

CALIFORNIA INSTITUTE FEDERAL REPORT

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EXECUTIVE SUMMARY

The Federal Report is prepared by the California Institute staff for its semi-annual Board meetings. This report contains information on the legislative issues the Institute has worked on so far this year. The report also details the products and services that the Institute provides to its Advisory Board and the congressional delegation.

LEGISLATIVE ACTIVITY

Over the last several months, the Institute has engaged in activities regarding a number of significant issues, including:

- **Immigration** -- For the last two years, the Institute has worked to provide reimbursement to the state for the costs of illegal immigration, to monitor efforts to restrict various benefits to legal immigrants, and to reform federal laws regarding illegal immigration.
- **Medicaid Formula** -- As budget balancing plans proposed changes to Medicaid, the Institute has analyzed the impact of formula change proposals on California, and provided the delegation with this up-to-the-minute fair share information.
- **Natural Disaster Insurance** -- The Institute has sought establishment of a national disaster insurance plan to protect against damages caused by earthquakes and other natural disasters.
- **Education** -- The Institute has worked with the delegation and a California K-12 alliance to protect and further California's interests in federal education funding allocations.
- **FDA Reform** -- The Institute will continue to provide the delegation with information on the importance of this issue to California's biomedical technology industry.
- **Tax Policy** -- The Institute has worked to support a targeted capital gains tax cut; making the research and development tax credit permanent with an appropriate base year; and allowing for the three-year depreciation of semiconductor manufacturing equipment.
- **Budget, Appropriations and Other Key Projects** -- The Institute has been active and will continue to track policy and funding for a range of important California concerns in transportation, defense, space, science, energy, trade, and other areas.

PRODUCTS AND SERVICES

To promote the exchange of policy views between the congressional delegation, the Institute's Advisory Board members and others, and to provide timely information on legislative issues of importance to California, the Institute provides the following products and services:

- **Member Breakfasts** -- Advisory Board members are invited to attend a monthly breakfast hosted by the Institute featuring one or two members of the delegation.
- **Briefings** -- The Institute has sponsored recent briefings for the delegation on immigration, the California economy, NetDay, fusion energy, and defense downsizing.
- **Policy Papers** -- Recently, the Institute has produced papers on the microelectronics industry, the NGA Medicaid proposal, and the use of poverty data in federal formulas.
- **Capitol Hill Bulletins** -- The Institute has continued to monitor and report on federal issues of significance to California in its weekly *California Capitol Hill Bulletin*.
- **Electronic Products** -- The Institute will continue to expand availability of its written products and other services via e-mail, a home page, and other electronic means.

I. CALIFORNIA INSTITUTE FEDERAL REPORT

The mission of the California Institute is to identify issues critical to the economic health of California, coordinate the development of research data pertaining to those issues, and communicate this information to the California congressional delegation in a manner that encourages the delegation to address the issues in a bipartisan fashion consistent with the best interests of California. In keeping with that mission, the California Institute has been engaged with respect to the following issues over the last several months.

A. IMMIGRATION

The Institute has worked closely with the congressional delegation, the Governor's office, and other interested parties on numerous immigration issues this year. A major success occurred when \$500 million in funding was provided under the final FY1996 budget agreement to reimburse the states for the cost of incarcerating illegal immigrant felons. California, which currently spends almost \$400 million annually to incarcerate over 19,000 illegal immigrant criminals, could receive as much as 60 percent of this money.

This year also marked the passage of illegal immigration reform bills in the House and Senate. Although both bills initially contained provisions also overhauling legal immigration, the majority of those provisions were stricken and Congress will deal with separate legislation on them at a later time. The House passed its illegal immigration bill in late March. The Senate passed its version on May 2.

In general both bills crack down on illegal immigration by beefing up the number of border patrol agents and other INS personnel responsible for apprehending undocumented immigrants, and by instituting tougher enforcement provisions. For instance, the bills authorize the hiring and training of 1,000 new border patrol agents per year over the next five years. This will roughly double the border force to 10,000. Similarly, both bills call for a pilot program to test an employment verification system. Under the program, employers would call a nationwide hotline to determine whether new employees are eligible to work in the United States. The House program would be voluntary for employers during the test phase, while the Senate bill mandates that employers use the hotline.

A major difference between the two bills, however, is in the area of public education. The House passed a Proposition 187-type amendment, sponsored by Rep. Elton Gallegly (Simi Valley), that would give states the right to deny K-12 education to illegal immigrant children. The Senate bill does not have a counterpart provision. Proponents of the Gallegly amendment have argued that the provision is a necessary part of breaking the magnet that draws illegal immigrants to the United States. Opponents say its retention in the final legislation may draw a Presidential veto. A conference committee is expected to begin resolving differences between the two bills in the near future.

As part of its efforts to provide the congressional delegation with useful and reliable information on various aspects of the debate, the Institute co-sponsored an immigration briefing on March 1, 1996 with the Population Resource Center and the Sunbelt Institute. Approximately 65 staff members from the California delegation and other immigration-impacted states attended. Three respected experts on immigration policy served on the panel. A detailed account of the

briefing can be found in Section II at page 16. Another briefing including California experts is currently under development.

In other action on the illegal immigration issue, the President issued an Executive Order denying federal government contracts to any business that hires illegal immigrants. Prior to that Order, a government contractor could lose its contract if it violated the law prohibiting the employment of illegal immigrants, but there was no restriction on a contractor's ability to pursue other federal contracts. Under the Executive Order, any business that knowingly hires illegal aliens would be barred from bidding on, or receiving, any future federal contracts as well. The Order is expected to have its greatest impact on contractors that supply cleaning, landscaping, and food preparation services to federal offices and installations.

A legal immigration issue that the Institute is working on with California's computer electronics industry is the number of skilled foreign worker visas authorized under the legal immigration bills. Consideration is being given to restricting the number of these workers permitted to enter the United States annually. The computer electronics industry, in order to remain globally competitive, must be able to hire skilled foreign engineers and technicians for employment in the United States when U.S. workers with the same skills are unavailable. Restricting the number of visas available for these workers may eventually be a factor in a company's decision whether to retain or expand a manufacturing operation in the U.S., or move production abroad.

Another important issue related to legal immigrants has come to be known as "deeming." Currently, for several years after a legal immigrant has entered this country, the income of that immigrant's sponsor -- the U.S. citizen who has recommended that immigrant's entry -- is deemed to be added to the immigrant's income for purposes of calculating whether the immigrant is eligible for welfare and various other federal benefits. The welfare reform bills, student aid revision, and other legislation under consideration by Congress contemplate lengthening the deeming period and otherwise restricting legal immigrants' access to federal benefits. Since California's share of the nation's legal immigrants is triple our share of the nation's population as a whole, such measures would likely have a pronounced impact on the state. The impact might be somewhat mitigated, however, depending on to what extent recent immigrants elect to become citizens, which would exempt them from most deeming proposals.

Immigration issues are of significant importance to California, and the Institute has been actively involved in the debate over these issues since 1994. As the Congress turns its attention to legal immigration reform, the Institute will continue to analyze the issues from California's unique perspective and provide the delegation with the best information possible.

B. MEDICAID FUNDING

Throughout the budget debates, the savings that changes in the Medicaid program could realize were hotly contested by both sides. The Institute was actively involved in providing the delegation with the most up-to-date information regarding how the many proposals would affect California's share of federal Medicaid dollars. It also prepared an opinion editorial warning of the dire consequences to the state if certain formula factors were included. In the end, it may have been at least a partial victory for California that Medicaid reform was not included in the final 1996 budget agreement, though the rapidly increasing cost to the federal treasury will likely necessitate some addressing of the issue in the near future.

California's perspective on the Medicaid formula debate is unique. California has been a "donor state" for nearly 10 years, sending billions more dollars into the federal treasury than it receives back. So it was no surprise that as budget balancers attempted to negotiate an overhaul of the Medicaid program, California again was being asked to subsidize medical care for the poor of other states. None of the numerous proposals on the balanced-budget negotiating table would have rectified the disparity between California's federal Medicaid receipts and our large numbers of poor patients.

In purely percentage terms, the Congressional Republicans' block grant proposal would have given California a larger share than the other proposals. California's share of federal Medicaid funds would grow from 9.5% in 1996 to 10.8% in 2002 under the Congressional conference agreement, according to the General Accounting Office. However, because California now houses 15% of the nation's persons in poverty and 14% of the nation's Medicaid-eligible population, this level is still well short of "fair."

Three other major proposals were aired -- one from the Clinton Administration, another from a coalition of conservative House Democrats (the Blue Dog Democrat plan), and a third from a bipartisan group of 21 Senators (the Breaux-Chaffee plan). Each would have retained the entitlement status of Medicaid, but would have done so by locking states into their current receipts per beneficiary with a "per capita cap." Since California now receives only 9.5% of federal Medicaid funds, that low share would have been fixed in place permanently.

While preferable on a percentage basis, the Republican Congressional proposal might well have resulted in fewer total federal Medicaid dollars to California in the long run. By converting the program from an open-ended entitlement to a block grant, the plan would no longer allow for added growth during economic hard times. Yet this impact was distributed evenly among all states. The other plans allowed for such emergencies, and would have adjusted more for inflation, features which would have reduced those plans' savings, or at least the certainty of them. Under the Republican plan, California would have received \$80.3 billion of the nation's \$790 billion federal Medicaid block grant dollars between fiscal years 1996 and 2002. (For the same period, the Urban Institute predicted that California would receive \$95.7 billion of the nation's \$954 billion under the existing Medicaid program.)

According to a GAO source, the per capita cap concept, used in all bills except the House Republican leadership plan, would favor states already providing high levels of medical service to a relatively narrow range of patients. Since more federal funds would be provided only if Medicaid enrollment increases, such states could simply expand coverage and rake in federal dollars at a high matching rate. Since California now provides more limited service to a broad range of patients, our potential for growth would be severely limited. According to GAO, California ranks 51st (50 states plus D.C.) in level of service, yet we are 6th in breadth of patient coverage.

California receives a small relative share of federal Medicaid dollars. While we serve nearly twice as many indigent patients as New York, the next largest state, California receives roughly 9.5% of Medicaid funds compared to New York's 13%. New York spends more than three times as much to care for each patient as does California. In 1993, California served 4.8 million persons with combined state-federal funding of \$9.6 billion, while New York served 2.7 million persons with \$17.6 billion. Thus, California spent \$2,000 per patient, while New York spent \$6,500. (The national average was \$3,100.) To lock in these inequitable distribution levels

would unfairly penalize California and other states which have worked hard to control excess spending on medical care, and it would reward inefficient states for their exorbitance.

During the debate, the Institute argued that there should be per capita parity -- or at least real progress toward it -- rather than a per capita cap. California manages to serve more Medicaid patients with fewer federal dollars, and it should not be punished for doing so. Allocating Medicaid funds according to numbers of poor persons would be vastly more equitable.

Undoubtedly, significant changes in the Medicaid program will continue to be considered as Congress and the President continue negotiations on a balanced-budget agreement. The Institute will continue to diligently analyze the proposals put forth to ensure that the delegation has the best and most accurate information regarding their impact on California.

C. NATURAL DISASTER INSURANCE

The Institute has actively supported the establishment of a national insurance program to protect against the damages caused by earthquakes and other natural disasters. No one questions the need to address how the federal government responds to natural disasters. The startling fact is that from 1979 to 1993, the federal government provided disaster assistance funding and loans of over \$130 billion. The issue of how to reform federal disaster assistance funding to ease the burden on the treasury, without sacrificing effective assistance, has occupied Congress for the last four years.

In 1995, H.R. 1856, the Natural Disaster Protection Partnership Act, was introduced by Rep. Bill Emerson (Mo.) and former Rep. Norman Mineta. By the spring of 1996, the bill had garnered over 225 co-sponsors, including over 39 members of the bipartisan California congressional delegation. The Senate counterpart, S. 1043, also has broad, bipartisan support. Last fall, hearings were held in the House and Senate on both bills. At the House hearing, several members of Congress testified in support of the bill, including California Reps. Bill Baker, Vic Fazio, and Steve Horn. All three are co-sponsors of the bill and support its expeditious passage, although they suggested minor amendments to the legislation.

The bills establish a national insurance program, operated by a private corporation and funded by insurance companies. All property owners in high-risk disaster areas would be required to purchase insurance to protect against the disasters prevalent in their area. Insurance companies would contribute to an insurance pool operated by the disaster insurance corporation to insure against losses. If losses from a disaster exceeded the amount in the pool, the federal government would provide guaranteed loans to the insurance companies, repayable with interest. Since the hearings, concerns have been raised that the insurance pool will not be funded sufficiently to insure against a major disaster and that the government's exposure remains too great. Consequently, the sponsors of the bill are currently working with other interested parties to rework the bill.

In the meantime, Reps. David Dreier (San Dimas) and Bill McCollum (Fla.) gathered signatures from the California and Florida delegation on two letters requesting that the bill receive expedited consideration by the House Transportation Committee, and be made a legislative priority in this Congress by the House leadership. A bipartisan group of 24 members of the California congressional delegation signed the letters. The Institute disseminated information on these letters to the delegation and continues to support consideration of the bill this year.

D. EDUCATION

Since its inception, the Institute has monitored education issues as they affect the state, particularly in ensuring that the formulas used to allocate federal education dollars do not shortchange California. Recently, the Institute has begun to increase its focus on K-12 education issues, and it will work with Congressional offices and the California-D.C. Education Alliance to further California's interests in the K-12 education arena.

Last month, the House Subcommittee on Early Childhood, Youth and Families, chaired by Rep. Randy (Duke) Cunningham of San Diego, passed a bill to rewrite the Individuals with Disabilities Education Act (IDEA). With respect to the funding mechanism, the subcommittee's bill would replace the current funding allocation formula from one based on reported counts of disabled children (which can be subject to gaming of numbers and inconsistency of application by other opportunistic states) to a "bright-line" formula based simply on the number of children in the state as counted by the Census Bureau. In doing so, the proposal would significantly increase California's funding allocation. California now receives \$236 million from IDEA's primary grant, out of \$2.27 billion nationwide. Once fully implemented, the Cunningham subcommittee's proposal would raise California's allocation to \$286 million, if the total pot remains stable. Thus, California receipts would rise from the current 10.4% of the nation's total IDEA funds to 12.5% -- a share more reflective of our state's share of the nation's child population. Unfortunately, the shift to the new figures would take place over 10 years (10% per year), an unusually long phase-in period. The Institute will work to monitor the progress of these formula changes and assist where possible as Congress continues to consider the bill.

On another education issue, Governor Pete Wilson reached an agreement with Education Secretary Richard Riley on the conditions for California's acceptance of \$42 million in Goals 2000 education funding. Wilson said his decision to accept the funds was based on assurances from Secretary Riley that participation in the Goals 2000 program would not interfere with the implementation of California education reforms such as home schooling, opportunity scholarships, and the creation of single-gender academies. Both the Governor and the California Superintendent of Instruction Delaine Eastin laid out the following additional requirements for the acceptance of Goals 2000 funding: (1) the members of the California State Board of Education will serve as the state Goals 2000 panel; (2) the federal peer review panel to be appointed by the U.S. Secretary of Education will consist of a majority of Californians, and will be advisory only, having no authority to impose any conditions on the state; (3) of the \$42 million available to California, \$11 million is to be allocated to local school districts that received planning grants from the first-year allotment, and the remainder will be expended by the state to provide funds for a major initiative focused on improving basic skills in reading and math in grades K-4; and (4) acceptance of the Goals 2000 funding does not obligate California to participate in the program in subsequent years.

E. EXPORT ADMINISTRATION ACT REAUTHORIZATION

Foreign trade is one of the most significant factors driving California's economic recovery. In 1994, almost 10 percent of the Gross State Product was attributable to foreign trade. In that year, California's merchandise exports rose to \$81.2 billion, an increase of almost \$23 billion since 1990. The export of computers, and industrial and electrical equipment account for \$40.2 billion,

half of all of California's exports by value. Silicon Valley, where a significant portion of the computer and electronics industry is located, accounts for 34 percent of California's foreign trade.

In March, the House International Relations Committee favorably reported H.R. 361, the Export Administration Act of 1996. The bill replaces the Export Administration Act of 1979, which expired in August of 1994, and which was the statutory basis for the control of exports of dual-use commodities and technologies. The purposes of H.R. 361 are twofold: one, to strengthen the effective use of U.S. export controls in preventing international terrorism and the proliferation of weapons of mass destruction; and two, to improve U.S. export competitiveness by streamlining the U.S. export license process to eliminate unnecessary governmental regulations.

Dual-use commodities and technologies are non-munitions, civilian items that have potential military applications. Their export has been controlled for national security and foreign policy purposes, and to alleviate potential "short supply" problems in the United States if exports are allowed to continue. The federal government controls exports under this system by requiring the issuance of an export license for dual-use commodities and technologies that have been placed on the Commodity Control List. The Department of Commerce has the primary role in approving or disapproving applications; however, many applications are also referred to the Departments of State and Defense, and other national security agencies for comments and recommendations. These referrals can cause significant delays in the issuance of an export license.

Members of the computer electronics industry have expressed concern that the House bill will not result in expediting licensing procedures or removing existing impediments to the export of computer technology and equipment. Under the bill as drafted, an industry negatively-affected by export controls could petition the government for relief if it could show that: 1) foreign availability of the controlled products are, or soon would be, adversely affecting U.S. market share; 2) the controls do not meet the stated objective; or 3) the controls are causing adverse economic impact on the affected industry. In order to ensure that the National Security Committee did not request sequential referral of the bill, the International Relations Committee during mark-up deleted the second and third criteria, and removed the prospective factor from the foreign availability clause. The electronics industry believes these changes have made the unfair impact provision essentially meaningless.

In addition to this problem, the bill does not address the export of encryption devices, manufactured by U.S. computer electronics companies to ensure the security of financial and other transactions conducted electronically. Currently, the U.S. prohibits the export of these items because of the potential that terrorists and other criminal groups may use them to cover up their activities. This is an important issue for U. S. electronics companies, because foreign competitors are manufacturing and selling encryption devices abroad. The companies have been negotiating with the administration in an effort to develop a suitable compromise on the export of these devices.

During the committee mark-up of H.R. 361, Chairman Toby Roth (Wis.) allowed that the current system of controls on encryption devices was cumbersome and jeopardized the competitiveness of U.S. manufacturers. Although he pledged to work with the administration and interested companies to reach a satisfactory regulatory solution, he expressed concern that dealing with the problem through legislative language would bring a request for sequential referral from the National Security Committee, a possibility he opposed because of the short time left on the legislative calendar for this year.

The Institute is preparing a white paper analyzing H.R. 361, and pointing out the concerns expressed by the computer electronics industry. The paper will be disseminated to the congressional delegation prior to floor action on the bill. The Institute will continue to follow the consideration of the bill closely and ensure that the delegation is kept abreast of its impact on California's export industry.

F. FDA REFORM

An important issue to California's growing biomedical industry is the proposed reform of the Food and Drug Administration. The current process for approval of drugs and medical devices for public use can add significant costs to developing new products and delay marketing. In May, the House Commerce Committee began hearings on three bills aimed at overhauling the FDA. The three companion bills are: H.R. 3199 dealing with regulation and approval of new drugs and biological products; H.R. 3200, dealing with food and nutritional regulations; and H.R. 3201, dealing with biomedical devices. The Senate marked up a more limited version of FDA reform in late March.

The Institute is working with the California Health Care Institute and other interested parties to ensure that the congressional delegation is made aware of the importance of this issue to California. It will also sponsor a briefing on FDA reform in early June. Members of the biotechnology industry, as well as congressional committee staff with expertise in the area, will be invited to brief the delegation. It is hoped that final action on these bills can occur before the end of the session.

G. NORTH AMERICAN DEVELOPMENT BANK

The Institute worked closely with Reps. Esteban Torres, Duncan Hunter, Ron Packard, and other Southern California members to ensure the full \$56.25 million funding for the North American Development Bank (NADBank) under the foreign operations appropriations bill. NADBank, created under NAFTA, will finance environmental clean-up projects along the U.S.-Mexican border.

As a result of the bipartisan support for the bill, the foreign operations appropriations conference report provided the full funding for NADBank. It is one of the few foreign operations programs that escaped any funding cut. Going into conference, the Senate appropriations bill contained only \$25 million in funding, whereas the House bill contained the full \$56.25 million. Initially, a compromise of \$50 million was considered, but Reps. Torres and Packard, both conferees on the bill, successfully pushed for the full amount. Under the agreement between the U.S. and Mexico, if U.S. funding had fallen short, Mexico would have reduced its matching contribution by a like amount. Several clean-up projects in the San Diego area are expected to be financed through the Bank.

In addition, in February, NADBank opened a U.S. Community Adjustment and Investment Office in Los Angeles. The Office will provide financial assistance to any U.S. communities and businesses that have experienced job losses related to NAFTA. The Bank will provide capital to help business start-ups, diversification, and retooling to create new job opportunities for workers in their communities.

H. ALAMEDA CORRIDOR PROJECT

The proposed Alameda Corridor would consolidate train traffic from the ports of Los Angeles and Long Beach onto a 20-mile high-speed, high capacity, and fully grade-separated transportation corridor, linking those ports with transcontinental rail yards near downtown Los Angeles. The project would also widen and improve the highway running parallel to the corridor. The total cost to design and build the corridor is estimated at \$1.8 billion. The Alameda Corridor Transportation Authority estimates that the project will be completed by 2001. The Institute is on record in support of the project and funding for the effort will continue to be a priority. Completion of the corridor would likely lead to large scale economic revitalization in the Los Angeles area and throughout the state. It is estimated that the Alameda Corridor will generate 700,000 permanent jobs by the year 2010.

In late March, the Clinton Administration announced its plans to seek Congressional approval for a \$400 million loan to fund the Los Angeles Alameda Corridor project. The Alameda Corridor Transportation Authority would utilize corridor user fees to repay the loan within the next thirty years. Payments on the loan would not begin until the railway is in use, estimated to be in 2001. The \$59 million appropriation to cover the government's start-up costs for the loan is currently under consideration in the House Transportation Appropriations Subcommittee. Mark-up is expected to occur in the next several weeks.

I. DEFENSE AIRCRAFT PROCUREMENT

Among many others, two major DoD aircraft programs have been the subject of much recent Washington focus and are particularly important to California: the B-2 Stealth Bomber and the C-17 Cargo Jet.

In February, administration officials announced President Clinton's decision to discontinue funding for the purchase of new B-2's. This year's defense budget already includes \$493 million, appropriated by Congress last December and signed by the President, for future production of the planes. According to the administration, the money will now be spent on upgrades and modifications to the existing fleet of 20 bombers. Furthermore, the President did not include funding for B-2 production in his FY97 budget request. It is believed that the decision came at the behest of senior Pentagon officials, who for some time have opposed the production of additional B-2's. The aircraft, produced by California-based Northrop-Grumman, is estimated to support more than 20,000 California jobs. Representing 30 percent of defense dollars coming into Los Angeles County, the B-2 program is a core component of Southern California's high-technology aerospace industry. The only potentially good news came when a spokesperson for the President stated that the White House has ordered a study of the military's long range fighting capabilities and the role of the B-2, in relation to other weapons, in meeting these defense needs. The Institute has communicated its research regarding the program's value to the state in letters to the congressional delegation, and will continue efforts seeking a future for the program.

Last November, the Pentagon announced it would purchase 80 additional C-17 cargo jets, which McDonnell Douglas builds primarily in California. The C-17 military transport is designed to airlift heavy payloads over long distances without refueling. With a total price tag of about \$18 billion, the purchase should bolster the prospects for one of the state's largest aerospace firms. It is estimated that the order will preserve 8,700 jobs at the company's plant in addition to about 9,000 other aerospace jobs in Southern California. The decision to purchase more C-17's is also good

news for another California firm, Northrop Grumman, the largest subcontractor on the project. Officials from McDonnell Douglas said that the announcement will enhance their ability to sell the C-17's to foreign nations who were waiting for cues from Washington before making any decisions. More good news came this February when the President announced his decision to speed up production of the C-17, from its original ten year schedule to an accelerated seven year schedule. It is estimated that this move will bolster McDonnell Douglas' Southern California workforce by 2,300. Under the accelerated schedule, McDonnell Douglas would produce as many as 15 aircraft per year. Faster production of the aircraft will save the Pentagon an estimated \$893 million. Although the move will mean more jobs for the region in the short term, it also means that the project will be completed earlier, without assurances of continuing projects.

Later this year, the Pentagon will narrow from three to two the number of potential contractors for the next generation of tactical strike aircraft. Known as JAST, the plane will be used jointly by branches of the armed services, and the winner of the contract may find itself well positioned to be a dominant force in the defense aerospace industry. While California firms will serve major roles in all three proposals as subcontractors, the prime contract competitors include Boeing, Lockheed-Martin and Northrop Grumman. A decision on which two proposals will move to the prototype creation phase will be made around the end of this year.

J. CENSUS UNDERCOUNTING AND USE OF OUTDATED POVERTY DATA

On March 20, the U.S. Supreme Court unanimously rejected a request from Los Angeles, New York and other major cities to force the Census Bureau to recalculate the 1990 census. Recalculation could have resulted in additional federal formula funding to California and, theoretically, perhaps an additional Congressional seat for the state. By the Census Bureau's own estimation, the 1990 census undercounted the population of California by 834,000 people. The Census Bureau determined that it undercounted the nation's population by 1.6% and California's by more than 2.7%. Because California was undercounted more than the rest of the nation, the decision not to recalculate cost California tens and perhaps hundreds of millions of dollars in unrealized formula grant funds. In 1991, then-Commerce Secretary Robert Mosbacher overruled his own Census Bureau's recommendation and declined to apply the adjusted figures. In 1994, a New York federal appeals court found that the 1991 decision violated Constitutional equal protection rules because the poor and minorities were disproportionately undercounted. The Supreme Court action overruled that decision. The Institute has worked actively on this issue since testifying before the Census Bureau several years ago.

Another important census data issue is poverty data currency. Because census information on income and poverty is collected only every ten years and has not been estimated between censuses, California and other growing states have been disadvantaged in the distribution of federal formula program dollars to the states. In one potential bright spot, thanks largely to California Congressional delegation efforts in 1994, the Title One education program has been directed to use new intercensal poverty data now being developed. The Institute and the delegation will continue to work together to ensure these data are used, and that other formula grant programs which still rely on outdated census data are given the most current data possible. For more information on this subject, please refer to the recently-released Institute publication entitled, *"Usage of Poverty Data in Federal Formula Programs: California Implications."*

K. FISCAL YEAR 1997 BUDGETS

The White House presented an FY97 budget proposal in late March, despite the fact that FY96 figures had not yet been finalized. The House and Senate have just completed work on their FY97 budget bills and are ironing out differences in conference. Funding allocations based on the final budget, known as 602(b) allocations, will then be made to the appropriations subcommittees with jurisdiction. Those subcommittees will be charged with determining the amount of funding given specific programs.

Prior to the consideration of the House and Senate proposals, the Institute identified several items in the President's proposal that are of particular interest to California. At the time of the presentation of this Report, the House and Senate had not completed work on their budget proposals. The Institute will watch these, and other California issues, closely as work on the final congressional FY97 budget proceeds.

The President's FY97 budget reiterated the President's support for a per-person cap on Medicaid growth, an approach that would hurt California. As mentioned previously, California's per-person Medicaid spending is very low, thanks in large part to cost-containment efforts at the state level and by the state's health care industry. A per capita cap would penalize California for having been efficient by locking in the state's low per-person receipts level permanently.

The Administration's budget follows the success realized in the final FY96 budget agreement by recommending \$500 million to reimburse state and local governments for the costs of incarcerating criminal illegal aliens, a program fought for strongly by the Institute, Governor Wilson, and the California Congressional delegation. The budget would also fund 700 additional Border Patrol agents, 150 INS inspectors, and 657 Customs Service personnel; fund new weapons and electronic detection technology; and spend \$33 million to replace outdated equipment. In its discussion of welfare reform, the Administration proposes extending income "deeming" for legal immigrants beyond current levels, but in keeping with the recently passed immigration bills. With a number of exceptions, the budget proposes that the income of sponsors of legal immigrants should be "deemed" to be part of that immigrant's income for purposes of determining eligibility for public assistance until the immigrant becomes a citizen. Since California is home to more than one third of the nation's legal immigrants, this provision would impact our state far more than any other. Finally, the budget recommends doubling the immigrant education program from \$50 million to \$100 million, and increasing other programs under the immigrant/bilingual education office.

Defense discretionary funding, of which California perennially receives a large share, would decline from \$286.4 billion to \$279.2 billion under the Administration's proposed budget. California received 18% of defense procurement contract awards in 1994, and 16% of all DOD expenditures. The Clinton budget also proposes reducing NASA spending from \$14.2 billion in 1996 to \$13.7 billion in 1997. Again, California receives a very substantial share of NASA funds.

Federal research and development expenditures, across all federal agencies, would rise 1.7%, less than the rate of inflation. The budget would spend \$72.7 billion on R&D in FY97, up from \$71.45 billion in FY96 and \$71.1 billion in FY95. California received 22.6% of total R&D expenditures by the federal government in FY93. The budget also would increase the Department of Commerce's Advanced Technology Program (ATP) from \$300 million to \$348 million; California has historically competed well for ATP funds. Fusion energy programs would be funded at \$264 million, up slightly from the current FY96 level, but below the \$275 million currently being sought by the fusion community and more than \$100 million below the FY95

level. The budget states that the Administration “looks forward to working with Congress” to permanently extend the research and experimentation (R&E or R&D) tax credit.

L. TRANSPORTATION FUNDING

Last November, the President signed a bill designating 160,000 miles of U.S. highways as the National Highway System. The measure freed up \$6.5 billion in road funding to the states, which was unavailable until the National Highway System was adopted. According to Federal Highway Administration data, of the total \$15.6 billion apportioned under the bill, California will receive \$1.5 billion, or about 9 percent. Included in this figure is approximately \$253 million for the National Highway System and \$126 million for congestion mitigation and air quality control. California will also receive about \$101 million, or 23.5%, of "donor state bonus" dollars -- a fund created to reimburse states, such as California, which put more tax dollars into the system than they receive back in funding.

Also enacted as part of the National Highway System Designation Act were the newly created State Infrastructure Banks (SIB). The SIBs are designed to support bond financed programs and to leverage state, local and private sources of capital to increase investment in the nation's surface transportation infrastructure. Although DOT has the authority to establish ten SIBs, approval of only eight of the fifteen applicant states has been announced. California is among the seven remaining applicants. Transportation Secretary Federico Peña plans to announce the final two winners next month.

On the legislative horizon is the reauthorization of the Intermodal Surface Transportation Efficiency Act (ISTEA), a process which has only recently begun with initial hearings but which will take much of the next 18 months. Tens of billions of federal dollars are distributed according to transportation funding formulas, and the Institute will monitor and engage in ISTEA reauthorization events as they unfold.

M. TAX POLICY AND THE MICROELECTRONICS INDUSTRY

Last year, the Institute organized a workshop between its Economic Advisory Council and representatives of the microelectronics industry in Silicon Valley. The EAC members were briefed on the importance of the industry and its beneficial impact on California's economy. As a result of that seminar, the EAC prepared a report, which was disseminated to the California congressional delegation, the news media, Institute supporters and others in the California-Washington community.

After analyzing the industry, the EAC made several recommendations for policy changes that would help ensure future growth of microelectronics companies in California. Among these recommendations were three dealing with tax policy: a targeted capital gains tax reduction; a permanent R&D tax credit using a realistic base year; and, a three-year depreciation schedule for semiconductor manufacturing equipment. The EAC found that each of these changes could encourage investment in the industry. In addition, a permanent extension of the R&D tax credit would help to compensate for the decline in federal funding for research.

As a result of the EAC's findings, the Institute has taken a position in support of each of these tax changes. It will continue to work with the microelectronics industry to help ensure passage of a tax package containing these amendments this year.

N. FEDERAL RESEARCH & DEVELOPMENT EXPENDITURES

Another issue which is critical to retaining California's academic and intellectual prominence and which will be an increasing focus in the coming weeks and months is federal funding for science, research and development. In its recent survey of research and development spending by ten federal agencies, the National Science Foundation determined that 22.6 percent of federal R&D funds are spent in California. Of \$65.7 billion spent nationally on federal R&D in FY 1993, \$14.9 billion was spent in California. (These data are for federally-funded R&D only, and do not include significant non-federal research activities of California's universities and industries.) The federal government has spent roughly \$800 billion on research and development activities over the past 20 years. In each of those years, California has won between 21 percent and 27 percent of those funds. Since California's contributions back to the federal government in taxes and other revenues have never exceeded 13.4 percent, federal R&D expenditures constitute a good bargain for California. Nearly half of federal R&D dollars are spent at industrial firms. Of the \$30.3 billion spent at U.S. companies, nearly one third (\$9.2 billion) went to firms in California. This level eclipsed the next highest state, Georgia, whose firms received \$2.6 billion, and number three Maryland, where companies took in \$2.2 billion. Combined firm receipts in six states were between \$1 billion and \$2 billion -- they were Florida, Virginia, Massachusetts, Pennsylvania, Texas, and Alabama, in descending order. (New Mexico's private sector receipts from federal R&D are also above \$1 billion when that accounting also includes funds spent at federally funded research and development centers (FFRDCs) which are administered by firms.)

California is likewise a big winner of federal research and development dollars spent at universities and colleges. Of the \$14.6 billion spent, California universities receive more than \$3.3 billion, or more than 22 percent of total U.S. university R&D. In this category, only New York (at \$1.2 billion) even breaks the \$1 billion level; total university R&D receipts in Massachusetts, New Mexico, Pennsylvania, Illinois, and Texas each exceeded \$500 million. The University of California alone receives close to 10 percent of general science expenditures for university research. The Institute will continue to monitor California's share of R&D spending.

O. BASE REUSE

Base closure, cleanup and reuse issues are critical to California. While California housed only 15 percent of the nation's military personnel as the recent base closure rounds began in 1988, our state took two-thirds of the nation's net cuts in base jobs during the four closure rounds. Consequently, California has one of the largest stocks of former military installations to be transferred to civilian usage and has a keen interest in ensuring that the federal focus remains on efforts to smooth that transition. In particular, environmental remediation efforts or other mitigation approaches will be vital to ensure appropriate civilian use of former military installations. Most closed bases have significant environmental cleanup problems, and a careful strategy, which could include the federal government, states, local communities, and various components of the private sector, will be required to smooth the transition.

P. GIFT BAN RULES

The Institute also provided the delegation and its Advisory Board members with information on the interpretation of the new House rules restricting members and staff from receiving anything of value, including meals, from outside organizations. The new rules went into effect in January, but the House Ethics Committee did not issue its written interpretation of the rules until late March, causing some confusion in members' offices.

The rules placed new, stringent limitations on the gifts, food, and events that members of Congress could accept or attend as part of their official duties. Under the rules, a member is allowed to accept free attendance at an event, including accepting a meal, if: (1) the event is "widely attended;" (2) the invitation comes from the event's sponsor; and (3) attendance is related to the member's official duties.

The Ethics Committee's new guidelines define "widely-attended" as an event where: (1) there is a "reasonable expectation that at least twenty-five persons," other than members and congressional employees, will attend; and (2) attendance at the event is open to individuals from throughout a given industry or profession, or those in attendance represent a range of persons interested in a given matter. A "sponsor" is the primary organizer of an event, and does not include a person or group who just contributes money to an event.

Meetings with constituent organizations do not have to meet the above requirements, but the meeting or event must be "regularly scheduled," for example, an annual meeting, related to the representative's official duties, and open to all members of the constituent organization (as opposed to just officers or board members).

With the advice of the House Ethics Committee, the Institute was able to determine by February that its Member breakfasts fall under the "widely attended" exemption to the rules.

Q. OTHER IMPORTANT ISSUES

The Institute has also followed a number of other issues of interest to Californians, and at the request of members of the delegation or its Advisory Board is examining future issues of interest. Among these other important California issues are intellectual property protections for California's entertainment and software industries; the establishment of another National Science Foundation (NSF) earthquake research center; the rebidding of contracts for NSF supercomputing centers (the San Diego center is one of four in the nation); continued funding for the flat panel display consortium; development of a commercial spaceport at Vandenberg Air Force Base; the ultimate disposition of the Ward Valley site for a low-level radioactive waste depository; the impact on California's petroleum industry of exporting Alaska North Slope oil; the National Ignition Facility to be constructed at Lawrence Livermore National Laboratory; and federal support for fusion energy research (for further information on fusion, refer to Section II at page 17). The Institute is also considering examining the restructuring of the electric utility industry in California; the importance of the mortgage interest deduction to the state in the context of proposed tax changes; and, the impact of health care reform proposals on California's health care market.

One additional timely issue is continuation of the U.S.-Japan Semiconductor Trade Agreement, which is currently scheduled to expire on July 31, 1996. The semiconductor industry employs 60,000 people in California, and renewal of the agreement is important for the U.S. semiconductor industry to maintain market access in Japan. Since the first agreement was reached, the foreign share of the Japanese market has increased from 8.5 percent in 1985 to 25.4 percent in 1995. However, the U.S. share of the world market outside of Japan is 50 percent, while the U.S. share of the Japan market remains at only 18 percent.

II. INSTITUTE PRODUCTS AND SERVICES

A. MEMBER BREAKFASTS

In 1995 the Institute began a breakfast series with members of the California congressional delegation. The Institute invites its Washington-based Advisory Board representatives to attend a breakfast at which one or two members of the delegation brief the attendees on federal issues of importance to California. Since its inception, 14 members of the House, as well as Senator Dianne Feinstein have been guests of the Institute. Recently, our supporters have heard from Reps. Chris Cox, Sam Farr, Steve Horn, Nancy Pelosi, and Anna Eshoo. Other participants have included Reps. David Dreier, George Brown, Carlos Moorhead, Bob Matsui, Jerry Lewis, Vic Fazio, George Radanovich, Calvin Dooley, and Buck McKeon. A breakfast is scheduled for May 16 with Rep. Frank Riggs, and future breakfasts with Reps. Bill Baker and Bob Filner and others are being organized.

The breakfasts provide an excellent forum for the members and the Institute's supporters to exchange information and views on federal policy issues under consideration by the Congress. The member breakfasts have been a great success and are strongly supported by our contributors.

B. BRIEFINGS

This year the Institute has increased the number of briefings it sponsors for the Congressional delegation. The briefings provide the members with up-to-the-minute information on legislative topics, as well as other policy matters. Over the last few months, the Institute has organized briefings on the following subjects.

1. IMMIGRATION

On March 1, the Institute joined the Population Resource Center and the Sunbelt Institute in co-sponsoring a seminar on immigration issues. Approximately 65 congressional staff and other interested parties heard from three experts on immigration policy. Dr. Charles Keeley of Georgetown University discussed the supply and demand forces that drive migration to the United States. He pointed out that there are patterns of migration, based on networks of families and prior refugee migrations, that encourage immigrants to seek entry into the U.S. Dr. Sidney Weintraub, of the University of Texas, Austin and the Center for Strategic and International Studies, spoke on current and future immigration pressures from Mexico and Latin America. Dr. Weintraub discussed the depression experienced by Mexico last year and the pressure that put on its citizens to migrate, legally and illegally, to the United States. He stated that the success of current efforts to stop the flow of undocumented immigrants can only be measured over time. He also pointed out that there may be unintended consequences if all illegal traffic is halted, because Mexico is a major trading partner of the United States and there is a significant amount of legal cross-border traffic. Finally, Dr. Thomas Espenshade of Princeton University discussed undocumented immigration to the United States, since passage of the 1986 Immigration and Reform Act. He pointed out that even though about 30 illegal immigrants out of 100 are apprehended at the border, they try again to re-enter, and the vast majority make it into the United States by the second or third attempt. Once in the U.S. and working, the chances of being apprehended drop to about one percent. The Institute plans to co-host a second briefing on other immigration issues with the Population Resource Center in the near future.

2. THE CALIFORNIA ECONOMY

In late March, representatives of the Center for Continuing Study of the California Economy (CCSCE) and the Center for the New West (CNW) discussed their recent report *California: A Twenty-First Century Prospectus* with an audience of California members, staff, news media and other interested parties. Commenting on the future of the California economy were Philip Burgess, president of CNW, Stephen Levy, report author and director of CCSCE, and Mark Dowling, a California Economy Fellow with the CNW. The speakers relayed encouraging findings about the economic opportunities available to the state, particularly in the areas of foreign trade, high technology, professional services, and entertainment. They noted, however, that for the economic prosperity to persist, the state needs to rebuild its infrastructure foundation of quality schools, universities, transportation, ports, airports and water supplies. The panelists also pointed out that federal policies that encourage foreign trade, such as market access and intellectual property rights, as well as those that support high technology, R&D, and basic research, would assist the state in reaching its economic potential.

3. NETDAY 96

The Institute also sponsored a briefing in February on NetDay96 given by representatives of the White House and Sun Microsystems. NetDay96 was the effort of a broad cross-section of California companies, universities, unions, nonprofits, and government entities to mount a state-wide volunteer effort to wire thousands of California schools for connection to the Internet. NetDay96 was held all across California on March 9 and was successful in making many California schools Internet-ready.

4. FUSION ENERGY RESEARCH

The Institute hosted a briefing on federal fusion issues and their impact on California in March. California is a world leader in fusion energy research. Various institutions and companies across California participate in federally-supported fusion research activities, including Lawrence Livermore National Laboratory, General Atomics, Lawrence Berkeley Laboratory, UCLA, U.C. San Diego, SAIC, Lockheed-Martin, Varian Associates, Westinghouse (Sunnyvale), Rockwell International, and various other universities (including UC campuses at Berkeley, Davis, Irvine and Santa Barbara, as well as Cal Tech and Stanford). Supporters on the Hill are requesting that this year's appropriation for fusion energy research be at least \$275 million. Three California experts on fusion energy research outlined the importance of federal fusion research programs to the state. Dr. E. Michael Campbell, Associate Director of Lawrence Livermore National Lab for Laser Programs, outlined the National Ignition Facility (NIF), which is to be constructed at Livermore. The NIF would use powerful lasers to ignite small fuel capsules, resulting in massive energy output. The multiple missions of a NIF include retaining nuclear scientific expertise under a nuclear test ban, reproducing astrophysical conditions, and, eventually, electrical energy production. The entire project will cost \$1.07 billion, with 75% of those funds to be invested in U.S. industry. A recent report found that two-thirds of vendors currently supporting Livermore's projects are located in California, and that NIF will create 3,320 jobs in the Bay Area. Dr. David Baldwin of General Atomics Corporation outlined the federal magnetic fusion energy program and its significance to California. General Atomics runs the DIII-D fusion facility, which is the most flexible tokamak in the world. Baldwin noted that federal fusion funding to California exceeds \$200 million per year, which supports jobs in industry, at universities, and at the state's three National DOE Laboratories. Dr. Charles Baker, U.S. Home Team Leader for ITER (the International Thermonuclear Experimental Reactor) and Associate Director - Fusion at U.C. San Diego, discussed ITER. ITER is a 4-way collaboration among the U.S., Japan, the European Union, and the Russian Republic to develop a large reactor capable of creating and sustaining a fusion burn for several minutes, thereby demonstrating the viability of fusion as an energy source. Dr. Baker noted that California institutions lead the U.S. ITER effort and play a major role in the technical work.

5. IMPACT OF BASE CLOSURES AND DEFENSE DOWNSIZING

The Institute sponsored a briefing on May 7, at which Kevin McCarthy, Coordinator for California Research for the RAND Corporation, discussed a recently released report on the economic impact of base closures and defense industry downsizing in California. The study, funded by the Pentagon, indicates that there were somewhat fewer negative economic consequences to the reduction of base, aerospace and defense-related positions in California than had previously been predicted.

To determine the impact on communities in which military bases were closed, RAND studied the economic impacts on three such areas: George Air Force Base in San Bernardino County, the Fort Ord Army base in Monterey County, and Castle Air Force Base in Merced County. In Monterey County, Mr. McCarthy stated, the report concluded that the Fort Ord base closure resulted in a three percent reduction in population, a figure below the anticipated 15 percent. Additionally, unemployment in the area increased one percent as opposed to the projected seven percent, according to the study. In contrast to economic predictions of drastically reduced retail sales following base closures, sales rose by two percent following the closure. And contrary to

early predictions, both George and Castle air bases experienced increases, some sizeable, in population, retail sales, housing purchases and school enrollments.

In explaining these outcomes, the report outlines factors which limited the negative impacts of base closures. In many cases, military retirees would no longer shop at base stores, thereby contributing to rising retail sales. The departure of spouses of military personnel who had worked in the private sector resulted in job opportunities for local residents. Finally, the development of commercial uses for base property resulted in job creation and economic opportunities. The report stresses the difficulty in developing anticipatory impact studies and encourages federal and local agencies to focus on analysis of already closed bases to assess economic-impact patterns. Mr. McCarthy stressed that the report should not be read as stating that no economic injury occurred. On the contrary, the defense shifts caused significant hardship on a great many individuals. Nevertheless, the RAND study concluded that the painful dislocation that was felt on an individual level did not result in a severe economic dislocation in the aggregate.

C. POLICY PAPERS

The Institute has prepared several research papers this year on federal policy issues. These papers are disseminated to the congressional delegation, the Advisory Board, and the media. Last summer the Institute prepared reports on Medicaid formula changes, factors used in federal formula allocation schemes, and natural disaster insurance. Several more papers on export controls, federal research and development funding, and transportation issues are planned in the near future.

Papers released to date this year include:

— *"California's Microelectronics Industries and Federal Technology Policy"* --

Prepared by the Institute's Economic Advisory Council the paper examines the importance of the industry to California's economy and suggests several changes to federal tax and trade laws that would ensure the industry's continued growth.

— *"The National Governor's Association Medicaid Proposal: Overview and California Implications"* -- This paper analyzes the Medicaid proposal proffered by the National Governor's Association and points out several areas, including the proposed formula and the treatment of immigrants, that would have a significant impact on the State.

— *"Usage of Poverty Data in Federal Formula Programs: California Implications"* -- This recently completed paper examines poverty data collected through the census, and points out the adverse effect on California of using a single national poverty threshold in determining poverty levels for funding purposes. It also examines the impact of using poverty data from the outdated census on the formula funds received by California.

D. CALIFORNIA CAPITOL HILL BULLETINS

Since late 1994, the Institute has prepared a weekly report of current activity on Capitol Hill which directly impacts our state. The *California Capitol Hill Bulletin* is published weekly during

sessions of Congress, and occasionally during other periods. Since the beginning of this year, Institute staff has worked hard to increase the coverage and quality of the reporting. Legislative Director Mary Beth Sullivan and Research Fellow Darby Morrisroe deserve special credit for having "done more with less," and consistently turning out quality products.

We view our *California Capitol Hill Bulletin* as an opportunity to discern, translate and relay California's federal priorities within the California-Washington community. The Institute welcomes suggestions for input. The *Bulletin* is faxed to roughly 350 recipients, and more than 400 readers now receive it by electronic mail.

E. ELECTRONIC PRODUCTS

Late last fall, Sun Microsystems generously donated a high-powered Internet server to the Institute, providing a wide range of future applications. Initially, it has allowed greater and more immediate Internet access to Institute staff, and serves as a platform for our recently-enhanced Internet account. Soon, it will act as a host server for the California Institute-Economic Advisory Council home page which is being developed by EAC consultant Joe Nation. In addition to Institute reports and other written products, a key feature of the home page will be a searchable database of California economic and other data. In the future, the Sun server and the Institute-EAC home page can be the basis for a variety of potential opportunities, such as an interactive sounding board for discussion of California-federal issues or, with further enhanced line speed, a touchpoint for video conferencing and multimedia distribution of selected Washington activity.