Statewide Issues

The Statewide Issues Section of the Budget Summary includes issues that affect multiple departments in various major program areas. This chapter describes items in the budget which fall into these categories. These issues do not lend themselves to a discussion of a program mission or accomplishments from the previous year, but have a year-to-year impact on the state budget. The following sections describe a few of these statewide issues that are not specific to a program but which have significant effect either on the state budget or how the state conducts business.

Other Post Employment Benefits

The Government Accounting Standards Board (GASB) prescribes accounting standards for all governments in the United States. Long-standing GASB standards recommend that governmental entities estimate the future costs of pension benefits and report those to the public. Until recently, there has not been a similar standard for governments' non-pension retirement benefits, often called "other post-employment benefits (OPEB)". GASB has adopted new standards (GASB 45) for how governments should report the liabilities and the actuarially required contribution (ARC) to fund the future costs of OPEB.

As governments, including the state, start reporting these liabilities in their annual accounting statements, investors who buy government bonds will become increasingly interested in how the governmental entities plan to pay those future costs, and how those payments will affect governmental entity's ability to make bond payments.

Post Employment Benefits Commission

The Governor established the Public Employee Post Employment Benefits Commission (Commission) to study the funding of OPEB. The Commission was directed to provide a report to the Governor and the Legislature by January 1, 2008, that:

- Identifies the full amount of unfunded liabilities for the State of California and local governments for OPEB;
- Compares and evaluates various approaches for addressing unfunded post employment benefits;
- Considers the advantages for the state as an employer from OPEB, such as retiree health care, and;
- Proposes a plan or plans for addressing unfunded post employment benefits.

Included in the report is a recommendation to the state that it establish prefunding as a policy and budget priority, develop and make public a prefunding plan, and begin prefunding its OPEB liabilities.

Liabilities for the State's Other Post Employment Benefits

Pursuant to the new reporting standards adopted by GASB 45, the State Controller recently released an actuarial valuation which identified the total estimated future liabilities as $47.88 billion. The State Controller's GASB 45 valuation assumed the annual increase in health care premiums will decline from the current 10 percent in 2008-09 to only 4.5 percent in 2017-18 and beyond. The assumption regarding future increases in health care costs is a significant departure from the historical trends. In order for these assumptions to be realized, the state will need to focus on how best to manage future health care costs.

Budget Considerations

The Governor's Budget includes $1.4 billion ($834 million net General Fund) for health and dental benefits for retirees on a pay-as-you-go basis. If the state continues with the current pay-as-you-go method and does not pay the unfunded liability, the difference between the pay-as-you-go amount and the ARC would accrue as an increasing liability on the annual accounting statements issued by the State Controller.

The Administration is considering a number of possible approaches to budgeting for future OPEB costs. In selecting an appropriate strategy for funding future costs, the Administration must balance two competing and potentially conflicting criteria. First, the funding strategy must minimize the disruption of existing critical state programs when the state begins to budget for the future costs of OPEB. Second, the funding strategy must assure bond rating agencies and future investors that the state will fund all future retirement costs.

State Controller Assumptions

The State Controller's valuation for OPEB liabilities used the following health care inflation assumptions:

- 9.5 percent for 2009-10
- 9.0 percent for 2010-11
- 8.5 percent for 2011-12
- 8.0 percent for 2012-13
- 7.5 percent for 2013-14
- 7.0 percent for 2014-15
- 6.5 percent for 2015-16
- 5.5 percent for 2016-17
- 4.5 percent for 2017-18

While the Commission considered the issue from a "best practices" viewpoint, funding the cost of OPEB must also be considered from a budgetary perspective as well. There are three funding options displayed in Figure SWI-01: (1) continue to budget for the costs annually on a pay-as-you-go basis, at a cost of $1.6 billion ($935 million GF) in 2009-10; (2) fully fund the ARC, at a cost of $1 billion ($600 million GF) more than the projected pay-as-you-go cost beginning in 2009-10; or, (3) fund the pay-as-you-go costs plus an amount that would eliminate any new liability from being accrued, at a cost of $650 million ($375 million GF) more than the projected pay-as-you-go costs beginning in 2009-10. All three options would result in the state paying approximately the same amount by 2022-23.

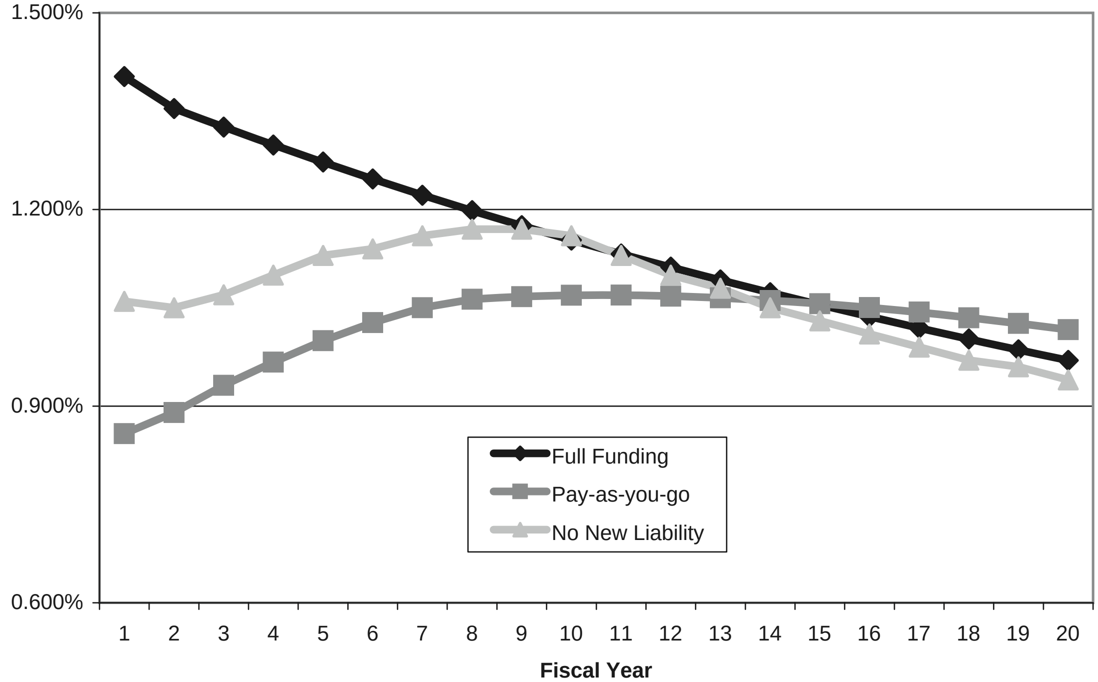
State Active and Retiree Health Benefits

In addition to considering how best to fund these obligations, the state must implement strategies to achieve efficiencies, including economic, within its health benefits program.

The Administration contracts with the California Public Employees Retirement System (CalPERS) to provide health benefits for state employees. Under this arrangement, CalPERS negotiates health premiums with the providers, designs the benefit package, and otherwise controls the overall policies of the health program. The CalPERS health

Figure SWI-01

OPEB Options as a Percent of GF Revenue



program provides coverage to approximately 1.2 million active and retired state and local government public employees and their family members. In the past 6 years, the average premium increase has exceeded 12 percent annually. The employer pays the bulk of these premiums.

In recent years, CalPERS has attempted to control these rising health costs by eliminating high-cost hospitals, reducing the number of providers, and adding high performance health plans. While effective to a degree, CalPERS' cost-containment strategies represent a "one-size-fits all" approach for all the public employer groups with whom it contracts (the state and 1,100 local agencies).

The Administration prefers an approach that allows greater program flexibility so that health benefits and the plan design can be customized to better serve the needs of the state employer, employees, annuitants, and covered family members. Included in this approach should be discussions with the employee organizations on the feasibility of the employer and the employee unions meeting and conferring in good faith directly over the design of the benefit programs and other ways to customize the delivery of health benefits to state employees.

State Civil Service Human Resources Reform

The state, as with most employers in the nation, will be facing the loss of many of its most experienced and knowledgeable employees as the "baby boomers" retire. As the current workforce ages and moves into retirement, government services must be able to respond to public needs and changing times. The Administration has long recognized that the state's civil service system is unable to rapidly adapt to changing demands in the workplace or keep pace with a highly competitive labor market. To address this urgent situation, the Human Resources Modernization Project (HRMOD) was approved in the 2007-08 budget to address this urgent business need.

"Getting the Right People into the Right Jobs at the Right Time" is the key to a model state government civil service system that responds to our changing business needs and a key theme of the project. The HRMOD is a collaborative effort sponsored by the Department of Personnel Administration, the State Personnel Board, and the Department of Finance. These departments have partnered to create a strategic plan that defines the direction for civil service reform. Through implementation of the strategic plan, the HRMOD will result in a streamlined system enabled to recruit, develop, and maintain a well-qualified, high-performance workforce. When the project is fully implemented, each agency, department, board, and commission will benefit from: (1) an aggressive recruitment strategy that markets California as an "employer of choice;" (2) a streamlined and flexible selection and hiring process; (3) a simplified classification system based on competencies rather than duties; (4) an improved performance management program; and (5) an integrated, automated system featuring on-line recruitment, classification, compensation, examination, certification, performance management, and workforce planning processes and tools.

The HRMOD formally began work in 2007-08 and ends with the final rollout tentatively planned for 2014-15. The project team formally began operating on October 1, 2007, with five permanent project staff. Currently, recruitment is underway for redirected or loaned staff from agencies, departments, boards, and commissions to complete the project staffing. The project management staff has extensive experience managing large scale projects to successful implementation as well as extensive experience in human resources for the state. Goals for the first two years of the project will be to: (1) develop a classification and compensation model based on competencies; (2) streamline the classification process by abolishing unused classifications; (3) develop a long-term recruitment and retention plan as well as a marketing plan focusing on disciplines who face the largest attrition rate; (4) develop a certified training program for state managers/

supervisors and human resources professionals; and (5) develop a system automation procurement plan, requirements, and Request for Proposal.

In addition, in 2008-09, a pilot project for the state information technology classifications will be implemented. This project will pilot some of the models identified in the HRMOD strategic plan.