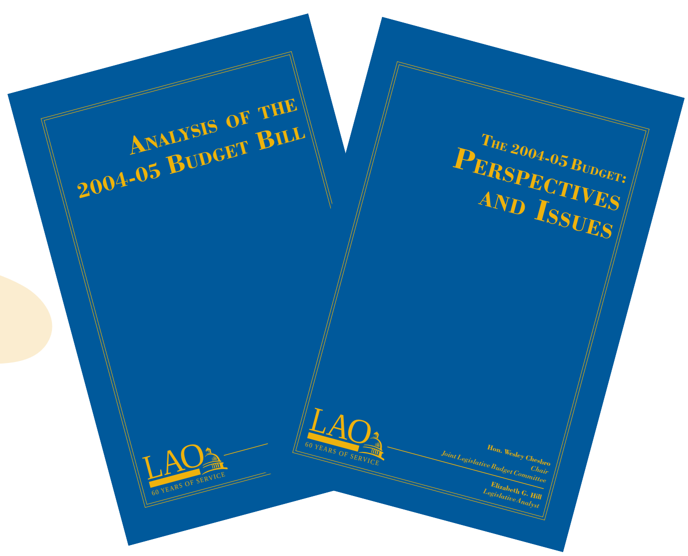
February 18, 2004

# Highlights of the:

# 2004-05 Analysis and Perspectives & Issues

ELIZABETH G. HILL • LEGISLATIVE ANALYST



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# STATE FISCAL PICTURE

## The Budget Outlook

- The fiscal problem facing the state in 2004-05 totals $17 billion.
- Of this, $15 billion relates to an ongoing structural imbalance between revenues and expenditures in 2004-05, while the remainder is a $2 billion current-year shortfall.
- We estimate that the Governor's budget proposal, if its solutions are fully adopted and realized, would address most of the gap in the current and budget years, falling about $780 million short of fully balancing in 2004-05.
- There are a number of major risks, however, that could increase this shortfall to about $4 billion.
- The budget does not fully address the ongoing structural shortfall. A $7 billion ongoing gap between revenues and expenditures would occur in 2005-06 and continue in subsequent years, absent further corrective action. (*P&I*, Part I.)

## Economic and Revenue Outlook

- The U.S. and California economies are entering 2004 with significant momentum, which we expect to continue through the budget year.
- While the lack of job growth is disturbing, such variables as output, business investment, and consumer spending are doing well.
- Our economic forecast is similar to the Governor's budget, in that we both anticipate improving growth in personal income and employment in California. (*P&I*, Part II.)
- We project modestly lower revenues than the administration, however, due to lower trends in wages and personal income tax liabilities beginning in 2003. Compared to the January budget forecast, we are down roughly $1 billion in revenues—about $500 million in both 2003-04 and 2004-05. (*P&I*, Part III.)

# K-12

## ➢ Proposition 98—Governor Proposes $2 Billion Suspension

- The budget proposal suspends the Proposition 98 minimum guarantee by $2 billion in 2004-05. It also spends below the minimum guarantee in 2002-03 and 2003-04 by a combined $966 million, but does not suspend for these years, thereby creating a "settle-up" obligation.

- We recommend the Legislature (1) suspend the minimum guarantee for 2002-03 through 2004-05 and (2) balance funding for K-14 education with other General Fund priorities without regard to the exact suspension level proposed by the Governor. (*Analysis*, page E-13.)

## ➢ Education Credit Card Balance Continues to Grow

- We estimate that the state would end 2004-05 with a $3.8 billion debt to K-14 education under the Governor's proposal. The outstanding balance increases by over $300 million because the Governor defers the 2004-05 costs of state reimbursable mandates, and does not reduce other deferrals or deficit factors. (*Analysis*, page E-20.)

## ➢ K-12 Categorical Reform Headed in Right Direction

- The Governor proposes to consolidate $2 billion in funding for 22 existing categorical programs into revenue limits to provide schools and districts with greater funding flexibility. We recommend the Legislature transfer 17 programs into revenue limits including 14 proposed by the Governor plus two class size reduction programs and deferred maintenance. (*Analysis*, page E-37.) We propose redirecting the remaining programs in the Governor's proposal into a professional development block grant, or a restructured Economic Impact Aid program. (*Analysis*, page E-58.) We also propose a separate block grant for school safety programs. (*Analysis*, page E-65.)

# HIGHER EDUCATION

## ➢ More Fee Increases Planned for All Public Colleges and Universities

- The Governor's budget assumes student fees will increase at all public segments of higher education. At the University of California (UC) and the California State University (CSU), undergraduate fees would increase by

10 percent and graduate fees would increase by 40 percent. Student fees at the California Community Colleges (CCC) would increase by $8 per unit. Other fee increases and surcharges are also planned.

- While we believe that most of the proposed fee increases are reasonable, we recommend smaller increases for graduate students and nonresident students. We also propose establishing long-term fee targets that would set fees as a fixed percentage of the cost of educating students. (*Analysis*, page E-197.)

### Reduced and Restricted Financial Aid Would Impede Student Access

- The Governor's budget proposes new restrictions for the state's Cal Grant program. In addition, Cal Grant award amounts would not be increased to cover planned fee increases at UC and CSU. Moreover, needy students attending private institutions would see their Cal Grant awards reduced by 44 percent.

- We are concerned that these proposals, coupled with planned student fee increases, would unreasonably restrict access for financially needy students. We therefore recommend the Legislature reject these financial aid proposals. We offer an alternative that would preserve the integrity of the Cal Grant program while still achieving General Fund savings in other areas. (*Analysis*, page E-214.)

### Outreach Services Should Be Maintained, but Restructured

- The budget proposal would eliminate all General Fund support for K-14 outreach programs at UC and CSU. While we agree that the state's outreach efforts are in need of reform and restructuring, we believe that the Governor's proposal would not sufficiently address the needs of disadvantaged K-14 students.

- We recommend the creation of a College Preparation Block Grant, which would provide assistance to K-12 schools whose students have low college participation rates. We recommend that most of a recent large augmentation to CCC for financial aid outreach be redirected to this block grant program. We also recommend that a small number of outreach programs continue to be funded at UC and CSU. (*Analysis*, page E-160.)

### Even With No New Funding, UC and CSU Can Enroll More Students

- As called for in the 2003-04 budget package, the Governor's 2004-05 budget includes no new funding for enrollment growth at UC and CSU. (The budget does provide funding for 3 percent enrollment growth at CCC.)
- We find that UC and CSU have enrolled fewer additional students in the current year than they were funded to serve. Even though no *new* enrollment funding is proposed, the unused enrollment funding from the current year would remain in UC and CSU's base budgets for 2004-05.
- Under the Governor's proposal, therefore, UC and CSU would be able to serve more students in 2004-05 than they are serving this year. (*Analysis*, page E-182.)

## HEALTH

### Better Care Reduces Health Care Costs for Aged and Disabled Persons

- The Medi-Cal Program today offers a paradox: Aged and disabled beneficiaries who would benefit the most from the improved health care that can come from receiving coordinated care are the very population that has been excluded from many Medi-Cal managed care plans. Moreover, this group offers the state the greatest opportunity to contain Medi-Cal expenditures.
- We recommend the enactment of legislation to gradually shift certain beneficiaries to a managed care setting and to address problems in the existing system that affect access to services and quality of care. (*P&I*, Part V.)

### "Remodeling" the Drug Medi-Cal Program

- California's program for substance abuse treatment services for Medi-Cal beneficiaries provides a patchwork of services with an inconsistent level of support for different modes of treatment and different treatment populations.
- We recommend an approach for addressing these concerns which would provide greater authority and resources for community-based treatment services, contain the fast-growing costs of methadone treatment, and integrate a new and potentially more cost-effective mode of treatment into the program without a net increase in state General Fund resources. (*P&I*, Part V.)

### Federal Funds and State Savings Possible Through Fee Mechanism

- The Governor's budget plan proposes a "quality improvement assessment fee" on Medi-Cal managed care health plans to enable the state to draw down additional federal funds for support of the program. We identify additional options for establishing such fees. (*Analysis*, page C-52.)

### Moving Toward a Model Antifraud System

- Although the Legislature has approved significant increases in resources to combat fraud in the Medi-Cal Program, fraud remains a major concern in the Medi-Cal Program. In our analysis, we explain the structure of the Department of Health Services' (DHS) antifraud program and how it compares to national models of fraud control, identify areas in which the DHS could become more effective in combating Medi-Cal fraud, and offer recommendations as to how the DHS could better manage and structure its antifraud efforts. (*Analysis*, page C-111.)

### An Agenda for Long-Term Reform of the Medi-Cal Program

- The Governor's budget plan offers a package of proposals for long-term reform of the Medi-Cal Program that it estimates would achieve General Fund savings of $400 million beginning in 2005-06.

- The Legislature should direct DHS to present a more detailed proposal for reform at budget hearings so that it will be in a better position to assess its policy implications and savings that would actually be achieved under the administration plan. We also suggest that the Legislature consider other reform options that we believe would improve the program for many beneficiaries and potentially achieve substantial state savings. (*Analysis*, page C-94.)

### Enrollment Cap and Block Grant Proposals Raise Concerns

- The Governor's budget plan proposes to (1) establish limits on enrollments for certain specified health and social services programs and (2) consolidate funding for certain state-only programs which serve immigrants into a single block grant for counties.

- We recommend that the Legislature reject (1) the block grant proposal because the programs proposed for transfer to the counties are not well-suited for local control; and (2) most of the cap proposals because of administrative difficulties, equity issues, and other concerns that outweigh the potential benefits. (*Analysis*, pages C-37 and C-47, page C-147, and C-198.)

### Failure of County Organized Health Systems Would Increase State Costs

- The Governor's budget plan assumes that the Health Plan of San Mateo (HPSM), a managed care health plan, which provides services to roughly 50,000 Medi-Cal beneficiaries, will not be in operation in 2004-05. The HPSM is one of eight such County Organized Health Systems (COHS) that contract with Medi-Cal. At least two of these plans reportedly face financial problems and others may in the future.

- The failure of HPSM or other COHS plans could prove costly to the state. Accordingly, we recommend that the Legislature initially reject the administration proposal to budget for the phase-out of HPSM and direct DHS to explore alternatives that would permit it to remain in operation. The Legislature should also consider several options to address the COHS plans' financial problems in order to avoid an increase in General Fund costs and the other serious consequences of their loss for Medi-Cal beneficiaries. (*Analysis*, page C-103.)

### Regional Center System: Spending Growth Rate Remains a Fiscal Concern

- The cost to the state of operating regional centers (RCs) for persons with developmental disabilities has continued to escalate at a rapid pace, with General Fund spending more than doubling in the past five fiscal years despite efforts to obtain more federal funds to offset state support.

- In our analysis, we analyze recent caseload and program spending trends to examine what is driving this growth, review the major initiatives initiated to date to address the situation, consider the Governor's proposal to address these issues, and offer additional approaches for containing RC program costs. (*Analysis*, page C-168.)

### Shift of Access for Infants and Mothers (AIM) to Healthy Families Could Maximize Use of Federal Funds

- We recommend that the Legislature take steps to shift all new AIM-eligible mothers to the Healthy Families Program possibly as soon as the budget year. The Legislature also has the option of shifting this group of enrollees to Medi-Cal coverage. Our analysis indicates that either approach would maximize the state's use of available federal funds and result in state savings of as much as $20 million in 2004-05 and $42 million in 2005-06. (*Analysis*, page C-161.)

# SOCIAL SERVICES

## Governor's Welfare Reform Proposal May Increase Participation, but Limits County Flexibility

- The Governor's budget proposes to increase California Work Opportunity and Responsibility to Kids (CalWORKs) participation by imposing further sanctions on noncompliant families and requiring that all recipients engage in employment or on-the-job training within 60 days of receiving aid. We believe the administration's assumptions concerning program participation improvement are overly optimistic. In addition, the proposal unnecessarily limits county flexibility to find the optimal mix of work, training, and employment barrier removal activities so as to help recipients become self-sufficient. In evaluating this proposal, the Legislature needs to weigh the benefits of increased program participation against the potential adverse impact on children in families who are unable or unwilling to comply with stricter work requirements. (*Analysis*, page C-227.)

## Grant Reductions and COLA Suspensions Save $554 Million

- Reducing CalWORKs grants by 5 percent and not providing the October 2003 and July 2004 statutory cost-of-living adjustments (COLAs) result in combined savings of $407 million in 2004-05. By deleting the Supplemental Security Income/State Supplementary Program state COLA and "not passing through" the federal January 2005 COLA, the budget achieves additional savings of $147 million compared to current law. (*Analysis*, pages C-222 and C-276.)

## Reforming the Adoptions Assistance Program (AAP)

- Currently, virtually every family who adopts a child from the foster care system is eligible for a grant averaging $725 per month until the adopted child turns 18. California's relatively broad eligibility criteria in combination with this relatively high grant make AAP one of the fastest growing social services programs. We recommend tying the AAP grant level more closely to the needs of the child. (*Analysis*, page C-255.)

### Child Care Reforms

- The Governor's budget proposes a number of significant reforms to California's subsidized child care system including eligibility restrictions and higher family fees. Although the proposals effectively prioritize limited child care resources, they lack important policy, implementation, and administrative details that would help the Legislature weigh state savings against reducing child care services for a significant number of lower-income families. (*Analysis*, page C-19.)

### Evaluating the Governor's IHSS Proposal

- The Governor's proposal to eliminate the state-only funded ("residual") In-Home Supportive Services (IHSS) program, limit state participation in provider wages, and reduce services to recipients with relatives results in General Fund savings of $492 million and a potential hardship for low-income Californians who receive IHSS. We recommend that the Legislature consider each aspect of the proposal on a case-by-case basis, assessing both its impact on recipients and the estimated savings. We believe the proposal to limit service hours for recipients living with family members merits approval because it is a reduction in services that can probably be absorbed by family members. With respect to the other proposals, we make no recommendation. (*Analysis*, page C-267.)

## CORRECTIONS

### 2003 Parole Reforms Experience Implementation Delays

- The *2003-04 Budget Act* required the California Department of Corrections (CDC) to implement a number of parole reforms designed to reduce parolee recidivism and save money. We find that the department is experiencing implementation delays which will reduce the savings from these reforms. To achieve greater savings, we recommend that the Legislature consider further expansion of programs designed to prevent returns to prison. (*Analysis*, page D-50.)

### CDC Continues to Experience Budget Deficiency

- The Governor's budget proposes to fund most of CDC's $540 million deficiency request submitted in October, including amounts for salary increases, retirement costs, and unanticipated growth in the inmate population. The remaining unfunded deficiency request—about $50 million—

includes recurring deficiency items, such as overtime and workers' compensation. We recommend that the administration propose a plan to reduce the department's ongoing deficiency. (*Analysis*, page D-43.)

### $400 Million in Unspecified Cuts to Corrections May Be Difficult to Achieve

- The Governor's budget includes $400 million in unidentified cuts, which the administration proposes to submit as part of the May Revision. Achieving spending reductions of this size in 2004-05 will require significant and immediate policy changes affecting the inmate population and labor costs—the two major determinants of the corrections budget. Given the magnitude of this proposal, we recommend the Legislature urge the administration to provide its plan before May to allow more time to review it. Given likely implementation delays, savings of that magnitude will be difficult to achieve. (*Analysis*, page D-45.)

### Request for Over 1,200 Prison Positions Lacks Sufficient Detail

- The administration's request for $99.5 million and over 1,200 positions could result in reduced costs for overtime and temporary help. However, the budget lacks sufficient detail regarding the savings to be generated, or how the new positions will be distributed to institutions. We withhold recommendation, pending receipt of additional details. (*Analysis*, page D-68.)

### *Valdivia* Remedial Plan Will Be Costly to State, but Not Included in Budget

- In compliance with a federal judge's order in the case of *Valdivia v. Schwarzenegger*, the state recently submitted a plan to reform the parole revocation process. We believe that the implementation of this plan will result in significant costs for the state and possibly for local governments, as well. We recommend that the CDC and the Board of Prison Terms report to the Legislature on the full fiscal impacts of this plan. (*Analysis*, page D-13.)

### Elimination of Office of Inspector General (OIG) Not Justified

- The Governor has recently indicated that he plan's to withdraw the administration's budget proposal to eliminate the OIG. We think that eliminating the office would result in reduced oversight of California's correctional system. We recommend retaining the office, and offer suggestions for strengthening it. (*Analysis*, page D-18.)

### Elimination of TANF Block Grant Could Have Unintended Consequences

- The Governor's proposal to eliminate the Temporary Assistance for Needy Families block grant for county juvenile probation could result in additional youthful offenders being sent to the Youth Authority, and thus increased state costs. As an alternative, we recommend that the Legislature consider suspending or eliminating the Citizens' Option for Public Safety and Juvenile Justice Crime Prevention Act grant programs, which would likely have less of an impact on public safety, without increasing state costs. (*Analysis*, page D-23.)

### State Should Close Fred C. Nelles Youth Correctional Facility

- Pursuant to current law, the Governor's budget proposes to close the Fred C. Nelles Youth Correctional Facility in Whittier for savings of $25.9 million. We recommend approval of the proposed closure because of the significant and continuing decline in youthful offenders in Youth Authority institutions. The state could generate tens of millions of dollars from sale of the land. We further recommend that the Youth Authority be required to report to the Legislature on opportunities for closing additional facilities. (*Analysis*, page D-75.)

## CAPITAL OUTLAY

### UC Can Finance Research Facilities With Nonstate Funds

- The University of California (UC) receives billions of dollars a year from faculty research contracts and grants, primarily with the federal government and private companies and organizations. Included in this revenue is hundreds of millions of dollars that the university charges for the use of facilities for this research. Because UC has the ability to recover these costs, we recommend the construction of new faculty research facilities be funded from this nonstate revenue. (*Analysis*, page G-64.)

### Community Colleges' Enrollment Projections

- Enrollment projections used to justify needed facilities for specific community college campuses in many cases appear to overstate likely student demand. We recommend the Legislature direct the Chancellor's Office to examine the methods it uses to prepare these projections and report back to the Legislature about any improvements that it might adopt to make these projections more realistic. (*Analysis*, page G-86.)

# TRANSPORTATION

## Transportation Project Delay Harms the Economy

- State funding for transportation has been highly unstable for several years, causing delays in transportation projects. Since 2001-02, $2.2 billion has been diverted from the Traffic Congestion Relief Program and Proposition 42 to address the state's budgetary shortfall. Transportation projects have been planned and started expecting these funds, but they have not materialized. The Governor's proposals would divert an additional $2 billion from transportation. When the transportation system fails to keep pace with the state's population and travel demand, traffic congestion worsens. Such delays cost California drivers more than $4.7 billion in wasted time and fuel a year—thereby diverting these resources from more productive use, causing higher costs and reduced profits for businesses, and potentially reducing economic output and jobs. (*Analysis*, page A-23.)

## State Should End "Stop-and-Go" Transportation Funding

- State transportation funding in California has not kept pace with increasing travel for a variety of reasons, including the fund transfers noted above. Stabilizing transportation funding would increase the efficiency of transportation expenditures. We recommend the Legislature (1) ask voters to repeal Proposition 42, (2) replace the lost transportation revenue with an increase in the gas tax, and (3) index the gas tax to prevent future erosion of transportation revenues relative to transportation demand. (*Analysis*, pages A-29 through A-36.)

## Failure to Invest in Pavement Maintenance Shortchanges Taxpayers

- Timely pavement maintenance protects taxpayers' investment in the highway system and can reduce long-term costs by postponing the need for more expensive rehabilitation of the state highway system. Poorly maintained roadways increase costs to motorists for vehicle repair. Drivers in Los Angeles or San Jose, for instance, will pay an average of more than $700 a year for these costs. There is now a backlog of $587 million worth of pavement maintenance work. We recommend Caltrans refocus its maintenance efforts by developing an investment plan for highway maintenance. We also recommend Caltrans develop performance measures that link the state's investment to the resulting quality of the highway system. (*Analysis*, pages A-52 through A-62.)

### One-Time Accounting Change Creates Ongoing Workload, Increases Project Risk

- The budget proposes to free up one-time money to help the General Fund by changing how the state accounts for federal funds used by local transportation projects. This change will create unknown, ongoing workload for Caltrans. It will also put potentially thousands of local projects at risk of not receiving enough funds to cover anticipated project expenses. We recommend the Legislature specify in statute the priority of future cash expenditures to reduce the risk to local projects. (*Analysis*, page A-36.) We also recommend Caltrans provide workload and risk information to the Legislature prior to budget hearings. (*Analysis*, page A-44.)

### Budget Provides Too Few Staff to Meet Storm Water Requirements

- Caltrans' maintenance personnel have to perform various storm water management activities to comply with its statewide pollution discharge permit. While the administration recognizes that the cost of these activities will increase over time, the budget proposes a level of staffing that is lower than justified by ongoing workload. Combined with the statewide hiring freeze, this means that Caltrans would have to redirect staff from other maintenance activities to meet storm water management requirements. In order that Caltrans can meet these legal requirements and adequately maintain the highway system, we recommend a higher level of permanent staff for storm water management. (*Analysis*, page A-50.)

### Wait Times Grow Longer for DMV Customers

- Every year, over 30 million customers visit the Department of Motor Vehicles (DMV) field offices. In the past few years, staff reductions have caused average wait times for these customers to grow significantly, from 35 minutes in 2001-02 to a projected 80 minutes in 2004-05. We recommend that the Legislature reexamine the levels of service to be provided by DMV. If the Legislature determines that current wait times and overall service levels are unacceptable, we recommend the Legislature restore selected field office positions. (*Analysis*, page A-71.)

### Opportunities Exist to Improve Driver Licensing Process

- The DMV's driver licensing process can be improved in terms of customer service, driver safety, and cost-effectiveness. We recommend the department report at budget hearings on the viability of making administrative changes to reduce the millions of in-person visits at field offices. We further recommend the enactment of legislation for various fees to encourage fewer in-person visits at field offices and to cut costs related to the program. (*Analysis*, pages A-75 through A-82.)

# RESOURCES

## Budget's Bond Proposals to Come Later—Will They Reflect Legislative Priorities?

- The Governor has deferred the submittal of most of his resources bond expenditure proposals to later in the spring. In contrast to the current year where estimated bond expenditures are projected to total about $4.1 billion, the January budget proposal totals $136 million.

- We find that roughly $2 billion of current- and prior-year bond fund appropriations have yet to be spent, and that staffing reductions have substantially delayed the implementation of some new bond-funded programs. We recommend that the administration report to the Legislature on the status of expenditures made from prior bond fund appropriations and its plans to improve the timeliness of implementing bond-funded programs.

- Recent resources bond measures have provided close to $3 billion to various state agencies for land acquisitions. Coordination among these agencies is crucial to ensure the state is acquiring land in a strategic manner. In addition, these land acquisitions can create substantial future-year cost obligations to develop and operate these lands. Given this, we recommend the Secretary of Resources report to the Legislature on its coordination efforts and its plans to fund development and operations costs that arise from land acquisitions.

- The Legislature should also consider whether the Governor's bond proposals are consistent with the bond measures and prior legislative direction, whether administrative costs are reasonable, and, most importantly, whether the proposals reflect the Legislature's priorities for bond funding. (*Analysis*, page B-34.)

## Do We Still Need the Power Authority?

- The budget proposes elimination of the California Consumer Power and Conservation Financing Authority (CPA), which was created to assure a reliable energy supply by financing electricity generation. While CPA has been unable to finance any electricity generation, this is in part due to market conditions beyond its control.

- We find the adequacy of the state's long-term energy supply remains uncertain. Given this, we provide the Legislature with two options for retaining CPA's most critical function—the ability to finance new power plants using its bonding authority. These options include retaining this function in CPA provided it is self-supporting or eliminating CPA and transferring its bonding authority to other existing state agencies. (*Analysis*, page B-110.)

### ➢ More Strategic Approach to Flood Management Needed

- We find that residential and commercial development in and around floodplains has contributed to increased losses due to floods and that California's current pattern of development is likely to result in more people living in and around flood-prone areas of the state. Despite this, the state's efforts to improve floodplain management have been reduced significantly over the last several years.

- We recommend the enactment of legislation that reduces the state's share of funding for certain flood control projects to better reflect the local benefit from these projects. This would save the state between $115 million and $230 million in future budget years. A portion of these future savings could be used to make more strategic flood management investments, including increasing support for floodplain management programs. (*Analysis*, page B-86.)

### ➢ Increasing State Park Public-Private Partnerships Worth Evaluating

- The Governor's budget proposes a constitutional amendment that would allow for increased contracting out in the delivery of state services. The Department of Parks and Recreation currently contracts with the private sector for the delivery of a number of services. Our review finds that other federal and local park jurisdictions contract with the private sector for the delivery of types of services that are not currently contracted out by the department.

- Based on the experience of other park jurisdictions, as well as the fact that contracting out state park services is not new in California, we think that the issue of increasing private sector involvement in the delivery of state park services warrants consideration. We recommend a pilot program to further explore the pros and cons, as well as the costs and benefits, of expanding these public-private partnering activities in state parks. (*Analysis*, page B-65.)

### Governor's Fee Proposals Can Go Further

- The budget proposes a few fee increases for resources programs. We offer additional fee proposals to shift funding from the General Fund to fees, totaling $170 million. We propose to shift to fees services provided directly to beneficiaries (such as fire protection), or costs to regulate the activities of individuals or businesses that degrade public resources. The additional opportunities that create General Fund savings include:

  - ***Fire Protection—***$150 million savings if property owners who benefit from state fire protection services pay an increased fee so that the Department of Forestry and Fire Protection's costs for these services are shared equally between the General Fund and the property owners. (Analysis, page B-51.)

  - ***Timber Harvest Plan (THP) Review—***$9 million savings by having timber operators fully cover the costs incurred by state agencies in their review and enforcement of THPs. (Analysis, page B-43.)

  - ***Coastal Development Permitting and Enforcement—***$7.8 million savings by increasing fees on developers to replace General Fund support for coastal development permitting and enforcement activities. (Analysis, pages B-57 and B-76.)

  - ***Risk Assessment—***$3.6 million savings by shifting costs of the Office of Environmental Health Hazard Assessment's risk assessment activities that directly support regulatory programs to fee-based special funds that support these regulatory programs. (Analysis, page B-98.)

### "Beneficiary Pays" Principle Not Applied Much in Funding CALFED

- The CALFED Bay-Delta Program is a 30-plus year effort by multiple state and federal agencies to address water-related problems in the state's Bay-Delta region at an estimated cost of $9.2 billion for the program's first seven years.

- Funding sources have been identified for only about one-third of the program's estimated cost, leaving a funding gap of over $6 billion. To date, the state has been the biggest funding contributor to the program by far, and there has been little direct application of the beneficiary pays principle in making CALFED funding decisions.

- We propose a funding framework for CALFED that applies the beneficiary pays principle. This includes the enactment of legislation to (1) guide the application of this principle and (2) establish a fee on a broad group of Bay-Delta water users who benefit jointly with the public-at-large from several CALFED activities. (*Analysis*, page B-17.)

# GENERAL GOVERNMENT

## ➢ Rethinking How to Address Unexpected Expenses

- The use of the deficiency process (Control Section 27.00) to address unexpected expenses has a history of problems—from being used to establish new programs with no statutory authority to serving as an alternative to the normal state budget process. Given this history, we outline a framework for legislative consideration which identifies a new approach to meet unexpected expenses. (*P&I*, Part V.)

## ➢ Retirement Bond Is Ill-Advised, but Other Proposals Merit Consideration

- To reduce budget costs, the administration proposes to issue bonds to finance almost $1 billion in scheduled retirement contributions. A Superior Court has thus far prevented the state from issuing such bonds. Regardless of its legality, incurring decades worth of debt to avoid an annual operating expense as a budget-balancing tool is poor fiscal policy. We recommend the Legislature reject the administration's proposal. (*Analysis*, page F-17.)

- The administration also proposes having current employees contribute more of their salaries to retirement. The idea is worth pursuing in collective bargaining, but the Legislature should be aware of what this provision might cost the state in return. (*Analysis*, page F-18.)

- For new employees, the administration proposes rolling back retirement benefits to those in place in 1999. We recommend that the Legislature consider this proposal, but also consider alternatives such as Tier 2 and defined contribution plans for all new employees. These alternatives would result in more state savings and other state benefits compared to the administration's proposal. (*Analysis*, page F-20.)

➢ **Risky Assumption of $500 Million, but Existing Gaming Revenue Can Help Budget Shortfall**

- The budget assumes $500 million in new revenues to the General Fund from the renegotiation of revenue sharing agreements with Indian tribes. The agreements are voluntary and the proposed amount is four times what tribes currently pay. The realization of such revenue in the budget year, therefore, is unlikely. (*Analysis*, page F-47.)

- The administration does not propose a spending plan for $137 million in the Indian Gaming Special Distribution Fund. We recommend using these funds for gambling-related expenses currently paid by the General Fund, such as public safety and mental health funding for local governments. (*Analysis*, page F-49.)

➢ **Food and Agriculture's Position Management Fails to Provide Adequate Oversight**

- The California Department of Food and Agriculture (CDFA) created 500 permanent positions at its own discretion without proper approval. These positions have not been subject to routine administrative and legislative reviews. We make a number of recommendations to ensure appropriate oversight of CDFA's positions. (*Analysis*, page F-103.)

➢ **Budget Fails to Account for Federal Election Funds**

- The budget fails to account for more than $250 million in expected federal election reform funds. We recommend that the Secretary of State provide a proposed spending plan, so that the Legislature can determine the best use of the funds. (*Analysis*, page F-57.)

# LOCAL GOVERNMENT

➢ **Not Another Property Tax Shift**

- Similar to the 1990s, the budget proposes to shift $1.3 billion of property taxes from local governments to K-14 districts—and reduce state education spending by an equal amount.

- This proposal raises questions concerning the state's role regarding the property tax. In our view, the Legislature should use its authority over this tax for the overall betterment of local government, not as a state rainy day fund. We recommend the Legislature reject this proposal.

- If the Legislature considers local government revenue reductions, we outline guidelines for it to review—as well as an alternative to the administration's proposal. While our alternative also represents an undesirable intrusion into local finance, it would have somewhat fewer negative effects.

- Our alternative includes a: $216 million reduction in local subventions, $400 million locally determined special district property tax shift, $320 million redevelopment property tax shift, and $400 million reduction in city and county sales taxes, and a reallocation of vehicle license fees. (*P&I*, Part V.)