CITIZENS'
Budget
2003–05

A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities

Reason

The Performance Institute

Project Director: Carl DeMaio

This is the Executive Summary of our full Citizens' Budget for California. To access the entire California Citizen's Budget, go to www.rppi.org/cacitizensbudget.html. For printed copies email your request, with address, to mtoledo@reason.org. For questions about the report, contact george.passantino@reason.org or 310-391-2245

Citizens' Budget

A Balanced Approach to Solving the Deficit while Safeguarding California's Quality of Life

By Carl DeMaio, Adrian Moore, Adam Summers, Geoffrey Segal, Lisa Snell, Vincent Badolato, and George Passantino

Project Director: Carl DeMaio

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April 30, 2003

Governor Gray Davis and Members of the State Legislature
State Capitol Building
Sacramento, CA 95814

Dear Governor Davis and Members of the State Legislature:

As you are all well aware, California faces the worst fiscal crisis of any state in the nation with its mind-numbing $26-34 billion budget deficit. With each day that passes without action on the budget, the situation only gets worse. In order to contribute to the state's effort to meet this fiscal challenge, the Citizens' Budget outlined in this report provides a non-partisan and comprehensive plan that will balance California's budget without raising taxes and without reducing vital citizen services.

Before you consider this budget, there are a few things you should know.

- If you believe that our state government is 100% efficient and programs cannot possibly be redesigned to do more with less…then this budget is not for you.
- If you believe that the only way to balance the budget is to raise taxes…then this budget is not for you.
- If you believe that the only way to balance the budget is to sacrifice vital program services…then this budget is not for you.
- If you want to use the current budget crisis to play to your base and score political points…then this budget is not for you.

However, if you are serious about balancing the budget while protecting the quality of life in California, then this budget plan brings good news and provides some much-needed advice on how this present crisis can indeed be addressed without resorting to the false choices of increased taxes or draconian cuts in services.

Ultimately, the Citizens' Budget plan provides more reductions than needed to balance the budget. Indeed, should all of the reforms and recommendations be accepted, California could emerge from this plan with a $6.5 billion surplus by 2005.

How? The Citizens' Budget plan calls for a fundamental overhaul of most state programs using proven management reforms that not only produce cost savings but also improve program performance. It implements well-documented innovations pioneered by other states that have demonstrated that state government can indeed do "more with less." Most importantly, it keeps California's commitment to investing in our children's education and maintains public health and social services.

At the heart of this plan is the belief that with serious effort and leadership, California's best days are ahead of us. To get there, all sides of the budget debate must work together constructively—and all options and ideas must be put on the table. The time and effort put into constructing the Citizens' Budget is but one initial contribution to that effort.

Sincerely,

Carl DeMaio
President, The Performance Institute
Senior Fellow, Reason Foundation

Adrian Moore
Executive Director
Reason Public Policy Institute

Outline of Citizens' Budget Plan

(available at www.rppi.org/cacitizensbudget.html)

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Reason Public Policy Institute and The Performance Institute

Citizens' Budget

A Balanced Approach to Solving the Deficit while Safeguarding California's Quality of Life

BY CARL DEMAIO, ADRIAN MOORE, ADAM SUMMERS, GEOFFREY SEGAL, LISA SNELL, VINCENT BADOLATO, AND GEORGE PASSANTINO

PROJECT DIRECTOR: CARL DEMAIO

Executive Summary

It is amazing what a difference four short years can make. In 1998, California was running a $12 billion surplus—economically on the rebound and adding nearly 500,000 new jobs to its economy that year. Yet, in the past four years, California has fallen from the *most* jobs-friendly state to the *least* jobs-friendly state in the nation.[1] Instead of saving record-breaking one-time surpluses produced by the stock bubble of the late 1990s, the state went on an unsustainable (and undeniable) spending spree in 1999, 2000 and 2001. As a result, today California faces a monumental budget deficit of between $26 and $34 billion dollars—and its economy has shed over 489,000 jobs alone since March 2001!

The state's budget deficit is merely a symptom of an overall decline in our quality of life in California. Indeed, in terms of cost of living and quality of life, the average Californian is finding living in our state harder and less satisfying.

Businesses are leaving the state in droves—not because consumers are not spending, but because the price of operating in California has skyrocketed due to higher costs for energy, workers' compensation insurance, and regulation. Mismanagement of the state's finances only contributes to a growing sense of uncertainty for businesses. In a sick cycle, as more jobs leave the state, the deficit gets worse with fewer and fewer taxpayers contributing. If every Californian that *wanted* a job could *get* a job, the state would actually face a budget surplus this year.

A Tale of Three Californias: Past, Present and Future		
Past (1998): Surplus	**Present (2002): Deficit**	**Future (2005): Possible ?**
		
$12 billion state budget surplus • 8.6 state employees per thousand population • K-12 education spending was $5,756 per pupil, California ranked 37 in achievement tests • Workers' compensation costs totaled $6.6 billion • The state's economy was creating 500,000 new jobs that year, keeping unemployment to a modest 5.6 percent.	**$26-34 billion state budget deficit** • 9.3 state employees per thousand population • Lowest bond credit rating of all US states! • K-12 education spending is $9,072 per pupil, California still ranked 37 in achievement tests (64 percent increase in spending, no increase in performance) • Workers' compensation costs soaring to over $15 billion • The state's economy shed 489,000 jobs since March 2001, pushing unemployment up to an unhealthy 6.6 percent.	**Should the state adopt the Citizen's Budget:** • $1.5 billion surplus • 8.7 state employees per thousand population • $10,000+ in per pupil spending, and top 25 and improving in academic achievement tests • 600,000 new jobs created in California since June 2003 (not a record, but good nonetheless)



California is spending more, but getting less in its education system.

Even Californians with jobs are finding it harder to make ends meet. Prices for basic necessities such as utilities, health care, and housing are rising beyond what many families can afford. One in five Californians cannot afford health insurance; more than half cannot afford to buy their own house at today's market rates. Then there are various taxes and fees, which may go up on everything from baby diapers to cars if Sacramento gets its way. Like the now-infamous case of golf pro Tiger Woods moving to Florida to avoid high California taxes, many Californians are fleeing what was once the golden state of opportunity…and taking their tax revenues with them.

The basic public services that define much of a quality life are failing our residents. Despite increasing spending to more than $9,072 per pupil (up dramatically from $5,756 in 1998), California's schools still have not made the mark—and only 30 percent of students in the seventh grade can pass state math and language proficiency exams. The transportation system is overburdened, with some Californians spending hours each day away from work, their families and their hobbies—sitting in bumper-to-bumper traffic. Finally, lawmakers at all levels are threatening to address the budget crisis by cutting back police and fire coverage, library hours, park and recreation opportunities, and a number of social services.

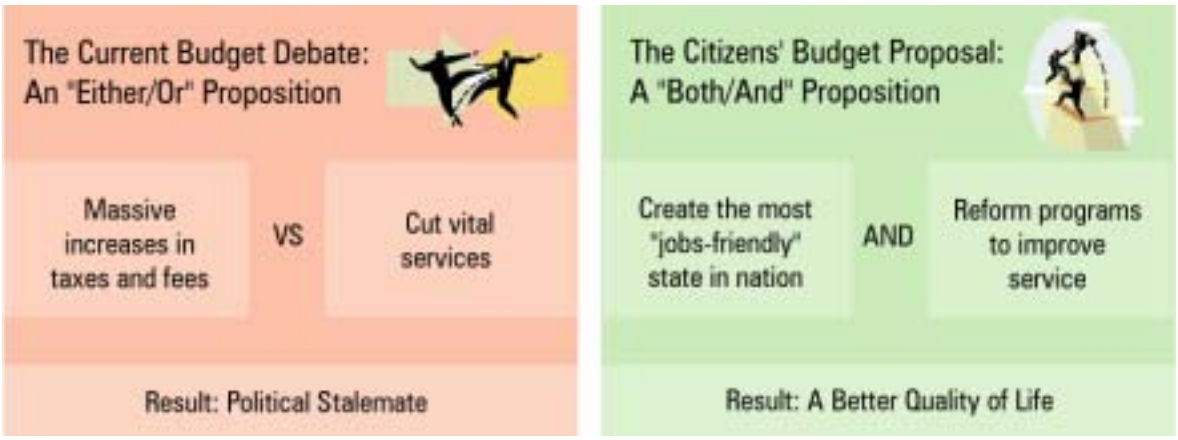
Today, California finds itself at a crossroads. The decisions made during the current budget crisis will affect Californians not only today but for years to come. Many of the quality-of-life challenges detailed above directly relate to decisions the state has (or has not) made each year in its budget. By not addressing a "job-killing" economic environment in the state through our tax and regulatory policies, we run the risk of driving away more businesses and the jobs they provide. By not examining the soaring cost of living in utilities, health care, and housing, residents will only see their quality of life further diminished. Most importantly, by not using the budget to fundamentally rethink and reform how the state provides essential citizen services such as education, transportation, public safety, and social services, we drive even more jobs and residents from the state…and see further decay in our quality of life.

The present challenge is not merely how to balance the books in Sacramento today; it is about what quality of life we want for California tomorrow.

Failure of Leadership in Sacramento Creates the Need for the "Citizens' Budget"

Depending on how you keep score, the state faces a budget deficit of between $26 and $34 billion dollars. With each passing day, the situation seems to be getting worse, not better. Gov. Gray Davis and the state legislature seem hopelessly deadlocked, engaging in a partisan game of finger-pointing and attacks. Only a fraction of the Governor's proposed emergency budget reductions have been enacted by the legislature. Indeed, much of the Governor's plan has been labeled by Legislators from both parties as "dead-on-arrival."

To date, the factions in Sacramento have yet to engage in a constructive, bipartisan dialogue on Long-term solutions to the state's fiscal mess and quality-of-life challenges. The **"Citizens' Budget"** hopes to fill that vacuum by offering a plan that balances the state's budget without tax increases, while maintaining important programs and services that are vital to our quality of life in California.



Most importantly, the **Citizens' Budget** fundamentally rejects the two extremes being presented by Sacramento on the budget. On one side, Republicans oppose tax increases they say would further dampen the economy and cost hundreds of thousands of jobs across the state. On the other side, Democrats reject cuts to programs they say would result in loss of vital services to the poor, women and children. And in the middle of these two extremes, some suggest a "balanced" approach would mix tax increases with cuts in services.

Neither extremes nor the middle is accepted in the **Citizens' Budget** plan. Balance cannot be defined as raising a dollar in taxes for every dollar cut in services. Balance is keeping taxes low to encourage job creation and a low cost of living, while ensuring vital public services can still be provided in a quality manner.

As a result, the **Citizens' Budget** provides comprehensive strategies for restructuring the state government, maintaining the public's commitment to increasing funding for education, improving performance of key state health and social service programs, and revitalizing the state's economy by creating an environment where businesses can once again create jobs in California. Instead of seeing the budget as an "either-or" proposition, the **Citizens' Budget** takes the view that California can close the deficit and *still* offer the same (or better) vital services currently being relied on by the citizens.



The **Citizens' Budget** offers line-by-line suggestions on how to achieve a balanced budget—as well as detailed implementation recommendations on how to enact spending reductions without sacrificing vital services. First, the plan identifies areas where the state is grossly mismanaging taxpayer money and where cost saving improvements can be implemented. (The examples we uncovered will truly enrage hard-working taxpayers who foot the bill!) Second, the plan identifies innovations from other states that are providing the same services to their citizens but at a better price. By adopting these "best-in-class" reforms to each state program, California can redesign *how* services are provided rather than identifying what services should be cut. Finally, the plan makes targeted spending reductions in the least essential programs—suspending programs temporarily for this budget cycle rather than eliminating them.

The **Citizens' Budget** actually contains *more* spending reductions than will be needed to balance the budget. In doing so, the plan serves as a "menu" of options for lawmakers to consider. Nevertheless, balancing the state budget will require a detailed, program-by-program review by the legislature rather than rhetoric and across-the-board, cookie-cutter solutions. It will take hard work, but it can be done—should Sacramento be willing.

The Citizens' Budget: How it All Adds Up

Budgets must start with a clear understanding of three elements. How much revenue is expected? How much do you have to spend to meet citizen needs? How much of a deficit (or surplus) carry-over is there from the previous year?

Holding revenues constant, if the state were to completely close the deficit in one single year, it would need to reduce spending by **$17.1 billion**. Yet over a two year (biennial) budget, the state would only have to reduce spending by a more manageable **$11.7 billion**. In addition to opting for a two-year budget cycle, the **Citizens' Budget** provides a "menu" of over **$18.2 billion** in reductions in addition to what the Governor has proposed. As a result, Legislators need only select from a few of the reforms to create a workable budget solution.

The FY 2002-03 budget figures reflect actual expenditures this year given the legislature's rejection of most of the Governor's proposed reductions. From those baseline figures, the **Citizens' Budget** makes "adjustments" reflecting the rejection of items proposed by the Governor as well as the addition of one approach to selecting from the "menu" of reforms and reductions suggested by our plan. As a result, while the budget below reflects our suggested solution from a realistic assessment of how fast and how far the state can go with its reform of various programs, it remains merely *one* of several packages that could be constructed using our recommendations.

Table ES 1: Biennial Budget Cycle 03-05 ($ millions)

Budget Year	2002-2003	2003-2004	2004-2005	2005-2006
Carry-Over	**-2135**	**-8054**	**-5146**	**1532**
Revenues	**72964**	**70643**	**73293**	**79012**
Adjust Indian Revenue	0	-1000	-800	-700
Divest Unused Assets		200	800	
Defer Transportation Loan			650	
Adjusted Revenues	72964	69843	73943	78312
Total Resources	**70829**	**61789**	**68797**	**79844**
Baseline/Governor's Proposal	**78883**	**63186**	**66935**	**78200**
Reject Realignment to Special Fund		8154		
Reject VLF Backfill Elimination		2900		
Reject Fee Increases		595		
Maintain Proposition 98 (restore current deferral)		-1100	1100	
Reform/Realign Health/Social Services			-500	
Allocate Mandatory Increases in 04-05 (caseloads, federal mandates)			2400	
Enact Performance-Based Reductions		-4400		
Reform Procurement and Competitive Sourcing		-800	-1800	
Reform Personnel and Create Employee Incentives		-1200	-400	
Streamline and Reorganize		-400	-470	
Final/Proposed Expenditures	**78883**	**66935**	**67265**	**78200**
Fund Balance	**-8054**	**-5146**	**1532**	**1644**
Encumbrances	-1400	-1400	-1400	-1400
Reserve	**-9454**	**-6546**	**132**	**244**

The bottom-line expenditures proposed by the Citizens' Budget reflect a roll back of budgets to funding state government at FY 1999-00 levels—a mere correction of the "spike" of uncontrolled and unsustainable spending increases enacted during the 2000-2001 cycle.

Achieving Balance: Recommended Reforms in the Citizens' Budget

1. Adopt Biennial (Two Year) Budgeting

By moving California to a two-year budget cycle under biennial budgeting, the challenge of balancing the budget becomes easier. Biennial budgeting is an accepted (and many would argue preferred) way to budget on the state level. Moreover, it will take time to thoughtfully implement the various management reforms and program restructuring recommended by our plan. By moving to a two-year cycle, the state can enact our recommended management changes in year one to reform programs to "do more with less" and prevent a disruption in services. Finally, additional revenues in 2004-05 make the shortfall easier to manage.

2. Use Realistic Revenue Expectations for Indian Gaming

The Governor assumes $1.5 billion in revenue from negotiations with Indian tribes over revenue sharing from casino gambling. We agree that this revenue source should be pursued. California is the only state in the nation to not receive a portion of casino gambling revenues. However, the Governor's projected revenues are not realistic and our plan adjusts revenues to a more reliable level of about only 40 percent of the Governor's expected revenue. Should the Governor's projections be correct, these revenues could be used to offset unrealized savings/revenues elsewhere.

 **Available Revenue**: $3 billion

 **Citizens' Budget Assumption**: $1.2 billion

3. Divest Unused Assets

As detailed in the supporting chapters of our plan, the state of California has a number of vacant, unused and under-utilized assets and real estate on its books that could be converted to other governments, the private sector or individuals through divestiture. While our analysis shows well over $1.5 billion is available from this recommendation, our budget assumes only $1 billion in revenue phased in over the two years of the budget. (Additional savings from operation and maintenance costs are not reflected in this reform but could be reflected in individual program budgets.)

 **Available Revenue**: $1.5 billion

 **Citizens' Budget Assumption**: $1 billion

4. Defer Transportation Loan

The Governor proposed to forgive a $500 million loan repayment from the General Fund to the Transportation Congestion Relief Fund (TCRF) in fiscal year 2003-04. By deferring the loan repayment for two years rather than forgiving the loan, the General Fund in 2004-05 will reflect an additional $650 million in resources.

 **Available Revenue**: $650 million  **Citizens' Budget Assumption:** $650 million

5. Reject Increased Taxes and Realignment Initiative

The Governor proposes to realign a variety of health and social service programs to the local level—and to provide a dedicated funding stream for these services to localities using increased taxes on tobacco, an increase in sales tax, and an increase in personal income taxes. Not only is it a bad idea to increase taxes during an economic downturn, but Proposition 98 rules might sequester half of the new revenue from these taxes to education. (We propose instead an alternate realignment based on block grants.)

6. Reject Elimination of VLF Backfill

The Governor proposes to violate a prior agreement with local governments to "backfill" the loss from the reduction in vehicle license fees adopted several years ago. Raiding local government to mask the state's own spending problems is no solution to the crisis—it merely shifts the pain to a level of government that had no part in the problem.

 **Available Cost Savings**: $2.9 billion in FY 03-04  **Citizens' Budget Assumption:** $0

7. Reject New Fees

The Governor proposes a myriad of new fees be charged to businesses, individuals and even students. These increased fees are ironically claimed as "cost savings" as they would defray on-budget costs for the services tied to the fees. One fee would increase fees charged to community college students for classes by 150 percent! With the cost of living already skyrocketing throughout the state, now is a bad time to be raising fees unless all other options have been exhausted first.

 **Available Cost Savings**: $565 million in FY 03-04; $605 million in FY 04-05  **Citizens' Budget Assumption:** $0

8. Protect and Improve Education/Maintain Proposition 98

The Governor proposes to reduce Proposition 98 funding to the mandatory level through a reduction of 2.7 percent. While some have proposed temporarily suspending Proposition 98, the **Citizens' Budget** flatly rejects that idea. Instead, Proposition 98 funding must be maintained in full. Moreover, during this legislative session, a one-time deferral in Proposition 98 funding was made by merely extending a $1.1 billion payment from June to July to create a "phantom" cost savings in FY 03-04. The **Citizens' Budget** restores this phantom savings in FY 04-05. (NOTE: It is possible that if revenues fall below expectations, other reductions in required funding under Proposition 98 could be made.)

Furthermore, instead of opting for the Governor's proposed across-the-board cut, our plan requires that reductions must be made outside of the classroom in a way that allows school districts greater flexibility over how they receive and allocate funding. As our recommendations and analysis detailed in a supporting chapter demonstrate, all of the Governor's reductions can indeed be made outside of the classroom through three reforms: reforming categorical funding in education, allowing school districts to competitively source non-instructional services, and adopting a "weighted funding formula" so schools can better anticipate and manage funding. Finally, during the 04-05 year of the budget, schools would move to an open enrollment system allowing funding tied to each child to move seamlessly within and among school districts.



Governor's Cost Proposal: $1.4 billion



Citizens' Budget Assumption: $1.4 billion (provided that no funding to classroom instruction is affected)

9. Realign and Reform Health/Social Services

The Governor proposes making $2.9 billion in reductions to health and social services. Health and social services are vitally important to the neediest in California, and as such the Citizens' Budget proposes to maintain services while achieving the Governor's proposed reductions through management reforms. While $1.5 billion of the Governor's reduction comes from a suspension in cost-of-living increases, the other $1.4 billion comes from actual reductions in health services. Under our plan, services levels will be maintained, but at a lower cost by implementing fixed-price/performance-based contracts, recovery auditing and entitlement fraud reduction, competitive sourcing, participation in the Independence Plus waiver program for Medicaid, and improved enforcement of child support payments.

The Citizens' Budget also proposes to realign the programs identified under the Governor's realignments proposal—but without the tax increases. Instead, the state will transfer over $8.2 billion to counties in realignment of the following categories of programs: Healthy Communities, Long-term Care Medicare, Mental Health and Substance Abuse, Children and Youth and Court Security. While the Governor did not identify cost savings from realignment, the integration of services at the local level and removal of a state-wide bureaucracy should be able to save between 5-7 percent on the net expenditures during the second year of the budget cycle (assuming the first year is a transition period.)



Realignment Cost Savings: $574 million



Citizens' Budget Assumption: $500 million

10. Allocate Mandatory Increases in 04-05

Due to projected caseload increases, federal and state mandates, and other factors, the budget for some program areas will have to be increased. A total of $2.4 billion is needed in FY 04-05 to satisfy these mandatory spending increases.

 **Mandatory Increases**: $2.4 billion

 **Citizens' Budget Assumption:** $2.4 billion

11. Enact Performance-based Reductions

Using program assessments examining the priority, performance and management of each state program, significant reductions can be made in a targeted manner that preserves priority and high-performance programs, while reforming or eliminating low priority and low-performing programs. In most cases where a program was not deemed a priority, our plan proposes a temporary "suspension" of the program until the state recovers financially. In other cases, the plan calls for reforms and eliminations. A line-by-line list of targeted reductions using performance-based criteria as well as LAO recommendations is contained in the Appendix of the budget plan.

 **Available Cost Savings**: $6.03 billion

 **Citizens' Budget Assumption:** $4.4 billion

12. Reform Procurement and Competitive Sourcing

Competitive sourcing is the best tool government can use to redesign its programs to be more efficient—producing cost savings of 30 percent on average each time it is applied. A review of state agencies reveals that state employees are routinely performing activities that could be best contracted out for a lower price. Moreover, many of the contracts being used by state agencies are outdated "fee-for-service" contracts that open the state to substantial cost overruns. Those contracts should be converted to fixed-price/performance-based contracts. Finally, the plan centralizes large contracting and procurement decisions in a single contracting agency for the state to improve competitive bidding, improve efficiency, and reduce payment errors through recovery auditing of all state contracts.

Choosing state functions that have been successfully subjected to competition in other states, and applying competition to a total of *only* 10 percent of those functions in 2003 and *just* 25 percent in 2004, at a conservative average cost savings of 30 percent would create a savings of $980 million in 2003 and $2.4 billion in 2004. A more aggressive program that applies competitive sourcing to the opportunities identified in the Appendix of the plan documents savings of as much as $8.2 billion. Recovery auditing could save at least $100 million in its first year of implementation, and perhaps more. Our plan assumes no cost savings from performance-based contracts and will use this reform instead to improve program services.

 **Available Cost Savings**: $3.5-8.2 billion

 **Citizens' Budget Assumption:** $800 million in '03-04; $1.8 billion in '04-05

13. Personnel Reform and Employee Incentives

While the Governor has made a modest proposal to achieve some savings from renegotiation of contracts, the **Citizens' Budget** proposes enacting a 5 percent reduction in state personnel costs through attrition, renegotiation of employee contracts, limits on overtime, and reduction in staff levels to compensate for excessive growth in recent years. A 5 percent reduction is not an enormous target to achieve. As countless private companies (employee-owned United Airlines even!) are renegotiating with their unions, so should the state open renegotiations during this time. Moreover, in Florida, Gov. Jeb Bush is making 5 percent reductions in state employees *each year* for four years! Even Governor Davis has asked state agencies to consider how they could achieve a 10 percent reduction in personnel costs. In addition, our plan calls for an of the Department of Personnel's Merit Award Program to provide bonuses to employees who identify and enact cost-saving measures and have documented accounting to prove savings.



Available Cost Savings: $1.1 billion from 5 percent cut; $2.3 billion potential from employee Merit Award Program



Citizens' Budget Assumption: $1.2 billion in '03-04; $400 million in '04-05

14. Streamline and Reorganize

Through reorganization of the state government, use of information technology to deliver services, and consolidation of administrative services into a centralized department, the state can create cost efficiencies, reduce duplication and overhead, and improve cross-program coordination. To achieve the $870 million in savings detailed in the budget appendix, our restructuring plan would shrink the number of cabinet-level agencies from twelve to seven. Implementation of the reorganization would be phased in over the two years.



Available Cost Savings: $870 million



Citizens' Budget Assumption: $400 million in '03-04; $470 in '04-05

15. Convert Medi-Cal to Cash Basis

Senate Republicans propose to shift Medi-Cal from accrual accounting to cash-basis accounting, reflecting a one-time savings of $1.1 billion. Eventually, accrual accounting would have to be restored and a commensurate $1.1 billion "expense" would occur during a future budget year. Moving to a cash-basis accounting of Medi-Cal flies in direct contrast with generally accepted accounting rules and constitutes only "phantom" savings.

16. Adopt Miscellaneous Reforms

Concurrent with many of the recommendations identified above, the **Citizens' Budget** suggests a variety of other reforms to state government programs, including:

- Adopt a **Performance Budgeting** statute to evaluate the relative priority, performance, and management efficiencies in programs to determine where to make targeted spending reductions without sacrificing vital services.

- Create a **California Sunset Commission** that would systematically review the continued relevance and performance achievements of 20 percent of all state programs annually.
- Consolidate **Independent Boards and Commissions** into the seven new state Departments to create one-stop decision-making, program management and service delivery.
- Implement **Employee Performance Contracts** for every employee in state government to hold them accountable for clear and transparent performance goals.
- Enact **Managerial Flexibility Legislation** that restores the authority of department and program heads to effectively manage the state workforce.
- Adopt **State Employee Retirement Reforms** by adjusting PERS and STRS benefits and allowing partial privatization of retirement funds that would provide beneficiaries greater freedom to invest in their own retirement.

Create the Most "Jobs-friendly" State in the Nation

California cannot achieve Long-term stability in its budget unless it has a flourishing economy that creates high-paying jobs. Indeed, a good job is the most important factor in securing a quality of life. California must *in perception and in reality* become the most jobs-friendly state in the nation. Three key actions must be taken this year to set that process in motion:

- Resist **Tax or Fee Increases** that would only worsen the state's economic condition.
- Reform the **Workers' Compensation System** that has robbed the state of billions in revenue and increased the cost of creating jobs in California.
- Create a **Regulatory Review and Innovation Commission** that would systematically review regulations for their cost-effectiveness and negotiate and enforce "Performance Incentive Agreements" with businesses to achieve regulatory results without high regulatory costs. It is important to note that under this Commission, no state law could be set aside in terms of intended outcomes, but the manner in which an outcome is achieved could be made more flexible and performance-based.

While most observers might assume that tax and regulatory policies are the primary determinants of whether businesses move or stay in a state, the quality of life of a state has just as significant an impact on how jobs-friendly a state is. In fact, businesses look for the same thing families look for in a quality economic environment: good schools for their employees and for an educated future work force, quality and affordable health care, a clean environment, reliable transportation and infrastructure, and safe neighborhoods.[2] In the end, the state will expand its revenue base through more job growth.

Prevent the Problem from Returning through Fundamental Constitutional Reform

The final element of the **Citizens' Budget** addresses Long-term structural reforms to the state's approach to managing its finances. An analysis of why the state faces this current crisis reveals that this massive budget deficit could have been avoided if Sacramento had kept realistic revenue assumptions during the stock market bubble as well as resisted the urge to increase spending faster than the economy could sustain in the Long-term.

As a result, the **Citizens' Budget** proposes the following three reforms;

- Adopt a **Constitutional Revenue Limit (Taxpayer Bill of Rights)** that holds increases in state revenue growth to population and inflation increases.
- Restore a **Modified Gann Spending Limit** that allows for larger carry-over reserve.
- Adopt a **Balanced Budget Trigger** that automatically makes proportional spending reductions to discretionary programs should revenue forecasts not match actual revenue collections.

Some have tried to blame Proposition 13 for causing the current crisis. While the facts dispute that claim, a fundamental re-examination of the state-county relationship of sales, personal income and property taxes should be initiated among all interested parties to produce a less volatile tax system and a more reliable way to distribute revenues.

An Open Challenge to State Agencies: Put Up or Shut Up

The **Citizens' Budget** relies heavily on fundamental management reforms in each state agency. No state program should escape performance reviews, management analysis and competitive sourcing under our plan. As a result, those inside state agencies as well as their advocates on the outside who find the existing bureaucratic processes to their liking might claim that they are already operating at absolute efficiency with no room for more cost savings.

Put simply: ***Don't believe them***. The evidence we present in the chapters that follow should shock and anger all taxpayers—even if they work for the state government. And what we found is only the tip of the iceberg. However, should you want to give a state agency the benefit of the doubt, ask it to answer three questions and provide concrete evidence to back up its assertions:

- Does your agency have a "full cost" accounting system that tracks your cost-per-unit of service provided to the taxpayer? (If the answer is no, stop the conversation right here.)
- Have you benchmarked your performance and operating costs against similar programs in other states and where do you rank?
- If I asked three vendors how much they would charge to deliver the same service you provide at the same or better quality, would your price always be lower?

In the Event of Total Failure by Sacramento: "The Failure of Governance Bond of 2004"

In the end, the **Citizens' Budget** can only advocate solutions—it will be up to the Governor and legislature to come to an agreement as our elected leaders. However, should politics prevent both sides from constructing a win-win solution for California, we suggest taking the issue directly to the voters as a *last* resort. A single vote should be held on deficit bond as well as the Constitutional amendments identified above and an additional constitutional requirement that there be open and routine competitive sourcing of all state activities every five years.

Based on where the various parties are in their positions today, a ten-year $15 billion bond would be required at the least to bridge the gap. Debt servicing on the bond would begin immediately and would burden future

budget cycles. The loan would be enough to transition past the present crisis along with Long-term constitutional changes necessary to impose discipline on Sacramento. However, the opportunity to make Long-term reforms to key quality-of-life state programs would be lost.

Remaining Focused on a Vision of Renewing California's Quality of Life

At the heart of this plan is the belief that with serious effort and leadership, California's best days are ahead of us. To get there, all sides of the budget debate must work together constructively—and all options and ideas must be put on the table. By approaching the budget not just from a fiscal perspective but from the "quality-of-life" perspective, we can fashion a vision of what California ought to be and how to get there, and make the necessary reforms and financial investments to get the job done. The time and effort put into constructing the **Citizens' Budget** is but one initial contribution to that effort.

Part 1

Put Politics and Accounting Gimmicks Aside to Create a Bipartisan and Effective Solution

"This is not a time for a political debate; this is a time to have a business-management approach."

—Steve Peace, Director, California Dept. of Finance

In 2001-2002, the Governor and the legislature realized that the state was facing a serious fiscal crisis. As will be clearly demonstrated in Part 2, spending increases had outpaced revenue increases so much that a huge deficit was opening. Much worse, the state had engaged in three years of over-spending based on unrealistic revenue expectations predicated on the dot.com stock market boom. Yet, instead of correcting the problem, the Governor and legislature resorted to short-term measures such as dipping into tobacco settlement money, restructuring existing debt, implementing transfers, and engaging in accounting shifts and tax deferrals.[3]

This year is a dramatically different scenario. **The gimmicks are gone…the phantom savings won't work…and the problem is much, much worse.**

While most states are facing difficulties, California's fiscal challenge tops the list—with the largest deficit in terms of size and the greatest magnitude of change from the 2000 high. Indeed, California's deficit constitutes half of the entire shortfall of $70 billion for all states combined! Worse still, just a few short years ago, California was actually well-positioned in relation to other states—both in terms of its surplus and its climate for businesses.

California Budget FACTS:



$34.6 Billion

Total deficit predicted by Governor for 2002-03 and 2003-04 fiscal years.

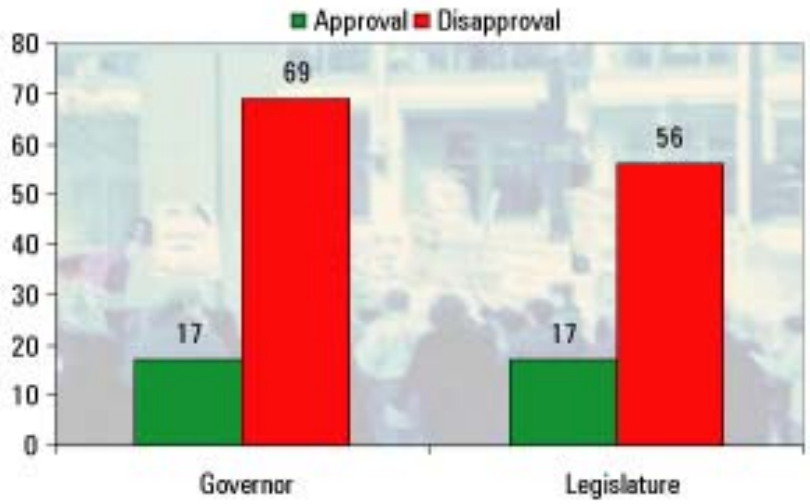
$5.5 Billion

New spending added by the Governor to his $34.6 billion budget shortfall before he proposes tax increases and spending cuts.

$26.1 Billion

Total deficit predicted by non-partisan Legislative Analyst's Office for 2002-03 and 2003-04 fiscal years.

Figure 1: Public Disapproves of Handling of Budget by Governor & Legislature



Source: *Los Angeles Times*, April 10, 2003

Elected leaders in Sacramento (in particular the Governor, Senate and Assembly) are responsible for analyzing the scope and cause of the current fiscal crisis and enacting both short-term and Long-term changes to ensure California can meet its obligations today and tomorrow. Unfortunately, all sides seem (to a greater or lesser degree) to have neglected their responsibilities to constructively address the budget challenge. Politics and the gravity of the crisis faced by California have prevented either party from offering a viable budget plan that will protect California's quality of life.

The Typical Chorus in the Budget Debate

The annual budget debate is always colored by the typical inflammatory rhetoric—with each side jockeying for political advantage over the other. Republicans are painted by Democrats as heartless and uncaring—dead-set on shutting down the government, protecting rich and corporate interests, and ignoring the needs of the poor, the sick, and the elderly. Democrats are portrayed as bureaucracy-building tax-and-spenders looking to expand government intrusion into daily lives, over-regulate business, and build welfare programs for every want, care or desire of needy and special interest populations.

Consider the following quotes from State Treasurer Phil Angelides and former California Republican Party Chairman Shawn Steele:

> *Angelides: "I say if the Republicans want to cut education, let them be the ones to rip the textbooks out of our children's hands."*[4]

> *Steele: "Gross negligence is too soft of a word. It's almost like child molestation that prevents generations of young people from having an equal chance in our society."(Referring to Democrat leadership in California)*[5]

Both positions are extreme. Both yield gridlock. Neither is helpful to solving such important problems as the state budget. Neither protects the quality of life of Californians. What is desperately needed in the budget debate is some serious resolve to find serious Long-term solutions. Instead of a Democrat or Republican perspective on the budget, we should take a citizen's perspective.

Agreeing On the True Size of the Deficit: $34.6 vs. 26.1 Billion

Assuming for the moment that the political parties can put aside the rhetoric and approach the budget debate in a constructive manner, the first step in crafting a sound budget solution is to agree on the magnitude of the problem. Unfortunately, Sacramento cannot even provide a solid number for how big a deficit the state faces! Indeed, there are two competing figures being used in Sacramento—one by the Governor, the other by the non-partisan Legislative Analyst's Office (LAO). Governor Davis has placed the projected deficit for the rest of this year and all of next year at $34.6 billion[6] while the (LAO) estimates the deficit at $26.1 billion.[7]

So why is there such a big difference and, more importantly, who is right? According to Legislative Analyst Elizabeth Hill, about $3 billion of the difference is due to the Governor's more pessimistic economic assumptions, particularly with regard to the revenue forecast. The remaining $5.5 billion is due to "definitional differences" over the baseline level of state spending. In the words of the LAO:

> *Our standard for this baseline is spending that would occur under current law (or, if more applicable, current legislative practice). In contrast, the administration's baseline in some cases reflects additional spending that would be required to achieve the administration's policy goals as well as proposals that have not yet been adopted.*[8]

In other words, Governor Davis is including in his estimate his own wish list of new spending that the legislature has not even approved! By inflating the true size of the deficit, the Governor's approach allows him to suspend the proposed $5.5 billion of funding (that never actually existed) and then claim that he has eliminated 16 percent of the projected budget deficit through these "cuts." The authors believe this approach to be irresponsible and disingenuous, and thus consider the LAO's $26.1 estimate to be more reliable.

California Budget FACTS:



24%

Percentage of Governor's solution to baseline budget shortfall addressed through tax and fee increases

40%

Percentage of Governor's solution to baseline budget shortfall addressed through program savings

15%

Percentage of Governor's solution to baseline budget shortfall addressed through shifts to local governments

$2.2 Billion

Amount of budget Senate Republicans address through the accounting gimmick of switching Medi-Cal to cash accounting basis and deferring Proposition 98 funding

Existing Budget Plans Not Adequate to Solve Budget Challenges

To date, there have been only two complete proposals to address the projected budget shortfall—and only one with concrete details. Governor Davis submitted his 2003-04 Governor's Budget in January, as required by law, complete with concrete details on what reductions would be necessary to achieve balance. In addition, Senate Republicans have submitted their own proposal, which adopts a number of the Governor's suggested cuts, and claims to balance the budget without tax increases. Unlike the Governor's proposal, the Senate Republican plan contains few specifics on what reductions would be necessary. Even worse, the Democrats in the legislature have abdicated their responsibility to put forward a comprehensive plan. A review of what each side has offered provides several positive and negative critiques.

The Governor's Budget

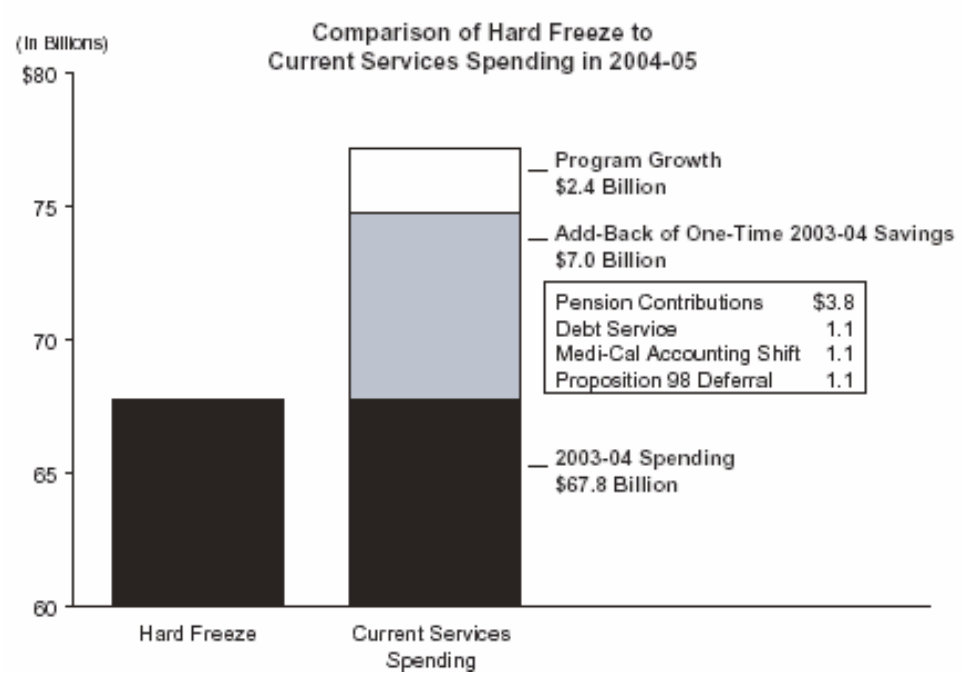
There are several positive features in the Governor's Budget. First, the Governor takes some important first steps in correcting the state's spending problem by proposing spending reductions. When setting aside his phantom savings as defined above, the Governor proposes a total of $8.2 billion in real reductions to programs—representing at this point in the debate the only specific package of reductions offered. Another positive feature of the budget is the realignment of state programs to the local level. As will be discussed in Part 4, many state and local services should be realigned to produce efficiencies and performance improvements. Finally, the Governor is to be commended for correctly calling for systemic reforms in state management and finances.

However, a number of flaws exist in the Governor's Budget making it an inadequate proposal:

- **Incorrect Budget Deficit Figure:** The Governor's Budget proposes to close an estimated two-year budget gap of $34.6 billion. However, as already established, the Governor's numbers are not credible, given that the Legislative Analyst's Office put the figure at $26.1 billion.
- **Phantom Spending Reductions:** The Governor's Budget contains $5.5 billion in *new spending* that is not required by law. His so-called spending reductions of $13.7 billion detailed in his plan actually become $8.2 billion when the "phantom" $5.5 billion in "reductions" are factored in.
- **Inadequate Correction of Spending Binge:** As will be demonstrated in Part 2, the appropriate growth rate on average for state programs should be 21 percent. Unfortunately, the governor does not correct the unsustainable explosion in programmatic spending in any of the budget categories—pushing spending up by 36 percent. Simply put, further reductions are needed before state spending can return to a sustainable level. For example, planned spending for corrections, including a $220 million renovation of death row at the San Quentin facility and an exorbitant new labor agreement with correctional peace officers that will cost hundreds of millions of dollars over the next several years, will actually increase, while virtually every other area of government is made to share in the cost cutting and pain of spending reductions.
- **Across-the-board Cuts:** The Governor does make several specific and targeted reductions in programs, but in many cases his proposal relies on across-the-board cuts. Across-the-board cuts are generally not a good idea, as effective, high-priority programs are forced to suffer equally with those programs that are inefficient and of lower priority. Difficult as it may be, legislators are elected to make tough decisions, such as what government should be doing, in good times and in bad. The focus should thus be on eliminating waste and low-priority programs, not throwing the baby out with the bath water.

- **Excessive and Regressive Tax and Fee Increases:** The Governor's proposal seeks to assess an additional $8.3 billion in taxes and fees on California taxpayers. In doing so, the plan imposes additional strain on California's struggling economy and workers that could drive jobs out of the state.
- **Over-reliance on Bonds and Loans:** The Governor proposes to use loans and bonds to cover $3.3 billion of the shortfall—including a $1.6 billion to cover state contributions to the employee retirement funds. This is exacerbated by bond financing, which costs much more than pay-as-you-go spending and will hit taxpayers harder in the future, as the bonds will have to be paid off somehow (i.e., through taxes).
- **Raiding Local Government:** The Governor's plan eliminates the Vehicle License Fee (VLF) backfill provided to local governments as part of an agreement reached in 1998. By not honoring this agreement (or by not fundamentally reforming state-local finances), the state is imposing severe burdens on local governments that provide the most essential services to citizens.
- **No Plan for Long-term Reforms:** Even though the Governor calls for fundamental reform, his budget fails to articulate a clear package of reforms to address Long-term liabilities and flaws in the current state fiscal structure. In fact, some of his proposals will worsen the volatility of the state's fiscal system. For example, while California increasingly relies on volatile personal income tax revenue, which includes taxes on stock market gains, the Governor has proposed increasing personal income taxes on those in the wealthiest income bracket, who are the very people with the most volatile incomes and who pay the largest share of state taxes. This will only increase the volatility of future tax revenues, and thus increase the likelihood of future budget deficit emergencies.

Figure 2: Senate Republican "Hard Freeze" Doesn't Reflect Mandatory Spending in Second Year



Source: Legislative Analyst's Office

The Senate Republican Plan

The Senate Republicans' plan also has several positive elements. First, it relies on no tax or fee increases. Second, it wisely embraces the concept (albeit for the next two years) of "biennial budgeting." Third, it uses the more reliable LAO estimates of the budget shortfall. The plan also wisely rejects the inclusion of $1.5 billion in Indian Gaming Revenue. Until pacts are negotiated and revenue forecasts from this source are more reliable, it is best "to be very conservative when factoring this revenue into a budget deal..

However, a number of flaws exist in the Senate Republican Budget making it an inadequate proposal:

- **Lack of Details:** The plan is only five pages long and is nowhere near as comprehensive as the Governor's Budget. It does not utilize a line-by-line or even a detailed agency-by-agency analysis.
- **Across-the-board Approach:** Rather than highlighting a list of recommended cuts, the Senate Republicans' plan calls for a 7 percent across-the-board reduction in spending, yielding $5.1 billion in savings, and a cap on spending at the same levels for the following year. However, according to legislative analyst Elizabeth Hill, some $9.65 billion in program spending is mandated by court orders, federal requirements, or provisions of the California constitution, and thus could not be included in the proposed cuts.[9] In order to make up for this, the cuts would actually have to be larger for remaining programs.
- **Year Two Mandatory Increases Not Addressed:** As noted above, each year certain programs have mandated spending increases reflecting requirements outside of the legislature's control. Unfortunately, the plan proposed by Republicans merely calls for a "hard freeze" between year one and two of their budget, not reflecting a $2.4 billion increase in mandatory spending during the second year. This mandatory spending increase would have to be offset by an equal reduction in discretionary spending to achieve the plan's "hard freeze" (see Figure 2).
- **Accounting Gimmicks:** The plan also suffers from some of the same accounting gimmicks the Republicans have accused Governor Davis and the Democrats of using to solve budget gaps during the past couple of years. For instance, the plan realizes $1.1 billion in "savings" from shifting Medi-Cal from accrual accounting to cash-basis accounting, despite the trend of moving all government accounting in the opposite direction. Like the Governor's Budget, the Senate Republicans' plan relies on the issuance of Pension Obligation Bonds to pay $1.5 billion that the General Fund was supposed to contribute to the Public Employees' Retirement System and the State Teachers' Retirement System. This proposal suffers from the same criticisms of bond funding mentioned previously.
- **Raiding Local Government:** Finally, the Senate Republicans' plan favors $500 million in "contributions" from local governments for each of the next three years instead of the Governor's realignment proposal. It additionally calls for the deferral of approximately $1 billion in reimbursements to local governments for state-mandated programs. Again, the state should deal with its own budget problems, rather than shifting the burden to local governments and taxpayers.

The Legislative Democrats "Plan"

The Democrats in the legislature have not put together any kind of plan on their own. As a result, they have abdicated their leadership role. Until the Democrats who control the legislature can offer a proposal, their criticisms of the Governor's proposal and the Senate Republican proposals should be viewed lightly—if not hypocritically.

Digging in for Partisan Trench Warfare

Like armies preparing for battle, the various sides of the budget debate are digging into their positions without offering realistic plans for solving the budget crisis long term. At present, the only two proposals on the table *both* fail to balance fiscal responsibility with ensuring investments in quality-of-life programs as well as creating the conditions necessary for a jobs-friendly state. By labeling one side as "uncaring, mean-spirited" and one side as "job-killing tax-and-spenders" there seems little hope for a positive "win-win" outcome from the present debate. As a result, an alternate budget package presented by a coalition of interests might be needed—if not for a vote, at least to spur creative thinking.

Part 2

Identify the Problem: Out-of-Control Spending

"Total General Fund spending rose from $57.8 billion in 98-99 to $76.8 billion in 01-02, an increase of $18.9 billion, or 33 percent. About 60 percent *of the growth was attributed to general inflation and population increases. The remaining* 40 percent *represents such factors as new or expanded programs; increased levels of services; and—in some instances—caseload growth in excess of population and/or cost increases above general inflation."[emphasis added]*

– LAO Analysis of Sources of General Fund Spending Growth, March 25, 2003

In order to craft an effective solution to California's budget crunch, one must first start by identifying—correctly—the root cause of the problem. Moreover, without a clear understanding of the problem, the state is bound to repeat its mistakes in the future. Unfortunately, with all of the finger-pointing going on over the budget in Sacramento, it has been difficult to sort out fact from fiction and rhetoric from reality. A close analysis of data provided by the non-partisan Legislative Analyst's Office provides an ironclad case that the state has a spending problem, rather than a revenue problem.

Putting to Rest the "Myth" that Revenue is to Blame for the Crisis

Many have claimed that the state's budget troubles arose as the result of an overall decline in revenues. Due to a bad economy and tax decreases (notably the vehicle license fees), everyone is paying less in taxes and the state is taking in less revenue. The solution according to this theory is to raise vehicle license fees and increase taxes.

California Budget FACTS:



26%
Increase in state revenue from 1998-99 to 2002-03

45%
Increase in total state spending from 1998-99 to 2002-03

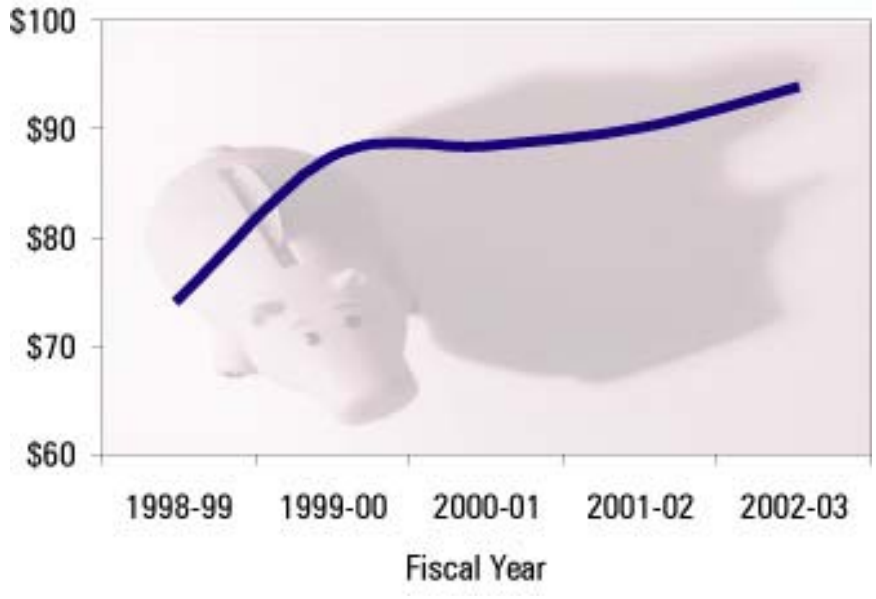
37%
Increase in just the General Fund portion of state spending from 1998-99 to 2002-03

9,000
The number of new workers hired as of September 2002 in state government since the Governor's "hiring freeze" was imposed March 2002

37,000
The number of new workers hired as of March 2003 in state government since the Governor's "hiring freeze" was imposed March 2002 (that's 37,000 new hires in ONE year!)

Yet, despite the many assertions to the contrary, California's revenue stream is most certainly *not* the cause of the current budget crisis. In fact, revenues actually rose 26 percent from FY 1998-99 to FY 2002-03, from $74.3 billion to $93.8 billion (see Figure 3).[10] Revenues to the General Fund, the largest source of state funding, have likewise grown. After realizing a 22.7 percent increase between FY 1998-99 and FY 1999-2000, general fund revenues leveled off and have remained about the same into the current fiscal year (see Figure 4).

Figure 3: State Revenues, Fiscal Years 1999-2003 ($ in Billions)



Note: Revenues include General Fund & Special Fund revenues and transfers to the General Fund from other state funds.

Source: Legislative Analyst's Office

Unrealistic Revenue *Expectations* by Sacramento Led to Unsustainable Spending Increases

When Sacramento says there is a revenue problem, it should more correctly say there is a revenue expectation problem. At the heart of this problem of unrealistic revenue expectations is the stock market and the capital gains portion of the state's annual revenue. As everyone knows, the dot-com revolution created a meteoric rise in the stock market. Indeed, during 1999 and 2000, as the nation "cashed out" of the stock market, state receipts from capital gains spiked exponentially.

Figure 4 illustrates the amount of revenue from stock options and capital gains, compared with all other General Fund revenues. During the height of the economic expansion, revenues rose from $7.5 billion in FY 1998-99 to $12.7 billion in FY 1999-00, then to $17.6 billion in FY 2000-01, before falling to $8.2 billion in FY 2001-02. Revenues from these sources are expected to fall further to $5.6 billion in FY 2002-03 and remain about the same at $5.7 billion in FY 2003-04.

Figure 4: Stock Options and Capital Gains Tax Revenue as a Share of Total General Fund Revenues ($ in Billions)



Sources: 2003-04 Governor's Budget Summary and Department of Finance Budget Documents

Of course, everyone knows how the dot-com stock market bubble finally burst. Moreover, most investors were wise enough to cash out at some point during 2000—and those that didn't took losses in 2001 and 2002. Unfortunately, the state of California was not one of the wise actors in this scenario. Not only did it not "cash out," it continued to spend as though it were a dot-com billionaire. Rather than stashing away enough of the revenues to ensure a smooth transition and continuation of public services during and after the inevitable economic decline, the state spent to its limits—and beyond.

Even after 2000 when the entire world realized the party was over, the Governor and the legislature spent money at a rate they expected revenues to increase, based on the high-flying stock market. When actual revenues did not meet their expectations, it was too late to "unspend" spent money. Moreover, as it became clearer that capital gains revenues were dropping, the Governor and legislature looked the other way and adopted totally unrealistic and "rosy" revenue forecasts. Rather than rolling back spending following the economic downturn that took place after FY 2000-01, the state largely maintained General Fund spending, cutting it by only 1.7 percent. It was not until 2003 that the Governor suggested any significant rollbacks in spending.

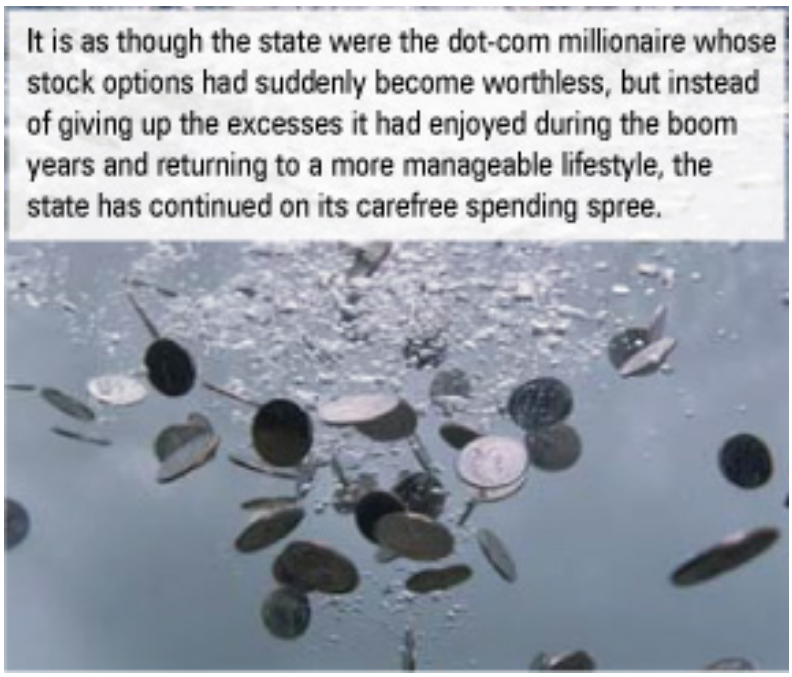
Proof of the expectations problem can be found in both the 2002-03 and 2003-04 budget documentation:

In the 2002-03 Governor's Budget Summary, it declared:

> *Year-over-year losses in personal income tax withholding* are believed to be attributable primarily to the loss of stock option income*, which plunged with the slowing economy and the market's retreat. Taxpayers are also anticipating less non-wage income—primarily capital gains—which has eroded estimated payment receipts. Similarly, consumers have cut back, resulting in a deterioration in*

purchases of taxable goods. This softness in revenues is expected to be short-lived*, and growth is expected to resume by mid-2002.*[11]

In 2000-01, the contribution to total General Fund revenues from [stock options and capital gains] had grown to 25 percent from 6 percent five years earlier. It was clear that phenomenal gains in stock prices that boosted revenues to double-digit growth over the past few years could not continue indefinitely *and that revenues were increasingly vulnerable to a market turnaround. What was not clear, however, was when that turnaround would come or how steep it would be.*[12] *[emphasis added]*



Ironically, the Department of Finance notes "it was clear…boosted revenues…could not continue indefinitely." It may have been clear to the average investor and working family, but not our leaders in Sacramento. Instead of owning up to the expectations problem, Sacramento is blaming the market and the economy for not recovering quickly enough to support a dot-com-like spending binge the state had become accustomed to.

Even more irony is seen in the Governor's current budget proposal. The state's disastrous experience with relying on stock market income begs the question: given that the vast majority of these revenues are derived from the richest 5 percent of Californians, does not Governor Davis's proposed increase in income taxes for the state's top earners seem all the more foolish? Could it only lead to greater dependence on this volatile source of revenue and require even more speculation on the state of the stock market and the economy as a whole in crafting the state's budget?

The short-term revenue problem has been the unrealistic expectations of Sacramento. The Long-term revenue problem facing the state will remain the state's increasing reliance on revenues from personal income taxes, and especially on revenues from stock options and capital gains. Thus, volatility is built into the California tax and revenue structure. Any Long-term solution to the current budget crisis must address this issue.

Clear and Convincing Evidence of Over-spending in California

As established above, the stock market capital gains fueled an unrealistic expectation of massive revenue increases as far as the political eye could see. And as expectations were raised, so were the budgets of every state agency. In fact, state spending increased 45 percent over a four-year period, from $75.3 billion in FY 1998-99 to $109.4 billion in FY 2002-03. During this time, General Fund expenditures rose over 36 percent,

from $57.8 billion to $78.9 billion. To underscore the extent of the spending spree during the economic expansion and the stock market's meteoric rise, consider that this includes a record one-year spending increase of 15 percent from FY 1998-99 to FY 1999-00, which was surpassed by a 17.4 percent increase the following year!

The most important indicator of whether the state engaged in "over-spending" is benchmarking increases in the total state budget, as well as increases in specific program areas, to the growth in population and inflation. Why benchmark against population and inflation? If a state increases in budget at the same rate of population and inflation, it is maintaining a static level of services (assuming it doesn't "do more with less.") In other words, state government would increase spending only to provide expanded services to satisfy an expanding population and to keep pace with rising operating costs.

Examining California's spending in relation to population and inflation growth exposes the state's over-spending. Had the state held its increases to meet population growth and inflation, spending should have increased by 21 percent between 1998-99 and 2002-03—not the 36 percent by which the spending actually increased. Using this benchmark, the state engaged in severe overspending.

Table 1: General Fund Spending Compared to Inflation and Population Growth Baseline

1998-99 Actual	2002-03 Appropriate	2002-03 Actual	Difference	Appropriate Increase	Actual Increase
$57.8 billion	$69.9 billion	$78.9 billion	$9.0 billion	21.0%	36.5%

Table 2: Comparison of General Fund Spending by Program Area, 1998-99 to 2002-03
(Dollars in Thousands)

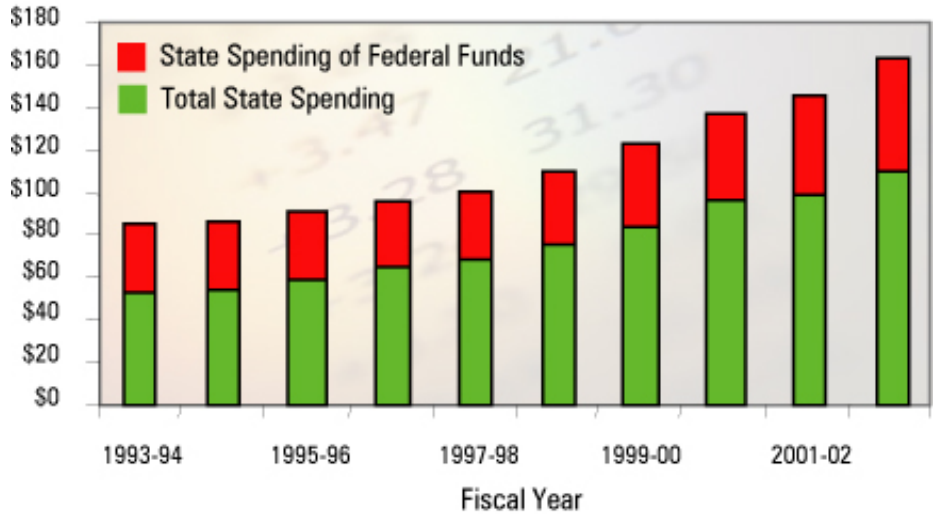
Program Area	1998-99 Actual	2002-03 Enacted*	Difference, 1998-99 Through 2002-03	Percentage of Total Growth 1998-99 Through 2002-03	Percent Growth, 1998-99 Through 2002-03	Combined Inflation and Population Growth
Education – Prop. 98	$24,656,705	$31,766,000	$7,109,295	38%	29%	21%
Education (K-12 & Higher)–Non-Prop. 98	6,440,736	8,533,102	2,092,356	11%	32%	21%
Health and Human Services	16,063,177	21,632,674	5,569,497	29%	35%	21%
Youth and Adult Correctional Agency	4,547,387	5,284,526	737,139	4%	16%	21%
Resources and Environment	1,280,331	1,214,668	-65,663	0%	-5%	21%
Business, Transportation, and Housing	311,238	228,270	-82,968	0%	-27%	21%
Tax Relief**	931,845	4,422,496	3,490,651	18%	375%	21%
Other	3,595,656	3,640,004	44,348	0%	1%	21%
Total General Fund	$57,827,075	$76,721,740	$18,894,655	100%	33%	21%

* Does not include mid-year spending adjustments **Tax relief reflects on-budget cost of VLF backfill.
Sources: Spending data are from the Legislative Analyst's Office; Inflation and population growth data are from Department of Finance documents

Finally, a number of other dimensions of the state's spending practices illustrate the true extent of the spending problem:

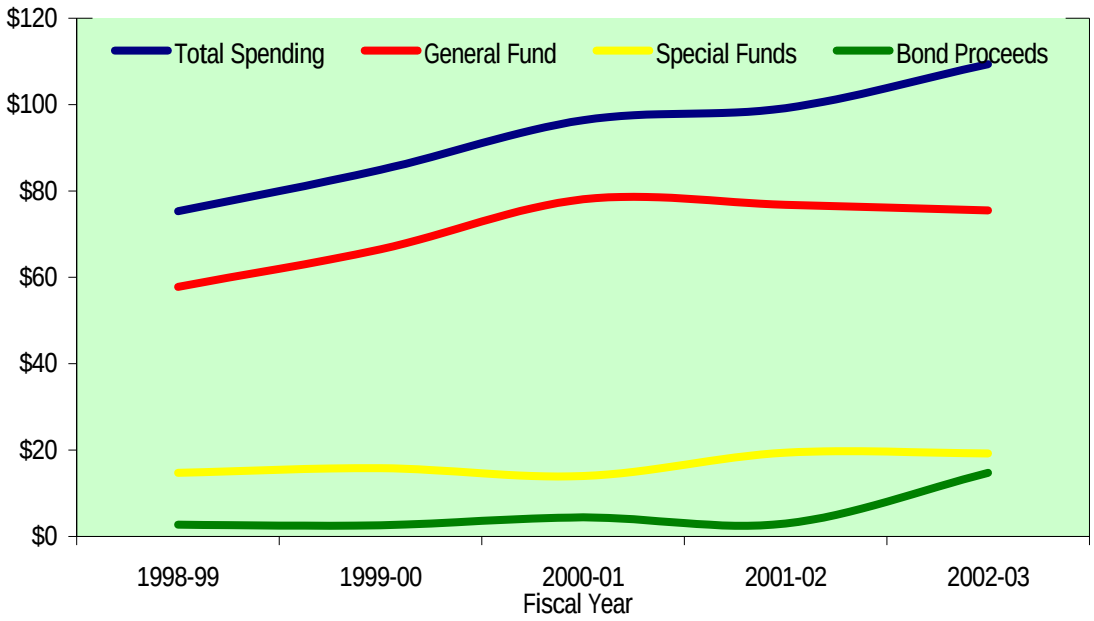
- **Comparison to Other State Spending Practices:** California's spending is not only high in absolute terms, but also relative to that of other states. In fact, California's 9.4 percent average General Fund growth from fiscal 1997 to 2002 was a full percentage point higher than the second-highest spending growth state—Rhode Island—and well over the U.S. average of 5.6 percent (see Table 3).[13]
- **Explosion of State Workers: During Governor Davis's first four-year term, nearly 44,000 employees were added to the state's payroll.**[14] In fact, according to Ross DeVol of The Milken Institute, even during the height of the tech boom, "State and local [government] jobs were the fastest growing job category in the state in 1999, 2000 and even 2001."[15]
- **Elimination of a Record Surplus:** In 1998 Gov. Gray Davis inherited a $12 billion surplus. As already noted, today the state has a $26.1 billion deficit. Had the state kept its spending increases to population and inflation growth, the state would face a $5.5 billion *surplus* this year (assuming all previous surpluses had been given back to the taxpayer through tax rebates.)
- **Per Capita Spending Up:** An excellent [change chart (right) to "Figure 4"]gauge of *real* spending increases can be gained by looking at per capita spending of the state government. According to the LAO, "per capita spending—which adjusts for both inflation and population growth—has increased by about 17 percent…(to) $2,469 per capita in 2003-04, up from $2,109 in 1993-94."[16]
- **Elimination of Potential Taxpayer "Rebates":** A recent study by the Cato Institute found that if aggregate spending growth of the 50 states had been held to a benchmark of inflation plus population growth from fiscal years 1990 to 2001, and if revenues above this benchmark had been returned to the taxpayers, the states would have realized a savings of $93 billion by FY 2001.[17] (This approach to state funding will be explored further in the next section of the paper.) The study also ranked the states by the amount of their per household "tax windfalls" above the benchmark, money that would have remained in the pockets of taxpayers if the state had stuck to the benchmark spending growth. California's $22.2 billion tax windfall amounted to a per household windfall of $1899, the third-highest in the nation.[18]

Figure 5: State Spending Over Time (Dollars in Billions)



Source: Data from California Department of Finance and Legislative Analyst's Office

Figure 6: State Spending by Fund Category ($ in Billions)



Source: Department of Finance Budget Documents

Table 3: Fastest Growing State General Funds		
State	**Average Annual Change, 1997-2002**	**Projected Change, 2003**
California	**9.4%**	**-0.2%**
Rhode Island	8.4%	0.8%
Maryland	8.2%	-3.5%
Colorado	8.1%	-2.7%
Virginia	8.0%	1.6%
Maine	7.9%	4.9%
Idaho	7.3%	-1.7%
Georgia	7.0%	4.5%
Nebraska	6.8%	0.8%
Delaware	6.8%	2.4%
United States Average	***5.6%***	***1.5%***

Sources: National Association of State Budget Officers and USA Today research

Other Spending Habits of Concern: Bonds and Special Funds

Any budget plan has to take into account state spending that occurs outside of the "General Fund" in the area of "Bond Proceeds" and in the "Special Fund." For the purposes of the budget, Bond Proceeds represent the debt service cost for principal and interest on bonds, not the actual use of these proceeds. While the state

may have little latitude in affecting the cost of bonds approved by the voters, it is worth noting that Bond Proceeds expenditures never exceeded a few billion dollars throughout the 1990s, before suddenly jumping from $3 billion in FY 2001-02 to nearly $15 billion in FY 2002-03. While this cost is expected to drop to a little over $7 billion in FY 2003-04, this is still significantly higher than the historical average.

Even more disturbing is the spending trend for Special Funds. Special Funds are furnished mostly by motor-vehicle related levies, but also by gasoline, cigarette, and sales and use taxes, as well as other licenses and fees revenues. They are used to direct state income to particular government functions or activities designated by law. Many transportation projects, for example, rely upon Special Funds. Since 1998, Special Funds spending has gone in exactly the *opposite* direction as the economy, declining slightly between FY 1998-99 and FY 2000-01 before rising from $14 billion in FY 2002-03 to over $19 billion in FY 2003-04. Incredibly, the Governor's Budget proposes to raise Special Funds spending by 38 percent to nearly $26.5 billion in FY 2003-04!

Part 3

Target Spending Reductions Based on Priorities and Performance-based Budgeting

"Democrats have taken to describing some of the pending cuts in health and social services as tantamount to a death sentence for the people who depend on those programs. Schools across the state are preparing to lay off thousands of teachers. Local governments say they can't afford to keep their police on the streets. Why, then, does the state continue to maintain programs that are not a matter of life and death?"
–Dan Weintraub, Sacramento Bee, April 13, 2003

Summary of Citizens' Budget Recommendations in This Section:

1. Adopt **Performance Budgeting** statute to evaluate the relative priority, performance, and management efficiencies in programs to determine where to make targeted spending reductions without sacrificing vital services.
2. Enact up to $4.4 **billion in Spending Reductions** identified by analysis conducted by research team for Citizens' Budget
3. Create a **California Sunset Commission** which would systematically review the continued relevance and performance achievements of 20 percent of all state programs annually.

California Budget FACTS:



$4.1 billion

Dollar value of cost savings for '03-04 budget recommended by the Legislative Analyst's Office from its review of performance, management and relevance of state programs

$8.9 billion

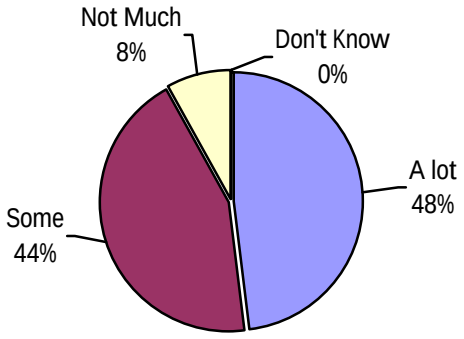
Dollar value of cost savings for '03-04 budget recommended by the Citizens' Budget project from its review of performance, management and relevance of state programs

The first obvious step in balancing the budget is to focus on reducing waste, eliminating pet projects or "pork," and prioritizing programs based on how vital they are. Yet, while it may be "obvious," it is much harder to do in practice than it is in theory. What one person considers waste, another could argue is a key priority. Nevertheless, an approach to evaluating program performance and prioritizing program importance can yield significant savings in targeted ways. In this section, the Citizens' Budget lays out the case for using performance-based criteria for the review of the state's expenditures—resulting in cost savings and protection of key quality-of-life programs.

Defining the Level of Waste, Poor Performance and Improper Priorities in State Government

Governments of all types and at all levels are prone to a certain amount of wasteful spending due to the nature of politics. This waste is only exacerbated in times of abundance. During the "boom years," when the state coffers benefited from the tax revenues of fortunes built upon the dot-com explosion and the soaring economy in general, legislators and the Governor did not feel the need to be so stingy with taxpayer dollars, and many pet projects were funded as a result.

Figure 7: Do you think people in state government waste a lot of the money we pay in taxes, waste some of it, or don't waste much of



Source: PPIC CA Statewide survey, 2001.

Government waste can best be defined in three ways:

- **Relevance**: A program that is not as important a priority as other competing needs, or is duplicative of other government, non-profit or private programs.
- **Performance**: A program that does not have an impact or does not produce an appropriate level of performance results.
- **Management Efficiency:** A program that suffers from poor management (whether or not it is a priority or delivers performance) resulting in internal inefficiencies, fraud, error, poor resource allocation, etc.

A program not meeting the first criteria (Relevance) should be suspended temporarily during tight budget times. It is not that the program is not worthy or beneficial—there are just not enough resources to fund all of the "nice idea" programs and maintain the "vital imperative" programs. A program not meeting the second criteria (Performance) should be terminated and its funding allocated to other programs in its mission area that can produce results. Finally, a program not meeting the third criteria (Efficiency) should be reformed immediately and cost savings from improved management should either be reallocated to that program to expand service levels or allocated to other important programs.

How much "waste" exists in the California state government? *The honest answer is: we don't really know!* That's because the state government has not implemented transparent systems for evaluating the performance, cost and management of state programs. There has been no benefit for the bureaucracy to do program reviews on its own, and the legislature long ago abdicated its role in program oversight.

Indeed, the research team working on the Citizens' Budget learned first-hand how difficult it was to do good analysis of state programs when it contacted state agencies with basic questions on how many staff were employed, what performance goals each program had set, what performance results each program could report, etc. Our requests to various departments produced a dearth of information and often we were told that the information we requested was not collected or could not be determined. In one case, we discovered that an e-mail request for information had been deleted without even being opened!

What are abundant are stories of extreme and obscene mismanagement, waste, error, redundancy, and poor performance. The media has been the best source of information on government waste, followed by the average taxpayer or government worker who becomes a "whistleblower." The Citizens' Budget provides only a handful of hundreds of examples uncovered during the course of this project.

Besides the examples we lay out below—as well as an initial list of $8.9 billion in savings the Citizens' Budget compiled based its own analysis of the state government—there are a number of signs that the state indeed has a severe problem with waste:

- **Public Perception:** While the public is naturally suspicious of government and holds government bureaucracy in low regard, California state government has significantly higher negative ratings on its efficiency and management than the federal government and the average for state governments. In a recent poll, 65 percent of Americans complained about the efficiency of the federal government, whereas only 58 percent had negative views on their state government. In stark contrast, over 92 percent of Californians feel our state government wastes some or a lot of the money we pay in taxes.

- **Good Government Groups**: Numerous good-government groups have issued reports critical of California state government. Some groups are agency-specific, pointing out problems in social services, foster care, corrections, education, etc. Others are cross-cutting and examine overall spending and management practices. For example, in June 2001, Governor Davis was given the dubious honor of "Porker of the Month" by the nonprofit organization Citizens Against Government Waste—the nation's largest government watchdog group.[19] In October 2002, the Governor was anointed with the California Golden Fleece Award by the Pacific Research Institute "for his failure to protect the state's fiscal health by cutting waste from the state budget."[20] Finally, the California Taxpayer's Association has documented waste, fraud and poor performance at hundreds of state and local programs…all detailed on its Web site www.caltax.org.

- **Governor's Proposal**: In reviewing the Governor's proposed $10.2 billion in mid-year spending reduction proposals, it is apparent that many of the cuts come from reviews on performance, management or relevance.

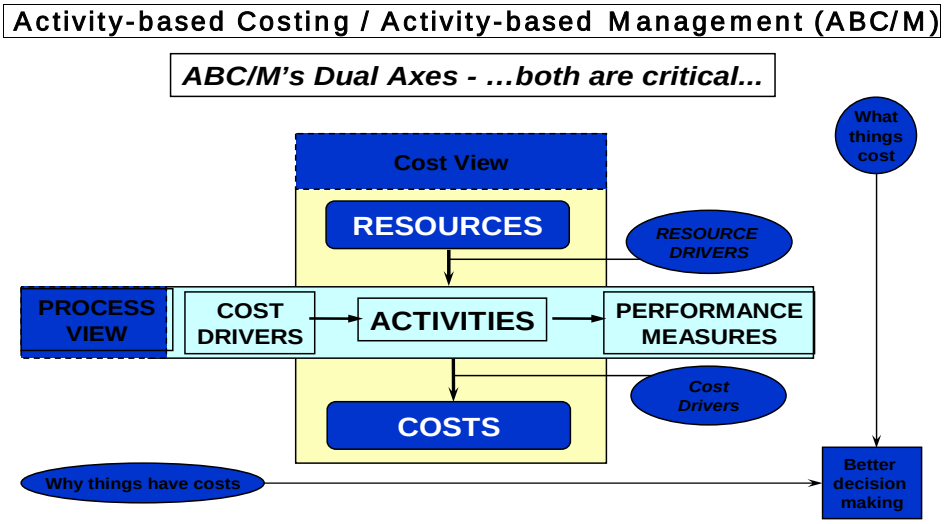
- **LAO Program Reviews**: The non-partisan Legislative Analyst's Office routinely provides recommendations to the legislature on potential cost savings from programs with poor performance, faulty management and/or questionable relevance. A laundry list of programs with problems has been compiled by the LAO—with the LAO recommending reforms or elimination to over $5 billion in program expenditures over the next two budget cycles.

Implementing Performance Budgeting in California

California currently uses an incremental budgeting system in which budget requests are made as adjustments to the previous year's level of spending. Oftentimes, little justification is provided for budget increases. As can be seen by a perusal of LAO Budget Analysis documents, information provided to the legislature and even to the Governor is often incomplete and sometimes inconsistent.

The Citizens' Budget strongly recommends the full implementation of performance budgeting in California. Performance Budgeting changes the state budgeting process to focus less on the *intentions* of programs and more on the *results* of programs. Instead of automatically granting programs "adjustments to the base budget," performance budgeting would examine a program using the three criteria articulated above: relevance, performance and management.

Figure 8: How Activity-based Costing and Performance Budgeting Can Help Make Spending Reductions



Source: The CAM-I Glossary of Activity-based Management, 1990

Performance budgeting is a budgeting method that "costs out" various activities of a program and correlates those costs to services provided (outputs) and results achieved (outcomes). By implementing performance budgeting, the true costs of government can be known—and with the transparency of true costs, comparisons can be made to other programs and cost-benefit analyses conducted.

The use of performance budgeting would not only lead to quantitative savings by placing an increased emphasis on efficiency, it would also lead to *qualitative* enhancements by promoting ever-improving outcomes. Thus, a new focus on performance and results would not only reinvent the budgeting process, it would reinvent government itself. Through performance budgeting, legislators will reveal worthy priorities as well as government waste, and both legislators and taxpayers will be better able to see just what their tax dollars are buying.

It should be noted that several years ago California attempted a few performance budgeting pilot projects. The pilots were discontinued—killed by the bureaucracy and the legislature's cultural resistance to performance and accountability—as well as by poor implementation. The pilot projects did not implement performance budgeting correctly. The performance measures selected to track performance were not results-oriented, and instead measured meaningless process, activity and effort levels. Even worse, the pilots failed to link their resources to performance goals through activity-based costing. Instead, pilots lumped their entire program budget into a single justification—providing very little useful information to allocate resources on activities that had a greater impact on performance.

This time around, California has to have an ironclad commitment to performance budget—exhibited by the Governor, legislature and agency managers. Specifically, the legislature should adopt a formal performance budgeting statute based on the landmark "Government Performance and Results Act"—already law at the federal level. More importantly, it has to be implemented correctly using results-oriented performance measures and backed up by cost information on an activity level.

Using Program Assessments to Select Targets for Spending Reductions

For the immediate challenge, the Governor and legislature should require each agency to submit a performance budget by June 15th based on a series of questions relating to the relevance, performance and management of each of its programs. Regardless of the assessment approach the state takes, a program-by-program approach to spending reductions has to be conducted—with performance at the heart of each assessment. A program that cannot provide an answer to the questions—backed up by clear and convincing evidence—should NOT be given the presumption of relevance, performance or good management. Instead, its funds should be suspended wholly or in part until a solid justification can be made.

The **Citizens' Budget** uses three categories in assessing each program.



***Relevance*: Key Oversight and Budget Review Questions to Ask**

1. *Purpose*: Does the program address a specific interest, problem or need that is clearly identified and immediately pressing?
2. *Appropriateness*: Does the program represent a critical, essential role for state government to play?
3. *Impact*: If the program were eliminated would no other parties wholly or in part mitigate the loss of the program?
4. *Uniqueness*: Is the program designed to make a unique contribution that is not duplicative of other federal, state, local government programs or private and non-profit programs?
5. *Growth*: Has the program's budget grown over the past 10 years in a manner consistent with the growth in the need it is designed to address?

Evaluating Program Relevance

The first element of an assessment should consider whether the state should be spending money on a given program or activity in the first place. Moreover, a number of factors should be weighed.

First, the program should have to justify that there is a critical and compelling need addressing a major problem that requires state intervention. For example, during tight budget times, non-essential programs such as exhibitions, fairs, demonstration projects, etc. should be postponed or scaled back.

In many, many cases, reviews of programs should go beyond an overall program review to include the activities and spending practices. Some expenditures at an activity level came to our attention that clearly did not meet the relevancy criteria:

- The 2001 budget contained funding for the Department of Conservation that included appropriations for nine staff positions to investigate an estimated five complaints per month of predatory pricing by recyclers, and for the creation of computer-generated maps using Global Positioning Services in order to identify the locations of neighborhood recycling centers. Judging by the "need" of this program (a mere 5 complaints per month) it probably does not warrant nine full-time positions.[21]
- In 2001, the Resources Agency spent $12,000 on a series of poetry readings. According to Resources Secretary Mary Nichols, "Poets give us the inspiration that we need to do our work."[22]

In other cases, we found that the program duplicated other federal, state, local, non-profit or private efforts. A few examples we found included:

- The Employee Development Department's Workforce Investment Act Program ($537,166,000) and the Office of Statewide Health Planning and Development's Healthcare Workforce program ($10,593,000) are duplicative of other job-training and student-aid programs. These services also happen to be readily available in the private sector.



***Performance*: Key Oversight and Budget Review Questions to Ask**

1. *Outcomes*: Does the program have specific, Long-term performance measures focusing on outcomes?
2. *Progress Toward Outcomes*: Does the program have a limited number of annual performance measures demonstrating progress toward Long-term goals?
3. *Achievements*: Does the program actually meet the goals established above?
4. *Comparative Performance*: Does the program deliver quality performance in comparison to similar program activities in other governments, the private sector and non-profits?
5. *Quality Information*: Does program collect timely and credible performance information that can be verified and validated?

Another way to tell a program has low relevance is if it delivers benefits to a targeted industry or group without broad-based benefits. In many cases, our project uncovered examples of "corporate welfare" programs that benefit certain industries by subsidizing activities that should be funded by the industry itself. Good examples of these kinds of programs include:

- The Office of Statewide Health Planning and Development's Cal-Mortgage Loan Insurance program ($4,241,000) is an insurance program for health facility construction, improvement, and expansion loans. These clearly can be obtained in the private sector and it is unclear why the health care industry was singled out to receive such subsidies.
- The Governor's Budget proposes spending $80,767,000 on the Department of Agriculture's Marketing, Commodities, and Agricultural Services program. Other private industries must rely upon their own marketing budgets for building their reputations and selling their products. There is no reason certain elements of the agricultural industry should receive government subsidies for their marketing, as this type of corporate welfare only disadvantages unprivileged competitors, drives up prices, takes money out of the pockets of consumers/taxpayers, and encourages further special interest lobbying of the sort that obviously got the program enacted in the first place.

Finally, another tell-tale sign that a program has a budget larger than its need can justify is when spending on the program has skyrocketed without an increase in problems it is addressing. Two good examples of this:

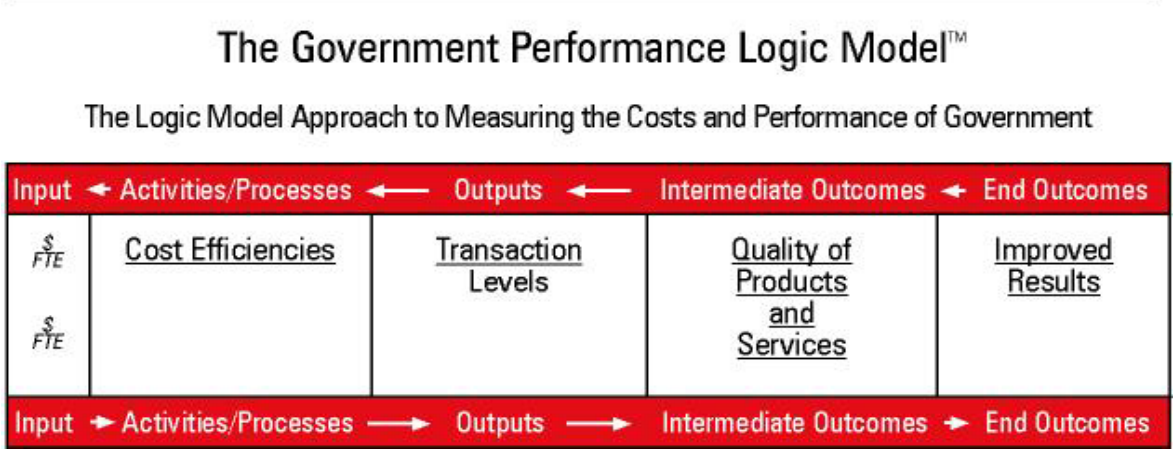
- The 2003-04 Governor's budget contains an 84 percent one-year increase in funding for the Committee on Health and Safety and Workers' Compensation of the Department of Industrial Relations, although there is no evidence to suggest that such an increase is necessary or warranted. Reducing the proposed budget by $850,000, from $2,661,000 to $1,811,00 would still yield a one-year budget increase of over 25 percent.
- Funding for the Office of the Secretary of Resources increased a staggering 2476 percent in one year from $17,098,000 in 2001-02 to $440,519,000 in 2002-03. Even the planned sizeable reduction to $54,285,000 in fiscal year 2003-04 yields a budget increase of 217.5 percent over two years. Implementing our suggested additional $25,000,000 budget reduction would still fund the office at a level that would represent an average growth rate of nearly 20 percent over the past two years.

Evaluating Program Performance

The second element of a program assessment should consider whether the program is producing solid results and is achieving its goals. In this element, the state should examine performance goals and performance measures for each program.

First, the program should identify what its outcomes are. Outcomes are the tangible results or benefits to be gained for the taxpayer as a result of a program performing a certain mission. While outcomes are difficult to measure and can take several years to achieve, nonetheless *all* programs can and should measure outcomes. If a program cannot measure its outcomes, there is serious question whether the program can be managed to achieve results.

Second, the program should identify tangible goals and measures on an annual basis (outputs and intermediate outcomes) that lead to the program's outcomes. These measures provide the means for policymakers to assess program progress on an annual basis instead of waiting several years for outcomes to be measured. Most importantly, these measures provide programs with key "milestones" that must be achieved to ensure the program produces intended results. (Programs might want to present performance information using a logic model as represented in the graphic below.)



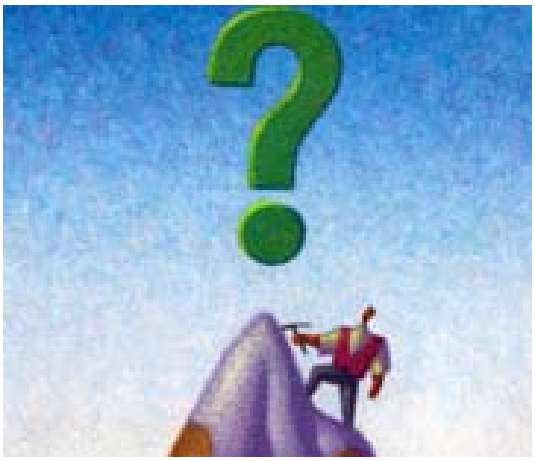
Source: The Performance Institute

Finally, when evaluating performance goals and measures for each program, the state should examine whether the goals of the program have been met. If a program does not meet its goals, were there external factors that caused the failure? How did the program compare with similar activities in the private sector, non-profit organizations, or other government agencies? Most importantly, the state should review all performance information provided in this assessment to ensure reliability and accuracy of the information.

The research team contacted each state agency to request goals and measures for each program. No state agency provided this project with goals and measures despite repeated requests. Indeed, several agencies noted that the practice of setting goals and measuring performance had been discouraged by management and certainly would not be part of the budget presentation to the legislature. As a result, the research team found it hard to systematically evaluate the performance of state programs. Nevertheless, the sheer fact that programs do not set goals and do not have evidence of their achievements should call into question the need for funding.

In other cases (such as with education scores, foster care, substance abuse, etc.) state programs have poor performance achievements well-documented by the media and interest groups.

- Internal audits of the State Disability Insurance program, which provides aid to pregnant women and those unable to work due to injuries received outside of their jobs (and thus ineligible for workers' compensation benefits), revealed that state employees made errors on nearly 40 percent of the claims processed and approved benefits payments to people ineligible for the program.[23]
- According to the LAO's 1999-00 Budget Analysis, the California State University had no idea how many additional full-time students enrolled in teaching preparation programs as a result of the $13.8 million appropriated during the previous two years to increase program enrollment.[24]
- The Department of Consumer Affairs spent $62 million on the Low-Income Repair Assistance Program, established to provide state assistance to eligible low-income participants for smog check automotive repairs, in 1998-99 and was allotted an additional $62 million in the Governor's 1999-00 budget, despite the fact that only 3 people had participated in the program.[25]
- The Early and Periodic Screening, Diagnosis and Treatment, or EPSDT Program, which provides mental healthe services for children, has grown from zero to $770 million in eight years, with half that cost paid by the state and half by the federal government. Even as the rest of state government is cutting back, this program is expected to grow dramatically in the coming year, by another $150 million. Known only to insiders, the program is hardly a household word, like welfare or Medi-Cal. But it has caught the attention of the number crunchers at the Department of Finance, who call its growth "alarming." The state's director of mental health is also concerned, because, he concedes, he cannot say with confidence that the money is being well-spent.[26] Additionally the state has not studied whether or not the treatment is working, and whether or not the children are receiving help. To date the program has been focused on performing the court-mandated services without regard to whether or not those services are working.
- A December 2001 Bureau of State Audits report on the Technology, Trade and Commerce Agency concluded that "without adequate strategic planning, the agency lacks an effective way to demonstrate that it is wisely using the more than $200 million spent on its programs each year."[27]
- Another perfect example is provided by the state's foster care system, where an estimated 25 percent of the children in foster care have not received timely medical care and 50 percent have not received appropriate mental health services.[28]



***Management*: Key Oversight and Budget Review Questions to Ask**

1. *Resource Allocation:* Does the program provide a compelling cost-per-unit of service? Are there examples of egregious spending?
2. Personnel Management: Are employees held accountable for performance standards and trained/managed to produce optimal results?
3. Process Re-engineering: Have IT and other processes been leveraged to improve performance and cost efficiencies of the program?
4. Competitive Sourcing: Does the program use partnerships, grants and contracts to improve efficiency of operations and service delivery?
5. Financial Integrity: Does the program have strong internal controls and has it reduced waste, fraud and errors in its payment and financial management systems?

Evaluating Program Management

The third element of a program assessment should consider whether the program is being managed properly and efficiently. Programs can be designed and managed to produce results in a variety of different ways. Just because a program is relevant and producing results does not mean it is optimally designed using the latest best management practices.

Just as with performance goals and measures, state programs were reluctant to share any management information requested. Indeed, virtually no program in the state could provide a reliable "cost-per-unit-output" figure to the research team. In most cases, the research team again had to rely on media reports, whistleblower complaints and examples provided by watchdog groups.

Examining spending practices is the first key step in evaluating a program's management. Certainly analysis of cost-per-unit activity or output of a program can reveal serious mismanagement of resources. For example,

- In January 2002, the state paid $913,000 to the Stanford Medical Center for a heart transplant for a two-time felon.[29] The average cost of a heart transplant in the nation is just over $200,000. The action caused many critics to claim that prisoners receive better medical care than average Californians.
- In FY 1999-00, the Department of the Youth Authority proposed spending $2,900 per window to modify 36-inch-square windows in ward rooms.[30]

In addition to looking at "cost-per-unit-output" the state should examine any inappropriate spending practices or allocation of resources. Examples of egregious spending included:

- Chief Deputy Director Elwood "Woody" Allshouse of the California Department of Forestry and Fire Protection acquired on behalf of the state a "very expensive, very fast, executive-style aircraft that he often flies personally and—according to those familiar with it—is unsuited to any serious firefighting role."[31] The plane will cost the state over $7 million in lease payments over the twelve-year term of the lease, plus maintenance and operational expenses.
- A December 2002 Bureau of State Audits report concluded that in fiscal year 2001-02, the Department of Health Services paid an average of $3,121 for wheelchairs with unlisted Medi-Cal codes, more than five times the $622 cost of wheelchairs with listed codes.[32]

- According to a March 30, 2002 article in the *Contra Costa Times*, "California National Guard troops assigned to protect four major bridges are housed at hotels—including the four-star Marriott in downtown San Francisco—rather than in military barracks, at a cost to taxpayers of more than $750,000, government records show. The total tab for the guard's anti-terrorism efforts on four state suspension spans already exceeds $2.5 million, according to the Department of Finance."[33]

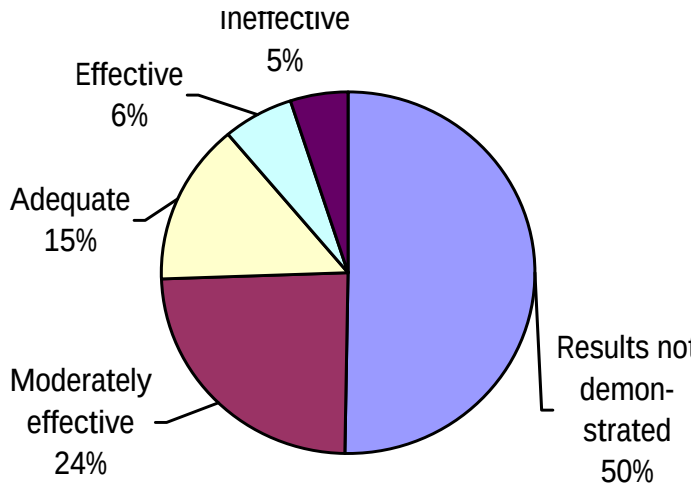
Programs manage processes. Just like a factory has an assembly line, government programs have various processes and procedures for how they serve the taxpayer. As with any operation, they can be efficient or absurdly inefficient. The state should examine the processes of each program to evaluate whether the program has effectively used information technology to streamline operations and whether unnecessary layers of bureaucracy have been eliminated. Of all of the areas where cost savings can be found, redesigning state programs offer perhaps one of the best opportunities. Among the numerous examples of inefficient and bureaucratic processes, we found that: According to the LAO's fifth annual Budget Analysis Quiz, the Department of General Services charged other state departments $6,200 to check a forest fire station, which does not have a school, for school seismic requirements and $2,000 for environmental documents to replace lighting fixtures at a prison.[34]

Three other management issues should be evaluated: personnel management, competitive sourcing, and reducing payment errors/fraud. Given the significant cost savings associated with these three management issues, this report has two chapters (Parts 5 & 6) dealing with these challenges in greater detail, complete with egregious examples uncovered by our research.

Scoring Programs Using Performance Criteria

Based on the questions posed above, it might be useful to "score" programs based on responses to the questions and provide a complete assessment of each program's performance in categories such as in Figure 9. A number of scoring approaches can be taken.

Figure 9: Results of the "Program Assessment Rating Tool"in the '04 Federal Budget: How Accountable are Federal Programs (In Percentage of Programs)



Source: President's FY04 Budget

For example, at the federal level, the Office of Management and Budget used the Program Assessment Rating Tool (PART) to score 20 percent of all federal programs. The PART assessment reflects most of the issues raised by the Citizens' Budget for the state of California to use in its assessment of state programs. When OMB "scored" federal programs using the PART criteria, more than half of the programs failed! Based on the scoring, targeted spending changes were made, with "effective" programs receiving an average budget increase of 6

Figure 10: Targeting Spending Reductions



Source: Carl DeMaio, The Performance Institute

percent while "ineffective" programs were held to a paltry 1 percent increase. Most programs with performance problems were reformed—with conditions put on their funding levels.

California might also want to use a scoring approach. One way to rank programs is to use the four-quadrant model in Figure 10.

Programs would be given a score on a scale of 1 (low) to 4 (high). Then, the program's ranking would be "plotted" on the graphic, along with all others in that agency. Based on which box the activity falls into, an agency can determine what opportunities for change may exist.

A. **Attention Needed**—Activities plotted here are highly relevant to the agency's overall mission, but are not performing or being managed very well. These activities are prime candidates for reform (and even spending increases) designed to improve activity performance and management.

B. **Proven Success**—Activities plotted here are relevant to the agency's overall performance and are performing very well. Building on success might be warranted here.

C. **Exit Opportunity**—Activities plotted here are not relevant to the agency's overall mission and are not performing or being managed very well. The agency may choose to shift resources to more important areas after ceasing these activities.

D. **Resources Available**—Activities plotted here are not relevant to the agency's overall mission but are performing and being managed very well. The agency may have resources and staff here that can deliver similar high performance in more important activities or may choose to shift resources to more important areas after ceasing these activities.

Spending Reductions Identified by Citizens' Budget Analysis

In applying elements of the performance-based methodology outlined above to the state's budget, the Citizens' Budget proposes a list of spending reductions totaling over $5 billion. In addition, the LAO's spending reductions package, using a similar approach to the Citizens' Budget, contains an *additional* list to save $4.1 billion in 2003-04 and $3.3 billion in 2004-05. It is important to note that the Citizens' Budget reductions are in addition to the LAO cuts. Appendix B contains the specific reductions on a line-by-line basis in the budget. Moreover, next to each reduction, a justification is provided.

In many cases we categorized programs as low priority because they were duplicative of other state programs, they were duplicative of services that are adequately provided in the private sector, they had experienced explosive and unjustified budget growth, they were better suited to more local levels of government, or we simply felt they did not perform a core government role. Even without an abundance of performance information, we also made recommendations based on poor results and poor management of programs.

Clearly, should state policymakers apply the methodology outlined above and firmly demand detailed information from each state program, additional opportunities for reductions can be found. At the very least, the state should carefully consider both the LAO and Citizens' Budget reduction packages.

Creating a California Sunset Commission

Often times, the Governor and the legislature are too close to political pressures to adequately and appropriately review the performance of each state program. That's why, long term, we recommend the creation of a "California Sunset Commission" to conduct a thorough audit of state finances and expenditures and to recommend ways the government can cut costs, reduce waste, and improve efficiency and service levels. Specifically, the Commission should:

- Review 20 percent of state programs each year (like the PART process used at the federal level by the Office of Management and Budget)
- Assess the importance of agency functions and eliminate or consolidate programs that are deemed outdated or unnecessary
- Provide suggested performance goals and measures for programs that have shown an inability to focus on meaningful results
- Be appointed by the Governor and legislature
- Present an annual package of program reforms that would be voted on en masse with a single up-down vote

The success of such commissions in other states, such as Texas, Illinois and Virginia, suggest that this would represent a significant first step in helping legislators to identify ways to improve state budgeting and services. The Texas model describes how the California Sunset Commission might work. About 150 state agencies are subject to the Texas Sunset Act. The legislature groups and schedules agencies for review by function to allow the examination of all major state policies related to a particular function at once, such as health and human services, natural resources, and financial regulation. About 20 to 30 agencies go through

the Sunset process each legislative session. Since the first reviews, 44 agencies have been abolished and another 11 agencies have been consolidated. In addition, the legislature has adopted a large majority of the recommendations of the Sunset Commission.[35]

Targeting Reductions the Right Way

In time of abundance, budgeting decisions are fairly simple. They often come down not to *whether* programs should be funded, but *how much*. Those days are gone, however, and now the Governor and the legislature must craft a budget that is more in line with the economic reality that hit the California consumer two years ago. In their mission to balance the budget, Governor Davis and members of the state legislature must separate low-priority programs and functions from those that are central to the operation of state government.

As this section details, there is an incredible amount of waste occurring in California state government. The good news, however, is that it is never too late to commit to cutting government waste. With some vigilance and common sense, waste can be minimized, thereby freeing up resources for higher-priority programs and services.

Part 4

Streamline and Reorganize State Government through Consolidation and E-Government

"Today each citizen pays the price of a government which has developed haphazardly in a piecemeal response to the pressure of growth. We are burdened by layer upon layer of patchwork agencies, and confusing lines of authority. The time has come for us to modernize State Government and improve its service to our people."

—Former Calif. Governor Edmund G. "Pat" Brown (D), First Inaugural Address, January 5, 1959

Summary of Citizen Budget Recommendations in This Section:

1. **Restructure State Government** by creating seven main departments to integrate and coordinate programs in key mission areas in government for a savings of $770 million.
2. **Consolidate Independent Boards and Commissions** into the seven main Departments to create one-stop decision making, program management and service delivery.
3. Create a **State Administrative Services Office** run by the Department of Finance to provide one-stop administrative services to all state agencies—as well as sell services on a fee basis to other federal, state and local governments.
4. Expand the use of **Information Technology and E-Government** to streamline agency business processes, achieve cost efficiencies and improve citizen service.
5. Hire contractors under a 12 month, **"Share-in-savings" Reorganization Implementation Contract** to manage the reorganization of the state government.

California Budget FACTS:



140

Number of state-wide boards or commissions in California today

15%

Conservative estimate in overhead and operational savings achieved by consolidation of two similar agencies or programs

$770 million

Amount of annual savings identified by the Citizens' Budget from comprehensive reorganization of the state government

The words captured in the quotation above from former California Gov. Pat Brown in 1959 are truer today than ever. Indeed, every governor since Pat Brown—including Gray Davis—has called for substantial reform in how the California state government is structured. In reality, the Governor has very little authority over the agencies in the executive branch. This undermines accountability for decision-making and creates a major challenge for effectively managing the state.

In the last section, the Citizens' Budget laid out a performance-based methodology for evaluating the relevance, performance and management of each program. Once a program is deemed "worthy" of taxpayer investment, where it is housed can have a substantial impact on how much it costs and how much it can accomplish. Indeed, it is clear that if California is to improve its fiscal situation and deliver improved performance, it will need to consolidate overlapping and duplicative functions, streamline its operations, and improve coordination of effort.



Why So Many Boards and Commissions in California?

"Nearly one-fifth of the $64 million Gov. Gray Davis has raised for his reelection, about $12 million, has been directed to his campaign by people he appointed to state boards and commissions.

At least 75 of the roughly 140 boards that have statewide authority include at least one Davis donor. Many have a majority who are contributors and some are filled exclusively with political donors, according to a *Times* analysis."

Los Angeles Times, October 13, 2002

Strategically Redesigning California State Government

Consolidation efforts can save the state money and improve services to the taxpayer. First off, every agency in the state has certain "fixed costs" and "overhead" necessary to operate. Each agency has to have public affairs, legal counsel, human resource management, information technology, office space, administrative support, etc. By consolidating similar programs into one agency, significant overhead cost savings can be achieved.

More important than just the cost savings, coordination can be improved dramatically. With duplicative and overlapping programs, it is hard for the right hand to know what the left hand is doing. In many cases, duplicative activities and initiatives are funded—or even worse, conflicting efforts are funded.

Our restructuring plan would shrink the number of cabinet-level agencies from twelve to seven.[36] This reorganization does NOT affect legislative responsibilities, but it does reorganize the organizations performing those responsibilities into a more strategic and coordinated structure. The remaining seven cabinet-level departments reflect the core "quality-of-life" responsibilities to be carried out by state government:

- Education
- Health and Human Services
- Transportation and Infrastructure
- Commerce, Agriculture and Consumer Services
- Public Safety and Corrections
- Finance, Technology and Personnel
- Environment Protection and Natural Resources Management

California state government should go well beyond just consolidating programs into seven super-departments. Instead, as each department takes shape, a top-down strategic planning process should be used



Source: Carl DeMaio, Performance Institute

to strategically "architect" the new department to be outcome-oriented. The graphic of "Building a Results-oriented Agency" reflects the design process suggested by the Citizens' Budget. Using this process, each department would create a mission and define outcome goals. Next, strategies for achieving results would be defined, complete with intermediate outcome performance goals to track success. Then, programs would be "grouped" under each strategy (e.g. improve health care for children; reduce violent crime; improve habitat for species conservation; etc.). Each program would have to demonstrate how it worked in a coordinated way with the other programs in its groupings. Based on priority and effectiveness, the new programs would be given a piece of the budget resources allocated to achieving each strategy.

Reforming Commissions and Boards

A myriad of commissions and boards has been created to address specific needs, but oftentimes they are rarely, if ever, evaluated to ensure that a need for them still exists or that similar services are not provided by other agencies. The Citizens' Budget suggests that "advisory" Commissions and Boards be eliminated and that "policy-making" boards be placed under one of the seven departments created in the reorganization plan. Where necessary, political independence of boards and commissions will be preserved in how reporting relationships within the department are structured.



Shared Administrative Services in Consolidation Plan

- Travel
- Payroll
- Recruitment
- Employee Training
- Information Technology
- Financial Management
- Contracting and Acquisition
- Records Management
- Fleet/Vehicle Management
- Facilities Management

Consolidating Administrative Services into a "Shared Services" Operation

The final element of the reorganization of state government involves the streamlining and consolidation of certain "administrative" services. An example of reforming administrative services can be seen with the President's Management Agenda (PMA)—currently being implemented at the federal level.[37] The PMA maps out five federal government-wide goals to improve federal management and make government citizen-centered, results-oriented, and market-based. One of the Initiatives, Expanded Electronic Government, is designed to bring more services to the American citizen over the Internet, make government more efficient, and improve IT

management throughout the executive branch. Within this goal, the Office of Management and Budget outlined 24 initiatives under four categories for improvement: Government to Citizens, Government to Business, Government to Government, and Internal Efficiency and Effectiveness. The seven initiatives within the Internal Efficiency and Effectiveness category have been designated as areas where programs can be consolidated and efficiency can be improved government-wide.

These shared services within the federal government are necessary to each agency, yet not distinct to each agency, making it possible to merge each agency's office into one or two all-encompassing offices. Several of these federal initiatives can be "borrowed" by the state of California and implemented to streamline some government processes and save a substantial amount of resources. Several shared services that have provided the federal government with significant results and cost savings are:

- **e-Training:** Provides a single point of online training and strategic human capital development solutions for all federal employees, reducing instructor and travel costs and improving human capital management. The official federal Web site for training, GoLearn.gov, was launched in July and is the most visited e-training site in the world. Containing information on thousands of e-training courses, e-books, and career development resources, GoLearn.gov has already allowed over 30,000 federal employees to receive on-line training, reducing variable training costs to less than a penny per student.
- **Recruitment One-stop:** Outsources delivery of USAJOBS Federal Employment Information System to deliver state-of-the-art on-line recruitment services to job seekers, including intuitive job searching, on-line resume submission, applicant data-mining, and on-line feedback on status and eligibility. With Monster Government Solutions selected as the primary vendor, Recruitment One-stop's "single point of entry to respond to many job openings" functionality will improve customer satisfaction by simplifying the application process and reducing application times. It will also help agencies achieve the desired quality level of new hires and enhance agency response times.
- **e-Payroll:** Consolidates 22 federal payroll systems into two in order to simplify and standardize federal human resources/payroll policies and procedures to better integrate payroll, human resources, and finance functions. The federal government is projected to save $1.2 billion over the next 10 years by modernizing only two providers as opposed to 22.
- **e-Travel:** Consolidates, streamlines and automates the travel management function across the federal government by providing a common, Web-based, end-to-end travel management service. The service stands to transform travel planning, authorization and reservations, expense reporting, and claims and voucher reconciliation. It will leverage commercial travel management "best practices" to realize significant cost savings, improve service, and broaden the range of travel-related services available to federal travelers.
- **Integrated Acquisition Environment:** Designed to create a secure business environment that facilitates and supports cost-effective acquisition of goods and services by agencies, while eliminating inefficiencies in the current acquisition landscape. Through the initiative, common acquisition functions that can benefit all agencies, such as the maintenance of information about suppliers (e.g., capabilities, past performance histories) are managed as a shared service.
- **e-Records Management:** Provides policy guidance to help agencies to better manage their electronic records, so that records information can be effectively used to support timely and effective decision-making, enhance service delivery, and ensure accountability. Ultimately, this initiative will improve the government's ability to ensure the integrity of electronic records and related information that agencies require to meet their legal and internal business needs.



The proposal for California would be to implement these consolidated offices and then require state agencies to opt-in to these services or devise a business case and offer these services up to competition with the private sector for improved cost savings. Payroll Services will serve as an example of this process. Under the Citizens' Budget plan, the state will mandate that a state-wide Office of Payroll Services will be created to handle the payroll maintenance of every state agency. State agencies will then be given two options for managing payroll: either opting-in to the consolidated Office of Payroll Services, or developing a business case for keeping payroll in-house. Should the agency opt to develop a business case for its payroll services, the agency's payroll service must be entered into a competition with the private sector to determine cost efficiencies. If the agency can prove that its payroll services can be done in the most cost effective manner in-house after going through the development of a business case and a public/private competition, then the agency can maintain its own Office of Payroll. No matter which method an agency chooses, cost efficiencies are guaranteed through this process, allowing resources to be reallocated to other programs.

California can readily implement consolidated offices for each of the shared service examples that are being implemented by the federal government, as well as additional services that are done by state agencies. Piggybacking on the successes and cost savings being produced by the federal government, California's state government can benefit from the efficient and enhanced services, as well as the significant savings in resources, from the consolidation of shared services.[38]

Expanded Use of Information Technology and E-Government

The California state government already spends $2 billion each year on information technology purchases. (Indeed, the federal government alone spends roughly $54 billion annually on information technology services.) The Citizens' Budget does *not* propose increasing funding for information technology in the aggregate. After all, there is not a whole lot of room for budget increases in this budget! However, it is vital that the state stretch its information technology budget and demand accountability for results.

Using information technology in government is not about putting up pretty Web sites or posting irrelevant information online; it is also not about giving every state employee the fastest and best personal computer. Rather, it is about government making better use of technology to improve citizen service and improve government efficiency. It is about cutting government's time to make decisions from weeks or months to hours or days.

In order to ensure every dollar spent by the state on IT is results-oriented, the state should create in the Dept. of Finance a Director of Technology and e-government (patterned after a similar position in the U.S. Office of Management and Budget). The director would not only manage information technology services provided by the Dept. of Finance, but would also review each state program's use of technology to perform its mission. The director would have the authority to suspend poorly planned or managed IT projects and could sequester IT funds for cross-agency technology initiatives that would reduce the total cost of technology to the state. The result of this improved approach to technology management would be to focus IT spending to improve mission performance, reduce duplication, ensure information security, and enhance cooperation across traditional program silos.

Implementation and Cost Savings Under the California Government Reorganization Plan

The reorganization of the California state government would be modeled after the massive and historic reorganization of the federal government under the Homeland Security Act of 2002 (which reorganized 22 agencies and over 170,000 federal employees into the Dept. of Homeland Security.) In order to ensure effective implementation of the reorganization, a management firm would be hired under a 12 month "Share-in-savings" Reorganization Implementation Contract to manage the reorganization of the state government. The management firm would *not* be paid up front—and would be paid solely out of documented cost savings achieved by reorganizing the state government in a timely and effective manner. Even if the contract provided a 0.1 percent "share-in-savings" bonus, the contractor would receive $770,000 for its services.

What should emerge within each of the seven departments is a streamlined, integrated and coordinated organizational structure that maximizes the efficiency and performance of each program. In constructing the new state organizational chart, the Citizens' Budget estimates cost savings will total $770 million annually. These cost savings were calculated by taking the smaller budget of two agencies combined in our reorganization and estimating a 15 percent cost savings on the budget. At the federal government, overhead rates under OMB Circular A-76 are pegged at 12.5 percent of a program's budget, but this figure has been criticized as too low. Moreover, evidence from other consolidation projects demonstrates at least a 15 percent cost savings factor due to elimination of overhead, duplicative services, streamlining, etc.[39] By

taking cost savings based on the smaller of the budget of two or more agencies consolidated, we feel the $770 million figure is quite conservative.

Old vs. New Organizational Chart and Details

In this section, we provide a listing of the seven new departments, complete with mission statements and strategic goals for each, along with details on what existing state agencies and programs will be folded into these new entities. Finally, Appendix B provides cost savings estimates for each commission or department and includes some agencies not contained in the organizational charts.

Figure 11: A Maze of Overlapping Bureaucracy

The Old California State Government Chart

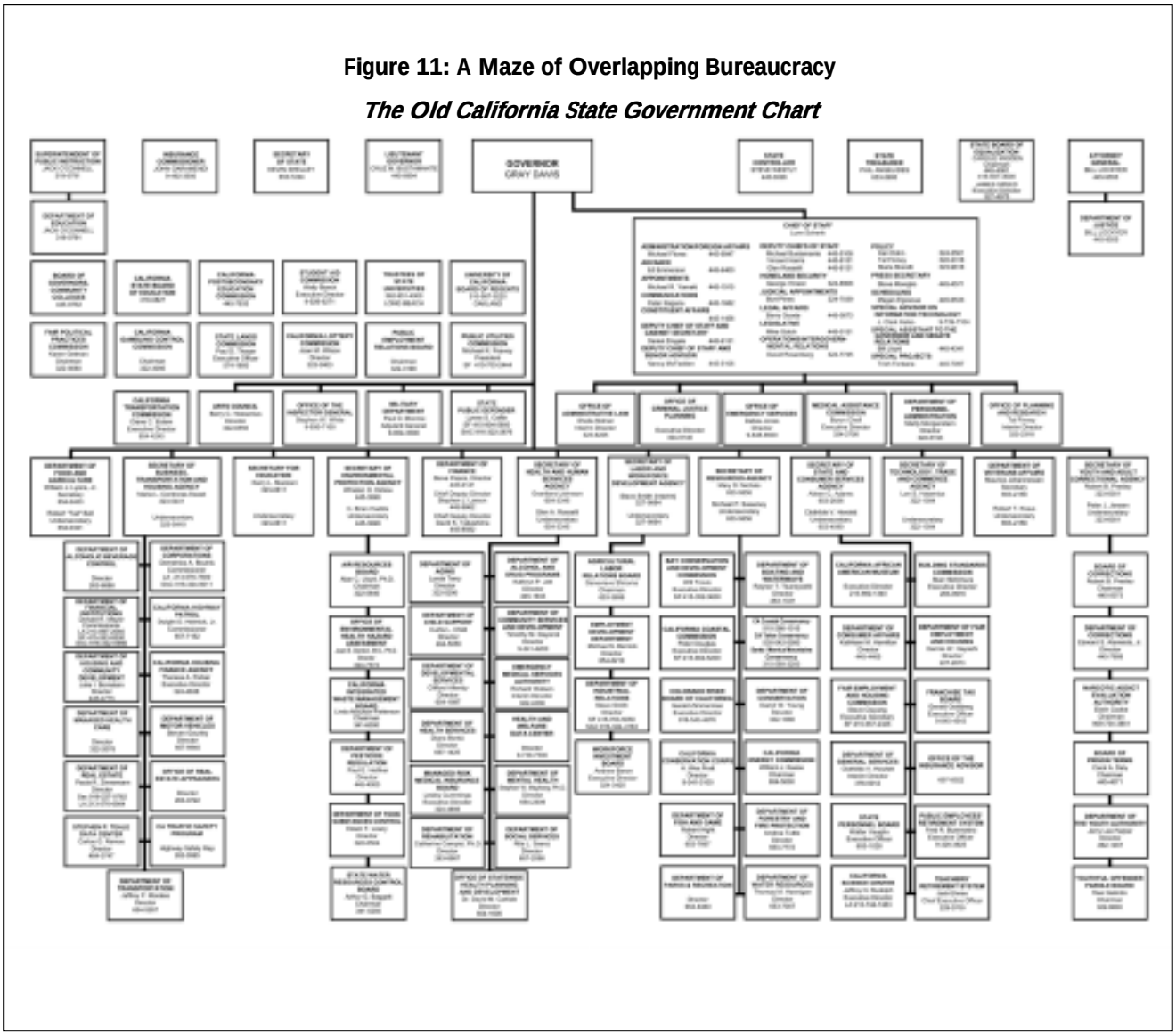
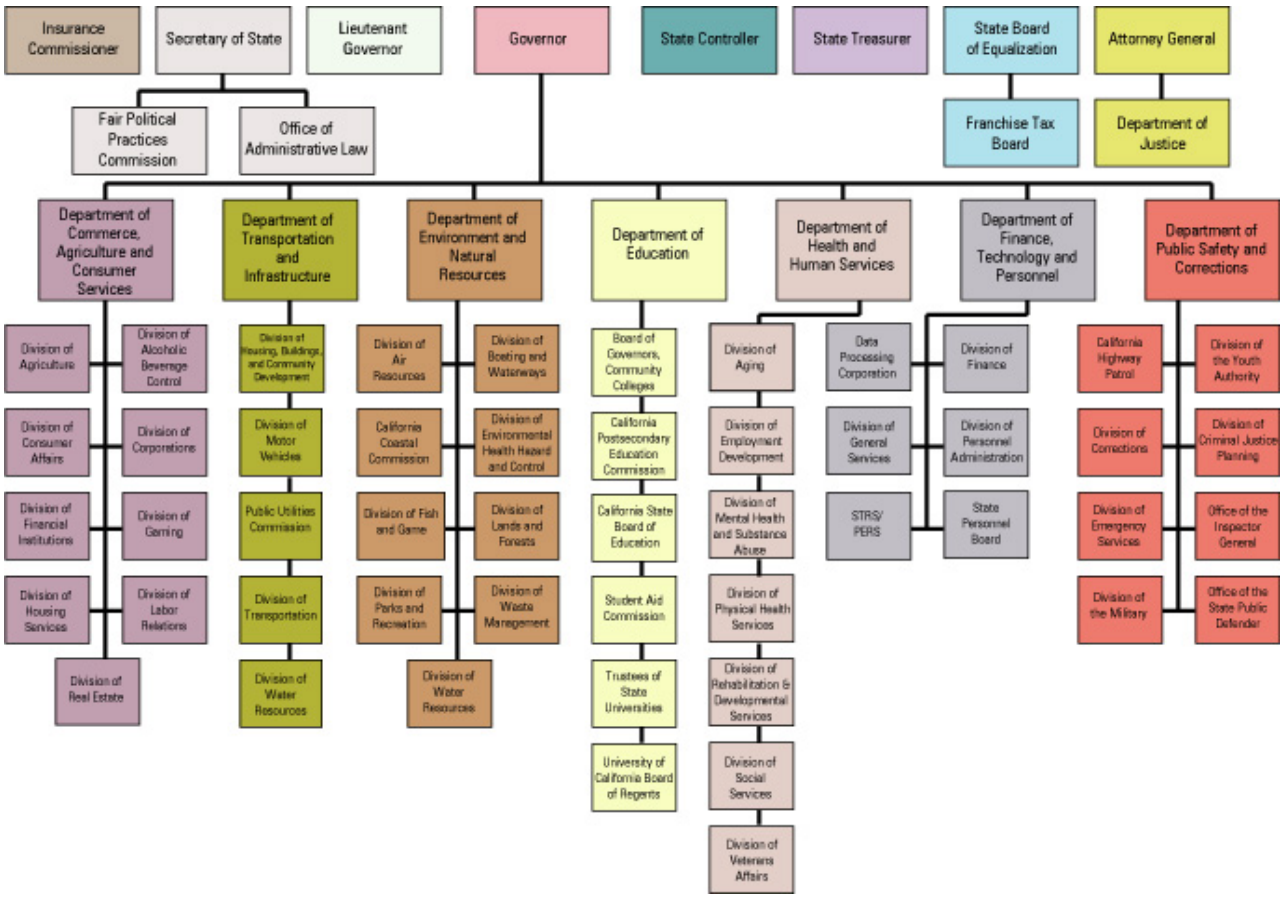


Figure 12: Strategic Redesign for Improved Efficiency

The New California State Government Chart



Department of Commerce, Agriculture, and Consumer Services

Mission Statement

The mission of the Department of Agriculture, Commerce, and Consumer Services is to promote fair markets to provide for stable commerce in California's agriculture, housing, and other industries.

Strategic Goals

- Ensuring that only safe food reaches the consumer;
- Protecting against invasion of exotic pests and diseases;
- Licensing professionals and regulating various industries, including the financial and real estate industries;
- Protecting consumers from fraud and professional misconduct;

- Monitoring the administration of workers' compensation claims;
- Mediating employee-employer disputes; and
- Regulating the gaming industry and administering the California Lottery.

New Division Names

This department consists of nine divisions, including the Division of Agriculture, the Division of Alcoholic Beverage Control, the Division of Consumer Affairs, the Division of Corporations, the Division of Financial Institutions, the Division of Gaming, the Division of Housing Services, the Division of Labor Relations, and the Division of Real Estate.

Where They Came From

The Department of Commerce, Agriculture, and Consumer Services (DCACS) consists of much of the Business, Transportation and Housing Agency's departments, although the transportation and public safety departments from that agency have been moved to the Department of Transportation and Infrastructure and the Department of Public Safety and Corrections, respectively. The Department of Food and Agriculture (renamed the Division of Agriculture) and the Technology, Trade and Commerce Agency have also been included here due to their influences on California commerce. The Agricultural Labor Relations Board has been folded into the Department of Industrial Relations (now the Division of Labor Relations) and moved to the DCACS as well. In addition, certain departments from the State and Consumer Services Agency have been moved here, including the Department of Consumer Affairs and the Department of Fair Employment and Housing (renamed the Division of Housing Services). Furthermore, the new department includes the state's gaming functions, which have been consolidated by integrating the California Horse Racing Board and the California Gambling Control Commission into the California Lottery Commission and naming the new organization the Division of Gaming. Finally, we agree with the Governor's proposal to eliminate funding for the Office of Real Estate Appraisers in FY 2003-04.

Department of Transportation and Infrastructure

Mission Statement

The mission of the Department of Transportation and Infrastructure is to provide Californians with safe, reliable and efficient roads and bridges, license drivers and transportation services throughout the state, and ensure reliable access to water, power, housing and other utilities.

Strategic Goals

- Improve efficiency, safety, mobility and operation of California State Highway System, as well as that portion of the Interstate Highway System within the state's boundaries;
- Ensure reliability and appropriate provision of key water, power and utility infrastructure; and
- Ensure safe buildings and housing are developed throughout the state.

New Division Names

This department consists of five divisions, including the Division of Housing, Buildings, and Community Development; the Division of Motor Vehicles; the Public Utilities Commission; the Division of Transportation; and the Division of Water Resources.

Where They Came From

The Department of Transportation and Infrastructure is comprised of the Department of Housing and Community Development (which now includes the Building Standards Commission and is renamed the Division of Housing, Buildings, and Community Development), the Department of Motor Vehicles, and the Department of Transportation (which now includes the California Transportation Commission) from the Business, Transportation and Housing Agency, as well as the Department of Water Resources (which now includes the Colorado River Board of California) from the Resources Agency and the Public Utilities Commission (which now includes the California Energy Commission from the Resources Agency and the California Consumer Power and Conservation Financing Authority).

Department of Environment and Natural Resources

Mission Statement

The mission of the Department of Environment and Natural Resources is to protect public health from environmental risks and safeguard the state's environmental resources.

Strategic Goals:

- Maintain quality, accessibility and safety at state parks, as well as the use of other state lands, bodies of water, and coastal regions;
- Reduce loss of property and life from wildland fire;
- Improve environmental outcomes for the state, including clean air, clean water, healthy lands, protected species, healthy oceans and sustainable development; and
- Facilitate sustainable use of California's natural resources.

New Division Names

This department consists of nine divisions, including the Division of Air Resources, the Division of Boating and Waterways, the California Coastal Commission, the Division of Environmental Health Hazard and Control, the Division of Fish and Game, the Division of Lands and Forests, the Division of Parks and Recreation, the Division of Waste Management, and the Division of Water Resources.

Where They Came From

The Department of Environment and Natural Resources is chiefly the result of a merger between the state's two environmental agencies, the Environmental Protection Agency and the Resources Agency. Many boards, commissions, and departments have been combined, however, to improve efficiency and eliminate duplicative functions. For example, from the Environmental Protection Agency, the Department of Toxic Substances and the Office of Environmental Health Hazard Assessment are combined to form the Division of Environmental Health Hazard and Control, and the Department of Pesticide Regulation is folded into the Department of Toxic Substances Control. From the Resources Agency, the San Francisco Bay Conservation and Development Commission, the California Tahoe Conservancy, the Santa Monica Mountains Conservancy, the California Conservation Corps, the State Lands Commission, the Department of Conservation, and the Department of Forestry and Fire Protection are combined to form the Division of Lands and Forests. In addition, the California Coastal Conservancy is folded into the California Coastal Commission.

Department of Education

Mission Statement

The mission of the Department of Education is to administer the state's public education system and to distribute state educational resources to local (primary education) public school districts and public secondary education institutions as directed by law.

Strategic Goals:

- Improve outcomes of students K-12 in math, science, reading and other achievement indices, and
- Ensure state population is "ready to work" with the latest skills needed to succeed in a 21st century economy.

New Division Names

This department consists of six divisions, including the Board of Governors, Community Colleges; the California Postsecondary Education Commission; the California State Board of Education; the Student Aid Commission; the Trustees of State Universities; and the University of California Board of Regents.

Where They Came From

The aforementioned commissions and boards that comprise the new Department of Education have heretofore enjoyed more independence—and less accountability. This structure should encourage a more direct chain of responsibility and accountability to the Secretary for Education. In addition, we see no need for the head of the Department of Education to be an elected official (after all, other agency heads are not elected), and so recommend the Superintendent of Public Instruction serve as the Secretary for Education and be appointed by the Governor instead of elected.

Department of Health and Human Services

Mission Statement

The mission of the Department of Health and Human Services is to administer state and federal programs for health care, social services, public assistance, job training, rehabilitation, and veterans services.

Strategic Goals:

- Improve public health outcomes by improving access to treatment, health care, mental health services and preventative medicine, and
- Administer veterans services.

New Division Names

This department consists of seven divisions, including the Division of Aging, the Division of Employment Development, the Division of Mental Health and Substance Abuse, the Division of Physical Health Services, the Division of Rehabilitation and Developmental Services, the Division of Social Services, and the Division of Veterans Affairs.

Where They Came From

The Department of Health and Human Services will remain, for the most part, unchanged from the Health and Human Services Agency, although the former Department of Veterans Affairs is now included in the new department, and there are some instances of consolidation. The Department of Rehabilitation and the Department of Developmental Services are merged to form the Division of Rehabilitation and Developmental Services, the Department of Alcohol and Drug Programs is combined with the Department of Mental Health to form the Division of Mental Health and Substance Abuse, and the Department of Managed Health Care (from the Business, Transportation and Housing Agency), the Medical Assistance Commission, and the Managed Risk Medical Insurance Board are integrated into the Department of Health Services (renamed the Division of Physical Health Services to distinguish its focus from that of mental health services). In addition, we support the Governor's plans to eliminate funding for the Emergency Medical Services Authority, as core emergency services are provided by other agencies, including the Department of Forestry and Fire Protection, the Department of General Services (which oversees the state's 911 system), the California National Guard, and the Governor's Office of Emergency Services. Furthermore, we concur that the Department of Community Services and Development should be integrated into the Department of Social Services.

Department of Finance and Personnel

Mission Statement

The Department of Finance and Personnel supports the efficient and effective operation of California state programs through provision of financial management, human resources, procurement, and information technology services.

Strategic Goals:

- Establish and evaluate fiscal policies to carry out the state's programs;
- Monitor and audit expenditures by state departments to ensure compliance with law, approved standards, and policies;
- Administer public retirement systems;
- Adopt and administer civil service rules and regulations; and
- Provide support services to other state agencies in information technology, human resources management, financial management and facility management.

New Division Names

This department consists of eight divisions, including the Data Processing Corporation, the Division of Finance, the Division of General Services, the Division of Personnel Administration, the Public Employees' Retirement System, the Public Employment Relations Board, the State Personnel Board, and the Teachers' Retirement System.

Where They Came From

The Data Processing Corporation is to be formed from the existing Stephen P. Teale Data Center and the Health and Human Services Agency Data Center. Its operations will be completely outsourced and the new data center will sell its services to various government agencies, making it self-sufficient and requiring no taxpayer dollars for its support. In addition, the State Personnel Board, the Department of General Services, the Public Employees' Retirement System, and the Teachers' Retirement System are moved here from the State and Consumer Services Agency, and the Public Employment Relations Board and the Governor's Office of Personnel Administration, which formerly were directly responsible to the Governor, are included in the new department.

The Department of General Services (DGS) deserves special mention here due to its complete lack of organization around a central mission or function. The DGS has become a hodgepodge of miscellaneous functions that legislators apparently could not figure where else to place. It should thus be reexamined, and its functions reorganized, into more suitable agencies. For example, the financing and construction of K-12 classrooms should be transferred to the Department of Education, or perhaps to the Department of Transportation and Infrastructure, the management of the state's vehicle fleet, the maintenance of the state government's telecommunication systems, and the management of state-owned or leased warehouses and office space should be transferred to the Department of Transportation and Infrastructure, and the

administration of the 911 emergency system should be transferred to the Department of Public Safety and Corrections. Functions such as the procurement of certain goods and services for state agencies (particularly when purchased in bulk for a large number of agencies to save on costs) and reprographics services can be maintained under DGS.

Department of Public Safety and Corrections

Mission Statement

The mission of the new Department of Public Safety and Corrections is to ensure the safety of California citizens and residents, to respond to and provide assistance during emergencies, and to incarcerate those convicted of crimes.

Strategic Goals

- Incarcerate and rehabilitate offenders, and
- Respond to and mitigate the impacts of emergencies

New Division Names

This department consists of eight divisions, including the California Highway Patrol, the California Traffic Safety Program, the Division of Corrections, the Division of Emergency Services, the Office of the Inspector General, the Division of the Military, the Office of the State Public Defender, and the Division of the Youth Authority.

Where They Came From

The Department of Public Safety and Corrections is comprised of the California Highway Patrol and the California Traffic Safety Program from the Business, Transportation and Housing Agency; the former Youth and Adult Correctional Agency (YACA); and the Military Department; the State Public Defender; and the Governor's Office of Emergency Services, which formerly reported directly to the Governor. In addition, several of the departments of the YACA have been consolidated, as the Board of Corrections, the Narcotic Addict Evaluation Authority, and the Board of Prison Terms have been collapsed into the Department of Corrections, and the Youthful Offender Parole Board has been integrated into the Department of the Youth Authority. Furthermore, the Department of Criminal Justice Planning has been divided up such that many of its Victims Services programs, which are duplicative of Health and Human Services (HHS) programs, are eliminated or consolidated with corresponding HHS programs and its other programs and administrative functions are integrated into the new Division of Corrections.

Miscellaneous

In addition to the aforementioned changes from restructuring the state government into seven cabinet-level departments, there are a few other changes that fall outside these seven departments. For instance, the Fair Political Practices Commission and the Office of Administrative Law are moved into the jurisdiction of the Secretary of State. In addition, the Office of the Insurance Advisor has been moved from the State and Consumer Services Agency into the Office of the Insurance Commissioner and the Commission on State Mandates has been folded into the Department of Finance.

The Department of Insurance has been split up such that its fraud control and other prosecutorial functions are now handled by the Office of the Attorney General (the Department of Justice) and its tax collection and audit functions are performed by the new Division of Tax Collection. Other functions may be deemed "low priority" and the remainder of the department eliminated, but this will be up to the Governor and the legislature to decide.

We also recommend that the state's two tax collection agencies, the Franchise Tax Board and the Board of Equalization, be combined to form the Division of Tax Collection. There has been talk of merging these two bodies for years, and the authors feel it is time for the state to take the initiative and do it.

Part 5

Create Personnel Reforms and Workforce Incentives

"The report from Inspector General Steve White, prompted by the Board of Prison Terms' request late last year for an extra 24 deputy commissioners to hold parole-revocation hearings, said the board not only doesn't need more employees, but also that it could do its job with about half the officers it has now if they worked harder."

—Sacramento Bee, April 13, 2003

Summary of Citizen Budget Recommendations in This Section:

1. **Enact a 5% Reduction in State Personnel Costs** ($1.1 billion) through attrition, renegotiation of employee contracts, limits on overtime, and reduction in staff levels to compensate for excessive growth in recent years.
2. Overhaul the Department of Personnel's Merit Award Program by creating a real **Employee Performance Incentives Fund** to provide bonuses to employees who identify and enact cost-saving measures…and have documented accounting to prove savings. (Savings: $2.3 billion)
3. Implement **Employee Performance Contracts** for every employee in state government to hold them accountable for clear and transparent performance goals.
4. Enact **Managerial Flexibility Legislation** that restores authority of Department and program heads to effectively manage the state workforce.
5. Adopt **State Employee Retirement Reforms**—adjusting benefits and allowing partial privatization of retirement funds that would allow beneficiaries greater freedom to invest in their own retirement.

California Budget FACTS:



5%

Average salary increase slated for state employees in fiscal year 2003-04

157%

Increase in CHP spending on staff benefits over the past three years

23%

Percentage of portfolio assets lost by the PERS pension fund in the past two and a half years

44,000

Number of employees added to the state payrolls between 1998 and 2002

The state desperately needs to improve management of its personnel if it is to address the structural nature of the budget problem—short term (labor costs) and long term (retirements). Why focus on personnel reforms? First, a significant amount of the California state budget is devoted to personnel costs. It is estimated that California will spend approximately $17.4 billion in salaries and wages ($22 billion when including benefits) in fiscal year 2002-03 for the state's 327,000-plus workforce.[40] Second, employee management is the key to



"State and local [government] jobs were the fastest growing job category in the state in 1999, 2000 and even 2001."

– Ross DeVol, The Milken Institute

improving the performance of state programs—and identifying cost savings. Finally, like any organization, state government must view its employees as a key asset—to be cultivated and well managed.

Unfortunately, California's personnel management system is in complete disarray. The growth in the number of state employees has been appalling—and unjustified given the increase in state population and program workload. Even worse, compensation packages and retirement benefits of many state employees (as determined by union contracts) are completely unacceptable. Finally, due to constraints imposed by one-sided employee union contracts, an inflexible work environment limits the ability of agency managers to supervise and manage their employees.

As the economy (and state tax revenues) surged from 1999 through 2001, the public workforce grew like the rest of the government. What is troubling is that the state workforce has continued to grow since the advent of the economic downturn. During Governor Davis's first four-year term, nearly 44,000 employees were added to the state's payroll.[41] In fact, according to Ross DeVol of The Milken Institute, even during the height of the tech boom, "State and local [government] jobs were the fastest growing job category in the state in 1999, 2000 and even 2001."[42] Furthermore, this state job growth was not only an increase in absolute terms, but also in per capita terms. State employees per 1,000 population grew each year, from 8.6 to 9.3, during the Governor's first four years in office.[43]

California should thus strive to reduce its government workforce. A 5 percent reduction in personnel costs from personnel reductions would produce $1.1 billion in savings. Such a proposal is modest, given that Governor Davis himself has just ordered department heads to develop plans to reduce labor costs by 10 percent.[44] In Florida, Governor Jeb Bush is in the middle of four years of 5 percent cuts in personnel costs *each* year. Yet, Governor Davis is proposing to only cut a mere $470 million through future labor negotiations—not the full 10 percent. This raises a serious question: what if state agencies can actually achieve a full 10 percent reduction? How about a 5 percent reduction?

Achieving a Five Percent Reduction in Personnel Costs: Human Capital Planning and De-layering

Managing a workforce effectively begins with analyzing how many workers are needed to perform the agency's mission and where best to deploy them. This requires workforce analysis and the development of a comprehensive agency Human Capital Plan. Each state agency should be required to devise and implement Human Capital Plans that detail the kind of workforce skills that are needed, how many employees are needed for each program, and how those employees will be recruited, retained and trained.

From the Human Capital Plan, the agency should de-layer the levels of middle and upper management to streamline reporting levels. As in any enterprise, managerial positions tend to carry higher salaries. Personnel cost reductions can best be made through a robust de-layering initiative. Moreover, human capital planning and de-layering will enable each agency to confront projected workforce retirements and the pending "human capital crisis" facing government Long-term.

Achieving a Five Percent Reduction in Personnel Costs: Eliminate Vacant Positions

The first and easiest way to reduce personnel costs by 5 percent is to eliminate vacant positions. Indeed, the state has been grappling with the discovery and elimination of a large number of vacant positions for the past 6 months—with varying degrees of success depending on the agency in question. Vacant positions, which have resulted in waste from mismanagement from the concurrent use of overtime pay, and which have been used to circumvent the legislature's intended budget appropriations, must be aggressively detected and eliminated. While efforts to abolish more vacant positions would not result in immediate savings, the state would likely achieve savings of at least $300 million in fiscal year 2004-05 and additional savings in the future, pending the creation of an effective process for detecting vacant positions and reporting them to the legislature.

Vacant positions have become a major problem in recent years, although steps are being taken to address the issue. These "phantom positions" arise when agencies are unable or unwilling to fill positions authorized (and paid for) in the budget. The Bureau of State Audits (BSA) issued a report on vacant positions within the Department of Corrections in November 2001 that caused quite a stir. Among its findings, the Bureau concluded: "The department could save the state about $42 million in overtime costs by filling roughly 1,500 of its 2,300 vacant custody positions."[45]

That agencies waste money on overtime pay while maintaining these vacant positions is not the only problem, though. The BSA conducted a broader study of the phantom position problem and issued a report in March 2002 revealing that a substantial number of vacant positions existed in the state government, that departments routinely misused personnel transactions to circumvent the abolishment of vacant positions, that changes in the law to address the problem had only been partially successful, and that a reliable method of tracking vacant positions still had not been established.[46]

Although some agencies have difficulty filling some positions, the six-month legal limit for positions to remain vacant before being eliminated should provide more than enough time even for tough hires—especially in this weak economy. Furthermore, exemptions may be obtained from the Department of Finance for special circumstances.

Far too often, however, positions are not held vacant because an honest effort to fill them simply proved unsuccessful. Rather, agencies have made it a practice to deliberately maintain a large number of vacant positions so they may bypass the intended budget process and use the funding slated for those employees' compensation for programs and purposes not authorized by the legislature.

In order to preserve these unfilled positions and keep from triggering the six-month rule, employees are frequently shifted from one position to another within the agency. From the examples provided in the BSA report, it appears that this practice has evolved into something of an art. For example, the report noted that in one instance:

> *The Department of Industrial Relations (Industrial Relations) moved one employee 10 times within 16 months. In fact, on several occasions, it initiated transactions on the same day to move the employee in and out of the same position. Industrial Relations moved the employee in this manner to preserve six vacant positions from abolishment.*[47]

Of course, this type of budgetary game takes some time to perform, which detracts from the core missions the agency is supposed to be advancing. Again, the BSA report provides suitable examples, this time from the Employee Development Department and the Water Resources Control Board:

> *[Employee Development] Department staff told us they devote a significant workload to avoid having positions abolished, especially since the implementation of the shorter vacancy period in July 2000. For example, the EDD reported that it used 1,840 hours during fiscal year 2000–01 to monitor and preserve its vacancies. It begins its preservation process in October and continues efforts through the remainder of the fiscal year to ensure it does not lose positions. In another example, the Water Resources Control Board stated that its focus on filling vacant positions within the six-month period resulted in a 20 percent to 30 percent increase in existing workload for the analyst responsible for position control.*[48]

Such revelations prompted a crackdown on vacant positions. Control Section 31.60 of the Budget Act of 2002 required the Director of Finance to abolish 6,000 vacant positions, excluding those in the areas of public safety and 24-hour care, that existed on June 30, 2002. On November 14, 2002, the department of Finance announced that it had identified 6,129 positions and would be eliminating them effective July 1, 2003.[49] This will result in a savings of $300,447,000. This is on top of the elimination of 6,600 such vacancies announced previously, yielding a three-year total of over 12,700 vacant positions eliminated.

The administration is to be commended for these efforts, but there is still much work to do. Chapter 1023, Statutes of 2002, directs the Department of Finance to eliminate at least 1,000 additional vacant positions by June 30, 2004. Given the results of prior BSA reports, which were far from comprehensive, this goal seems too conservative. Rather, the government should shoot for the abolishment of another 6,000 vacant positions. This would return approximately $300 million in additional savings, although this savings would not be realized until the 2004-05 fiscal year.

To ensure that this goal is feasible, and to achieve greater savings from the elimination of vacant positions in the future, the state will have to develop an ongoing monitoring system to prevent the types of job-shifting and other maneuvers intended to circumvent the law and inflate agency budgets. Only then will the legislature have the accurate information it requires to determine legitimate agency needs and ensure that appropriations go to those areas of greatest need and highest priority.

Achieving a Five Percent Reduction in Personnel Costs: Renegotiate Labor Contracts

Renegotiating employee contracts is another key element to reducing personnel costs. Part of the trouble the state has had with its personnel cost containment stems from unreasonable concessions to labor unions. During the past two years, several ill-advised contracts have been signed with various labor unions providing exorbitant benefits for some employees at a time when the state should be looking to contain costs as much as possible. The proposed budget-year cost of scheduled employee wage increases is estimated to be $532 million.[50]

Table 4 lists the 21 bargaining units with which the state has to reach agreement on labor contracts. Analysis of two labor contracts provides a mind-numbing demonstration of how inappropriate and wasteful these contracts have become.

Table 4: California State Government Collective Bargaining Units			
Bargaining Unit	**Employee Description**	**Union**	**Contract Agreement Terms**
1	Professional, Administrative, Financial, and Staff Services	California State Employees Association (CSEA)	1/31/02 – 7/2/03
2	Attorneys and Hearing Officers	California Attorneys, Administrative Law Judges and Hearing Officers in State Employment (CASE)	7/1/01 – 7/2/03
3	Education and Library	CSEA	1/31/02 – 7/2/03
4	Office and Allied	CSEA	1/31/02 – 7/2/03
5	Highway Patrol	California Association of Highway Patrolmen (CACHP)	7/3/01 – 7/2/06
6	Corrections	California Correctional Peace Officers Association (CCPOA)	7/1/01 – 7/2/06
7	Protective Services and Public Safety	California Union of Safety Employees (CAUSE)	7/1/01 – 7/2/03
8	Firefighters	California Department of Forestry Firefighters (CDF Firefighters)	7/2/01 – 6/30/06
9	Professional Engineers	Professional Engineers in California Government	Effective 9/1/02
10	Professional Scientists	California Association of Professional Scientists (CAPS)	7/1/01 – 6/30/03
11	Engineering and Scientific Technicians	CSEA	1/31/02 – 7/2/03
12	Craft and Maintenance	International Union of Operating Engineers (IUOE)	7/3/01 – 7/2/04
13	Stationary Engineers	IUOE	7/1/02 – 7/2/03
14	Printing Trades	CSEA	7/18/02 – 7/2/03
15	Allied Services	CSEA	1/31/02 – 7/2/03
16	Physicians, Dentists, and Podiatrists	Union of American Physicians and Dentists (UAPD)	7/3/01 – 7/1/03
17	Registered Nurses	CSEA	7/8/02 – 7/2/03
18	Psychiatric Technicians	California Association of Psychiatric Technicians (CAPT)	9/15/01 – 7/2/03
19	Health and Social Services – Professional	American Federation of State, County and Municipal Employees (AFSCME)	7/3/01 – 7/2/03
20	Medical and Social Services	CSEA	7/18/02 – 7/2/03
21	Educational Consultant and Library	CSEA	1/31/02 – 7/2/03

Source: Department of Personnel Administration, http://www.dpa.ca.gov/collbarg/contract/bumenu.shtm#6.

Case Study #1: California Highway Patrol (CHP)

- CHP officers currently receive fitness bonuses of $130 per month—$1,560 per year—even though the fitness tests used to qualify officers for the bonuses were discontinued in 1995.[51] Active-duty officers are granted the bonuses so long as they have passed one of these tests anytime in their careers. Apparently, the policy was changed because too many officers were suffering injuries while playing sports such as football, basketball, and racquetball during off-duty hours and then claiming workers' compensation because, they argued, their off-duty training was necessary in order for them to pass the fitness test.
- Expenditures on staff benefits grew significantly over the past three years, from $110 million to an estimated $283 million, a 157 percent increase (see Table 5).[52]
- Retirement costs have grown the most dramatically during this time, as stock market losses have depleted the surplus in the CHP Public Employees' Retirement Account, thus shifting a greater financial burden onto the Motor Vehicle Account, which is funded mostly from vehicle registration and driver's license fees.[53]
- Health insurance costs have risen 24 percent over the three-year period. Workers' compensation costs have skyrocketed 49 percent and will likely increase even faster than the Governor's Budget projection due to recent workers' compensation benefits legislation.[54]

Table 5: Costs for CHP Staff Benefits (*2000-01 Through 2003-04 (In Millions)*)

Compensation Category	2000-01	2001-02	Estimated 2002-03	Proposed 2003-04
Retirement	$3	$40	$142	$142
Health Insurance	51	54	63	67
Workers' Compensation	41	41	61	59
Other	15	21	17	19
Totals	$110	$156	$283	$287

Source: Legislative Analyst's Office, "Analysis of the 2003-04 Budget Bill," P. A-77, http://www.lao.ca.gov/analysis_2003/transportation/transportation_anl03.pdf.

Case Study #2: Correctional Peace Officers

- A January 2000 report by the Bureau of State Audits (BSA) found that the Department of Corrections had been mismanaging its sick leave and other personnel costs. The report stated, "The [Department of Corrections] could save about $17 million a year if average sick leave use among custody staff dropped to 48 hours per year and roughly $29 million a year if it reduced its average sick leave usage to a level compatible to that of the California Highway Patrol."[55]

- The new labor contract provides salary increases of about one-third by 2006 (veteran correctional officers will be paid at least $73,428 per year by 2006), and allows guards to retire at age 50 and receive up to 90 percent of their last salary.[56]
- The total cost of the new wage package to taxpayers will be about $700 million per year.[57]
- Political contributions totaling $2.6 million from the CCPOA to Governor Davis, combined with the approval of the compensation package and a decision by the Governor to close several privately-run prisons housing 1,400 low-security inmates at a cost of $16 million per year to taxpayers, have led to accusations of improper political dealings.[58]



State Prisons: Soaring Sick Leave

"Use of sick leave and resultant overtime in the state prisons system increased dramatically in the first four months in 2002 of a new labor contract approved by the Davis administration. A 20 percent hike in sick leave will add $12.5 million to the state budget over a full year. Overtime would be up $58.4 million. The new contract makes it more difficult for prison wardens to clamp down on suspected abuse of sick leave."

Los Angeles Times, June 27, 2002

Despite the egregious examples presented by the two case studies above, employee union representatives contend that you cannot balance the state budget on the backs of its employees—and that employees have already sacrificed pay increases in recent years. We agree with the sentiment of the first part of their argument: budget cuts cannot rest entirely on personnel reductions. However, personnel reductions should be *part* of the solution.

As to the claim that employees have already forgone pay increases, most union contracts are exceedingly generous and have raised state employee pay dramatically in recent years. For example, under existing contracts, most state employees are scheduled to receive a 5 percent salary increase on July 1, 2003.[59] Meanwhile, the federal government is giving its employees barely a 3 percent increase. Finally, for most state employees, the state has actually given a "phantom" raise in each of the past two years by paying portions or entirety of the employee pension contributions. In essence, take-home pay has gone up for state employees even in the last two years.

The Citizens' Budget anticipates that the Governor's proposed renegotiation of employee contracts will meet the cost savings identified in his budget proposal—as well as additional cost savings to contribute to our overall target of a 5 percent decrease in personnel costs beyond the Governor's Budget proposal.

Implement Employee Performance Agreements and Reform the Employee Incentive Plan

The government, like any private firm, must strive to get the most out of its employees. This is best done through individual employee performance contracts that would be used to evaluate and manage each state employee on the basis of performance and results. Toward this end, each state agency should devise a short and measurable performance plan for each state employee to be signed by employees and managers. Should an employee consistently fail to deliver expected performance, corrective action would be taken. Moreover, should an employee exceed goals, financial and non-financial recognition and rewards should be provided.

The Department of Personnel Administration currently operates a program intended to provide financial incentives to employees. The Merit Award Program allows employees to receive between $50 and $5,000 awards, either from the program itself or the agency for which the employee works, for suggestions that result in:

1. Improved procedure,
2. Improved safety, or
3. Cost savings.[60]

Unfortunately, the program is an abysmal failure—prone to fraud and mismanagement. For example, awards are generally no more than 10 percent of the value of the cost savings.[61] Furthermore, officers and employees of the University of California and the California State University are prohibited from participation in the program.[62] This means that some 116,000 employees, representing organizations with a combined budget of nearly $23 billion, are prevented from participating in a cost-savings program. What is more, it is uncertain whether many state employees that are eligible to participate in the program are even aware of its existence.

Finally, any employee incentive program must adequately address the potential for fraud and erroneous bonus awards. For example, cost savings must be calculated based on baseline spending numbers, not projected spending. This could be confirmed using activity-based costing, which allocates overhead costs to specific products instead of lumping together all overhead costs, thus providing a more accurate accounting of costs than traditional cost accounting.[63]

Increasing the amount of the award for cost savings to 20 percent of the amount of the savings would provide a much stronger incentive for generating innovative cost-saving solutions. In short, the greater the award, the greater the supply of ideas. The new program still would not cost the state anything but a negligible amount for a board to determine the legitimacy and feasibility of suggestions (which could also be done by each individual agency), since it would only be surrendering a portion of any additional *savings* achieved. Note that the corresponding agency or the state would still realize two-thirds of the total savings. The new employee cost-savings incentive program would be open to all employees, and agencies would be directed to inform their employees of the program.

If this new incentive program achieved only 3 percent additional savings on the entire state budget, that would represent $2.9 billion in savings, $579 million of which would be awarded as bonuses to the employees responsible for the savings and $2.3 billion of which would be realized by the agencies and the state.

Managerial Flexibility: Giving Managers the Tools and Freedom to Manage

Consistent with providing employee incentives, the state should provide managers greater flexibility and authority to manage their programs in the most cost efficient and performance-based ways. Unfortunately, a number of statutory and political forces limit state manager flexibility. For example, labor contract restrictions include limitations on the state's managerial control and hiring and firing decisions. Despite the soaring use and abuse of sick leave and overtime in the state's prison system, the new labor contract the state

reached with the peace officers' union restricts the ability of prison wardens to address the problem. In the end, most state managers do *not* feel as though they can effectively manage their employees because the tools of "consequence management" (hiring, firing, approval of leave, employee performance evaluations) have been taken from them. As a result, the Citizens' Budget strongly encourages the passage of legislation that prohibits the state from entering into contracts or agreements with unions that limit managerial flexibility to evaluate, hire, reward, manage or remove employees.

Retirement System in Need of Reform

Poor investments, general asset erosion from the stock market decline, and rising costs from a trend toward earlier retirement will likely render the state's retirement systems, such as the California Public Employees' Retirement System (PERS) and the California State Teachers' Retirement System (STRS), unsustainable in their current form. PERS, in particular, has garnered a great deal of unwanted press from accusations of political activism and scandal. It is time that legislators take a closer look at the state's retirement systems and use the current budget situation as an opportunity to enact real reform to ensure the security of the pension and health benefits of the state's employees and retirees.

PERS was established in 1932 to administer pension plans for state employees. In 1962, state law expanded its role to provide health benefits to state employees as well. Today, PERS is the nation's largest public pension system. It manages the pension and health benefits of approximately 1.3 million California public employees and retirees and their families.

Poor Portfolio Performance

As of January 31, 2003, PERS managed an investment portfolio of $131.4 billion.[64] Over the past two and a half years, however, the pension fund has declined 23 percent and is now down to its lowest level since early 1998.[65] It has also underperformed other large pension funds during this time.[66] In response, PERS has decided to recoup its lost assets by engaging in higher risk, higher return investment strategies and by increasing employer contributions to the fund. According to *The Wall Street Journal*, "state school districts, for example, have been told [they] will have to start contributing about 2.8 percent of payroll."[67]

Scandal and Inefficient Management

PERS has been plagued by other forms of scandal as well. In 1998, it was discovered that several trustees had taken expense-paid trips and received gifts from parties attempting to do business with the fund.[68] Former State Controller Kathleen Connell successfully sued PERS, alleging that it had violated state law by establishing its own pay system and granting 11 percent pay raises to investment managers and a 400 percent increase in per diem pay—increasing annual compensation from $7,500 to $30,000—for five board members.[69] Connell, it should be noted, also had a seat on the PERS board. In addition, just within the past couple of years, there have been several allegations of cronyism and conflicts of interest. Major investments have been made in companies and partnerships owned by major contributors and fundraisers of Governor Davis and members on the PERS board.[70] Moreover, members of the PERS board are permitted to own stock that is also held by PERS, further increasing the prospect of corruption within the fund.

Restoring the Tier 2 Benefits Package: The Senate Republicans' Proposal

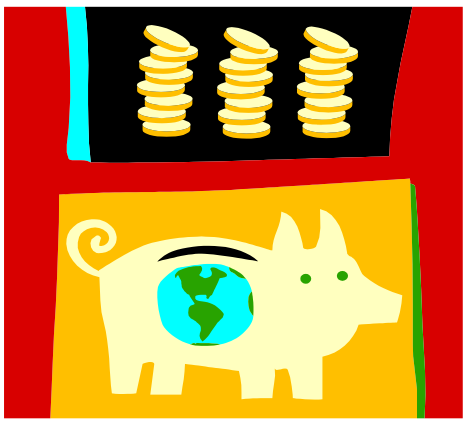
Senate Republicans have suggested that the system be improved by restoring the Tier 2 retirement benefits package, which was done away with in the late 1990s when the PERS fund, like the stock market in general, was soaring. The Tier 2 package provides a reduced set of retirement benefits to new employees and was implemented in the late 1980s as a cost-savings measure.

Restoring the Tier 2 benefits package to new employees would allow the state to allocate benefits based on tenure, which might be considered a more fair approach than the current system maintains. This also would put the state more in line with private sector retirement benefits practices. In addition, restoring Tier 2 benefits would result in cost savings, as newer employees would be receiving fewer benefits than their veteran counterparts.

Private Retirement Accounts: An Alternative to Address Issues of Cost and Politics

While restoring the Tier 2 benefits package would certainly help the state save on costs, it would do nothing to address the problems stemming from political ties and conflicts of interest. Any legitimate reform proposal must recognize that "PERS is fundamentally a political organization. It is the monopoly provider of pension services to California's state public servants. Its board is composed overwhelmingly of political types: elected officials and political appointees. And it has close union links."[71] That is a dangerous combination for an organization that has the power and responsibility to invest for the retirement of 1.3 million beneficiaries.

The problems at PERS stem from allowing government officials to use retirement investments as social and political tools in the first place. As a *New York Times* article illustrates, "Some California public employees view the mood at PERS with alarm … saying their retirement nest eggs are not suitable for advancing a social cause, worthy or not."[72] Referencing the political scandals at PERS, *The Wall Street Journal* editorial asserted: "If PERS were a private investment fund, this would all be hilariously high comedy. But PERS is not a public fund. Ultimately, the buck stops with the taxpayers of California. For them, it might turn out to be pure tragedy."[73] And that is exactly the point: PERS must be reformed so that it can place its focus rightly on protecting the retirement benefits of its beneficiaries, not on satisfying special interests.



"If PERS were a private investment fund, this would all be hilariously high comedy. But PERS is not a public fund. Ultimately, the buck stops with the taxpayers of California. For them, it might turn out to be pure tragedy."

–"Cronyism at PERS," *The Wall Street Journal*, January 31, 2003

Instituting a conflict of interest rule that prohibits board members from holding stocks that the fund also owns is just a beginning step. In order to protect its employees' nest eggs from the waste and politics of its public pension system, California should take the lead in experimenting with private personal retirement accounts. Such accounts would allow beneficiaries to invest a portion of their accumulated benefits on their own, separate from the decisions of the PERS board. The portion to be privatized

would be small at first, and expanded later if the pilot program proves successful.

The poor performance of public pension systems at the state and federal levels, in conjunction with successful pension privatizations and other nations, have caused pension reform to go from the untouchable "third rail of politics" to a viable option. Indeed, partial pension privatization was a significant plank of President Bush's campaign platform and continues to be a focal point of his Administration.

A system of personal retirement accounts would not only permit beneficiaries to seek returns that are typically greater than those of public pension system portfolios, it would allow individuals to better manage their own levels of risk, thus eliminating concerns such as the questionable risky investments made by the PERS board of trustees.

Finally, the very personal nature of one's retirement plan cannot be overlooked. People wish to structure their plans differently because they have different goals, needs, and financial situations. The state's one-size-fits-all system simply does not adequately address these personal issues. As with taxes, government officials must remember that the money they are managing belongs to the beneficiaries, not to them. The argument is perhaps best summed up by a Cato Institute article:

> *Do individuals decide how their money is to be invested, or do politicians make those decisions for them? Do individuals decide whether their money should have a social conscience, or does someone else force his own social views on them?*
>
> *Under a system of personal retirement accounts, nothing prevents a worker from making socially responsible investments, according to his own definition of social responsibility. But nothing forces him to, either. Government directed investment doesn't just make lower returns; it turns personal decisions into political issues, with results like those seen in California.*[74]

Acknowledging the Resistance from Unions

Complicating all of these reforms will be the influence of labor unions. Rather than permitting individuals to negotiate freely on their own and to come to a voluntary agreement with the state for their wages, labor unions compel membership and/or the payment of representation fees—even for those that do not wish to be a part of the union—in order to act as the negotiating agent for people wishing to take certain jobs. This violates the rights of those that do not wish to be members of the union to contract for their employment on their own terms.

Unions rationally try to get the highest wages and best benefits for their members. When dealing with the government, however, there is necessarily a political component introduced. Oftentimes, political connections and power bases result in the adoption of unreasonable agreements that provide wages and benefits well in excess of the value of the same labor in the private sector. The use of compulsory dues for political activities that some union members may not agree with is another example of injustice and the corruption of the political sphere with which unions are interlinked.

Just as the government has the right to recognize a union as the agent for some of its employees, however, it should also have the right not to recognize a union if it deems the union's demands unreasonable or otherwise contrary to the interests of the state. The state should consider moving to a non-union system of labor contracting. Workers' fundamental rights and adequate working conditions would still be protected by

numerous existing laws and they would have the added freedom to work, or not work, based on employment offers by the state, and to refrain from supporting political causes with which they disagree through the absence of compulsory union dues. The state would benefit by gaining managerial flexibility more on par with the private sector (with which it competes for employees), which would allow it to more easily eliminate inefficiency and to more quickly adjust to financial emergencies.

The Citizens' Budget is not anti-union, but it is pro-taxpayer and pro-state worker. As such, we believe unions should be allowed in state government, but should also be closely monitored. Most importantly, Sacramento decision-makers, the media and the general public should always be on-guard for sweetheart employee contracts that do not represent the best interest of taxpayers and people who depend on government services.

Part 6

Enact Competitive Sourcing and Procurement Reforms

"This administration will look to the private sector and public-private partnerships to get the job done when government can't do it alone. We have much to learn from private ventures and charitable institutions. We can use joint ventures and partnerships to accomplish new goals."

~Governor Brad Henry, (D-Oklahoma)

"Going forward, I am committed to greater partnerships with the private sector, and we will continue to actively pursue new opportunities through the public-private acts."

~Governor Mark Warner, (D-Virginia)

Summary of Citizen Budget Recommendations in This Section:

1. Implement **Competitive Sourcing for State Commercial Activities** to achieve cost savings target of $2.4 billion.
2. Transition state contracts to **Performance-based Contracting and Fixed Price Contracts** for most state service contracts.
3. Generate New Revenue through **Asset Divestiture of Unused State Assets** ($200 million in 03-04; $800 million in 04-05)
4. Implement **Recovery Auditing** for all state contracts to achieve cost savings target of $100 million annually.
5. Enact **Procurement and Competitive Bidding Reforms** to increase Department of General Services oversight over purchasing activities and by encouraging the use of bulk purchasing.
6. Improve **Infrastructure Financing System** by creating a shared infrastructure fund for both state and local projects modeled after the proposal in Assembly Constitutional Amendment (ACA) 11.

California Budget FACTS:



30%

Average magnitude of cost savings on government activities using competitive sourcing—regardless of who wins

7

Number of times per ten competitions conducted by state governments where state employees win the competition

20%

Estimated amount of California's real estate assets that could be more productive if privatized

$149 million

Proceeds to the state being realized from selling surplus real estate in the Silicon Valley in 2001

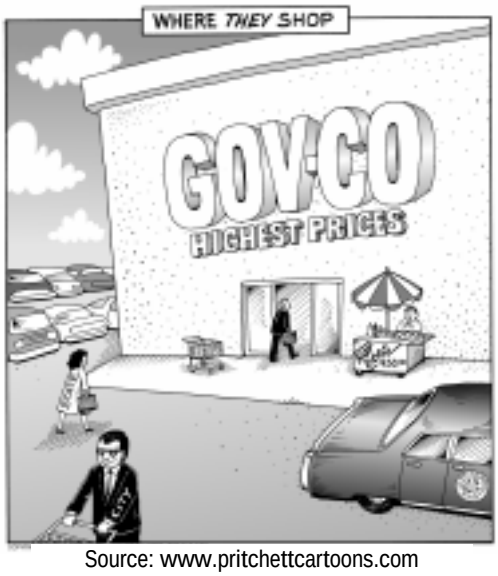
The California state government spends billions of dollars each year on purchasing goods and services—and carries out work and creates its own products and services that it probably would be better off buying from the marketplace. The Government Performance Project at Syracuse University reported that at the end of 2000, contracting consumed on average about 19 percent of

state operating budgets.[75] Given the current size of the state's General Fund budget, California spends approximately $14.8 billion annually on purchases and contracts.

Unfortunately, the current rules governing what the state buys through contracts—and more importantly what it does *not* buy through contracts—are outdated and extremely wasteful. As such, the state should reform its procurement system, tap the marketplace for ideas and solutions, and look for "best value" or bargain prices.

Implement Competitive Sourcing of State Commercial Activities

At its most basic level, competitive bidding of services is a powerful tool for improving quality and saving money when properly implemented. Competition in services involves the examination of an activity of an agency to determine whether the activity should continue to be carried out within the agency or should be purchased from an outside entity. Put simply, "Should the agency 'make' or 'buy' this activity?"



Source: www.pritchettcartoons.com

Yet in a larger sense, competition goes beyond the decision to "make" or "buy" to examine such considerations such as:

- Whether an activity is needed in the first place.
- Whether an activity should be "re-engineered" to be more efficient.
- Whether an activity should be "sourced" differently, either through another staff unit, another agency, a non-profit organization, a program partner, or a private-sector vendor.

The issue of improving "performance" should dominate the three considerations above—with the concept of "competition" driving the process to ensure the best sourcing solution is adopted by the agency. However, true "competition" can only be achieved when multiple players are competing under a fair and transparent process where performance results expected from the activity in question are clear.

As reported by the Council of State Governments, more than half of state government officials predict that states will be expanding their use of competition and outsourcing,[76] and the Government Contracting Institute points out that the dollar value of government contracts awarded to private vendors has risen 65 percent over the past five years.

Indeed, here in California competition and outsourcing have played an important role in helping to manage fiscal crises at the local level. In the mid-1990s, San Diego County faced a major fiscal crisis. Part of its successful strategy to return to fiscal health was a competition and outsourcing program that over several years moved at a modest pace and still generated $16 million a year in savings. And in 2000, California voters showed they understand the value of competition when they voted overwhelmingly to approve Proposition 35 to expand outsourcing of state services.

Stephen Goldsmith, former mayor of Indianapolis and one of the most accomplished practitioners of competition and privatization, has long recommended a simple guide to competition—the "yellow pages test."

> *If the phone book lists three companies that provide a certain service, the [government] should not be in that business, at least not exclusively. The best candidates for marketization are those for which a bustling competitive market already exists. Using the yellow pages test, [you] can take advantage of markets that have been operating for years.*[77]

Remove Barriers to Competitive Sourcing

Over the years laws and court decisions to protect certain public employees from competition have accumulated on the books. Article VII of the California Constitution, for example, states that, with few exceptions, public services rendered by the state must be performed by state employees. The thinking is, in effect, "if it can be done at all, it must be done by the state."[78] This is precisely the wrong approach. Rather, the thinking should be "if it can be done at all, it should be done locally or in the private sector." To ignore the vast resources and innovation of those outside the gilded halls of government would be a colossal waste of both money and human capital.



The Power of Competition

In 2002, the Office of Management and Budget broke with tradition and decided to see if private printers could beat the Government Printing Office's deal for printing the 2004 federal budget. The result—the GPO cut its price 23 percent ($108,370) and kept the work. That is $100k a year that GPO could have saved taxpayers any time they chose, but they never chose to do so until they faced direct competition.

—Brian Friel, 'Printing office cuts price, wins bid to handle 2004 budget," *GovExec.com,* December 27, 2002 http://www.govexec.com/dailyfed/1202/122702b1.htm

State leaders must recognize their first responsibility to protect the taxpayers and confront those special interest protections that prevent using competition to cut costs and improve services. A first and most crucial step would be to add an Article to the state Constitution similar to Article XXII, added by Proposition 35 in 2000, which amended Article VII to permit state and local government entities to contract out architectural and engineering services for all phases of public works projects, but that would apply to all commercial functions performed by state agencies. Oversight of state agency commercial activities inventories and of their competition plans will effectively expose additional specific legal barriers.

Implementing the Competitive Sourcing Program

The first step to figuring out where to begin applying competition to services is for the legislature in its oversight function to demand that agencies understand their own business. They need to break their functions down into core government and commercial activities, and then examine commercial activities for

places where applying competition makes sense. The federal government and state of Virginia have used such a tool.[79]

Too many states approach competition in a piecemeal fashion, with no leader taking ownership of reform and little or no follow-through on competition efforts. To overcome internal obstacles and maintain focus, it is important to have one highly organized team to implement and oversee competition goals and efforts. The team builds experience in both the politics and process of competition and can assist state agencies in implementing their programs. The oversight function is just as important, helping to ensure competition goals are met, to require agencies to document savings realized,[80] and to avoid such process problems as penalties for late payments to vendors.[81] As such, a "Competition Corps" should be created at the Department of Finance to staff all state agency competitive sourcing projects. Furthermore, each state activity should undergo a competitive sourcing examination at least once every five years—meaning an average of 20 percent of activities would be studied each year.

Cost Savings from Competitive Sourcing

Choosing state functions that have been successfully subjected to competition in other places, and applying competition to a total of 10 percent of those functions in 2003 and a total of 25 percent in 2004, at a conservative average cost savings of 15 percent would create a lower range of savings of $490 million in 2003 and $1.2 billion in 2004. A more aggressive effort to compete more services or a more typical average cost savings of 30 percent could create savings of $980 million in 2003 and $2.4 billion in 2004. Real Long-term savings will be greater as additional services are competed. (See Appendix B for a detailed list of potential outsourcing targets.)

Reforming the State's Procurement Practices Using Standards and Performance

California state government should reform its procurement system to encourage competitive bidding as well as leverage its purchasing power through the centralization of its procurement processes and use of innovative contracting vehicles. A Recent Bureau of State Audits (BSA) report roundly criticized state agencies for wasting millions of dollars on no-bid contracts without even bothering to shop around.[82] The report was requested by State Senator, and then-Joint Legislative Audit Committee Chairman, Dean Florez (D-Shafter) in the wake of the Oracle computer software scandal, in which Oracle was awarded a $95 million no-bid contract that would have cost the state $41 million more than was necessary.[83] Allegations of campaign fundraising allegations were made in connection with the deal. In response, the contract was rescinded and the Department of Information Technology was eliminated.

The BSA report illustrated a Department of Motor Vehicles purchase of $125,000 worth of teddy bears for a promotion to get people to fill out their 2000 census forms as an example of what is wrong with the system. The bears were purchased through the use of an "emergency" procedure and no competitive bidding process was utilized. Responding to the conclusions of the report, current Joint Legislative Audit Committee Chairwoman Assemblywoman Rebecca Cohn (D-Saratoga) said, "This report highlights significant, acute and systemic problems that probably cost the state hundreds of millions of dollars in wasted spending."[84]

While the Davis administration has enacted some reforms in this area since the Oracle scandal, such as requiring competitive bids on all computer contracts and all contracts over $500,000 in value, the BSA report

suggests that further changes are needed. For example, the Department of General Services must strengthen its oversight of sole-source contracts, emergency purchases, and other state purchasing activities. The report further stated that questionable purchases, such as obtaining multiple consulting services that provided duplicative information, and generally not confirming that state agencies receive the services they paid for, "illustrate the danger of having multiple departments making purchases for a single project and not communicating with each other."

Centralizing Procurement and Contracting

"In this type of environment, authority and accountability lines become vague, the chance of error increases, and the state has less assurance that its resources are being spent wisely," the report went on to say.[85] The use of a central purchasing unit at the Department of Finance—be it for a project, an agency, or the state government as a whole, depending on the goods or services required—would eliminate errors stemming from this communication project and would additionally allow the state to realize cost savings through bulk purchases.

Performance-based and Fixed-price Contracting

Another powerful reform that can save government money and improve program results is implementing "performance-based contracting (PBC)" for as many contracts as possible. Performance-based contracting is the soliciting of bids based on what results government wants accomplished, rather than what activities it wants conducted. It relies on performance standards being included in the contract as well as payments tied to the achievement of results.

This is a significant change. By compensating a contractor for results rather than effort or activity, the transaction becomes more efficient for both the vendor and government. The vendor has the freedom and flexibility to do what he does best (produce the service) without micromanagement on activities from government. If it takes 10 hours or 10 months to deliver the service to government consistent with the quality standards of the contract, the payment is the same. And if the contractor does not perform the service according to the quality standards, he must re-do the work until the job is done. Period.

The contract is structured under a "fixed price" for each service purchase, with no payment until performance is delivered. As a consequence of this payment method, transaction costs are reduced for both government and the vendor as paperwork and auditing requirements are streamlined. And of course, the focus on performance is likely to improve chances that government gets quality service.

This scenario stands in stark contrast to the preferred contracts used by government today: "cost-reimburse" and "fee-for-service" contracts. Under these contracting vehicles, government pays every time a contractor "works" on a project—encouraging a contractor to drag on the contract for as long as possible and take every opportunity to engage in an authorized activity under the contract.

The state might want to consider a variety of other innovative contracting vehicles. Not all of these vehicles are appropriate for every service provided by government, but should at least be given consideration to see if a good fit can be made:

- *Share-in-savings Contracts:* As referenced in the reorganization part of this report, share-in-savings contracts limit the liability of government by paying contractors through the cost savings realized from a particular service. For example, the state might want to convert many information technology services into share-in-savings contracts whereby the vendor provides the information technology services for free, but collects a percentage of the cost savings to the government from use of the technology.
- *Fee-based Service Delivery*: Under this model, firms would be allowed to design a better process for delivering a state service (such as a license). The firm would then "sell" the service to the market at a fee. If the service provided was not faster and better, the market would not pay. However, if the firm could provide better services, then it would generate revenue. The state would still offer the service, but at a reduced staffing need.
- *Reverse Auctioning Online:* The state can tap the power of the Internet to procure many goods and services using online auctions similar to those seen on e-Bay. Reverse auctioning works like this: under the new reorganization plan, several state agencies will have new agency names. A state agency could advertise for a bid for new letterhead over the Internet with a set time period for submission of bids. The "current" bid price would fall as each vendor submitted a new, lower bid to win the contract. The U.S. Postal Service has achieved cost savings totaling more than $100 million on purchases of supplies and services using this reverse auctioning method.

Implement Recovery Auditing for Past and Present State Contracts

Another significant cost savings tool is the use of recovery auditing—a strategy that requires no risk and no difficult political decisions. Each year, millions of dollars are wasted through overpayments to contractors. While a few state programs have a version of recovery auditing for one or two programs, the expanded and systematic use of recovery auditing can recoup for the state millions of dollars lost to errors.

Overpayments may result from a variety of sources, including:

- Payments to ineligible beneficiaries;
- Duplicate payments;
- Payments to unsupported claims;
- Inadvertent pricing errors on invoices;
- Fraud;
- Advertised discounts mistakenly not applied by vendors;
- The omission of allowances and rebates; and
- Miscalculated freight charges.[86]

These payment errors are not necessarily evidence of gross mismanagement, but simply an unavoidable evil of conducting business for such a large organization as the state government. The private sector has been utilizing recovery auditing for decades, and the use of these services in government has increased substantially in just the past five or six years. Leading recovery audit firms have recovered billions of dollars for their public- and private-sector clients.

How It Works

The government selects one or more private recovery audit firms to analyze contracts, invoices, disbursements, and other relevant records. The firm then documents and recovers any overpayments. The recovery firm's services cost the state nothing, as recovery audit contracts are performance-based and provide that the firm is paid a contingency fee based on a percentage (typically, about 20 percent, but for government we suggest no more than 10 percent) of the savings recovered. Firms may additionally offer consulting services to help clients minimize future overpayments.

The typical overpayment error rate for large purchase and payment organizations in the private sector is about 0.1 percent. In the area of contracts and grants, error rates for government agencies may reach up to 0.4 percent to 1.8 percent.[87] Error rates vary greatly among different government agencies. (For entitlement programs, error rates are significantly higher—but that challenge is dealt with in a future part of this budget.) Simply put, overpayments may not be an issue at all in some agencies, but error rates may be significantly higher for agencies that engage in a large amount of contracting.

Table 6: Federal Government Agency Payment Errors and Error Rates

Programs	Erroneous Payments	
	Amount (in millions)	Percent
Medicare – Fee-for-Service	$12,100.0	6.30%
Earned Income Tax Credit	$9,200.0	29.35%
Housing Subsidy Programs	$3,281.0	17.38%
Unemployment Insurance	$2,251.3	9.21%
SSI	$1,590.0	5.73%
Food Stamps	$1,340.0	8.66%
OASI	$1,339.0	0.36%
Disability Insurance	$1,313.0	2.22%
Medicare – Cost Reports	$493.0	2.7%
Student Assistance Pell Grants	$336.0	0.71%
FEHBP	$241.0	1.14%
Federal Retirement	$167.0	0.35%
Student Aid – External	$65.0	0.14%
Military Retirement Fund	$18.6	0.05%
Student Aid – Internal	$13.3	0.03%
Commodity Loans	$7.6	0.09%
Federal Transit Administration	$5.5	0.09%
(7a) Business Loan Program	$0.3	1.9%
Airport Improvement Program	$0.3	0.01%
FEGLI	$0.2	0.01%

Source: Testimony of Mark W. Everson, OMB Deputy Director for Management before the U.S. House of Representatives, Committee on Government Reform, Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations

While 0.1 or 0.4 percent may not appear to represent significant savings potential, for an operation the size of the California government, the savings do add up. Consider that for every $1 billion in purchases and payments to beneficiaries, the state can expect to save between $1 million and $4 million through the use of recovery auditing. More importantly, recovery auditing is not done just on the current budget year, but can be applied to payments made in the past two to three budget years—recouping monies long-thought-spent already.

For the purposes of our model, we have assumed that relevant activities subject to recovery audit comprise, on average, approximately 15 percent of California government agency budgets. This estimate is conservative, considering that The Government Performance Project at Syracuse University reported that at the end of 2000, contracting consumed on average about 19 percent of state operating budgets.[88] Furthermore, this figure does not include the amount of budgets from agencies, such as Health and Human Services Agency programs, that are devoted to making payments to program beneficiaries, and which are typically rife with payment errors (resolution and savings for which are dealt with in a later part).

Using this estimate and the aforementioned range of error rates, we conclude that, through the use of recovery auditing, California will realize a savings of between $9.4 million and $37.7 million using one year budget expenditures (see Table 7). Assuming that the overpayments error rate for California falls directly in the middle of the range yields a median savings estimate of approximately $23.5 million annually. Moreover, the Citizens' Budget will apply recovery auditing to the previous two budget years to produce total savings of $71 million in biennial year one, and $23.5 million in biennial year two.

Table 7: Estimated Savings From Recovery Auditing (Dollars in Thousands)

Agency	2003-04 General Fund Expenditures	Budget Subject to Review (15% of Total Expenditures)	Estimated Savings Range (0.1-0.4%)
Legislative, Judicial, and Executive	$2,167,000	$325,050	$325-$1,300
State and Consumer Services	$438,000	$65,700	$66-$263
Business, Transportation, and Housing	$216,000	$32,400	$32-$130
Technology, Trade, and Commerce	$21,000	$3,150	$3-$13
Resources	$959,000	$143,850	$144-$575
Environmental Protection	$100,000	$15,000	$15-$60
Health and Human Services	$15,146,000	$2,271,900	$2,272-$9,088
Youth and Adult Corrections	$5,639,000	$845,850	$846-$3,383
K-12 Education	$27,390,000	$4,108,500	$4,109-$16,434
Higher Education	$8,509,000	$1,276,350	$1,276-$5,105
Labor and Workforce Development	$90,000	$13,500	$14-$54
General Government	$2,094,000	$314,100	$314-$1,256
Total	**$62,769,000**	**$9,415,350**	**$9,415-$37,661**

Source: Data in column 1 from 2003-04 Governor's Budget Summary, P.40



Research on Savings from Competition and Privatization:

- Center for Naval Analysis, *Long-run Cost and Performance Effects of Competitive Sourcing*, 2001—**Average savings are 34 percent and are sustained over time.**
- John Hilke, *Cost Savings from Privatization: A Compilation of Study Findings*, 1993—**Savings usually range from 20 percent to 50 percent**.

Note: In this report, we used a conservative range of 15-30 percent average savings, even though many sources suggest greater savings can be realized.



Key Questions To Ask State Agencies:

- How much of your agency's activity is commercial in nature?
- How much of your agency's activity is currently contracted out?
- How many real property assets do you have? What is their value? What is the cost of maintaining them?
- How much is spent on contracts each year?

Case Studies in Recovery Auditing in Government

As noted previously, private firms have recognized the value of recovery auditing and have been reaping the benefits of these services for many years, but government use of these auditing services is a relatively new trend. The use of recovery auditing seems to be a natural cost-savings strategy for government, given the size of programs and the amount of contracts and beneficiary applications involved in providing services. The financial statements of federal government agencies, for example, have revealed overpayments totaling approximately $20 billion for each of the past few years.[89]

The federal government began experimenting with recovery auditing in the mid-1980s for the Army Air Force Exchange Service and Naval Exchange Command. In 1996, the Department of Defense (DOD) initiated a recovery audit demonstration program in response to a federal mandate to explore the option of using private firms to identify overpayments to vendors. The Defense Supply Center, Philadelphia was able to identify $17.9 million in overpayments between 1996 and March 2000.[90] Of this amount, $5.3 million was quickly recovered, and the government is negotiating with vendors for several million additional dollars worth of disputed payments.[91]

Although the pilot program ended in 1999, the Department of Defense has since expanded its use of recovery auditing. Section 831 of Public Law 107-107, the National Defense Authorization Act for Fiscal Year 2002, reauthorized the pilot program and required all executive agencies that enter into contracts totaling $500 million or more to implement programs for recovering any amounts erroneously paid to contractors, including the use of recovery audits. The use of recovery auditing has spread outside the DOD as well and is now used by the Department of Veterans Affairs, the General Services Administration,

the Federal Aviation Administration, the Federal Highway Administration, and the Federal Transit Authority within the Department of Transportation.[92] Indeed, the Bush administration has recognized the value of recovery auditing, making it a key part of the President's Management Agenda, issued in August 2001.

A recent GAO report reported the successful implementation of recovery auditing programs in other government agencies:

> *When Illinois had assessed the risk of improper payments in its Medicaid program, based on the results, it implemented initiatives to improve payment accuracy. To monitor the effect of the new initiatives, the state uses random claims sampling to test the accuracy of payments. The goal of the project, which reviews 1,800 claims per year, is to ensure that every paid claim faces an equal chance of random review. This approach not only provides periodic estimates of payment accuracy rates but helps deter future erroneous and fraudulent billings*.[93]

The GAO report also noted the key role performance measurement plays in maintaining agency accountability for overpayments and ensuring the accuracy of the payment errors identified:

> *Performance measures are key to monitoring progress in addressing improper payments. The government of New Zealand, for instance, requires audited statements of objectives and service performance to be included along with financial statements. These statements include performance measures related to improper payments. Work and Income New Zealand (WINZ), a government agency that provides income support and employment assistance to eligible people, has established performance measures for entitlement accuracy, services to reduce benefit crime, and debt management. WINZ's financial statements are the main accountability reports used by Parliament to monitor the agency's performance. In addition, Parliament uses the audited information to make informed decisions on resource allocation, and through a monitoring body, to hold the entity's chief executive officer responsible if performance standards are not met.*[94]

Since recovery audit programs have been effectively implemented in governments at the federal and state levels, there is no reason to believe that California would not similarly benefit from their use. The mere fact that this cost-savings strategy is rapidly becoming more and more widely adopted in the public sector is testament of its success.

Recovery auditing may not be a dramatic way to save money, but it is effective. Its use presents no risk to the government, as nothing is paid to the contracted auditing firms unless savings are realized, and even then payment is just a percentage of that savings. Furthermore, since recovery auditing can provide savings without the need for difficult political decisions, there is no reason not to use these services.

Recovery auditing may not result in multi-billion dollar savings to the government, but the millions of dollars saved do add up and become significant in an environment where numerous agencies are trying to stretch their appropriations as far as possible and taxpayers are clamoring for the elimination of government waste. The use of recovery auditing, in addition to strengthened anti-fraud measures, would represent a large step in the right direction to reducing this unnecessary waste.

Divestiture of Under-utilized State Assets and Improved Asset Management

The final reform involves improving the state's management of public assets and infrastructure. It involves improvement in the construction, operation and maintenance of assets. It also involves getting rid of things the government has bought or built in the past, but no longer has a use for.

The state must improve its management of public assets—which constitute an important element of a state's economic prosperity. Roads, water, energy, and other types of public works constitute an integral component of service delivery. Transportation networks consisting of roads, railways, airports, and harbors foster a vibrant, interconnected business climate by providing the avenues through which trade takes place. The Information Age has also created an increased emphasis on quality of life, while parks, schools, public hospitals and recreational facilities serve to make a community more attractive to potential residents and businesses, all demands that place further stresses on infrastructure. Infrastructure renewal and maintenance is vital to sustained growth and development.

Each year the American Society of Civil Engineers (ASCE) issues a report card on the status of the nation's infrastructure. California received a one of the worst grades in America. Among other things it reported that:

- 47 percent of California's major roads are in poor or mediocre condition;
- 28 percent of the bridges are structurally deficient or functionally obsolete;
- 87 percent of California's schools have at least one unsatisfactory environmental condition;
- 71 percent of schools have at least one inadequate building feature; and,
- California's drinking water infrastructure needs $18.8 billion over the next 20 years. [95]

Most alarming though is that driving on roads in need of repair costs California's motorists $7.4 billion a year in extra vehicle repairs and operating costs – nearly $354 per motorist.

Additionally, under new state government accounting standards, all government entities must determine the value of their infrastructure facilities and reflect that value in their books. They then must either maintain the facilities to sustain their value or depreciate the value in their accounts. This is likely both to improve the data on infrastructure values and needs and to create new incentives to avoid deferring maintenance.

Another serious problem plaguing Californians is the amount of congestion on the freeways. Less than three years ago, Governor Davis enacted the Traffic Congestion Relief Program (TCRP) to alleviate congestion and gridlock. The program called for an initial appropriation of approximately $1.6 billion and annual allocations from the sales tax on gasoline, as stipulated by Proposition 42. However, none of the sales tax revenue has been allocated, and almost all of the initial appropriation has been "borrowed" by other state programs in the General Fund.

To add insult to injury, the Governor has called for additional cuts in the 2003-04 budget including, further suspension of Prop. 42 funding and $500 million in loan forgiveness of funds borrowed by the TCRP.

To better prepare and align statewide priorities the state implemented a five-year strategic plan. However a Legislative Analyst's Office (LAO) review of the plan noted several flaws in the plan.[96] For starters, the LAO noted that the strategic plan failed to accomplish its goal and purpose.

> *While the plan presents various departmental priorities, it does not place these priorities in the context of the administration's overall, statewide priorities. For example, the plan does not state whether the administration's priorities are: the renovation of aging facilities, addressing certain critical deficiencies, the development of new facilities and capacity, or a combination of these. We believe that such a context is needed in order to better understand and assess the departmental proposals and priorities in context of the entire state budget.*[97]

Another critique of the "strategic plan" is that it only identifies projects where funding has been identified or is available. This approach fails to properly assess the state's needs and is unrealistic if the backlog of deferred maintenance is accounted for.

A number of reforms are advocated by the Citizens' Budget:

- **Improved Financing System:** Serious financial commitments to rebuild, rehabilitate, and renew the state's infrastructure are needed. Assembly Constitutional Amendment (ACA) 11 is a bipartisan bill that would amend the state Constitution to create an infrastructure fund for both state and local projects. If passed by voters in March, ACA 11 would establish the California Twenty-First Century Infrastructure Investment Fund to provide a dedicated fund source for capital outlay. It would require that monies in the Infrastructure Fund be allocated by the legislature for capital outlay purposes, of which 50 percent would be for state-owned infrastructure and 50 percent would be for local government infrastructure.
- **Performance-based Contracting and Outsourcing**: The state should expand its use of performance-based contracts for construction, operation and maintenance of all public assets. Moreover, no state employee should be charged with operating and maintaining state assets. These are responsibilities more efficiently and effectively performed by professional contractors under fixed-price contracts with clear performance standards. Numerous studies indicate that from road repairs and building improvements to bike trail maintenance and snow removal, performance-based contracting and outsourcing of operations and maintenance saves significant resources.
- **Asset Divestiture**: With such a large inventory of assets needing improvements, it is important for the state to prioritize and shed any unused or under-utilized assets. Divestiture of assets is examining what real property the state owns and if it can be put to more productive or efficient use if it is privately owned and used by the state under agreement with private owners.

The Little Hoover Commission for California state government has issued several reports criticizing the state for not effectively managing its real property assets.[98] While there is certainly room for improvement and money to be saved, there have also been some examples of success. In 2001, for instance, Governor Davis sold surplus state real estate in Silicon Valley for $149 million. Building on California's existing experience in identifying and selling surplus properties is a good place to start. In addition, many other government agencies have more advanced experience in figuring out how to benefit from privatizing real property and equipment, where appropriate.[99]

Focusing first on state real estate assets, estimating that about 20 percent of it could be more productive if privatized, and a very conservative estimate of land and building values, selling half of those viable properties would generate a lower bound estimate of **$1 billion in 2003 and in 2004**, while an accelerated pace of sales or selling prices more in line with typical California market values would generate **$1.5 billion in 2003 and 2004.**[100] Additional revenue benefits kick in after assets are sold and enter the property tax rolls.

Table 8: Major State Infrastructure

Program Area	Major State Infrastructure
Water Resources	▪ 32 lakes and reservoirs ▪ 17 pumping plants ▪ 3 pumping-generating plants ▪ 5 hydro-electric power plants ▪ 660 miles of canals and pipelines ▪ 1,595 miles of levees and 55 flood control structures in the Central Valley
Transportation	▪ 50,000 lane miles of highways ▪ 9 toll bridges ▪ 11 million square feet of Department of Transportation offices and shops ▪ 209 Department of Motor Vehicles offices ▪ 138 California Highway Patrol offices
Higher Education	▪ 192 primary and satellite campuses of higher education, including 10,000 buildings containing 138 million square feet of facilities space
Natural Resources	▪ 266 park units containing 1.4 million acres and 3,000 miles of trails ▪ 238 forest fire stations and 13 air attack bases ▪ 21 agricultural inspection stations
Criminal Justice	▪ 33 prisons and 38 correctional conservation camps ▪ 11 youthful offender institutions ▪ 12 crime laboratories
Health Services	▪ 4 mental health hospitals comprising over 4 million square feet of facilities and 2,300 acres ▪ 5 developmental centers comprising over 5 million square feet of facilities and over 2,000 acres ▪ 2 public health laboratory facilities
General State Office Space	▪ 8.5 million square feet of state-owned office space ▪ 16.6 million square feet of leased office space



Unanimous and Bipartisan "Competitive Sourcing" Guidelines from the Federal Commercial Activities Panel



The federal government recently completed work through a bipartisan commission examining how best to use competitive sourcing in government. The results were historic—demonstrating how a commission of Republicans, Democrats, union leaders and businesses could endorse 10 common principles for doing competitive sourcing well.

In order to guide the new process of competitive sourcing in government, the Commercial Activities Panel (CAP) offered these ten principles:

- **Align to Mission and Goals of the Agency:** Federal agencies should link any competitive sourcing program they undertake to program strategic plans and performance goals.
- **Link to Human Capital Planning:** Competitive sourcing initiatives should include investments in training federal workers to be more competitive, as well as identify areas where recruitment shortages are projected to be the greatest.
- **Recognize Inherently Governmental Activities:** Federal agencies should clearly and carefully identify "inherently governmental" activities and ensure federal workers continue to oversee those functions.
- **Create Incentives for Performance-based Management:** Competitive sourcing must be fully integrated into a comprehensive performance-based management system for the agency that encourages and rewards high-performance.
- **Ensure Transparency and Consistency in Competitions:** The federal government should devise a clear and transparent process for managing competitions and be consistent in applying that process across federal agencies.
- **Avoid Arbitrary Targets for Outsourcing:** The Administration and individual agencies should refrain from setting quotas or goals for how many activities or positions should be outsourced.
- **Provide for Full Competition:** When activities are competed—whether they are inside the agency or already contracted out—the process should allow for full competition between federal workers and the private sector.
- **Ensure Fairness in the Competitive Sourcing Process:** It is not enough to allow both sides to bid on federal activities—bids must be evaluated and judged fairly. Without fairness, and confidence in the system by all parties, the interests of the taxpayer (the ultimate beneficiary of competitive sourcing) cannot be safeguarded.
- **Focus on "Best Value" in Determining Winning Bid**: Competitions for federal activities should be evaluated and judged based on cost and performance standards. Moving to a best value formula will remedy one of the biggest flaws in the existing competitive sourcing process: the single-minded focus on cost cutting rather than performance improvement.
- **Provide for Accountability throughout the Process**: Regardless of who wins the competition, federal agencies should demand accountability for performance from the winners. Only by measuring performance—and managing contracts for results—can accountability be guaranteed.

Overview of Innovative Government Procurement Models

A variety of alternative service delivery techniques can be employed to maximize efficiency and increase service quality. Some methods will be more appropriate than others depending on the service. In searching for ways of cutting costs and increasing delivery, consider using a combination of these techniques:

a. ***Contracting Out (also called "outsourcing").*** The government competitively contracts with a private organization, for-profit or non-profit, to provide a service or part of a service.

b. ***Management Contracts***. The operation of a facility is contracted out to a private company. Facilities where the management is frequently contracted out include airports, wastewater plants, arenas and convention centers.

c. ***Public-Private Competition (also called "managed competition," or "market testing").*** When public services are opened up to competition, in-house public organizations are allowed to participate in the bidding process.

d. ***Franchise.*** A private firm is given the exclusive right to provide a service within a certain geographical area.

e. ***Internal Markets.*** Departments are allowed to purchase support services such as printing, maintenance, computer repair and training from in-house providers or outside suppliers. In-house providers of support services are required to operate as independent business units competing against outside contractors for departments' business. Under such a system, market forces are brought to bear within an organization. Internal customers can reject the offerings of internal service providers if they don't like their quality or if they cost too much.

f. ***Vouchers.*** Government pays for the service; however, individuals are given redeemable certificates to purchase the service on the open market. These subsidize the consumer of the service, but services are provided by the private sector. In addition to providing greater freedom of choice, vouchers bring consumer pressure to bear, creating incentives for consumers to shop around for services and for service providers to supply high-quality, low-cost services.

g. ***Commercialization (also referred to as "service shedding")***. Government stops providing a service and lets the private sector assume the function.

h. ***Self-Help (also referred to as "transfer to non-profit organization").*** Community groups and neighborhood organizations take over a service or government asset such as a local park. The new providers of the service also are directly benefiting from the service. Governments increasingly are discovering that by turning some non-core services—such as zoos, museums, fairs, remote parks and some recreational programs—over to non-profit organizations, they are able to ensure that these institutions don't drain the budget.

i. ***Volunteers.*** Volunteers are used to provide all or part of a government service. Volunteer activities are conducted through a government volunteer program or through a non-profit organization.

j. ***Corporatization.*** Government organizations are reorganized along business lines. Typically they are required to pay taxes, raise capital on the market (with no government backing—explicit or implicit), and operate according to commercial principles. Government corporations focus on maximizing profits and achieving a favorable return on investment. They are freed from government procurement, personnel and budget systems.

k. ***Asset Sale or Long-term Lease.*** Government sells or enters into Long-term leases for assets such as airports, gas utilities or real estate to private firms, thus turning physical capital into financial capital. In a *sale-leaseback* arrangement, government sells the asset to a private sector entity and then leases it back. Another asset sale technique is the *employee buyout*. Existing public managers

and employees take the public unit private, typically purchasing the company through an Employee Stock Ownership Plan (ESOP).

l. ***Private Infrastructure Development and Operation.*** The private sector builds, finances and operates public infrastructure such as roads and airports, recovering costs through user charges. Several techniques commonly are used for privately building and operating infrastructure.

m. With **Build-Operate-Transfer** (BOT) arrangements, the private sector designs, finances, builds, and operates the facility over the life of the contract. At the end of this period, ownership reverts to the government.

n. A variation of this is the **Build-Transfer-Operate** (BTO) model, under which title transfers to the government at the time construction is completed.

o. Finally, with **Build-Own-Operate** (BOO) arrangements, the private sector retains permanent ownership and operates the facility on contract.

Part 7

Protect and Improve Education

"During these times of fiscal crisis and uncertainty, districts need maximum flexibility to review all options for accomplishing support service tasks, particularly when the only major cost cutting alternative is to drastically reduce services in the regular education program."
– James Fleming, Capistrano Unified School District

Summary of Citizen Budget Recommendations in This Section:

1. Make Education a Priority by **Adhering to Proposition 98 Funding Requirements** during the 2003-2005 budget cycles.
2. **Reform Categorical Funding System** to streamline funding provided to school districts.
3. Adopt a **"Funding to Follow the Child" Model** that distributes education funds within districts and among districts using a weighted student funding formula to more appropriately and effectively reflect individual student needs.
4. Implement **Competitive Sourcing for Non-Instructional Services** to ensure cuts proposed by the Governor do not affect classroom funding
5. Move toward **Greater Local and Parental Control of Education Funding** through expanded pilot projects in school choice.

The Citizens' Budget sees education as the most important function state government can play—as well as the most important investment to safeguard in a state budget. Toward that end, our budget firmly commits to making all budget expenditures necessary for keeping the funding commitments outlined under Proposition 98. Indeed, under our plan, Proposition 98 will not have to be suspended. However, the Citizens' Budget does call for fundamental education reform.

The Governor's 2003-2004 Budget includes a total of $52.1 billion in operational funding from state, local, and federal sources for K-12 schools for 2003-04. This is a decrease of $1.4 billion, or 2.7 percent,

California Budget FACTS:



100%
The amount of funding the Citizens' Budget fulfills of Proposition 98 funding

$8750
Amount spent per pupil in state public schools this year

70%
Percent of students in 7th grade that do not meet state proficiency standards in math

67%
Percent of students in 7th grade that do not meet state proficiency standards in language arts

29%
Percent of each dollar spent at school district level that goes to non-instructional activities (transportation, food service, etc.)

from estimated expenditures in the current year. The budget also includes a total of $30.3 billion in state, local, and federal sources for higher education. This is an increase of $447 million, or 1.5 percent, over estimated expenditures in the current year.[101]

While our budget accepts the reductions to education funding called for in the Governor's plan, we do not share the Governor's view that across-the-board cuts are the best way to make reductions. School districts across the state are reacting by giving teachers pink slips. State law requires that teachers be put on notice six months in advance of layoffs.[102] These pink slips may be one method to put pressure on the legislature to raise taxes rather than cutting education spending.

In contrast to the behavior above, we propose to achieve the Governor's proposed 2.3 percent reduction without taking a single dollar from the classroom and without issuing a pink slip to a single teacher. Finally, the state cannot simply make education "whole" by maintaining Proposition 98 funding levels. It must ensure that the money spent under Proposition 98 and other sources is put to good use and achieves the best academic performance possible. In order to ensure California has a world-class education system that leaves no child behind, fundamental reforms must be enacted to improve the entire education system.

Rather than announcing teacher layoffs, local school districts need to enact the 1.2 percent reduction through three key reforms. First, school districts should have the ability to competitively source non-instructional services through performance-based contracting. Additionally, school districts need local flexibility to manage the one-third of education revenue (approximately $12 billion in restricted categorical funding) by collapsing these programs into general block grant funding on a per-pupil funding allotment. Finally, academic performance should be tied to individual per-pupil funding through a general public school choice program that allows students to attend any public school using a weighted student formula and through an opportunity scholarship program that allows students in failing schools to transfer to private or higher-performing public schools.

Table 9: Governor's Proposed K-12 and Higher Education Funding 2001-02 Through 2003-04 (Dollars in Millions)

	Actual 2001-02	Estimated 2002-03	Proposed 2003-04	Amount Change from '02-03	% Change from '02-03
K-12[a]	$51,663	$53,521	$52,078	-$1,443	-2.7%
Higher education[b]	28,890	29,874	30,320	447	1.5%
Totals	**$80,553**	**$83,395**	**$82,398**	**-$997**	**-1.2%**

[a] Includes state, local, and federal funds. Excludes debt service for general obligation bonds.

[b] Includes state, federal, and local funds. Excludes direct capital outlay spending and debt service for general obligation bonds.

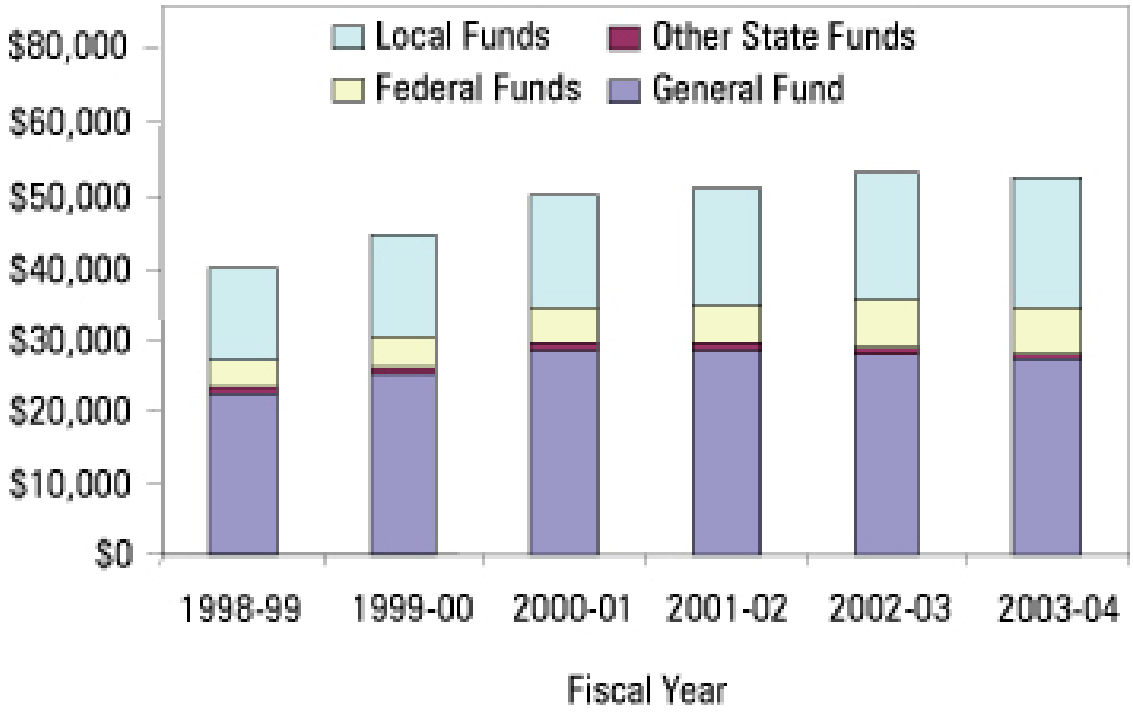
Source: Legislative Analyst's Office,
http://www.lao.ca.gov/analysis_2003/education/ed_1_ov_anl03.htm#_Toc32819890

More Money, Less Performance

California enrolls approximately 6 million students in its public schools, 12.5 percent of the nation's total. In a forthcoming article in *California Policy Options 2003*, UCLA, school management expert William G. Ouchi describes the state of California education:

> *By most measures, these schools are failing in their mission. On the 2000 National Assessment of Educational Progress—Science Examination, California's eighth graders tied for last in the nation with those of Hawaii. California's fourth graders had sole claim to last place in the nation. In the 2001 TIMSS international mathematics test, California again ranked dead last in the U.S., this time tied with Mississippi. A 2000 study by RAND concluded that California ranks last in the nation when reading and math scores are compared for students of the same socio-economic categories. Fewer than 25 percent of California students scored either proficient or advanced in reading.*[103]

Figure 13: Total Revenue for K-12 Education by Funding Source (Dollars in Millions)



Source: Data from Governor's Budget Summary, 2003-04,
http://www.dof.ca.gov/HTML/Budgt03-04/BudgetSum03/10_K-12.pdf

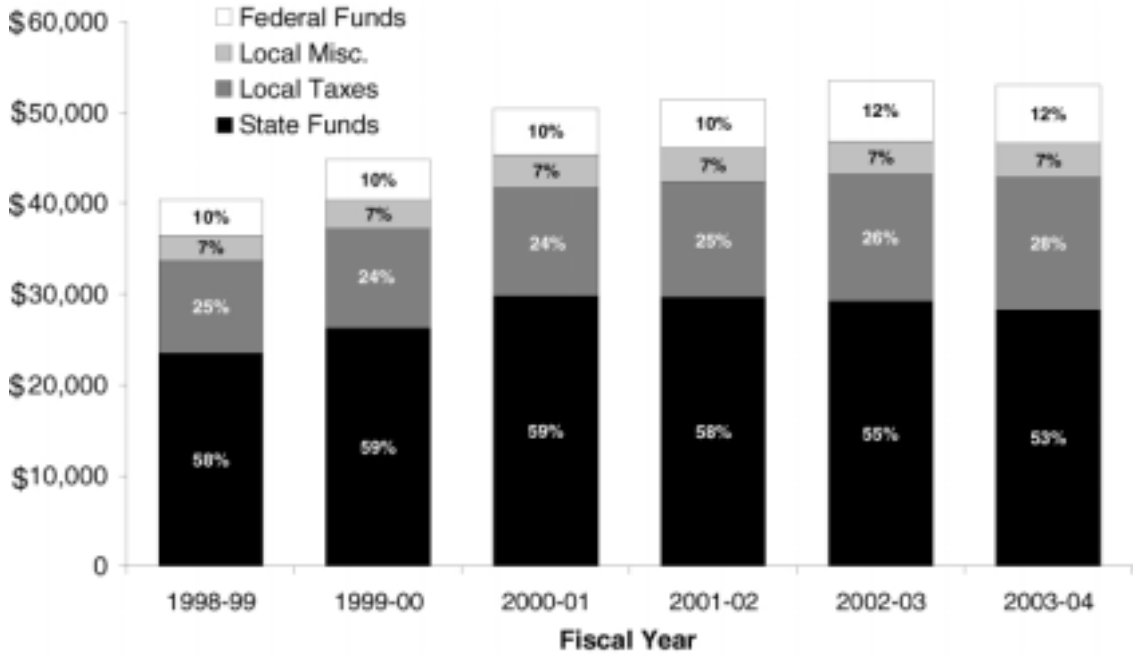
Other indicators also demonstrate how poorly California's schools are performing. The Legislative Analyst's Office estimates that by 2007 100 percent of Title I schools will be failing by federal standards. California ranked 34th in the nation in terms of educational inputs and math scores on the National Assessment of Education Progress for 8th graders and ranked 36th in the nation in terms of educational inputs versus SAT scores. Finally, when examining proficiency exams, between approximately 30 and 38 percent of all California students are proficient in reading and math at grade level (see below).

Table 10: Percent of Students Proficient or Above in English Language Arts and Mathematics (Results From the 2002 California Standards Test)				
	English Language Arts		Mathematics	
	Grade 3	Grade 7	Grade 3	Grade 7
All students	34%	33%	38%	30%
English language learners	12	5	22	9
Economically disadvantaged	18	16	25	16
Special education	17	6	21	6

Despite dismal performance, funding is not the issue. In fact, by a number of accounts, the state is spending more on education but getting less. Despite the much-publicized cries that Sacramento budget cuts are causing financial strain on our schools, analysis of education spending in California shows steady increases in the past five years, especially when all revenue sources to schools are accounted for.

Estimates of per-pupil spending vary depending on which funding sources are included. The Legislative Analyst's Office projects that spending from all sources will total $8,750 per pupil in 2003-2004.[104] This does not include expenses for capital costs. In other comparisons, a study by the *Los Angeles Business Journal* reported that for 25 independent schools in Los Angeles, the average annual tuition was $7,091.[105] A recent study by Ouchi found that the 298 Catholic schools in Los Angeles spend an average of about $2,500 per student in elementary schools and $5,100 per student in high school. By contrast, when school facility construction costs are added into the funding mix, the Los Angeles Unified School District spent a total of $13,267 per student for the 2000-2001 school year.[106]

Figure 14: Revenue for California's K-12 Schools: Source for Revenues ($ Millions, % of Total)



Source: Governor's Budget Summary, 2003-04, http://www.dof.ca.gov/HTML/Budgt03-04/BudgetSum03/10_K-12.pdf

So how can it be that California has dumped billions more into its education system but has seen the same old poor levels of education performance? Research by the American Legislative Exchange council finds that there appears to be *no significant correlation* between four measures of educational inputs: per-pupil expenditures, total funds received from the federal government, average teacher salaries, and student achievement.[107] For example, Washington, Iowa , and Wisconsin rank below the top ten in each of these measures and yet have achieved the highest average test scores in the nation. Several other states including California spend a relatively high amount of resources as measured per pupil and receive significant support from the federal government yet do not demonstrate high levels of student achievement.

Use Competitive Sourcing and Performance-based Contracting for Non-instructional Services

One of the most clear-cut ways school districts can save money or improve services is to outsource non-instructional services. California classrooms and students will sustain less damage in this financial debacle only if local school districts have maximum flexibility to manage their budgets. In May 2002, the city of Philadelphia's school district, which has faced budget deficits the last four years, passed a $1.7 billion budget that projected a $28 million deficit by the end of this fiscal year. Now, the district expects a $2 million surplus. Officials credit administrative cuts, better facilities management, and across-the-board cuts in programs not tied to the classroom. Philadelphia's school district has saved over $29 million in just two years by relying on privatized transportation, food service, custodial, and other support functions. Philadelphia made these financial cutbacks without a teacher hiring freeze or firing any teachers. In fact, Philadelphia is still running a robust teacher recruitment program.[108] Similarly, Chicago's school district saved $20 million over three years by contracting its bus services.[109]

According to the U.S. Department of Education, National Center on Education Statistics, and the California Department of Education, California schools spend between 26 and 28 percent of their budgets on non-instructional services, including operation and maintenance, transportation, and food service.[110] In the 2002-03 and the 2003-04 budgets, this amounts to more than $13 billion each year spent on non-instructional school-site services. According to the American School & University school privatization surveys from 1997-2001, 40 percent of the nation's school districts outsource transportation and more than 20 percent outsource food service.[111] Literature reviews of education privatization cost savings have found between 20 and 40 percent savings from school outsourcing.[112] If 25 percent of the more than $13 billion in California non-instructional services were outsourced at a savings of 20 percent, California school districts would save approximately $651 million in each of the 2002-03 and 2003-04 fiscal years on non-instructional services.

A new California law will cripple the flexibility of local school officials to target spending cuts to non-instructional services and away from teachers and other instructional programs. The privatization law, SB 1419, effective January 1, 2003, requires school officials to analyze potential cost savings from privatization, forbids the private firm from paying workers less than industry standards, and forbids the layoff or demotions of school employees as a result of the contract. The law requires school districts to use the same standards that state agencies must comply with before privatizing jobs done by classified, i.e.non-teaching, school employees. While analyzing potential cost savings is an important step of all school privatization programs, this law provides a serious disincentive to privatizing school support services in California; control of personnel is one of the most crucial aspects of any successful privatization effort. We therefore

recommend that this law be suspended during the state fiscal emergency so that districts may achieve efficiencies through outsourcing.

The Governor's Budget also proposes an $890 million decrease in General Fund expenditures for higher education in 2003-2004. Outsourcing non-instructional services could also lead to cost savings for higher education expenditures. Colleges tend to outsource services at a higher rate than school districts. Conservatively, if California colleges and universities spend 10 percent of their $30.3 billion budget on services that could be potentially outsourced and achieve cost savings of 25 percent, that would result in cost savings of $757 million each year.

When considering the potential of non-instructional competitive outsourcing, the $1.2 billion in proposed cuts to education are not that extreme and demonstrate that additional state monies could be saved if the state took a few specific actions:

- Suspend recently enacted restrictions that have dramatically limited the ability of school districts to outsource support services;
- Tie budget cuts to school districts with incentives that encourage outsourcing; and
- Outsource support services at the UC, CSU, and CC systems.

Reform Categorical Programs

California's state government distributes tax dollars to local school districts and county offices of education in two ways. One method allocates tax dollars to local districts that districts may spend as they deem appropriate. The second method, which accounts for one-third of total K-12 programs from all sources, is through categorical programs. These programs earmark tax dollars for specific purposes and programs. A recent exposé in *The Sacramento Bee* describes California's categorical education funding system as "a monumental mess."[113] The categorical system has grown into a massive and convoluted web, filled with deep disparities, outdated programs, and unaccountable cash streams.

The state has more than 100 categories of money for specific purposes, such as helping poor children or training algebra teachers or educating the academically gifted. Each has a different history, a different funding pattern, and different people in charge. The distribution of categorical money from district to district is uneven, with politics often determining who gets the most cash. A lot of the money is doled out based on outdated programs and formulas with little connection to needs in schools.

In the 1988-89 school year, categoricals together made up about 22 percent of the state budget for education. By 2001-02, that share had grown to about 31 percent—more than $12 billion in a $40 billion budget.[114] The state has at least 20 separate categoricals devoted to the training of teachers and school staff, each with its own bureaucracy. And a dozen or so programs cover some aspect of school safety, but there's no coordinated plan for safe schools.[115]

The Little Hoover Commission explains the administrative costs of a categorical system:

> *Categorical programs have their own paperwork, justifying district eligibility and documenting expenditures. Teams of district personnel to fill out the paperwork are matched by teams of state workers to check it. In addition, most school districts of any size spend money on consultants for advice*

on how to maximize funding or pass audits. The commission also found that districts with high amounts of categorical funding spent a disproportionate amount of money on administration linked to those programs. The Legislative Analyst's Office and a more recent Pacific Research Institute report, and the Sacramento Bee report that there is little evidence that any categorical program is actually meeting its stated purpose.[116]

The Governor's Budget proposes to create a $5.1 billion categorical block grant in lieu of funding 58 individual K-12 programs in order to provide school districts with greater fiscal and program flexibility.[117] The Legislative Analyst's Office proposes an alternate categorical block grant program that would collapse 62 categorical programs into 5 block grants.[118]

The Governor's 2003-04 proposal would continue separate funding for 13 categorical programs because they reflect an administration priority (such as K-3 class size reduction [CSR]), satisfy a federal mandate (such as special education), or would be discontinued in the near future (year-round schools, principal training, and mathematics and reading staff development). The 13 separately funded programs would distribute $5.6 billion in 2003-04. Four programs—special education, K-3 CSR, child development, and summer school—account for $5 billion, or 90 percent of the total.

The Governor's proposal and Legislative Analyst's Office proposal would yield state and district savings by reducing the administrative effort entailed in operating multiple categorical programs. Currently, districts must apply for, separately track, and monitor the appropriate use of categorical funds. The amount of local savings that would result is unknown, however, as established in the chapter on reorganization and streamlining government, estimates confirm an overall savings rate of 15 percent. The budget identifies significant state savings, however, proposing to reduce State Department of Education (SDE) administrative support by $6.7 million and 97 positions to reflect workload savings resulting from the consolidation. In the end, this represents 15 percent of the department's 2002-03 General Fund support.

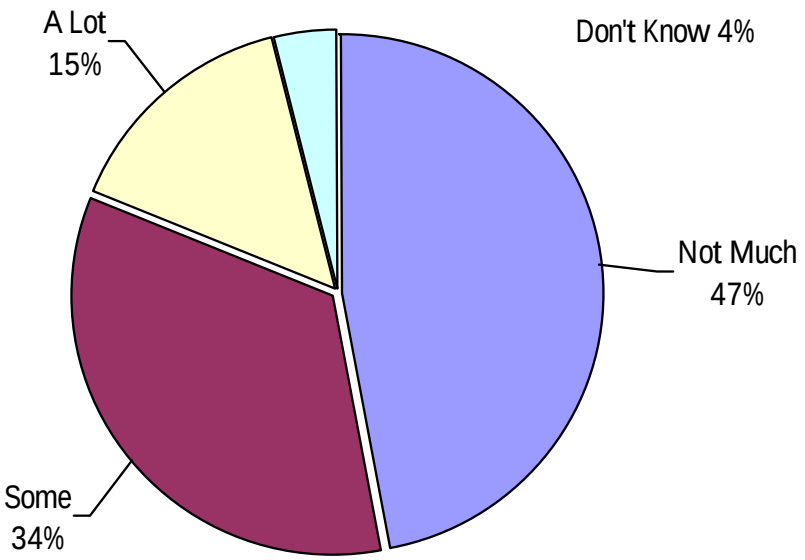
We recommend providing local schools maximum flexibility by creating a block grant for the entire $12 billion and changing the California school finance system to have funding follow the child using a weighted funding formula and devolve fiscal accountability to the school level, which is discussed in the next recommendation. Approximately, 15 percent of the $12 billion covers various administrative costs at the state, district, and local level, for a total cost of $1.8 billion. By collapsing the categorical programs and reducing reporting and compliance activity at the local level, school districts would be able to "stretch" block granted dollars. Therefore, the state could reduce total categorical spending by 5 percent and save $600 million in 2003-2004.

Implement a "Funding to Follow the Child" System

California has one of the most centralized public school systems in the United States. In California, local property taxes are aggregated in Sacramento and then re-allocated to school districts on a per-capita basis. These reallocated funds—both general revenue and categorical funds—flow not directly to schools, but to school district central offices. The central offices then allocate people to schools rather than money based on complex formulas. It is ironic that in California the state accountability systems hold principals accountable for student achievement, but give the principals no authority to make local spending decisions. In Los Angeles, for example, school principals control only 6.7 percent of their school budgets.[119]

In a recent study, UCLA school management expert and management Professor William G. Ouchi found that school districts that use more decentralized management organizations and allow principals to control a larger percentage of the local school budget have better outcomes in terms of student achievement and cost containment. For example, Ouchi's study compared the highly centralized Los Angeles Unified School District and the more decentralized Houston Independent School District. Both districts have 90 percent minority students, and both are heavily low-income, with Los Angeles at 74 percent and Houston at 71 percent. Given these similarities, it is striking that Houston students outperform those of Los Angles by nine or ten points in reading, and by six or seven points in mathematics, on the same Stanford 9 standardized test.[120]

Figure 14: Do you have a lot of confidence, some confidence or not much confidence that your local school district officials are spending money wisely?"



Source: PPIC, March 2002

The study also found that more decentralized districts, such as Edmonton, Seattle, and Houston, had less fraud and corruption and smaller central audit staff per 100,000 students than New York City, Los Angeles, and Chicago.

These decentralized districts use an innovative budgeting system known as Weighted Student Formula. Ouchi explains how the model works in Seattle:

> *All that is needed is to capture the several state-allocated categorical funds, such as those for Special Education, Reading Programs, and GATE (Gifted and Talented Education) and assign the money to the student who qualifies for each special fund. Thus, the money follows the student. In the Seattle system, a "minimum" student—one who qualifies for no categorical funds, receives only his or her per capita basic state allocation. The "maximum" student—one who has multiple learning disabilities, is from a low-income home, and who is a non-English speaker, carries a weighting of up to 9.2 times the basic*

allocation. In addition, each school receives a flat block grant of more than $200,000, so that smaller schools can meet their basic costs.

In addition to the rule that the money follows the student, Weighted Student Formula has a second rule, that each family has a choice of any public school in the system. If a family chooses an out-of-area school, and if the child does not qualify for transportation funding, the family must transport the child to that distant school. Schools must compete for students, and under Weighted Student Formula, they actively seek to enroll Special Education and other students who bring additional Weighted Student Formula funding. The families are empowered by this system, and schools must respond to the needs of families, or suffer declining enrollments. Weighted Student Formula does not create a punitive environment for teachers and does not increase the number of teachers who are subject to discipline or to dismissal. Principals are more publicly accountable under the system.[121]

As Pacific Research Institute's *Grand Theft Education* report recommended, "parental choice in education would overhaul the system and make financial efficiency, student achievement, and parental satisfaction the priority benchmarks."[122] In addition to using a weighted student formula and a public school choice program, California could tie student performance more directly to per-pupil funding by instituting an opportunity scholarship program to allow students in failing schools to transfer to private or better performing public schools.

Rather than using the perverse incentive that offers more funding to failing schools, California could set up an accountability program that allows the lowest performing students to use scholarships to attend private schools. If funding followed children in the bottom 25 percent of school districts, (including more than 25 percent of the student population because of large low-performing districts like LAUSD and Oakland) this would result in at least $2.6 billion in savings. Using the Los Angeles Independent School tuition figure of $7,000 (which is higher than the national per-pupil spending average) and letting the $7,000 follow each of the students in the bottom 25 percent of academic achievement would save more than $2.6 billion.

A complete school choice system where the money follows the child to any public or private school represents the most decentralized system on the school funding continuum and will likely yield the most cost savings. As a thought experiment, if $7,000 followed each of the 5,954,154 California children to a school of his or her parent's choice the cost would equal close to $42 billion and save California close to $10 billion in 2003-2004 in education spending.

Part 8

Implement Health and Social Welfare Reforms

"With no one in charge, the foster care system fumbles forward, and often backwards, and costs children and families their happiness, their prosperity and even their lives. It is imperative that the Governor and Legislature clarify who is responsible for the children and families in the foster care system. Without that clarity, millions of dollars and millions of hours will continue to be wasted."

—Little Hoover Commission, 2002

Summary of Citizen Budget Recommendations in This Section:

1. Implement **Recovery Auditing and Fraud Reduction** efforts to reduce erroneous payments in the state health and social service programs.
2. Expand **Realignment of Health and Social Service Programs** to encourage cost savings, better service and local flexibility.
3. Implement **Competitive Sourcing and Performance-based Contracts** for all health and social services to eliminate cost-reimburse arrangements that encourage over-spending.
4. Improve **Child Support Enforcement** to reduce state compensating for parents unwilling to support their own children.
5. Follow the Wisconsin Works model for Long-term welfare reform by **Strengthening Work Requirements for Beneficiaries** and increasing the use of private vendors for program administration.
6. Consider participation in the **Independence Plus Demonstration Program** offered by the U.S. Department of Health and Human Services to reduce costs.

California Budget FACTS:



$1.3 billion
Estimated federal fines the state will accumulate by 2006 for the poor performance of its child support system

$115.8 million
Amount of federal fines California was assessed last year for operating "the most error-plagued food stamp program in the nation"

$3 billion
Amount spent on a foster care system that even the Secretary of the Health and Human Services Agency admits is broken

3
Number of people who participated in the $62 million department of Consumer Affairs Low-Income Repair Assistance Program

Second only to education, the state spends billions each year on a myriad of health and social service programs. Funding these programs and ensuring they deliver high performance is crucial to safeguarding California's quality of life. There are currently about 6.5 million people, just over one in five Californians, who qualify for Medi-Cal in any given month. While California has one of the most generous entitlement and welfare programs in the nation, the performance of many of our health and social services has been dismal.

Two-thirds of the states are cutting Medicaid benefits, increasing co-payments, restricting eligibility or removing poor people from the rolls.[123] Governor Davis plans on eliminating some optional services like hospice care, optometry, physical therapy, prosthetics and hearing aids. (It should be noted that nationwide, about 70 percent of all Medicaid spending is optional, covering either beneficiaries that do not have to be covered, or services that do not have to be covered, or both.[124] Since the average state currently spends 19.6 percent of its budget on Medicaid,[125] almost 14 percent of Medicaid spending could be saved in an average state by eliminating optional people and optional services.[126])

Yet, drastic cuts might not have to equate to the elimination of key services. Indeed, health and social service programs provide numerous opportunities for fundamental reforms. As such, the Citizens' Budget provides recommendations for reforming health and social services to achieve the reductions proposed by the Governor without cutting any services.

Realignment to Appropriate Level of Government

The current fiscal climate shares many similarities that Gov. Pete Wilson faced during his 1991 inaugural year. He inherited a $14 billion deficit and had to implement a plan immediately. His plan called for devolving 12 percent of state programs down to the control of local authorities where they could be managed better. Faced with a similar situation, Gov. Davis has taken a page from Wilson's playbook. He is asking counties to take over court security and realigning the mental and physical health programs administration from the state to the auspices of the county.

The concept is a great one, i.e., most actually argue for more local control over programs and expenditures. Davis's realignment resembles Wilson's plan, but his methods and internal motives are different. For example, while ceding responsibility for many social services including health care to counties, Davis and his administration will still determine the rules of the game the counties have to play by. The 58 counties are fighting realignment because there is little discretion and ultimately there is no accountability or guarantees that the money will flow.

Davis's plan also calls for the money to go straight to the local authorities. Of the $8.2 billion in new tax revenue, $7.9 billion has been slotted by Davis to go to the counties, $300 million will go to the courts for security and $100 million will generally compensate municipalities for lost sales tax. However, Davis' plan does not avoid Proposition 98 requirements, meaning that 50 percent of all tax revenues would have to be allocated for K-12education.

Still, the largest difference between Wilson's and Davis's plan is the term of the tax increases. Wilson did ask for some tax increases, but they were minor and short term. Davis is using realignment not to improve efficiency or improve programmatic results but rather as a mechanism to raise tax revenues. Furthermore, in order for realignment to work, the local governments (i.e., counties) need authority over the programs—they cannot simply function as administrators of state programs. Counties need the flexibility and ability to control the programs and administer them as they see fit.

The Governor's realignment plan begs the question: given that local control is such a great thing because it means local accountability and allows decisions to be made based on the needs and resources of each community (the counties, in this case), why then must the money be funneled through Sacramento? This only serves to whittle down resources by unnecessarily passing funds through another layer of bureaucracy

at the state level and making appropriations subject to political pressures and interest groups. If local control truly is the goal—as it should be—then the counties should be allowed to both raise and spend money for such "realigned" programs locally. The state government would still have regulatory oversight of these programs, but such an arrangement would provide genuine local control without the state's strings attached.

The Citizens' Budget plan strongly endorses the realignment of the services proposed by the Governor through block grant to local government. While funding would still be provided through the General Fund, services should improve and cost efficiencies realized. However, the Citizens' Budget does not count on these cost savings to achieve a balanced budget—choosing to reinvest them into the programs instead as an "efficiency dividend."

Reduce Fraud through Recovery Auditing

The state of California is losing billions each year in erroneous and fraudulent claims in our health and social service programs. To boot, the federal government has cited California's fraud and error problems through millions in fines levied on the state!

Medi-Cal

The General Accounting Office estimates that fraud and abuse may be a high as 10 percent of Medicaid spending.[127] Likewise, at the state level, Medi-Cal fraud costs the state in excess of $1 billion annually. Several programs provide no-cost Medi-Cal to people who are not eligible. The Accelerated Enrollment Program will cost in excess of $10 million as a result of ineligible persons receiving benefits while the CHDP Gateway to Medi-Cal will cost in excess of $137 million to provide two months of Medi-Cal eligibility to people who have not even submitted a Medi-Cal application. If fraud can be eliminated in these two areas a $147 million will be saved. If an additional 10 percent of fraud is eliminated, that is another $100 million, for a total savings of $247 million. While savings cannot be guaranteed, it is important to highlight nonetheless.

Food Stamps

Another program that has been susceptible to federal fines is California's administration of the federal food stamp program. Last year, the state was reprimanded to the tune of a $115.8-million fine for operating "the most error-plagued food stamp program in the nation."[128] California's 17.4 percent error rate was over twice the national average of 8.66 percent. The fine was the largest ever imposed by the program, which dates back to the 1960s.

According to Eric Bost, U.S. Agriculture Department undersecretary for nutrition programs, negotiations between the state and the federal government would reduce the fine, but California would still end up paying at least 40 percent, or $46 million, of the fine.[129] The penalty comes on top of a $47.4-million fine, which was later reduced to $11.8 million, imposed for the state's second-worst-in-the-nation performance for the previous fiscal year.

So how can California tackle its fraud and error rates in these and other programs? As outlined in a previous chapter, recovery auditing can substantially address the problem of payment errors and fraud—not only

collecting overpayments but improving internal controls to prevent them in the future. In addition, the Citizens' Budget strongly endorses outsourcing of fraud and error detection efforts. Oftentimes, state employees (who created the problem in the first place) are too close the problem to improve the situation. Moreover, contracts should be performance-based, using the "Share-in-Savings" model where the contractor only gets paid by identifying and correcting fraud and errors.

Improve Child Support Enforcement

One area where fraud and payment obstacles must be addressed is at the new Department of Child Support Services, which was created to administer the child support collection program in an attempt to improve upon a child support collection rate that was for years the worst in the nation. During its first full year in operation in 2001, the new program collected and delivered $1.1 billion in monthly payments, a collection rate of 40 percent. That rate is actually 1 percent below the rate for 1999.[130]

In addition, the state has been racking up federal fines since 1998-99 because it has not complied with the federal Family Support Act of 1988, which required the states to develop a statewide automated system to track and collect court-ordered child support payments and to locate nonpaying parents. A December 2002 Bureau of State Audits report estimates that accumulated federal fines could total as high as $1.3 billion by 2006.[131] The state tried to build such a system beginning in 1992, but in 1997, after spending $111 million designing, developing, piloting, and implementing the system, the project was declared a failure.[132]

This collection rate forces many children to survive on welfare benefits and causes an unnecessarily increased social safety net cost for California taxpayers.

- The state should enable counties to form better partnerships and yield improved outcomes with child support enforcement.
- The state should allow for competitive service delivery, using highly experienced, state-of-the-art private companies to perform specialized child support enforcement services. For example, Montana has partnered with a private entity to perform the state's customer service function, allowing Montana's child support staff to devote more time to increasing collections. The private entity provides the key education function, interviews custodial parents to support paternity establishment, and verifies the identity of non-custodial parents.[133]
- The state should examine successful child support enforcement models, including competitive service delivery, in other states.

Competitive Sourcing and Performance-based Contracting

A host of other health and social services would benefit dramatically from competitive sourcing and performance-based contracting (described in detail in a previous chapter.) As such, commercial activities in health and social services such as benefit reviews, processing of claims, and most treatment should be performed by contractors under the supervision of the state. Of course, no services should be provided on a "cost-reimburse" basis—instead, the state should use fixed-price, performance-based contracts. A few examples of opportunities for the state to consider:

- The state should contract with hospitals the way private insurers do, choosing hospitals that charge the lowest price for a given level of quality.
- The state should stop paying for empty nursing home beds and instead pay for services rendered, not costs incurred.
- The state should substantially increase the number of beneficiaries enrolled in managed care plans, particularly beneficiaries with disabilities where managed care programs can meet their special needs.
- The state should employ techniques to detect and eliminate unnecessary or questionable procedures being authorized or performed by contractors.

Strengthen Work Requirements for Welfare Benefits

Since January 1993, 38 states have seen welfare caseloads decline by more than 50 percent. Nationwide, the welfare rolls have fallen by almost 60 percent, from 14.1 million to 5.8 million. Unfortunately, California does not have much to celebrate. Despite some progress in reducing the state's caseload, California is near the bottom.[134]

The state should follow the Wisconsin Works model for Long-term welfare reform. For starters, a work requirement is universal—"financial penalties for non-participation in work are strict and substantial."[135] More importantly, 80 percent of the program is administered by private vendors, both profit and non-profit. Results from a Wisconsin Legislative Audit Bureau indicate that the private vendors spent considerably less money than the government-run counterparts.[136] Additionally, the quality of services was comparable i.e., at least as good if not better.[137]

Enroll California in the Independence Plus Program

In 2001, the federal Department of Health and Human Services launched the New Freedom Initiative, a "comprehensive plan to reduce barriers to full community integration for people with disabilities."[138] The initiative "allows participants to live in their family residence or their own home and have control over the planning and purchase of Long-term supports and services by way of a cash allowance."[139]

The New Freedom Initiative consists of a demonstration program known as Independence Plus, which caters to Medicaid-eligible populations consisting of frail elders, adults with physical disabilities, adults with developmental disabilities, and children with developmental disabilities in participating states. According to a program in Florida, the first state to adopt the Independence Plus template,

> *Personal care services are provided to consumers enrolled in the treatment group by providers of their choosing. Treatment group consumers determine the services they need, and from whom to receive them. The consumers pay their workers from accounts set-up for them through the State, which contains the amount of funds the Medicaid program would have spent on their personal care services.*[140]

The U.S. Department of Health and Human Services describes the goals of the Independence Plus templates as follows:

Independence Plus:
A Demonstration Program for Family or Individual Directed Community Services



This initiative expedites the ability of states to offer families with a member who requires long-term supports and services, or individuals who require long-term supports and services, greater opportunities to take charge of their own health and direct their own services. Families and individuals will exercise greater choice, control and responsibility for their services within cost neutral standards. Two template versions will be available to enable states to tailor the program to their preferences; the §1115 Demonstration Template and the 1915(c) Waiver Template. These templates further the interests of the administration, states and beneficiaries. The program builds on the experience and research from a number of pioneer states that have pre-tested these concepts.

The Goals of the Templates

1. The templates will assist states to develop programs that will permit individuals needing long-term supports and services to obtain assistance while living with their family or in their own home. This will be accomplished by:
   - Recognizing the essential role of the family or individual in the planning and purchasing of health care supports and services by providing family or individual control over an agreed resource amount.
   - Increasing family and individual satisfaction through the promotion of personal control and choice - a major theme expressed during the *New Freedom Initiative* - National Listening Session.
   - Encouraging cost effective decision-making in the purchase of supports and services. Allowing eligible families and individuals to receive a cash allowance (in the §1115 Demonstration) or individual budget (in the 1915(c) Waiver) to obtain personal assistant services and related supports.
   - Promoting solutions to the problem of worker availability.
   - Providing fiscal/employer agent and supports brokerage services to support and sustain families or individuals as they direct their own services.
   - Delaying or avoiding institutional or other high cost out-of-home placement by strengthening supports to families or individuals.
2. The templates will provide states the tools, resources and guidance to create effective programs and continue the CMS commitment to create a "culture of responsiveness" by:
   - Assisting states with meeting their legal obligations under the Americans with Disabilities Act (ADA) and the Supreme Court *Olmstead* decision.
   - Providing flexibility for states seeking to increase the opportunities afforded families and individuals in deciding how best to enlist or sustain home and community services.
   - Incorporating the essential elements of self direction such as person-centered planning, individual budgets, participant protections and quality assurance and improvements.
   - Providing states with streamlined and standardized application formats to reduce the administrative burden for preparing proposal submissions and to reduce the Federal review period.

Features of the Templates

Electronic format for easier submission.
Database platform to enable electronic tracking, sorting, querying and analyzing.
Structured series of check boxes to facilitate completion.
Pop-up instructions imbedded in the check boxes offering completion instructions.
Technical Guide for developing the 1915(c) Waiver or the §1115 Demonstration applications.

Additional features of the §1115 Demonstration include simplified/streamlined budget neutrality model and sample terms and conditions.

Source: U.S. Department of Health and Human Services, http://cms.hhs.gov/independenceplus/summary.pdf

Participation in such a program would not only reduce costs, but also allow beneficiaries to achieve more freedom of choice in their health care coverage and improved quality of life. California should, therefore, strongly consider the merits of joining the Independence Plus program.

The Foster Care System:
One Example of California's Failure to Provide Effective Health and Social Services to its Citizens

The Little Hoover Commission reported in its 2001-2002 Biennial Report that the state spends over $3 billion each year on a foster care system that even the Secretary of the Health and Human Services Agency admits is broken.[1] The Commission recently released a follow-up report showing that little has changed since then. The new report summarized its findings as follows:

With no one in charge, the foster care system fumbles forward, and often backward, and costs children and families their happiness, their prosperity and even their lives.

It is imperative that the Governor and legislature clarify who is responsible for the children and families in the foster care system. Without that clarity, millions of dollars and millions of hours will continue to be wasted. In the last three years alone:

- *The legislature and Governor have considered over 100 bills intended to address deficiencies in the child welfare system. But legislative action has not dramatically improved the foster care system.*
- *The Department of Social Services has launched a $3 million planning process, but the proposed reforms do not address fundamental concerns about state and local responsibilities.*
- *State agencies spent over $8 million on research related to child and family welfare, to assess unmet needs and to explore options for reform. But some of that research has been disregarded, and many of the findings have not been publicly released or presented to the legislature.*
- *State and county officials have spent hundreds of thousands of dollars on consultants, staff time and travel to meet, explore options, debate reforms, champion legislation, defeat legislation and lament the lack of progress. But these actions have not yielded the direction or leadership that would give anyone confidence that real reform is underway.*

All of this is on top of the billions that taxpayers have spent to serve children in foster care over the last three years. The 2002-03 budget for foster care services is $2.2 billion. Yet despite this enormous price tag, we continue to fail these children. In many cases the system fails to meet formal standards of care. In some extreme but intolerable cases, the level of care is no better than the abusive homes from which those children were rescued.

During the last three years:

- *An additional 100,000 children have experienced abuse or neglect that is so severe as to warrant their removal from their homes.*
- *An estimated 25 percent of the children in foster care have not received timely medical care and 50 percent have not received appropriate mental health services.*
- *While the failure of the educational system to meet the needs of these children is well documented, officials have not even agreed on who is in charge of this issue,*
- *Unemployment rates for emancipated youth are still estimated at 50 percent.*
- *Most appalling, an estimated 2,800 children have emancipated from the foster care system only to become homeless.*
- *Los Angeles County alone has spent over $12 million to address lawsuits involving children who were neglected, harmed or killed while in foster care.*[1]

A Contrast to California's Failed Foster Care System: State of Kansas — Competitive Contracting

In 1996-97, Kansas became the first state in the nation to fully privatize its adoption, foster care, and family preservation services.

Kansas's Department of Social and Rehabilitation Services (SRS), previously the state's largest provider of adoption and foster care services, now is strictly a purchaser of services and contract monitor with respect to child welfare services.

In all three areas — family preservation, foster care, and adoption — the private contractors are paid a one-time, lump-sum rate per child. As with managed health care plans, the rate is "capitated." Previously, providers were paid on a fee-for-service basis. This provided little incentive to move a child quickly out of foster care, because the contractor would be out the monthly state payments for that child. The result was "foster care drift": kids floated through the system because there were no structural incentives to move them out of it.

In contrast, each contractor's fiscal soundness will now be linked directly to preventing such drift. For example, Lutheran Social Services, the lead adoption agency in a 13-agency private consortium, receives $13,500 for each child. Out of the $13,500 lump-sum payment, the agency must pay for foster care and counseling services for as long as the child remains in foster care. Thus, if the agency fails to place the child in less than one year, it will lose money. If the new adoptive home fails, the consortium must place her again—but with no additional state money.

All the contracts also are outcome-based. For adoption, the contractor must meet five key outcome measures in order to have the contract renewed. One is shortening the length of time between foster care and adoption. Previously, the state was placing only one-fourth of the children in homes within six months of being freed for adoption. State officials want the private consortium to increase this rate to 70 percent within 180 days and 90 percent within a year.

While a major challenge, the non-profits are confident that over time they will vastly improve on the state's performance. "In the future, the kids who need to be adopted will be younger, will have spent less time in out-of-home care and will have fewer problems as a result," Joan Wagnon, the director of Kansas Families for Kids, told the Kansas City Star.

Early results are encouraging. Inquiries from potential adoptive parents have tripled in five months while the number of adoptions has risen by one-third.

In the first seven months of the family preservation privatization, 91 percent of families served have remained intact, meaning that children did not require an out-of-home placement. This is substantially higher than the 80 percent outcome goal.

In addition, since privatizing its child welfare services, Kansas has seen a 44 percent increase in adoptions finalized; private contractors have met or exceeded outcome goals related to child safety, minimizing placement moves, keeping siblings together, and keeping children near their home community; and contractors have exceeded goals for longevity of placements.

Virginia Rodman, a consultant with Lutheran Social Services, is convinced privatization represents the future of foster care and adoption in America. "The national trend is certainly in the direction of privatization," says Rodman. "It may be different models than in Kansas but some kind of privatization is definitely coming to child welfare."

Part 9

Adopt a Biennial Budget and Limit Constitutional Revenue and Spending

"The total annual appropriations subject to limitation of the State and of each local government shall not exceed the appropriations limit of the entity of government for the prior year adjusted for the change in the cost of living and the change in population, except as otherwise provided in this article."

– California Constitution, Article XIII-B, "Government Spending Limitation," Sec. 1.

Summary of Citizen Budget Recommendations in This Section:
1. Adopt a **Biennial Budget** (2-Year Budget) where state budget is approved in year one and oversight of state government occurs in year two.
2. Adopt a **Constitutional Revenue Limit (Taxpayer Bill of Rights)** that holds increases in state revenue growth to population and inflation increases.
3. Restore a **Modified Gann Spending Limit** that allows for carry-over reserve.
4. Adopt a **Balanced Budget Trigger** that automatically makes proportional spending reductions to discretionary programs should revenue forecasts not match actual revenue collections.

In Governor Davis's 2003 State of the State Address, he stated that he would not entertain any budget that does not contain "substantial structural reform." Unfortunately, other than calling for reform, the Governor did little to propose specific steps the state could take to prevent this crisis from happening again.

As a result, the first step in addressing the state's short-term and Long-term spending challenges is to enact a biennial budget and create real Constitutional revenue and spending limits. Both of these reforms

California Budget FACTS:



$87 Billion

Reserve Surplus today had California adopted Gann-like spending limit with Spending Ratchet method

$93.9 Billion

Surplus today had California adopted 10-year moving average Revenue-based limit with Growth Freeze method

$151.4 Billion

Surplus today had California adopted population plus California CPI (inflation) spending limit with Growth Freeze method

$166.4 Billion

Surplus today had California adopted population plus California CPI spending limit with Spending Ratchet method

enacted together can provide much-needed discipline to ensure California does not find itself victim to the same scenario of inflated revenue forecasts and over-spending. Moreover, it provides an impetus for the legislature to improve its oversight of state government, while limiting the growth of government.

Moving to a Biennial Budget

Biennial budgeting is the adoption of a two-year budget rather than a one-year budget. Currently, 23 states already have a biennial budget cycle, and one more is considering it.[141] Given the complexity of the federal government's budget process, there have been numerous suggestions over the years that the federal government move to a biennial budget.

The U.S. General Accounting Office surveyed of a number of states to discover the benefits and problems of switching budget cycles. According to the survey, switching from an annual cycle to a biennial cycle afforded states the following benefits:

- More time is available in the off-year for review of program issues through effective legislative oversight; and
- Biennial budgeting requires departments and programs to consider the long-range implications of their budget requests and their program operations.[142]

Opponents of biennial budgeting note that it is sometimes hard to forecast revenues for one year, let alone doing it for two years. While biennial budget spending and revenue forecasts are necessarily less reliable for the second year of the budget cycle, off-year corrections can be made easily. In addition, should the state follow the next recommendation and adopt a revenue limit, the need for 100 percent precision in revenue forecasts will not be as great. In the end, expanding the time horizon of the budget cycle forces legislators to place greater emphasis on planning and performance evaluation, leading to more sound budget priorities and financial management.

For the short term, adopting a biennial budget allows for California to address today's fiscal crisis in a way that requires less drastic cuts. Indeed, a biennial budget for the next two years would allow time for cost savings measures to be implemented as well as provide time for the economy to recover—resulting in greater revenues.

Adopting Real Constitutional Revenue and Spending Limits

Many states have attempted to curtail spending (or, more accurately, spending *growth*) with mixed success. In fact, 45 states currently maintain some sort of spending limit, combined with rainy day funds. The effectiveness of the spending restraints and the size of the rainy day funds vary greatly, however.[143]

In fact, California has a rich history of its own in reining in tax rates and state spending. In 1978, Californians passed Proposition 13. The measure amended the state's constitution to cap property taxes at 1 percent of fair market value and prohibit valuations from growing more than 2 percent per annum unless the property was sold, effectively reducing property taxes by 57 percent. Proposition 13 did not affect the state's power to spend, however, and the government's response was predictable: raise taxes from other sources. According to Michael New of the Cato Institute, "in the years following the passage of Proposition 13, California raised the income tax, the sales tax, and taxes on beer, wine, and cigarettes."[144]

Californians followed up Proposition 13 with Proposition 4 in 1979. Proposition 4, commonly known as the Gann limit, established a state appropriations limit (SAL) that grows each year based on population and cost-of-living factors. Any tax proceeds that exceed the SAL limit over a two-year period are to be refunded to taxpayers in the form of tax rebates.[145]

Unfortunately, in 1990, the Gann limit was effectively gutted with the passage of Proposition 111. Proposition 111 altered how the Gann limit is calculated, adding K-12 public school enrollment rates in the population formula to correct a school funding inequity. Locals were provided the option of using California per capita personal income growth or the percentage of local assessed value attributable to non-residential new construction. It based cost-of-living adjustments solely on per capita income growth to recognize state economic growth and directed half of the excess revenues to be returned to taxpayers and half to go to schools. It also exempted certain state expenditures from the limit such as responding to natural disasters, "qualified" capital outlay projects (defined by the legislature) and projects funded by the gas tax and other fees. Finally, it declared the Gann limit refund would be triggered only if tax proceeds are in excess in two consecutive fiscal years.[146]

In addition, since the SAL has grown each year, even as the economic downturn has caused tax revenues and state spending to fall, the limit is presently so high that it is nowhere near binding on the state. The Legislative Analyst's Office reports that appropriations subject to the SAL will fall $14.5 billion short of the limit in FY 2001-02 and $6.3 billion below the limit in FY 2002-03.[147] In fact, the SAL has only resulted in one tax rebate, when tax revenues surged roughly 20 percent in 1987, resulting in $1.1 billion in rebates. The last time the limit was exceeded was FY 1999-00, by $702 million, although state appropriations fell well below the limit the following year and thus did not trigger a rebate due to the two-year surplus requirement.



"It's very reasonable to think that population increase and inflation should be your basis for increasing the budget. And during boom years, obviously you are going to have a surplus, (and) that surplus should not be touched, but should be put aside for rainy days."

– Esmael Adibi, author of Chapman University's semiannual economic forecast

An Alternate Solution: Colorado's Taxpayer Bill of Rights (The TABOR Model)

One of the most successful checks on government spending has been the Taxpayer Bill of Rights (TABOR), adopted by Colorado taxpayers in 1992. Although TABOR is often referred to as a spending limit, it is actually a limit on the *revenues* the state may collect, and thus serves as a *de facto* spending limit. (Although, given recent spending behavior by those in Sacramento, almost anything is possible in California!)

What It is and How It Works

TABOR caps the growth in state tax revenues at the combined growth rates of inflation and population. Any amount collected above this limit must be returned to the taxpayers through refunds, temporary tax credits, or any other "reasonable means." The state exceeded the revenue limit for the first time in FY 1997-98, and has exceeded it every year thereafter. Since 1997, Colorado has reduced taxes more

than any other state in the nation, returning over $3.2 billion to taxpayers.[148] While other states have been grappling with their financial woes, Colorado enjoyed a balanced budget and still managed to issue $927 million in tax refunds in fiscal 2001.

Increases above the tax revenue limit may only be obtained by approval of the voters in a referendum, giving the system a degree of flexibility. Since TABOR's inception, several such referenda have been offered to the voters. The only ones to pass thus far are Amendment 23, which allows for over $300 million per year to be exempted from the limit for increased public school funding, and Referendum A, which directed $44 million from the TABOR surplus toward property tax relief for qualified seniors. Both measures passed in the 2000 election.

In addition to the TABOR revenue limit, Colorado does have a spending limit as well. The Arveschoug-Bird limit, put in place in 1991, restricts General Fund appropriations growth to 6 percent per annum. Exceptions are made for federal mandates, court orders, Medicaid over-expenditures, and transfers to the state's Capital Construction Fund. According to State Treasurer Mike Coffman, "if the state collects tax revenues that exceed the Arveschoug-Bird limit but that are less than the total TABOR revenue limit … that money is normally spent on transportation and capital construction projects."[149]

Although the "6 percent limit" was merely a statute, a specific provision of TABOR prohibits the state (and local governments) from weakening any spending limitations that existed at the time of TABOR's inception, including Arveschoug-Bird. Thus, the 6 percent limit has become "constitutionalized."

Benefits of TABOR

There can be no denying the success of TABOR and its impact on the Colorado economy. In the words of University of Colorado economics professor Dr. Barry Poulson, "Colorado has achieved unprecedented growth over the past decade due to a favorable business climate."[150] By helping to keeping tax rates low and stable, TABOR has allowed taxpayers and business owners to invest more of their earnings into the economy, spurring further growth. Colorado's favorable business climate and economic growth are evidenced by the following:

- Colorado's 60 percent growth in per capita disposable income growth during the 1990s ranked first among all states.[151]
- During this period, Colorado's population grew an average of 2.3 percent per year—the third highest growth rate in the nation. The number of full-time jobs increased 43 percent, from 1,655,000 jobs in 1990 to 2,363,000 jobs in 2000. What is more, most of the jobs created during the economic expansion were not for low-skilled work, but rather for relatively high-paying positions.[152]
- Between 1995 and 2000, Colorado's 51 percent growth in gross state product was the second fastest in the nation.[153]

In addition, TABOR has made the budgeting process more transparent. This has allowed taxpayers to become more informed and have a stronger and more direct say as to what their tax dollars are buying. If taxpayers feel legislators are not adequately funding the programs that truly need funding, they can agree to set aside a special allotment for that purpose through the referendum process.
Since under the TABOR system, any funds for such a program will be taken from revenues collected over the limit—revenues that would otherwise be returned to the taxpayers—taxpayers can make the funding priority decisions that legislators are unable, or unwilling, to make. The crucial point is that, under TABOR,

excess tax collections are rightly recognized as property of the taxpayers, not the legislators. This implies that, when deciding whether or not spending (and thus, taxes) should be increased to pay for programs not covered under the TABOR limits, Colorado taxpayers can more easily factor in the costs of programs, and not simply focus on the benefits heralded by legislators or special interest groups, since the money to pay for such programs will be coming from their own tax refunds. Without such a check on the power of the purse, taxpayers might just as well kiss their tax dollars goodbye, knowing that they will all be spent, regardless of whether or not the state collected too much money in the first place.

In case the above benefits are not evidence enough of TABOR's success, its growing reputation as a model for other states should serve as proof. If, indeed, "imitation is the sincerest flattery," then TABOR has much to be proud of. Last year, State Representative Russell Pearce introduced a TABOR proposal for Arizona and Senator Curtis Person of Tennessee announced plans to sponsor a Tennessee Taxpayer Bill of Rights (TN TABOR), both built on the Colorado model.

Some Refinements Are Necessary

Despite its many attractive features, however, TABOR is not flawless. The main drawback is that Colorado lacks an effective "rainy-day fund" to resort to in times of economic hardship. While the state does maintain very limited emergency reserve funds, "it does not currently have a device in place to smooth government revenues and expenditures over the business cycle," according to Professor Poulson.[154] This is not so much a criticism of TABOR itself as it is the tax collection system as a whole, but it nonetheless deserves comment.

TABOR may be able to limit the amount that the state can collect, and thus spend, but it cannot prevent legislators from spending the maximum amount of tax dollars from the General Fund and dipping into reserves not subject to the TABOR limit. Thus, while the pot may be smaller to begin with, lack of fiscal discipline will still cause it to be depleted, leaving little or nothing in reserve for use in the event of an emergency. Indeed, this has proven to be the case in Colorado. In the words of State Treasurer Mike Coffman, "The problem is a legislature that spends to its legal limits in good times and is reluctant to set aside any of that money for the tough ones. What we need to do is ensure a balance that restrains government growth in prosperous times and permits the state to meet the needs of its citizens when times get tough."[155] To that end, Coffman has proposed the creation of a rainy-day fund.

In addition to the lack of a rainy-day fund, TABOR has been weakened by the practice of pre-spending the surplus. In 1998, legislation passed that allowed the state to recognize the TABOR surplus obligation in the year after the money is realized instead of in the year in which revenue comes in the door. Thus, the surplus is treated as an asset in the year it occurs and a liability the subsequent year. According to the Colorado Office of State Planning and Budgeting:

> *Beginning in 1998, the state did not restrict the TABOR surplus revenue in the year it occurred. Rather the legislature, through House Bill 98-1414, obligated the TABOR refund from the next year's revenues. This pre-spending of the TABOR revenues in FY 1998-99 allowed $468.3 million in spending for capital construction and highways. If the TABOR surplus had been restricted in the year it was realized, only $287 million would have been available for capital and highway expenditures in FY 1998-99.*[156]

This raises a potential cash flow problem if the TABOR surplus is less than that of the preceding year or if an economic downturn causes revenues to come in under projections. In addition, permanent tax relief in the full amount of the surplus is now much more difficult, as the prior year's TABOR surplus must be incurred in the current year. If a similar measure is to be employed in California, efforts must be made to avoid these dilutive effects and the accounting gimmicks that the legislature is so adept at using.

Alternate Models to TABOR

The TABOR model is certainly not the only means of addressing California's spending problem. Several types of spending limits have been proposed. Some of the most common include the following:

- **Gann-like.** Modeled after California's Gann limit, this measure would establish a spending limit equal to the combined growth in population and per capita personal income.
- **Revenue-based.** This method would prohibit spending from increasing more than the 10-year moving average increase in revenues, thus preventing spending splurges during short-term economic booms.
- **ACA 6.** This approach would limit spending increases to the growth in population plus the growth in the California Consumer Price Index (inflation). This proposal is similar to the Colorado TABOR model, but focuses on the spending side of the equation instead of the revenue side.

A recent analysis modeled how the above spending limits would have affected the state's fiscal situation, had they gone into effect in FY 1990-91, using historical data and Governor's Budget spending and revenue numbers.[157] Table 11 illustrates both General Fund and total budget spending, and denotes the cumulative deposits made into the rainy-day fund for each alternative. In addition, each option was analyzed using three different methods of spending limit implementation:

- **Continuous Accrual.** This approach allows spending limits to grow each year, even when actual spending falls below the limit.
- **Spending Ratchet.** This technique focuses on actual spending instead of prior spending limits by re-setting the base year at the previous year's spending level. Thus, spending limits can be reduced and, once reduced, must grow from the lower base level.
- **Growth Freeze.** This method is a combination of the two previous methods. It allows the spending limit to grow when actual spending for the previous year is restrained by the limit, but freezes the limit at the previous year's level during years in which spending falls short of the limit.

The analysis concluded that, had the above plans been put into effect beginning in FY 1990-91, all of them except for the revenue-based continuous accrual option would have resulted in significant rainy-day fund balances.[158] Moreover, these rainy-day funds would have been more than enough to balance the budget today *without tax increases or spending cuts*.

The analysis also noted that if the spending limits were allowed to accrue continuously, each would have resulted in significantly higher spending limits for 2003-04 than those proposed by the Governor's Budget, both for general funds and total funds. The spending ratchet and growth freeze methods would have resulted in much lower spending limits than proposed by the Governor's Budget. For all three methods, the revenue-based formula would have produced the highest spending limit and the ACA 6 option the lowest.[159]

Structuring California's Revenue and Spending Limits

While almost any serious revenue and spending limit would be helpful, the Citizens' Budget Plan proposes California adopt the following:

- **TABOR Revenue Limit:** California desperately needs a revenue-limit to serve as a de-facto discipline on spending, as well as on taxes.
- **Tax Rebate/Revenue Reserve Fund**: Critics of TABOR point out that should the state spend exactly to the revenue limit each year, it might be possible that a year of falling revenue would produce a deficit. As a result, we propose to modify TABOR to keep a running balance of up to 30 percent of the revenue over-collection accumulated during the previous five-year cycle. As a result, a maximum of 70 percent of over-collected revenues could be automatically rebated to the taxpayer, while provisions would be made for the retention of over-collections to meet the 30 percent reserve.
- **Restore Gann Limit, with Spending Ratchet**: California should restore its Gann spending limit and adopt the spending ratchet formula for setting the spending limit each year. While it is unlikely that Sacramento will resist spending right up to the Gann limit, a restored Gann limit along with the revenue limit outlined above will impose the right mix of restraint on Sacramento's ability to overspend.
- **"Balanced Budget Trigger":** California should adopt an Automatic Spending Reconciliation in Biennial Year Two—thus providing another way to correct for any intentional or accidental inflation of revenues. The "trigger" would adjust discretionary spending levels to achieve a balanced budget based on a program's proportion in the budget. This would make balancing the budget automatic and shield politicians from making the hard votes of reducing spending on popular programs. Now, should the legislature actually want to craft its own package of reductions and take a formal vote, it certainly could. However, to ensure gridlock doesn't prevent the balancing of the budget, an automatic "trigger" would be necessary.

Table 11: Comparison of Three Options for Spending Limits ($ in Millions)

	Continuous Accrual		Growth Freeze		Spending Ratchet	
	General Fund $	Total $	General Fund $	Total $	General Fund $	Total $
Option 1, Gann-like (Population and Per Capita Personal Income)						
▪ Spending	71,874	91,834	66,851	86,186	63,882	87,044
▪ Rainy-day Fund	11,242	59,682	57,148	109,011	83,906	98,968
Option 2, Revenue-based (10-year Moving Average Revenue Increase)						
▪ Spending	82,399	113,230	67,891	91,061	66,105	93,552
▪ Rainy-day Fund	(57,911)	(92,770)	64,857	93,899	85,372	76,398
Option 3, ACA 4 (Population and California CPI)						
▪ Spending	67,698	86,499	60,404	80,142	57,409	78,224
▪ Rainy-day Fund	38,911	92,036	108,842	151,421	134,395	166,433
For Comparison, the Governor's Budget Proposes:						
▪ General Fund Spending	$62,769 million					
▪ General Fund Reserve	$531 million					
▪ Total State Spending	$96,437 million					

Source: California State Senate Republican Caucus, "Options for Spending Limits and Rainy-Day Funds," January 15, 2003.

Part 10

Stabilize Revenues by Creating the Most Jobs-friendly State in the Nation

"[Since March 2001,] when the downturn began, California has lost a net 370,000 private-sector jobs. That's 75 percent of the loss in the early 1990s recession, regarded by many economists as the worst in the state since the Depression."

– David Friedman, Los Angeles Times*, March 9. 2003*

Summary of Citizen Budget Recommendations in This Section:

1. **Resist Tax or Fee Increases** which would only worsen the state's economic condition.
2. **Reform Workers Compensation System** that has robbed the state of billions in revenue and increased the cost of creating jobs in California.
3. Create **Regulatory Review and Innovation Commission** a cross department body that would systematically review regulations for their cost-effectiveness and negotiate and enforce **"Performance Incentive Agreements"** with businesses to achieve regulatory results without high regulatory costs.

California Budget FACTS:



-489,000

The number of jobs lost from *high-wage, high-skills* industries in California since March 2001.

-370,000

The number of jobs lost in all private sector industries since March 2001.

+125,000

The number of government employees (mostly new teachers) added since March 2001.

As noted in the introduction to the Citizens' Budget, a budget should provide a vision for how California will make investments and create conditions necessary for a better quality of life. One of the major elements of a quality of life is a growing economy, where anyone who wants a job can get a job. Focusing on creating jobs also solves the state's need for increased resources—not through tax rate increases—but by expanding the tax base. As more Californians get more jobs and higher paying jobs, the state will naturally see an increase in revenues collected. Finally, a strong economy will allow for lower expenditures on social safety net programs, as individuals become more self-sufficient they will rely less on government aid. Indeed, the best safety net is a good job and a strong economy.

As a result, California needs a balanced approach to addressing both the short-term and Long-term fiscal challenges of the state. This balance must include fiscal responsibility, as discussed in other sections of this report, and stabilizing revenues with an ambitious agenda of removing impediments to greater economic

growth. While most of the recommendations contained in the Citizens' Budget focus on improving spending controls, changes also need to be made that will create conditions for stable revenue.



One of the most important ways to secure a better quality of life is a growing economy, where anyone who wants a job can get a job.

Economic Growth, Not Higher Taxes, Grows Revenue

A steadily growing economy provides steady revenue to the state, while an economy subject to the whims of state spending, taxation, and regulations is doomed to provide cyclical or erratic revenue. Nowhere is that more true than with taxes. Taxes that cover needed provision of infrastructure, protection of property, and investment in education improve the productivity of the state economy. But beyond that point, especially as taxes focus on redistribution and trying to mold people's behavior, numerous studies suggest that taxes lower the rate of economic growth.[160]

Lessons From the Early 1990s

There is a growing and convincing body of evidence that reveals the deleterious effects of tax increases on job creation, population growth, personal income growth, bond ratings, and even state tax revenues. A study by the Federal Reserve Bank of Atlanta that analyzed state economic performance from 1960 to 1992 concluded that "relative marginal tax rates have a statistically significant negative relationship with relative state growth" and advised: "if [a state's] Long-term growth rates seem too low relative to other states, lowering aggregate state and local marginal tax rates is likely to have a positive effect on Long-term growth rates."[161] Or, as simply stated by another study, "When states reduce their aggregate and marginal tax burdens, they improve their economic performance."[162] Indeed, a Joint Economic Committee report found that when states lowered their taxes by 1 percent, personal income rose 3.6 percent.[163]

During the recession of the early 1990s nearly half the states raised taxes to try to increase revenues and avoid budget cuts, and those states tended to have the most persistent budget woes and the slowest economic recoveries.[164] Meanwhile, those that reacted to the recession by cutting income taxes had double the population growth, nearly three times the job growth, and about 25 percent faster income growth than the states that raised tax rates.[165]

The best example from the early 1990s recession is the "Michigan Miracle." Then-Governor John Engler made substantial spending cuts and a series of tax cuts. In part, due to taking those tough measures, Michigan's economy boomed. Unemployment fell and per capita incomes rose from 2.9 percent below the national average to 2.8 percent above the national average by 1995.[166]

In contrast, then-Governor Pete Wilson and the legislature enacted a $7 billion tax increase—the largest in history for any state—in California in 1990. The parallels to Governor Davis's plan are frightening. Compare Governor Wilson's $7 billion tax increase to Governor Davis's proposed $8.3 billion increase in taxes and fees. In 1990, Governor Wilson and the legislature raised taxes on the top income bracket from 9.5 percent to 11 percent. Governor Davis proposes to raise taxes on top income earners from 9.3 percent to 10 percent or 11 percent through the addition of two tax brackets.



"At least half of the nation's governors (Republicans and Democrats alike) believe they can tax their way back to prosperity. Recent history suggests otherwise. Governors attempted to enact 'soak the rich' tax hikes in the early 1990s only to see their states plunge into even deeper pools of red ink and endure further economic contraction."

– Steve Moore, American Legislative Exchange Council

According to a report by the American Legislative Exchange Council, the 1990 tax increase

> *…was noteworthy because* it failed to raise any new revenue while sinking the state deeper into recession. *The already ailing economy continued to decline; from 1990 to 1993 the state lost 350,000 jobs. In 1995 the tax hike was repealed, and over the next four years the state gained more than 200,000 jobs and the unemployment rate fell sharply.*[167] *[emphasis added]*

Hopefully, California will not make the same mistake again.

Certainly, tax increases are no way to deal with a budget crisis. In testimony given before the U.S. Senate Finance Committee earlier this year, Cato Institute Director of Fiscal Policy Chris Edwards advised:

> *Current state budget woes are not the result of revenue shortfalls, but of spending excesses built up during the 1990s. The solution for states should fit the problem: State spending should be frozen or cut.*[168]

Similarly, an American Legislative Exchange Council report concluded:

> *At least half of the nation's governors (Republicans and Democrats alike) believe they can tax their way back to prosperity. Recent history suggests otherwise. Governors attempted to enact 'soak the rich' tax hikes in the early 1990s only to see their states plunge into even deeper pools of red ink and endure further economic contraction.*[169]

California, and other states in similar financial straits for that matter, should heed the counsel of Mr. Edwards and ALEC and focus on reducing both spending and the tax burden if they are to return to strong economic growth and financial stability.

California's Situation: A Job-killing State

California already suffers from high taxation. California ranked 44th among the 50 states in terms of economic freedom.[170] The state's worst scores were from high taxes as a percent of personal income, relatively high taxes on low-income residents, and high special taxes and fees such as on utilities, gasoline, tobacco, and alcohol. A recent *Los Angeles Times* article noted that California ranks near the top of states in terms of state and local taxes and that personal income taxes especially are among the highest in the nation.[171] In fact, California had the sixth highest per-capita tax collections in the 50 states for fiscal year 2001.[172] In addition, an economic model analysis estimates that the sales and income tax increases proposed by Governor Davis and Democrats in the legislature will destroy 590,000 California jobs over three years and shrink the capital stock by 1.2 percent," which leads to our next point.[173]

The state's business climate is also hostile to jobs creation. In 1998, the Department of Finance, in its 1996-97 Single Audit Report astutely noted:

> *Maintaining California's growth cannot be taken for granted. California's success depends on the individual decisions of investors and households who find the state an attractive place to live, work, build new businesses, and expand existing ones. They have been encouraged by decisions of the Governor and the legislature that have promoted a positive business climate while taking care to improve the environment, rebuild highways, enhance the quality of public schools, and find new ways to replace the commands of regulation with the market forces of competition.*[174]

That was then, this is now.

Not long ago, California was still considered a pretty good place to do business. Sadly, things have changed for the worse. A survey of 287 top business executives saw their rating of California's business climate fall from second best in 1999 to worst in the nation in 2002.[175] More than half of the executives flagged California as the worst business climate in the nation, while only one-third chose New York as the second worst. The report's author said that it "revives the state's reputation as a job-killer gained in the recession of the early '90s."[176] In addition, the California Business Roundtable/California Chamber of Commerce 12th Annual Business Climate Survey found that "California businesses have been hit hard by recent events and the economic downturn. With 67 percent of California business leaders agreeing that business conditions in California have worsened—a startling jump of 39 percent since the 2000 survey—we have to be worried about keeping jobs and companies in our state."

Such business perceptions are substantiated by the facts. There are already at least 20 major U.S. markets where it is cheaper for corporations to locate than in California's cheapest major market—San Diego.[177] California's other major markets are even more costly corporate locations. Julie Meier Wright, head of the San Diego Regional Economic Development Council cautions that, with further tax increases, "we could see the early 1990s all over again, when there was an exodus from the state."[178]

Immediate Action Needed to Create Better Jobs Climate

Instead of reversing this perilous situation—and in sharp contrast to conclusions drawn from years of economic data outlined above—Governor Davis's budget plan proposes a broad range of tax and fee increases. What is worse, after only three months of the legislature being in office, over 70 bills have been introduced to raise taxes or impose fees in California. If enacted, these proposal would only aggravate an already difficult job and business climate through several billion dollars worth of additional tax and fee increases. (See Appendix A for a list of job-killing proposals.)

Governor Davis's budget plan also includes spurious plans to stimulate job growth via increasing the government workforce. In his State of the State Address, Governor Davis announced a goal of "creating" 500,000 jobs over the next four years—125,000 jobs per year, but his own Finance Department predicts that even before his proposals, baseline job growth would be about 220,000 jobs per year. In other words, the Governor proposes to LOWER the state's goal for job creation by almost half! That's not setting a high standard. What's worse, "creating" *government* jobs does not add to the economy—every dollar the state pays someone it must first take from someone. Davis's proposal is not about economic growth, but

government growth. That's not hard—and has nothing to do with creating a jobs-friendly state. While reducing tax burden during this fiscal crisis might be difficult, three recommendations should be considered:

1. **Do *not* raise taxes and fees.** The energy being spent on devising increases in sales taxes, Internet sales taxes, sin taxes, raising fees, and other desperate measures to raise revenue would be better spent finding ways to manage spending and devising ways to create the conditions for economic growth.

2. **Create a Regulatory Review and Innovation Commission (RRIC).** During the Wilson Administration, a "Red Team" was created to streamline and expedite regulation compliance and permit applications. This provided some degree of flexibility on the part of the state and served to enhance service to businesses, which in turn, enhanced services to consumers. Colorado, Virginia, Pennsylvania and other states have also used systematic reviews of existing legislation and regulations to improve their business climate and job growth. California should return to this model and establish a Regulatory Review and Innovation Commission to conduct a thorough but streamlined nonpolitical economic and technical analysis and identify existing laws and regulations that are outdated or no longer worthwhile.[179]

   Most importantly, the state should allow the RRIC to negotiate "Performance Incentive Agreements" with interested industries or individual businesses where alternatives to command-and-control regulation (such as self-audit, ISO standards, etc.) could be used in lieu of state regulations but *only if the outcome result intended by the regulation is achieved.* This option would recognize that one-size regulations do not fit all businesses and the market can sometimes (when incentivized) come up with better, more cost-efficient ways to comply than government.

3. **Revisit reform of workers' compensation insurance.** California's workers' compensation costs are already very high. Premiums have increased 80 percent since 1999 and some firms are now refusing to provide coverage in California. Legislation signed last year will increase workers' compensation insurance costs for California businesses by more than $3 billion per year. The law increases employee benefits and is scheduled to cost employers $600 million this year, $1.7 billion next year and $3.2 billion in fiscal year 2006-07.[180] This law should be repealed and more serious workers' compensation reforms undertaken. Workplace safety is best promoted by well-functioning workers' compensation markets where rates closely reflect expected claim costs, and thus loss control decisions, by employers, employees, and insurers. Price and service competition among insurers is the best method of achieving a close alignment between rates and expected claim costs, and thus strong incentives for efficient loss control.[181]

About the Authors

Carl DeMaio is the founder and president of The Performance Institute—a private think tank dedicated to reforming government programs through the principles of performance, transparency, competition and accountability. Under his leadership the Institute has grown to be the largest government reform think tank in the nation-leading thought on public administration at federal, state and local levels of government and training over 10,000 elected and career government officials each year in the principles of performance-based management.

Mr. DeMaio is a national authority on government reform, government budgeting and appropriations, performance management, competitive sourcing, government contracting, civil service reform, and policy development. He has pioneered numerous management methodologies in each of these areas that are being widely used throughout government. His advice and counsel has been sought by federal, state and local government leaders (both elected and career) seeking to redesign the operations, reorient the workforce, and improve the performance of their agencies.

He is the author of numerous reports, articles and papers on government reform, including a Transition Report for President Bush that generated many of the ideas for the President's Management Agenda (PMA). His efforts at the federal level focus primarily on identifying, analyzing and promoting "best practices" being generated under the PMA in each agency.

Mr. DeMaio is also a senior fellow for government redesign at the Reason Foundation. He holds a degree in international politics from Georgetown University and received his certification in strategic planning and organizational change management from O.D. Resources, Inc.

Adrian T. Moore is Executive Director of Reason Public Policy Institute. He is author of many studies and articles on government management, and he is co-author of *Curb Rights: A Foundation for Free-Enterprise in Public Transit,* published in 1997 by the Brookings Institution Press. He has a Ph.D. in economics from the University of California (Irvine).

Vincent Badolato is the director of research at The Performance Institute and a research associate at the Reason Foundation. Mr. Badolato oversees Institute research and survey projects on a multitude of issues in the areas of government performance, contracting, information technology, regulatory, and workforce management. He also writes three monthly and bimonthly electronic newsletters: "Implementation Update on the President's Management Agenda," "State Management Innovations," and "City and County Management Innovations." He graduated with a degree in history from The George Washington University.

George Passantino is Director of Public Affairs for Reason Foundation. In this role, George is responsible for Reason’s efforts to convert cutting-edge policy ideas into workable, real-world policy change through direct interaction with public officials and staff, key stakeholder organizations, and allied groups.

Geoffrey F. Segal is the director of privatization and government reform at Reason Foundation. He is also a research fellow at the Davenport Institute at Pepperdine University's School of Public Policy. Mr. Segal has authored numerous studies and articles on governance, privatization, government performance and efficiency, and infrastructure policy issues. His articles have appeared in publications as diverse as Public Administration Times, LA Daily News, Intellectual Ammunition, and Investor's Business Daily. Segal holds a Masters in Public Policy from Pepperdine University with specializations in Economics and Regional/Local Government. While at Pepperdine, Segal was named a Hansen Scholar. He graduated cum laude from Arizona State University with a Bachelor of Arts in Political Science.

Lisa Snell directs the Education Program at Reason Foundation, where she oversees research on child welfare and education issues. Her most recent policy studies include: *Child Welfare Reform and the Role of Privatization; School Vouchers as a Legal Sanction; Workplace Charter Schools: Florida Blazes the Trail; Remedial Education Reform: Private Alternatives to Traditional Title I Private Options to Help Students Read*; and *Innovative School Facility Partnerships: Downtown, Airport, and Retail Space.*

Adam B. Summers is a visiting policy analyst at RPPI. He has a Master of Arts degree in Economics from George Mason University and Bachelor of Arts degrees in Economics and Political Science from the University of California, Los Angeles.

Appendix A

Tax and Fee Increases

Appendix : Tax and Fee Increases	
AB 94	Circumvents Proposition 13 by allowing a local agency to impose a higher property tax rate to make payments in support of public employee pension programs. Estimates suggest the bill will cost California taxpayers $1 billion.
AB 151	Imposes a mitigation fee for anyone who purchases, or causes the purchase of, electricity from Mexico.
AB 216	Imposes a $100 million new tax on beer manufacturers, distilled spirits manufacturers, beer importers, and distilled spirits importers.
AB 553	Imposes sales tax at point of sale on concrete sales.
AB 602	Imposes a tax of 10 cents on all munitions to finance a Trauma Center Fund.
AB 651	Limits the use of the Manufacturer's Investment Credit to only those who participate in the Career Technical Education Campaign, which is created to encourage in-kind donations of career technical education.
AB 848	Increases personal income taxes by imposing an additional tax in the amount of the federal tax allowance for expensing of SUVs.
AB 854	Requires the state board to impose a $3 fee on every person that purchases a gallon of perchloroethylene in the state, and to deposit the revenues generated by that fee in the Nontoxic Dry Cleaning Incentive Trust Account
AB 880	States the intent of the legislature to enact a program to impose an excise tax on temporary employment agencies for the "privilege of employing temporary workers."
AB 992	Imposes a tax of 10 cents on all munitions to finance a Trauma Center Fund.
AB 1412	Authorizes certain cities to increase their sales tax by 0.25 percent or 0.5 percent upon approval by the voters in those cities.
AB 1500	Enacts the Petroleum Pollution Cleanup and Prevention Act of 2003, which would require the operator of every refinery to pay a $1 fee for each barrel of crude oil received at a refinery within the state.
AB 1546	Authorizes the City/County Association of Governments of San Mateo County to impose an annual fee of up to $4 on vehicles registered within the County for a program for the management of traffic congestion and storm water pollution within that county.
ABX 4	Provides for the tripling of the car tax.
AB 16	Limits by half the existing cap on allowable mortgage interest deductions.
ACA 4	Reduces the voting threshold to pass a local parcel tax from 2/3 of the voters to 55 percent.
ACA 7	Reduces the voting threshold to pass a local transportation tax from 2/3 of the voters to 55 percent of the voters.

Appendix : Tax and Fee Increases	
ACA 9	Reduces the voting threshold to pass a local special tax from 2/3 of the voters to 55 percent.
SB 2	Requires California employers to provide health insurance to all employees and their dependents or pay a tax.
SB 17	Increases corporate property taxes by as much as $1 billion.
SB 103	Establishes nexus for certain out-of-state retailers for collection of sales taxes on Internet purchases.
SB 108	Imposes a "nickel per drink" tax on any wholesaler who distributes alcoholic beverages to retailers.
SB 400	Extends sales taxes to "specialized services."
SB 433	Declares intent of the legislature to impose a tax on retailers of cigarette and tobacco products.
SB 516	Limits the use of "S corporation" status to only those corporations with less than $20,000,000 in total gross receipts for the taxable year, thereby increasing taxes.
SB 533	Mill tax bill. Amount is still undefined.
SB 557	Establishes a timber products user forest restoration fee on timber products sold for consumption in California.
SB 676	Imposes a new fee, to be determined by the State Department of Health Services on tobacco product manufacturers.
SB 819	Increases business taxes by limiting the tax deduction some companies may take for CEO compensation.
SB 921	Establishes a single government-run health insurance plan to be funded by a payroll tax on all employers, employees, the self-employed and recipients of unearned income, plus taxes on tobacco and alcohol.
SB 981	Enacts the Children's Health and Petroleum Pollution Remediation Act of 2003 and a $0.30 fee for each barrel of crude oil received at a refinery.
SB 1005	Requires the department to levy a fee on health facilities in order to ensure an adequate level of licensing and certification staff to perform inspections, as required by this bill.
SBX 3	Increases business property taxes by as much as $1 billion by imposing a new split roll.
SBX 5	Imposes a "nickel per drink" tax on any wholesaler who distributes alcoholic beverages to retailers.
SBX 6	Imposes additional and significant fees, with *no cap*, for air pollution permits and expands the entities that are required to be permitted.
Minimum Wage Increases	
AB 1053	Existing law provides that employees are to be paid at least a minimum wage. This bill would express the legislature's intent to address the accountability of tax credits.
AB 1093	Enacts the California Living Wage Act, which would require the state, and any employer that contracts with the state pursuant to provisions governing state procurement to pay a living wage ($10 with health benefits; $12 without) to its employees.
SB 57	Increases the hourly minimum wage on January 1, 2004, and annually thereafter, to maintain employee purchasing power (tied to the federal Consumer Price Index).
Employment Law	
AB 196	Expands the prohibition on sexual discrimination to cover not just gender but "gender identity."
AB 274	Creates a rebuttable presumption that an adverse employment action taken within 90 days after an employee exercises his or her employment rights is retaliatory.
AB 276	Doubles the penalties for certain Labor Code violations.
AB 330	Provides a special labor exemption for *unionized* employees with a *valid* collective bargaining agreement in the wholesale baking industry.

Appendix : Tax and Fee Increases	
AB 331	Provides for the payment of unemployment compensation benefits during the period that a person is unemployed, provided the person has been unemployed for a period of one week. Existing law provides that this waiting period may be waived during a state of war emergency or state of emergency. This bill would waive the one-week waiting period for any individual who is unemployed due to a lockout related to a labor dispute.
AB 572	Provides that if an employee is discharged or otherwise discriminated against within 90 days of filing a complaint, there is a rebuttable presumption that the action was retaliatory.
AB 1133	Double fines every six months for unpaid wage claims, following a judgment.
AB 1721	Provides that when an employer has violated the wage and hour laws of the state, the Labor Commissioner shall also require the employer to post a notice describing the violation and declaring that the employer will not violate the wage and hour laws of the state in the future.
SB 75	Requires the ALRB to compile a list of all labor organizations that have not obtained a collective bargaining agreement with an employer of the agricultural employees represented by the labor organization and to post the list on the board's Web site.
SB 179	Holds those who contract for construction, farm labor, garment, janitorial, or security guard services liable if that person should know that the contract does not provide funds sufficient to allow the labor contractor to comply with all applicable labor laws. Creates a rebuttable presumption in favor of the employer only if a collective bargaining agreement has been agreed to.
SB 573	Creates a program which mandates that the Labor Commissioner notify the FTB and other taxing agencies of employers with labor code violations so that they can perform tax audits on them.
Workers' Compensation Expansion, Health Insurance and Unemployment Tax Increases	
AB 372	Imposes a fee on health plans to fund poison control centers, further increasing the high cost of medical care.
AB 438	Mandates osteoporosis screening on all health plans, further increasing the cost of health care in California.
AB 456	Increases the amount of mandatory auto insurance that must be obtained by individuals and businesses.
AB 968	Increases the cost of workers' compensation by mandating that adverse effects of bioterrorism preventive measures are compensable.
AB 1324	Increases the cost of workers' compensation by allowing the dependents of injured workers, who are infected with an infectious disease from an injured worker to receive compensation. Creates a significant and potentially costly precedent.
SB 191	Significantly lowers the threshold for triggering a part-time employee to be eligible to receive unemployment insurance.
Increasing Legal Liability	
AB 447	More than doubles the amount of attorney's fees that may be recovered in a mechanics lien suit.
SB 796	Allows aggrieved employees, rather than governmental entities on employees' behalf (current law), to bring civil actions to recover penalties from Labor Code violations. In addition, the aggrieved employee would be authorized to recover attorney's fees and costs.
SB 917	Prohibits a director of a corporation from performing his or her duties at the expense of the environment, human rights, the public health and safety, the communities in which the corporation operates, or the dignity of the corporation's employees. The bill would, on and after January 1, 2017, make a corporation and, under certain conditions, a director liable for damages caused by a violation of these provisions. The bill would, on and after January 1, 2017, authorize the Attorney General to bring an action to enjoin a violation of these provisions or to pursue a civil penalty.
Regulatory Mandates	

Appendix : Tax and Fee Increases	
AB 623	Prohibits the dumping of or "exposing" any individual to hazardous materials in the course of doing business, without regard to whether it was accidental.
AB 830	Requires every gas station in this state to provide a public restroom.
AB 844	Requires the state to adopt fuel efficiency standards for replacement tires.
AB 1256	Establishes a modified version of rent control and by allowing a local jurisdiction to control the rental rates of a dwelling or unit older than 25 years.
AB 1309	Expands eminent domain law to include any property necessary to replace existing residential or commercial development displaced by school construction.
SB 50	Expresses the intent to establish a regulatory structure on bottled water products and mandate new fees.
SB 444	Declares intent of the legislature to implement provisions of Kyoto Accord.
SB 532	Expands CEQA to include "cumulative effects."
SB 810	Expands the mandates of the Z'berg-Nejedly Forest Practice Act to include any surface water or groundwater source.

Note: List compiled by Senator Chuck Poochigian's Office

Appendix B

A Menu of Possible Reductions in Budget Line-Items

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
Agricultural Labor Relations Board	7300	Agricultural Labor Relations Board	4,765,000			715,000	715,000	Integrate into Division of Labor Relations
Assessments	6110-123-0001	California Achievement Test-6 (CAT-6)			10,000,000		10,000,000	(LAO) Recommend legislature reduce emphasis on norm-referenced tests by requiring school districts to administer the CAT-6 only in grades 4 and 8 instead of grades 2 through 11, and reduce funding by $10 million.
Assessments	6110-123-0001	Primary Language Assessment			1,600,000		1,600,000	(LAO) Recommend legislature reduce the primary language test requirement to be consistent with the state's emphasis on English language development and reduce funding by $1.6 million.
Assessments	6110-295-0001	Physical Performance Test			1,100,000		1,100,000	(LAO) Recommend legislature make the physical fitness test optional for grades 5, 7, and 9, and reduce funding of $1.1 million.
Assessments	6610-123-0001	Golden State Exams			5,900,000		5,900,000	(LAO) Recommend legislature reduce the Golden State Exams to reduce duplicative testing at the high school level and reduce funding by $5.9 million.
Board of Corrections	5430	Board of Corrections	132,058,000	19,809,000			19,809,000	Division of Corrections
Board of Pilot Commissioners for the Bays of San Francisco, San Pablo and Suisun	8530	Board of Pilot Commissioners for the Bays of San Francisco, San Pablo and Suisun			1,203,000		1,203,000	Reduce fuding for the board. The board's functions focus is on a very small region of the state, are not necessary for the operation of the state, and can be adequately performed through MOU arrangements with other federal, state and local government entities.
Board of Prison Terms	5440	Board of Prison Terms	28,813,000	4,322,000			4,322,000	Division of Corrections
CA Consumer Power and Conservation Financing Authority	8665	CA Consumer Power and Conservation Financing Authority	228,383,000			34,257,000	34,257,000	Integrate into Public Utilities Commission
CA Gambling Control Commission	855	CA Gambling Control Commission	5,498,000			825,000	825,000	Integrate into CA Lottery Commission (new Division of Gaming)
California Alternate Energy and Advanced Transportation Financing Authority	971	California Alternate Energy and Advanced Transportation Financing Authority	177,000		177,000		177,000	Suspend program funding. Relevance and priorities requires suspension for this budget cycle
California Arts Council	8260	California Arts Council	13,566,000		6,783,000		6,783,000	Suspend 50 percent of program funding. Relevance and priorities requires suspension for this budget cycle
California Children and Families Commission	4250	California Children and Families Commission	571,986,000		285,993,000		285,993,000	Eliminate this commission as programs are duplicative (child care is handled by HHS, child literacy is handled by the public schools), and realign 50 percent of commission funding to these programs better suited to provide services to children
California Community Colleges	6870	Part-Time Faculty Compensation			50,800,000		50,800,000	(LAO) Reduce Part-Time Faculty Compensation funding. This program increases part-time faculty salaries with no demonstrated linkage to improved student outcomes.
California Community Colleges	6870	Part Time Faculty Office Hours			3,900,000		3,900,000	(LAO) Reduce Part Time Faculty Office Hours funding. Office hours can be negotiated as part of collective bargaining, without categorical funding.
California Community Colleges	6870	Partnership for Excellence Program	164,500,000		164,500,000		164,500,000	(LAO) Terminate Partnership for Excellence program. Program is due to sunset at end of 2004 calendar year. Has shown little evidence of progress in reaching performance targets.
California Community	6870-301-	Contra Costa Community			700,000		700,000	(LAO) Recommend the legislature delete $716,000 for

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
Colleges	6028 (13)	College District (CCD), Los Medanos College: Math, Science and Technology						development of preliminary plans for the Math and Science Building at Los Mandanos College and recognize zero future costs.
California Community Colleges	6870-301-6028 (31)	Long Beach CCD, Long Beach City College: Industrial Technology Center, Manufacturing			698,000		698,000	(LAO) Recommend the legislature delete $698,000 for development of preliminary plans and working drawings for the Industrial Technology Center, Phase I, at Long Beach City College and recognize zero future costs.
California Community Colleges	6870-301-6028 (32)	Los Angeles CCD, East Los Angeles College: Fine and Performing Arts Center			15,882,000		15,882,000	(LAO) Recommend the legislature delete $15,882,000 for development of preliminary plans, working drawings, construction and equipment for the Fine and Performing Arts Center at East Los Angeles College.
California Community Colleges	6870-301-6028 (33)	Los Angeles CCD, Los Angeles Harbor College: Applied Technology Building.			613,000		613,000	(LAO) Recommend the legislature delete $613,000 for development of preliminary plans and working drawings for the Applied Technology Building at Los Angeles Harbor College and recognize zero future costs.
California Conservation Corps	3340	California Conservation Corps	73,980,000			11,097,000	11,097,000	Integrate into Division of Lands and Forests
California Debt and Investment Advisory Commission	956	California Debt and Investment Advisory Commission	1,995,000		598,500		598,500	Suspend municipal education program / continuing education programs in the public debt and investment areas, as well as research and publications not directly related to the state of California's public debt and finances.
California Gambling Control Commission	855	Special Distribution Fund			88,000,000		88,000,000	(LAO) Recommend legislature use available $88 million in the Special Distribution Fund for programs, currently funded from General Fund, that address the impact of gambling on communities
California Health and Human Services Agency Data Center	4130-25	Operations	117,566,000	35,269,800	750,000	8,817,450	44,837,250	Operations is a commercial activity that should be competitively sourced for savings; integrate into centralized data processing center for entire state; prioritize and reduce data sets to achieve additional $750,000 target of savings
California Horse Racing Board	8550	California Horse Racing Board	6,525,000			979,000	979,000	Integrate into CA Lottery Commission (new Division of Gaming)
California Industrial Development Financing Advisory Commission	965	California Industrial Development Financing Advisory Commission	521,000		521,000		521,000	Suspend program funding. Relevance and priorities requires suspension for this budget cycle
California Integrated Waste Management Board	3910	California Integrated Waste Management Board	115,478,000	25,077,324	16,500,000		41,577,324	Maintain regulatory functions; competitively source permitting and inspection functions; suspend research (leave this to the universities and the private sector), education programs, and public awareness/advocacy programs.
California Medical Assistance Program	4260-101-0001	County Eligibility Determinations			41,300,000		41,300,000	(LAO) Reject proposed augmentation for county administration because the budget has not demonstrated that county failure to complete annual redeterminations is the result of inadequate funding. Recommend adoption of the budget proposal to implement performance standards for the counties. Recommend the legislature go further and adopt workload or productivity standards for county eligibility workers and tie the level of funding to that individual county's performance in meeting the new standards.
California Medical Assistance Program	4260-101-0890	County Eligibility Determinations			41,300,000		41,300,000	(LAO) Reject proposed augmentation for county administration because the budget has not demonstrated that county failure to complete annual redeterminations is the result of inadequate funding. Recommend adoption of the budget proposal to implement performance standards for the counties. Recommend the legislature go further and adopt workload or productivity standards for county eligibility workers and tie the level of funding to that individual county's performance in meeting the new standards.
California State Library	6120	California State Library	61,151,000	18,345,300			18,345,300	Certain library functions are commercial activities that should be competitively sourced for savings
California State Summer School for the Arts	6255	California State Summer School for the Arts	1,623,000		1,623,000		1,623,000	Suspend program funding. Relevance and priorities require suspension for this budget cycle
California State University	6610	Institutional Aid Programs	51,100,000		51,100,000		51,100,000	(LAO) Suspend General Fund support for institutional aid programs. Substantial growth in state Cal Grant programs has weakened justification for separate institutional aid programs.
California State University	6610-001-0001	Higher Education Enrollment	66,200,000		66,200,000		66,200,000	(LAO) Recommend legislature suspend funding in the budget for enrollment growth at the California State University because proposed growth rates significantly exceed demographic projections.
California State University	6610-001-	Precollegiate Courses			10,000,000		10,000,000	(LAO) Recommend legislature fund CSU's precollegiate

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
	0001							writing and mathematics courses at the same rate it funds credit courses at the community colleges.
California State University	6610-04	Academic Support	489,194,000	146,758,200			146,758,200	Academic support functions are commercial activities that should be competitively sourced for savings
California State University	6610-7	Operation and Maintenance of Plant	374,011,000	112,203,300			112,203,300	Operation and maintenance functions are commercial activities that should be competitively sourced for savings
California Tahoe Conservancy	3125	California Tahoe Conservancy	15,609,000			2,341,000	2,341,000	Integrate into Division of Lands and Forests
California Transportation Commission	2600	California Transportation Commission	77,353,000			11,603,000	11,603,000	Integrate into Division of Transportation
California Victim Compensation and Government Claims Board	8700-12	Quality Assurance and Revenue Recovery Division	8,310,000	2,493,000			2,493,000	Functions of this division are commercial activities that should be competitively sourced for savings
California Victim Compensation and Government Claims Board	8700-21	Disaster Relief Claim Program	19,000		19,000		19,000	Reduce program funding. This program "allows reimbursement to claimants for personal injury and property damage as a result of a natural or environmental disaster." This is the function of private insurance, not government.
Child Welfare Services	5180-151-0001	Projected Caseload Decline			11,000,000		11,000,000	(LAO) Recommend that the proposed expenditures for the CWS program be reduced by $11 million in General Funds because the budget does not reflect savings from its projected caseload declines.
Colorado River Board of California	3460	Colorado River Board of California	1,067,000			160,000	160,000	Integrate into Division of Water Resources
Commisison on Teacher Credentialing	6360-10.10	Certification, Assignment and Waivers	10,080,000		10,080,000		10,080,000	Relevance and priorities require the suspension of this program for this budget cycle
Commission on Teacher Credentialing	6360-10.20	Professional Services	51,941,000	15,582,300		5,194,100	20,776,400	Professional service functions are commercial activities that should be competitively sourced for savings; integrate into Dept. of Education
Commission on Aging	4180	Commission on Aging	644,000		322,000		322,000	The commission is duplicative of the department of Aging. Eliminate this commission and reallocate 50 percent of funding to the department
Commission on State Mandates	8885	Commission on State Mandates	1,302,000			195,000	195,000	Integrate into Department of Finance
Commission on the Status of Women	8820	Commission on the Status of Women	445,000		445,000		445,000	Reduce funding for the commission, request all relevant government programs factor in special needs for women into their services.
Corrections	5240	Prison Terms	15,000,000		15,000,000		15,000,000	(LAO) Remove prison as an option for persons convicted of petty theft with a prior. "Petty theft with a prior" is currently prosecuted as either a misdemeanor or a felony. This proposal would require the crime to be prosecuted as a misdemeanor, thereby reducing admissions to state prison in the budget year and beyond.
Corrections	5240-21	Institutional Programs	3,859,270,000	1,157,781,000			1,157,781,000	Using other states experiences as a model, institutional programs are commercial activities that should be competitively sourced for savings
Corrections	5240-22	Health Care	886,909,000	266,072,700	6,500,000		272,572,700	Using other states' experiences, health care is a commercial activity that should be competitively sourced for savings; prioritize and reduce health services for two year period
Corrections	5240-61.12.027	San Quentin Death Row	220,000,000		220,000,000		220,000,000	Suspend construction on this prison until better budget environment
Delta Protection Commission	3840	Delta Protection Commission	307,000		307,000		307,000	Duplicative of the California Bay-Delta Authority, eliminate funding for the commission. Land-use planning under this commission is "implemented by local governments, through local land use planning procedures and enforcement" and thus should not be a state function.
Department of Aging	Reduce 4170, Increase 5180	Aging Programs	3,400,000		908,000		908,000	(LAO) Recommend eliminating the Department of Aging and shifting all of its functions to the Department of Social Services. This consolidation results in a net savings of 37 positions and $3,420,000 ($908,000 General Fund).
Department of Alcohol and Drug Programs	4200	Asset Forfeiture Proceeds			10,000,000		10,000,000	(LAO) Redirect state and federal asset forfeiture proceeds. This option would use part of the proceeds taken from illegal narcotics traffickers to help pay for substance abuse treatment programs.
Department of Alcohol and Drug Programs	4200	Department of Alcohol and Drug Programs	483,144,000			72,472,000	72,472,000	Integrate into Division of Mental Health and Substance Abuse
Department of Boating and Waterways	3680-30	Beach Erosion Control	1,290,000		1,290,000		1,290,000	Relevance and priorities require the suspension of this program for this budget cycle, replace with local

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
								investment
Department of Boating and Waterways	3680-50	Capital Outlay	13,655,000	4,096,500			4,096,500	Capital outlay functions are commercial activities that should be competitively sourced for savings
Department of Child Support Services	5175	Local Administration			26,400,000		26,400,000	(LAO) Suspend half of child support program initiatives for two years. The initiatives that have been established over the last two years are not part of the core collections program.
Department of Conservation	3480	Department of Conservation	541,138,000			81,171,000	81,171,000	Integrate into Division of Lands and Forests
Department of Conservation	3480-50	Beverage Container Recycler and Litter Reduction Program	499,945,000		499,945,000		499,945,000	Relevance and priorities require the suspension of this program for this budget cycle
Department of Corrections	5240-001-0001	Elderly Inmates Parole	9,000,000		9,000,000		9,000,000	(LAO) Given the high cost of housing *nonviolent* elderly inmates, and research showing the high rates of parole success among older inmates, we recommend the legislature release *nonviolent* inmates over 55 years of age to parole. In addition to saving approximately $9 million in the budget year, this would reduce prison health care costs, and reduce prison overcrowding, thereby increasing the level of safety in California prisons.
Department of Developmental Services	4300	Regional Centers			97,100,000		97,100,000	(LAO) Establish annual expenditure limits for regional centers for selected services. This option would establish limits for the maximum allowable units of specific types of services regional centers are allowed to purchase for clients thereby slowing the rapid rate of growth in this program. Regional centers would have to reduce the amount of services provided to clients in order to implement this option.
Department of Developmental Services	4300	Regional Centers			48,800,000		48,800,000	(LAO) Draw down federal funding for regional center services provided residents in intermediate care facilities for the developmentally disabled (ICF-DDs). The state could draw down additional federal funds to offset the state costs of services provided to these residents by modifying the rate structure of the ICF-DDs and through other changes.
Department of Developmental Services	4300	Medicaid Waiver Enrollment Cap			49,500,000		49,500,000	(LAO) Assume higher Medicaid waiver enrollment cap. The state can obtain greater federal fund support for regional center services than is budgeted to the extent that federal authorities will allow additional clients to be included in a Medicaid waiver program.
Department of Developmental Services	4300	Early Start Program			59,100,000		59,100,000	(LAO) Shift General Fund spending for the Early Start program to Proposition 98 funds. This option would shift all of the state's General Fund cost of early intervention services to Proposition 98, thus permitting a net reduction in non-Proposition 98 General Fund expenditures.
Department of Fish and Game	3600-25	Hunting,Fishing, and Public Use Program	43,469,000	13,040,700			13,040,700	Functions of this program are commercial activity that should be competitively sourced for savings
Department of Fish and Game	3600-30	Management of Department Lands and Facilities	39,854,000	11,956,200			11,956,200	Management of this program is commercial activity that should be competitively sourced for savings
Department of Fish and Game	3600-40	Conservation, Education, and Enforcement	47,292,000	14,187,600			14,187,600	Management of this program is a commercial activity that should be competitively sourced for savings
Department of Food and Agriculture	8570-11	Agricultural Plant and Animal Health; Pest Prevention; Food and Safety Services	131,857,000		131,857,000		131,857,000	Suspend funding for these programs. The protection of the livestock industry against losses of animals by theft and straying, marketing of nursery stock, seed quality assurance, and phytosanitary certification are all part of the costs of doing business and should not be subsidized by the state.
Department of Food and Agriculture	8570-21	Marketing; Commodities and Agricultural Services	80,767,000		80,767,000		80,767,000	Suspend program funding. Private firms are responsible for their own marketing efforts and should not be subsidized by the state
Department of Food and Agriculture	8570-31	Assistance to Fairs and County Agricultural Activities	55,471,000		55,471,000		55,471,000	Relevance and priorities require the suspension of this program for this budget cycle
Department of Forestry and Fire Protection	3540-0001-0022	Computer Aided Dispatch (CAD) Proposal	2,600,000		2,600,000		2,600,000	(LAO) Recommend rejection of CAD proposal because funding the proposal from the State Emergency Telephone Number (911) Account is inconsistent with current law and changes the nature of the 911 surcharge.
Department of Forestry and Fire Protection	3540-001-0140	Resource Assessment			100,000		100,000	(LAO) Recommend expenditure reductions for nonessential activities.
Department of Forestry and Fire Protection	3540-11.4	Cooperative Fire Protection	164,954,000	49,486,200			49,486,200	Functions of this program are commercial activities that should be competitively sourced for savings
Department of Forestry and Fire Protection	3540-11.6	Conservation Camps	69,618,000		69,618,000		69,618,000	Relevance and priorities require the suspension of this program for this budget cycle

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
Department of Forestry and Fire Protection	3540-11.8	Emergency Fire Suppression	79,000,000	23,700,000			23,700,000	Functions of this program are commercial activities that should be competitively sourced for savings
Department of Health Services	4260	Medi-Cal			30,100,000		30,100,000	(LAO) Impose a moratorium on new adult day health centers. This would temporarily slow the rapid growth that has been occurring in the number of adult day health centers.
Department of Health Services	4260	Medi-Cal			76,200,000		76,200,000	(LAO) Rescind continuous eligibility for children. This option would disenroll children who are no longer eligible to receive Medi-Cal benefits. Administrative set-up would take three months and implementation would phase-in after that.
Department of Health Services	4260	Medi-Cal			7,600,000		7,600,000	(LAO) Exclude over-the-counter drugs from coverage. Coverage is not required by federal government and such an exclusion is similar to many private health coverage plans. This option would exclude analgesics and cough and cold medications.
Department of Health Services	4260	Medi-Cal			800,000		800,000	(LAO) Change default care to managed care for newly enrolled disabled persons. This option could help improve the coordination of care for disabled persons.
Department of Health Services	4260	Indian Health Program				4,000,000	4,000,000	(LAO) Move the Indian Health Program from DHS to MRMIB. Consolidating this program with similar programs would maintain overall funding at the current level by shifting support from General Fund to federal funds.
Department of Health Services	4260	Seasonal, Agricultural and Migratory Worker Program				5,000,000	5,000,000	(LAO) Move the Seasonal, Agricultural and Migratory Worker Program from DHS to MRMIB. Consolidating this program with similar programs would maintain overall funding at the current level by shifting support from General Fund to federal funds.
Department of Health Services	4260	Medi-Cal			250,000,000		250,000,000	(LAO) Screen for veterans who could receive VA health coverage. Federal survey data suggest that there could be more than 100,000 veterans on Medi-Cal (at a cost to the state of an estimated $250 million annually) who could be eligible instead for comprehensive health care from the Veterans Administration (VA). The state could verify this data to determine if actions are warranted to ensure they receive VA care, thereby reducing General Fund costs.
Department of Health Services	4260	Medi-Cal			39,600,000		39,600,000	(LAO) Establish a provider-specific fee to fund rate adjustments for Long-term care facilities. This proposal would impose a fee on nursing homes to draw down additional federal funds that would offset General Fund costs.
Department of Health Services	4260	California Children's Services Medical Therapy Program				37,000,000	37,000,000	(LAO) Shift financial responsibility for the California Children's Services Medical Therapy Program to Proposition 98. This option would shift all of the state's General Fund cost of these non-medical therapy services to Proposition 98, thus permitting a net reduction in non-Proposition 98 General Fund expenditures.
Department of Health Services	4260-10	Public and Environmental Health	976,700,000	293,010,000			293,010,000	Biomedical, bioenvironmental, and forensic alcohol and methadone drug analysis laboratory services are commercial activities and can be competitively sourced for savings. Also, cancer research can be conducted by universities and private sector
Department of Housing and Community Development	2240	Department of Housing and Community Development	16,619,000			2,493,000	2,493,000	Integrate into California Housing Finance Agency (new Division of Housing Services)
Department of Industrial Relations	7350-36	Committee on Health and Safety and Workers' Compensation	2,661,000			850,000	850,000	Revelance and priorities require a reduction in funding by $850,000 this budget cycle
Department of Industrial Relations	7350-60	Promotion, Development, and Administration of Apprenticeship and Other On-the-Job Training (Division of Apprenticeship Standards)	8,140,000		8,140,000		8,140,000	Suspend program funding. The program is duplicative of numerous job-training programs and its functions are the responsibility of the private sector. Note the 35 percent budget increase over two years, including a proposed 19 percent increase from 2002-03 to 2003-04.
Department of Industrial Relations	7350-70	Labor Force Research and Data Dissemination (Division of Labor Statistics and Research)	3,783,000	1,134,900			1,134,900	Functions of this program are commercial activities that should be competitively sourced for savings
Department of Insurance	845	Department of Insurance	169,058,000			25,359,000	25,359,000	Integrate prosecution functions into the Department of Justice and tax collection/audit functions into the new Division of Tax Collection

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
Department of Justice	0820-001-0001	Youth Authority Lawsuit Funding	4,300,000		4,300,000		4,300,000	(LAO) We recommend deletion of $4.3 million requested for the defense of the California Youth Authority's class action lawsuit because the parties will probably reach settlement, and adoption of budget bill language to allow the Department of Justice to submit a funding request in the event that settlement is not reached.
Department of Justice	820-12.01	Legal Support and Technology	41,837,000	12,551,100			12,551,100	Legal support and technology are commercial activities that should be competitively sourced for savings
Department of Managed Health Care	2400	Department of Managed Health Care	34,544,000			5,182,000	5,182,000	Integrate into Division of Physical Health Services
Department of Mental Health	4400	Department of Mental Health	2,318,758,000	695,627,400			695,627,400	Competitively source four state hospitals (Atascadero, Metropolitan, Napa, and Patton) and the Acute Psychiatry Program at the California Medical Facility in Vacaville. Move to fixed-price, performance-based contracting for all services
Department of Mental Health	4260-101-0001	Early and Periodic Screening, Diagnosis and Treatment Costs			11,700,000		11,700,000	(LAO) New Projection Method Increases Early and Periodic Screening, Diagnosis and Treatment Costs. While there is merit to the effort to more accurately budget the costs of these children's mental health services, we recommend funding adjustments at this time to correct for apparent overbudgeting for this program.
Department of Mental Health	4440-011-0001	Patient Caseload			14,100,000		14,100,000	(LAO) Given the disparity between the actual census count in the state hospitals and the caseload assumptions in the current budget, it is recommended that caseload funding be reduced at this time.
Department of Motor Vehicles	2740-11	Vehicle Identification and Compliance	384,223,000	115,266,900			115,266,900	Vehicle identification and compliance are commercial activities that should be competitively sourced for savings
Department of Motor Vehicles	2740-22	Driver Licensing and Personal IDing	172,071,000	51,621,300			51,621,300	Driver licensing and personal IDing are commercial activities that should be competitively sourced for savings
Department of Motor Vehicles	2740-25	Driver Safety	87,134,000	26,140,200			26,140,200	Driver safety functions are commercial activities that should be competitively sourced for savings
Department of Motor Vehicles	2740-32	Occupational Licensing and Investigative Services	36,791,000	11,037,300			11,037,300	Occupational Licensing and investigative services are commercial activities that should be competitively sourced for savings
Department of Parks and Recreation	3790-10	Facilities	114,010,000	34,203,000			34,203,000	Facility management is a commercial activity that should be competitively sourced for savings
Department of Parks and Recreation	3790-10	Public Safety	59,148,000	17,744,400			17,744,400	Public safety management is a commercial activity that should be competitively sourced for savings
Department of Parks and Recreation	3790-10	Recreation	38,433,000	11,529,900			11,529,900	Recreation management is a commercial activity that should be competitively sourced for savings
Department of Parks and Recreation	3790-10	Education/Interpretation	29,165,000		29,165,000		29,165,000	Relevance and priorities require the suspension of this program for this budget cycle
Department of Parks and Recreation	3790-301-6029	Statewide Acquisition Program			35,000,000		35,000,000	(LAO) Recommend deletion because the budget provides minimal information on (1) how the funding will be spent and (2) future costs associated with the acquisitions.
Department of Parks and Recreation	3790-301-6029 [22]	California Indian Museum			5,000,000		5,000,000	(LAO) Recommend deletion of $5 million for preliminary plans, working drawings, and construction for the California Indian Museum (CIM). The department already has $5 million to begin the development of the CIM, and the California Indian Cultural Center and Museum Task Force has yet to make recommendations on the site location and design of the CIM.
Department of Parks and Recreation	3790-301-6029 [9]	California Heritage Center Project	10,000,000		6,600,000		6,600,000	(LAO) Recommend the legislature approve $3.4 million of the proposed $10 million project to fund the acquisition of a site for the project and the development of a master plan to establish facility standards, project programming, and site plan.
Department of Pesticide Regulation	3930-12	Registration and Health Evaluation	15,558,000		15,558,000		15,558,000	Suspend program funding. The program is duplicative of the Department's Pest Management, Environmental Monitoring, Enforcement, and Licensing program. CalOSHA could also perform these functions.
Department of Rehabilitation	5160	Department of Rehabilitation	343,820,000			51,573,000	51,573,000	Integrate into Department of Developmental Services (new Division Of Rehabilitation and Developmental Services)
Department of Rehabilitation	5160-10	Vocational Rehabilitation Services	321,250,000	96,375,000			96,375,000	Vocational rehabilitation services are commercial activities that should be competitively sourced for savings
Department of Rehabilitation	5160-30	Support of Community Facilities	22,570,000	6,771,000			6,771,000	Support of community facilities is a commercial activity that should be competitively sourced for savings

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
Department of Social Services	5180	Child Welfare Services			20,800,000		20,800,000	(LAO) Cap total cost per caseworker (including administrative costs) at $135,000. Under this proposal, 11 high-cost counties would need to reduce their cost per caseworker.
Department of Social Services	5180	Child Welfare Services			7,500,000		7,500,000	(LAO) Reduce frequency of group home visits from monthly to quarterly. This option would still leave the frequency of home visits above the federal requirement which is semi-annual.
Department of Social Services	5180-101-0001	Adoptions Assistance Program (AAP)			4,600,000		4,600,000	(LAO) Recommend that proposed spending for the AAP be reduced by $2.6 million in General Funds for 2002-03 and $4.6 million in General Funds for 2003-04 because the caseload is overstated.
Department of Social Services	5180	Child Welfare Services			3,600,000		3,600,000	(LAO) Suspend emancipated foster youth stipend for two years. The emancipated foster youth stipend is not a core component of the foster care program.
Department of Social Services	5180	Foster Care			3,300,000		3,300,000	(LAO) Suspend supplemental clothing allowance for two years. The clothing allowance is not a core component of the foster care program.
Department of Social Services	5180	Community Care Licensing			3,200,000		3,200,000	(LAO) Remove FBI fingerprinting fee exemption for small licensed providers (caring for six children or less). This creates parity among large (non-fee exempt) and small (fee exempt) providers. The fee for FBI fingerprinting is $24 and there is an additional $16 live-scan fee.
Department of Social Services	5180-16.40	Foster Care	530,927,000	159,278,100			159,278,100	Certain foster care functions are commercial activities that should be competitively sourced for savings
Department of Social Services	5180-16.50	Adoption Assistance Program	214,396,000	64,318,800			64,318,800	Certain adoption assistance functions are commercial activities that should be competitively sourced for savings
Department of Social Services	5180-16.55	Refugee Cash Assistance	6,465,000		6,465,000		6,465,000	Relevance and priorities require the suspension of this program for this budget cycle
Department of Social Services	5180-25	Social Services and Licensing	4,600,462,000	1,380,138,600			1,380,138,600	Social service and licensing functions are commercial activities that should be competitively sourced for savings
Department of Social Services	5180-35.15	Disability Evaluation	204,407,000	61,322,100			61,322,100	Disability evaluations are commercial activities that should be competitively sourced for savings
Department of Social Services	5180-45	Energy Programs	95,202,000		95,202,000		95,202,000	Suspend funding for the programs. Utilities providers already offer reduced rates programs, making these programs unnecessary. If additional assistance is needed (for energy expenses or other purposes), it should simply be included in general welfare assistance programs, eliminating the need for a separate energy assistance program.
Department of Social Services	5180-101-0890	CalWORKs Program			100,000,000		100,000,000	(LAO) Recommend that proposed spending for California Work Opportunity and Responsibility to Kids (CalWORKs) grants be reduced by $250 million (federal Temporary Assistance for Needy Families [TANF] funds) in 2002-03 and $100 million in 2003-04 because the caseload is overstated.
Department of Social Services	5180-101-0890	CalWORKs Program			7,300,000		7,300,000	(LAO) Recommend a technical adjustment to reduce proposed expenditures for CalWORKs administration by $7.3 million (federal TANF funds) because the budget does not reflect the administrative savings from the Governor's proposal to reduce CalWORKs grant payments.
Department of the Youth Authority	5460-20	Institutions - Camps	315,728,000	94,718,400			94,718,400	Camp management is a commercial activity that should be competitively sourced for savings
Department of the Youth Authority	5460-30	Parole Services and Community Corrections	46,707,000	14,012,100			14,012,100	Youth parole services and community corrections are commercial activities that should be competitively sourced for savings
Department of the Youth Authority	5460-40	Education	50,024,000	15,007,200			15,007,200	Education management is a commercial activity that should be competitively sourced for savings
Department of Toxic Substances Control	3960-12	Site Mitigation	89,301,000	26,790,300			26,790,300	Toxic site mitigation is a commercial activity that should be competitively sourced for savings
Department of Toxic Substances Control	3960-20	Science, Pollution Prevention, and Technology	11,324,000		11,324,000		11,324,000	Suspend program funding. Such research activities can be performed by universitites and private sector researchers.
Department of Transportation	2660-10	Aeronautics	8,267,000		8,267,000		8,267,000	Relevance and priorities require the suspension of this program for this budget cycle
Department of Transportation	2660-20	Highway Transportation	5,581,621,000	1,674,486,300			1,674,486,300	Certain highway functions are commercial activities that should be competitively sourced for savings and converted to fixed-price, performance -based contracts
Department of Transportation	2660-60.10	Equipment Program	146,060,000	43,818,000			43,818,000	Certain equipment program functions are commercial activities that should be competitively sourced for

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
								savings
Department of Transportation	2740-35	New Motor Vehicle Board	1,708,000		1,708,000		1,708,000	Relevance and priorities require the suspension of this program for this budget cycle
Department of Veterans Affairs	8950	Yountville Veterans' Home			2,000,000		2,000,000	(LAO) Close acute care hospital at Yountville veterans' home. The state could close the underutilized acute care hospital at the Yountville veterans' home and provide care to veterans at a lower cost through facilities in the surrounding community.
Department of Veterans Affairs	8950-30	Care of Sick and Disabled Veterans	112,164,000	33,649,200			33,649,200	Competitively source Yountville, Barstow, and Chula Vista Veterans Homes
Department of Water Resources	3860-101-6031	Desalination Program	15,000,000		15,000,000		15,000,000	(LAO) Suspend funding for desalination grants in the budget year, pending legislative receipt and review of a specified report. Also, recommend the enactment of legislation to direct the department to develop, as part of the specified report, a plan for expenditure of Proposition 50 bond funds.
Department of Water Resources	3860-20.20	Design, Right of Way, and Construction of the State Water Resources Development System	41,619,000	12,485,700			12,485,700	Design and construction of the Water Resource Development System are commercial activities that should be competitively sourced for savings
Department of Water Resources	3860-20.30	Operation and Maintenance of the State Water Resources Development System	143,079,000	42,923,700			42,923,700	Operation and maintenance of the Water Resource Development System are commercial activities that should be competitively sourced for savings
Department of Water Resources	3860-40	Services	6,279,000	1,883,700			1,883,700	Certain water services are commercial activities that should be competitively sourced for savings
Departments of Social Services and Education	5180	Child Care			400,000,000		400,000,000	(LAO) On a one-time basis, replace state child care spending with federal Temporary Assistance for Needy Families block grant funds transferred to the Child Care and Development Fund block grant. If child care is realigned, as proposed by the budget, General Fund savings can be achieved by either (1) reducing the amount of revenues transferred to the counties with the state "recapturing" these revenues or (2) shifting other state program costs to counties. If child care is not realigned, the cost of maintaining current child care programs could be reduced by the $400 million proposed fund shift.
Dept of Boating and Waterways	3680-20	Boating Operations	16,726,000	5,017,800			5,017,800	Boating operations are commercial activities that should be competitively sourced for savings
Dept of Child Support Services	5175-30	Child Spport Services Program	1,164,360,000	349,308,000			349,308,000	Child support payment collection services and database management/IT services are commercial activities that should be competitively sourced for savings
Dept of Community Services	4700-40	Community Services	59,932,000	17,979,600	4,400,000		22,379,600	Certain community services are commercial activities that should be competitively sourced for savings. Note: 26 percent single-year increase in the budget from 2001-02 to 2002-03, compared with a 12 percent increase in staff. Suspend $4,400,000 from this budget to correct for this.
Dept of Consumer Affairs	1111	Bureaus (Licensing)	146,519,000	43,955,700			43,955,700	Licensing operations are commercial activities that should be competitively sourced for savings while the state oversees quality of licensing process
Dept of Developmental Services	4300-10	Community Services Program	2,558,318,000	767,495,400	100,000,000		867,495,400	Certain community services are commercial activities that should be competitively sourced for savings; $100,000,000 suspension can be supplemented by moving to a "one-stop" service model with affiliated programs at the local level
Dept of Developmental Services	4300-20	Developmental Services Program	668,913,000	200,673,900			200,673,900	Certain developmental services are commercial activities that should be competitively sourced for savings
Dept of Social Services	5180-16.85	Welfare Program - Automation Projects	280,890,000	84,267,000			84,267,000	Welfare automation projects are commercial activities that should be competitively sourced for savings, using Wisconsin as a model
DOT	2660-365	Historic Property Maintenance	1,521,000	456,300			456,300	Historical property maintenance is a commercial activity that should be competitively sourced for savings
Education - Prop. 98	6110	Staff Development Buyout Days	202,000,000		202,000,000		202,000,000	(LAO) Suspend funding for one year. One-time reduction would help preserve core services.
Education - Prop. 98	6110	Mathematics and Reading Professional Development Program	27,900,000		27,900,000		27,900,000	(LAO) Suspend funding. Short-term program would serve only 3 percent of core subject matter teachers in 2003-04. The State Board of Education has approved few training providers.
Education - Prop. 98	6110	Principal Training Program	28,700,000		28,700,000		28,700,000	(LAO) Suspend funding over next several years. The State Department of Education (SDE) can fund all existing commitments for 2003-04 using $15 million in

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
								2001-02 carryforward funds. This option would increase costs in 2004-05.
Education - Prop. 98	6110	Administrator Training and Evaluation Program	4,700,000		4,700,000		4,700,000	(LAO) Suspend funding. Program is outdated and is duplicative with the new Principal Training program.
Education - Prop. 98	6110	Peer Assistance and Review	76,600,000		76,600,000		76,600,000	(LAO) Suspend funding. No available evidence showing program effectiveness.
Education - Prop. 98	6110	Advanced Placement Challenge Grant Program	3,200,000		3,200,000		3,200,000	(LAO) Sunset one year early. Program would otherwise terminate at end of 2003-04.
Education - Prop. 98	6110	Teacher Recruitment Centers	8,300,000		8,300,000		8,300,000	(LAO) Suspend program funding. Various other entities recruit and assist aspiring teachers.
Education - Prop. 98	6110	Year Round Operations Grant Program			14,200,000		14,200,000	(LAO) Phase out over next two years. Program no longer meets original intent.
Education - Prop. 98	6110	Charter School Facilities Grant Program	2,300,000		2,300,000		2,300,000	(LAO) Suspend funding. Program no longer needed because Proposition 39 requires school districts to provide charter schools with sufficient facilities.
Education - Prop. 98	6110	K-3 Class Size Reduction			219,000,000		219,000,000	(LAO) Change student teacher ratio to 22 to 1 for schools with less than 50 percent free and reduced priced lunch eligible students. Schools with at least 50 percent free and reduced lunch eligible students continue at 20 to 1.
Education - Prop. 98	6110	College Preparation Partnership Program	4,800,000		4,800,000		4,800,000	(LAO) Suspend funding. Duplicative and more restrictive than the Academic Improvement and Achievement program (also administered by SDE).
Education - Prop. 98	6110	Local Arts Education Program	5,700,000		5,700,000		5,700,000	(LAO) Suspend funding. Program provides supplemental services that could be funded using other resources.
Education - Prop. 98	6110	Miller-Unruh Reading Program	25,500,000		25,500,000		25,500,000	(LAO) Suspend funding. Current funding distribution promotes historic inequities.
Education - Prop. 98	6110	School Improvement Program			85,800,000		85,800,000	(LAO) Reduce funds by 20 percent. Funds generally used for one-time purposes. These purposes could be delayed.
Education - Prop. 98	6110	Civic Education	300,000		300,000		300,000	(LAO) Suspend program. Program funds curriculum development by nonprofit entity that is duplicative of state efforts.
Education - Prop. 98	6110	County Offices of Education	22,300,000		22,300,000		22,300,000	(LAO) Suspend growth funding in county apportionments. County offices fund services similar to categorical programs, which would receive no growth funding in 2003-04.
Education - Prop. 98	6110	Elementary School Intensive Reading Program	26,900,000		26,900,000		26,900,000	(LAO) Suspend program. Services are duplicative of those provided through the existing supplemental instruction programs.
Education - Prop. 98	6110	At Risk Youth (Angel Gate Academy LAUSD	600,000		600,000		600,000	(LAO) Suspend funding. The federal Department of Defense provides $4 million in funding that covers a majority of the program's expenses.
Education - Prop. 98	6110	Intensive Algebra Instruction Academies	11,200,000		11,200,000		11,200,000	(LAO) Suspend program. Duplicative of services provided through existing supplemental instruction programs.
Education - Prop. 98	6110	Gifted and Talented Education (GATE)	49,800,000		49,800,000		49,800,000	(LAO) Suspend the program for one year. Targets extra resources at highest-achieving students. These students can be served within base resources.
Education - Prop. 98	6110	School Law Enforcement Partnership	13,100,000		13,100,000		13,100,000	(LAO) Suspend program. Program duplicative of services provided through the School Safety and Violence Prevention Grant Program.
Education - Prop. 98	6110	Statewide Education Technology Services	2,300,000		2,300,000		2,300,000	(LAO) Suspend program. Program services do not directly affect core classroom services.
Education - Prop. 98	6110	Gang Risk Intervention Program	2,900,000		2,900,000		2,900,000	(LAO) Suspend program. These services can be provided through existing safety programs.
Education - Prop. 98	6110	School Library Materials	20,400,000		20,400,000		20,400,000	(LAO) Suspend program for one year. Suspend this program because of one-time nature of expenses.
Education - Prop. 98	6110	Institute for Computer Technology			500,000		500,000	(LAO) Reduce state funding. This program receives a significant amount of foundation and grant funding.
Education - Prop. 98	6110	California Technology Assistance Project			1,300,000		1,300,000	(LAO) Reduce funding by 10 percent. Program does not directly affect students.
Education - Prop. 98	6110	Deferred Maintenance	181,000,000		181,000,000		181,000,000	(LAO) Suspend funding for one year. Existing law would continue to require that 3 percent of districts' unrestricted funds go to maintenance.
Education - Prop. 98	6110	9th Grade Class Size Reduction	97,000,000		97,000,000		97,000,000	(LAO) Suspend funding. Schools with greatest need less likely to use program because of lack of qualified teachers.
Education Audit Appeals Panel	6125	Education Audit Appeals Panel	1,500,000		1,500,000		1,500,000	Relevance and priorities require the suspension of this program for this budget cycle
Employee Development Department	7100-10	Employment and Employment-Related	207,981,000	62,394,300			62,394,300	Employment-related services are commercial activities that should be competitively sourced for savings

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
		Services						
Employee Development Department	7100-50	Employment Training Panel Program	67,583,000		67,583,000		67,583,000	Suspend program funding. The program is duplicative of other unemployment and job-training programs, particularly Workforce Investment Act (WIA). While performance-based contracting is a positive feature of the program, the program can be deemed unnecessary due to the existence of adequate alternatives in the private sector
Energy Resources Conservation and Development Commission	3360	Energy Resources Conservation and Development Commission	355,728,000		255,728,000		255,728,000	Suspend portion of funding for the commission. The commission's functions are duplicative of the Public Utilities Commission. In addition, it duplicates private sector activities such as research and development.
Environmental Protection Agency	3900	Environmental Protection Agency	1,260,000,000			189,000,000	189,000,000	Integrate into Resources Agency
Fair Employment and Housing Commission	1705	Fair Employment and Housing Commission	1,308,000		1,308,000		1,308,000	Suspend funding for the commission; duplicative of federal and court programs. If duplication of federal role is truly needed, the commission's functions are, and should be, performed by the courts.
Fair Political Practices Commission	8620	Fair Political Practices Commission	6,522,000			978,000	978,000	Integrate into Office of the Secretary of State
Food and Agriculture	8570	Pierce's Disease	6,400,000		6,400,000		6,400,000	(LAO) Suspend General Fund support for control of Pierce's Disease. Fees already support a portion of the program's costs. The General Fund costs could be shifted to fees as well.
General Services	1760	California Home Page	3,000,000	3,000,000			3,000,000	(LAO) Competitively sourcing the home page and make it self-sufficient. Other states have competitively sourced their home pages and cover costs through the collection of fees for online services (primarily for businesses).
Hastings College of the Law	6600-30	Law Library	3,060,000	918,000			918,000	Library functions are commercial activities that should be competitively sourced for savings
Hastings College of the Law	6600-55	Operation and Maintenance of Plant	1,804,000	541,200			541,200	Plant operation and maintenance are commercial activities that should be competitively sourced for savings
Health and Human Services Agency Data Center	4130-001-0632	Child Welfare Services/Case Management System (CWS/CMS) Maintenance and Operation	11,000,000		11,000,000		11,000,000	(LAO) Suspend request and direct HHSDC to submit a revised request that finances all proposed hardware.
Health and Human Services Agency Data Center	4130-001-0683	Equipment Proposal	4,700,000		4,700,000		4,700,000	(LAO) Recommend rejecting an equipment augmentation since the estimate is based on past workload growth trends. Direct Health and Human Services Agency Data Center (HHSDC) to report at hearings on actions it will take to reduce costs and rates. Direct HHSDC to report at hearings on status of requested rate study.
Health and Human Services Agency Data Center	4130-001-0683	Operational Recovery Proposal	1,200,000		1,200,000		1,200,000	(LAO) Recommend denying request since proposal is inconsistent with Feasibility Study Report and HHSDC did not examine all viable options.
High Speed Rail Authority	2660-30 (2665)	High Speed Rail Authority	2,581,000		2,581,000		2,581,000	Relevance and priorities require the suspension of this program indefinitely.
Housing and Community Development	2240	Regional Planning for Cities and Counties	2,000,000		2,000,000		2,000,000	(LAO) Recommend the elimination of the regional planning mandate for cities and counties since it provides broad discretion on effort and does not ensure compliance with state law. This would result in reduced state liabilities of approximately $2 million annually.
Housing and Community Development	2240	Regional Governments Mandate	700,000		700,000		700,000	(LAO) Recommend the suspension of the regional planning mandate for councils of government, pending the enactment of legislation to reform the housing element process. This would result in reduced liabilities of roughly $700,000.
Judges' Retirement System	0390-101-0001	Judges' Retirement System			10,000,000		10,000,000	(LAO) Recommend that the legislature reduce the appropriation for the Judges' Retirement System by $10 million to help address the General Fund shortfall but still leave an adequate reserve.
Legislature	100	Assembly - Printing	3,173,000	951,900			951,900	Printing is a commercial activity that should be competitively sourced for savings
Legislature	100	Assembly - Office Supplies	675,000	202,500			202,500	Pool purchases for savings; competitively bid management of this activity
Legislature	100	Senate - Printing	539,000	161,700			161,700	Printing is a commercial activity that should be competitively sourced for savings
Legislature	100	Assembly - Publications	283,000	42,450			42,450	Publication management is a commercial activity that should be competitively sourced for savings
Legislature	100	Senate - Office Supplies	198,000	59,400			59,400	Pool purchases for savings; competitively bid

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
								management of this activity
Legislature	100	Senate - Publications	160,000	48,000			48,000	Publication management is a commercial activity that should be competitively sourced for savings
Legislature	100	Assembly - Session Per Diem	2,496,000		2,496,000		2,496,000	Suspend per diem funding. Legislators already receive generous wage and benefits compensation.
Legislature	100	Assembly - Furniture and Equipment Expense	1,982,000		1,982,000		1,982,000	Suspend funding for furniture and equipment expenses. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Session Per Diem	1,320,000		1,320,000		1,320,000	Suspend per diem funding. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Furniture and Equipment Expense	837,000		837,000		837,000	Suspend funding for furniture and equipment expenses. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Automotive Expenses	802,000		802,000		802,000	Suspend funding for automotive expenses. Legislators already receive generous wage and benefits compensation.
Legislature	100	Assembly - Automotive Expenses	452,000		452,000		452,000	Suspend funding for automotive expenses. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Office Alterations	280,000		280,000		280,000	Suspend funding for office alterations. Legislators already receive generous wage and benefits compensation.
Legislature	100	Assembly - Office Alterations	230,000		230,000		230,000	Suspend funding for office alterations. Legislators already receive generous wage and benefits compensation.
Legislature	100	Assembly - Automotive Repairs	132,000		132,000		132,000	Suspend funding for automotive repairs. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Meals	128,000		128,000		128,000	Suspend funding for meals. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Automotive Repairs	120,000		120,000		120,000	Suspend funding for automotive repairs. Legislators already receive generous wage and benefits compensation.
Legislature	100	Assembly - Meals	98,000		98,000		98,000	Suspend funding for meals. Legislators already receive generous wage and benefits compensation.
Legislature	100	Assembly - Ceremonies and Events	43,000		43,000		43,000	Suspend funding for ceremonies and events. Legislators already receive generous wage and benefits compensation.
Legislature	100	Senate - Ceremonies and Events	35,000		35,000		35,000	Suspend funding for ceremonies and events. Legislators already receive generous wage and benefits compensation.
Legislature – Senate Printing Services	100	Legislature – Senate Printing Services	539,000			81,000	81,000	Integrate into legislature – Assembly Printing Services
Legislature – Senate Publications Services	100	Legislature – Senate Publications Services	160,000			24,000	24,000	Integrate into legislature – Assembly Publications Services
Little Hoover Commission	8780	Little Hoover Commission	900,000		900,000		900,000	(LAO) Suspend the Little Hoover Commission. The commission is a nonessential state operation.
Local Government	9210	High-Tech Law Enforcement Grants	18,500,000		18,500,000		18,500,000	(LAO) Suspend the High-Tech Law Enforcement Grants. This program provides grants to local law enforcement agencies for equipment. The statewide objective of this program is unclear. Law enforcement is largely a local function, and local funds can be used to purchase equipment if it is a local priority.
Local Government	9210	Rural County Law Enforcement Grants	18,500,000		18,500,000		18,500,000	(LAO) Suspend the Rural County Law Enforcement Grants. This program provides grants to rural county sheriffs for equipment. The statewide objective of this program is unclear. Law enforcement is largely a local function and local funds can be used to purchase equipment if it is a local priority.
Local Government	9210	Citizen's Options for Public Safety (COPS) Grant Program	116,300,000		116,300,000		116,300,000	(LAO) Suspend Citizen's Options for Public Safety (COPS) grant program. The COPS program provides grants to local law enforcement mostly for personnel and equipment. Given that COPS funding represents a small share of total local law enforcement expenditures, its impact on public safety, if any, is likely to be relatively small.
Local Government	9210	Juvenile Justice Grants Program	116,300,000		116,300,000		116,300,000	(LAO) Suspend the Juvenile Justice grants program for one year pending evaluation results. The Juvenile Justice grants provide funds to address service gaps in county juvenile justice systems. This proposal would suspend funding for one year pending completion of evaluations currently under-way. Suspension should not adversely affect the programs because grant recipients

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
								receive funding one year in advance of projected expenditures.
Managed Risk Medical Insurance Board	4280	Managed Risk Medical Insurance Board	972,350,000			145,853,000	145,853,000	Integrate into Division of Physical Health Services
Managed Risk Medical Insurance Board	4280-20	Access for Infants and Mothers (AIM) Program	117,488,000		117,488,000		117,488,000	Suspend program funding temporarily. Coverage for most recipients of this program is already provided for under Medi-Cal if their family incomes are up to 200 percent of the Federal Poverty Level (FPL). Extending this to include families with incomes up to 300 percent of the FPL is not sustainable in such a budget climate.
Memberships in Interstate Organizations	8800	Memberships in Interstate Organizations	931,000		931,000		931,000	Suspend funding for these organizations. The organizations are not essential to the operation of the state. Offer in-kind support instead.
Military Department	8940-50	California Cadet Corps	848,000		848,000		848,000	Suspend program fuding. Numerous non-profit and private organizations perform these functions and serve these goals. DOD programs can supplement for 2 years during suspension
Military Department	8940-65	California National Guard Youth Programs	11,889,000		11,889,000		11,889,000	Relevance and priorities require the suspension of this program for this budget cycle; DOD programs can supplement for 2 years during suspension
Office of Administrative Law	8910	Office of Administrative Law	2,000,000		2,000,000		2,000,000	(LAO) Suspend funding to the Office of Administrative Law. The office is a nonessential state operation.
Office of Administrative Law	8910	Office of Administrative Law	2,004,000			301,000	301,000	Integrate into Office of the Secretary of State
Office of Criminal Justice Planning	8100	Office of Criminal Justice Planning	253,866,000			38,080,000	38,080,000	Integrate Victims Services programs into HHS and other programs and administration into the Division of Corrections
Office of Environmental Health Hazard Assessment	3980	Office of Environmental Health Hazard Assessment	10,846,000			1,627,000	1,627,000	Integrate into Department of Toxic Substances (new DEHHC)
Office of Planning and Research	650	Office of Planning and Research	54,095,000		54,095,000		54,095,000	Suspend funding for the office. Volunteer activity should require no state funding
Office of Planning and Research	650-11	State Planning and Policy Development	5,395,000		5,395,000		5,395,000	Suspend land-use, growth planning, and California Environmental Quality Act functions, as these should be performed by the Environmental Protection Agency or the Resources Agency. If not, they should be incorporated into the aforementioned agencies.
Office of Statewide Health Planning and Development	4140-30	Healthcare Workforce	10,593,000		10,593,000		10,593,000	Suspend program funding. The program is duplicative of multiple job-training and student-aid programs.
Office of Statewide Health Planning and Development	4140-45	Cal-Mortgage Loan Insurance	4,241,000		4,241,000		4,241,000	Suspend program funding. Mortgage loans are readily available in the private sector, causing the program to be unnecessary
Office of Statewide Health Planning and Development	4140-60	Healthcare Information	9,550,000	2,865,000			2,865,000	Providing healthcare information is a commercial activity that should be competitively sourced for savings
Office of the Secretary for Education	558-20	Academic Volunteer and Mentor Service Program	5,017,000		5,017,000		5,017,000	Relevance and priorities require the suspension of this program for this budget cycle; school districts should best design and implement these programs
Office of the Secretary of State	0890-001-0228	Vacant Positions	200,000		200,000		200,000	(LAO) Recommend denying augmentation request since no workload data have been provided.
Office of the State Controller	0840-001-0001	Unclaimed Property Program			2,400,000		2,400,000	(LAO) Recommend the legislature adopt a processing fee to be charged on all approved claims sufficient to cover program administrative costs. This would result in additional General Fund savings of $2.4 million in the budget year and $4.8 million thereafter.
Proposition 50 Water-Related Proposals	3860-001-6031	Proposition 50 Water-Related Proposals			5,900,000		5,900,000	(LAO) Recommend deletion of bond funding for water-related activities because funding should be put in legislation that better defines the programs.
Proposition 50 Water-Related Proposals	3860-101-6031	Proposition 50 Water-Related Proposals			50,600,000		50,600,000	(LAO) Recommend deletion of bond funding for water-related activities because funding should be put in legislation that better defines the programs.
Proposition 50 Water-Related Proposals	3940-001-6031	Proposition 50 Water-Related Proposals			600,000		600,000	(LAO) Recommend deletion of bond funding for water-related activities because funding should be put in legislation that better defines the programs.
Proposition 50 Water-Related Proposals	3940-101-6031	Proposition 50 Water-Related Proposals			32,500,000		32,500,000	(LAO) Recommend deletion of bond funding for water-related activities because funding should be put in legislation that better defines the programs.
Proposition 50 Water-Related Proposals	4260-001-6031	Proposition 50 Water-Related Proposals			400,000		400,000	(LAO) Recommend deletion of bond funding for water-related activities because funding should be put in legislation that better defines the programs.
Proposition 50 Water-Related Proposals	4260-101-6031	Proposition 50 Water-Related Proposals			9,900,000		9,900,000	(LAO) Recommend deletion of bond funding for water-related activities because funding should be put in legislation that better defines the programs.
Public Utilities Commission	8660-15	Universal Service Telephone	892,513,000	267,753,900			267,753,900	Competitively source this program through a PBC

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
		Programs						
San Francisco Bay Conservation and Development Commission	3820	San Francisco Bay Conservation and Development Commission	4,240,000		4,240,000		4,240,000	Suspend funding for the commission. The commission is duplicative and no longer needed due to the larger, newly-created California Bay-Delta Authority, which assumes the same functions.
San Francisco Bay Conservation and Development Commission	3820	San Francisco Bay Conservation and Development Commission	4,240,000			4,240,000	4,240,000	Integrate into CA Coastal Commission
Santa Monica Mountains Conservancy	3810	Santa Monica Mountains Conservancy	676,000			101,000	101,000	Integrate into Division of Lands and Forests
ScholarShare Investment Board	954	ScholarShare Investment Board	45,526,000			45,526,000	45,526,000	Suspend funding for the board. The board's functions are duplicative of other state resources (UC Student Financial Aid, CSU Student Financial Aid, California Student Aid Commission). In addition, scholarships are already provided by public and private colleges, as well as by non-profit organizations and federal programs.
Secretary for California Health and Human Services Agency	530-21	Office of HIPAA Implementation	3,572,000	1,071,600			1,071,600	Functions of this office are commercial activities that should be competitively sourced for savings: Note the 140 percent increase over two years, including a 30 percent increase from 2002-03 to 2003-04, despite the fact that the planned staffing level remains the same from year to year
Secretary for Environmental Protection	555-20.10	Permit Assistance Centers	152,000		152,000		152,000	Suspend program funding. These functions can adequately be performed by the private sector, as has been demonstrated in other public agencies.
Secretary for Labor and Workforce Development Agency	559	Secretary for Labor and Workforce Development Agency	2,311,000		2,311,000		2,311,000	Suspend funding for this office. Our plan would reduce this agency and incorporate necessary functions of its departments elsewhere.
Secretary for Resources	540	Secretary for Resources	54,285,000			25,000,000	25,000,000	Reduce funding by $25,000,000; The planned sizeable reduction in 2003-04 yields a budget increase of 217.5 percent over two years (from the 2001-02 level)
Secretary for Resources	0540-001-6029	River Parkways and Sierra Nevada Cascade Programs			7,900,000		7,900,000	(LAO) Recommend deleting the proposed funding because funding should be included in legislation that defines the programs, establishes grant or project funding criteria, and sets expenditure priorities.
Secretary for Resources	0540-001-6031	River Parkways and Sierra Nevada Cascade Programs			32,000,000		32,000,000	(LAO) Recommend deleting the proposed funding because funding should be included in legislation that defines the programs, establishes grant or project funding criteria, and sets expenditure priorities.
Secretary of State	890-30	Archives	13,772,000	4,131,600			4,131,600	Archive management is a commercial activity that should be competitively sourced for savings
Secretary of State	890-32	International Business Relations	2,590,000		2,590,000		2,590,000	Relevance and priorities require the suspension of this program for this budget cycle
Secretary of State	890-38	Information Technology	7,515,000	2,254,500			2,254,500	IT is a commercial activity that should be competitively sourced for savings
Secretary of State	890-5	Business Programs	39,624,000		39,624,000		39,624,000	Suspend the Notary Republic function, which can be adequately served by the private sector. Other services can be provided through other CA state programs
State and Consumer Services	1100	California Science Center	17,683,000	5,304,900			5,304,900	Management of this center is a commercial activity that should be competitively sourced for savings
State Board of Equalization	860	State Board of Equalization	321,397,000			48,210,000	48,210,000	Integrate into Franchise Tax Board (new Division of Tax Collection)
State Coastal Conservancy	3760-25	Coastal Resource Enhancement	2,573,000		2,573,000		2,573,000	Relevance and priorities require the suspension of this program for this budget cycle
State Coastal Conservancy	3760	State Coastal Conservancy	7,020,000			1,053,000	1,053,000	Integrate into CA Coastal Commission
State Controller	840-40	Information Systems	13,335,000	4,000,500			4,000,500	Information systems are commercial activities that should be competitively sourced for savings
State Controller	840-50	Collections	12,878,000	3,863,400			3,863,400	Collections are commercial activities that should be competitively sourced for savings
State Controller	840-60	Disbursement and Support	32,915,000	9,874,500			9,874,500	Disbursement and support are commercial activities that should be competitively sourced for savings
State Independent Living Council	5170	State Independent Living Council	515,000		515,000		515,000	Suspend funding for the council. The council's functions are duplicative of Department of Rehabilitation programs.
State Lands Commission	3560	State Lands Commission	21,805,000			3,271,000	3,271,000	Integrate into Division of Lands and Forests
State Treasurer	950-50	Administration and Information Technology	9,100,000	2,730,000			2,730,000	Administration and IT are commercial activities that should be competitively sourced for savings
Stephen P. Teale Data Center	2780	Stephen P. Teale Data Center	101,209,000	30,362,700		15,181,000	45,543,700	Streamlining by integrating into single state data center; competitively source the activity since it is a commercial activity.
Stephen P. Teale Data Center	2780-001-0683	California Home Page	500,000		500,000		500,000	(LAO) Recommend suspending proposal to increase spending for the Home Page by five positions, due to the lack of workload data.

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
Student Aid Commission	7980	Cal Grant T Program	3,000,000		3,000,000		3,000,000	(LAO) Suspend Cal Grant T program. State has another, better structured financial aid program that also encourages aspiring teachers to become fully credentialed and work in low-performing schools.
Student Aid Commission	7980	Graduate Assumption Program of Loans for Education	500,000		500,000		500,000	(LAO) Suspend Graduate Assumption Program of Loans for Education. This is a highly specialized program that benefits few students (only two warrants were redeemed in 2000, for a total cost of $4,000).
Technology, Trade and Commerce Agency	2920-07	Technology and Community Innovation	2,038,000		2,038,000		2,038,000	Relevance and priorities require the suspension of this program for this budget cycle
Technology, Trade and Commerce Agency	2920-10	Economic Development - Boards and Commissions	11,212,000		11,212,000		11,212,000	Relevance and priorities require the suspension of this program for this budget cycle. The program's impact is questionable.
Technology, Trade and Commerce Agency	2920-20	Global Economic Development	6,215,000		6,215,000		6,215,000	Relevance and priorities require the suspension of this program for this budget cycle
Technology, Trade and Commerce Agency	2920-60	Economic Research	188,000		188,000		188,000	Suspend program funding. This function is duplicative of Department of Finance research responsibilities, as well as that of numerous universities, non-profit organizations, and private organizations.
Technology, Trade, and Commerce Agency	2920	Technology, Trade, and Commerce Agency			16,500,000		16,500,000	(LAO) Reduce General Fund support for various programs. Estimated savings assumes elimination of funding for the Film Commission, small business loan guarantee program, and Office of California-Mexico Affairs.
Technology, Trade, and Commerce Agency	2920-012-0001	Foreign Trade Offices	3,400,000		3,400,000		3,400,000	(LAO) Recommend that the legislature suspend all trade offices—five contract offices and seven state-staffed foreign trade offices—because they have questionable effectiveness.
Technology, Trade, and Commerce Agency	2920-111-0001	Film Permit Subsidy Program	8,200,000		8,200,000		8,200,000	(LAO) Recommend elimination of the film permit subsidy program and three related positions in the Film Commission because the program has an unclear rationale and a questionable impact on film location decisions. Further recommend that remaining monies in the fund be reverted.
University of California	6440-001-0001	Higher Education Enrollment	48,700,000		48,700,000		48,700,000	(LAO) Recommend legislature suspend funding in the budget for enrollment growth at the University of California because proposed growth rates significantly exceed demographic projections.
University of California	6440-20	Academic Support (Libraries)	244,245,000	73,273,500			73,273,500	Library functions are commercial activities that should be competitively sourced for savings
University of California	6440-301-6028 (16)	UC San Diego - Mayer Hall Addition and Renovation			2,072,000		2,072,000	(LAO) Recommend the legislature reduce $2,072,000 for development of preliminary plans and working drawings for the Mayer Hall Addition and Renovation project at the San Diego campus and recognize future costs of $15,029,000 for construction and $441,000 for equipment.
University of California	6440-302-6028 (9)	UC Irvine - Biological Sciences Unit 3			3,100,000		3,100,000	(LAO) Recommend the legislature reduce $3,080,000 for development of preliminary plans and working drawings for the Biological Sciences Unit 3 building at the Irvine campus and recognize future costs of $7,003,000 for construction and $3,150,000 for equipment.
University of California	6440-40	Operation and Maintenance of Plant	422,847,000	126,854,100			126,854,100	Plant operation and maintenance functions are commercial activities that should be competitively sourced for savings
University of California	6440	California State Summer School for Math and Science	1,600,000		1,600,000		1,600,000	(LAO) Suspend General Fund support for California State Summer School for Math and Science. The program serves high-achieving high school students.
University of California	6440	Community Teaching Internships for Mathematics and Science Programs	1,300,000		1,300,000		1,300,000	(LAO) Suspend General Fund support for Community Teaching Internships for Mathematics and Science Programs. The programs provide stipends to juniors and seniors majoring in math, science, and engineering, who work in local public schools as teaching interns. Other state and federal programs provide similar services.
University of California	6440	Digital California Project			6,600,000		6,600,000	(LAO) Reduce funding for Digital California Project by an additional 30 percent. Option leaves approximately $15 million for program.
University of California	6440	Cooperative Extension Program			3,000,000		3,000,000	(LAO) Reduce General Fund support for cooperative extension program by an additional 5 percent. Governor proposes a 10 percent reduction.
University of California	6440	UC Merced	11,300,000		11,300,000		11,300,000	(LAO) Suspend augmentation for UC Merced. UC Merced is not scheduled to open until fall 2004. Approximately $10 million will still be available for start up costs associated with the campus in 2003-04.

Department/ Service	Line Item	Descriptor	Base Amount Analyzed ($)	Competitive Sourcing ($)	Performance-based Reductions ($)	Reorganization Plan Savings ($)	Final Budget Savings ($)	Comments
University of California	6440	Institutional Aid Programs	68,900,000		68,900,000		68,900,000	(LAO) Suspend General Fund support for institutional aid programs. Substantial growth in state Cal Grant programs has weakened justification for separate institutional aid programs.
University of California	6440	Federal Overhead Reimbursements			35,000,000		35,000,000	(LAO) Increase state's share of federal overhead reimbursements by 10 percent. The federal government reimburses UC for the overhead costs of contracted research. The state funds much of this overhead, but currently shares with UC these federal reimbursements. This option would increase the state's share from 55 percent to 65 percent, generating an estimated General Fund savings of $35 million.
Wildlife Conservation Board	3640	Natural Heritage Preservation Tax Credit Program			8,700,000		8,700,000	(LAO) Suspend award of new credits for two years. This program allows the donation of property to state or local agencies or nonprofit organizations, and gives the donor a partial state tax credit based on the assessed value of the property. The act authorizes $100 million of tax credits through 2005. As of January 2002, a balance of approximately $60 million of credits remains to be authorized by the Wildlife Conservation Board. The General Fund fiscal impact of this option reflects a reduction in tax credits that would otherwise be claimed if it were not for the suspension.
Workforce Investment Board	7120	Workforce Investment Board	5,378,000			807,000	807,000	Integrate into Division of Employee Development
Youth Authority	5460	Gang Violence Reduction Program	1,700,000		1,700,000		1,700,000	(LAO) Suspend the Gang Violence Reduction Program. This program, which provides grants to local law enforcement agencies for gang prevention, is duplicative of crime prevention programs administered by the Office of Criminal Justice Planning, Department of Justice, and Department of Education.
Youth Authority	5460	Young Men as Fathers Program	900,000		900,000		900,000	(LAO) Suspend the Young Men as Fathers Program. This program provides grants to counties for parenting programs in county juvenile facilities and alternative schools. This program is duplicative of a program administered by the Department of Health Services.
Youthful Offender Parole Board	5450	Youthful Offender Parole Board	3,287,000			493,000	493,000	Integrate into the Division of the Youth Authority
Totals			39,210,210,000	8,989,839,074	6,036,381,500	881,109,550	15,907,330,124	

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Reason Foundation
3415 S. Sepulveda Blvd., Suite 400
Los Angeles, CA 90034
www.rppi.org

The Performance Institute
1515 N. Courthouse Rd., 6th Floor
Arlington, VA 22201
www.performanceweb.org