Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Loni Hancock, Chair
Senator Joel Anderson
Senator Lois Wolk

Tuesday, February 1, 2011
1:30 p.m.
Room 113

Consultant: Kris Kuzmich

OUTCOMES

Item Number/Title

7100	Employment Development Department
7350	Department of Industrial Relations
CS 3.90	Employee Compensation

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AGENDA – DISCUSSION / VOTE ITEMS

Employee Compensation (Control Section 3.90)

Background. Currently the state employs about 358,000 employees at a salary cost of approximately $23.6 billion (all funds). This total includes the Executive Branch, Judicial Branch, UC and CSU, and elected members of the Legislature; this total does not include legislative staff. About two-thirds of these employees work in the Executive Branch, with the employees of the California Department of Corrections and Rehabilitation accounting for approximately 30 percent of those employees in the Executive Branch. About 83 percent of Executive Branch employees are represented by one of the state's 21 bargaining units. Most of the remaining 17 percent of the Executive Branch workforce are managers, supervisors, and Governor appointees. Executive Branch employee compensation accounts for about 12 percent of projected GF expenditures in 2011-12, including $7 billion in salaries and $3.4 billion in benefits. The employees of the California Department of Corrections and Rehabilitation represent roughly two-thirds of all GF salary costs.

Issue Proposed for Discussion Only

Issue 1 – Bargaining Units with Expired Contracts; Salary Reductions

Governor's Budget Request. The January budget reflects savings of $308.4 million GF ($207 million other funds), representing a ten percent reduction for employees represented by the six bargaining units that do not currently have contracts with the state. These savings will be achieved through collective bargaining or other administrative actions and are intended to be commensurate with savings achieved in the 2010 ratified agreements.

Background. The six bargaining units currently not under contract represent roughly 25 percent of the Executive Branch employees and include the following: Attorneys (CASE); Correctional Peace Officers (CCPOA); Protective Services and Public Safety (CSLEA); Professional Engineers (PECG); Professional Scientific (CAPS); and Stationary Engineers (IUOE). These bargaining units remain on a 3-day-per-month furlough through June 30, 2011.

The labor agreements reached in 2010, covering 15 of the state's 21 bargaining units, contained compensation concessions ranging in a reduction to take-home pay between eight and ten percent for most of the state workforce.

LAO Comment. The MOUs negotiated in 2010 achieved eight to ten percent savings in employee compensation. Unless the contracts with the remaining six bargaining units achieve savings at the top end of this spectrum, the state will not realize the saving anticipated in the budget. If the contracts provide eight percent savings, for example, over $60 million in assumed GF savings ($40 million other funds) would not be realized.

The LAO proposes the following alternatives for the Legislature's consideration in 2011-12:

- *Enhance Savings Through Collective Bargaining and Administrative Actions*. The Legislature could increase the level of proposed savings associated with employees with expired contracts. For example, approving MOUs or authorizing administrative actions that continue the current level of savings associated with these employees could reduce GF costs by over $100 million in 2011-12.

- *Authorize Furloughs at End of Personal Leave Program (PLP)*. The Legislature could authorize administrative actions that impose a one-day per month furlough at the conclusion of the 12-month PLP for employees represented by Bargaining Units 1, 3, 4, 11, 12, 14, 15, 16, 17, 20, and 21, and for employees not represented by a union. This option is not authorized under MOUs for the other bargaining units currently under contract. This solution could save the state $147 million GF ($175 million other funds) in 2011-12.

- *Reduce Employee Salary*. Reducing employee salary offers the greatest legislative flexibility. Collective bargaining is largely a process of quid pro quo, and right now the state has little or nothing to give employees. Under the Ralph C. Dills Act, the Legislature has reserved the right for itself its constitutional powers to appropriate funds and, therefore, the right to set salary levels for represented employees at the level it desires.

Committee Questions. Based on the above information, the Committee may wish the Administration to provide responses to the following questions:

1. What is the status of negotiations with the six bargaining units that are without contracts?
2. What is the Administration's timeframe for these negotiations? When can the Legislature expect to see MOU bills that reflect the ten percent savings?

Staff Recommendation: None; information item only.

Issue Proposed for Discussion / Vote

Issue 2 – Proposed Trailer Bill Language; Core Health Care Plan Option

Governor's Budget Request. The January budget reflects savings of $72 million GF ($36 million other funds) from the: (1) addition of a core health care plan option to the current health benefit plan options to provide fundamental coverage at a lower premium to benefit both the employee and the state; and (2) identification of additional efficiencies.

Background. State employer health and dental care benefit costs in 2010-11 for active employees and retirees total approximately $3.6 billion ($2.4 billion GF). To reduce the escalating cost of state employee and retiree health care, the Administration proposes the addition of a core health plan to the current benefit plan options for savings of $72 million GF from the projected increase in the 2012 calendar year health rates. Through proposed budget trailer bill language, the Administration proposes that the California Public Employees' Retirement System (CalPERS) 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 for the purpose of shaping the core health plan option and identifying and advocating for more economical options within existing plans.

LAO Comment. The state's contribution to employee health care is based on the average cost of the four health plans with the most enrolled state employees. Beginning in the 2012 calendar year, the Administration proposes adding a new health plan that provides somewhat less coverage at a lower premium. The 2011-12 budget assumes that this plan will attract enough employees so that the state will realize the savings noted above. A plan that is less expensive than the current health plans will likely have less coverage. Because the state workforce is aging, the LAO is cautious in assuming that many employees would be attracted to a plan with fewer benefits.

Staff Comment. Generally speaking, establishing an additional choice, including one that provides fundamental coverage at a lower premium, is a reasonable proposal from a policy perspective. This proposal is also different in its approach when compared to the proposals of the prior Administration. The prior Administration sought to contract for lower-cost health care coverage either directly from an insurer or through CalPERS. The current Administration instead proposes to direct CalPERS to add the low cost option to its current plan offerings. The Administration also indicates that approximately 20 percent of active state employees do not utilize the health care coverage offered through their employer.

Committee Questions. Based on the above information, the Committee may wish to ask the Administration to provide responses to the following questions:

1. How will the Administration attract employees to the new plan? Will some portion of the premium savings flow to employees to encourage enrollment?
2. If established, should the new core health care plan option be approved on a trial basis to allow its impacts to be ascertained before making the option permanent?
3. Does the Administration have a concern that dividing the pools could potentially make the richer benefit plans "sicker;" i.e., if younger/healthier active employees are attracted to the lower-cost plan, what would the effect be on the pools of the other plans?
4. How does this proposal intersect with federal health care reform and the requirements therein which mandate an "essential benefit design?"
5. The $72 million in savings is from the: (a) addition of a core health care plan option and (b) identification of "additional efficiencies." What are the "additional efficiencies" that the Administration is referencing here?
6. The proposed trailer bill would include a state representative in CalPERS' health contract negotiations. Health negotiations are and must be confidential. Is the Administration proposing to insulate the state representative from Open Records Act requests?

Staff Recommendation: Approve placeholder trailer bill language as described in the background section above.

Vote: Issue held open.

Employment Development Department (7100)

Department and Budget Overview. The Employment Development Department (EDD) administers services to employers, employees, and job seekers. The EDD pays benefits to eligible workers who become unemployed or disabled, collects payroll taxes, administers the Paid Family Leave Program, and assists job seekers by providing employment and training programs under the federal Workforce Investment Act of 1998. In addition, the EDD collects and provides comprehensive labor market information concerning California's workforce.

	2009-10 (actual)	2010-11 (estimated)	2011-12 (proposed)
Expenditures	$30,883,630,000	$23,471,859,000	$25,963,988,000
General Fund	$24,983,000	$33,107,000	$403,826,000
Personnel Years	11,192.7	11,022.5	10,208.9

Issues Proposed for Discussion / Vote

Issue 1 – Automated Collection Enhancement System (ACES)

Governor's Budget Request. The Governor requests $21.9 million ($19.5 million GF and various special funds) and 49.3 positions to fund year six of the Automated Collection Enhancement System (ACES), an information technology project intended to improve EDD's ability to track, collect, and audit the payment of employer payroll taxes, including UI and personal income taxes. This request also includes a reduction of 18 baseline positions for support of the ongoing Tax Accounting System (TAS) that will no longer be needed post implementation of ACES.

2010-11 Budget. The 2010-11 Budget included a one-time augmentation of $31.4 million (GF and Unemployment Insurance Fund) and 65 positions for the ACES project.

Background. EDD's Tax Branch is a major revenue collection organization for the state, receiving and processing approximately $50 billion annually from over 1.2 million registered California employers. In 1986, TAS was implemented to provide an accounting system to handle employer contributions and employee withholdings for California's payroll taxes. However, TAS is an antiquated system, written in Common Business-Oriented Language (COBOL), with significant functional limitations which, twenty-five years later, place the state at risk for system failure.

In the 2006 budget, the Legislature approved and started funding the ACES project. The ACES project is modeled after the systems currently used by the Franchise Tax

Board and Board of Equalization. ACES is a new collection system that will increase the effectiveness of the EDD tax collection operations. ACES will also collect penalties and back-wages that are due to the Department of Industrial Relations (currently collected by the Franchise Tax Board). ACES began implementation on January 18, 2011.

The ACES project is a benefits-based procurement, whereby the additional revenue generated by the project will offset all project costs thereby minimizing risk for the state. The ACES solution is expected to increase GF revenue by $27 million in 2011-12 by improving collection capabilities for delinquent accounts. The majority of the 2011-12 costs is a one-time augmentation of $18.7 million for the estimated Prime Solution Provider payment if sufficient revenue is collected with the new system.

Staff Comment. The ACES project is on-time and on-budget. Project roll-out and implementation began as scheduled on January 18, 2011. At a future time, i.e., when the ACES system is fully operational, clean-up trailer bill language will need to be adopted to remove from statute the Franchise Tax Board's authority to collect delinquent accounts for the Department of Industrial Relations.

Staff Recommendation: Approve the budget request.

Vote: Budget request approved 2-0; Senator Anderson absent.

Issue 2 – Disability Insurance Automation (DIA) Project

Governor's Budget Request. The Governor requests a one-time augmentation of $38.9 million (Disability Insurance Fund) to fund 16.1 new positions and 47 existing positions for the DIA Project. The resources will be used to continue the design, development, and implementation phase of the DIA project.

2010-11 Budget. The 2010-11 budget included a one-time augmentation of $34.047 million (Disability Insurance Fund) and 47 positions to continue the development of the DIA project, including year two of Systems Integration vendor activities to continue the design, development, and implementation phase of the project.

Background. Initially funded in the 2006 Budget, the DIA project will provide greater access to services for claimants, medical providers, and employers by allowing these individuals to use the Internet to submit claims data using a direct electronic interface or through web-based intelligent forms. This will simplify and automate the numerous manual work processes involved when a Disability Insurance claim is filed with EDD. Further, 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.

Staff Recommendation: Approve the budget request.

Vote: Budget request approved 2-0; Senator Anderson absent.

Issue 3 – Unemployment Insurance Loan Interest

Governor's Budget Request. The Governor requests an increase of $362.3 million GF to make the first interest payment due to the federal government for the quarterly loans the EDD has been obtaining from the federal government since January 2009 to cover the Unemployment Insurance (UI) fund deficit. The Governor proposes that this expenditure be offset by a transfer from the Disability Insurance (DI) Fund to the GF, resulting in no net GF cost in 2011-12. Proposed budget provisional language requires that the loan from the DI Fund to the GF be repaid by the GF with interest over the next four years.

Background. California's UI fund was depleted on January 26, 2009, and at that time the EDD began borrowing funds from the Federal Unemployment Account in order to continue paying UI benefits to qualifying unemployment claimants. The UI fund deficit was $10.3 billion at the end of 2010 and is expected to increase to $13.4 billion at the end of 2011. The federal loans have permitted California to make payments to UI claimants without interruption. Generally, loans lasting more than one year require interest payments; the federal American Recovery and Reinvestment Act (ARRA) of 2009 provided temporary relief to states from making interest payments on UI loans through December 31, 2010. With the expiration of the ARRA provisions, the first interest payment to the federal government is due in September 2011 with growing interest obligations in the out years. Federal law requires that the interest payment come from state funds; i.e., the payment cannot be paid by the Unemployment Fund or by a state's UI administrative grant.

Federal law includes provisions to ensure that a state does not continue to incur loans over an extended period. Specifically, if a state has an outstanding loan balance on January 1 for two consecutive years, the full amount of the loan must be repaid before November of the second year or employers face higher federal UI taxes. Due to California carrying an outstanding loan balance for two consecutive years, the federal unemployment tax credit will decrease from 5.4 percent to 5.1 percent on January 1, 2012. This will result in employers paying a federal tax rate of 1.1 percent in calendar year 2012. This translates to an increase of $21 per employee per year; the aggregate increase in employer costs in 2012 is $325 million.

The DI program is a component of State Disability Insurance (SDI) and provides benefits to workers who are unable to work due to pregnancy or a non-work related illness or injury. The SDI program taxes covered employees up to a statutory ceiling, which is projected to increase to $93,316 in 2011. The statutory formula for calculating the SDI contribution rate helps to maintain an adequate DI Fund balance. While contributions account for the majority of total receipts to the DI Fund, interest earnings and other receipts are also included in the DI Fund balance.

Staff Comment. The DI Fund is projected to have a fund balance of $1.6 billion at the end of 2011. The Administration proposes this fund source to pay the federal interest due, as opposed to the EDD Contingent Fund or the EDD Benefit Audit Fund, because those funds do not have sufficient balances to pay off the interest due for the outstanding loan balance (together, the 2011-12 projected fund balance for these two funds excluding scheduled transfers to the GF is $63.3 million).

This request is accompanied by proposed budget provisional language to: (1) authorize the Department of Finance to increase/decrease the actual amount paid/borrowed from the DI fund based on a more precise calculation of the interest due; and (2) specify that the annual contribution rates for the DI fund shall not increase as the result of any loan made to the GF (in calculating the annual disability insurance tax rate each year, the EDD shall treat outstanding DI loans as available cash in the DI Fund). This latter provision is key to preventing any potential increase in employee paid DI taxes as a result of the loan from the DI Fund to the GF.

Finally, staff notes that the out year GF implications of not addressing the insolvency of the UI Fund are significant. The estimated September 12, 2012, interest liability is $592.8 million. This figure does not include the roughly $90.6 million that the GF will be required to pay out to the DI fund over the next four fiscal years as payment for the 2011-12 loan. The Governor's January budget did not include a proposal to address the underlying insolvency of the UI fund.

Staff Recommendation: Approve the budget request.

Vote: Budget request approved 2-0; Senator Anderson absent.

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.

Staff Recommendation: Approve trailer bill language to adopt the three-year look-back statutory changes related to determination of state eligibility for FedEd extended unemployment benefits.

Vote: Staff recommendation approved 2-0; Senator Anderson absent.

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.

Staff Recommendation. Approve and accept the 2011-12 WIA Program Adjustments but deny without prejudice approval and authorization of the Governor's proposed expenditures and distribution of 15 Percent funds and consider the 15 Percent funds proposed expenditure and distribution during the Spring 2011 budget process.

Vote: Staff recommendation approved 2-0; Senator Anderson absent.

Department of Industrial Relations (7350)

Department and Budget Overview. The objective of the Department of Industrial Relations (DIR) is to protect the workforce in California; improve working conditions; and advance opportunities for profitable employment. The DIR enforces workers' compensation insurance laws and adjudicates workers' compensation insurance claims; works to prevent industrial injuries and deaths; promulgates 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.

	2009-10 (actual)	2010-11 (estimated)	2011-12 (proposed)
Expenditures	$358,567,000	$393,185,000	$418,131,000
General Fund	$24,077,000	$4,664,000	$4,811,000
Personnel Years	2,588.8	2,656.7	2,725.1

Issue Proposed for Discussion / Vote

Issue 1 – Reimbursement for Ancillary Mediation Services

Governor's Budget Request. The Governor requests to extend a limited-term position through June 30, 2013, utilizing existing reimbursement authority to fund the $75,000 cost of this position, for the State Mediation and Conciliation Service (SMCS).

Background. The SMCS was established in 1947, beginning 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 the 1970s, the law was changed to have SMCS take on the responsibility of mediating labor disputes in the schools, community colleges, public higher education, local government, state government, transit, and (in recent years) the trial courts. The Federal Mediation and Conciliation Service took over most of the private sector mediation work.

While the core of SMCS' public interest mission, to provide dispute resolution mediation services to labor and management parties, remains free to the parties, in 2009 statute was changed to authorize SMCS to charge fees for certain services. Further, in the 2009-10 budget, SMCS was granted two limited-term positions for two years based on the inauguration of SMCS' reimbursed services program. Regulations adopted in June 2010 established the fee structure; fees are now charged in three limited areas: (1) election services; (2) training and facilitation services; and, (3) arbitration services. Because of lag time in developing and then finalizing the regulations, the Department indicates that it needs more time to determine the degree to which the following revenue projections can actually be achieved and sustained: (1) $166,000 for election services; (2) $47,000 for training and facilitation services; and, (3) $62,000 for arbitration services.

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.

Staff Recommendation: Approve the budget request.

Vote: Budget request approved 2-0; Senator Anderson absent.