CALIFORNIA LEGISLATURE

1968 REGULAR SESSION

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1968, to June 30, 1969

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

STATE CAPITOL
Sacramento, February 20, 1968

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, 1968, to June 30, 1969.

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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PRELIMINARY STATEMENT ON THE FORM AND CONTENT OF THE ANALYSIS OF THE BUDGET BILL

This Analysis of the Budget Bill is comprised of several major parts.

First, it contains a summary and general description of the budgeted expenditures, particularly those of the General Fund but also distinguishing between bond funds, federal funds, and special funds. It analyzes the problem of balancing the budget and the surplus and cash flow situations. It describes the programs in which the greatest growth in expenditures has taken place as well as the general trend in expenditures. It makes comparisons with other states, both on a per capita basis in general and in respect to certain major programs such as education and welfare. Finally, this section contains a comprehensive description of the state's bonded debt and the General Fund debt service obligations. This expenditure section covers pages IX to XXXI of the Analysis.

Second, this report includes a description and analysis of the revenue estimates prepared by the Department of Finance including a summary of national and state economic conditions and other economic data which are used in developing revenue estimates. The section contains comparisons with prior years and with other states, and includes recent data on the collections under the new tax increase. Although it uses much of the same data as that employed by the Department of Finance in making revenue estimates, our Analysis contains an independent evaluation. This portion of the Analysis covers pages XXXII to XLVII.

Third and finally, the report contains an item-by-item analysis of each of the items of appropriation in the Budget Bill. These appropriation items reflect only that portion of the amounts budgeted for the individual state programs which require specific appropriations in the Budget Bill for the 1968–69 fiscal year. In this respect it should be noted that the Budget Bill contains only 38 percent of the total state expenditure program, the other continuing appropriations being provided for by statute or Constitution. Nevertheless this item-by-item analysis of the Budget Bill will largely constitute a program analysis of California state government including review of the on-going program and the amounts proposed by the Governor for the coming fiscal year. Because so large a part of the state budget is not included in the Budget Bill we have broadened those sections which deal with such important subjects as education, welfare, capital outlay, to include general preliminary statements reflecting consideration of total program expenditures including those which are outside the Budget Bill and including major fiscal issues which we believe must be of concern to the Legislature in determining the proper total level of expenditure. The Analysis will, as required by law, contain our recommendations, primarily directed to efficiencies and economies, although the recommendations will also include proposed improvements in organization and management. Some of the recommendations contained in this analysis would require changes in the statutes or even the Constitution, both of which are, of course, within the power of the Legislature to either change or initiate change.

Recommendations for reductions in expenditures total $14.4 million, offset by recommendations for increases totalling $3.9 million in areas where we believe that additional expenditures will produce actual economies or efficiencies.

SUMMARY AND GENERAL DESCRIPTION OF STATE EXPENDITURES

Total state expenditures including bond funds are proposed at $5,699,536,034 for 1968–69. In addition, the state will also spend or subvene an estimated $2,353,646,662 in federal grants-in-aid and $471,858,399 in federal reimbursements and special projects. This indicates an overall expenditure level of $8,525,041,095.

The expenditures from bond funds and federal funds are summarized for 1966–67, 1967–68, and 1968–69 as follows:

	1966–67	*1967–68*	*1968–69*
Bond Fund Expenditures:			
State Construction Program and State Higher Education Construction Program Funds	$126,891,451	$246,370,625	$25,743,742
California Water Resources Development Bond Fund	343,030,417	291,414,903	137,780,381
Central Valley Water Project Construction Fund	10,307,326	76,076,144	266,356,714
State Beach, Park, Recreational and Historical Facilities Fund	34,063,505	35,958,625	35,150,874
Total, Bonds	$514,292,699	$649,820,297	$465,031,711
Expenditures of Federal Funds:			
Grants-in-Aid, Reimbursements and Special Projects	2,434,953,029	2,671,003,882	2,825,505,061

Under standard state accounting procedures these expenditures from bonds and federal funds are not included in budget totals. The inclusion here is for information only to show the overall impact of state expenditures and they will not be included in the sections on budget expenditures and totals which follow.

ELEMENTS OF THE BUDGET

Ordinarily budget expenditures are reported as excluding bond funds. Thus, reduced by the $465 million in bonds, the total of expenditures is $5,234,504,323. This is an increase of $564,139,614, or 12.1 percent, from 1967–68 and is $1,089,897,571, or 26.3 percent, above the budget total for 1966–67. A breakdown of these amounts by totals and into functional categories is shown for the latest three fiscal years as follows:

	1966–67	*1967–68*	*1968–69*
State Operations	$1,326,283,824	$1,431,480,835	$1,607,962,521
Local Assistance	2,409,135,398	2,695,534,523	3,144,749,950
Capital Outlay	409,187,530	543,349,351	481,791,852
Total Expenditures	$4,144,606,752	$4,670,364,709	$5,234,504,323

The trend of growth in expenditures becomes more clearly evident from the following illustration which shows the amounts and percentage changes that occur in these categories, first, in the two years between 1966–67 and 1968–69, and again between 1967–68 and 1968–69.

	Changes in Amount and Percent Between			
	1966–67 and 1968–69		*1967–68 and 1968–69*	
	Amount	*Percent*	*Amount*	*Percent*
State Operations	$281,678,697	21.3	$176,481,686	12.3
Local Assistance	735,614,552	30.5	449,215,427	16.7
Capital Outlay	72,604,322	17.8	*—61,557,499*	*—11.3*
Total Expenditure	$1,089,897,571	26.3	$564,139,614	12.1

This comparison shows that the local assistance category, with an increase of 30.5 percent between 1966–67 and 1968–69 and of 16.7 percent from 1967–68 and 1968–69 is by far the fastest growing category in the state budget. If local tax relief were to be measured by the increased amount of state money subvened to local government, this trend could be called a significant tax relief program. But this in itself is not a good measure of local tax relief.

The large decrease shown for capital outlay expenditures between 1967–68 and 1968–69 is not representative of the actual situation in this budget category. It has been the practice in constructing the budget to include in the expenditure totals for the middle year in certain special fund budgets, namely that of the Division of Highways, large fund balances in addition to expenditures, falsely assuming that these balances will be spent. This balloons the current year figures above what is reasonably expected to be expended and thus presents a misleading impression as to the actual situation. There is no justification for the Department of Finance adding these fund balances to the expenditure level and a proper budgeting procedure would separate them.

This practice is illustrated in the following example which shows the cycle as it occurred in the 1966–67 special funds category of capital outlay expenditures, taken from three different budget documents.

1966–67 Capital Outlay Expenditures—Special Funds

	Millions
As proposed in 1966–67 Budget Document	$334.8
As reestimated for 1966–67 in 1967–68 Budget Document	488.6
Actual for 1966–67 as shown in 1968–69 Budget Document	360.7

The above comparison, showing the large difference between the middle-year estimate and the proposed and actual amounts in this budget category, illustrates this practice. As indicated, the state highway program for which funds are continuously appropriated under Section 183 of the Streets and Highways Code is the major factor.

SUMMARY OF GENERAL FUND EXPENDITURES

The budget proposes $3,898,079,623 in General Fund expenditures for 1968–69. This represents an increase of $569,810,193, or 17.1 percent, from the $3,328,269,430 estimated total for 1967–68. In 1966–67 the total was $3,017,197,433 indicating an extraordinary gain in General Fund expenditures of $880,882,190 in only two years. The totals and a breakdown by budget categories are shown below:

	1966–67	*1967–68*	*1968–69*
State Operations	$1,061,521,349	$1,125,988,666	$1,268,524,892
Local Assistance	1,907,160,245	2,162,761,620	2,539,152,511
Capital Outlay	48,515,839	39,519,144	90,402,220
Total	$3,017,197,433	$3,328,269,430	$3,898,079,623

It is again evident that the local assistance category is where the largest part of growth is taking place in General Fund expenditures. The more than doubling of capital outlay expenditures between 1967–68 and 1968–69 reflects provisions of the 1967 tax legislation which reserved $90 million for this purpose. Part of these expenditures, however, $21.4 million as budgeted in 1968–69, are for programs which were in prior budget documents classified in the local assistance category by the Department of Finance. The work involves construction of juvenile homes and camps, flood control projects, riverbank protection, and beach erosion control, (see Items 364–367 of the Budget Bill). This is merely an arbitrary shift in category made in this budget for the years 1966–67, 1967–68, and 1968–69 and the real expansion in capital outlay is therefore, less than the amount reserved by the tax legislation.

The major part of the rapid growth in General Fund expenditures can be accounted for in a relatively small number of programs. The most significant program changes are summarized below showing the estimated 1967–68 expenditure level and the proposed amount for 1968–69, as well as the amount and percent of increase or decrease between the two years.

	In Millions			
	Expenditures		*Amount of increase or decrease*	*Percent increase or decrease*
Program	*1967–68*	*1968–69*		
State Operations				
Youth and Adult Corrections	$123.5	$127.7	$4.2	3.4%
Higher Education				
University of California	243.4	280.0	36.6	15.0
State Colleges	197.0	224.3	27.3	13.9
Scholarship Commission	5.6	8.9	3.3	58.9
Franchise Tax Board	13.2	16.1	2.9	22.0
Mental Hygiene	192.3	194.5	2.2	1.1
Bond Interest and Redemption	67.8	76.2	8.4	12.4
Salary Increase	(44.9) [1]	57.3	57.3	27.6
Other	283.2	283.5	0.3	--
Total	$1,126.0	$1,268.5	$142.5	12.7%
Local Assistance				
Youth and Adult Corrections	7.7	11.3	3.6	46.7
Education	1,375.7	1,445.0	69.3	5.0
Health and Welfare				
Mental Health Services	23.9	27.5	3.6	15.1
Public Health—Hospital Construction	22.9	0.0	*—22.9*	*—100.0*

Expenditure Summary

Program	*Expenditures* 1967–68	*Expenditures* 1968–69	*Amount of increase or decrease*	*Percent increase or decrease*
Social Welfare — Public Assistance Programs	409.4	456.0	46.6	11.4
Medical Assistance	254.0	336.0	62.0	22.6
Tax Relief				
Property Tax Relief	0.0	194.1	194.1	--
Senior Citizens Property Tax Assistance	0.0	22.0	22.0	--
Other	49.2	47.3	*—1.9*	*—3.9*
Total	$2,162.8	$2,539.2	$376.4	17.4%
Capital Outlay	39.5	90.4	50.9	128.9
Over-all Total	$3,328.3	$3,898.1	$569.8	17.1%

In Millions

[1] The 1967–68 salary increase is distributed among the separate programs.

These programs as listed account for practically the entire increase in General Fund expenditure between 1967–68 and 1968–69. The remaining increases and decreases in other programs not listed therefore largely offset each other. The summary shows the elements of the large increase in local assistance to be for tax relief, health and welfare, and education. The major increases in state operations are for higher education and salary increases, although it should be noted that the program for higher education was reduced to an unusual degree last year and much of this increase is simply a reinstatement of what was represented at that time to be a one-year retrenchment. It is also noteworthy that the mental hygiene and corrections programs are growing at a much higher rate in the local assistance category than in state operations.

GENERAL FUND FINANCIAL PICTURE

The state's budget problem for 1968–69 centers as is usual in the General Fund. This is because expenditures from that fund have regularly increased at a rate about half again as fast as the General Fund tax base produces increased revenues. In the years 1963–64 through 1965–66 this dilemma was resolved largely with one-time tax adjustments each year. In 1966–67 the state placed most revenues on an accrual basis, and as a result of this it was possible for additional taxes to be postponed until 1968–69. Major tax legislation passed in 1967 raising about $1 billion in added General Fund revenue has made it possible for the state to show a prospective cash surplus, as well as a larger surplus on the accrual basis, at the end of 1967–68. However, for 1968–69, a tight budget situation again faces the General Fund, with attendant problems of controlling expenditures to the extent that they can be financed from income.

The General Fund ended the 1966–67 fiscal year with borrowings from other funds totaling $194 million. But on the accrual basis, after paying all obligations and in effect offsetting savings in education and other programs against increased costs in Medi-Cal and other programs, the year ended with an accrued free surplus of $9.5 million plus

$46.9 million in committed reserves. Thus the state General Fund began 1967–68 with a carry-forward debt from 1966–67 of $194 million and an accrued free surplus of $9.5 million. In addition, there was $35.5 million in cash in the treasury at June 30, 1967, most of it reserved for the impending debt service payment which was due July 1, 1967 on state general obligation bonds.

Accrual Position of General Fund

On an accrual basis the state General Fund thus started 1967–68 with resources of $56.4 million, of which $46.9 million consisted of committed reserves (carryover balances from prior years appropriations) and $9.5 million consisted of free surplus. Income for 1967–68 is estimated by the Department of Finance at $3,515.8 million and outgo at $3,328.4 million. This indicates a current surplus of $187.5 million, to which can be added the $56.4 million of prior-year resources to form an end-of-year resources balance of $243.9 million. This is shown in the following schedule.

	Millions
Carryover of prior year resources	$56.4
1967–68 Income	3,515.8
Total	$3,572.2
Expenditures	3,328.3
Ending resources (June 30, 1968)	243.9
Committed reserves	12.2
Reserve for working capital	194.0
Free surplus (June 30, 1968)	$37.7

Of the $243.9 million shown, $12.2 million represents committed reserves to be carried into the following year, and the remaining $231.7 million represents surplus. However, out of this latter total the Department of Finance has reserved $194 million as a "Reserve for Working Capital," leaving free surplus at $37.7 million as of June 30, 1968. This reserve is similar in concept to the "Reserve for Cash Liquidity" which was proposed in the 1966–67 Budget but not accepted by the Legislature.

Under these provisions the state will, during 1967–68, pay off the $194 million in borrowings carried forward from 1966–67 plus the additional intrayear borrowings made during 1967–68. The 1967–68 fiscal year will thus end with no General Fund borrowings. As will be explained in a later section, should these surplus income accruals be utilized to support additional expenditures in 1967–68, as was done in 1966–67, the state will end the year at June 30, 1968, in a net borrowed cash position to the extent these are used.

Assuming a carryover of resources from the prior year as shown above of $243.9 million, most of which has been restricted by the Department of Finance, the 1968–69 fiscal year budget problem can be outlined as follows.

Revenue to the General Fund is estimated in the Governor's Budget document to total $3,863.6 million. To this, $6.2 million in other income can be added for a total of $3,869.8 million. This other income category is comprised of three proposed separate transfers into the General Fund from other funds as follows:

	Millions
Department of Employment Contingent Fund	$2.7
Motor Vehicle Fund	2.8
Water Resources Revolving Fund	.7
Total	6.2

Expenditure as proposed for 1968–69 at $3,898.1 million includes special reserved amounts of $216.1 million for property tax relief and senior citizens property tax assistance. There is also provision for $90.4 million of General Fund capital outlay. It is necessary to pass implementing legislation in the 1968 session in order to place the greater part of the property tax relief proposals into effect.

AB 272, Chapter 1209 of the 1967 session, specified that the $155 million reserved for general property tax relief during 1968–69 must be appropriated by June 15, 1968, or the state sales tax rate will automatically drop from 4.0 percent to 3.5 percent on July 1, 1968. This rate reduction would result in a $193 million General Fund revenue loss during 1968–69. This is $38 million more than the savings which would result from not enacting the property tax relief and would result in a reduction of General Fund surplus.

The estimated General Fund condition for 1968–69 on an accrual basis and relative to the budget proposals and estimates as prepared by the Department of Finance, including the the proposal to continue the $194 million reserve for working capital, is shown in the following statement:

	Millions
Carryover of prior-year resources	$243.9
Income	3,869.8
Total	$4,113.7
Expenditures	3,898.1
Ending Resources (June 30, 1969)	$215.6
Reserve for working capital	194.0
Committed reserves	12.3
Free Surplus (June 30, 1969)	$9.3

Should the reserve for working capital as proposed by the Department of Finance in the amount of $194 million not be set up, the accrual surplus would total $203.3 million instead of $9.3 million as shown at June 30, 1969. This should be considered in relation to its effect on the cash position of the General Fund, which will be explained in the following section.

Cash Position of General Fund

In order to determine the cash position of the General Fund in 1968–69 it is necessary to begin the analysis with the situation at the end of 1966–67. At June 30, 1967, as shown by the Controller, there was a borrowed balance of $194 million owed by the General Fund which was carried into 1967–68 and is expected to be paid off during that year. There was also a restricted reserve of $35.5 million in cash set aside by the Controller in the State Treasury—most of it obligated for the July 1, 1967 payment of bond debt service. Had this reserve not been set up it would have been necessary to immediately borrow the necessary funds on July 1 in order to pay this obligation, in effect placing borrowings practically on an hourly basis. This apparently will be the case at the beginning of 1968–69 as no such provision has been made to meet this obligation at the end of 1967–68.

Total cash disbursements in the General Fund during 1967–68 are estimated in the Governor's Budget to total $4,334.6 million and total receipts to amount to $4,300.1 million. In 1968–69 the estimate for cash disbursements and also for cash receipts are equal at $4,655.2 million. There is sufficient short-term borrowing capacity available in all months of both years so that no cash flow problem is anticipated even if outgo were to be significantly increased above that budgeted. The totals indicated above on a disbursement and receipts basis should not be confused with budget estimates. These amounts in both cases are larger than cash income or expenditure totals because duplicating and other transactions are included such as the payment of veterans' bond debt service which is advanced from the General Fund and is counted as a disbursement when paid. It is also, however, counted as a receipt when the General Fund is reimbursed for this payment. The cash receipts and disbursements basis, while not representing budget totals, is a useful and valid means of showing the cash position of the General Fund, as well as the cash surplus implications. This is done below indicating the estimated cash position, which can be compared to the accrual position, shown in the previous section, on June 30, 1968 and June 30, 1969.

	Millions
Restricted cash surplus June 30, 1967	$35.5
Cash Receipts during 1967–68	4,300.1
Total	$4,335.6
Cash Disbursements during 1967–68	4,334.6
Cash in Treasury June 30, 1968	$1.0
Cash Receipts during 1968–69	4,655.2
Total	$4,656.2
Cash Disbursements during 1968–69	4,655.2
Cash in Treasury June 30, 1969	$1.0

This treasury cash balance of $1 million estimated at the end of 1967–68 and 1968–69 should not be considered as a free surplus amount. This is probably the minimum amount that the treasury should have on hand in till money and for other needs in order to facilitate state transactions.

Relating the anticipated cash situation in the treasury at the end of 1967–68 and 1968–69 to the much larger balances as shown on an accrual basis, it is evident that if these accruals, such as the "Reserve for Working Capital," are utilized to support expenditures above the levels budgeted the General Fund will end the fiscal year in a borrowed position. This would be similar to the situation at the end of 1966–67.

Also to be considered is the fact that borrowings carried over in one year will at least double at the end of the following year, thus compounding the problem, if no upward adjustment is made in taxes or expenditures are not reduced. The need for new taxes could by this means be postponed as was the case in 1966–67, but the alternative appears to be the creation, when the limit of income accruals is reached, of another situation such as was faced in 1967. This possibly could result in another cash-flow problem under certain circumstances, but this would probably be only secondary as the ceiling on accrued income would ordinarily be reached before the maximum monthly borrowing capacity is exhausted.

Appraisal of General Fund Condition

Changes in budget accounting practices have an effect on the estimates of surplus. The two major adjustments cited previously increase the surplus balance which has been offset against the increased expenditures proposed in the budget. The actions are as follows:

1. The budget shifts $21.4 million of local assistance expenditures, already General Fund supported, to capital outlay. This action in effect reduces by this amount the additional funds required to meet the $90 million reserved in 1967 tax legislation for General Fund capital outlay. This action raises a question of legislative intent.

2. Budgeting practices are changed. No provision is made to reserve funds at the end of 1967–68 to pay July 1, 1968 bond debt service obligations. This in effect utilizes most of the $35.5 million which the Controller reserved mainly for this purpose at June 30, 1967 instead of offsetting it with a similar reserve at June 30, 1968. This will require immediate borrowings by the General Fund on July 1, 1968 in order to pay this obligation, whereas funds had been set aside to meet the July 1, 1967 payment.

In essence these adjustments result in one-time increases in resources for expenditure available to the General Fund.

The preceding sections analyzing General Fund accrual and cash condition are based on estimates and other data as proposed in the Governor's Budget. There are certain other factors to be considered that may significantly change the situation.

In this respect the $336 million in state funds proposed for 1968–69 expenditure in the medical assistance program appears to be no more than a very tentative approximation of the amount that might be required. The proposed amount is $66 million less than that derived after applying caseload and cost factors to the program elements and we have reservations as to the accuracy of these caseload estimates. The reduction is predicated on the effect of certain anticipated administrative controls, final decisions, the impact of the Social Security amendments of 1967, and other items. No separate estimates are shown as to the anticipated effect of these individual changes. The tentative nature of the $66 million lump sum reduction is demonstrated by the further statement that specific proposals to effect this reduction will be submitted to the Legislature between 30 and 60 days after submission of the Governor's Budget. We believe that both the 1967–68 and 1968–

69 Medi-Cal expenditure estimates are not accurate as stated in the budget and will need to be revised.

The medical assistance program expenditures are therefore likely to be significantly changed. This would have a direct effect on the General Fund condition. Additional reporting on this will be made later as our studies are completed.

Not included in the expenditure totals is a recommendation, page 1111 of the budget document, made by the Governor that additional funds in the amount of $910,500 should be made available for salary increases to instructional classes of the state colleges. This would bring the recommended salary increase to 7.5 percent instead of 6.8 percent which is provided for in the budget. In addition to raising the budgeted expenditure total, the proposal will, if approved, reduce General Fund surplus by $910,500 from that shown in the budget. This would substantially delete the cash balance of $1 million in the treasury as estimated for June 30, 1969 and reduce the accrual free surplus to $8.4 million.

A savings of about $40 million was made in school apportionments in 1966–67. The budget has been adjusted to reflect estimated savings of $60 million each year for both 1967–68 and 1968–69. The stated basis for the reductions is estimates made in connection with 1967 tax legislation anticipating $60 million less in apportionment expenditures, largely owing to equalization aid adjustments, areawide tax adjustments, and local property reassessment in both years.

Additional savings are estimated by the Department of Finance in school apportionments totaling $4 million in 1967–68 and $14 million in 1968–69. These are anticipated on the basis of a reduced rate of public school attendance, unification savings, improved property assessment practices throughout the state, and a continuing saving in the county school service fund. These savings as well as the $60 million above are all anticipated in the budget. If they do not materialize to the extent anticipated they will adversely affect the General Fund surplus.

These assumed savings are speculative. With such large sums involved an adverse result could have serious budget implications. One problem is that, in some cases, there has been insufficient time, since changes in tax and assessment factors have been introduced, to properly evaluate the effect these will have on state school expenditures. More will be known after the first principal apportionment is made in February 1968.

The budget reflects $25 million in proposed savings in the social welfare local assistance programs of which $10 million will be General Fund savings. The stated basis for this savings is changes to be developed in the reevaluation process and through legislative changes to be proposed. Therefore these savings should be considered a tentative proposal. In addition, recent changes in the federal Social Security Act may significantly affect federal-state-local cost relationships.

In addition to these major areas of possible changes in state expenditures and surplus, the Department of Finance and other agencies can, by making special efforts, reduce, slow down, or otherwise alter the expenditure level. There is a continuing opportunity to follow through on these efforts in the individual agencies, and make savings which are in addition to the $7.5 million in estimated unidentifiable savings shown at the end of the State Operations section of Schedule 3 on page A-42 of the budget.

The General Fund surplus situation is also directly related to the amount of income the state obtains. The precise total of collections will not be known until after the fiscal year ends. Therefore, the expenditure commitment made by the Legislature and the Governor this year must rely on estimates which are subject to significant adjustment. For instance, the estimate of revenue to the General Fund for 1966–67 was reduced by $51 million between January 1967 and May 1967—long after the budget had been passed for the year. Further consideration of the revenue estimates for 1967–68 and 1968–69 is given in a later section.

INTERSTATE COMPARISONS IN STATE AND LOCAL EXPENDITURE PROGRAMS

There are large differences among the states in economic capacity, tax effort and other factors which lead to widely varying levels of services provided to their respective citizens. This is illustrated by total state-local general expenditures per capita in fiscal year 1965–66 which ranged from a high of $922.64 in Alaska to a low of $267.78 in South Carolina, a ratio of more than 3½ to 1. For public education, the range was from $275.98 in Alaska to $117.82 in Mississippi, a ratio of more than 2½ to 1. Other examples include public welfare in which the highest per capita outlay in Oklahoma was five times the lowest in Virginia, and public health, in which New York, the highest, was four times South Dakota, the lowest. Even when the average of the highest five states and the lowest five states is taken in the various expenditure categories, the disparities are great. These are shown in Table 1.

Table 1

Average per Capita Expenditure of the Five Highest and Lowest States on Selected Items for the Fiscal Year 1965–66 [1]

	Expenditures	*Education*	*Public welfare*	*Health and hospital*
Five Highest States	$688.63	$255.73	$57.92	$44.70
Five Lowest States	310.13	122.60	17.33	16.02

[1] Source: Developed from data in U.S. Department of Commerce, Bureau of the Census, Governmental Finances in 1965–66.

On the tax side, the five highest states raise twice as much revenue per capita from their own sources as the five lowest states. In 1965–66, the five top states in terms of per capita revenue collections (Alaska, Nevada, California, Wyoming and Hawaii) collected an average $646.15 per capita against $310.16 per capita in the five bottom states (South Carolina, North Carolina, Arkansas, Mississippi and Tennessee). Because of the wide ranging disparities between states it is more appropriate to compare California with the other major industrial states.

In this respect we have developed comparisons of combined state and local expenditures in the most significant program categories for California and nine other major industrial states. This is shown in Table 2.

The expenditure totals include funds collected by the state and local governments from their own sources as well as funds received from the federal government to be expended through the various grant-in-aid and other programs.

Although the data are essentially comparable for public expenditures in these program areas, there are certain private expenditures which are more significant in the programs of some states than in others, especially in higher education. Therefore, while the data may provide a good index of public effort, this is not necessarily the case for total state effort in all programs.

Table 2 provides three different types of expenditure figures: (1) The total state and local budget expenditures, (2) the expenditures per capita, (3) the percent of the total expenditures devoted to the particular function by the state. The use of one expenditure figure alone may be misleading. For example, California spends $941.3 million for higher education while Indiana spends $245.3 million. On this basis alone one might assume that Indiana extends comparatively little effort in the area of higher education in comparison to California. However, the expenditures per capita by each of the states is very similar, $49.75 in California and $49.87 in Indiana, indicating that there is near parity in support. However, in terms of the relative percentage of the total expenditures devoted to higher education in each state, Indiana must place a higher portion of total expenditures into its higher education programs (13 percent as compared to California at 8.5 percent) in order to maintain the approximate equality on a per-capita basis. This results in proportionately less being available to support other programs in Indiana and emphasizes that for comparative purposes these statistical measures should be employed as part of a complex of comparisons.

California's total state-local expenditures at $11,036.3 million in 1965–66 were the highest for any state. The per capita expenditures at $583.37 were also the highest with Pennsylvania at the bottom of the range with $360.65 per capita.

The most significant variations are in the individual program categories. In the total education category California had the highest per capita expenditures at $219.10 but, as a percentage of total expenditures the rate at 37.6 percent for California was exceeded by six other states.

An especially interesting comparison is presented for the higher education component. At $49.75 per capita California is exceeded by only Michigan and Indiana, but as a percent of total expenditures four states are higher. The per capita and percentage amounts are generally lower for the eastern (mainly New England) states where privately financed higher education is much more important relatively than in other parts of the country.

One of the most significant differences among the states is evident for public welfare expenditures. The per capita amounts vary between $15.77 for Indiana and $59.65 for California. Public welfare expenditures in Massachusetts at 11.5 percent of total state-local expenditures made it the only state exceeding the 10.2 percent expended for this

Table 2

Interstate Comparisons of State and Local Expenditures by Program Amount, Per Capital Amount and Percent of State Total for Fiscal 1965–66
(Amounts in millions)

	California	New York	Pennsylvania	Illinois	Michigan	New Jersey	Ohio	Connecticut	Massachusetts	Indiana
Total	$11,036.3	$9,678.8	$4,177.1	$4,090.9	$3,744.7	$2,595.8	$3,769.4	$1,229.8	$2,314.6	$1,888.4
Per capita	583.37	530.11	360.65	381.53	447.18	376.30	365.78	427.74	429.97	383.98
Education—total[1]	4,145.1	3,466.5	1,750.6	1,739.6	1,728.4	1,016.4	1,613.7	433.8	717.7	961.6
Per capita	219.10	189.85	151.15	162.24	206.40	147.35	156.59	150.87	133.32	195.53
Percent of total	37.6%	35.8%	41.9%	42.5%	46.2%	39.2%	42.8%	35.3%	31.0%	50.8%
Local schools	$3,148.0	$2,787.2	$1,443.0	$1,321.6	$1,186.3	$886.2	$1,266.0	$362.0	$604.1	$703.1
Per capita	166.40	152.65	124.58	123.25	141.65	128.47	122.85	125.91	112.21	142.96
Percent of total	28.5%	28.8%	34.5%	32.3%	31.7%	34.1%	33.5%	29.4%	26.1%	37.2%
Higher education	$941.3	$492.2	$192.8	$384.1	$514.4	$109.0	$332.9	$50.5	$89.2	$245.3
Per capita	49.75	26.95	16.64	35.82	61.42	15.79	32.30	17.56	16.57	49.87
Percent of total	8.5%	5.1%	4.6%	9.4%	13.7%	4.2%	8.8%	4.1%	3.9%	13.0%
Highways	$1,302.4	$929.2	$624.1	$511.0	$442.1	$330.1	$676.1	$213.3	$284.0	$288.0
Per capita	68.84	50.89	53.88	47.66	52.79	47.84	65.61	74.18	52.75	58.56
Percent of total	11.8%	9.6%	14.9%	12.5%	11.8%	12.7%	17.9%	17.3%	12.2%	15.3%
Public welfare	$1,128.6	$843.9	$332.2	$346.0	$215.2	$146.9	$275.9	$98.3	$265.1	$77.6
Per capita	59.65	46.22	28.68	32.26	25.69	21.29	26.77	34.17	49.25	15.77
Percent of total	10.2%	8.7%	8.0%	8.5%	5.7%	5.7%	7.3%	8.0%	11.5%	4.1%
Health and hospitals	$665.2	$990.5	$242.9	$316.0	$318.4	$171.5	$221.6	$73.5	$207.3	$130.3
Per capita	35.16	54.25	20.96	29.47	38.01	24.85	21.50	25.56	38.50	26.49
Percent of total	6.0%	10.2%	5.8%	7.7%	8.5%	6.6%	5.9%	5.9%	8.9%	6.9%
Police and fire protection	$590.2	$657.0	$186.6	$244.8	$178.2	$196.6	$174.1	$71.3	$168.2	$76.7
Per capita	31.19	35.97	16.09	22.82	21.26	28.50	16.88	24.78	31.24	15.57
Percent of total	5.3%	6.8%	4.5%	6.0%	4.8%	7.6%	4.6%	5.8%	7.3%	4.1%
Public improvments[2]	$441.0	$534.1	$208.7	$235.3	$214.1	$147.2	$181.4	$60.2	$81.4	$75.7
Per capita	23.29	29.24	18.00	21.93	25.56	21.34	17.59	20.96	15.12	15.38
Percent of total	4.0%	5.5%	4.9%	5.8%	5.7%	5.7%	4.8%	4.9%	3.5%	4.0%

Financial administration and general control	$437.2	$369.2	$152.0	$140.9	$126.2	$109.4	$123.6	$46.5	$93.1	$60.4
Per capita	23.10	20.21	13.11	13.13	15.06	15.84	11.98	16.14	17.29	12.27
Percent of total	4.0%	3.8%	3.6%	3.4%	3.4%	4.2%	3.3%	3.8%	4.0%	3.2%
Interest on general debt	$303.8	$422.5	$188.1	$142.7	$120.1	$103.9	$111.9	$64.7	$103.2	$43.3
Per capita	16.05	23.14	16.23	13.30	14.34	15.06	10.85	22.50	19.16	8.80
Percent of total	2.8%	4.4%	4.5%	3.5%	3.2%	4.2%	3.0%	5.3%	4.5%	2.3%
All other general expenditures	$2,022.9	$1,465.8	$492.0	$414.5	$402.1	$373.8	$391.2	$168.3	$394.6	$174.9
Per capita	106.92	80.28	42.47	38.65	48.01	54.19	37.95	58.52	73.29	35.56
Percent of total	18.3%	15.1%	11.8%	10.1%	10.7%	14.4%	10.4%	13.7%	17.1%	9.3%

[1] The components, local schools and higher education, do not add to the total because certain other educational expenditures are included only in the totals.
[2] Includes sewerage and other sanitation expenditures and local parks and recreation.

purpose in California. On the other hand, Indiana at the low end of the range only expended 4.1 percent.

Only Connecticut had greater per capita highways expenditures in 1965–66 than California. As a percentage of total expenditures seven states exceeded California.

There are other significant variations between the states as shown in Table 2 for the relatively smaller programs. Especially significant are the comparisons of interest on general debt. California state and local expenditures at $16.05 per capita (as compared to $23.14 for New York) for this purpose were exceeded by four states and as a percent of total expenditures by eight states.

It is evident that the emphasis a state might place on any type of program can be much different than in another state. In this respect, California appears to place relatively greater importance as a public endeavor on education, public welfare, highways, financial administration, and the category comprising the smaller programs classified as all other general expenditures.

There are many reasons why these variations exist and are so large in some programs. In addition to the basic preference in one state to encourage certain activities more than others there are diverse factors such as area, climate, resources, degree of urbanization, income levels, and distribution, educational attainment of the population, and the industrial, resource, and occupational distributions within states. The data, therefore, should be interpreted relative to these considerations.

COMPARATIVE GROWTH TRENDS IN SELECTED STATE PROGRAMS AND AS RELATED TO POPULATION AND OTHER GROWTH FACTORS

Population and Other Growth Factors

The purpose of state government is to provide services to its people. Therefore, population is one of the elemental factors that determines the level and distribution of government services. Further, the composition of the population by age group, and the fundamental changes taking place in these groups are of particular importance for budget considerations. The population factors should also be considered together with other factors such as changing price levels for wages, goods and services and the changes in quantity and quality of services desired by the people. In this latter respect there has been a definite increase in the level and scope of services provided in most state programs.

The state's civilian population has grown steadily since 1960. The rate of growth, however, has been declining since 1963. The declining rate can be attributed to two factors: (1) a lower birthrate, and (2) a moderation in the annual net in-migration. The lower growth rate would seem to indicate some easing in budget workload factors. However, the relationship between workload factors and population trends is more substantial in terms of the demographic changes taking place in the specific age groups which largely affect the individual state programs. For example, the state's educational programs for the most part serve the specific age group between 5 and 24 years of age. This is also largely the case for welfare and other major programs which combined with education form the major portions of the total General Fund. This discussion is largely limited to General Fund elements because the major budget problems are centered in this category.

The major General Fund programs, such as Health and Welfare, Corrections, and Education, are inherently "service" oriented rather than "product" oriented. The services category is the fastest growing element of consumer prices. A large component is salary and wage costs. Therefore state costs rise significantly faster than consumer prices in general, mainly because productivity advances are much more limited than in goods producing industries. The price level for "services less rent" as measured by the Consumer Price Index reached 132.7 in October 1967, an increase of 32.7 points over the base period of 1957–59. In the same time period and from the same base the "all items" category of the index including the costs of food, clothing, automobiles, etc., advanced only 17.5 points.

Growth Rate Comparisons

Table 1 shows a composite picture of the relative changes in selected General Fund expenditure categories in comparison to changes in the total state population and total General Fund expenditures as estimated for the fiscal years 1959–60 through 1968–69. The fiscal year 1959–60 is the index year and arbitrarily equals 100, for all of the programs except Medical Assistance to the Aged and Medi-Cal. The Medical Assistance to the Aged program began in fiscal year 1962–63 and Medi-Cal, incorporating the earlier program, began in fiscal year 1965–66. For each of these programs, the first fiscal year of existence is used as the index year equaling 100. The dollar amounts used in calculating the data in the table were not adjusted to constant dollars. If the dollar amounts had been adjusted, the index items would merely have shifted downward, closer to the population growth in the state, but then would not have accounted for the inflation factor which has raised prices during the period.

The General Fund programs shown in Table 1 are: (1) Medi-Cal, (2) Medical Assistance to the Aged, (3) Debt Service, (4) Higher Education, (5) Youth and Adult Corrections, (6) Mental Hygiene, (7) Social Welfare, and (8) Public School Aid. Growth in direct General Fund salaries and wages and total General Fund expenditures are also included for comparison purposes.

A ratio between the growth in the total population which was 29 percent for the fiscal years from 1959–60 through 1968–69 and the expenditure growth in the selected programs for the same period produces the following comparisons: (1) Medi-Cal, since its inception in 1965–66 of 15.2 times total population, (2) Debt Service of 15.7 times, (3) Higher Education of 5.3 times, (4) Youth and Adult Corrections of 5.3 times, (5) Mental Hygiene of 3.2 times, (6) Social Welfare of 4.5 times, (7) Public School Aid of 2.9 times, (8) Salaries and Wages of 5.9 times, and (9) total General Fund expenditures of 5.9 times.

Table 1

Relative Change in Population, Selected General Fund Expenditures and Related Factors From Fiscal Years 1959–60 to 1968–69 (1959–60 = 100)

	1959–60	*1960–61*	*1961–62*	*1962–63*	*1963–64*	*1964–65*	*1965–66*	*1966–67*	*1967–68*	*1968–69*
Medi-Cal	0	0	0	0	0	0	100	408	443	543
Medical Assistance to the Aged	0	0	0	100	303	405	300	0	0	0
Debt Service	100	143	168	232	246	302	348	537	526	556
Youth and Adult Corrections	100	117	134	154	174	192	212	233	246	255
Higher Education	100	123	138	155	169	193	222	267	288	332
Mental Hygiene	100	112	122	134	148	161	176	184	189	195
Social Welfare [1]	100	107	116	131	144	169	176	180	206	230
Public School Aid	100	103	107	115	125	139	148	159	178	186
Salaries and Wages	100	114	125	138	152	164	184	218	241	271
Total General Fund Expenditures	100	110	118	132	144	163	180	213	231	271
Total State Population	100	104	108	111	115	118	121	123	126	129

[1] Aid to the blind, potentially self-supporting blind, the needy disabled, families with dependent children, old age security.

Medical Services

The Medical Assistance to the Aged, Medi-Cal, and Debt Service categories have experienced the most rapid growth. The Medical Assistance to the Aged and Medi-Cal programs are, in effect, the continuation of the same program but on a rapidly widening basis with respect to eligibility, allowances and other factors. The rapid increase in Medi-Cal can be ascribed to three factors: (1) Increased eligibility for and availability of the services; (2) the heretofore unmet demand for medical services among certain segments of the population; and (3) the increasing costs of medical services. This is demonstrated on an age group basis. About 77 percent of the caseload serviced by Medi-Cal is either under 20 years of age or over 65 years of age. Estimates indicate that 48.7 percent of the state population will fall in these two groups by July 1968, compared to 47.5 percent in July 1962. By 1970 the percentage will decrease slightly to 48.1 percent. With the continuing high percentages of the population in these two age groups with their generally low income levels, it is expected that the expenses of the medical program will continue to rise rapidly as a larger portion of the citizens in these groups seek the care available and the costs of self-financed medical services increase. In this latter respect, the Consumer Price Index for "medical services" climbed 35.3 points from 1959 to December 1967, as compared to an advance in "all items" for the same period of 16.3 points. All evidence indicates further rapid increases in the years ahead. The anticipated rate of growth in "certified eligibles" for the Medi-Cal program as shown in Table 2, indicates this pressure for growth.

Table 2
Anticipated Rate of Growth in Certified Eligibles and Population Age Group

	1965–66	*1966–67*	*1967–68*	*1968–69*
Certified eligibles	100	114	138	159
State population under 21 and over 65 years of age	100	102	105	107

Debt Service

The Debt Service category entails the cost to the General Fund for servicing State Construction Program Bonds, Higher Education Construction Bonds, State Beach, Park and Historical Facilities Bonds, and the state's portion on School Building Aid Bonds. Also included are short-term borrowing costs to the General Fund. Before 1966–67 it also included several small bonding programs which have now been paid off. Debt Service has expanded rapidly at 15.7 times total population and 2.7 times total General Fund expenditures because of the large capital outlay requirements during the period which were funded by bonding instead of by increasing taxes. The level of short-term borrowings by the General Fund which is included in this category has also increased significantly in recent years, however, this is a comparatively small element in the total. Bonding merely has the effect of postponing the taxes which later must rise to meet the increasing debt service costs. The Bond Debt Service category is discussed in more detail beginning on page XXIX.

Expenditure Summary

Higher Education

The Higher Education category showing a growth rate 5.3 times total population and 1.4 times total General Fund expenditures had the next highest rate of increase. This category embraces the Coordinating Council on Higher Education, the University of California, the state colleges and the State Scholarships Commission. A significant part of the growth may be attributed to the population age group served by the University and state colleges which generally ranges between 18 and 24. This specific age group has been increasing at an average rate of 6 percent a year compared to 2.9 percent for the total population. Too, larger percentages of people in the age group as well as older persons are enrolling in college, the average annual enrollment for both the state colleges and the University has more than doubled since 1959. Individuals are also staying in college for longer periods of time. Nationally, the college enrollment level in the 25- to 34-year-old age group increased 5 percent between 1955 and 1966.

Corrections

The Corrections program includes the Youth and Adult Corrections Agency, the Department of the Youth Authority and the Department of Corrections. Local Assistance expenditures are not included. The expansion of the Corrections program at 5.3 times population and .91 times total General Fund expenditures can be related to a multiplicity of factors including: (1) rapid increases in numbers of positions and resulting costs, (2) the increase in the combined average daily inmate populations in the Department of Corrections and Youth Authority facilities—from 22,551 in 1959–60 to an anticipated 33,964 in 1968–69, (3) the addition of nonfelon programs, and (4) the increase in the number of parolee programs.

Mental Hygiene

The Mental Hygiene category has grown at .55 times the relative increase in total General Fund expenditures and expanded at a rate of 3.2 times the total state population. The Mental Hygiene category is derived from the support and local assistance budgets of the Department of Mental Hygiene. An important trend in this area is the decreasing resident population in the hospitals for the mentally ill. The average resident population in state institutions for the mentally ill in fiscal year 1959–60 was 36,207. The department projects a total population of 17,148 for 1968–69 revealing a decline of 52.6 percent in resident population for the period. One reason for the downward trend is the availability of alternative means of care for the mentally ill. The number of patients has increased during the same period in hospitals for the mentally retarded but the most rapid growth has taken place in the area of community mental health services, supported by the state through the Short-Doyle program.

Social Welfare

This category has expanded at a rate of 4.5 times total population and .76 as fast as total General Fund expenditures. The Social Welfare category is composed of five Public Assistance programs: (1) Aid to the Blind, (2) Aid to the Potentially Self-supporting Blind, (3) Aid to the Needy Disabled, (4) Aid to Families with Dependent Children, and (5) Old Age Security. In 1967–68 the General Fund expenditures for social welfare programs constituted 34.8 percent of total federal-state-local welfare expenditures in California. The federal government finances 48.6 percent and the counties 16.7 percent. The comparatively low rate of growth in state General Fund expenditures in these programs is probably to some extent the result of increased benefits becoming available from social security and other programs for the aged as well as low unemployment conditions generally prevailing which tended to hold back the rate of increase. There has also been some shifting of certain services to the Medi-Cal program. The federal share has also grown larger reducing the comparative burden on the state and local governments. The federal share was 44.5 percent in 1959–60 and has increased to an estimated 48.6 percent in 1968–69.

Public School Aid

The Public School Aid category has shown the least relative growth of the major programs compared although the budget has increased from $722,741,000 in 1959–60 to $1,277,958,000 in 1968–69. As compared to total state population it has grown 2.9 times as fast and .50 as fast as total General Fund expenditures. The category encompasses the total state aid to elementary and secondary education, including the supportive activities carried out by the State Department of Education. A minimum amount in school apportionment per student in daily attendance is provided for in the Constitution as a fixed sum. This amount can be increased by the Legislature and action has been taken to increase the amount a number of times in the past.

In the absence of legislative action, growth in funding would closely follow the population growth in the age categories utilizing these services. What has actually taken place on a relative basis is shown in Table 3.

Table 3
Rate of Growth in Public School Apportionments and Related Factors

	1959–60	*1961–62*	*1963–64*	*1965–66*	*1967–68*	*1968–69*
Public school apportionments	100	106	124	145	174	182
Average daily attendance grades K-12	100	111	124	133	143	[1]
5 to 17 age group	100	112	123	129	134	137

[1] Not yet available for 1968–69.

This comparison shows the relative increases in apportionments, average daily attendance and the state population between the ages of 5 and 17. Apportionments are based on the average daily attendance, which in turn is dependent upon the state population between 5 and 17 years of age. The growth in apportionment has exceeded the increases in the average daily attendance and the population age group. It is evident that state expenditures for school apportionments as based on fixed constitutional provisions do not grow fast enough to provide for increases in price and wage factors. In recognition of this, the Legislature has seen fit to increase the level of expenditures. An alternative to periodic legislative adjustments might be the consideration of relating apportionments to state personal income. The apportionments would grow at a predeterminal ratio to changes in personal income, thus automatically accounting for changes in price and wage levels.

Certain population trend changes are underway which are significantly affecting the program. The combined average daily attendance of kindergarten through 12th grades has been growing at a faster rate than the 5- to 17-year-old age group. The average daily attendance in kindergarten through eighth grades has grown at a slower rate than grades 9 through 12. This corresponds to the shifts occurring in the state population under 17.

From 1959 to 1967, the state population between 5 and 17 years of age increased at an average rate of 3.6 percent while the total state population grew at an average rate of 2.9 percent. This trend should diminish in the near future because of the declining average rate of increase in children under five years of age. For the same period the average rate of increase in the five years of age and under group was only 0.9 percent.

Salaries and Wages

Direct salary and wage costs paid from the General Fund have grown between 1959–60 and 1968–69 at a rate about equivalent to total General Fund expenditures and 5.9 times total state population growth. Increases in numbers of personnel and salary adjustments are the factors responsible for the growth. This item comprises about 26 percent of total General Fund expenditures.

It does not include indirect state salary costs which are paid mainly from state subventions such as public school apportionments or Medi-Cal. Adding these indirect items would significantly increase the total salary element in General Fund expenditures, but the measure would not be as precise an indicator of growth as direct state salary costs because the salary element in the cost is not clearly separable in many of these programs.

A further comparison of the growth in the direct salary element of state costs is presented in Table 4. Because part of the series is not available on a General Fund only basis, the data in the table are based on combined general and special fund salary costs, personnel, and salary increase adjustments.

Table 4

Rate of Growth in Total Salaries, Personnel Man-Years, and Salary Increases

	1959–60	*1961–62*	*1963–64*	*1965–66*	*1967–68*	*1968–69*
Total salaries and wages	100	125	152	184	234	254
Personnel man-years	100	113	124	139	156	159
Salary increase adjustments	100	113	121	128	141	149

STATE BONDED DEBT AND GENERAL FUND DEBT SERVICE OBLIGATIONS

Bonded Debt

Bonded debt of the State of California consists of both general obligation bonds and revenue bonds.

The general obligation bonds are secured by pledge of the full faith and credit of the state for payment of principal and interest. As an obligation of the state they are subject only to a prior claim for support of the public school system and the University of California. These bonds can only be authorized by a vote of approval by the majority of the people.

Revenue bonds are not secured by this pledge and depend on the specific revenues to be generated by the project they finance. This type of bonding has been used by state agencies principally for toll bridges, University and state college housing, and recently for State Fair facilities.

Bonds issued as general obligations of the state comprise by far the larger portion of total state bonded debt.

Certain of these general obligation bonds, in addition to being secured by the full faith and credit of the state, are also serviced by earmarked receipts from other than general tax sources. Should the earmarked revenues be insufficient to pay debt service charges, tax sources would be obligated to the extent of the deficiency. This situation has not occurred to the present time. The debt redemption and interest charges of the remaining general obligation bonds are serviced directly from the general revenues of the state. These bonds are often called General Fund bonds because debt service is supported from this source. Our discussion is concerned with this major group of state bonds because the debt service on these bonds has such a material effect on the General Fund budget.

Table 1 shows the state general obligation bonded debt outstanding which totaled $4,378,450,108 as of November 30, 1967. The table also classifies the debt by the categories self-liquidating and non-self-liquidating, or General Fund liquidating, and shows the individual bond programs within each category. Also listed is the amount of bonds outstanding and the amount authorized but unsold as of November 30, 1967. Since that date, an issue totaling $100 million of State Higher Education Construction Program bonds was sold. This sale on January 23, 1968, reduces the amount of unsold bonds in this program to $80 million and increases the outstanding amount to $150 million.

Sales of state general obligation bonds totaled $535 million in 1965, $500 million in 1966, and $585 million in 1967. Of total sales in 1967, $300 million was for the water program, $150 million was for State Construction and Higher Education Construction programs, $75 million was for veterans, $50 million was for school building aid, and $10 million was for harbors.

The large requirements for the water program (sales have totaled $700 million from the beginning of 1965 to the end of 1967) has resulted in problems in marketing the bonds. This has been further com-

Expenditure Summary

Table 1
General Obligation Bonds of the State of California by Purpose
As of November 30, 1967

Purpose	*Unsold*	*Outstanding*
General Fund Bonds		
California Tenth Olympiad of 1927 [1]	--	$100,000
School Building Aid	$335,000,000	1,206,200,000
State Construction Program	100,000,000	848,800,000
State Higher Education Construction Program	180,000,000	50,000,000
State Beach, Park, Recreational and Historical Facilities	75,000,000	74,100,000
Totals	$690,000,000	$2,179,200,000
Self-Liquidating Bonds		
Water Resources Development	$900,000,000	$850,000,000
Veterans Farm and Home Building Fund	75,000,000	1,292,380,000
Harbor Bond Funds	8,197,000	58,191,000
Totals	$983,197,000	$2,200,571,000
Totals All Bonds	$1,673,197,000	$4,379,771,000
Less Sinking Funds Available	--	1,320,892
Net Bonded Debt	--	$4,378,450,108

[1] Although this is classified as a General Fund bond program, debt service is being paid from sinking fund provisions out of the Olympic Bond Fund.

pounded by the monetary situation which has caused bond interest rates to rise drastically since 1965.

As an example, an issue of state water program bonds was sold in February 1965 at an average interest rate of about 3.5 percent. Another issue of $100 million for the same program was sold in November 1967 at an average interest rate of nearly 4.7 percent. The total interest cost alone on this latter issue will be $163,881,840.

Debt Service Requirements on General Fund Bonds

Because the General Fund must make provision for these debt service requirements it is especially pertinent to show the magnitude of the obligation as it has grown and what changes are taking place. As shown in Table 2 total debt service charges on General Fund bonds were about $11 million in 1955–56. The next year the total dropped to $10 million, but since then there has been strong upward growth every year. The total is anticipated to reach almost $130 million in 1968–69, representing an increase of nearly 12-fold since 1955–56.

Table 2 separates the School Building Aid bond program from the remaining General Fund bond programs. Only the state's portion of total debt service charges is listed for the School Building Aid bonds. The General Fund portion comprised 47.2 percent of total debt service in 1955–56 and is anticipated to comprise 56.9 percent in 1968–69.

The School Building Aid bond program was over three times as large as the other bonds category in 1955–56. However, debt service costs on these other bond programs is expected to be nearly one-half again as large as for School Building Aid bonds in 1968–69. The State Construction program has accounted for practically all this growth since a policy of bonding for capital outlay needs was initiated in the late 1950's.

Table 2
Debt Service Costs to the General Fund for State General Obligation Bond Programs, 1955–56 to 1968–69
(In thousands of dollars)[3]

	Total	School Building Aid Bonds[1]	State Construction, etc. Bonds[2]
1955–56	$11,095	$8,658	$2,437
1956–57	9,999	7,403	2,596
1957–58	12,669	9,852	2,817
1958–59	17,089	13,276	3,813
1959–60	25,536	16,183	9,353
1960–61	36,483	20,387	16,097
1961–62	42,877	26,401	16,476
1962–63	59,198	36,770	22,428
1963–64	62,694	35,690	27,004
1964–65	75,865	45,411	30,454
1965–66	87,402	50,110	37,292
1966–67	103,115	52,575	50,540
1967–68	116,046	52,542	63,504
1968–69	129,483	54,463	75,020

[1] Includes only state portion of total debt service charges for these bonds.
[2] Includes State Construction Program bonds, State Higher Education Construction bonds, and State Beach, Park, Recreational and Historical Facilities bonds in 1966–67 to 1968–69. Earlier data also includes other bond programs paid off in years before 1966–67.
[3] Cash basis.

More recently, bonds for State Beaches, Parks and Recreational Facilities have added to the debt service total, as have the Higher Education Construction bonds which were authorized in 1966.

The 1967 Legislature, by reserving $90 million in General Fund revenues for capital outlay in 1968–69, is beginning to move back to a pay-as-you-go basis for capital outlay. Should no more bonds be authorized for these purposes, debt service costs will rise, but at a slower rate in the next few years, as a result of the marketing of the remaining bonds authorized. Then a long-term trend of gradually diminishing charges will be the case.

There has been a recent but definite slowing down in the School Building Aid program. Bonds marketed in 1967 for this purpose totaled only $50 million, as compared to $100 million each year in 1965 and 1966 and $150 million in 1964. This trend is also evident in the recent slowing down in the growth of debt service costs for this program as shown in Table 2. Larger marketings, however, are anticipated in the period ahead.

Only school districts that have issued their own bonds to the extent of 95 percent of the maximum each district is qualified for, or is within $25,000 of reaching this 95-percent requirement, may apply for state loans supported by the State School Building Aid bonds. The loans are repaid on the basis of a formula involving a district's assessed valuation and computed debt service payments for each fiscal year. The state permits the districts to repay over a 30-year period and in certain instances, based on reduced ability, an additional 10 years may be added to the repayment period.

REVENUE ESTIMATES

During 1968 Californians will receive personal incomes totaling $74 billion. This magnitude is comparable to the combined incomes of residents in 12 neighboring states. California's economy is so large and diversified that we have been called a nation-state. As a result of our size, changes in economic conditions at the national level are bound to have an impact on numerous sectors in the California economy. For this reason, it is necessary to forecast national economic changes in order to predict the effect on our sensitive state tax sources such as the retail sales, personal income and corporate franchise taxes.

This section of the analysis will contain information on:

1. National and California economic conditions during 1967,
2. A review of the Department of Finance's 1967 economic and revenue estimates,
3. An examination of the department's revenue and economic forecasts for the budget year, and
4. Interstate comparisons of state and local tax burdens on a per capita and personal income basis.

The National Economy in 1967

Nineteen sixty seven was *not* a banner year for the national economy. Growth in the first half was sluggish, a modest recovery accelerated in the second half, but the overall results were disappointing compared to previous years. In current dollars, Gross National Product increased by $41.8 billion, or 5.5 percent, but 60 percent of this growth was attributable to inflation. In real terms, growth was only 2.5 percent, or $16.6 billion, the smallest gain since the 1961 recession.

Governmental purchases of goods and services accounted for over half of the 1967 GNP gain (current dollars). National defense spending rose by 20 percent, the sharpest gain since the Korean War. State and local governmental expenditures also rose significantly.

Table 1 shows the growth in the components of GNP over the last four years. These data indicate that on a current dollar basis 1967 had a growth rate lower than the two previous years, but comparable to 1964. However, in real terms (constant dollars) the 1967 gain was less than half of the previous year's and substantially below 1964.

Gross National Product. Activity in the first half of 1967 was slow because of a major adjustment in business inventories. In the fourth quarter of 1966, inventories were at an $18.5 billion annual rate, but declined by $18 billion during the first half of 1967. In the second half, these inventories added to the growth of GNP. Table 2 shows the changes in GNP by quarters during 1967, and it also illustrates the growing rate of price increases in the last half of the year.

Personal consumption expenditures. Consumer spending was unusually restrained during 1967. Personal consumption expenditures rose by 5.5 percent which was much slower than the gain (7 percent) in disposable income. Table 3 shows that the most sluggish component of

Table 1
Annual Changes in Gross National Product, 1964 to 1967,
In Billions of Current and Constant Dollars

	Current dollars				*Constant—1958 dollars*			
	1964	*1965*	*1966*	*1967*	*1964*	*1965*	*1966*	*1967*
Gross national product	$41.9	$51.5	$59.4	$41.8	$30.1	$35.6	$35.9	$16.6
Personal consumption expenditures	26.2	31.9	32.8	25.7	20.4	24.7	19.6	11.9
Durables	5.3	6.8	4.3	1.8	5.3	7.4	4.9	0.8
Nondurables	10.1	12.5	16.3	10.0	8.1	8.6	8.8	5.1
Services	10.9	12.6	12.2	14.0	7.0	8.8	5.9	5.8
Gross private domestic investment	6.9	13.4	10.6	*—5.9*	5.3	10.2	7.6	*—8.7*
Fixed investment	6.9	9.8	6.6	2.4	5.2	7.2	3.9	*—0.9*
Nonresidential	6.8	10.0	9.1	2.3	5.9	8.2	6.8	0.2
Residential	0.1	*—0.1*	*—2.6*	0.1	*—0.6*	*—1.0*	*—3.0*	*—1.0*
Changes in business inventories	0.0	3.6	4.0	*—8.3*	0.0	3.0	3.8	*—7.9*
Net exports	2.6	*—1.6*	*—1.8*	0.1	2.7	*—2.3*	*—1.6*	*—0.6*
Government purchases of goods and services	6.2	7.7	17.9	22.0	1.6	3.1	10.2	14.1
Federal	1.0	1.6	10.2	12.9	*—1.4*	*—0.3*	6.9	9.3
National defense	*—0.7*	0.1	10.4	12.1	—	—	—	—
Other	1.7	1.5	*—0.2*	0.8	—	—	—	—
State and local	5.3	6.1	7.6	9.2	3.1	3.2	3.5	4.7

Source: U.S. Department of Commerce, "Survey of Current Business," July 1967 and January 1968 issues.

consumption expenditures was durable goods which increased by only 2.6 percent. This mediocre performance of the durable goods sector was primarily responsible for a decline in corporate profits, the first annual decrease since 1960.

Spending on automobiles and parts actually declined during 1967, partly as a result of the summer automobile strike. Expenditures on furniture and household appliances registered a strong gain which reflected the improvement in residential construction. Spending on nondurable goods such as clothing, food, and gasoline made modest gains. Consumer outlays for services rose by 7.4 percent, but a large part of this increase reflected higher prices, and in real terms the increase was only 3.7 percent, which was a little lower than the growth during the previous year.

Table 2
Quarterly Changes in GNP During 1967
Billions of Dollars

	I	*II*	*III*	*IV*
Gross national product				
Current dollars	$4.2	$8.8	$16.1	$16.4
Constant dollars	*—0.4*	4.0	7.3	7.4
Business inventories				
Current dollars	*—11.4*	*—6.6*	3.3	5.2
Gross national product				
Price increases	0.7%	0.6%	1.1%	1.2%

Gross private domestic investment. This category includes business investments in plant and equipment, institutional construction such as hospitals and religious structures, residential building and the change in business inventories.

Revenue Estimates

Table 3
Personal Consumption Expenditures
(In billions)

Durables	*1966*	*1967*	*Percentage increase*
Autos and parts	$29.8	$29.3	*—1.7%*
Furniture and household equipment	29.9	32.0	7.0
Other	10.6	10.8	1.9
Durables—Total	$70.3	$72.1	2.6%
Nondurables	$207.5	$217.5	4.8%
Services	188.1	202.1	7.4
Total Personal Consumption Expenditures	$465.9	$491.6	5.5%

Business capital spending rose only 2.9 percent in 1967, the smallest gain of the decade. The decline in industrial buildings offset most of the increase in equipment purchases. The slowdown in the national economy, especially in the first half of 1967, undoubtedly was an important factor in depressing business capital outlays. Other factors having an influence were the high cost of borrowing and the excess industrial capacity which has been added during the last few years.

After a serious decline in 1966, residential construction made substantial gains during 1967 as saving institutions and mortgage lenders benefited from unusually large inflows of funds. Building starts (private nonfarm) rose from a low of .9 million units in the fourth quarter of 1966 to a 1.5 million annual rate in November 1967. The total for 1967 came to 1.3 million units, as compared with 1.14 million in 1966 and 1.45 million in 1965. Although the 1967 recovery affected all classes of dwelling units, it was particularly strong on apartment units. Total expenditures on residential construction during 1967 were little different from 1966 because the recovery started from such a low base and the outlays for apartments are much lower in price than single family units.

The substantial turnabout of business inventories during 1967 is illustrated in Table 2.

Table 4
Gross Private Domestic Investment
(In billions)

	1966	*1967*	*Percentage increase*
Nonresident investment—structures	$27.9	$26.8	*—4.0%*
Producers equipment	52.3	55.7	6.5
Subtotal	$80.2	$82.5	2.9%
Residential structures	$24.4	$24.5	0.4%
Changes in business inventories	13.4	5.1	*—61.9%*
Total	$118.0	$112.1	*—5.0%*

Government purchases of goods and services. Most of the national defense expansion (20 percent) occurred during the first part of 1967, and modest increases were recorded in later quarters. Deliveries of goods accounted for a larger proportion of the increase than in the prior year. Military and civilian payrolls advanced at a slower rate.

Expenditures for guided missiles and ships showed little change during 1967, but military construction declined. Space expenditures fell for the first time since the commencement of this program, dropping about $1 billion below their 1966 level.

State and local expenditures rose by 11.9 percent, and higher payrolls accounted for 60 percent of this advance. Employment in this sector showed a record gain, increasing by over 500,000. Two-thirds of this increase was for educational staffs, as many school districts, especially in metropolitan areas, intensified their efforts to lower the pupil-teacher ratio and improve the quality of education. Construction outlays, especially state and local hospitals, increased substantially during 1967, partly in response to the demand created by the new medicare and medicaid programs.

Table 5

Government Purchases of Goods and Services
(In billions)

	1966	*1967*	*Percentage change*
Federal			
National defense	$60.5	$72.6	20.0%
Other	16.5	17.3	4.8
Total Federal	$77.0	$89.9	16.8%
State and local	77.2	86.4	11.9%
Total	$154.3	$176.3	14.3%

Income and savings. Personal income grew faster than GNP during 1967 because: (1) dividends rose by $1.3 billion despite a $3 billion reduction in corporate profits, and (2) there was an unusual rise ($7.9 billion) in federal transfer payments resulting mainly from the growth in medicare disbursements.

Federal, state and local personal income tax liabilities rose by $6.5 billion during 1967, and as a result of this rapid advance, disposable income increased at a slower rate than personal income (Table 6).

The low level of consumer expenditures combined with a rapid growth in personal income produced a record savings rate in 1967. This rate corresponded to 7.1 percent of disposable income, and in the postwar period savings rates of this magnitude have only occurred during recession years and in the Korean War period. The average annual savings rate during 1960–66 was 5.5 percent.

Table 6

Income and Savings
(In billions)

	1966	*1967*	*Percentage change*
Personal income	$584.0	$626.3	7.2%
Minus personal income taxes	75.2	81.7	8.6
Equals disposable income	$508.8	$544.6	7.0
Personal savings	$29.8	$38.7	29.9
Savings as percentage of disposable income	5.9%	7.1%	

Revenue Estimates

Employment and profits. The slowdown in the economy and the disappointing growth in consumer spending had a marked impact on the nation's labor market. Employment grew by only 2 percent in 1967, the slowest growth rate since 1963. Job opportunities in construction and durable goods manufacturing declined and there also was a drop in the average factory workweek. This decline in hours, plus the increases in prices, led unions to demand stiff increases in hourly wages. These increases contributed to the 7 percent gain in personal income, but higher taxes and prices resulted in only a 4 percent rise in their real take-home pay, the smallest gain of the last four years. Despite the modest advances in employment, the unemployment rate remained below 4 percent during most of 1967.

Business firms were limited in their ability to recoup increases in labor and nonlabor costs during 1967, and as a result profit margins fell after a six-year period of expansion. Output per man-hour rose only 2 percent, or at about half the average 1960–66 pace. Unit labor costs, after remaining stable during the 1960's, jumped 8 percent between mid-1966 and late 1967. Table 7 shows that corporate profits declined by $3.7 billion during 1967, or 4.4 percent.

Table 7
Employment and Corporate Profits
(In billions)

	1966	*1967*	*Percentage change*
Corporate profits	$83.8	$80.1	*—4.4%*
Compensation of employees	261.3	278.2	6.5
Civilian employment (millions)	72.9	74.3	2.0

Prices and financial conditions. Consumer prices rose by 2.8 percent during 1967. Although this increase was comparable in magnitude to the increase during the prior year, the composition was quite different. Consumer food prices increased very little during 1967 after a 5-percent increase in 1966. However prices of nonfood commodities—both durable and nondurable—rose sharply in 1967, and the prices of consumer services rose nearly 4.5 percent, for the largest annual increase since the early postwar period. The advance in prices of medical care services—8.75 percent—far outdistanced the increases for other services.

Wholesale prices of industrial commodities averaged 1.5 percent higher in 1967. This increase was about two-thirds of the gain during the previous year and about the same magnitude as the increase in 1965. From 1959 to 1964 these wholesale prices were exceptionally stable. Wholesale prices of farm products, processed foods, and feeds declined 3.5 percent during 1967. These reductions, attributable primarily to larger supplies of meats, poultry and grains provided partial offsets to the sizable increase in other components of the wholesale and consumer price indexes.

During 1967, both monetary and fiscal policy were highly expansive. The U.S. Treasury ran the largest deficit since WWII, and the Federal Reserve supplied the largest volume of reserves to the banking system since 1945. In spite of these expansion policies, the financial markets had problems absorbing the record amounts of new corporate and municipal securities, and long-term interest rates rose to heights not seen since the Reconstruction Era.

The California Economy in 1967

Last year California outpaced the nation in employment growth and construction, registered a slightly lower growth in personal income, and matched the rise in disposable income.

Employment. The aerospace, government and service industries accounted for 84 percent of the employment growth during 1967. The defense buildup was a major factor in this increase. Employment by utilities advanced significantly, while construction, mining and agriculture continued their declines.

Table 8
California Employment by Type of Industry
(In thousands)

Industry	*1966*	*1967*	*Increase Amount*	*Increase Percent*
Mining	34	33	*—1*	*—3.0%*
Agriculture	327	318	*—9*	*—2.8*
Construction	370	341	*—29*	*—7.8*
Finance	359	367	8	2.2
Utilities	426	449	23	5.4
Government	1,196	1,271	75	6.3
Services	1,410	1,475	65	4.6
Trade	1,522	1,553	31	2.0
Manufacturing	1,576	1,637	61	3.9
Aerospace-electronics	(517)	(565)	(48)	(9.3)
Total	7,220	7,444	224	3.1%

California's employment growth was modest compared to the previous year, but the trend of outpacing the nation continued.

Table 9
Growth in Civilian Employment

	1964	*1965*	*1966*	*1967*
United States	2.3%	2.6%	2.5%	2.0%
California	2.9	2.9	5.8	3.1

Construction. At the national level, business capital outlays for structures (Table 4) declined by 4 percent while the value of residential construction increased by only 0.4 percent. California's building recovery was substantially better than the nation's. Our nonresidential construction showed a slight increase (Table 10), while residential building contracts jumped dramatically during the second quarter and continued their upward trend throughout the year. Both northern and southern California shared in this recovery, which was heavily influenced by an increase in multiple units.

Retail sales. Consumers were cautious during 1967. Total retail sales advanced by only 3.9 percent. The sluggish automobile market in California followed the national trend, while furniture and appliances fared better nationally than in California, despite our more rapid growth in residential construction. Apparel sales were the retail leaders during 1967.

Revenue Estimates

Table 10

California Construction

	1966	1967	Percentage change
Building contract awards (millions)			
Nonresidential structures	$2,105	$2,040	—3.1
Public works and utilities	1,655	1,755	6.0
Total nonresidential	$3,760	$3,795	0.9%
Residential	$1,838	$2,040	11.0
Total	$5,598	$5,885	4.2%
New dwelling units (thousands)			
Northern California	45	51	13.3%
Southern California	56	63	12.5%
Total	101	114	12.9%

Source: Bank of America, Economics Department.

Income and Corporate Profits. Personal income in California advanced by 7 percent during 1967, which was slightly lower than the gain registered nationally. This pattern existed in the two prior years.

Table 11

California Retail Sales *

(In millions)

By type	1966	1967	Percentage change
Automotive	$4,689	$4,760	1.5%
Furniture-appliance	1,377	1,395	1.3
Apparel	1,594	1,715	7.6
General merchandise	4,012	4,215	5.1
All other	17,043	16,980	—0.4
Total	$32,151	$33,410	3.9%

Source: Bank of America, Economics Department.
* Includes both taxable and nontaxable transactions.

Disposable income (personal income minus federal and state personal income taxes) expanded by 6.8 percent which matched the national growth rate in 1967.

Table 12

Growth in Personal Income

	1964	1965	1966	1967
United States	6.9%	8.1%	8.5%	7.2%
California	7.5	6.1	8.3	7.0

Taxable corporate profits in California fell by $260 million or 3.9 percent during 1967, which was comparable to the 4.4-percent loss at the national level. Our business firms were subject to the same cost pressures and sluggish market conditions that existed throughout the country. Real estate corporations suffered the largest drop in profits (15 percent), while banks and other financial firms moved against the downward trend and scored a 13-percent increase in their profits.

Agriculture and Lumber. California's crop production was severely affected by the damp spring which reduced the output of fruits and early spring vegetables. Cotton production also suffered from the weather. Grain farmers, by contrast, benefited from the abundant moisture. Tomato production continued to grow and 80 percent of the crop was harvested by machine. Crop receipts in total declined by $112 million, or 4.6 percent, during 1967.

Poultry and egg production increased substantially while livestock sales from California feedlots were depressed. Total livestock receipts gained $40 million, or 2.6 percent, during the year.

Despite the upturn in housing activity, the lumber industry underwent another year of declining output and employment.

A REVIEW OF THE DEPARTMENT OF FINANCE'S 1967 ECONOMIC FORECASTS

There are two distinct steps in the revenue estimating cycle of the Department of Finance. The first and most critical consists of preparing economic forecasts for both the national and state economies, covering such elements as personal income, employment, corporate profits, taxable sales, housing construction, automobile sales and the general price level. It has been demonstrated that when the economic assumptions are accurate, then the revenue estimates will be within tolerable limits. In the second step, these economic data are fed into a variety of mathematical equations which produce the individual revenue estimates.

The economic forecasting process starts in October when the department's technicians attend a revenue estimating conference sponsored by the National Association of Tax Administrators. These conferences have been held each year since 1946 and the program consists of nationally recognized economists reviewing each major segment of the economy and presenting their opinions on what changes will possibly occur during the following year. The 1967 conference had speakers from the U.S. Department of Commerce, the Bureau of the Budget, Federal Reserve Board, a former member of the Council of Economic Advisers, a leading retailer, and the chief economist for McGraw-Hill Publications (e.g., Business Week).

Following the national conference, the department prepares its own national and state economic forecasts which are incorporated into a memo (about 25 pages) that is sent to a group of leading California economists including representatives from the major universities, the banks including the Federal Reserve, the large utilities, petroleum, construction and trade industries. In late November of each year, this group of economists meets with the department to discuss and evaluate the economic assumptions contained in the memo. Based upon these discussions (1½ days), which have been held annually since 1946, the department prepares the economic forecasts which are used to estimate individual taxes and which are presented in the budget document (page A-12 of the 1968–69 Budget).

Table 13 shows the Department of Finance's original economic forecasts which were printed in the 1967–68 Budget, the revised estimates which were the basis for the May 25, 1967 revenue adjustments, and the actual (preliminary) results as reported by the U.S. Department of Commerce for national data, and by various state agencies for California data. This table also includes selected estimates that were published in the 1967 Economic Report of the President. As a matter of policy, the Council of Economic Advisers does not publish a complete list of its economic projections. All of the forecasting figures, both those of the Department of Finance and the Council of Economic Advisers, have been adjusted for the changes made in these series by the U.S. Department of Commerce, as reported in the July 1967 issue of the Survey of Current Business. As a result, the forecasts are on the same basis as the actual data, but in some instances the estimates will differ from the original material.

The Table 13 comparisons show that the January 1967 estimates by the Department of Finance generally were more accurate than those of the Council of Economic Advisers. In most sectors, the department's estimates were slightly on the high side. Two areas that the department underestimated were total government purchases of goods and services (—$3.1 billion) and savings (—$4.1 billion). The Council of Economic Advisers also underestimated these two sectors, but by different magnitudes; government purchases were $2 billion low, while savings were off by $8.6 billion. In the gross private domestic investment sector, the council had the closest estimate.

This table also shows that the May 1967 revisions by the Department of Finance generally moved in the right direction, and resulted in an

Table 13

Comparison of Department of Finance's Original and Revised Economic Forecasts for Calendar Year 1967 with Actual Results

(In billions)

	Department of Finance estimates [a]			*Council of Economic Advisers* [a]
National data	*Original Jan. 1967*	*Revised May 1967*	*Actual* [b]	*Jan. 1967*
Gross national product	$788.4	$785.4	$785.1	$790.4
Personal consumption expenditures	493.9	490.9	491.6	495.9
Gross private domestic investment	116.5	111.5	112.1	113.3
Net exports	5.2	5.2	5.0	6.1
Government purchases of goods and services	173.2	178.0	176.3	174.2
Federal	90.0	92.0	89.9	89.0
National defense	72.5	74.5	72.6	–
Other	17.5	17.5	17.3	–
State and local	83.0	86.0	86.4	85.2
Personal income	627.1	624.6	626.3	–
Disposable income	541.1	541.0	543.2	–
Savings	33.0	35.6	37.1	28.5
Corporate profits	79.9	77.4	80.1	–
Consumer price index	116.5	116.0	116.3	116.0
Employment (000)	75,100	–	74,330	–
California data				
Personal income	$69.97	$69.67	$69.55	–
Disposable income	62.00	61.81	61.84	–
Taxable corporate profits	6.80	6.43	6.41	–
Employment (000)	7,425	7,420	7,444	–
Number of housing starts (000)	91	100	110	–
New car sales (000)	830	820	815	–
Taxable sales	36.20	35.90	35.20	–
Consumer price index	118.2	–	118.1	–

[a] Adjusted for changes made in these series by the U.S. Department of Commerce, as reported in the July 1967 issue of the "Survey of Current Business."
[b] Preliminary—national data by U.S. Department of Commerce.

overall improvement and a high degree of accuracy in the forecasts. This improvement applied to both the national and California data.

ANALYSIS OF 1967–68 GENERAL FUND REVENUE ESTIMATE

Total General Fund tax revenues for the current fiscal year, as revised in the proposed budget, are $53 million below the original January 1967 projections. The slowdown in the 1967 economy was primarily responsible for these downward adjustments. The Department of Finance, in its May 1967 revenue changes, took account of over 80 percent of this total reduction.

Retail sales taxes had the largest reduction, over $20 million, which was directly attributable to the sluggish economy. Taxable sales increased by only 2.8 percent during 1967, a mediocre performance compared to the 7.3 percent growth during the prior year. Automobile sales were depressed, building material outlets suffered an actual decline of 5.1 percent, and tax receipts from manufacturing and wholesalers were particularly disappointing (Table 14). The dramatic growth in personal savings and the downturn in business capital outlays are the two main reasons for the poor performance of the sales tax.

Table 14
Taxable Sales in California
(In millions)

		1967			
Category	*1966*	*Estimated* [a]	*Increase over prior year*	*Actual*	*Increase over prior year*
Retail stores	$15,661	$16,750	6.9%	$16,536	5.6%
Automotive	5,715	5,790	1.3	5,789	1.3
Building materials	3,551	3,660	3.1	3,370	—*5.1*
Manufacturing and wholesaling	8,126	8,770	7.9	8,280	1.9
Business and personal services	1,183	1,230	4.0	1,225	3.6
Total	$34,236	$36,200	5.7%	$35,200	2.8%

[a] As estimated by Department of Finance in January 1967.

Personal income tax estimates were reduced by $7.2 million in May 1967 to reflect the downward economic revisions. After the enactment of SB 556, the Department of Finance tested the growth potential of the new income tax rate and bracket structure by applying these changes to income tax statistics dating back to 1959. These computations showed that the department's estimates were slightly low and, as a result, the revised estimates were increased by 1.7 percent, or $13.4 million.

Bank and corporation franchise taxes were reduced by $24 million in May 1967 to reflect the drop in corporate profits. The revised estimate was increased by $15.9 million because the new prepayment provisions contained in SB 556, especially those affecting fiscal year corporations, are producing more revenue than originally contemplated.

Inheritance and gift tax estimates were reduced by $3.6 million in May and another $9.7 million in the proposed budget. These taxes are

Table 15

History of Department of Finance's 1967–68 General Fund Revenue Estimates
Accrual Basis—In Thousands

		Revisions during 1967			1967–68 As revised in 1968–69 budget	
Taxes	*Original budget estimate January 1967*	*May 1967* [a]	*1967 Legislation*	*Total December 1967* [c]	*Amount* [d]	*Change from December 1967 estimate*
Alcoholic beverage	$82,070	$80,400	$24,350	$104,750	$101,501	*$—3,249*
Bank and corporation	454,000	430,000	124,100	554,100	570,000	15,900
Cigarettes	77,050	76,500	85,079	161,579	156,679	*—4,900*
Horseracing	44,991	44,450	12,000	56,450	49,259	*—7,191*
Inheritance and gift	137,550	133,950	7,800	141,750	132,030	*—9,720*
Insurance	117,300	122,250	—	122,250	117,200	*—5,050*
Personal income	554,100	546,900	249,650 [b]	796,550	810,000	13,450
Private car	2,700	2,750	—	2,750	2,931	181
Sales and use	1,138,600	1,127,400	332,875	1,460,275	1,451,000	*—9,275*
Total Taxes	$2,608,361	$2,564,600	$835,854	$3,400,454	$3,390,600	*$—9,854*
Other revenues						
Interest on investments	$32,614	$33,250	—	$33,250	$33,483	$233
Oil and gas royalties and bonuses	2,433	2,383	—	2,383	2,485	102
Penalties on traffic violations	11,000	11,000	$30	11,030	11,386	356
All other revenues	71,480	74,535	120	74,655	71,587	*—3,068*
Total Other Revenues	$117,527	$121,168	$150	$121,318	$118,941	*$—2,377*
Total Revenues	$2,725,888	$2,685,768	$836,004	$3,521,772	$3,509,541	*$—12,231*

[a] Department of Finance memo, May 25, 1967.
[b] Includes the effect of AB 113 (Chapter 44) which deducted $100.3 million in personal income tax accrual revenues during 1967–68.
[c] Department of Finance's Summary of Financial Legislation, December 1, 1967, Schedule 4A.
[d] 1968–69 Budget, Schedule 2.

very difficult to estimate. During the four-year period 1962–63 to 1965–66, the Department of Finance consistently underestimated these taxes. In 1966–67, a reverse cycle started, and from all indications is continuing, whereby the original estimates overstate the revenue potential. A possible reason for this reversal is that high interest rates in the private sector no longer make it attractive for estates to pay the taxes within six months in order to claim the 5-percent discount allowed by the state.

The revised cigarette and liquor tax estimates were reduced by $8.1 million as a result of disappointing floor tax receipts during 1967 when the tax rates changed, and an apparent drop in the rate of consumption of these products.

General Fund horseracing estimates have been reduced by $7.2 million because the extended racing season and the duplication of racing dates at two major southern California tracks have reduced the daily parimutuel handle.

Table 15 contains a history of the 1967–68 General Fund revenue estimates.

ANALYSIS OF THE DEPARTMENT OF FINANCE'S 1968 ECONOMIC FORECASTS

An improvement over 1967, but not as prosperous as 1966, especially in real terms, is a capsule version of the consensus of economic forecasts for 1968.

Table 16 compares the Department of Finance's economic forecasts with those of the Council of Economic Advisers, the National Planning Association, the UCLA economics faculty, and the economics department of the Bank of America. The dates in the titles indicate when the forecasts were published.

This information shows wide areas of agreement among these forecasts. The Council of Economic Advisers is slightly more bullish about the growth in GNP, i.e., 7.8 percent versus the department's 7.4 percent. All of these forecasters predict an upturn in personal consumption expenditures. The department predicts that durable goods will rise by $5.4 billion, from the very low increase of $1.8 billion during 1967. This change anticipates a better year for automobiles and household appliances. Nondurable goods also are expected to increase, but at a modest rate. Services are expected to match the high growth rate achieved in 1967.

Residential construction will lead the upturn in private investment if credit conditions do not stifle the present recovery. The department predicts that 125,000 housing units will be built in California. This estimate corresponds to the UCLA faculty projection and the prediction in the Wells Fargo Bank newsletter (December 1967), but is bearish compared to the very optimistic Bank of America outlook. The Council of Economic Advisers has an optimistic forecast for the entire private investment sector.

The department's estimate for government purchases assumes a modest increase over the very high 1967 level. It is interesting to note

Table 16

Comparison of 1968 Economic Forecasts
(In billions of dollars)

National Data	*Department of Finance Feb. 1968*	*CEA [a] Feb. 1968*	*NPA * Nov. 1967*	*UCLA Faculty Dec. 1967*	*Bank of America Jan. 1968*
Gross National Product	$843.5	$846.0	$844.5	$843.0	
Personal consumption expenditures	525.5	524.0	525.1	524.0	
Private investment	120.0	125.0	119.3	121.0	
Net exports	5.0	--	4.4	4.0	
Government purchases	193.0	191.0	195.7	194.0	
Personal income	668.0				
Disposable income	574.9				
Savings	34.4				
Corporate profits	86.0			83.5	
Consumer price index	119.8			120.0	
Employment (000)	75,700				
California Data					
Personal income	$74.40				$74.90
Disposable income	65.23				
Taxable corporate profits	6.90				
Employment (000)	7,690				7,705
Number of housing starts (000)	125			127	154
New car sales (000)	870				
Taxable sales	37.60				
Consumer price index	121.6				

[a] President's Council of Economic Advisers.
* National Planning Association.

that CEA has the lowest estimate for this sector. Since California is heavily dependent upon national defense expenditures, changes in this sector will have a direct impact on our economy. The economics department of the Bank of America anticipates a 20,000 growth in aerospace and electronics employment in Califronia during 1968, which is a moderate gain compared to the 48,000 increase during 1967.

The department forecasts that on a national basis both personal and disposable incomes will increase at a slower rate than in 1967. For California, the growth in personal income is expected to match last year's 7-percent rate, but disposable income will grow by only 5.5 percent, compared to 6.8 percent in 1967. This slower growth rate is mainly attributable to the anticipated adoption of the federal income surtax. The savings rate is expected to drop from its 1967 peak, which should have a stimulating effect on personal consumption expenditures. A turnabout in corporate profits, both at the state and national levels, is anticipated as a result of the upturn in personal consumption and private investment. Employment is expected to rise faster in California than at the national level, but both sectors will have moderate gains. Both CEA and the department anticipate that consumer prices will advance by about 3 percent. This price rise assumes the adoption of the increased federal income taxes, and if this action is not taken or taken very late in the year then prices probably will increase at a faster pace.

CALIFORNIA REVENUE ESTIMATES, 1968–69

The enactment of SB 556 (Chapter 963, Statutes of 1967) and the changes in the method of accruing personal income taxes (Chapter 44, Statutes of 1967) complicates any comparison between the estimated revenue for the budget year and the revised estimates for the current year. For example, the increase in the retail sales tax rate will be effective during 11 months of the current fiscal year, but its full impact will not be felt until the budget year. Therefore, the 8.5 percent increase in sales tax receipts noted in Table 17 reflects not only an upturn in the economy but also the difference between a partial and full year effect of the rate change. The percentage increase for the personal income tax also is distorted. Chapter 44 had the effect of reducing personal income tax accruals by over $100 million during the current fiscal year. If this one time adjustment was deleted, then the increase in personal income taxes would be 11.9 percent. During the legislative review of SB 556, it was explained that the increase in franchise taxes would be abnormally large during 1967–68 because of the retroactive nature of the rate change, and as a result revenues would drop in 1968–69. The cigarette, inheritance and gift, alcoholic beverage, and horseracing revenues are also affected by the differences between a partial and full year effect of the rate and structural changes contained in SB 556.

Table 17 shows that General Fund revenues are estimated to increase by $354.1 million, or 10.1 percent during 1968–69. These changes reflect the expected upturn in the economy and the structural differences noted above. Over the last decade, General Fund taxes typically have increased at a 7-percent annual rate (excluding tax changes). Therefore, the 1968–69 growth is substantially above a normal pattern. Special fund revenues, by contrast, are estimated to increase by only 3.5 percent.

We believe that the basic economic assumptions of the department and their conversion into revenue estimates for 1968–69 are as reasonable and accurate as can be determined at this time.

Table 17

Estimated State Revenue Collections During 1968–69
(In millions)

		Increase over present year	
General Fund	*1968–69*	*Amount*	*Percent*
Sale and use	$1,574.5	$123.5	8.5
Personal income	1,018.0	208.0	25.7
Bank and corporation	548.0	*—22.0*	*—3.9*
Cigarette	166.5	9.8	6.3
Inheritance and gift	147.7	15.7	11.9
Insurance	126.6	9.2	8.0
Alcoholic beverage	109.1	7.6	7.5
Horseracing	52.6	3.3	6.7
Other sources	120.6	*—1.3*	*—1.1*
Total General Fund	$3,863.6	$354.1	10.1
Special Fund			
Motor Vehicle			
Fuels	$593.6	$18.1	3.1
Registration, weight	245.2	11.4	4.9
License (in lieu tax)	204.0	6.0	3.0
Transportation	20.6	1.5	7.8
Cigarette	71.4	11.5	19.2
Alcoholic beverage	12.3	0.7	6.0
Horseracing	9.0	0.4	4.6
Other	119.9	*—5.9*	*—4.7*
Total Special Fund	$1,276.1	$43.7	3.5
Grand total	$5,139.7	$397.8	8.4

Comparison of State and Local Tax Burdens in Selected States

Table 18 shows that in 1965–66 California ranked second among these 11 states in state and local taxes on per capita basis and third on personal income basis.

These comparisons cover a period before the enactment of SB 556, and, therefore, are no longer valid. Page A-18 of the budget indicates that California's state taxes, on a per-capita basis, will increase by $70 between 1965–66 and 1968–69. This same material shows that on a personal income basis, California's state taxes will increase by $0.97. At this time we do not have information on the tax increases that have occurred in these other states, but they are probably less significant than the growth in California. A possible exception to this statement might occur if New York State adopts the recently proposed tax increases.

Table 18

State and Local Taxes per Capita and as a Percent of Personal Income 1965–66 Data

	Per capita			*Per $100 of personal income*		
	State taxes	*Local taxes*	*Total*	*State taxes*	*Local taxes*	*Total*
California	$181.72	$213.56	$395.28	$5.73	$6.74	$12.47
New York	187.09	222.86	409.95	5.75	6.85	12.60
Pennsylvania	144.59	116.24	260.83	5.26	4.23	9.49
Illinois	127.33	169.83	297.17	3.91	5.19	9.10
Michigan	175.27	134.65	309.92	5.86	4.50	10.36
New Jersey	85.40	202.45	287.75	2.68	6.36	9.04
Ohio	108.95	126.94	235.89	3.88	4.52	8.40
Connecticut	153.00	162.68	315.68	4.57	4.86	9.43
Massachusetts	143.64	191.51	335.15	4.73	6.31	11.04
Indiana	148.27	136.42	284.69	5.24	4.82	10.06
Wisconsin	197.76	144.80	342.56	7.29	5.34	12.63

Source: U.S. Department of Commerce, Governmental Finances in 1965–66.