CALIFORNIA LEGISLATURE

1972 REGULAR SESSION

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1972, to June 30, 1973

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

State Capitol
Sacramento, California
February 1, 1972

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

Gentlemen:

In accordance with the provisions of Government Code, Sections 9140–9143, and Joint Rule No. 37 of the Senate and Assembly creating the Joint Legislative Budget Committee, defining its duties and providing authority to employ a Legislative Analyst, I submit an analysis of the Budget Bill of the State of California for the fiscal year July 1, 1972, to June 30, 1973.

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

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

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

Respectfully submitted,

A. ALAN POST
Legislative Analyst

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PRELIMINARY STATEMENT

The 1972–73 budget is one which starts with a relatively narrow $46.4 million carry forward balance in the General Fund and ends on June 30, 1973, with a projected surplus of $157.9 million.

The passage of the December 1971 tax program (Chapter 1, Statutes of 1971, First Extraordinary Session) was intended to fund the current year deficit and balance the new budget with a small ending surplus, and it would appear that this objective will be achieved. We have some reservations concerning the magnitude of savings in Medi-Cal and welfare estimated in the budget, but we are somewhat more optimistic on revenues than reflected in the budget estimates. So, on balance we see no problem of balancing the budget.

We will point out in this Analysis the fact that there is one major program deficiency in the budget which will require additional state revenues if it is to be solved in a manner consistent with the Legislature's and Governor's positions on property tax relief. That problem is the financing of apportionments to local school districts. The state appropriation for school apportionments does not fit the general pattern of this budget, which otherwise is essentially a status quo financial program. The state's share of school support continues to slip downward, and the local property tax burden will of necessity rise accordingly. The passage of the tax increase in 1971 reflected an awareness of the changes that would be required to solve the major problem of restructuring and refinancing the state school program on a basis which meets the test of a sound and equitable financial plan and conforms to the criteria established by the Supreme Court in its decision rejecting the present system as unconstitutional, but it did not directly address itself to that problem. It did not include major revenue increases for this purpose, leaving that to become a future special legislative program. On the other hand it did provide sufficient revenue to hold the line on the state's share of education costs. We point out that maintenance of the current sharing ratio would cost more than the $65 million budgeted in Item 269 as "new" money in the Governor's Budget, an amount which is scarcely sufficient to offset the savings otherwise gained by the state at the expense of the local districts by application of the State School Fund formula. We also recognize the probability that approximately three-fourths of a billion dollars in new state or federal revenue will be needed to reform the school program in a manner which will provide any long-term property tax relief for schools.

In respect to the welfare budget, we are not confident that the substantial savings which are assumed can in fact be realized. The precarious nature of last year's administration proposals incorporated into the welfare reform act, a hazard fully reported on at that time, is hanging over this budget because of the growing list of injunctions and adverse court decisions affecting these sections of the act and

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reducing the savings assumed to be realized in the budget. These possible losses must realistically be taken into account, for they can have, and probably will have, the effect of reducing the yearend surplus materially. Whether revenues will increase to offset this loss, in accordance with our optimism, can be determined more accurately in the spring prior to final passage of the budget.

These major local assistance items constitute the principal financial factors at issue in the budget, although there are a number of other important program changes and issues which will need to be resolved and which we discuss in the analysis which follows.

Included also will be many items of cost reduction which we are recommending, along with several items of increase, the largest of which, by far, is a cost-of-living salary increase for state employees adjusting the rate so as to restore the real dollar level as it stood at the date of the last salary increase two years ago (three years for faculty).

EXPENDITURE SUMMARY

State expenditures of $7,616,673,213, including $377,039,207 in bond funds, are proposed in the 1972–73 budget. The state will, in addition, administer or subvene another $4,526, 918,723 in federal grants-in-aid, reimbursements and special projects. These components combine to a total state expenditure program of $12,143,591,936.

The combined expenditure level is presented in Table 1 which compares the data for three separate years; 1970–71, 1971–72 and 1972–73. Included in the financial aggregates are (1) state budget

Table 1
Combined Expenditure Summary

	1970–71	*1971–72*	*1972–73*
State budget expenditures	$6,213,208,145	$6,471,243,483	$7,239,634,006
Bond fund expenditures			
State Construction Program	44,858,079	42,566,098	45,764,875
State Beach, Park, Recreational, and Historical Facilities	16,670,529	26,311,728	4,704,248
California Water Resources Development	246,401,187	172,280,569	193,024,172
Central Valley Water Project	34,743,184	83,233,641	770,000
Clean Water Bond Fund	443,800	65,550,000	100,950,000
Recreation and Fish and Wildlife Enhancement	--	11,426,568	14,614,912
Health Science Facilities Construction Program Fund	--	--	17,211,000
Total bonds	$343,116,779	$401,368,604	$377,039,207
Overall state expenditures	$6,556,324,924	$6,872,612,087	$7,616,673,213
Expenditure of federal funds, grants-in-aid, reimbursements and special projects	4,173,613,703	4,650,560,935	4,526,918,723
Total	$10,729,938,627	$11,523,173,022	$12,143,591,936

expenditures as defined under usual accounting procedures to include the General Fund and special funds, (2) detail on the various bond expenditure programs, and (3) expenditures of federal funds. Although the latter two categories are not strictly classified as part of the state budget, they finance significant portions of many state programs and are separately identified in the budget detail for the specific agencies involved.

The State Budget Program

State budget program expenditures, including all General Fund and special funds and excluding bond and federal funds, are proposed at $7,239.6 million in 1972–73. This is an increase of $768.4 million or 11.9 percent over the estimated $6,471.2 million in expenditures for 1971–72. This is a much larger increase than the $258 million or 4.2 percent increase from 1970–71 to 1971–72.

There are three major functional categories in the budget. These consist of state operations, local assistance and capital outlay. A comparison of the expenditure trends by category indicates that local assistance is by far the largest and most rapidly growing element as indicated in Table 2.

Table 2
Total Budget Expenditures

	Amounts in millions		
	1970–71	*1971–72*	*1972–73*
State operations	$1,764.6	$1,845.2	$2,039.3
Capital outlay	372.0	359.3	396.2
Local assistance	4,076.6	4,266.7	4,804.1
Total budget expenditures	$6,213.2	$6,471.2	$7,239.6

The state operations budget will increase $194.1 million or 10.5 percent between 1971–72 and 1972–73. The increase over this same period for local assistance is $537.4 million or 12.6 percent and capital outlay is up $36.9 million or 10.3 percent.

GENERAL FUND BUDGET

The major portion of budget expenditures is from the General Fund for which $5,657.1 million is proposed for 1972–73. This is 78 percent of total budget expenditures and 74.3 percent of overall state expenditures including bonds. General Fund expenditures in 1972–73 are slated to increase $681.1 million or 13.7 percent over the 1971–72 level of $4,975.9 million. The increases in components are $152.5 million or 10.6 percent for state operations, a decrease of $14.3 million or 82.7 percent for capital outlay and an increase of $543 million or 15.4 percent for local assistance. By comparison total 1971–72 expenditures are up only $122.1 million or 2.5 percent over 1970–71.

Over the three-year period 1970–71 to 1972–73 General Fund expenditures in the three budget categories are shown on Table 3.

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Table 3

General Fund Budget Expenditures

	Amounts in millions		
	1970–71	*1971–72*	*1972–73*
State operations	$1,385.1	$1,441.9	$1,594.4
Capital outlay	72.5	17.3	3.0
Local assistance	3,396.2	3,516.7	4,059.7
Total	$4,853.8	$4,976.0	$5,657.1

The amount as well as the rate of growth is greater for local assistance than the other categories. Local assistance is up $663.5 million or 19.5 percent for the two-year period 1970–71 to 1972–73. Growth in state operations for the same period was $212.3 million or 15.3 percent. In contrast capital outlay expenditures have declined from $72.5 million to only $3.0 million in 1972–73. However, the actual level of capital outlay for 1972–73 probably will be significantly above this amount when expenditures from the $150 million reserved for that purpose in AB 1 of the First Extraordinary Session of 1971 are added. These expenditures, which can total as much as $50 million in any one year, are not listed in the budget document.

GENERAL FUND CONDITION

General fund expenditures tend to expand more rapidly than income. It has been necessary to remedy this situation periodically in the past with major tax increases. This was the case in the 1967–68 fiscal year. As a result of that tax increase, funds were available to maintain balanced budgets through the 1969–70 fiscal year. At the end of the 1970–71 fiscal year, however, the General Fund was in deficit by $170.4 million. This was covered by borrowings from other state fund sources.

It was necessary during the 1971 session of the Legislature, to pass new tax legislation in order to avert a much larger deficit at the end of the 1971–72 fiscal year.

The General Fund income and expenditure cycles are illustrated in Table 4 which compares the two series since 1966–67 and shows the effects of the 1967–68 and the 1971–72 tax increases.

Table 4

Comparative Increases in General Fund Income and Expenditures
1966–67 to 1972–73
(in millions)

	Income	*Increase over prior year*	*Expenditures*	*Increase over prior year*
1966–67	$2,894.9	--	$3,017.2	--
1967–68	3,682.3	$787.4	3,272.8	$255.6
1968–69	4,135.9	453.6	3,908.8	636.0
1969–70	4,330.5	194.6	4,456.1	547.3
1970–71	4,533.5	203.0	4,853.8	397.7
1971–72	5,314.6	781.1	4,975.9	122.1
1972–73	5,779.9	465.3	5,657.1	681.2
Average yearly increase 1966–67 to 1972–73		$430		$440

1971–72 Program

The abnormally small increase in expenditures of $122.1 million for 1971–72 over 1970–71 resulted from the Governor's action vetoing $481.4 million in General Fund expenditures which had been approved by the Legislature for schools, higher educational programs, medical assistance and other programs. Proposed salary increases for state workers as well as employees of the University of California and the California State Colleges were also vetoed. In addition, a number of special transfers and adjustments were effected such as the transfer of $78 million from the contingency reserve of the Teachers' Retirement Fund to the General Fund. These transfers were largely one-time only adjustments, and in some instances will have to be repaid. For instance, the Teachers' Retirement Fund will be reimbursed under the funding provisions of AB 543 (Chapter 1305, Statutes of 1971).

When the 1971–72 budget was submitted, the Governor proposed to reduce General Fund expenditures by $15 million from the 1970–71 level. In spite of efforts to reduce expenditures, the 1971–72 budget as approved by the Governor in July reflected an increase of $50.3 million. It was also recognized at that time that there was insufficient funding for social welfare, the courts, debt service and other required costs.

Adjusting for the additional 1971–72 expenditure needs as well as for the effect of new tax legislation and also reducing the proposed 1971–72 expenditure for Medi-Cal by $80 million, the 1971–72 budgeted expenditure level is now estimated at $4,976 million. This is an increase of $101 million over the amount originally proposed.

New tax legislation was required to prevent another yearend deficit in 1971–72. After enactment of Chapter 1 (First Extraordinary Session), and other legislation which will add an estimated $427 million to General Fund resources, raising total income to $5,314 million, the free surplus at June 30, 1972, is estimated at $46.4 million in contrast to the deficit at June 30, 1971, of $170.4 million.

1972–73 Programs

The budget assumes that the carryover surplus from 1971–72 added to income during 1972–73 will support the proposed 1972–73 expenditure program and provide an unrestricted surplus of $157.9 million at June 30, 1973.

The surplus is calculated after adjustment for three special reserves. These are:

1. *Committed Reserves* (or as cited in the budget, "Reserve for Unencumbered Balances of Continuing Appropriations") for which $1,322,461 is earmarked at the end of 1972–73. These are appropriated funds which are being carried over into the subsequent year for actual expenditure.

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2. *Reserve for Working Capital.* This adjustment is required by Chapter 571, Statutes of 1970, and requires the State Controller to reduce the yearend resources through this reservation to the actual cash balance at the end of the fiscal year. The Department of Finance estimates the amount for this reserve until the Controller determines the actual cash balance and the reserve after the close of each fiscal year.

3. *Reserve in Accordance with Chapter 1, Statutes of 1971, First Extraordinary Session.* This act requires that $150 million of one-time nonrecurring revenue provided for by the act shall be used for capital outlay purposes. The Department of Finance has set up this reserve, in effect, to limit the unrestricted surplus by this amount. This reserve is to be appropriated only for capital outlay. If not reserved, this amount would be added to the unrestricted surplus ballooning that figure out of proportion to the amount that is actually available.

The June 30, 1973, unrestricted surplus, estimated in the budget at $157.9 million, results mainly from the passage of AB 1, Chapter 1, 1971, First Extraordinary Session. This act and other tax measures are estimated to raise $504 million in the budget year which when added to the $5,275.9 million estimated on the old tax base will yield total General Fund income of $5,779.9 million in 1972–73.

General Fund expenditures are proposed at $5,657.1 million, an increase of $681.1 million. The surplus of income (current surplus) over expenditures during 1972–73 is therefore $122.8 million, down from $338.6 million in 1971–72. Both years are affected by one-time expanded income generated from withholding as a result of AB 1, Chapter 1, 1971 First Extraordinary session.

These various estimates of income, expenditures, reserves and carryover balances as projected in the budget proposal, are listed in Table 5 for both the 1971–72 and the 1972–73 fiscal years. They indicate

Table 5
General Fund Condition
(in millions)

	1971–72	*1972–73*
Prior year resources (including unrestricted deficit of $170.4 million on June 30, 1971)	$195.9	$534.5
Income	5,314.6	5,779.9
Outgo	4,976.0	5,657.1
Current surplus	$338.6	$122.8
Yearend carryover surplus	534.5	657.3
Less yearend carryover committed reserves	6.6	1.3
Total yearend resources	$527.9	$656.0
Less reserve for working capital	331.5	348.1
Less reserve for capital outlay (Chapter 1, Statutes of 1971, First Extraordinary Session)	150.0	150.0
Yearend unrestricted surplus	$46.4	$157.9

an unrestricted surplus at June 30, 1972, of $46.4 million and an unrestricted surplus at June 30, 1973, of $157.9 million.

Elements of the Budget Problem

In considering the tax package the 1971–72 yearend deficit was estimated at $310 million. The yearend 1972–73 deficit was at that time calculated to be $340 million. The information supplied the Legislature in conjunction with the tax program showed a yearend, June 30, 1973, unrestricted surplus of $39 million after covering the above deficits and providing $150 million for capital outlay (including $40 million in the Bagley Conservation Fund).

The estimated $39 million June 30, 1973, surplus is, in this budget, now revised upward by $119 million to $157.9 million (as shown in Table 5). This adjustment has been made despite a $90 million reduction by the Department of Finance from the December tax package revenue estimates.

Realization of the surplus estimated in the budget for both 1971–72 and 1972–73 depends on the accuracy of the assumptions as to income and expenditures, including major savings estimates in the current year.

We are somewhat more optimistic as to revenues and uncertain about projected savings in Medi-Cal and welfare, especially.

The major areas of differences, or related problems, appear in the following budget categories:

1. We believe the General Fund revenue estimates shown in the budget are about $40 million too low in 1971–72 and $50 million too low in 1972–73, a total difference of $90 million for the two years.

2. We cannot at this time reconcile the assumed $80 million in savings proposed for the medical assistance program in 1971–72 nor the assumptions relative to cost savings proposed by the Governor's Medi-Cal Reform Plan in both 1971–72 and 1972–73.

3. Data at this time are not available to confirm the Department of Social Welfare caseload estimates for 1972–73. Results of court actions also may significantly affect the caseload and expenditure levels.

4. The proposed budget actually does not provide enough money for schools to offset inflation and continues to shift the cost of schools to the local tax base.

5. The increase proposed in the 1972–73 budget for the University of California is slightly less than the amount needed to maintain the 1971–72 budget level after adjusting for merit increases, price increases and other funding adjustments.

6. The proposed funds for salary increases do not keep up with changes in the cost of living since the last adjustments were made in 1969 and 1970. We recommend that the General Fund budget be

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augmented $42,022,000 to more nearly reflect cost-of-living increases.

7. The budget detail does not fully reflect the adjustments resulting from the passage of Chapter 1, 1971 First Extraordinary Session. This legislation was enacted too late to incorporate these adjustments. For instance no expenditure detail is presented for the $150 million reserved for capital outlay by this act. A presentation detailing the various program adjustments is to be made by the Department of Finance during the 1972 session.

The budget also does not reflect certain expenditures resulting from legislation which was signed after December 8, 1971. Major items included in this category are: Chapter 1813 which provides free textbooks to private schools (estimated 1972–73 cost $4 million), Chapter 1752 which extends the homeowners' exemption to cooperatives (estimated 1972–73 cost $2.5 million), and Chapter 1811 which adds hyaline membrane disease to those conditions included by statute in the Crippled Children Services program (provides an augmentation of $800,000 to the Budget Act of 1971). The Department of Public Health estimates that state cost for addition of hyaline membrane will be $3,750,000 in the budget year if the program is fully implemented.

A discussion of the major expenditure and revenue programs is presented in the following sections. All expenditure programs are also taken up in detail in the associated items in the analysis.

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. The largest single element of direct General Fund expense is the salaries and wages of state employees.

The state's total population as of July 1, 1972, is estimated at 20.5 million. As of July 1, 1973, the state's population is projected to be 20.7 million, an increase of 0.2 million over July 1, 1972. The U.S. Consumer Price Index (1967 prices = 100) indicates that the cost of living rose from 118.5 in November 1970 to 122.6 in November 1971, an increase of 3.5 percent. If the Consumer Price Index "services less rent" category (which reflects wages and salaries) is used as a base for comparison, the October 1971 level is estimated to be 4.8 percent higher than in October 1970.

An estimated $1,270.7 million of proposed General Fund expenditures in the 1972–73 fiscal year is for salaries and wages of state employees. This comprises 79.7 percent of the total General Fund expenditures for state operations. This is an increase of 8.3 percent over the estimated $1,172.9 million expended in 1971–72.

Specific Program Elements

The Governor's Budget proposes a total expenditure from the General Fund of $5,657.1 million for the 1972–73 fiscal year. Human relations, education, higher education, property tax relief, and other major programs discussed in this section comprise 87.1 percent of total General Fund expenditures.

Each of the major program elements as well as programs of special interest are described in the following sections. A detailed analysis of each of the programs can be obtained by referring to the appropriate item in this analysis.

Most state agencies have articulated goals and objectives for their programs. However, more often than not the objectives are not measurable by the data furnished by the agency.

Measuring an agency's accomplishments is difficult. At the present time very little data are available in a form which is compatible with an agency's objectives. The budget document does not indicate an agency's past performance in terms of its current performance or its budget proposal.

A task force composed of representatives from the Department of Finance and various agencies is attempting to develop measurable objectives and the necessary data. If the task force is able to accomplish this, it should allow the Governor and the Legislature to alter priorities based upon *alternative levels of service*. Under current budgeting practices, changes in priorities are based upon increases or decreases in the amount available for the program.

Table 6 indicates the major program changes in General Fund

Table 6
1972–73 Selected General Fund Budget
Program Changes from 1971–72 Expenditure Level
(in millions)

Major Program Increases	*Amount*	*Percent*
Social welfare—state operations	$4.4	45.2
Social welfare—local assistance	54.4	7.3
Mental hygiene—local assistance	29.7	15.4
Public health—state operations	1.0	8.7
Education—apportionments	99.0	6.6
University of California—state operations	18.7	5.5
State colleges—state operations	31.5	9.9
Property tax relief—local assistance	127.9	39.9
Teachers' retirement—local assistance	115.0 [1]	575.0
Debt service	11.4	6.2
Health care services	137.5	26.6
Open space	13.0	N.A. [2]
Salary increases	74.2	N.A.
Major Program Decreases		
Capital outlay	—14.3	—82.5
Mental hygiene—state operations	—9.6	—7.5
Public health—local assistance	—20.1	—48.2
Parks and recreation	—4.9	—24.0

[1] An additional $42 million for teachers' retirement purposes is included in the Education—apportionments category.
[2] Not applicable.

expenditures. The budget proposes major increases in expenditures for teachers' retirement, the state operations portion of the social welfare program, the Property Tax Relief Program, the Department of Health Care Services, and the local assistance portion of mental hygiene. Major program decreases are budgeted for the General Fund capital outlay program, the local assistance portion of the public health program and for the Department of Parks and Recreation.

Health Care Services

	Estimated 1971–72	*Proposed 1972–73*	*Increase*	*Percent*
Local assistance	$517,097,750	$654,584,708	$137,486,958	26.6
Average monthly caseload	2,761,000	3,474,900	713,900	25.9

The California Medical Assistance Program provides medical care to those financially needy individuals eligible for the program.

Persons eligible for the program include (1) public assistance recipients, (2) medically needy welfare-linked persons, (3) medically indigent children, and (4) medically indigent adults. The last two categories were added to the program by the Medical Reform Program passed by the 1971 session of the Legislature. Before the enactment of the legislation health services for medically indigent children and adults were provided by the state and the counties. The reform program eliminates this county-state program, and transfers the caseload to Medi-Cal.

As indicated above the average monthly caseload will increase by an estimated 713,900. The bulk of this increase (537,700) can be attributed to the reform program. The Governor's Budget also indicates that the reforms will result in some savings to the state and counties by adding medically indigent under age 21 to the Medi-Cal program and thus increasing the size of the caseload eligible for the federal sharing. The state will also realize savings from other reforms in the program such as a copayment or service fee requirement. The estimated expenditure figure ($517,097,750) shown above for the 1971–72 fiscal year is based in part on an $80 million savings to the General Fund. According to the budget document, this savings is a result of anticipated decreases in caseload. We are unable to reconcile this decrease and it has not been reflected in federal expenditures for the program.

Under current federal law expenditures for the Medi-Cal program for the federally eligible caseload are shared equally between the state and federal government. Any increase or decrease in cost to the federal government must be matched by an equal decrease in cost to the state government. However, the budget does not reflect that this has been the case in the 1971–72 fiscal year. The federal share of the program increased 32.3 percent while the state cost increased 6.7 percent. Even taking into consideration that the state has gone to a cash basis for the payment of bills, it is very difficult to understand how the state *alone* will save $80 million.

Social Welfare

General Fund	*Estimated 1971–72*	*Proposed 1972–73*	*Increase*	*Percent*
State operations	$9,801,474	$14,227,370	$4,425,896	45.2
Local assistance	749,604,791	804,025,690	54,420,899	7.3
Totals	$759,406,265	$818,253,060	$58,846,795	7.7

Department of Social Welfare Estimates— Monthly Average Persons Aided:	*Estimated 1971–72*	*Proposed 1972–73*	*Increase*	*Percent*
Aged	$318,200	$320,275	$2,075	0.7
Blind	14,175	14,490	315	2.2
Disabled	202,900	211,150	8,250	4.1
AFDC	1,604,400	1,691,850	87,450	5.5
Totals	$2,139,675	$2,237,765	$98,090	4.5

The Department of Social Welfare provides cash grant assistance to the financially needy, the blind and disabled, and furnishes social services designed to assist needy persons to develop a capacity for self-support.

A total 1972–73 General Fund expenditure of $818.3 million is proposed for the Department of Social Welfare. Included in this figure is an increase of $54.4 million in local assistance over the previous fiscal year. This increase is partially due to a change in federal grant sharing ratios—lowering the county share. The state support expenditure is proposed to increase by $4.4 million, based, in part, on a recently initiated departmental reorganization which emphasizes new management priorities.

These proposed budget expenditures are contingent upon full implementation of Chapter 578, Statutes of 1971, the Governor's Welfare Reform Program. The proposed local assistance budget may prove to be underestimated due to court challenges of this legislation. For example, the budget narrative appears to assume implementation of the Old Age Security Responsible Relatives' Liability Scale, Section 33 of Chapter 578. The State Department of Social Welfare had estimated a $17.6 million General Fund savings associated with

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implementation of the scale. Currently, enforcement of Section 33 is being challenged in the superior court. Should the courts invalidate Section 33, Old Age Security General Fund support may be understated by approximately the amount of the section's estimated fiscal impact, $17.6 million.

Our estimates of the 1972–73 public assistance caseloads must remain tentative until at least April or May of the current fiscal year. At that time, sufficient data should be available to either confirm or adjust the departmental estimates.

The department has been attempting to meet its stated goal—provision of grant assistance and social services to the needy. The efficiency and economy with which this assistance is provided is hard to evaluate because of the lack of adequate measurement criteria. The criteria generally used to measure the effectiveness of the department are caseload increases and decreases. This criteria does not measure the stated goal, except as an indication of the number of persons receiving assistance.

Mental Hygiene

	Estimated 1971–72	*Proposed 1972–73*	*Change*	*Percent*
State operations	$127,401,300	$117,800,243	—$9,601,057	—7.5
Local assistance	192,815,716	222,474,936	29,659,220	15.4
Totals	$320,217,016	$340,275,179	$20,058,163	6.3

The Department of Mental Hygiene administers programs for the treatment of the mentally disordered and mentally retarded.

General Fund expenditures for the department are proposed to increase $20.1 million in the 1972–73 fiscal year. This increase is comprised of a $29.7 million increase in local assistance and a $9.6 million decrease in state operations. The increase in local assistance is partly a result of transfers from other departments; for example, $8 million from public health for Mental Retardation Regional Centers, and $4.3 million from the Department of Health Care Services for Medi-Cal payments. The $9.6 million decrease in state operations represents reduced support for state hospital operations.

The department's policy of providing treatment in a community setting has led to the closing of two state hospitals and part of another and to the transfer of the patients from the hospitals to local mental health (Short-Doyle) treatment programs. Closure of more state hospitals is clearly indicated, and the budget proposes a reduction in state hospital services. The proposed increase in the Short-Doyle programs (approximately $4.2 million) may not be sufficient to adequately treat the patients which will be placed in the communities from future hospital closures. Therefore, funds presently budgeted may not be sufficient to meet the stated goal of the department—the ensured availability of appropriate mental health to all Californians.

Public Health

	Estimated 1971–72	*Proposed 1972–73*	*Change*	*Percent*
State operations	$10,997,731	$11,953,739	$956,008	8.7
Local assistance	41,614,266	21,559,719	—20,054,547	—48.2
Totals	$52,611,997	$33,513,458	—$19,098,539	—36.3

The Department of Public Health programs to protect the health of the people of California through identification of new or changing health problems, development of improved techniques for prevention or control of disease and environmental health problems.

The 1972–73 budget proposes a total General Fund expenditure of $33.5 million. As shown in the table, this reflects a $1 million increase in support for the department and a $20.1 million decrease in the local assistance budget. The increase in the support expenditure reflects a proposed increase in the level of service in the areas of food and drug inspection, water sanitation, measle control and venereal disease control. Transfers of funds for mental retardation services to the Department of Mental Hygiene account for the decrease in the local assistance budget.

The criteria generally used in evaluation of the department's effectiveness are quantitative; for example, number of activities performed, facilities visited, or persons served. These quantitative outputs fail to measure the defined goals and objectives of the department which are directed toward health problems and the quality of health services.

Education

	Estimated 1917–72	*Proposed 1972–73*	*Increase*	*Percent*
Local assistance [1]	$1,552,077,292	$1,650,429,529 [2]	$98,352,237	6.3
Apportionments	1,497,183,900	1,596,193,300 [2]	99,009,400	6.6

[1] Excludes debt service on school building aid bonds, direct contributions to Teachers' Retirement Fund and Community College Extended Opportunity Program.
[2] Includes $42 million for teachers' retirement included in apportionments for the first time in 1972–73.

Local assistance expenditures for education, excluding debt service on school building bonds, $135 million in direct state contributions to the Teachers' Retirement Fund and the Community College Extended Opportunity Program are budgeted to increase 6.3 percent from 1971–72 to 1972–73. State apportionments to public schools which

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comprise 96.7 percent of the local assistance expenditures are budgeted to increase $99 million or 6.6 percent over the same period. However, this increase includes $42 million for state contributions to teachers' retirement through school apportionments. Thus, the budget includes only $57 million in "new" state aid. This "new" money, however, is not enough to offset the effects of inflation on school districts during the current year or the budget year. The $88 million identified in the budget as an inflation factor covers inflation which occurred in the 1970–71 fiscal year. If the $88 million were not appropriated it would simply permit inflation in the 1971–72 fiscal year and the 1972–73 fiscal year to reduce the state support for the program. Thus, the $88 million inflation factor should be considered as part of the base for school support rather than a separate item.

If the state were to maintain its share of the cost it would take an additional $41.6 million to maintain the ration of state expenditures to local expenditures for the current year. It would take an additional $156 million to move back to the 1970–71 ratio of 34.1 percent. The state's share of this joint program is consistently slipping.

A comparison of the estimated average daily attendance in 1971–72 and 1972–73 is shown below by school level.

Estimated Average Daily Attendance

	1971–72	*1972–73*	*Change*	*Percent*
Elementary	3,251,500	3,226,000	—25,500	—0.8
High school	1,410,290	1,431,440	21,150	1.5
Community college	476,500	529,000	52,500	11.1
Adults	147,155	151,570	4,415	3.0
Totals	5,285,445	5,338,010	52,565	1.0

The total average daily attendance is projected to increase only 1 percent between 1971–72 and 1972–73. However, the overall increase of 1 percent represents an 0.8 percent decline in the average daily attendance at elementary schools and an 11.1 percent increase in average daily attendance at community colleges.

Teacher's Retirement System

	Estimated 1971–72	*Proposed 1972–73*	*Increase*	*Percent*
Contributions to Teacher's Retirement Fund	$20,000,000	$135,000,000 [1]	$115,000,000 [1]	575

[1] Excludes $42 million funded in school apportionments which when added brings the total program level to $177 million.

The $135 million request is an essential part of a major overhaul of the Teachers' Retirement System as authorized by AB 543 (Chapter 1305, Statutes of 1971). Although the request is substantially higher than the $20 million appropriation for the 1971–72 fiscal year, it should be noted that the difference between member and school district contributions and the cost of benefit payments in the 1971–72 fiscal year is estimated at $98 million which, based on traditional financing patterns, would have been a General Fund obligation. However, as a result of the Governor's veto action, $78 million of that deficit was funded from the Teachers' Retirement Contingency Reserve Fund.

Prior to the enactment of AB 543, the system's benefits were funded from the following three sources: (1) teachers, (2) school districts, (3) the General Fund. The General Fund contribution made up the difference between benefits due and payable and the combination of the other two sources. As noted above, this difference was estimated at $98 million in 1971–72 and was projected to increase to $116 million in 1972–73 and to an estimated $625 million by 1990.

An additional provision of AB 543 provides an annual transfer of $8 per average daily attendance (ADA) (state basis) from the General Fund to the State School Fund, to be apportioned and disbursed to the local school districts for retirement costs in accordance with existing state aid formulas. The $8 per ADA payment would be increased by an additional $2 annually to a total of $20 per ADA in 1978–79. This provision has an estimated cost of $42 million to the General Fund in 1972–73. This $42 million is included in the budget item for state school apportionments. The state contribution will increase to $105 million in 1978–79, based on projected ADA levels. Future state costs would be determined by the rate of growth (or decline) in ADA.

Higher Education—University of California

	Estimated 1971–72	*Proposed 1972–73*	*Increase*	*Percent*
University of California	$337,091,074	$355,800,000	$18,708,206	5.5
Enrollments (full-time equivalents)	106,059	107,346	1,287	1.2

State appropriations to the University of California are proposed at $355.8 million. This is an increase of $18.7 million or 5.5 percent over the 1971–72 appropriation. The $18.7 million is $700,000 less than the increase needed to maintain the 1971–72 budget level after adjusting for merit increases, price increases and other funding adjustments.

The budget includes only one workload change by adding 29 faculty positions related to enrollment growth. This was funded by a savings in staff benefits. All other state-funded programs will remain at the 1971–72 level without adjustment for enrollment increases or other workload-related needs.

Various measurement criteria are used to determine the appropriate level of state funding for each function of the University. One is the enrollment in terms of full-time equivalents. This is shown above. Another is the number of degrees awarded. During 1969–70 a total of 16,207 baccalaureate degrees, 4,635 master degrees, and 2,676 doctoral degrees were awarded. In 1970–71, 17,935 baccalaureate degrees, 5,084 masters and 2,951 doctoral degrees were awarded.

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California State Colleges

	Estimated 1971–72	Proposed 1972–73	Increase	Percent
State operations	$318,692,616	$350,167,004	$31,474,388	9.9
Enrollments (full-time equivalents)	221,020	232,700	11,680	5.3

The state colleges proposed 1972–73 General Fund support budget totals $350.2 million. This is 9.9 percent above the 1971–72 fiscal year. The additional funds will be used for price increases, workload growth and program enrichment (approximately $4 million).

Major issues within the budget for legislative review include the continuation of faculty support on a student–faculty ratio of 18.25 to 1 which was a product of the task force report one year ago, the elimination of all state grants to college Economic Opportunity Program enrollees, the implementation of a major library augmentation based on comparison with major university standards and a policy determination that the colleges will be able to handle future enrollments without the implementation of year-round operations as specified in the Education Code.

Various criteria are used in measuring the system's performance. Two of these are comparative full-time equivalent enrollment figures, shown in the table above, and the number of degrees granted, shown below:

Degrees Granted by the California State Colleges

	Undergraduate degrees	Graduate degrees	Total degrees
1968–69	32,558	5,996	38,554
1969–70	37,490	6,798	44,288
1970–71	40,651	7,567	48,218

These figures are indicators of the quantity of output of the state college system but do not provide a basis for the evaluation of program achievements.

Property Tax Relief

	Estimated 1971–72	Proposed 1972–73	Increase	Percent
Local Assistance:				
Senior citizens,[1] property tax relief	$8,800,00	$55,200,000 [1]	$46,400,000	527.3
Personal Property tax relief	79,000,000	138,000,000 [2]	59,000,000	74.7
Homeowners' property tax relief	232,500,000	255,000,000 [3]	22,500,000	9.7
Totals	$320,300,000	$448,200,000	$127,900,000	39.9

[1] The $9.2 million shown in the budget is not adjusted for Chapter 1 of 1971 First Extraordinary Session.
[2] The $48 million shown in the budget is not adjusted for Chapter 1 of 1971 First Extraordinary Session.
[3] The $252 million shown in the budget is not adjusted for Chapter 1752, 1971 session.

The state's Property Tax Relief Program provides reduced property taxes to senior citizens, personal property (business inventory) owners, and homeowners. The principal objectives of these programs are to preserve homeownership for senior citizens, to stabilize the tax burden on business inventories and to ensure a lower tax burden on homeowners than on other types of property owners.

General Fund expenditures for property tax relief, revised to include provisions of recent legislation, total $448.2 million in the 1972–73 fiscal year. This is an increase of $127.9 million over last year, primarily due to the effects of recently passed legislation (Chapter 1, 1971 First Extraordinary Session and Chapter 1752, 1971 session).

The program is composed of three elements, senior citizens' property tax assistance, homeowners' property tax relief and personal property tax relief. Senior citizens' tax assistance is budgeted at $55.2 million, a $46.4 million increase over 1971–72. This increase is due to the expanded eligibility and increased state payments provided by Chapter 1, 1971 First Extraordinary Session.

Personal property tax relief is budgeted at $138 million, a $59 million increase over last year. This significant increase is due to a change in budgeting procedures, higher tax rates, growth in the exempt base and the change in local payments guaranteed under Chapter 1 (1971 First Extraordinary Session).

Homeowners' tax relief has increased by $22.5 million to $255 million in 1972–73. Of this total increase, $2.5 million is due to new legislation (Chapter 1752, 1971 session) which extend the homeowners' exemption to cooperatives. The remainder of the increase is attributive to be growth in the number of claimants and the increase in the average property tax rate.

Debt Service	*Estimated 1971–72*	*Proposed 1972–73*	*Change*	*Percent*
Bond interest and redemption [1]	$160,726,854	$182,112,995	$21,386,141	13.3
Payment of interest on General Fund loans [2]	24,400,000	–14,400,000	–10,000,000	–41.0
Totals	$185,126,854	$196,512,995	$11,386,141	6.2

[1] Includes state construction program. State higher education construction program, community college construction, state beach, park recreation and historical facilities, recreation and fish and wildlife enhancement, California clear water and state portion of school building aid bonds.

[2] A special adjustment shown on page A-64 of the Governor's Budget document reduces the 1971–72 amount by $10.4 million to $14 million and the 1972–73 amount by $10.5 million to $3.9 million.

Bond Debt Service

Debt service on general obligation bonds, consisting of the payment of interest and redemption costs on bonds sold and outstanding, is guaranteed in the various bond acts and ratified in the Constitution. The full faith and credit of the General Fund is pledged toward the repayment of these debts.

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Debt service charges to the General Fund are estimated to rise by $21.4 million or 13.3 percent from 1971–72 to a total of $182.1 million in 1972–73. The sharp rise in debt service payments is attributable to heavy marketings of bonds since June 1970. For more than a year before that time, the state had been unable to sell bonds because the maximum authorized interest rate was below the market rate.

General Fund bond programs to (1) provide for construction of state facilities especially for the University of California and the state colleges, (2) provide aid for construction of community college facilities, (3) acquire and construct beach, park and other recreational facilities, (4) provide aid for construction of sewer and other facilities to improve the water quality in the state, and (5) provide part of the costs for construction of school buildings.

Interest on Temporary Loans

It has been necessary in recent years for the General Fund to borrow extensively from other state funds (internal borrowing) and in 1971–72, when these resources were depleted, the state has also issued short-term State of California notes in the financial markets (external borrowing). These borrowings have generally been for short periods within a fiscal year when expenditures exceeded revenues with the balance being repaid by the end of the year. However, borrowed balances were carried over from the 1970–71 fiscal year into 1971–72.

The proposed $24.4 million in 1971–72 and $14.4 million in 1972–73 as shown in the budget programs do not reflect the reduced borrowing needs in each of these years that results from the passage of AB 1 (Chapter 1, 1971 First Extraordinary Session). This legislation institutes state withholding of the personal income tax, and therefore short-term borrowing needs will be greatly reduced in both years. These savings however, are confirmed on page A-64 of the budget document which indicates that $10.4 million will be saved in the 1971–72 budget and $10.5 million in savings will result in 1972–73. This reduces the 1971–72 program total to $14 million and the 1972–73 total to $3.9 million. These savings are already accounted for in budget totals and the estimates of surplus for both years.

Parks and Recreation

Estimated 1971–72	*Proposed 1972–73*	*Change Decrease*	*Percent*
$20,297,940	$15,431,295	–$4,866,645	–24.0

The Department of Parks and Recreation develops and operates parks of cultural, historical and environmental value. The department's objective is to manage the park system for the benefit of over 45 million annual visitors.

Traditionally the department has used such factors as the number of picnic units, camp units, acres of beach, miles of trail, and the number of parking facilities to measure its progress in terms of its objective. However, this has led to a lack of departmental direction. A comprehensive master plan against which these measurements can be applied does not exist.

Two major changes in budgetary policy are proposed in the department's budget which may eventually result in changing the application of its objectives. In the first instance the department proposes to decrease its General Fund support appropriation from $20.3 million in the current year to $15.4 million in the budget year. This is to be accomplished by allowing the department to retail all of the state park system fees it collects and using them for payment of operating costs. A second change would be to limit any increases in operating costs to increased revenues starting in 1972–73. This policy will probably cause the department to shift acquisition and development towards those projects with low operation and maintenance costs and the highest revenues.

Open Space Program

	Estimated 1971-72	*Proposed 1972-73*	*Increase*	*Percent*
Open-space program	–	$13,000,000	$13,000,000	NA

As authorized by AB 1 (Chapter 1, of First Extraordinary Session of 1971) the Governor's Budget includes $13 million for state payments to counties, cities and reimbursements to school districts for open-space lands starting in 1972–73. The act was passed too late to include the program in the budget detail. However funding is included on page B-12 of the Governor's Budget document.

County and city payments are at a specified amount per acre depending upon the type of land and its location. For example, prime agricultural land within or adjacent to a city is reimbursed at $3 per acre, while other prime agricultural lands are reimbursed at $1.50 per acre. Nonprime land, of "statewide significance," is reimbursed at $0.50 per acre. The amount of school district reimbursements is variable depending upon the district tax rate.

Capital Outlay	*Estimated 1971–72*	*Proposed 1972–73*	*Decrease*	*Percent*
General Fund capital outlay expenditures	$17,340,954	$3,032,000	—$14,308,954	—82.5
State Building Program:				
Resources	374,221	--	—374,221	—100
Human relations	150,000	2,145,000	1,995,000	1,330
Education	43,000	--	—43,000	—100
Higher education	12,020,748	--	—12,020,748	—100
District fair construction program	—100,000	—100,000	--	--
Other	$4,852,985	$987,000	—$3,865,985	—79.6

General Fund expenditures for capital outlay are budgeted to decrease by $14.3 million between fiscal years 1971–72 and 1972–73. Most of the decrease ($12 million) is in higher education and represents cost augmentations which occurred in fiscal year 1971–72. These were offset by reversions from the Capital Outlay Fund for Higher Eduation.

The 1971–72 program for higher education was supported entirely by the Capital Outlay Fund for Higher Education, bond funds (for community colleges) and the Education Fee Fund (University). These totaled over $97.6 million, most of which were new appropriations, the balance being carryovers.

The General Fund, in the current year and in the budget year, will contribute very little directly to the overall State Construction Program and nothing to the higher education segment. Indirectly, it contributes by repayment of bond funds including interest.

In its present form, the budget for fiscal year 1972–73 does not include any allocation from Chapter 1, 1971 Extraordinary Session, new tax funds for capital outlay. Bond funds are included on a contingent basis subject to the acceptance by the electorate of a new proposal for community colleges and a new one for health science instructional facilities. The contingent total is $63 million.

Also included is $39 million from the Capital Outlay Fund for Public Higher Education and $34.2 million from the Education Fee Fund (University). Carryovers from prior appropriations are of little consequence.

Salary Increases

	Estimated 1971–72	*Proposed 1972–73*	*Increase*	*Percent*
General Fund	–	$74,233,000	$74,233,000	NA

The Governor's 1972–73 Budget proposal recommends $74,233,000 from the General Fund for salary increases. This proposal is based on a 5 percent across-the-board increase for state civil service and nonacademic employees, and a 7.5 percent increase for University and state college academic employees. State civil service and nonacademic employees have not received a salary increase since July 1970, while University and state college academic employees have not had their salaries increased since July 1, 1969.

In contrast to these proposals it is estimated that the California consumer Price Index will increase by 13.4 percent from mid-1969 to mid-1972. The increase from mid-1970 to mid-1972 is estimated at 7.9 percent.

We recommend a budget augmentation of $42,022,000 to provide for an additional 2.5 percent general salary increase for state civil service and nonacademic employees of the University and state colleges and an additional 5 percent increase for academic and academic-related employees. This would bring the overall salary increase for state civil service and nonacademic employees to 7.5 percent and the overall increase for academic and academic-related employees to 12.5 percent. Adding this recommendation to the General Fund salary increases proposed by the Governor brings the total to $116,255,000.

The effect of this recommendation on the General fund is shown below:

	Governor's recommendation		Legislative Analyst recommended Augmentation		Total	
Civil service and related	$31,659,000	(5%)	$15,829,000	(2.5%)	$47,488,000	(7.5%)
University of California:						
Academic and related	13,314,000	(7.5%)	8,874,000	(5.0%)	22,188,000	(12.5%)
Nonacademic	7,391,000	(5.0%)	3,695,000	(2.5%)	11,086,000	(7.5%)
State Colleges:						
Academic and related	16,151,000	(7.5%)	10,766,000	(5.0%)	26,917,000	(12.5%)
Nonacademic	5,718,000	(5.0%)	2,858,000	(2.5%)	5,576,000	(7.5%)
Totals	$74,233,000		$42,022,000		$116,255,000	

GENERAL OBLIGATION BONDS

State general obligation bonds outstanding on December 31, 1971, totaled $5,214,612,000, a gain of $353,266,000 or 7.3 percent over the $4,861,346,000 outstanding on December 31, 1970.

There are two types of general obligation bonds; (1) those in which the debt service (includes interest and redemption payments) obligation is fully paid, or the major portion is paid from the General Fund and (2) those in which debt service is paid from project or program revenues. The full faith and credit of the state is pledged however, to make these payments in any case from the General Fund should revenue be insufficient to cover these costs.

The state also issues short-term bond anticipation notes when bond market conditions make it advisable to utilize this means. This provides temporary financing in hopes that more favorable terms can be obtained on the actual sale of the bonds at a later date. In 1971–72 the state also began issuing short-term "State of California notes" in the financial markets to provide operating funds during temporary periods when General Fund expenditures exceed revenues. All these notes must be redeemed by June 30, 1972.

State agencies also issue revenue bonds for certain projects on which only the revenue generated from the enterprise is pledged for payment of the bonds. These have been issued for University and state colleges dormitories, parking lots, Cal Expo facilities, bridges and other construction projects and purposes. The revenue bonds, bond anticipation notes and State of California notes, are not included in the totals in this summary but rather are mentioned merely to indicate the different types of debt instruments with which the state is involved.

In addition to legislative approval, general obligation bonds must be authorized by the electorate. Bond issues have been approved in this manner for the development of water and other resources, school building aid, construction of higher educational facilities and other

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state construction, purchasing and developing park and recreational facilities, veterans' farm and home purchases, clean water programs and for other purposes.

The state general obligation bonded debt by the various program categories is shown in Table 7. Information is included to show the amount by program of the $630,597,000 in authorized bonds which have been approved but not sold as well as bonds sold and outstanding at December 31, 1971.

Table 7
General Obligation Bonds of the State of California by Purpose as of December 31, 1971

Purpose	*Unsold*	*Outstanding*
General Fund Bonds:		
State construction	--	$809,500,000
Beaches, parks, recreational and historical facilities	$25,000,000	110,700,000
Higher education construction	--	210,030,000
Community college construction	--	62,800,000
School building aid[1]	94,900,000	1,208,525,000
Recreation and fish and wildlife	50,000,000	10,000,000
Clean water	200,000,000	50,000,000
Totals	$369,900,000	$2,461,555,000
Self-Liquidating Bonds:		
Water resources development	$250,000,000	$1,500,000,000
Veterans' farm and home	50,000,000	1,196,650,000
Harbor bond programs	697,000	56,407,000
Totals	$300,697,000	$2,753,057,000
Totals, all bonds	$670,597,000	$5,214,612,000

[1] The General Fund bears the major portion of debt service. School districts contribute the remainder.

During 1961 the state sold $560 million of general obligation bonds at interest rates ranging from 4.4510 percent to 5.6909 percent.

Anticipated sales of bonds in the last half of the 1971–72 fiscal year include:

	Millions
Clean water	$50
Veterans	50
Water resources development	50
Total	$150

Sales during 1972–73 are anticipated as follows:

	Millions
State school building aid	$94.9
Fish and wildlife	25.0
Beaches, parks, recreational and historical facilities	25.0
Clean water	100.0
Total	$244.9

The 1971 session of the Legislature proposed four major general obligation bond issues totaling $1,054,000,000. These will be voted on by the electorate during 1972 as summarized below:

Legislation	Program	Vote by electorate	Amount (in millions)
Chapter 105 (AB 75)	School building aid and earthquake reconstruction	June 6, 1972	$350
Chapter 665 (SB 281)	Health science facilities	November 7, 1972	294
Chapter 1167 (AB 171)	Veterans Bond Act	June 6, 1972	250
Chapter 937 (SB 168)	Community college construction	November 7, 1972	160
Total			$1,054

The Legislature also passed AB 3066 proposing a $250 million issue for beaches, parks and historical facilities. The bill, however, was vetoed by the Governor.

The category General Fund bonds includes those programs for which the redemption and interest charges are entirely or for the most part paid from the General Fund. Programs for which full debt service is paid from the General Fund include state construction; beaches, parks recreational and historical facilities; higher education construction; community college construction, recreation and fish and wildlife; and clean water. The state pays the major portion of debt service for school building aid bonds and the local school districts bear the remainder.

Table 8 projects the debt service charges on those programs fully funded from the General Fund and Table 9 projects these charges for school building aid bonds including the estimated portion projected to be contributed from the General Fund. Combining these projected General Fund debt service charges as shown in Tables 8 and 9 indicates that if all proposed new issues are approved by the electorate in 1972, debt service charges are anticipated to total $182.1 million in 1972–73 and will rise to $247.2 million by 1976–77. Should other new issues be authorized after 1972, these costs to the General Fund will rise even faster. The combined debt service charges are projected below for the period 1970–71 to 1976–77.

1970–71	$141,111,861
1971–72	160,726,854
1972–73	182,112,995
1973–74	207,369,435
1974–75	230,760,950
1975–76	240,525,019
1976–77	247,218,280

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Table 8

Estimated Interest and Redemption Charges on General Fund Bonds[1] 1970–71 to 1976–77

Fiscal year	*Total debt service*	*Debt service on authorized bonds*[2]	*Debt service on proposed new issues*[3]
1970–71	$90,680,817	$90,680,817	--
1971–72	105,417,284	105,417,284	--
1972–73	116,278,353	115,095,020	$1,816,667
1973–74	139,934,111	128,375,986	11,558,125
1974–75	156,111,511	134,974,636	21,136,875
1975–76	160,314,836	132,496,711	27,818,125
1976–77	167,833,568	129,674,193	38,159,375

[1] Includes state construction; state beach, park, recreation and historical facilities; clean water; state higher education construction; junior college construction; recreation and fish and wildlife enhancement.

[2] Debt service on bonds sold as of December 31, 1971 plus estimated debt service on $50 million sale anticipated during last half of 1971–72 fiscal year; $150 million sales anticipated during 1972–73 fiscal year and $75 million sales during 1973–74 fiscal year. Assumes 5.5 percent average interest rate on sales.

[3] Includes sales from proposed $454 million bond issues ($294 million—health science facilities, $160 million—community college construction) to be placed before the electorate—November 7, 1972. If passed we assume sales of $85 million in 1972–73, $100 million in 1973–74, $80 million in 1974–75, $40 million in 1975–76 and $30 million in 1976–77 at projected 5.5 percent interest rate.

Table 9

Estimated Interest and Redemption Charges on State School Building Aid Bonds, 1970–71 to 1976–77

Fiscal year	*Total debt service*	*Debt service on authorized bonds* 1	*Debt service on proposed new issue* 2	*General fund portion* 3
1970–71	$103,495,797	$103,495,797	--	$50,431,044
1971–72	113,190,703	113,190,703	--	55,309,570
1972–73	124,284,642	124,284,642	--	65,834,642
1973–74	127,236,462	123,111,462	$4,125,000	67,435,324
1974–75	140,847,999	121,178,749	19,669,250	74,649,439
1975–76	151,339,969	119,289,969	32,050,000	80,210,183
1976–77	149,782,476	114,751,226	35,031,250	79,384,712

1 Accrual basis. Debt service on bonds sold as of December 31, 1971, plus estimated debt service on $94.9 million sale anticipated during 1972–73. Assumes 5.5 percent average interest rate on sale.

[2] Includes sales from proposed $350 million bond issue to be placed before the electorate—June 6, 1972. If passed, we assume sales of $150 million in 1973–74, $150 million in 1974–75 and $50 million in 1975–76 at projected 5.5 percent interest rate.

[3] Includes both currently authorized and proposed new issues. General Fund portions projected at 1972–73 level of 53 percent of total.

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REVENUE ESTIMATES

Summary

The longest economic expansion in the nation's history occurred during the 1960's. This expansion started in February 1961, peaked in November 1969, and was followed by a recession which lasted one year at the national level, and a little longer in California. When the economy is expanding, as during the 1960's, the main problem facing the revenue estimator is predicting the magnitude of the annual *growth* in revenues. When errors are made, typically they understate growth, and therefore, the revised estimates show a healthier financial condition for the state.

This pattern changed with the 1970 recession. Table A shows that General Fund revenues during 1970–71 were $236 million, or 5.2 percent, below what they would have been without the economic downturn. Table B shows that each revised estimate of tax revenues since June 1970 has been a downward adjustment, but the magnitudes are decreasing. If California participates as expected in the economic recovery during 1972, future tax revenue revisions probably will be increases, and this factor will allow the Legislature more freedom in balancing the budget.

Table A
History of the Department of Finance's 1970–71 Estimates of General Fund Tax Revenues (in millions)

	Original (Feb. 1970) estimates	*Revisions June 1970*	*Revisions Feb. 1971*	*Revisions June 1971*	*Actual*	*Change Feb. 1970 to Actual*
Retail sales	$1,848	$1,845	$1,810	$1,807	$1,808	—$40
Personal income	1,418	1,355	1,335	1,258	1,264	—154
Bank and corporation	583	555	545	527	532	—51
All others	677	677	679	689	686	+9
Total	$4,526	$4,432	$4,369	$4,281	$4,290	—236

We are in general agreement with the Department of Finance's economic forecasts for both California and the nation. However, we are more optimistic on revenues, and therefore believe the Department of Finance's General Fund revenue estimates could be low by $40 million in 1971–72, and another $50 million in 1972–73. While this $90 million, two-year difference appears large in absolute terms, it is a difference of less than 1 percent.

Table B
Downward Revisions In General Fund Tax Revenues [1] (in millions)

	1969–70	*1970–71*	*1971–72*
June 1970	–$18	–$93	—
January 1971	—	– 63	—
June 1971	—	– 88	–$114
January 1972	—	—	–21
Total	–$18	–$244	–$135

[1] For 1970–71 Table A, also shows the difference between June 1971 estimates and actual collections.

Analysis of the Department of Finance's Revenue Estimates

1971–72 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 budget estimates anticipated a moderate upturn in the California economy during 1971, with personal incomes increasing by 6.1 percent, employment growing by 89,000, new car sales totaling 950,000, and a strong upswing in residential construction with 190,000 building permits. The growth in consumer prices was expected to slow to 4.4 percent compared to a 5.5-percent increase in 1970. However, the unemployment rate was expected to increase from 6.0-percent in 1970 to 7.0-percent in 1971.

By May it was apparent that the upturn in the economy was being delayed. As a result, the Department of Finance lowered its estimate of personal income gain to 5.9-percent, lowered employment growth to 34,000, and was more pessimistic on both the unemployment rate (7.2%) and inflation (4.5%). In June the department translated these lower economic projections into a $124.7 million downward revision in revenue estimates with the major reductions occurring in personal income ($73 million) retail sales ($40 million) and bank and corporation taxes ($8 million). The drop in income tax estimates was

Table 1
History of the Department of Finance's 1971–72
General Fund Revenue Estimates
(in millions)

Taxes	*Original budget estimates Feb. 1971*	*Subsequent revisions June 1971*	*Legislation*	*Jan. 1972*	*Revised total* [1]
Alcoholic beverage	$120.0	$0.2	--	—$0.7	$119.5
Bank and corporation	616.0	—8.0	53.0	12.0	673.0
Cigarette	174.5	—1.5	--	—1.4	171.6
Horseracing	65.3	—6.1	--	--	59.2
Inheritance and gift	202.4	12.0	-- [2]	—3.4	211.0
Insurance	175.3	2.2	--	—6.5	171.0
Personal income	1,510.0	—73.0	371.0 [3]	—61.0	1,747.0
Private car	4.4	--	--	0.4	4.8
Sales and use	1,970.0	—40.0	3.0	40.0	1,973.0
Total taxes	$4,837.9	—$114.2	$427.0	—$20.6	$5,130.1
Other revenues	195.0	—10.5	0	—5.7	178.8
Total General Fund Revenue	$5,032.9	—$124.7	$427.0	—$26.3	$5,308.9

[1] As shown in the Governor's 1972–73 Budget.
[2] Consists of a $4-million increase in gift taxes offset by a $4 million decrease in inheritance taxes.
[3] This is a net figure which includes the gross receipts from withholding, offset by the 20-percent tax forgiveness, and a $53-million reduction in accruals after this tax is converted to a cash basis.

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mainly for wages and salaries and for taxes from proprietors. By contrast, the department anticipated an increase in taxes from capital gains. A weaker automobile sector and a general softness in the economy were the main reasons for the lower sales tax estimates.

In December 1971, the Legislature enacted and the Governor signed Chapter 1, of the First Extraordinary Session (AB 1). This measure initiated a system of personal income tax withholding, granted 20-percent forgiveness of 1971 income tax liabilities, and increased bank and corporation taxes. Other legislation Chapter 1741, Statutes of 1971, (AB 2109) changed sales tax exemptions and the timing of gift tax payments. When these measures were enacted, it was generally agreed they would yield $455 million in new General Fund revenue during 1971–72. In the Governor's 1972–73 Budget, the Department of Finance has lowered its revenue estimate for this legislation to $427 million. The main differences are a higher cost for the 20 percent forgiveness and a greater delay in the initial cash flow from withholding.

A review of economic conditions at the end of 1971 indicated a disappointing recovery. Employment in California reached bottom in March 1971. It was stagnent from April to August, and only since last September has it shown a healthy growth rate. The actual increase in personal incomes was a disappointing 5.2 percent. The total number of jobs actually declined by 31,000 from the prior year level. *This was the first annual loss in the total number of jobs since the 1958 recession.* Buoyant new car and residential construction markets partially offset these depressing conditions. About one million new cars were sold during 1971, compared to 870,000 the year before. The number of housing permits was 250,000, a 29-percent increase over the 1970 level.

In January 1972, the Department of Finance also revised the revenue estimates for the old tax base and the net change amounted to a $26.3 million reduction. Led by the growth in car sales, building supplies, and the expectation of a good 1971 Christmas trade, a $40 million upward revision was made in the sales tax estimate, and this amount exactly cancels out the adjustment of last June. The most significant change was the $61 million drop in personal income taxes with most of the loss occurring in the taxes attributable to capital gains. Last June the department estimated (Table 2) that $145 million would be collected from this tax source. However, it reduced this estimate after reviewing the November 1971 Franchise Tax Board report on the actual tax collected from the prior year's returns. This report indicated that 1970 had been a very poor capital gains year, and the department realized that the old formula for estimating this tax had not foretold the magnitude of the revenue loss. Therefore it developed a new formula and reduced this capital gains estimate by $64 million or 44 percent. The difference between the $61 million reduction in income tax estimates since last June, as shown in Table 1, and the $88 million reduction shown in Table 2, is due to changes in accruals and other accounting features of this tax.

Table 2
1971-72 Personal Income Tax Estimate
(in millions)

Tax attributed to	*Original budget estimate Feb. 1971*	*Revised estimates June 1971*	*Revised estimates Jan. 1972*	*Change Feb. 1971 to Jan. 1972*
Wages and salaries	$919	$884	$892	—$27
Proprietors	220	200	184	—36
Dividends	83	83	73	—10
Interests	63	62	60	—3
Rent	23	23	21	—2
Miscellaneous	34	31	29	—5
Capital gains	137	145	81	—56
Less credits	—12	—12	—12	--
Total Tax Assessed	$1,467	$1,416	$1,328	—$139

Based on data gathered from a questionnaire from a broad cross section of corporate taxpayers, the department has increased its bank and corporate tax revenues by $12 million. During 1971, all major industry groups except services had increases in profits compared to the previous year.

The reduction in "other revenues" is primarily an accounting change. Some of the agency charges were converted from General Fund revenues to reimbursements which are used to offset expenditures.

Summary, 1971-72. In our view, the Department of Finance's latest revenue estimates for 1971-72 could be $40 million too low. Our own estimates indicate a stronger growth in retail sales taxes ($+10 million), and a higher level of taxes from capital gains ($+18 million). Our third difference relates to the loss in withholding tax collections because of the late enactment of the tax bill. The department, when it made this forecast in the middle of December, increased this loss by $12 million. Information available in mid-January indicates that the loss may not be as severe as the department feared, and therefore we have added back this $12 million in income tax revenues.

1972-73 General Fund Revenue Estimates

The Department of Finance's General Fund revenue estimates for the budget year are shown in Table 3. These data indicate a $468.3 million or 8.8 percent increase over the anticipated level for the current year.

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Table 3
Estimated State Revenue Collections During 1972–73
(in millions)

	1971–72	1972–73	Increase Amount	Increase Percent
General Fund				
Sales and use	$1,973.0	$2,110.0	$137.0	6.9
Personal income	1,747.0	1,880.0	133.0	7.6
Bank and corporation	673.0	770.0	97.0	14.4
Inheritance and gift	211.0	291.1	80.1	38.0
Cigarette	171.6	173.8	2.2	1.3
Insurance	171.0	187.0	16.0	9.4
Alcoholic beverage	119.5	126.0	6.5	5.4
Horseracing	59.2	62.8	3.6	6.1
Interest on investments	44.9	45.8	.9	2.0
Health Care Deposit Fund	46.6	48.0	1.4	3.0
Other sources	92.1	82.7	—9.4	—10.2
Total General Fund	$5,308.9	$5,777.2	$468.3	8.8
Special Fund				
Motor Vehicle				
Fuels	$704.4	$731.4	$27.0	3.8
Registration, weight	287.6	298.6	11.0	3.8
License (in lieu)	256.6	270.8	14.2	5.5
Transportation	27.3	29.4	2.1	7.7
Cigarette	73.5	74.5	1.0	1.4
Alcoholic beverage	12.8	13.0	.2	1.6
Horseracing	8.3	8.9	.6	7.2
Other	115.0	162.3	47.3	41.1
Total Special Funds	$1,485.4	$1,588.8	$103.4	7.0
Totals	$6,794.3	$7,366.0	$571.7	8.4

Sales Taxes. The sales and use tax, despite the adoption of income tax withholding, is still the largest source of state revenue. Table 4 contains the department's estimates of taxable sales for calendar years 1971 through 1973. These estimates assume a moderate 6.5 percent increase in total taxable sales during 1972, which is a lower growth rate than the 7.5 percent anticipated increase in disposable (after tax) incomes. Both the automoble and building material groups are expected to have smaller increases in 1972 then they had in 1971.

Table 4
Taxable Sales in California
(in millions)

	1971	1972	Percentage increase	1973	Percentage increase
Retail stores	$21,819	$23,236	6.5	$24,763	6.6
Autos and parts	7,886	8,243	4.5	8,559	3.8
Building materials	4,744	4,956	4.5	5,085	2.6
Manufacturing, wholesaling, and miscellaneous outlets	12,361	13,435	8.7	14,593	8.6
Totals	46,810	49,870	6.5	53,000	6.3

NOTE: Data does not include the effect of such 1971 legislation as Chapter 1400, SB 325 (gasoline), or Chapter 1741, AB 2109 (candy, hot food and auto use tax). Effect of Chapter 1, 1971 1st Ex. Sess., is included.

Last year the automobile sector grew by 15.6 percent, because both the spring and fall sales of new cars were inflated. The spring increase (30,000 additional cars) represented a recoupment from the prior year's General Motors' strike. The fall increase (20,000 additional cars) was due to the price freeze and the announcement that the federal excise tax would be repealed. One million new cars, including those 50,000 of inflated purchases, were sold in California during 1971. The Department of Finance anticipates that 1,050,000 new cars will be sold in 1972.

Building material sales increased by 8.8 percent in 1971, when 250,000 residential permits were issued. In 1972, the department expects this sector to slow down in the second half of the year as vacancies in residential units increase. The department anticipates that both the automobile and building material sectors will have slower rates of growth in 1973.

The buoyant sector of taxable sales is the manufacturing and wholesaling group with anticipated increases of 8.7 percent in 1972. The growth in plant and equipment investments is responsible for this strong sector.

Personal Income Tax. The second largest revenue source is the personal income tax which is expected to increase by 7.6 percent in 1972–73. This percentage figure is somewhat misleading because the net revenue from the first year windfall effects of withholding, even after deducting 20-percent forgiveness, will be $140 million higher than the budget year revenues. A more realistic comparison of the changes in this tax can be obtained by examining Table 5 which shows the compositon of the self-assessed taxes by types of income. These data indicate that wages and salaries and capital gains will account for practically all of the revenue increase in 1972. They also demonstrate the volatile nature of the taxes on capital gains. For example, in 1969, these taxes were $97 million, and last June the Department of Finance estimated that in 1970 these would be $104 million. The actual

Table 5
Personal Income Taxes by Sources of Income
(in millions)

	Income Years				*Increase 1972 over 1971*	
Taxes attributed to	*1969*	*1970*	*1971*	*1972*	*Amount*	*Percent*
Wages and salaries	$744	$826	$892	$1,034	$142	15.9
Proprietors	182	181	184	193	9	4.9
Dividends	74	65	73	75	2	2.7
Interests	49	54	60	65	5	8.3
Rent	21	22	21	22	1	4.8
Capital gains	97	58	81	100	19	23.5
Miscellaneous	29	29	29	31	2	6.4
Less credit	—12	—12	—12	—12	0	0
Total Tax Assessed	$1,184	$1,223	$1,328	$1,508	$180	13.6
Annual increases						
Amount	$111	$39	$106	$180		
Percent	10.3	3.2	8.7	13.6		

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collections, however, were only $58 million. Another interesting aspect about this table is the apparent sluggishness in the growth of taxes from proprietors. These figures, however, are adjusted for the law change which allowed certain proprietors to be taxed as professional corporations. That law reduced proprietorship taxes by $25 million in 1972, and these reductions have been growing rapidly during the last four years.

Bank and corporation taxes, the third largest General Fund revenue source, are expected to increase by $97 million or 14.4 percent during the budget year. Both of these figures are somewhat distorted because Chapter 1 increased these taxes by $53 million during the current year, and by $100 million in 1972–73. Therefore, half of the total revenue gain represents the difference between the first and the full year effect of legislation enacted last year. Table 6 shows the department's estimates of corporate income by type of industry. These estimates were obtained by sending a questionnaire to a broad group of businesses, representing all industry classifications, and covering about 45 percent of the total tax base. The results indicate that corporate income is expected to increase by 7.6 percent in 1971 and 10.6 percent in 1972, compared to national increases of 11.1 and 15.4 percent for these two years.

Table 6
Taxable Corporate Income in California
(in millions)

Industry	*1970*	*1971*	*Percent change*	*1972*	*Percent change*
Agriculture	$76	$76	–	$80	5.3
Mining and oil production	239	288	20.5	310	7.6
Construction	236	238	0.8	230	–3.4
Manufacturing	2,248	2,580	14.8	2,987	15.8
Trade	1,539	1,563	1.6	1,680	7.5
Service	423	397	–6.2	427	7.6
Financials subject to bank tax	621	656	5.6	736	12.2
Real estate and other financials	486	518	6.6	550	6.2
Utilities	852	918	7.7	1,000	8.9
Totals	$6,720	$7,234	7.6	$8,000	10.6

Neither Table 3 nor Table 6 reflect the December 1971 regulation change by the Franchise Tax Board which modified the bad debt reserve allowances of banks and savings and loan associations. This change will increase these corporate taxes by about $15 million during 1972–73. Due to the lateness of the board's action, this revenue increase was not included in budgetary totals but will be recognized in Department of Finance change letters to the fiscal committees.

Table 3 indicated that inheritance and gift taxes would increase by $80.1 million or 38 percent in 1972–73. However, $67 million of this increase is attributable to Chapter 1 which changed the timing of these tax payments with the result that cash collections will be accelerated during the budget year.

Each year the Department of Finance surveys the major insurance companies to obtain their estimates of the growth in premiums. A combination of premium volume plus changes in rates determines the growth in this tax base. The latest survey indicated no significant increases in rates were anticipated during 1972. Therefore, the 9.4 percent growth in taxes represents an increase in real volume.

Summary, 1972–73. In our view, the budget estimates of General Fund revenue could be $50 million too low during 1972–73. Our own estimates indicate a stronger growth ($+25 million) in sales and use taxes, especially the retail store sector. Studies we have conducted in the past show a strong correlation between spendable income (disposable income minus savings) and taxable sales of retail stores. When we applied this historical relationship to calendar 1972 and 1973 taxable sales, our results were about $25 million above those in the budget. We also are more optimistic on the growth in the taxes on capital gains, ($+25 million), because 1972 looks like a strong year for corporate profits and the stock market. If withholding receipts come in as we anticipate, 1971–72 income taxes will be increased, and 1972–73 income taxes *reduced* by $12 million. The final adjustment is the $15 million revenue increase from the Franchise Tax Board's change in the bad debt reserve. These changes total a net increase of $53 million which we rounded to $50 million.

1972–73 Special Fund Revenues

Table 3 indicated that Special Fund revenues are expected to increase by $103.4 million, or 7 percent in the budget year. Motor vehicle taxes and licenses will account for about half of this increase. Most of these tax levies use specific rather than ad valorem rates and therefore they do not benefit from inflation or have growth rates comparable to General Fund revenues.

The other half of the total gain involves a $46.4 million increase in oil and gas royalties which consists of: (1) termination of the payments to the Long Beach unit field contractor for advance royalties and development costs, with the effect that these revenues now go to the state, and (2) a shift in the distribution of $25 million in revenues from the Central Valley Water Project Construction Fund (a nongovernmental cost fund) to the California Water Fund.

The "other revenue" category also includes a $3.4 million increase in fish and hunting licenses.

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

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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 1971 and comment on the forecasts for 1972. The next section will analyze California's economic conditions.

1971—The Elusive Recovery

A year ago, predictions of GNP for 1971 by most economic forecasters clustered in the range of $1,045 to $1,050 billion. Standing well above this consensus level was the $1,065 billion "goal" of the President's Council of Economic Advisers. Current estimates now put GNP at $1,052 billion for the year, although recent Commerce Department announcements of downward revisions in second and third quarter data indicate this may be high. The apparent accuracy of the consensus prediction is misleading, since most forecasters did not anticipate the wage price freeze and other features of the administration's "new economic policy".

Based on the preliminary GNP estimate of $1,052 billion, the level of economic activity measured in current dollars rose by 8 percent in 1971. Real growth, however, amounted to only 3.1 percent with a 4.8 percent rise in prices accounting for the balance of the dollar gain. The economy was off to a strong start in the first quarter of the year with the annual rate of GNP advancing by $32 billion. A major contribution to the rise was a surge in auto buying following the fourth quarter 1970 auto strike. Increases of $22 billion and $18 billion, at annual rates, were posted in the second and third quarters, and preliminary data indicate a fourth quarter gain of about $22 billion. The final two quarters were bolstered by a second bulge in auto sales occurring in September and October, following the announcement of the President's plan to rescind the 7-percent excise tax. Total purchases of consumer durables, however, leveled off in the fourth quarter. Residential construction was strong throughout the first three quarters, contributing $10 billion to the total $78 billion gain in GNP for the year. Nonresidential investment lagged toward the end of the year possibly in anticipation of the promised investment credit in 1972.

Despite the bright spots in housing and autos, the rest of the economy was sluggish during 1971. The persistent high level of unemployment throughout the year prevented the economy from achieving the substantial real growth rate that is necessary for a true recovery following a recession year. The unemployment rate rose to over 6 percent in May, and hovered close to that level for the remainder of the year. Total civilian employment rose by only 500,000 in 1971, the smallest annual gain since 1961, well below the 725,000 employment increase of last year, and a fraction of the 2 million gain in 1969.

The unemployment situation continues to be aggravated by a high rate of entry into the civilian labor force of women and teenagers, and by the return to the labor force of men released from the Armed Forces.

1972 Forecasts

The Department of Finance estimates that GNP will total $1,146 billion in 1972, a gain of 8.9 percent over 1971. Price increases are expected to account for 3.7 percent of this gain while real output will be up 4.9 percent. In total, the department's forecast coincides very closely with those of nationally recognized economists. A short comparison of these forecasts is contained in Table 7 which indicates that the department's estimate of real growth is on the low side of the spectrum while its estimate of price increases is on the high side. All of these estimates were prepared before the January 14, 1972 announcement by the U.S. Department of Commerce which stated that the previously published GNP figures for the first three quarters of 1971 had overstated the real growth in the economy. As a result of this announcement, many forecasters will be inclined to reduce their estimates of real growth in 1972.

Table 7

Comparison of 1972 GNP Forecasts

	GNP (billions)	*Real growth*	*Price increase*	*Unemployment rate*
Department of Finance	$1,146	4.9%	3.7%	5.5%
UCLA	1,148	5.3	3.7	5.5
United California Bank	1,150	6.5	3.0	5.4
Walter Heller	1,150	6.0	3.3	5.6
Wharton model	1,150	5.5	3.6	5.4

A more detailed comparison of GNP estimates is contained in Table 8, which also includes the national forecasts of the UCLA Graduate School of Business Administration and the United California Bank. This data shows that the latter is the most optimistic on personal consumption expenditures, especially durables, while the department has the highest growth in residential investment. Both UCLA and UCB anticipate a stronger growth in inventories during 1972. UCLA also has the highest employment total, and savings rate.

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

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Table 8
GNP and National Economic Data
(in billions of dollars)

National data	Actual 1970	Actual 1971	Percentage increase	1972 Forecast[1] D.F.	1972 Forecast[1] UCLA	1972 Forecast[1] UCB
Gross national product	$974.1	$1,052.0	8.0	$1,146.0	$1,148.4	$1,150
Consumer expenditures	615.8	665.6	8.1	723.5	722.8	725
Durables	88.6	102.0	15.1	110.8	109.0	112
Nondurables	264.7	280.6	6.0	302.7	303.4	303
Services	262.5	283.1	7.8	310.0	310.4	310
Private investment	135.3	152.4	12.6	169.0	169.7	170
Fixed investment	132.5	148.8	12.3	162.4	159.6	161
Residential	30.4	40.9	34.5	46.4	43.8	44
Other	36.8	38.6	4.9	41.3	41.7	42
Producers durables	65.4	69.2	5.8	74.7	74.1	75
Change in inventories	2.8	3.6	28.6	6.6	10.1	9
Net exports	3.6	1.2	—66.7	1.5	1.1	5
Government purchases	219.4	232.7	6.1	252.0	254.8	250
Federal	97.2	97.1	—0.1	102.0	101.9	101
Defense	75.4	72.0	—4.5	74.0	73.7	73
Other	21.9	25.1	14.6	28.0	28.2	28
State and local	122.2	135.6	11.0	150.0	152.9	149
GNP in 1958 dollars	$720.0	$742.0	3.1	$779.1	$781.8	$790
GNP deflator	135.3	141.8	4.8	147.1	146.9	146
Personal income	$803.6	$858.5	6.8	$928.0	$929.3	$929
Disposable income	687.8	742.9	8.0	804.9	805.5	808
Savings	54.1	58.3	7.8	61.5	62.4	59
Corporate profits	75.4	83.8	11.1	96.7	–	97
Consumer price index	116.3	121.3	4.3	125.5	125.5	125
Employment (000)	78,627	79,124	0.6	80,860	81,100	80,800
Unemployment (000)	4,088	4,963	21.4	4,720	4,700	4,600
Unemployment rate	4.9%	5.9%	20.4%	5.5%	5.5%	5.4%

[1] Department of Finance, University of California at Los Angeles Graduate School of Business Administration and United California Bank.

Consumer Expenditures (63.3 percent of GNP)

During 1971, consumers disposable (after tax) incomes increased by $55 billion, their expenditures grew $50 billion, and the remainder went into higher personal savings. Table 9 shows that spending on durable goods including autos, household furniture, and television sets, grew by 15.1 percent in 1971, the second highest growth rate for this category in the last two decades. This unusual growth rate occurred because 1970 formed a depressed base for durables (i.e. General Motors strike), there were inflated automobile sales at both the beginning and end of the year, and the high level of housing starts boosted the spending on household related items. The general expectation for 1972 is a more normal growth rate in durables with the housing related items continuing to be strong, and auto sales equaling their 1971 record of 10.2 million units including 1.6 million of imports.

The Department of Finance expects a stronger growth in nondurables such as clothing, food and gasoline during 1972. This sector typically grows at the same rate as changes in disposable income, unless part of the growth is diverted to higher durable purchases.

In 1971, service expenditures became the largest consumer expenditure category surpassing nondurables. The department expects a 9.5-percent growth in this sector during the current year.

Table 9 compares the levels and growth rates of personal incomes, consumer expenditures, the savings rate and consumer prices. The anticipated 2.2-percent increase in national employment, plus higher compensation rates, will lead to the 8.1-percent increase in personal incomes. The department expects only a modest drop in the personal savings rate during 1972. Traditionally, consumers save more during times of uncertainty or recession. During both 1970 and 1971, the savings rate hovered slightly below 8 percent, compared with a normal level of 6.5 percent. If there is a dramatic improvement in consumer confidences during 1972, then this savings rate could drop one or more points and cause a real boom in consumer expenditures.

The department expects consumer prices to increase by 3.5 percent during 1972, which is a better record than 1971, but still above the national price board's 2.5-percent guideline.

Table 9

Consumer Incomes, Expenditures, Savings and Prices

(in billions)

	1970	*1971*	*Percentage increase*	*1972*	*Percentage increase*
I. Consumer Expenditures:					
Durables	$88.6	$102.0	15.1	$110.8	8.6
Nondurables	264.7	280.6	6.0	302.7	7.9
Services	262.5	283.1	7.8	310.0	9.5
Totals, Expenditures	$615.8	$665.6	8.1	$723.5	8.7
II. Personal income	$803.6	$858.5	6.8	$928.0	8.1
III. Disposable income	687.8	742.9	8.0	804.9	8.3
IV. Personal Savings	54.1	58.3	–	61.5	–
V. Savings rate—%	7.9%	7.8%	–	7.6%	–
VI. Consumer price increases	–	4.3%	–	3.5%	–

Private Investment (14.5 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 11.5 percent, but the growth rate dropped to 5.5 percent in 1970, and 2.2 percent in 1971. The latest U.S. Department of Commerce survey indicates a 9-percent growth during 1972. The federal changes in the tax depreciation schedule, the granting of a 7 percent tax credit, and the anticipated general improvement in the economy, all will combine to boost these expenditures.

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Residential construction was the economic pacesetter during 1971. Expenditures in this category increased from $30.4 billion in 1970 to $40.9 billion in 1971, or a gain of 34 percent. The number of housing starts increased from 1.5 million in 1970 to almost 2 million in 1971, and by November of last year the annual rate had reached a peak of 2.3 million units. During 1972, it is anticipated that housing starts will continue at the 2 million annual level during the first half of the year, and then taper off in the second half, with an overall average rate slightly below last year's level.

The Department of Finance expects a $6.6 billion in business inventories during 1972. By contrast, several other forecasters such as UCLA, UCB, and the Wharton model expect increases in the neighborhood of $9 to $10 billion. One of the reasons for this difference is that the department is less optimistic on the rate of real growth in the economy.

Government Purchases (22.1 Percent of GNP)

Federal national defense purchases declined by $3.4 billion in 1971, while nondefense purchases increased by $3.3 billion, leaving a net decline of $100 million. The Department of Finance anticipates a $2-billion increase in defense purchases during 1972, primarily to fund the military pay increases. Nondefense outlays are also expected to continue their upward trend. During the current fiscal year, the federal deficit is estimated at $38.8 billion, and there is a strong possibility, due to the recently enacted tax reductions, that it will exceed the $25-billion level in 1972-73. Deficits of these magnitudes add a very strong stimulus to the national economy, and they pose the problem of renewed inflation after Phase II controls are relaxed or eliminated.

State and local expenditures are expected to increase at their historical rates.

Employment. While the total civilian labor force was growing by 1,372,000 during 1971, 875,000 persons, accounting for almost two-thirds of the labor force increase, were being added to the unemployment rolls. The net gain of 497,000 wage and salary workers, the smallest since 1961, represented an advance of only 6/10 of 1 percent in civilian employment. The pattern of employment change in 1971, as shown in Table 10, is strikingly similar to that of 1970, with employment growth in services, trade, local government and agriculture largely offset by losses in the construction and manufacturing sectors.

The national unemployment rate, which averaged 4.9 percent during 1970, peaked at 6.2 percent in May of 1971, dropped to the year's low of 5.6 percent in June, then climbed back to about the 6-percent level where it remained for the balance of the year. Consistent with the shift of jobs from construction and manufacturing into services, trade, and government, the unemployment rate among "blue collar" workers stayed close to 7½ percent during most of the year.

The Department of Finance forecasts a drop in the average rate of unemployment to 5.5 percent for 1972. Achievement of this average will require that the rate approach the 5 percent level by year end. Employment is forecast to rise by 1.74 million during the year, absorbing the expected 1.5 million new entries into the labor force and reducing unemployment by 240,000.

Table 10

Wage and Salary Workers in Nonagricultural Establishments (in thousands)

			Increase	
	1970	*1971*	*Amount*	*Percent*
Mining	622	599	—23	—3.7
Construction	3,345	3,257	—88	—2.6
Finance, insurance and real estate	3,690	3,794	104	2.8
Transportation and utilities	4,504	4,484	—20	—0.4
Services	11,630	11,903	273	2.3
Government:				
Federal	2,705	2,661	—44	—1.6
State and local	9,830	10,172	342	3.5
Trade	14,922	15,154	232	1.6
Manufacturing	19,369	18,613	—756	—3.9
Totals	70,616	70,637	21	-
Labor force	82,715	84,087	1,372	1.6
Total employment	78,627	79,124	497	0.6
Unemployment	4,088	4,963	875	21.4
Unemployment rate	4.9%	5.9%		

Corporate Profits. Corporate profits before taxes recovered moderately during 1971, advancing by 11 percent to $83.8 billion, still considerably below the peak rate of $89 billion achieved in the 4th quarter of 1968. Recorded profits in 1971 were reduced by the liberalization of depreciation rules by the IRS. The Department of Commerce estimated that the higher depreciation charges permitted by the new rules reduced the annual rate of corporate profits during the first quarter of 1971 by about $3½ billion. Profit margins (profits as a percent of sales) continued the downward trend during 1971 that started in 1966.

Corporations experienced an improvement in liquidity during the year, stemming in part from the higher level of after tax profits and larger capital consumption allowances. Also contributing to the more comfortable liquidity position was a shift in the corporate debt structure from short-term to long-term obligations.

Improved profit margins and substantial increases in sales volume are expected to boost corporate profits dramatically in 1972. A record $96.7 billion is anticipated by the Department of Finance, which is a 15.4 percent increase. Most other forecasters have increases of this same magnitude.

Wages. The wage-price freeze played a significant part in holding

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back wage increases during the last half of 1971. Up until August when the freeze was imposed, wages had been increasing much more rapidly than productivity. During the first eight months of 1971, major labor union contract settlements provided a first-year adjustment of 11.8 percent, almost exactly the same as the increase registered the year earlier. Construction contracts were the pacesetters with first-year settlements averaging 13.5 percent, which is comparable to the record 17.6-percent rise registered during 1970.

The pay board has indicated that it will attempt to hold contract settlements at the 7-percent level during 1972.

For all sectors, union and nonunion, the Department of Finance anticipates a 6-percent growth in wages and salaries during 1972.

Monetary Policy and Interest Rates. During the first half of 1971, monetary policy was stimulative and the money stock increased at an 11.6-percent annual rate, the fastest six-month increase since World War II. About midyear, the monetary authorities became concerned over the persistent inflation, and as a result, slowed the growth in monetary aggregates. After the Prsident announced the price freeze, there was less pressure on the monetary authorities to control inflation.

Both long and short-term interest rates dropped during the second half of 1971, with the biggest declines occurring in short-term rates. By January 1972, Treasury bills traded at their lowest rate since March 1971.

There is a general expectation that short-term rates will decline by another one-fourth to one-half of 1 percent over the next two or three months, and then start moving up again as corporate and Treasury borrowing accelerates. Long-term rates probably will decline in the near future and increase moderately near the end of 1972.

Both the UCLA and Walter Heller forecasts anticipate a strong (8 or 9 percent) growth in the money supply during 1972 in order to avoid straining interest rates when business and government credit demands increase during the year.

ANALYSIS OF CALIFORNIA ECONOMIC CONDITIONS

Last year the nation led California in growth of personal income, corporate profits and employment. A comparison of Tables 8 and 11 shows that personal income grew by 6.8 percent in the nation, but only 5.2 percent in California. Corporate profits advanced 11.1 percent in the nation, but only 7.6 percent in California. Employment registered a small increase, 0.6 percent, in the nation, but declined in California. Nationally, the unemployment rate was 5.9 percent, while California had a 7.0 percent rate. Both areas experienced the same rate of inflation, 4.3 percent.

Next year, the Department of Finance and other forecasters predict that the economic recovery in California will generally match the national upturn. For example, the department estimates that personal

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income will increase by 8.1 percent in the nation, and 8.0 percent in California. Employment is anticipated to grow by 2.2 percent in both areas.

The nation will continue to have a higher rate of growth in corporate profits. The unemployment rate is expected to decline to 5.5 percent in the nation and to 6.1 percent in California.

Table 11 contains the Department of Finance's economic estimates for California, along with those of UCLA and UCB. This information shows general agreement among these forecasters on both the direction and the magnitudes of the economic changes during 1972. In this table, we have adjusted the UCB estimates to coincide with the 1971 base figures used by both the Department of Finance and UCLA.

Table 11
California Economic Data
(in billions of dollars)

				1972 forcasts		
	1970	*1971*	*Percentage change*	*DF*	*UCLA*	*UCB*
Personal income	$88.8	$93.4	5.2%	$100.9	$100.9	$100.3
Disposable income	77.9	83.0	6.5	89.2		
Taxable corporate profits	6.7	7.2	7.6	8.0		
Taxable sales	43.2	46.8	8.3	49.9		
Employment (000)	8,036.0	8,005.0	—0.4	8,180.0	8,172.0	8,180.0
Unemployment (000)	519.0	600.0	15.6	530.0	549.0	
Unemployment rate	6.1%	7.0%		6.1%	6.3%	6.1%
Number of building permits (000	194.0	250.0	28.9	220.0		210.0
New car sales (000)	874.0	1,000.0	14.4	1,050.0		1,030.0
Consumer price index	114.9	119.8	4.3	124.0	124.2	123.3

Employment and Unemployment

During the decade of the 1960's, California's employment increased by an average of 220,000 a year. In 1970, as a result of the recession, this annual growth slowed to only 25,000. Last year, California lost 31,000 jobs, *the first annual decline in employment since the 1958 recession.* Table 12 shows where the weaknesses were in employment, by sector. Considerable publicity has been given to the decline in aerospace employment. However, weaknesses in services, trade and "other manufacturing" employment were the main factors which depressed the California labor picture during 1971.

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Table 12
California Employment by Type of Industry
(in thousands)

Industry	1970	1971	Increase Amount	1972	Increase Amount
Mining	31	30	–1	30	–
Agriculture	289	287	–2	283	–4
Construction	303	297	–6	300	3
Finance	374	385	11	400	15
Transportation and utilities	459	453	–6	465	12
Government	1,425	1,455	30	1,490	35
Federal	327	318	–9	319	1
State and local	1,098	1,137	39	1,171	34
Services	1,266	1,272	6	1,315	43
Trade	1,531	1,554	23	1,590	36
Manufacturing	1,558	1,470	–88	1,500	30
Aerospace	497	440	–57	435	–5
Other	1,061	1,030	–31	1,065	35
Totals employment	8,036	8,005	–31	8,180	175
Civilian labor force	8,555	8,605	50	8,710	105
Unemployment	519	600	81	530	–70
Unemployment rate	6.1%	7.0%	–	6.1%	–

The Department of Finance anticipates a 175,000 increase in employment during 1972, with strong gains being registered in finance, services, state and local government, and "other manufacturing" employment. The UCLA forecast has a similar total gain, but it anticipates a higher growth in trade employment and no gain in "other manufacturing."

Table 13 shows the recent history of unemployment rates in California. From September 1970 to October 1971, unemployment hovered around the 7-percent rate. These rates declined last fall when employment started its upturn.

Table 13
Unemployment in California, by Months

Months	1970 Amount (thousands)	1970 Percent	1971 Amount (thousands)	1971 Percent
January	458	4.9%	681	7.0%
February	514	5.0	696	6.7
March	484	5.2	676	7.1
April	438	5.5	594	7.4
May	472	5.8	604	7.4
June	543	5.9	672	7.3
July	560	6.2	631	7.0
August	555	6.4	608	7.0
September	508	7.0	513	7.1
October	507	7.2	486	7.0
November	578	7.0	NA	6.2
December	613	6.9	NA	6.1

One of the oddities about recent employment and unemployment statistics is that California's population has grown faster than the nation's, but our civilian labor force has grown more slowly. In 1971, the national civilian labor force increased by 1.6 percent, but California's increased by only 0.6 percent, which is down significantly from the growth rates recorded in previous years. The pattern of our out-migration and differences in the labor force participation rate are offered as explanations of this situation.

Residential Construction

Table 14 shows tht 250,000 housing units were authorized in 1971, the largest volume since 1964. This table also indicates that multiples accounted for almost 55 percent of the total units. In addition to these housing permits, 28,670 mobilehomes were sold in California during 1971, an increase of 42 percent over the 1970 volume.

Table 14
Number of New Private Housing Units Authorized and Mobilehome Sales in California
(in thousands)

	Housing units authorized				
Year	*Single dwelling*	*Multiple units*	*Percent multiple*	*Total*	*Mobile-homes*
1962	122.9	126.8	50.8%	249.7	NA
1963	128.7	175.5	57.7	304.2	NA
1964	112.1	146.0	56.6	258.1	NA
1965	94.8	83.3	46.8	178.1	12.2
1966	64.8	33.9	34.4	98.7	11.2
1967	67.8	43.6	39.1	111.4	11.4
1968	86.8	72.9	45.7	159.7	16.1
1969	80.1	104.1	56.5	184.2	18.7
1970	74.7	119.0	61.4	193.7	20.1
1971	113.8	136.2	54.5	250.0	28.7[1]

[1] Annual rate during first 10 months of 1971.

The Department of Finance anticipates that the number of housing units will drop to 220,000 in 1972, with the second half being weaker than the first. There are several strong indications that even this reduced level of construction in 1972 will result in overbuilding and increased vacancy rates, especially among multiple units.