CALIFORNIA LEGISLATURE

1971 REGULAR SESSION

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1971, to June 30, 1972

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

State Capitol
Sacramento, California
March 1, 1971

THE HONORABLE STEPHEN P. TEALE, *Chairman*
and Members of the Joint Legislative Budget Committee
State Capitol, Sacramento

Gentlemen:

This Analysis of the Budget Bill of the State of California for the fiscal year July 1, 1971, to June 30, 1972, has been prepared in accordance with the provisions of the Government Code 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 and supporting staff.

I should like to express my gratitude not only to the State Department of Finance and the other agencies of state government for their extremely cooperative assistance, but particularly to the Budget Committee staff who, with great dedication and effectiveness, produced this document in the short time allowed.

Respectfully submitted,

A. ALAN POST
Legislative Analyst

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INTRODUCTORY STATEMENT

The 1971–72 proposed budget differs in several respects from previous budgets.

1. It proposes to reduce General Fund costs below those of the current year.

2. It does not present the details of program changes which support a number of major proposed reductions in costs.

3. It does not fully recognize inflation and the impact of increased unemployment on state costs, along with the continuing pressures of a growing population.

General Fund expenditures in the past three fiscal years increased \$636 million, \$547 million and \$434 million, respectively.

In comparison, the 1971–72 budget proposes a General Fund expenditure reduction of \$15 million.

Lacking pertinent program information and basic statistical detail, we have been unable to provide the Legislature with a meaningful analysis of certain portions of the proposed budget. This is particularly true of Health Care Services, Welfare and Education.

Over the past several decades California's budget has not been static. Its growth has been influenced by increasing population, inflation and the prevailing demands of more government for more people. As adopted it represents the concerns of public demand in a form annually determined by the Legislature and the Governor.

The mechanics of budget construction consists generally of initially projecting existing policies and programs into the next year. This forms a "workload" budget against which governors measure the goals and achievements of their administrations and to which they then add or reduce proposed budget expenditures in the light of administration policies and success. It is a logical and valuable point of reference.

Similarly, the Legislature has made indirect reference to the "workload" basis of evaluating levels of service and related costs by requesting the Legislative Analyst, in evaluating the Governor's proposals, to indicate the extent to which the budget items increase or decrease the existing level of service. This type of comparision is particularly meaningful with respect to the total budget this year .

The comparison indicates that for 1971–72 both the Governor's proposals and our recommendations advocate substantial reductions in the levels of many state services.

According to our calculations, the Governor's Budget reduces the existing level of service (a workload budget extension of 1970–71 without including salary increases or a school inflation factor) by about \$425 million. Our inability to accept some of these reduced amounts until we are able to analyze the supporting data and proposals leaves us with no firm recommended budget figure that is comparable. We are sure, however, that the magnitude of our recommended savings will be substantially less for reasons that will be apparent from the discussion that follows.

Like the budget, we are proposing major legislative reforms in Medi-Cal, welfare and school apportionments. Although we will have more complete recommendations on these items when the budget details are provided, the details and supporting data for our proposals are spelled out in this analysis. We are specifically recommending reductions in levels of service totalling $180 million throughout the entire budget. A preliminary and incomplete proposal for reducing welfare costs by $17.1 million is included in this total. Additional welfare reforms which we propose will have savings which are not yet precisely determined but which will be substantial. The same is true for a number of proposed reductions in Medi-Cal for which no final savings estimate has been completed. The $180 million total does include $452,000 in specific reductions in Medi-Cal. School apportionments are reduced over $12 million for county superintendent offices' subventions prior to considering major increases recommended for other school purposes.

We recommend increases in the budget for the following major General Fund items:

1. Denial of the reduction in the Teachers' Retirement Fund—$72 million. This fund needs to be strengthened, not reduced.
2. Cost-of-living salary increases for state employees—$81.6 million.
3. Increase in school apportionments for inflation and student growth, offset in part by savings from statewide uniform property tax reform. The net amount of the increase is approximately $30 million.
4. About $33 million in miscellaneous increases including state colleges, community colleges and University of California. Beyond this there are increases for the state colleges which we recommend be financed from a proposed fee increase of about $15 million, corresponding in principle to the fee recently assessed University students.

In summary, we continue to find many areas in which state cost reductions can be justified.

Conversely, there are areas in which, in our judgment, good public policy justifies increases or smaller reductions than those proposed in the budget, in part to avoid shifts in cost to local government which thereby would have the effect of increasing property taxes.

EXPENDITURE SUMMARY

State expenditures totaling $6,738,651,775 are proposed for 1971–72. This includes $368,560,101 in bond funds.

In addition to the above, state agencies will administer or subvene another $3,844,318,792 in federal grants-in-aid, reimbursements, and special projects.

Altogether, then, the proposed expenditure program for state government in 1971–72 is $10,582,970,567.

Bond fund and federal expenditures are not included in budget totals under standard state accounting procedures. However, they finance significant portions of many state programs and are separately identified in the budget detail for the specific programs. In order to show the overall financial importance of these funds to various programs, the combined expenditure level is presented in Table 1 for indicated years.

Table 1
Combined Expenditure Summary

	1969–70	*1970–71*	*1971–72*
State budget expenditures	$5,974,921,307	$6,293,453,668	$6,370,091,674
Bond fund expenditures			
State construction program	28,077,188	59,317,698	28,017,959
State Beach, Park, Recreational, and Historical Facilities	11,550,827	33,897,600	19,449,664
California Water Resources Development	133,860,194	269,962,247	177,468,569
Central Valley Water Project	153,363,241	51,899,237	83,233,641
Clean Water Bond Fund	--	5,708,000	51,561,000
Recreation, Fish and Wildlife Enhancement Fund	--	--	8,829,268
Total bonds	$326,851,450	$420,786,782	$368,560,101
Overall state expenditures	$6,301,772,757	$6,714,240,450	$6,738,651,775
Expenditure of federal funds, grants-in-aid reimbursements and special projects	3,349,708,932	4,037,713,949	3,844,318,792
Total	$9,651,481,689	$10,751,954,399	$10,582,970,567

State Budget Program

The state budget program excluding bond and federal funds but including all expenditures from the General Fund and special funds is proposed at $6,370.1 million for 1971–72. This represents an increase of $76.6 million or 1.2 percent more than the $6,293.5 million estimated for 1970–71. This is much smaller than the usual year-to-year increase. For instance, the 1970–71 budget is $318.5 million or 5.3 percent above that of 1969–70.

The budget includes three major functional categories: state operations, local assistance, and capital outlay. For the three-year period, amounts for each of these categories are:

	1969–70	*1970–71*	*1971–72*
State operations	$1,660,631,465	$1,785,596,392	$1,818,170,771
Local assistance	3,697,297,817	4,121,956,557	4,191,885,986
Capital outlay	616,992,025	385,900,719	360,034,917
Total budget expenditure	$5,974,921,307	$6,293,453,668	$6,370,091,674

Between 1970–71 and 1971–72 the state operations budget will increase $32.6 million. Local assistance will increase $69.9 million. Capital outlay, on the other hand, will decrease $25.9 million. Especially noteworthy is the small increase in local assistance compared to the $424.7 million increase in this category between 1969–70 and 1970–71.

Expenditures for local assistance comprise 65.8 percent of the 1971–72 budget, state operations 28.5 percent, and capital outlay 5.7 percent. Ten years ago, in 1961–62, local assistance was 56.2 percent of the budget, state operations 32.4 percent, and capital outlay 11.4 percent. During the decade, therefore, state expenditures have shifted toward local assistance and away from capital outlay and state operations.

THE GENERAL FUND BUDGET

The General Fund comprises 72.4 percent of overall state expenditures including bonds.

The Governor proposes $4,875.4 million in General Fund expenditures for 1971–72. This is a decrease of $15.1 million or 0.3 percent from

1970–71. By comparison, the 1970–71 General Fund budget was $434.4 million or 9.7 percent above 1969–70 expenditures. The totals for these three years by categories are:

	1969–70	*1970–71*	*1971–72*
State operations	$1,315,000,916	$1,390,426,208	$1,410,731,769
Local assistance	3,046,458,102	3,422,526,619	3,454,717,515
Capital outlay	94,623,036	77,542,921	9,987,000
Totals	$4,456,082,054	$4,890,495,748	$4,875,436,284

As with the total budget, the largest and fastest growing component of General Fund expenditure is local assistance. Between 1969–70 and 1970–71, the increase was $376.1 million or 12.3 percent. Between 1970–71 and 1971–72, it is only $32.2 million or 0.9 percent.

The state operations category while growing by $75.4 million or 5.7 percent from 1969–70 to 1970–71, shows a much smaller gain of $20.3 million or 1.5 percent between 1970–71 and 1971–72.

Capital outlay shows a steep decline during the period with a drop of $84.6 million or 89.4 percent in the two-year period, 1969–70 and 1971–72.

GENERAL FUND CONDITION

Summary

The major problem in General Fund financing is that revenues are insufficient to meet rapidly expanding expenditure demands. This has been remedied periodically in the past with major tax increases, the last of which was in the 1967–68 fiscal year, and that balanced the budget through the 1969–70 fiscal year. Tax revenues and carryover resources are again insufficient and the General Fund faces a large deficit in its 1970–71 fiscal program.

Table 2 compares increases in income and expenditures since 1967–68. The deficits in the most recent years, 1969–70 and 1970–71 have been balanced by carryover surpluses generated in the early years after the tax program was passed.

Table 2
GENERAL FUND
Comparative Increases in Income and Expenditures
1967–68 to 1971–72
(in millions)

	Income	*Increase prior year*	*Expenditures*	*Increase over prior year*
1967–68	$3,682.3		$3,272.8	
		$453.6		$636.0
1968–69	4,135.9		3,908.8	
		194.6 [1]		547.3
1969–70	4,330.5		4,456.1	
		282.6		434.4
1970–71	4,613.1		4,890.5	
		426.0		—15.1
1971–72	5,039.1		4,875.4	
Average yearly increase 1967–68 to 1971–72		339		400

[1] The Governor sponsored a one-time personal income tax reduction of $82.6 million in 1969–70. The relatively small increase over 1968–69 reflects this.

Expenditures increased over the prior year $636 million in 1968–69, $547 million in 1969–70 and $434 million in 1970–71. Against this, the proposed budget shows a $15 million decrease.

Another pertinent consideration is that revenues in 1967–68 were $409.5 million above expenditures in that year. However, 1970–71 expenditures exceed income by $277.4 million. The free surplus was $144.8 million at the end of the 1969–70 fiscal year, but in 1970–71 the state General Fund has moved into a current deficit position with revenues $277.4 million lower than expenditures for the year. Even considering the free surplus carryover and the special one-time transfers and adjustments of $97.7 million, a yearend deficit of $124.5 million is anticipated at June 30, 1971.

The budget problem can be resolved by (1) increasing the revenue base, (2) reducing expenditures, or (3) by a combination of these. The Governor proposes to carry the deficit over at June 30, 1971, and to remedy the situation in 1971–72 by reducing expenditures and effectuating a package consisting of $127 million in one-time special transfers and adjustments, hoping thereby to bring the revenue and expenditure programs into balance. No increase in taxes is proposed.

Table 3 shows the fiscal dilemma of the General Fund in 1970–71 and 1971–72. The following sections provide a detailed discussion of the various ramifications of the problem.

Table 3
General Fund Condition
(millions)

	1970–71	*1971–72*
Prior-year resources (including free surplus of $144.8 million)	$513.0	$235.6
Income	$4,613.1	$5,039.1
Outgo	4,890.5	4,875.4
Current surplus or deficit	$—277.4	$+163.7
Yearend carryover surplus	$235.6	$399.3
Yearend carryover committed reserves	11.8	0.1
Yearend surplus	$223.8	$399.2
Less reserve for working capital	348.3	397.3
Yearend free surplus	$—124.5	$+1.9

Subtracting the Governor's proposed $127 million in one-time special transfers and adjustments from the $163.7 million 1971–72 current surplus shown in Table 3 leaves $36.7 million. This is a more representative figure in comparing the difference between the income and expenditure bases for 1971–72.

Several factors, singly or in combination, could easily turn the projected free surplus of $1.9 million into a deficit by the end of 1971–72. Among these are: (1) This estimated unrestricted surplus is extremely small relative to the number of variables involved in a General Fund budget of nearly $5 billion; (2) some programs appear to be underfunded, and the major reductions in the medical assistance and welfare program proposals are not yet fully developed; (3) implementation of some program proposals is dependent on other legislation or contingent on federal action which may not materialize; (4) the usual potential error between revenue estimates and actual revenue for a fiscal year is much larger than this free surplus figure; and (5) miscalculations in coordination of the cash-flow data with budget proposals.

Elements of the Budget Problem

Although the yearend surplus is shown at $223.8 million for 1970–71 and $399.2 million in 1971–72, these are accrual balances and must be restricted to prevent the state from overspending its cash resources.

The Controller is required under Chapter 574 (AB 1943), Statutes of 1970, to establish a so-called reserve for working capital in the General Fund in the amount of the difference between gross surplus available for appropriation and the amount of the cash balance in the Treasury at the end of the fiscal year, after adjustment for temporary loans under specified provisions.

The Department of Finance, although not required by the statute to follow this same procedure, is attempting to do so in projecting the reserve for the current and the budget years. In the 1970–71 budget as submitted, the department had arbitrarily set the working capital reserve at $228 million. The June 30, 1971 deficit of $124.5 million will require carryover borrowing by the General Fund of $126 million in order to maintain a cash balance of $1.5 million. The Derivation of the Reserve for Working Capital at $348.3 million in Table 3 is as follows:

	Millions
1970–71 Yearend restricted surplus	$223.8
Borrowings	126.0
Total	$349.8
Less cash in Treasury	1.5
Reserve for working capital	$348.3

The 1970–71 budget is therefore not balanced, and this has serious implications relative to the creation of debt and the repayment of the deficit in 1971–72. It will be recalled that the 1966–67 budget was similarly not balanced, and $194 million in borrowings by the General Fund were carried over into 1967–68. Not fully funding a budget in this manner compounds the problem the next year, and a major tax increase was required in 1967–68 to meet General Fund requirements.

This situation in 1971–72 is even more serious in that: (1) It is not yet clear how the budget is to be funded, (2) cash needs cannot be met during the year from regular borrowing sources within state resources, and new taxes or special outside borrowing arrangements such as revenue anticipation notes or registered warrants will have to be resorted to, and (3) a significant element in funding depends on special one-time transfers and adjustments in both 1970–71 and 1971–72.

The Cash-Flow Problem

In 1966–67, the state changed from a cash basis to an accrual basis in accounting for General Fund revenues. The income base was thereby increased by crediting resources earned but as yet uncollected in each fiscal year. These extra revenues should only be spent, however, to the extent that they do not generate a demand for cash above the total amount of cash available for that year. This is the purpose of the reserve for working capital. Borrowings during past fiscal years from other state funds have been a regular practice. This alleviates temporary cash shortages. However, the carryover of borrowed balances at the end of a fiscal year should be avoided. Yet, this occurred at the end of 1966–67 and is proposed for 1970–71. When yearend borrowings are resorted to, that budget is not balanced. A question of the creation of

Table 4

Borrowing Resources and Cumulative Borrowing During 1971–72
(By General Fund from State Special Funds)
(in thousands)

	July	*August*	*September*	*October*	*November*	*December*
				1971		
Amount available	$534,800	$488,400	$448,800	$456,400	$420,000	$477,000
Month-end cumulative borrowings	294,000	382,000	497,000	485,000	307,000	444,000
Unused borrowing capacity	$240,800	$106,400	$—48,200	$—28,600	$113,200	$33,000
				1972		
	January	*February*	*March*	*April*	*May*	*June*
Amount available	$695,800	$793,200	$738,900	$632,500	$535,800	$497,700
Month-end cumulative borrowings	538,000	648,000	758,000	62,000	17,000	———
Unused borrowing capacity	$157,800	$145,200	$—19,100	$570,500	$518,800	$497,700

General Fund debt is raised, and a compounded deficit impact is felt in the following year.

State balances in other funds are sufficient to carry the $126 million in borrowings anticipated at June 30, 1971. However, by September 1971, cash needs are expected to deplete state internal borrowing resources and require other means to fund $48,200,000 in that month, as well as $28 million in October. No further external needs are anticipated until March 1972, when $19,100,000 will be required.

The amount of monthly resources available from other state funds that can be loaned to the General Fund during 1971–72 as well as the cumulative borrowing requirements are listed in Table 4.

The Department of Finance does not specify how these additional funds are to be raised for September and October 1971 and March 1972. A footnote to the cash-flow calculations states that. "This difference can be resolved by administrative action under current statutes or by legislative action."

Several alternative approaches may be considered. The needs could be met by: (1) Revenue from a new tax program or by instituting withholding, (2) authorizing special short-term taxes to be dropped when state sources become sufficient, (3) authorizing additional escalation of tax prepayments, (4) issuing revenue anticipation notes or (5) issuing registered warrants.

Ramifications of the cash-flow situation are also evident in other budget problems which are discussed hereafter.

Special Transfers and Adjustments

As a means of narrowing the gap between General Fund income and expenditures in the 1970–71 budget, the Governor, near the end of the 1970 legislative session, proposed $97.7 million in special transfers and adjustments. These are shown in Table 5.

Table 5
Special Transfers and Adjustments in 1970–71

	Millions
From the Capital Outlay Fund for Public Higher Education	$31.7
Surplus in the School Fund	25.0
Unencumbered balance in the Driver Training Penalty Assessment Fund at June 30, 1970	6.5
Shift junior college capital outlay to bond funds (x-factor, transfer)	16.5
Transfer from Motor Vehicle Transportation Tax Fund	18.0
Total	$97.7

At the time, we pointed out that these special transfers would increase General Fund resources for only one year and would need to be replaced with more permanent funding sources. The Department of Finance did not, on the other hand, adjust the cash flow estimates to account for certain expenditure changes which were made in the budget, part of which accelerated the need for cash. This was a material factor in the change in estimates of the 1970–71 year-end condition of the General Fund from a then-estimated small free surplus to a now-estimated $124.5 million deficit as of June 30, 1971.

The Governor has now proposed another package of one-time special transfers and adjustments for 1971–72, including a "one-time" transfer from the Motor Vehicle Transportation Tax Fund. These items are listed in Table 6.

Table 6

Special Transfers and Adjustments Proposed in the 1971-72 Budget

Budget Bill reference		
Item 279	Reduce support to Teachers Retirement Fund from the General Fund	$72,000,000
Item 302	Capital outlay—District Agricultural Associations—Transfer from Fair and Exposition Fund to General Fund	1,750,000
Section 19.2	Repay to State School Fund "loan" for community college capital outlay (X-factor "loan" repay)	16,000,000
Section 19.3	Transfer from Motor Vehicle Tax Fund to the General Fund	20,000,000
Sections 19.4 and 19.5	Transfer amount of certain loan balances from the Harbors and Watercraft Revolving Fund to the General Fund via the California Water Fund	3,300,000
Section 19.8	Transfer on June 30, 1971 the undisbursed balances from prior appropriations for Black Butte and New Hogan Dams from the California Water Fund to the General Fund	13,740,000
	Total	$126,790,000

The proposed transfer from the Motor Vehicle Transportation Tax Fund could be made a permanent source of funds to the General Fund. However, Section 19.3 of the Budget Bill provides this only for the 1971–72 fiscal year.

The language in Chapter 784, Statutes of 1969, indicates that the Legislature appropriated—instead of loaned—the $16 million for community college capital outlay. Therefore, the provisions in Section 19.2 of the Budget Bill appear not to be valid. An opinion from the Legislative Counsel supports that conclusion.

The reduction of $72 million in General Fund support for the Teachers Retirement System represents a lessening in the financial soundness of that program. This will have a compounding effect in future years unless replaced.

The transfer of $13.7 million from the California Water Fund is actually scheduled at June 30, 1971, in the current year. Otherwise, the June 30, 1971 deficit would be larger by that amount.

Carryover Balances of Continuing Appropriations

Many appropriations are available for more than one year and the unexpended balances are carried at the end of a fiscal year forward into the following years until the appropriation is expended or reverted. Reversions may be made automatically when the terms for which an appropriation expires or they may be terminated at an earlier date by legislative action.

These carryovers each year have a significant impact on the subsequent budget, and they directly affect the monthly cash-flow position of the General Fund. One of the major problems with the handling of continuing appropriations has emerged since the state went on a revenue accrual system. This created the need for a careful cash-flow management program to prevent the state from outspending its cash resources, resulting in a deficit condition in the General Fund.

If properly estimated and accounted for on both the accrual and cash basis, then unexpended balances of continuing appropriations would not be a problem; however, this has not been the case. Last year in our Analysis we pointed out various inconsistencies between the cash-flow schedule of expenditures and the regular budget. This was especially evident in the capital outlay and the salary increase items. There has also been the recurring problem that the actual carryover balances of continuing appropriations turn out significantly different and usually much larger than estimated earlier. These differences are indicated for the years 1964–65 to 1969–70 in Table 7.

Table 7
General Fund
Estimated and Actual Year-End Balances of Continuing Appropriations
1964–65 to 1969–70
(in millions)

	Mid-year estimate	*Actual*	*Difference*	*Percent increase*
1964–65	$12.2	$55.3	$43.1	353.3%
1965–66	37.2	52.6	15.4	41.4
1966–67	11.3	46.9	35.6	315.0
1967–68	12.2	15.0	2.8	23.0
1968–69	15.6	85.0	69.4	444.9
1969–70	7.6	130.0	122.4	1,610.5

The actual carryover of $130 million at June 30, 1970, which differs from the earlier estimates of $14 million in the budget as proposed and $7.6 million as reestimated in the midyear calculation; was an important element in the change in estimates of General Fund free surplus at June 30, 1971. These were changed from the original estimate of $28.4 million free surplus to a now estimated deficit of $124.5 million. The change was due to revisions in expenditures and revenue estimates as well as the special one-time adjustments and transfers authorized for 1970–71. One of the major problems was that significant changes in the amount and timing of expenditures and other factors developed as the budget progressed and funds were allocated for different purposes than had been proposed when the budget was submitted. Yet no new cash-flow data were made available either to reflect the June reestimates of revenues and expenditures, or at the time the budget was passed, when data on the special transfers and the adjustments to carryover balances could have been incorporated into the cash-flow schedule. The various changes in the budget utilizing the special transfers and carryover appropriations resulted in earlier expenditures and thereby accelerated the needs for cash, a significant factor in causing the prospective deficit at June 30, 1971. We recommend that the Department of Finance prepare and make available to the Legislature revised cash-flow estimates incorporating the effect of various changes in the situation while the budget is in progress so that early warning will be available to prevent such a situation occurring again.

The estimated 1970–71 disposition of the prior year appropriations carried over at the end of 1969–70 is indicated in Table 8. It is noted that capital outlay is by far the largest component and that a significant portion of capital outlay ($64.1 million) will be reverted during 1970–71; part will be reverted directly but $31.7 million will be reverted indirectly by transfer through the Capital Outlay Fund for Public Higher Education and then returned to the General Fund.

Table 8
General Fund
Disposition of Carryover Balances of Continuing Appropriations in 1970–71
(Carried forward at June 30, 1970)

In millions

	Total 6–30–70 carryover	*1970–71 To be expended*	*1970–71 Reverted*	*Total carryover at 6–30–71*
State operations	$3.6	$2.5	$0.2	$0.9
Local assistance	10.4	5.4	3.7	1.3
Capital outlay				
General administration	2.0	0.5	1.5	10.0
Higher education	103.2	38.3	54.9	--
Unallocated	2.2	0.1	2.1	--
Parks and Recreation Acquisition and Development Program	6.9	2.6	4.3	--
Other	1.7	0.4	1.3	--
Total Capital Outlay	$116.0	$41.9	$64.1	$10.0
Total General Fund	$130.0	$49.8	$68.0	$12.2[1]

[1] The $12.2 million estimated is a revised amount derived since the budget estimate of $11.8 million was prepared.

MAJOR GENERAL FUND PROGRAM ELEMENTS

The two major components of growth in state expenditures are the state's increasing population and rising prices of goods and services. These two elements directly affect state budget needs. Direct and indirect salary and wage costs are the largest single element of General Fund expense.

The state's total population as of July 1, 1971 is estimated at 20.2 million. As of July 1, 1972, the state's population is estimated at 20.4 million, an increase of 1.0 percent. The U.S. Consumer Price Index (1967 prices = 100) indicates that the cost-of-living rose from 112.9 in December 1969 to 119.1 in December 1970. This is an increase of 5.5 percent. The "service less rent" component of the index, which is more representative of state costs because of the large salary element in state costs, rose from 117.7 in December 1969 to 128.0 in December 1970, an increase of 8.8 percent.

An estimated $1,181.4 million in General Fund expenditures is for salaries and wages of state employees. This comprises 84 percent of the total General Fund expenditures for state operations. This is an increase of 0.6 percent over the estimated $1,174.2 million expended in 1970–71. The 1971–72 amount does not include a general salary increase.

Specific Program Elements

Table 9 indicates the major program changes in General Fund expenditures. The budget proposes major increases in expenditures in the Department of Health Care Services, the local assistance portion of the mental hygiene program, the local assistance portion of the public health program and in debt service. Major program decreases are budgeted for the state operations and local assistance portions of the social welfare program, for the capital outlay program, and for the local assistance portion of the education program. A major program decrease is proposed for Medi-Cal, despite the substantial dollar increase in the appropriation. This apparent discrepancy is due to the rapid increase in cost of the program. While the program level is to be trimmed, the overall costs still climb. Information on these expenditure adjustments as shown in Table 9 is contained in the program summaries that follow.

More detailed information can be obtained by referring to the discussion of these programs in the appropriate sections of this analysis.

Table 9
1971–72 Selected General Fund Budget
Program Changes from 1970–71
Expenditure Level
(in millions)

	1971–72 Change in amounts and percents from 1970–71	
	Amount	*Percent*
Total decrease in expenditures	$—15.1	—0.3%
Major program increases		
Debt service[1]	18.1	18.1
Mental hygiene-local assistance	21.6	13.1
Public health-local assistance	13.6	51.7
State colleges	5.4	1.7
Property tax relief	3.8	1.2
Health care services	104.4	21.5
Major program decreases		
Salary adjustments, etc.[2]	—35.0	—88.0
Mental hygiene-state operations	—6.0	—4.5
Public health-state operations	—1.9	—15.2
Social welfare-state operations	—11.4	—56.2
Social welfare-local assistance	—55.4	—7.8
Education-local assistance[3]	—58.4	—3.5
Capital outlay	—67.6	—87.1

[1] Excludes debt service on school building bonds.
[2] Salary increase amount authorized for 1970–71 was $39.7 million. The 1971–72 amount of $4.8 million is mostly for other benefits rather than a general salary increase.
[3] Includes debt service on school building bonds.

Debt Service

	1970–71	*1971–72*	*Increase*	*Percent*
Bond interest and redemption[1]	$142,402,881	$161,736,616	$19,333,735	13.6%
Payment of interest on General Fund loans	$9,200,000	$14,400,000	$5,200,000	56.5

[1] Includes General Fund portion of charges on State School Building Aid bonds as well as full debt service charges on State Construction Program, State Higher Education Construction, State Beach, Park, Recreational, and Historical Facilities, Community College Construction and other bonds.

Bond interest and redemption costs borne by the General Fund will increase sharply in 1971–72 mainly owing to the new bond sales since state bonds again became marketable last year. This will increase interest charges as well as add to already rising redemption payments.

The increase in interest payments on short-term General Fund loans is attributable to anticipated large increases in short-term borrowings by the General Fund in 1971–72. In fact, the cash flow schedule indicates that the state will exceed the limits of internal borrowing resources in three different months during the year.

Salary Increases

	Estimated 1970–71	*Proposed 1971–72*	*Decrease*	*Percent*
Salary Increases	$39,737,791	$4,759,000	$—34,978,791	—88.0

The 1971–72 budget as proposed makes no provision for general salary increases for state employees. A token amount of $5,000 is included in place of the judges' statutory salary increase requirement. The $4.8 million shown in the table is for various employee benefits including unemployment insurance, premium pay for overtime and a night shift differential.

We have recommended that a general 5-percent cost-of-living adjustment be granted state workers and nonacademic university and state college employees. We have also recommended a 10-percent cost-of-living adjustment for university and state college academic employees who were denied an increase in 1970–71 in order to limit their loss of salary increase to the one year 1970–71. The total cost to the General Fund for all recommended increases would be $81,593,900.

Mental Hygiene

	Estimated 1970–71	*Proposed 1971–72*	*Difference*	*Percent*
Mental hygiene				
Local assistance	$165,339,612	$186,938,327	$21,598,715	13.1%
Support	131,297,545	125,333,038	—5,964,507	—4.5
Total	$296,637,157	$312,271,365	$15,634,208	5.3%

General fund expenditures for the Department of Mental Hygiene are proposed to increase by $15.6 million in the budget year over the 1970–71 fiscal year. The increase is comprised of a $21.6 million increase in local assistance programs and a $6.0 million decrease in state operations. Of the $21.6 million increase in local assistance, $9.6 million is for inflation, and $4.0 million is a transfer from the Department of Social Welfare. The remaining $8 million is composed of a number of factors including a transfer to the Medi-Cal program, payments to counties, and fourth quarter adjustments. These are discussed in more detail in the mental hygiene item analyses. The decrease in the support category of this budget is primarily a reduction in the training and research work element.

Public Health

	1970–71	*1971–72*	*Difference*	*Percent*
Public health				
Local assistance	$26,318,804	$39,927,249	$13,608,445	51.7%
Support	12,686,409	10,762,700	—1,923,709	—15.2
Total	$39,005,213	$50,689,949	$11,684,736	29.5

The 1971–72 budget proposes an overall increase for the Department of Public Health of $11.7 million. As shown in the table, this increase reflects a $1.9 million decrease in support for the agency and a $13.6 million increase in the local assistance budget.

The $13.6 million increase in local assistance is composed of two factors: (1) a transfer from the Department of Social Welfare of $12.8 million for the support of the Community Services Division, and (2) provision for an increase in the caseload of the mental retardation centers. The Community Services Division provides services to mentally retarded persons on leave and upon discharge from state hospitals. The $12.8 million will be contracted back to the Department of Social Welfare, which will retain the administrative responsibility for the program. The remainder of the increase is based on an increased caseload in the regional mental health centers. These centers will reach their full operating capacity by July 1, 1971.

The $1.9 million decrease in support is spread throughout all of the agency's programs. The largest reduction in any one program was $303,360 from the occupational health and epidemiology element.

Social Welfare

State General Fund Only

	Estimated 1970–71	*Proposed 1971–72*	*Difference*	*Percent*
Support:				
Department of Social Welfare	$20,322,762	$8,891,374	$—11,431,388	—56.2%
Local Assistance:				
Public assistance program	$705,780,600	$790,421,600	$84,641,000	12.0
Less undistributed program reduction	0	$—140,000,000	$—140,000,000	N.A.
Total Public Assistance	$705,780,600	$650,421,600	$—55,359,000	—7.8%

Support for the state administration of social welfare programs in the 1971–72 fiscal year is to decrease by $11.4 million, while total state expenditure for the social welfare public assistance program is to decrease by $55.4 million. The decrease in the administrative side of the budget is primarily a transfer of the funding for the Community Services Division of the Department of Social Welfare to the Department of Public Health. This relationship is explained in more detail under the section on the Department of Public Health.

The decrease in the public assistance portion of the budget is composed of an undistributed reduction of $140 million identified only as "program reductions." In addition, the $790.4 million shown for the 1971–72 public assistance program is after a reduction of $79.8 million in administrative reforms for which the department has as yet provided no firm information. Thus, the General Fund portion of the public assistance program as shown in the Governor's Budget has been reduced a total of $219.8 million ($140 million undistributed reduction plus $79.8 million administrative reforms) the specific basis for which is to be provided later. In addition, we believe that the department has underestimated its 1971–72 caseload expenditure by $48.4 million. Therefore, we see the total estimated General Fund reduction in the program to be $268 million. When federal and local funds are included, the total program reduction is approximately ¾ of a billion dollars.

Health Care Services

	1970–71	*1971–72*	*Increase*	*Percent*
Department of Health Care Services	$484,691,859	$589,120,692	$104,428,833	21.5%
	Medical Eligibles			
Department of Health Care Services estimate:	2,402,900	2,731,500	328,600	13.6%
Legislative Analyst estimate:	2,363,273	2,805,220	441,947	18.7

The Department of Health Care Services has budgeted $589.1 million for the 1971–72 fiscal year. This is based on an estimated caseload of

2,731,500. In contrast, we have estimated that the number of medical eligibles will increase to 2,805,220. Based on this projection, we estimate that the state expenditure for medical assistance in the 1971–72 fiscal year will be $625.9 million, an increase of $36.7 million over the department's 1971–72 budget proposal.

Education

	Estimated 1970–71	*Proposed 1971–72*	*Difference*	*Percent*
Local assistance [1]	$1,665,264,194	$1,606,824,795	$—58,439,399	—3.5%
School apportionments	$1,453,241,072	$1,459,400,000	$6,158,928	0.4
Average daily attendance	5,110,054	5,222,100	112,046	2.2

[1] Includes debt service on school building bonds.

State General Fund expenditures for local education programs are budgeted to decrease by $58.5 million to $1,606.8 million in 1971–72 from an estimated $1,665.3 million in 1970–71. State school apportionments, which account for over 90 percent of the state's expenditures for local education programs, are to increase by $6.2 million, or 0.4 percent. This is compared to a 2.2 percent increase in average daily attendance for state-supported school programs.

Major reductions in other local assistance education programs are as follows:

Major Reductions in Local Assistance to Education (Excluding State Apportionments)

	Estimated 1970–71	*Proposed 1971–72*	*Decrease*	*Percent*
Teachers' retirement	$91,000,000	$26,000,000	$—65,000,000	—71.4%
Mathematics improvement	925,000	—	—925,000	—100.0
Free textbooks	21,307,110	17,828,000	—3,479,110	—16.3
Community colleges extended opportunities	4,505,347	3,350,000	—1,155,347	—25.6

Higher Education

University of California	*1970–71*	*1971–72*	*Increase*	*Percent*
University of California	$337,090,295	$337,090,295	—	—

Average Annual Student Enrollment (FTE)

Lower division	28,975	30,780	1,805	6.2%
Upper division	41,928	43,187	1,259	3.0
Graduate	30,830	32,092	1,262	4.1
	101,733	106,059	4,326	4.3

The General Fund contribution to the University of California is budgeted at the 1970–71 amount. The total average annual student enrollment, however, is projected to increase by 4.3 percent. The budget proposes that the University absorb this difference by increasing the teaching load of the University faculty.

State colleges	*1970–71*	*1971–72*	*Increase*	*Percent*
State colleges	$310,597,216	$315,972,193	$5,374,977	1.7%
Average annual enrollment (FTE) (including the summer quarter)	202,495	221,020	18,525	9.1

The average annual enrollment in the California State Colleges is expected to increase from 202,495 in 1970–71 to 221,020 in 1971–72. This is an increase of 9.1 percent. The proposed budget, however, represents an increase of only 1.7 percent. The budget proposes that the difference between the increases in workload and expenditures be made up by increasing the teaching load of the state college faculties.

State Scholarship and Loan Commission

	1970–71	*1971–72*	*Increase*	*Percent*
State Scholarship and Loan Commission	$16,997,060	$20,000,000	$3,002,940	17.7%
Number of scholarships	15,194	21,509	6,315	41.6

The budget proposes to increase total support for the commission to $20.0 million in 1971–72. This is an increase of 17.7 percent over the 1970–71 level. Eighty percent of this expenditure or $16,631,000 will be for state scholarships.

Legislation enacted during the 1970 Regular Session of the State Legislature increased the availability of state scholarships. It is estimated that the state will award 6,315 more scholarships in 1971–72 than it did in 1970–71. However, the $20.0 million budgeted for 1971–72 is based on a reduction in the average scholarship of $120. Funding the program at its full level would require an additional $2.8 million.

Property Tax Relief

	Estimated 1970–71	*Proposed 1971–72*	*Difference*	*Percent*
Senior citizens property tax assistance	$8,600,000	$10,000,000	$1,400,000	16.3%
Homeowners property tax relief	217,700,000	235,000,000	17,300,000	7.9%
Personal property tax relief	93,928,571	79,000,000	—14,928,571	—15.9%
Total	$320,228,571	$324,000,000	$3,771,429	1.2%

Property tax relief is budgeted to increase from $320.2 million in 1970–71 to $324 million in 1971–72. The program is composed of three elements, senior citizens' property tax assistance, homeowners' property tax relief, and personal property tax relief. Senior citizens' property tax relief and homeowners' property tax relief are budgeted to increase by 16.3 percent and 7.9 percent respectively. Both of these increases are based on increases in local property taxes. In 1969-70, property taxes averaged $9.92 per $100 assessed valuation. In 1970–71, this figure rose to $10.84, an increase of 92 cents or 9.3 percent.

Personal property tax relief provides an exemption of 30 percent of the assessed value of business inventories and a reimbursement to local governments for the special assessment of movie films. General Fund support of this item is budgeted at $79 million in 1971–72, a decrease of 15.9 percent from the 1970–71 fiscal year. This, however, is not an accurate portrayal of the program, as it does not include $19.8 million from the Property Tax Relief Fund. Thus, the personal property tax relief program will actually total $98.8 million in 1971–72. A comparative figure for 1970–71 would be $90.5 million. This is $3.4 million less than the General Fund expenditure in 1970–71. This $3.4 million was not expended in 1970–71, but carried forward into 1971–72 as an accumulated surplus in the Property Tax Relief Fund.

Capital Outlay

	Estimated 1970–71	*Proposed 1971–72*	*Decrease*	*Percent*
Capital outlay expenditures	$77,542,921	$9,987,000	—$67,555,921	—87.1%
State Building Program:				
Resources	705,630	0	—705,630	—100.0%
Human Relations	654,713	150,000	—504,713	—77.1%
Education	103,365	0	—103,365	—100.0%
Higher Education	70,000,000	10,000,000	—60,000,000	—85.7%
District Fair Construction Program	—300,000 [1]	—1,850,000 [1]	—1,550,000	N.A.
Other	6,379,213	1,687,000	—4,692,213	—73.5%

[1] Repayment of loans and transfer to General Fund.

General Fund expenditures for capital outlay are budgeted to decrease by $67.6 million between 1970–71 and 1971–72. As shown in the table, $60 million of the decrease is in the higher education component of the state building program. Based on current student enrollments and currently applied utilization standards, the university as a whole is shown as utilizing 100 percent of the space available, while the state colleges overall have space dificiencies, particularly in libraries and laboratories.

Comparing these expenditure amounts does not provide a realistic indication of the current capital outlay funding problem because most of the expenditures in 1970–71 and 1971–72 are from prior year appropriations. A more meaningful comparison for that purpose would include only the appropriations made during each year. On this basis, the 1970–71 budget bill appropriated $4.7 million for capital outlay, reflecting a drastic decline from earlier years. The 1971–72 budget bill proposes to appropriate $1,837,000. This is composed of $1,587,000 for the Reclamation Board for transfer to the Department of Water Resources, $100,000 for the Department of Parks and Recreation, and $150,000 for the Department of the Youth Authority.

GENERAL OBLIGATION BOND PROGRAMS

On December 31, 1970, $4,861,346,000 [1] in state general obligation bonds were outstanding. This was an increase of $190,300,000 or 4.1 percent from the debt outstanding a year earlier.

The general obligation bonded debt of the state consists of two types of bonds: (1) those for which the charges for debt services are paid directly from the General Fund and (2) those for which these interest and redemption costs are paid from project revenues to the extent these are sufficient. In both cases, the full faith and credit of the state is pledged, and should program revenues be insufficient, the General Fund would be required to cover any deficit.

In addition to general obligation bonds, various state agencies issue revenue bonds which are backed only to the extent that revenues from the projects constructed are sufficient to repay the debt. Revenue bonds are issued for various purposes, such as university and state college housing, water projects, toll bridges, and the California Exposition. In addition, the Legislature in the 1970 session enacted Chapter 1488 (AB 1826) authorizing a $50 million issue of revenue debentures for veterans farm and home loans. The revenue bonds are not included in the totals in this summary, being mentioned only to indicate the various types of bonds issued by the state.

The voters of the state have authorized general obligation bonds for developing water and other resources, school building aid, veterans farm and home purchases, harbor improvement, higher education and other construction, and other purposes. In 1970 (1) a $250 million issue was approved for construction of sewerage, treatment, and disposal facilities (clean water bonds) and (2) a $60 million issue was authorized for planning and developing facilities at state water projects for recreation and fish and wildlife management. Table 10 shows a breakdown for the individual general obligation bond programs now authorized with respect to the amounts sold or outstanding and the amounts of bonds authorized but unsold as of December 31, 1970.

[1] This total does not include $200 million in short term bond anticipation notes sold for the water program on June 16, 1970, and maturing June 1, 1971.

Table 10

General Obligation Bonds of the State of California by Purpose As of December 31, 1970

Purpose	*Unsold*	*Outstanding*
General Fund bonds		
California Tenth Olympiad of 1927 [1]	—	$25,000
State construction	—	847,500,000
Beaches, parks, recreational and historical facilities	$45,000,000	95,300,000
Higher education construction	—	218,490,000
Community college construction	30,000,000	34,400,000
School building aid [2]	144,900,000	1,226,815,000
Recreation and fish and wildlife	60,000,000	—
Clean water	250,000,000	—
Totals	$529,900,000	$2,422,530,000
Self-liquidating bonds		
Water resources development	$600,000,000 [3]	$1,150,000,000
Veterans' farm and home	100,000,000	1,229,900,000
Harbor bond programs	697,000	58,916,000
Totals	$700,697,000	$2,438,816,000
Totals, all bonds	$1,230,597,000	$4,861,346,000

[1] Although classified as a general fund bond program, debt service is actually being paid from the sinking fund balance in the Olympic Bond Fund.
[2] The General Fund bears the major portion of debt service. The school districts contribute the remainder.
[3] Against this amount, $200 million in water bond anticipation notes were sold 6-16-70; dated 6-1-70 and mature 6-1-71.

The state was unable to sell state general obligation bonds (other than small amounts through specially arranged sales) from January until June of 1970. This resulted because the market interest rate was above the maximum 5 percent ceiling the state was allowed to pay. However, with the passage of Proposition 7 at the June primary, the maximum rate was raised, and since that time the state has sold $375 million in bonds as well as $200 million in water bond anticipation notes. The notes have a one-year maturity and therefore will require either the sale of the actual bonds or a new issue of notes by June 1971, to replace the maturing issue.

Sales of bonds and notes tentatively anticipated in the last half of the 1970–71 fiscal year include:

	Millions
Water resources development	$300
Clean water	10

Anticipated sales during 1971–72 are as follows:

	Millions
Community college construction	$30
State beach, park, recreational and historical facilities	25
Recreation, fish and wildlife	5
Clean water	50
State school building aid	50
Veterans farm and home	100
Water resources development	100

As previously indicated, the debt service costs are regularly paid from the General Fund for state construction, parks and recreational facilities, higher education and community college construction bonds. The state and the local school districts concerned share these costs for school building aid bonds. It is estimated that in the 1971–72 fiscal year the state will contribute $58,773,931 and the local jurisdictions will contribute $52,090,000 out of total debt service charges of $110,863,931. The state portion is 53 percent of the state-local total.

Table 11 indicates that debt service costs borne by the General Fund have mounted rapidly since 1960–61 and will have increased more than fourfold by 1971–72.

Table 11

Debt Service Costs to the General Fund for State General Obligation Bond Programs—1960–61 to 1971–72 (in thousands of dollars) [1]

	Total	School building aid bonds [2]	State construction and other bonds [3]
1960–61	$36,484	$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	103,114	52,574	50,540
1967–68	115,429	52,452	62,977
1968–69	123,619	48,452	75,167
1969–70	132,584	47,692	84,892
1970–71 (est.)	136,689	49,043	87,646
1971–72 (est.)	162,725	58,774	103,951

[1] Cash basis for all years.
[2] Includes only State General Fund portion of total debt service charges for these bonds.
[3] Includes State Construction Program bonds, State Higher Education Construction bonds, State Beach, Park, Recreational and Historical Facilities bonds, junior college construction bonds, and several small bonding programs that were paid off before 1966–67.

The division between interest and redemption costs on 1971–72 debt service charges is estimated as follows:

	Total	Interest	Redemption
School building aid	$58,773,931	$22,358,191	$36,415,740
State construction and other	103,951,325	49,845,325	54,106,000

Interest costs are 38 percent of total debt service charges for school building aid bonds and 48 percent for the state construction and other General Fund bonds.

REVENUE ESTIMATES

Summary

A year ago economists were sharply divided on the business outlook for 1970. Those who were heavily influenced by monetary policy predicted a recession with a Gross National Product (GNP) of $970 billion. Others forecast that the economic expansion which started in 1961 would continue through 1970 and GNP would be $990 billion. The Governor's Budget reflected this uncertainty by containing both of these economic forecasts. Revenue estimates for the more sensitive tax sources were prepared from both the high and low economic forecasts, and the budget used the midpoint between these two estimates.

The Department of Finance estimated there was a $54.5 million difference in 1970–71, between the midpoint revenue estimates used in the budget, and what the low forecast would have produced.

Our 1970–71 Analysis recommended that the Legislature rely upon the low economic forecast, because in an economic downturn there is a built-in bias to underestimate its severity.

By June, 1970, the economic downturn was apparent, and the Department of Finance reduced its 1970–71 estimates of *tax* revenues by $93.5 million and increased the nontax revenues by $20.7 million for a net reduction of $72.8 million in General Fund income. On June 15th, we issued a special report on these revised estimates, which contended they were still somewhat too high.

In December 1970, the Department of Finance announced that the continued softness in the economy necessitated a further downward revision in current year revenue estimates. The Governor's latest budget indicates a drop of $72 million from the revised estimates of last June, or a total reduction of $144.7 million from the estimates contained in his 1970–71 Budget.

1971 Economic Forecasts. The Governor's Budget estimates that GNP will be $1,046 billion in 1971, which is a moderate 7.1 percent increase over last year. Most private economists also are forecasting GNP in the $1,045 to $1,050 billion range. By contrast, the President's Council of Economic Advisers has established a GNP "goal" of $1,065 billion. However, their report for the first time in 10 years fails to contain any specific forecasts on consumer spending, business investment or government expenditures, and as a result it is impossible to ascertain which sectors of the economy they expect will produce a 9 percent growth.

The budget anticipates that California's economy will improve during 1971, but at a less buoyant rate than the national growth because of the continual decline in our aerospace employment. California's unemployment is expected to average 7 percent during 1971, compared to a 6-percent annual rate during 1970.

1971–72 General Fund Revenues. The Department of Finance anticipates a $470.3 million, or 10.3-percent increase in General Fund revenues during 1971–72 (Table 3). This rate of increase is above normal, but this situation should be expected in any recovery period.

With one exception, we are in general agreement with the Department of Finance's revenue estimate for the budget year.

The exception is the $49.9 million in General Fund revenue from the Health Care Deposit Fund. These revenues, in effect, reimburse the state for its costs of caring for Medi-Cal patients, primarily the mentally retarded, in our state hospitals. The Governor's Budget, however, proposes to reduce Medi-Cal expenditures, but no change was made in these Health Care Deposit revenues. We asked the Department of Finance to explain this apparent inconsistency, and its answer was that regulations will be proposed *to exempt* the state mental hospitals from the Medi-Cal cuts. This raises the policy issue of why the state should be fully reimbursed for its Medi-Cal costs while counties and private providers would bear all of the reductions. Whether the federal government and the courts will approve of this arrangement, is open to question. Until this issue is resolved, we have serious reservations on the validity of this revenue estimate. It could be substantially overstated, and if any significant downward revision is made, then the budget would be unbalanced as submitted because there is only a $1,957,000 estimated free surplus as of June 30, 1972.

The February 9th earthquake in Los Angeles will have an unknown impact on General Fund revenues during both the current and budget years. Income taxes will probably be reduced during the current year because existing law allows taxjayers with casualty losses to claim them when they file their 1970 returns on April 15, 1971, rather than waiting until next year. If they fail to take the deductions this year, they can be claimed in April, 1972, which will depress budget year revenues.

Corporate franchise taxes also will be reduced as a result of these casualty losses. Part of the reduction will be experienced this June when calendar year firms make their first prepayment, but the major portion will occur in the budget year.

Sales tax revenues will be increased as governments, business firms and private persons make repairs to their damaged property. Whether these sales tax increases will offset the income and corporate franchise tax losses is unknown.

Analysis of the Department of Finance's Revenue Estimates

1970–71 General Fund Revenues

Table 1 traces the history of the Department of Finance's General Fund revenue estimates for the current fiscal year. The original February 1970 figures were based on the midpoint between the high and the low economic forecasts. When the downturn in the economy became apparent, the department in June 1970 reduced its estimates of tax revenues by $93.5 million, with the largest changes occurring in the personal income and bank and corporation taxes. The new estimates contained in the Governor's 1971–72 Budget made further reductions in these two tax sources and also reduced sales tax revenues.

The increase in unemployment and the shift of workers from higher paid manufacturing jobs to lower paid trade and service employment

Table 1

History of Department of Finance's 1970–71 General Fund Revenue Estimates

Taxes	*Original budget estimate Feb. 1970*	*Revisions during 1970*			*1970–71 as revised in the 1971–72 Budget*		
		June 1970	*Legislation*	*Total Nov. 1970*	*Amount*	*Changes from Nov. 1970 estimated*	*Changes from original estimate after legislation*
Alcoholic beverage	$116,300	$2,800	—	$119,100	$114,700	—$4,400	—$1,600
Bank and corporation	583,000	—28,000	—540	554,460	545,000	—9,460	—37,460
Cigarettes	159,900	4,100	—	164,000	170,000	6,000	10,100
Horseracing	59,571	100	+120	59,791	59,481	—310	—210
Inheritance and gifts	184,000	—3,300	—10	180,690	176,700	—3,990	—7,290
Insurance	151,800	—2,700	—	149,100	153,300	4,200	1,500
Personal income	1,418,000	—63,000	+1,500	1,356,500	1,335,000	—21,500	—84,500
Private car	3,800	—	—	3,800	4,147	347	347
Sales and Use	1,848,500	—3,500	—136	1,844,864	1,810,000	—34,864	—38,364
Total Taxes	$4,524,871	—$93,500	$934	$4,432,305	$4,368,329	—$63,977	—$157,476
Other Revenues							
Interest on investments	$56,238	$5,762	—	$62,000	$53,214	—$8,786	—$3,024
Penalties on traffic violations	17,000	1,000	—	18,000	14,750	—3,250	—2,250
Receipts from Health Care Deposit Fund	42,300	—2,300	—	40,000	49,417	9,417	7,117
Pay patient board charges	20,556	5,944	—	26,500	28,918	2,418	8,362
All other	43,163	10,294	2,285	55,742	47,963	—7,779	2,515
Total Other Revenues	$179,257	+$20,700	$2,285	$202,242	$194,262	—$7,980	$12,720
Total Revenues	$4,704,128	—$72,800	$3,219	$4,634,547	$4,562,591	—$71,957	—$144,756

resulted in a slower than anticipated growth in wages and salary incomes. Table 2 shows that this slowdown was mainly responsible for the downward revisions in income tax estimates. The figures in Table 2 cover most, but not all, of the components of the income tax; audit revenues, changes in accruals, and other adjustments make up the remainder. The difference between the $69.7 million reduction shown in Table 2 and the $84.5 million shown in Table 1 is attributable to a downward adjustment in accruals.

Table 2
1970–71 Personal Income Tax Estimates
(in millions)

Tax attributed to	*Original budget estimate Feb. 1970*	*Revised estimates June 1970*	*Revised estimates Feb. 1971*	*Change Feb. 1970 to 1971*
Wages and salaries	$892.5	$865.5	$827.2	—$65.3
Dividends	86.0	83.0	78.8	—7.2
Interest	57.5	57.8	56.7	—0.8
Proprietors	195.5	201.1	195.0	—0.5
Rent	19.0	20.0	22.5	3.5
Capital gains	102.5	68.7	99.1	—3.4
Miscellaneous	28.0	25.6	32.0	4.0
Less credits	—12.0	—13.4	—12.0	—
Total Tax Assessed	$1,369.0	$1,308.3	$1,299.3	—$69.7

In February 1970 the department estimated that corporate profits would total $7.2 billion during 1970. The latest estimate is only $6.7 billion. Substantial downward revisions were made in the anticipated profits from manufacturing, oil, and utility firms. Construction, trade and financial corporations had higher than anticipated profits, but their magnitude was not sufficient to offset the reductions in the other categories. As a result the department reduced corporate tax estimates by $37.5 million.

Sales tax revenues held up fairly well during the first half of calendar 1970. However, in the third quarter, a sluggishness developed which accelerated in the last quarter as a result of the automobile strike. During the last half of calendar 1970, sales tax receipts were about $15 million below the June estimates. The remaining $20 million estimated decline in these revenues will occur during the next two quarters as unemployment is expected to peak in the spring.

The decline in per capita cigarette consumption, which began with the 1964 Surgeon General's report and was accelerated by the 1967 tax increase, appears to have ended in 1970. This change is responsible for the $10 million increase in cigarette tax revenues shown in Table 1.

Inheritance and gift taxes are $7.3 million below the original budget estimates. A large part of this decline represents a postponement rather than a loss in revenue. Due to the high level of interest rates in 1970, fewer estates took advantage of the 5-percent discount for payment of inheritance taxes within six months. This change in the timing of payments reduced current year revenues but will accelerate budget year receipts.

Insurance premiums increased by 10.9 percent during calendar 1970. This was a more rapid growth than anticipated and is responsible for the latest $4.2 million upward revision in these tax estimates.

Interest income estimates have been volatile during the year. During the first half of 1970 interest rates increased dramatically and, as a result, the department made a $5.7 million upward revision in these estimates in June. Due to budgetary changes which increased the state's cash flow obligations, the reduction in tax receipts, and the softening in interest rates during the second half of the year, the department has reduced its estimate by $8.7 million.

Another volatile source has been the receipts from the Health Care Deposit Fund. The fluctuations in these estimates have been attributable to changes in expectations of whether or not the federal government would accept all of the state's Medi-Cal billings for patients in state hospitals.

1971–72 General Fund Revenue Estimates

Table 3 shows that General Fund revenues are estimated to increase by $470.3 million, or 10.3 percent, during 1971–72. This is a higher than normal growth rate, but any increase from a depressed base tends to distort the magnitude of gain.

The major component of General Fund revenues is receipts from the sales tax. The Department of Finance's estimates of taxable sales for calendar years 1970 through 1972 are shown in Table 4. These estimates assume a moderate increase in retail store sales during 1971, the growth rate paralleling the increase in disposable (after tax) income, with a larger gain during the following year. Automible sales were depressed in the fourth quarter of 1970 due to the General Motors strike. The department predicts a partial recoupment of these sales in the first

Table 3
Estimated State Revenue Collections During 1971–72
(in millions)

			Increase	
General Fund	*1970–71*	*1971–72*	*Amount*	*Percent*
Sales and use	$1,810.0	$1,970.0	$160.0	8.8%
Personal income	1,335.0	1,510.0	175.0	13.1
Bank and corporation	545.0	616.0	71.0	13.0
Inheritance and gift	176.7	202.4	25.7	14.5
Cigarette	170.0	174.5	4.5	2.6
Insurance	153.3	175.3	22.0	14.3
Alcoholic beverage	114.7	120.0	5.3	4.6
Horseracing	59.5	65.3	5.8	9.7
Interest on investments	53.2	53.1	—0.1	---
Health Care Deposit Fund	49.4	49.9	0.5	1.0
Other sources	95.8	96.4	0.6	0.6
Total General Fund	$4,562.6	$5,032.9	$470.3	10.3%
Special Fund				
Motor Vehicle				
Fuels	$682.6	$716.3	$33.7	4.9%
Registration, weight	282.6	298.2	15.6	5.5
License (in lieu)	247.5	262.4	14.9	6.0
Transportation	25.0	26.6	1.6	6.4
Cigarette	73.0	74.5	1.5	2.1
Alcoholic beverage	13.0	13.0	0	0
Horseracing	8.5	8.9	.4	4.7
Other	148.8	104.0	—44.8	—30.1
Total Special Funds	$1,481.0	$1,503.9	$22.9	1.5%
Totals	$6,043.6	$6,536.9	$493.3	8.2%

Table 4
Taxable Sales in California
(in millions)

	1970	1971	Percentage increase	1972	Percentage increase
Retail stores	$20,341	$21,720	6.8%	$23,415	7.8%
Autos and parts	6,906	7,630	10.5	8,335	9.2
Building materials	4,481	4,900	9.4	5,250	7.1
Manufacturing, wholesaling, and misc. outlets	11,750	12,150	3.4	13,000	7.0
Totals	$43,478	$46,400	6.7%	$50,000	7.8%

quarter of 1971, which inflates this category during the current year. Sales of building materials are expected to be strong during the first half of 1971, but as vacancy rates on apartments increase during the year, this sector is expected to soften and be less buoyant in 1972. These estimates were made before the Los Angeles earthquake and, therefore, are probably too low for 1971. The weakness in the manufacturing, etc., sector reflects an anticipated slow growth in plant and equipment expenditures during 1971. The department expects taxable sales to be rather soft in the first half of 1971, gain momentum in the second half, and continue this upward trend during 1972.

A second major revenue source is the personal income tax. Personal income tax receipts are expected to increase by about 13 percent in the budget year compared to a 10-percent growth (after adjusting for the one-time 10-percent credit) in the current year. The dramatic increase in the taxes from capital gains and higher incomes of proprietors are mainly responsible for the more rapid growth in these taxes during the budget year. Little change is expected in the growth rate of the taxes on wages and salaries. Table 5 shows these comparisons, and the data in the table cover most but not all of the components of this tax.

Table 5
Personal Income Taxes by Source
(in millions)

	Income Years		Increases	
Tax Attributable to	*1970*	*1971*	*Amount*	*Percent*
Wages and salaries	$827.2	$919.2	$92.0	11.1%
Dividends	78.8	83.4	4.6	5.8
Interest	56.7	63.5	6.8	12.0
Proprietors	195.0	220.0	25.0	12.8
Rent	22.5	23.5	1.0	4.4
Capital gains	99.1	136.9	37.8	38.1
Miscellaneous	32.0	34.0	2.0	6.2
Less credits	—12.0	—12.0	--	--
Total Tax Assessed	$1,299.3	$1,468.5	$169.2	13.0%

Bank and corporation taxes, the third largest General Fund revenue source, are expected to increase by $71 million, or 13 percent during the budget year. However, Table 6 shows that even with this rate of increase, corporate profits will be only slightly higher than the 1969 level. The difference between the growth in profits and taxes represents higher audit revenues and the timing of collections.

Inheritance and gift taxes will have the highest growth rate, 14.5 percent, but part of this growth represents postponed collections from

Table 6
Taxable Corporate Income in California
(in millions)

Industry	*1969*	*1970*	*Percent change*	*1971*	*Percent change*
Agriculture	$85	$80	—5.9	$80	--
Mining and oil production	231	220	—4.8	250	13.6
Construction	215	200	—7.0	220	10.0
Manufacturing	2,693	2,290	—15.0	2,650	15.7
Trade	1,536	1,490	—3.0	1,550	4.0
Service	496	520	4.8	560	7.7
Financials subject to bank tax	582	620	6.5	645	3.2
Real estate and other financials	506	430	—15.0	500	16.3
Utilities	999	886	—11.3	966	9.0
Other	4	4	--	4	--
Totals	$7,347	$6,740	—8.3	$7,420	10.1

prior years. As mentioned earlier, inheritance tax receipts were depressed during the current year because the high level of market interest rates made the five percent inheritance tax discount for payment within six months unattractive. In the budget year many of these estates will be settled because their two-year interest-free period will expire.

Each year the Department of Finance surveys the major insurance companies to obtain their estimates of the growth in premiums. The results of the latest survey indicate that premiums increased by 10.9 percent during calendar 1970, and are estimated to grow by 12.3 percent in 1971. Automobile, disability, and fire insurance firms expect the largest increases. Based on this, the department estimates that these taxes will increase by 14.5 percent in the budget year. These revenues, because of the prepayments, cover portions of both calendar years, and this feature accounts for the difference between the growth in taxes and the growth in premiums.

Interest income accruing to the General Fund from investments is expected to decline slightly during the budget year, but this is a highly tentative estimate. The actual level will depend upon what solution the Legislature adopts to solve the cash flow shortage this fall.

In our opening summary, we mentioned our reservations about the validity of the Health Care Deposit Fund revenue estimate.

1971–72 Special Fund Revenues

Turning from General Fund to special fund revenues it is noted that these are expected to increase by only $22.9 million, or 1.5 percent. These figures, however, are distorted by the inclusion of over $44 million in unusual current year adjustments which will not be repeated in the budget year. For example, the 1971 Budget Act proposes to revert $14 million from the Black Butte-New Hogan water project during 1970–71. However, these funds will be treated as a transfer to the Water Fund before they are transferred to the General Fund. As a result, the "other" category in Table 3 includes this amount as a General Fund revenue during the current year. This category also contains about $33 million of excess highway lands which are treated as a revenue during the current year and will be a balance carried forward in the budget year.

Most of the special fund levies are based upon specific rather than ad valorem rates and, therefore, they do not benefit from inflation or have growth rates comparable to General Fund revenues.

Analysis of National Economic Conditions

Introduction

Each year the Department of Finance prepares national economic forecasts as the starting point in its revenue estimating cycle. After the national data is completed, the department forecasts California's economic conditions, by examining past relationships between this state and the nation and by making adjustments for unusual conditions, such as our depressed aerospace industry. Many private economists and firms also prepare national forecasts, and by examining these studies we are able to judge the validity of the department's estimates. Only a few organizations, however, publish California forecasts, and therefore our sources of verification are more limited.

This section will examine national economic conditions during 1970 and comment on the forecasts for 1971. The next section will analyze California's economic conditions.

The 1970 Recession

The nation experienced a mild recession during 1970. In current dollars the Gross National Product (GNP) rose to $976.8 billion, for an increase of 4.9 percent. Inflation (on the GNP deflator basis) increased at an even more rapid rate, by 5.3 percent, with the result that real GNP in constant dollars declined for the first time since 1958.

The mildness of the recession was primarily attributable to the strength in consumer spending on nondurables, services, and the growth in expenditures by state and local governments. These sectors account for about two-thirds of total GNP and their increases more than offset the declines in spending on consumer durables, private investment, and national defense.

The quarterly pattern for 1970 is shown in Table 8. Spending on consumer durables was depressed during three quarters, with the largest reduction occurring in the last quarter as a result of the General Motors strike. The private investment sector also was weak during most of the year, the exception being residential construction in the last quarter. Federal defense outlays declined during the last three quarters. For reference, this table also shows the GNP pattern during 1969 and UCLA's forecast for 1971. The latter was inserted because the Department of Finance does not publish its quarterly estimates, and the UCLA data were used as a proxy because they were very similar to the department's total estimates. The UCLA data indicate a very strong first quarter, with $11.5 billion of this increase representing higher sales of automobiles (a recoupment from the G.M. strike) and higher inventories. As a hedge against the possible steel strike on August 1, inventories are expected to rise again in the second quarter and then drop in the third. By year-end, UCLA expects a rather strong rate of growth in the economy.

Table 7
GNP and National Economic Data
(in billions of dollars)

National Data	Actual 1969	Actual 1970	Percentage increase	1971 Forecasts D.F.[1]	1971 Forecasts UCLA[2]	1971 Forecasts UCB[3]
Gross National Product	$931.4	$976.8	4.9%	$1,046.0	$1,045.5	$1,050
Consumer expenditures	577.7	616.9	6.8	664.0	664.8	668
Durables	90.9	89.5	—0.7	98.0	100.1	98
Nondurables	245.9	264.8	7.7	280.5	280.6	280
Services	241.7	262.6	8.7	285.5	283.9	290
Private investment	139.8	135.8	—2.9	148.0	145.4	151
Fixed investment	131.4	132.2	0.6	140.0	138.8	146
Residential	32.0	29.7	—7.2	35.0	35.4	36
Other	33.8	35.1	3.8	36.0	36.3	38
Producers' durables	65.5	67.4	2.9	69.0	67.1	72
Change in inventories	8.5	3.6	—58.0	8.0	6.6	5
Net exports	1.9	3.6	89.5	4.0	3.6	4
Government purchases	212.2	220.5	3.9	230.0	231.6	227
Federal	101.3	99.7	—1.6	96.5	98.0	95
Defense	78.8	76.6	—2.8	71.5	73.6	69
Other	22.6	23.1	2.2	25.0	24.4	26
State and local	110.8	120.8	9.0	133.5	133.6	132
GNP in 1958 dollars	$727.1	$724.3	—0.4%	745.5	742.0	750
GNP deflator	128.1	134.9	5.3	140.3	141.0	
Personal income	$748.9	$801.0	7.0%	$854.0	$852.8	$865
Disposable income	631.6	684.6	8.4	735.0	731.5	745
Savings	37.6	50.0	33.0	51.4	47.3	47
Corporate profits	85.8	77.4	—9.8	85.5	87.5	
Consumer price index	109.8	116.3	5.9	121.6	121.6	121.2
Wholesale price index	106.5	110.4	3.7	110.7	113.6	113.2
Employment (000)	77,902	78,627	0.9	79,770	79,300	80,000
Unemployment (000)	2,831	4,088	44.4%	4,840		
Unemployment rate	3.5%	4.9%		5.7%	5.8%	4.8%

[1] Department of Finance, prepared in December 1970.
[2] University of California at Los Angeles, prepared in December 1970.
[3] United California Bank, national data published in November 1970.

1971 Forecasts

The Department of Finance estimates that GNP will total $1,046 billion in 1971, which is a 7.1 percent increase over last year. About 2.9 percent of this increase is real growth in constant dollars, and the remaining 4.2 percent is continuing inflation. Table 7 also contains the national forecasts of the UCLA Graduate School of Business Administration, and the United California Bank. The latter was compiled in October 1970, when published data on unemployment was only 5.5 percent, and this may partially account for its more optimistic estimates.

The department estimates that consumer expenditures will increase by 7.7 percent, which corresponds to the average growth rate from 1965 through 1969. Durable goods are expected to rebound from their depressed 1970 level, and increased spending in this sector is expected to divert funds from the nondurable category. Residential building is forecast to have a 17.8 percent increase, the largest gain of any sector. Plant and equipment expenditures are anticipated to grow slower than inflation, which represents a net decline in real purchases. The department's estimate for national defense expenditures is lower than the President's budgetary request. National unemployment is estimated at

Table 8
Quarterly Changes in GNP
(in billions—at annual rates)

	By Quarter 1970			
	I	II	III	IV
Consumer expenditures:				
Durables	—$1.7	$2.8	—$0.7	—$5.8
Nondurables	6.8	3.8	3.2	5.9
Services	5.4	4.7	5.2	5.4
Subtotal	$10.5	$11.3	$7.7	$5.5
Private Investment:				
Nonresidential	$0	$0.2	$0.8	—$2.2
Residential	—1.3	—0.7	0.8	2.8
Change in inventories	—5.6	1.5	2.4	—1.4
Subtotal	—$6.9	$1.0	$4.0	—$0.8
Net exports	$0.9	$0.6	$0.1	—$1.5
Government purchases:				
Federal				
National defense	$0.5	—$2.5	—$1.0	—$1.2
Other	—0.3	—0.1	0	0.9
State and local	3.2	1.3	3.7	2.4
Subtotal	$3.4	—$1.3	$2.7	$2.1
Total GNP	$7.9	$11.6	$14.5	$5.3
	1969			
Total	$16.2	$16.1	$18.9	$9.1
	UCLA 1971 Forecast			
Total	$29.5	$16.0	$12.5	$23.5

5.7 percent during 1971, which is lower than the current 6 percent level, but still 16 percent higher than the 1970 annual rate.

UCLA's forecast differs from the department's in that it expects a higher rate of inflation, slightly lower real growth, is less optimistic about expenditures for private investment, has a lower savings rate, and higher corporate profits.

The UCB forecast is more optimistic on consumer spending, private investment (especially producer durables), has lower defense expenditures, and substantially lower unemployment. Its personal income estimates are $11 billion higher than the department's. These estimates, in our opinion, are on the high side and we placed greater reliance upon the department's and UCLA's forecasts.

A more detailed discussion of each sector of the national economy follows.

Consumer Expenditures (63.1 percent of GNP)

From 1965 through 1969 consumer expenditures increased at an average annual rate of 7.6 percent. In 1970, the increase was only 6.8 percent. Despite this lower growth rate, this sector constituted an important force in sustaining aggregate demand early in the year when the economy was contracting. The reduced level of the federal surtax, in the first half of the year, added to disposable (after tax) incomes which in turn sustained consumer expenditures. By the third quarter, however, consumers had become very cautious since their incomes were rising less rapidly and there were increased fears of unemployment.

During 1970, consumers' disposable income rose by $53 billion, but expenditures increased only $39 billion, with a resulting dramatic increase in personal savings. Table 10 shows the savings rate was 7.3 percent in 1970, compared to a more normal 6 percent level in 1969.

The weakest consumer sector in 1970 was durable goods, especially automobiles. The strike cut deeply into fourth quarter auto sales; new domestic models had an annual sales rate of only 5.4 million units, compared to the first three quarters level of 7.7 million units. Even discounting the impact of the strike, 1970 was not a strong year for domestic cars. The prestrike pace (7.7 million units) was weak compared to over 8 million units which were sold in both 1968 and 1969. By contrast, sales of imported cars boomed in 1970, especially in the fourth quarter.

Table 9 shows that the other components of consumer durables also were weak during 1970.

The Department of Finance estimates a strong 9.5 percent recovery in durable purchases in 1971 (Table 9). This forecast assumes a recoupment in auto sales and higher furniture and household equipment purchases as a result of the strong upturn in residential construction.

Nondurables were overly strong in 1970, as consumers diverted spendable resources from the durable sector to this category. Table 9 shows that food and beverages and gasoline had increased over 8 percent. However, a significant part of these increases was attributable to inflation. In total, clothing and shoes registered a rather weak gain because of depressed women's apparel sales. The department expects a more modest increase in this sector in 1971 as consumers shift their funds

Table 9
Consumer Expenditures
(in billions)

	1969	*1970*	*Percentage increase*	*1971*[1]	*Percentage increase*
Durables:					
Auto and parts	$40.3	$37.3	—7.4%		
Furniture and household equipment	36.7	38.5	4.9		
Other	13.1	13.7	4.6		
Subtotal	$90.1	$89.5	—0.7%	$98	9.5%
Nondurables:					
Food and beverage	$121.7	$131.7	8.2%		
Clothing and shoes	49.9	52.3	4.8		
Gasoline and oil	21.1	22.9	8.5		
Other	53.2	57.9	8.8		
Subtotal	$245.9	$264.8	7.7%	$280.5	5.9%
Services:					
Housing	$84.0	$91.8	9.3%		
Household operations	33.9	36.3	7.1		
Transportation	16.7	18.1	8.4		
Other	107.1	116.4	8.7		
Subtotal	$241.7	$262.6	8.6%	$285.5	8.7%
Total Consumer Expenditures	$577.7	$616.9	6.8%	$664.0	7.6%

[1] Department of Finance estimates.

to durable expenditures. Also, there is anticipated to be less inflationary increases in 1971.

The service sector had large increases in 1970 and the department expects a continuation of this growth in 1971. Housing expenditures registered over a 9-percent increase last year but a large part of this was due to higher interest rates and local property taxes.

One of the factors which limited the growth of consumers' expenditures was that from mid-1969 to the end of 1970, there was not only a large rebound in the savings rate, but also a sizable cut in the rate of consumer credit expansion. The latter was only partly attributable to weak auto sales; there also was a slowing in the growth of other types of consumers credit, including personal loans.

Table 10 shows that personal savings reached their peak in the third quarter of 1970. The department expects a modest reduction in this savings rate in 1971, while the other forecasts estimate a more significant decline.

Table 10
Income and Savings
(in billions)

	1969	*1970*	*Percentage increase*	*1971* [1]	*Percentage increase*
Personal income	$748.9	$801.0	7.0%	$854.0	6.6%
Minus personal income taxes	117.3	116.4	—0.8	119.0	2.2
Equals disposable income	$631.6	$684.6	8.4%	$735.0	7.4%
Personal savings	37.6	50.0	33.0	51.4	2.8
Savings as a percentage of disposable income	6.0%	7.3%		7.0%	

Changes by Quarters During 1970
(Annual Rates)

	I	*II*	*III*	*IV*
Personal income	$11.8	$19.0	$5.9	$6.2
Minus personal taxes	+2.9	—0.7	+3.5	—2.3
Equals disposable income	$14.7	$18.3	$9.4	$3.9
Minus consumption expenditures	10.9	11.6	8.1	5.8
Equals change in personal savings	$3.8	$6.7	$1.3	—$1.9
Savings as a percentage of disposable income	6.7%	7.5%	7.6%	7.3%

[1] Department of Finance estimates.

Private Investment (13.9 Percent of GNP)

This sector includes business investment in plant and equipment, institutional construction such as hospitals, residential building, and changes in business inventories.

From 1963 through 1969 business demands for new plants and equipment were very strong. In 1969 this category increased by almost 12 percent. By contrast, 1970 expenditures were up only 3.2 percent (Table 11), which was less than the rate of inflation. The latest (January 1971) U. S. Department of Commerce-Security and Exchange Commission survey of expected plant and equipment expenditures during 1971, shows a very modest (less than 2 percent) gain. Manufacturing industries are anticipating an actual decline in current dollars. The main source of continued strength in this sector will be expenditures by electrical public utilities.

With the easing in the mortgage markets, residential construction became very strong at the end of 1970. However, the character of homebuilding changed substantially during the year with more emphasis on multiple units and lower-priced single-family dwellings. New houses had smaller floor area and fewer of the amenities associated with housing quality. One of the reasons for this change in composition is the impact of the federal mortgage interest subsidies under Section 235 of the 1968 Federal Housing Act. This program financed an increasing portion of the total housing units in 1970.

Residential housing is expected to be one of the strongest sectors in 1971. The department estimates (Table 11) a 17.8 percent increase in expenditures. Several financial institutions expect the housing strength to be concentrated in the first half of the year and weaknesses to develop in the second half when vacancies, especially among multiple units, start to rise.

Table 11
Private Investment
(in billions)

	1969	*1970*	*Percentage increase*	*1971* [1]	*Percentage increase*
Nonresidential:					
Structures	$33.8	$35.1	3.8%	$36	2.6%
Producers equipment	65.5	67.4	2.9	69	2.4
Subtotal	$99.3	$102.5	3.2%	$105	2.4%
Residential	32.0	29.7	—7.2	35	17.8
Change in business inventories	8.5	3.6	—57.6	8	122.2
Total	$139.8	$135.8	—2.9%	$148	9.0%

[1] Department of Finance estimates.

The rate of inventory accumulation dropped substantially between the fall of 1969 and the spring of 1970. This swing was milder than many past inventory corrections. The accumulation rate increased after the first quarter but remained modest as the downturn in the economy became more apparent. In the last quarter, the automobile strike depressed inventories.

The department expects inventories to increase by $8 billion in 1971, as the economy improves. However, part of this increase will consist of stockpiling steel products in anticipation of a possible strike on August 1.

Government Purchases (22.6 Percent of GNP)

For the first time in ten years, federal government purchases of goods and services declined in 1970. The $1.7 billion reduction occurred despite a $3 billion increase in the compensation of military and civilian personnel. Defense purchases fell by more than $2 billion, the first decline since 1964. Nondefense purchases rose one-half billion dollars, the smallest increase in four years. Military manpower declined by 400,000 and Defense Department civilian employment was down 100,000. As a result of the defense cutbacks, private employment may have been reduced by about 600,000 during the year. All told, the President's Council of Economic Advisers estimates there was a decline of about 1.1 million jobs attributable to the Department of Defense expenditure reductions during 1970.

The Department of Finance expects a further decline in national defense expenditures during 1971. At this time the magnitude of the reduction is open to question, depending upon congressional action on the President's Budget. Nondefense expenditures are anticipated to increase faster than the depressed 1970 rate.

Table 12
Government Purchases
(in billions)

	1969	*1970*	*Percentage increase*	*1971* [1]	*Percentage increase*
Federal:					
National defense	$78.8	$76.6	—2.8%	$71.5	—6.7%
Other	22.6	23.1	2.2	25.0	8.2
Total federal	$101.4	$99.7	—1.7%	$96.5	—3.2%
State and Local	110.8	120.8	9.0	133.5	10.5
Total government purchases	$212.2	$220.5	3.9%	$230.0	4.3%

[1] Department of Finance estimates.

State and local governmental purchases rose by $10 billion in 1970, a percentage increase somewhat smaller than those of recent years. Transfer payments—largely for welfare and pensions—rose a record $2.5 billion to a total of almost $14 billion.

Employee compensation rose $7 billion as a result of higher average pay—up 6 percent—and steady growth in employment. State and local construction outlays increased modestly.

Table 12 shows that the department anticipates a 10.5 percent growth in this sector in 1971, which corresponds to the long-range trend.

Employment and Profits

Employment. The total civilian labor force increased by nearly 2 million during 1970, but employment grew by only 725,000, or 0.9 percent, which was the smallest rise since 1961. Table 13 shows that manufacturing employment dropped by 768,000, while construction and federal employment also declined. The categories with the largest increases were finance, services, and state and local governments. These

Table 13
Wage and Salary Workers in Non-agricultural Establishments
(in thousands)

	1969	*1970*	*Increase Amount*	*Increase Percent*
Mining	619	622	3	0.5%
Construction	3,437	3,346	—91	—2.6
Finance, insurance and real estate	3,557	3,679	122	3.4
Transportation and utilities	4,431	4,499	68	1.5
Services	11,211	11,577	366	3.3
Government				
Federal	2,758	2,707	—51	—1.9
State and local	9,446	9,893	447	4.7
Trade	14,645	14,947	302	2.1
Manufacturing	20,169	19,401	—768	—3.8
Total	70,273	70,671	398	0.6%
Labor force	80,733	82,715	1,982	2.5%
Total employment	77,902	78,627	725	0.9
Unemployment	2,831	4,088	1,257	44.4
Unemployment rate	3.5%	4.9%		40.0

increase areas typically require different skills and have lower wage rates than the categories which declined.

The Department of Finance expects a 1.5 percent increase in employment during 1971 (Table 7), which is better than the 1970 record, but about half the growth rate of 1968 and 1969 which were prosperous years.

Unemployment. During 1970 unemployment increased by 1.2 million, or 44 percent, to reach an annual rate of 4.9 percent, the highest since 1964. The decline in the armed forces, the reductions in defense-related employment, and the sluggishness of the civilian economy, all contributed to this increase in unemployment.

Table 14 shows the increases in unemployment by type of worker. One of the unusual aspects of 1970 is that the unemployment rate for nonwhite workers did *not* increase as fast as the total growth. This table indicates that married men, even though they had one of the lowest rates, experienced the most rapid increase in unemployment.

The Department of Finance anticipates that unemployment will continue to increase during 1971 and the annual rate will be 5.7 percent, compared to a January 1971 level of 6 percent. These figures assume that unemployment will peak this spring and then decline throughout the year.

Table 14

Unemployment Rates—By Categories

	1961	*1969*	*1970*	*Percentage increase 1969 to 1970*
All workers	6.7%	3.5%	4.9%	40%
By Color				
White	6.0	3.1	4.5	45
Nonwhite	12.4	6.4	8.2	28
By Age				
16 to 19 years	16.8	12.2	15.3	25
Selected Groups				
Married men	4.6	1.5	2.6	73
Experienced workers	6.8	3.3	4.8	45

Wage Increases. The large wage increases that have become common in recent years continued with few exceptions in 1970. Compensation per hour in the private economy increased by 7.1 percent in 1970, showing little change from the 7.2 percent increase in 1969.

Wage rate increases in nonmanufacturing industries accelerated much more rapidly during 1970 than those in manufacturing, mainly because of the large settlements in construction and trucking. Over half of the construction workers who were affected by new labor contracts in 1970 received first-year wage increases of 15 percent or more, compared to only 5 percent increases for similarly affected manufacturing workers.

Corporate Profits. Table 15 shows that corporate profits declined in total by 9.8 percent during 1970. The largest reduction, over 30 percent, was experienced by durable goods manufacturers. This category was adversely affected by the General Motors strike. Financial institutions were the only major segment which bucked the general trend and had an increase in profits.

The Department of Finance anticipates that corporate profits will increase by 10.3 percent to $85.5 billion in 1971. This level would be almost identical to the 1969 profit rate.

Table 15
Corporate Profits Before Taxes
(in billions)

	1969	*1970*	*Percentage change*
Financial institutions	$12.0	$12.7	5.8%
Manufacturing	41.8	34.1	—18.4
Nondurables	19.3	18.5	—4.2
Durables	22.4	15.6	—30.4
Transportation and utilities	10.7	9.1	—15.0
All other	21.4	21.5	0.5
Total corporate profits	$85.8	$77.4	—9.8%

Prices

Table 16 shows that consumer prices continued to increase during 1970, rising by 5.9 percent. Food prices, which account for about 25 percent of the consumer index, rose sharply during the first half of the year, but then moderated in the second as prices of meats and poultry declined. Nonfood commodities had about the same rate of increase as in 1969, with higher prices on new and used cars offsetting the slower growth in nondurables, especially clothing. Service costs continued to have the highest growth rate, and one of the influencing factors was an 11½ percent increase in transportation charges.

Wholesale prices rose 2.3 percent from December 1969 to December 1970, after a 4.7 percent rise during the previous year. This pronounced slowdown was mainly a reflection of the easing of upward pressure on prices of farm products and food, which led the inflationary surge in 1969. The slowdown in the rise of industrial products was much smaller—from 3.9 percent in 1969 to 3.6 percent in 1970.

During 1971 the Department of Finance anticipates that consumer prices will increase by 4.6 percent and wholesale prices by less than 1 percent. This wholesale price forecast is much more optimistic than either UCLA's or UCB's estimates.

Table 16
Changes in Consumer Prices

A. Percentage increase over prior year			*1969*	*1970*
All items			5.4%	5.9%
Food			5.1	5.5
Housing			6.3	7.0
Durables			3.8	4.1
Nondurables			4.5	3.8
All services			6.9	7.8
Medical services			6.9	6.1
B. Changes during 1970, by quarter	*I*	*II*	*III*	*IV*
All items	5.9%	6.4%	4.5%	5.2%
Food	8.8	3.4	3.1	—2.0
Nonfood commodities	1.1	6.0	3.1	7.8
Services	9.6	8.8	6.6	7.0

Monetary Policy and Interest Rates

1970 opened with credit shortages and abnormally high interest rates; short-term rates hit their highest point in a century. It closed with credit becoming easier and short-term rates registering one of the sharpest declines on record. This shift represented an easing in monetary policy, weakness in consumer and business loan demand, and some dampening of inflationary expectations.

Table 17 shows that short-term rates declined by over a third from their 1970 peaks. There has been a smaller decline in long-term rates because corporations and state and local governments were heavy borrowers during the year.

Table 17

Changes in Interest Rates During 1970

	1970 High	*December 11th rates*	*Percent decline*
Short Term			
3-month Treasury bills	8.02%	4.88%	—39.2%
4–6-month commercial paper	9.08	5.75	—36.7
Long Term			
3–5-year federal bonds	8.26	5.80	—29.8
Municipal bonds	7.12	5.63	—20.9
Corporate Aaa bonds	8.60	7.78	—9.5
FHA mortgage yields	9.29	8.90 [a]	—4.2

[a] November 1970.

The money supply advanced at a rapid 7.6 percent annual rate during 1967 and 1968, and some critics blamed our inflationary problems on this rate of growth. In 1969, the Federal Reserve Board adopted an anti-inflationary posture by restricting the money supply growth to only 3 percent. The board changed its position in 1970 by allowing a moderate 5.5 percent annual increase. The President's $1,065 billion GNP "goal" for 1971 assumes that the Federal Reserve Board will adopt an expansionary monetary policy. No official figures have been published on what rate of increase in the money supply would be necessary to obtain the President's GNP goal, but private estimates range from 8 to 9 percent.

ANALYSIS OF CALIFORNIA ECONOMIC CONDITIONS

Last year the nation lead California in growth of personal income and consumer prices. California, however, had a smaller decline in corporate profits, but a higher rate of unemployment.

A comparison of Tables 7 and 18 shows that personal income grew by 7 percent in the nation but only 6.6 percent in California; both areas had only a 0.9-percent increase in employment. Nationally, corporate profits declined by 9.8 percent while they registered only a 6.9-percent loss in California. The reason for this variance is that durable manufacturers are a larger segment of the national economy than they are in this state. Consumer prices advanced by 5.9 percent nationally, but only 5.5 percent in California. For the last several years, California's unemployment rate has exceeded the nation's. In 1970, California had an annual unemployment rate of 6 percent, compared to the national rate of 4.9 percent.

Table 18 shows that the Department of Finance anticipates California's personal income will be $94.3 billion in 1971, an increase of 6.1 percent. This is a slower growth than it estimated for the nation (6.6 percent), because our employment is expected to grow only 1.1 percent compared to the national 1.5 percent. Corporate profits were anticipated to increase by 10.3 percent in both areas. The department also estimates that consumer prices will continue to grow faster in the nation (4.6 percent) than in California (4.4 percent), but the difference will narrow. As a result of our depressed aerospace industry, it is also expected that the unemployment rate will be higher (7 percent) than the nation's (5.7 percent).

UCLA's California forecast is very similar to the department's, except it anticipates a higher rate of unemployment. The UCB forecast, by contrast, estimates a substantially lower level of unemployment. However, this forecast was published in October 1970, and probably compiled in August or September, which was prior to the substantial increases in our unemployment rates last fall.

Table 18

California Economic Data
(in billions of dollars)

	1969	*1970*	*Percentage change*	*D.F.* [1]	*1971 Forecasts UCLA* [2]	*UCB* [3]
Personal income	$83.4	$88.9	6.6%	$94.3	$94.3	$94.5
Disposable income	72.0	78.0	8.4	83.4		80.7
Taxable corporate profits	7.3	6.8	—6.9	7.5		
Taxable sales	42.4	43.5	2.6	46.4		
Employment (000)	8,016	8,091	0.9	8,180	8,174	
Unemployment (000)	372	520	39.8	620	630	
Unemployment rate	4.4%	6.0%		7.0%	7.2%	5.5%
Number of building permits (000)	183.3	190.0	3.7	190	195	180
New car sales (000)	976	874	—10.4	950		1,000
Consumer price index	128.9	136.0	5.5	142.0		140.9

[1] Department of Finance, prepared in December 1970.
[2] University of California at Los Angeles, prepared in December 1970.
[3] United California Bank, California data published in October 1970.

Employment and Unemployment

During both 1968 and 1969, employment in California increased by an average of 275,000. Last year, the growth was only 75,000, or about one-fourth of the previous rate. Table 19 shows that the declines in manufacturing employment, especially the aerospace industry, were mainly responsible for this reversal. The figures in this table are annual averages. From January 1970 to January 1971 there was a reduction of 131,000 manufacturing jobs in California, of which 83,000 were in the aerospace industry. These losses are mainly responsible for our high rate of unemployment and the weak growth in personal income.

The Department of Finance and the aerospace industry expect employment to decline further in 1971. The department's estimate of a 64,000 decline in 1971 was made before the recent announcement that Lockheed will lay off 6,500 employees as a result of its difficulty in obtaining engines for the Tri Star Jetliner. As a result, the department's 1971 estimate probably is too optimistic.

Regarding the other employment sectors, a comparison of Tables 13 and 19 show that California's employment growth during 1970 was more rapid than the nation's in finance, services and trade, and we had a smaller decline in construction. It is anticipated that these same sectors will provide the employment strength in 1971. The construction estimate was made before the Los Angeles earthquake, and, therefore, is probably on the low side.

Table 19
California Employment by Type of Industry
(in thousands)

Industry	*1969*	*1970*	*Increase Amount*	*Increase Percent*	*1971* [1]	*Increase Amount*	*Increase Percent*
Mining	34	33	—1	—2.9%	33	0	0%
Agriculture	318	318	0	0	315	—3	—0.9
Construction	373	370	—3	—0.8	370	0	0
Finance	410	429	19	4.6	445	16	4.0
Transportation and utilities	477	477	0	0	480	3	.6
Government							
Federal	337	329	—8	—2.4	318	—11	—3.4
State and local	1,055	1,096	41	3.9	1,137	41	3.7
Services	1,620	1,683	63	3.9	1,748	65	3.9
Trade	1,686	1,742	56	3.3	1,791	49	2.8%
Manufacturing							
Aerospace	571	499	—72	—12.6	435	—64	—12.8
Other	1,135	1,115	—20	—1.8	1,108	—7	—0.6
Total employment	8,016	8,091	75	0.9%	8,180	89	1.1%
Civilian labor force	8,388	8,611	223	2.7%	8,800	189	2.2%
Unemployment	372	520	148	39.8	620	100	19.2%
Unemployment rate	4.4%	6.0%			7.0%		

[1] Department of Finance estimates.

Unemployment. Table 20 shows that Stockton, with 9.1 percent, had the highest unemployment rate in December 1970, but the Anaheim-Santa Ana labor market area had the greatest rate of increase, 97 percent, during the year. A close examination of this table indicates that those areas which were heavily dependant upon the aerospace industry generally had the highest unemployment rates. With the expectation that aerospace employment will continue to decline, these same areas will be adversely affected in 1971.

Table 20
Unemployment Rates in California

Labor Market Areas	*December 1969*	*December 1970*	*Percent increase*
Santa Barbara	3.6%	5.6%	55%
San Francisco-Oakland	4.1	5.9	44
Vallejo-Napa	4.4	6.3	43
Bakersfield	4.9	6.5	33
San Diego	3.9	6.5	67
Sacramento	5.1	6.7	31
San Bernardino-Riverside	4.6	6.8	48
Fresno	5.9	7.2	22
Los Angeles-Long Beach	4.3	7.3	70
San Jose	4.3	7.4	72
Oxnard-Ventura	4.3	7.5	74
Anaheim-Santa Ana	3.9	7.7	97
Stockton	7.0	9.1	30
California	4.4%	7.0%	59%

Residential Construction

Table 21 shows that about 189,000 residential housing units were authorized in California during 1970, but almost two-thirds of these were multiple dwellings. Many economists, including those in the Department of Finance, are predicting a strong surge in housing activity during 1971. The economists for Bank of America and Wells Fargo, however, are cautioning against too much optimism because multiple vacancy rates are beginning to climb in many areas. A more important factor is that California expects population to increase by only 215,000 of which about 88 percent would be due to natural increase and only 12 percent attributable to migration. This small rate of migration, which is affected by our sluggish employment picture, will reduce the demand for new housing. As a result of these factors, the Department of Finance anticipates that 190,000 housing units will be authorized in 1971, with the first half of the year being stronger than the second.

Table 21
Number of New Private Housing Units Authorized in California (in thousands)

Year	*Single Dwellings*	*Multiple Units*	*Total*	*Percent Multiple*
1962	122.9	126.8	249.7	50.8%
1963	128.7	175.5	304.2	57.7
1964	112.1	146.0	258.1	56.6
1965	94.8	83.3	178.1	46.8
1966	64.8	33.9	98.7	34.4
1967	67.8	43.6	111.4	39.1
1968	86.8	72.9	159.7	45.7
1969	80.1	104.1	184.2	56.5
1970 [1]	69.5	119.5	189.0	63.2

[1] Annual rate during first 10 months of 1970.
Source: Proceedings of the December 10, 1970, U.C.L.A. business forecasting meeting, page 72.