Highlights of the 2005-06 Analysis
Acknowledgments

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K-12 EDUCATION

Proposition 98—Governor Proposes $2.9 Billion Increase

The budget proposes to leave 2004-05 Proposition 98 appropriations at roughly the level provided in the 2004-05 Budget Act. This proposal would create $2.3 billion in General Fund savings over the two years. While the Governor’s 2005-06 spending plan for K-14 grows by $2.9 billion, it does not include funding to cover all K-14 operating expenses that districts would incur under the budget proposal.

We recommend the Legislature build a base budget for 2005-06 that fully funds the current K-14 education program. (Analysis, page E-13.)

State Teachers’ Retirement System (STRS) Proposal Lacks Benefits

The Governor proposes to shift financial responsibility from the state to K-14 education for $469 million in annual contributions to STRS. The proposal, however, may not achieve the intended short-term goal of budgetary savings and does not resolve the longer-term issues with the current plan. (Analysis, page E-28.)

Some School Districts Face Difficult Fiscal Conditions

Some school districts face huge fiscal liabilities to pay for retiree health benefits. It will be difficult for districts to deal with these obligations without a long-term strategy. We recommend the Legislature take various actions to start addressing this problem. (Analysis, page E-47.)

Around 40 percent of school districts face declining enrollment. The state continues to have inequities in revenue limit (general purpose) funding across school districts. We recommend an approach to address both of the problems, allowing declining enrollment districts to increase their per pupil revenue limit until they reach the equalization target. (Analysis, page E-53.)

Proposition 49—Recommend Repeal

We recommend the Legislature enact legislation placing before the voters a repeal of Proposition 49 because (1) it triggers an autopilot augmentation even though the state is facing a structural budget gap of billions of dollars, (2) the additional spending on after school programs is a lower budget priority than protecting districts’ base education program, and (3) existing state and federal after school funds are going unused. (Analysis, page E-103.)
HIGHER EDUCATION

- Governor Proposes to Put Universities’ Budgets on “Autopilot”

  The Governor’s budget for the University of California (UC) and the California State University (CSU) follows the “compact” he developed with the segments last spring. The compact lays out annual targets for enrollment growth, fee increases, General Fund base increases, and other factors through 2010-11. By mapping out these funding choices up to six years ahead of time, the Governor’s compact attempts to put the higher education budget on autopilot.

  We recommend the Legislature disregard the compact, and instead consider its various funding choices annually in the context of what is needed to achieve the state’s higher education goals as expressed in the Master Plan. (Analysis, page E-149.)

- Enrollment Growth Funding Should Be Based on Anticipated Demand

  The Governor’s budget includes funding for enrollment growth of 2.5 percent at UC and CSU, and 3 percent at California Community Colleges (CCC). The budget makes no attempt to link these growth rates to anticipated demand under the Master Plan.

  We recommend the Legislature fund enrollment increases of 2 percent at UC and CSU, and 1.9 percent at CCC. These recommendations are based on our estimates of increased enrollment demand in 2005-06. Implementing these recommendations would free up state funding for other priorities. (Analysis, page E-164.)

- Budget Should Account for New Fee Revenue

  The Governor’s budget does not account for $190 million in new student fee revenue that would result from planned fee increases at UC and CSU. Instead, he proposes that use of the resulting revenue be left entirely to the discretion of the segments.

  We recommend the Legislature include this anticipated fee revenue as part of its budget plan. Traditionally, fee revenue is used interchangeably with General Fund support to fund the segments’ base programs. Taking this approach, the Legislature would be able to fully fund anticipated growth and inflation-driven increases, while freeing up some General Fund monies relative to the Governor’s proposal. (Analysis, page E-192.)
We also recommend the Legislature increase community college fees from $26 per unit to $33 per unit. This would raise about $100 million in new fee revenue that could be used to fund legislative priorities. It would also leverage about $50 million in federal funds to reimburse middle-income families for the higher fees. Financially needy students are exempt from paying fees at community colleges. (Analysis, page E-195.)

HEALTH SERVICES

- **Summary of Health Program Savings and Revenues**
  - About $294 million in Medi-Cal revenues from so-called “quality improvement fees” have not been counted as state revenues in the Governor’s budget. We recommend the Legislature recognize these fee revenues as it drafts its budget plan. (Analysis, page C-66.)

- We also identify the potential for an additional $100 million net gain to the state from establishing such fees for hospitals. (Analysis, page C-100.)

- In addition, we identify more than $190 million in potential expenditure reductions. (Analysis, pages C-105, C-138, C-142, C-143, C-157, C-162, and C-178.)

- **Part “D” Stands for “Deficit”: How the Medicare Drug Benefit Affects Medi-Cal**
  - Part D of the federal Medicare Modernization Act establishes a prescription drug benefit for Medicare recipients and in so doing has major implications for the Medi-Cal Program. It is likely to result in significant net costs to Medi-Cal beyond the budget year. (Analysis, page C-105.)

- **Medi-Cal Redesign Sound in Principle But Needs Further Development**
  - The seven-part administration redesign proposal would result in broad changes in Medi-Cal managed care as well as some more limited changes in benefits, cost-sharing, and eligibility administration. Overall, we find that the Governor’s proposals are conceptually sound but that the Legislature needs more information about some aspects of the package and that some refinements are warranted. (Analysis, page C-67.)
Hospital Financing Plan Could Begin to Right Ailing System

- The state’s hospital system continues to face a variety of fiscal challenges that weigh particularly heavily on public hospitals. The administration is negotiating with the federal government for a comprehensive redesign of hospital financing as part of its Medi-Cal redesign package. Our review of the plan now under development suggests that it could help preserve the financial stability of public hospitals but also raises some significant fiscal and policy issues. (Analysis, page C-83.)

Towards a More Systematic Rate-Setting Model for Regional Centers

- Our analysis finds that the way the state sets rates for vendors who provide community services for the developmentally disabled on the whole lacks a rational and consistent approach. We review how rates are set for these services and offer an improved and systematic approach that could achieve significant state savings. (Analysis, page C-167.)

Proposition 63 Language Requires Clarification

- In November, California voters approved Proposition 63, a measure imposing a new state income tax surcharge to expand community mental health systems. We recommend the enactment of legislation that would clarify the meaning of some key but ambiguous provisions of the measure in order to ensure its smooth and effective implementation and avoid future state budget problems. (Analysis, page C-182.)

Proposition 99: Too Many Programs, Too Few Dollars

- We recommend the Legislature approve the Governor’s budget proposal for Proposition 99-funded programs, which shifts allocations of tobacco tax revenues to maximize resources for health programs and achieve General Fund savings. We further recommend that the Legislature begin this year to address the long-term issues posed by the present structure of Proposition 99. (Analysis, page C-129.)

Accessing Federal Funds for Prenatal Services

- We recommend approval of the Governor’s proposal to draw down federal funds to offset state costs for prenatal services but examine the idea of expanding this option to also reduce the state cost of providing these services to incarcerated women. We further recommend enactment of
legislation to consolidate the Access for Infants and Mothers Program into the Healthy Families Program. (Analysis, page C-19.)

- **Antiobesity Initiative Should Itself Be Slimmed Down**
  - While additional state public health efforts to combat the spread of obesity are warranted, the Governor’s proposal launches new antiobesity projects before an assessment of existing efforts has been completed. It also does not take advantage of alternative funding sources available to the state. We recommend reducing the funding and staff requested for the projects. (Analysis, page C-138.)

- **Evaluating the Administration’s California Rx Proposal**
  - The Governor’s 2005-06 budget plan includes a funding request and related legislation for a new state program to help low- and moderate-income Californians purchase prescription drugs at discounted prices. Our analysis indicates that the Governor’s plan for drug discounts for the uninsured provides a reasonable starting point for the development of such a program. However, we propose, among other changes, that in the event that drug makers fail to make good on their promises for significant price concessions, an automatic trigger would phase out the proposed voluntary approach, and be replaced by an alternative strategy likely to result in greater discounts on more drugs for consumers. (P&I, “Part V.”)

**SOCIAL SERVICES**

- **Substantial Progress in Reducing Social Worker Caseloads**
  - In 2000, a legislatively mandated study found that it was difficult for social workers to provide services or maintain meaningful contact with children and their families because of the large numbers of cases they were expected to carry. Our analysis indicates California now meets or is approaching the three of the five workload standards in child welfare services. We recommend enactment of legislation requiring the administration to report annually on county-specific social worker staffing ratios so that the Legislature remains informed about progress in this area. (Analysis, page C-214.)

- **Reducing the Earned Income Disregard**
  - Effective October 2005, the Governor proposes to lower the grants for all working California Work Opportunity and Responsibility to Kids recipients,
by reducing the amount of earned income which is disregarded (not
counted) when determining a family’s grant. This proposal results in savings
of $80 million and is likely to have minimal impact on the work incentive. We
present alternative approaches which are likely to increase the work incen-
tive but result in less budgetary savings. (Analysis, page C-214.)

➤ **Social Services Reductions Represent Substantial Ongoing Budget Solution**

- The Governor proposes to reduce social services expenditures by $1.1 bil-
  lion (in comparison to the requirements of current law). Social services
  expenditures represent just under 11 percent of the total General Fund
  budget while the reductions account for about 20 percent of the proposed
  budget solution excluding borrowing. The Legislature faces difficult choices
  in the area of social services because rejection of any the social services
  reductions will require making ongoing reductions in other programs or
  increases in revenues.

➤ **Child Care Reforms Merit Serious Consideration**

- The Governor proposes a number of significant reforms to California’s
  subsidized child care system including eligibility restrictions, a new waiting list
  system, and tiered reimbursement rates. With certain qualifications, we
  support proposed eligibility and waiting list changes. Although tying reim-
  bursement rates to quality makes sense, the Legislature may wish to con-
  sider alternative approaches which increase reimbursement rates for higher
  quality care rather than simply reducing reimbursement rates (as the Gover-
  nor proposes) for lower quality care. (Analysis, page C-25.)

➤ **Social Services Programs Overbudgeted by $180 Million**

- Our review of various social services programs identifies a series of over-
  stated caseloads and estimating errors. We find that for 2004-05 and
  2005-06, the budget overstates social services costs by almost $180 million
  and we recommend that the Legislature score corresponding savings.
  (Analysis, pages C-206, C-212, C-232, C-241, and C-244.)

➤ **Other LAO Saving Recommendations**

- In addition to the almost $180 million in caseload and estimating savings
  described above, we make recommendations in Foster Care, Child Support,
  and the Employment Development Department resulting in other General
  Fund savings totaling $12 million. (Analysis, pages C-197, C-243, and F-92.)
CORRECTIONS

CDC Disciplinary Confinement Practices Need Improvement

- As a means of controlling prison violence, California Department of Corrections (CDC) has established several “disciplinary confinement” options, including administrative segregation and special housing units. Despite increasing use of such options, data show inmate assaults (and the associated state costs) continue to increase. Our examination identifies a number of shortcomings in the department’s disciplinary confinement policies and practices, and offers recommendations for improvement. Depending on the recommendations adopted, savings could be up to $10 million in 2005-06. (Analysis, page D-34.)

Court Requires Further Improvements in Inmate Health Care

- In September 2004, a federal court issued an order requiring further improvements in CDC’s inmate health care delivery system. We recommend a number of modifications to the Governor’s budget proposal that would result in state General Fund savings, while allowing the state to comply with the court order. (Analysis, page D-52.)

State Could Save More on Foreign Prisoner Transfers

- The Foreign Prisoner Treaty Transfer program has the potential to reduce state incarceration costs by transferring inmates to their country of origin. Because of administrative issues, the state does not obtain the maximum benefit that could be achieved from this program. We offer recommendations for increasing the program’s use and state savings. (Analysis, page D-19.)

Ward Population Continues to Decline, More Closures Proposed

- The Youth Authority projects the ward population to drop 12 percent (465 wards) by June 2006, and to further decline to just over 3,000 by June 2009. The Governor’s budget proposes to close two youth conservation camps at the end of the current year. Given the continuing drop in the ward population, and the low number of wards who qualify to participate in the camp program, we think the proposed closure is prudent. However, we think the administration should report on its plans to convert these camps to adult inmate camps. (Analysis, page D-67.)
 Proposition 69 (DNA) Request Overbudgeted

The Governor’s budget includes funds for implementation of Proposition 69—DNA Collection—by the Departments of Justice, Corrections, and Youth Authority. While these departments will require funding to collect and process tens of thousands of additional DNA samples in 2005-06, our analysis indicates that the requests for Corrections and Youth Authority are overbudgeted by $3.5 million. (Analysis, page D-13.)

 Up to $65 Million in General Fund Savings Identified

In our review of the Governor’s budget, we recommend a number of actions that would result in up to $65 million savings in 2005-06, mostly in CDC’s budget. This level of savings would primarily be achieved by reducing budget requests that are overbudgeted or that lacked sufficient justification. (Analysis, pages D-13, D-19, D-30, D-34, D-46, D-48, and D-52.)

 Assessing the Governor’s Reorganization Proposals

On January 6, 2005, the administration released its plans to eliminate 88 boards and commissions and to reorganize the Youth and Adult Correctional Agency (YACA). For each of the plans, we provide an assessment of its fiscal effect and raise key issues. Although the administration recently has decided not to forward its boards and commissions proposal to the Legislature, the piece provides key considerations for the Legislature when seeking to consolidate these types of entities. Regarding the YACA proposal, we conclude it has the potential to improve the efficiency, accountability, and effectiveness of the state’s prison system. However, the plan omits important details that the Legislature requires in order to fully evaluate its merits. Our analysis indicates that the proposed reorganization would probably result in net costs in the short term, but has the potential to achieve significant long-term net savings by placing a greater emphasis on inmate rehabilitation as a means of increasing public safety. (P&I, “Part V.”)

 CAPITAL OUTLAY

 Administration Did Not Submit Statewide Infrastructure Plan

The administration did not submit a statutorily required infrastructure plan that identifies (1) the statewide infrastructure improvements to be funded over the next five years and (2) the funding sources for these improvements. Without the plan, the Legislature has no information about the
administration’s priorities regarding infrastructure investment. We recommend the Legislature defer action on all capital outlay proposals for new projects until the 2005 infrastructure plan is submitted. (Analysis, page G-15.)

**Bond Funds Are Not Sufficient to Complete All Higher Education Projects**

- The budget proposes to use higher education bond funds to develop 17 projects that will require substantial funding to complete in future years. There are not sufficient bond funds remaining to cover all of the projects’ future costs, and the availability of other state funds to complete the projects is uncertain. We recommend that the remaining bond funds be used to fund the completion of ten projects based on their priority ranking. We further recommend that funding to develop seven lower-priority projects be approved contingent upon the higher education segments committing to using nonstate funds to complete the projects if state funds are not available in the future. (Analysis, page G-34.)

**TRANSPORTATION**

**Misleading Caltrans’ Budget Display Weakens Legislative Oversight**

- It is impossible to determine Caltrans’ total transportation expenditures because its budget display uses a mix of cash and accrual accounting. As a result, the Legislature is unable to ascertain the magnitude of Caltrans’ project commitments or payments in any one year. We recommend the enactment of legislation requiring transportation expenditures to be displayed according to standard budget display requirements. (Analysis, page A-18.)

**More Thorough Diagnosis of “Chief’s Disease” Needed**

- Since 2000, more than three-fourths of California Highway Patrol’s (CHP’s) senior-ranking officers have retired due to work-related injuries (referred to as industrial disability retirement [IDR]). This compares to 60 percent of rank-and-file officers. The CHP cannot adequately explain the disparity between the IDR rates for senior officers and rank-and-file officers. We recommend the Legislature direct CHP to report on the nature of the problem—particularly the reasons for the difference in IDR rates among chiefs and lower-ranking uniformed staff—as well as ways to assess the effectiveness of the department’s actions in addressing workers’ compensation and IDR issues. (Analysis, page A-31.)
DMV Needs to Avoid Delays in Evaluating Unsafe Drivers

In 2003-04, the Department of Motor Vehicles (DMV) was able to complete within the 30-day statutory deadline only 8 percent of administrative hearings for drunk-driving cases. In addition, in that year it took an average of 42 days before DMV staff scheduled a “regular re-examination” of certain drivers who may not be physically or mentally able to safely operate a motor vehicle. Absent corrective actions at the department, delays in evaluating potentially unsafe drivers are likely to increase. We recommend the Legislature direct DMV to transfer certain workload involving high-risk drivers to the customer-service field offices in order to reduce these delays and to report on the impact of the transfer. (Analysis, page A-38.)

Transportation Funding Instability Continues

The administration proposes to suspend $1.3 billion in Proposition 42 transportation funding and to reduce the General Fund’s commitment to repay transportation loans in the near term. This would help the General Fund condition but restrict already limited transportation funding and increase near-term funding uncertainty. We recommend the administration provide information to clarify (1) the effect of the Governor’s proposals on the size of the transportation program and (2) Traffic Congestion Relief Program funding requirements in 2005-06.

The administration also proposes to prohibit the suspensions of Proposition 42 after 2006-07. This would increase transportation funding stability in the long run. However, this stability would be lessened by another administration proposal that General Fund expenditures, which include Proposition 42 funding, be cut across the board under certain circumstances. In order to provide long-term transportation funding stability while freeing up General Fund revenue for other purposes, we continue to recommend (1) the repeal of Proposition 42, (2) an increase of the gas tax to generate an amount of funding equivalent to Proposition 42, and (3) adjusting the gas tax for inflation. (P&I, “Part V.”)

Toll Bridge Seismic Retrofit: Hard Decisions Before the Legislature

The administration recently estimated the toll bridge seismic retrofit program requires an additional $3.2 billion to complete and has recommended changing the Bay Bridge’s design to save money. The Legislature faces two key decisions: (1) whether to approve a redesign of the Bay Bridge east
span and (2) how to fund the program’s completion. Redesigning the Bay Bridge could save money, but also raises the risk of cost and schedule increases that could more than offset the savings. As regards the funding issue, we recommend that support be provided by both state and local sources. The Legislature has several options regarding the sources used and the amount to provide from each. (P&I, “Part V.”)

RESOURCES

Should the State Issue Debt to Finance Flood Lawsuit Settlement?

- The budget proposes to use a “judgment bond” to finance a pending $464 million settlement of a lawsuit stemming from a major flood in Yuba County in 1986. We believe that there may be alternative ways to fund the state’s obligation from the lawsuit. However, if the administration proceeds with its plan to finance the settlement with a judgment bond, there are a number of legal, policy, and fiscal issues for the Legislature to consider, including whether the proposed bond would require a vote of the people and how the bond should be structured to minimize its cost. We highlight these issues and recommend the Department of Finance report at budget hearings on them. (Analysis, page B-79.)

Reorganization of Energy-Related Agencies Raises Issues

- The Governor’s Reorganization Plan Number One proposes to eliminate two energy-related agencies—The California Consumer Power and Conservation Financing Authority and the Electricity Oversight Board—and transfer their responsibilities to the California Energy Commission. Although the administration recently decided not to forward this plan to the Legislature, the piece provides an assessment of issues related to such a reorganization. (Analysis, page B-27.)

Recycling Goals Could Be Met More Effectively and Efficiently

- In order to more effectively and efficiently meet the state’s recycling goals, we recommend that the recycling and related waste prevention programs in the Department of Conservation (DOC) and the California Integrated Waste Management Board (CIWMB) be consolidated into one department. In addition, we recommend the elimination of CIWMB and the transfer of its remaining responsibilities to an expanded Department of Toxic Substances Control, thereby generating $2 million in special fund savings. Finally, we
recommend the Legislature consider options for transferring the remaining nonrecycling functions of DOC to existing state agencies. (Analysis, page B-17.)

- **Significant Amounts of Pesticide Fees Not Being Collected**
  - The Governor’s budget does not address an undercollection of the pesticide mill assessment (levied at the first point of sale of a pesticide in California) that has been identified in recent departmental audits of retailers of consumer (nonagricultural) pesticides. We offer options to improve the collection of the pesticide mill assessment and recommend that the administration report on these and other ways of addressing this issue at budget hearings. (Analysis, page B-85.)

- **Fire Protection Budget: Details Lacking, Oversight Difficult**
  - The budget proposes $10.8 million for new firefighting equipment and helicopters and $9 million for year-round firefighting staffing in Southern California. We find that details and justification for these proposals are lacking and therefore recommend the Legislature deny the funding requests. (Analysis, page B-52.)

  - It has been difficult for the Legislature to oversee the California Department of Forestry and Fire Protection’s use of federal funds, which it receives after assisting the federal government at a fire. In some cases, these funds have been diverted to purposes other than fire protection. We make recommendations to improve legislative oversight over the department’s receipt and use of these federal funds. (Analysis, page B-56.)

- **Water Policy Issues Facing the State**
  - The state oversees about 1,600 miles of levees that are aging and deteriorating. Should these levees fail, the state would face a major liability. We analyze and make recommendations regarding the strategies proposed by the administration to address various flood management problems identified in a recent Department of Water Resources White Paper. Our recommended legislative steps include actions to evaluate the structural integrity of the state flood control system, enact a flood control benefit assessment, re-evaluate the state’s role with respect to Delta levees, and reduce the likelihood of ill-advised development approvals in flood-prone areas.

  - The CALFED Bay-Delta Program (CALFED) is at a funding crossroads given that its primary funding source in recent years—state bond funds—is running out at the same time as the program is projecting $6.3 billion of unmet
funding requirements over the next ten years. The program’s oversight agency—the California Bay-Delta Authority—has recently approved an $8.1 billion ten-year finance plan for the program that assumes major new sources of federal funds, unidentified state funds, and water user fees. Given that some of the revenue assumptions underlying the plan appear unrealistic, the Legislature will need to establish its expenditure priorities for CALFED so that the program can be “right sized” consistent with those priorities. (P&I, “Part V.”)

GENERAL GOVERNMENT

➤ **State Needs Unified Strategic Approach to Homeland Security**

- The state lacks a unified strategic approach to homeland security. The Office of Homeland Security and the Department of Health Services have not sufficiently coordinated their efforts. We make a number of recommendations to address these problems, including the development of a strategic plan and annual expenditure report. (*Analysis*, page F-13.)

➤ **Governor’s Data Center Consolidation Proposal Would Foreclose Legislative Oversight**

- The Governor proposes to consolidate the state’s two largest data centers into the Department of Technology Services. A consolidated data center should ultimately result in improved services and reduced costs. A number of specific components of the proposal, however, would preempt the Legislature’s appropriation and oversight roles. For instance, the department’s expenditures would be controlled by administration officials outside the purview of the Legislature. Consequently, we recommend the Legislature approve the consolidation but modify some key components. (*Analysis*, page F-76.)

➤ **Doubling the Size of the Gambling Commission Not Justified**

- The budget proposes an augmentation of $4.8 million and 46 two-year limited-term positions for increased regulatory activities related to tribal gambling. The request would double the size of the California Gambling Control Commission. The request fails to (1) clearly articulate what problems are being addressed, (2) justify a new state gaming lab, and (3) reflect a joint strategy with the Department of Justice. We recommend the Legislature reject the request and the administration resubmit a proposal which addresses these problems. (*Analysis*, page F-31.)
Federal Deadline for Voter Database Approaching

The implementation of the federal Help America Vote Act of 2002 (HAVA) represents a significant opportunity for the Legislature to upgrade the state’s election systems and improve the administration of election laws. At a statewide level, the most pressing HAVA deadline is the requirement to have a federally compliant voter registration database operational by January 1, 2006. We offer a number of key considerations to assist the Legislature in implementing HAVA. (Analysis, page F-40.)

Addressing Public Pension Benefits and Cost Concerns

California “defined benefit” pensions in the public sector raise certain benefits and cost issues. For instance, some formulas provide retiree benefits that equal their working income. In addition, governments are “on the hook” for all increased retirement system costs. In response, the Governor proposes shifting all new public sector employees to “defined contribution” plans. Defined contribution plans address concerns with defined benefit pensions, but also introduce issues of their own. The Legislature could also address the benefits and cost concerns of current retirement plans within the existing defined benefit structure or with other pension plan alternatives. (P&I, “Part V.”)

Lowering the State’s Costs for Prescription Drugs

Our review of the state’s $4.2 billion annual purchases of prescription and nonprescription drugs found several deficiencies in the state’s procurement process which lead to it paying higher prices than necessary. We offer a number of recommendations to correct these procurement and administrative problems that, if implemented, would generate savings totaling tens of millions of dollars annually. For example, we recommend a short-term fix of increasing collaboration between state drug purchasers in order to share more drug pricing information and a long-term fix of leveraging the Medi-Cal drug formulary to lower drug prices in non-Medi-Cal programs. (P&I, “Part V.”)