MAJOR EXPENDITURE PROPOSALS IN THE 1996-97 BUDGET

In this section, we discuss several of the most significant spending proposals in the budget. For more information on these spending proposals and our findings and recommendations concerning them, please see our analysis of the appropriate department or program in the *Analysis of the 1996-97 Budget Bill*.

WELFARE GRANT REDUCTIONS AND REFORMS

The state's two primary welfare programs are known as Aid to Families with Dependent Children (AFDC) and the Supplemental Security Income / State Supplementary Program (SSI / SSP).

The AFDC Program provides cash grants to qualifying families with children whose incomes are not sufficient to provide for their basic needs. The SSI / SSP program provides cash assistance to low-income persons who are elderly, blind, or disabled, with the disabled being the largest group of recipients.

In the current year, the budget estimates that the General Fund cost of these programs will be \$2.6 billion for AFDC and \$2 billion for SSI / SSP.

AFDC Proposals for the Budget Year

The Governor proposes to make permanent (1) certain past-year and current-year AFDC grant reductions and (2) the suspension of the statutory cost-of-living adjustment (COLA) that, under current law, will be restored in 1996-97. In addition, the Governor proposes a 4.5 percent grant reduction in the budget year. The budget estimates that these actions would result in General Fund savings and cost avoidance of $442 million in 1996-97. The Governor's Budget assumes that Congress will enact federal legislation necessary for the state to implement some of these changes.

The major proposals are summarized below:

- ***Make Permanent the Temporary Grant Reductions and COLA Suspension.*** The Governor proposes to make permanent the grant reductions adopted in 1992-93 (5.8 percent) and 1995-96 (4.9 percent statewide), and the COLA suspension that was implemented in 1991-92, for a General Fund cost avoidance of $331 million in 1996-97.

- ***Additional Grant Reduction.*** The budget proposes an additional grant reduction of 4.5 percent, for a General Fund savings of $111 million in 1996-97.

- ***Savings From Federal Block Grant.*** The budget assumes enactment of federal legislation to provide block grant funding of the AFDC and Child Welfare Services programs. (Such legislation was vetoed by the President, but remains part of the federal budget negotiations.) The budget estimates that the state would receive more federal funds ($87 million in 1995-96 and $267 million in 1996-97) than it would otherwise, assuming that the Governor's proposed grant reductions are adopted. The budget assumes that the additional federal funds will result in a corresponding General Fund savings.

Issues for Legislative Consideration

The Governor's AFDC proposals would result in significant savings to the state in 1996-97. The grant reductions could be fully offset by increases in earnings from employment. Thus, one effect of the proposals would be to increase the financial incentive for recipients to work. As a result, the impact of the reductions generally would be felt most by nonworking recipients.

The proposals raise a number of significant issues.

Impact on Families. To the extent that recipients do not or cannot offset the grant reductions with additional income from other sources, the total income available to families would be reduced substantially. Under current law, the combined maximum grant and food stamps benefit would be equal to about 82 percent of the federal poverty level in 1996-97 (family of three in high-cost county). As a result of the grant reductions, recipients would have their resources reduced to about 75 percent of the poverty level to the extent that these reductions are not offset by income from other sources such as employment.

Availability of Training. Many AFDC recipients have relatively low levels of education and work experience. To address this problem, California's Greater Avenues for Independence Program provides training and basic education specifically for AFDC recipients. The program, however, currently is not funded at a level sufficient to accommodate all recipients who are required to, or wish to, participate.

Availability of Jobs. The economy plays an important role in the ability of AFDC recipients to obtain jobs. The recent recession suggests that AFDC recipients may find it difficult to obtain employment if the economy's recovery is not sustained.

Potential for Cost-Shifting. The reduction in families' incomes may, to some extent, increase the use of other public services such as health and foster care. Thus, to the extent that such shifting occurs, some of the savings in the AFDC Program will be offset by unknown costs, to the federal, state, and county governments in other programs.

Proposal to Redesign the AFDC Program in 1997-98

The Governor proposes legislation to redesign the welfare system, effective July 1997. Under the proposal, the AFDC Program would be replaced by four separate programs. The major features of the proposal are as follows:

Eligibility. As is currently the case, families would have to include a child under age 18 and would have to be low-income, based on a yet unspecified income and asset test. Families could consist of either one-parent or two-parent households. The proposal eliminates the requirements that one of the adults in a two-parent family have a prior connection with the workforce.

Grants. The current grant structure, which increases with family size, would be replaced by one flat grant (the amount has not yet been specified). Recipients who work could, in effect, keep their earnings to the extent that the amount of earnings plus the grant do not exceed a "work equivalency benchmark."

New Programs. The four proposed programs are:

- **The Ready-to-Work (RTW) Program.** This program would include those adults with a work history or who are currently working. Recipients would receive a flat grant, which would be reduced after six months and again at twelve months, with a total time limit on aid of two years. The program would provide short-term employment services, child care, work-related expenses, and a voluntary program of support services for 18- and 19-year old teen parents who have a work history.
- **Family Transition Assistance Program (FTAP).** This program would serve families in which the parent has not been employed at any time during the preceding ten years and teen parents under age 18. In addition, families could be referred from the RTW Program if significant employment barriers are identified. Instead of a cash grant, the program would provide noncash aid, including vouchers for services such as housing, transportation, and child care. The program would also provide intensive support services, including case management. Teen parents would be required to participate in a support services program that focuses on in-home counseling. The duration of benefits would be limited to five years.
- **The Disabled Family Assistance Program.** This program would assist families in which either a parent or child is disabled and receiving SSI/SSP, IHSS, or disability benefits. Recipients would receive a cash grant for as long as the disability continues. Those who are able to work would receive employment services, child care, and work-related expenses.
- **The Child-Only Assistance Program.** This program would include (1) children living with parents (primarily undocumented persons) who are not eligible for aid and (2) children living with adult relatives acting as the child's caretaker. Recipients would receive a cash grant, which would be less than the flat grant established for families in the RTW Program. Grants for those children in the first category would be subject to a five-year time limit, and no support services would be included. Grants for those in the second category will not be time-limited, and child care would also be provided if needed.

Administration. The state would contract for local administration, with counties given the first choice. If counties refuse, they would continue to share in the costs of the program. Local administrative agencies would be funded on a per capita basis for each program, based on the number of eligible recipients and potentially on other risk factors that have not been identified by the administration.

Issues for Legislative Consideration

We believe that the Governor's proposal is a useful starting point for the Legislature's deliberations on welfare reform. In our companion volume, *Analysis of the 1996-97 Budget Bill,* we raise several areas of concern regarding certain aspects of the proposal. In summary, we draw the following conclusions:

- ***Recognizing Differences Among Recipients.*** We believe that it makes sense to structure the successor to the AFDC Program in a way that takes into account the differences among recipients. Dividing the caseload into four programs is consistent with this concept, but we believe that the criteria established for the two major programs—the RTW and the FTAP—may be too inflexible in that there will be significant differences among families within and between each program, with respect to their readiness for work and their need for support services.
- ***Structuring Work Incentives.*** The proposal includes several elements designed to increase the work incentive, the most significant being the flat grant and time limits on eligibility. Little is known about the impact of such proposals, including their effectiveness in moving persons from welfare to employment. However, the time limits would result in significant state savings in AFDC grants. If they do not increase employment levels significantly, however, they could also result in a major shift of costs to other state programs and, in particular, to county programs. The potential shift of costs to counties would be mitigated to some degree by recent legislation (Ch 6/1996 [SB 681, Hurtt]) which, among other provisions, permits counties to limit General Assistance to three months in any 12-month period, for persons considered employable.
- ***Impact on Children.*** Failure of parents to become self-sufficient will have consequences for their children. Thus, it is important to consider what happens to families when aid is reduced or discontinued due to time limits. Given the limitations on General Assistance, the final "safety net" for children may be the child welfare system. In fact, under the Governor's proposal, families

that reach the five-year time limit would be referred to a child welfare professional for an assessment of the capability of the parents to continue to care for their child. The proposal, however, does not address the potential consequences—both to children and to the child welfare programs—of such assessments.

- ***Support Services.*** The proposal provides for support services in order to help recipients achieve self-sufficiency. The provision of case management and other services, if needed, for all FTAP participants represents a significant change from current law. While additional information is needed, there is some evidence that under the proposal the cost of support services would be significantly higher than under current law, if the proposed program is fully funded.
- ***Cost-Effectiveness.*** Because (1) the grant levels are not specified and (2) the long-term impact on employment levels cannot be predicted, the cost-effectiveness of the proposal cannot be estimated.

Finally, we note that the proposal to redesign the AFDC Program serves as an opportunity to consider the state's welfare system in a broader perspective. More specifically, we recommend that the Legislature consider state assumption of responsibility for the General Assistance program, as we discuss elsewhere in this volume. At a minimum, the Legislature should ensure that any welfare redesign clearly links program responsibility, accountability, and financing to achieve its policy objectives.

SSI/SSP Proposals

The Governor's SSI/SSP proposals assume that Congress will enact federal legislation allowing the state to implement current-year grant reductions and the changes proposed for the budget year.

The major proposals are summarized below.

- ***Make Permanent the Temporary Grant Reductions and COLA Suspension.*** The Governor proposes to make permanent the grant reductions adopted in 1992-93 (5.8 percent) and 1995-96 (4.9 percent statewide) and the COLA suspension that was implemented in 1991-92, for a General Fund cost avoidance of $777 million in 1996-97.
- ***Bar Immigrants From Receiving SSI/SSP Benefits.*** The budget assumes enactment of federal legislation barring most legal

noncitizens from receiving SSI/SSP benefits, beginning January 1997, for a net General Fund savings of $90 million in 1996-97. (The budget also indicates that the Governor proposes legislation to prohibit counties from providing General Assistance to these noncitizens.)

Issues for Legislative Consideration

The Governor's proposals raise the following significant issue.

Impact on Individuals' and Couples' Grant Levels. The SSI/SSP grant reductions would result in a loss of income to recipients. Many SSI/SSP recipients do not have the option of offsetting this loss through earnings. Under the budget proposal, the grant level for individuals (in high-cost counties) would be 96 percent of the poverty level. The grant for aged or disabled *couples* exceeds the poverty level and would continue to do so under the Governor's proposal.

MEDI-CAL

The California Medical Assistance (Medi-Cal) Program is a joint federal-state program that provides necessary health services to public assistance recipients and to other individuals who cannot afford to pay for these services themselves. Funding for most services provided under California's program is split equally between the state and the federal government.

Proposals

The budget proposes the following program reductions in Medi-Cal.

Elimination of Medi-Cal Optional Benefits. The budget assumes enactment of legislation to eliminate 8 of the 29 optional service categories in the Medi-Cal Program, for a net General Fund savings of $34 million in 1996-97.

The services that would be eliminated are nonemergency transportation, medical supplies (excluding incontinence supplies), speech and audiology, psychology, acupuncture, podiatry, chiropractic, and independent rehabilitation centers. The budget proposes to continue these services for children under age 21, persons in long-term care facilities, and developmentally disabled clients.

Eliminate Prenatal Care for Undocumented Women. The budget proposes to eliminate the existing “state-only” program that provides prenatal care for undocumented immigrant women, effective March 1, 1996. Undocumented immigrants would remain eligible for delivery services and emergency treatment, which are required by federal law and partially funded by the federal government. The budget estimates savings of $22 million in 1995-96 and $65 million in 1996-97 from eliminating this program.

Reduce Nursing Facility Reimbursement Rates. The budget proposes to reduce reimbursement rates by 20 percent for nursing facilities that operate as a "distinct part" of a hospital, for a General Fund savings of $26 million in 1996-97.

Issues for Legislative Consideration

Potential for Cost-Shifting. In some cases, eliminating one type of optional medical service could result in increased costs for other services provided by the Medi-Cal Program or other health programs. The budget has attempted to account for this with respect to the proposed elimination of optional benefits; however, its savings assumptions may still be optimistic. The Legislature will need to evaluate the net savings potential of these proposals, in particular, if it wishes to achieve General Fund savings in the Medi-Cal Program.

PROPOSITION 98

Proposition 98 establishes a minimum funding level that the state must provide for public schools and community colleges (K-14 education) each year. K-12 education receives about 90 percent of total Proposition 98 funding. In this section, we describe the budget's K-12 Proposition 98 proposals for the current and budget years.

Current-Year Proposal

The budget includes a revision to current-year K-12 Proposition 98 funding, proposing an additional $509 million above the level provided in the 1995 Budget Act enacted in August. This current-year increase results primarily from higher-than-anticipated General Fund revenues. The Governor's Budget proposes to spend most of the additional funds for one-time school improvement activities including:

- $100 million for reading and math improvement in elementary grades.
- $100 million for education technology.

- $100 million for block grants for one-time purposes, such as deferred maintenance, instructional technology, and educational technology.
- $41 million for "hardship" deferred maintenance projects
- $14 million for state mandate payments.

In addition, the budget proposes $139 million in baseline changes, primarily due to a higher-than-expected growth in the number of K-12 students.

Budget-Year Proposal

The budget proposes to provide $24.8 billion in total Proposition 98 funding in 1996-97. This is a projected increase of $831 million, or 3.5 percent, in comparison to the 1995-96 revised amount. However, student attendance is projected to increase by 2.3 percent, resulting in an estimated *per-student* increase of $44 per average daily attendance or 1 percent more than the revised 1995-96 amount. The slower growth in Proposition 98 funds in 1996-97 reflects both the Governor's Budget expectation of moderate underlying General Fund revenue growth and the budget's proposal to reduce taxes by 15 percent, phased in over the next three years.

The budget proposes funding for a projected 2.27 percent increase in enrollment ($453 million) and a 3.34 percent cost-of-living adjustment (COLA) ($714 million) for revenue limits, special education, and summer school. The budget offsets these increases by deleting $512 million from the budget, as follows: (1) $136 million provided in the current year for growth and COLA for programs funded through the categorical mega-item and (2) $376 million in proposed one-time 1995-96 expenditures (discussed above). Finally, the budget proposes to provide an additional $111 million for the following categories (1) $54 million for program expansions and (2) $57 million for new programs.

CTA v. Gould. The budget also includes funding related to the settlement of the *CTA v. Gould* lawsuit, which contests the legality of $1.8 billion in Proposition 98 loans made in the 1992 and 1993 Budget Acts. While a final settlement has not been reached, the proposed budget includes the major elements of the tentative agreement. First, the budget appropriates $150 million for loan repayments in 1996-97—$100 million from within the Proposition 98 guarantee and $50 million above the level of the minimum guarantee. Second, the budget assumes spending of $377 million in Proposition 98 funds (primarily for revenue limits) in both 1995-96 and 1996-97. Under current law, these 1995-96 funds are not appropriated until the Director of the Department of Finance certifies a settlement agreement in this case.

Issues for Legislative Consideration

We have identified several issues raised by the budget proposal.

Revenues Dictate Budget Choices. The level of General Fund revenues—and therefore, the amount of Proposition 98 funds—projected for 1995-96 and 1996-97 will shape the Legislature's options for K-12 education. In 1995-96, our estimate of available Proposition 98 funding is $120 million higher than the Governor's Budget because our projection of General Fund revenue is modestly higher than the amount assumed in the budget.

For 1996-97, the minimum guarantee under Proposition 98 would be $856 million more than the budget estimate assuming our revenue projections and no tax cut. The impact of these two factors on Proposition 98 funds increases over time. By 1999-2000, the tax cut by itself would reduce the Proposition 98 minimum guarantee by $2.7 billion. The revenue difference over the period would account for an additional $1 billion.

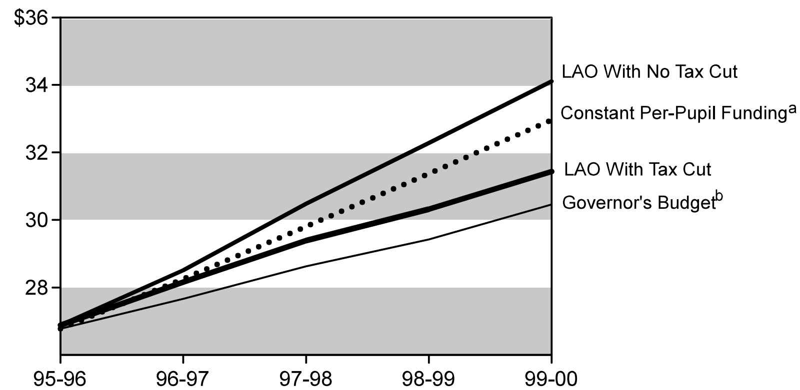
The Legislature will be faced with very different choices regarding K-12 funding depending on the actual growth in General Fund revenues and the Legislature's actions on the proposed tax reduction. Figure 8 displays the long-term impact on Proposition 98 of three revenue scenarios. With a tax reduction, our analysis shows that, under either the Governor's or the Legislative Analyst's Office's (LAO's) revenue assumptions, Proposition 98 per-pupil funding will not keep pace with the cost of living. Under this circumstance, the Legislature must decide which programs must be cut due to the decline in the inflation-adjusted value of state and local funding. At the other end of the spectrum, assuming the higher LAO projection of state revenues and no tax cut, the Legislature must decide how to spend a significant amount of additional resources—up to $856 million—that would not only maintain, but increase the real spending power of state and local funds.

How Should the State Spend Any New Funds in K-12? Over the past five years, the state has focused little attention on the issue of the best use of additional resources in K-12 education. Because of the recession, funding under Proposition 98 grew more slowly than the increase in the number of students and the impact of inflation. As a result, the Legislature's budget plan over this period focused on *maintaining* per-pupil funding levels. As the resource picture improves, however, we see the need for a different long-term plan over the next five years, one that

Figure 8

Proposition 98 Minimum Funding Guarantee
LAO and Governor's Budget Scenarios
1995-96 Through 1999-2000

(In Billions)



[a] Revised 1995-96 Proposition 98 minimum adjusted annually for inflation.

[b] LAO long-term extrapolation of Governor's Budget revenue projections.

addresses how additional funding would meet the needs of the K-12 system and support the long-term goals of the state in improving public schools. The key elements of a plan include:

- Funding the continuing costs of the current program.
- Striking a balance between state and local funding needs.
- Reviewing and reforming current programs consistent with long-term goals.
- Reducing average class sizes beginning in grades K-3.
- Supporting critical reform efforts.

Based on this long-term plan, we present spending alternatives for the current year and budget year. For the budget year, we offer recommendations for the Proposition 98 funding level based on the level of General Fund revenues projected by the (1) Governor's Budget, (2) LAO economic forecast, assuming enactment of the tax cut, and (3) LAO economic forecast, assuming no tax cut.

Under the Governor's Budget level of revenues, the Legislature must choose between funding for new programs and maintaining current funding levels for K-12 categorical programs. Under the LAO revenue projections, the Legislature must determine the best use of a significant amount of new funds for schools. We recommend using the additional funds to:

- ***Increase and Equalize Revenue Limits.*** Revenue limits provide general purpose funding for school districts and county offices of education. We recommend using up to $272 million for revenue limit increases in the budget year. These increases would be in addition to COLAs that are proposed in the Governor's Budget. We recommend that the Legislature distribute these funds to (1) increase revenue limits for all districts and (2) equalize the revenue limits of the lowest funded districts.

- ***K-3 Class Size Reduction.*** We recommend that the Legislature take the first step in a long-range effort to reduce class sizes, beginning in grades K-3. Research shows that smaller class sizes results in sustained increases in achievement for all students. We recommend up to $271 million for this purpose in the budget year. This level of funding would reduce the average K-3 class size by up to 9 percent, from 28.5 to 26 pupils. As a long-term goal, we recommend a class size of about 20 students for grades K-3.

- ***Special Education Funding Reform.*** We recommend the Legislature set aside up to $50 million, subject to enactment of special education funding reform legislation as proposed by the Departments of Finance and Education and the LAO. In November 1995 the three agencies released a joint report proposing a new funding model that would:

  — Equalize special education funds and simplify the allocation model.

  — Allow local education agencies flexibility to tailor special education services based on local pupil needs.

  — Enhance accountability to ensure that students receive needed special education services and benefit from the services provided.

  The set-aside would permit the equalization process proposed in the report to occur more quickly.

HIGHER EDUCATION

California's system of public higher education is the largest in the nation, serving approximately 2 million students. This system consists of three distinct segments—the University of California (UC) with 9 campuses, the California State University (CSU) with 22 campuses, and the California Community Colleges (CCC) with 107 campuses. The UC awards bachelor's degrees and a full range of graduate and professional degrees. The CSU awards bachelor's and master's degrees and accepts students from the upper third of high school graduates. The CCC offers a variety of academic and occupational programs, as well as basic skills and citizenship instruction. It is basically open to all persons 18 years or older.

The Student Aid Commission provides financial aid to students through a variety of grant and loan programs. The Cal Grant program is the major state-funded aid program.

Proposal

The UC and the CSU. The budget proposes General Fund support for the UC and the CSU of $3.8 billion in 1996-97, an increase of about $220 million or 6.1 percent compared with estimated current-year expenditures. Budgeted enrollment levels at the UC and the CSU will increase slightly in 1996-97—by 1,500 full-time equivalent (FTE) students at the UC and 2,000 FTE students at the CSU. The proposed General Fund increase is sufficient to eliminate the need for undergraduate student fee increases proposed by both segments for 1996-97. As a result, the budget assumes no undergraduate student fee increase in the budget year.

Of the $220 million increase for the UC and the CSU, the budget proposes to allocate the funds for employee compensation ($152 million), debt costs on previously authorized lease-payment bonds ($24 million), enrollment growth ($21 million), and price increases ($16 million). Both segments also receive funds for deferred maintenance. The CSU budget allocates $9.6 million of its General Fund increase for deferred maintenance. The UC budget would address deferred maintenance with $10 million in funds from the proposed general obligation bond for education that is on the March 1996 ballot.

Community Colleges. The budget proposes $1.5 billion in General Fund local assistance for the community colleges in 1996-97. This entire amount counts towards the state's K-14 minimum funding guarantee under Proposition 98. The 1996-97 General Fund request represents an increase of $87 million, or 6.3 percent, from the current year. The combined increase proposed from the General Fund, local property tax revenues, and net student fee revenues (after accounting for financial aid) is $94 million, which represents a 3.3 percent increase in combined funding. This figure understates actual budget-year growth, however, because 1995-96 expenditures include $79 million in one-time spending. Thus, actual growth in the CCC base budget is $173 million, or 6.2 percent. Like the UC and the CSU, the budget assumes no student fee increase in the budget year.

In 1996-97, the budget provides $91 million for a 3.5 percent COLA for general-purpose spending, $38 million for statutory enrollment growth, $18 million for debt costs on previously authorized lease-payment bonds, and $10 million to fund enrollment growth at new community college centers. In 1995-96, as a result of an increase in the Proposition 98 guarantee in the current year, the budget provides a total of $79 million in one-time funding for a block grant for instructional equipment, library materials, and education technology ($52 million), deferred maintenance ($18 million), and funds to restore a current-year local property tax revenue shortfall ($9 million).

Student Aid Commission. The budget proposes a General Fund increase of $11.4 million for the Student Aid Commission in 1996-97. The majority of this increase, $10 million, supports the administration's proposal to increase the maximum annual Cal Grant award for recipients who choose to attend nonpublic schools from $5,250 to about $7,200 (37 percent). New students who receive this higher grant level in 1996-97 would continue to receive it in future years as they progress toward a degree. Eventually, all Cal Grant recipients at nonpublic institutions would be eligible for the higher maximum award. As a result, by 1999-2000, the annual cost of this proposal would be about $30 million.

Issues for Legislative Consideration

Deferred Maintenance. Over the past 10 to 15 years, California's three public higher education systems have not kept pace with the demand for facility maintenance. As a result, the systems report a combined deferred maintenance backlog of about $900 million. This is a major concern because deferral of maintenance projects reduces the useful life of facilities and increases future capital outlay needs.

The budget proposes to continue the state's recent approach to deferred maintenance. Specifically, the budget provides to each segment a relatively small amount of funding specifically for deferred maintenance, about $10 million each for the UC and the CSU and $26.2 million ($17.5 million one-time) for the community colleges.

The state's current approach to deferred maintenance has several shortcomings. Most importantly, it treats deferred maintenance as an ongoing program. The existence of deferred maintenance, however, really represents a maintenance program *failure*. The state's current approach does not work because it does not address the ongoing underfunding of regular maintenance programs that causes the continuing deferred maintenance buildup. This underfunding is the joint responsibility of the state and the systems. The practice of providing separate funding for deferred maintenance also creates problems, because it may create a fiscal incentive to defer projects rather than deal with them in a more timely manner.

We recommend an alternative approach that would:

- Provide additional funding to move the systems toward adequate funding of regular, ongoing maintenance to protect the state's considerable investment.
- Hold the systems accountable for improving regular maintenance efforts.
- Prohibit the segments from deferring maintenance projects in the future.
- Eliminate existing deferred maintenance backlogs over time.

Community College Funding Priorities. The Legislature's options for funding the community colleges depend on the level of Proposition 98 funding that is available for the community colleges. As we discuss in the K-12 section, Proposition 98 funding will depend on the growth in General Fund tax revenues, and the Legislature's action on the Governor's proposed tax cut. Our revenue estimates for 1996-97 indicate that the amount actually available to the community colleges could exceed the amount proposed in the budget by $47 million (with a tax cut) to $78 million (with no tax cut).

Because of these different revenue scenarios, we developed recommended spending plans for each scenario. With the amount proposed in the budget, funding is not sufficient to support both the current level of service in existing programs and the administration's proposal to fund enrollment growth in new community college centers. We recommend the Legislature redirect a portion of this growth funding to support growth and COLA for the CCC categorical programs that have been a high legislative priority.

Under LAO revenue estimates, there is sufficient funding to support all of the Governor's 1996-97 proposals, growth and COLA for categorical programs, and more. We recommend using the additional monies to fund augmentations for regular maintenance, replacement of instructional material and equipment, enrollment growth, and equalization.

Increased Funding for Cal Grants. As discussed above, the budget proposes $10 million to increase the maximum Cal Grant award for students attending nonpublic schools. The proposal would narrow the significant gap between the maximum Cal Grant award and tuition and fees at nonpublic institutions. However, we have several concerns about it:

- The proposed $10 million General Fund increase may be needed to backfill federal cuts in student aid spending.
- The proposal will have little influence on students' choice of schools in 1996-97.
- The proposal addresses only one of the Legislature's Cal Grant goals—providing needy students a degree of choice between public and nonpublic institutions. It does not address the goal of broadening overall student access to higher education by increasing the number of Cal Grant awards.

If the $10 million is not needed to backfill federal spending reductions, and the Legislature is willing to commit to a $30 million long-term increase in the annual cost of the Cal Grant program, we recommend the Legislature approve the augmentation, but direct the Student Aid Commission to allocate half of the funds to increase the number of new grants and half of the funds to increase the maximum award level for first-time grant recipients in nonpublic institutions. This allocation would allow the state to make balanced progress toward the two statutory goals of the Cal Grant program.

If the Legislature cannot accept a long-term annual increase of $30 million in program costs, we recommend the Legislature reject the augmentation, because little lasting progress can be made toward the statutory goals of the program at a lower level of long-term spending. We believe the Legislature could better use the $10 million to address other program priorities elsewhere in the budget.

DEPARTMENT OF CORRECTIONS

The California Department of Corrections (CDC) is responsible for the incarceration, training, education, and care of adult felons and nonfelon narcotic addicts. It also supervises and treats parolees released to the community, as part of their prescribed terms.

Currently, the department operates 32 institutions, 52 community correctional centers, and 39 fire and conversation camps. The department will open one new prison before the end of the current year. The Community Correctional Program includes parole supervision, operation of community correctional centers and facilities, outpatient psychiatric services for parolees, and narcotic testing.

Proposal

The Governor's Budget proposes $3.6 billion from the General Fund for support of the CDC in 1996-97, an increase of $349 million, or 11 percent, over the current year. This amount provides full funding for projected growth in the number of prison inmates and parolees under current law, as well as several program changes. It also includes funds to offset the effects of inflation—the CDC is one of only a handful of state departments to receive a specific inflation adjustment for its operating expense costs. The budget does not propose any policy or program changes to reduce the inmate or parole populations.

The budget's total spending figures assume that the state will receive $324 million in federal funds in 1996-97 to offset the costs of incarcerating, and supervising on parole, illegal immigrant adults and juveniles who have been convicted of a felony in California.

Issues for Legislative Consideration

Over the past ten years, the CDC has been one of the state's fastest growing budgets, increasing at an average annual rate of about 8.1 percent. Given projected increases in the state's prison population, in part due to enactment of the "Three Strikes and You're Out" law in 1994, the budget will likely continue to increase substantially. We estimate that, given current population projections, the costs to operate the department will probably reach about $5 billion by 2000-01, an increase of almost 40 percent over a five-year period. In addition, we estimate that the state would need to construct at least 24 prisons by mid-2005 at a cost of $7 billion in order to accommodate the projected population increase (we discuss the administration's prison construction proposals in the section of this chapter that examines the state's infrastructure needs).

Given the long-term implications of the CDC's projected growth on the state's budget, the Legislature will need to consider various options for addressing these increases. There are two basic approaches: (1) reduce the costs of operating the state's prison system and (2) reduce the prison population caseloads themselves.

First, in our analysis of the CDC, we offer several examples of ways to reduce the costs of operating the state prison system. One example that we believe is worth particular examination by the Legislature is to provide alternative forms of punishment and parole outside of the traditional prison setting for aging inmates. In addition, as the Legislature considers the administration's prison construction proposals, it could direct the CDC to construct facilities that are less costly to operate due to design features that require fewer staff.

Second, because the CDC is a *caseload-driven* budget, significant expenditure reductions would require controlling inmate and parole population growth. We have offered a number of alternatives for legislative consideration over the years. The Legislature will have a unique opportunity to focus on such options this year as it considers two major bills (SB 760, Lockyer, and AB 126, Rainey) that would transfer the punishment responsibility for some short-term offenders from the state to counties. Both measures recognize the need to provide funding to the counties for the incarceration and supervision costs associated with such a shift.

TRIAL COURT FUNDING

The trial courts are funded jointly by the state and the counties. In 1995-96, the state funded approximately 37 percent of the $1.8 billion total budget for the trial courts, with the counties paying the remaining 63 percent. The Trial Court Realignment and Efficiency Act of 1991 stated the Legislature's intent to increase state support for trial court funding as a means of promoting equal access to justice. Due to fiscal constraints, however, the state contribution for trial courts has not increased in accordance with the intent of the measure.

Proposal

The Governor's Budget proposes a major consolidation of funding responsibility for the trial courts. Under the Governor's proposal, counties would be responsible for contributing an amount to the Trial Court Trust Fund roughly equivalent to their 1994-95 level of funding for trial courts. The state would be responsible for all trial court costs in excess of the county contribution, including all future cost increases. Counties would continue to contribute fine and penalty revenues to the state, but they would now get a share of the growth in this revenue source.

Issues for Legislative Consideration

The state has an interest in ensuring uniform access to justice through the courts. Transferring funding responsibility for the courts from the counties to the state offers the best means of ensuring such uniformity. Policy control and funding responsibility would be largely consolidated with the same level of government, improving accountability. Such a policy would also help ease county fiscal distress. In addition, it would improve the state-county relationship both by relieving counties of their obligation to fund increases in court costs as well as by creating the appropriate incentives for collection of fine and penalty revenues. Therefore, from both a fiscal and a programmatic standpoint, the governor's proposal makes sense.

There are, however, several important factors relating to accountability and court costs that remain to be resolved. Namely,

- ***Performance Goals Are Needed.*** If the state is to have funding responsibility for court operations, it must also have the ability to hold the courts accountable for performance. Currently, there is insufficient data available to evaluate progress toward meeting specific output goals or to permit cross-court comparisons.
- ***Proposal Needs Mechanisms for Controlling Costs.*** Because the proposal will likely result in significant cost increases to the state in future years, it will be important to enable the state to have greater involvement and control over trial court expenditures. The Governor's proposal does not contain sufficient cost control mechanisms. For example, under the Governor's proposal, most of the nonjudicial court employees would continue as county employees, with their salaries and benefits being set by the county Board of Supervisors. To effectively control costs and exercise program oversight greater controls are needed, including converting trial court employees to state employees over time .

TRANSPORTATION

After the 1989 Loma Prieta earthquake, the state established a program to retrofit state highways and bridges for seismic safety. The Department of Transportation (Caltrans) is responsible for this program and has identified about 2,220 state highway bridges and seven state-owned toll bridges to be retrofitted for earthquake safety.

Proposal

Proposition 192 (the Seismic Retrofit Bond Act of 1996)—which is on the March 1996 primary election ballot—would authorize the state to sell $2 billion in general obligation bonds for seismic retrofit purposes. This includes $1.3 billion for the retrofit of state highways and $650 million for toll bridge seismic retrofit. While Caltrans originally estimated the cost to retrofit toll bridges at $650 million, it now estimates these costs at between $1.7 billion and $2.1 billion, triple its initial estimate.

Issues for Legislative Consideration

Because Proposition 192 contains only $650 million for toll bridge retrofit, any additional costs would have to be paid from either state and federal highway funds or from toll bridge revenues. Using existing toll revenues would crowd out other bridge improvement projects, such as improving approach roads to the Dumbarton and San Francisco-Oakland Bay Bridges and widening the San Mateo-Hayward Bridge. On the other hand, using state and federal highway funds would require that previously authorized projects be deleted from the State Transportation Improvement Program (STIP) and other STIP projects be delayed.

In order to ensure that enough funds will be available for seismic retrofit of toll bridges, the Legislature will need to determine the relative funding priorities of toll bridge seismic retrofit, other STIP projects, and other toll bridge projects (funded from toll revenues).

CAPITAL OUTLAY

Based on five-year capital outlay plans developed by state agencies, the state's investment in infrastructure over the next five years would total nearly $25 billion. This amount includes capital outlay projections by various state agencies plus our estimate of needs in K-12 schools. (The amount does not include transportation, which is discussed above.) The capital outlay plans include a wide range of needs such as state office buildings, higher education facilities, prisons, forestry stations, and development of state parks. The five-year estimates should be viewed with caution because some of the plans are incomplete and also may include proposals that, upon examination, would not merit funding. Nevertheless, the plans provide a reasonable assessment of the overall magnitude of the state's capital outlay needs.

Proposal

The Governor's Budget includes a capital outlay plan consisting of two elements. One element is the proposal contained in the annual Budget Bill for proposed capital outlays in the budget year. The other element includes a proposal for $7.84 billion in general obligation bonds to finance a portion of the budget-year proposal as well as capital outlays in future years.

Budget Bill Proposal. This element of the capital outlay proposal includes $820 million for various state departments. About $647 million (80 percent) of this amount is from general obligation bonds. The remainder includes $77 million from the General Fund and $95 million from special funds and federal funds. Over 80 percent of the Governor's proposal is in three areas—higher education ($413 million), seismic retrofit of state office buildings ($155 million), and youth/adult corrections ($116 million).

General Obligation Bond Proposal. The Governor's bond proposal includes two bond measures that have already been placed on the March 1996 ballot and three measures he proposes for the November 1996 ballot. This bond proposal is shown in Figure 9.

Figure 9

Governor's 1996 Bond Proposal

March 1996 Ballot

- $2 billion for seismic retrofit of state-owned bridges and toll bridges (Proposition 192).
- $3 billion for public education facilities (Proposition 203).
  - — $2.025 billion for K-12 education.
  - — $975 million for higher education.

Governor's Proposal for November 1996 Ballot

- $2.2 billion for youth and adult corrections.
  - — $1.642 billion for six new state prisons.
  - — $150 million for additional capacity at the Department of the Youth Authority.
  - — $274 million for existing prison and Youth Authority facilities.
  - — $150 million for local juvenile detention facilities.
- $540 million for water-related facilities and programs.
  - — $220 million to implement a water management plan for the San Francisco Bay/Sacramento-San Joaquin Delta.
  - — $320 million for local wastewater treatment plants and water reclamation facilities.
- $100 million for a state infrastructure bank "dedicated to nontransportation infrastructure with an emphasis on projects that promote economic development."

Issues for Legislative Consideration

The state's capital outlay program should be based on a comprehensive plan that identifies and finances the revitalization of existing infrastructure and the development of new infrastructure to address the state's economic and demographic needs. Unfortunately, the state's infrastructure has been steadily deteriorating over the years and the state and local governments continue to be faced with tens of billions of dollars of capital outlay needs.

In recent years, bonds have been the primary fund source for capital outlay. As a result, the state's debt service burden has increased significantly since 1990—from 2.5 percent of General Fund revenues to 5.1 percent currently. This debt ratio will decline, in the budget year, if no new bonds are approved and sold. However, if the bonds proposed by the Governor are approved by the Legislature and the voters, we estimate that the debt ratio would peak at 5.5 percent in 1999-2000 and decline thereafter. We believe the state could prudently approve and issue additional general obligation bonds, but in doing so it is essential that any additional bonds—including those placed on the November 1996 ballot—be directed to the state's highest priority needs.

As we have discussed in the past, state capital outlay programs and the consideration of assistance to local governments have not been reviewed and funded in the context of a *statewide* program. We believe that the Legislature must undertake a comprehensive review of the state's capital outlay needs, set priorities and establish a financing plan to fund these priorities over a multiyear period. Development of a comprehensive statewide plan should be a precursor of the Legislature's deliberations on bond measures—beginning with those that may be placed on the November 1996 ballot.

Specific Capital Outlay Issues Facing the Legislature. There are several areas within the state's capital outlay program that merit consideration in the near-term. The following is a list of major areas of direct state responsibility that fit into this category:

- ***State Prisons.*** Based on current inmate population projections and policies, the state will have to construct at least 24 new prisons in the next ten years at a cost of $7 billion. Furthermore, the state should authorize at least two new prisons early in 1996.

- ***Higher Education.*** The segments of higher education have identified a five-year capital outlay program totaling over $6 billion. In addition, the segments have identified a deferred maintenance problem totaling in the hundreds of millions of dollars.

- ***State Office Space.*** The state continues to lease several million square feet of building space to house various agencies. This method of providing office space is, over the long-term, more costly than state-owned space.