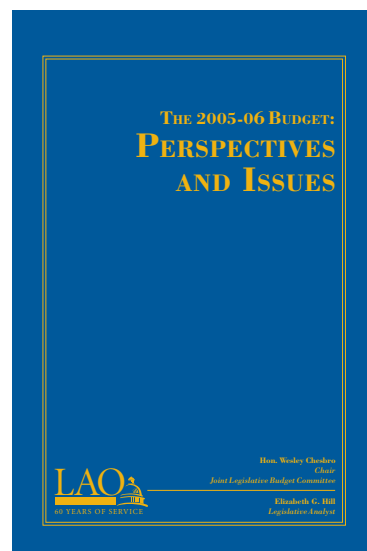


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Highlights of the:  
**2005-06**  
**Perspectives & Issues**

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## PART I—STATE FISCAL PICTURE

- The Legislature has an important budget opportunity. We project that revenues are \$2.2 billion higher (for the current and budget years combined) than reflected in the Governor's budget. This, combined with the magnitude of ongoing solutions proposed in the budget plan, would result in a balanced 2005-06 budget with a solid reserve.
- However, the price of inaction is significant. Without the adoption of ongoing solutions of the magnitude offered by the budget plan, the 2005-06 budget would be precariously balanced and the state would experience major budget shortfalls in 2006-07 and beyond. These shortfalls would be close to \$10 billion.

## PART II—PERSPECTIVES ON THE ECONOMY AND DEMOGRAPHICS

- The California economy is expanding at a healthy pace in early 2005, as evidenced by real estate construction, exports, company reports of sales and profits, and business-related tax receipts.
- The one area of concern remains jobs, which are lagging due to intense focus on cost cutting and efficiencies.
- We project the California economic expansion to continue at a moderate pace, with personal income expanding by roughly 5.6 percent and jobs growing 1.5 percent annually during the next two years.

## PART III—PERSPECTIVES ON STATE REVENUES

- The current strength in the economy is translating into solid growth in receipts from the state's taxes—particularly the corporate tax and personal income tax.
- Recent cash receipts trends have been even stronger than anticipated in the Governor's budget, mainly because of strong 2004 year-end collections from the personal income tax and corporation tax.

- Based largely on these positive trends, we project that General Fund revenues will exceed the budget forecast by \$1.4 billion in the current year and \$765 million in the budget year.

## PART IV—PERSPECTIVES ON STATE EXPENDITURES

- The budget proposes total state expenditures of \$109 billion in 2005-06. This includes \$85.7 billion from the General Fund (up 4.2 percent from the current year) and \$23.3 billion from special funds (up 5.3 percent from the current year).
- The overall General Fund spending growth rate reflects (1) changes in caseloads and utilization for major programs; (2) the impacts of the Governor’s savings proposals; and (3) the impacts of numerous other special factors, such as one-time savings in the 2004-05 budget.
- The proposal includes about \$3.5 billion in new budgetary borrowing related primarily to deficit-financing bonds, a judgment bond, and Proposition 42 suspension. This brings the total amount of budgetary borrowing outstanding to about \$29 billion as of the end of 2005-06.

## PART V—MAJOR ISSUES FACING THE LEGISLATURE



### **Governor’s Budget-Related Reforms**

- In this piece, we review the Governor’s budget-related constitutional reforms.
- Our main conclusion is that the Governor’s proposals put more spending on autopilot and would make it more difficult to balance future budgets in a rational way. The changes would also result in a diminution of legislative authority.
- The aim of potential reforms should be on increasing the tools and flexibility available to policymakers for dealing with changing budgetary circumstances. Specific options include (1) strengthening reserve provisions of Proposition 58 and (2) “unlocking” the budget by modifying existing provisions in law that earmark spending.

*(Contact: Brad Williams, 319-8306)*



### **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.

*(Contact: Michael Cohen, 319-8310)*



### **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.

*(Contact: Michael Cohen for Boards, 319-8310, and Greg Jolivet for YACA, 319-8340)*



### **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 that 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.

*(Contact: Dana Curry, 319-8320)*



### **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.

*(Contact: Dana Curry, 319-8320)*



### **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.

*(Contact: Mark Newton, 319-8323)*



### **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.

*(Contact: Dan Carson, 319-8350)*



### **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.

*(Contact: Michael Cohen, 319-8310)*

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