



Highlights of the 2007-08 Analysis

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PERSPECTIVES AND ISSUES

PART I—STATE FISCAL PICTURE

- The Governor's budget attempts to bridge a significant fiscal shortfall in 2007-08 through a variety of means, including a major redirection of transportation funds, significant reductions in social services, and a substantial increase in tribal gambling revenues.
- Based on our projections, we estimate that the Governor's budget plan would result in 2007-08 expenditures exceeding revenues by \$2.6 billion. This would leave the state with a \$726 million year-end deficit, compared to the Governor's January 10th estimate of a \$2.1 billion positive reserve.
- In addition, the state would face operating deficits of \$3.4 billion in 2008-09, \$2.5 billion in 2009-10, and \$1.4 billion in 2010-11.
- Thus, additional solutions will be needed to bring the budget into balance, such as budgetary savings, enhanced resources, or reduced supplemental payments toward paying off budgetary debt. It will also be important to avoid raising ongoing budget commitments without identifying alternative reductions or new revenues to pay for them.

PART II—PERSPECTIVES ON THE ECONOMY AND DEMOGRAPHICS

- Both the U.S. and California experienced continued economic expansion with modest inflation in 2006. The pace of growth varied during the year, however, being strong early-on, slowing subsequently due to a sharp decline in housing, and strengthening some at year-end.
- We forecast that California's economy will continue to expand in 2007, but at a slower pace than 2006. Growth will be weakest during the first half of the year but accelerate as the year progresses and the housing market stabilizes.
- This forecast is subject to risks, however, primarily relating to the future course of energy prices and whether the housing market stabilizes without adversely affecting the economy generally.

PART III—PERSPECTIVES ON STATE REVENUES

- Following two years of significant growth, revenues in 2006-07 appear to have slowed sharply, reflecting the more moderate economic expansion and a dip in income from capital gains.

- The budget assumes that revenue growth will revive somewhat in 2007-08.
- Budget-year revenues include nearly \$800 million from policy-related changes, including over \$500 million in additional tribal gambling revenues and about \$300 million from tax-related actions.
- We forecast that revenues and transfers will fall below the budget forecast for the current and budget years combined by about \$2 billion, primarily reflecting our weaker personal income tax projections.

PART IV—PERSPECTIVES ON STATE EXPENDITURES

- The budget proposes total state expenditures of \$130.8 billion in 2007-08, including \$103.1 billion from the state's General Fund and \$27.7 billion from special funds.
- General Fund spending would grow by a small 1 percent between 2006-07 and 2007-08, while special funds spending would grow by 13 percent. The year-to-year changes in many programs are affected by special factors, such as transfers of programs, funding redirections, and one-time actions.
- Spending for Proposition 98, the General Fund's largest program area, is proposed to be \$36.9 billion, an increase of only 0.5 percent. This relatively low growth rate reflects the Governor's proposal to shift home-to-school transportation expenditures from Proposition 98 to the Public Transportation Account, as well as the administration's assumption that local property tax revenues (which reduce General Fund expenditures for schools) will increase fairly rapidly, despite the state's real estate slowdown.
- Despite some repayment progress in recent years, the state would still have \$18 billion in budgetary debt outstanding at the close of the budget year. General Fund costs related to this debt would be \$4.1 billion in 2007-08 and peak at \$4.5 billion the following year.
- On a real per capita basis, total spending proposed in the budget would decline slightly in 2007-08. As a percent of state personal income, total spending would also decline slightly in 2007-08, to 8.5 percent.

PART V—MAJOR ISSUES FACING THE LEGISLATURE

Governor's Tax Proposals Make Sense

- The Governor is proposing to permanently eliminate the existing teacher retention tax credit, which was adopted in 2000 but was suspended in four of the past six years. We analyze the credit and conclude that it is neither an effective nor cost-efficient means of either retaining teachers or reimbursing

them for the supplemental instructional materials and supplies they choose to purchase. We thus recommend that the credit be eliminated. Doing so would generate revenues of \$165 million in 2007-08 and increasing amounts annually thereafter.

- The Governor also is proposing to make permanent the current temporary one-year test for determining whether a vessel, vehicle, or aircraft purchased out-of-state should be subject to California's use tax. We discuss the findings of a report we prepared for the Legislature on the fiscal and economic effects of using this one-year criterion. In that report we recommended that the one-year test be made permanent, and thus we recommend that the Governor's proposal be adopted. Doing so would generate revenues of \$35 million in 2007-08 and increasing amounts annually thereafter.

K-12

➤ **Fiscal Outlook Has Implications for the Guarantee**

- Although General Fund revenues would drop in both the current and budget years under our forecast, the Proposition 98 minimum guarantee for 2007-08 would increase. When combined with an overestimate of property taxes and a risky administration rebenching proposal, the Legislature is likely to face more than \$1 billion in additional Proposition 98 General Fund obligations.
- Lower current-year revenues also mean the state's 2006-07 minimum guarantee is now roughly \$600 million lower than proposed spending. We recommend the Legislature reduce current-year spending by a like amount in areas that would have minimal impact on program. This would generate major one-time and ongoing savings while still providing enough funding to support a K-14 baseline budget in 2007-08. (*Analysis*, page E-25.)

➤ **Five-Year Forecast Shows Large Increases on the Horizon**

- Our five-year forecast projects Proposition 98 funding would increase significantly more than needed to cover current program costs (adjusted for inflation and attendance growth). Thus, we think this is an opportune time to develop a long-term roadmap for K-14 education. Such a roadmap could help the Legislature establish long-term funding priorities, coordinate investments, and maximize potential benefits by linking new monies with policy improvements. (*Analysis*, page E-33.)
- In our suggested roadmap, we highlight the achievement gap that continues persists between K-12 special education, low-income, and English learner students and other K-12 students. To address these gaps, we suggest the Legislature make various investments in child development programs and

programs for at-risk students as well as strengthen accompanying assessment and accountability systems. (*Analysis*, page E-39.)

- Our roadmap also highlights the low graduation and transfer rates of community college students. To address these issues, we suggest the Legislature provide “student success” block grants that would create incentives for improvement while still allowing community colleges flexibility to develop local solutions. (*Analysis*, page E-39.)
- Finally, our roadmap would set aside a significant portion of the new discretionary funds for fiscal solvency block grants to K-14 school districts. These would help districts address their retiree health benefit unfunded liabilities. (*Analysis*, page E-42 and E-50.)

➤ **Settlement Programs Could Be Improved**

- In response to a recent settlement, the state agreed to pay an additional \$2.5 billion over a seven-year period for a new K-12 education reform program. We have concerns with the program as established and recommend small changes that could yield big payoffs. (*Analysis*, page E-109.)
- The settlement agreement also includes funds for career technical education (CTE) at the community colleges. When combined with current support for CTE, the state will have about \$400 million over the next seven years available for this program. We recommend an approach that would support comprehensive improvement in the delivery of career technical services throughout the state. (*Analysis*, page E-53.)

HIGHER EDUCATION

➤ **Recommend Smaller Student Fee Increases for Public Universities**

- The Governor’s budget calls for a 7 percent increase in student fees at the University of California (UC) and a 10 percent increase at the California State University (CSU). Given the state has no explicit policy for setting student fees, we recommend that fees be adjusted so that students next year pay, the same share of their total education costs as they are paying this year. Since we estimate that education costs will increase by 2.4 percent next year, we recommend that fees be increased by the same percentage. As a result, full-time undergraduates at UC and CSU would pay \$283 and \$192 less, respectively, than they would under the Governor’s proposal. (*Analysis*, page E-192.)

➤ **Community Colleges Have Unused Enrollment Funding**

- Enrollment at the California Community Colleges (CCC) has been declining over the past several years. At the same time, CCC’s budget has been

increased annually to accommodate enrollment growth. For the current fiscal year, we estimate that CCC will be unable to use more than \$100 million in enrollment funding. We recommend that the Legislature reduce this funding in CCC's budget in order to improve the state's overall fiscal health. (*Analysis*, page E-269.)

➤ **Reported Faculty Salary "Gaps" Are Misleading**

- The Governor's budget would direct the California Postsecondary Education Commission (CPEC) to develop a new methodology for comparing compensation for faculty at UC and CSU with other universities. The current methodology measures only salaries, and compares UC and CSU to a selected group of public and private universities.
- We agree that CPEC's measurement of faculty compensation needs to be improved. For example, while the average salary of UC and CSU faculty is lower than the average of selected comparison institutions, UC and CSU's faculty benefits (such as retirement and healthcare) tend to be well above average. As a result, CPEC's reporting of salary gaps between California's public universities and other institutions can be misleading. We recommend that the Legislature rethink the basis for comparing faculty compensation and direct CPEC to take an alternative approach on collecting and reporting specified faculty compensation information. (*Analysis*, page E-215.)

➤ **Standardize Approach for Funding Nursing Expansion**

- Given the rapid increases in nursing enrollment, we recommend that the Legislature provide UC and CSU with additional funding above the normal marginal cost to cover recognized higher costs of nursing students. However, we recommend that growth in nursing enrollment be treated as part of the overall enrollment growth provided in the budget, which already includes funding for marginal cost. (*Analysis*, page E-210.)

HEALTH

➤ **Short-Term Savings in Proposition 36 Could Result in Long-Term Costs**

- We review the administration's proposal for a net reduction of \$25 million for Proposition 36 programs, discuss why this reduction might eventually result in increased prison costs, and recommend redirecting funds in order to support Proposition 36 programs at their current level. (*Analysis*, page C-29)

➤ **Data Match Increases Veterans' Access to Benefits and Reduces State Costs**

- We estimate a shift of veterans from Medi-Cal to the federal Veterans Administration health system could save the state up to \$250 million annually, while providing those veterans with quality health care services. We recommend that California join 42 other states participating in a federal data matching process that would facilitate achieving these goals. (*Analysis*, page C-42.)

➤ **Department of Public Health Reorganization Cost Neutrality Uncertain**

- The budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz), that creates a new Department of Public Health and Department of Health Care Services from the existing Department of Health Services. We recommend the Legislature require the administration to provide additional information to ensure cost neutrality as required under Chapter 241. (*Analysis*, page C-63.)

➤ **Governor's Health Care Reform Proposal Has Both Merit and Risks**

- The Governor has announced a comprehensive health care reform proposal aimed at ensuring that all Californians have health care coverage. While not reflected in the budget plan, the proposal is an important starting point for discussions on health care expansion in California, although it contains a number of fiscal risks and uncertainties which could exceed \$3.2 billion. (*P&I*, "Part V.")

➤ **Promoting Health Information Technology in California**

- Health information technology (HIT) offers the potential to improve health care delivery and quality, but adoption of these tools by health care providers has been slow. Our review assesses the potential for health information tools such as electronic health records and provides an overview of health information development efforts in government and the private sector. We conclude that the state should take steps to promote widespread adoption of HIT, and we outline several strategies to achieve that goal. (*P&I*, "Part V.")

SOCIAL SERVICES

➤ **CalWORKs Sanction and Time Limit Proposals Not Necessary to Avoid Federal Penalties**

- In order to increase work participation and avoid federal penalties, the Governor proposes new time limits and sanctions on children whose parents cannot or will not comply with California Work Opportunity and Responsibility to Kids (CalWORKs) work participation requirements. However, under the

budget's own assumptions, California will meet federal participation requirements by federal fiscal year 2008. Thus, these policy changes are not needed to avoid federal penalties, and we recommend their rejection. (*Analysis*, pages C-124, C-128, and C-133.)

- As an alternative to the Governor's full-family sanction, we recommend an in-person engagement strategy for cases in sanction status. If upon being contacted by a caseworker, the family does not have good cause, cannot meet an exemption criteria, and is unwilling to participate, we recommend reducing the family's grant to one-half of its total. (*Analysis*, page C-132.)

➤ **Redirect SSI/SSP COLA Funds to CalWORKs**

- For 2007-08, the Governor proposes to provide the statutory January 2008 cost-of-living adjustment (COLA) for Supplemental Security Income/State Supplementary Program (SSI/SSP) recipients and suspend the July 2007 CalWORKs COLA for low-income families with children. Thus, the Governor's proposal increases grants for SSI/SSP recipients who are currently above the federal poverty guideline, while it suspends COLAs for CalWORKs families whose grants are currently below the guideline. In order to more effectively utilize General Fund resources to reduce poverty, we recommend redirecting \$124 million of the funds proposed for the SSI/SSP COLA to provide the CalWORKs COLA. (*Analysis*, page C-19.)

➤ **Enhancing In-Home Supportive Services (IHSS) Program Integrity**

- In-Home Supportive Services recipients are assigned hours of service by their social workers. There is no explicit prohibition, however, on reallocating hours across tasks or weeks. Thus, recipients may believe that the hours they receive are flexible and treat them as a block grant of hours. We make several recommendations that clarify IHSS program expectations and increase the likelihood that IHSS recipients will receive the care they need to avoid nursing home placement. (*Analysis*, page C-142.)

➤ **IHSS Wage Freeze**

- The Governor's budget proposes to freeze state participation in wages for IHSS providers. Under current law, the state participates in wages and benefits up to \$11.10 per hour, rising to \$12.10 per hour in 2007-08. If all counties increase their wages up to \$12.10, the state faces a General Fund exposure of \$350 million annually. The proposed wage freeze would result in savings of about \$14 million in 2007-08, and would eliminate this \$350 million exposure. We estimate the General Fund costs of several alternatives to the Governor's proposal. (*Analysis*, page C-139.)

➤ **Child Support Pass-Through Options**

- The Federal Deficit Reduction Act of 2005 increases federal participation in the amount of child support that states may pass through to welfare families. Although there is no requirement that states pass through a portion of collected child support to welfare families, California passes through the first \$50 of child support. We discuss the potential costs and benefits of increasing the amount of child support that is passed through to welfare families. (*Analysis*, page C-110.)

➤ **Child Welfare Performance Has Improved, But State Still Faces Federal Penalties**

- One year ago, the state failed to meet all seven federally required goals for outcome measures in the child welfare system. Current data suggests that the state now meets federal goals in four of seven outcome measures. Despite this improvement, failure on the remaining three outcomes will likely result in over \$20 million in federal financial penalties in 2007-08. (*Analysis*, page C-157.)

➤ **Plan Upgrades Licensing Automation, but Delays Internet Access to Compliance of Information**

- The Department of Social Services (DSS) oversees the licensing of about 86,000 facilities which care for vulnerable populations of children, adults, and the elderly. The Governor's budget includes a two-year plan to improve DSS's automated data system in order to more accurately track facility inspections and enforcement actions. The two-year plan, however, does not include the posting of licensing compliance information on the Internet, which has been a goal of the Legislature. (*Analysis*, page C-168.)

CRIMINAL JUSTICE

➤ **Governor's Prison Overcrowding Package More Balanced, But Too Big**

- The administration proposes \$9.6 billion (combined General Fund and lease-revenue bonds) as part of a 14-part package of proposals designed primarily to address overcrowding in state prisons and county jails. We find that the package has merit in that it provides a balance between adding new beds and reducing the inmate population. However, we estimate that it would result in a large surplus of state prison capacity and provide the wrong mix of beds. We recommend consideration of an alternative package that would address overcrowding, result in a smaller surplus of prison capacity, and reduce state costs relative to the Governor's proposal. (*Analysis*, page D-52.)

➤ **The California Prison Receivership: An Update**

- The federal court appointment last year of a Receiver to take over the state's prison medical care system is already resulting in a number of actions intended to improve inmate care as well as significant uncertainties regarding the state costs and savings likely to result from his actions. Given this situation, it will be important for the Legislature to provide oversight of these major changes in the prison medical system and carefully review and modify as appropriate budget requests submitted on behalf of the Receiver. (*Analysis*, page D-82.)

➤ **Enhancing Public Safety by Increasing Parolee Employment**

- A majority of state parolees are not regularly employed, thereby increasing the likelihood that they will commit crimes and return to prison. We identify several steps the Legislature can take to increase rates of parolee employment, including better targeting of funding to cost-effective programs, continuing federal funding for them, looking outside of California for successful approaches, requiring the department to track parolee employment rates, improving contracts for job referral programs, and improving case management by parole agents. (*Analysis*, page D-102.)

➤ **Juvenile Population Shift Warranted,
But Construction Funding Not Justified**

- The budget plan reflects administration proposals to (1) shift some offenders from the state to the local level and (2) enact a new state grant program to build county juvenile facilities. We find that the shift in offenders to the local level could mutually benefit the state, counties, and the offenders and their families. However, we recommend rejection of the \$400 million in bond financing to build as many as 5,000 local juvenile beds, given the current excess of about 4,000 such beds. (*Analysis*, page D-147.)

➤ **State Has Inadequately Maintained Its Investment in
Prison Infrastructure**

- State prison facilities represent an investment in today's dollars of as much as \$20 billion. Nevertheless, the state faces a growing backlog of special repair work that now exceeds \$200 million, due in part to problems in the way preventative and other maintenance responsibilities are managed and organized. We recommend a series of actions to protect the state's major investment in prison infrastructure. (*Analysis*, page D-119.)

➤ **Courthouse Bond Proposal Deserves Close Scrutiny**

- The Governor proposes to place a \$2 billion bond issue on the ballot for courthouse construction and to establish public-private partnerships to leverage additional resources for this purpose. We withhold recommendation on the bond issue pending further review of the proposal. We recommend rejection of the companion legislation for public-private partnerships because it provides a weak model for legislative control and oversight of these major projects. (*Analysis*, page D-17.)

➤ **An Update on the Implementation of Proposition 69**

- Our review of the Proposition 69 DNA Program finds that it is likely to require \$10 million to \$20 million annually from the General Fund if all incoming samples were to be processed on a timely basis. Although the Department of Justice has taken steps to reduce a backlog of samples, it faces difficulties in recruiting and retaining staff to handle its workload and must also deal with the expected increase in samples in 2009 that is likely to significantly increase the backlog. (*Analysis*, page D-26.)

TRANSPORTATION

➤ **Eliminate Arcane Spillover to Simplify Transportation Funding Structure**

- The “spillover” mechanism—a source of transit funding—is arcane and outdated with the passage of Proposition 42, which results in all state gasoline sales tax revenues being used for transportation. We recommend that the mechanism be eliminated effective 2008-09. This would simplify the transportation funding structure and increase the predictability and stability of the Public Transportation Account. (*Analysis*, page A-25.)

➤ **Governor’s Proposition 1B Proposals Circumvent Accountability**

- The budget proposes to appropriate in 2007-08 three years’ worth of Proposition 1B bond funds, even though the administration has not as yet identified the projects to be funded with these monies. In addition, the budget proposes to give the administration the authority to transfer these funds among programs. These proposals run counter to the bond measure’s intent that the Legislature appropriate specific amounts for various programs. The “power of the purse”—appropriation authority—is one of the Legislature’s most powerful tools to ensure accountability. We recommend rejecting the Governor’s proposals as they would circumvent accountability in how funds are used. (*Analysis*, page A-52.)

➤ **Slow Progress in Traffic Congestion Relief**

- Seven years into the Traffic Congestion Relief Program, only 26 of 141 projects have been completed. This is because delayed state funding and cost increases have impeded the delivery of projects. Looking forward, the availability of state funding and costs increases will continue to threaten project delivery. We recommend steps that the Legislature can take so that projects are completed, including setting project deadlines and reverting funds where projects are no longer viable. (*Analysis*, page A-63.)

➤ **Aging Highway System Requires More Maintenance and Rehabilitation**

- The state faces increasing costs to maintain and rehabilitate its highways as the system ages. While the budget proposes more funding for these activities, it does not address the long-term issue that maintenance and rehabilitation requirements are growing faster than the revenues which pay for them. As a consequence, there is an estimated \$2 billion annual shortfall in funding for highway maintenance and rehabilitation. We offer options for the Legislature's consideration in addressing this shortfall, including increasing and indexing the gasoline tax. (*Analysis*, page A-30.)

➤ **Time to Bite the Bullet for the Bullet Train**

- The Governor proposes to indefinitely postpone submitting a high-speed rail bond measure to the voters. The budget provides \$1.2 million to support the High-Speed Rail Authority, but provides no money for contract services to develop the rail system. This would essentially end the project unless another source of funding is provided. We recommend that the Legislature decide whether to continue the project or disband the authority. (*Analysis*, page A-77.)

➤ **Real ID Regulations and Funding a Big Question**

- It is virtually impossible for California—or any other state—to implement Real ID by the federal deadline of May 2008, especially in light of the delayed federal regulations. Given the lack of federal direction to date, the absence of any federal plan to fund the law's costly implementation, and growing opposition to the program in a number of other states, we recommend the Legislature and administration go slowly, and limit any state funding to planning activities. (*Analysis*, page A-88.)

RESOURCES

➤ **\$2.3 Billion of Bond Expenditures: State Should Proceed Carefully**

- The budget proposes over \$2.3 billion in bond funding for various resources programs, a majority coming from two resources bonds approved by voters in November 2006—Proposition 1E (\$4.1 billion for flood management) and Proposition 84 (\$5.4 billion for various water projects, natural resource protection, and park improvements). This reflects substantially higher bond expenditures than in the current year, particularly for flood management.
- We think that there are a number of actions that the Legislature can take to ensure that the new bonds are implemented effectively, efficiently, and consistent with legislative priorities. For example, we recommend that the Legislature set funding priorities and eligibility criteria to guide a number of new programs created by the bonds. The Legislature should also establish appropriate cost-sharing arrangements, particularly for flood management projects, and ensure similar bond programs are coordinated and administrative costs are reasonable. (*Analysis*, page B-17.)

➤ **Implementation of AB 32 Heats Up, but Leaves Legislature in the Cold**

- The budget proposes a \$36 million, multiagency effort to implement the Global Warming Solutions Act of 2006 (also known as “AB 32”) to reduce the state’s greenhouse gas emissions. In a number of areas, the proposal moves ahead of or is contrary to legislative direction. We therefore recommend eliminating funding for activities at the Secretary for Environmental Protection and the California Public Utilities Commission that are inconsistent with the act. We also recommend legislative language that would bar the implementation of “market-based mechanisms” until the Air Resources Board has comprehensively evaluated them and advised the Legislature of its findings. (*Analysis*, page B-50.)

➤ **Flood of New Flood Control Spending on the Horizon, But What Is Guiding It?**

- The budget proposes spending \$624 million from the Proposition 1E flood management bond in the budget year, but the Department of Water Resources is late in submitting a required expenditure plan for these funds. In addition, the department’s criteria for selection of bond-funded projects are unclear. If a systematic approach to project selection is not used, this could potentially result in unwise flood control investments that increase flood risk, rather than reduce it.

- We also find that there is not a process in place to provide an adequate level of independent oversight of the department’s new flood-related capital outlay projects. We therefore recommend the Legislature withhold its approval on all flood-related capital outlay projects until the department addresses these shortcomings. (*Analysis*, page B-117.)

➤ **State Water Project Has Increasingly Important Role in Statewide Water Policy**

- The role of the State Water Project (SWP)—the state’s main water conveyance system connecting Northern and Southern California—has changed significantly since voters approved a bond in 1960 to begin its construction. Increasingly, SWP is fiscally and programmatically related to a number of the state’s water programs, such as the CALFED Bay-Delta Program, that receive their funding in the annual budget bill. However, SWP is “off budget,” meaning that it is not subject to legislative appropriation in the budget bill. This off-budget status makes it difficult for the Legislature to comprehensively evaluate the state’s water policy issues. Therefore, we recommend that SWP be brought on budget, in order to facilitate legislative oversight of these issues. (*Analysis*, page B-129.)

➤ **Surface Water Supply Projects Need Funding Partners**

- We recommend that the Legislature deny \$9.8 million of state bond funding proposed to continue feasibility studies for two surface storage projects, given the lack of identified federal and/or local funding partners necessary to allow the studies to practically move forward. (*Analysis*, page B-46.)

➤ **Improvements Needed in Water Board’s Information Technology (IT) Activity**

- On numerous occasions, the Legislature has stressed the fundamental role that management of data—including data on permitting, enforcement, and water quality—plays in assisting the State Water Resources Control Board carry out its mission. There is room for improvement in the board’s IT activity. For example, due to the constantly expanding scope of some IT projects, backlogs in the entry of data have occurred at the regional board level, resulting in less than complete water quality data being displayed on publicly accessible Web sites. We make a number of recommendations to improve the board’s IT activity and to provide the necessary oversight of its projects. (*Analysis*, page B-139.)

➤ **Science Still Out on State’s Regulation of Drinking Water Contaminants**

- The Office of Environmental Health Hazard Assessment (OEHHA) develops public health goals (PHGs) that serve as the scientific basis for the state’s drinking water standards that are adopted and enforced by the Department of Public Health. We find that OEHHA has consistently lagged statutory timelines for developing PHGs and keeping them current. Absent up-to-date PHGs, the Department of Public Health lacks a scientific basis for regulating drinking water contaminants, such as perchlorate, more stringently than the floor set by the federal standards that otherwise govern. We recommend that OEHHA report on the resources it requires to complete its statutorily defined responsibilities in a timelier manner, and we provide a fee-based funding source for it to do so. (*Analysis*, page B-145.)

➤ **San Joaquin River Restoration Lawsuit Settlement: Responsible Parties Should Pay First**

- The budget proposes to use \$14 million in Proposition 84 bond funds to implement a recent court settlement providing for the restoration of the San Joaquin River. While the state is not a party to the lawsuit, the budget, nonetheless, proposes to use state funds to implement the settlement, before Congress has authorized the federal share of funds under the settlement. We recommend against appropriating any state funds for the restoration until the federal funding contribution is secured. (*Analysis*, page B-63.)

➤ **Wildland Firefighting Expenditures Continue to Rise Significantly**

- The fire protection budget of the California Department of Forestry and Fire Protection (mostly funded from the state General Fund) continues to rise significantly, and is proposed at \$1.2 billion for the budget year. While the primary mission of the department is to provide wildland fire protection, it also responds to medical emergencies and structure fires, which are not state responsibilities.
- We make a number of recommendations to control the rising costs, including clarifying state and local roles for providing emergency services, modifying the criteria by which land is designated a state responsibility for fire protection, and enacting a fee on private landowners to partially cover the state’s costs in providing fire protection services that benefit them. (*Analysis*, page B-77.)

➤ **Budget Fails to Address State Parks Maintenance Requirements**

- Last year, the Legislature appropriated \$250 million from the General Fund to partially address an over \$900 million backlog in state parks deferred maintenance projects. The budget proposes to transfer \$160 million from this

appropriation back to the General Fund—the amount projected to be unspent at the end of the current fiscal year—while proposing no replacement funding sources. We recommend appropriating \$160 million in Proposition 84 bond funds for deferred maintenance projects to replace the General Fund monies proposed to be returned to the General Fund. We also recommend augmenting the department’s ongoing maintenance budget by \$15 million per year, funded from increased park fees, to slow the growth in the department’s deferred maintenance problem. (*Analysis*, page B-102.)

➤ **Telephone Ratepayer Relief on the Horizon**

- One of the Public Utilities Commission’s programs which provides subsidies to larger telephone corporations serving high cost areas has a projected fund balance of \$333.5 million. A statutorily required review by the commission of this program’s cost-effectiveness is long overdue. In light of the fund balance, we recommend that the commission phase out and eliminate the telephone surcharge that pays for this program. (*Analysis*, page B-153.)

GENERAL GOVERNMENT

➤ **Guaranteeing Teacher Benefit Not Advisable**

- The administration proposes to reduce contributions to the California State Teachers’ Retirement System’s purchasing power account—which protects retired teachers’ benefits from being eroded by inflation—by \$75 million on an ongoing basis. The reduction in contributions would be accompanied by a state guarantee of protection from inflation. There are risks to achieving the savings because the state could be obligated to make much higher contributions in the future if there is high inflation or poor investment returns. We recommend rejecting the proposal. (*Analysis*, page F-68.)

➤ **Cost-of-Living Increase for State Employees Appears Overbudgeted**

- The Governor’s budget includes \$549 million (\$155 million General Fund) to pay for 2007-08 general salary increases for state employees. For employees in 15 of the state’s 21 bargaining units, these raises are tied to a specific inflation rate for the 12 months ending in March 2007. The administration assumes that the inflation rate will be 3.3 percent. We believe the inflation rate (to be released in April) will be lower—an estimated 2.3 percent. This would save the state \$100 million (\$40 million General Fund). (*Analysis*, page F-119.)

➤ **Increasing Legislative Oversight of Employee Compensation**

- Recent agreements with unions, arbitration decisions, and administration actions have all undermined the Legislature’s ability to effectively oversee the compensation that is paid to state employees. We offer recommendations

that would (1) limit the authority of arbitrators to order large payments based on their interpretation of future labor agreements and (2) end the use of automatic pay raise formulas tied to actions by other governmental employers. (*P&I*, “Part V.”)

➤ **Delete Midyear Reduction Authority for More Honest Budgeting**

- The administration assumes \$146 million in General Fund savings from proposed authority to reduce departmental budgets during the year. Savings from these types of proposals are rarely achieved. For instance, it is unclear how the Department of Corrections and Rehabilitation will absorb a proposed \$31 million reduction—given that the department has experienced budget shortfalls of more than \$100 million every year since 2000-01. We recommend that the Legislature delete the proposed authority. The administration should identify any specific proposed savings in departmental budgets during the spring budget process and how it expects these savings to be achieved. (*Analysis*, page F-126.)

➤ **Governor Proposes IT Changes**

- The Governor’s budget proposes a \$1.3 billion project over the next decade to develop a new statewide financial IT system that would be used by all departments. Our analysis discusses the primary components of this project proposal, key issues the Legislature should consider in evaluating the project, and recommends additional oversight tools if the Legislature decides the project should go forward. (*Analysis*, page F-81.)
- The administration also proposes a number of changes to the state’s IT governance structure. While components of the proposal have merit, we recommend several changes. Specifically, in order to maintain objectivity, we recommend not moving IT project oversight from the Department of Finance to the Chief Information Officer (CIO). In addition, to avoid creating another layer of review, we recommend rejecting a separate security office. Instead, the CIO’s new responsibilities should include data security. (*Analysis*, page F-28.)

CAPITAL OUTLAY

➤ **Effectively Implementing the November 2006 Bond Package**

- The infusion of \$43 billion in bond funds authorized at the November 2006 election provides the state with a major opportunity to make infrastructure investments that will last for a generation or more. More than \$18 billion of the funds is allocated to 21 new programs. In designing the framework for these new programs, the Legislature should emphasize long-term benefits and statewide priorities. A program’s goals and the criteria for selecting projects should be clearly defined. The Legislature can add additional oversight by

rejecting the use of continuous appropriations, limiting administrative costs, using special committees and joint hearings, and requiring and reviewing annual reports. (*Analysis*, page G-13.)

- Of the \$43 billion, the Governor proposes spending \$2.8 billion in 2006-07 and an additional \$8.7 billion in 2007-08. The Governor recently issued an executive order on increasing accountability and public information of the bonds. The Legislature will want to ensure that the audits and Web site called for in the order are strategically implemented to avoid duplicating existing accountability measures. (*Analysis*, page G-27.)
- In paying off these bonds, the state's debt burden will rise to a peak of 5.6 percent of annual revenues in 2010-11. (*Analysis*, page G-20.)

➤ **Governor Proposes Billions in Additional Borrowing**

- The Governor proposes \$29 billion in additional general obligation bonds to be put before the voters at the 2008 and 2010 elections. The Governor also proposes \$12 billion in lease-revenue bonds, primarily for corrections and local jails. If approved, this additional borrowing would raise the state's debt burden to a peak of 6.1 percent of annual revenues in 2014-15. (*Analysis*, page G-10.)

LOCAL GOVERNMENT

➤ **Improving the Mandate Process**

- The State Constitution requires the state to reimburse local governments for state mandates, but the process for determining the existence of mandates and providing payments for them is a major source of state-local friction. Building on the administration's reform proposal, we offer the Legislature a three-part plan that would greatly simplify and expedite the mandate determination process. (*P&I*, "Part V.")

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