

ANALYSIS OF THE 1993-94 BUDGET BILL

*Summary of Findings
and Recommendations*



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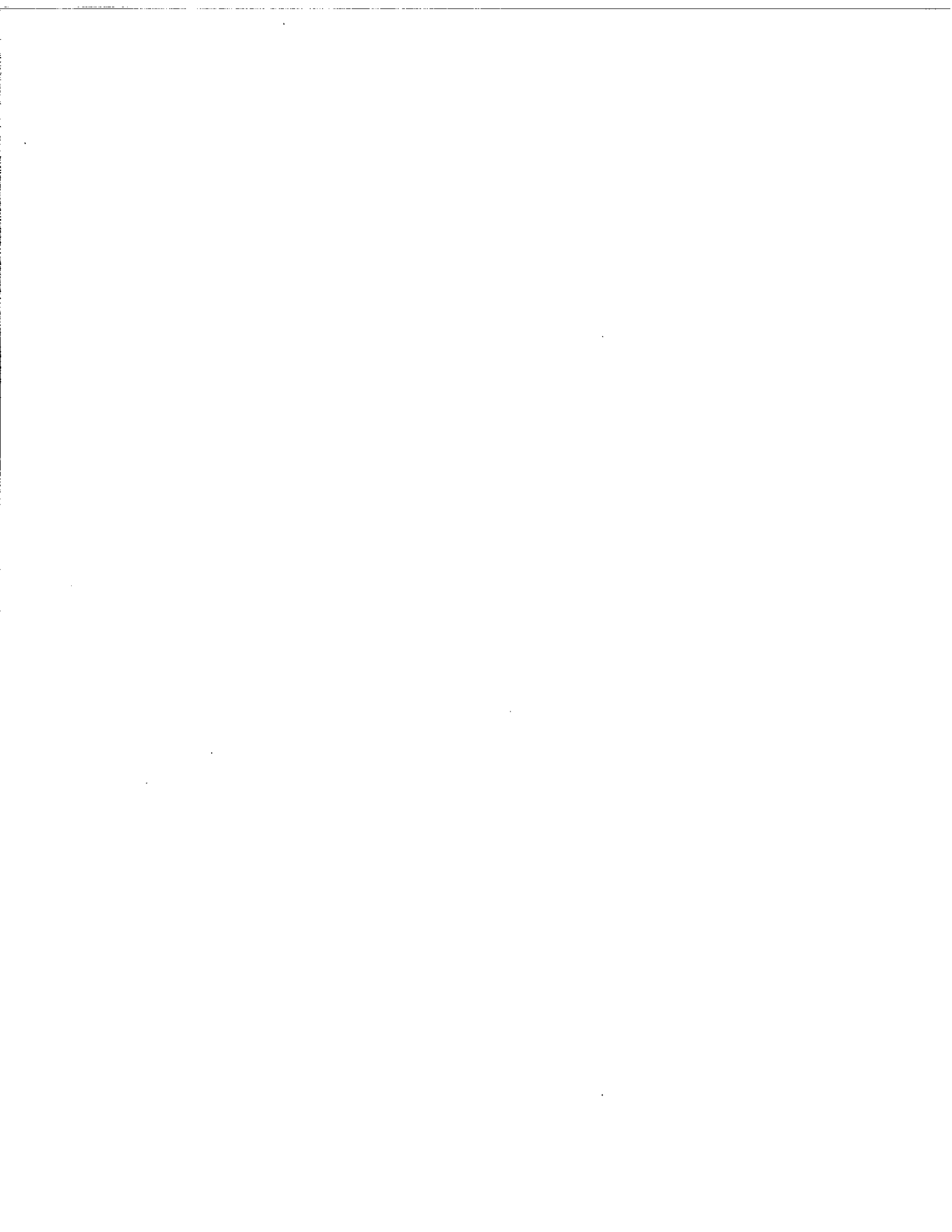
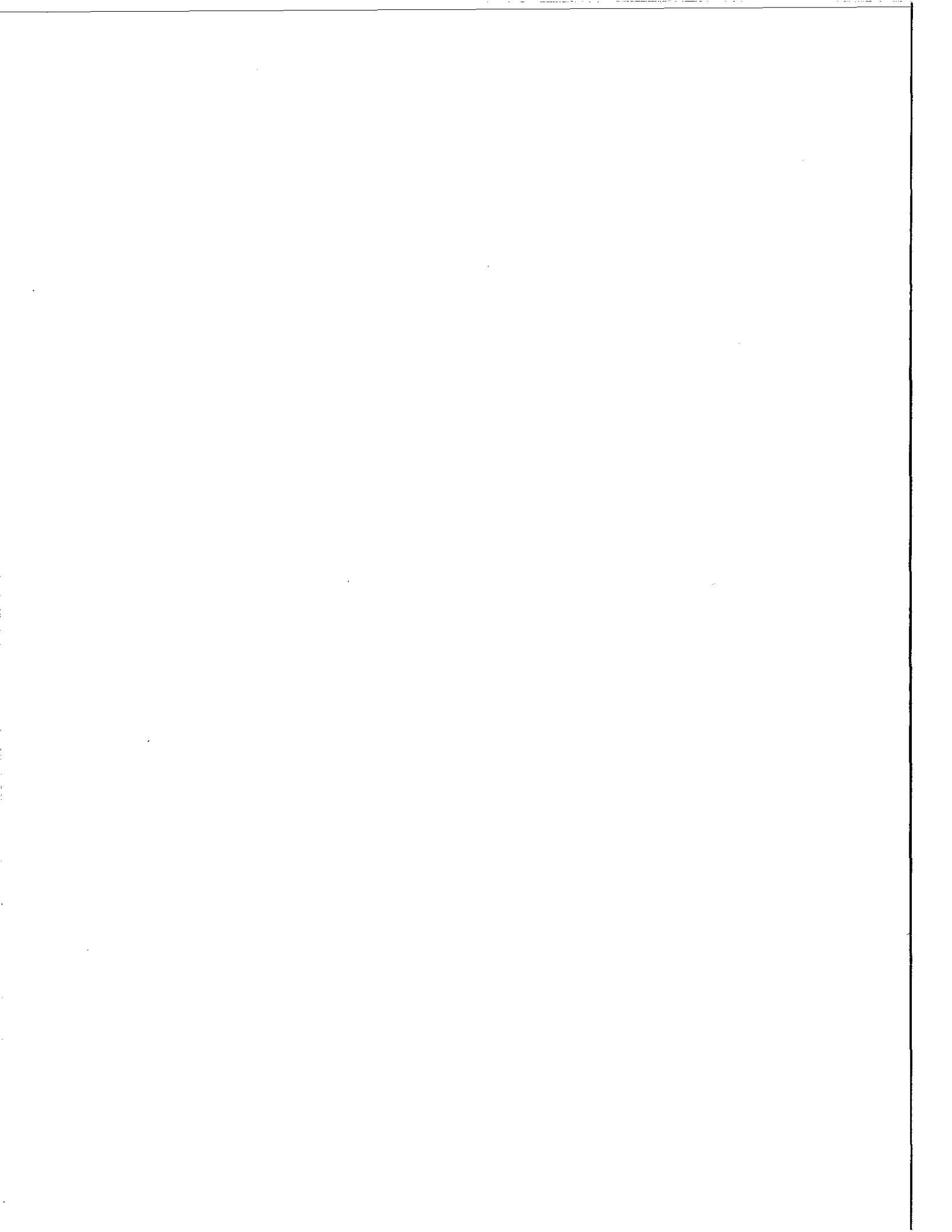


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INTRODUCTION

In the *Analysis of the 1993-94 Budget Bill*, we report the results of our detailed examination of the Governor's department spending proposals for the coming fiscal year. By contrast, *The 1993-94 Budget: Perspectives and Issues* provides an overall perspective on the state's revenues and expenditures for the budget year. It also examines some key issues related to restructuring state and local government in California.

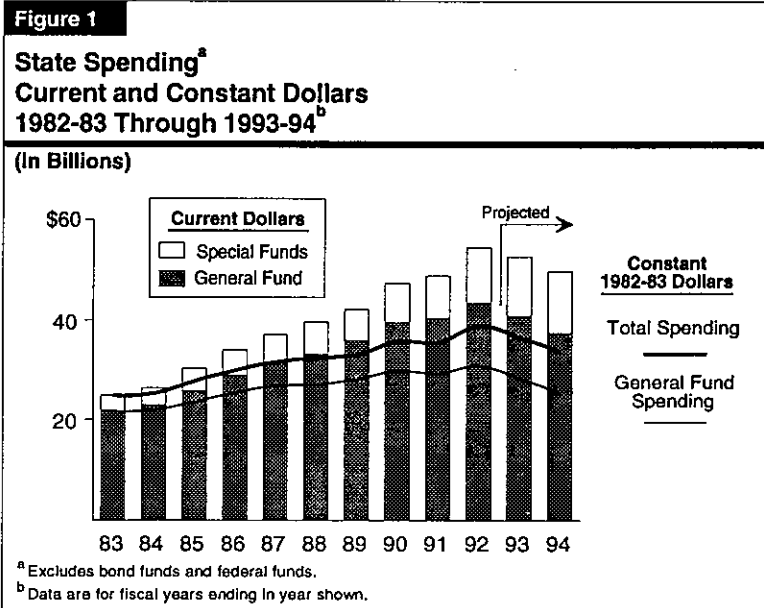
This document summarizes, by program area, the principal findings and recommendations set forth in the *Analysis* and the *Perspectives and Issues*.

BUDGET OVERVIEW

Figure 1 illustrates the trends in state General Fund and special fund expenditures from 1982-83 through 1993-94. The figure shows expenditures in both "current dollars" (amounts as they appear in the budget) and "constant dollars" (current dollars adjusted for the effects of inflation). This adjustment allows comparisons of the "purchasing power" of state spending over time.

As Figure 1 illustrates, state spending peaked in 1991-92 and is projected to decline in the current and budget years. This decline is without precedent in recent history—state spending has not registered a year-to-year reduction since the 1961-62 fiscal year. From 1982-83 through 1991-92, total spending increased at an annual rate of 8.1 percent (in current dollars) and, after adjusting for inflation, still grew by 5 percent annually.

Our review of the proposed budget for 1993-94 resulted in the following significant findings:



STATE FISCAL PICTURE

- **State Faces \$8.6 Billion Budget Gap.** The Governor's Budget addresses the two-year budget gap, primarily by shifting \$4.3 billion of costs to local governments and the federal government, and by program reductions totaling \$2.4 billion. (*Perspectives and Issues*, page 8.)

- ▶ **Budget Not a Workable Plan.** Some major budget proposals are presented only in outline form. The most significant example is the proposed \$2.6 billion property tax shift from local governments to schools, where only a small portion of the proposal has been detailed for the Legislature. The budget also faces a variety of large risks, primarily from pending judicial and federal actions. (*Perspectives and Issues*, page 19.)
- ▶ **Off-Budget Transactions Add \$2 Billion to State's Future Liabilities.** State support for schools in the current year and 1993-94 would include a total of \$1.5 billion in off-budget "loans" against future Proposition 98 funding requirements. The state also plans to defer payment of \$600 million of sales tax refunds required by a court decision. These off-budget transactions would leave the General Fund with a future liability of \$2 billion at the end of 1993-94. (*Perspectives and Issues*, page 14.)
- ▶ **No Cushion Available in 1994-95.** The outlook for 1994-95 is for only modest revenue growth. Thus, the bulk of the budget solutions adopted for 1993-94 must be ongoing. Furthermore, there is no cushion in 1994-95 to absorb a carry-over deficit or cost deferrals from 1993-94. (*Perspectives and Issues*, page 18.)

**PERSPECTIVES ON THE
ECONOMY AND REVENUES**

- ▶ **Cautious California Economic Outlook Justified.** Historically, U. S. employment growth has been the major determinant of California employment growth. The budget's cautious forecast of a much slower than average California recovery is reasonable, given the state's rapid decline in defense-related employment, adjustments to an overbuilt or overpriced real estate market, and a variety of regulatory issues. (*Perspectives and Issues*, page 37.)

- ▶ **Tax Changes Explain Most of Revenue Declines.** The projected \$1.1 billion (2.6 percent) decline in tax revenues from fiscal 1992-93 to 1993-94 is primarily attributable to the end of the temporary half-cent sales tax rate and the reinstatement of the net operating loss deduction for businesses. (*Perspectives and Issues*, page 43.)
- ▶ **Forecast is Reasonable.** The budget's revenue forecast is not as optimistic as it has been in the past two years. The forecast provides a reasonable basis for the Legislature to proceed with its budget-planning efforts. (*Perspectives and Issues*, page 53.)

**PERSPECTIVES ON
STATE EXPENDITURES**

- ▶ **Transportation and Corrections Programs Fare Best, Higher Education and Welfare Programs Fare Poorest.** The budget increases spending for transportation and corrections programs by roughly 8 percent in 1993-94. Funding for higher education and welfare programs (after adjusting for shifts to local and federal funds) declines by 8.2 percent and 4.4 percent, respectively. (*Perspectives and Issues*, page 66.)
- ▶ **Property Tax Shift Would Reduce Services Provided by Local Governments.** The Administration's proposal to shift \$2.6 billion in property taxes from local governments to K-14 districts would significantly reduce traditional municipal programs—and may discourage local governments from approving new land developments. (*Perspectives and Issues*, page 82.)

**RESTRUCTURING
CALIFORNIA GOVERNMENT**

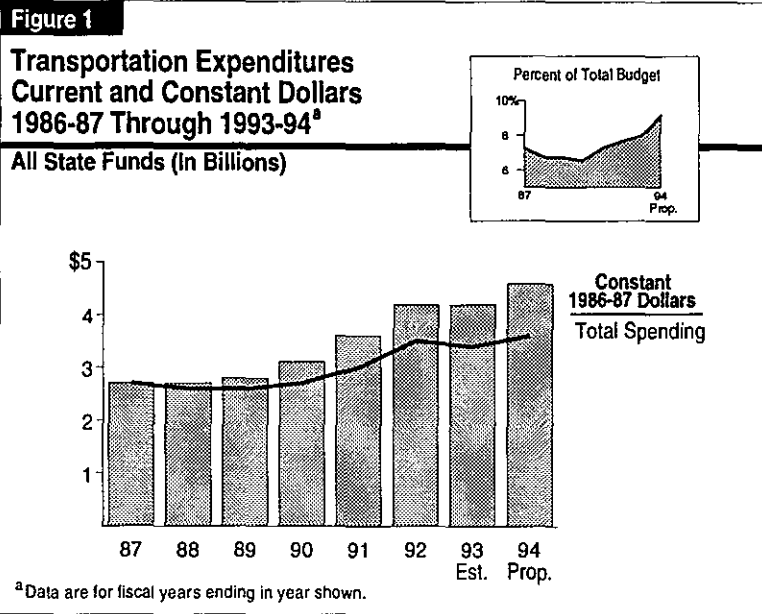
- ▶ **What is Governmental Restructuring?** We examine what restructuring is and what's involved in doing it, and suggest strategies for the Legislature to pursue in considering restructuring proposals. (*Perspectives and Issues*, page 101.)

- ▶ **Making Government Make Sense.** California's existing "system" of government is dysfunctional. A fundamental reorganization of state and local government responsibilities is required in order to fix the problem. We offer a model for restructuring the state-local relationship which would enable the public to hold government accountable for results. The level of government responsible for program operations would determine how best to carry out its responsibilities. We recommend that the Legislature proceed to develop a plan for its implementation. (*Perspectives and Issues*, page 111.)

TRANSPORTATION

State fund expenditures for transportation programs are proposed to be higher in 1993-94. The budget proposes total state expenditures of about \$4.6 billion for transportation programs in 1993-94. This is an increase of \$354.3 million, or 8.4 percent, over estimated expenditures in the current year.

Figure 1 shows that state-funded transportation expenditures increased by \$1.9 billion since 1986-87, representing an average annual growth of 7.6 percent. When adjusted for inflation, these expenditures increased by an average of 4.2 percent annually.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

DEPARTMENT OF TRANSPORTATION

- **Increased Revenues Should Be Used to Close Transportation Funding Gap.** The state faces a \$4.1 billion funding gap in its transportation program between now and 1998-99. We consider several options for closing the funding gap, and conclude that the option which makes the most sense is to increase revenues, relying on various user fees and pricing strategies. The revenue increases should have a

delayed operative date based on when cash is needed. (*Analysis*, page A-18.)

- ▶ **Caltrans Will Not Construct \$748 Million Worth of Projects Due to Lack of Funds.** Based on recent estimates of available state and federal funds, Caltrans believes there will not be sufficient funds to construct all the highway projects scheduled for delivery in 1993-94. Consequently, Caltrans estimates that the construction of about \$748 million in projects will be deferred into 1994-95. (*Analysis*, page A-37.)
- ▶ **Caltrans Cuts Back Project Development Staff.** The department proposes to reduce staff for project design and development in anticipation of increased efficiencies in the department. Project delivery could suffer if the efficiencies are not achieved. (*Analysis*, page A-36.)
- ▶ **Headquarters Staff Should Be Reduced.** The department proposes virtually the same level of headquarters staff in the current year, even though project development staff are declining. We recommend that headquarters staff be reduced by 127 personnel-years (\$9.6 million) to correspond with fewer project development staff and a lower workload. (*Analysis*, page A-37.)
- ▶ **Transit Capital Improvement (TCI) Program Should Be Abolished.** Recent changes in transit funding call into question the need for a separate TCI Program. We recommend ending the program and transferring funding to the Flexible Congestion Relief Program in order to improve state fiscal flexibility while providing the same amount of funding for transit improvement. (*Analysis*, page A-42.)

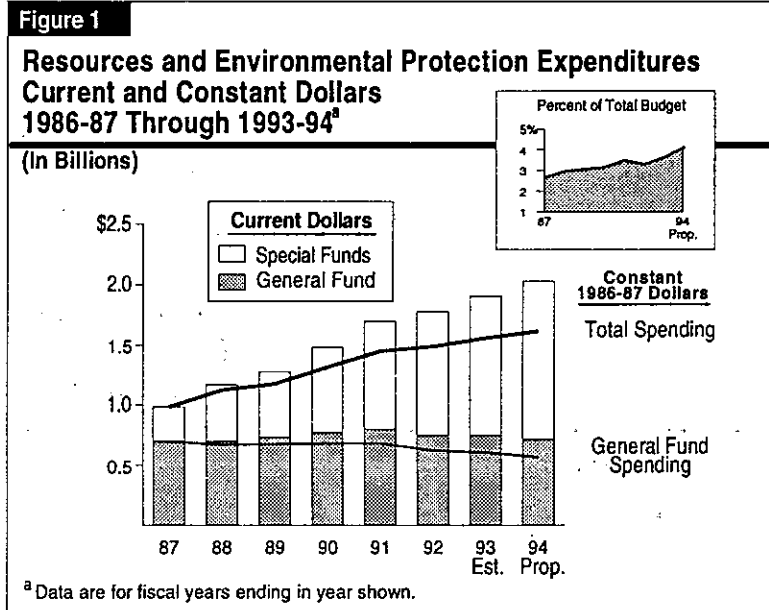
- ▶ **High-Speed Rail Study Goes Beyond Legislative Direction.** Caltrans has decided, without legislative direction, to focus exclusively on high-speed rail development in the Los Angeles-San Francisco corridor, instead of comparing the feasibility of developing other corridors. We recommend that the Legislature reduce funding for the study and enact legislation to set policy and programmatic guidelines for development of high-speed rail in the state. (*Analysis*, page A-46.)

RESOURCES

The proposed expenditure level for resources and environmental protection programs is moderately higher than estimated current-year expenditures. Expenditures for resources and environmental protection programs are proposed to total \$2 billion in 1993-94, which is an increase of approximately \$120 million, or 6.3 percent over estimated expenditures for the current year.

Figure 1 shows that resources and environmental protection expenditures from all state funds increased by approximately \$1 billion since 1986-87,

representing an average annual increase of approximately 11 percent. This increase primarily reflects the establishment of various programs to address environmental problems (such as leaking underground tanks). When adjusted for inflation, these expenditures increased at an average annual rate of 7.3 percent.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

DEPARTMENT OF CONSERVATION

- ▶ **Recycling Program Should Be Transferred to Waste Board.** We recommend enactment of legislation to transfer the recycling program from the Department of Conservation to the Integrated Waste Management Board in 1993-94, because the board is responsible for all other waste recycling programs, and consolidation

RESOURCES—CONTINUED

with the board should improve coordination of state recycling efforts. (*Analysis*, page B-36.)

DEPARTMENT OF FISH AND GAME

- ▶ **Natural Community Conservation Plan (NCCP) Program Increase Not Justified.** We recommend a reduction of \$933,000 requested to fund continued development of the state's first NCCP because (1) the proposal does not include sufficient fee reimbursements as required by current law and (2) an increase in funding is not justified because the Department of Fish and Game has not provided program information requested by the Legislature. (*Analysis*, page B-48.)

ENVIRONMENTAL PROTECTION

- ▶ **Several Resources and Environmental Protection Programs Should Be Funded From Fees.** Several resources and environmental protection programs are more appropriately funded from fees, rather than from the General Fund. Consequently, we recommend the enactment of legislation setting fees for powerplant siting, fire protection, timber harvest regulation, air pollution control, and water quality/water rights regulation. (*Analysis*, pages B-28, B-35, B-43, B-44, B-58, B-65, and B-69.)
- ▶ **Special Fund Reserves Need to Be Increased.** The proposed reserves for several special funds in the environmental protection programs are not sufficient to address potential revenue shortfalls or unanticipated expenditures. We recommend the Air Resources Board, Integrated Waste Management Board, and Department of Toxic Substances Control submit plans for reducing expenditures or increasing revenues to establish reasonable special fund reserves at the end of 1993-94. (*Analysis*, pages B-60, B-61, and B-72.)

- ▶ **Water Rights Program Backlogs Need to Be Reduced.** There are backlogs in the State Water Resources Control Board's program for issuing and enforcing permits to use water. These backlogs (1) reduce the board's abilities to ensure that water is properly used without harm to other users and the environment and (2) slows business development and growth in the state. We recommend that the board submit a plan for addressing these backlogs. (*Analysis*, page B-66.)



HEALTH & SOCIAL SERVICES

General Fund expenditures for health and social services programs are proposed to decrease in the budget year, primarily due to (1) shifting some of the state's costs to the federal government, (2) reductions in welfare grants, and (3) elimination of certain optional benefits in the Medi-Cal Program. The budget proposes General Fund expenditures of \$12.6 billion for health and welfare programs in 1993-94, which is a reduction of \$643 million, or 4.9 percent, from estimated current-year expenditures.

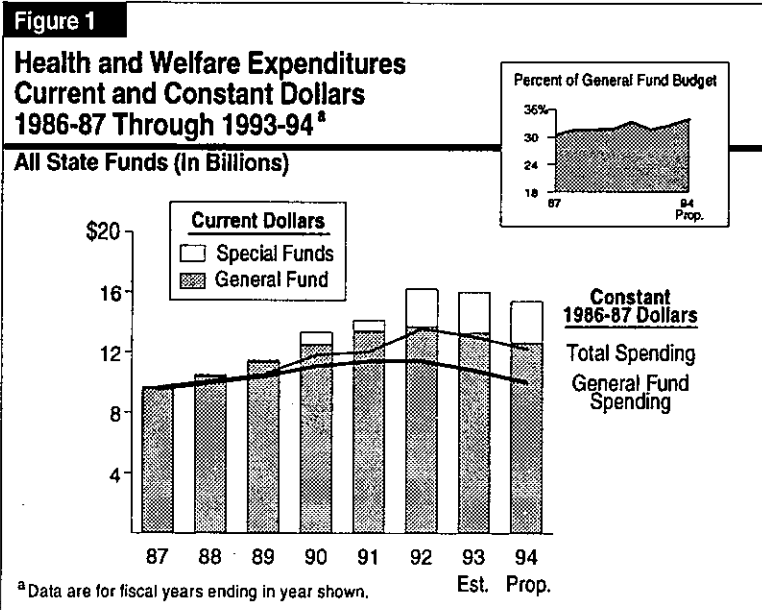


Figure 1 shows that General Fund expenditures for health and social services programs are projected to increase by \$3 billion, or 32 percent, between 1986-87 and 1993-94. This is an average annual increase of 4 percent. When adjusted for inflation, these expenditures increased at an average annual rate of less than 1 percent.

Our review of the proposed budget for 1993-94 resulted in the following significant findings:

CROSSCUTTING ISSUES

- ▶ **Assuming Federal Reimbursement for Immigration-Related Costs Entails Risk of Budget Shortfall.** There is a substantial risk that the \$1.6 billion in additional federal funds (General Fund savings of \$1.4 billion) assumed in the budget for immigration-related costs will not be provided. Consequently, we recommend that the Legislature review the Governor's contingency plan to address this potential shortfall and develop an

plan to address this potential shortfall and develop an alternative plan based on its own policy priorities. (*Analysis*, page C-15.)

- ▶ **Recommend Legislation to Facilitate Collaborative Efforts to Coordinate Service Delivery.** A wide variety of state and local collaborative efforts to coordinate the delivery of public services, particularly to low-income target groups, have recently been undertaken. We review some of these efforts, identify common elements of success, and recommend legislation to (1) provide planning and operational grants for community-based collaborative efforts, (2) allocate a portion of existing categorical funds as block grants to local governments, and (3) conduct long-term evaluations of these demonstrations. (*Perspectives and Issues*, page 133.)

MEDI-CAL PROGRAM

- ▶ **Major Expansion of Managed Care Is Premature.** The Department of Health Services (DHS) proposes to expand managed care arrangements to serve nearly half of all Medi-Cal beneficiaries by the end of 1993-94. We recommend that the expansion not occur until the Legislature has reviewed the department's expansion plan. We also identify several key issues that the Legislature should address in reviewing the plan. (*Analysis*, page C-52.)
- ▶ **Prepaid Health Plan Rates Need Review.** The department proposes a \$16 million rate increase for the CIGNA Health Plan, but does not propose to adjust rates for other plans. We recommend that the Legislature reject the proposed increase because it has not been justified. We further recommend that the Legislature direct the department to adjust rates for all plans, which would result in an estimated General Fund savings of \$23 million. (*Analysis*, page C-55.)

- ▶ **Budget Proposes Elimination of Nine Optional Benefits.** This proposal, to be effective March 1, 1993, would result in total General Fund savings of \$219 million in the Medi-Cal Program in the current and budget years. We recommend that the department report on the magnitude of increased hospitalizations that may occur as a result of eliminating the optional benefits. (*Analysis*, page C-59.)
- ▶ **New Hospital Reimbursement System Could Achieve Major Savings.** The Medi-Cal Program spends 36 percent of its budget on inpatient hospitalization, reimbursing hospitals for each day a beneficiary is hospitalized. In lieu of a per day reimbursement rate, we recommend that reimbursements be based on the patient's diagnosis. Ultimately, this approach could result in major General Fund savings—potentially in the range of \$100 million annually. (*Analysis*, page C-61.)
- ▶ **Medi-Cal Subsidy of University of California (UC) Hospitals Is Unnecessary.** Currently, UC hospitals receive federal "disproportionate-share" payments intended to compensate them for serving a large number of indigent persons. We recommend that the UC hospitals receive the *minimum* federal payment allowed under state law because the hospitals are profitable without the Medi-Cal subsidy; the UC hospital system is expected to generate a net revenue gain of 4 percent *without* the subsidy. Adoption of our recommendation would result in General Fund savings of about \$26 million in the budget year. (*Analysis*, page C-64.)
- ▶ **Additional Federal Funds Available.** Currently, California is not claiming federal reimbursements for a state program that provides Medi-Cal services to pregnant women with family incomes between 185 percent and 200 percent of the poverty level, even though federal law authorizes such reimbursements. We recommend that the Legislature (1) direct the DHS

to claim these reimbursements and (2) redirect the \$7.9 million of Proposition 99 funds currently budgeted for these services to replace General Fund monies budgeted for other programs. (*Analysis*, page C-67.)

PUBLIC HEALTH

- ▶ **Budget Assumes No Savings From the Direct Purchase Vaccine Program.** Because the first phase of the program will be operational by July 1993, we estimate that a savings of up to \$1.9 million will be realized in the budget year. We recommend that these savings be redirected to implement activities designed to increase immunization levels among children who are most at risk of not being adequately immunized. We also recommend that, to the extent additional federal Maternal and Child Health funds are received in the budget year, up to \$700,000 of these funds be allocated for immunization activities. (*Analysis*, page C-69.)

**MAJOR RISK MEDICAL
INSURANCE BOARD**

- ▶ **Access for Infants and Mothers (AIM) Program May Have Significant Unexpended Balances.** The AIM Program provides perinatal health insurance coverage for pregnant women who are not eligible for Medi-Cal. While additional data are needed to assess the effect of a new outreach campaign, we estimate that, even if program enrollments increase by 20 percent, unexpended balances at the end of the budget year will amount to \$15 million from the Cigarette and Tobacco Products Surtax Fund (Proposition 99). Consequently, we recommend that these balances be redirected to replace General Fund monies currently budgeted for other programs. (*Analysis*, page C-97.)

**AID TO FAMILIES WITH
DEPENDENT CHILDREN
(AFDC) PROGRAM**

- ▶ **AFDC Caseload Likely to Be Lower Than Budget Projections.** Based on an analysis of recent data, the budget may significantly overestimate AFDC Program costs. We estimate that General Fund costs could be \$19 million lower in the current year and \$43 million lower in the budget year. (*Analysis*, page C-108.)

**WELFARE POLICY
PROPOSALS**

- ▶ **Budget Proposes Major Welfare Policy Changes.** The budget assumes that these changes—including AFDC grant reductions—will be effective March 1, 1993. The net General Fund savings would amount to \$32 million in 1992-93 and \$467 million in 1993-94. We believe, however, that it is unrealistic to assume implementation by March 1; and, we find that a delay of even a few months would reduce the savings substantially, both in the current and budget years. We also review the budget proposals and present several alternatives for consideration by the Legislature. (*Analysis*, page C-110.)

**IN-HOME
SUPPORTIVE SERVICES
(IHSS) PROGRAM**

- ▶ **Additional IHSS Recipients Could Be Eligible for Federal Reimbursements Under the Personal Care Option.** The department's plan to obtain additional federal Medicaid reimbursements due to implementation of the Personal Care Option does not include a certain category of IHSS recipients—generally, those who meet SSI/SSP eligibility criteria but are not receiving cash grants. Consequently, we recommend that the department

amend its regulations to include these recipients. We estimate that this would generate an additional \$8 million in federal funds, resulting in a corresponding General Fund savings. (*Analysis*, page C-147.)

JUDICIARY & CRIMINAL JUSTICE

Expenditures for judiciary and criminal justice programs are proposed to decrease slightly in the budget year, primarily due to the assumption that the state will receive federal funds to offset the costs of incarcerating undocumented immigrants in state prison. The budget proposes General Fund expenditures of \$3.8 billion for judiciary and criminal justice programs in 1993-94, a reduction of \$120 million, or 3 percent, below estimated expenditures in the current year.

Figure 1 shows that judiciary and criminal justice expenditures from the General Fund increased by \$2.2 billion since 1986-87, representing an average annual increase of 11 percent. On an inflation adjusted basis, this represents an average annual increase of 7.5 percent.

Our review of the proposed budget for 1993-94 resulted in the following significant findings:

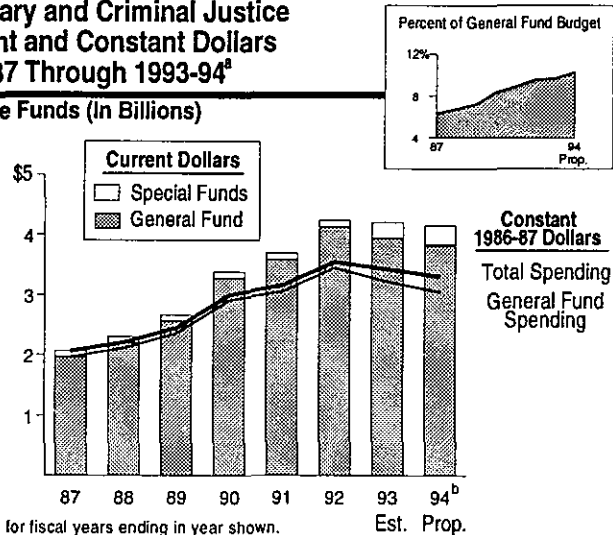
DEPARTMENT OF CORRECTIONS

- ▶ **Assuming Federal Reimbursements for Incarceration of Undocumented Immigrants Entails Risks.** The budget assumes that the state will receive \$250 million in additional federal funds to offset the costs of incarcerating undocumented immigrants who have been convicted of felonies. There is substantial risk that the federal funds will not be provided, however. We recommend that the Legislature review the

Figure 1

**Judiciary and Criminal Justice
Current and Constant Dollars
1986-87 Through 1993-94^a**

All State Funds (In Billions)



^a Data are for fiscal years ending in year shown.
^b Assumes receipt of \$250 million in federal funds.

Governor's contingency plan to address such a potential shortfall and develop an alternative plan, based on its own priorities. (*Analysis*, page D-15.)

- ▶ **Prison Inmate Population Continues to Grow.** The Department of Corrections projects that the prison population will increase at an average annual rate of about 5.2 percent, reaching 141,000 inmates by 1997-98. There are, however, a number of potential risks that could result in substantial changes in these projections. (*Analysis*, page D-22.)
- ▶ **Legislature Should Consider Measures to Reduce Prison Population.** A number of studies have raised questions about the benefits of incarceration for certain types of offenders, and whether incarceration has much impact on reducing crime. We recommend that, as the Legislature looks for ways to solve the state's overall fiscal problem, it consider various options (particularly options that target nonviolent offenders) for controlling the growth in the prison and parole populations. The options we present could reduce prison costs by up to \$227 million in 1993-94. (*Analysis*, page D-30.)
- ▶ **New Alternative Sentencing Program Behind Schedule.** The new boot-camp style "shock incarceration" program is significantly behind schedule. We recommend a number of changes to improve the implementation of the program. (*Analysis*, page D-39.)
- ▶ **Questionable Payments to Local Return-to-Custody Operators.** Recent audits have raised a number of questions about state payments to local governments that operate facilities to house state inmates. We recommend that the Department of Corrections report on its plan to recover \$1.9 million in unallowable and questionable costs by the City of Shafter, and that the department review the financial records of facilities in other cities. (*Analysis*, page D-43.)

- ▶ **Civil Addict Program Should Be Eliminated.** We recommend that legislation be enacted to eliminate the program because it has failed to provide substantive treatment services for committed nonfelon narcotic addicts. (*Analysis*, page D-48.)
- ▶ **Budget Proposes Inappropriate Use of Bond Funds.** The budget proposes to spend \$16.2 million in bond funds for administrative support positions and recurring maintenance. We recommend that the Legislature deny the request because it represents an inappropriate expenditure of these funds. (*Analysis*, page D-52.)

DEPARTMENT OF THE
YOUTH AUTHORITY

- ▶ **Ward Population to Increase Steadily.** Following several years of declines, the ward population is expected to increase steadily, reaching 10,000 wards by 1996-97. Among the reasons for the increase is the increasing number of juveniles admitted to the Youth Authority for violent offenses. (*Analysis*, page D-55.)
- ▶ **Closure of County Probation Camps Could Have Significant Effect on Youth Authority.** Recent announcements that some counties (particularly Los Angeles County) plan to close some or all of their juvenile probation camps could result in a significant increase in the number of wards admitted to the Youth Authority. We recommend that the Administration consider the impact of the closures on its ward and parole population when developing the May revision. (*Analysis*, page D-61.)
- ▶ **Special Education Programs Remain Out of Compliance with Federal Law.** We recommend that the Youth Authority report to the Legislature on its efforts to come into compliance with federal requirements for special education, as well as the status of a court

judgment against the department on the issue. (*Analysis*, page D-64.)

TRIAL COURT FUNDING

- ▶ **Budget Proposal Falls Short of Legislative Intent.** Although the Legislature expressed its intent to support 60 percent of trial court costs in 1993-94, the proposed budget will support only 46 percent. In order to fund the program at the 60 percent level, the budget would have to be augmented by about \$218 million. (*Analysis*, page D-70.)
- ▶ **Trial Court Funding Program Has Not Met Expectations.** The Legislature expressed three goals when it established the program: (1) increase state funding for the trial courts, (2) transfer local court revenues to the state for a net benefit to the General Fund, and (3) improve the public's access to justice through implementation of efficiencies and cost savings measures. Based on our review, we conclude that these goals have not been met. As a result, the Legislature needs to assess whether to continue the program. (*Analysis*, page D-73.)

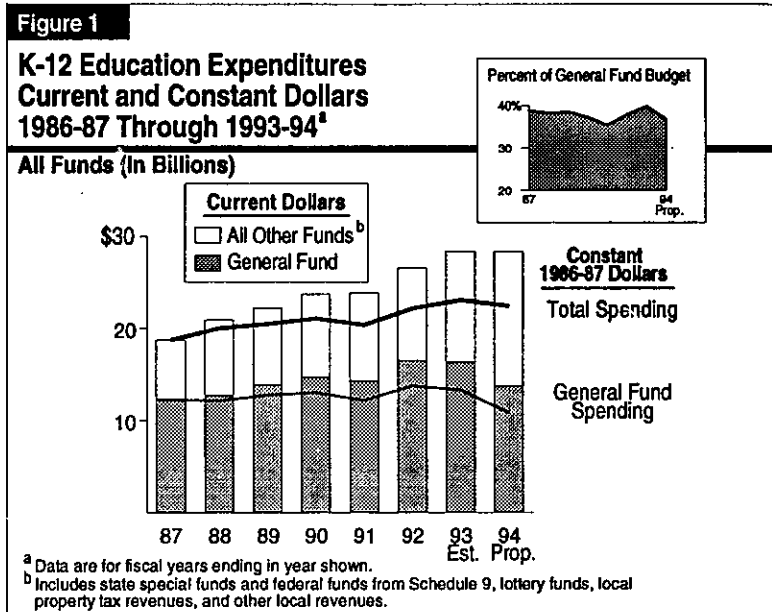
DEPARTMENT OF JUSTICE

- ▶ **Local Governments Should Pay for Support of Criminalistic Laboratories.** We recommend that local law enforcement agencies reimburse the state for services provided by these laboratories, because the benefits accrue to the local governments. This would result in General Fund savings of \$7.5 million. (*Analysis*, page D-81.)

K-12 EDUCATION

The K-12 education budget reflects a substantial General Fund reduction of \$2.6 billion due to a proposal to shift \$2.2 billion in local property tax revenues to schools from other local government entities. The budget proposes expenditures of \$28.3 billion from all sources for K-12 education in 1993-94, including \$13.7 billion from the General Fund. This is \$70 million, or 0.2 percent, less than estimated expenditures from all sources in the current year.

Figure 1 shows that K-12 education expenditures from all sources have increased by \$9.6 billion since 1986-87, representing an average annual increase of 6 percent. When these figures are adjusted for inflation, spending increased by an average of 2.6 percent annually.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

PROPOSITION 98

- **Proposition 98: Budget Maintains K-12 Per-Pupil Funding.** Significant Proposition 98 proposals include (1) a shift of \$2.6 billion in local property tax revenues to schools from other local government entities, (2) a \$540 million loan to maintain K-12 per-pupil spending at the 1992-93 level, (3) a \$266 million unallocated reduction in community college spending, and (4) deferral of a \$121 million community college loan repayment. (*Analysis*, page E-17.)

K-12 EDUCATION—CONTINUED

K-12 BUDGET PRIORITIES

- ▶ **Loan Poses a Threat if the Economy Improves More Slowly Than Anticipated.** Under the Department of Finance's General Fund forecast, Proposition 98 funding will support current baseline expenditures (\$4,220 per pupil in K-12 programs) in both 1993-94 and 1994-95. If the economy improves more slowly than forecast, however, additional loans totaling \$1 billion will be needed to maintain baseline spending in the two years. We recommend that the Legislature take action to minimize budget-year borrowing, in order to increase the state's ability to fund K-12 program needs in 1994-95 and increase the probability that schools will receive cost-of-living adjustments and program augmentations beginning in 1995-96. (*Analysis*, page E-24.)
- ▶ **Budget Reduces Per-Pupil General-Purpose Spending.** Proposed 1993-94 general-purpose funding for school districts is \$260 million less than necessary to maintain per-pupil spending at the level funded in 1992-93. (Overall K-12 per-pupil funding is constant despite this reduction due to offsetting increases in categorical, or special-purpose, programs.) We recommend that the Legislature reallocate funds among Proposition 98 programs in order to increase per-pupil general-purpose funding to the currently funded level. (*Analysis*, page E-21.)

CATEGORICAL PROGRAMS AND THE MEGA-ITEM

- ▶ **Mega-Item Proposal Misses the Mark.** The Governor's Budget proposes to give districts complete discretion to decide which categorical programs should receive funding during 1993-94. Our review of categorical programs indicates that increasing district program flexibility would yield greater productivity gains by allowing districts to provide services in a way that best meets student needs. Accordingly, we recommend

elimination of the mega-item and restoration of separate appropriations in the budget. (*Analysis*, page E-42.)

- ▶ **Categorical Program Consolidation Warranted.** Despite our recommended rejection of the proposed mega-item flexibility, we believe considerable benefits will accrue from strategic consolidation of categorical programs. We recommend consolidation of 19 existing programs into three block grants: a School Improvement Block Grant, a School Incentives Award Program, and a High School "At-Risk" Block Grant. (*Analysis*, page E-44.)

SPECIAL EDUCATION

- ▶ **Special Education Overbudgeted by \$17 Million.** Due to two technical errors, the Department of Finance overbudgeted the amount of resources available to special education programs by \$17 million in 1993-94. (*Analysis*, page E-62.)

OTHER ISSUES

- ▶ **Grants for Year-Round Schools Exceed State's Avoided Costs.** The state avoids much less in school construction costs through year-round school operations than it pays out to school districts in year-round operating grants. We recommend a reduction of \$26.3 million in year-round operation grants to make the level of the grants consistent with a realistic estimate of the state's avoided costs. (*Analysis*, page E-76.)

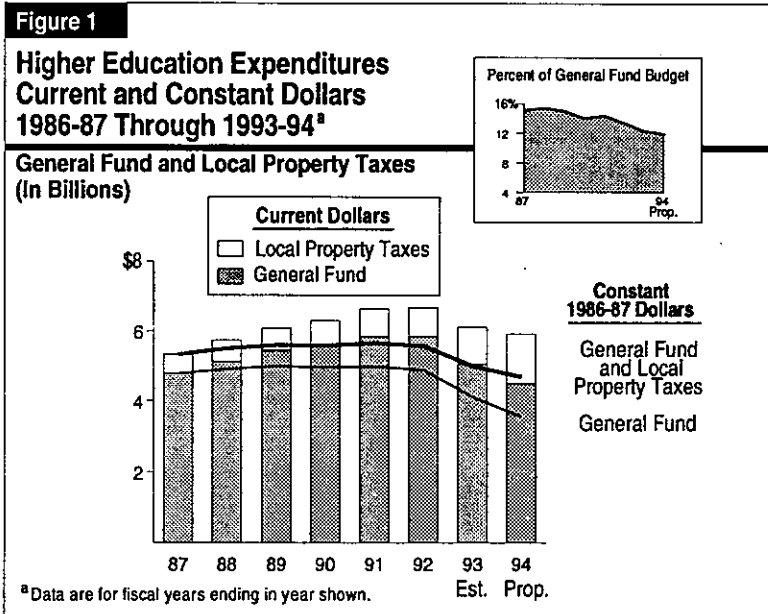


By _____
Special Agent in Charge

HIGHER EDUCATION

The budget contains major unallocated spending reductions for all higher education segments. The budget proposes General Fund expenditures of \$4.5 billion for higher education in 1993-94. This is \$576 million, or 11 percent, less than estimated expenditures in the current year.

Figure 1 shows that higher education expenditures from the General Fund have decreased by \$309 million since 1986-87, representing an average annual decrease of 0.9 percent. When adjusted for inflation, General Fund spending decreased over this time period by an average of 4.2 percent annually.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

BUDGET GAP IN HIGHER EDUCATION

- **Difficult Choices Left to Legislature.** For the University of California (UC) and the California State University, the budget proposes unallocated General Fund reductions of \$135 million (7.2 percent) and \$68 million (4.5 percent), respectively. The budget does not contain any information on (1) how the segments will accommodate the budget reductions, (2) enrollment levels in 1993-94, or (3) levels of fee increases related to the 1993-94 budget. (*Analysis*, page F-17.)

HIGHER EDUCATION—CONTINUED

UNIVERSITY OF CALIFORNIA

- ▶ **Deficit Financing of the UC's Current Budget Is Ill-Advised.** The regents currently plan to borrow up to \$70 million from a private bank to balance the UC's 1992-93 budget. This loan would be paid off over a five-year period with student fee revenue. We recommend that the UC use unexpected revenue gains from its teaching hospitals—available as a result of enactment of SB 855 (Ch 279/91, Robbins)—on a one-time basis to avoid the current-year loan. (*Analysis*, page F-33.)

CALIFORNIA COMMUNITY COLLEGES

- ▶ **Unallocated Reduction of \$266 Million (10 Percent) Proposed at the Community Colleges.** The budget proposes to authorize the Board of Governors to increase fees from \$10 to up to \$30 per credit unit, to offset all or part of the reduction. Due to pressures in other areas of the budget, the Legislature may conclude that a significant General Fund reduction is unavoidable. (*Analysis*, page F-52.)
- ▶ **Legislature Should Review Policies Affecting Community College Enrollment.** For practical purposes, "open access" cannot be achieved, given the current budget situation. We identify several enrollment priority and fee increase strategies that would maintain the community colleges' mission to the maximum extent possible. (*Analysis*, page F-43.)
- ▶ **Impact of New BA Fee.** Less than 5 percent of community college full-time-equivalent students are affected by the new \$50 per unit fee that took effect in January 1993. About 66 percent of BA degree holders have household incomes of \$25,000 or more. Since most take either one or two courses per semester, it seems reasonable that they could afford the roughly

\$150 to \$300 per semester in fees. To reduce the effect of the fee on poorer students, we recommend that the Legislature enact legislation broadening the fee exemption for dislocated workers. (*Analysis*, page F-55.)

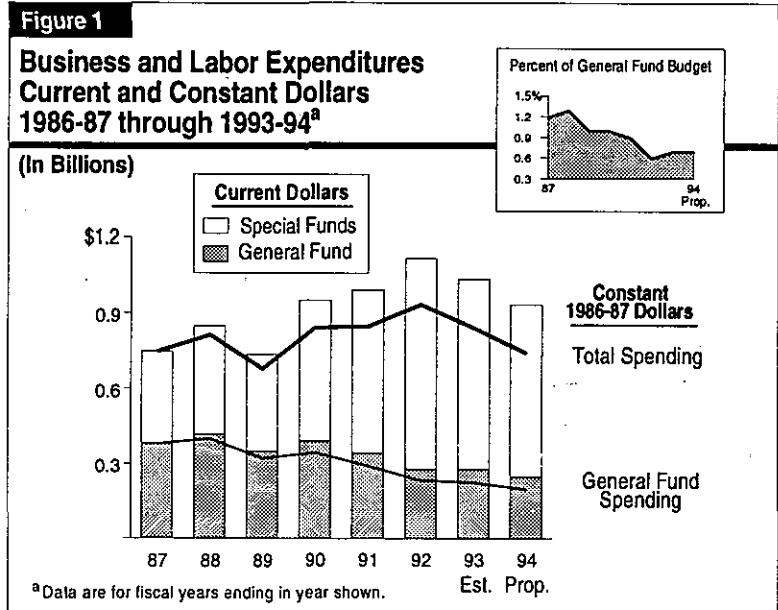
**STUDENT AID
COMMISSION**

- ▶ **Time to Reevaluate the Cal Grants Program.** Since 1990-91, the number of students who are eligible for the Cal Grants financial aid program has increased significantly due to federal law changes, increased higher education fees, the state's economy, and other factors, while program funding has decreased. The Legislature may wish to refocus the goals of the program to target, for example, students with the highest financial need. (*Analysis*, page F-65.)

BUSINESS & LABOR

Expenditures for business and labor programs in 1993-94 are proposed to decline, primarily because of the reduced need for expenditures for disaster relief associated with the Loma Prieta earthquake and the termination of the earthquake insurance program. The budget proposes total state expenditures of \$934 million for business and labor programs in 1993-94. This level of spending is a decrease of \$100 million, or 9.7 percent from the estimated current-year expenditures.

Figure 1 shows that state expenditures for business and labor programs increased by nearly \$200 million between 1986-87 and 1993-94. This represents an average annual increase of 3.1 percent. When these expenditures are adjusted for inflation, total spending has decreased by an average of 0.1 percent annually.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

CROSSCUTTING ISSUES

- **Restructure Consumer-Related Boards and Commissions.** California currently has 27 separate consumer-related boards and bureaus within the Department of Consumer Affairs, and three others located outside the department. This fragmented regulatory approach limits the state's effectiveness and efficiency in protecting consumers. We recommend that the Legislature (1) eliminate all separate boards and bureaus as independent entities and (2) remove

the state's regulatory role over 13 consumer-related business activities, resulting in a \$33 million special fund savings in 1993-94. (*Analysis*, page G-11.)

- ▶ **Consumer-Related Regulatory Programs Should Demonstrate Effectiveness.** The Legislature needs to ensure that each consumer-related regulatory program is adequately addressing the Legislature's goals and objectives. We conclude that the boards and bureaus should provide information that demonstrate their effectiveness at budget hearings or at joint hearings involving the policy committees and the appropriate budget subcommittees. (*Analysis*, page G-16.)

**STATE FINANCIAL
REGULATORY PROGRAMS**

- ▶ **Regulation of Financial Services Should Be Consolidated.** The state's current regulation of certain financial services programs (such as those provided by savings and loans, banks, and credit unions) is divided among four departments and is uncoordinated. We recommend enactment of legislation to establish a new Department of Financial Services, which would consolidate the State Banking Department, the Department of Savings and Loan, the lending and fiduciary programs of the Department of Corporations, and the mortgage brokering program under the Department of Real Estate. (*Analysis*, page G-19.)

**DEPARTMENT OF HOUSING
AND COMMUNITY
DEVELOPMENT**

- ▶ **Disaster Program Costs Should Be Reduced.** We recommend that the Legislature enact legislation shifting more of the burden for disaster insurance from the state to property owners. (*Analysis*, page G-24.)

- ▶ **Housing Element Law Needs Fundamental Reform.** We recommend that the Legislature enact legislation substantially revising current housing element law, because it is not fulfilling its stated objectives. (*Analysis*, page G-26.)
- ▶ **Mobilehome Fee Increase Included in Budget.** Contrary to the Governor's assertions that the budget does not include fee increases, the budget proposed for the HCD presumes fee increases totaling \$1.9 million. We recommend that the HCD explain its rationale at budget hearings. (*Analysis*, page G-28.)

DEPARTMENT OF
SAVINGS AND LOAN

- ▶ **State-Chartered Savings and Loans Should Be Terminated.** The decline in the number of state-chartered savings and loan associations, coupled with extensive federal regulation and enforcement, eliminates the need to continue a state-charter program. Consequently, we recommend the Legislature enact legislation terminating this program. (*Analysis*, page G-36.)

TRADE AND COMMERCE
AGENCY

- ▶ **Information Needed on Strategic Technology Program.** The agency has requested \$8.2 million from the General Fund for a program to create jobs and assist in industry conversions. The agency, however, has not provided the Legislature information regarding the specific objectives, components, implementation schedule, and anticipated benefits of the \$8.2 million requested for this program. The agency should provide this information prior to legislative action on this request. (*Analysis*, page G-39.)

- ▶ **Proposed Contracts Need to Be Justified.** The agency has requested \$8.8 million, primarily for external contracts for services concerning business and tourism promotion and assistance to small business. The agency, however, has not provided any information to clarify and justify this request. The Legislature should not act on this request until the agency has provided information regarding the specific benefits anticipated from these expenditures. (*Analysis*, page G-40.)

- ▶ **Appropriation for Small Business Loan Program Should Be in Legislation.** The proposed \$2 million General Fund appropriation is part of—and contingent upon enactment of—separate legislation to expand and restructure the program. Thus, we recommend that the Legislature delete the proposed appropriation because (1) the Legislature should review the proposal in its entirety, including all fiscal and policy implications when the required legislation is considered, and (2) any necessary funding should be included in the legislation required to expand and restructure the program. (*Analysis*, page 41.)

- ▶ **No Justification Provided for Reclassified and New Positions.** The Legislature has not been provided with justification for the proposed reclassification of existing positions and the establishment of new positions in the Trade and Commerce Agency. In addition, the legislation that created this agency requires that the agency be funded from existing resources of the entities merged into the new agency. For these reasons, we recommend that the Legislature delete the \$796,000 General Fund appropriation requested to fund these personnel changes. (*Analysis*, page G-43.)

**DEPARTMENT OF FOOD
AND AGRICULTURE**

- ▶ **Responsibility for the Agricultural Export Program Should Be With the Trade and Commerce Agency.** The California Agricultural Export Program, within the Department of Food and Agriculture, duplicates the responsibilities of the new Trade and Commerce Agency. Therefore, we recommend elimination of this program because the program activities should be subsumed by the Trade and Commerce Agency, for a General Fund savings of \$605,000. (*Analysis*, page G-45.)

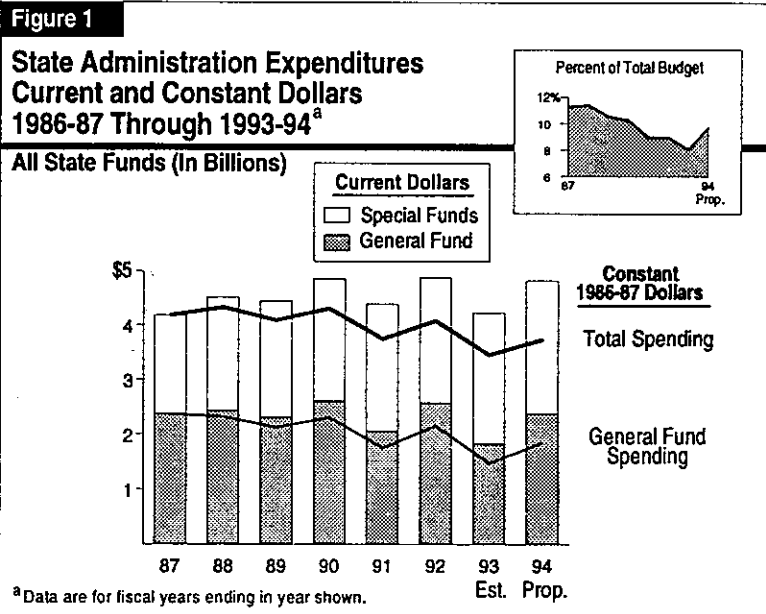


STATE ADMINISTRATION

Funding for state administration is proposed to increase in the budget year, primarily due to higher costs of retirement benefits and employee compensation. The budget proposes expenditures for state administration of \$4.8 billion, an increase of about \$586 million, or 14 percent, over estimated current-year expenditures.

Figure 1 shows that expenditures for state administration from all state funds have fluctuated moderately within the range of \$4.2 billion and \$4.9 billion during the period from 1986-87 through 1993-94.

When adjusted for inflation, total spending for state administration has actually decreased at an average annual rate of 1.6 percent.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

CROSSCUTTING ISSUES

- **State Tax Administration Agencies Should Be Consolidated.** A long-standing recommendation of the Legislative Analyst's Office has been to consolidate the existing tax administration functions of the Franchise Tax Board (FTB) and the Board of Equalization (BOE) into a new Department of Revenue. The Governor's Budget proposes that legislation be enacted to accomplish this reorganization. We recommend the enactment of legislation establishing the Department of Revenue and direct the FTB and BOE to begin

planning for consolidation in 1993-94. (*Analysis*, page H-14.)

**CONTRIBUTIONS TO
JUDGES' RETIREMENT
FUND**

- ▶ **Major Funding Shortfalls Require Changes to the Existing System.** We recommend enactment of legislation that reduces the General Fund cost of the existing judges' retirement system, including increasing judges' contributions, for a potential \$4.7 million General Fund savings in 1993-94. The Legislature also should consider options of (1) reducing benefits and (2) increasing court filing fees transferred to the Judges' Retirement Fund. Such additional steps could save the General Fund as much as \$10 million in 1993-94, and could produce major additional savings thereafter. (*Analysis*, page H-21.)
- ▶ **Create a New Retirement System for New Judges.** The state will spend more than \$50 million in 1993-94 to subsidize judges' retirement costs because judges' and employer contributions are inadequate. We recommend enactment of legislation to create a less costly retirement benefit plan for new judges that will be fully funded on an actuarially sound basis. (*Analysis*, page H-22.)

**PUBLIC EMPLOYEES'
RETIREMENT SYSTEM**

- ▶ **Legislation Needed to Clarify PERS Role.** Proposition 162—the California Pension Protection Act of 1992—appears to grant unprecedented authority to the PERS and other retirement systems in the state, but many important areas of authority are unclear. We recommend the enactment of legislation clarifying the extent to which public retirement systems, including the PERS, still are subject to state laws and the State

Constitution in the wake of the proposition. (*Analysis*, page H-25.)

- ▶ **Legislature Should Continue Oversight of the PERS Through the Budget Process.** The PERS may be correct in interpreting Proposition 162 as granting it authority to spend monies from its various trust funds without appropriations by the Legislature. The state's annual employer contributions to the PERS, however, are another matter. We recommend the enactment of legislation to require that the state's employer contributions to the PERS (estimated \$765 million in 1993-94) be reviewed and approved through the annual Budget Act. (*Analysis*, page H-27.)
- ▶ **Legislative Review of PERS Spending on Outside Investment Advisors Is Needed.** Over the last decade, this spending has grown dramatically, without any review through the budget process, to the point where such spending (estimated \$56 million in 1993-94) almost equals spending on all other aspects of PERS administration (\$62 million). Moreover, this spending has not produced clear results in the form of higher returns on investments. (*Analysis*, page H-32.)
- ▶ **Increase PERS Accountability to Employee Members.** We recommend the enactment of legislation to require periodic adjustment of employee contribution rates as one means to increase PERS management accountability to system beneficiaries, and to have cost changes shared equitably between employees and the state. (*Analysis*, page H-33.)

**STATE TEACHERS'
RETIREMENT SYSTEM**

- ▶ **General Fund Transfer to STRS Overbudgeted by \$16.6 Million.** The Governor's Budget overstates the amount of General Fund monies needed for transfer to the STRS in 1993-94. We recommend that the Legislature recognize the availability of these funds as

part of the Legislature's budget solution, for a General Fund savings of \$16.6 million. (*Analysis*, page H-39.)

► **Redefining the State's Role in Teachers' Retirement.** The state will spend as much as \$835 million in 1993-94 for teachers' retirement costs because teachers and school districts do not contribute enough to fund the actuarial costs of the teachers' benefit plan. In no other case is the state responsible for retirement costs for nonstate employees/retirees. We recommend the enactment of legislation to establish an alternative benefit plan for future entering members of the STRS that is fully funded by teacher and school district contributions on an actuarially sound basis. (Eventual General Fund savings of \$400 million annually, in today's dollars.) (*Analysis*, page H-40.)

► **Option to Reduce General Fund Expenditures in 1993-94.** The state is expected to spend \$226 million in 1993-94 on purchasing power benefit payments to qualifying retired teachers. Since this is a nonvested benefit, the Legislature has the option of suspending or reducing these payments in order to save General Fund monies in the budget year. (*Analysis*, page H-42.)

EMPLOYEE COMPENSATION

► **Legislature Has Option to Save More Than \$200 Million on State Employee Pay Increases.** As a result of legislation, the state is required to pay the estimated \$34 million in salary increases for correctional employees, scheduled to take effect June 30, 1993. However, the state has the option to not fund the salary increases for all other employees, due to take effect January 1, 1994. Thus, the Legislature has the option of saving more than \$200 million (\$100 million General Fund) by not appropriating funds for the other pay increases. (*Analysis*, page H-48.)

FRANCHISE TAX BOARD

- ▶ **Budget Ignores Administrative Consequences of Eliminating Renters' Credit.** The budget proposes to eliminate the Renters' Tax Credit program for the 1992 and 1993 tax years. We recommend that the Legislature act on this proposal *no later than mid-March* to alleviate potential short-term negative consequences that would result from adopting the proposal for the 1992 tax year. In addition, the Franchise Tax Board should report to the Legislature on the administrative cost impacts of eliminating the program on a permanent basis. (*Analysis*, page H-57.)
- ▶ **Tax Settlement Authority Works.** Legislation was enacted in 1992 which allows state tax officials to negotiate settlements to many existing tax disputes during 1992-93. While negotiated settlements to these disputes have resulted in an acceleration of tax revenue into 1992-93, they benefit both taxpayers and the state in the long run as well. Therefore, we recommend that the Legislature enact legislation that permanently allows state tax officials to negotiate settlements to tax disputes. (*Analysis*, page H-59.)

DEPARTMENT OF
GENERAL SERVICES

- ▶ **Fundamental Rethinking of Departmental Services Is Needed.** We outline two steps that the Legislature can take now to improve the department's delivery of support services to state agencies: (1) introduce competition into the procurement of state services and (2) authorize a business audit of the services provided by the department. (*Analysis*, page H-70.)

- ▶ **9-1-1 Surcharge Rate Should Be Reduced.** The surcharge on all telephone bills in California for support of the 9-1-1 system is generating revenues far in excess of the expenditures needed to support the system. We recommend that the Department of General Services and Board of Equalization decrease the current surcharge rate to better reflect expenditures. (*Analysis*, page H-73.)

OFFICE OF
EMERGENCY SERVICES

- ▶ **Disaster-Related Costs Uncertain.** The Office of Emergency Services (OES) has been unable to provide the information needed to track disaster-related costs on an ongoing basis for purposes of legislative oversight. We recommend that the office provide the Legislature with its cost estimates and establish an internal mechanism for tracking basic revenue and expenditure data. (*Analysis*, pages H-76 to 78.)

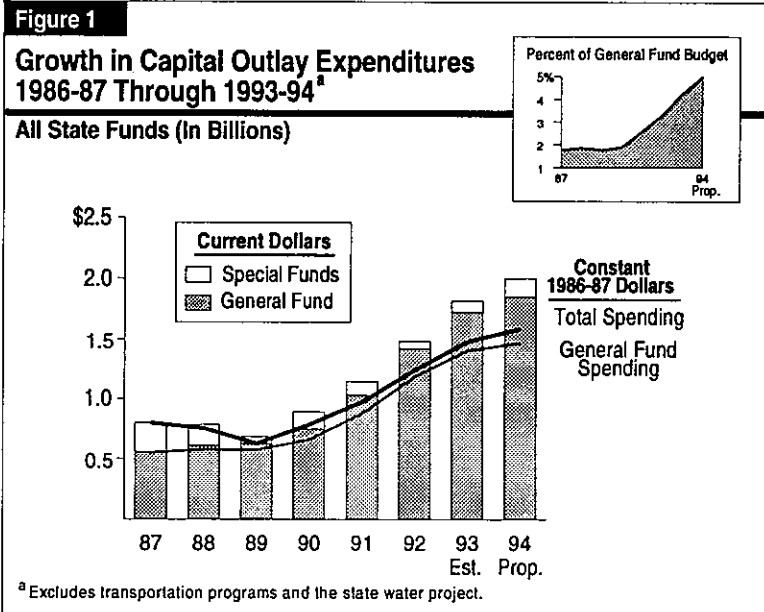
BOARD OF CONTROL

- ▶ **Victims of Crime Program Facing Funding Shortfalls.** This program is expected to experience a shortfall of \$1.7 million in the current year and between \$18.4 million and \$20.1 million in the budget year. We recommend that the board report to the Legislature on the status of these shortfalls and the changes in the program needed to address them. (*Analysis*, page H-79.)

CAPITAL OUTLAY

Capital outlay expenditures are expected to increase significantly as a result of increased debt service payments for bonds that have been used to acquire capital assets. Expenditures for capital outlay are proposed to total \$2 billion from all state funds in 1993-94. This is about \$184 million, or 10 percent, more than estimated current-year expenditures.

As shown in Figure 1, expenditures for capital outlay, excluding the state water project and direct expenditures on transportation, have increased significantly since 1986-87—growing from less than \$800 million in 1986-87 to \$2 billion in 1993-94.



Our review of the proposed budget for 1993-94 resulted in the following significant findings:

CROSSCUTTING ISSUES

- ▶ **Bond Funding for Capital Outlay Drives Debt Service Costs.** State expenditures on debt service will increase by 10 percent in 1993-94 due to increased issuance of bonds in prior years. The state's debt ratio is increasing rapidly, rising from 2.6 percent of General Fund revenues in 1990-91 to a projected 5.4 percent in 1995-96. (*Analysis*, page I-5.)

- ▶ **Resources Available to Meet Infrastructure Needs Are Diminishing.** The state has infrastructure needs totaling tens of billions of dollars, and diminishing resources to finance these needs. The Legislature should assess the variety of infrastructure needs, establish priorities, and determine how much of the state's revenues should be spent on investment in infrastructure versus support or enhancement of other state programs. (*Analysis*, page I-22.)
- ▶ **State-Owned Office Space Needed in Sacramento.** The Department of General Services has completed the first phase of a much-needed plan to acquire state office space in Sacramento. We recommend that the department reassess some aspects of the plan and recommend that the Legislature take several steps regarding the acquisition of additional state-owned office space. (*Analysis*, page I-28.)
- ▶ **Huge Deferred Maintenance Problem.** General Fund agencies that control significant state assets have amassed an \$820 million backlog of deferred maintenance projects. In addition, we estimate that K-12 schools have five-year deferred maintenance needs of about \$2.5 billion. (*Analysis*, pages I-37 and I-60.)

DEPARTMENT OF
GENERAL SERVICES

- ▶ **Potential Relocation of State Agencies from San Francisco to Oakland or Sacramento.** Prior to deciding on the Governor's Budget proposal for office building projects in San Francisco and Oakland, the Legislature should determine whether the Supreme Court and the Departments of Industrial Relations, Insurance, and Justice should remain in San Francisco or should relocate to Oakland or Sacramento. (*Analysis*, page I-50.)

DEPARTMENT OF
CORRECTIONS

- ▶ **Potential Huge Need for More Prisons.** Based on the Department of Corrections' most recent population projection, and absent any state policy changes to reduce prison population, the state will need to build an additional 26,000 to 32,000 beds by 1998. These new prisons will cost \$2.4 billion to \$2.9 billion to construct and \$500 million to \$700 million annually to operate. (*Analysis*, page I-55.)

UNIVERSITY OF
CALIFORNIA

- ▶ **University of California Capital Program Leaves Large Deficits in Teaching Space.** The university's capital outlay program continues to emphasize the construction of research laboratories and office space, leaving large space deficits in lecture rooms and teaching laboratories. We recommend that the Legislature delete \$106 million (12 projects) that would overbuild research laboratories and/or offices. (*Analysis*, page I-65.)

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