek federal assistance. Consequently, the potential cost to the federal government of increased immigration funding could be significantly greater than the $3.1 billion California is requesting. Federal budget constraints will make finding these funds difficult for Congress.

Changing the FMAP formula also presents a difficult problem to Congress and the Clinton Administration. A fiscally neutral change in the formula will result in a reduction of the FMAP for a significant number of states in order to offset an increase in the FMAP for California and other states. Avoiding any losers would require a substantial increase in federal spending.

While we agree that the state has a good case for additional federal funding, we also believe that it is very likely that federal funding will fall short of the amount assumed by the budget, and that the Legislature will face a large budget hole when federal budget actions take shape this spring and summer. In fact, the new federal budget presented to the Congress by President Clinton includes none of the $3.1 billion in funding requested by the administration. (The state also faces substantial other budget risks, as we point out in Part One.) Almost $500 million of the current budget gap results from the failure of Congress to provide funding for immigrant health care costs that President Clinton had requested and which was assumed to be received in the 1993-94 state budget.

Because the federal budget is not enacted until several months after the state's budget deadline, the Legislature should consider a backup budget plan that can be implemented to achieve necessary savings if federal funding (or other budget assumptions) falls short. Because achieving significant savings becomes more difficult as the fiscal year progresses, the Legislature also should consider program reductions that could be implemented in the budget, but restored later if the state receives adequate federal funding.

Restructuring Plan Depends on Federal Funds. The fiscal balance of the Governor's plan for restructuring state and county health and welfare responsibilities depends on: (1) the assumed increase in the FMAP and (2) the assumption of full federal funding of the Medi-Cal costs of undocumented persons and of refugee health and welfare costs. Without these federal actions, the costs shifted to counties by the plan would exceed the revenues provided to them. We discuss this risk to the restructuring plan more fully in Part Five.

PROPOSITION 98

Proposition 98 establishes a minimum funding level that the state must provide for public schools and community colleges (K-14 education) in each year. Generally, this is determined based on one of three so-called "tests." Specifically, the minimum funding level is equal to the greater of:

- ***Test 1—Percentage of General Fund Revenues.*** This is defined as the 1986-87 percentage of General Fund tax revenues provided to K-14 education.
- ***Test 2—Maintenance of Prior-Year Funding Levels.*** This is defined as the prior-year level of total funding for K-14 education from state and local tax sources, adjusted for enrollment growth and for growth in per capita personal income.

In low revenue growth years, defined as years in which General Fund revenue growth, measured on a per capita basis, is more than one-half percentage point below the growth in per capita personal income, the minimum funding guarantee is based on:

- ***Test 3—Adjustment Based on Available Revenues.*** This is defined as the prior-year total level of funding for K-14 education from state and local sources, adjusted for enrollment growth and for growth in General Fund revenues per capita, *plus* one-half percent of the prior-year level. However, the increase in per-pupil funding must be at least equal to the increase in per capita expenditures for all other General Fund supported programs. This per-pupil funding floor (the so-called "equal pain, equal gain" or "Test 3b" provision) was intended to ensure that K-14 education is treated no worse, in years of low revenue growth, than are other segments of the state budget.

Other provisions of Proposition 98 allow the minimum funding level to be suspended by the Legislature and establish a "maintenance factor," which provides for restoration of funding levels in years following suspension or low revenue growth. These provisions ensure that any reductions in K-14 funding levels below those called for by the Test 1 or Test 2 formulas are only temporary in nature.

"Cash" Spending. In evaluating the effect of budget proposals, it is important to determine the amount actually available for K-14 programs ("cash" spending from state, local, and student fee sources), as well as the Proposition 98 funding provided in a given fiscal year. Cash spending differs from Proposition 98 funding due to a variety of adjustments involving funding sources that are not recorded on the state's books at all or are not recorded in the fiscal year that the schools receive the funds. For example, community college fees are not shown in the state budget at all. In the case of loans, funds are received by districts in a different year than the expenditures are recorded on the state's books.

For a more complete discussion of Proposition 98 provisions and additional background on Proposition 98 funding levels, please see the "Overview of K-12 Education" in the *Analysis of the 1994-95 Budget Bill.*

Proposal

The thrust of the Proposition 98 budget proposal is to maintain K-12 funding at the level of $4,217 per pupil in both the current year and 1994-95.

Current Year. The budget proposes $24.4 billion in Proposition 98 cash spending, $68 million less than assumed in the 1993 Budget Act. This reduction consists of a $17 million reduction in funding for K-12 schools (due to minor changes in enrollment and spending) and a $51 million reduction at the community colleges ($41 million due to property tax shortfalls plus a loss of $10 million due to changes in community college fee revenues).

The result of these proposals is to reduce the total amount of state and local spending that counts toward 1993-94 Proposition 98 funding by $58 million. The budget estimate of the minimum Proposition 98 requirement, however, is $385 million less than the June estimate, primarily due to lower estimates of General Fund tax revenues. As a result, proposed Proposition 98 General Fund spending exceeds the budget estimate of the revised Proposition 98 minimum guarantee by $327 million. Our estimate of the Proposition 98 minimum guarantee is lower (due primarily to our lower estimate of General Fund revenues) than the administration's estimate, however. The proposed level of Proposition 98 General Fund spending exceeds our estimate of the minimum guarantee by $566 million.

Budget Year. The budget proposes to provide a total of $25.2 billion in Proposition 98 funding on a cash basis from all sources in 1994-95, $714 million more than proposed current-year funding. This includes (1) $586 million to maintain funding for K-12 schools at $4,217 per pupil; (2)

$122 million for community colleges to fund enrollment growth, backfill the current-year property tax shortfall, and reflect a $7 per unit increase in student fees; and (3) $6 million for growth in other Proposition 98 programs.

The budget proposes $24.9 billion from funding sources that count toward meeting the 1994-95 Proposition 98 minimum funding requirement, $1.3 billion more than provided from these sources in the current year (almost half of this increase is necessary to backfill a current-year off-budget loan). This consists of a General Fund increase of $1.9 billion, offset by a reduction of $640 million in local property tax revenues. The property tax revenue reduction is the net effect of a proposal to shift $1.1 billion in property tax revenues from schools to other local governments partially offset by baseline growth of $460 million in local property tax revenues.

The budget proposes to overappropriate the budget estimate of the Proposition 98 guarantee by $336 million. Our estimate of the Proposition 98 guarantee, under the assumption that the Legislature adopts the administration's proposed 1993-94 budget actions and the 1994-95 property tax shift, is higher than the budget estimate. The level of General Fund spending proposed in the budget exceeds our estimate of the guarantee by about $280 million.

Issues for Legislative Consideration

Revenue Shortfalls Will Result in Painful Choices. The budget overappropriates the Proposition 98 minimum guarantee in 1993-94 and 1994-95 by about $1.4 billion. In other words, the Legislature could use that amount, without suspending the Proposition 98 guarantee, to fund other General Fund programs. To do so, however, would require per pupil funding to drop below the $4,217 level.

Categorical Program Funding. The budget proposes to continue funding most categorical programs through a single mega-item ($4.6 billion). Local education agencies would have substantially more flexibility over the allocation of these funds than the current budget affords. In addition, the budget proposes about $100 million in targeted program increases. Our review indicates that the budget proposal (1) provides too much local flexibility in allocating mega-item funding and (2) unnecessarily diverts funds from instructional programs to new policy initiatives. We recommend an alternative that maintains the Legislature's priorities for mega-item program funding and provides additional local flexibility over new categorical expenditures.

Child Development Carryover Funds Are Available. The budget fails to provide a plan for $7.5 million in state child development carryover funds and $80 million to $93 million in federal child care block grant carryover funds. The funds may be used to increase child development services provided in 1994-95 or substitute for budget-year child development services that would otherwise be provided with Proposition 98 funds. We recommend that $26.5 million ($6.5 million in state carryover and $20 million in federal carryover) free up a like amount of Proposition 98 support included in the proposed 1994-95 budget. We also recommend using $20 million of the federal carryover to increase child development services in the budget year.

California Learning Assessment System (CLAS) Plan Needed. The budget proposes to reduce the amount of performance testing included in state CLAS tests. While this would permit expansion of the program at a minimum of state costs, the proposal leaves unanswered questions about the long-term direction of the program that could have a significant impact on the 1994-95 program and expenditure plan. To ensure the Legislature has all the information needed to understand its CLAS options, we recommend the Departments of Finance and Education provide specified information on their long-term plans for CLAS.

HIGHER EDUCATION

California's system of public higher education is the largest in the nation, serving approximately 2 million students. This system is separated into three distinct segments—the University of California (UC) with 9 campuses, the California State University (CSU) with 20 campuses, and the California Community Colleges (CCC) with 107 campuses. The UC awards bachelor's degrees and a full range of graduate and professional degrees. It accepts students in the top eighth of high school graduates. The CSU primarily awards bachelor's degrees and accepts students from the upper third of high school graduates. The CCC offers a variety of academic and occupational programs, as well as basic skills and citizenship instruction. It is basically open to all persons 18 years or older.

Proposal

The UC and the CSU. The budget proposes General Fund support for the UC and the CSU of $3.4 billion in 1994-95, an increase of 3.5 percent compared with the current year. The increase is primarily for salary-related increases and debt costs on lease-revenue bonds.

For the second year in a row, the budget does not include information on projected enrollment or proposed student fees. It does indicate, however, that the administration “stands ready to discuss fee increase proposals.”

Community Colleges. The budget proposes $1.2 billion in General Fund local assistance for the community colleges in 1994-95. This entire amount counts towards the state's K-14 minimum funding guarantee under Proposition 98. The 1994-95 General Fund request represents an increase of $298 million, or 32 percent, from the amount of estimated General Fund expenditures in the current year. Considering funding from property tax revenues and loan funds (available in the current year), the net increase is $33 million (1.2 percent).

A total of $265 million of the proposed General Fund increase at the community colleges relates to funding source shifts. The budget proposes a General Fund increase of $178 million to support services that were funded by a one-time $178 million loan in the current year. The budget also reflects a General Fund increase of $87 million to offset a net decrease in revenue from the local property tax. This figure represents the net effect of (1) an increase of $151 million related to a proposed property tax shift from the colleges to local governments that is part of the Governor's state-county restructuring proposal and (2) a decrease of $64 million to reflect estimated growth in property tax revenues.

The budget also includes a proposal to raise fees from $13 per credit unit to $20 per credit unit. After accounting for financial aid, this fee increase would raise $53 million.

Issues for Legislative Consideration

As we noted above, the Administration has not offered its view on major issues affecting the higher education segments. In addition to the failure to specify enrollment and fee levels, the administration's proposed higher education budgets do not fund many of the costs of continuing existing programs or address critical long-term needs, such as deferred maintenance.

As in past years, the Legislature faces the difficult task of determining—within severe budget constraints—how to achieve the twin goals of providing open access to higher education and maintaining high-quality programs.

In its deliberations on the higher education budget, we believe the Legislature should consider the following specific actions:

- Specify each segment's enrollment levels, considering expected growth under the Master Plan for Higher Education, and hold the segments accountable for achieving them.
- Specify fee levels, including reasonable fee increases, and provide for adequate financial aid.
- Address, to the extent possible, long-term critical needs such as deferred maintenance, instructional equipment replacement, and library books and materials purchases.

- Provide for productivity increases and the use of non-General Fund resources where feasible.

In our *Analysis of the 1994-95 Budget Bill*, we offer alternative budget proposals for the UC, the CSU, the CCC, and the SAC that address these issues. As a starting point, our alternative budget proposals would provide about the same level of funding as allotted to higher education in the Governor's proposal. As has been true in previous years, additional enrollment and other information will become available in the spring.

AFDC GRANT REDUCTIONS AND REFORMS

The state's two primary welfare programs are known as Aid to Families with Dependent Children (AFDC) and Supplemental Security Income/State Supplementary Program (SSI/SSP). Both the state and federal governments fund these programs. In the current year, the budget estimates that the General Fund cost of these programs will be $2.8 billion for AFDC and $2.1 billion for SSI/SSP.

The AFDC program provides cash grants to qualifying families with children whose incomes are not sufficient to provide for their basic needs. The largest component of the AFDC caseload is the AFDC-Family Group (AFDC-FG), in which a family's financial need is related to the death, incapacity, or continued absence of one or both parents. Other program components provide for unemployed families with children and for children in foster care. The federal government shares the cost of AFDC grants primarily with the state. Counties also provide a small contribution that the Governor's state-county restructuring proposal would increase.

The SSI/SSP program provides cash assistance to low-income persons who are elderly, blind or disabled, with the disabled being the largest group of recipients. The federal Social Security Administration administers the program and pays the cost of the SSI grant. California has chosen to supplement the federal payment by providing a state-funded SSP grant.

Proposal

The Governor's package of AFDC grant reductions and reforms is similar to proposals made by the administration in the previous two years. The budget estimates that the package would result in General Fund savings of $460 million (net of administrative costs) in 1994-95. The major proposals are summarized below:

- ***Across-the-Board Grant Reductions.*** The budget proposes a 10 percent reduction in the AFDC maximum grant levels effective July 1, 1994, and an additional 15 percent reduction for families that have an able-bodied adult and are on aid more than six months, beginning January 1, 1995. The impact of the reductions would be primarily on nonworking recipients—those who currently get the maximum grants. The grant reductions would be partially offset by increases in federally funded food stamps. The estimated state savings from these grant reductions in 1994-95 is $432 million.

- ***Maximum Family Grant.*** Under this proposal, the maximum amount of the grant, which increases with family size, would not increase for a child born after the parent has been on aid for nine months. (In effect, the grant would not increase for children conceived while the family is on aid.)

- ***Reduction in Pregnancy Benefits.*** AFDC pregnancy-related payments would be eliminated except for the federally assisted program, which provides payments during the last trimester of pregnancy. Specifically, the budget proposes to eliminate (1) grants provided to pregnant women without other children during the first six months of pregnancy and (2) a $70 monthly supplement that is provided to all pregnant women who are receiving AFDC.

- ***Teen Parent Provisions.*** The budget proposes to require parents under age 18, with some exceptions, to reside with their parents, legal guardian, or adult relative in order to receive AFDC.
- ***Time-Limited Aid.*** The budget proposes legislation to provide that AFDC grants for families with an able-bodied adult will be reduced by the amount of the grant associated with the adult, once the family has been on aid for more than two years cumulative time. The two-year "clock" would not start running until July 1, 1994, so that these grant reductions would not affect any grants until July 1, 1996.

Issues for Legislative Consideration

The Governor's AFDC proposals would result in significant savings to the state in 1994-95, with the amount increasing substantially in future years due primarily to the impact of the maximum family grant proposal and the two-year time-limited aid proposal. Because the grant reductions could be fully offset (without penalty) by increases in earnings from employment, the proposals would have the effect of increasing the financial incentive for recipients to work. The proposals, however, raise a number of significant issues.

Impact on Families. To the extent that recipients do not offset the grant reductions with additional income from other sources, the total income available to families would be reduced substantially. Under current law, the combined maximum grant and food stamps benefit is equal to about 80 percent of the federal poverty guideline. Those subject to both the 10 percent and additional 15 percent reductions in grants would have their resources reduced to about 70 percent of the guideline in the absence of other income.

Availability of Training. Many AFDC recipients have relatively low levels of education and work experience. To address this problem, California's GAIN Program provides training and basic education specifically for AFDC recipients. The program, however, currently is not funded at a level sufficient to accommodate all recipients who are required or wish to participate. Persons facing the expiration of their two-year time limit would have a priority for GAIN services.

Availability of Jobs. The downturn in the state's economy adds to the difficulty of finding employment, even for those adequately prepared. We estimate that nonagricultural employment will *decrease* by 1 percent in 1994 and remain virtually unchanged in 1995. We note that the Governor's two-year time-limited proposal does not include provision for alternatives—such as placement in community service jobs—for those unable to find employment through normal channels; although the federal administration has indicated that such a feature might be incorporated into the President's proposal for a two-year time limit on AFDC eligibility.

Potential for Cost-Shifting. The reduction in families' incomes will, to some extent, increase the use of other public services such as health and foster care. Thus, some of the savings in the AFDC Program will be offset by costs, in an undetermined amount, to the federal, state, and county governments in other programs.

MEDI-CAL

The California Medical Assistance Program is a joint federal-state program that provides necessary health services to public assistance recipients and to other individuals who cannot afford to pay for these services themselves. Federal laws establish a set of minimum eligibility criteria and the basic scope of the benefits to be provided. The states may provide for additional optional categories of eligibility and benefits. Funding for most services provided under California's program is split equally between the state and the federal governments. The budget estimates that the General Fund cost of the Medi-Cal program will be $5.8 billion in the current year.

Proposal

The budget makes two major proposals for program reductions in Medi-Cal.

Elimination of Medi-Cal Optional Benefits. The budget assumes enactment of legislation to eliminate 9 of the 28 optional service categories in the Medi-Cal Program, for a General Fund savings of $168 million in 1994-95. These savings would be partially offset by additional costs of $14 million in the Department of Developmental Services in order to maintain these services for regional center clients.

The services that would be eliminated are adult dental, nonemergency transportation, medical supplies (excluding incontinence supplies), speech and audiology, psychology, acupuncture, podiatry, chiropractic, and independent rehabilitation centers. The budget proposes to continue these services for children under age 21, persons in long-term care facilities, and developmentally disabled clients.

Eliminate Prenatal Care for Undocumented Women. The budget proposes to eliminate the existing “state-only” program that provides prenatal care for undocumented immigrant women. Federal law does not require or fund this program, which is financed entirely from the General Fund. Undocumented immigrants would remain eligible for delivery services and emergency treatment, which are required by federal law and partially funded by the federal government. The budget estimates savings of $14 million in the current year and $92 million in 1994-95 from eliminating this program effective February 1, 1994. No action had been taken as of the time of this writing.

Issues for Legislative Consideration

Potential for Cost-Shifting. In some cases, eliminating one type of service could result in increased costs for other services provided by the Medi-Cal program or other health programs. Although the budget has attempted to account for this, its savings assumptions may still be optimistic. For example, elimination of van transportation as an optional benefit does not relieve the state of its responsibility under federal law to provide "necessary transportation" for Medi-Cal beneficiaries who cannot otherwise access medical care. Thus, it is likely that most, if not all, of the savings from eliminating this service will be offset by other transportation costs, such as the increased use of ambulances. Similarly, eliminating prenatal care for undocumented immigrant women could result in poorer birth outcomes, which would increase Medi-Cal costs. The Legislature will need to examine the cost-shifting potential of these proposals, in particular, to evaluate their savings potential if it wishes to achieve General Fund savings in the Medi-Cal Program.

DEPARTMENT OF CORRECTIONS

The California Department of Corrections (CDC) is responsible for the incarceration, training, education, and care of adult felons and nonfelon narcotic addicts. It also supervises and treats parolees released to the community, as part of their prescribed terms.

Currently, the department operates 28 institutions, including a treatment center for narcotic addicts under civil law commitment. The department also operates 38 fire and conservation camps. The department will open two new prisons before the end of the current year and another two new prisons during the budget year. The Community Correctional Program includes parole supervision, operation of community correctional centers and facilities, outpatient psychiatric services for parolees and their families, and narcotic testing.

Proposal

The Governor's Budget requests $3 billion from the General Fund for support of the CDC in 1994-95, an increase of $251 million, or 9.2 percent, over the current year. This amount funds projected growth in the numbers of prison inmates and parolees. The projected growth is based on provisions of *current law* and does not assume passage of any legislation or ballot measures that may increase the numbers of inmates and parolees.

The budget does not propose any *significant* policy or program changes to reduce the inmate and parolee populations. However, the budget proposes two small programs to provide additional services to parolees who have a history of sex offenses and domestic violence, that are designed to reduce their chances of recidivism and return to prison.

The budget's total spending figures assume that the state will receive $300 million in federal funds for the state's costs of incarcerating, and supervising on parole, undocumented immigrants who have been convicted of a felony in California. However, the CDC's budget has not been reduced by that amount; rather, the funds are counted as General Fund revenues. Thus, the department's budget is held harmless should the federal funds not materialize.

Issues for Legislative Consideration

As part of its efforts to balance the state's budget, the Legislature will need to consider budget-cutting options in *all* areas of the budget, including the CDC. As we have indicated previously, because the CDC is a *caseload-driven* budget, significant expenditure reductions require controlling inmate and parole population growth or major reductions in the cost per inmate or parolee. However, achieving savings in the corrections program will be difficult. A number of pieces of legislation are currently moving through the Legislature that could result in a *major increase* in the state's future prison and parole populations and, thus, the General Fund costs to support the CDC.

Notwithstanding the current concern to ensure that repeat felons remain in prison, we believe that the Legislature should examine reducing the inmate and parole populations. In considering such reductions, the Legislature should follow these principles:

- Target reductions to nonviolent offenders.
- Target reductions to offenders who typically are incarcerated for very short periods.

- Make greater use of enhanced community supervision (such as intensive parole or electronic monitoring) for offenders who would be redirected from the prison system.
- Consider greater use of other community-based sanctions in lieu of incarceration.
- Take into account the impacts of any changes on local governments, particularly local law enforcement, and be aware of behavioral changes on the part of local prosecutors that could mitigate efforts to reduce the prison population.

TRIAL COURT FUNDING

The Supreme Court, the courts of appeal, and the superior, municipal, and justice courts make up the components of the California judicial system. The Supreme Court and the courts of appeal are entirely state-supported. The state and the counties share the costs of supporting the trial (superior, municipal, and justice) courts. Currently, state expenditures for trial court operations are partially offset by a portion of the fines, fees, and forfeitures collected by the courts. The fines, fees, and forfeitures transferred to the state pursuant to Ch 90/91 (AB 1297, Isenberg) are deposited into the General Fund, while the fees collected pursuant to Ch 696/92 (AB 1344, Isenberg) are deposited into the Trial Court Trust Fund. These latter fines, fees, and forfeitures, once collected by the trial courts and remitted to the state, are then redistributed back to the participating counties.

Proposal

The Governor's Budget proposes total expenditures of $1 billion for support of trial courts in 1994-95. This amount is $400 million, or 65 percent, above estimated expenditures in the current year. This major increase is proposed as part of the financing mechanism for the Governor's state-county restructuring plan, which proposes a shift of program responsibilities and funding from the state to counties. Another element of the restructuring plan proposes that counties and cities retain fine, fee, and forfeiture revenues that they currently transmit to the General Fund (estimated to be $348 million in 1994-95). The entire restructuring proposal is designed to be fiscally neutral. The additional trial court funding is intended to free up an equal amount of county funding in order to assume health and welfare costs from the state.

Issues for Legislative Consideration

There are a number of policy issues for the Legislature to consider regarding the Trial Court Funding Program.

Governor's Restructuring Proposal. We find much programmatic merit to the Governor's plan to move toward state financial assumption of the majority of trial court functions because of the compelling statewide interest in promoting the uniform application of justice, and because trial court operations are governed exclusively by state statutes and regulations. It will be important, however, for the Legislature to consider all of the various aspects of the restructuring plan and determine whether each piece is in the best interest of the state (for a full discussion of the restructuring proposal, please see Part V later in this document).

Expenditure Level. The Governor's Budget indicates that the proposed expenditure level will support 65 percent of trial court costs. The level of support is consistent with legislative intent as expressed in Chapter 90. More recent data on the total costs of trial courts suggests, however, that the level of support proposed may represent only about 58 percent of trial court costs. If the Legislature wishes to fund the program at the 65 percent level, the budget would have to be augmented by up to $108 million.

Revenue Sources. Although revenues from fines, fees, and forfeiture collections continue to be below projected levels, permitting local governments to retain these revenues is likely to increase collections significantly. Significant changes in levels of revenue collections could affect the restructuring proposal's fiscal neutrality.

In addition, Trial Court Trust Fund revenues continue to fall significantly below projections. To the extent that these revenues fall below projected levels in 1994-95, the state will fund less than 58 percent of total statewide trial court costs.

Implementation of Efficiencies and Cost Reductions Measures. Although many courts have implemented various efficiencies and cost savings measures, a wide disparity among courts still exists. In order to reduce the state's costs of the Trial Court Funding Program, the Legislature should consider enacting legislation to provide for additional court efficiencies. In addition, the Legislature should direct the Judicial Council to allocate funds to courts based on a system of incentives to encourage implementation of efficiencies and cost savings measures.

THE STATE'S MANAGEMENT STRUCTURE

The Governor's Budget estimates that the state will spend roughly $10 billion in the current year for the support of state agencies and institutions, other than higher education. This includes approximately $9.6 billion for the costs of salaries and benefits of 183,500 authorized positions.

Proposal

Middle Management Reduction. The Governor's budget assumes savings of $150 million ($75 million General Fund) in 1994-95 by reducing the number of managers and supervisors in state government by 10 percent. According to the Department of Personnel Administration (DPA), there are currently about 28,500 supervisors and managers overseeing the work of 150,000 full-time and part-time civil service workers. To accomplish this "downsizing" task, the DPA has imposed a freeze on appointments to management and supervisor positions in civil service, and has asked all state departments to submit plans to reduce management/supervisor positions by 5, 10, and 15 percent. The plans are to be submitted to the DPA and the Department of Finance by March 1, 1994.

Manager "Pay-for-Performance." The budget assumes savings of $21 million ($11 million General Fund) from the institution of a "pay-for-performance" plan for most manager classifications in lieu of across-the-board salary COLAs. Under this plan, approved by the Governor last December, managers did not receive the five percent pay COLA received by rank-and-file employees on January 1, 1994, nor will they receive the COLA due on January 1, 1995 (an expected three percent). Instead, managers in specified classifications may receive pay increases of *up to* five percent each January based on a performance review. Any pay increase that a department approves for a manager, however, must be funded out of existing resources. Under previous pay and budgeting policies, department budgets were augmented for salary COLAs. Data provided by the State Controller as of February 1, 1994 indicate that 86 percent of eligible managers received the full 5 percent.

Issues for Legislative Consideration

Savings Are Likely to Be Less Than Budgeted. The savings estimate used in the budget for the middle manager reduction is very optimistic. The sheer number of managers and supervisors involved in this proposal, combined with the elaborate nature of the civil service process, means that the 10 percent reduction may not be completed before September (as assumed). Moreover, many of those "demoted" to nonsupervisory positions may be entitled under civil service laws to be paid at or very near their current salary levels for some period of time, in which case assumed salary savings would be overstated.

REORGANIZING STATE DEPARTMENTS

Governors and Legislatures are continually looking at ways that governmental agencies can be organized differently. The recent attention given to "reinventing government," however, has given added impetus to reorganization efforts. Indeed, governmental reorganization can be viewed as one means of achieving a reinvented government. But, whereas the primary objectives of reinvention are to make government more responsive to the essential needs of its citizens, and to do so in a more effective manner, a common objective of reorganization, especially during difficult economic times, is to save money. The belief that savings can be made through reorganization is based on the premise that the current organizational structure of state departments includes, for a number of reasons, duplication and otherwise unnecessary work which increase the cost of government, and that these conditions can be avoided through appropriate restructuring.

Proposal

The Governor's Budget proposes a number of changes in the organizational structure of the executive branch to (1) consolidate functions, (2) reduce costs, and (3) improve service. Some of the changes reflect the elimination of various commissions, revenue bond authorities, and programs or consolidation of activities into existing or new organizational units, and these changes are reflected in the proposed budget. The most significant of the proposed changes are *not* reflected in the budget.

Changes Which are Reflected in the Budget. The bulk of the proposed changes reflected in the budget involves the elimination and consolidation of several revenue bond authorities, programs, and commissions. Many would be eliminated outright, while others would have their functions transferred to a new organization—the California Revenue Bond Financing Authority. The Commission for Economic Development would be eliminated, while the duties of the California Tax Credit Allocation Committee and the California Debt Advisory Committee would be transferred to other existing agencies.

According to the *Governor's Budget Summary*, the proposed organizational changes which are reflected in the Governor's Budget will produce an annual savings of approximately $2.7 million. Actual savings in 1994-95 would be less because some of the organizations targeted for elimination are provided funding until January 1, 1995.

Changes Which Are Not Reflected in the Budget. As noted above, the most significant of the proposed changes—changes which would have the greatest fiscal and policy impacts—are not reflected in the budget. Specifically, the Governor proposes:

- Work toward the creation of a single Revenue Department combining current functions of the Franchise Tax Board and the State Board of Equalization in order to consolidate administration of state tax laws.
- Create a new Department of Energy and Conservation, which would assume some of the functions now performed by the California Energy Commission, the State Lands Commission and the Department of Conservation, all of which would be eliminated.
- Create a new Department of Waste Management and transfer to it the functions of the California Integrated Waste Management Board, which would be eliminated, as well as the Beverage Container Recycling Program currently administered by the Department of Conservation.
- Transfer ownership of the Museum of Science and Industry to the County of Los Angeles.
- In conjunction with the state-county restructuring plan, refocus the efforts of state departments on ensuring program accountability and performance at the local level, rather than overseeing counties' day-to-day operations.

Issues for Legislative Consideration

The administration has not provided a specific plan for the most significant of the changes which have been proposed, nor has it provided information which would indicate whether the proposed reduced level of funding will be sufficient to perform remaining workloads. Therefore, in considering the proposed reorganization, the Legislature should:

- Consider whether the reorganizations are appropriate.

- Consider whether the reduced level of funding will ensure that all necessary work performed under the current organizational structure will continue to be performed *in an improved manner* following reorganization.

The Legislature will be in the best position to make these considerations when it has been provided sufficient detail regarding the administration's specific plans for accomplishing the proposed changes. This detail is not currently available.