Perspectives on
State Expenditures

MAJOR EXPENDITURE PROPOSALS IN THE 2000-01 BUDGET

In this section, we discuss several of the most significant spending proposals in the budget. For more information on these spending proposals and our findings and recommendations concerning them, please see our analysis of the appropriate department or program in the *Analysis of the 2000-01 Budget Bill*.

EDUCATION

Education programs account for 53 percent of General Fund spending in the *2000-01 Governor's Budget*. Below we provide an overview of the budget for K-12 and higher education, beginning with a focus on Proposition 98.

Proposal—K-12

Background. Proposition 98 establishes a minimum funding level that the state must provide for public schools and community colleges each year. K-12 education receives about 90 percent of total Proposition 98 funds.

Governor's Budget-Year Plan. The budget proposes $35.8 billion in total K-12 Proposition 98 funding in 2000-01 (consisting of state General Fund and local property tax allocations). This is an increase of over $1.9 billion, or 5.7 percent, compared to the 1999-00 revised amount. Pupil attendance is projected to increase by 1.26 percent, resulting in funding of $6,313 per pupil, an increase of $268 (4.4. percent) from the revised 1999-00 amount.

The major 2000-01 budget proposals include:

- $947 million for a 2.84 percent cost-of-living-adjustment (COLA).

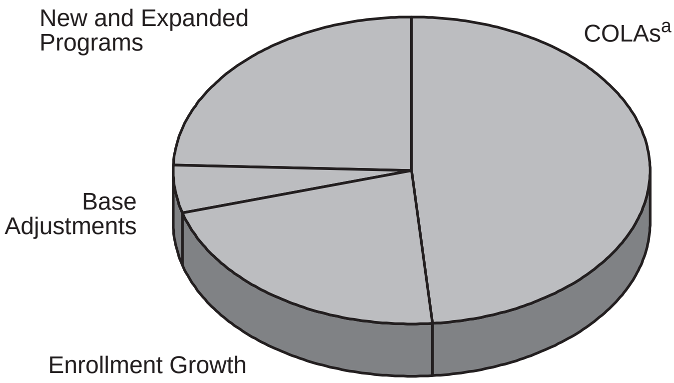
- $428 million for projected 1.26 percent growth in average daily attendance (ADA).
- $75 million for grants to schools to purchase computers.
- $62 million to increase the reimbursement rate for various supplemental instructional programs, including summer school and after school.
- $52 million for various incentives to recruit and retain teachers.

Figure 7 illustrates how the budget would allocate projected growth in K-12 Proposition 98 funds in 2000-01.

Figure 7

Proposed Use of New K-12 Proposition 98 Funds

2000-01



[a]Cost-of-living adjustments.

Budget "Overappropriates" Proposition 98 Minimum Requirement. The Governor's proposed spending level for Proposition 98 (including the community colleges) exceeds his estimate of the constitutionally required minimum amount for 2000-01 by $257 million. Our estimate of the required minimum funding level exceeds the Governor's estimate by $99 million. Both estimates, however, are somewhat academic given the current positive fiscal environment and the stated priorities of the Governor and Legislature regarding education.

Proposal—Higher Education

The University of California (UC) and the California State University (CSU). The budget proposes General Fund support for UC and CSU of $5.4 billion in 2000-01, an increase of $519 million, or 11 percent, compared with estimated current-year budgets. After adjusting for one-time spending in 1998-99, the actual increase is $557 million, or 11 percent. Budgeted enrollment levels at UC and CSU would increase substantially in 2000-01—by 6,000 full time equivalent (FTE) students at UC and 12,577 FTE students at CSU. The budget proposes a 6 percent baseline funding increase totaling $282 million in General Fund appropriations for UC and CSU. The proposed budget also includes a total General Fund increase of $30 million in lieu of student fee increases. The budget proposes $83.8 million in new funding for the two segments for teacher preparation, recruitment, and K-12 staff development aimed at improving California's K-12 educational system.

Community Colleges. The budget proposes $2.5 billion in General Fund support for the community colleges in 2000-01. All but $89 million of this amount counts towards the state's K-14 minimum funding guarantee under Proposition 98. The 2000-01 General Fund request represents an increase of $160 million, or 6.7 percent, from the current year. The combined increase proposed from the General Fund, local property tax revenues, lottery funds, and net student fee revenues (after accounting for financial aid) is $347 million, which represents a 6.5 percent increase in combined funding.

In 2000-01, the budget provides $103 million for a 2.84 percent COLA for general-purpose spending, $106 million for enrollment growth, and $25 million for the Partnership for Excellence program.

Student Aid Commission. The budget proposes a General Fund increase of $71.3 million, or 18.4 percent, for the Student Aid Commission in 2000-01. The majority of this increase, $40 million, pays for the cost increase associated with past increases in the number and maximum amount of Cal Grant awards. The budget also includes $31 million to increase the number of new first-time Cal Grant A and B awards and raise the maximum award amount. The budget eliminates the Cal Grant T program for teacher-preparation students, for a reduction of $10 million.

Issues for Legislative Consideration

Relative Needs of Education Segments. In the *Analysis,* we take issue with some of the broad priorities and approaches to higher education and K-12 education taken by the budget. We conclude that the administration's relative allocation of resources between the UC and the

CSU on the one hand, and K-12 education and the community colleges on the other, does not match the relative needs of these distinct parts of the education spectrum. We recommend transferring to K-12 education and the community colleges $149 million budgeted for base adjustments at UC and CSU. Even with these redirections, UC's General Fund budget would exceed the current-year amount by 9 percent and CSU's General Fund budget would exceed the current-year amount by 7.4 percent. In considering the relative needs of the education segments, we believe the Legislature should take into account the following:

- K-12 schools appear to face greater challenges of program quality.
- K-12 schools appear to face greater challenges in obtaining quality faculty.
- K-12 schools and community colleges have adopted accountability measures, while the universities have not.

Options for More Proposition 98 Spending. In the *Analysis,* we make various recommendations regarding the K-12 education budget that, if fully adopted, would increase Proposition 98 funding above the Governor's proposed spending level for 2000-01 by $172 million. (This amount would exceed the administration's estimate of the minimum funding requirement by $429 million.)

The Legislature may wish to allocate even more resources to Proposition 98 programs—not only for K-12 education but for community colleges as well. To the extent the Legislature wishes to do this, we would suggest that it place as much emphasis as possible on the following:

- ***Increase General Purpose Funding.*** During the recession years of the early 1990s, statutory COLAs for K-12 revenue limits were not fully funded, producing a statutory "deficit" for revenue limits. This statutory deficit is presently at 6.996 percent. We recommend in the *Analysis* (please see the Education chapter) augmenting revenue limits by $70 million to reduce this deficit. The Legislature could provide more funds for this purpose, which would help stop the decade-long downward trend in general purpose funding as a share of Proposition 98 resources. (Every $100 million of additional funds "buys" about 0.4 percentage points of deficit reduction.)
- ***K-12 Equalization***. This option is actually another form of general purpose funding, but addresses present inequalities in the per pupil distribution of revenue limit funding. In our discussion on discretionary funding in the *Analysis*, we recommend a $65 million augmentation for K-12 equalization. This level of funding, if followed by similar augmentations in the subsequent

five years, would result in 90 percent of the K-12 system's ADA receiving the same revenue limit. To the extent the Legislature provides more funds, it could shorten the time frame for reaching this target.

- ***Community Colleges Equalization***. In our analysis of the community colleges, we recommend a $28 million augmentation for equalization purposes, enough to make general purpose funding equal for slightly more than 50 percent of the system's FTE students. An additional $25 million would equalize funding for 60 percent of students.

- ***Block Grants for Disadvantaged Schools.*** The Governor's budget gives significant attention to the problems of recruiting and retaining qualified teachers in low-performing schools. This attention is warranted, as we detail in our discussion of teacher quality and supply. We point out, however, that the administration's definition of "low-performing" schools is overly broad. We also point out problems related to the lack of meaningful local discretion in the operation of the proposed programs. Our analysis indicates that the state could usefully deploy more funds to address not just the problem of teacher recruitment/retention, but the larger array of problems facing disadvantaged schools—which tend to be schools serving large numbers of children in poverty. We believe the most effective way to deploy additional resources to these schools is through one or several block grants that would allow school districts broad discretion to meet their particular local needs.

- ***Block Grants for One-Time Purposes.*** We estimate that the state has approximately $2.1 billion of additional revenues that could be used for one-time purposes beyond those already reflected in the Governor's budget. In addition, under the rules governing Proposition 98, the Legislature could spend additional funds for one-time purposes, count it towards the Proposition 98 requirement *for 1999-00*, and thereby avoid unnecessary increases in the long-term Proposition 98 "base" that might otherwise constrain future legislative options. The level of such one-time augmentations could be roughly equal to whatever amount the Legislature decides to go above the minimum guarantee for 2000-01. Again, we emphasize the advantages of block grants for one-time funding, which could allow local districts broad discretion to meet one-time needs, including, but not limited to, deferred maintenance, safety improvements, and staff development.

Logic of Accountability Calls for More Local Discretion. With regard to K-12 education, one of the salient aspects of the *2000-01 Governor's Budget* is the lack of discretion given to local school districts. The budget adds to the major area of general purpose funds—"revenue limits"—only what existing law requires to cover COLAs and enrollment growth. The budget proposes spending the remainder of new funds for K-12 education on a long list of new and expanded categorical programs. As well-intentioned as these programs are, we believe most will be diminished in effectiveness because of the constraints on local discretion.

In our view, the K-12 reforms adopted in the 1999 Special Session create both the opportunity and the need for a K-12 budget that grants greater local flexibility. In particular, the accountability framework established by Chapter 3x, Statutes of 1999 (SB1x, Alpert), and the high school exit exam established by Chapter 1x, Statutes of 1999 (SB 2x, O'Connell), logically lead to a shift in the state's budgeting and oversight emphasis—from a focus on educational *inputs* to attention to educational *outcomes.* To maximize the chances for improving educational results, however, the state must give local school districts and school sites more flexibility to fit budgetary resources to local circumstances and needs. The approach we take to the state's education budget in the *Analysis* builds on this foundation.

Funds Budgeted in Non-K-12 Entities for K-12 Purposes. Another significant aspect to the Governor's budget is the extent to which it proposes new funds to address K-12 purposes, but which are budgeted in non-K-12 entities (and thereby are "outside" Proposition 98). These proposals include—but are not limited to:

- $71 million for expansion and creation of teacher training programs to be administered by UC.
- $50 million for a Teachers Home-Buyers Assistance Program in the Department of Housing and Community Development.
- $25 million for a contract between the Secretary for Education and CSU to provide computer training to K-12 teachers.

In the *Analysis,* we address these proposals in detail and recommend transferring the funds to where they can be deployed more effectively—directly to school districts.

Higher Education Partnership. As noted above, the budget proposes to increase the base General Fund budgets of UC and CSU by 6 percent. This consists of 5 percent as part of the Governor's proposed Higher Education Partnership, plus an additional 1 percent increase for 2000-01. The partnership proposes to guarantee the 5 percent base increase every year, plus additional funds for enrollment growth and "necessary" capital outlay, plus additional funds for "high-priority" initiatives. The guaranteed increases would be contingent on UC and CSU developing accountability measures.

In our view, guaranteed annual funding is not necessary and will create the wrong incentives. The proposed partnership would:

- Not provide greater accountability than can be obtained under the annual budget process.
- Reduce the Legislature's annual budgetary discretion, undermining its ability to respond to the state's policy needs in the face of changing fiscal conditions.
- Reduce incentives for CSU and UC to reduce costs and improve outputs on an annual basis.

We, therefore, recommend in the *Analysis* that the Legislature not endorse the proposed annual funding guarantee for CSU and UC.

Aging With Dignity Initiative

Proposal

The Governor's Aging with Dignity Initiative consists of numerous components administered by several departments, at a General Fund cost of $140.4 million (and 221.5 positions) in 2000-01. The purpose of the initiative is "to help elderly people remain at home, or with their families, rather than in nursing homes; dramatically increase the availability of innovative community-based alternatives to nursing home care; and enhance the quality of care in California's nursing homes." Figure 8 (see next page) lists the proposed components of the initiative that have fiscal effects. In the discussion that follows, we present our analysis of one of these components—the long-term care tax credit.

Long-Term Care Tax Credit. The budget proposes a $500 tax credit for persons who provide or pay for care at home for seniors or disabled individuals of any age. This credit would result in an estimated General Fund revenue loss of $47 million in 2000-01. In order for the taxpayer to qualify for the credit, the senior or disabled person would have to meet certain criteria for needing care.

The credit would typically be available to taxpayers for each individual residing with them who is certified by a physician as requiring long-term care—defined as a continuous period of at least six months. Individuals with long-term care needs must meet certain criteria for a tax-

Figure 8

Aging With Dignity Initiative 2000-01

(In Millions)

	General Fund	Other Funds	Totals
Community Programs			
Caregiver tax credit	$47.0	—	$47.0
In-Home Supportive Services wage increases	20.0	$35.7	55.7
Long-term care innovation grants	20.2	—	20.2
Expand no-cost Medi-Cal for aged, blind, and disabled	2.4	2.4	4.8
Senior housing information and support center	1.0	—	1.0
Senior wellness education campaign	1.0	—	1.0
Improving Quality of Care and Enforcement			
Caregiver recruitment and training	—	$50.0	$50.0
Five percent pay increase for nursing home workers	$32.5	33.3	65.8
Nursing home quality awards	8.0	2.0	10.0
Increased nursing home inspections	3.0	4.5	7.5
Focused nursing home quality review	2.5	1.5	4.0
Rapid response to nursing home complaints	2.2	1.7	3.9
Nursing home fiscal review advisory board	0.5	—	0.5
Totals	**$140.3**	**$131.1**	**$271.4**

payer to qualify for the credit—for example, those six years and older must be unable to perform without assistance at least three basic activities of daily living.

The proposal is modeled after a similar proposal at the federal level for a $3,000 credit. For calendar year 2000, the Franchise Tax Board assumes that approximately 120,000 taxpayers would take advantage of the new state credit. The estimated revenue reduction from the credit is $47 million in 2000-01, reaching $52 million by 2004-05.

Issues for Legislative Consideration

Credit Not Likely to Meet Stated Objectives. Whether tax credits are an effective and efficient means of accomplishing their objectives depends on their specific provisions and purpose. They can, for example, be a good method of providing tax *relief* to certain categories of taxpayers or outright *subsidies* to them, *if* they are well-targeted. However, if their objective is to encourage certain types of *behavioral changes*, tax credits generally do *not* score particularly well as an effective and efficient tool. This is largely because it is hard to ensure that credits go only to those persons whose behavior changes, thus, many taxpayers receiving credits are simply rewarded for doing things they would have done anyway.

Thus, in the case of the proposed credit, a key question is whether it is primarily intended to *subsidize* the care costs of taxpayers who already provide long-term care in their homes or, alternatively, to provide an incentive for expansion of home-based long-term care. In either case, the proposal raises a number of concerns:

- ***Distribution of Benefits.*** First, because the proposed credit is *nonrefundable* (only available to individuals with state tax liability), certain taxpayers who may be most effective to target will only be able to benefit partially from it, or not at all. This is especially the case for lower-income taxpayers without large tax liabilities to offset. In addition, because there is no "means test" regarding who can receive the credit, much of it could go to those taxpayers who do not have the greatest financial need.
- ***Effects on Behavior.*** Second, at $500, the credit may simply be too small to significantly increase the amount of home-based long-term care that taxpayers are willing and able to provide. Caring for an elderly or disabled person can be a large financial burden. Even with Medicare, out-of-pocket health care costs (primarily for medication) can be large and other types of costs can be significant. For example, home modifications may be necessary, or a family member may have to give up a job or limit his or her work hours to provide care. In addition to financial issues, providing in-home care may also involve major changes in living arrangements and habits. It would seem unlikely that the availability of the $500 annual credit would be the determining factor in more than a small fraction of care decisions.
- ***Potential for Abuse.*** Third, the credit has an inherent potential for abuse that could require significant monitoring and enforcement efforts. While a doctor's certification will be required, assessing the physical or mental limitations of an individual involves a degree of judgment that may get stretched over time by the natural desire of physicians to accommodate patients and their families. Moreover, taxpayers need not demonstrate that they have incurred any cost in order to claim the credit. This could make it attractive to "push the envelope" when claiming that an elderly person or child in the home meets the test for qualifying limitations.

- ***Federal Interactions Diminish Impact.*** Fourth, because California income taxes are an itemized deduction on federal income tax returns, as much as a third of the state's credit paid to certain taxpayers will wind up "in the pockets" of the federal government.

Alternative Approaches. Given these concerns, we do not believe that the proposed credit would be an effective or efficient means of providing either (1) significant assistance to those taxpayers who bear the greatest burden for the care of seniors or disabled persons or (2) an effective incentive for an expansion of home-based care for seniors and the disabled. Consequently, we recommend that the Legislature explore alternative approaches to accomplishing the objectives of the proposed tax credit that would provide both more financial relief to many families and individuals and would help more seniors avoid institutionalization. With respect to alternative approaches, please refer to the Health and Social Services chapter of our *Analysis of the 2000-01 Budget Bill*, where we discuss expanding Medi-Cal coverage for seniors and the disabled beyond the relatively modest expansion proposed in the budget.

CALWORKS PROGRAM

The federal welfare reform legislation of 1996 replaced the Aid to Families with Dependent Children (AFDC) program with the Temporary Assistance for Needy Families (TANF) program. The Legislature subsequently enacted Chapter 270, Statutes of 1997 (AB 1542, Ducheny, Ashburn, Thompson, and Maddy), which created the California Work Opportunity and Responsibility to Kids (CalWORKs) program to replace the AFDC program in the state. The CalWORKs program provides cash grants and employment and training services to eligible families.

Proposal

Background. The CalWORKs legislation requires that savings resulting from (1) exits due to employment, (2) increased earnings, and (3) diverting clients from aid with one-time payments, be paid by the state to the counties as performance incentives. Current law also requires that the Department of Social Services (DSS), in consultation with the welfare reform steering committee, determine the method for calculating these savings.

Growing Obligation to the Counties. By the end of 1998-99 counties had earned approximately $900 million in performance incentives. This amount excludes incentives based on exits due to employment during 1998-99 because the data are not yet available. By the end of 1999-00, we estimate total incentives earned by the counties (including incentives based on exits to employment) will be approximately $1.6 billion. The total of the appropriations (from 1998-99 and 1999-00) for incentive payments is approximately $1.1 billion. Thus, we estimate that the unfunded obligation to the counties will be approximately $500 million by the end of 1999-00. We note that county receipt of fiscal incentives has significantly lagged the appropriation, and that counties have spent very little of their incentive payments. As of September 1999, they had received a total of $685 million but had spent only $5.3 million.

Governor's Proposal. The Governor proposes to prohibit counties from earning additional performance incentives until the unmet obligation to the counties has been satisfied. For 2000-01, the budget proposes an expenditure of $252 million toward this obligation, which, as noted above, is estimated to be $500 million by the end of 1999-00. If $252 million is paid to the counties in 2000-01, a remaining obligation of about the same amount will be carried forward into 2001-02. The department estimates that the counties would earn an additional $496 million in 2000-01 under current law. Thus, the Governor's proposal to prohibit counties from earning additional incentives results in savings of $496 million in 2000-01. The administration also indicates that it will propose legislation to either eliminate or "sharply modify" the performance incentive program.

Issues for Legislative Consideration

To assist the Legislature in considering these issues, we begin by examining the rationale for the county performance incentive program. While the Legislature did not specify the purpose of the program, we can identify several possible rationales. Specifically, performance incentives could have been intended as (1) a *reward* for county performance, (2) an *inducement* for counties to make an effort to achieve better program outcomes, and/or (3) a *funding source* for the CalWORKs program. Below we discuss each of these potential rationales for the program.

Reward System. The incentive payments may have been intended simply to be a reward to the counties. If this is the case, however, it is not clear what distinguishes county implementation of CalWORKs from county administration of other state programs in areas such as health, welfare, and criminal justice where there are not incentive payments. There is no analytical basis for determining whether incentive payments should be provided as a reward.

Inducement for Better Program Performance. Another argument for providing incentive payments is that they may act as an incentive for counties to make extra efforts toward improving their programs. As noted above, the counties have spent very little of their incentive payments and are still in the early stages of CalWORKs implementation. Thus, while incentive payments could have some impact in the future, it does not appear that they have had any appreciable effect on county behavior so far.

We also note that, as currently structured, counties can earn substantial incentive payments without demonstrating any program improvement. About $800 million of the performance incentives owed to the counties as of 1998-99 are due to savings attributable to the earnings of recipients. According to DSS, about two-thirds of these savings would have occurred even if CalWORKs had never been implemented (because many recipients were working before CalWORKs started). We believe that for incentives to serve as an inducement, the conditions under which incentives are "earned" must be limited to situations in which program outcomes actually improve.

Finally, we note that given the way fiscal incentives have been budgeted, the counties must spend the incentive payments within the CalWORKs program. Thus, county government programs outside of CalWORKs receive no direct fiscal benefit from the incentive payments.

Program Funding. A third argument for the performance incentives is that they could provide the counties with a source of funding for the CalWORKs program. Under CalWORKs, counties have had two sources of funds for employment services: (1) the regular budget allocation to fund estimated program needs and (2) the performance incentives. Performance incentives were to be used for county-specific enhancements to the CalWORKs program. We note that this has not been the experience to date. Counties have spent only about 60 percent of their single allocation funds and hardly any of their performance incentives.

Pursuant to Chapter 147, Statutes of 1999 (AB 1111, Aroner), the regular budget allocation for employment services will be based on county expenditure plans beginning in 2000-01. The change to budgeting employment services according to individual county expenditure plans should reduce the need for county performance incentives as a *funding source*. This is because the county plans, or budgets, can include any funding proposals the counties deem appropriate.

Analyst's Conclusion and Recommendation. The experience so far with CalWORKs suggests that the county performance incentives have not served as an effective reward, inducement toward better program outcomes, or funding source for program enhancements. While it is possible that, in the future, incentive payments might have some behavioral effect in inducing better performance, we believe that there is little chance of this as the program is currently structured.

Based on the amount of prior-year obligations, we concur with the Governor's proposal to prohibit counties from earning new county performance incentives until the outstanding obligation to the counties is satisfied. With respect to whether the program should be eliminated, we have no analytical basis for determining the cost-effectiveness of fiscal incentives. Should the Legislature choose to retain such a system, however, we recommend that it (1) be funded with General Fund monies that can be used by the counties for *any* purpose and (2) tie the amount of incentive payments to *improvement* in CalWORKs program outcomes.

We believe that performance incentives would have a better chance of being effective if paid for with General Fund monies that the counties can use for any purpose. This would increase their value to the counties, making it more likely to induce the counties to make an effort to improve the program. Furthermore, it will require the Legislature and the Governor to weigh the potential benefits of the incentives against the costs because the incentives would compete with other state priorities for funding.

As we have previously recommended, tying performance incentive payments to improvement in outcome measures should increase the chances that these payments will induce counties to make an effort to improve their programs. (For a discussion of this aspect of the issue, please see our analysis of CalWORKs in the *Analysis of the 1999-00 Budget Bill*.)

Finally, we note that repealing the performance incentive system, or replacing it with a new system supported by the General Fund, will free up a significant amount of federal TANF funds which have been the principal source of funding for the incentive payments. These TANF funds could be (1) held in a reserve, (2) provided to the counties or other local governments to provide services to TANF-eligible individuals, or (3) used to fund state level initiatives for the working poor. (Please refer to "TANF Regulations Increase State Flexibility to Serve Working Poor" in the Health and Social Services chapter of the *Analysis of the 2000-01 Budget Bill* for a complete discussion of the possible uses of TANF funds.)

CAPITAL OUTLAY

The state owns a vast amount of infrastructure including nearly 2.5 million acres of land, 180 million square feet of building space, and 15,000 miles of highways. Much of this infrastructure is aging. For example, 55 million square feet in the three public higher education segments was built or renovated over 30 years ago and most of the 9.5 million square feet of buildings in the state hospitals and developmental centers was built over 40 years ago.

The state departments responsible for this infrastructure have estimated that over the next five years more than $25 billion will need to be spent on improvements and expansion. As we have consistently cautioned, some of the planning effort to develop these estimates may be incomplete and some of the estimates may contain proposals that upon further review may not merit funding. In general, however, the estimates give a reasonable overall magnitude of the capital outlay needs.

Proposal

Budget Bill Proposal. The budget includes $1.2 billion for the state's infrastructure (excluding highways and rail programs). As shown in Figure 9 over 60 percent of the proposal is for higher education with the next largest amounts in resources and youth and adult corrections.

Figure 9

State Capital Outlay Program

1999-00 and 2000-01
(In Millions)

	1999-00 Appropriations	2000-01 Governor's Budget	Difference
Legislative, Judicial, and Executive	$48.7	$19.2	-$29.5
State and Consumer Services	3.9	5.4	1.5
Transportation (excluding highways and rail)	31.7	34.4	2.7
Resources	253.3	199.3	-54.0
Health and Human Services	51.4	10.5	-40.9
Youth and Adult Corrections	485.4	143.4	-342.0
Education	1.1	8.5	7.4
Higher Education	648.5	731.3	82.8
General Government	10.7	15.6	4.9
Totals	**$1,534.7**	**$1,167.5**	**-$367.2**

Budget Increases Use of Pay-As-You-Go Funding. Nearly 50 percent of the amount proposed in the budget is for pay-as-you-go funding. Of this amount about $400 million is from the General Fund, with the balance from special funds and federal funds. These direct appropriations are for 28 departments for a variety of proposals—such as land acquisition, new courthouses, fire stations, and various infrastructure and building improvements. General obligation bond financing totals $662 million, of which $656 million is for higher education. The budget does not include any proposed financing from lease-payment bonds.

Bond Debt. The state's debt payments on bonds will be about $2.9 billion in the budget year. This is an increase of 7.5 percent over current-year payments. The payments include $2.2 billion for general obligation bonds and $665 million for lease-payment bonds. We estimate that the amount of debt payment on General Fund-backed bonds as a percent of General Fund revenue (that is, the state's debt ratio) will be 3.9 percent in the budget year. We estimate that as currently authorized bonds are sold, the debt ratio will increase to 4 percent in 2001-02 and decline thereafter (assuming no further bond authorizations).

Issues For Legislative Consideration

State's Infrastructure Planing and Financing Process. Addressing the issues of an aging infrastructure and population growth will require expenditures of billions of dollars to renovate existing infrastructure and develop new public infrastructure. To effectively address the variety and complexity of infrastructure projects, the state needs a well-defined process for planning, budgeting, and financing these projects. A significant step toward developing such a process was the Legislature's enactment of Chapter 606, Statutes of 1999 (AB 1473, Hertzberg). Chapter 606 requires that—beginning January 10, 2002 and annually thereafter—the Governor submit a proposed five-year infrastructure plan to the Legislature. The plan is to be updated each year and is to cover a five-year period. The plan is to contain the infrastructure needs of all state departments (including the State Transportation Improvement Program and higher education) and K-12 public schools.

Legislature Should Develop Strategies for Reviewing and Implementing Infrastructure Plan. As mentioned above, the initial infrastructure plan called for under Chapter 606 will be sent to the Legislature January 10, 2002. Thus, the Legislature has less than two years to establish strategies to position itself to effectively review and implement the plan. We recommend the Legislature take the following steps:

- Establish legislative committees to oversee and implement the infrastructure plan. Important considerations for the committees would include establishing statewide criteria for setting priorities across programs, reviewing and approving the statewide capital outlay plan, and determining the appropriate financing mechanisms to undertake and complete projects. The committees would also regularly review the long-range plan to determine if it is still valid with regard to program needs.

- Determine which local government infrastructure programs is appropriate for the state to continue funding and assure that these programs are included in the five-year infrastructure plan.
- Provide steady, stable funding for the infrastructure plan. We have recommended (see *The 1999-00 Budget: Perspectives and Issues*, page 109) adopting a policy to dedicate 6 percent of annual General Fund revenues to fund infrastructure investments (including debt payments). The Legislature could take advantage of the opportunity provided by the current positive budgetary situation to set aside funds—on a one-time basis and/or ongoing basis—to invest in the state's infrastructure.

In addition to these planning and process issues, there are several areas within the state's infrastructure program that merit consideration in the near term.

Setting Priorities for Higher Education. With limited resources, the state should invest in higher education capital outlay projects that will result in maximum educational benefit statewide. This can be done by considering capital outlay proposals across higher education rather than for each segment in isolation of the others and evaluating capital needs using statewide guidelines. To establish such a legislative review and approval process, we recommend the Legislature take the following actions:

- Appropriate funds on the basis of statewide priorites and criteria, not the "one-third/one-third/one-third" formula used in recent years to allocate funds to the three segments.
- Evaluate projects from all three segments as a common pool.
- Focus resources on undergraduate instruction needs and projects that bring campuses to no more than 95 percent of space guidelines.
- Recognize the existing large investment in research facilities and fund projects that bring campus research space to no more than 90 percent of space guidelines.
- Use construction cost guidelines for all segments—including the University of California.
- Use campus facilities on a year-round basis.

Management of the Capital Outlay Program. Given the need for improving and expanding the state's infrastructure, it is essential that the administration have the necessary staff available and an accountable process in place to implement approved projects in a timely manner. Unfortunately, the administration is not able at this time to undertake the current program, let alone an expanded program, in either a timely manner or, for the most part, within the approved budget. In our *Analysis of the 1999-00 Budget Bill* and again this year, we point out that a large number of approved projects are both behind schedule and over budget. As a result, many projects the Legislature funded in the current year are not proceeding as approved. The management of the capital outlay program must improve significantly if the state's infrastructure needs are to be addressed in a timely manner.

CRIMINAL JUSTICE

State and local governments in California spend more than $17 billion annually to fight crime. Local governments are largely responsible for crime fighting and, thus, spend the bulk of total criminal justice monies for law enforcement activities. State expenditures have grown significantly in recent years, however, particularly for support of the state's largest criminal justice department, the California Department of Corrections (CDC), which is responsible for the incarceration, training, education, and supervision in the community of adult criminals. Other state entities spend large sums of money on criminal justice activities as well, including the Departments of the Youth Authority and Justice, the courts, and the Office of Criminal Justice Planning.

Proposal

The budget proposes about $7.5 billion from the General Fund and other funds for support of criminal justice programs in the budget year, an increase of 5.5 percent over the current year.

The CDC accounts for the largest share of this funding, $4.4 billion, or about 3 percent more than the current-year amount. The CDC budget provides full funding for projected growth in the number of prison inmates and parolees under current law, as well as augmentations for several programs.

Other major criminal justice program augmentations include $100 million for a new one-time grant program in the Office of Criminal Justice Planning that would provide funds to local law enforcement agencies for technology equipment and school safety, and $21 million for state assistance to local law enforcement through the Citizen's Option for Public Safety (COPS) program.

Issues for Legislative Consideration

Declining Crime Rates. Since 1991 California has experienced a steep drop in crime. In fact, the 1998 rate is the lowest the state has experienced since 1966. This decline has not been confined to any one type of crime, but rather has been across-the-board.

There are probably many reasons for this sharp drop, including the improved economy and greater access to jobs, demographic shifts in the population away from persons in the most crime-prone age brackets (ages 18 to 49), the incapacitation and deterrent effects of longer criminal sentences enacted in recent years, improvements in policing and other law enforcement techniques, and the decline in usage of some types of serious drugs.

Slowdown in Correctional Population Growth. Among the consequences of the steep drop in crime rates has been the slowdown in the growth of the state's correctional populations. The CDC expects the prison population to increase about 1.9 percent in the current year and about 1.2 percent in the budget year, reaching about 167,100 inmates by June 2001. The CDC projects that the number of inmates will exceed 183,000 by June 2005. These growth percentages are significantly smaller than actual and estimated rates of recent years. Still, our review indicates that the actual growth rates will be slower than projected.

Focusing Crime-Fighting Efforts. The Legislature could allocate resources to crime-fighting activities that could help further reduce the already declining level of crime in California. In our view, some of the Governor's budget proposals meet that objective. For example, the Governor's budget provides $126 million (an increase of about $40 million) for programs for inmates and parolees, such as drug treatment and casework services in communities that are designed to prevent the future criminality of these offenders.

Other proposals are not well justified. For example, the $100 million augmentation for local law enforcement agencies for technology equipment and school safety lacks important details, contains no evidence of demand, and is duplicative of other programs.

TRANSPORTATION

Transportation Planning. The Department of Transportation (Caltrans) shares responsibility for developing transportation projects with local agencies. Typically, projects on the state highway system are designed by Caltrans, while projects off the state highway system, such as transit or local street and road projects, are designed by local agencies. Both Caltrans and local agencies schedule state-funded projects in a four-year programming document—the State Transportation Improvement Program (STIP).

The state also funds the intercity rail program, as well as provides local assistance funds for public transportation.

Proposal

Governor's Transportation 2000 Initiative. The budget includes a Transportation 2000 initiative designed to relieve congestion by accelerating funding for transportation projects. The key elements of the proposal are summarized in Figure 10 (see next page). As the figure shows, the initiative addresses both highway and road transportation, as well as public transit. It focuses on getting projects constructed sooner. This is to be achieved mainly by (1) scheduling more projects in the STIP to be delivered between 2000-01 through 2000-03, and (2) inducing local agencies to use their share of transportation funds more expeditiously via use-it-or-lose-it provisions.

In addition, the initiative provides funding for specific rail track and signal improvements and equipment acquisition for urban and commuter rail as well as intercity rail. The budget also provides funds for planning work to be done for a Bay Area ferry system, in accordance with recent legislation.

With the exception of expenditures for various rail and ferry projects, the initiative contains no *new* funding for transportation.

Issues for Legislative Consideration

We have identified several issues that the Legislature should consider when assessing the Governor's transportation initiative.

Availability of Projects for Expanded STIP Is Questionable. We think that scheduling more projects in the STIP would allow project design work to proceed sooner. However, the Governor's initiative would result in a 2000 STIP that is about 23 percent larger than the program would otherwise have been under current law. We question whether the state and local agencies can deliver, in short order, a program of this magnitude. Because neither Caltrans nor local agencies could have anticipated this substantial acceleration of funds for additional projects, it is highly unlikely that they will have even close to \$3.6 billion worth of planned projects to use the advanced funding generated by the Governor's initiative.

Figure 10

Key Provisions of Transportation 2000 Initiative

Funding Proposals

- Accelerate $3.6 billion of funds into the 2000 State Transportation Improvement Program (STIP).
  - $3 billion in bonds backed by future federal transportation funds.
  - $600 million from the State Highway Account by lowering reserve.
- Amend Article XIX of State Constitution to allow a portion of fuel taxes to be used for transit capital and operating costs.

Transportation Programming

- Extend the STIP from four years to seven years to allow work to begin on projects that would otherwise be delayed until funds become available in the 2002 or 2004 STIP.

Environmental Streamlining

- Direct the Business, Transportation and Housing Agency, the California Environmental Protection Agency, and the Resources Agency to develop methods to streamline environmental review.

Use-It-or-Lose-It Provisions

- Expedite use of $300 million in local gas tax funds and $800 million in unused local agency federal funds. If local agencies do not spend funds within certain time period, state would reprogram funds for other projects.

Public Transportation

- $50 million for intercity rail improvements.
- $71 million for specific equipment, station, and track improvement projects for commuter and urban rail.
- $12 million for planning and studies for a Bay Area ferry system.

Initiative Would Necessitate Significant Staff Expansion. Beyond the question of whether projects are ready to be scheduled is an even more critical question—whether Caltrans or local agencies have the ability to hire and train staff to perform the necessary design and project development work to deliver an additional $3.6 billion worth of projects. Depending on the mix of projects that would be scheduled, Caltrans would have to expand its capital outlay support staff significantly—ranging from an additional 4,000 personnel-years to over 8,000 personnel years, at a total cost of between $400 million to over $800 million. This increase would have to occur mainly in the next two years if the projects are to be delivered in the 2000 STIP period. Given Caltrans' current vacancy rate (about 9 percent in its project development and engineering staff), it would likely have difficulty in hiring enough staff to meet the expectations of the Governor's initiative.

Impediments to Project Delivery Need to Be Addressed. In addition to not having adequate staff to work on projects, there are other factors which cause delay in the delivery of transportation projects. One major challenge is the complexity of delivering projects that are supported with federal funds. Our review found that federal funds can add several years to the length of time it takes to deliver projects. This is due to a number of factors, such as the length of time federal agencies take to review environmental documents and the project development process that must be followed in order to receive federal reimbursement.

We recommend the enactment of legislation to allow local agencies to pool their federal funds and, in certain instances, swap them for state funds. This would allow the use of federal funds to be more concentrated on certain large projects, rather than spread out across projects of various sizes. Additionally, we recommend that the California Congressional delegation seek enactment of legislation that would (1) delegate to Caltrans the authority to review and approve federally required environmental documents and (2) require federal permitting agencies to participate earlier in the federal environmental review process.

As regards the state environmental review process required by the California Environmental Quality Act (CEQA), we recommend that legislation be enacted to require that all state permitting agencies participate earlier in the CEQA process. Specifically, if a permitting agency fails to participate and inform Caltrans of its concerns after being formally notified of the project, it would forego the right to raise issues that have already been addressed in the CEQA review process.

Use-It-or-Lose-It Provisions Not Warranted. The initiative proposes use-it-or-lose-it provisions for two types of local transportation funds—federal funds and gas tax revenues—in order to encourage local agencies to expend these funds more expeditiously on projects. Given recent improvements in the rate local agencies have expended their federal transportation funds, as well as recently enacted timely use of funds provisions, we conclude that additional changes are not warranted at this time. As regards the gas tax revenues held as reserves by local agencies, we recommend that the Governor's proposal not be adopted given the estimated backlog in local streets and road repair needs (of over $10 billion).

Funding of Commuter and Urban Rail Proposal Should Use Existing Process. The budget proposes $71 million for specific capital improvement and acquisition projects on commuter and urban rail systems. Consistent with current legislative practice, we recommend that funding for individual projects not be provided in the budget act. Instead, we recommend that the amount be appropriated as a lump sum to be allocated by the California Transportation Commission to commuter and urban rail projects in accordance with project application and evaluation processes under existing law.

RESOURCES

CALFED Bay-Delta Program. The CALFED Bay-Delta Program was created in 1995 as a consortium of ten federal and five state agencies to develop a long-term solution to water problems in the San Francisco Bay/ Sacramento-San Joaquin Delta Estuary (the Bay-Delta). The program's goals are to improve water quality, fish and wildlife habitat, flood control, and the reliability of water supplies. The program is developing a plan that, once approved by federal and state environmental agencies (likely this summer), will guide the program's implementation phase that is expected to last at least 30 years at a total cost of potentially $10 billion.

The existing organizational structure of the program, currently housed in the Department of Water Resources (DWR), is loosely configured. This reflects the fact that the program has evolved administratively and has not been spelled out in state statute.

Older School Buses Are Significant Polluters. Of the 24,000 school buses operating in the state, most have diesel engines and about 1,900 predate 1977, the year when major federal safety standards took effect. Diesel school buses are a major source of "particulate matter" pollution that has been identified by the Air Resources Board (ARB) as a toxic air contaminant. Newer diesel buses, while subject to stricter air emission standards than older ones, continue to emit significantly greater toxic pollutants than low-emission alternative fuel buses (such as natural gas).

Watershed Assessment. An effective watershed assessment can provide valuable information necessary for improving regulatory and restoration efforts on watersheds. A watershed assessment compares historical and current habitat conditions and evaluates the extent to which changing habitat conditions have affected the populations of particular species. For a watershed assessment to be most effective in achieving regulatory and restoration goals, it should include three components: (1) data collection, (2) data analysis, and (3) applications to regulatory and restoration efforts.

California Coastal Commission. The California Coastal Commission is responsible for protecting the state's coastal resources through land use regulation, planning, educational programs, and other means.

Proposal

CALFED Bay-Delta Program. The budget proposes $42.3 million for the CALFED Bay-Delta Program under DWR. Of this amount, $20 million is for ecosystem restoration projects, $12.3 million is for planning and operations, and $10 million is for local water management and water transfer programs in areas served by Delta water. Our review, however, finds that an additional $93.8 million of proposed expenditures in DWR and various other state agencies should appropriately be characterized as CALFED-related expenditures. These include, for example, $51.5 million to be allocated by the Resources Agency for Bay-Delta ecosystem restoration projects.

Older School Bus Replacement Program. The Governor proposes a new $50 million "Older School Bus Replacement Program" to be administered by ARB. According to the budget, the intent of the program is to provide grants for school districts to replace pre-1977 diesel school buses with safe and clean alternative fuel buses.

Watershed Assessment Initiative. The budget requests $6.9 million and 56 personnel-years for various resources departments to do watershed assessments on state and private lands on the North Coast. The budget proposes to compile existing data and collect a limited amount of new data on North Coast watersheds. However, the proposal indicates that the data analysis will not result in specific recommendations related to land use activities such as timber harvesting or for restoration efforts.

Coastal Commission Seeks New Enforcement Positions. The Coastal Commission requests nine new positions to supplement the five positions currently dedicated to enforcement in the coastal zone. It also requests three new positions for other purposes, as well as additional funding for operating expenses and equipment.

Issues for Legislative Consideration

CALFED Bay-Delta Program. The focus of the CALFED Bay-Delta Program will soon shift from the planning to the implementation phase. During this phase, decisions will be made on the type, location, timing, and financing of specific projects. A number of important policy decisions will also have to be made, including setting expenditure priorities among the program's several areas of activity.

Because of the substantial state funding potentially at stake and the major decisions yet to be made, it will become increasingly important that a formal organizational structure be in place that the Legislature can hold accountable for CALFED-related decisions and expenditures. We recommend the enactment of legislation that establishes a structure that provides this accountability. The structure, which could take a number of different forms, should facilitate coordination among the various agencies implementing the program and ensure that the Legislature's information needs (such as being informed of the program's expenditure priorities, work plans, and budget) are met.

Older School Bus Replacement Program. There are several policy and implementation issues that remain unresolved with the Governor's proposal. We recommend that these issues be addressed in legislation prior to approving funding for the program. These issues include deciding the following:

- ***The Program's Overriding Goal.*** Setting a clear, primary goal for the program is necessary to establish criteria and guidelines for allocating the grant funds. For example, is the primary goal to achieve the maximum possible reduction in diesel particulate, or is it rather to modernize the school bus fleet to improve safety while achieving pollution reductions?
- ***Whether Funds Are for Bus Replacement, Retrofits, or Both.*** Establishing the program's primary goal would affect the extent to which the program focuses on bus replacement versus retrofits. For example, if the goal were to achieve the maximum reduction in diesel particulate statewide, it would be more cost-effective to use at least part of the funding for retrofits.
- ***The Age of Bus Fleets Eligible for Funds.*** The proposal's emission reduction potential is also affected if funding eligibility is limited to school buses of a certain age. Focusing solely on the oldest buses in the state, while modernizing the school bus fleet to improve safety, is likely to limit the potential to reduce emissions.
- ***Whether There Should Be a Matching Requirement.*** While a matching requirement would likely result in greater emission reductions statewide than under full grant funding, such a requirement could raise issues of fairness if poorer school districts are thereby excluded from the program.

Watershed Assessment Initiative. Our review finds the proposal lacks the components of an effective watershed assessment. Specifically, we do not think the proposal will achieve the goals of improving regulatory and restoration efforts for two reasons: (1) the data collection design is flawed and (2) the finished assessments are inadequately linked to regulatory and restoration efforts. We recommend that the Secretary for Resources report to the Legislature on how data collection dissemination would be coordinated among various resource departments, and how assessment results would be used to improve regulatory and habitat restoration efforts.

Coastal Enforcement Should Be Improved. We find that the commission is inadequately carrying out some of its statutory duties. In addition, a number of local governments are not fulfilling their responsibilities under the Coastal Act. While we believe the Coastal Commission's proposed staffing augmentations are warranted, we believe the Legislature should consider additional ways to help ensure the Coastal Act is adequately enforced. Specifically, the Legislature should consider ways to:

- Restrict the use of new staff to enforcement activities.
- Ensure that the commission addresses its backlog of Local Coastal Program (LCP) reviews.
- Strengthen incentives for local governments to adopt the commission's recommendations.
- Strengthen the incentives for local governments, that have not already done so, to adopt LCPs as required by law.