

CALIFORNIA LEGISLATURE
1962 REGULAR SESSION

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1962, to June 30, 1963

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

STATE CAPITOL
SACRAMENTO, CALIFORNIA
February 9, 1962

THE HONORABLE GEORGE MILLER, JR., *Chairman*
and Members of the Joint Legislative Budget Committee
State Capitol, Sacramento, California

GENTLEMEN: In accordance with the provisions of Government Code, Sections 9140-9143 and Joint Rule No. 37 of the Senate and Assembly creating the Joint Legislative Budget Committee, defining its duties and providing authority to employ a Legislative Analyst, I submit an analysis of the Budget Bill of the State of California for the fiscal year July 1, 1962, to June 30, 1963.

The duty of the committee in this respect is set forth in Joint Rule No. 37 as follows:

"It shall be the duty of the committee to ascertain facts and make recommendations to the Legislature and to the houses thereof concerning the State Budget, the revenue, and expenditures of the State, and of the organization and functions of the State, its departments, subdivisions and agencies, with a view of reducing the cost of the state government, and securing greater efficiency and economy."

Although the 1962 session of the Legislature is a budget session which is limited to consideration of the budget and related revenue measures, we have included in this analysis recommendations for changes in legislation which ordinarily would be considered only in a general session. The purpose of this is to bring these matters to the early attention of the Legislature in order that appropriate consideration by interim committees may be undertaken prior to the convening of the Legislature in the 1963 General Session.

Because of the growing importance of bond programs in the financing of California state government, we have included as Part III of this analysis a general summary of state bond issues, the programs which they support, and related financial considerations.

Historically, this office has been provided with budget information by the State Department of Finance at the earliest possible date, and the other agencies of government have supplemented this with additional supporting data which we require for our analysis. We should like to express our sincere appreciation to the Department of Finance and the other agencies of state government for this very generous assistance.

Respectfully submitted,

A. ALAN POST
Legislative Analyst

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PRELIMINARY STATEMENT FORM OF THE ANALYSIS

There are three sections to this analysis. Part I constitutes a preliminary statement of the size of the budget and Budget Bill in comparison with prior years, the General Fund revenue and expenditure picture related to the problem of balancing the budget in the coming fiscal year and the succeeding year, as well as some analysis of the basic assumptions underlying the revenue and cost factors contained in the budget.

Part II contains a detailed analysis of each item in the Budget Bill with recommendations for approval or reduction, including certain recommendations for statutory changes which will affect future expenditure requirements.

Part III is a summary of the State's bond issues and the programs which are supported by such borrowings, including a brief analysis of trends, interest costs, and related economic factors.

BUDGET TOTALS

The budget for 1962-63 totals \$2,744,372,056 * compared with \$2,576,106,018 for 1961-62 and \$2,525,394,024 for 1960-61. These totals reflect an increase in the budget of \$168,266,038 or 6.5 percent over the current fiscal year, 1961-62.

The expenditure program proposed by the budget consists of three major sections with expenditures and increases as follows:

State Operations -----	\$883,454,678, up \$79,293,362
Capital Outlay -----	\$346,762,854, down \$56,588,760
Local Assistance -----	\$1,514,154,524, up \$145,556,436

THE BUDGET BILL

The Budget Bill represents that part of the total budget which must be acted upon by the Legislature in the 1962 session to carry out the total expenditure program proposed in the budget. The other proposed expenditures are provided for by existing statutes or by the Constitution. The amount of this program financed from appropriations made in the Budget Bill comprises approximately one-third of the total budget. The items in the Budget Bill, generally speaking, provide financing for the bulk of the state operations portion of the budget as well as several of the numerous local assistance items of appropriation. That portion of the authorized expenditure program which is not in the Budget Bill does not require legislative action for the reason that the appropriations are made by existing statute law or are required by the Constitution. These are commonly referred to as continuing appropriations. The principal state expenditures which are provided for by the Constitution and by the statutes include \$771.1 million in public school apportionments, \$260.0 million for the state highway system, \$290.8 million for social welfare assistance, and \$138.6 million in highway users revenues shared with cities and counties.

* The budget message uses the figure of \$2,885,523,247 as the budget total, including \$141 million bond expenditures. This is a new concept since it includes both bond expenditures and service on bonds. Our figure, however, follows the normal practice so that it will be consistent with past and future budgets in accordance with longstanding accounting practices of state government.

GENERAL FUND FINANCIAL PICTURE PRESENTED BY THE BUDGET

The budget problem is a General Fund problem, since special fund functions are financed by revenues earmarked for these special purposes.

There is no problem of balancing the General Fund budget as submitted for 1962-63 since by borrowing for capital outlay and using a small reserve and anticipating savings the proposed expenditure program is fully financed. This assumes that no additional requests will be made by the administration for additions to the budget as submitted. Nevertheless, it should be noted that proposed expenditures actually exceed anticipated current revenues by \$33,920,386, the difference being made up by carryover balance of \$38,699,309, including fund transfers, and the subtraction from the total of an "undistributed savings" of \$6 million. With a growth pattern of expenditures which in post-war years has been rising faster than the state revenue base, the real financial issue is whether, by allowing the increases proposed in this budget, it will be necessary to raise taxes in the next session to finance the 1963-64 budget.

Despite a rapid growth in the State's economy and tax base, costs of state government have consistently risen even faster. Part of this is due to the extraordinary growth in numbers of students in the State's schools at every level. School apportionments in the budget year will, under existing law, require an increase of \$46.5 million over last year. State University and state college support costs add approximately \$20 million to this increase. There is no prospect that this problem will not be equally present in the next budget, for 1963-64. It should also be noted that total General Fund appropriations for local assistance, including local school apportionments, will increase \$129.8 million over the current year. Thus, the increase in local assistance and higher education totals \$149.7 million. If \$7.2 million of added bond service (a 43.8 percent increase) is included as an unavoidable cost, these three items of increase alone will absorb 92.2 percent of all the estimated increase in General Fund revenues for the budget year over the current year. These figures serve to illustrate the difficulty of the budget problem for 1963-64, and the need to look as critically at the basis for existing program expenditures as at budgeted increases.

Thus, a reasonably conservative extension of the revenues and expenditures contained in this budget indicates that a possible revenue gap or tax issue will exist in 1963-64 even if all major capital outlay is again financed from borrowings. On the other hand, the question of whether taxes will be required can, in our judgment, largely be resolved by the action of the Legislature on this budget. This is to say, if reductions in this year's proposed appropriations can be made, and interim study begun on fiscal issues which will result in law changes and some additional savings in 1963-64, the budget can be balanced for the next two years without new taxes.

The budget for 1962-63 estimates General Fund revenues of \$1,868,-891,031 to which is to be added (1) a \$38,669,309 carryover surplus from the current fiscal year of which \$19,275,483 represents the unencumbered balance of continuing appropriations and \$19,393,826 is the surplus available for appropriation, and (2) fund adjustments of \$13,790,464, making a total of \$1,921,350,804 in budget resources. Against this, General Fund outgo is proposed to total \$1,916,601,881,

leaving a prospective surplus on June 30, 1963, of \$4,748,923. Of this \$4,748,923, the unencumbered balance of continuing appropriations totals \$2,676,971 and the surplus available for appropriation is \$2,071,952. It should be noted, however, that the estimated expenditures have been reduced by a special unallocated savings item of \$6 million. These savings have been deducted from the amounts otherwise appropriated and must, therefore, be achieved if the budget is to be balanced.

The income and outgo factors for 1962-63, as budgeted, are summarized in the following:

Income	
Carryover balances -----	\$38,669,309
Fund transfers -----	13,790,464
Current revenues -----	1,868,891,031
Total -----	\$1,921,350,804
Outgo (reduced by \$6 million in estimated unidentified savings) -----	\$1,916,601,881
Total Surplus * June 30, 1962 -----	\$4,748,923
* Consisting of:	
Unencumbered balance of continuing appropriations -----	\$2,676,971
Surplus available for appropriation -----	\$2,071,952

Although the estimation of revenues and expenditures as far ahead as 1963-64 is admittedly subject to qualification, it has been quite successfully done by the Joint Legislative Tax Committee in its report of 1958, and the methods employed in this and similar revenue and expenditure projections can appropriately be relied upon to illustrate the nature of the problem of balancing the budget which follows the one which is presently under consideration.

We believe that an estimate of revenues for 1963-64 would show an increase of from \$100 million to \$140 million over 1962-63. The budget estimates that 1962-63 revenues will increase \$170 million over the current fiscal year, but we do not believe that a similar increase for the following year is likely. The current year was a relatively low income year and the rate of increase for next year is therefore unusually large. Characteristically, in recent years the annual increase has been about \$100 million or less.

Expenditures for 1963-64 likewise should not increase as greatly over 1962-63 as the proposed budget increases over the current year. The budget increase is 10 percent and a repeat of this rise would produce additional spending of \$191 million and obviously result in a substantial deficit. However, a significant portion of the increase in this budget is caused by legislation enacted in the 1961 session, including \$54 million in social welfare legislation. This particular increase will not be repeated in 1963-64 although 1963 will be a general session year and historically some cost increases must be expected. The use of bonds for practically the entire capital outlay program this year reduces the possibility of flexibility in this respect. Despite these difficulties, we believe that it is possible under a policy of complete austerity and the absence of costly new legislation in 1963 to avoid a deficit for that year. At the same time, reductions in this budget would be consistent with such austerity and in view of the historical record on general session expenditure increases, almost a practical necessity if a deficit is to be avoided.

Our recommendations for reduction in line with instructions from the Joint Legislative Budget Committee to hold back wherever possible the growing costs and numbers of positions in state service, add up to over \$40 million in total, of which \$30 million are General Fund reductions. This is exclusive of bond fund reductions. If these or other similar general and special fund reductions are effected, the savings will substantially be reflected again in next year's budget. An exception to this second year effect is the approximately \$18½ million recommended reduction in the proposed retroactive salary increase, of which \$11½ million is General Fund. Thus, we calculate that about \$40 million can be removed from the 1963 prospective General Fund deficit by making the reductions proposed in this analysis and by not adding offsetting new items to the budget as initially submitted. Other suggestions in the Analysis calling for legislation which will effect savings can cut more deeply into the deficit prospect. It should be noted that the Legislature in recent years has accepted a very substantial number of our recommendations for economies, but additional requests for augmentations to the budget have added back approximately all the savings achieved. Thus, a realistic assessment of the possibility of net savings of this magnitude requires as careful review of proposed budget *augmentations* as it does review of the budget originally submitted by the Governor.

We have, in making our recommendations, made serious efforts to relate the work performed to the actual positions available to do the job, by eliminating many positions which, although budgeted, were vacant for most, if not all, of the past year. The policy of carrying from year to year large numbers of vacant positions completely distorts the validity of any comparison between what is really needed to get the work done in any agency and the size of the actual staff which has been available to do the work. Only by relating the staff on the job to the work performed and cutting back vacant positions to reflect the relationship between the actual work force and demonstrated workloads, including specific identification of accumulated backlogs, can full efficiency and effectiveness of the work force be encouraged by the budget process. Our recommendations are based on allowing sufficient manpower to meet current needs augmented by anticipated growth in workloads. To this extent the basic program objectives of this budget can be achieved by accepting our proposed cuts, except only in a relatively small number of cases where we do disagree with the proposed program. Most of the positions proposed for reduction are actually not currently filled or are proposed new, and their work capability is for that reason not reflected in the current year's output.

With the knowledge that educational costs, as a major factor in state expenditures, are increasing faster than the population growth and the growth in the tax base, and with the knowledge also that unless economies are achieved in educational costs and reductions made in other less urgent areas, the state budget will continue to increase faster than state revenues can support it, a conscious effort to relate the growth in the budget to the reasonably anticipated growth in the existing tax base might serve as an appropriate long-range budget policy.

Correspondingly, this approach or goal makes necessary a long-range appraisal of the use of credit, with inclusion of projected bond service

costs in the comparisons of budget trends and revenue projections. For this reason we have included in Part III of this analysis a full discussion of the State's bond programs, with projections.

We have pointed out in previous analyses, starting with that of 1955, that we believe the State's policy for financing capital outlay should be to use bonds only where there is a clear-cut short-term rise in the State's projected construction requirements, thus using credit to flatten out or spread the impact of this short-run hump in capital outlay requirements. We also emphasized, however, that our analysis of the long-term needs of the State showed that there would be a substantial need *every* year, and this annually recurring cost should be financed from current revenues. Thus, \$100-150 million in capital outlay can be expected every year, and there is no sound basis for assuming that bond financing equates or spreads this cost. Under these conditions, borrowing of the magnitude proposed in recent budgets serves, rather, to defer the full impact of the cost, and by so doing encourages a more lenient attitude toward all costs including both construction costs and the current costs of other functions which probably would be displaced to accommodate to the needs of the capital outlay program if credit were unavailable and the issue became one of raising taxes for these costs. We believe a sound long-range policy would be to issue bonds when construction requirements exceed, in any year, the predetermined average or normal amount, e.g. \$100 million, and buy up the bonds in years when requirements are less than the norm.

REVENUE ESTIMATES

The estimated total of \$2,652,472,328 in revenue from all sources including special funds represents an increase of \$208,749,214, or 8.5 percent, over the estimated collections of \$2,443,723,114 for 1961-62. Of this total the General Fund portion is estimated at \$1,868,891,031, up \$170,065,437, or 10 percent, from the \$1,698,825,594 estimated for 1961-62. The General Fund portion is about 70 percent of the total budget for 1962-63.

Increased revenues are estimated for 1962-63 over 1961-62 in all the major General Fund tax categories; however, retail sales and use, personal income, and bank and corporation taxes provide by far the larger part of the revenue as demonstrated in the following table.

General Fund Revenues
(Millions)

	1961-62	1962-63	Increase	
			Amount	Percent
Sales and Use Tax.....	\$751.5	\$832.5	\$81.0	10.8
Personal Income Tax	298.1	330.7	32.6	10.9
Bank and Corporation Tax.....	287.3	320.3	33.0	11.5
Inheritance and Gift Tax.....	73.2	78.1	4.9	6.7
Insurance Tax	69.8	75.8	6.0	8.6
Cigarette Tax	66.3	71.8	5.5	8.3
Alcoholic Beverages Taxes	59.2	61.5	2.3	3.9
Horse Racing Tax.....	17.6	18.7	1.1	6.3
Other sources	75.8	79.5	3.7	4.9
Total	\$1,698.8	\$1,868.9	\$170.1	10.0

The importance of the three major tax sources of General Fund revenue for 1962-63 is further emphasized in the table above by the fact that these are the only taxes showing gains of over 10 percent for 1962-63 as compared to 1961-62. Furthermore, of the total estimated increase in revenue of \$170.1 million, the sales and use, personal income, and bank and corporation taxes are expected to provide \$146.6 million, or 86.2 percent. These three taxes are very sensitive to economic conditions and the estimated increases indicate that 1962-63 is expected to be a period of relatively high prosperity.

The fact that such a large portion of the anticipated increase in revenue is based on taxes which fluctuate closely with the business cycle emphasizes the element of uncertainty attendant in estimating such large increases in revenue for 1962-63 over 1961-62 and at the same time in budgeting commensurate or larger increases in expenditures predicated on these revenue estimates.

An unexpected though minor change in any of many important assumptions with reference to the economic outlook could affect the revenue collections by several million dollars. Probably of most importance in the realization of these revenues is that consumer spending will continue to rise as forecast.

In the budget document presented last year, General Fund revenue was estimated at \$1,607,019,848 for 1960-61 and \$1,680,718,333 for 1961-62. Actual revenue collections for 1960-61 at \$1,597,887,158 were lower than the estimate by \$9,132,690. Collections for 1961-62 are re-estimated at \$1,698,825,594, an increase of \$18,107,261. For the two years taken together, the net change from the original estimates is a gain totaling \$8,974,571. The revenue increase for the budget year over the current year in this budget document is projected at \$170.1 million, bringing the totals to \$1,868,891,031. The corresponding increase projected for the budget last year was \$73.7 million. This increased rate for 1962-63 over 1961-62 is explained by the fact that the recession during 1960 and 1961 retarded the rate of growth. The economy has been emerging from the low point of the recession which was reached in early 1961; whereas for 1962-63, significant further expansion in the business cycle is expected to take place.

The Department of Finance bases its 1962-63 revenue estimate on the forecast that gross national product for 1962 will be \$560 billion as compared to \$520 billion for 1961, and that total personal income will be \$445 billion in 1962 of which California will receive \$49.5 billion. Calculated in terms of personal income, the General Fund will, therefore, collect taxes and fees of \$3.78 for each \$100 of personal income, or a total of \$1,868,891,031.

The estimates prepared by the Department of Finance appear reasonable at this time in relation to forecasts made by other reputable government and private organizations. The estimates specifically assume a strong upward movement of the economy through 1962 stimulated by increased spending by the federal government, a strong upward consumer buying trend, increasing capital expenditures for plant and equipment, and stability in prices and interest rates.

In addition, the stimulus of California's expanding population, economic base, and needs is expected to carry the State to new high levels of economic activity. The total population of California is anticipated

to reach 17,033,000 on July 1, 1962, and 17,655,000 on the same date in 1963. This increase of 622,000 would place the annual rate of growth at 3.7 percent. In comparison, the national rate of increase was 2 percent in 1960.

POLICY ON FILLING VACANT POSITIONS

It has come to our attention that some state agencies are utilizing the device of first filling the oldest vacant positions in some job classifications as a means to prevent them from being continuously vacant over long periods of time.

Another method used by agencies to prevent a realistic computation of the vacancy factor is to downgrade positions that are continuously vacant for extended periods of time and then fill them at a lower classification level. This procedure results in an interruption of a vacancy that would otherwise be continuous. The aforementioned administrative manipulations enable agencies to defeat the intent of the control on this factor, as exemplified by the required periodic reporting of all extended vacancies.

The correct approach would be to require that the agency first fill the most recent vacant position in contradistinction to the current practice of filling the oldest vacancy. This method should result in a more effective budget review and a better continuing appraisal of manpower needs as it would enable both the agencies and the Legislature to make an actual determination of those positions which are seldom, if ever, filled.

We recommend that state agencies be directed to adopt the procedure of filling vacant positions by the assignment of new employees to the most recent vacant positions, including newly authorized positions, in the classification for which recruited.