Court), all class actions filed by Los Angeles attorney Richard I. Fine on behalf of state licensees, allege that the State of California illegally diverted money from the reserve funds of special-funded agencies in California. "Special-funded agencies" (including all the regulatory programs in DCA) receive funding support not from the general fund but from licensing and other fees imposed on their licensees; those fees are generally passed on by the licensees to the consumers of their services as a cost of doing business. In the Budget Acts of 1991–92, 1992–93, and 1993–94, the legislature included provisions which reduced the reserve funds of special-funded agencies down to three months' worth of operational expenses, and diverted the rest to the general fund. In *Malibu Video Systems*, Fine claims that the 1991–94 diversions reduced the total amount in special-funded agencies' reserve funds by 46% (from $1.569 billion in 1991 to $848.5 million in 1994); *Abramovitz* challenges similar diversions in the 1994–95 budget, and *Hathaway* (filed on October 25, 1995) challenges similar diversions in the 1995–96 budget. Fine alleges that these funds were collected for consumer protection purposes, and that diverting them to help pay the state's deficit both deprives consumers of protection from incompetent and dishonest practitioners and serves to double-tax taxpayers who are consumers of the services of state licensees. *[14:4 CRLR 22; 12:4 CRLR 1]*

At this writing, *Malibu Video* and *Abramovitz* have been consolidated. If settlement negotiations break down, petitioners' motion for class certification is scheduled to be heard on February 20. A similar federal court lawsuit filed by Fine, ***Malibu Video Systems, et al. v. Kathleen Brown, Treasurer of the State of California, et al.***, No. CV942093-RMT(EX) (C.D. Cal.), has been stayed pending resolution of the state court cases.

OFFICE OF THE LEGISLATIVE ANALYST

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Created in 1941, the Legislative Analyst's Office (LAO) is responsible for providing analysis and nonpartisan advice on fiscal and policy issues to the California legislature.

LAO meets this duty through four primary functions. First, the office prepares a detailed, written analysis of the Governor's budget each year. This analysis, which contains recommendations for program reductions, augmentations, legislative revisions, and organizational changes, serves as an agenda for legislative review of the budget. Second, LAO produces a companion document to the annual budget analysis which paints the overall expenditure and revenue picture of the state for the coming year. This document also identifies and analyzes a number of emerging policy issues confronting the legislature, and suggests policy options for addressing those issues. Third, the Office analyzes, for the legislature's fiscal committees, all proposed legislation that would affect state and local revenues or expenditures. The Office prepares approximately 3,700 bill analyses annually. Finally, LAO provides information and conducts special studies in response to legislative requests.

LAO staff is divided into nine operating areas: business and transportation, capital outlay, criminal justice, education, health, natural resources, social services, taxation and economy, and labor, housing and energy.

MAJOR PROJECTS

1995–96 Budget Enacted. On August 3, Governor Wilson signed the 1995–96 Budget Act; the Act and related trailer legislation authorize total state spending of $58.6 billion in 1995–96, including $43.3 billion from the general fund, an increase of 3.9% over 1994–95.

In September, LAO published the *State Spending Plan for 1995–96: The 1995 Budget Act and Related Legislation*, which summarized the key features of the 1995–96 budget package. Among other things, LAO noted that—once again—the budget depends largely on federal actions to achieve almost $800 million of savings. *[15:2&3 CRLR 24; 14:2&3 CRLR 23]* In addition to immigrant funding, most of the budgeted savings in welfare and health programs require either federal law changes or administrative waivers. Accordingly, LAO noted that the success of California's 1995–96 budget depends to a large extent on the actions of Congress and the Clinton administration.

The major features of the 1995–96 budget package include the following:

• The budget increases per-pupil spending for K–12 education to $4,435, or $126 more than the adjusted per-pupil level in last year's budget.

• General fund support for higher education increased by 4–5%, and the budget package does not include any undergraduate student fee increases.

• The budget package reduces statewide welfare grant levels by 4.9%, and establishes regional grant levels that will be lower in counties with less expensive housing costs.

• The corrections budget increased by 8.6% over last year.

• The Wilson administration anticipates ending fiscal year 1995–96 with about $2 billion of unused borrowable cash in special fund balances; this cash cushion, if realized, will avoid the need to make across-the-board spending cuts.

The budget package does not include two major initiatives originally proposed by the Governor: (1) his tax reduction proposal, and (2) a further realignment of state responsibilities to the counties. *[15:2&3 CRLR 24]*

California's Crime Rate Hits Ten-Year Low in 1994. In August, LAO released a *California Update* addressing California's crime rate. According to the report, California's crime rate is the lowest in ten years, dropping 6.5% between 1993 and 1994. The crime rate is measured using the California Crime Index (CCI), which is composed of reported incidents of four types of violent crimes (homicide, rape, robbery, and assault) and two types of property crimes (burglary and motor vehicle theft). California's overall crime rate for 1994 was 3,147.7, meaning that there were about 3,148 reported crimes per 100,000 Californians that year. However, LAO noted that because the CCI measures only crimes that are reported to law enforcement authorities, the crime rate probably understates the actual number of crimes committed.

In its report, LAO opined that possible reasons for the drop in crime may include the continued aging of the population (particularly the aging of the so-called "baby boomers"); relative stability in the illegal drug trade and corresponding reductions in drug-related violence; and the possible deterrent effects of criminal sentencing legislation such as the "Three Strikes and You're Out" law. *[15:1 CRLR 30]* However, LAO also noted that California's crime rate has been steadily declining since 1991, and is consistent with trends in other states.

According to LAO, many researchers attribute the recent decline in crime rates to the decline in the number of juveniles, because juveniles commit a disproportionate number of crimes. However, LAO noted that the juvenile population is expected to increase rapidly over the next ten years, and opined that juvenile crime may increase commensurately.

The Welfare Reform Struggle Continues. In a September *California Update*, LAO again analyzed pending congressional welfare reform proposals and their effect on Aid to Families With Dependent Children (AFDC), Supplemental Security Income (SSI), and restrictions on welfare for noncitizens. *[15:2&3 CRLR 26]*

Specifically, both S. 1120, the Work Opportunity Act of 1995, and H.R. 4, the so-called Personal Responsibility Act, would replace public assistance programs currently classified as entitlements with block grants. According to LAO, H.R. 4 would result in an net reduction of $8.3 billion in federal funding to California over the first five years; the overall net fiscal effect of S. 1120 would be an estimated $6.6 billion reduction in federal funds over the first five years.

LAO also summarized the major fiscal effects of the proposals on state and county funds. However, LAO noted that the net effect on state and county funds would depend on several variables, such as whether the state chooses to backfill for lost federal funds in order to maintain current service levels; whether the state conforms to the measures' restrictions on the eligibility of immigrants for various federally-funded public assistance programs; the impact of county costs, primarily for general assistance and indigent health services, if state aid for immigrants is eliminated; and the number of immigrants who become citizens in response to the measures' restrictions.

Proposition 62 Voter Approval Requirements Upheld. In an October *California Update*, LAO analyzed the effects of the California Supreme Court's recent decision in *Santa Clara County Local Transportation Authority v. Guardino*, 11 Cal. 4th 220 (1995), which upheld Proposition 62's voter approval requirements for local taxes. In 1986, California voters approved the measure, which prohibits local agencies from imposing a tax for specific purposes unless approved by two-thirds of the voters, and from imposing a tax for general purposes unless approved by a majority of the voters. In *Guardino*, the court held that a half-cent sales tax increase for transportation purposes is invalid because the initiative failed to receive two-thirds voter approval as required by Proposition 62.

LAO explained how this decision has implications in seventeen other counties with similar sales taxes, all of which were passed without two-thirds voter approval. However, LAO noted that these measures have been in effect for several years, and the time periods for legal challenge as provided in each measure have expired. As the existing measures expire, however, any future extension would require two-thirds voter approval as a result of the *Guardino* decision.

Remedial Education in California. According to a November *California Update*, a recent report indicates that over 40% of freshmen entering the California State University (CSU) system are deficient in reading, writing, and mathematics, and need remedial education to succeed in regular college courses. In addition to CSU, remedial education is also offered by the University of California, the California Community Colleges, and by school districts through adult education courses.

According to LAO, almost no information is available on the eventual college graduation rates of students who require remedial education. However, LAO noted that students who are involved in remedial education tend to take longer to graduate than those who are not.

State Transportation Funding Shortfall. In a December *California Update*, LAO reported that the California Transportation Commission (CTC) projected in August that the state's revenues and expenditures for transportation programs indicate a $600 million shortfall. The projection, which covers a seven-year period from 1996–97 through 2002–03, is the basis for the 1996 State Transportation Improvement Program (STIP). In the absence of corrective action by CTC, LAO opined that the funding shortfall will result in construction delays, deferrals, unfunded projects, and the absence of new projects. According to LAO, the funding shortfall is a result of "overly optimistic resource projections coupled with underestimating expenditures." LAO noted that Proposition 192, the Seismic Retrofit Bond Act of 1996, could offer a possible solution for eliminating the funding shortfall; if approved by the voters in March 1996, Proposition 192 would authorize the state to sell $2 billion in general obligation bonds to retrofit state-owned highways and bridges.

LAO Publishes Fiscal Outlook for California. In November, LAO released the first in a series of reports which provides its projections of the state's general fund condition for 1995–96 through 1997–98. The purpose of the report, which LAO will update periodically as needed, is not to predict future policy decisions by the legislature or to recommend spending and revenue levels, but to provide a starting point for the legislature's evaluation of the state's fiscal condition; aid the legislature in establishing long-term budget priorities; and allow the legislature to address fiscal issues in a more stable fiscal environment.

Initially, LAO opined that, unlike the past five fiscal years when the legislature and Governor faced multi-billion-dollar budget gaps, the near-term fiscal outlook is significantly more favorable; LAO estimated that the state will end 1995–96 with a modest reserve. According to LAO, the more positive budget outlook is related to the following three general factors:

• The economic and revenue outlook has improved significantly. According to LAO, general fund revenues will grow at an average annual rate of about 6.3% between 1994–95 and 1997–98, which is significantly higher than combined inflation and population increases.

• Underlying caseload growth has slowed dramatically in the state's health and welfare programs.

• Revenues thus far in 1995–96 are exceeding expenditures by over $900 million.

LAO estimated that general fund revenues will total $45.3 billion in 1995–96, which is $1.3 billion more than the revenue forecast contained in the 1995–96 budget enacted in August; LAO further estimated that general fund revenue growth will average 6.1% over the following two years, with revenues totaling about $47.9 billion in 1996–97 and $51.1 billion in 1997–98. LAO estimated that general fund spending will experience an annual average growth rate between 1994–95 and 1997–98 of 7.2%, with total spending increasing by $9.6 billion.

LAO noted that a variety of factors could cause the general fund to perform differently than projected; such factors include unpredicted economy changes, major federal budgetary changes, adverse litigation outcomes, natural disasters, and unexpected developments in major caseloads.

Bleak Outlook for Accommodating Inmate Population Growth. In late December, LAO released a policy brief entitled *Accommodating the State's Inmate Population Growth*, concerning the problems associated with the state's growing inmate population; specifically, the brief addresses issues concerning the development of facilities for the prison system. *[15:2&3 CRLR 25]* LAO reported that Department of Corrections has projected that inmate population will exceed available prison housing space by mid-1998; even the immediate authorization of a new prison is unlikely to alleviate the problem, as the projected number of inmates will exceed prison capacity by roughly 9,000 at the time of completion.

Accordingly, LAO recommended that the legislature immediately take the necessary steps to authorize funds to develop plans for the construction of two prisons. LAO further recommended that the legislature adopt a long-term plan for accommodating the state's inmate population growth. According to LAO, the legislature should consider actions which would reduce the actual growth of the inmate population; such measures might include the adoption of policies which would divert nonviolent offenders to other less costly forms of punishment. Finally, LAO suggested that the legislature authorize a general obligation bond measure for the November 1996 ballot to finance necessary prisons.

LEGISLATION

SB 60 (Kopp), as amended July 28, requires the State Bar to conduct a plebiscite of its active members in good standing to determine whether the members favor abolishing the State Bar as the agency regulating lawyers. The bill specifies the contents of the ballot for the plebiscite, which includes an analysis by the Legislative Analyst. The Board of Governors is required to report the results of the plebiscite to the Supreme Court, Governor, and legislature by July 1, 1996. This bill was signed by the Governor on October 12 (Chapter 782, Statutes of 1995).

AB 921 (Friedman). Existing law authorizes the establishment of an administrator training and evaluation program to provide school administrators support and development activities designed to improve clinical supervision skills. As amended May 1, this bill would require LAO, in consultation with the Commission on Teacher Credentialing, to convene a School Administrator Evaluation Work Group to develop a set of criteria to assist school districts in assessing the competencies of school administrators, particularly school principals. The bill would require LAO to prepare and submit a report no later than July 1, 1996, to the legislature on the criteria developed and to distribute and make the report available to school districts upon request. *[A. Rules]*

AB 1390 (V. Brown). The State Government Strategic Planning and Performance Review Act requires the Department of Finance (DOF), by March 1, 1995, and each March 1 thereafter, in consultation with the Bureau of State Audits (BSA) and LAO, to conduct a survey of all state agencies, departments, offices, and commissions, with certain exceptions, containing specified information regarding strategic plans for performance reviews, and to report the results of the survey to the Governor, the legislature, and the Joint Legislative Budget Committee. As amended September 7, this bill would change the dates that DOF conducts the survey and reports its results from March 1, 1995, and each March 1 thereafter, to December 1, 1995, and each December 1 thereafter.

The Act requires each agency, department, office, or commission for which strategic planning efforts are recommended to develop a strategic plan and to report to the Governor and to the Joint Legislative Budget Committee by April 1, 1995, and by each April 1 thereafter, on the steps being taken to develop and adopt a strategic plan. This bill would change the dates that this report is due from April 1, 1995, and each April 1 thereafter, to February 1, 1996, and each February 1 thereafter.

The Act further requires DOF, by March 1, 1996, and by each March 1 thereafter, after consultation with the Controller, BSA, and LAO, to recommend to the Governor and to the Joint Legislative Budget Committee a plan for conducting performance reviews for agencies, departments, offices, and commissions that have completed strategic plans. This bill would repeal this requirement, and instead require the Director of Finance, by March 1, 1996, and each March 1 thereafter, to convene a Joint Performance Audit Task Force, chaired by the Director and including the Controller, the State Auditor, the Legislative Analyst, the Chair of the Joint Legislative Budget Committee, and the Chair of the Joint Legislative Audit Committee, for the purpose of establishing a plan for conducting performance audits for agencies, departments, offices, and commissions that have completed strategic plans pursuant to the Act. It would also require the Task Force, on or after July 1, 1996, and each July 1 thereafter, to direct the commencement of performance audits, in accordance with specified guidelines. *[S. Inactive File]*

SB 974 (Alquist, et al.), as amended May 15, would create the Performance Audit Joint Task Force, consisting of the Governor and the Controller, that would be required to periodically identify state executive branch agencies, programs, or practices that are likely to benefit from performance audits. The bill would provide that agencies, programs, or practices that are so identified would be in addition to those otherwise identified under the Act. *[A. Appr]*

SCR 26 (Hayden), as amended July 6, would state the following:

- The state budget process needs fundamental overhauling and both expenditures and revenues need to be carefully reviewed to make sure they are functioning adequately, efficiently, and fairly.
- There are $24 billion in tax loopholes that constitute a hidden drain on state revenues.
- There are 268 tax expenditure programs, 197 at the state level and 71 at the local level.
- In 1985, the legislature required the Legislative Analyst to review, every two years, the state's tax expenditure program; that process has been suspended due to a decrease in funding and staff due to Proposition 140.
- In its last report in 1991, the Legislative Analyst recommended the following "Action Steps for Legislative Review of Tax Expenditures": review and agree upon the basic rationales and objectives of individual tax expenditure programs, review the available evidence of the overall effectiveness and economic efficiency of individual tax expenditure programs, and take actions with regard to individual tax expenditure programs including elimination or modification, or both.

Accordingly, the resolution would state that it is the intent of the legislature to promote the regular review of state tax expenditure programs to determine the economic impact of these programs and to review their cost-effectiveness; and direct the Legislative Analyst, utilizing existing resources, to analyze each tax expenditure program and determine if its objectives are being realized, whether each tax expenditure program's benefits exceed its revenue cost, and whether there is a less costly way of providing the same benefits. Based on this analysis, the Legislative Analyst shall report to the legislature whether and to what extent these specific programs have been effective in influencing taxpayer behavior, including the extent to which new jobs are created or new businesses are formed; whether these specific programs have been cost-efficient; whether these programs continue to provide targeted tax benefits; and its recommendations on which programs, if any, should be reauthorized or revised. The measure would provide that the Legislative Analyst, in carrying out these provisions, shall analyze select tax expenditure programs, in consultation with the Committees on Revenue and Taxation in each house of the legislature, subject to workload considerations.

The measure would also state the intent of the legislature to periodically review tax expenditure programs to ensure that they continue to be cost-effective and provide their intended benefits. *[A. Rules]*

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Established and directed by the Senate Committee on Rules, the Senate Office of Research (SOR) serves as the bipartisan, strategic research and planning