CALIFORNIA LEGISLATURE

1967 REGULAR SESSION

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1967, to June 30, 1968

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

STATE CAPITOL
Sacramento, February 24, 1967

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

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, 1967, to June 30, 1968.

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 revenues 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."

I should like to express my gratitude to the staff of the State Department of Finance and the other agencies of state government for their generous assistance in furnishing information necessary for this report.

Respectfully submitted,

A. ALAN POST
Legislative Analyst

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INTRODUCTORY STATEMENT

This analysis provides a detailed review of that portion of the budget which is incorporated in the Budget Bill, as well as related program information on certain major subventions such as educational apportionments and welfare, which although not in the Budget Bill must because of their size be considered in relation to balancing the budget.

This year the form of the analysis has been revised. This was made necessary by a change in the format and nature of the budget. In the budget for the first time flat and undetailed 10 percent reductions have been applied to most General Fund support programs. The failure to identify specific items of reduction made analysis of the real fiscal or policy issues involved in the 10 percent cut impossible.

For this reason our analysis this year does not base its review on the appropriation amounts contained in the Budget Bill, but starts its review by considering the need and possible reductions to the workload or "barebones" budget which was computed by the Department of Finance prior to application of any unidentified 10 percent cut. Since the administration is preparing and will later submit details of the blanket reductions, we have held those amounts open, subject to later review. An analysis of such detail will be submitted to the appropriation committees shortly after we receive the information.

This analysis is, in fact, an evaluation of the financial needs for state government as it has operated in the current year, with adjustments for workload and inflationary increases. Based on the findings of our ongoing studies of efficiency and economy in state programs, we are proposing reductions from current operations totaling over $80 million from the General Fund, and $1.4 million from special funds, as well as other budget reductions of $8.5 million from capital outlay.

In addition, we are placing before the Legislature for its consideration a number of possible changes in established programs which are not prompted necessarily by efficiency studies, but are intended to pose questions about programs of marginal value. These are called "policy options." This analysis also includes recommendations which, if approved, would increase General Fund expenditures by at least $48.5 million and special fund expenditures by $11.5 million. The General Fund increases would result from provisions for academic salary increases, service centers, graduate fellowships, and the substitution of General Fund financing for the University and state colleges in lieu of tuition. In addition, we have endorsed in principle salary increases for other state employees if supported by April survey data. Special fund increases would add a second increment to the previously approved expansion of the Highway Patrol and proceed as previously planned with automation in the Department of Motor Vehicles.

While numerous additional economies and budget reductions can undoubtedly be effected, particularly with the sincere cooperation of agency management, we have not proceeded from the idea that all agencies can properly reduce costs equally. In judging the possibilities of program reductions we have not only considered the problems of fixed and variable costs, but we have also given great weight to the relative productivity of programs. We have gone to great lengths in most instances to provide objective measurements of productivity, although this is often very difficult in the case of public services, where social values are frequently more important than immediate economic values. It will be apparent that we have not given the same weight as the budget has to the desirability of a ''pause'' or delay in meeting critical needs such as those of education and the courts since the passage of time is inexorable and investments in the education of our youth and the prompt administration of justice are especially closely related to and affected by the passage of time. Our analysis differs conspicuously from the budget in that it gives considerable attention to proposing the revision of existing laws as a basis for reducing costs, whereas the Governor's program has been applied to programs operating within existing laws. Our suggested major policy options, particularly, depend on statutory changes, although we have also made numerous firm recommendations based on statutory revision.

The budget will require a major tax program regardless of the final action on the Budget Bill. The needs of the public schools alone will probably demand major increases to the Governor's Budget. For example, one major program added in the 1966 session on a one-year basis is now in fact an ongoing $33 million part of school apportionments which the budget does not recognize nor make financial provision for. Other major school problems stand in the wings. Many of these are related to the policy issue of property tax reform.

No provision has been made in the Governor's tax proposal for capital outlay needs for 1968–69, which is an immediate issue because the budget proposes the exhaustion of all authorized bond money for this purpose. If, as both legislative and executive policy statements have declared, the state should move to a basis of financing capital outlay from current revenues, a $150–$200 million additional amount must be added to the tax program.

SIZE OF THE BUDGET

State spending for 1967–68 is budgeted at $4,624,634,742 including $519,256,119 in bond funds. These bond expenditures include:

State Construction Program Fund	$150,651,435
California Water Resources Development Bond Fund	202,213,334
Central Valley Water Project Construction Fund	156,173,018
State Beach, Park, Recreational and Historical Facilities Fund	10,218,332
Total	$519,256,119

During 1967–68 the state will also spend or subvene an estimated $1,615,162,152 in federal grants-in-aid and $403,569,023 in federal reimbursements and special projects.

Expenditures from bond and federal funds are not included in budget totals under standard state accounting procedures. Including them in this summary is only for information and they will not be included in the sections on budget totals and expenditures which follow.

BUDGET ELEMENTS

Expenditures proposed in the 1967–68 budget total $4,105,378,623 excluding bonds funds. This is a decrease of $145,433,113 from 1966–67. These totals, as well as a breakdown of amounts into the major budget categories, are shown for the latest three fiscal years in the following table.

	Total expenditures	*Support*	*Local assistance*	*Capital outlay*
1965–66	$3,636,357,637	$1,158,758,101	$2,100,948,315	$376,651,221
1966–67	4,250,811,736	1,339,313,725	2,380,137,125	531,360,886
1967–68	4,105,378,623	1,272,637,090	2,490,103,507	342,638,026
Amount of change from 1966–67	—145,433,113	—66,676,635	+109,966,382	—188,722,860
Percent change	—3.4	—5.0	+4.6	—35.5
Amount of change from 1965–66	+469,020,986	+113,878,989	+389,155,192	—34,013,195
Percent change	+12.9	+9.8	+18.5	—9.0

Local assistance, up about $100 million, alone shows an increase for 1967–68; and between 1965–66 and 1967–68 local assistance, with an increase of 18.5 percent, will grow at approximately double the rate for the support category. The large decrease shown in the capital outlay category between 1966–67 and 1967–68 presents a misleading picture, as it historically has, because large carryover special fund (largely highway) balances are included in the 1966–67 figure in addition to expenditures, thus balooning current year spending and creating an artificial reduction in the budget year. This continuing practice which results in unrealistic budget totals and comparisons is illustrated as it occurred for the 1965–66 fiscal year.

Special Funds Capital Outlay Expenditures for 1965–66	*Millions*
As proposed in 1965–66—Governor's Budget document	$320.4
As reestimated in 1966–67—Governor's Budget document	442.5
Actual as shown in 1967–68—Governor's Budget document	353.2

The above comparison from different budget documents shows that the reestimated total is much above either the proposed or actual amount for that fiscal year. This is the case for 1966–67 as shown in the 1967–68 Governor's Budget document—it being the reestimated amount in this case.

One of the major programs involved in the process of regularly carrying over large unexpended balances is the State Highway Department. Actual expenditures are not affected since these funds are continuously appropriated under Section 183, Streets and Highways Code, but there is no justification for continuing this practice of adding these excess funds to the expenditure level as a method of accounting for them.

GENERAL FUND FINANCIAL PICTURE

The state's budget problems for 1967–68 center in the General Fund. The major problem is a deficiency of revenues to match proposed expenditures. For a number of years, current cash income has been less than outgo, but the problem has been temporarily solved since 1963–64 with larger one-time tax adjustments each year. In effect, this has postponed major tax increases. Such increases, however, are necessary for the budget year.

The revenue accrual program initiated in 1966–67 enabled the state to operate through that fiscal year without raising taxes, but it has greatly increased the borrowings by the General Fund from surplus balances in special funds. Ordinarily these short-term borrowings to level off variations in cash inflow related to cash disbursements would have been repaid by March or April when heavy revenue receipts are obtained. This year, however, because of the added borrowings (covered by revenue accrued but not yet received), the General Fund will continue into the 1967–68 fiscal year in a net borrowing position. According to the budget document, the year will end June 30, 1967, with a borrowed balance of $54 million. This figure, however, does not reconcile with other budget data, and current estimates of the Department of Finance indicate a cash borrowed position at yearend of $180 million.

We are preparing a detailed analysis of the cash flow problem in a special report pursuant to separate resolutions. The following analysis, therefore, only outlines the major aspects of this problem.

Since the budget proposes a tax program of only $254 million to balance income and outgo at $2,987 million, it is estimated by the Department of Finance that the additional inflow of cash from existing revenues and the new tax program will be insufficient to cover cash requirements in the critical months of December 1967 through February 1968. Therefore, in addition to requesting new cash revenues of $254.3 million to balance the budget, additional taxes are suggested to provide sufficient cash revenues early enough during 1967–68 (as well as some in 1966–67) to keep General Fund borrowings for cash purposes within the capacity of state special fund balances available for this purpose.

The Governor's Budget also proposes to change the present revenue accrual program, established by the 1966 Legislature, to remove from the accrual basis of accounting $100 million of revenues from personal income taxes beginning in 1966–67. It should be emphasized that this reduction in accrued revenue will not affect cash revenue collections to the General Fund in either 1966–67 or 1967–68, but it is intended to reduce surplus charges not in cash form so as not to overstate the amount actually available for cash expenditure.

At this time it is difficult to project cash flow needs and new revenue requirements during 1967–68 with a high degree of accuracy. The budget will be substantially amended to reflect the detail of proposed reductions within the next few weeks. The feasibility of proposed reductions and the possibility of significant additions to meet certain program requirements which may have been understated, add to the difficulty of formulating precise estimates of expenditure. Correspondingly, the need for substantial additional taxes and the failure of the budget to identify the specific sources and rates of taxation which will be requested, make projection of month-by-month revenue inflow impossible of precise calculation.

As indicated previously, both accurate estimates of expenditures and revenue inflow are essential to a determination of the cash flow measurement with its correlated problem of short-term borrowings. Certain assumptions, however, can be made to place both the cash flow problem and the budget problem in perspective.

The summary of General Fund condition shown below has been prepared on the basis of estimates and adjustments as contained in the 1967–68 budget. It is noted that should the proposed legislation reducing accrued personal income tax revenues of $100 million not be approved, the June 30, 1968, yearend surplus balance as stated would be $131.4 million instead of $31.4 million. This would, however, not affect cash income or the deficit cash position of the General Fund at June 30, 1968, being merely a change in the basis of accounting for these funds.

The carryover surplus of $31.4 million at June 30, 1967, as reflected in the budget, will be affected by any significant reduction in expenditures during the last half of the current fiscal year produced by the Governor's salary freeze and other current economies in state operations.

It is our tentative estimate that the magnitude of these reduced expenditures should be at least $10 million more than shown in the budget. Any such savings would be added to the yearend surplus as well as reducing cash borrowings at yearend. Thus, the $31.4 million surplus figure at June 30, 1967 should rise to around $40 million as the result of these expenditure cutbacks, and cash borrowings are estimated to be within a range of $130 to $160 million.

Estimated General Fund Condition
(In Millions)

Free surplus June 30, 1967 (present revenue basis)	$131.4	
Less—Governor's proposed legislation reducing accrued revenue	*—100.0*	
Free surplus June 30, 1967		$31.4
1967–68 income		
Existing revenue program (cash basis)	2,720.4	
Additional revenue needs (proposed in budget)	254.3	
Accrual revenues	12.4	
Total income		$2,987.1
Total available		$3,018.5
Less expenditures		2,987.1
Free surplus June 30, 1968		$31.4

REVENUE ESTIMATES

Income to the General Fund in 1966–67 is estimated at $2,869,758,117 and is forecast to increase by $117,277,444, or 4.1 percent, to $2,987,035,561 in 1967–68. These figures include both cash and accrual income and are adjusted to show the effect of the Governor's proposed tax adjustments as well as transfers into the General Fund from other funds. A summary of these adjustments is shown below:

	(In Millions of Dollars)	
	1966–67	*1967–68*
Total revenue (existing tax base)	$2,962.2	$2,722.8
Transfers into General Fund	7.6	10.0
Governor's proposed tax adjustments	*—100.0*	+254.3
Total income	$2,869.8	$2,987.0

The proposed transfers into the General Fund for 1967–68 totaling $10 million is comprised of four items: $2.1 million from the Department of Employment Contingent Fund, $2.6 million from the Central Valley Water Project Construction Fund, $3.1 million from the Motor Vehicle Fund, and $2.2 million from the Water Resources Revolving Fund. In 1966–67 almost the entire transfer of $7.6 million was from the California Water Fund.

The Governor's proposed changes in the revenue structure include new legislation to decrease by $100 million the amount of personal income tax to be accrued. This would delete accrual of personal income tax on the current year's income as now provided in Section 19355 of the Revenue and Taxation Code. The proposed increase in 1967–68 of $254.3 million for additional cash revenue needs is not detailed in the budget. But increased taxes on alcoholic beverages, cigarettes, and other tobacco products, and changes in the sales tax are mentioned as possibilities for consideration together with a recommendation that if possible some new rates should become effective April 1, 1967.

The table below summarizes the revenue picture for 1966–67 and 1967–68. The anticipated amounts for both years are shown on both the cash and the accrual basis together with the effect of the Governor's proposed tax program.

General Fund Revenue
(In Millions)

Taxes, fees, etc.			*Change*	
Cash Revenues	*1966–67*	*1967–68*	*Amount*	*Percent*
Sales and use	$1,078.0	$1,131.0	$+53.0	+4.9
Personal income	508.7	551.7	+43.0	+8.5
Bank and corporation	476.5	454.0	*—22.5*	*—4.7*
Inheritance and gift	124.5	135.0	+10.5	+8.4
Insurance	107.9	115.3	+7.4	+6.9
Alcoholic beverage	77.7	81.8	+4.1	+5.3
Cigarette	75.6	77.0	+1.4	+1.9
Horse racing	40.0	45.0	+5.0	+12.5
Other sources	131.2	119.6	*—11.6*	*—8.8*
Total cash revenues (existing tax base)	$2,620.1	$2,710.4	$90.3	+3.4
Governor's proposed revenue program		$254.3		
Total cash revenue		$2,964.7		
Accrual revenue *	$344.2	$12.4		
Proposed Legislation	*—100.0*			
(Reducing personal income tax accruals)				
Total revenues	$2,864.3	$2,977.1		

* After adjustment for accrued interest expense and includes $2.1 million of accrued transfers for 1966–67.

Cash revenues on the existing tax base are estimated to gain by $90.3 million, or 3.4 percent, between 1966–67 and 1967–68. This is a smaller than usual gain but three major factors apply: (1) The bank and corporation tax actually shows a decline of $22.5 million between the two years. This results because no further acceleration in payments will be required after 1966–67. (2) The reduction of $11.6 million in revenue from other sources can be attributed to a change in procedure (Chapter 155, 1966 First Extraordinary Session) by which oil and gas royalty revenues go into a special fund for public higher education beginning in the budget year. Previously these went to the General Fund. (3) Economic forecasts for 1967 generally indicate a slowing in the rate of expansion as the economy continues to adjust to new forces. This will tend to reduce the amount collected in each of the state taxes for 1967–68.

In view of these factors the cash revenue estimate of $2,710.4 million on the existing tax base appears to be a sound estimate for 1967–68. The figure would possibly be slightly on the conservative side if fiscal and monetary policies can in the months ahead ease credit sufficiently to stimulate demand while at the same time control inflation. The course of the war in Vietnam is the most important and most uncertain factor reflecting on the future course of the economy and consequently the revenue pattern. Some of the major economic forces and trends that relate to revenue prospects are discussed in the following sections.

ECONOMIC SITUATION IN 1966

Continued strong growth characterized the national economy during 1966. Gross national product for the year was a record $739.5 billion, an increase of $58.3 billion from the $681.2 billion level for 1965. This was an increase of 8.5 percent with physical volume growing about 5.5 percent.

Of major significance in 1966 was the expanding demand for credit against the countering action to tighten the supply. This resulted in rapidly increasing interest rates and near panic conditions in the money markets by September, but there has been cautious easing of credit since then with interest rates gradually falling.

The continued buildup to support the action in Vietnam required a shifting of resources in the economy during 1966 from the private to the public sector, and with the economy operating at near capacity levels it was determined to be necessary to tighten the money supply to accomplish this shift in the face of high employment and continued strong consumer, investment, and other demands. These actions have been successful to some extent in cooling the civilian economy, but consumer prices rose 3.3 percent in 1966 and other crosscurrents and imbalances began developing during the year which will directly influence the economy in 1967.

In spite of the strong overall level of economic activity there were also significant areas of weakness in the civilian economy. Residential building construction continued its long decline since 1963 and in 1966 reached the lowest levels in about 20 years. Lack of available financing and the previously built housing surpluses are the major factors for the declining activity. Automobile, and appliance sales, while strong for the year as a whole, have trended down, weakening especially in the last six months. The expansion in investment for new plant and equipment by private industry, while much above the prior year levels in 1966, began to show an appreciable decline in rate of expansion during the latter part of the year. The steel industry experienced a similar downtrend. There was a very strong increase in the rate of inventory accumulation during the last quarter of 1966 indicating a general slowing in demand but to some extent this was also a further buildup of inventory for military requirements.

The California economy in general paralleled the national economy during 1966. There was a larger drop in unemployment in the state, moving from near the 6-percent level of 1965 to about the 5-percent level for 1966. Unemployment in the state has, however, continued a full percentage point or more above the national average. The drop in residential construction in the state has been relatively more severe than nationally but surplus construction from prior overbuilding is being rapidly eliminated. The impetus from defense, space, commercial aviation, manufacturing and agricultural industries continued to support the state economy strongly during 1966.

NATIONAL ECONOMIC OUTLOOK FOR 1967

In contrast to a year ago when the economy was vigorously expansive there is at present a strong mixture of strengths and weaknesses. In order to accommodate increased military expenditures, demand in the civilian economy is purposely being dampened. This is resulting in softness in a number of major areas and there are signs in a classical sense that the civilian economy may be moving into a recession, but much of this slack is being picked up in military procurement. In this context the course of the economy during 1967 will therefore be importantly affected by the war in Vietnam, as it influences government spending, the questions of credit availability, a tax increase, inventory adjustments, and other factors.

We are assuming that continued emphasis on military requirements, as well as facility in adapting monetary supply and fiscal action to economic conditions, will tend to provide sufficient support to prevent a recession and allow the civilian economy to readjust gradually during 1967. This will result in new areas of demand being opened up during 1967 which can begin replacing others in providing stimulus. It appears that 1967 might be characterized as a transition year for which it is unusually difficult to project the level of economic activity but during which the overall economy is likely to expand at a somewhat slower rate than during 1965 and 1966.

The major considerations and assumptions relative to the 1967 outlook are discussed below:

1. Credit should be gradually eased during the year as more slack develops in some areas of the economy. This will require careful management to successfully balance supply and demand in relation to domestic needs, the balance of payments problems, and other considerations.

2. Government Expenditures. An increase of from \$10 billion to \$15 billion is expected in defense expenditures, bringing the total amount for national security purposes to the \$70–\$75 billion range. Other federal expenditures are expected to move up only moderately but the steady increase in state and local government outlays is expected to continue. The governmental sector will therefore probably be one of the strongest stimulative factors in the economy during 1967.

3. Prices. The strong upward price movement during 1966 resulted for the most part from more rapidly growing demand than supply.

The situation has been changing and the strong impact on prices during 1967 will result from the cost push element as labor and other factors seek to better their position. This indicates an anomalous, but not infrequent, situation in adjustments of this type. In similar periods during past economic cycles prices were rising strongly while the general economy was lacking in vigor. In this context a consumer price increase of about 2.5 percent is expected during 1967.

4. Inventories. A rapid increase in inventory accumulation occurred in the last quarter of 1966 at an annual rate of $14.4 billion as compared to $9.9 billion in the third quarter. This increased accumulation was largely involuntary as sales were slowing in some lines —a classical recession indicator. This may also be viewed, however, as a necessary element in accomplishing the intended transition in the economy; it will in any case bear close observation and perhaps nimble fiscal action to provide the correct balance to counteract a depressing effect on the economy as inventories are readjusted during the next few months.

5. Construction. With the exception of the housing category the construction industry has provided strong support to the economy, but there was an erratic downward trend in construction contracts for commercial and industrial buildings categories through most of 1966, and this appears to have fallen more rapidly since September. Housing construction rates continued to fall with a drastic downward move during 1966. The industry is in a recession with signs appearing that the bottoming out phase is being reached at around $1 million to $1.1 million new starts. With surplus housing being rapidly depleted in major areas there will be strong demand support for an upturn beginning later in 1967. This indicates that construction during 1967 will probably be near the 1966 level, but moving up instead of down. The expansionary strength will, however, hinge importantly on the availability of credit. Population and other factors indicate the prospects of a strong upward cycle over the next few years in housing that could by 1968 provide vigorous support to the economy.

6. Employment, Unemployment and Productivity. Employment expanded in line with increases in the labor force during 1966 and resulted in an average unemployment rate for the year of slightly less than 4 percent. The outlook for 1967 is for the average unemployment rate to remain near the 4 percent level for the year, but with a number of labor contracts in major industries due for renewal in 1967 (such as automobiles, trucking, railroads, rubber, copper, meatpacking and farm machinery) a more volatile and erratic employment picture is expected with wage gains around 5 percent in contrast to productivity gains for the year of nearly 3 percent. This will, therefore, be one of the major forces with respect to further inflation during 1967.

7. Consumption Expenditures. Recent consumer surveys indicate more restraint in planning major purchases in the months ahead especially of durable items. This is already being reflected in slowing sales of new automobiles and appliances as well as the recent surge in inventory accumulation. The portion of personal income going into savings is now increasing so only a moderate overall advance in consumption expenditures is expected during 1967. The trend in consumption expenditures will also be directly influenced by the avail-

ability of credit and should receive some stimulus by late 1967 if the housing cycle begins showing more firmness.

8. Investment. After two especially strong years, the rate of expansion in capital investment for plant and equipment has begun to taper off significantly with the average level for 1967 expected to be about 5 percent above 1966 as compared to a better than 15 percent gain for 1966 over 1965. Elimination of the 7-percent investment tax credit and accelerated depreciation factors, as well as overall credit stringency, were all directed toward slowing the expansion. And in view of the new productive capacity being placed in operation from prior outlays together with the recent buildup in consumer goods inventories, a moderated impact on the economy is anticipated during 1967 from investment outlays.

9. Tax Situation. The President's request for increased taxes on individuals and corporations beginning July 1967 diminishes the economic prospects for the year. This proposal will be considered in light of evolving economic conditions before being approved or rejected by Congress. If a further softening in the economy occurs it appears highly unlikely that a tax program will be approved. Athough the tax proposal, as well as any resultant taxes, constitutes an overall drag on the economy, there are on the other hand some positive elements such as signs of lower interest rates, thus providing a stimulus to housing and other areas that have been unduly depressed because of tight money.

In considering the above economic factors among others it is evident that rates of growth which have been well above secular trends and which were building serious pressures and imbalances are in the process of adjustment. The main purpose of the "cooling down" in the economy has been to cut back the excesses and prevent runaway deterioration of purchasing power. This process and a transformation to a different set of economic relationships will occupy much of 1967, as well as set the stage for new forces in 1968.

Assuming that a recession will be averted and that no significant changes are in prospect in the military situation, a gross national product level of close to $790 billion is estimated for 1967. This would raise the economy about $50 billion, or 6.7 percent, above the $740 billion level for 1966 and compares with a near $60 billion gain between 1965 and 1966. Of the $50 billion, around $20 billion would represent inflationary price increases, and $30 billion, or about 4.0 percent, would be real gain.

CALIFORNIA ECONOMY

The California economy, after having grown less rapidly than usual in the prior two years, gained new momentum during 1966 with a 9-percent increase in personal income. This carried the personal income total for 1966 to $65.3 billion, as compared to $59.9 billion for 1965. Major factors in the uptrend were increased manufacturing activity, especially commercial aviation and defense-oriented industries. Other important areas of support were the government and military categories. The decline in housing, which began in early 1964, reached severe proportions in the state during 1966 and appears now to be bottoming out.

The total population of California is expected to reach 19,743,000 by July 1, 1967. This will represent an increase of 548,000, or a 2.9-percent annual change. If this total is reached it will be larger than the increase of 469,000 persons, or 2.5 percent, between 1965 and 1966.

With the rapid expansion in economic activity last year, the unemployment rate moved down from the 6-percent level to near 5-percent where it has remained since around the middle of the year. Although the rate of unemployment has remained higher than the national rate, this fact alone provides some possibility of flexibility for economic expansion during 1967 with less pressure on prices than nationally. The seasonally adjusted rate of unemployment fell from 5.2 percent in December 1966 to 4.7 percent in January and we estimate the rate for 1967 will average between 4.5 percent and 5.0 percent.

The defense, space, and commercial aviation industries in the state are expected to maintain solid support for the economy but will not match their expansionary impact in 1966.

Of special significance during 1967 will be the residential construction industry. Building permits probably will total only 90,000 to 100,000 units—near the 1966 level—but the long decline should be reversed. In 1963 construction was at the rate of over 300,000 units. The subsequent curtailment in California has been relatively much more severe than in other major areas of the country. This was required to work off surpluses which were built up from the prior overbuilding period, and these should be substantially wiped out in 1967 with the help of the current tight money situation. Toward the end of the year incipient new demand forces based on population, income, and other factors should be appearing, but the actual impact of these will be alternatively moderated by or stimulated by changes in building prices, the amount of credit which will become available, and the facility with which the industry can make the turnaround.

These are some of the major areas for consideration in 1967. The national economic trends are also reflected in state activities. As at the national level, barring a recession, the state economy should be moving up again at a more vigorous pace in the last half of 1967, and the relative expansion during the year is expected to be slightly greater than for the country as a whole. Within this framework personal income for California in 1967 is expected to reach around $70 billion. This would represent about a 7.5 percent increase over the $65.3 billion level for 1966.

STATE POPULATION TRENDS AS REFLECTED IN BUDGET WORKLOAD FACTORS

There have been some fundamental changes gradually taking place in state population trends in the last few years which are beginning to significantly alter state budget workload growth rates and portend further impact on future budget levels.

The state's civilian population growth from 1960 with a projection for 1967 and 1968 together with age group growth characteristics is shown in the following table:

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California Civilian Population
By Selected Age Group Categories 1960 to 1968
(As of July 1 each year)
(In Thousands)

	Total	*Inter-year percent increase*	*Under 5 years*	*Inter-year percent increase*	*5–17 years*	*Inter-year percent increase*	*18–24 years*	*Inter-year percent increase*	*25–64 years*	*Inter-year percent increase*	*65 years and older*	*Inter-year percent increase*
1960	15,567		1,759		3,733		1,248		7,432		1,395	
		3.8		3.5		5.1		8.6		2.6		3.1
1961	16,163		1,821		3,922		1,355		7,627		1,438	
		3.6		2.3		6.6		5.7		2.2		1.7
1962	16,737		1,862		4,182		1,432		7,798		1,463	
		3.7		1.9		6.9		6.9		2.0		2.3
1963	17,349		1,896		4,470		1,531		7,956		1,496	
		3.2		1.3		2.4		5.6		3.1		5.8
1964	17,902		1,921		4,577		1,616		8,205		1,583	
		2.9		–0.7		2.1		11.1		2.9		1.1
1965	18,417		1,907		4,671		1,795		8,444		1,600	
		2.3		–0.8		2.7		6.0		1.9		3.3
1966	18,848		1,892		4,797		1,903		8,604		1,652	
		2.9		0.9		2.8		7.1		2.4		3.8
1967	19,403		1,909		4,933		2,039		8,808		1,714	
		3.0		2.1		2.7		4.6		2.9		3.4
1968	19,980		1,949		5,067		2,132		9,060		1,772	
Average rates of increase		3.2		1.3		3.9		6.9		2.5		3.1

Source: California Population 1966.

It is noted that total state civilian population is continuing to grow strongly as it has since 1960 but will be at generally lower rates of increase in the latter part of the period to 1968. This is resulting from falling birth rates, as well as some easing of in-migration pressures. The latter was especially relevant from 1965 to 1966. While these trends would indicate some easing of workload growth factors, the more conclusive impact on budget workload requirements, however, is in the trends among the various age group categories.

Trends in the under-five-year age group have been strongly down since 1960 with a reversal expected in 1967 and 1968. This age group category does not have a large immediate effect on state budget workload factors except to some extent in welfare requirements, but the significance is that in later years these trends will be reflected in the older age groups.

The 5–17 age group has a direct relationship with state budget levels as these youngsters are the beneficiaries of elementary and secondary school apportionments which are now running at a rate of well over $1 billion a year from the General Fund. The large interyear percentage increases of the early 1960's, after falling, now appear to be stabilizing at a much lower (2.7 percent to 2.8 percent) yearly increase level, but sharp drops in the under-five-year category from 1964 to 1967 indicate further declines. This is also borne out by separate projections of student enrollment over the coming years. While absolute growth in numbers is expected each year, the rate will lessen and while workload amounts will continue to grow, the rate of increase should slacken somewhat thus relieving budgetary pressures for these purposes.

An even more significant trend is developing in the high-budget-cost college level, the 18–24-year age group category. A rapid downtrend in the percentages of increase is shown since the abnormal increase of 11.1 percent (born in 1947) between 1964 and 1965. Although continuing state construction increments will be required for institutions of higher learning, as well as increasing enrollment particularly in graduate (high cost) instruction, nevertheless the rate of increase should begin to slacken thus reducing the relative impact on budget workload needs. There is the complicating factor that an increasingly large proportion of this population age group and of other age categories for that matter will seek to utilize those facilities. This, however, introduces another not purely workload element into the situation.

The future growth in state resources to meet fiscal demands is largely represented in the 25–64-year age group category. These are the productive age levels that provide the income for state budgets. The group has declined slowly in rate of population growth since 1960, whereas it should at least stabilize as a portion of total state population in the next few years and may rise slightly. This indicates that revenue growth rates will be at least maintained depending, of course, on general economic conditions which also appear favorable during the next five years.

A static to slightly upward trend characterizes the over-65 age group on a relative basis of growth from 1960 to 1968. Benefits for this group have been greatly liberalized at the state and federal support levels and with broader social security coverage state budget requirements should not grow as fast in the next few years as they have in the past.

This analysis thus attempts to show that some of the factors which have caused fast growing increases in the rates of state budget expansion are tending to moderate. And although continued increases in dollar amounts will be required to meet rising price levels and the absolute growth in state workload budget requirements in the years immediately ahead, there is some reason to expect a gradually more favorable relationship to evolve between fiscal capacity and workload outgo in the state General Fund budget picture. Not considered, of course, is the effect of upward adjustment in levels of service that may be proposed in the future and which were a major factor in the past income and outgo gaps, requiring large increases in taxes.