MAJOR ISSUES

Transportation

✔ **1996 STIP Funding and Expenditures Balanced, But Toll Bridge Seismic Retrofit Needs Funding Solution**

- Over the seven years of the 1996 State Transportation Improvement Program (STIP), transportation revenues and expenditures are roughly in balance (see page A-12).
- Although STIP funding and expenditures are balanced, there is currently a $1 billion balance in the State Highway Account due to lower capital outlay expenditures, primarily for highway bridge seismic retrofit (see page A-15).
- Seismic retrofit of state-owned toll bridges still faces a $1.4 billion gap; funding solution is needed for 1997-98 for retrofit to proceed (see page A-17).

✔ **Prospects Good for 1998 STIP, But Threats Loom**

- The 1998 STIP will provide the first opportunity in six years to add a large number of new projects to the STIP (see page A-16).
- Three risks—toll bridge seismic retrofit, reauthorization of the federal transportation act, and higher rehabilitation costs—could reduce the level of funds available to program new projects in the 1998 STIP (see pages A-17, A-19, and A-20).

✔ **More Proposed Staff for Capital Outlay Support Engineering**

- Caltrans' capital outlay support staffing level would climb to 9,099 personnel-year equivalents (PYEs). We withhold recommendation because the department has not justified its request (see page A-29).

- Caltrans proposes to contract out 1,680 PYEs of capital outlay support work, but we recommend that the Legislature deny the request unless the department improves its use of contract resources (see page A-32).

✔ Actions Necessary to Balance Motor Vehicle Account

- The Motor Vehicle Account (MVA) will have a deficit in both the current and budget years if corrective actions are not taken. The budget proposes to reduce expenditures, shift funding to other sources, and raise $50 million in fee revenues in the budget year. Legislation will be needed to accomplish this (see pages A-22 to A-25).

✔ Transfer of Intercity Rail Service Under Negotiation

- Chapter 1263, Statutes of 1996 (SB 457, Kelley) authorized the transfer of intercity rail service from Caltrans to regional boards. Regional boards have expressed several concerns that have slowed the negotiations for the transfer (see page A-44).
- Caltrans should be subject to requirements of Chapter 1263 and submit a business plan annually for the intercity rail services it continues to administer (see page A-46).

TABLE OF CONTENTS

Transportation

Overview A-5

Spending by Major Program A-6

Major Budget Changes A-8

Crosscutting Issues A-11

Funding Outlook for State Transportation Programs A-11

Motor Vehicle Account Condition A-22

Departmental Issues A-27

Department of Transportation (2660) A-27

Department of the Highway Patrol (2720) A-54

Department of Motor Vehicles (2740) A-61

Findings and Recommendations A-67

OVERVIEW

Transportation

State expenditures for transportation programs are proposed to be somewhat higher in 1997-98 than in the current year. The increase is due mainly to proposed higher expenditures for the seismic retrofit of state highways and bridges.

For traffic enforcement, the budget proposes increases in the expenditures of both the California Highway Patrol and the Department of Motor Vehicles. The expenditure increases are primarily to accommodate workload related to the implementation of various new statutes.

The budget proposes total state expenditures of about $5.3 billion for transportation programs in 1997-98. This is an increase of $390.4 million, or 7.9 percent, over estimated expenditures in the current year.

Figure 1 shows that state-funded transportation expenditures increased by $1.7 billion since 1990-91, representing an average annual increase of 5.8 percent. When adjusted for inflation, these expenditures increased by an average of 3.4 percent annually. This increase is largely the result of the passage of the *Transportation Blueprint* legislation in 1990 which provided additional state funds for highway and mass transportation programs. In addition, in March 1996, voters passed Proposition 192, authorizing $2 billion in bonds for seismic retrofit of highways and bridges, including state-owned toll bridges.

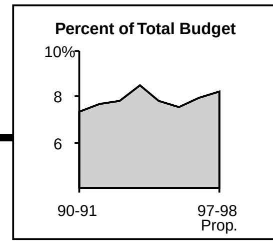
Figure 1 also shows that transportation expenditures have increased slightly as a share of total state expenditures over the period. In 1997-98, proposed transportation expenditures will constitute about 8.2 percent of all state expenditures.

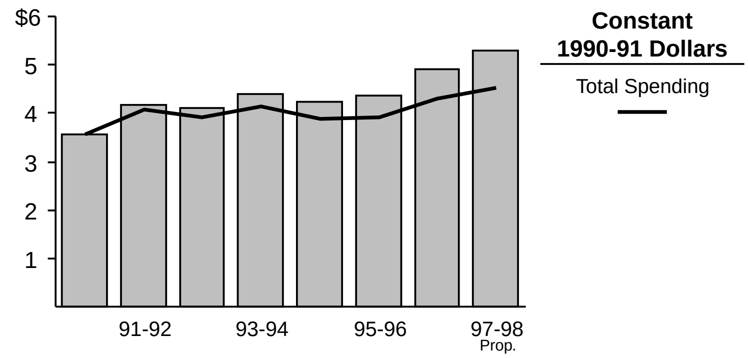
Of the 1997-98 state transportation expenditures, about $4.1 billion is proposed for programs administered by the state, and about $1 billion is for subventions to local governments for streets and roads. Another $213 million will be for debt-service payments on rail bonds issued under Propositions 108 and 116 of 1990, and on seismic retrofit bonds to be issued under Proposition 192 of 1996.

Figure 1

Transportation Expenditures Current and Constant Dollars 1990-91 Through 1997-98

All State Funds (In Billions)





SPENDING BY MAJOR PROGRAM

Figure 2 shows spending for the major transportation programs in detail. Specifically, the budget proposes expenditures of $5.8 billion (from all fund sources) for the Department of Transportation in 1997-98—an increase of $703 million (14 percent) above estimated current-year expenditures. The higher expenditure level reflects mainly an increase of about $464 million in Proposition 192 expenditures for seismic retrofit of highways and bridges, and an increase of about $248 million in State Highway Account expenditures for other highway transportation activities.

Spending for the California Highway Patrol (CHP) is proposed to increase in 1997-98 by $59 million, about 7.4 percent. A large portion of the increase will be funded from the Motor Vehicle Account (MVA) with the remainder of the increase being funded from other sources. In particular, the budget proposes to shift the funding of CHP's Commercial Vehicle Inspection program from the MVA to the State Highway Account (SHA). This will increase the SHA support of CHP by about $33 million in 1997-98.

For the Department of Motor Vehicles (DMV), the budget proposes expenditures of $564 million, about 5.3 percent more than in the current year. The increase will be funded with a combination of MVA revenues and revenues from motor vehicle license fees.

Additionally, the budget proposes an increase in the State Transportation Assistance (STA) program in 1997-98 from $76 million to $84.8 million. This increase reflects higher projected revenues into the Transportation Planning and Development (TP&D) Account. The STA program provides funds to local transportation agencies to operate public mass transit systems. Annual funding of the program is determined based on a statutory formula, and the level varies depending on anticipated revenues into the TP&D Account.

Figure 2

Transportation Budget Summary Selected Funding Sources 1995-96 Through 1997-98

(Dollars in Millions)

	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	Change From 1996-97	
				Amount	Percent
Department of Transportation					
State funds	$2,043.2	$2,846.6	$3,622.4	$775.8	27.3%
Federal funds	2,061.4	1,808.8	1,765.4	-43.4	-2.4
Reimbursements	542.8	498.1	468.6	-29.5	-5.9
Totals	**$4,647.4**	**$5,153.5**	**$5,856.4**	**$702.9**	**13.6%**
California Highway Patrol					
Motor Vehicle Account	$660.9	$702.6	$726.3	$23.7	3.4%
Other	83.8	89.4	124.7	35.3	39.5
Totals	**$744.7**	**$792.0**	**$851.0**	**$59.0**	**7.4%**
Department of Motor Vehicles					
Motor Vehicle Account	$329.5	$308.0	$311.4	$3.4	1.1%
Motor Vehicle License Fee Account	166.8	172.7	192.1	19.4	11.2
Other	19.6	54.7	60.5	5.8	10.6
Totals	**$515.9**	**$535.4**	**$564.0**	**$28.6**	**5.3%**
State Transportation Assistance					
Transportation Planning and Development Account	**$71.0**	**$76.1**	**$84.8**	**$8.7**	**11.4%**

Figure 3

Transportation Programs Proposed Major Changes for 1997-98 All Funds[a]

Department of Transportation	**Requested:**	**$5.8 billion**	
	Increase:	**$702.9 million**	**(+13.6%)**

- ✚ $456.7 million for highway capital improvement, primarily seismic retrofit
- ✚ $69 million in engineering and design staff support
- ✚ $18.7 million to offset price increases
- ✚ $14 million to maintain traffic management centers
- ✚ $9.2 million to support intercity rail service
- ✚ $7.6 million for increased highway maintenance workload

California Highway Patrol	**Requested:**	**$851 million**	
	Increase:	**$59 million**	**(+7.4%)**

- ✚ $5.6 million for telecommunications equipment
- ✚ $4.3 million for the full-year cost of traffic officers and to strengthen supervisory control
- ✚ $3.8 million for reimbursed services
- ✚ $1.4 million to regulate commercial trucking

- ▬ $1.6 million from termination of inspection of hazardous waste transport vehicles and California Motorcyclist Safety Program

Department of Motor Vehicles	**Requested:**	**$564 million**	
	Increase:	**$28.6 million**	**(+5.3%)**

- ✚ $19 million for 562.4 personnel-years to implement legislation requiring proof of insurance for vehicle registration
- ✚ $8.1 million to regulate commercial trucking
- ✚ $5.1 million for database conversion, computer programming, and to redesign business practices

[a] Includes expenditures from bond funds

CROSSCUTTING ISSUES

Transportation

FUNDING OUTLOOK FOR STATE TRANSPORTATION PROGRAMS

California finances its highway and mass transportation programs with a combination of state, federal, local, and private funds. The multi-year expenditure of state and federal funds for transportation capital projects is contained mainly in the seven-year State Transportation Improvement Program (STIP), which is adopted in even numbered years by the California Transportation Commission (CTC). The STIP includes projects designed to increase the capacity of the state's transportation infrastructure. Another program, the State Highways Operation and Protection Program (SHOPP) includes projects that do not increase capacity, but rather projects that primarily address rehabilitation and safety issues.

State law requires the Department of Transportation (Caltrans) to submit, every two years, a fund estimate to CTC that projects state and federal revenues and expenditures for highway and rail projects over a seven-year period. The CTC used the 1996 fund estimate as the basis for scheduling projects to be funded in the 1996 STIP, extending from 1996-97 through 2002-03.

In the following sections, we conclude that:

- Revenues and expenditures are essentially balanced over the 1996 STIP period; however, higher Caltrans support and local assistance expenditures may consume the full $1.35 billion in new revenues resulting from the passage of Proposition 192.

- The 1996-97 year end cash balance in the State Highway Account (SHA) will exceed $1 billion, primarily due to low capital outlay expenditures in 1995-96.
- The CTC plans to adopt the 1998 STIP four months early, in order to make earlier use of SHA cash balances.
- The 1998 STIP will provide the first opportunity in six years to add a substantial number of new projects to the STIP. However, three threats may reduce available funding in the 1998 STIP: (1) an additional $1.4 billion is required for toll bridge seismic retrofit, and SHA is likely to pay part of the cost, (2) the federal transportation act expires in 1997, and the funding levels to be provided by a subsequent act are not known, and (3) the state highway system is aging and rehabilitation projects will present a growing draw on transportation funds.

1996 STIP Close to Balance

We find that funding for the 1996 State Transportation Improvement Program (STIP) is close to balanced over seven years. However, higher expenditures for Department of Transportation (Caltrans) support and local assistance may consume most of the new revenues resulting from the passage of Proposition 192. We recommend that the Legislature adopt supplemental report language directing Caltrans to include in the STIP fund estimate a reconciliation of estimated and actual support and local assistance expenditures.

1996 STIP Deleted Projects. As we have reported in previous *Analyses*, there has been a chronic shortage of funds for transportation projects scheduled in the STIP, due to a multitude of factors. As a consequence, CTC added no new projects in either the 1994 or 1996 STIPs. The CTC took a further step to balance projected revenues and expenditures in the 1996 STIP by deleting about $500 million of projects. As a result, few new projects have been scheduled in the past six years, and the projects originally scheduled in the 1992 STIP will take much longer to deliver than initially intended.

Funding for 1996 STIP Improves. As we reported in the *1996-97 Analysis*, the 1996 STIP began about $560 million out of balance, because it did not reserve full construction funding for projects in the last years of the STIP. One year later, we find that available revenue will be substantially higher than forecast, primarily due to the passage of Proposition 192. Support and local assistance expenditures will also be higher, and the net result, summarized in Figure 4, is that the gap narrows to about $210 million.

Proposition 192 Provides $1.35 Billion. The 1996 STIP reserved approximately $1.35 billion of state and federal funds for seismic retrofit of highway bridges. However, voters approved Proposition 192 in March 1996, which provides $1.35 billion in general obligation bond funds for highway seismic retrofit. (Proposition 192 also provides $650 million for toll bridge seismic retrofit.) These bond funds free up the funds that had been reserved in the STIP, providing an additional $1.35 billion over the 1996 STIP period.

State and Federal Revenue Changes. We estimate that SHA revenues for the 1996 STIP could be about $300 million higher than forecast, as shown in Figure 4. (This estimate is based upon gas tax revenues for 1996-97 and 1997-98 that are projected to exceed the revenues assumed by the fund estimate.) Federal funds in the first two years of the 1996 STIP have been close to the levels predicted in the fund estimate; however, as we discuss later in this section, the level of federal funds in later years is contingent upon enactment of a new federal transportation act.

Figure 4

1996 STIP Funding Outlook
Summary of Major Changes

(In Millions)

Initial funding deficit	-$560
New revenues	
Proposition 192 bonds	1,350
State funds	300
Federal funds	—
New expenditures	
Caltrans support	-700
Local assistance	-600
Total	**-$210**

Higher Support and Local Assistance Expenditures. Although new bond funds and higher revenues improve the condition of STIP funding, these factors are partially offset by an increase in Caltrans' support and local assistance expenditures. Caltrans was unable to reconcile its actual support expenditures to those projected in the 1996 STIP fund estimate in time for this analysis, but we estimate higher support costs of at least $100 million each year in 1996-97 and 1997-98. If this trend continues, then support of Caltrans will require an additional $700 million of revenues over the seven years of the 1996 STIP.

Additionally, the 1996 fund estimate assumes that the State-Local Transportation Partnership Program (SLTPP), a local assistance program, will be funded at $100 million annually. In the 1997-98 budget, however, Caltrans proposes increasing SLTPP funding to $200 million, the level specified in statute. If the Legislature funds the SLTPP at $200 million in 1997-98 and in the each of the remaining years of the 1996 STIP, the program will consume $600 million not anticipated in the fund estimate.

STIP Is Close to Balance. As Figure 4 illustrates, the net effect of these changes is to reduce the fund gap from $560 million to $210 million. This amount is less than 1 percent of total revenues assumed during the seven-year STIP. We believe that a $210 million gap is within the margin of error of the 1996 fund estimate, and consequently find that revenues and expenditures are essentially balanced over the 1996 STIP period. However, we note that a balanced STIP was achieved only at the cost of two STIP cycles (1994 and 1996) that added no new projects and by deleting about $500 million of projects from the 1996 STIP. In addition, while Proposition 192 freed up $1.35 billion in SHA funds, higher support and local assistance expenditures threaten to use the entire amount. As a result, the 1998 STIP may be unable to use any of the $1.35 billion freed up by Proposition 192 for new projects. Furthermore, as we discuss later in this section, several significant financial threats exist that could again plunge STIP finances into a shortfall.

Recommend that Fund Estimate Contain Reconciliation. As illustrated in Figure 4, support and local assistance expenditures that exceed those forecast in the fund estimate can have a substantial impact on STIP funding. Were it not for new bond revenues and higher state revenues, Caltrans' support and local assistance expenditures could have reduced funding for STIP project construction. In order to improve the accuracy of fund estimate forecasts and to hold Caltrans more accountable for its expenditures, we recommend that the Legislature adopt supplemental report language directing Caltrans to include a reconciliation in future fund estimates:

> Beginning with the 1998 STIP fund estimate, and for all future STIP fund estimates, Caltrans shall include in the fund estimate (1) a reconciliation of actual support and local assistance expenditures shown in the Governor's budget to those forecast in the previous fund estimate and (2) a summary of forecast expenditures over the seven years of the fund estimate, in a format suitable for comparison to the Governor's budget.

We additionally recommend that the Legislature enact this requirement in statute, to ensure that Caltrans includes a reconciliation in future STIP fund estimates.

SHA Cash Balance Exceeds $1 Billion

The 1996-97 year-end State Highway Account balance will exceed $1 billion. We find that the high balance results primarily from lower capital outlay expenditures due to a decision to restrict the number of nonseismic projects and slow construction of seismic retrofit projects. The Department of Transportation historically overestimates its capital outlay expenditures, so actual year-end balances are likely to be even higher than estimated by the Governor's budget.

The cash balance in the SHA, the primary source of state funds for transportation expenditures, has grown substantially since 1994-95. While Caltrans and CTC endeavor to keep the fund balance around $200 million—by ensuring that SHA funds are spent on projects rather than accumulating in the account—the current cash balance is around $1 billion (and the budget estimates the balance at $991 million by the end of the current year). This large balance, however, does not represent funding capacity for programming of additional projects. Rather it indicates that, while expenditures and revenues are roughly balanced over the seven years of the 1996 STIP, timing differences between receipts and expenditures have allowed cash to accumulate in the account.

Much of the balance accumulated in 1995-96. For that year, Caltrans initially proposed $901 million in SHA capital outlay expenditures, only to revise the amount down to $477 million by mid-year. Actual SHA capital outlay expenditures were $276 million, or $625 million less than proposed. With expenditures down and revenues holding steady, the cash balance grew.

Allocation Plan Restricted Expenditures. The low level of capital outlay expenditures in 1995-96 results primarily from Caltrans' slow delivery of seismic retrofit projects and from a decision to ration nonseismic construction. In late 1994, Caltrans and CTC determined that there would not be sufficient funds to construct all programmed projects along with Phase 2 of highway bridge seismic retrofit (having a $1 billion construction cost). They therefore adopted a "1995 allocation plan" that restricted the number of nonseismic projects that would be financed from January 1995 through June 1996. By limiting the construction of nonseismic projects, the allocation plan intended to ensure that cash would be available to construct Phase 2 retrofit projects.

However, Caltrans did not deliver retrofit projects on the assumed schedule, and the funds saved by constructing fewer nonseismic projects were not yet needed for seismic retrofit. Caltrans now anticipates that the bulk of its retrofit expenditures will occur in 1997-98 and later; however, Proposition 192 now provides bond funds for retrofit, so the accumulated SHA cash is not needed. We conclude that the allocation plan's restriction of nonseismic construction, Caltrans' failure to deliver retrofit projects on its assumed schedule, and the passage of Proposition 192 are primarily responsible for the high SHA cash balance.

SHA Cash Balance Outlook. Actual 1996-97 year-end cash balances will be even higher than the $991 million estimated in the Governor's budget. This is because the Governor's budget does not include $103 million of Proposition 192 bond funds that CTC transferred to SHA as repayment for earlier seismic retrofit expenditures. Additionally, Caltrans historically overestimates its capital outlay expenditures. Caltrans' year-to-date SHA capital outlay expenditures are only $137 million, so it probably will not achieve the full-year expenditure of $716 million that the budget assumes. If actual expenditures remain lower than estimated, the account balance will rise further.

Caltrans indicates that SHA balances will not drop soon, and the Governor's budget predicts that balances near $1 billion will persist through the end of 1997-98. As we discuss in the Highway Transportation section of this *Analysis*, Caltrans proposes to accelerate delivery of some STIP projects, and CTC is likely to schedule new projects in the early years of the 1998 STIP in order to use the available cash.

CTC Plans Early 1998 STIP

Because of the large State Highway Account balance and the Proposition 192 revenues, the California Transportation Commission plans to adopt the 1998 State Transportation Improvement Program (STIP) about four months early. Several financial risks may limit the ability to program new projects in the 1998 STIP.

Due to the additional funds provided by Proposition 192 and the billion dollar SHA balance, CTC plans to adopt the 1998 STIP earlier than usual. The CTC plans to adopt the 1998 fund estimate in May (rather than August) 1997 and the 1998 STIP, including a list of projects to be funded from 1998-99 through 2004-05, in December 1997 (rather than March 1998). The 1998 STIP will present the first opportunity in six years to add a large number of new projects to the STIP, and early adoption could somewhat speed project design and construction. However, while the outlook for the 1998 STIP is positive, there are several prominent threats that may reduce funding for the STIP and constrain its ability to fund new projects. In the following sections, we discuss three issues that may reduce STIP funding:

- Toll bridge seismic retrofit has a $1.4 billion unfunded cost, which will probably require some SHA funds.

- The Intermodal Surface Transportation Efficiency Act (ISTEA), the federal transportation act, expires in 1997, and its successor act has not been drafted.
- Pavement rehabilitation costs are growing, and will constitute a growing draw on transportation revenues.

Toll Bridge Seismic Retrofit Needs Funding Solution

There is a $1.4 billion shortage of funds for seismic retrofit of state-owned toll bridges, which may reduce funds available for the 1998 State Transportation Improvement Program. If the Department of Transportation keeps to its design and construction schedule, the Legislature must enact a funding solution in 1997-98 in order to allow retrofit to proceed. We recommend the Legislature enact a funding solution consisting of a mix of toll revenues and State Highway Account funds.

In early 1995 Caltrans raised its cost estimate for seismic retrofit of state-owned toll bridges from $650 million to $2.1 billion. Even with $650 million in bond funds provided by Proposition 192, a $1.4 billion gap remains. The Governor has suggested that SHA contribute $500 million to close the gap, but whatever amount of SHA funds the Legislature provides will reduce funds available for other projects in the 1998 STIP.

Funding Needed for 1997-98. At this time last year, Caltrans reported that it would begin construction on all bridges in 1996-97, creating an urgent need for the Legislature to develop a funding solution so that Caltrans could begin construction. Caltrans now indicates that schedules have slipped three to six months, and that it will require only $102 million in 1996-97. This delay pushes the funding crisis to 1997-98, when Caltrans believes that it will award construction contracts worth $1.5 billion.

The retrofit of the San Francisco-Oakland Bay Bridge is responsible for the largest share of estimated costs in 1997-98—$860 million out of the $1.5 billion total. When this analysis was prepared, Caltrans had not decided whether to retrofit or replace the east span of the Bay Bridge. (As we discuss later, these options have different price tags.) Consequently, we believe that the cost and schedule for the Bay Bridge retrofit are subject to change.

Even if Caltrans begins no construction on the Bay Bridge in 1997-98, construction on other bridges will require $650 million. According to Caltrans, however, only $380 million from Proposition 192 will remain uncommitted for 1997-98. Therefore, even without Bay Bridge costs, the Legislature will need to enact a funding solution in 1997-98 to enable retrofitting to proceed.

Solution Should Use SHA and Toll Funds. The Legislature could close the entire $1.4 billion gap with SHA funds, but this would greatly reduce funds available for the 1998 STIP to program new projects throughout the state. Still, we believe that it is appropriate that statewide funds—the SHA—should contribute to toll bridge retrofit, because toll bridges are part of the state highway system, intended to benefit the state by facilitating travel and commerce between cities. We also note that SHA currently funds other rehabilitation, safety, and retrofit projects according to need and without regard to their geographic location, an approach that we believe should apply as well to toll bridge retrofit.

Alternatively, the Legislature could require that bridge users fund the entire $1.4 billion gap through toll revenue. This would require a $1 toll surcharge on all toll bridges for at least 14 years, and would also likely delay construction of other bridge improvements that are already scheduled to use toll funds. Still, it is appropriate that toll funds contribute to retrofit, because bridge users are the most direct beneficiaries.

In order to share the burden between bridge users and drivers statewide, we recommend that the Legislature enact a funding solution that combines SHA and toll revenues. Additionally, we believe that it is important to enact a funding solution in time to allow retrofit to proceed on schedule.

New Bay Bridge Span May Cost Less. At the time this analysis was prepared, Caltrans had not determined whether to retrofit or replace the east span of the Bay Bridge (between Treasure Island and Oakland). Retrofitting this span of the Bay Bridge is the most expensive and difficult element of the toll bridge retrofit program. A recent report, prepared for Caltrans by expert consulting engineers, concludes that Caltrans should replace, rather than retrofit, the east span. The report finds that a new bridge would cost less to construct and maintain, and would also offer better seismic resistance, improved driver safety, less environmental damage, and less traffic disruption during construction. Caltrans, however, is concerned that it could take several years longer to construct a new bridge and that it could be further delayed by environmental reviews.

At the time we prepared this analysis, it was not clear when Caltrans will have an official recommendation on whether to retrofit or replace the east span of the bridge. While Caltrans can consider engineering factors in its analysis, we believe that it is the appropriate role of the Legislature to weigh the relative cost, timing, seismic safety, traffic disruption, aesthetics and other factors that distinguish the retrofit and replacement options. The Legislature should then enact its choice in statute, along with a funding solution.

Federal Transportation Act Expires in 1997

The current federal transportation act expires in September 1997, and the terms of a successor act are unknown. The 1998 State Transportaton Improvement Program (STIP) fund estimate will not reflect the new transportation act, and changes in funding levels or program restrictions could complicate programming the 1998 STIP.

The 1996 STIP fund estimate assumes that California will receive $1.6 billion in federal highway funds during each year of the seven-year STIP period. Caltrans based this estimate upon the historical funding level that California has received under the federal Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). However, ISTEA expires in September 1997, thus the amount of federal highway funds that California will receive during the last six years of the 1996 STIP is unknown.

It is our understanding that Congress intends to write a new federal transportation act during the current year. However, the CTC has accelerated the 1998 STIP process, and Caltrans will present the 1998 fund estimate in April 1997—well before Congress will have completed ISTEA reauthorization. If the new federal transportation act changes funding levels significantly, the 1998 STIP could face either a shortfall or surplus. In addition, the federal act specifies how states may use federal transportation funds, and if the new act adds program requirements then some projects in the 1998 STIP may not qualify for federal funds.

We understand that the most likely result of the reauthorization process will be a new federal act which is similar, in provisions and funding levels, to ISTEA. However, there are several competing proposals that could have very different effects on the 1998 STIP:

- ***California Consensus Proposal.*** Developed by Caltrans and California's local and regional transportation planning agencies, the Consensus proposal recommends that the general structure of ISTEA be continued, with a decrease in federal restrictions and more rapid return of federal fuel taxes to the states.

- ***STEP 21.*** Introduced in Congress in the 1996 session, STEP 21 guarantees that donor states would receive at least 95 percent of the federal gas tax generated in the state. Because California is a donor state, STEP 21 could yield higher funding for California. STEP 21 also proposes to consolidate federal programs and provide greater flexibility to states.

- ***Substantial Devolution.*** The Wilson administration supports eliminating 70 percent of the federal gas tax. Current state law would automatically raise the state gas tax to offset *part* of the

> decrease in federal tax, but total revenue would still be lower. However, if the Legislature raised the state gas tax to *fully* offset the reduced federal tax, California would receive higher revenue, because no funds would be withheld by the federal government or shared with other states.

Other Issues. Congress will consider other issues as it debates ISTEA reauthorization. Congress may consider taking transportation funds off-budget, in order to reduce the tendency to use transportation funds to balance the federal budget. Also, 4.3 cents of the federal gas tax currently goes to the federal budget for deficit reduction; Congress must determine whether to maintain this 4.3 cent tax, divert it to the transportation fund, or eliminate it. If the new federal transportation act provides a different level of funds than anticipated in the 1998 fund estimate, or changes restrictions on the uses of federal funds, the revenues and expenditures in the 1998 STIP may become unbalanced.

Higher Rehabilitation and Safety Costs Squeeze STIP

Expenditures for pavement and bridge rehabilitation projects will continue to grow, because most of the state highway system is reaching the end of its design life. The Department of Transportation estimates that rehabilitation needs may grow by up to $1.4 billion over the seven years of the 1998 State Transportation Improvement Program (STIP), reducing funds available for new STIP projects.

Projects that extend the useful life of the existing transportation infrastructure and improve its safety are scheduled in the SHOPP, rather than in the STIP, which includes projects that increase transportation system capacity. Typical SHOPP projects include pavement rehabilitation, bridge repair, roadway alignment, and landscaping. Because SHOPP projects protect the state's investment in its existing transportation system, SHOPP expenditures have a higher priority in statute than do STIP expenditures. Thus, the amount of money available for new projects in the 1998 STIP will be partially determined by how much is set aside for projects in the SHOPP. In 1995, CTC increased SHOPP funding by $96 million per year, which reduced funds available for the 1996 STIP by $675 million. As Caltrans and CTC prepare for the 1998 STIP, it is likely that SHOPP expenditures will continue to grow, further squeezing funding for the STIP.

Pavement Rehabilitation Costs Will Grow. As we reported in last year's *Analysis*, the primary reason that CTC increased SHOPP funding is that most pavement on the state highway system is over 30 years old and is beginning to deteriorate rapidly. Rehabilitation projects add many years to pavement life and can be very cost-effective, because if pavement deterioration is not addressed in time it will progress into serious pavement failure requiring much more expensive reconstruction.

Because of the advanced age of the state highway system and its heavy use, particularly by commercial trucks that cause the most pavement damage, pavement rehabilitation costs are likely to continue rising. Caltrans has identified six options for improving pavement conditions over the next 10 years, such as holding pavement deterioration constant, repairing structural damage on major highways, or increasing pavement strength on major commercial routes. The department estimates that it would cost $4.7 billion over ten years to implement all of its options. This would require an increase of about $800 million above current rehabilitation funding levels during the seven years of the 1998 STIP. Caltrans and CTC will determine the actual level of funding for rehabilitation when they adopt the 1998 STIP fund estimate in April.

Bridge Expenditures to Rise. In addition to pavement rehabilitation, Caltrans estimates that expenditures will rise for bridge rehabilitation. The SHOPP currently provides an average of about $80 million per year for bridge rehabilitation and replacement. As highway bridges age along with the rest of the state highway system, Caltrans estimates that rehabilitation and replacement costs will increase to $250 million per year by 2005. If fully funded, this would require about $600 million above current levels during the seven years of the 1998 STIP, and still higher levels in later STIPs.

Less Funds Available for STIP. Expenditures for both pavement and bridge rehabilitation are likely to continue increasing through the next decade, reducing the level of funds that can be used for STIP projects. Most STIP projects provide new transportation capacity to meet local and regional transportation demand. As SHOPP rehabilitation costs increase at the expense of STIP funding, less funds will be available to accommodate local traffic growth and congestion.

MOTOR VEHICLE ACCOUNT CONDITION

Without additional revenues or reductions in expenditures, the Motor Vehicle Account will experience a shortfall in the current and budget years.

The Motor Vehicle Account (MVA) derives most of its revenues from vehicle registration and driver license fees. In 1996-97, these fees account for 79 percent ($870 million) and 10 percent ($109 million), respectively, of the estimated $1.1 billion in MVA revenues. The majority of MVA revenues are used to support the activities of the Department of Motor Vehicles (DMV), the California Highway Patrol (CHP), and the Air Resources Board (ARB).

Our review shows that the account faces significant challenges in the current and budget years. Specifically, current-year revenues are estimated to fall below projected amounts while expenditure of these revenues are higher than originally anticipated, necessitating corrective actions to balance the account. For the budget year, the account will incur a deficit if the expenditures proposed by the budget are approved without additional revenues being generated to the account.

MVA Faces Deficit in Current Year; Corrective Actions Proposed

Lower-than-expected revenues and higher-than-anticipated expenditures will result in a deficit of about $50 million in the Motor Vehicle Account in 1996-97. The budget proposes actions to bridge the funding shortfall. We recommend the Department of Finance advise the Legislature on (1) the availability of funds to pay California Highway Patrol (CHP) retirement contributions in 1996-97 and (2) the services and activities reduced by CHP and the Department of Motor Vehicles in order to achieve the proposed savings.

Since July 1996, the condition of the MVA has worsened significantly, such that the account will be in a deficit by the end of the current year instead of having a balance of $25.4 million as projected a year ago. This change in the account's condition is due to a combination of lower-than-expected revenues and higher-than-anticipated expenditures. Specifically, current-year MVA revenues are estimated to be less than originally estimated by approximately 3 percent (or $36.4 million). The lower revenues reflect:

- ***Lower Driver License Fee Revenues.*** Total driver license fee revenues are $6 million lower than projected a year ago. This is after adjusting for $2.2 million in additional revenues anticipated from a $3 increase in driver license fees beginning January 1997, pursuant to Chapter 1043, Statutes of 1996 (AB 2352, Speier).
- ***Lower Registration Fee Revenues.*** As a result of Chapter 1126, Statutes of 1996 (AB 650, Speier) which requires motorists to show proof of financial responsibility (liability insurance) as a condition for vehicle registration, DMV estimates that registration fee revenues will decrease by one percent, or $4 million in the current year (half year).
- ***Lower Revenues From Other Sources.*** The budget also revised downward anticipated revenues from other sources. In particular, revenues from the sale of information are now expected to be $17 million lower than projected.

Total MVA expenditures for 1996-97 are also anticipated to be higher by about $35 million. The net result of the lower revenues and higher expenditures is that MVA will have a deficit of about $50 million if no corrective actions are taken.

Actions Proposed for Current Year. In order to balance the account in the current year, the budget proposes the following actions:

- ***Unallocated Reductions to Achieve $15 Million in "Unidentified Savings."*** The budget proposes unallocated cuts of $7.5 million each for CHP and DMV. As of yet, the administration has provided no specific details on the reductions, and consequently there is no assurance that the savings will materialize.
- ***Loan of $12.8 million From the SHA to MVA.*** The loan is proposed to fund the support of CHP's Commercial Vehicle Inspection Program. (Please see discussion of this issue under Item 2720.)

In addition, the budget assumes that about $22.2 million in CHP retirement contributions would be paid by surplus funds in CHP's Public Employees' Retirement Account (PERS). The availability of this amount, however, is not certain at this time. The Department of Finance indicates that a more definite estimate will be forthcoming by April.

With these actions, the budget estimates that MVA will end the current year having practically no reserve—only a balance of $25,000.

Legislative Oversight Necessary to Ensure Expenditure Reductions. We believe that the Legislature needs to be informed of the administration's (and departments') spending priorities, and how the "unidentified savings" will be achieved. Therefore, we recommend that the Department of Finance (DOF) report to the Legislature during budget hearings on the activities or services that would be reduced in the current year by CHP and DMV as a result of the expenditure reductions. The DOF should also report on the availability of CHP-PERS surplus funds assumed in the budget for the current year.

Budget-Year Balance Hinges on Raising Fees: Legislation Required

To balance the Motor Vehicle Account in the budget year and avert a deficit, the budget proposes to raise $50 million in unspecified fees. Enactment of legislation would be required to raise these fees.

Our analysis shows that, as in the current year, MVA will have a shortfall in 1997-98 of about $77 million. The budget proposes to balance MVA in the budget year by:

- Raising $50 million in new revenue through unspecified fee increases. While no specific proposal had been provided at the time this analysis was prepared, DOF indicates that it will be proposing a number of driver license-related fees. We estimate that to generate $50 million from this source, a 40 percent *average* increase in these fees would be required.
- Shifting the full cost of CHP's Commercial Vehicle Inspection Program—$55.5 million—to SHA.

With these actions, the budget projects a balance of $23 million in MVA by the end of 1997-98.

However, our review shows that the balance of MVA is still shaky even if the Legislature adopts the above proposals, for the following reasons. First, the budget assumes that $17.8 million in CHP retirement contributions in 1997-98 would be funded from a projected surplus in the PERS account, and it is not certain if the amount would be forthcoming. Second, the full impact of Chapter 1126 on vehicle registration is highly uncertain, as it is yet unknown how motorists will react to this insurance requirement. If registration decreases by more than the 1 percent assumed, revenues will be less. (We estimate that a 1 percent drop in vehicle registration would result in about $8 million less in MVA revenues.)

Third, CHP's employee compensation expenditures might be higher than projected. The budget year expenditure estimates do not take into account the upcoming labor agreement negotiations with CHP traffic officers over salary and employee compensation. The current labor agreement will expire on June 30, 1997, and CHP's employee compensation expenditures may change as a result of a new agreement.

Legislative Action Necessary to Avert Deficit. Without new revenues and with the proposed budget-year expenditure levels, the account will face a deficit in the budget year. To balance the account, the Legislature will have to take action by enacting legislation to raise motor vehicle fees; by decreasing the proposed program expenditures, or by enacting a combination of both.

DEPARTMENTAL ISSUES

Transportation

DEPARTMENT OF TRANSPORTATION (2660)

The Department of Transportation (Caltrans) is responsible for planning, coordinating, and implementing the development and operation of the state's transportation system. These responsibilities are carried out in five programs. Three programs—Highway Transportation, Mass Transportation, and Aeronautics—concentrate on specific transportation modes. In addition, Transportation Planning seeks to improve the planning for all travel modes, and Administration encompasses management of the department.

The budget proposes expenditures of $5.9 billion by Caltrans in 1997-98. This is about $703 million, or 14 percent, more than estimated current-year expenditures.

HIGHWAY TRANSPORTATION

Increases for Highway Program

The budget proposes $5.4 billion for the highway transportation program, 12 percent more than in the current year. The increase is primarily the result of higher proposed expenditures for both capital outlay support and capital outlay project construction.

Of the total expenditures proposed in the department's budget, $5.4 billion is for the highway transportation program. This is an increase of $557 million, or 12 percent, over estimated current-year expenditures.

The major responsibilities of the highway program are to design, construct, maintain, and operate state highways. In addition, the highway program provides local assistance funds and technical support for local roads.

As shown in Figure 5, Caltrans expects that state funds will support $3.2 billion (60 percent) of highway program expenditures. Federal funds make up $1.7 billion (32 percent) of the program budget, and the remaining $420 million (8 percent) is reimbursements, primarily from local governments.

Figure 5

**Department of Transportation
Highway Transportation Budget Summary
1995-96 Through 1997-98**

(Dollars in Millions)

	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	Percent Change From 1996-97
Expenditures				
Capital outlay support	$685	$784	$835	7%
Capital outlay projects	1,810	2,222	2,679	21
State-Local Partnership	139	35	91	160
Local assistance	730	762	825	8
Program development	42	60	62	3
Technical services	90	100	—[a]	—[a]
Legal	58	62	62	—
Operations	122	116	134	16
Maintenance	452	519	651	25
Equipment and telecommunications	116	134	12[b]	-91
Totals	**$4,244**	**$4,794**	**$5,351**	**12%**
State funds	*$1,755*	*$2,597*	*$3,225*	*24%*
Federal funds	*1,986*	*1,751*	*1,706*	*-3*
Reimbursements	*503*	*446*	*420*	*-6*

a The 1997-98 budget shows technical services in the Administration Program.

b The 1997-98 budget shows equipment expenses (other than telecommunications) distributed to the affected programs.

Budget Changes Display of Program Expenditures. The Governor's budget, as summarized in Figure 5, includes two expenditure realignments that complicate year-to-year comparisons in the highway program. First, the proposed budget moves "technical services" expenditures (such as reprographics, facilities management, and procurement) from the highway program to the administration program for 1997-98, but retains these expenditures in the highway program for 1995-96 and 1996-97. Thus, total highway program expenditures for 1997-98 are not directly comparable to previous years.

Second, the budget displays equipment expenditures under equipment and telecommunications for 1995-96 and 1996-97. Starting in 1997-98, however, the budget distributes equipment expenditures to each program according to their equipment use. Thus, 1997-98 expenditures for individual elements of the highway program are not comparable to earlier years, because part of the increase is attributable to redistribution of equipment expenditures.

Increases in Most Highway Programs. Most highway program support costs are in two programs—capital outlay support and highway maintenance. The budget shows a $132 million (25 percent) increase for highway maintenance, but $118 million of this increase is from distributing equipment costs, leaving a $14 million (3 percent) increase in maintenance program activities. The budget also shows a $51 million (7 percent) increase for capital outlay support, but $11 million of this increase is distributed equipment, leaving a $40 million (5 percent) increase in program activities.

Most of the increase in highway program expenditures is proposed for capital outlay projects—$457 million (21 percent) higher than the current-year level. This growth is mostly due to an anticipated increase in seismic retrofit capital outlay. However, Caltrans consistently overestimates its capital outlay expenditures, so expenditures in 1996-97 and 1997-98 are likely to be lower than shown.

Large Increase for Capital Outlay Support

Caltrans proposes to increase expenditures by $128 million (for 539 personnel-year equivalents) in order to deliver projects earlier than scheduled. We withhold recommendation on this proposal because (1) Caltrans has not identified projects that it will deliver early, (2) Caltrans has not sufficiently improved its workload estimating practices as directed by the Legislature, and (3) a pending Supreme Court ruling could intervene in the department's plans to increase contracting out.

The budget proposes 9,099 personnel-year equivalents (PYEs) of work for the highway capital outlay support program—an increase of 539 PYEs (6.3 percent) from the amount estimated in the current year. Capital outlay support staff provide engineering, right-of-way acquisition, environmental clearance and construction oversight on highway capital improvements.

Figure 6 shows both the source of the 9,099 PYEs, as well as Caltrans' proposed uses for the PYEs. In order to increase its staff by 539 PYEs, Caltrans proposes to increase its use of consultant contracts by 374 PYEs and add 15 PYEs of cash overtime and 150 student assistant PYEs. At the same time it proposes to hold the level of state staff constant at 6,956 PYs.

Figure 6

Department of Transportation Capital Outlay Support Staffing 1995-96 Through 1997-98

(Personnel-Year Equivalents)

	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	Proposed Change from 1996-97
Sources				
State staff	7,096	6,956	6,956	—
Cash overtime	348	298	313	15
Student assistants	9	0	150	150
Consultant contracts	596	1,306	1,680	374
Totals	**8,049**	**8,560**	**9,099**	**539**
Uses				
Basic STIP program	5,106	5,631	6,450	819
Pre-STIP state projects	298	335	515	180
Seismic retrofit	1,675	1,634	1,187	-447
Regional Measure 1	48	410	312	-98
Locally funded projects	363	190	219	29
Local tax measure projects	559	360	416	56
Totals	**8,049**	**8,560**	**9,099**	**539**

Less Staff for Seismic Retrofit. Figure 6 also shows how Caltrans proposes to distribute 9,099 PYEs among the various categories of transportation projects. The largest changes are in seismic retrofit and the basic state program (STIP, State Highways Operation and Protection Plan [SHOPP], and Traffic Systems Management [TSM]). Caltrans proposes to reduce staffing for seismic retrofit by 447 PYEs, because design is complete for most highway bridges in the Phase 2 program and workload will therefore be lower.

Accelerated Delivery Proposed. Caltrans proposes to increase staffing for the basic state program by 819 PYEs, for two reasons. First, Caltrans reports that its workload will be higher because of greater numbers of projects scheduled in the STIP and SHOPP. Second, it requests 250 PYEs to accelerate delivery of some STIP and SHOPP projects by 12 to 18 months. The department reports that its proposal will not increase the *total* number of PYEs required over several years to deliver these projects, but that the PYEs will be needed *earlier* in order to accelerate delivery. However, we note that Caltrans has not yet identified specific projects that it proposes to accelerate and therefore cannot compare the required PYEs under the as-scheduled and accelerated alternatives. In addition, because Caltrans has not identified projects to accelerate, it cannot be held accountable for its performance in delivering projects early.

Budget Not Developed According to Legislative Intent. Last year the Legislature directed Caltrans to improve its workload estimating and budget development practices for capital outlay support. The Legislature was concerned about Caltrans' inability to demonstrate the connection between its capital outlay support budget and its workload in terms of projects scheduled for delivery in the STIP, SHOPP and TSM. The Legislature directed Caltrans to develop its 1997-98 budget by estimating and totaling PYE needs for each project in the workplan. Additionally, the Legislature directed Caltrans to have its approach validated by a peer review committee and an independent management consultant.

Caltrans submitted a peer review report in 1996, which reported that Caltrans' proposed method for estimating workload was meritorious, but that much work remained to be done. The department has not submitted the independent management consultant report that was due January 1, 1997. Our review indicates that so far Caltrans has only slightly changed its workload budgeting practices. As a result, the Legislature remains unable to evaluate whether Caltrans' proposed budget provides a staffing level that is appropriate to deliver scheduled projects. Caltrans reports that it will provide the management consultant's report and the department's required response by March.

Pending Supreme Court Ruling. As Figure 6 also illustrates, Caltrans proposes to make greater use of consultant engineering contracts in 1997-98 than it has in previous years. The department will use consultant engineers on STIP and SHOPP projects, rather than exclusively in seismic retrofit, as has been the case in recent years. Caltrans' authority to contract for engineering services has been at the center of an ongoing legal challenge, and the case is currently pending before the California Supreme Court. If the Supreme Court rules against Caltrans, the department's contracting out plan for 1997-98 could be disrupted.

Withhold Recommendation. We withhold our recommendation on Caltrans' proposed $128 million increase for capital outlay support. Before approving any increase, we believe that Caltrans must address three issues for the Legislature. First, Caltrans should identify specific projects that it proposes to accelerate, and show the cost of accelerating and the effect on workload in subsequent years. Second, Caltrans should demonstrate improvements in its workload estimating and budgeting practices and should show a linkage between its capital outlay support budget and programmed projects. Finally, due to the pending Supreme Court case, the department's ability to increase contracting out is uncertain. If the case is not resolved in Caltrans' favor by the time of budget hearings, the department should provide a contingency plan that considers the possibility that the Supreme Court will restrict Caltrans' ability to contract out. (In the following section, we discuss the contracting out element [374 PYEs] of the proposed increase in capital outlay support.)

Caltrans Can Improve Use of Consultant Engineers

We were unable to perform a contracting out cost comparison study because Caltrans could not provide the necessary data. Nonetheless, we find that contracting out for engineering services can benefit Caltrans by (1) improving its response to workload fluctuations and (2) fostering competition between Caltrans staff and consultant staff. However, Caltrans' use of consultant staff to date does not maximize these benefits. We recommend that the Legislature hold Caltrans' level of contracting out constant at the current-year level, unless the department presents an acceptable plan to obtain greater benefits from its use of consultant engineers. (Reduce Item 2660-001-0042 by $25 million.)

As shown in Figure 6, Caltrans staffs its capital outlay support program with a mix of state staff and private sector consultant engineers. Chapter 433, Statutes of 1993 (SB 1209, Bergeson) authorizes Caltrans to contract out for consultant engineers, based on the Legislature's conclusion that the department cannot adequately manage its project delivery without contracting out. Chapter 433 also requires the Legislative Analyst's Office to conduct a study that compares the engineering cost of projects designed by Caltrans to the cost for comparable projects designed by consultant engineers. However, Caltrans has informed us that, due to court-imposed restrictions on the size of its contracting out program in recent years, it could identify only two pairs of comparable projects. Given the lack of comparable projects, we were unable to conduct the analysis required by Chapter 433. Caltrans informs us that it is developing a proposal for consideration by the Legislature that would extend the study for a few more years in order to enlarge the sample of projects and permit a valid comparison.

Contracting Out to Increase. As shown in Figure 6, Caltrans proposes to increase its use of consultant engineers from 596 PYEs in 1995-96 to 1,680 PYEs in 1997-98. Because a recent court ruling upheld the constitutionality of Chapter 433, Caltrans plans to expand its use of consultants, using them not only on seismic retrofit but also on projects in the state's ongoing STIP and SHOPP. In order to assist the Legislature in evaluating Caltrans' proposed contracting out increase, we review the rationale for Caltrans' contracting out program. We have identified five potential justifications for contracting out, which we discuss below.

Direct Cost Savings. The most basic justification for contracting out engineering services is the possibility that consultant engineers will do comparable work at lower cost than state employees. Contracting out for this reason is allowable by state law, but Caltrans does not invoke this justification.

Although Caltrans does not claim direct cost savings from contracting out, it nonetheless commissioned a cost comparison study. The report, completed in 1992, found no significant cost difference between projects designed by Caltrans staff and those designed by consultant engineers. As described above, we were unable to perform a similar study required by Chapter 433, because Caltrans could not provide data on comparable projects.

Savings from Stable Workforce. Caltrans' primary justification for using consultant engineers is to accommodate year-to-year fluctuations in the department's workload. Hiring and training employees is costly and time consuming, and shrinking the state workforce in response to workload reductions can be difficult. Caltrans claims that it reduces its overall program cost by contracting out for workload peaks and retaining a stable level of state staff. In addition, Caltrans believes that this approach enhances its ability to deliver projects as scheduled, because the department can more readily vary its staffing level as required. An independent management evaluation of Caltrans, conducted by SRI International at the request of the Legislature, validated this approach. Their 1994 report recommended that Caltrans use contracting out as a management tool to stabilize the state workforce and respond quickly to workload peaks. However, Caltrans has not analyzed the extent to which it has actually reduced overall costs or enhanced project delivery as a result of contracting out.

Specialty Skills. State law allows contracting out for services of a "highly specialized or technical nature that . . . are not available through the civil service system." Caltrans annually contracts out about 260 PYEs of "specialty work" under this authority, including such services as archaeology and hydrology studies for specific projects.

Emergency Needs. State law also allows contracting out during emergency situations, in order to allow rapid and effective emergency response. Caltrans uses this authority as necessary, primarily in response to natural disasters such as storms and earthquakes.

Foster Competitive Environment. Although not specifically cited in statute, an additional rationale for Caltrans to contract out is to create a competitive environment leading to greater efficiency by both state staff and consultants. By creating either explicit or implicit competition between state staff and consultant engineers, both groups can be motivated to improve their performance.

Although Caltrans describes its contracting out program as making the department more competitive, we find that Caltrans' use of consultants is in fact characterized by a distinct *lack* of competition. There are several reasons for this lack of competition, some of which are not within the department's control. As required by state and federal law, Caltrans selects consultants based only upon their qualifications and *then* negotiates a contract price after selecting the best-qualified consultant. While this system protects against inexpensive but unqualified consultants, it also virtually eliminates price competition among consultants.

Even where Caltrans has more direct control, we find that competition is lacking. Specifically, there is a distinct lack of competition between state staff and consultant staff. First, there is no explicit competition between Caltrans staff and consultant staff to determine which can design individual projects at lower cost. Such explicit competition could stimulate efficiency improvements by both Caltrans staff and consultants. In order for state staff to compete with private consultants, however, it is necessary first to identify contractor costs for each project. Because this is a time consuming process, we believe that it would be difficult to employ on more than a small number of projects.

Caltrans could, however, readily create an *implicit* competition by using detailed measures of past actual cost and schedule performance to compare Caltrans staff and consultants. With performance measures, managers can highlight both exemplary and mediocre performance. For example, performance measures could be the amount of time and support costs expended in order to accomplish a certain amount of design work. Performance measures that cover both consultants and Caltrans staff would expand this comparison, by providing reference to performance outside of the Caltrans organization. However, as SRI International found in their 1994 independent management evaluation, Caltrans lacks performance measures—at the individual, group, and district level—by which to measure actual performance against targets and compare individual and group performance. Furthermore, in a 1996 update, SRI found that

Caltrans had made very little progress towards developing useful performance measures.

Analyst's Evaluation. We believe that it is unlikely that any study that compares the direct costs of Caltrans staff and consultants will be definitive enough to form the basis for staffing decisions. Nonetheless, we agree that Caltrans should contract out workload peaks in order to maintain a stable level of state staff. Contracting peak workloads should increase the department's effectiveness and may reduce its costs regardless of the relative costs of state and consultant staff. However, if the department's primary justification is to stabilize its state staff, then it should contract out *only* its actual workload peaks. Unfortunately, Caltrans would not be able to implement this approach because the department has not identified a stable staffing level against which workload peaks could be measured. Because of ongoing uncertainty about funding levels and future decisions in scheduling projects, Caltrans believes that it is impossible to forecast its future workload and identify a long-term stable staffing level.

Nonetheless, we believe that Caltrans could potentially justify a greater reliance on contracting out in order to increase internal competition and improve efficiency. However, as we describe above, we believe that Caltrans' current use of consultant engineers does not foster competition, either between consultants or between state staff and consultant staff.

Recommend Improvements. We believe that Caltrans should continue to contract out, because of the potential benefits to the department. However, we also believe that Caltrans should make better use of its contract resources, by increasing competition between consultants and state staff. Accordingly, we recommend that Caltrans present a plan, including specific actions and target dates, to use consultant engineers to foster competition by (1) implementing detailed performance measures to spur internal competition between Caltrans staff and consultant staff, (2) increasing competition between consultant staff, and (3) any other proposals to gain greater benefits from use of consultant engineers. In the previous issue, we withhold recommendation on $128 million to increase capital outlay support staff by 539 PYEs, including an increase of 374 consultant PYEs. Should Caltrans fail to submit an acceptable plan prior to budget hearings, we recommend that the Legislature reject the department's proposed increase of 374 consultant PYEs and delete $25 million. This reduction would leave sufficient funds for an equivalent budget-year increase of 374 state staff or cash overtime PYEs.

Additional Capital Outlay Support Increase Unjustified

We recommend that the Legislature deny $23.8 million requested for various operating expense increases proposed for capital outlay support. (Reduce 2660-001-0042 by $23.8 million.)

In addition to its request for 539 additional PYEs for capital outlay support, Caltrans also requests an increase of $23.8 million in operating expenses for the program. This request is not justified, and we recommend that the Legislature delete the funds, for the following reasons:

- ***Computer Aided Drafting and Design (CADD) Equipment ($3.7 Million).*** We recommend rejection because the Legislature has in the past provided permanent funding for CADD costs. Caltrans was unable to identify its base budget for CADD, show planned expenditures against this base, or demonstrate why an additional increase is justified.

- ***Project Management Software ($2.9 Million).*** For several years Caltrans has been attempting to install project management software for highway design projects. During the past four years Caltrans has spent over $18 million on a larger project of which this is a component. However, the department's effort to install project management software is far behind schedule and an independent evaluation has raised serious concerns regarding the project's success. Furthermore, the department is nearly two years overdue in submitting a required special project report that details cost and schedule changes; until this information is submitted, the department should not proceed with this project.

- ***Photocopiers and Materials Testing Equipment ($2.2 Million).*** Caltrans' current-year equipment budget exceeds $65 million. Caltrans has not demonstrated any reason why its base equipment budget is insufficient to fund these one-time purchases.

- ***Contracts for Specialty Skills ($11.1 Million).*** Caltrans requests additional funds to contract for specialty skills not available within the department, such as hazardous waste mitigation, biological studies, and construction material testing. Caltrans has provided no detail to justify this increase, which we believe should be funded from the base budget for capital outlay support.

- ***Expert Witnesses ($3.9 Million).*** These expert witnesses would assist Caltrans in resolving construction claims (payment disputes between Caltrans and its construction contractors). Caltrans believes that its claims workload will increase in 1997-98, but has not provided detail to substantiate this claim.

Accordingly, we recommend that the Legislature reject these requests and reduce Caltrans' proposed budget by $23.8 million.

Seismic Retrofit Expenditures Lag

About 88 percent of Phase 2 retrofit projects are under contract for construction. However, Caltrans' capital outlay expenditures for Phase 2 will occur much later than planned. Additionally, Caltrans' support costs for Phase 2 are much higher than estimated.

Following the 1994 Northridge earthquake, Caltrans expanded its seismic retrofit program for state highway bridges, creating a Phase 1 program and a Phase 2 program. Phase 1 includes bridges that Caltrans identified in its first screening, following the 1989 Loma Prieta earthquake. The Phase 2 program includes bridges that Caltrans added as a result of an additional screening that followed the Northridge earthquake.

Phase 2 Design Progressing but Expenditures Lag. Caltrans has set targets for all Phase 2 bridges to be under construction by December 1996 and for construction to be complete by December 1997. As Figure 7 illustrates, as of December 31, 1996 construction was complete on 279 Phase 2 bridges, with another 743 under contract for construction. Thus, about 88 percent of the bridges met the December 1996 target.

Figure 7

Highway Seismic Retrofit Program Scope and Progress As of December 31, 1996

(Dollars in Millions)

	Number of Bridges	
	Phase 1	**Phase 2**
Retrofit construction complete	1,001	279
Under contract for construction	33	743
Design engineering complete	0	23
Engineering not complete	5	110
Totals	**1,039**	**1,155**
Estimated construction cost	$786	$1,050
Construction complete target	12/95	12/97

While the department may substantially meet its target dates to award projects for construction, it has been extremely inaccurate in estimating its construction expenditures because construction is not completed as anticipated. Additionally, the department is very inaccurate in estimating its capital outlay support needs to actually deliver projects as scheduled. For example, in late 1994 Caltrans reported that it would construct $50 million of Phase 2 projects in 1994-95, $500 million in 1995-96, and the final $500 million in 1996-97. This prediction created an urgent need for construction funds and, as described in the State Highway Account (SHA) writeup in the Crosscutting Issues section of this chapter, led the California Transportation Commission (CTC) to ration funds and restrict construction of nonseismic projects.

Ultimately, however, Caltrans' expenditures have fallen far behind its predictions. Rather than expending the entire $1.1 billion over the three years from 1994-95 through 1996-97, Caltrans now reports that it will have expended only $182 million over the same period. Caltrans also estimates 1997-98 expenditures of $279 million, and reports that the remaining $589 million will be expended between 1998-99 and 2002-03. According to the department, there are 44 bridges that must be entirely replaced, at a cost around $400 million, that account for most of the late expenditures.

Support Costs Underestimated. While *overestimating* its capital outlay expenditures, Caltrans has also consistently *underestimated* its support costs for seismic retrofit. As we reported in last year's *Analysis*, Caltrans increased its 1995-96 support expenditures for Phase 2 by $37 million, using funds from a one-time appropriation that the state received in settlement of a petroleum anti-trust lawsuit. Although the Legislature appropriated the full $81 million of this settlement for seismic retrofit capital outlay, it allowed Caltrans to transfer funds to support as necessary. Caltrans could not cite any additional workload or schedule changes that necessitated this $37 million increase in 1995-96, claiming only that it had underestimated its support needs. For 1996-97, Caltrans has again increased its expenditures for Phase 2 support, by transferring a further $35 million from the same seismic retrofit capital outlay item, leaving only $9 million for capital outlay. Again, Caltrans cannot identify any schedule or workload changes that account for this increase.

For 1997-98, Caltrans proposes $49 million for Phase 2 support costs; however, given the department's past record it is likely that actual expenditures will be much higher. While we do not take issue with Caltrans' $49 million request for 1997-98, the department's consistent underestimation of support costs illustrates the need for improvements in its capital outlay support budgeting practices (discussed earlier in this section).

Project Delivery Near Targets for Reduced Program

Caltrans delivered 96 percent of the projects proposed for delivery between January 1995 and June 1996, but many projects were deferred because of an anticipated funding shortfall. The total value of projects delivered in 1995-96 was slightly higher than in 1994-95.

Because of concerns over project delays, the Legislature has enacted various requirements to monitor Caltrans' delivery of state highway projects. Our office is required to annually assess the department's progress in delivering projects as they are scheduled in the three state highway programs, STIP, SHOPP and TSM.

Allocation Plan Limited Delivery. During 1995-96, because of a feared shortage of funds, CTC replaced STIP, SHOPP and TSM schedules with an interim 18-month "allocation plan." The allocation plan, running from January 1995 through June 1996, was constrained by Caltrans' estimate of available funding and excluded many projects that were originally programmed for delivery in the period. In the following discussion, we report on Caltrans' delivery of projects included in the allocation plan, while recognizing that the allocation plan did not include many of the projects that were originally scheduled during the period.

Most Projects in Allocation Plan Delivered. Caltrans reports that over the 18 months of the 1995 allocation plan it delivered 285 projects worth $1.1 billion. This represents 96 percent of the number, and 96 percent of the total value, of projects scheduled in the allocation plan. Compared to previous years, this is an improved delivery record. However, this improvement is expected, because the allocation plan intentionally excluded projects that would be difficult to deliver.

Higher Delivery in 1995-96. During the 1995-96 fiscal year—the last 12 months of the 1995 allocation plan—Caltrans delivered a total of 202 STIP, SHOPP and TSM projects worth $823 million. In addition, the department delivered 123 seismic retrofit projects worth $465 million, and 145 emergency repair projects worth $69 million, for a total delivery valued at $1.4 billion. This level of project delivery is about 9 percent higher than total delivery in 1994-95.

The allocation plan ended in June 1996, and CTC has reprogrammed projects in the 1996 STIP to be consistent with available funding. Thus, in 1996-97 and subsequent years Caltrans' delivery will again be held to the schedules in the STIP, SHOPP and TSM plans.

Augmentation for Highway Maintenance Not Needed

We recommend that the Legislature reject Caltrans' request to increase its highway maintenance budget by $7.6 million. Our analysis indicates that Caltrans has not fully used its previous maintenance appropriations, and does not require an augmentation for new activities. (Reduce Item 2660-001-0042 by $7,614,000.)

In most years, Caltrans' highway maintenance responsibilities increase through the addition of new highway inventory, such as new miles of highway, landscaped areas, and drainage systems. As a result of new highway inventory added during 1995-96, Caltrans requests an increase of $7.6 million in its highway maintenance budget for 1997-98.

We recommend that the Legislature deny this augmentation. While we believe that highway maintenance—the preservation of the state's multibillion dollar investment in the state highway system—is a high priority and should be adequately funded, we find that the augmentation is unneeded. Our analysis indicates that Caltrans has not spent the funds that the Legislature has previously provided for maintenance, and proposes a budget much higher than it is likely to need.

In 1995-96, the first year that the budget act provided a specific amount that could only be used for maintenance, Caltrans spent $43 million less than the Legislature provided. (As described later in the Legislative Oversight section of this chapter, Caltrans transferred the funds to other programs.) For 1997-98 Caltrans' proposed maintenance budget is over $80 million higher than its actual expenditures in 1994-95 and 1995-96. We believe that Caltrans is unlikely to expend the full amount requested in 1997-98, given the department's historically lower levels of expenditure and its inability in 1995-96 to use its entire appropriation. We therefore believe that no augmentation is needed for 1997-98 and recommend that the Legislature delete the $7.6 million.

Price Increase Not Justified

We recommend that the Legislature reduce Caltrans' budget by $12 million, because two components of its operating expense price increase proposal are not justified. (Reduce Item 2660-001-0042 by $11,860,000.)

Caltrans requests $19 million to cover price inflation for goods and services purchased with its operating expense budget. This amount represents a 2.2 percent increase over the department's estimated current-year operating expense expenditures of $842 million.

We recommend that the Legislature reject $12 million of the proposed increase, because two parts of the request are not justified. First, the proposed increase includes $5 million for higher costs for engineering consultant contracts. Costs for engineering contracts are zero-based each year, using an average contract cost—$138,000 per personnel-year equivalent for 1997-98—that reflects Caltrans' estimate of likely costs. Therefore, a price increase for consultant contract costs is not justified. Second, the proposed increase includes $7 million for higher operating costs in the maintenance program. However, as we discuss above, the maintenance program has not expended the amounts already appropriated to it; therefore, an augmentation for price increases is not justified.

MASS TRANSPORTATION

The Mass Transportation program provides operating and capital support for the implementation of urban, rural, and interregional public transportation services, primarily bus and rail transportation. For 1997-98 the Mass Transportation program will account for 4.6 percent of Caltrans' total expenditures. The budget proposes $268.2 million in program expenditures, which is $62.4 million (or 30 percent) higher than estimated current-year expenditures. The increase is primarily due to a projected increase in state funds for rail transit projects.

As Figure 8 (see next page) shows, the Mass Transportation program includes the State and Federal Mass Transit program and the Rail Transit Capital program. For the State and Federal Mass Transit program, the budget proposes $34.7 million, a decrease of approximately 5 percent over the current year.

The budget proposes $233.2 million for the Rail Transit Capital program, an increase of 38 percent over the current-year level. This increase is mainly due to higher expenditures for rail projects programmed in the 1996 STIP. Under this program, Caltrans administers the intercity rail program, the Proposition 108 bond program for commuter and urban rail, and the Transit Capital Improvement (TCI) program. For 1997-98, the budget proposes $58.3 million for intercity rail service and expenditures of $32.5 million in the TCI program. The budget also proposes SHA expenditures of $77.7 million for rail capital projects that have been programmed into the 1996 STIP and for which funds had not been previously available.

The budget also proposes $303,000 for a High Speed Rail Authority that is charged with preparing a plan to finance and build a high speed rail network in California.

Figure 8

Department of Transportation
Mass Transportation Expenditures
1995-96 Through 1997-98

(Dollars in Millions)

	Actual 1995-96	Estimated 1996-97	Proposed 1997-98	Percent Change From 1996-97
State and federal mass transit	$31.6	$36.4	$34.7	-4.7%
Rail transit capital	166.5	169.3	233.2	37.7
High Speed Rail Authority	—	—	0.3	—[a]
Transportation Demand Management	15.4	—	—	—
Other	3.6	0.1	0.1	—
Totals	**$213.9**	**$205.9**	**$268.2**	**30.3%**

[a] Not a meaningful figure.

High Speed Rail Authority Should Be Funded Separately

We recommend that the Legislature provide funding for the High Speed Rail Authority under a new item in order to ensure accountability and because the Authority is statutorily defined as an independent entity. (Reduce Item 2660-001-0046 by $291,000, reduce Item 2660-001-0042 by $12,000, and create a new item to provide the same amount.)

High Speed Rail Authority Established. Chapter 796, Statutes of 1996 (SB 1420, Kopp), established the High Speed Rail Authority, an independent authority consisting of nine members appointed by the Legislature and the Governor. The High Speed Rail Authority is responsible for developing a plan to finance, construct, and operate a statewide intercity high speed rail network. Chapter 769 requires the Authority to submit a financing plan to the Legislature, the Governor, and the voters by December 31, 2000. Chapter 769 also allows the Authority to hire its own staff to carry out its responsibilities. The High Speed Rail Authority continues the work of its predecessor, the High Speed Rail Commission which expired December 31, 1996.

Rail Authority Included in Caltrans' Budget. The budget includes $303,000 for the High Speed Rail Authority (for staff support and operating expenses) within Caltrans' Mass Transportation program.

Our review indicates that the funding request is justified. However, instead of appropriating the amount for the Authority as part of Caltrans' budget, we think it is more appropriate to provide the appropriation under a separate item. Doing so would ensure the Authority's ability to carry out its statutory responsibilities as an autonomous entity, independent of Caltrans' budgetary and programmatic decisions, and would be consistent with the provisions of Chapter 796. Funding the Authority under a separate item also facilitates legislative oversight of the Authority's activities and provides greater accountability. Accordingly, we recommend that the Legislature reduce Item 2660-001-0046 by $291,000 and reduce Item 2660-001-0042 by $12,
under a new budget item for the High Speed Rail Authority.

Recent Legislation Will Change Administration Of Intercity Rail Program

To improve the administration and performance of the state's intercity rail program the Legislature enacted the Intercity Passenger Rail Act of 1996 (Chapter 1263, Statutes of 1996—SB 457, Kelley).

The intercity rail program was established to provide motorists with a safe, efficient, and cost-effective transportation alternative that reduces congestion and improves air quality. The state currently supports and funds intercity rail passenger services on three corridors—the San Diegan in Southern California, the San Joaquin in the Central Valley, and the Capitol in Northern California. All train routes are supplemented and integrated by a dedicated feeder bus service.

Currently, Caltrans contracts with Amtrak for the operation and maintenance of the intercity rail service. Caltrans staff, along with advisory committees, plan route schedules, and project ridership and revenues.

Problems Lead to the Enactment of Chapter 1263. As we discussed in the *1995-96* and *1996-97 Analyses*, the state's intercity rail program faced the following problems:

- Ridership levels have remained relatively flat and were not adequate to meet the statutorily required farebox recovery ratio for two of the three corridors.
- The state's costs to provide intercity rail service increased rapidly, primarily as a result of Amtrak shifting an increasing portion of its operating cost to the state.
- Until 1995-96, the intercity rail program lacked an annual business or operating plan that defined the program's goals and provided cost and ridership projections to guide decisions on service provision.

Enactment of the Intercity Passenger Rail Act. These problems prompted the Legislature to re-assess the state's support and administration of intercity rail service. Chapter 1263, Statutes of 1996 (SB 457, Kelley) was enacted as an urgency statute in September 1996 in order to improve the program. The key provisions of Chapter 1263—the Intercity Passenger Rail Act of 1996—are summarized in Figure 9. Specifically, Chapter 1263 authorizes the transfer of the administration of intercity rail service from Caltrans to regional joint powers boards (comprised of the jurisdictions through which each of the three corridors operates). In order for the transfer to take place, regional boards must submit a business plan to the Secretary for Business, Transportation and Housing (BT&H) that reflects cost reductions in providing the services. The expectation is that with regional boards administering the intercity rail service, administrative costs will decrease, and service improvements will occur through better coordination of local commuter and intercity rail service.

Implementation of Chapter 1263 Is Slow: Regional Boards Express Concerns

Chapter 1263 set target dates for executing interagency agreements to transfer the intercity rail service from the state to regional boards. Regional boards have expressed several concerns relating to the implementation of Chapter 1263, including (1) the ownership of rail cars, (2) the regional boards' versus state's share of legal liability, and (3) an assurance of continued future funding for the service. These concerns will slow the progress of the negotiations to transfer the service.

Interagency Agreement Not Signed by the Target Date. Chapter 1263 required that an interagency agreement to transfer the intercity rail service's administration be signed with regional boards by December 31, 1996—an optimistic target date given that the legislation was enacted in September 1996. As of January 1997, no interagency agreement has been signed and each regional board is in different stages of preparation. Only the Capitol Corridor board has been formally established, with the Bay Area Rapid Transit (BART) District as its lead agency. This board is the furthest along in its negotiations with Caltrans, and an interagency agreement may be signed by July 1, 1997 to transfer the administration of the service to BART in fall 1997.

In the San Diegan corridor, members of the Southern California Regional Rail Authority, and other corridor jurisdictions, have established an interim board to examine the feasibility of the transfer. In the San Joaquin corridor, no joint powers board has been established.

Regional Boards Express Concerns. In addition to expressing concern over the target dates set by Chapter 1263 for the transfer of the service,

Figure 9

The Intercity Passenger Rail Act of 1996 Key Provisions

	Target Date
Interagency Transfer Agreement	
• Authorizes the transfer of the administration of intercity rail service to local joint powers boards under specified conditions.	December 31, 1996, or later date
Joint Powers Board	
• Creates or expands three joint powers boards which may administer intercity rail service.	December 31, 1996 for Capitol Corridor[a]
Business Plan	
• Requires boards to submit annual business plans containing: fares, operating strategies, capital improvements needed, and marketing and operational strategies.	Annually, April 1
State Funding	
• Guarantees state funding for the intercity rail program for the next three years.	Until 2000
• Requires BT&H Secretary to establish funding levels for each corridor through the annual budget.	
• Requires state-sponsored rail service be accounted for separately from locally sponsored services.	
Service Expansion	
• Requires joint powers board jurisdictions to fund service expansion and improvements.	
Performance Measures	
• Repeals 55 percent farebox recovery ratio.	
• Requires BT&H Secretary to establish uniform performance standards for all corridors.	December 31, 1997
• Requires joint powers boards to meet performance standards to receive state funds.	

[a] Target dates for other corridors not specified.

local entities that would be members of the joint powers boards have expressed other concerns. These include:

- ***Ownership of the train cars.*** Chapter 1263 does not specify whether the state will maintain ownership of the train cars. Regional boards express apprehension about owning the train cars because these cars have electrical and mechanical problems which are currently the subject of a warranty dispute with the manufacturer.

- ***Legal liability.*** Chapter 1263 does not specify whether the state will remain liable for train accidents (legal liability). Regional board members do not believe that they have the resources necessary to cover legal liability claims, and that therefore this should remain a state responsibility.

- ***State funding commitments.*** Regional board members are concerned that the state will withdraw financial support after the transfer is made because Chapter 1263 guarantees state funding for only the next three years.

Resolving these concerns through interagency agreement negotiations between the regional boards and the Secretary for BT&H will take time. Consequently, the Legislature will not know the full impact of Chapter 1263 for another year or two. In addition, it is likely that Caltrans will continue to administer two of the three intercity rail corridors for the budget year.

Caltrans Should Be Subject to Chapter 1263 Requirements

To improve the administration and the quality of the intercity rail service, we recommend supplemental report language requiring Caltrans to submit an intercity rail program business plan to the Secretary for Business, Transportation and Housing (BT&H) and the Legislature that meets the requirements specified in Chapter 1263. We also recommend supplemental report language requiring BT&H Agency to submit an annual report to the Legislature on the progress that regional boards and Caltrans have made in meeting the state's intercity rail service performance standards.

Business Plan Should be Required. Caltrans will continue to administer at least part of the intercity rail program during the budget year, and we believe that it should be held accountable to the same business plan requirements specified by Chapter 1263 for the regional boards. Currently, Caltrans submits an annual business plan for intercity rail service to CTC. We believe that this business plan should incorporate the same plan components required in Chapter 1263. Accordingly, we recommend the following supplemental report language:

> Caltrans shall submit annually on January 10 as part of its budget request to the Legislature and to the Secretary for Business, Transportation and Housing, a business plan for each intercity rail corridor which Caltrans administers. The plan shall contain all of the business plan requirements set forth by Chapter 1263.

Performance Measures Necessary. Since Chapter 1263 repealed the 55 percent farebox recovery ratio, there currently is no indicator to measure the intercity rail service's performance and cost-efficiency. Chapter 1263 requires the Secretary for BT&H to establish performance standards by December 31, 1997, and that regional boards include these in their business plans. Staff of the BT&H Agency indicate that the Secretary intends to establish the performance measures as soon as possible.

Multiple Indicators Should Be Used to Measure Performance. In establishing performance measures, we believe that the Secretary for BT&H should consider multiple performance measures that take into account the economic and operational differences of each intercity rail corridor. Figure 10 provides a potential list of performance indicators to measure the usage, cost-efficiency, and quality of the state's intercity rail service.

Figure 10

Intercity Rail Service
Performance Measurement Alternatives
(Measured Monthly and Annually)

Usage

- Ridership—Number of riders by corridor.
- Revenues—Dollar revenues from ticket fares, and food and beverage sales per year.
- Load factor—Percent of seats filled/vacant for each corridor.
- Passenger miles per train mile—Number of passengers for each mile traveled.

Cost Efficiency

- Farebox recovery ratio—Total revenues divided by total costs.
- Ticket yield—Total revenues per passenger mile.
- State subsidy per passenger (loss per passenger)—Total state support for service divided by the total number of passengers (by corridor).

Service Quality

- On-time performance—Frequency of trains arriving at scheduled times.
- Customer satisfaction—Survey of customer opinions, preferences, and profiles.

Performance Measures Should Apply to Caltrans. We believe that these performance measures should not only be required as part of the interagency agreement with regional boards, but that Caltrans also be required to meet these performance standards for the intercity rail services it continues to administer. Furthermore, we believe that the Legislature should be notified of Caltrans' and the regional boards' progress in meeting the performance standards. Accordingly, we recommend the following supplemental report language:

> Beginning in 1998-99, the Secretary for BT&H shall submit, as part of its annual budget request for intercity rail services funding, a report which sets forth performance standards to measure the usage, cost-efficiency, and quality of the intercity rail service that is administered by regional boards and Caltrans. The report shall also describe the progress that the regional boards and Caltrans have made in meeting such standards.

Cost of Intercity Rail Service Will Be Less Than Budgeted

We withhold recommendation on $56.1 million requested to fund the existing intercity rail service in 1997-98 because the amount needed will be lower. We recommend that the Department of Transportation (Caltrans) report at budget hearings on the status of the transfer of service administration to regional boards and provide an update on Amtrak contract costs for the service. Based on the information provided by Caltrans, the Legislature should adjust accordingly the amount of support for the intercity rail service.

The budget proposed $56.1 million to support continuation of the current level of intercity rail service in 1997-98. This amount includes estimated Amtrak costs to provide the service and $2 million for Caltrans' support and marketing of the program. Our review shows that the amount needed will be lower.

Caltrans' Administrative Costs May Be Less. The budget proposal assumes that Caltrans will continue to administer the intercity rail program and requests $2 million for marketing and administration costs. However these costs may be lower if the Capitol corridor service is transferred during the budget year. This is because Caltrans will not need to have the staff it currently devotes to administration of that service, and marketing costs may also be lower.

Amtrak Costs for Current Service Will Be Adjusted. The budget requests $54.1 million for Amtrak contract costs to provide existing intercity rail service. This amount is higher than current-year costs by about $7 million. Caltrans estimated the higher costs based on the assumption that Amtrak would shift more of its operating costs to the state in 1997-98 in order to achieve its goal to operate independently without any federal support by federal fiscal year 2002. However, Caltrans' staff has informed us that Amtrak may revise its cost calculations and contract costs to the state may change by spring 1997. Our discussions with Amtrak officials indicate that, in fact, contract costs will be significantly lower.

Withhold Recommendation. Because the amount needed to provide the current level of intercity rail service will be lower, we withhold recommendation on $56.1 million requested by the department. We further recommend that the department report at budget hearings on the status of the transfer of the intercity rail service to the regional boards, and provide an update on Amtrak's contract costs. We recommend that the Legislature adjust the amount for current intercity rail service based on Caltrans' updated information.

Stockton-Sacramento Extension Premature

We recommend that $2.2 million be deleted because the proposal to extend intercity rail service from Stockton to Sacramento is premature. (Reduce Item 2660-001-0046 by $2.2 million.)

The budget also proposes $2.2 million to extend intercity rail service between Sacramento and Stockton on the San Joaquin. Currently, a bus service connects the two cities. This request is not justified for two reasons. First, Caltrans and Amtrak have not yet negotiated an agreement with the private rail road companies to use the rail tracks connecting the two cities. Second, the new service would require several rail and station improvements, which have not yet been funded by CTC. Caltrans estimates that these improvements will take at least two years to complete. Accordingly, we recommend a reduction of $2.2 million for the proposed expansion of the San Joaquin from Stockton to Sacramento because Caltrans' plan to offer this service is premature (Reduce Item 2660-001-0046 by $2.2 million.)

LEGISLATIVE OVERSIGHT

Caltrans Disregards Budget Limitation

Caltrans increased its own appropriation level and spent more for certain programs than authorized by the Legislature in the 1995-96 Budget Act, without providing the required legislative notification. We recommend that the Legislature adopt budget bill language to increase budgetary control, and revise provisions proposed by the administration that Caltrans could use to circumvent legislative budget control.

In the *1995-96 Budget Act*, the Legislature increased its control over Caltrans' budget, in order to hold the department more accountable for its support expenditures. While previously the act appropriated a lump sum (exceeding $1.5 billion) for support of the department's highway program, the 1995-96 act appropriated specific amounts for each of the elements of the program. For example, it provided $553 million for capital outlay support, and $486 million for highway maintenance. By specifying the amounts for individual program elements, the Legislature sought to exercise greater oversight and control to ensure that Caltrans' actual expenditures would follow the Legislature's intent.

However, our review of actual 1995-96 expenditures reveals that Caltrans disregarded the terms of the *1995-96 Budget Act* and, with the approval of the Department of Finance, (1) increased its own appropriation level and (2) shifted funds between program elements. First, Caltrans increased its support appropriation with an additional $50 million of federal funds, without providing for legislative notification and review as required by Section 28 of the act. The department also shifted funds among program elements—increasing funding for individual programs, including capital outlay support and operations, and decreasing funding for highway maintenance (described earlier in this chapter)—again without required legislative notification and review. By doing so, Caltrans has thus violated both the spirit and the terms of the budget act. Below we recommend that the Legislature delete two budget bill provisions in Caltrans' budget and adopt substitute language in each case that increases legislative control.

Recommend Legislature Exercise Greater Budgetary Control. We believe that, in order for the Legislature to exercise its budgetary oversight, Caltrans should submit budgets that accurately reflect its planned expenditures and should notify the Legislature, in accordance with provisions in the budget act, of changed circumstances that require adjustments in the department's expenditure authority. As Caltrans has failed to adhere to these principles in the past, we recommend that the Legislature adopt budget bill language to strengthen its control of the department's expenditures. Specifically, we recommend that the Legislature delete Provision 1 of Item 2660-001-0042, which the department could use to circumvent legislative control, and replace it with the following language:

> The department shall comply with the schedule of appropriation shown in this item, which may be revised by the Department of Finance only as authorized by law and subject to required legislative notification. In revising appropriations as authorized by law, Section 8.50 of this Act does not supplant the requirements of Section 28, and Section 1.50 does not supplant the requirements of Section 26. All legislative notification requirements related to any revision to this item or its subsidiary items shall remain in effect without regard to fiscal year. Not later than 14 days after the end of each fiscal quarter, the Department of Finance shall transmit to the chairpersons of the budget committees in each house and the chairperson of the Joint Legislative Budget Committee (a) all budget revisions authorized in the previous quarter that affect this item or its subsidiary items and (b) a display of the appropriation levels provided by this item and its schedule, as revised.

New Budget Provisions Unjustified. Caltrans often receives a supplemental distribution of federal funds near the end of the fiscal year, and in order to expend these funds the budget proposes new language to allow the Department of Finance to increase Caltrans' appropriation from federal funds and reduce its SHA appropriation. The language also permits SHA funds to be transferred from support to capital outlay. While we find merit in this concept, we have two concerns with the proposed language, which we believe Caltrans could use to again subvert the Legislature's budgetary authority. First, the proposed language does not adequately guarantee that an increase in federal funds will be fully offset by an equivalent reduction in SHA funds. Thus, Caltrans could use this language to increase its total support budget, as it did in 1995-96, without legislative approval. Second, the proposed language does not require legislative notification prior to increasing federal funds or reducing SHA funds.

Recommend Substitute Language. We recommend that the Legislature reject the proposed language and adopt substitute language that achieves the same objective while preserving the Legislature's oversight role. Specifically, we recommend that the Legislature (1) delete Provision 3 of Item 2660-001-0890, because Section 28 already provides authority to increase appropriations subject to notification and approval of the Legislature and (2) delete Provision 3 of Item 2660-001-0042 and replace it with the following budget bill language:

> Notwithstanding any other provision of law, the Department of Finance may reduce funds appropriated from the State Highway Account in schedule (b) of this item, in conjunction with an equivalent increase in federal funds in Item 2660-001-0890 subject to Section 28 of this Act. The Department of Finance may authorize the transfer of all or a portion of State Highway Account funds reduced pursuant to this provision to Item 2660-325-0042 for capital outlay projects subject to provisions of that item. The Director of Finance shall authorize reduction or transfer pursuant to this provision not sooner than 30 days after notification in writing to the chairpersons in each house that consider budget appropriations and the chairperson of the Joint Legislative Budget Committee.

Deficiency Appropriation Not Needed

We recommend that the Legislature delete a proposed $40 million deficiency appropriation, because Caltrans has not demonstrated its necessity and there are insufficient controls on use of the appropriation. Should Caltrans demonstrate the necessity of a deficiency appropriation, we recommend adoption of substitute language. (Delete Item 2660-012-0042.)

Caltrans' budget proposes a new $40 million deficiency appropriation from the SHA. This appropriation would allow the Department of Finance to increase Caltrans' support budget by up to $40 million. According to the department, the deficiency appropriation would simplify its administrative burden in responding to emergency situations. The department did not claim or demonstrate, however, that the appropriation would in any way increase its *ability* to respond to emergencies, only that it would simplify budget administration.

Insufficient Justification. While we acknowledge the importance of rapid response by Caltrans in emergency situations, we have two concerns with the proposed deficiency appropriation. First, the proposed language does not restrict the appropriation to emergency or contingency situations only, as do other such deficiency appropriations. Rather, the Department of Finance could interpret the language to allow it to increase Caltrans' budget for any purpose. Second, while Caltrans funds emergency response activities from its State Highway Account appropriation, the Federal Highway Administration generally reimburses Caltrans for most of its costs. Thus, a potential deficiency exists only *until* Caltrans receives reimbursement, after which, if it received an appropriation under the proposed deficiency item, it would be budgeted twice for the same expense. The department could therefore use this appropriation to attempt to evade legislatively imposed limits on its budget as it has done in the past.

Delete Proposed Deficiency Appropriation. Caltrans provided no information to demonstrate the necessity of this appropriation, or to address our concerns. We therefore recommend that the Legislature delete the proposed item. Should Caltrans, prior to budget hearings, provide information that justifies its need for a deficiency appropriation, we recommend that the Legislature adopt the following substitute item, which is restricted to emergency and contingency situations only:

> 2660-012-0042—For Augmentation for Contingencies or Emergencies, subject to all provisions of Item 9840-001-0001, payable from the State Highway Account .... (40,000,000)
>
> Provisions:
>
> No deficiencies shall be authorized by the Director of Finance in any appropriation of money from this item under the provisions of Section 11006 of the Government Code. Required notification to the Legislature of deficiency appropriations pursuant to this item shall include, in addition to all other required information, (a) an estimate of federal funds or other funds that the department may receive for the same purposes as the proposed deficiency appropriation, and (b) explanation of the necessity of the proposed deficiency appropriation given anticipated federal funds or other funds. Not more than 14 days after the receipt of federal funds or other funds for the same purposes as the proposed deficiency, the Department

of Finance shall notify the chairperson of the Joint Legislative Budget Committee and the chairpersons of the budget committees in both houses of the amount of funds received and the planned use of such funds.

DEPARTMENT OF THE CALIFORNIA HIGHWAY PATROL (2720)

The California Highway Patrol (CHP) is responsible for ensuring the safe, lawful, and efficient transportation of persons and goods along the state's highway system and to provide protective services and security for state employees and property. To carry out its responsibilities, the department administers four programs: (1) Traffic Management, (2) Regulation and Inspection, (3) Vehicle Ownership Security, and (4) Protective Services. These four programs are funded primarily with Motor Vehicle Account funds.

The budget proposes $851 million to support CHP in 1997-98. This is approximately $59 million or about 7.4 percent above estimated current-year expenditures. The increase is primarily the result of the following augmentations: (1) $5.6 million for telecommunications equipment, (2) $4.3 million for the full-year cost of traffic officer positions and to upgrade 28 officer positions to sergeants, (3) $1.4 million to regulate commercial motor carrier activities previously regulated by the Public Utilities Commission, and (4) $1.1 million to reestablish the Salvage Vehicle Inspection Program.

The budget also proposes a reduction of $1.6 million in expenditures due to the termination of the California Motorcyclist Safety Program, and the Hazardous Waste Transport Vehicle and Container Inspection and Certification Program.

Workers' Compensation Costs Still Significant

We recommend that the California Highway Patrol (CHP), jointly with the Department of Personnel Administration (DPA), report on (1) steps DPA will take in its negotiations with the State Compensation Insurance Fund to lower CHP's administrative costs and (2) the feasibility of changing the payment methodology and adding performance measures to the master agreement, as well as the feasibility of contracting out as a pilot project.

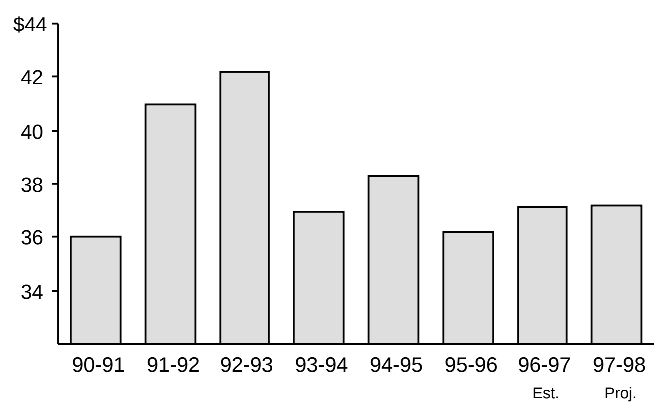
Workers' compensation laws require employers to pay for the cost of treating job-related injuries sustained by their employees. As a self-insured agency, CHP pays directly for all the costs associated with treating injuries sustained by traffic officers while on duty. Workers' compensation expenditures account for a significant amount of CHP's annual budget. Workers' compensation costs reduce CHP's ability to use its resources for core activities, such as traffic enforcement.

Figure 11 shows workers' compensation costs to CHP since 1990-91. From 1990-91 through 1995-96, the department paid about $230 million in compensation expenditures. As the figure shows, costs peaked in 1992-93 reaching $42.2 million. Since that time, workers' compensation costs have dropped and average about $37 million a year. Changes in workers' compensation laws in part explain the decrease in costs in 1993-94.

Figure 11

California Highway Patrol
Workers' Compensation Expenditures
1990-91 Through 1997-98

(In Millions)



Key Components of Workers' Compensation Costs. The CHP's workers' compensation costs are made up of several components. Medical costs account for the largest portion of total costs. In 1995-96, medical costs accounted for 38 percent ($13.7 million out of $36.2 million) of total workers' compensation expenditures.

Besides receiving full medical payments to treat their injuries, traffic officers are eligible to receive salary payments for up to one year if an injury requires them to be away from regular work duties. (This benefit is referred to as "4800.5 time" as it is provided under Labor Code Section 4800.5.) Other cost components include: (1) temporary disability payments that provide a salary if the injury continues for more than one year, (2) permanent disability payments that provide a monetary award to compensate an employee for sustaining a permanent injury that diminishes the employee's ability to compete in the labor market, and (3) vocational rehabilitation payments that provide an injured employee with up to $16,000 for rehabilitation treatment or courses that will enable the injured employee to return to work. In 1995-96, CHP paid a total of $5 million for 4800.5 time benefits, and $10.7 million for temporary and permanent disabilities and vocational rehabilitation costs.

Administrative costs are another important component in CHP's total workers' compensation exposure. In 1995-96, administrative costs totaled 18 percent ($6.4 million) of CHP's workers' compensation expenditures.

Expenditures Driven by Number of Claims. Total workers' compensation expenditures are determined in large part by the number and types of injury claims. The higher the incident of injuries, and the more serious the nature of the injuries, costs are correspondingly higher.

CHP Takes Action to Curb Workers' Compensation Costs. As a result of a 1992 internal audit, CHP took several steps to lower its workers' compensation costs. For example, CHP staff developed an Occupational Safety Manual and provided staff training on injury management. In 1995, the department also eliminated its mandatory physical performance testing and fitness program, in order to eliminate injuries sustained as a result of preparation and participation in physical performance tests.

Despite Lower Number of Claims, Administrative Costs Increase. Our review shows that in the past three years, CHP has reduced the number of claims opened each year from 5,779 in 1994 to 4,938 in 1996. As the number of claims decreases, one might expect total costs to drop also. This is not the case, however. Our review shows that while all other costs have remained stable, costs charged to CHP to administer its workers' compensation claims have increased.

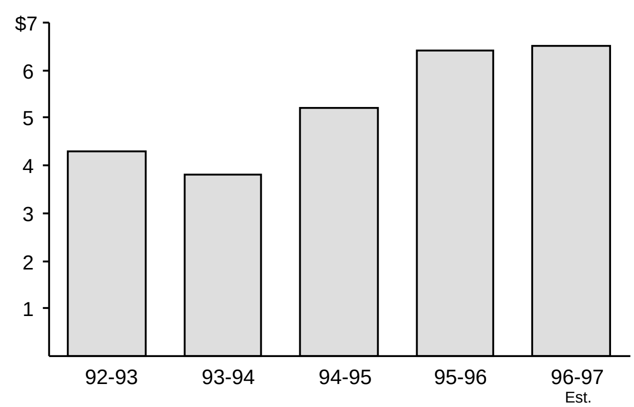
As required by law, CHP contracts with a third party administrator, the State Compensation Insurance Fund (SCIF), to process, adjust, and manage all claims. The contract is executed under a Master Agreement which is negotiated and managed by the Department of Personnel Administration (DPA). The current Master Agreement will expire on June 30, 1998.

Currently, SCIF charges a $103 monthly fee for each open claim, and an additional $68 fee for claims that are being litigated. (A claim is open for as long as SCIF has to provide a workers' compensation benefit.) As shown in Figure 12, SCIF fees have increased by 68 percent, from $3.8 million in 1993-94 to $6.4 million in 1995-96. Based on payments through December 1996, we estimate SCIF fees to stay at about $6.5 million for the current year. This increase is attributable to two factors. First, in 1995, SCIF changed its charging methodology under the current Master Agreement with DPA from a percentage of the total medical payments to a flat fee for every open claim. Second, SCIF purchased new database equipment and charged the cost back to state agencies. Prior to this equipment purchase, SCIF charged $94 per claim compared to the current $103, a 10 percent increase since 1995.

Figure 12

California Highway Patrol SCIF Fees Trending Up 1992-93 Through 1996-97

(In Millions)



Master Agreement With SCIF Should Be Assessed. Because current law requires CHP to contract with SCIF, it does not have much flexibility in reducing its claims administrative costs, apart from reducing the number of claims. However, current law also allows SCIF to charge CHP different rates/fees than other state agencies. As DPA negotiates with SCIF for a new contract during the budget year, we think that this is one option that ought to be explored. In our review of DPA's budget, we have recommended that it report to the Legislature on the steps DPA will take in its negotiations with SCIF to lower the state's administrative costs (see Item 8380).

Additionally, we recommend that CHP, jointly with DPA, report at budget hearings on the feasibility of the following:

- ***Changing Payment Methodology and Adding Performance Measures to the Master Agreement.*** Currently, SCIF fees are based on the number of open claims. The DPA should explore the pros and cons of different payment methodologies for CHP. Also, DPA should consider including performance-based goals in the new contract. Various types of performance-based goals can be devised. For instance, goals could be established to measure the timely processing and payment of claims. Such goals would provide CHP and DPA a means to ensure claims are handled in a timely and appropriate manner.
- ***Competitively Contracting With Third Party Administrators for a Pilot Project.*** Currently, CHP is prohibited from contracting with private companies to administer its workers' compensation claims. It is not clear whether by contracting out, CHP could achieve savings in its claims administration. The DPA should explore the feasibility of getting cost comparisons from private third-party administrators to guide its negotiations with SCIF. Additionally, DPA should explore the feasibility of initiating a pilot project to contract out a portion of CHP's workers' compensation claims to evaluate whether that is an acceptable alternative.

Legislature Should Determine Policy On Use of State Highway Account Funds

The budget proposes $55.5 million from the State Highway Account (SHA) to support the California Highway Patrol's Commercial Vehicle Inspection program for 1997-98. The department also proposes a loan of $12.8 million from SHA for the same purpose in the current year. We recommend the enactment of legislation to specify the appropriate funding mix of Motor Vehicle Account and SHA funds for this program.

The CHP operates and staffs 15 truck inspection stations throughout the state. Trucks are weighed and inspected to promote truck safety, to ensure that registration/weight fees are collected, and to protect the highways from excessive truck weights. Approximately 300,000 trucks are inspected on an annual basis and 600,000 safety violation citations are issued. For 1997-98, the budget proposes $55.5 million for the operation of the inspection stations.

State Highway Account Provides Up to 40 Percent of Cost. Up until 1991, Motor Vehicle Account (MVA) revenues were used to fully fund CHP's operation of the truck inspection program. Beginning in 1992, SHA funds have been used to provide partial funding for this activity. Typically, SHA funds contribute between 20 and 40 percent of the program's total costs.

Current-Year SHA Loan Requested and Budget-Year Costs to Be Paid Solely From SHA. For the current year, the Legislature decided that SHA ought to pay 40 percent of the costs of the truck inspection operations despite a request by CHP to shift more of the cost from MVA to SHA. As we discussed in the Crosscutting Issues section of this chapter, because of the condition of MVA, the department proposes a loan of $12.8 million from SHA for 1996-97 truck inspections. However, no repayment terms are specified.

For 1997-98, the budget proposes to shift all costs totaling $55.5 million to SHA. This is not consistent with legislative direction for the current year. (See MVA writeup in Crosscutting Issues section.)

Legislature Should Determine Funding Mix. Generally, in the past, SHA funds have been used for highway construction and maintenance, and MVA funds for vehicle and driver regulation activities. Because truck weight fees are deposited into SHA, using SHA to pay for part of the cost of the truck inspection program is reasonable. However, what the appropriate funding mix of MVA and SHA ought to be is a decision that the Legislature should make. Without that determination, as the MVA condition worsens, it is very likely that SHA funds will be called upon to fund not only CHP's truck inspection program, but potentially other traffic enforcement and management functions, such as the operation of traffic management centers.

Accordingly, we recommend enactment of legislation to specify on an ongoing basis the statutorily appropriate funding mix of MVA and SHA funds for CHP's truck inspection program. For the budget year, we offer the following options.

- Provide 40 percent of costs from SHA for the truck inspection program in a way that is consistent with legislative direction to date, while funding the remainder with MVA funds ($33 million). This would require additional MVA funds beyond what is proposed in the budget. (See MVA writeup in Crosscutting Issues section.)
- Provide 40 percent in SHA funds and the remaining $33 million as a SHA loan in 1997-98. We also recommend that the Legislature specify the loan repayment terms.

- Provide full funding from SHA for 1997-98, as proposed, and adopt language directing a funding mix for 1998-99.

The Legislature ought to decide on an option that is consistent with its priorities for MVA and SHA funds.

Expansion of Statewide Radio System Premature

We recommend that the Legislature reduce by $1.4 million the California Highway Patrol's (CHP) request to expand its radio system because the expansion is premature and CHP is withdrawing this request. (Reduce Item 2720-001-0044 by $1,407,000).

The CHP originally requested $1.4 million to purchase telecommunications equipment for a statewide radio system to expand CHP's existing radio communications network. After discussions with CHP regarding the timing of the proposal and its feasibility, CHP now indicates that it is withdrawing the request because the telecommunications project is not feasible at this time. Accordingly, we recommend that $1.4 million be deleted.

DEPARTMENT OF MOTOR VEHICLES (2740)

The Department of Motor Vehicles (DMV) is responsible for protecting the public interest in vehicle ownership by registering vehicles and for promoting public safety on California's roads and highways by issuing driver licenses. Additionally, the department licenses and regulates vehicle-related businesses such as automobile dealers and driver training schools, and also provides revenue collection services for state and local agencies.

The budget proposes total expenditures of $564 million for support of DMV in 1997-98. This is an increase of $29 million, or 5.3 percent, above estimated current-year expenditures. The majority of the increase is due to costs to implement new legislation, primarily legislation that requires proof of financial responsibility (liability insurance) prior to vehicle registration, and legislation that transfers commercial trucking regulation from the Public Utilities Commission to DMV and the California Highway Patrol (CHP).

Computer Improvements Behind Schedule

We withhold recommendation on $5.1 million to continue various information technology projects because the projects have slipped behind schedule and the Department of Motor Vehicles has not been able to provide a revised work schedule, nor has the department identified the scope and cost of the work to be performed in 1997-98.

Since 1994, when DMV abandoned its ambitious but flawed computer redevelopment project, the department has been pursuing a new project to improve its information technology systems. The process began in 1994-95 with an independent consultant evaluation, and in 1996-97 the Legislature provided $5.8 million for three projects to begin implementing the consultant’s recommendations. The Legislature provided these funds for only one year, however, with funding in subsequent years contingent upon continued progress and success in meeting targets.

Schedule, Scope, and Cost Uncertainties. For 1997-98, DMV requests $5.1 million to fund these three projects for a second year. However, two of the projects—rewriting outdated computer programs, and replacing custom database software with industry standard software—have slipped several months behind schedule. At the time this analysis was written, DMV was still preparing to solicit contractors to perform the necessary work for these projects, and the department was unable to provide a schedule of work to be performed in 1997-98. The third project—business process reengineering, an effort to streamline departmental functions for higher efficiency—is on schedule, but DMV has not yet identified the scope of work for 1997-98 or the cost, which may range between $2 million to $3.5 million.

Withhold Recommendation. We believe that the Legislature should not provide additional funding for these projects without information on their schedule, scope, and costs for 1997-98. Accordingly, we withhold recommendation on the department's request pending receipt of this information. With the assistance of contractors that DMV plans to hire in February, the department should be able to develop this information for the budget year. This information will allow the Legislature to determine if a second year of funding is warranted and hold DMV accountable for its planned accomplishments.

DMV Should Revise Financial Responsibility Proposal

We recommend that the Legislature reject the Department of Motor Vehicle's (DMV) proposal for $19 million to implement new financial responsibility legislation because it does not consider less costly alternatives. We further recommend that, prior to budget hearings, DMV submit a revised proposal based upon less costly alternatives. (Reduce Item 2740-001-0044 by $19 million.)

Chapter 1126, Statutes of 1996 (AB 650, Speier) requires that vehicle owners provide proof of financial responsibility (liability insurance) prior to renewing a vehicle registration, effective January 1, 1997. The DMV will require that vehicle owners submit insurance information with their vehicle registration renewal application. The department will reject applications that lack *complete* insurance information; however, it will not *validate* the authenticity of the insurance information in order to prevent fraudulent reporting. In order to implement Chapter 1126 in 1997-98, DMV requests $19 million and 562 personnel-years. These costs are primarily for field office staff time to explain the new requirement to vehicle owners, and for data entry of insurance information.

Concerns With Department's Proposal. While Chapter 1126 will certainly increase the department's workload, the $19 million request is based upon a large number of questionable assumptions, such as the percent of vehicle owners that will submit incomplete insurance information, and the time—in number of minutes—that field staff will spend discussing the requirement with vehicle owners. Because these numerous assumptions cannot be validated or tied directly to current DMV experience, we are unable to determine whether the requested increase is appropriate to the requirements of the new legislation.

More importantly, however, we believe that the legislation could be implemented at much lower cost and greater convenience to vehicle owners if DMV were to receive insurance information directly from insurance companies via electronic data transfer. Electronic data transfer would also increase the effectiveness of Chapter 1126, as it would virtually eliminate fraudulent insurance information. Currently, DMV uses electronic data transfer to receive smog check information from inspection stations, and several other states receive insurance information through electronic data transfer.

Recommendation. We recommend that the Legislature reject the department's current proposal, because it does not consider less costly alternatives. We further recommend that DMV submit a new proposal for implementing Chapter 1126 that considers electronic communication and other options to minimize cost. Finally, we recommend that any funds that the Legislature provides to implement Chapter 1126 be provided on a one-year basis, thus requiring DMV to justify its costs based on actual experience in order to receive funds for 1998-99 and subsequent years.

DMV Should Address Vehicle Registration Evasion

We find that there are increasing incentives for vehicle owners to evade vehicle registration, due to requirements that have to be met before they can register their vehicles. We recommend that, as part of a revised plan to implement Chapter 1126, the Department of Motor Vehicles should develop a plan to increase compliance with vehicle registration requirements.

California uses the vehicle registration process to serve a number of purposes in addition to the basic function of identifying vehicle ownership. In order to register vehicles, most owners must prove that their vehicles meet pollution standards, pay 2 percent of the vehicle value as an in-lieu property tax (with revenues accruing mainly to local governments), and pay local fees to support roadside callbox, abandoned vehicle abatement, and air quality programs. In addition, DMV can reject vehicle registration applications for owners that have not paid outstanding traffic citations, and new legislation (Chapter 1126) also requires vehicle owners to provide proof of insurance prior to registration.

Using the vehicle registration process in this manner encourages compliance with these requirements because of the importance of vehicle ownership and operation for most persons; vehicle owners cannot evade the prerequisite requirements without losing the ability to operate their vehicles legally. However, as the number of prerequisites linked to vehicle registration increases, owners' incentives to not register their vehicles—in order to evade the other requirements and costs—rise correspondingly. The DMV agrees that nonregistration increases when new requirements are added, but it has not estimated the total number of unregistered drivers or the number that it has lost with each new requirement.

Revenue Loss. When drivers fail to register their vehicles, state and local governments lose revenue. Each 1 percent drop in vehicle registration reduces Motor Vehicle Account (MVA) revenues by about $8 million, while local governments lose about $27 million in revenues from the Motor Vehicle License Fee Account. Because DMV does not know the number of unregistered vehicles, it cannot estimate the amount of lost revenue.

New Financial Responsibility Requirements May Increase Evasion. The DMV believes that approximately 30 percent of California drivers currently lack insurance. Now that Chapter 1126 requires proof of insurance in order to register a vehicle, some of these drivers will obtain insurance, but others will fail to register their vehicles rather than pay the additional cost of insurance. The department assumes, for the purposes of estimating MVA revenues, that vehicle registration will drop 1 percent (see our discussion on the MVA fund condition in the Crosscutting Issues section of this chapter). However, because of the large number of uninsured drivers and the high cost of insurance, the potential increase in nonregistration resulting from Chapter 1126 may be much higher than 1 percent.

DMV Should Combat Nonregistration. Adding prerequisite requirements to vehicle registration has been an effective way for the state to enforce certain laws and collect revenue. However, the increasing number of requirements, including the new financial responsibility requirement of Chapter 1126, may result in more drivers failing to register their vehicles. We therefore recommend that DMV, as part of a revised proposal to implement Chapter 1126, present to the Legislature (1) an estimate of the total number of unregistered drivers and the related lost state and local revenue, and (2) a plan to combat nonregistration, registration sticker theft, and other attempts to evade vehicle registration requirements.

Policy Proposals Lack Detail and Require Legislation

We recommend that the Legislature reject three proposals contained in the proposed budget because, while they have minor budgetary effects, detail is lacking and they are contingent upon enactment of legislation. (Increase Item 2740-001-0044 by $478,000.)

The proposed DMV budget includes three policy proposals intended to transfer DMV responsibilities to the private sector. The proposals are:

- Transfer to private third-party groups the responsibility to conduct the drive test portion of the commercial driver license exam. The DMV has not developed a plan to do so or identified costs or savings that would result, thus the Legislature cannot evaluate the merit of this proposal.

- Discontinue licensing of automobile salespersons, which is currently required by statute. It should be noted that DMV estimates that this proposal will result in a fee revenue loss to the MVA that is greater than the savings which would result from eliminating the program. Specifically, DMV estimates half-year savings in 1997-98 of $444,000 and loss of $750,000 (half-year) fee revenue to the MVA. While potentially meritorious, this proposal will require legislation and the budget reduction is therefore premature.

- Transfer the California Motorcyclist Safety Program (CMSP), currently run by CHP, to private third-party groups. The CMSP is a safety training program that is mandatory for motorcyclists under age 21 and optional for others. If passed, it fulfills the drive test portion of DMV's motorcyclist driver license exam. The CHP's authority to run CMSP expires on January 1, 1998. The DMV proposes, upon expiration of CMSP, to design a new training and testing program to be administered by private third-party organizations. The DMV estimates a savings of $34,000 in 1997-98. The DMV's proposal will require legislation. The Legislature has several options: extending CHP's authority to run CMSP, allowing testing responsibility to revert to DMV, or enacting DMV's proposal for private third-party testing. Thus, the budget proposal is premature.

Reject Proposals in Budget. None of these proposals has a significant budget impact, but implementation would require statutory changes. The proposed legislation should reflect the fiscal changes. Accordingly, we recommend that the Legislature delete these three proposals and restore $478,000 to the department's budget. The higher departmental cost will be more than offset by the $750,000 fee revenue from continued licensing of automobile salespersons.

FINDINGS AND RECOMMENDATIONS

Transportation

	Analysis Page

Crosscutting Issues

Funding Outlook for State Transportation Programs

1.	**1996 STIP Close to Balance.** Although funding for the 1996 State Transportation Improvement Program (STIP) is close to balanced over seven years, expenditures for Caltrans support and local assistance are higher. Recommend supplemental report language directing Caltrans to include in the STIP fund estimate a reconciliation of estimated and actual support and local assistance expenditures.	A-12
2.	**SHA Cash Balance Exceeds $1 Billion.** The 1996-97 year-end State Highway Account (SHA) balance will exceed $1 billion due to lower capital outlay expenditures and slow construction of seismic retrofit projects.	A-15
3.	**CTC Plans Early 1998 STIP.** The California Transportation Commission (CTC) plans to adopt the 1998 STIP about four months early. Several financial threats may limit the ability to program new projects in the 1998 STIP.	A-16
4.	**Toll Bridge Retrofit Needs Funding Solution.** Funding solution is needed during 1997-98 to provide $1.4 billion to retrofit state owned toll bridges. Use of SHA funds will reduce funds for the 1998 STIP.	A-17
5.	**Federal Transportation Act Expires in 1997.** The current federal transportation act expires in September 1997. The 1998 STIP fund estimate will not reflect terms of the new transportation act, and changes in funding levels or program restrictions could complicate programming the 1998 STIP.	A-19
6.	**Higher Rehabilitation and Safety Costs Squeeze STIP.** Expenditures for pavement and bridge rehabilitation projects will continue to grow, because most of the state highway system is reaching the end of its design life. Higher expenditures during the 1998 STIP period will reduce funds available for STIP projects.	A-20

Analysis Page

Motor Vehicle Account Condition

7. **MVA Faces Deficit in Current Year; Corrective Actions Proposed.** Lower-than-expected revenues and higher expenditures will result in a deficit of about $50 million in the Motor Vehicle Account (MVA) in 1996-97. Recommend the Department of Finance advise the Legislature on (a) the availability of funds to pay CHP retirement contributions in 1996-97 and (b) the services and activities to be reduced by both CHP and DMV to achieve the proposed savings. A-22

8. **Budget-Year Balance Hinges on Raising Fees: Legislation Required.** To balance the MVA in the budget year and avert a deficit, the budget proposes to raise $50 million in unspecified fees. Enactment of legislation would be required to raise these fees. A-24

Department of Transportation

Highway Transportation

9. **Increases for Highway Program.** The budget proposes $5.4 billion for the highway program, 12 percent more than the current year. The increase is primarily the result of higher projected expenditures for both capital outlay support and capital outlay project construction. A-27

10. **Large Increase for Capital Outlay Support.** Withhold recommendation on $128 million to increase staff. Caltrans proposes a large increase in capital outlay support, but has not demonstrated required improvements in its budget estimating practices. A-29

11. **Caltrans Can Improve Use of Consultant Engineers. Reduce Item 2660-001-0042 by $25 million.** Recommend increase in consultant contracts be denied unless Caltrans provides plan to improve use of consultant engineers. A-32

12. **Additional Capital Outlay Support Unjustified. Reduce 2660-001-0042 by $23.8 million.** Recommend reduction because proposed increase in operating expenses for capital outlay support is unjustified. A-36

13. **Seismic Retrofit Expenditures Lag.** About 88 percent of Phase 2 retrofit projects are under contract for construction, but capital outlay expenditures for Phase 2 will occur much later than planned. Caltrans' support costs for Phase 2 are much higher than planned. A-37

14. **Project Delivery Near Targets for Reduced Program.** Caltrans delivered 96 percent of the projects proposed for delivery between January 1995 and June 1996. The total value of projects delivered in 1995-96 was slightly higher than in 1994-95. A-39

	Analysis Page
15. **Augmentation for Highway Maintenance Not Needed. Reduce Item 2660-001-0042 by $7.6 million.** Caltrans has not fully used its previous maintenance appropriations and does not require an augmentation for new activities.	A-40
16. **Price Increase Not Justified. Reduce Item 2660-001-0042 by $11,860,000.** Two components of proposed operating expense price increase are not justified.	A-40

Mass Transportation

17. **High Speed Rail Authority Should Be Funded Separately.** Recommend funding for the High Speed Rail Authority be provided in a separate item to ensure accountability.	A-42
18. **Recent Legislation Will Change Administration of Intercity Rail Service.** Chapter 1263, Statutes of 1996 is enacted to improve the administration and performance of the state's intercity rail program.	A-43
19. **Implementation of Chapter 1263 Is Slow; Regional Boards Express Concerns.** Chapter 1263 set target dates for executing interagency agreements to transfer the intercity rail service to regional boards. Regional boards have expressed several concerns relating to the implementation of Chapter 1263.	A-44
20. **Caltrans Should Be Subject to Chapter 1263 Requirements**. Recommend supplemental report language requiring the department to submit an intercity rail service business plan to the Legislature that meets Chapter 1263 requirements. Further recommend supplemental report language directing the Secretary for Business, Transportation and Housing to submit a report on the progress that the regional boards and Caltrans have made in meeting performance standards for intercity rail services.	A-46
21. **Cost of Intercity Rail Service Will Be Less Than Budgeted.** Withhold recommendation on $56.1 million to fund existing intercity rail service. Further recommend that the Department of Transportation report at budget hearings on the status of service transfer to regional boards and provide an update on Amtrak contract costs. Recommend funding level be adjusted accordingly.	A-48
22. **Stockton-Sacramento Extension Premature. Reduce Item 2660-001-0046 by $2.2 million.** Recommend reduction because the proposed extension of intercity rail service from Stockton to Sacramento is premature.	A-49

Legislative Oversight

23. **Caltrans Disregards Budget Limitation.** Caltrans increased its own appropriation level and spent more for certain programs than autho-	A-49

Analysis Page

rized by the Legislature in the *1995-96 Budget Act*. Recommend budget bill language to increase budgetary control.

24. **Deficiency Appropriation Unneeded.** Recommend deletion of a proposed $40 million deficiency appropriation, as Caltrans has not demonstrated its necessity. Should Caltrans show necessity, recommend adoption of substitute item providing greater budgetary control. A-51

California Highway Patrol

25. **Workers' Compensation Costs Still Significant.** Recommend that the California Highway Patrol (CHP), jointly with the Department of Personnel Administration (DPA), report on (a) steps DPA will take in its negotiations with the State Compensation Insurance Fund (SCIF) to lower CHP's administrative costs and (b) the feasibility of changing the payment methodology and adding performance measures to the master agreement with SCIF, as well as the feasibility of contracting out as a pilot project. A-54
26. **Legislature Should Determine Policy on Use of State Highway Account Funds**. Recommend the enactment of legislation to specify the appropriate funding mix of State Highway Account and Motor Vehicle Account funds for the Commercial Vehicle Inspection program. A-58
27. **Expansion of Statewide Radio System Premature. Reduce Item 2720-001-0044 by $1,407,000.** Recommend reduction because expansion of radio system is premature. A-60

Department of Motor Vehicles

28. **Computer Improvements Behind Schedule.** Withhold recommendation on $5.1 million requested to continue various computer projects pending receipt of information from the Department of Motor Vehicles (DMV) on the schedule, scope, and costs of these projects in 1997-98. A-61
29. **DMV Should Revise Financial Responsibility Proposal. Reduce Item 2740-001-0044 by $19 million.** Recommend Legislature reject DMV proposal to implement new financial responsibility legislation, because proposal does not consider less costly alternatives. A-62
30. **DMV Should Address Vehicle Registration Evasion.** Recommend DMV develop a plan to combat evasion of the vehicle registration process. A-63
31. **Policy Proposals Require Legislation. Increase Item 2740-001-0044 by $478,000.** Recommend that Legislature reject three proposals to transfer DMV responsibilities to the private sector, because they require legislation and must be considered by policy committees. A-65