MAJOR EXPENDITURE PROPOSALS IN THE 1997-98 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 1997-98 Budget Bill*.

WELFARE REFORM

The state's two primary welfare programs are the Aid to Families with Dependent Children (AFDC) program, also called Temporary Assistance to Needy Families, or TANF, pursuant to federal welfare reform legislation , and the Supplemental Security Income / State Supplementary Program (SSI / SSP).

The AFDC program (Family Group and Unemployed Parent components) provides cash grants to qualifying families with children whose incomes are not sufficient to provide for their basic needs. The SSI / SSP provides cash assistance to low-income persons who are aged, blind, or disabled.

In the current year, the budget estimates that the General Fund cost of these programs will be $2.2 billion for AFDC and $2.1 billion for SSI / SSP.

Proposal to Redesign the AFDC/TANF Program

The Governor proposes legislation to replace the existing AFDC/TANF Program with the California Temporary Assistance Program (CalTAP), effective January 1, 1998. Key program changes include:

- ***Time Limits***. Recipients on aid prior to January 1, 1998 would be limited to two years of cash assistance in any three-year period. New recipients (on or after January 1, 1998) would be limited to one year of cash assistance in any two-year period. Recipients removed from cash assistance pursuant to these time limits may return to cash assistance after staying off of aid (both cash assistance *and* the non-cash assistance safety net program described below) for one year. All recipients face a five-year lifetime limit on receipt of cash assistance; however, non-cash assistance pursuant to the safety net program has no time limit. Families with non-needy caretaker relatives, minor parents, and families with severely disabled parents or children are exempt from the time limits.

- ***Grant Reduction After Six Months***. Beginning January 1, 1998, CalTAP recipients on aid for more than six months would receive a grant reduction of 15 percent.

- ***Safety Net***. Families reaching the time limits described above would be eligible for a state-funded "safety net" program which provides noncash benefits. These benefits are roughly 15 percent lower than the cash grant, depending on family size. All safety net benefits would be paid in the form of vouchers. The state would provide 100 percent of the funding. No additional funding would be provided for county administration, but the counties would be permitted to use funds provided for the safety net program for administration.

- ***Participation Mandate***. To receive the full amount of the cash grant, recipients must participate for 32 hours per week (35 hours for two-parent families) in work and/or county-approved education or training activities. After conducting an assessment, counties would determine how recipients will fulfill their participation requirement through various allowable activities, such as limited job search, employment training (for up to one year), education, community service/work experience, and nonsubsidized employment. Families unable to meet their participation requirement would have their grants reduced proportionally, based on the number of hours they fail to participate. Families with less than 16 hours of participation per week would lose their entire grant, and would not be eligible for the safety net program. Weekly hours of required participation for families in the *safety net* program, if any, would be determined by each county, pursuant to its state-approved county Cal-TAP plan.

- ***Modification to Grant Structure.*** Families with earnings would have lower grant payments (roughly 30 percent) than under current law as a result of reducing the amount of income that is excluded when calculating the grant.
- ***Paternity Establishment Requirements and Penalties***. For cases coming on aid after January 1, 1998, a family's grant would be reduced until paternity is established. The reduction would be the portion of the grant for the adult (between 10 and 39 percent, depending on family size). Failure by the custodial parent to cooperate completely on all child support issues would result in aid being denied to the entire family. Under current law, failure to cooperate results in a grant reduction.
- ***Eligibility Conditioned Upon Child Immunizations and School Attendance***. In order to be eligible for CalTAP, applicants must provide proof of certain childhood immunizations and school enrollment (no outstanding truancies).

Program Flow. Following eligibility determination, counties would have the flexibility to meet temporary emergency needs of families (such as rent, car repairs, relocation expenses, or referrals to other assistance programs) for the purpose of diverting a family from aid. (Under current law, qualified applicants are eligible for Medi-Cal and child care benefits if they choose not to go on AFDC/TANF.) Families that go on aid would proceed to job club/job search for approximately three weeks. Adults unable to find employment would be assessed for employment readiness. An individual participation plan would be developed, which specifies how the 32- or 35-hour participation requirement would be met. After six months on aid, recipients who are not employed would have their grants reduced by 15 percent. Recipients would continue to receive the reduced grant for six months (eighteen months for those on aid prior to January 1, 1998), at which time they will be transferred to the safety net program.

Benefit Levels. Under the Governor's proposal, the maximum monthly grant for a family of three in a high-cost county would be $565; including food stamps, the total benefits would be $826 per month (76 percent of poverty). Total benefits would be reduced by $60 after six months and an additional $64 under the safety net. The full safety net benefit—*if counties do not reduce benefits to fund administrative costs*—would be approximately 64 percent of the poverty level.

Support Services. To the extent funding is available, child care, transportation and other work expenses would be provided to recipients to complete their participation plan. The child care "disregard" (which accounts for child care costs in the grant structure) would be replaced by a system of direct child care payments.

Program Administration. The state would set basic program elements such as eligibility, time limits, and maximum grant levels. Counties would administer the program pursuant to county plans that are subject to state review and approval. Counties would have the option of contracting with private firms for administration of the program but would remain responsible for their share of costs. Beginning in 1998-99, counties would receive funds for administration and employment/training services in the form of a block grant, if they satisfy unspecified maintenance-of-effort (MOE) requirements. Counties would continue to pay their share (5 percent) of non-federal costs for grants. Counties would be able to share in up to 25 percent of program savings. If the federal government assesses a penalty for noncompliance with federal requirements, the penalties would be passed on proportionally to counties that failed to meet the requirement, unless the state concludes that the failure was beyond the counties' control.

Entitlement Status. The administration indicates that the individual entitlement to benefits would be eliminated; however, it is not clear whether any provision would be made to appropriate additional funds in years when the caseload is higher than budgeted.

Issues for Legislative Consideration

Any welfare reform proposal must address at least three competing goals: provide support for children, establish incentives for parents to work, and control public costs. There are few easy answers in resolving the conflicts among these goals. In January 1997, we presented our approach to welfare reform in our policy brief, *Welfare Reform in California: A Welfare-to-Work Approach* (reprinted in Part V of this volume).

Time Limits. Time limits are an important component in both CalTAP and our Welfare-to-Work approach. In both cases, reaching the time limits result in benefit reductions rather than termination of aid; however the time limits are much shorter in the Governor's proposal.

Time limits will result in savings to the government, but these savings may be the result of actions that increase family income (that is, from obtaining employment) or decrease family income (that is, grant reductions from reaching the time limits). A consideration of time limits therefore involves balancing the potential advantages of the behavioral effects

AFDC Characteristics Survey, about 85 percent of recipients were on aid for more than one year, 70 percent for more than two years, and 35 percent for more than five years. Other studies have estimated that over 40 percent of persons receiving AFDC will eventually accumulate five years on aid.We note that these estimates assume a continuation of the AFDC program as it has operated in past years. It is important to keep in mind that welfare reform interventions—such as the GAIN program, community service jobs, and the time limits themselves—are designed with the intent of increasing the number of participants who obtain employment, thereby reducing the number of recipients who actually reach the time limit.

While several states are beginning to implement various forms of time-limited aid, no evaluations have been completed on such provisions. An interim report on Florida's time-limited welfare program should be available soon, but the findings will be preliminary.After adjusting for the number of families that would be exe the time limits, we estimate that about 600,000 families potentially could be affected by a one-year limit, 500,000 by a two-year limit, and 250,000 by a five-year limit. The number that would actually reach these limits in the future depends on the success of the various welfare reform provisions in increasing the level of employment among recipients.

Several factors affect a recipient's prospects of obtaining a job. One of these is job availability. By the end of 1999, approximately 600,000 cases could reach their CalTAP time limit. We estimate that the California economy will create approximately 330,000 new jobs per year for the next three years. Based on the current pattern of job creation, less than half of these jobs (each year) would be at a skill level where most welfare recipients could realistically expect to compete. These data suggest that there will be considerable competition for these and other job openings, and that we cannot expect all existing welfare recipients to obtain jobs without some job loss on the part of others (in other words, an increase in the unemploym

Families) would be eligible for the state-funded, county-administered safety net. ***Safety Net.*** Under CalTAP, safety net benefits must be paid in the form of vouchers or other types of non-cash assistance. The state would provide funding equivalent to a child-only case, but would not provide any additional funding for administration. Pursuant to their state-approved CalTAP plan, counties would have the flexibility to set (1) benefit levels lower than the equivalent of the child-only case, (2) income disregards (for working recipients), and (3) participation requirements. We note that by not providing separate funding for administration of the safety net, counties would have a fiscal incentive to reduce the level of aid to recipients in order to cover their administrative costs.

Eliminating cash benefits in the safety net program has two potential advantages. First, it makes the benefit package less attractive to recipients, thus increasing their incentive to work. Second, in cases where parents may have difficulty managing money, it may help to assure that most of the benefit will go toward meeting basic needs such as food and housing. We note, however, that providing benefits in voucher form results in additional administrative costs; and, as noted above, the counties would have a fiscal incentive to further reduce benefits in order to cover these additional administrative costs. We also note that inability to obtain employment within one or two years cannot be equated with inability to manage aid in the form of cash. We believe that most AFDC / TANF recipients are probably capable of handling cash.

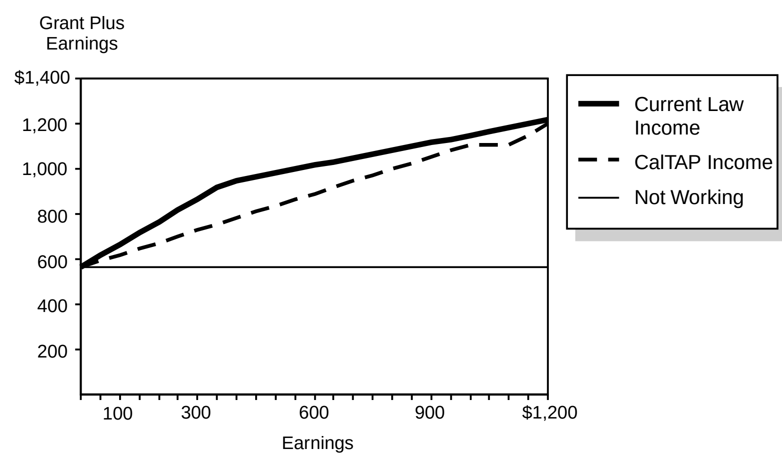
The voucher proposal may stem from a concern that adult recipients with substance abuse or other personal problems may not use the grant to benefit their children. In this respect, we note that an alternative approach would be to give case managers the flexibility to provide aid in the form of vouchers in those cases where they believe it is in the best interest of the children.

Modified Grant Structure. The existing grant structure contains the following work incentives: (1) the $30 and one-third disregard, whereby about one-third of work earnings are disregarded in determining the amount of a recipient's income that offsets his or her grant; and (2) the "fill-the-gap" grant structure, whereby recipients can earn the "gap" between their grant ($565, family of three) and the need standard ($735, family of three) without having their grant reduced. The Governor proposes to eliminate the current system of disregards and replace them with a single "work incentive." Working recipients would keep 54 percent of every dollar that they earn until they reach an income of $996 per month (full time work at the minimum wage). Earnings above $996 would reduce the grant payment on a dollar for dollar basis.

Compared to current law, the CalTAP provision results in lower levels of family income (grant plus earnings) for working recipients and others with income, regardless of the amount of income. As shown in Figure 8, combined grant and earnings under current law are always greater than under CalTAP. Thus, for welfare recipients who are not working, the CalTAP reduces the work incentive in comparison to current law. However, for recipients who are earning over about $400 per month, the CalTAP provides a greater incentive to earn more money because recipients retain 54 percent of additional earnings, compared to retaining about 33 percent under current law. Thus, for the policy objective of moving recipients into the work force, current law provides the stronger work incentive. However, if the policy objective is to motivate those with half-time earnings to increase hours toward full-time work, then CalTAP has the stronger work incentive for this segment of the caseload. We note, however, that in the latest survey (October 1995), only about 13 percent of AFDC cases reported earned income, and this includes full-time as well as part-time workers.

Figure 8

Combined Grant and Earnings For AFDC/TANF Recipients, Current Law and CalTAP Family of Three, High-Cost County



Services and Participation Requirements. As noted above, CalTAP would require able-bodied adults to participate for 32 hours per week (35 hours for one member of a two-parent family) in some combination of work and / or county-approved education and training activities.

County administrators would determine how this 32-hour or 35-hour requirement breaks down between the number of hours that recipients would be required to work, and the hours required in employment preparation activities. We note that the administration has proposed no guidelines for determining the mix of required work and employment preparation activity in meeting the work component of the requirement. Consequently, counties may vary considerably in how they determine this requirement. The combination of a fixed 32-hour or 35-hour participation requirement and a block grant allocation for services could lead to a situation where the work requirement is primarily a function of the amount of funds a county receives for services, rather than a function of an assessment of the recipient's prospects of obtaining and keeping a job. This could have significant consequences for the recipients, who will be sanctioned for not meeting the 32-hour (or 35-hour) requirement.

In this respect we note that the Governor's budget includes about $140 million in additional funds for employment preparation services in 1997-98, and earmarks $53 million for education of welfare recipients in the community colleges. This would not be sufficient to provide 32 hours of job search and training activities to all eligible recipients, if such activities were provided at a service level comparable to the GAIN program.

Paternity Establishment Provisions. For cases coming on aid after January 1, 1998, paternity must be established before the custodial parent is included in the household for purposes of calculating the family's grant. For a family consisting of a mother and one child, this represents a sanction of approximately 39 percent. For larger families, the sanction is between 10 and 20 percent.

The Department of Social Services estimates that each month 8,800 CalTAP applicants will need paternity establishment and will become subject to this sanction. The department assumes that paternity will be established in an average of seven months in 95 percent of the cases. For the remaining 5 percent, the department assumes that paternity will never be established. The department does not know the comparable rate of paternity establishment currently, but in our judgment 95 percent would be a very significant increase.

We make the following observations regarding this proposal:

- There is no analytical basis for projecting the 95 percent rate. It rests, in large part, on the assumption that in almost all of the cases where paternity is not established, it is due to a lack of cooperation by the custodial parent in identifying and locating the noncustodial parent. (Establishing paternity generally requires that the noncustodial parent be located.) We note, in this respect, that according to a national survey of 46 state child support enforcement directors conducted in 1994, about two-thirds indicated that AFDC applicants are usually willing to cooperate in establishing paternity, and will provide complete and correct information to the best of their ability. To the extent respondents perceived noncooperation as a problem, they most often viewed this as "passive" noncooperation (in other words, applicants volunteer no more information than directly asked or are vague in their response), rather than overt noncompliance (clients deliberately providing false information).

- The sanctions (reduced grants) would be imposed on those parents who are cooperating as well as those who are not cooperating. The sanctions would take effect immediately; whereas the department assumes that it would take seven months, on average, to establish paternity in those cases where the parent is "cooperating."

In summary, an assessment of this proposal will involve balancing the benefits of budgetary savings against the adverse effects of the sanctions on families, including those that are fully cooperating with paternity establishment requirements.

As an alternative to this policy, the Legislature could provide case managers with greater authority to make sanctions in cases where they have reason to conclude that the custodial parent is not cooperating.

Program Administration. As noted previously, counties would benefit by sharing in program savings, as measured in terms of reduced expenditures. We note that this mechanism rewards counties equally from savings that result from sanctions or time limited grant reductions and savings that result from increased employment.

Governor Proposes to Eliminate Requirement That Counties Provide General Assistance

Under current law, counties are required to provide General Assistance benefits to indigents who lack an adequate means of support. These are persons not eligible for assistance under the AFDC / TANF program or the Supplemental Security Income / State Supplementary Program (SSI / SSP). Counties pay the entire cost of General Assistance benefits (about $360 million, plus administrative costs). The Governor proposes to relieve counties of this responsibility by eliminating the mandate to provide this aid.

Issues for Legislative Consideration

Currently, General Assistance maximum monthly benefits range from about $175 to $345, depending on each county's policy. The Governor's proposals could result in further variation in grant levels. This, in turn, could cause migration effects whereby recipients move from lower paying counties (or counties with no benefits) to counties that offer higher levels of General Assistance. Thus, although this proposal is intended to offer fiscal relief for the counties, it could result in increased costs to some counties from migration of recipients if other counties reduce or eliminate GA. If this occurs, it would give counties a greater incentive to reduce or eliminate the program.

In our welfare-to-work approach, the GA program would be consolidated with the AFDC/TANF program. With respect to program requirements, however, adults without children would be subject to a different set of provisions than would families with children. (Please see Part V of this volume for more detail.)

SSI/SSP—Noncitizens' Eligibility

As a result of the enactment of federal welfare reform, noncitizens who are legally residing in the state are no longer eligible for SSI/SSP benefits. There are exceptions to this restriction—those individuals serving in the armed forces, veterans, and their dependents; refugees and asylees in their first five years of U.S. residence; and those who have worked ten years. In addition, noncitizens who subsequently become citizens would be eligible for benefits.

The budget estimates that about 87,000 noncitizens will not attain citizenship status and will therefore lose SSI/SSP benefits. This consists of about 49,000 aged persons, and 38,000 disabled persons. These individuals would be eligible for county-funded General Assistance (GA) benefits (averaging about $215 per month/per person, compared to $640 per person in SSI/SSP benefits). The budget also proposes legislation to eliminate the mandate that counties provide GA benefits.

Although no longer eligible for SSI/SSP benefits, legal noncitizens residing in the state as of August 22, 1996, would continue to be eligible for full-scope Medi-Cal services. Noncitizens arriving after that date would be eligible only for emergency services.

Issues for Legislative Consideration

Impact on Noncitizens Losing SSI/SSP Benefits. The Governor's budget assumes General Fund savings of $153 million attributable to noncitizens losing their eligibility pursuant to federal welfare reform. The budget does not estimate the costs to the counties for GA. In order to address the impact of benefit termination on aged and disabled noncitizens, the Legislature could consider various options, including (1) continuing full SSI/SSP benefits, (2) continuing grants for a limited time period while, for example, citizenship applications are pending, (3) reimbursing counties for GA costs for aiding these noncitizens, (4) supplementing county GA benefits with grants equal to the current SSP component of the SSI/SSP grant, and (5) adopting policies to facilitate the citizenship process, such as measures to facilitate access to citizenship classes offered by the public education institutions.

IHSS—Noncitizens' Eligibility

Federal welfare reform legislation made most noncitizens ineligible for SSI benefits. The federal act does not address the In Home Supportive Services (IHSS) program, but one of the indirect effects of the act is that noncitizens who lose SSI/SSP eligibility will no longer be eligible for IHSS benefits because, under current state law, these benefits are limited to persons who meet the SSI/SSP eligibility requirements.

The Governor's budget does not propose legislation to restore IHSS eligibility for these noncitizens, thereby assuming General Fund savings of $112,000 in 1996-97 and $23.8 million in 1997-98, and county savings of $61,000 in 1996-97 and $12.1 million in 1997-98. This is based on an estimate of about 11,800 noncitizens losing benefits.

Issues for Legislative Consideration

As indicated, the effect of the federal legislation on the IHSS program is a by-product of the policy changes made to the SSI/SSP program rather than a stated intent of Congress. We further note that the IHSS program is designed to provide assistance to persons who are unable to remain in their homes without such assistance. Thus, while the cost-effectiveness of the program may not be proven, we can expect some long-term savings from these services to the extent they prevent more costly institutionalized care.

For these reasons, we recommend the enactment of legislation to restore IHSS eligibility for needy noncitizens. This will result in a General Fund cost of $23.8 million in 1997-98.

MEDI-CAL

The California Medical Assistance (Medi-Cal) Program is a joint federal-state program that provides health services to public assistance recipients and other qualified individuals who cannot afford to pay for these services themselves.

Proposal

The budget proposes the following major program reduction in Medi-Cal:

Eliminate Prenatal Care for Illegal Immigrant Women. The budget reflects the adoption, effective July 1, 1997, of proposed regulations which would eliminate the existing "state-only" program that provides prenatal care for illegal immigrant women. The proposed regulations are based on the federal welfare reform law's prohibition of most types of services to illegal immigrants, absent adoption of new state laws authorizing such services. The budget estimates General Fund savings of $79.9 million in 1997-98 from eliminating this program.

Issues for Legislative Consideration

Potential Future Costs. Generally, prenatal care has been recognized to improve the health of newborns and therefore reduce the future costs associated with neonatal and pediatric care of children. Children born in California are United States citizens regardless of the legal status of their mother, and consequently increased health care costs that result from the absence of prenatal care are likely to increase future state Medi-Cal costs for the care of citizen children. The Legislature will need to evaluate the proposed savings in light of these potential future costs and the effects on the health of the children that would be affected.

PROPOSITION 98—K-12

Proposition 98 establishes a minimum funding level that the state must provide for public schools and community colleges each year. K-12 education receives about 90 percent of total Proposition 98 funds. In this section we describe the budget's K-12 proposal for prior-year Proposition 98 funds and for new funds required to meet the minimum guarantee in 1997-98.

Prior-Year Funds

The budget includes $837 million in funds to meet the Proposition 98 funding requirements for previous years. This results primarily from increases in the 1995-96 and 1996-97 minimum funding guarantee ($629.5 million) caused by higher student attendance (average daily attendance [ADA]) and General Fund revenues than previously assumed. In addition, the budget proposes to spend $204.5 million in Proposition 98 funds that were previously appropriated, but unspent, in prior budgets. The budget proposes to spend these available funds as follows:

- $304.2 million to increase district general purpose funding, pursuant to a provision in a trailer bill to the *1996-97 Budget Act*.
- $264.4 million to pay for higher-than-anticipated ADA in both 1995-96 and 1996-97.
- $151 million to provide support for the purchase of new portable classrooms or other facility costs related to the class size reduction program.
- $50 million for a new high school technology program.

Budget-Year Proposal

The budget proposes to provide $28.1 billion in total Proposition 98 funding in 1997-98. This is a projected increase of $1.7 billion, or 6.5 percent, in comparison to the 1996-97 revised amount. However, student attendance is projected to increase by 2.3 percent, resulting in funding of $5,010, an increase of $190 per student (3.9 percent) from the revised 1996-97 amount.

The major 1997-98 budget proposals include:

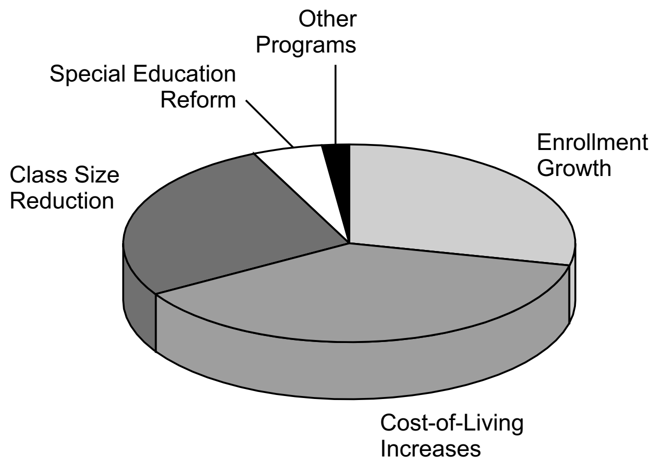
- $530.3 million for enrollment growth, based on a projected ADA increase of 2.35 percent.
- $628.8 million to provide a 2.53 percent cost-of-living adjustment (COLA).
- $296.8 million to expand the class size reduction program to a fourth grade.
- $76.7 million set-aside for special education funding equalization and funding reform legislation.

Figure 9 (see next page) illustrates how the budget would allocate projected growth in the Proposition 98 funds in 1997-98.

Figure 9

Proposed Use of Proposition 98 Funds
K-12 Education

1997-98



Issues for Legislative Consideration

We have identified several issues raised by the budget proposal.

Implementation of Class Size Reduction. The Legislature and the Governor created the Class Size Reduction (CSR) program as part of the *1996-97 Budget Act*. The program is intended to increase educational achievement by reducing statewide average class size from 28.6 students to no more than 20 students in up to three grades. The Governor's budget proposes expansion of the CSR program to four grades in 1997-98.

Our survey of district CSR implementation showed three major problems with the current program. First, districts are maintaining CSR classes at about 19 students to one teacher in order to be sure of remaining under the 20 students per teacher cap. This increases per-pupil CSR costs by as much as 21 percent, or more than $100 per student.

Districts also report that the approximately 18,400 teachers hired for CSR have less teaching experience, fewer qualifications, and a lower skill level, on average, than teachers hired in previous years. Finally, districts are running out of low-cost options for new facilities, which means that expanding CSR to more classes and grades next year will be more expensive on a per-classroom basis.

Based on these results, we make the following recommendations:

- ***Increase Flexibility Over the Use of CSR Teachers.*** The Legislature should allow districts to use CSR teachers more flexibly. There are a number of other effective educational interventions that require additional teaching staff that have been proven effective.

- ***Increase Flexibility Over the 20:1 Cap.*** If the Legislature decides to stay with the current program structure, we recommend redefining the cap to require a 20:1 ratio for all CSR classes in a district, while allowing individual class maximums of up to 22 students. This action would significantly reduce costs.

- ***Delay Implementation of a Fourth Grade.*** Due to shortages of qualified teachers and high costs for new facilities, we recommend the Legislature delay implementation of a fourth grade of CSR. The Legislature, however, should earmark $100 million toward funding expansion of a fourth grade in subsequent years.

- ***Provide New Funds in Revenue Limits, Not in Higher CSR Funding.*** We recommend that the Legislature *not* increase the per-student funding level (except for a COLA) and, instead, direct new Proposition 98 funds into revenue limits. Revenue limit funds could be spent for CSR, if needed, or for other local purposes.

- ***Allow $52 Million in Goals 2000 Funds to Be Used for CSR Staff Development.*** The CSR has created an acute need for new-teacher staff development. We recommend the Legislature allow districts to use $52 million in Goals 2000 funds for CSR-related staff development, in addition to the uses proposed by the Governor.

Addressing the K-12 School Maintenance Problem. One of the most common complaints about the state's educational system—from parents and school employees alike—is the physical disrepair of school facilities. These situations result from serious ongoing maintenance problems in California schools. There is also a growing body of educational research that suggests there is a positive relationship between student achievement and the condition of the facility in which they are schooled.

Inadequate funding for maintenance has long been a problem for K-12 school districts, resulting in huge backlogs of deferred maintenance. This backlog is a symptom of a failure of local school districts to adequately fund ongoing maintenance. At the state level, the current School Deferred Maintenance Program and state funding for school modernization may actually create a fiscal incentive for districts to defer projects rather than deal with them in a more timely manner.

We recommend a long-term approach to eliminate the backlog of projects and to fund ongoing maintenance at an adequate level.

- ***Address the Backlog.*** We recommend $2 billion in new state funds (over ten years) to help school districts reduce or eliminate their current deferred backlog.
- ***Ensure Adequate Ongoing Maintenance.*** To be eligible for the $2 billion in new funding, districts would be required to increase ongoing maintenance over three years to a level that ensures that districts are no longer deferring needed maintenance.

Reforming the K-12 Fiscal System. In our review of the 1997-98 K-12 budget, we also examined the overall fiscal structure that the state uses to finance schools. Based on this review, we think the Legislature should alter the structure to make the programs less complicated and focus districts on student achievement rather than state rules. Our recommendations fall into two areas:

- ***Simplify and Equalize Revenue Limits.*** Revenues limits, which provide general purpose funding to districts, are overly complex and cumbersome to administer. We recommend that the Legislature simplify the system, redesign the revenue limit cost-of-living adjustment so that it works to equalize revenue limits, and phase-out payments of “basic aid” to 56 districts over a three-year period.
- ***Consolidate Categorical Programs.*** Our current system of categorical programs creates too many local restrictions over the use of funds but does not require any real accountability in increasing student achievement. We recommend consolidating 21 current programs into four block grants. We also recommend establishing a program of evaluation that would begin assessing the impact of local categorical program strategies.

HIGHER EDUCATION

California's system of public higher education is the largest in the nation, serving approximately 2 million students. This system consists of three distinct segments—the University of California (UC) with nine campuses, the California State University (CSU) with 22 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. The system accepts students from the top one-eighth of high school graduates. The CSU awards bachelor's and master'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.

The Student Aid Commission provides financial aid to students through a variety of grant and loan programs. The Cal Grant program is the major state-funded aid program.

Proposal

The UC and the CSU. The budget proposes General Fund support for the UC and the CSU of $4.1 billion in 1997-98, an increase of about $239 million, or 6.2 percent, compared with estimated current-year budgets. Budgeted enrollment levels at the UC and the CSU will increase slightly in 1996-97—by 1,500 full-time equivalent (FTE) students at the UC and 2,500 FTE students at the CSU. The proposed General Fund increase is sufficient to eliminate the need for undergraduate student fee increases proposed by both segments for 1997-98. As a result, the budget assumes no undergraduate student fee increase in the budget year.

Of the $239 million increase for the UC and the CSU, the budget proposes to allocate the funds for employee compensation ($155 million), debt service costs on previously authorized lease-payment bonds ($15 million), enrollment growth ($25 million), and price increases ($15 million). Both segments also receive funds for additional facility maintenance ($8.5 million at CSU and $7.5 million at UC).

Community Colleges. The budget proposes $1.8 billion in General Fund local assistance for the community colleges in 1997-98. This entire amount counts towards the state's K-14 minimum funding guarantee under Proposition 98. The 1997-98 General Fund request represents an increase of $142 million, or 8.7 percent, from the current year. The combined increase proposed from the General Fund, local property tax revenues, lottery funds, and net student fee revenues (after accounting for financial aid) is $192 million, which represents a 5.8 percent increase in combined funding. This figure understates actual budget-year growth, however, because 1996-97 expenditures include $35 million in one-time spending. Thus, actual growth in the CCC base budget is $227 million, or 6.9 percent. Like the UC and the CSU, the budget assumes no student fee increase in the budget year.

In 1997-98, the budget provides $80 million for a 2.8 percent COLA for general-purpose spending, $34 million for statutory enrollment growth, $33 million for “extra” enrollment growth, $57 million for debt service costs on previously authorized lease-payment bonds, and $53 million for special services to students on welfare.

In 1996-97, as a result of an increase in the Proposition 98 guarantee in the current year, the budget provides a total of $59 million in one-time funding for a block grant for instructional equipment, library materials, deferred maintenance, and education technology ($53 million), and loans to child care providers to expand on-campus facilities ($6 million).

Student Aid Commission. The budget proposes a General Fund increase of $30.3 million for the Student Aid Commission in 1997-98. The majority of this increase, $10 million, supports the administration's proposal to increase the maximum annual Cal Grant award for recipients who choose to attend nonpublic schools from $7,164 to about $9,105. The annual cost of this proposal would be about $30 million by 1999-00. The budget also includes $15.8 million in second-year costs of a $20 million increase in the Cal Grant program approved by the Legislature in the *1996-97 Budget Act*.

Issues for Legislative Consideration

Deferred Maintenance. Over the past 10 to 15 years, California’s three public higher education systems have not kept pace with the demand for facility maintenance. As a result, the systems have accumulated a major deferred maintenance backlog. This is a major concern because deferral of maintenance projects reduces the useful life of facilities and increases future capital outlay needs.

The CCC’s maintenance problems have been easier to address because of the large amount of funds available for K-14 education under Proposition 98. The *1996-97 Budget Act* increased ongoing maintenance / repair funding for the CCC and provided $60 million of one-time Proposition 98 monies to address the CCC’s deferred maintenance backlog. The *1997-98 Governor’s Budget* proposes to continue the augmented level of $39 million ongoing maintenance / repair funding—with local matches of up to $39 million—and provides additional one-time monies for the deferred backlog as part of a proposed $53 million block grant. In view of the above, we believe the Legislature has placed the CCC on a sound fiscal footing regarding maintenance / repair needs.

Addressing the needs of the four-year universities has proved more difficult. In response to the issues we raised in last year’s *Analysis*, CSU and UC committed to increase annual maintenance / repair expenditures by $9.6 million and $7.5 million, respectively. To match these efforts, the Legislature added $7.5 million to each segment from the General Fund. These actions were seen as the first step in a multiyear effort to stop further growth of—and eventually eliminate—maintenance / repair backlogs. The Governor, however, vetoed the legislative augmentations, stating that the segments should address their maintenance needs within the funding levels he has committed to provide under his "compact" with them.

The *1997-98 Governor's Budget* proposes to increase maintenance spending by $8.5 million at CSU and $7.5 million at UC. While this commitment of additional resources to maintain the state's university facilities is commendable, more needs to be done. We think the Legislature should follow its previous plan and augment the CSU and UC budgets for maintenance for the following reasons:

- ***Additional Funds Will Stop Deterioration of the State's Facilities More Quickly.*** Failure to match UC and CSU increases will double the time it takes to reach an adequate level of ongoing maintenance. Moreover, each year of delay will increase deferred maintenance backlogs, complicating, rather than aiding, the state's already expensive efforts to solve this problem.
- ***It Sends the Right Signals to the Segments.*** By augmenting their maintenance budgets, the Legislature can be a partner in the segments' efforts and underscore its intent that higher education adequately maintain the public's facilities.

Funds Not Needed for "Extra" Growth at Community Colleges Should Help Meet K-12 Needs. As discussed above, the budget proposes Proposition 98 funding for community colleges to increase by $227 million in 1997-98. We agree with the Governor's 1997-98 spending proposals for the colleges in most program areas. We recommend, however, the following changes:

- Reduce funding for "extra" enrollment growth by $29.3 million to conform funding with the underlying change in the state's college-age population.
- Provide $8 million to address historic inter-district funding disparities.
- Redirect the net savings of $21.3 million to address pressing needs in K-12 programs.

Underlying our recommendation is the assumption that there should be no fixed proportion of Proposition 98 funds going to community colleges. Instead, we think the Legislature should weigh whether the funds would be better used to support additional growth in the community colleges or meet high priority needs in K-12 education. For 1997-98, we think these funds should be used to meet high priority K-12 needs.

Increased Funding for Cal Grants. The budget proposes $10 million to increase the maximum Cal Grant award for students attending nonpublic schools. We recommend approval. We also recommend transferring $19.8 million in General Fund support from the University of California to the Cal Grant program. The Legislature intended that these funds be spent for financial aid. The transfer would give recipients greater choice among all colleges and universities in the state and ensure the funds are used to provide financial aid.

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 32 institutions, 52 community correctional centers, and 38 fire and conservation camps. The Community Correctional Program includes parole supervision, operation of community correctional centers and facilities, outpatient psychiatric services for parolees, and narcotic testing.

Proposal

The Governor's budget proposes $3.7 billion from the General Fund for support of the CDC in 1997-98, an increase of $250 million, or 7.3 percent, over the current year. This amount provides full funding for projected growth in the number of prison inmates and parolees under current law, as well as several program changes. The budget does not propose any policy or program changes to reduce the inmate or parole populations.

The budget's total spending figures assume that the state will receive $299 million in federal funds in 1997-98 to offset the costs of incarcerating, and supervising on parole, illegal immigrant adults and juveniles who have been convicted of a felony in California.

Issues for Legislative Consideration

Over the past ten years, the CDC has been one of the state's fastest growing budgets, increasing at an average annual rate of about 11 percent. The increase has been largely due to costs to house increasing numbers of state prison inmates. The Governor's budget projects that the prison inmate population will increase to about 160,000 inmates by the end of 1997-98 (an increase of 5.9 percent in the budget year), and will increase to 250,000 inmates by the end of 2005-06. While the projected growth in the prison population is significant, the most recent projections are substantially lower than earlier forecasts. We estimate that, given the current population projections, the costs to operate the department will probably exceed $6 billion by 2005-06.

Given the long-term implications of the CDC's projected growth on the state's budget, the Legislature will need to consider various options for addressing these increases. There are two basic approaches: (1) reduce the costs of operating the state's prison system and (2) reduce the prison population caseloads themselves.

We have offered a number of examples of both approaches, both in the *Analysis* and in previous publications. For example, this year we recommend that the Legislature transfer a portion of the Prison Industry Authority's $26 million-cash surplus to the General Fund. In addition, we recommend that the Legislature consider expanding substance abuse treatment services to inmates at an existing prison, because the existing treatment programs have been shown to be successful in reducing the number of inmates who, after release from custody, commit new offenses and return to prison. In previous publications, we have offered a number of alternatives for legislative consideration to control inmate and parole population growth.

Whatever actions the Legislature decides to take, it will be important to closely monitor the changes in the prison population. As indicated earlier, although the population is projected to continue to grow, the rate of growth has slowed. In the *Analysis*, we offer several possible explanations for why this is so. In addition, we note that, as of mid-January, the population was almost 2,000 inmates below the current projection for that period.

TRIAL COURT FUNDING

The trial courts are funded jointed by the state and the counties. In 1996-97, the state funded approximately 41 percent of the $1.7 billion total budget for the trial courts, with the counties paying the remaining 59 percent. The Trial Court Realignment and Efficiency Act of 1991 stated the Legislature's intent to increase state support for trial court funding as a means of promoting equal access to justice. Due to fiscal constraints, however, the state contribution for trial courts has not increased in accordance with the intent of the measure.

Proposal

The Governor's Budget proposes a major consolidation of funding responsibility for the trial courts. Under the Governor's proposal, the 38 largest counties would contribute an amount to the Trial Court Trust Fund roughly equivalent to what they paid in 1994-95, and the state would provide all additional funding. The 20 smallest counties would not make a contribution, but the state would pay for all of their costs. All counties would continue to contribute fine and penalty revenues to the state.

Issues for Legislative Consideration

The state has an interest in ensuring uniform access to justice through the courts. Transferring funding responsibility for the courts from the counties to the state offers the best means of ensuring such uniformity. Policy control and funding responsibility would be largely consolidated with the same level of government, improving accountability. Such a policy would also help ease county fiscal distress in the long term by relieving counties of their obligation to fund increases in court costs. Therefore, the Governor's proposal has merit.

- ***Performance Goals Are Needed.*** If the state is to have funding responsibility for court operations, it must also have the ability to hold the courts accountable for performance. Currently, there is insufficient data available to evaluate progress toward meeting specific output goals or to permit cross-court comparisons.

- ***Mechanisms Needed to Control Costs.*** Because the proposal will likely result in significant cost increases to the state in future years, it will be important to enable the state to have greater involvement and control over trial court expenditures. For example, under the Governor's proposal, most of the nonjudicial court employees would continue as county employees, with their salaries and benefits being set by the county Board of Supervisors. To effectively control costs and exercise program oversight, the state will need greater controls over trial court employees, possibly by converting them to state employment over time. The Governor's proposal establishes a task force charged with reviewing and making recommendations with regard to a system of governance for these employees by 1999. We believe that this approach is an appropriate first step in addressing implementation issues.

TRANSPORTATION

The Department of Transportation (Caltrans) has determined that seven state-owned toll bridges are vulnerable to major damage in the event of an earthquake. Caltrans estimates a total cost of about $2.1 billion to retrofit all seven bridges. The Seismic Retrofit Bond Act of 1996 (Proposition 192) provided $650 million to retrofit toll bridges, but the remaining $1.4 billion remains unfunded.

Proposal

After several years of delays, Caltrans indicates that it will begin retrofit construction on all seven bridges during 1997-98 and will expend $1.5 billion for capital outlay. (A small number of projects that were initiated in prior years or are planned for later years will comprise the remainder of the $2.1 billion total retrofit cost.) However, the Governor's budget estimates that only about $380 million in Proposition 192 funds will remain available in 1997-98, because of earlier expenditures for support and minor capital outlay construction. The budget does not include any additional funds for retrofit; however, the Governor has suggested that the $1.4 billion gap be funded with $500 million from State Highway Account (SHA) gas tax revenues with the remaining money coming from other unspecified sources.

Issues for Legislative Consideration

In order to allow seismic retrofit of state-owned toll bridges to proceed, the Legislature will need to enact a solution in 1997-98 to close the $1.4 billion funding gap. The Legislature could close the entire $1.4 billion gap with existing SHA funds, but this would reduce funding for the 1998 State Transportation Improvement Program and limit the number of new transportation improvement projects that can be programmed throughout the state. Alternatively, an increase of 1 cent in the state gas tax, imposed for about ten years, would generate about $1.4 billion in new revenues.

The Legislature could also require that bridge users fund the cost of retrofit through higher tolls. Generating the entire $1.4 billion from tolls would require a $1 toll surcharge for about 14 years, and would also likely delay construction of other bridge improvements that are already scheduled to use toll funds. The Legislature could also use a combination of SHA and toll revenue.

RESOURCES INITIATIVES

In the past, programs for the conservation and management of natural resources in the state have taken a project-by-project approach to dealing with these issues. For example, programs have focused on the environmental impacts of a single project—such as a proposal to cut timber—or on restoring a single species of fish or wildlife. More recently, there has been a trend towards a broader approach, shifting the focus from particular projects to whole ecosystems, bioregions, watersheds, and natural communities. This new approach typically calls for the coordination of a number of state and local agencies, as well as the cooperation of affected private interests and the general public.

Proposal

The budget proposes about $37 million for three initiatives that are designed to implement a broader approach to natural resource conservation and management, as follows:

Watershed Initiative. The budget proposes $3.8 million to develop and implement plans to protect species, restore habitat, and enhance water quality on a watershed-wide basis.

Coastal Initiative. The budget proposes $17.1 million to improve coastal resources, by enhancing coastal access, restoring coastal wetlands and beaches (including establishing wetlands mitigation "banks"), assisting local governments with coastal planning, and continuing the development of statewide water quality plans.

Natural Community Conservation Planning. The budget proposes $16 million for land acquisition and implementation of local plans to promote the management and conservation of multiple species and natural communities. This is an expansion of the Natural Community Conservation Planning (NCCP) Program, established by Chapter 765, Statutes of 1991 (AB 2172, Kelley).

Issues for Legislative Consideration

In evaluating these initiatives, we think that the Legislature should consider the following:

- ***Measurable Objectives to Be Achieved and Work to Be Accomplished.*** The Legislature should consider whether (1) adequate details have been provided to assess the merits of the initiatives and their likely cost-effectiveness and (2) there are measurable objectives which allow it to hold the various departments accountable for results under the initiatives.

- ***Coordination of Existing Programs and Policies.*** Past reports by various state agencies have pointed to a lack of coordination in the state's programs for resource conservation and management. Thus, the Legislature should consider the degree to which the initiatives provide for improved coordination.
- ***Long-Term Costs and Fund Sources.*** The Legislature should assess the degree to which the initiatives could require significant state investments in future years, and consider appropriate funding sources to meet these needs.
- ***Legislative Policy Oversight.*** The Legislature should consider whether statutory authorization for the proposed programs is necessary.

Based on our review, we conclude that the initiatives do not measure up to these criteria.

CAPITAL OUTLAY

The five-year plans developed by state agencies indicates the need for a total investment of $10 billion in the state's infrastructure over the five-year time period. This estimate does not include highways and rail nor does it include K-12 schools—estimated to be $15 billion and $10 billion, respectively. The plans cover a wide range of state needs such as state office buildings, prisons, state hospitals, higher education, forestry fire stations, and development of state parks. As we have mentioned in the past, these five-year estimates should be viewed with caution because some plans are incomplete and some may include proposals that, upon examination, may not merit funding. Overall, however, the plans give a reasonable assessment of the magnitude of the state's capital outlay needs.

Proposal

The Governor's budget includes $1.2 billion for these capital outlay programs. The Governor has also indicated that he will seek legislation, separate from the budget bill, for over $500 million in lease-payment bonds to construct two prisons. In addition, the Governor has indicated he will support two general obligation bonds for the June 1998 ballot—a $2 billion measure for K-12 schools and a $200 million measure for a state infrastructure bank for local government projects—neither of which addresses the state capital outlay needs outlined above.

Budget Bill Proposal. The $1.2 billion in the budget bill consists of: (1) $678 million from bond proceeds—general obligation ($560 million) and lease-payment ($118 million), (2) $136 million general Fund, (3) $58 million special funds, and (4) $307 million federal funds. (The budget request includes an authorization for another $225 million in lease-payments bonds that the administration assumes will be offset by proposed appropriations of future federal funds.) The budget bill amount represents a 69 percent increase compared to current-year appropriations. The majority of this increase is in the area of Youth and Adult Corrections. Nearly 90 percent of the proposal in the budget is for prisons, higher education and resources. The future cost to complete all projects in the budget bill totals $1.3 billion.

Bond Debt. We estimate that the state's debt payment on bonds will be $2.5 billion in 1997-98. This is an increase of $114 million, or 4.8 percent, over current-year debt service costs. This amount includes payments on general obligation bonds ($1.95 billion) and lease-payment bonds ($527 million). Debt service on lease-payment bonds is becoming a greater portion of total debt, increasing from 13 percent in 1990-91 to 21 percent in 1997-98.

The debt service ratio (debt payments as a percent of General Fund revenue) is estimated to be 4.9 percent in the current year. We estimate that, as currently authorized bonds are sold, this ratio will increase to 5.2 percent in 1999-00 and decline thereafter if no new bonds are authorized. We estimate that if the Governor's proposal for lease-payment bonds and general obligation bonds is approved, the debt ratio would increase by about 0.4 percent in future years.

Issues for Legislative Consideration

The administration continues each year to present its capital outlay proposal to the Legislature in an ad hoc manner, without benefit of a single statewide plan. Thus, the Legislature is asked to review and approve individual projects that are not presented in the context of the overall picture of the state's capital outlay needs and priorities. The Legislature has recognized this problem and has adopted, and sent to the Governor numerous times, legislation requiring the administration to (1) provide an integrated five-year plan, including priorities and a financing plan; and (2) present this plan as part of the annual budget. This legislation has repeatedly been vetoed.

Lacking such a plan the Legislature is again presented with a series of funding proposals in 1997-98 absent any statewide context of needs and priorities or a financing plan to complete all proposed projects. Furthermore, the administration has not presented a plan for financing hundreds of million of dollars in costs to complete projects that have been previously approved and are not included in the budget for 1997-98.

The state has an immense inventory of physical facilities. As an example the three segments of higher education alone have about 120 million square feet of building space and extensive utility systems. Other areas such as prisons, state hospitals, parks and office facilities also have large amounts of building space and utility systems. These facilities are aging and will need major renovations to upgrade. Thus, even without additional demand for new facilities to meet growth in an area, the state will have to commit a portion of its annual revenue—on a pay-as-you-go basis and/or through debt financing—for capital improvements to a wide variety of state facilities.

Until a comprehensive long-term capital outlay plan is developed, the state will continue to fund individual projects without benefit of knowing the overall statewide priorities and will continue to initiate projects for which there are no funds to complete. This approach does not get the state the "biggest-bang-for-the-buck" in addressing state facilities and as a result does not serve well the citizens of California.

Specific Capital Outlay Issues Facing the Legislature. There are several areas within the state's capital outlay program that merit consideration in the near-term. The following is a list of some of the major areas that fit this category:

- ***Develop Plan to Complete Projects.*** The administration and the Legislature must develop a more deliberate capital outlay planning process. We believe the Legislature can take a first step along this path by holding the administration accountable for the plan it has put forth for 1997-98. To do this we recommend that the Legislature not approve any project unless there is a specific plan for funding its future cost. We also recommend the Legislature consider placing a multipurpose "Statewide Facilities Bond Act" on the June 1998 ballot.

- ***Federal Crime Bill Grants.*** The state could receive several hundred million dollars in federal grants over a five-year period to build or modify correctional facilities. The administration has proposed a plan to allocate all grant funds it anticipates receiving and requests legislative authorization of the entire plan in the 1997-98 budget. We recommend that the Legislature instead appropriate funds on an annual basis to retain legislative oversight of these expenditures and to allocate funds based on a yearly assessment of its priorities for using these monies.

- ***State Prisons.*** Inmate population growth continues to be lower than previously projected. Thus, although the Governor's budget proposes development of six new prisons, the need for and timing of new prison development is uncertain. The Legislature should have available for its review the administration's spring 1997 inmate population projections before making any decisions on the need for new prisons.