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To expand communications between Washington and California, the California Institute provides periodic faxed bulletins regarding current activity on Capitol Hill which directly impacts our state. Bulletins are published weekly during sessions of Congress, and occasionally during other periods.

FASB DELAYS STOCK OPTIONS EXPENSING RULE FOR SIX MONTHS

The Financial Accounting Standards Board (FASB) decided on Wednesday, October 13 to give companies an additional six months to comply with its new rule requiring stock options to be considered an expense at the time they are given to employees. Companies that use stock options will now have until June 15, 2005 to implement the new rule.

The delay was precipitated by company complaints that the complexity of implementing the new rule, especially determining how to value an employee option, would overburden administrative resources. The Securities and Exchange Commission supported the rule delay, noting that company resources are already being stretched in order to implement the new Sarbanes-Oxley financial reform requirements.

As part of its decision, the FASB Board also agreed that companies will be allowed, but not required, to restate their profits for the first two quarters of 2005 to reflect options expense.

Many of California's information and biomedical technology companies oppose the rule, arguing that it is an important tool in hiring and retaining top-notch employees, especially for start-up companies. On July 20, the House passed a bill, H.R. 3574, that would confine the new expensing provisions to the five highest-paid employees of a company. The Senate also has a bill, but has not taken any action on it.

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CONGRESS APPROVES CONFERENCED FY 2005 APPROPRIATIONS BILL FOR HOMELAND SECURITY

Shortly before Congress adjourned, a House-Senate conference committee reached agreement on a fiscal year 2005 spending package for the Department of Homeland Security and both houses approved the measure. The bill, H.R. 4567, was approved by the House on Friday, October 9, 2004 by a vote of 368 to 64. The Senate followed suit on Sunday, October 11, approving the measure by voice vote.

The FY 2005 Homeland Security Appropriations Conference Report provides that a total of nearly \$1.7 billion will be distributed according to a much-embattled state grant formula, originally contained in the USA Patriot Act, that fiscally advantages small states over larger states. (In 2004, formula funds

provided California \$5 per capita and Wyoming \$38 per capita.) That \$1.7 billion includes \$1.5 billion to be distributed under the state homeland security grant program or SHSGP (of which \$400 million is specifically directed for use for law enforcement purposes) and an additional \$180 million appropriation for Emergency Management Performance Grants (EMPGs), which have used the same distribution formula. The formula total for 2005 is considerably less than the \$2.2 billion that was distributed by the same formula in 2004.

The appropriations bill significantly increases discretionary grants, which are provided \$1.2 billion in total funding. Included in these discretionary grants are \$885 million for high-threat high-density urban area grants, \$150 million for port security grants, another \$150 million for rail and transit security grants, \$10 million for intercity bus security grants, and \$5 million for trucking security grants.

The change in funding totals is likely to increase total funding to California. In 2004, the state received less than 8% of formula grants, but more than 20% of urban area grants, so California's total funds will likely grow with the increasing relative proportion of urban area grants. (However, it is important to remember that urban area grants are distributed at the discretion of the Department and thus may fluctuate from year to year.)

In addition, the state recently received approximately 17% of port security grants and 14% of transit grants. However, past history may be a poor indicator of future rail and transit grant funding. Unlike prior years, when transit security grants were a component of urban area grant funding, the 2005 appropriations bill creates a freestanding \$150 million discretionary account that is to be used for "intercity passenger rail, freight rail, and transit security grants."

The conference report also provides \$715 million for firefighter assistance grants. The fire program is largely focused on rural fire departments, and California received 4% of funds in 2003. Conferees agreed to provide \$50 million for a technology transfer program as a freestanding program (not carved out of law enforcement grants, as the Senate had proposed). Report language indicates that the program is also designed to benefit primarily rural areas.

Funding of \$15 million is provided for the "Citizen Corps" program. Given the funding total provided, it appears that the funds may be used for national programs only, not distributed by formula to state or local entities as has been the case in the past. A separate program for "Continuing Training Grants" may fund or replace these formula grants.

In other areas, the 2005 Homeland Security conference report provides \$340 million for the U.S. VISIT project to track the status of immigrants in the United States on student, visitor and other types of visas. The Report states: "The conferees are troubled by the security gap on the nation's borders caused by delays in linking the Automated Biometrics Identification System (IDENT), the fingerprint database managed by Customs and Border Protection (CBP) and US Visitor and Immigrant Status Indicator Technology (US-VISIT), with criminal history data contained in the Federal Bureau of Investigation's Integrated Automated Fingerprint Identification System (IAFIS). The conferees understand that by the end of calendar year 2004, interoperability will exist at airports, seaports, and the largest and busiest Border Patrol stations and land ports of entry."

For Immigration and Customs Enforcement, the conferees agreed to provide \$2,438,494,000, instead of \$2,377,006,000 as proposed by the House and \$2,513,438,000 as proposed by the Senate. This funding includes increases of: \$11,000,000 for alternatives to detention; \$6,000,000 to reduce immigration court backlog; \$14,000,000 for the Visa Security Unit and Overseas Operations; \$30,000,000 for the Institutional Removal Program; \$25,000,000 for benefit fraud enforcement; \$5,000,000 for worksite enforcement; \$26,500,000 for detention bedspace support; \$16,000,000 for compliance teams; \$50,000,000 for fugitive operations (including associated detention and removal costs); \$6,216,000 for the Guantanamo Migrant Operations Center; and \$4,200,000 for the Cyber Crime

Center. \$828 million is also provided to modernize border, customs, and immigration information technology,

For Citizenship and Immigration Services (CIS), the conferees provide \$160,000,000, as proposed by the House, instead of \$140,000,000 as proposed by the Senate. This includes \$140,000,000 for backlog elimination, as well as \$20,000,000 for the historical records project to convert immigration records into an electronic, digitally-accessible format. Other activities of CIS will be offset by the estimated \$1,571,000,000 collected through fees.

HOUSE APPROVES INTELLIGENCE OVERHAUL MEASURE, CONFEREES MAY SEEK FINAL BILL BEFORE NOVEMBER 2 ELECTION

On Friday, October 8, 2004, the House of Representatives approved H.R. 10, a bill to overhaul the nation's intelligence system. Despite numerous differences between the House bill and the Senate's version, S.2845, some are hopeful that a conferenceable agreement can be worked before the November 2 election. The Senate passed its bill on October 6.

The House bill incorporates legislation by House Homeland Security Select Committee Chairman Christopher Cox (Newport Beach), the "Faster and Smarter Funding for First Responders Act," which would alter the frequently-criticized formula for allocating federal homeland security funding to state and local first responder agencies that includes an unusually large 0.75 percent minimum. H.R. 10 instead would provide a more common state minimum of 0.25 percent, with a higher minimum of 0.45 percent for states with a "significant" international border or that are "adjoining a body of water within North America through which an international boundary line extends." Although it still retain a state-level funding minimum, regardless of threat or risk, the altered formula provisions of the House bill would significantly lessen the funding gap between large and small states.

The Senate bill, sponsored by Sen. Susan Collins (ME), includes a complicated restructuring of homeland security grant programs. The discretionary Urban Area Security Initiative (UASI) program would receive 25 percent of total homeland grants -- a portion roughly comparable to the FY2004 level but below the share in both the FY2005 Homeland Security appropriations conference report. Remaining funds, now funded as the State Homeland Security Grant Program (SHSGP), would be distributed using the existing 0.75 percent small-state minimum. The Senate bill would require an additional amount, above the 0.75 percent per-state floor, be distributed to every state. Language would require funding be provided to every state that has a "substantial percentage" of its population living in metropolitan areas (which can house as few as 50,000 persons); an international border or coastline; or has at least one "key asset," which is not defined but could be a hospital, refinery, military base, state capitol building, etc. Last year, California received 20 percent of UASI funds and 8 percent of SHSGP money.

For more information on homeland security grant programs in 2003 and 2004, and on California's share thereof, see "Federal Formula Grants and California: Homeland Security" -- one of a series of joint publications by the Public Policy Institute of California (PPIC) and the California Institute reviewing state's share of formula funds, available at: <http://www.ppic.org/main/publication.asp?i=481> .

SENATE CHANGES COMMITTEE LINEUP FOR INTELLIGENCE SPENDING AND HOMELAND SECURITY OVERSIGHT

By a vote of 76-9 on Friday, October 9, the Senate voted to create a freestanding committee to deal with homeland security matters. The House adopted similar measures two years ago, creating the House Select Committee on Homeland Security, chaired by Rep. Christopher Cox (Newport Beach).

The Senate Governmental Affairs Committee, chaired by Sen. Susan Collins (ME), will become the Homeland Security and Governmental Affairs Committee. While it will have authority over the

Department of Homeland Security, several major agencies would remain under the purview of the existing committee structure. The Commerce, Science and Transportation Committee, for example will continue to oversee the Transportation Security Administration and Coast Guard.

In the same measure, S. Res. 445, the Senate provide for creation of a subcommittee of the Appropriations Committee to deal with intelligence matters. In order to maintain the current 13-subcommittee arrangement, two of the existing panels are expected to be merged. Some have speculated that the military construction subcommittee might be merged into the much larger defense appropriations panel, but a decision regarding how to achieve a new structure will be postponed until a later time.

Paralleling its thoughts regarding the executive branch, such as its design of a National Intelligence Director position in the administration, the 9/11 Commission recommended a single point of Congressional authority over federal intelligence matters.

DEFENSE AUTHORIZATION CONFERENCE REPORT PASSES SENATE AND HOUSE, INCLUDES 2005 ROUND OF BASE CLOSURES

On October 9, 2004, the Defense authorization conference report was approved in the House, 359-14, and in the Senate by voice vote. The final version of the bill, which authorizes \$445.6 billion for the Defense Department and defense activities, preserves a round of base closures to take place in 2005 -- an earlier House version of the bill would have delayed the closures until 2007. The President had threatened to veto any bill that delayed the base closures.

Although it allows the 2005 closure round to go forward, the bill, HR 4200, does slightly modify the procedures through which bases are designated for realignment or closure. Under the current process, the Department of Defense proposes a list of bases for closure. The President nominates a nine-member Base Realignment and Closure Commission (BRAC), which is the body responsible for analyzing the closure recommendations and putting forth a final base closure list for an up-or-down Congressional vote. The 2005 authorization bill requires that the Secretary of Defense's base closure list better accounts for the military infrastructure's ability to deal with "surge requirements of the armed forces." Additionally, whereas previously the approval of five BRAC members could add a base to the Defense Department's closure list, the 2005 bill requires seven of the nine members to vote for closing a base not specified by the Defense Secretary.

Unlike most components of the federal budget, where the authorization and appropriations processes are separate and often contradictory, a fiscal year's defense authorization and appropriations bills tend to parallel one another effectively. The FY 2005 appropriations bill for the Department of Defense (H.R. 4163) was approved July 22 by both the House, 410-2, and the Senate, 96-0. On August 5, the bill was signed by the President and became Public Law 108-287. The conference report accompanying the bill is H.Rept.108-622.

The appropriations conference report included \$416.2 billion in new discretionary spending authority for the Department of Defense, including \$25 billion in emergency spending requested by the President for FY05 for operations in Iraq and Afghanistan. The discretionary total is \$1.6 billion below the President's budget request and \$23.8 billion more than comparable FY04 funding levels (excluding the FY04 Iraq supplemental and the FY05 Emergency Wartime Appropriation.) The FY 2005 appropriations spending broke down as follows:

- \$103.7 billion for Military Personnel
- \$121.0 billion for Operation and Maintenance
- \$77.7 billion for Procurement
- \$70.0 billion for Research, Development, Test and Evaluation
- \$2.4 billion for Revolving and Management Funds

-\$20 billion for Other Department of Defense Programs

-\$25 billion for Emergency Wartime Appropriations

The final bill included a 3.5% military pay raise.

The appropriations conference report provided \$1.5 billion above the president's budget request for recapitalization of combat and tactical vehicles, helicopters, and ammunition production in order to restock inventory depleted by military operations in Iraq and Afghanistan. Included in this fund was \$625 million for procurement and fielding of one additional Stryker brigade.

This year's spending bill provided funding for a number of aerospace programs, many of which provide significant revenues to California's aerospace industry. For the Navy/Marine Corps, the defense appropriations conference report provided \$2.9 billion for 42 F/A-18 fighters, \$846.6 million for 8 Marine Corps V-22 transport aircraft and \$211.5 million for 2 E-2C Hawkeye surveillance aircraft. It also funded 2 UC-35 airlift aircraft, and 2 C-37s. For the Army, the conferees terminated the Comanche helicopter program, but added \$63.6 million for the procurement of 12 additional National Guard Blackhawk helicopters.

For the Air Force, the appropriations conference report provided \$3.6 billion for procurement of 24 F/A-22 fighters, \$2.7 billion for 15 C-17 aircraft, and \$176 million for Predator UAVs. Appropriators fully funded the procurement of 3 Air Force V-22 Ospreys and added \$60 million for development work on the B-2 and the next-generation bomber program. The bill authorized \$4.4 billion for the Joint Strike Fighter development program, an increase of \$97 million from FY04 levels. An additional \$586.5 million was provided for the Joint Unmanned Aerial System program.

The August appropriations conference provided \$10 billion for missile defense programs, an increase of \$1 billion over FY04 funding levels and decrease of \$183 million from the budget request. The amount included \$4.6 billion for ground-based midcourse defense in support of fielding a national missile defense initial operational capability in fall 2004. The bill also appropriated \$599 million for the Space Based Infrared System, and provides \$511 million for Enhanced Expendable Launch Vehicle procurement.

ONE-YEAR HIGHER EDUCATION EXTENSION CLEARS CONGRESS, BIPARTISAN SUPPORT FOR STUDENT LOAN SUBSIDY CUT

On October 9, 2004, Congress approved two higher education measures, one that would extend federal college education programs for one year and a second bill that would eliminate a unusually large subsidy to student loan lenders for a temporary period.

The subsidy rollback language in HR 5186 eliminates the authority granted to lenders to issue tax-exempt bonds to finance loans to students for one year. Such federally supported loans award lenders a 9.5 percent return on federal student loans paid for by taxpayers, whereas the current rate paid by students lies at 3.5 percent. The subsidy was instituted in the 1980s to induce nonprofit lenders to offer affordable loans at a time of rising interest rates. A Government Accounting Office (GAO) report, however, notes that the subsidy is costing the federal government billions of dollars in excess interest charges. The House approved the bill on October 7, 2004 by a vote of 414 to 0 and the Senate reported companion language by voice vote on October 9, 2004.

HR 5186 was approved with bipartisan support and is favored by the Bush administration, but Democrats say it does not go far enough to prohibit "recycled loans" or loans that require old borrowers to refinance loans in compliance with current market rates. House Republicans counter by accusing Democrats of stalling action on a Republican-written Higher Education Act (HEA) reauthorization measure, HR 4283, that would permanently end the subsidy. The College Access and Opportunity Act co-authored by Rep. Howard "Buck" McKeon (Santa Clarita) has not yet been brought to the

Committee on Education and the Workforce for consideration by its Chair John Boehner (OH). The Senate also has yet to act on a comprehensive reauthorization proposal.

White House budget experts estimate that if the subsidy is maintained it would place a \$4.9 billion burden on the Treasury over ten years. Savings earned from the subsidy's temporary elimination would be reinvested into loan-forgiveness programs for teachers choosing to work in low income communities under the newly approved bill.

The one-year extension of HEA (HR 5185), maintaining federal college education grants and loans programs at their current levels was reported out of both chambers of Congress last week by voice vote. HR 5185 is a clean extension with no significant policy adjustments included. It was approved to give House and Senate authorizers time to complete work on long-term reauthorization bills.

For more information, visit <http://edworkforce.house.gov/>.

CALIFORNIA & OREGON SIGN AGREEMENT WITH INTERIOR ON KLAMATH

On Wednesday, October 13, the States of California and Oregon signed an agreement with the U.S. Department of Interior and several other U.S. agencies establishing a framework to govern future cooperation and collaboration in Klamath River watershed activities, and pledging to make those activities a priority in their respective agencies. The agreement is intended to end the fragmented management of the Klamath watershed that has led to fights over water use among the states, Indian tribes, farmers, environmentalists, and others.

Under the agreement, the respective federal and state agencies and offices will continue to manage their own activities and resources, including the expenditure of their own funds, but will increase communication and cooperation to resolve water quantity, water quality, and fish and wildlife resource problems in the entire basin.

The agreement supports the creation of the Conservation Implementation Program (CIP), described by Interior Secretary Gale Norton as "a stakeholder-driven, watershed-wide, ecosystem restoration program. The CIP is a long-term approach that will identify the Basin's critical needs, set priorities and measures of success for addressing those issues, and monitor progress in resolving them."

The agreement contains no new funding for Klamath Basin issues. However, the Administration has budgeted \$105 million in federal funding for the Klamath next year, including habitat conservation, water banking and wetlands protection.

LA TIMES REPORT SHOWS WIDESPREAD FAILURE TO MEET "NO CHILD LEFT BEHIND" TARGETS

A computer analysis conducted by the *Los Angeles Times* this week identified more than 1,200 California public schools in danger of facing federal sanctions by the end of this year for failing to meet testing targets established by the "No Child Left Behind Act." The *Times* also predicted that by 2008, at least 3,500 of California's 9,000 public schools "would probably fail." Under the federal law, schools not meeting targets face sanctions that include replacing teachers and principals or bringing in outside managers to run failing schools.

The No Child Left Behind Act of 2001, signed into law by President Bush in January 2002, established testing targets in math and English with the goal of having all students proficient in both subjects by 2013-2014. Within certain ranges, the bill left the specific target numbers, in terms of the percentage of students demonstrating proficiency, up to the states. According to the article, California, which already had some of the most ambitious education goals in the nation, kept its standards in place, but required its schools to show the "least amount of improvement under the law in the first six years." However, at the conclusion of this school year, California's "No Child Left Behind" proficiency

standards in both math and English will rise more than 10%, to 26.5% in math and 24.4% in English. This large step means that many schools that are currently improving test scores will fail to meet federal requirements.

According to the article, a recent report published by the state portrayed an even gloomier picture. The report projected that 67% of schools will fail to meet targets next spring, 76% would fail by 2008, and an astounding 99% would fail to reach goals by 2013-2014.

The *Times* article includes a number of quotes from frustrated teachers and administrators, explaining that “No Child Left Behind” has unreasonable expectations. Others quoted in the article see the law as serving its purpose by attempting to radically rethink schools’ approach to improving education.

For more information, see the article entitled “1,200 Schools in State Could Face Federal Penalties” in the October 13 issue of the *Los Angeles Times*. The article can be viewed on the web at <http://www.latimes.com/news/local/la-me-failure13oct13,1,2298407.story?coll=la-headlines-California> .

EMPLOYMENT ANALYSIS ASSESSES STATUS OF CALIFORNIA WORKFORCE

The California Budget Project (CBP), a non-profit organization, recently released a study entitled “The State of Working California 2004: Little Progress for California’s Workers and Their Families.” The report addresses various employment metrics and concludes that California has, at best, experienced minimal economic gains over the past year, slightly outperforming the rest of the nation. California’s job growth outpaced the rest of the nation, 1.9% to 1.6%, and the California labor force grew by 1.1% as opposed to .9% nationally. Of the 158,600 jobs added between July 2003 and July 2004, many were in “low-paying industries” that paid below average wages. Similarly, while California’s unemployment rate was down to 6.1% from a high of 6.9% in July 2003, the long-term unemployment rate - meaning unemployment lasting 27 weeks or longer - had nearly doubled since March 2001, reaching 24.1%. Certain areas of the state, particularly counties in the Central Valley experienced unemployment rates “significantly above that of the state as a whole.” Furthermore, college-educated workers experienced a disproportionately high unemployment rate.

In terms of wages, the study found that “Californians’ wage gains were modest, but surpassed those of the nation in 2003.” Counterintuitively, low-wage workers experienced a higher increase in median hourly wage than higher-waged workers between 2002 and 2003. In the long-term (since 1979), however, the CBP points out that California’s inflation adjusted wages have actually fallen and wage gains lag behind growth in other areas of the nation.

From a poverty perspective, according to the report, California’s poverty rate has fallen significantly since the early 1990s. Nonetheless, 13.1% of California residents lived below the poverty line, and nearly one in three Californians had income levels below 200 percent of the federal poverty threshold. Poverty was concentrated more in Southern California than in the Bay area. Finally, California experienced a slight increase in the number of people lacking health coverage from 2002 to 2003. Overall, 6.5 million Californians lacked health care coverage in 2003, a level 200,000 higher than in 2000. Contributing to the health care problem, the study found that employer-sponsored health coverage was “down in both the US and California.”

For more information on the report or the California Budget Project, visit the organization’s website at <http://www.cpb.org> .