

FINANCIAL IMPLEMENTATION STRATEGY

INTRODUCTION

This Financial Strategy section identifies potential funding sources for the Solution. The potential funding sources discussed in this report are intended to apply to the Preferred Alternative, including Common Components. Although the Preferred Alternative has not been selected, the funding sources might apply to any of the three proposed Phase II alternatives under consideration as well as the Common Components. There may also be additional funding sources beyond those contained in this report.

PROCESS

During Phase II of the Program, a work group appointed by the Bay Delta Advisory Council ("BDAC") identified and discussed a number of issues relating to development of the Financial Implementation Strategy. The work group identified what it considered to be the most important issues relating funding the Solution. A summary of major Funding Sources is provided below followed by a brief discussion of Financial Principles and remaining issues to be addressed.

FUNDING SOURCES

The Implementation Strategy for Finance is to fund the Solution through a combination Federal, State and user funds. The majority of the funding to-date has been for ecosystem actions. Congress authorized Federal funding in the amount of \$143 million per year for three years in 1996 for ecosystem-related actions. Proposition 204 provides for in excess of \$500 million of State General Obligation (G.O.) bond funding for CALFED actions, the majority of which is for ecosystem-related activities. User funding is currently being provided through a number of ongoing programs for a variety of activities that are consistent with CALFED objectives, in addition to the over \$30 million of user funds for the Category III program.

FEDERAL FUNDING

Additional Federal funding for ecosystem actions as well as other Solution components will be required in future years. As was the case in 1997, Federal funding is expected to be appropriated in the form of a consolidated line item for the CALFED Solution, in order to maximize efficiency and effectiveness of the implementation of the Solution.

STATE FUNDING

Additional State funding will also be required for ecosystem and other Common Program actions. Governor Wilson has proposed \$1.3 billion in additional State G.O. bonds for a mix of CALFED actions, which would need to be approved by the Legislature and State voters during 1998.

USER FUNDING

Additional user funding is also required. As explained in more detail below, actions that benefit users directly are expected to be paid for with user funding. In addition, some portion of the Common Programs that create widespread user benefits may be funded with user money. To accomplish this, some type of new broad-based user charge will likely be necessary in order to reach the necessary spectrum of users benefiting from the Solution. The amount and potential application of such a charge has not been determined.

FINANCIAL PRINCIPLES

BENEFITS-BASED APPROACH

Sharing the costs of the Solution based on the benefits being created is the cornerstone principle of the CALFED Financial Strategy. The fundamental philosophy is that costs will be paid by those who enjoy the benefits of the actions, as opposed to seeking payment from those who, over time, were responsible for causing the problems being experienced in the Bay Delta system.

Among State and Federal agencies and within the stakeholder community, there is general agreement with this benefits-based approach as a guide for future cost sharing. A number of questions remain to be answered concerning the application of this principle.

Many of the benefits created by the Solution are difficult to quantify. Benefits associated with restoring ecosystem health, for example, are not measurable in the same way as the benefits of water supply improvements. This implies that while the benefits-based approach is useful as a guide, benefits cannot be used in a strictly quantitative way to arrive at an answer regarding sharing of costs.

Also, even though they agree in principle with the benefits-based approach for future costs, some stakeholders feel that water users should pay something for past damage to the ecosystem prior to using the benefits approach for future costs. This is difficult because there is not general agreement over what role any particular water diversion, or water diversions in general, may have played in degrading the ecosystem relative to the many other factors over the last century or more that man has been affecting the Delta. Water users also argue that they have already paid sufficient amounts over time to offset any past actions. This issue is discussed in more detail below in conjunction with the Ecosystem Restoration Program Plan component of the Solution.

The remaining questions that must be resolved relating to the benefits-based approach revolve around what to do when benefits that cannot be quantified, and whether or not any adjustment for past impacts is appropriate prior to using the benefits approach going forward.

PUBLIC/USER SPLIT

As stated above, both public money and user money will be used to fund the Solution. The public and user concepts have also been extended to describe the benefits produced by the Solution. In principle, public money will be used to do things that create public benefits, and user money will be used to do things that create user benefits. User money for the Solution refers to money, which is collected in exchange for provision of a good or service. Fees paid for water service are a clear example of user money. Although it is clear that many of the water providers are public agencies, funds collected by these agencies in exchange for their services are not defined as public money for purposes of funding the Solution.

Benefits can be generally classified as either "public" or "user" based on the practicality of excluding individuals from access. If individuals can be effectively excluded from receiving a benefit, then they can probably be charged for access to it.

Public benefits are generally those that are shared by a wide cross-section of the community and from which individuals cannot be realistically excluded. Inability to exclude individuals means that imposing charges for access to the benefit is difficult. If "free riders" can access the benefits without paying, there is no economic incentive for users to spend their money for these benefits. This means that if these benefits are to be created, public funding must usually be used.

User benefits are generally those that accrue to an identifiable subset of the community, and from which individuals can be excluded. The ability to restrict benefits to those that pay enables these benefits to be funded with user money. In some cases, such as metered water use, individuals can be charged based on volume of use.

In other cases, such as access to recreational facilities, charges are based on simple access to the benefit.

There are additional questions in defining public versus user benefits that arise in conjunction with benefits that are not clearly one or the other. Some user benefits are so widespread that the group sharing them is substantially the same as the general public. The keys to resolving this issue may lie in whether or not access to the benefit can reasonably be excluded to those who do not pay for that access, and in whether future behavior can be beneficially affected depending on the choice of funding mechanism.

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ABILITY TO PAY

This issue relates to whether or not specific users will be obligated to pay the full cost allocation for their benefits, or whether some obligations should be reduced based on the limited ability of certain users to pay the full cost of their benefits. Such reduced obligations would have to be subsidized either by other users or with public funds.

In principle, users should pay their full share, with any exceptions to be considered on a case by case basis after a full cost allocation has been made assuming no ability to pay constraints. The concept is that any reductions in cost obligations based on inability to pay the full cost share should be explicitly identified and justified. Further discussion of this issue is included in conjunction with specific Solution components.

CREDITING

This policy relates to reducing Solution-related cost obligations to reflect payments made by obligees toward other parallel efforts to address Bay-Delta issues. An interim policy granting credit for cash contributed to the Category III Program has been approved by CALFED, but no additional provisions for long-term crediting have been approved.

In principle, all expenditures directed at the Bay-Delta system are part of the overall effort to improve that system. Consolidating all of the parallel efforts to address Bay-Delta ecosystem issues has been advocated as an important step in ensuring effective and efficient use of the available funding for such efforts. Consolidating these efforts is seen as a way to coordinate the timing and implementation of many diverse and complex projects, as well as to enable flexible use of available funding. These issues are discussed in detail in the Assurances section of the Implementation Strategy. In principle, consolidation of these efforts for planning and funding purposes should include expansion of the crediting policy to reflect payments toward any of the consolidated efforts.

As part of the long-term crediting policy many additional details must be agreed upon, including the start date for crediting, types of payments to be credited, consideration of the timing of payments, and others:

COST ALLOCATION METHODOLOGY

This policy relates to selection of particular cost allocation techniques for making detailed cost allocations within the sphere of a benefits-based cost allocation approach. No policy decision has been articulated here, although individual CALFED agencies have historical policies relating to cost allocation techniques. Within the stakeholder community, there is general consensus that while traditional methodologies may be applicable for conventional facilities, they may not be appropriate for use with the Common Programs due to the difficulty in including non-market benefits created by the Common Programs in the allocation process.

There are many possible cost allocation methods, each with its own strengths and weaknesses. The BDAC work group developed a set of conceptual criteria to guide the selection of methods for dividing the costs of the Solution. Selection of a specific method for each Component may be in order, and this selection will probably involve tradeoffs among these criteria. There is no single best method that addresses all of the criteria in an optimal way. - The remaining issues that must be resolved with respect to cost allocation relate to selection of specific methods to use, and whether allocation should take place at the level of the composite Solution, or individually for each Component, or some other subset of the Solution.

SUMMARY

While the fundamental policy direction for each of the Financial Principles discussed above has been identified, much work remains to be completed. Most of the remaining work is in the detailed application of these policies to a Preferred Alternative. Resolution of these issues will require the involvement of policy level representatives of Federal and State agencies and stakeholder interests. The process for moving these issues through the public and stakeholder process that has defined the Program to-date will must be implemented during 1998 to enable resolution of these issues prior to finalization of the Implementation Strategy for the Preferred Alternative.