

Highlights of the *Analysis and P & I*

STATE FISCAL PICTURE

Budget Summary

➤ **State Faces \$4.9 Billion Budget Gap in 1994-95**

- The state faces a total budget gap of \$4.9 billion, consisting of a 1993-94 year-end budget deficit of \$2.5 billion and an operating shortfall of \$2.4 billion in 1994-95. Earthquake relief costs will add to that gap (*Perspectives and Issues*, page 6).

➤ **Governor's Budget Proposal Hinges on Actions by Others**

- Most of the budget solutions proposed by the Governor to bridge the budget gap depend on the actions of others, including \$3.1 billion of additional federal funds (none of this amount was included in the President's budget) and \$600 million of additional revenue hinging on a future decision by the U.S. Supreme Court (*Perspectives and Issues*, page 11).

➤ **Outlook for 1995-96 Not Bright**

- Our projections indicate that the state's fiscal situation worsens in 1995-96, even assuming a modest economic recovery. This is due to rapid increases in Medi-Cal caseloads and prison populations and to the need to replace \$1 billion of temporary budget savings (*Perspectives and Issues*, page 19).

➤ **Legislature Should Develop a Long-Term Budget Strategy**

- Given the state's fiscal condition, actions with significant future savings should be adopted even if they yield little immediate savings. Actions that achieve current savings by increasing future costs should be avoided (*Perspectives and Issues*, page 20).

Economy and Revenues

➤ **California Economic Conditions Continue to Be Difficult**

- Despite improvements in the national outlook, the California economy shows few signs of even the beginnings of a significant recovery. Total nonfarm employment continues to stagnate or drift downward, and the state's unemployment rate remains one of the highest in the nation.
- The administration's forecast for the California economy falls generally in the middle of the range of other California forecasters. The budget predicts that the economy will start to grow modestly in the later part of 1994.
- Although the administration's forecast is a reasonable one, we believe that there is an equally likely possibility that defense cuts and falling home prices could delay the state's recovery until the second half of 1995. Our forecast indicates that employment losses may continue until early 1995 (*Perspectives and Issues*, page 32).

➤ **Tax Revenues May Be Lower Than Forecast**

- Based on our forecast for the California economy, we believe that state revenues in 1993-94 and 1994-95 could be \$1.2 billion less than forecast by the administration (*Perspectives and Issues*, page 56).

Restructuring Government

- **Governor's Restructuring Proposal Provides a Reasonable Starting Point But Long-Term Vision Is Needed**
 - The Governor's Budget proposes a major shift of state costs for health and welfare programs to the counties, with local costs paid for by a shift of property taxes, state sales taxes, and increased state trial court funding support.
 - Our review suggests that the proposal offers a starting point for the Legislature to make progress in this area in 1994. We suggest modifications to increase the proposal's effectiveness, and encourage the Legislature to consider the state's restructuring needs within a long-term context (*Perspectives and Issues*, page 109).
- **Restructuring of School Finance Needed to Increase Local Flexibility**
 - The existing system of funding K-12 general education limits local program flexibility and does not encourage school district accountability to local communities. This is because it separates state decisions about how much funding is available from local decisions about how funds will be spent (*Perspectives and Issues*, page 137).
 - As a follow-up to our *Making Government Make Sense* model, we propose a local-option property tax that would provide a measure of local control over levels of general education funding without compromising the state's interest in ensuring equal educational opportunity for all.

PROGRAM HIGHLIGHTS

Transportation

- **State Transportation Program Faces \$3.5 Billion Funding Gap**
 - Lower revenues and higher-than-expected expenditures have resulted in the state being short at least \$3.5 billion to deliver

transportation projects as scheduled, and to retrofit toll bridges against earthquakes as required by statute.

- This funding gap will increase by at least \$1 billion if the 1994 rail bond measure is defeated (*Analysis*, page A-14).

➤ **Seismic Retrofit of Highway Bridges
Will Take Longer, Cost More**

- Although Caltrans reports that it will complete retrofit of multi-column bridges by December 31, 1994, our review finds that the department's retrofit activities will likely take several additional years to complete and cost more than estimated.
- The seismic retrofit program is likely to be expanded because the Northridge earthquake damaged some highway structures that Caltrans previously had thought were safe (*Analysis*, pages A-29 through A-32).

➤ **Surcharge Needed to Fund Additional
Highway Patrol Officers**

- Since 1981, a \$1 vehicle registration surcharge has been used to provide additional funds to support CHP traffic officer positions.
- We recommend that this surcharge—due to expire on January 1, 1995—be extended permanently in order to sustain the CHP traffic officer force at the proposed 1994-95 level (*Analysis*, page A-22).

Resources

➤ **Resources Programs Need to Increase Funding Reserves**

- Proposed reserves for some funds in resources and environmental protection programs are not sufficient to address potential revenue shortfalls or unanticipated expenditures.
- The departments with low reserves are Fish and Game, Parks and Recreation, Toxic Substances Control, and the Integrated Waste Management Board (*Analysis*, pages B-42, B-49, B-57, and B-67).

➤ **Serious Work Backlogs Exist in Water Quality/Water Rights Programs**

- Major backlogs exist in the State Water Resources Control Board's programs to renew and update permits to waste dischargers and to issue water rights.
- These backlogs can result in the deterioration of water quality, the loss of federal funding, and the slowing down of business development (*Analysis*, page B-61).

Health & Social Services

➤ **Expansion of Managed Care Program Should Be Reevaluated**

- There is evidence that managed care—which is intended to slow the growth in Medi-Cal expenditures—is resulting in costs rather than savings.
- We recommend that the Legislature reevaluate the broad authority it has granted to the department in expanding managed care arrangements. We also offer alternatives to the department's approach (*Analysis*, page C-35).

➤ **Rates for Prepaid Health Plans (PHPs) Should Be Reduced**

- We recommend reducing the reimbursement rates for PHPs, for a General Fund savings of \$18 million in 1994-95.
- This will ensure that the costs for PHPs will be less than the costs under the "fee-for-service" approach, as intended by state and federal law (*Analysis*, page C-35).

➤ **Medi-Cal Rate Increases of \$73 Million Can Be Avoided**

- Because of the low occupancy rates in hospitals, we believe that the California Medical Assistance Commission (CMAC) can avoid any net increase in inpatient hospital rates it negotiates for the Medi-Cal Program in 1994-95, for a General Fund savings of \$43 million.

- We also recommend enactment of legislation to expand the CMAC's role to include negotiating rates for selected skilled nursing facilities, for an estimated General Fund savings of \$30 million in 1994-95 (*Analysis*, page C-44).

➤ **Expanding Medi-Cal Instead of the AIM Program Can Save State Dollars**

- We recommend that the Medi-Cal Program be expanded to serve women and children who are currently served by the Access for Infants and Mothers (AIM) Program (pregnant women, and their infants, whose incomes are up to 250 percent of the poverty level).
- Such an expansion would achieve the Legislature's goal of providing health services to these persons, at a significantly lower cost to the General Fund (savings of approximately \$73 million in 1994-95) (*Analysis*, page C-53).

➤ **Governor Proposes Major Welfare Policy Changes**

- We find that the proposed reductions in the Aid to Families with Dependent Children (AFDC) Program will increase the financial incentive for recipients to work. Nevertheless, many families may not be able to offset the grant reductions with additional earnings due to factors such as low levels of education and employment experience and a potential lack of job opportunities (*Analysis*, page C-76).

Judiciary & Criminal Justice

➤ **County Probation Services Have Declined**

- Because of fiscal constraints, most county probation departments have reduced their services, including supervision of probationers. As a result, some probationers have fewer incentives to refrain from criminal activity.
- These fiscal constraints have spurred a number of innovative crime-fighting efforts by probation departments, especially in the

area of services for juvenile offenders, which the Legislature should encourage (*Analysis*, page D-19).

➤ **Prison Inmate Population Likely to Increase**

- Given the current crime legislation pending in Congress and the state Legislature, we believe that the state's prison population is likely to exceed the administration's estimates of 171,000 inmates by 1998-99 (*Analysis*, page 32).

➤ **State Prisoners in the CYA Should Be Returned to Corrections**

- We recommend that inmates, age 18 and older, who serve their time in the California Youth Authority (CYA), be returned to the Department of Corrections, because housing these inmates in the CYA is inconsistent with the CYA's mission.
- This recommendation will result in annual savings of \$10 million, and will eliminate the need for construction of a new Youth Authority facility (*Analysis*, page D-75).

➤ **Counties Need Greater Incentives to Deal Locally With Juvenile Offenders**

- Counties currently pay only \$25 per month for each juvenile offender they place in the Youth Authority, while the state pays the remaining \$2,600 per month.
- We recommend enactment of legislation to increase county payments (based on a sliding scale, with higher payments for the least serious offenders) to provide counties greater incentives to develop local juvenile treatment and delinquency prevention programs (*Analysis*, page D-79).

➤ **Trial Court Funding Falls Short of Budget's Claims**

- Although the budget indicates that it supports 65 percent of the total costs of trial courts as part of the Governor's state-county restructuring proposal, recent data indicate that the budget will support only about 58 percent, or about \$108 million less than assumed (*Analysis*, page D-87).

K-12 Education

➤ Revenue Shortfalls Result in Painful Choices

- The budget sets aside about \$1.5 billion more for K-14 education in 1993-94 and 1994-95 than required under the Proposition 98 minimum guarantee. This level of Proposition 98 funding maintains K-12 education funding at \$4,217 per pupil and provides the proposed level of support for community colleges (*Analysis*, page E-21).
- In the likely event that General Fund revenues fall short of the administration's estimates, the Legislature will need to consider (1) reducing funding for K-14 education, (2) further reducing funding for non-Proposition 98 programs, or (3) funding some portion of the proposed level of K-14 spending through loans.

➤ Legislature Should Restructure Categorical Education Program Proposal

- The budget proposes to provide local education agencies substantially more flexibility over the allocation of funds within the categorical "mega-item" than the current budget affords. In addition, the budget proposes about \$100 million in targeted program increases (*Analysis*, page E-28).
- Our review indicates that the budget proposal (1) substantially erodes the Legislature's priority-setting authority and (2) unnecessarily diverts funds from instructional programs to new policy initiatives. We recommend an alternative—the creation of a categorical block grant—that maintains the Legislature's priorities over mega-item program funding and provides additional local flexibility over new categorical expenditures.

➤ **Long-Term CLAS Plan Needed**

- The budget proposes to reduce the amount of performance testing included in state California Learning Assessment System (CLAS) tests, and increase the amount of multiple-choice testing. While this approach would permit expansion of the program at a minimum level of state costs, the proposal leaves unanswered long-term issues about the direction of the program (*Analysis*, page E-67).
- To ensure the Legislature has all the information needed to understand its CLAS options, we recommend the Departments of Finance and Education provide specified information on their long-term plans for the CLAS.

Higher Education

➤ **Proposed Alternative Higher Education Budgets**

- The Governor's Budget is silent on many important elements of higher education such as enrollment and fee levels (*Analysis*, page F-13).
- Consequently, we developed alternative budgets for the segments to assist the Legislature in taking a balanced approach toward the twin goals of providing student access and maintaining program quality.

➤ **Provide for Reasonable Student Fee Increases and Related Financial Aid**

- As part of our alternative budget proposal, we recommend an undergraduate fee increase of 10 percent at the University of California (UC) and the California State University (CSU), and higher graduate fee increases. We also recommend providing related financial aid (*Analysis*, pages F-30, F-49, and F-70). We recommend a \$2 per credit unit fee increase at the community colleges, and related financial aid (*Analysis*, page F-63).

- These proposed fee increases are significantly lower than those contemplated by the UC and the CSU, and by the Governor for the community colleges.

➤ **Hold the Segments Accountable for Enrollments**

- For the CSU, we recommend a 4,000 full-time-equivalent (FTE) student increase over the current year, based on historical participation rates (*Analysis*, page F-53).
- For the California Community Colleges, we recommend that state funding reflect recent declines in enrollment (*Analysis*, page F-66).

➤ **Focus on Higher Education Outcomes**

- We recommend that the Legislature establish a four-year degree pledge program at all UC and CSU campuses and require reporting on degrees conferred in relation to (1) the state's work-force needs and (2) legislative goals on diversity (*Analysis*, page F-14).

➤ **Redirect Excess Gains From Teaching Hospitals for Critical Campus Needs**

- The UC teaching hospitals' net gains exceed the amount needed by approximately \$40 million.
- We recommend that these excess gains be reallocated to the UC campuses to fund critical campus needs (*Analysis*, page F-32).

Business & Labor

➤ **The Department of Insurance's Conservation and Liquidation Division Needs Restructuring**

- The division has significant management and organizational issues that need to be addressed before the Legislature approves the division's budget (*Analysis*, page G-43).

➤ **Small Business Loan Guarantee Programs Should Be Consolidated**

- Transferring the responsibilities of the California Export Finance Program to the Small Business Loan Guarantee Program would help the state increase the number of loans guaranteed without additional cost to the General Fund (*Analysis*, page G-55).

➤ **Will the Defense Conversion Matching Grant Program Help California's Defense Conversion?**

- This program establishes a review process for defense conversion proposals seeking state and federal funds (*Analysis*, page G-52).
- Defense conversion proposals can receive state and federal funds without going through this review process. This raises questions concerning the future effectiveness of this program.

➤ **State Does Not Need Three Housing Agencies**

- The Governor's Budget proposes to consolidate the California Tax Credit Allocation Committee into the California Housing Finance Agency (CHFA).
- The proposed consolidation makes sense, but the Legislature should take the logical step of transferring the duties of the Department of Housing and Community Development (HCD) to the CHFA as well (*Analysis*, page G-11).

➤ **Administrative Cost for Low-Income Housing Programs Is Extraordinarily High**

- The HCD administers a number of bond-funded programs intended to develop low-income housing and ensure its affordability in the future.
- Our review of the HCD's costs to administer three housing programs indicates that they are extraordinarily high (about \$700,000 per project) and that the HCD will spend nearly 50 cents to administer each dollar it provided in loans (*Analysis*, page G-23).

➤ **Agricultural Industry Should Share in Medfly Program Costs**

- To date, the state and federal governments have borne the full costs—\$260 million since 1980—of efforts to eradicate the Mediterranean Fruit Fly (Medfly). We recommend that California's agriculture industry should help defray some of these costs (*Analysis*, page G-73).

➤ **Consolidate the Duties of the Agricultural Labor Relations Board (ALRB) Under the Public Employment Relations Board (PERB)**

- The ALRB's workload does not justify the expenditure of funds for a labor board dedicated solely to agriculture. The PERB has the expertise to handle the ALRB workload (*Analysis*, page G-73).

State Administration

➤ **Pay-for-Performance Raises Issues of Fairness and Executive Versus Legislative Authority**

- The administration has denied a cost-of-living adjustment (COLA) pay increase to managers in state service that it has granted to other state employees. In place of a COLA for managers, the administration has established a "pay-for-performance" policy that has merit in concept, but has problems in its particulars (*Analysis*, page H-15).

➤ **Legislature Should Consider Not Granting State Employee Pay Increase**

- The Legislature has the following four basic options in approaching employee COLA pay increases in 1994-95: (1) approve the administration's proposal to force all but 14 departments to absorb the costs of a COLA scheduled for January 1995, (2) fully fund the COLA, (3) require all departments to absorb the COLA, and (4) not grant the COLA.
- Given the state's fiscal situation, we believe the option of not granting the COLA is the most appropriate (*Analysis*, page H-29).

➤ **Reform of Judges' Retirement Is Overdue**

- Due to the state's chronic failure to adequately fund the obligations of the Judges' Retirement System, the system's unfunded liability has grown to \$1.3 billion, or an average of \$465,000 for each active and retired judge in California. This liability will grow indefinitely unless a new, less costly, retirement plan is established (*Analysis*, page H-35).
- We recommend that the Legislature enact legislation to establish a new retirement program for judges taking office in the future. The legislation should incorporate the plan developed by the Chief Justice's Select Committee on Judicial Retirement, with modifications to further reduce state costs.

➤ **Teale Data Center's Fiscal Stability Jeopardized by Problems**

- We found a number of serious deficiencies in the center's operations related to procurement, fiscal management, and compliance with state laws and procedures.
- We recommend a number of steps to correct the problems, including establishment of a board of directors to provide oversight of the center's operations (*Analysis*, pages H-110 to H-117).

➤ **Disaster-Related Information Remains Elusive**

- We found that it is difficult for the Legislature to obtain comprehensive information on current and prior disasters.
- We recommend that the Legislature direct the Office of Emergency Services to develop systems that will provide more information on the status of disasters, as well as information on disaster-assistance programs (*Analysis*, pages H-124 to H-127).

➤ **Victims of Crime Program Experiences
Continued Funding Shortfalls**

- Even if the Legislature approves the significant augmentations to the program proposed by the Governor, the program will still have a shortfall of at least \$8 million in the budget year.
- We offer several alternatives to bring resources and expenditures for the program in line (*Analysis*, page H-129).

Capital Outlay

➤ **Bond Debt Service Costs Increase Significantly**

- Debt service on bonds used to finance capital outlay will increase by 27 percent in 1994-95 (*Analysis*, page I-5). More than one-half of the increase is due to a one-time accounting savings in 1993-94.
- The state's debt ratio will reach 5.5 percent of General Fund revenues in 1996-97 *without the authorization of new bonds* (*Analysis*, page I-7).

➤ **Budget Committees Should Consider New Prison Proposals**

- The Governor has indicated support for constructing six new prisons, but no proposals are included in the Budget Bill.
- The Legislature should not approve proposed funding for capital outlay at existing prisons until the Department of Corrections submits proposals for new prisons to the budget committees for consideration in the 1994-95 budget (*Analysis*, page I-32).

➤ **Legislature Lacks Key Information on
Proposed CSU Campus at Fort Ord**

- The proposed Monterey Bay campus at Fort Ord raises significant fiscal and policy issues regarding the state's defense conversion efforts and higher education policy.
- To make an informed decision on the statewide and regional implications of the proposed campus, the Legislature needs

information from the CSU on the costs and implications of the new campus (*Analysis*, page I-43.)

➤ **Deferred Maintenance a Growing Problem**

- Nine state agencies and K-12 school districts have deferred maintenance backlogs of \$1 billion and \$2.5 billion, respectively.
- If not addressed on a long-term basis, these backlogs will grow and will result in higher capital outlay costs in the future as facilities wear out faster (*Analysis*, page I-15).