AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION

Assembly Member Joan Buchanan, Chair

THURSDAY, FEBRUARY 3, 2011
STATE CAPITOL, ROOM 447
UPON ADJOURNMENT

Items to Be Heard

ITEM CS 3.90 EMPLOYEE COMPENSATION

The total number of state employees is 358,000 resulting in a salary cost of $23.6 billion (including all funds). This tally includes employment at the Executive Branch, Judicial Branch, University of California (UC) and California State University System (CSUS), and elected members of the Legislature. Roughly two-thirds of total state employment is in the Executive Branch. Of this proportion, about one-third of Executive Branch employment is in the California Department of Corrections (CDCR).

Compensation for salaries and benefits accounts for approximately 12 percent of General Fund costs, and includes $7 billion in salary expense and $3.4 billion in benefit costs. Employees of CDCR account for approximately two-thirds of General Fund salary costs. Compensation of employees other than managers, supervisors, and gubernatorial appointees is through collective bargaining, pursuant to the Ralph C. Dills Act adopted in 1977.

Recent administrations have addressed budgetary savings through reductions in employee compensation. To date, savings in employee compensation has been achieved through unpaid leave days (furlough days and the personal leave program (PLP), retirement changes (increased employee contributions and a new formula for new state employees). Other measures adopted as part of collective bargaining, which could increase expected out-year costs, include annual floating paid leave days, future pay increases for top step employees in the future, and continuous appropriation of salaries during late budgets.

The Governor's 2011-12 Budget calls for additional savings from reductions in employee compensation. The significant budget solutions include reduced employee compensation costs for a savings of $308.4 million and a new health care option for savings of $72 million. The budget also assumes the continuation of the PLP initiated under the prior administration for savings of $71.6 million.

ISSUE 1: SALARY REDUCTIONS FOR CERTAIN BARGAINING UNITS

The Governor's Budget proposes applying savings associated with contracts that were finalized last year with many of the state's bargaining units, to those bargaining units, which have not come to an agreement and currently work under expired contracts. Specifically, 15 of the state's 21 bargaining units, representing 58 percent of the state workforce, have signed contracts that incorporate salary reductions of between 8 percent and 10 percent. The budget proposes to incorporate similar savings to those 6 bargaining units that have not reached agreement with the state.

The 6 bargaining units working under expired contracts include attorneys (CASE); correctional peace officers (CCPOA); protective services and public safety (CSLEA); professional engineers (PECG); professional scientific engineers (CAPS); and stationary engineers (IUOE). The bargaining units represent about 23 percent of the workforce. (Non-represented employees account for about 17 percent of the total workforce). The salary savings resulting from applying the 10 percent reduction in compensation is about $308 million. The Administration indicates these savings will be achieved through collective bargaining and/or through other administrative actions.

LAO suggests that unless the bargaining with the 6 outstanding units achieves savings at the top end of the salary spectrum, the state will not be able to realize the savings assumed in the budget. LAO notes that if the contracts provide savings of only 8 percent instead of the assumed 10 percent, over $60 million of the assumed General Fund savings would not materialize.

LAO's alternative suggestions include the following:

- **Enhance Savings through Collective bargaining and Administrative Actions.** This proposal would continue the current level of savings for those bargaining units that have not come to an agreement with the Administration. LAO scores this option at $100 million annually.

- **Authorize Furloughs at End of Personal Leave Program.** This proposal would authorize additional unpaid leave of one day per month at the conclusion of the PLP for certain bargaining units where this is an option. The LAO scores this savings alternative at $147 million.

- **Reduce Employee Salaries.** This option would reduce employee salaries as their contracts come up for ratification. Since the Legislature has reserved for itself the power to appropriate funds, it can therefore reduce employee salaries based on its lack of budgetary flexibility and resources. LAO does not score a revenue impact for this option.

COMMENTS

The Subcommittee may want to ask Department of Finance (DOF) what the status of bargaining is and when the Legislature can expect to review Memoranda of Understanding (MOUs) with the remaining bargaining units without contracts. LAO should provide additional information regarding its estimate of savings and how its alternative savings approaches could be achieved. In particular, the suggestion of furloughs would appear to run counter to previous court decisions regarding applicability of such policies over a long-term, non-crisis situation. In addition, LAO should expand on its suggestion to apply the current savings associated with the 6 outstanding units to the long term.

ISSUE 2: EMPLOYEE COMPENSATION REDUCTIONS

The Governor's Budget proposes additional employee compensation savings through the addition of a core health care plan to the current benefit plan options. This would result in a savings of $72 million from the projected increase in the 2012 calendar year health rates. The core health plan would provide fundamental coverage at a lower premium than the traditional coverage plans. Through legislation, the California Public Employees' Retirement System (CalPERS) would be directed to, (1) negotiate and add a core health plan option to the existing portfolio of health plans, and, (2) include a state representative in the health contract negotiations both for the purpose of shaping the core health care plan options and identifying and advocating for more economic options within the plans.

Health care benefit costs in 2010-11 for active employees and retirees are approximately $2.4 billion, General Fund. The administration's plan is an approach to reducing this cost by offering a less comprehensive (and less expensive) plan to employees. As noted by LAO, the state contribution to employee health is based on the average cost of the four plans with the greatest number of subscribers. Thus, under the current approach to calculating state contributions, in order to realize the savings assumed in the 2011-12 budget, the core plan must become one of the four plans with the most enrolled state employees. Because the state workforce is aging, LAO notes that it may be optimistic to assume that the proposed core plan will be subscribed to, to the extent necessary for the savings to be achieved.

COMMENTS

The Subcommittee may want DOF to comment on, and LAO to respond to, plans to attract state employees to the core health plan such that the savings can be achieved. Health plans can also suffer from an insurance phenomenon called "adverse selection." One potential result of this phenomenon is that healthier individuals choose low price/low coverage and less healthy individuals choose more comprehensive plans. The administration's proposal could have the effect of encouraging healthier individuals to leave the comprehensive plans and subscribe to the core plan To the extent that the cost of a health plan is linked to the overall health of its insures, this could drive up the cost of the comprehensive plans and reduce the expected savings. The Subcommittee may want DOF to address this issue the Administration is also assuming additional efficiencies from the proposal without identifying them.

7100 EMPLOYMENT DEVELOPMENT DEPARTMENT (EDD)

The EDD administers the Unemployment Insurance (UI), Disability Insurance (DI), and Paid Family Leave programs and collects payroll taxes from employers, including the Personal Income Tax. The EDD connects job seekers with employers through a variety of job services programs and at one-stop service centers, and provides employment training programs through the Employment Training Panel and the Workforce Investment Act of 1998. The Budget includes $26 billion ($385.2 million General Fund) and 10,208 positions to support the EDD programs.

ISSUE 1: AUTOMATED COLLECTION ENHANCEMENT SYSTEM (ACES)

Governor's Budget Request. The Employment Development Department request an augmentation of $21,917,000 and 49.3 positions (46.8 Personnel Years [PYs]) for fiscal year 2011-12 to fund year six of the Automated Collection Enhancement System (ACES) project. These funds include an estimated vendor payment of $18.7 million. This proposal also includes a reduction of 18 baseline positions (-17.1 PYs) for the ongoing Tax Accounting System (TAS) support that will no longer be needed post ACES implementation.

ACES is a new collection system that will increase the effectiveness of the EDD tax collection operations upon full implementation. It is estimated that ACES will increase collections revenue by approximately $71.4 million by the end of SFY 2013-14, and each year thereafter. For 2011-12, ACES is anticipated to increase General Fund revenue by $27 million

Source of Funds	Amount of Funding
General Fund	19,458,000
Disability Insurance Fund	2,381,000
Employment Training Fund	39,000
EDD Contingent Fund	39,000
Unemployment Insurance Fund*	(2,325,000)
TOTAL	**$24,242,000**

*Utilizing redirected UI Grant dollars.

Background. The ACES Special Project Report (SPR), approved by the Office of the Chief Information Officer (OCIO) on July 29, 2009, estimated $26,888,000 and 65 positions (61.1 PYs) for 2011-12 and did not include a reduction to baseline TAS staff. The SPR included an estimated PSP payment of $20.5 million as compared to the $18.7 million estimated in this Budget Change Proposal. The current 2011-12 request is $2.6 million less than the SPR amount due to the net result of the reduced PSP payment, increase in data center costs, reduction of 15 one-time ACES project positions (14.3 PYs), and reduction of 18 ongoing support positions (17.1 PYs).

LAO Recommendation. This project is on schedule with the budget expectations and meeting its deadlines for implementation.

ISSUE 2: DISABILITY INSURANCE AUTOMATION (DIA) PROJECT

Governor's Budget Request. The Employment Development Department (EDD) is requesting a one-time budget augmentation of $38,949,000 from the Disability Insurance (DI) fund to support 16.1 new positions (15.3 PYs) and 47 existing positions (44.6 PYs) for the sixth year of this DIA Project, which will allow claimants, medical providers, and employers to use the Internet claims data. The system is expected to be implemented in 2011-12.

Background. The DIA project includes adopting guidelines and practices to simplify and automate the numerous manual processes involved when filing a DI claim with EDD. The DIA solution will allow claimants, medical providers, and employers to use the Internet to submit claims data using a direct electronic interface or through web-based intelligent forms. Scanning/optical character recognition will be implemented to convert remaining paper claims to electronic format. Automated business logic will allow "in pattern" claims to be paid automatically, further increasing service delivery.

The DIA Project BCP for the current year was approved by the Legislature for $34.1 million and 44.6 PYs for the second year of the design, development, and implementation phase of the project. The DIA Special Project Report (SPR) was approved by the Office of the Chief Information Officer (OCIO) on November 23, 2009.

LAO Recommendation. This project is on schedule with the budget expectations and meeting its deadlines for implementation.

ISSUE 3: UNEMPLOYMENT INSURANCE LOAN INTEREST

Governor's Budget Request. The Governor's budget requests a $362.3 million appropriation from the General Fund to make interest payments on a federal loan that was required for the Unemployment Fund (the fund from which weekly unemployment insurance (UI) benefits are paid to eligible claimants. This proposal also requests that an immediate corresponding loan from the Unemployment Compensation Disability Fund to the General Fund for $362.3 million be made.

The proposed provisional Budget Bill Language would authorize the loan payment and specify that the annual contribution rates for the Unemployment Compensation Disability Fund shall not increase as the result of any loan made to the General Fund. In calculating the annual disability insurance tax rate each year, the EDD shall treat outstanding Unemployment Compensation Disability Fund loans as available cash in the DI Fund. The loan will be repaid with interest, at a cost to the General Fund of $90.6 million, over the course of four years and will be fully repaid by June 30, 2016.

Background. The Unemployment Insurance Program is a federal-state program that provides weekly UI payments to eligible workers who lose their jobs through no fault of their own. Benefits range from $40 to $450 per week depending on the earnings during a 12-month base period, with a current average of $313 per week during 2010. To be eligible, an applicant must have received enough wages during the base period to establish a claim; be totally or partially unemployed; be unemployed through no fault of his or her own; be physically able to work; be seeking work; be immediately available to accept work; and, meet eligibility requirements for each week of benefits claimed. The Budget includes $18.4 billion for unemployment benefit payments.

The UI program benefits are financed by employers who pay state unemployment taxes, ranging between 1.5 and 6.2 percent, on the first $7,000 in wages paid to each employee in a calendar year. Employers responsible for a high number of unemployment claims pay the highest tax rate. The maximum UI tax an employer can pay per employee is $434 per year, whereas an unemployed individual could collect up to $11,700 in benefits that same year. Estimated receipts in calendar year 2011 are $5.2 billion, including contributions from employers to support unemployment benefits.

Beginning in January 2009, the state's UI Fund was exhausted due to an imbalance between the benefit payments and annual employer contributions. To make UI benefit payments without interruption, the EDD began borrowing funds from the Federal Unemployment Account (FUA) to pay benefits to an increasing number of unemployed claimants. At the end of 2009, the UI Fund had a projected deficit of $6.2 billion. Based on EDD's October 2010 UI benefit estimates this deficit is expected to increase to $10.3 billion at the end of 2010 and, $13.4 billion at the end of 2011.

While annual interest payments were waived under the American Recovery and Reinvestment Act for 2010, interest totaling $362.3 million is due and payable in

September 2011. According to federal law, this interest payment must come from state funds. Interest will continue to accrue and be payable annually until the principal on the UI loan is repaid.

Issues to Consider. Appropriation of a state fund to make interest payments on a federal loan is consistent with federal law. Federal funds cannot be used to pay back a federal loan. If California carries a federal loan balance on January 1 for two consecutive years, employers would incrementally lose 0.3 percent of the Federal Unemployment Tax Act (FUTA) credit every year until the loan is repaid. However, employers would lose the entire 5.4 percent FUTA offset credit once California defaults on the interest payment. The reduction in the FUTA tax credit would equate to a tax hike of approximately $6 billion annually for California employers.

Furthermore, California would no longer be able to borrow from the federal government to continue paying UI benefits and California could also lose several hundred million dollars in federal UI administrative grant monies, until the interest due has been paid. In addition, this may create a conformity issue and the Secretary of Labor could “decertify” California. According to the Department of Labor, if the state were found out of conformity, the additional revenue collected from the loss of the entire FUTA credit would not be applied to the principal of the Title XII advances.

California would need to identify state resources to:

- Fund the UI administrative program in its entirety
- Fund benefit payments to eligible UI claimants
- Pay the outstanding interest
- Pay the outstanding loan principal

The removal of the entire FUTA tax credit, loss of the federal administrative funding, and inability to further borrow from the federal government would continue until the outstanding interest payments were paid. Once the interest was repaid, California would still be subject to incremental reductions (0.3 percent) of the FUTA tax credit for subsequent years while carrying a loan balance. Due to California carrying an outstanding loan balance for two consecutive years, the FUTA tax credit will decrease from 5.4 percent to 5.1 percent on January 1, 2012. This will result in employers paying a FUTA tax rate of 1.1 percent in calendar year 2012.

There have been situations where states have had loan balances in consecutive years and as a result had their FUTA tax credit reduced by 0.3 percent. The most recent case was New York in 2004 and 2005. However, no state has ever defaulted on an interest payment and lost their entire FUTA credit and federal administrative grants.

The EDD will update the estimated interest payment after the EDD May 2011 Fund Forecast. In addition, the proposed Budget Bill Language will allow the Department of Finance (DOF) to increase or decrease the actual amount paid/borrowed from the

Unemployment Compensation Disability Fund based on a more precise calculation of the interest due.

Factors that Contributed to the UI Insolvency.

- Significant statutory increases to the UI benefit levels that began in 2002.
- No change in the UI financing structure (for example, a taxable wage ceiling that has remained at the minimum level per federal law of $7,000 since 1983) despite significant increases to UI benefits.
- The current sluggish economy, which has resulted in, increased UI benefit payments and decreased UI revenues.

The Unemployment Compensation Disability Fund. The DI program provides partial wage replacement to eligible workers who are unable to work because of a disability. Disability is defined as any mental or physical illness or injury that prevents an employee from performing their regular or customary work. Benefits range from $50 to $987 per week depending on an individual's earnings in the base period calendar quarter. An individual's weekly benefit amount is approximately 55 percent of his or her earnings up to the maximum weekly benefit amount. The Governor's Budget includes $5.3 billion for disability benefit payments.

The DI program is financed by employees, who pay a sliding rate that is calculated annually, depending upon the balance in the DI fund. The 2010 rate is 1.1 percent of the wages, up to a maximum $93,316, earned by each employee. The maximum amount an employee can pay into the DI fund is $1,026 per year. By the end of 2011, the DI Fund is projected to have a fund balance of $1.6 billion.

Staff Comment. The Legislature has to make a difficult decision in determining how to repay the UI interest expense due September 30, 2011. If the Legislature decides not to approve the Governor's shift in DI funding proposal, it will have to account in the state's current General Fund deficit this additional cost and determine where to reduce expenditure by an additional $362.3 million.

Adopting the Governor's proposal allows the state time to begin addressing the overall structural imbalance of the UI fund, provides a one-time solution for the General Fund, and avoids disruption of the Federal UI Grant funding.

ISSUE 4: FEDERAL EXTENDED UNEMPLOYMENT BENEFITS, STATUTORY CHANGES FOR "THREE YEAR LOOK BACK"

Background. Federal extended unemployment benefits (FedEd) is a federally funded emergency benefits program for high unemployment states, including California. The extended benefits are designed to provide further income support to eligible unemployed workers who have been out of work for a long period of time. The chart below illustrates the maximum weeks available under each level of unemployment benefits. Generally speaking, when combined with the 26 weeks of initial state unemployment benefits and the four tiers of extended benefits totaling 53 weeks, FedEd allows eligible claimants to receive up to an additional 20 weeks of benefits, for a maximum of up to 99 weeks of unemployment benefits.

Unemployment Benefit Extensions

Benefit Period	**Weeks of Benefits**
Initial Benefits	26 weeks
Tier 1	Up to 20 weeks
Tier 2	Up to 14 weeks
Tier 3	Up to 13 weeks
Tier 4	Up to 6 weeks
FedEd	Up to 20 weeks
Maximum	**Up to 99 weeks**

Current federal law establishes "on" or "off" indicators to determine when FedEd benefits begin and end in a state. To ensure that FedEd is only payable during periods of high and rising unemployment, both the mandatory indicator based on the insured unemployment rate and the optional indicator based on the total unemployment rate include look-back requirements. Prior to December 2010, the look-back compares current unemployment rates to rates in the previous two years. However, in December 2010, Congress adopted legislation that permits states to amend their laws to temporarily modify the provisions dictating FedEd "on" and "off" indicators. Specifically, and through the end of 2011, the federal government is allowing states to make determinations of whether there is a FedEd "on" or "off" indicator by comparing current unemployment rates to the unemployment rates for the corresponding period in the three preceding years. This modification will enable many states, including California, to remain on FedEd longer.

Unless the three-year look-back modification is authorized, it is estimated that California will trigger off FedEd in Spring 2011. The impact of such a trigger off on UI claimants would be significant. The EDD estimates that between 263,000 and 500,000 claimants would potentially be impacted with a loss of their FedEd benefits. This figure does not include the claimants currently collecting regular California UI benefits who could be potentially eligible to file a FedEd extension if California's trigger remained "on" through the end of 2011. A rough estimate of the benefit to unemployed Californians of adopting the three-year look-back, ensuring the provision of federally funded extended UI benefits, totals between $1.0 billion to $2.6 billion. The range is large because UI claimants could be anywhere within the benefit tiers and therefore does not clearly equate to 20 additional weeks of benefits.

Staff Comment. In adopting the three-year look-back modification, the federal government acknowledged that while many states' unemployment rates are no longer increasing, the unemployment rate is also not decreasing markedly. By allowing a three-year look-back, an additional cushion is being provided for UI claimants and for states experiencing sustained levels of high unemployment.

Staff also notes that should the three-year look-back modification not be adopted prior to California triggering off FedEd under current law, and then subsequent action was taken to adopt the three-year look-back and trigger back on, EDD's administration of the UI program would be impacted negatively as resources would have to be redirected internally to ensure the timely provision of UI benefits. Staff expects that this redirection could negatively impact several high priority information technology projects at EDD by causing delays due to loss of staffing resources being redirected to the programming changes necessary to trigger off and then trigger back on.

ISSUE 5: WORKFORCE INVESTMENT ACT (WIA) ADJUSTMENTS

Governor's Request. The Governor's January Budget proposes several adjustments to the Workforce Investment Act (WIA) Program (federal funds), including a decrease of $625,000 in Special Grants and $847,000 in WIA Administration and Program Services.

Background. The goal of WIA is to strengthen coordination among various employment, education, and training programs. Under federal law, generally 85 percent of the state's total WIA funds are allocated to local Workforce Investment Boards (WIBs) and the remaining 15 percent of WIA funds ($69.1 million in 2010-11) is available for state discretionary purposes such as administration, statewide initiatives, and competitive grants for employment and training programs. Federal law also states that all WIA funds "shall be subject to appropriation by the state Legislature."

With regard to the Governor's January Budget, the reduction in Special Grant funding is a result of the fact that these funds were one-time in 2010-11, so it is typical to see a lower amount in 2011-12 (as compared to 2010-11). The reduction in WIA Administration and Program Services is a result of the 2010-11 workforce cap that reduced personnel expenses across all departments by five percent.

Staff Comment. Historically, WIA state discretionary expenditures and adjustments are considered post-May Revision. Further, these expenditures depend on gubernatorial and legislative priorities. Therefore, the LAO has consistently recommended that the Legislature review and potentially modify the Administration's WIA 15 Percent State Discretionary plan to meet legislative priorities.

Given the accelerated budget adoption process this year, a review of the Administration's plan is not possible at the time of this hearing because the plan is not yet finalized. Therefore, to preserve the Legislature's prerogative, the Subcommittee may wish to approve and accept the WIA Program Adjustments contained in the 2011-12 budget but withhold approval and authorization of the Governor's proposed expenditure and distribution of 15 Percent funds until the Spring 2011 budget process.

7350 DEPARTMENT OF INDUSTRIAL RELATIONS (DIR)

The Department of Industrial Relations protects the workforce in California, improves working conditions, and advances opportunities for profitable employment. The Department is responsible for enforcing workers' compensation insurance laws, adjudicating workers' compensation claims, and working to prevent industrial injuries and deaths. The Department also promulgates regulations and enforces laws relating to wages, hours, and conditions of employment, promotes apprenticeship and other on-the-job training, assists in negotiations with parties in dispute when a work stoppage is threatened, and analyzes and disseminates statistics, which measure the condition of labor in the state.

ISSUE 1: TWO-YEAR EXTENSION OF LIMITED TERM POSITIONS

Governor's Budget Request. The Department of Industrial Relations' (DIR) State Mediation and Conciliation Service (SMCS) requests to extend a limited-term Staff Service Analyst position, through June 30, 2013, and will utilize existing reimbursement authority. Originally established through a 2009-10 BCP (DIR 09-04) to assist in meeting historical demands for service, extending the term of this position will allow the division time to evaluate the demand for service and the sustainability of revenue.

The cost of the position is approximately $75,000 per year and will utilize existing Reimbursement authority, based on fees charged in three limited areas – election services, training and facilitation services, and arbitration services.

Background. The State Mediation and Conciliation Service (SMCS), founded in 1947, began as a service to help employers and unions in the private sector avoid strikes and other disruptions to commerce through the use of neutral mediators. In 2009-10, SMCS was granted 2.0 limited-term positions for two years based on the inauguration of SMCS' reimbursed services program. A statutory change in July 2009 authorized SMCS to charge fees for certain services. The core of SMCS' public interest mission – to provide dispute mediation services to labor and management parties – remain free to the parties. Fees are charged in three limited areas, listed above. Regulations were approved on June 30, 2010. Extending the SSA position will assist the division with time to evaluate the demand for service and the sustainability of revenue.

Demand for these services has remained relatively steady over the past five years. SMCS estimates revenues for 2011-12 as follows: $166,000 for election services, $47,000 for training and facilitation services, and $62,000 for arbitration services. However, since the regulations where just approved in June of 2010, the Department needs more time to determine the degree to which this projected revenue can actually be achieved and sustained.

Staff Comment. Extending the term of one position for another two years will allow the Department time to evaluate the demand for service and sustainability of the revenue stream. Staff notes that this request is for only one of the two limited-term positions approved in 2009-10; the other position will expire as scheduled on June 30, 2011.