CALIFORNIA LEGISLATURE

An Overview of the State's Fiscal Condition in 1982–83

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1982, to June 30, 1983

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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HON. WILLIE L. BROWN, JR.
Speaker of the Assembly

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LETTER OF TRANSMITTAL

925 L Street, Suite 650
Sacramento, California 95814
February 24, 1982

THE HONORABLE WALTER W. STIERN, *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, I submit for your consideration an analysis of the Budget Bill of the State of California for the fiscal year July 1, 1982, to June 30, 1983.

The purpose of this analysis is to assist the committee in performing its duties which are set forth in Joint Rule No. 37 as follows:

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

I am grateful to the staff of the Department of Finance and to the other agencies of state government for their generous assistance in furnishing information necessary for this report.

Respectfully submitted,

WILLIAM G. HAMM
Legislative Analyst

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INTRODUCTION

This *Analysis* reports the results of our detailed examination of the Governor's Budget. It also contains our recommendations on the budget, as well as our recommendations for new legislation.

Based on our analysis, we have recommended many reductions that appear to be warranted and can appropriately be made because:

- A program's objectives can be achieved at a lower cost to the state.
- Amounts requested have not been justified.
- A program or activity is not effective in achieving the purpose for which it was created.
- A program proposed for funding has not been authorized by the Legislature or does not fall under the legislative mandate of a particular agency.

No attempt has been made, however, to tailor these recommendations in such a way as to achieve a specific overall spending level.

Organization of the *Analysis*

The *Analysis* is divided into three parts:

Part 1, "The Budget Overview," which begins on page A-2, presents data on the budget as a whole—expenditures, revenues, and the General Fund condition—for the purpose of providing a perspective on the budget issues that the Legislature faces in 1982–83. Part 1 of the *Analysis* is divided into seven sections:

I. Summary, which begins on page A-2, briefly discusses expenditures and revenues in 1982–83;
II. Background—the Rise and Fall of the Surplus, which begins on page A-3, traces historical trends in the surplus from 1973–74 to the budget year;
III. Expenditures, which begins on page A-6, details the total spending plan of the state, highlighting the major agencies and programs;
IV. Revenues, which begins on page A-24, discusses the various sources which supply revenues to the state, as well as the economic circumstances that will influence the level of revenues in the budget year.
V. Condition of the General Fund, which begins on page A-56, describes the condition of the General Fund at mid-year 1981–82, as well as pending and proposed actions which will have an impact on the fund in both the short- and long-run.
VI. State Borrowing, which begins on page A-57, discusses general obligation and revenue bonds.
VII. State Employment, which begins on page A-71, looks at trends in the number of state employees, highlighting the agencies that are growing rapidly.

Part 2, "The Major Fiscal Issues Facing the Legislature," which begins on page B-1, discusses the major issues we have identified in our review of the state's current fiscal condition and the Governor's Budget for 1982–83. This part of the *Analysis* is divided into five sections:

I. Revenue Issues, which begins on page B-1.
II. Expenditure Issues, which begins on page B-12.
III. Local Fiscal Relief Issues, which begins on page B-32.
IV. Broad Fiscal Issues, which begins on page B-42.
V. Collective Bargaining Issues, which begins on Page B-44.

Part 3, *The Analysis of Budget Requests,* which begins on page 1, presents a consecutive item-by-item analysis of specific budget issues. This part of the report includes our recommendations for legislative action, which are based on our analytical findings.

PART 1
BUDGET OVERVIEW
I. SUMMARY

Introduction

For the second year in a row, the Legislature faces a budget that does not contain sufficient funds to maintain the existing levels of service. In terms of real purchasing power, the Governor's Budget for 1982–83 is 3.5 percent *lower* than the budget for the current year.

The General Fund portion of the Governor's Budget will be in balance only if several critical assumptions underlying the budget are borne out. These assumptions are:

- The state's economy will improve by mid-1982,
- the Legislature will approve the $338 million in tax accelerations during the current year, and an additional $645 million in accelerations and revenue increases in the budget year—a total revenue package of nearly $1 billion,
- at the June 1982 primary election, the voters will approve the bond measure for state prison construction, and disapprove the initiatives relating to income tax indexing and inheritance and gift taxes,
- the Legislature will approve a number of reductions in the existing level of state operations and local assistance expenditures,
- further reductions in federal aid for entitlement programs such as Medi-Cal will not be made, and
- user-fee increases will be enacted and fully implemented by July 1, 1982, and implementation of program reductions will not be delayed by the courts.

If these assumptions are not borne out, then the General Fund portion of the Governor's Budget will be out of balance, and other actions will have to be taken to bring it back into balance.

Expenditures

The 1982–83 budget provides for expenditures of $27.0 billion in state funds. This amount includes:

- $23.2 billion from the General Fund. Of this amount, $4.9 billion is for state operations, $7.3 billion is for direct aid to individuals and $10.9 billion is for aid to local governments and school districts. The remaining amount, $100 million, has not been earmarked for specific budget items.
- $3.5 billion from special funds.
- $0.4 billion from selected bond funds.

In addition, the budget provides for $11.3 billion in expenditures from federal funds and $7.3 billion from various "nongovernmental cost" funds including retirement, working capital, revolving, and public service enterprise funds. Adding all of these components, the total spending program is $45.7 billion, of which $38.4 billion is from governmental funds. Using this latter measure we estimate that during 1982–83 the state will spend $1,543 for every man, woman, and child in the state, or $105 million per day. These represent increases of 2.3 percent and 4.0 percent, respectively, over the expenditure rate in the current year.

Revenues

The budget is supported from a variety of different revenue sources including taxes, fees, bond proceeds, service charges and intergovernmental transfers. In 1982–83, the state's revenue sources will provide:

- $23.6 billion to the General Fund.
- $3.4 billion to some 135 different special funds.
- $11.3 billion in federal funds for a myriad of purposes.

Income from state sources—that is, revenues to the General Fund and the special funds—is estimated to be $27 billion in the budget year. This is an increase of $2.7 billion, or 11.3 percent, over 1981–82, and 22.0 percent above 1980–81 revenues.

The Department of Finance's estimate of General Fund revenues—$23.6 billion for 1982–83—is $2.1 billion, or 9.8 percent, higher than estimated revenues in 1981–82. This estimate reflects the continued softness in the economy anticipated by the Department of Finance for the first half of calendar year 1982, followed by a relatively strong recovery. In addition, it includes $645 million in additional revenues which require legislative approval.

A detailed discussion of the revenue estimates and the economic assumptions on which the budget is based begins on page A-24 of this overview.

II. BACKGROUND—THE RISE AND FALL OF THE SURPLUS

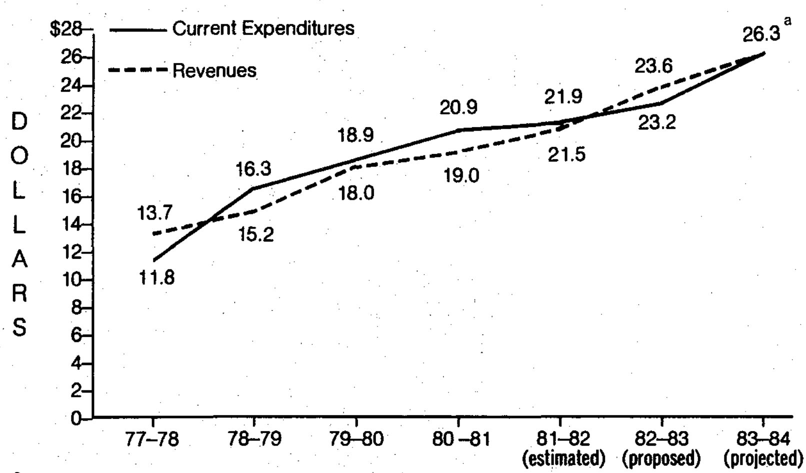
A. The Surplus—An Overview

The huge General Fund surpluses of past years have been used up. The only uncommitted resource shown in the budget as available to the General Fund on June 30, 1982, is the $116 million balance in the Reserve for Economic Uncertainties. This reserve started the year with a $658 million unobligated balance. Due to revenue shortfalls and expenditure overruns, however, the reserve will be fully depleted by year-end unless the Legislature accelerates revenues or reduces expenditures, as the Administration has proposed.

Chart 1

Comparison of General Fund Current Expenditures to Current Revenues

1977–78 through 1983–84 (in billions)



[a] Department of Finance projection.

B. Accumulation of the Surplus

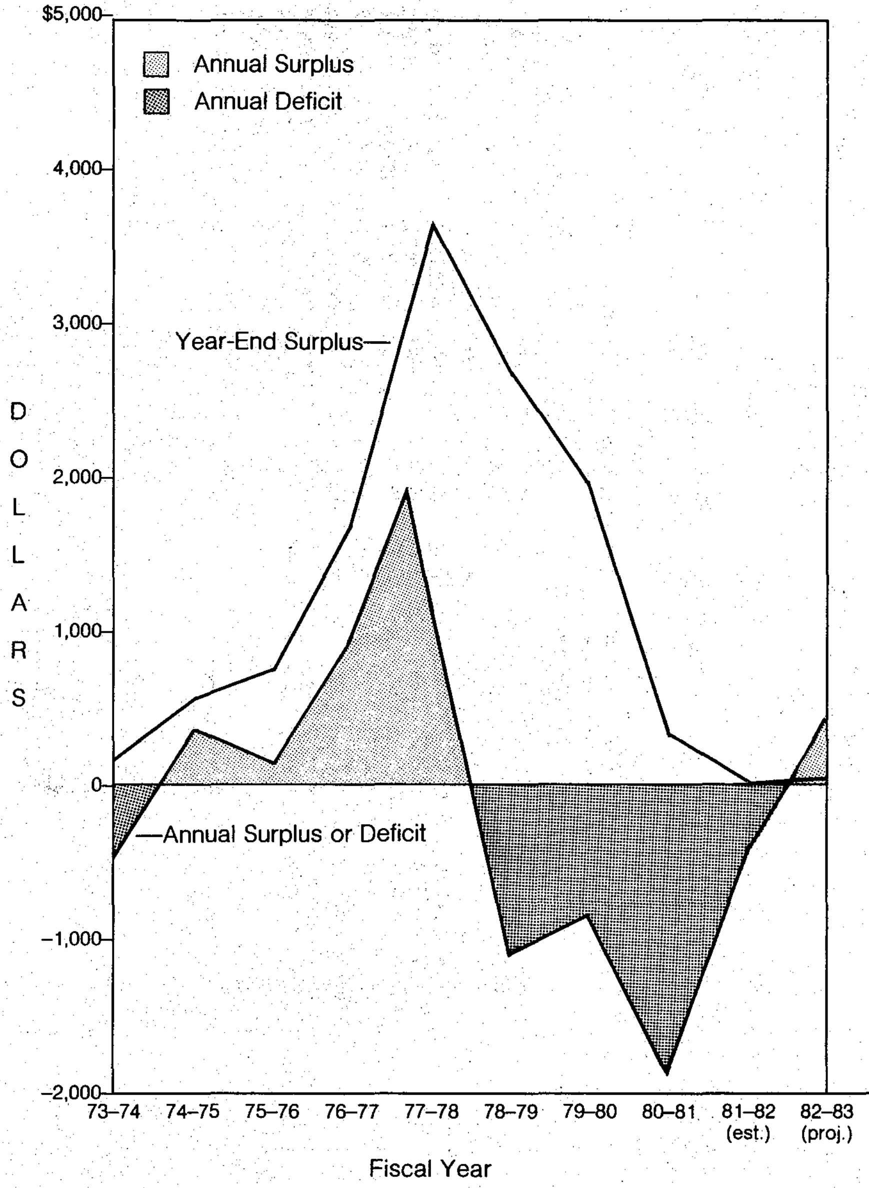
Table 1 and Charts 1 and 2 trace the history of General Fund expenditures, revenues, and the surplus since 1973–74. They indicate that the surplus reached a peak of $3.7 billion on June 30, 1978, shortly before Proposition 13 took effect.

Table 1
Trend in General Fund Unrestricted Surplus
1973–74 through 1982–83
(in millions)

	1973–74	*1974–75*	*1975–76*	*1976–77*	*1977–78*	*1978–79*	*1979–80*	*1980–81*	*1981–82*	*1982–83*
Prior-year resources	$683.9	$358.3	$660.1	$808.8	$1,818.2	$3,886.9	$2,905.5	$2,540.7	$681.0	$123.5
Adjustments to prior-year resources	4.6	24.7	36.0	95.8	59.3	50.9	184.7	222.1	—	—
Prior year resources adjusted	$688.5	$383.0	$696.1	$904.6	$1,877.5	$3,937.8	$3,090.2	$2,762.8	$681.0	$123.5
Revenues and transfers	6,965.5	8,617.3	9,612.8	11,380.6	13,695.0	15,218.5	17,984.6	19,023.1	21,481.4	23,580.3
Expenditures (—)	7,295.7	8,340.2	9,500.1	10,467.1	11,685.7	16,250.8	18,534.1	21,104.9	22,038.8	23,202.9
(Expenditures from reserves)	(113.3)	(−72.8)	(−28.4)	(28.0)	(95.8)	(24.6)	(317.5)	(−210.8)	(−141.7)	(−7.2)
(Current Expenditures)	($7,409.9)	($8,267.4)	($9,471.7)	($10,495.1)	($11,781.4)	($16,275.4)	($18,851.6)	($20,894.1)	($21,897.1)	($23,195.7)
(Annual surplus or deficit)	(−443.5)	(349.9)	(141.1)	(885.5)	(1,913.6)	(−1,056.9)	(−867.0)	(−1,871.0)	(−415.7)	(384.6)
Carry-over reserves (—)	178.2	105.4	77.0	105.0	200.8	225.3	542.8	332.0	7.5	0.3
Reserve for economic uncertainties	—	—	—	—	—	—	—	349.0	116.0	500.0
Year-end Surplus	$180.1	$554.7	$731.8	$1,713.1	$3,686.1	$2,680.2	$1,997.9	$349.0	—	0.7

Chart 2

General Fund Unrestricted Surplus[a] 1973–74 through 1982–83 (in millions)



[a] Excludes Federal Revenue Sharing Fund.

C. What Happened to the Surplus?

The adoption of local fiscal relief in the wake of Proposition 13, together with income tax indexing, helped create the fiscal condition in which state expenditures exceeded current revenues for three years in a row. From 1978–79 through 1980–81, state expenditures exceeded revenues by a total of $3.8 billion, thereby completely wiping out the June 30, 1978 surplus.

During the current fiscal year, revenues would have been in balance with expenditures, had it not been for the recession. The economic slowdown reduced current year revenues by over $800 million. As Table 1 indicates, the shortfall between current revenues and expenditures in 1981–82 will be reduced to $416 million.

The budget projects that current revenues will exceed expenditures by $385 million in 1982–83. This, however, is contingent upon the enactment of $645 million in additional revenue accelerations and increases.

III. EXPENDITURES

A. TOTAL STATE SPENDING PLAN

Table 2 and Chart 3 present the principal categories of the state spending plan in the 1980–81, 1981–82 and 1982–83 fiscal years. Included are expenditures from the General Fund, special funds and bond funds, which total $27,045 million in 1982–83. When added to expenditures of $11,346 million from federal funds and $7,323 million from nongovernmental cost funds, the total state spending plan as proposed by the Governor amounts to $45,714 million.

Table 2
Total State Spending Plan [a]
(in millions)

		Estimated 1981–82		*Proposed 1982–83*	
	Actual 1980–81	*Amount*	*Percent Change*	*Amount*	*Percent Change*
General Fund	$21,104.9	$22,038.8 [b]	4.4%	$23,202.9 [b]	5.3%
Special funds	3,261.6	3,425.3 [c]	5.0	3,471.4 [c]	1.3 [d]
Budget Expenditures	$24,366.5	$25,464.1	4.5%	$26,674.3	4.8%
Selected bond funds	144.7	342.1	136.4	370.7	8.4
State Expenditures	$24,511.1	$25,806.3	5.3%	$27,045.0	4.8%
Federal funds	10,247.6	11,095.6	8.3	11.345.6	2.3
Governmental Expenditures	$34,758.7	$36,901.9	6.2%	$38,390.6	4.0
Nongovernmental cost funds	6,287.4	6.909.2	9.9	7,323.0	6.0
Total State Spending	$41,046.1	$43,811.1	6.7%	$45,713.7	4.3%

[a] Based on amounts shown in the Governor's Budget.
[b] Includes expenditures from reserves of $141.7 million in 1981–82 and $7.2 million in 1982–83.
[c] Includes expenditures from reserves of $212.0 million in 1981–82 and $18.4 million in 1982–83.
[d] Excluding the one-time reduction in shared revenues to local governments from the Vehicle License Fund, the increase in special fund expenditures is 14.5 percent.

Governmental Expenditures

The budget proposes that expenditures from governmental funds—that is, state and federal funds—total $38.4 billion in 1982–83. The rate of increase in these expenditures—4.0 percent—is less than in either of two preceding years, due largely to the slow-down in federal aid to California (discussed below). Governmental expenditures in 1982–83 will average $1,543 for every man, woman and child in the state, or $105 million per day.

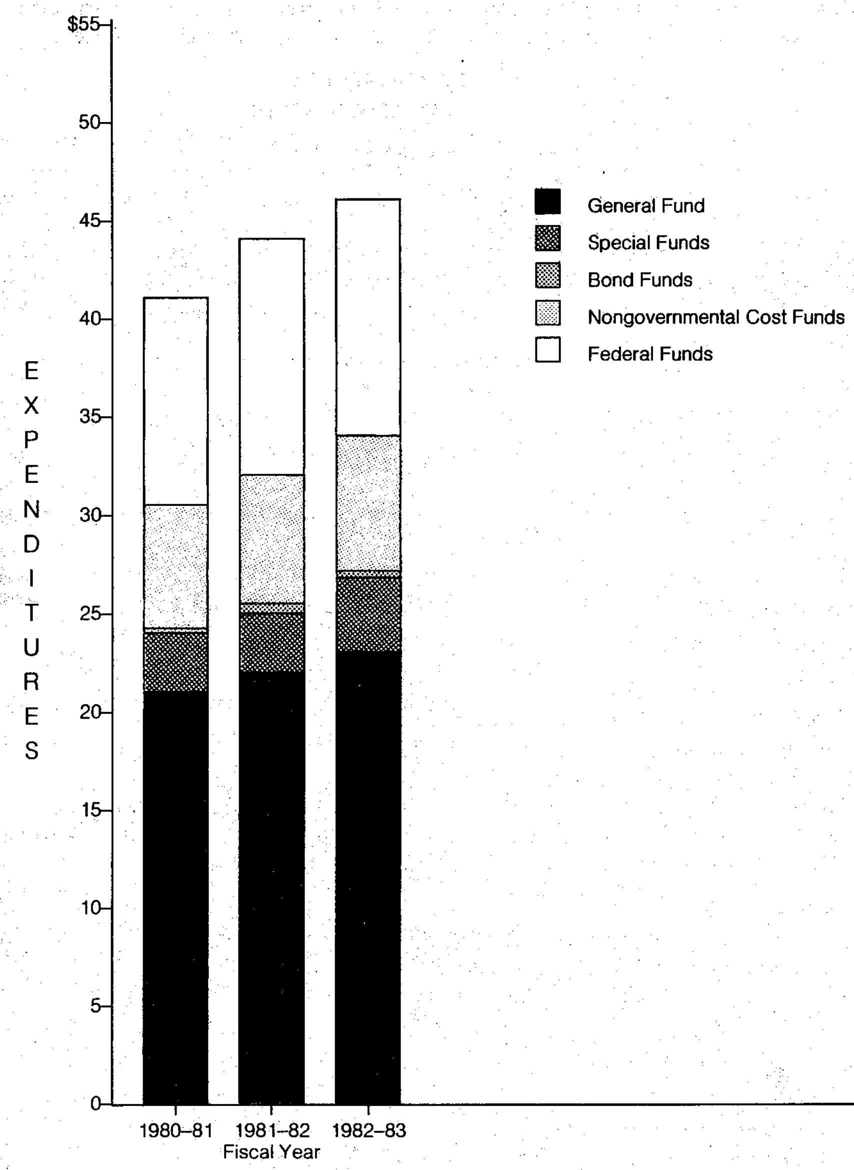
State Budget Expenditures

That portion of the state spending plan financed by state revenues deposited in the General Fund or special funds is usually referred to as "budget expenditures." As shown in Table 2, budget expenditures are proposed at $26.7 billion in 1982–83. Budget expenditures in 1982–83 account for 58 percent of the $46 billion state spending plan, and 69.5 percent of total governmental expenditures.

Chart 3

Total State Spending 1980–81 through 1982–83

(in billions)



Growth in General Fund Expenditures

General Fund expenditures account for more than one-half of all expenditures under the state's auspices.

Historical perspective is a useful tool in analyzing trends in General Fund spending. Table 3 presents the amount and rate of increase in expenditures since 1973–74, in both actual dollars and real dollars. (That is, adjusted for the effects of inflation.) The proposed 1982–83 General Fund budget is more than three times what it was in 1973–74 in actual dollars. As shown on Chart 4, between 1973–74 and 1980–81, General Fund expenditures increased at an annual rate of 10 to 15 percent in actual dollars, and by 3 to 6 percent in real dollars. Beginning in 1981–82, however, the rate of growth in General Fund expenditures decreased dramatically. In fact, the rise in expenditures in 1981–82 was less than the rise in prices, causing real expenditures to decline. The budget projects the same situation to occur in 1982–83.

Table 3
Annual Growth in General Fund Expenditures
(in millions)

	Actual Dollars	*Percent Change*	*Real[a] Dollars*	*Percent Change*
1973–74	$7,295.7	29.9%	$7,295.7	—
1974–75	8,340.2	14.3	7,513.7	3.0%
1975–76	9,500.1	13.3	7,963.2	6.0
1976–77	10,467.1	10.2	8,254.8	3.7
1977–78	11,685.6	11.6	8,624.1	4.5
1978–79	16,250.8	39.1	11,070.0	28.4
1979–80	18,534.1	14.1	11,664.0	5.4
1980–81	21,104.9 [b]	13.9	12,227.6	4.8
1981–82 (estimated)	22,038.8 [c]	4.4	11,741.5	−4.0
1982–83 (proposed)	23,202.9 [d]	5.3	11,401.9	−2.9

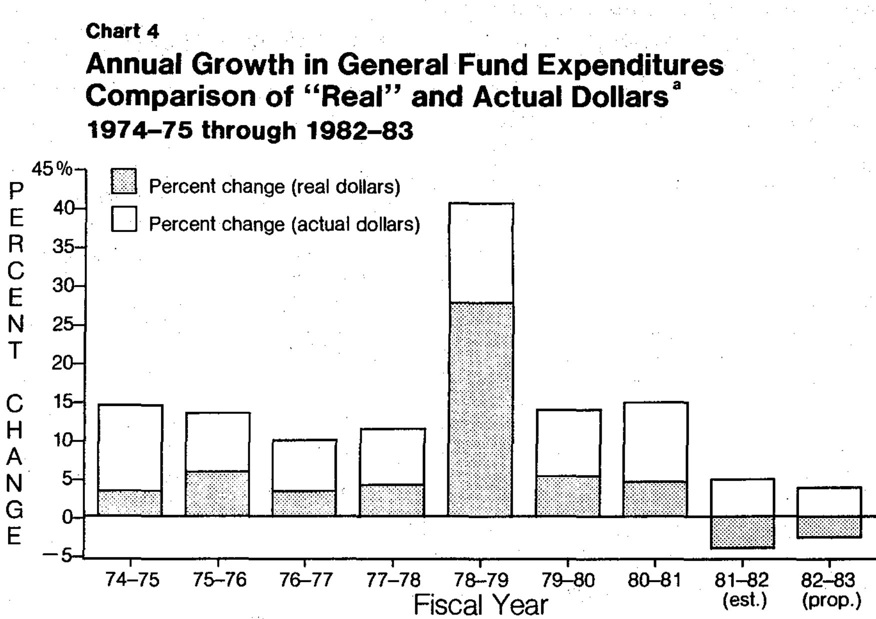
[a] "Real" dollars equal actual dollars deflated to 1973–74 dollars using the Gross National Product price deflator for state and local puchases of goods and services.
[b] Includes $210.8 million in expenditures from reserves.
[c] Includes $141.7 million in expenditures from reserves.
[d] Includes $7.2 million in expenditures from reserves.

Controlling Expenditures Through the Budget Process

A large portion of the budget is not easily controllable through the budget process because funding for many programs is set either by statute or the Constitution, rather than by the Budget Bill.

As Table 4 shows, expenditures of $23,150 million, or 99.8 percent of the $23,203 million in total General Fund expenditures proposed for 1982–83, are authorized in the Budget Bill. However, a significant portion of this amount—$11,615 million (or 50 percent), although included in the Budget Bill, is actually set by statute. This portion would be even higher if the budget requested funds to pay the full statutory cost-of-living adjustments.

Only $52 million, or 0.2 percent, does not appear in the Budget Bill. This is a net amount including $259 million for bond debt service payments, partially offset by "negative expenditures" of $207 million mainly reflecting General Fund credits from other funds (pro rata charges) and unidentified savings.



[a] "Real" dollars equal actual dollars deflated to 1973–74 dollars using the Gross National Product price deflator for state and local purchases of goods and services.
[b] The large increase in 1978–79 is due primarily to the increase in local fiscal relief following the passage of Proposition 13.

Table 4
1982–83 General Fund Expenditures in the Budget Bill
(in millions)

	Amount	*Percent of Total Expenditures*
1. *Expenditures in the 1982–83 Budget Bill:*		
Statutory authorizations also included in the Budget Bill:		
Education, K–12	$6,692.9	28.8%
Department of Social Services	3,017.7	13.0
Board of Governors—Community Colleges	543.2	2.3
Tax Relief	1,318.5	5.7
Legislature	3.9	0.02
Total, Statutory Authorizations	$11,576.2	49.9%
Expenditures authorized in the Budget Bill	11,574.4	49.9
Total, in the Budget Bill	$23,150.6	99.8%
2. *Expenditures Not in the Budget Bill*	*$52.2*	*0.2%*
Constitutional	(258.8)	(1.1)
Statutory	(−64.3)	0.3
Other	(−142.3)	(−0.6)
Total, Expenditures	$23,202.9	100.0%
Less Expenditures from reserves	7.2	
Current Expenditures	$23,195.7	

Budgeted Versus Actual Expenditures

The expenditure program initially proposed in the budget has invariably been changed—usually upward—during the budget process. Table 5 compares the magnitude of the original estimates with actual expenditures during the past nine years.

Table 5
Comparison of Budgeted and Actual General Fund Expenditures [a]
(in millions)

	Budget As Submitted	*Actual Expenditures*	*Change Amount*	*Change Percent*
1973–74	$7,151.1	$7,295.7	$144.6	2.0%
1974–75	7,811.9	8,340.2	528.3	6.8
1975–76	9,169.5	9,500.1	330.6	3.6
1976–77	10,319.7	10,457.1	147.4	1.4
1977–78	11,822.3	11,685.6	−136.7	−1.2
1978–79	13,482.5	16,250.8	2,768.3	20.5
1979–80	17,088.1	18,534.1	1,446.0	8.5
1980–81	20,683.9	20,894.1	210.2	1.0
1981–82	20,770.1 [b]	21,897.1 [c,d]	1,127.0	5.4

[a] Source: 1973–74 to 1982–83 Governor's Budget, Schedule 1.
[b] Excludes $28.5 million in expenditures from reserves.
[c] Midyear estimate.
[d] Excludes $141.7 million in expenditures from reserves.

Only once during this nine-year period—in 1977–78—was the actual amount expended less than the amount initially proposed. The unusually large net increase for 1978–79 was mainly due to the fiscal relief program enacted in the wake of Proposition 13. Local fiscal relief added $4.4 billion to that budget, but reductions in other state programs held the net increase to $2,768 million. The increase of $1.1 billion for 1981–82 is attributable primarily to increases in expenditures for K–12 Education ($600 million) and SSI/SSP ($218 million). Both of these increases were caused by increased cost-of-living adjustments. In addition, estimated unidentified savings were reduced from $200 million to $100 million for the current year.

Prediction or Plan?

It should be noted that the budget estimates are not *predictions* of how much ultimately will be spent, although these estimates reflect countless predictions about expenditure rates and other factors that are in part outside of the state's control. Rather, these estimates reflect the *Governor's fiscal plan*—that is, what he thinks expenditures *ought* to be, given all of those factors that the state cannot control. It is certain that, between now and June 30, 1983, expenditures (and revenues) will be revised by the Governor, the Legislature, changing economic conditions, and many other factors. Thus, actual revenues and expenditures will be different from the estimates contained in the Governor's Budget.

ARTICLE XIII B

On November 6, 1979, California voters overwhelmingly approved Proposition 4, the "Spirit of 13" Initiative. Proposition 4, which placed Article XIII B in the California Constitution, has three main provisions:

- It places a limit on the year-to-year growth in tax-supported appropriations of the state and individual local governments.
- It precludes the state and local governments from retaining surplus funds. Any *unappropriated* balances at the end of a fiscal year must

be returned to taxpayers within a two-year period.

- It requires the state to reimburse local governments for the cost of certain state mandates.

Spending Limit

Article XIII B seeks to limit the spending of government entities by establishing a limit on the level of tax-supported appropriations in each fiscal year. The article establishes a base-year limit for 1978–79, and adjusts this limit in subsequent years for changes in inflation and population. Once established, the limit increases (or decreases) independently of actual government spending.

Not all appropriations are covered by the article's provisions. The article limits only appropriations from tax revenues, such as revenues from property, sales, personal income and corporate franchise taxes. Appropriations financed from nontax revenues—such as federal funds, user fees and oil revenue—are *not* limited by Article XIII B.

The article also exempts from the limits of both the state and local governments appropriations made for the following purposes: (1) debt service, (2) retirement benefit payments, (3) federal or court mandates, (4) investment funds, and (5) refunds of taxes. In addition, it exempts from the state limit state subventions to local governments. After allowing for these exemptions, the remaining appropriations of tax revenues are subject to the limit.

Impact of Article XIII B in 1982–83

Table 6 shows the Department of Finance's estimate of the impact of Article XIII B on the state for fiscal years 1978–79 (the "base" year) through 1982–83. The department estimates that the state will be $1,723 million *below* its limit in 1982–83.

The large gap between the limit and spending subject to limitation results from the fact that the level of appropriations in the base year (1978–79) could not have been sustained indefinitely with the revenues produced by existing tax laws, even if there had been no limit on appropriations. This is because the state had a large portion of its base-year *limit* financed by *surplus* funds. Since the surplus is now depleted, 1982–83 appropriations can be financed only from *current* revenues. The large gap between the state's limit for 1982–83 and proposed expenditures reflects that portion of the state's limit originally financed by the surplus—and the year-to-year growth in that amount—which can no longer be financed because the surplus has been exhausted.

As a result, the state's appropriation limit will *not* be a fiscal constraint in 1982–83 and, barring the enactment of a general tax increase, it will probably not be a constraint in the foreseeable future. Only if revenues grow for several years at rates higher than the annual adjustments to the state's limit will the state have adequate resources to spend up to its limit.

Table 6
Impact of Article XIII B on the State
1978–79 through 1982–83
(in millions)

	1978–79[a]	*1979–80*[b]	*1980–81*	*1981–82*	*1982–83*
Appropriations limit	$12,564	$14,194	$16,237	$18,085	$19,899
Appropriations Subject to Limitations	12,564	—	15,584	16,957	18,176
Amount Under Limit	—	—	$653	$1,128	$1,723

[a] For the base year, the appropriations limit is, by definition, equal to appropriations subject to limitation.
[b] Article XIII B was not effective until 1980–81. A 1979–80 limit is shown for illustrative purposes only.

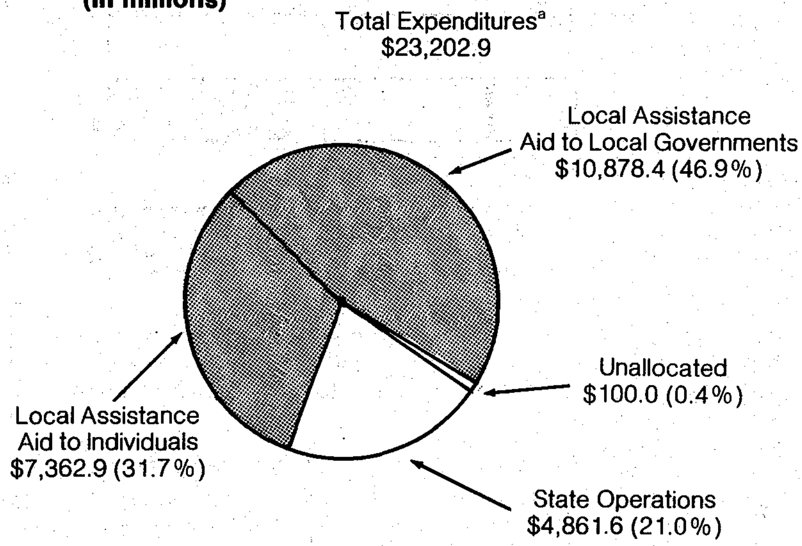
Establishing the 1982–83 Limit

The administration proposes to set the state's 1982–83 appropriations limit in Control Section 12.20 of the 1982 Budget Act. Although a 1982–83 limit of $19,899 million has been proposed, this number is subject to change, because the final inflation and population adjustments used to determine the 1982–83 limit will not be known until April of this year.

Chart 5

1982–83 General Fund Budget Structure

(in millions)



[a] Includes $7.2 million in expenditures from reserves.

B. MAJOR COMPONENTS OF THE BUDGET

State expenditures are traditionally divided into three categories: state operations, capital outlay, and local assistance. Table 7 presents the distribution of General Fund and special fund expenditures among these categories for the past, current and budget years. In 1982–83, the Governor's Budget includes $100 million in unallocated funds which have not been budgeted for any specific program or agency. Table 7 separately identifies expenditures from reserves (that is, from funds appropriated in prior years) in order to show expenditures from new appropriations (referred to as "current expenditures").

Chart 5 shows expenditures for state operations, capital outlay, and local assistance as a percentage of total General Fund expenditures. Local assistance, as defined in the Governor's Budget, accounts for 78.6 percent of total expenditures.

Chart 6

General Fund Budget Structure

1973–74 through 1982–83 (in billions)

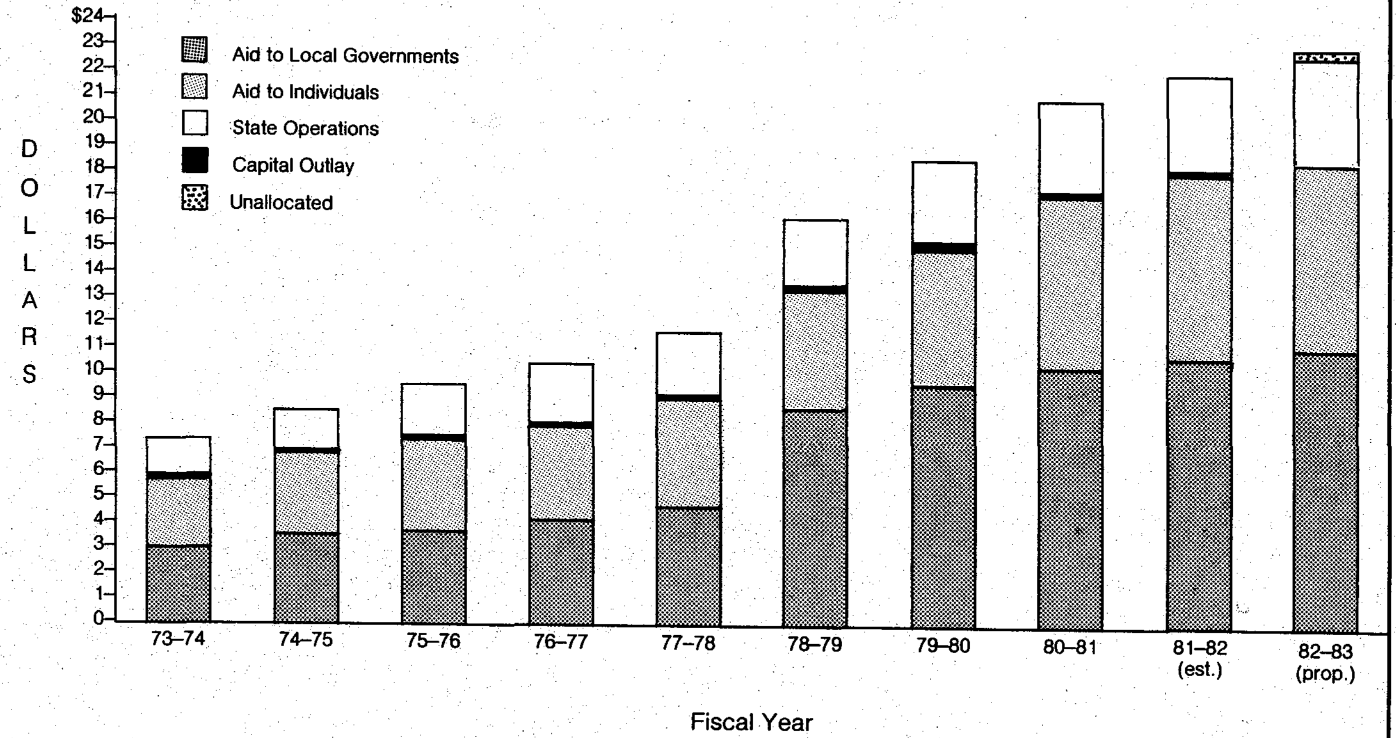


Table 7
General Fund and Special Fund Expenditures, by Function [a]
(in millions)

	Actual 1980–81	Estimated 1981–82 Amount	Estimated 1981–82 Percent Change	Proposed 1982–83 Amount	Proposed 1982–83 Percent Change
General Fund:					
State operations	$4,281.0	$4,592.8	7.3%	$4,861.6	5.8%
Capital outlay	53.6	38.5	−28.2	—	—
Local assistance	16,770.3	17,407.6	3.8	18,241.3	4.8
Aid to individuals	(6,677.0)	(7,101.6)	(6.4)	(7,362.9)	(3.7)
Aid to local governments	(10,093.3)	(10,306.0)	(2.1)	(10,878.4)	(5.6)
Unallocated	—	—	—	100.0	—
Totals	$21,104.9	$22,038.8	4.4%	$23,202.9	5.3%
Less expenditures from reserves	−210.8	−141.7	—	−7.2	—
Current Expenditures	$20,894.1	$21,897.1	4.8%	$23,195.7	5.9%
Special Funds:					
State operations	$1,362.9	$1,523.1	11.8%	$1,727.9	13.4%
Capital outlay	379.8	437.9	15.3	442.5	1.1
Local assistance	1,518.9	1,464.3	−3.6	1,301.0	−11.2
Totals	$3,261.6	$3,425.3	5.0%	$3,471.4	1.3%

[a] Based on amounts shown in the Governor's Budget.

Chart 6 shows the increase in expenditures for state operations, capital outlay and local assistance (which includes aid to individuals and aid to local governments) from 1973–74 through 1982–83.

State Operations

Expenditures for state operations during the period 1973–74 through 1982–83 have increased by $3.1 billion, or 178 percent. This growth is attributable mainly to increases in higher education and the state's corrections program.

The budget proposes an increase of $269 million, or 5.8 percent, for state operations in 1982–83. This reflects workload and salary increases, offset by a $115 million reduction in baseline budgets. Most General Fund-supported departments were subject to the baseline reductions mandated by the Governor, but in some cases, the required reductions were less than the standard 5 percent.

Capital Outlay

General Fund capital outlay expenditures over the past nine years have fluctuated from a high of $151 million in 1978–79 to a low of $17 million in 1974–75. The budget proposes no General Fund expenditures for capital outlay but does contain $442.5 million in capital outlay expenditures from special funds (mainly tidelands oil revenues). For a more detailed discussion of capital outlay, see page A-22.

Local Assistance

As shown in Chart 6, local assistance has increased by $12,712 million, or 230 percent, in the nine years from 1973–74 to 1982–83. The growth in state fiscal relief to local governments following the passage of Proposition 13 explains much of this increase. Additionally, direct benefit programs in local assistance have grown rapidly. The Governor's Budget proposes an increase in local assistance of $833.7 million in 1982–83, or 4.8 percent.

Local Assistance Versus Aid to Local Governments

Local Assistance, as the term is used in the budget, encompasses a wide variety of programs. Some of these programs, do not provide assistance to local government agencies; instead, it goes to *individuals*. Such payments may be made *directly* to individuals, as in the case of the Renters' Tax Relief program, or individuals may receive them through an intermediary, such as the federal or county governments. Examples of payments made through intermediaries are SSI/SSP payments, which are distributed by the *federal* government, and AFDC payments, which are distributed by *county* governments.

Our analysis indicates that it may be more appropriate to categorize local assistance expenditures in a fashion which reflects the direct beneficiaries of the expenditure. Thus, we have divided the local assistance category into two new categories, one being "Assistance to Local Governments" and the other being "Assistance to Individuals."

Table 8
Major Local Assistance Programs More Appropriately Categorized as Assistance to Individuals
(in millions)

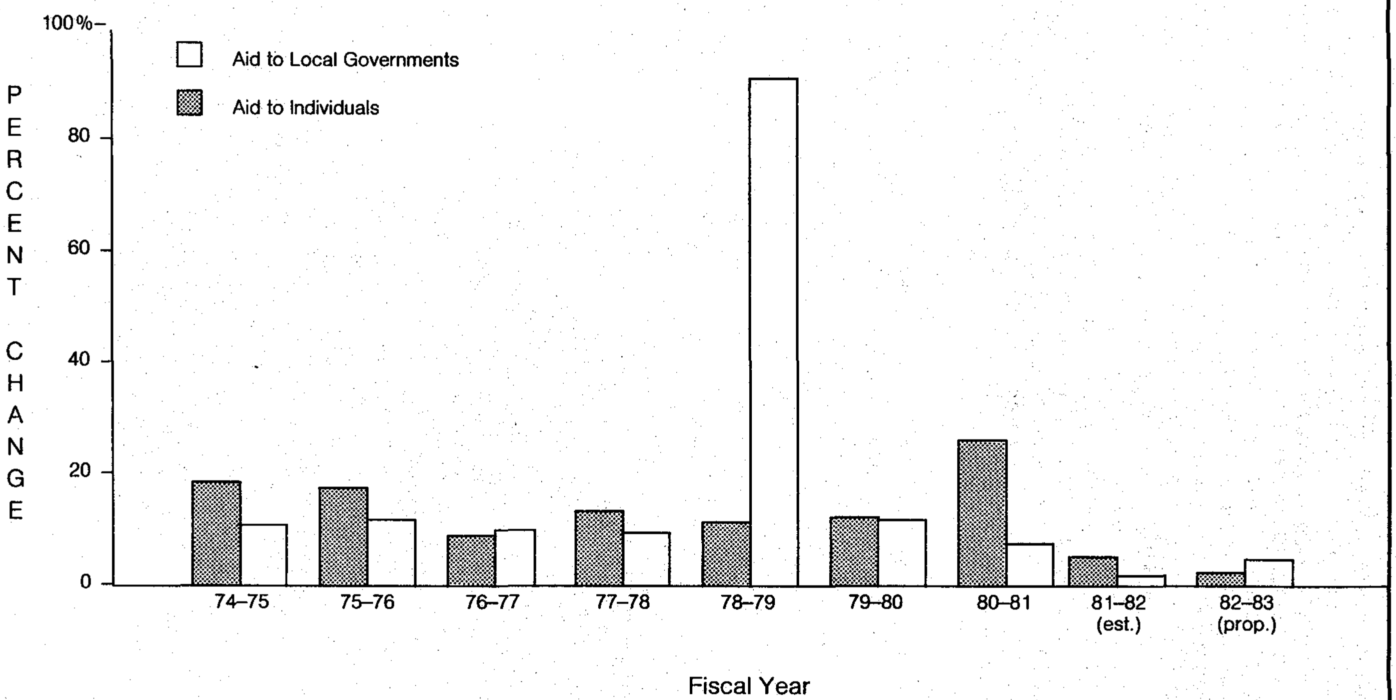
	1980–81	*1981–82*	*Governor's Budget 1982–83*
Medi-Cal [a]	$2,325.8	$2,609.4	$2,654.7
AFDC [b]	1,214.9	1,364.8	1,424.0
SSI/SSP	1,285.5	1,268.9	1,345.7
Developmental Services	513.1	521.2	540.9
Personal Property Tax Relief	496.8	467.3	537.2
Renters' Tax Relief	406.8	425.0	440.0
Homeowners' Property Tax Relief	333.7	335.0	338.0
Senior Citizens Renters' Tax Relief	49.6	48.0	46.0
Senior Citizens Property Tax Assistance	19.0	15.0	14.0
Subvention for Open Space	13.2	14.0	13.0
Senior Citizens Property Tax Postponement	4.2	5.0	6.1
Alternative Energy Tax Credit Refund	10.9	25.0	—
Payment to Local Governments for Sales and Property Tax Losses	3.5	3.0	3.3
Total	$6,677.0	$7,101.6	$7,362.9

[a] Excludes county administration.
[b] Grant payments only.

In dividing the present "local assistance" programs between these categories, it is important to keep in mind that some portion of "Assistance to Individuals" actually represents funds distributed to local governments. For example, the Homeowners' Property Tax Assistance program pro-

Chart 7

Expenditures for Local Assistance
Aid to Local Governments vs Aid to Individuals
1974–75 through 1982–83



vides *reimbursements* to local governments for the property tax revenue losses attributable to the homeowners' property tax exemption. The reimbursements, however, do not *increase* the fiscal resources of the local governments, but merely replace the property taxes lost due to the provision of tax relief to homeowners.

Conversely, some of the funds distributed to local governments and categorized as "Assistance to Local Governments" represent the state's contribution for programs, operated locally, which provide *services* to individuals. These programs do, in one sense, provide assistance to individuals, but they are not distinguishable from other programs operated by local governments. This is because *all* programs operated by local governments are intended to provide assistance to individuals in one sense or another. Thus, for example, although the state's subvention of funds for County Health Services is expended for programs which assist individuals, the monies represent the state's attempt to help local governments to fund these programs.

Table 8 lists the major "local assistance" programs which our analysis indicates are more appropriately categorized as "Assistance to Individuals".

Changes in Reporting Categories

We recommend that the Legislature adopt supplemental report language requesting that the Department of Finance revise its presentation of Local Assistance Expenditures.

As interest in the distribution of state expenditures by function increases, the usefulness of the traditional reporting categories utilized in the Governor's Budget becomes more and more questionable. These categories were established long ago, and have been maintained for purposes of year-to-year consistency. These categories, however, have become outmoded as a result of the dramatic shifts in state and local fiscal relationships that have occurred in the last decade. They would be more meaningful and useful if they were altered to reflect those changes. Therefore, we recommend that the Legislature adopt the following supplemental report language:

"The Department of Finance shall revise its presentation of Local Assistance expenditures beginning with the 1983–84 fiscal year, and provide new detail on historical expenditures consistent with this revision."

Chart 7 presents a comparison of the growth in these two categories of local assistance programs since the 1973–74 fiscal year. In six of the last nine years, the growth in assistance to individuals has exceeded the growth in aid to local governments. Due to the provision of fiscal relief to local governments following passage of Proposition 13, however, aid to local governments increased dramatically in 1978–79—by 92.5 percent. As a result, the growth in aid to local governments exceeds the growth in assistance to individuals over the nine-year period. On a cumulative basis, aid to local governments grew by 265.5 percent during the period, while assistance to individuals increased by 188.5 percent.

Local Fiscal Relief

Table 9 summarizes our estimates of local fiscal relief from 1978–79 through 1982–83. For the budget year, the table shows estimates of fiscal relief under existing law (Chapter 282, Statutes of 1979 (AB 8)), as well as the amounts proposed by the Governor. The budget proposes to reduce motor vehicle license fee subventions to cities and counties in order to reduce local fiscal relief below the level called for by existing law. It also reduces funding for the county health services subvention by $55 million. In the absence of these proposals, local fiscal relief in 1982–83 would increase by $798 million, or 13.4 percent under existing law (without considering the AB 8 deflator). This increase is higher than it otherwise would be, due to the one-time reductions in fiscal relief made by Ch 101/81 (SB 102) during the current year.

Table 9
Summary of Local Fiscal Relief
1978–79 to 1982–83
(in millions)

					1982–83	
	1978–79	*1979–80*	*1980–81*	*1981–82*	*Under Existing Law*	*As Proposed by Governor's Budget*
Block grants to local agencies	$835	$14	—	—	—	—
Property taxes shifted from schools to local agencies	—	782	$921	$1,046	$1,172 [a]	$1,172 [a]
Business inventory reductions for cities and counties	—	−38	—	—	—	—
Health and welfare buyouts	1,079	1,288	1,529	1,747	1,957	1,904
SB 102 reductions	—	—	—	−181	−49	−49
Education [b]	2,453	2,813	3,050	3,322	3,652	3,652
Subtotals	$4,367	$4,859	$5,500	$5,934	$6,732	$6,679
Proposed vehicle license fee reductions	—	—	—	—	—	−450
Totals	$4,367	$4,859	$5,500	$5,934	$6,732	$6,229

[a] Assumes 12 percent increase in assessed valuation.
[b] Department of Finance estimates.

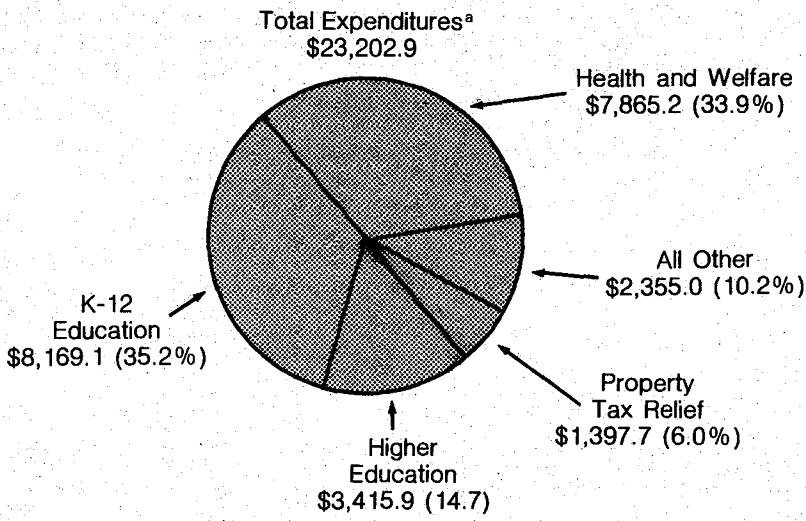
Table 10
Local Fiscal Relief by Type of Local Agency
1978–79 to 1982–83
(in millions)

	1978–79	*1979–80*	*1980–81*	*1981–82*	*1982–83* [b]	*Percent Increase 1982–83 Over 1979–80*
Cities	$221	$224	$280	$171	$319	44.3%
Counties	1,504	1,614	1,927	2,166	2,452	63.0
Special districts	190	206	243	276	309	62.6
K–12 Education [a]	2,193	2,507	2,721	2,964	3,261	48.7
Community colleges [a]	260	306	329	358	391	50.4
Totals [c]	$4,367	$4,859	$5,500	$5,934	$6,732	54.2%

[a] Department of Finance estimates.
[b] Existing law; does not reflect reductions proposed in the budget.
[c] Details may not add to totals due to rounding.

Chart 8

General Fund Expenditures—Major Components
1982–83 (in millions)



[a] Includes $7.2 million in expenditures from reserves.

Table 10 presents information as to the *distribution* of fiscal relief by type of local agency under current law. These data indicate that K–12 school districts receive nearly half of total fiscal relief to local entities (48 percent), while counties receive the second largest share (36 percent). The table also indicates that, under current law, total fiscal relief costs in 1982–83 would be 54.2 percent above the orginal level established in 1978–79, with the largest relative increases in relief going to counties and special districts.

C. PROGRAM EXPENDITURES

Where Does the Money Go?

Table 11 and Chart 8 show the distribution of General Fund expenditures by major program categories in 1982–83. These displays indicate that the two largest categories in the budget are Education and Health and Welfare. If the $11.6 billion proposed for education is added to the $7.9 billion proposed for health and welfare, the total for these two categories is $19.5 billion, or 83.8 percent, of total expenditures. The remaining $3.8

billion, or 16.2 percent, goes for tax relief and all other programs of state government, such as corrections and resources.

The so-called "people programs"—Education and Health and Welfare—have been the fastest growing components of General Fund expenditures in recent years. Chart 9 illustrates that since 1973–74 Health, Welfare, and Education have increased their share of the General Fund budget from about 75 percent to 83.8 percent. During the same period, expenditures on these programs have increased by more than 250 percent.

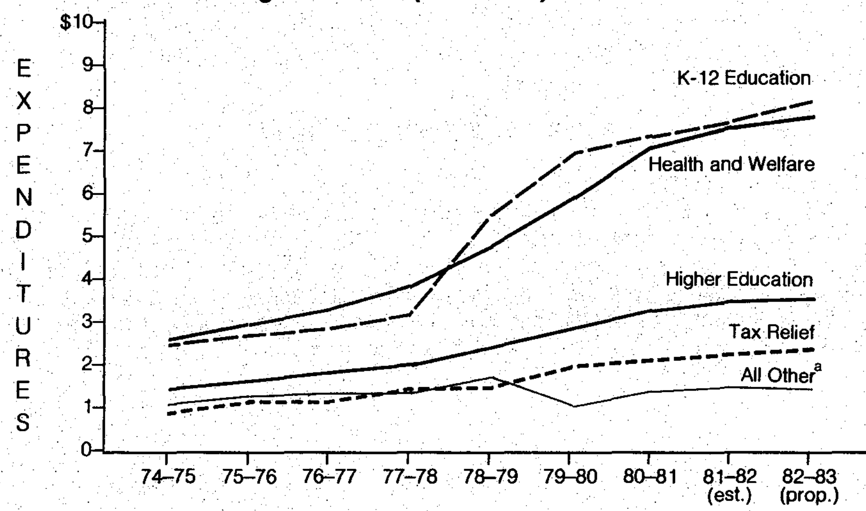
Table 11
Expenditures for Health, Welfare, and Education As a Percent of Total General Fund Expenditures 1982–83 (in millions)

	Amount	*Percent of General Fund Budget*
Health and Welfare	$7,865.2	33.9%
Education		
K–12	8,169.1	35.2
Higher education	3,415.9	14.7
Total, Education	$11,585.0	49.9%
Total, Health, Welfare, and Education	$19,450.2	83.8%
Other program areas	3,752.7	16.2
Total General Fund Budget	$23,202.9	100.0%
Less expenditures from reserves	7.2	—
Total, Current General Fund Expenditures	$23,195.7	100.0%

Chart 9

General Fund Expenditures By Major Program Categories

1973–74 through 1982–83 (in billions)



[a] Includes $100 million in unclassified funds for 1982–83.

Summary of Major Program Changes

The budget proposes an increase in General Fund expenditures of $1.3 billion for 1982–83. Table 12 shows that these increases are distributed among nearly all expenditure categories. There are, however, significant program changes within the broader categories. Some of the major shifts in historical trends include the following:

1. ***Medi-Cal*** expenditures from the General Fund in 1982–83 are budgeted at $2,817 million, which is $60.3 million, or 2.2 percent, above the current year expenditure level. In years past, Medi-Cal General Fund expenditures have grown at a rate of 3.5 percent to 22.2 percent. The principal reasons why the increase proposed for 1982–83 is so much smaller than the rate for recent years are:

- Provider reimbursement rate reductions offset almost all of the provider cost-of-living increases.
- Hospital inpatient reimbursement limitations (Ch 102/1980) which were applied during the current fiscal year are carried forward into 1982–83, for a savings of $56.1 million.
- The Governor's Budget proposes several restrictions in eligibility and scope of benefits.
- Cost savings changes enacted by recent legislation (AB 251) will become fully effective in 1982–83.
- Several administration cost control and anti-fraud projects approved for implementation in 1981–82 become fully effective in 1982–83.

2. ***SSI/SSP Grants*** are proposed to increase by $76.8 million in 1982–83. This increase reflects $211.3 million in increased expenditures and $134.5 million in offsetting savings. The major cost increases in the budget year are attributable to (a) an anticipated 1.2 percent increase in caseload ($16.7 million) and (b) an 8.8 percent cost-of-living increase ($170.3 million). The most significant reductions will result from increases in recipients' unearned income, such as social security payments. These income increases will reduce the size of the SSI/SSP grant, thereby resulting in overall program savings.

3. ***AFDC Grants*** are proposed to increase by $59.2 million in 1982–83. This reflects (a) savings of $83.7 million resulting from implementation of the federal Omnibus Reconciliation Act, and (b) the nonrecurring nature of one-time costs in 1981–82 ($43.7 million). The largest increase proposed in 1982–83 is $130.3 million to provide an 8.8 percent cost-of-living increase in aid payments.

4. ***Special social service*** programs are proposed to increase by 15.4 percent in the budget year. Because federal funding for these programs is capped, any increases provided as a cost-of-living adjustment to total program costs has to be borne by the state and counties. In effect, the state and counties must provide funds for a cost-of-living increase in federally supported activities because the federal government does not adjust its payments to the state for inflation.

5. ***K–12 Education*** increases by $460.6 million, or 6 percent in 1982–83. This amount includes $20 million in increased expenditures under the Governor's initiatives in mathematics and science. The budget does not, however, include $301 million in K–12 expenditures authorized under existing law. This is due to budget proposals that reduce transfers from the Tidelands Oil Fund (−$147 million), delete transfers of excess repayments of the State School Building Aid bond loans (−$83 million), and reduce cost-of-living adjustments in certain school apportionments (−$71 million).

6. *Community Colleges* expenditures are proposed to increase by close to $100 million in 1982–83. This reflects a 5 percent COLA ($67 million), replacement of one-time property tax revenues available during the current year ($60 million), savings from assessed property tax value growth (−$38.2 million), and the Governor's initiatives in Education ($10 million).

7. *Capital outlay* expenditures from the General Fund have been suspended in 1982–83. Capital outlay expenditures from all sources, including bond issues and Special Funds, however, total $632.1 million in the budget year.

8. *The Department of Corrections* expenditures are proposed to increase by $48 million in the budget year, primarily due to the growth in the state's prison population.

9. The Governor is also proposing $100 million in unallocated funds, which will be used to fund legislation and other expenditures, as directed by the Legislature.

Table 12
Proposed General Fund Program Changes
1981–82 to 1982–83
(in millions)

	1981–82 Estimated	*1982–83 Proposed*	*Change Amount*	*Change Percent*
Health and Welfare:				
Medi-Cal	$2,756.6	$2,816.9	$60.3	2.2%
SSI/SSP grants	1,268.9	1,345.7	76.8	6.1
AFDC grants	1,364.8	1,424.1	59.3	4.3
Mental health	590.3	618.0	27.7	4.7
Developmental services	536.8	558.2	21.4	4.0
Special social service programs	169.2	195.3	26.1	15.4
Other, health and welfare	872.1	907.0	34.9	4.0
Subtotals, Health and Welfare	$7,558.7	$7,865.2	$306.5	4.1%
Education:				
K–12	$7,708.5	$8,169.1	$460.6	6.0%
University of California	1,099.0	1,150.9	51.9	4.7
California State University	963.4	986.9	23.5	2.4
California Community Colleges	1,082.4	1,181.3	98.9	9.1
Other, higher education	96.8	96.8	—	—
Subtotals, Education	$10,950.1	$11,585.0	$634.9	5.8%
Property tax relief	$1,327.6	$1,397.6	$70.0	5.3%
Employee compensation	—	168.3	146.4	n/a
Capital outlay	27.7	—	−27.7	—
Unallocated	—	100.0	100.0	n/a
Debt service	221.7	278.8	57.1	25.8
All other	1,953.0	1,808.0	−145.0	−7.4
Totals	$22,038.8	$23,202.9	$1,164.1	5.3%
Less expenditures from reserves	−141.7	−7.2	134.5	—
Current Expenditures	$21,897.1	$23,195.7	$1,298.6	5.9%

D. CAPITAL OUTLAY

The Budget Bill includes $635.6 million from all sources for capital outlay in 1982–83. This is $232.6 million—58 percent—more than the appropriation for capital outlay contained in the 1981 Budget Act. The major changes from the current year appropriations are as follows:

	In Millions
State and Consumer Services	−$20.4
Business, Transportation and Housing	+95.0
Resources	+21.3
Health and Welfare	−43.2
Correctional Programs	+146.9
Postsecondary Education	+32.8

The most significant changes are in the areas of Business, Transportation/Housing and Corrections.

Business, Transportation and Housing. The $95.0 million increase for Business, Transportation and Housing reflects an increase of $82.3 million in Department of Transportation capital outlay, and increases totaling $12.7 million proposed by the California Highway Patrol and the Department of Motor Vehicles. The Department of Transportation's increase consists of $53.5 million in the highway program to pay the state's share of the State Transportation Improvement Program, and $28.8 million for the acquisition and improvement of intercity and commuter rail stations.

Correctional Programs. The $146.9 million increase in correctional programs reflects major appropriations from the proposed New Prison Construction Act of 1981 for new prison facilities. The majority of these appropriations is contingent on statewide approval of the bond program that will be on the statewide ballot in June 1982.

Other Programs. In general, the increases shown for other areas are not true increases. They reflect the administration's decision to defer capital outlay projects in 1981–82 and rebudget them in 1982–83. Thus, the proposed level of capital outlay includes both 1981–82 projects and new projects proposed for the budget year. In addition, the budget proposes an increase in appropriation from the Parklands Fund of 1980, for the Department of Parks and Recreation.

The $20.4 million reduction for State Consumer Services capital outlay is primarily a result of excluding construction funding for new office buildings. The budget indicates that the San Francisco office building, which was funded in the 1981 Budget Act ($34.4 million), may be constructed under a lease-purchase arrangement, rather than as a capital outlay project. The reduction shown for Health and Welfare reflects completion of the program to correct fire/life safety and environmental deficiencies at the state hospitals.

Distribution by Fund Source. Table 13 shows how the capital outlay amounts requested in the Budget Bill are distributed by fund among the major budget categories. The funds, if appropriated, will be available for expenditure over a three- to five-year period, and therefore do not represent the amount of expenditures to be made in the budget year.

As shown in Table 13, the capital outlay program is supported by special funds and bond funds exclusively. Approximately 48 percent ($201 million) of special fund appropriations are requested from the State Transportation Fund and various special funds in the Resources Agency. The remaining 52 percent ($220.1 million) is requested from tidelands oil revenues. The proposed bond fund appropriations are requested from the previously approved Parks and Recreation Bond Act, Health Science Facilities Construction Bond Act, and Community College Bond Act. The $161.8 million of bond funds for the Correctional programs, however, are contingent upon voter approval of the new Prison Construction Bond Act Program of 1981, which will be on the statewide ballot in June 1982.

Table 13
Summary of 1982–83 Proposed Capital Outlay Appropriations
(in thousands)

Category	*General Fund*	*Special Funds*	*Bond Funds*	*Total*
State and Consumer Services	—	$29,113	—	$29,113
Business and Transportation	—	188,031	—	188,031
Resources	—	65,190	$52,102	117,292
Health and Welfare	—	28,100	—	28,100
Correctional Program	—	22,316	161,800	184,116
Education	—	86,275	969	87,244
General Government	—	2,113	—	2,113
Totals	—	$421,138	$214,871	$636,009

IV. REVENUES

A. OVERVIEW

The various expenditure programs discussed in our *Analysis* are supported by revenues which are derived from many different sources. The budget identifies over 50 specific individual revenue categories, ranging from taxes levied on individuals and businesses, to income which the state derives directly from its own assets, such as oil-producing properties and financial investments.

About 85 percent of all state revenues are deposited directly in the General Fund, from which they may be appropriated to support the general activities of state government. In most years, nearly 90 percent of these General Fund revenues are derived from three specific sources: the sales and use tax, the personal income tax, and the bank and corporation tax. Those state revenues that are not deposited in the General Fund are placed into special funds to support specific programs and activities, including highway maintenance and various construction projects.

Because the availability of revenues is the key determinant of how much the state can afford to spend on its programs, it is important to consider whether sufficient revenues will be collected to fund the Governor's proposed spending plan for 1982–83. The level of these revenues will be influenced by a variety of factors. These include the state's tax base under current law, the tax rates applied to this tax base, how future economic conditions will affect the size of this tax base, the time lags between when tax liabilities are incurred and when they are actually paid to the state, and the extent to which the Legislature chooses to enact the various income-enhancing measures which the budget proposes.

This section examines the Department of Finance's forecast for revenues from which the Governor's spending plan is to be funded, including the economic projections and other assumptions on which the revenue forecast is based.

Summary of the Economic Outlook

The single most important factor explaining the past and future performance of California state revenues is the behavior of the state's economy. Economic performance in 1981 was generally disappointing. Nationally, real Gross National Product (GNP) declined in two of the four quarters, both nominal and "real" interest rates were highly volatile and reached record levels, corporate profits fell for the second straight year, and unemployment climbed. California's economic performance in 1981 was also poor. For example, job growth in the state (1.1 percent) was lower than in any year since 1975, and new residential building permits (109,000) were at their lowest level since 1966. At year-end, the economy was in a recession.

The Department of Finance's economic forecast for 1982 and 1983 generally reflects the consensus of other economists in calling for a mixed performance. In the near term, the economy is expected to remain weak, with a continued fall in real GNP, employment and corporate profits in the first quarter of 1982. During this period, however, the forecast also assumes that inflation, interest rates, and excess inventories will be declining. These developments are expected to help halt the economic downturn by spring and put the economy into a recovery phase by mid-year. Further support for the recovery will be provided after July, when the second installment of President Reagan's tax reduction package goes into effect. However, the pace of recovery in the second half of 1982 is expected to remain quite moderate, largely because of upward pressures on interest rates due to the combination of a tight monetary policy, rising demand for credit by businesses and individuals, and federal government borrowing to finance a deficit of unprecedented proportions. These interest rate pressures will limit the near-term recovery, particularly in such credit-sensitive sectors as business investment and residential construction.

Nevertheless, the recovery is projected to continue beyond 1983. The department predicts that the rate of job growth in California will climb from only 1.1 percent in 1982 to 4.1 percent in 1983, 5.2 percent in 1984, and 4.1 percent in 1985, resulting in a steady fall in the unemployment rate from 8.1 percent in 1982 to 5.8 percent by 1985.

No one can say whether the department's economic forecast will prove to be accurate. Economic forecasters have had a very poor record in projecting the economy's performance in recent years, and we can have only limited confidence in the ability of the Department of Finance or any other forecaster to accurately foresee the future, even over a period as short as the next 12 months. This is particularly true at the present time, given the tremendous uncertainties characterizing the current economic environment. These uncertainties include the future course of federal monetary policies, the Reagan Administration's decisions during 1982 affecting taxes, spending and the federal deficit, and the reactions of businesses and financial markets to future trends in interest rates and inflationary expectations, which are themselves difficult to predict. We believe that because of these factors, and the precariousness with which the 1981–82 and 1982–83 budgets are balanced, the Legislature will need to keep a close watch on economic developments in the months to come and be prepared to revise the state's revenue outlook accordingly.

Summary of the Revenue Outlook

Table 14 summarizes the Governor's Budget estimates of total, General Fund, and special fund revenues. The table shows that:

- ***Prior year*** (1980–81) total revenues were $22.1 billion (a growth of $1.2 billion, or 5.7 percent, over the preceding year). This amount included about $19 billion in General Fund revenues (a growth of $1 billion, or 5.5 percent), and $3.1 billion in special funds revenues (a growth of $190 million, or 6.6 percent).

- *Current year* (1981–82) total revenues are estimated to reach $24.2 billion (a growth of $2.1 billion, or 9.7 percent), including revenues of $21.5 billion to the General Fund (a growth of $2.5 billion, or 12.9 percent). Revenues to special funds are estimated at $2.8 billion, or $325 million (10.5 percent) below the prior year amount. As discussed below, this decline results primarily from the one-time shift of certain special fund income directly into the General Fund.
- *Budget year* (1982–83) total revenues are projected at $27.0 billion ($2.7 billion, or 11.3 percent, above the estimated current-year level). This amount includes $23.6 billion in General Fund revenue (a growth of $2.1 billion, or 9.8 percent), and $3.4 billion in special funds revenue (a growth of $635 million, or 23 percent). The unusually large jump in special funds revenue occurs because special fund transfers to the General Fund are much larger in the current year than in the budget year.

Table 14

Summary of 1980–81, 1981–82, and 1982–83
General Fund and Special Funds Revenue Performance
(dollars in millions) [a]

	Prior Year (1980–81)	*Current Year (1981–82)*	*Budget Year (1982–83)*
General Fund Revenue			
—Amount	$19,023	$21,481	$23,580
—Dollar change	$995 [b]	$2,458	$2,099
—Percent change	5.5% [b]	12.9%	9.8%
Special Funds Revenue			
—Amount	$3,081	$2,756	$3,391
—Dollar change	$190 [b]	−$325	$635
—Percent change	6.6% [b]	−10.5%	23.0%
Total, General Fund and Special Funds Revenue			
—Amount	$22,104	$24,237	$26,971
—Dollar change	$1,185	$2,133	$2,734
—Percent change	5.7%	9.7%	11.3%

[a] 1982–83 Governor's Budget. Detail may not add to totals due to rounding. Figures include effects of all revenue-enhancing measures proposed in the budget.
[b] 1979–80 base for computing changes has been adjusted to account for changes in the treatment of certain special fund transfer income.

By historical standards, revenue growth for these three years is low. For example:

- Growth in total ***current dollar*** revenues over the 10-year period preceding 1980–81 averaged over 15 percent per year, compared to 5.7 percent for 1980–81, 9.7 percent for 1981–82, and 11.3 percent for 1983–84;
- Growth in total ***constant dollar*** revenues (that is, revenues adjusted for inflation) averaged 7 percent over this 10-year period, compared to a decline of about 3 percent in 1980–81 and increases of only 1 percent in 1981–82 and 3 percent in 1982–83; and
- Growth in total ***constant dollar per capita*** revenues (that is, revenues adjusted for both inflation and population increases) averaged 5.2 percent over the 10-year period, versus declines of almost 5 percent in 1980–81 and 1 percent in 1981–82, and an increase of under 1 percent in 1982–83.

Of course, without tax enhancements proposed in the budget, the current and budget year revenue growth rates are even lower than those noted above.

The two main reasons for these historically-low rates of revenue growth are (1) the current weaknesses in the economy and (2) the fiscal effects of income tax indexing. The latter is projected by Finance to reduce 1982–83 General Fund revenues by over $3.1 billion below what it would have been without indexing. Our estimate of this effect is even larger—$3.6 billion. Current and budget year revenue growth, however, would be even weaker by historical standards were it not for the following factors:

- *First,* the budget revenue projections include the effects of a number of proposals to enhance revenues. These include accelerating the collection of certain taxes, increasing the interest penalties on late tax payments, and levying certain fees and user costs. These proposals amount to $338 million in 1981–82 (of which $233 million is a one-time gain) and $696 million in 1982–83 (of which $397 million is a one-time gain).
- *Second,* SB 215 (Ch 541/81) increased gasoline and diesel taxes, motor vehicle registration fees, truck weight fees, and driver's license fees. The result was to increase special fund revenues from motor vehicle user taxes and fees by $200 million in the current year and over $475 million in the budget year.

It is also important to recognize that the current and budget year revenue totals include significant redistributions of revenue from special funds to the General Fund. These redistributions, which are primarily one-time, are being proposed along with the other revenue-enhancing measures mentioned above in order to balance the General Fund budget. They total over $700 million in 1981–82 and $450 million in 1982–83. If the Department of Finance's economic forecast for 1982 and beyond comes true, a continuation of these transfers would not be necessary after 1982–83. This is because the regular General Fund tax base would generate enough revenues to fund the anticipated growth in future expenditures.

We now turn to a more detailed discussion of state revenues in the prior year (1980–81), current year (1981–82), and budget year (1982–83). First, however, it is important to look more closely at the economic assumptions on which the current and budget year revenue forecasts are based.

B. THE ECONOMIC OUTLOOK

1. THE 1981 ECONOMY IN RETROSPECT

On Balance, a Disappointing Year for California

For the second year in a row, the economy was a disappointment in many respects. Table 15 summarizes how the California economy fared during the year relative to Finance's projections. It indicates that:

- *Employment growth* fell below expectations. Civilian employment rose by only 1.1 percent, compared to the 4.5 percent increase expected one year ago. Wage and salary job growth was somewhat better (2.0 percent), although it, too, was less than predicted (2.4 percent).
- *Unemployment* averaged 7.4 percent compared to the 6.7 percent expected last year, and ended the year at 8.9 percent. This was the highest December rate in five years.

Table 15
Summary of 1981 Economic Performance for California [a]

Economic Indicators	*Original January 1981 Forecast* [b]	*Revised May 1981 Forecast*	*January 1982 Estimated Actual* [c]
Percent change in:			
—Personal income	11.9%	12.7%	12.1%
—Civilian employment	4.5%	2.5%	1.1%
—Wage and salary employment	2.4%	2.2%	2.0%
—Consumer prices	11.4%	10.3%	11.1%
Unemployment rate (%)	6.7%	7.6%	7.4%
Residential building permits (thousands)	175	155	109
New car sales (thousands)	975	1,015	930

[a] Forecasts and estimates by the California Department of Finance.
[b] 1981–82 Governor's Budget.
[c] 1982–83 Governor's Budget.

- ***Residential building permits*** were reported at only 109,000, compared to the predicted level of 175,000. This performance was the worst since 1966, when permits totaled about 100,000 but population was over 20 percent less than today.
- ***New car sales*** were 930,000, some 45,000 less than projected.
- ***"Real" personal income*** (that is, income adjusted for inflation) rose only 0.9 percent, if the Consumer Price Index (CPI) is used as a measure of inflation. This is because CPI inflation (11.1 percent) was very high relative to nominal personal income growth (12.1 percent). The CPI, however, has certain biases which appear to have overstated inflation. Depending on the extent of this bias, real income growth was probably somewhat more than 0.9 percent.
- ***Taxable sales*** rose 9.3 percent, well-below the 14.3 percent average from the preceding five years and much less than the increase in 1982 personal income.

Table 16 summarizes how successful forecasters other than Finance were in predicting California's economic performance. While the results are mixed, on balance these other forecasters appear to have expected somewhat better economic performance than occurred. For example, all but two forecasters overestimated personal income growth, everyone underestimated inflation and, as a result, all forecasters overestimated the state's growth in "real" personal income. Similarly, all but one forecaster overestimated employment growth. And as the last column in Table 16 indicates, no forecaster came even remotely close to foreseeing the collapse of the residential construction sector.

Economic Weaknesses a Nationwide Problem

California's economic problems in 1981 were, to a large extent, simply reflections of economic weaknesses affecting the nation generally. For instance:

- The ***nation's real GNP*** was only 2.1 percent higher in the fourth quarter of 1981 than in the first quarter of 1980, nearly two years earlier. On three occasions during this period, quarterly real GNP actually declined.

Table 16
Accuracy of 1981 Economic Forecasts for California[a]

	Economic Variables					
Forecaster	*Personal Income Growth*	*Consumer Price Inflation*	*"Real" Personal Income Growth*[b]	*Wage and Salary Employment Growth*	*Unemployment Rate*	*New Residential Building Permits (thousands)*
Department of Finance	11.9%	11.4%	0.5%	2.4%	6.7%	175
United California Bank	12.9	11.0	1.7	3.4	6.5	185
Security Pacific Bank	12.5	10.2	2.1	2.7	7.6	170
Wells Fargo Bank	13.0	10.0	2.7	2.8	7.0	175
Bank of America	12.0	10.0	1.8	2.2	8.0	175
UCLA	12.6	9.6	2.7	3.0	7.5	169
Crocker Bank	11.2	10.0	1.1	1.6	7.5	165
Average of All Forecasters	12.3%	10.3%	1.8%	2.6%	7.3%	173
Actual[c]	12.1%	11.1%	0.9%	2.0%	7.4%	109

[a] Forecasts as of approximately year-end 1980.
[b] Defined as personal income growth adjusted for consumer price inflation as measured by the California CPI. If the U.S. GNP Personal Consumption Expenditures (PCE) Deflator were used instead of the CPI to measure inflation, growth in "real" 1981 personal income would be 4.1 percent instead of 1.4 percent.
[c] As estimated in the 1982–83 Governor's Budget.

- U.S. before-tax ***corporate profits*** fell in each of the past two years.
- ***Housing starts*** in the fourth quarter of 1981 had fallen to an annual rate of only 870,000. For the year as a whole they averaged only 1.1 million, the worst performance since 1945;
- ***Capacity utilization*** averaged only 70 percent for the year, lowest in the postwar period.
- ***Interest rates*** remained high throughout the year, and were also quite volatile. Early in 1981, the prime rate reached 21.5 percent, then fell to 17 percent, rose again at mid-year to reach 20.5 percent and fell thereafter to end the year at 16 percent, slightly higher than it started 12 months earlier. Long-term interest rates, however, did not see an end-of-year decline. In fact, the corporate AAA bond rate had risen to 14.5 percent at year-end, while the average tax-exempt municipal bond rate exceeded 13 percent.

What Went Wrong?

Why did the economy perform so poorly in 1981? Some of the nation's leading economists openly disagree with one another about the exact causes of our current economic problems and the steps that are needed to overcome them. However, many economists share the belief that 1981's poor performance in terms of output and employment is most directly attributable to tight monetary policies pursued by the Federal Reserve Board (FED). These policies tend to restrict credit availability, put upward pressures on interest rates, and thereby discourage borrowing to finance home buying and business investment. However, the FED's purpose in attempting to reduce monetary growth stems directly from the need to lower inflation, which is ultimately caused by "too much money." Had more expansionary monetary policies been followed during 1981, it is possible that the economy might have performed better in terms of job growth and output, but at the cost of higher inflation in the future. Such inflation could, after a lag, result in even higher interest rates and a weaker economy than exists at present. Thus, selecting the proper policy prescription to rectify today's problems is a difficult and, as of yet, unresolved issue.

As 1982 begins, there is little data indicating that brighter days for the economy are immediately ahead. Indeed, softness in many underlying economic indicators, such as declining real income growth for consumers, excess inventories, and low capacity utilization rates, argue against any quick rebound in business activity. Because of preliminary data showing that real GNP declined at a 5.2 percent rate in the fourth quarter of 1981 and the high probability that there will be another (though probably smaller) decline in the current quarter, most economists concur that we are in the midst of a recession. Thus, the economy closed 1981 and began 1982 on a very negative note.

Table 17
Department of Finance Economic Outlook for California and the Nation (dollars in billions) [a]

	1981 Estimated		*1982 Forecast*		*1983 Forecast*	
	Level	*Percent Change*	*Level*	*Percent Change*	*Level*	*Percent Change*
A. *The Nation*						
GNP in current dollars	$2,914.9	11.0%	$3,164.8	8.6%	$3,557.3	12.4%
GNP in 1972 dollars	$1,507.8	1.8	$1,502.5	−0.4	$1,561.9	4.0
Personal income	$2,406.0	11.4	$2,624.0	9.1	$2,913.7	11.0
Corporate profits (pre-tax)	$225.3	−8.2	$229.6	1.9	$282.3	23.0
Employment (in thousands)	98,439	1.2	98,750	0.3	101,301	2.6
Housing starts (millions of units)	1.12	−13.8	1.24	10.2	1.54	24.0
New car sales (millions of units)	8.7	−3.4	8.5	−1.6	9.4	9.6
GNP price deflator (1972=100)	193.3	9.0	210.6	8.9	227.8	8.1
Consumer price index (1967=100)	272.8	10.5	296.0	8.5	318.2	7.5
GNP consumption deflator (1972=100)	193.8	8.3	208.9	7.8	224.4	7.4
Unemployment (%)	7.5%	—	8.4%	—	7.6%	—
Savings rate (%)	5.3%	—	5.7%	—	6.4%	—
B. *California*						
Personal income	$291.1	12.1%	$321.1	10.3%	$358.1	11.5%
Employment (in thousands)	10,557	1.1	10,668	1.1	11,131	4.3
Residential building permits (in thousands)	109	−24.3	125	14.4	175	40.0
Consumer price index	277.0	11.1	308.2	11.3	333.7	8.3
Unemployment rate	7.4%	—	8.1%	—	7.1%	—

[a] Source: Department of Finance and 1982–83 Governor's Budget.

2. THE ECONOMIC OUTLOOK FOR 1982 AND 1983

Economic activity in calendar 1982 will account for about one-third of current year (1981–82) General Fund revenues and about two-thirds of budget year (1982–83) General Fund revenues. The remaining one-third of budget year revenues will be determined by 1983 economic conditions. Table 17 summarizes the Department of Finance economic projections for 1982 and 1983 for both the nation and California.

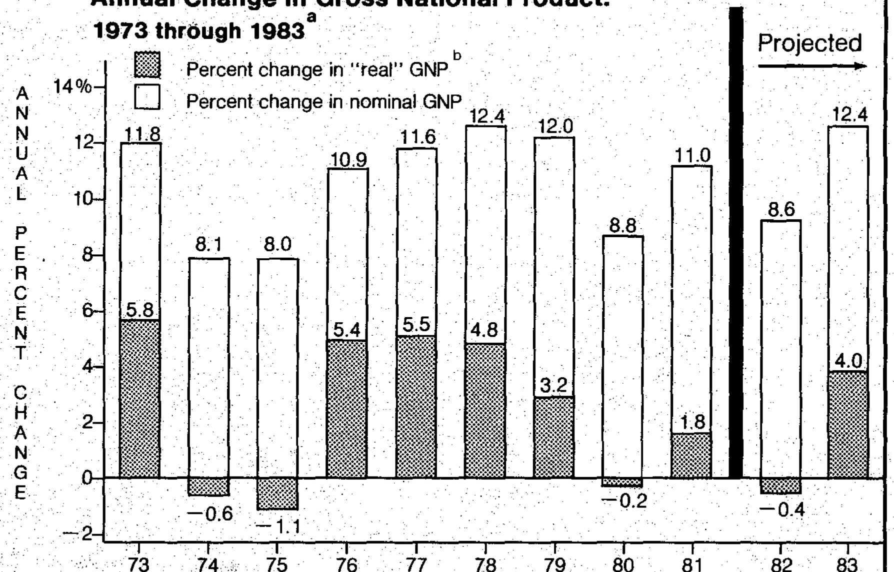
The Nation—From Recession to Recovery

The department predicts that the current recession will be over sometime in the spring months, and that economic recovery will be underway in the last half of 1982. The recovery is expected to be moderate, though sustained, carrying forward beyond 1983. As shown for the nation in Table 17:

- ***Real GNP*** is projected to decline by 0.4 percent for 1982 as a whole, and then rise by a strong 4.0 percent in 1983 (Chart 10).
- ***Pre-tax corporate profits*** are expected to post a very small gain in 1982, before rebounding to a 23 percent gain in 1983.

Chart 10

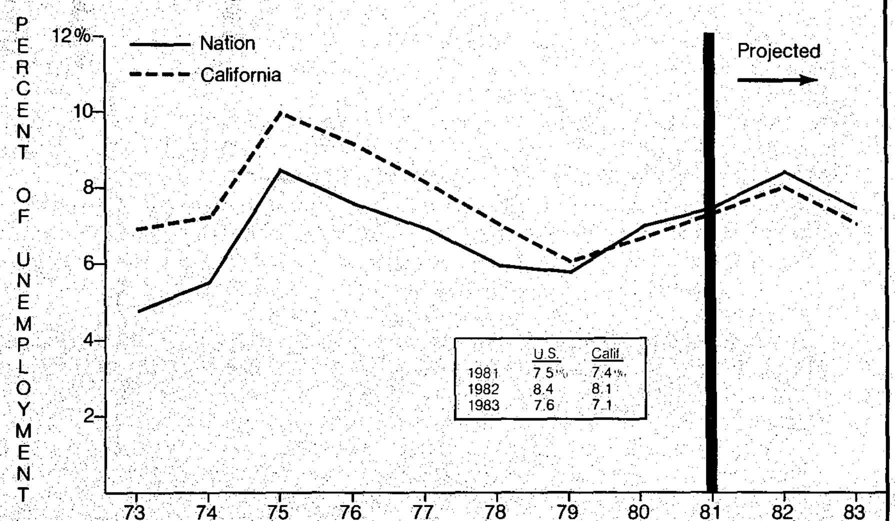
Annual Change in Gross National Product. 1973 through 1983[a]



[a] California Department of Finance. 1981 figures are preliminary.
[b] "Real" GNP is defined as current dollar nominal GNP deflated by the U.S. GNP price deflator.

Chart 11

Unemployment Rates for California and the Nation 1973 through 1983[a]



[a] California Department of Finance.

- *Unemployment* is expected to average 8.4 percent in 1982. In 1983, it is predicted to fall to 7.6 percent, which would still be above its 1981 level (Chart 11).
- *Employment growth* is expected to be negligible in 1982, rising only 0.3 percent versus the 1.2 percent gain of 1981. In 1983, a moderate gain of 2.6 percent is projected.
- *Housing starts* will remain weak in 1982 at 1.24 million units, and then rise to a modest 1.54 million units in 1983.
- *Car sales* will also remain weak in 1982, totaling only 8.5 million units, or even less than the 1982 level. In 1983, however, an increase to 9.4 million units is projected.

California—A Similar Recession-Recovery Outlook

Most economists who study the California economy believe that the state will fare better in the current recession than the nation. This is largely because California is less dependent than many other large industrial states on interest-sensitive heavy manufacturing industries (like the automobile industry), which are particularly vulnerable during recessions. Nevertheless, the recession clearly is expected to take its toll in the state. As shown in Table 17:

- *Civilian employment growth* in 1982 is projected to rise only 1.1 percent. As Chart 12 shows, California wage and salary job growth is also projected to be only 1.1 percent in 1982, representing just 114,000 new jobs. This would be the smallest number of new jobs created in any year since 1975.
- *The unemployment rate* is expected to rise from 7.4 percent in 1981 to 8.1 percent in 1982, or slightly below the nation's. As Chart 11 indicates, the state's unemployment rate is then expected to decline to 7.1 percent in 1983, or somewhat more rapidly than the nation's.
- California *construction activity*, like the nation's, is expected to improve only slightly in 1982. Building permits are projected to reach only 125,000 in 1982, before rising to 175,000 in 1983. Most economists believe that building permits in California need to average about 200,000 or more per year in order to meet the basic demand for new housing associated with natural population growth, new household formations and in-migration.

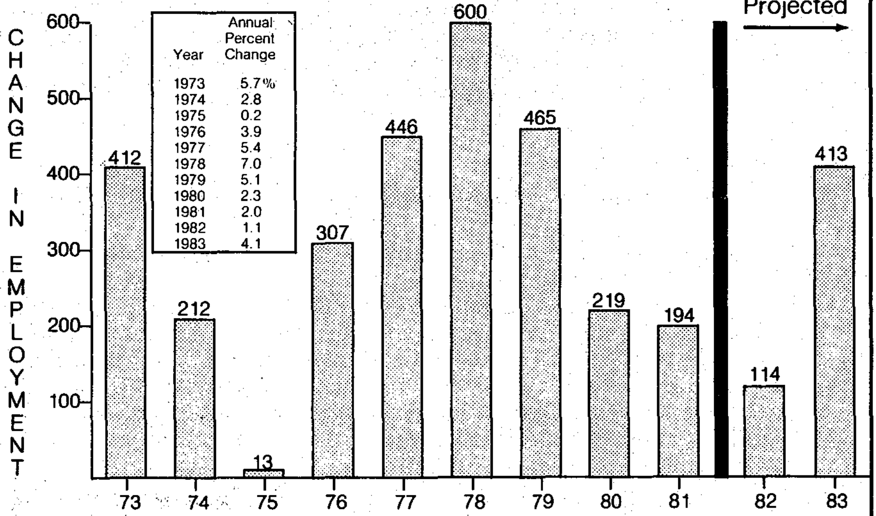
The implications of the current economic outlook for state revenues are best seen in the forecasts for those key California variables which most strongly affect the state's major revenue sources:

- *California personal income growth* (Chart 13) is projected to *decline* sharply from 12.1 percent in 1981 to only 10.3 percent in 1982, despite a projected rise in California inflation. As a result, "real" personal income growth (i.e., growth adjusted for inflation as measured by the CPI) is expected to fall by 1 percent in 1982.
- *Taxable corporate profits* are forecast to rise 10.8 percent in 1982 and 18.8 percent in 1983, following a gain of 11.9 percent in 1981. These 1982 and 1983 gains are below the 20-percent-plus increases experienced in 1976–78 after the previous recession had ended. However, they are still quite large, given the generally weak state of the economy. As discussed later, we believe that the growth in California corporate profits could easily fall below that projected by Finance.
- *Taxable sales* are predicted to rise only 9.6 percent in 1982. In 1983, however, the projected rise in nominal (15.7 percent) and real (8.6 percent) taxable sales is comparable to that of 1976, the first full year

Chart 12

Annual Growth in California Wage and Salary Employment

1973 through 1983 (in thousands)[a]

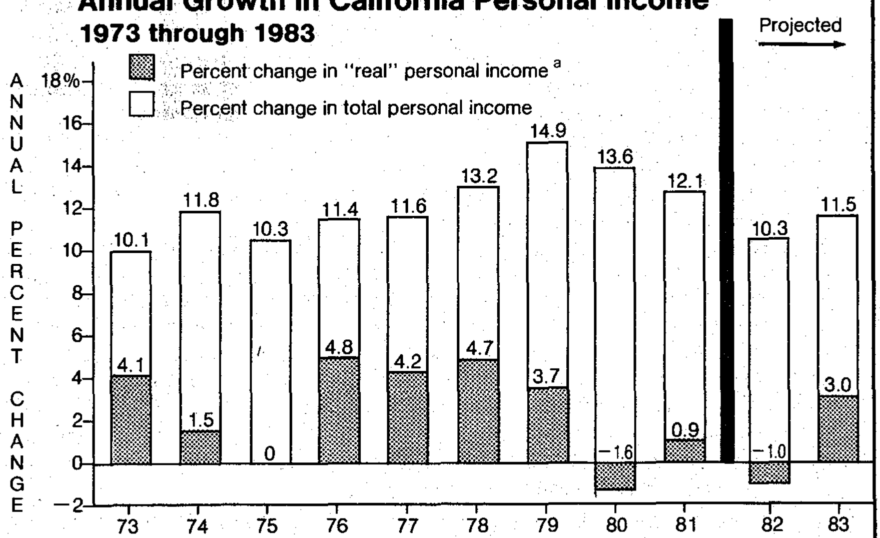


[a] Department of Finance and Employment Development Department. Data are estimated for 1981 and projected for 1982 and 1983.

Chart 13

Annual Growth in California Personal Income

1973 through 1983



[a] Real personal income is defined as total personal income deflated by the California Consumer Price Index for all urban households. Estimates for 1981, 1982, and 1983 prepared by the Department of Finance. Had real personal income been computed for these latter three years using the GNP Consumption Expenditures Deflator in place of the CPI, real income growth would be 3.5 percent (1981), 2.2 percent (1982) and 3.8 percent (1983).

of recovery following the 1973–75 recession. While the 1982 nominal gain exceeds the 9.3 percent gain of 1981, the increase, after adjustment for inflation, is only 2.5 percent.

These projections are all consistent with the concensus view of economists that the first half of 1982 will be a period of negative or flat growth, and that economic gains in the second half of 1982 will be only moderate. It is primarily because of this moderate economic recovery that only relatively modest gains are anticipated for state revenues in 1981–82 and 1982–83.

Inflation to Trend Downward

The outlook for inflation is moderately favorable. As shown in Table 17 and Chart 14:

- Inflation for the *nation* is expected to decline, though only slowly, through 1983. The nation's CPI is projected to fall to 8.5 percent in 1982 and 7.5 percent in 1983, and the GNP consumption deflator is projected to average 7.9 percent in 1982 and 7.4 percent in 1983.
- For *California*, the CPI is forecast to average 8.3 percent by 1983. Although this rate will exceed the nation's, primarily due to the state's tendency to record above-average increases in homeownership costs, this still represents a significant improvement over the average 15.5 percent inflation rate experienced in 1980.

Table 17 and Chart 14 indicate that the state's CPI increase in 1982 is expected to average 11.3 percent for the year as a whole, or slightly *above* the estimated 1981 rise of 11.1 percent. The higher *average* rate of inflation forecast for 1982 might appear to be inconsistent with the department's expectation of a declining *trend* in inflation during 1982. The explanation for the higher average increase lies not in the trend but in the monthly pattern which the CPI followed in 1981.

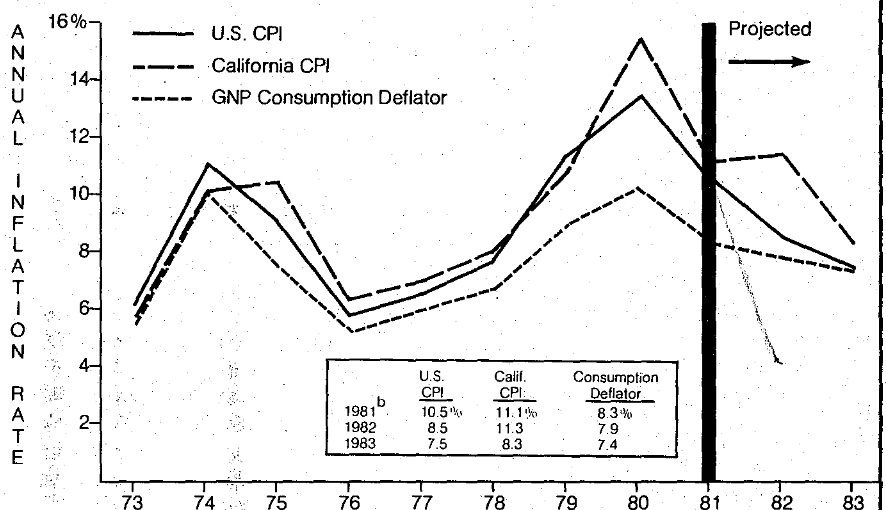
The outlook for a declining inflation trend in 1982 is supported by a number of fundamental inflation-determining factors. These include:

- Large amounts of *excess productive capacity* in the economy;
- A very favorable outlook for *food prices* in 1982 (projected to rise between 6 and 7 percent);
- The likelihood that *OPEC oil prices* will remain stable in 1982 and that petroleum demand may decline further, due to conservation efforts;
- Continued efforts by the Federal Reserve to avoid excessive rates of *money supply growth;* and
- Moderation in *collective bargaining wage increases.* In 1982, some 4.5 million workers will have new contracts negotiated, covering major industries like petroleum, rubber, electrical products, airlines, trucking and autos. In 1980 and 1981, wage increases averaged about 11 percent. Early evidence suggests that the average collective bargaining wage increase could drop into the 8 percent to 9 percent range, primarily because rising unemployment has weakened the bargaining power of unions. This moderation will help to reduce the growth in unit labor costs firms face, and enable them to achieve target profit margins with lower price increases.

Given these factors, it seems possible that the department's inflation projections could be on the high-side, since its predicted monthly inflation trend, though heading in a downward direction, declines at a mild rate. Some evidence that the department's inflation forecast may be too high appeared in late January, when the federal government reported that the increase in U.S. consumer prices from December 1980 through December 1981 averaged 8.9 percent, or about 1 percentage point below the department's budget estimate of 9.9 percent. Likewise, the December 1980 to December 1981 California CPI increase was 11.2 percent, compared to the department's estimate of 13 percent. As noted below, Finance's inflation projections are also on the high side relative to other forecasters.

Chart 14

Inflation Faced by Consumers in California and the Nation[a]
1973 through 1983



	U.S. CPI	Calif. CPI	Consumption Deflator
1981[b]	10.5%	11.1%	8.3%
1982	8.5	11.3	7.9
1983	7.5	8.3	7.4

[a] California Department of Finance. CPI figures are for all-urban index. Figures for the GNP Consumption Deflator are subject to revision for recent years, due to periodic GNP data adjustments.
[b] Preliminary estimates.

Federal Policies—Critical to the Outlook

There are two general categories of federal policies which can influence economic activity. First, there are the taxing and spending policies of the federal government, which are generally referred to as *fiscal policies.* And second, there are the policies regarding management of the nation's money supply and certain interest rates by the Federal Reserve Board, which are referred to as *monetary policies.* For 1982, the future course of these federal monetary and fiscal policies represents the single biggest uncertainty in the economic outlook, and will probably also exert the greatest influence on actual economic performance in the nation and state.

During 1981, the President developed and began implementation of a plan aimed at stimulating the economy, eliminating excessive inflation, encouraging productivity and investment, eliminating the federal deficit, and increasing the nation's defense capabilities. This plan has three major components:

- A significant *reduction* in the growth of *total federal spending;*
- A shift in the *mix* of federal spending, in favor of *defense-related* spending at the expense of nondefense spending; and
- Significant *tax cuts* for individuals and businesses, includng phased-in reductions in personal income tax rates and more liberal depreciation rules for plant, equipment, and residential and nonresidential properties. These tax cut provisions were enacted as the Economic Recovery Tax Act of 1981, which also included tax provisions to stimulate savings in the form of individual retirement accounts (IRA's).

In conjunction with these provisions, the administration expressed support for the Federal Reserve Board's current policy of limiting growth in the money supply so as to reduce inflation.

At present, the ability of the President to continue implementing his original plan is uncertain. He had hoped that the tax provisions would stimulate the economy and make up for the depressing effects of reduced federal spending. However, largely because of the recession, estimates of the federal deficit have risen dramatically in recent months to as high as $175 billion for fiscal 1983. Exactly how this might force the President to modify his current tax and spending plans is unknown. In addition, if the federal government is required to finance such a large deficit by borrowing, the effect could be to put increased pressure on the Federal Reserve Board to provide the economy with additional credit so that private sector borrowers are not "crowded out" by the federal government. The effect of this would be to increase the money supply and thereby possibly also increase inflation and interest rates in the future. Thus, the exact course which fiscal and monetary policies will take in 1982 and 1983 remains somewhat clouded.

Finance Versus Other Forecasters

Tables 18 and 19 compare the Department of Finance's national and California economic forecasts for 1982 with those of other economists. On balance, most of the forecasters envision the same general type of economy in 1982 as Finance does—weak economic growth, high inflation, and poor performance in terms of profits, home building, and car sales.

Table 18 indicates that Finance's *national* forecast is similar to the others in terms of real GNP growth and housing starts. However, Finance appears to be somewhat on the high-side regarding unemployment, inflation, and especially, profit growth. Regarding *California,* Table 19 suggests that Finance is on the high-side regarding personal income growth, inflation and employment growth, slightly optimistic regarding unemployment, and reflects the concensus regarding residential housing activity. The difference in inflation forecasts is particularly striking. Even if UCLA's low-end 1982 inflation forecast of 5.7 percent is excluded from the comparison, Finance's inflation forecast is still about three percentage points higher than the remaining forecasters'.

Our discussions with these forecasters indicate that they all exhibit considerable uncertainty about exactly what will happen over the next two years, and expect to have to revise their projections frequently in the months to come. Given this, we believe that the department's economic forecast is as reasonable as anyone's at this point in time, although the odds are low that it, or any of the other forecasts shown, will turn out to be on target.

Table 18
Comparison of 1982 National Economic Outlook for Selected Forecasters

	Percent Change in: Real GNP	GNP Prices	Consumer Prices	Before-Tax Profits	Unemployment Rate	New Car Sales (millions of units)	Housing Starts (millions of units)
Department of Finance	−0.4%	8.6%	8.5%	1.9%	8.4%	8.5	1.24
Other Forecasters[a]							
First Interstate Bank[b]	2.5%	7.9%	8.2%	11.2%	7.1%	9.7	1.55
Security Pacific Bank	−0.3	7.9	7.8	−3.5	9.2	8.9	1.30
Wells Fargo Bank	0.1	7.8	8.3	N.A.	8.2	9.2	1.20
Bank of America	−0.9	7.7	8.2	−15.6	8.7	8.9	1.20
Crocker Bank	−0.5	7.5	7.6	N.A.	8.6	8.9	1.32
UCLA	−1.7	7.1	5.9	−15.9	8.9	8.3	1.32
Chase Econometrics	—	8.2	8.4	−7.0	9.0	9.4	1.26
Data Resources	−0.6	7.7	8.3	−7.1	8.6	9.1	1.28
Average of "Other" Forecasters	−0.2%	7.7%	7.8%	−6.3%	8.5%	9.0	1.31

[a] Forecasts as of approximately year-end 1981.
[b] Formerly United California Bank (UCB). Forecast as of October 1981.

Table 19
Comparison of 1982 California Economic Outlook for Selected Forecasters

	Percent Change in: Personal Income	Consumer Prices	"Real" Personal Income[c]	Wage and Salary Employment	Unemployment Rate	New Residential Building Permits (thousands)
Department of Finance	10.3%	11.3%	−0.9%	1.1%	8.1%	125
Other Forecasters[a]						
First Interstate Bank[b]	11.0%	8.3%	2.5%	2.7%	6.9%	164
Security Pacific Bank	9.9	8.4	1.4	1.0	8.6	125
Wells Fargo Bank	11.0	8.0	2.8	1.0[d]	8.5	110
Bank of America	9.0	7.5	1.4	1.0[d]	8.0	135
Crocker Bank	9.0	7.8	1.1	0.2	8.4	138
UCLA	7.8	5.7	2.0	−0.5	8.8	133
Average of "Other" Forecasters	9.6%	7.6%	1.9%	0.9%	8.2%	134

[a] Forecasts as of approximately year-end 1981.
[b] Formerly United California Bank (UCB). Forecast as of October 1981.
[c] Defined as personal income growth adjusted for consumer price inflation. If the GNP consumption expenditures deflator were used instead of the CPI, "real" personal income growth would be somewhat higher.
[d] Civilian employment growth estimate.

C. PRIOR YEAR (1980–81) REVENUES

Smallest Increase in 10 Years

Table 20 summarizes 1980–81 General Fund revenue collections. These receipts totaled $19,023 million, or only 5.5 percent ($994 million) over 1979–80—a very modest increase. In fact, this was the smallest rate of increase in General Fund revenues since 1970–71. As Table 20 shows:

- ***Sales and use taxes*** increased 7.4 percent, or $484 million. This increase was much less than the rate of growth in state personal income, and reflects the depressing effect of high interest rates and declining real income on purchasing, especially of building supplies and consumer durables like automobiles.
- ***Personal income taxes*** rose only 1.9 percent, or $123 million. This extremely low growth is primarily due to income tax indexing, and reflects two factors. First, the June-to-June inflation rate, which is the basis for indexing, rose by 17.3 percent in 1980, or far in excess of 1980 personal income growth (13.6 percent). And second, the indexing of the marginal tax brackets in 1980 shifted from "partial" to "full" indexing. The net result of these two factors was that many taxpayers essentially moved "backwards" through the income tax structure in 1980, causing their tax liabilities to actually fall as a percent of their income.
- ***Bank and corporation taxes*** rose by 8.8 percent, or $221 million.

Table 20
Growth of Prior Year (1980–81) General Fund Revenues by Type (in millions)[a]

	Actual 1979–80	*Actual 1980–81*	*Change*	
			Amount	*Percent*
Three major taxes:				
—Sales and use	$6,522	$7,006	$484	7.4%
—Personal income[b]	6,506	6,629	123	1.9
—Bank and corporation	2,510[c]	2,731	221	8.8
Other major taxes and licenses	1,366	1,442	76	5.6
Interest income	547	464	−83	−15.2
Other revenues and transfers[d]	578	751	173[e]	29.9[e]
Total General Fund Revenues and Transfers	$18,029[c]	$19,023	$994	5.5%

[a] Detail may not add to total, due to rounding.
[b] Includes effect of moving from "partial" to "full" indexing of the personal income tax marginal rate brackets between 1979 and 1980.
[c] Includes $43.6 million shown in the 1981–82 Governor's Budget as bank and corporation tax special fund revenue associated with AB 66 (Ch 1150/79). The 1982–83 budget does not treat these transfers as direct special fund income.
[d] Includes transfers from Federal Revenue Sharing Fund of $276.2 million in each year.
[e] Primarily reflects increased receipts from the Health Care Deposit Fund.

- ***Interest income*** fell by $83 million, primarily because of the decline in the size of the General Fund budget surplus available for investment.

Weakening Economy Causes Downward Revenue Revisions

Table 21 shows how the Department of Finance revised its 1980–81 revenue forecast over the past two years:

- Actual revenues were *less than the original estimate* presented in the 1980–81 Governor's Budget (January 1980) by $283 million, or 1.5

percent. This amount, which *excludes* the effects of 1980 tax legislation, reflects downward adjustments of $231 million for the sales and use tax, $136 million for the personal income tax, and $52 million for the bank and corporation tax. The total downward revision would have been much larger were it not for greater-than-expected interest income of $66 million, caused by the upward surge in interest rates during 1980.

- Actual revenues were also *less than the May 1980 revenue revision* provided to the Legislature before its action on the 1980–81 budget, by $277 million (1.5 percent).
- Actual revenues were *less than the mid-year estimate* prepared in January 1981 for the 1981–82 Governor's Budget, by $80 million, or 0.4 percent.

Table 22 compares the department's revenue estimating errors for 1980–81 to those over the seven-year period since 1973–74. Two important points about the 1980–81 revenue estimates stand out:

- ***First,*** 1980–81 is the *only* year during this period when the department *overestimated* revenues; and

Table 21

1980–81 General Fund Revenues and Transfers History of Department of Finance Estimates (in millions) [a]

	Original Estimate in January 1980	Revisions: May 1980	Revisions: Adjustment for 1980 Legislation [b]	Revisions: January 1981	Revisions: May 1981	Revisions: January 1982	Actual	Total Revisions Adjusted for Legislation
Taxes:								
Sales and use	$7,240.0	$—	−$3.5	−$225.3	$27.8	−$33.2	$7,005.8	−$230.7
Personal income	6,800.0	−130.0	−35.2	15.2	−35.0	13.7	6,628.7	−136.1
Bank and corporation [c]	2,723.0	83.0	−17.2	−112.8	50.0	4.6	2,730.6	−52.2 [f]
Other taxes	1,517.1	−5.6	−14.7	48.1	−88.2	−13.7	1,443.0	−59.4
Total Taxes	$18,280.1	−$52.6	−$70.6	−$274.8	−$45.4	−$28.6	$17,808.1	−$478.4 [f]
Interest income	400.0	25.0	−2.0	28.6	8.4	3.6	463.6	65.6
Other revenues and transfers [d]	603.9 [e]	37.4	17.8	62.7	5.2	24.4	751.4	129.7
Total General Fund Revenues and Transfers	$19,284.0	$9.8	−$54.8	−$183.6	−$31.7	−$0.6	$19,023.1	−$283.1 [f]

[a] Detail may not add to total due to rounding.

[b] Department of Finance estimates, December 1980. Major fiscal legislation includes Ch 29/80 (AB 325), which provides for changes in the timing of income tax withholding remittances from certain employers. This measure reduced revenues by an estimated $30 million in 1980–81. In addition, Ch 1043/80 (AB 3383), which makes various changes in the horse racing statutes, reduced 1980–81 revenues by about $15 million.

[c] Revenues shown in this table have been reduced by $77 million for January 1980, $61 million for May 1980, $48 million for January 1981, and $53 million for May 1981, to account for transfers to special funds under AB 66 (Ch 1150/79). During this period, Finance was *proposing* legislation to treat these transfers as *direct* special fund income. In the 1982–83 Governor's Budget, however, there are no such transfers excluded from General Fund revenues.

[d] Includes $276.2 million transfer from the Federal Revenue Sharing Fund.

[e] Excludes a transfer of $77.8 million in tidelands oil income to the General Fund, which was *proposed* in the 1980–81 Governor's Budget. This proposal was not enacted, although additional tidelands oil revenues were allocated to the General Fund at later dates.

[f] Adjusts for effect due to change in treatment of AB 66 transfers between January 1980 and January 1982. See footnote "c."

Table 22
General Fund Revenue Estimating Errors, 1973–74 Through 1980–81 [a]

	Errors Made in Original January Budget [b]		Errors Made in May [c]		Errors Made in Midyear [d]	
	Dollar Error (in millions)	Percent Error [e]	Dollar Error (in millions)	Percent Error [e]	Dollar Error (in millions)	Percent Error [e]
1973–74	−$205	−2.9%	−$184	−2.6%	−$243	−3.5%
1974–75	−697	−8.1	−322	−3.7	−166	−1.9
1975–76	−459	−4.8	−621	−6.5	−451	−4.7
1976–77	−1,011	−9.8	−726	−6.4	−394	−3.5
1977–78	−1,339	−9.8	−966	−7.1	−331	−2.4
1978–79	−974	−6.4	−780	−5.1	−220	−1.4
1979–80	−680	−3.8	−502	−2.8	−204	−1.1
1980–81	283	1.5	277	1.5	80	0.4

[a] Revenue effects of new legislation and changes in the treatment of special fund transfers over time have been removed. Negative numbers indicate that revenues were underestimated; positive numbers indicate that revenues were overestimated.
[b] Difference between receipts estimated in January prior to the start of the specified fiscal year and actual receipts.
[c] Difference between receipts estimated in May prior to the start of the specified fiscal year and actual receipts.
[d] Difference between receipts estimated in January of the fiscal year specified and actual receipts.
[e] Error as a percent of actual revenues.

- *Second,* 1980–81 shows the *smallest* percentage errors for any of these years.

Prior to 1980–81, there had been concern that the department's persistent tendency to underestimate revenues—often by significant amounts—reflected an inherent conservative bias in its economic forecasting and revenue estimating procedures. However, based upon the record of 1980–81 as well as the downward revisions that have been made thus far to the 1981–82 revenue estimate, no such bias is evident today. We see no reliable indications at this time that the state can count on any significant revenue "windfalls" during the current or budget years, relative to what the department is projecting.

D. CURRENT YEAR (1981–82) REVENUES

Revenues Include Over $1.1 Billion Due to Special Factors

Table 23 summarizes the Department of Finance projections for General Fund revenues in 1981–82. Before turning to these figures, however, it is important to note that these current year estimates include $1.1 billion in "new" and primarily one-time General Fund monies. Thus, *the published revenue figures in the budget provide a distorted and overly-optimistic picture of the underlying growth trend of the state's General Fund revenue base.*

This $1.1 billion, which is needed in order to finance 1981–82 General Fund expenditures without incurring a budget deficit, includes the following:

- ***A $338 million increase in tax receipts*** from accelerating the payment of income tax withholding funds to the state ($200 million), increasing

Table 23
Growth of Current Year (1981–82)
General Fund Revenues by Type
(in millions)[a]

Revenue Source	*Actual for 1980–81*	*Current estimate for 1981–82*	*Change Amount*	*Change Percent*	*Change Without One-time Transfers or Revenue-Enhancement Proposals Amount*	*Change Without One-time Transfers or Revenue-Enhancement Proposals Percent*
Sales and use tax	$7,006	$7,593	$587	8.4%	$569	8.1%
Personal income tax	6,629	7,575	946	14.3	721	10.9
Bank and corporation tax	2,731	3,055	324	11.9	259	9.5
Other major taxes and licenses	1,442	1,477	35	2.4	−25	−1.7
Total Major Taxes and Licenses	$17,808	$19,700[b]	$1,892	10.6%	$1,524	8.6%
Interest income	464	314	−150	−32.3	−150	−32.3
Other revenues and transfers	751	1,468[c]	717	95.5	−19	−2.5
Total General Fund Revenues and Transfers	$19,023	$21,481	$2,459	12.9%	$1,355	7.1%

[a] Detail may not add to total, due to rounding.
[b] Includes $338 million in tax revenue enhancements proposed in the 1982–83 Governor's Budget.
[c] Includes over $730 million in increased transfers to the General Fund resulting primarily from a combination of (1) 1981 legislation regarding the distribution of tidelands oil revenues, (2) SB 102 (Ch 101/81) and (3) proposals contained in the 1982–83 Governor's Budget and in the 1982 Budget Bill.

the interest due on delinquent tax payments ($125 million), and eliminating the 1981–82 transfer to the State Highway Account of certain gasoline sales tax receipts ($13 million). One portion of this plan—the acceleration of withholding receipts—was enacted in January after the budget was introduced (AB 6x, Ch 2/82). The revenue gain for this provision is now estimated at $180 million, or $20 million less than proposed in the budget.

- A one-time transfer of $131 million to the General Fund from the *Motor Vehicle License Fee Account* under SB 102 (Ch 101/81), plus over $35 million in additional General Fund revenues due to permanent elimination of three local subvention payments under SB 102.
- ***Additional one-time transfers*** of nearly $600 million into the General Fund from various special funds, including the Capital Outlay Fund for Higher Education, the Energy and Resources Fund, the Special Account for Capital Outlay, the State Parks and Recreation Fund, the State School Building-Lease Purchase Fund, the Transportation Planning and Developoment Account, and the Employment Development Contingent Fund.

Of the total $1.1 billion of these new General Fund receipts, about $960 million represents purely one-time revenues, of which over $700 million reflects a temporary shift of income from special funds.

Limited Strength in Underlying Revenue Trend

Table 23 indicates that 1981–82 General Fund revenues are estimated to reach nearly $21.5 billion, including $7.6 billion for both the sales and use tax and the personal income tax, and $3.1 billion for the bank and corporation tax. This represents a gain in General Fund revenues of almost

$2.5 billion (12.9 percent) over 1980–81, or an increase of 4 percent in constant dollars and 2 percent in constant dollars per capita.

However, the table also indicates that the *underlying* General Fund revenue growth, computed by excluding the $1.1 billion in new revenues due to special funds transfers and tax proposals, is only $1.4 billion, or 7.1 percent. Furthermore, even when the low-growth non-tax components of interest income and remaining transfers are omitted, the projected increase in baseline revenues from the major taxes is still only 8.6 percent, or well below the 12.1 percent increase in personal income recorded for 1981.

The limited strength in the state's 1981–82 underlying General Fund revenue trend can be traced primarily to five factors:

- ***First,*** revenue growth has slowed significantly due to the *recession.* For example, taxable sales grew only 9.3 percent in 1981, or less than both California personal income (12.1 percent) and inflation (11.1 percent).
- ***Second,*** the personal income tax rate brackets were *fully indexed* in 1981 for inflation. This has reduced the frequency and pace at which taxpayers move upward through the state's progressive income tax schedules.
- ***Third, inheritance and gift tax*** revenues are projected to *decline* in 1981–82, reflecting the continued phasing-in of AB 2092 (Ch 634/80), which exempted all spouses from inheritance and gift taxation and increased certain other exemptions. This legislation is estimated to reduce 1981–82 revenues by about $100 million.
- ***Fourth, interest income*** is projected to fall by $150 million in the current year, due to the decline in the General Fund surplus available for investment.
- ***Fifth,*** 1981–82 General Fund receipts from the Federal Revenue Sharing Fund total only $180 million, compared to $276 million in 1980–81. This decline is because the federal revenue sharing program for states has now terminated, and the 1981–82 transfer reflects only the remaining partial year monies left over from the final federal payment. Thus, in 1982–83, the General Fund will not receive any revenue sharing funds.

Current Year Revenues—Largest Downward Revision on Record

Table 24 presents the history of General Fund revenue estimates for 1981–82. Clearly, the current recession has had a tremendous negative impact on the current year's revenue outlook. The table indicates that:

- 1981–82 revenues were initially revised *upward* in *May 1981,* by over $250 million. This revision included offsetting effects. Upward adjustments were made to the bank and corporation tax ($245 million), personal income tax ($100 million), and interest income ($48 million), while downward adjustments were made to the sales and use tax (over $41 million) and the "all other" tax category ($98 million). The department made this net upward adjustment primarily based on the economy's performance in the first quarter of 1981, which was far stronger than had been expected. For example, in the first three months of 1981 the nation's real GNP rose at an annual rate of 8.6 percent, personal income rose by over 14 percent (annual rate), and before-tax profits rose by nearly 22 percent (annual rate).
- In *January 1982,* however, projected revenues have been revised *downward* from the May estimate by over $870 million. This revision,

which adjusts for the fiscal effects of legislation enacted in 1981 and assumes *current law,* is the *largest downward revision recorded at midyear for any fiscal year in history.* It includes downward adjustments for the bank and corporation tax ($228 million), the personal income tax ($184 million), the sales and use tax ($359 million), other taxes ($49 million), and interest income ($61 million). When this January 1982 downward revision is combined with the upward May 1981 revision, baseline January 1982 General Fund revenues total nearly $21 billion—about $620 million lower than originally projected 12 months ago (after adjustments are made for legislative changes).

- The 1981–82 General Fund revenue total appearing in the budget—nearly $21.5 billion—results from adding to the $21 billion baseline revenue figure approximately $520 million in tax enhancements and special fund transfers proposed in the budget. This latter amount, when combined with the $585 million in General Fund revenue gains from special funds transfers enacted earlier in 1981, accounts for the nearly $1.1 billion special General Fund revenue adjustments discussed earlier.

Latest Cash-Flow Data Indicates Continued Weakness

January 1982 was the latest month for which data on agency cash collections of General Fund revenue was available before our *Analysis* went to print. During January, these revenue collections were $129 million below the forecast for January contained in the 1982–83 Governor's Budget. Even after adjustment for cash-flow shifts, the shortfall was $108 million. The largest source of the shortfall was the sales and use tax—down $44 million.

January data also indicated a shortfall in withholding receipts of about $7 million. While this was a relatively small dollar shortfall, it was the sixth consecutive month that these receipts have fallen below the department's projections. Because withholding is a key barometer of economic conditions and a good indicator of the income base which supports future spending, January's revenue performance was not very encouraging.

Revenue Picture Still Uncertain

We have taken the Department of Finance's economic assumptions and inserted them into our own revenue estimating equations to determine whether the 1981–82 revenue forecast is consistent with the economic forecast. In general, we believe that it is, as our computations produce a level of current year revenues which is only $30 million below the Finance estimates.

However, the 1981–82 revenue picture is still far from certain. Economic conditions during the first half of 1982 will account for about one-third of total current-year revenues, and it is very likely that certain aspects of the economic forecast which are key to estimating revenues will prove to be inaccurate. January's revenue performance is certainly consistent with this possibility.

In discussing the problem of revenue estimating error margins, the budget suggests that current year revenues could differ from the department's estimate by as much as 3 percent, or about $650 million. This is certainly possible, based on the record of previous mid-year estimates, as Table 22 illustrates. Given this and the absence of any significant reserve for absorbing revenue shortfalls or expenditure overruns, it is imperative that the department continuously review its 1981–82 revenue forecast in the coming months as additional economic and revenue data are available, and alert the Legislature as to any significant changes in the outlook.

Table 24

1981–82 General Fund Revenues and Transfers
History of Department of Finance Estimates
(in millions) [a]

Revenue Source	Original Estimate in January 1981	Revisions: May 1981 Revision	Revisions: 1981 Legislation	Revisions: January 1982 Baseline Revision [e]	Total Revisions Adjusted for Legislation	January 1982 Baseline Revenues [e]	January 1982 Proposed Enhancements to Revenues & Transfers	January 1982 Budget Estimate
Bank and corporation tax [b]	$3,035.2	$244.8	$28.0 [c]	–$288.0	–$43.2	$3,020.0	$35.0	$3,055.0
Personal income tax	7,435.0	100.0	–0.8	–184.2	–84.2	7,350.0	225.0	7,575.0
Sales and use tax	8,000.7	–40.7	–26.3	–358.7	–399.4	7,575.0	18.0	7,593.0
Other taxes	1,563.7	–97.8	–0.3	–48.9	–146.7	1,416.7	60.0	1,476.7
Total taxes	$20,034.6	$206.3	$0.6	–$879.8	–$673.5	$19,361.7	$338.0	$19,699.7
Interest income	$326.6	$48.4	—	–61.3	–12.9	313.7	—	313.7
Other revenue	401.7	–4.0	17.4	95.0	91.0	510.0	—	510.0
Total, revenues	$20,762.9	$250.7	$18.0	–$846.2	–$595.5	$20,185.4	$338.0	$20,523.4
Transfers	256.8 [g]	—	546.6 [g]	–26.4	–26.4	777.0	181.0 [f]	958.0
Total, General Fund revenues and transfers	$21,019.7	$250.7	$564.6 [d]	–$872.6	–$621.9	$20,962.4	$519.0	$21,481.4

[a] Detail may not add to totals due to rounding.

[b] Reduced by $27 million in January 1981 and $30 million in May 1981 for FALA Fund transfers under AB 66 (Ch 1150/79). Finance treated these monies as direct special fund revenues.

[c] Includes $30 million for elimination of FALA Fund transfers under SB 102 (Ch 101/81).

[d] Total legislation change of $564.6 million includes four main components: (1) revenues under SB 102, which Finance estimated in its *1981 General Fund Update and Financial Legislation Report* to total $179.1 million. This was comprised of (a) $130 million in General Fund transfers from the Motor Vehicle License Fee Account, (b) $30 million in bank and corporation tax revenues due to elimination of FALA fund transfers under AB 66, (c) $14.9 million in General Fund "other revenues" due to elimination of Liquor License Fee subventions and (d) $4.2 million in General Fund "other revenues" due to elimination of subventions for highway carriers; (2) $399.6 million in General Fund transfer income from special funds including (a) the Capital Outlay Fund for Higher Education ($53.6 million), (b) the Energy and Resources Fund ($24.0 million, (c) the Special Account for Capital Outlay ($47.0 million), (d) the State Parks and Recreation Fund ($41.0 million), (e) the State School Building-Lease Purchase Fund ($200.0 million), (f) the Transportation Planning and Development Account ($25.0 million) and (g) other miscellaneous special funds ($9.0 million). Provisions for transferring these funds, which represent tidelands oil revenues, were contained in the 1981 Budget Act; (3) increased sales and use tax transfers under SB 215 to the State Highway and Transportation Planning and Development Accounts. These combined transfers are currently estimated to total $26 million in 1981–82; and (4) miscellaneous other legislation enacted during 1981.

[e] Excludes proposed enhancements to revenues and transfers contained in the 1982–83 Governor's Budget and 1982 Budget Bill. Includes certain unidentified revisions to estimated fiscal effects of 1981 legislation.

[f] The 1982–83 Governor's Budget proposed transfers in 1981–82 of $128.2 million to the General Fund from the Capital Outlay Fund for Higher Education, the Energy and Resources Fund, the Parks and Recreation Fund, the Special Account for Capital Outlay, and the Employment Development Contingent Fund. In addition, General Fund transfer income of $52.8 million from the State School Building Lease Purchase Fund is proposed.

[g] The 1981–82 budget included a $10 million U.C. profit transfer to the General Fund for loan repayment. The 1981 Budget Act increased this transfer to $25 million.

E. BUDGET YEAR (1982–83) REVENUES

1. General Fund Income

Special Factors Again Critical—Total $1.2 Billion

Table 25 presents the department's estimates of budget year (1982–83) General Fund and special funds revenues and compares them with revenues for the current and prior years. As with current year revenues, the department's budget year estimates include a large volume of new General Fund revenues from special funds transfers and tax enhancements. These revenues, which are needed to balance the budget and replenish the Reserve for Economic Uncertainties, amount to about $1.2 billion and account for nearly 55 percent of the total dollar increase in 1982–83 General Fund income. Of this $1.2 billion, about $870 million (70 percent) represents "one-time" money. Specifically:

- The budget proposes to increase 1982–83 *tax revenues* by $645 million. Of this amount, $105 million represents ongoing effects of the tax revenue-enhancing proposals for the current year, while $540 million reflects new revenues. The two most important of these new revenues are the acceleration of sales tax payments (a gain of $300 million) and insurance tax payments (a gain of $120 million) to the state. Of the $645 million, about $400 million is "one-time."
- The budget proposes to transfer $450 million from the *Motor Vehicle License Fee Account* to the General Fund. This transfer is essentially local governments' share of the state's 1982–83 spending cuts. Normally, this $450 million would go to cities and counties. The General Fund transfer is being made in lieu of activating the "deflator" mechanism of AB 8 (Ch 282/79).
- $20 million in *tidelands oil revenues* are being provided to reimburse the General Fund for energy tax credits. This amount is in addition to the $42 million reimbursement for these tax credits already provides for under current law (Ch 899/80).

Table 25
Projected 1982–83 State Revenue Collections (in millions) [a]

General Fund	*Actual 1980–81*	*Estimated 1981–82*	*Projected 1982–83*	*Change Amount*	*Change Percent*
Taxes:					
Sales and use	$7,005.8	$7,593.0	$8,900.0	$1,307.0	17.2%
Personal income	6,628.7	7,575.0	8,055.0	480.0	6.3
Bank and corporation	2,730.6	3,055.0	3,630.0	575.0	18.8
Inheritance and gift [b]	530.1	528.0	503.0	−25.0	−4.7
Insurance	460.9	496.0	660.0	164.0	33.1
Cigarette	196.4	202.0	207.0	5.0	2.5
Alcoholic beverage	142.9	143.0	147.2	4.2	2.9
Horse racing	112.7	107.7	117.3	9.6	8.9
Total Taxes	$17,808.1	$19,699.7	$22,219.5	$2,519.8	12.8%
Other Sources:					
Health Care Deposit Fund	$234.9	$288.8 [c]	$249.1 [c]	−$39.7	−13.7%
Interest on investments	463.6	313.7	303.8	−9.9	−3.2
Federal Revenue Sharing Transfer [d]	276.2	180.3	—	−108.3	−100.0
Other revenues and transfers	240.3	998.9 [e]	807.9 [f]	−191.0	−19.1
Total General Fund	$19,023.1	$21,481.4	$23,580.3	$2,098.9	9.8%

Special Funds					
Motor vehicle:					
Fuel tax [g]	$840.0	$834.7	$914.7	$80.0	9.6%
License fee (in lieu) [g]	693.7	735.0	804.0	69.0	9.4
Registration, weight and miscellaneous fees [g]	433.6	650.0	855.0	205.0	31.5
Other Sources:					
Oil and gas tax revenues	480.7	495.1	458.0 [h]	−37.1 [h]	−7.5
Sales and use [i]	125.7	152.0	155.0	3.0	2.0
Interest on investments	108.7	90.7	97.3	6.6	7.3
Cigarette tax	81.8	84.2	86.2	2.0	2.4
Other	316.5	−285.7 [j]	20.6	306.3	N.C.
Total Special Funds	$3,080.7	$2,756.0	$3,390.8	$634.8	23.0%
Total State Funds	$22,103.8	$24,237.4	$26,971.2	$2,733.8	11.3%

[a] Detail may not add to total due to rounding. Figures for 1981–82 and 1982–83 include the effects of a variety of measures, either enacted in 1981 or proposed in the 1982–83 Governor's Budget and the 1982 Budget Bill, to augment General Fund revenues and transfers. For *1981–82*, these factors amount to approximately $1.1 billion, including $338 million in measures to increase tax collections, and over $765 million in transfers from special funds. Approximately $960 million of these amounts constitutes one-time General Fund revenues. For *1982–83*, measures to increase tax collections account for $645 million in revenues, while special fund transfers to the General Fund will exceed $450 million. When combined with other revenue-enhancing proposals in the budget, these factors amount to approximately $1,220 million, of which about $870 million constitutes one-time revenues.

[b] The Department of Finance estimates that AB 2092 (Ch 634/80), which exempted all spouses from inheritance and gift taxation and increased certain other exemptions, has reduced inheritance and tax revenues by approximately $2.2 million in 1980–81, $100 million in 1981–82, and $150 million in 1982–83.

[c] Health Care Deposit Receipts in 1981–82 were unusually large, because certain time lags in reporting health-related claims and reimbursing the General Fund were eliminated between June and December of 1981. This accelerated receipts and produced a one-time General Fund revenue gain.

[d] Under current federal law, the General Fund will receive no additional revenue sharing funds after 1981–82.

[e] Includes primarily one-time transfers of $84.9 million from the Capital Outlay Fund for Public Higher Education, $89.8 million from the Energy and Resources Fund, $131.3 million from the Motor Vehicle License Fee Account, $80.5 million from the Special Account for Capital Outlay, $53.8 million from the State Parks and Recreation Fund, and $252 million from the State School Building Lease-Purchase Fund.

[f] Includes a one-time transfer of $450 million from the Motor Vehicle License Fee Account.

[g] Senate Bill 215 (Ch 541/81), which increased gasoline and diesel taxes, vehicle registration fees, weight fees, and drivers' license fees, is projected by Finance to increase motor vehicle user taxes and fees by $200 million in 1981–82 and by $478 million in 1982–83.

[h] Revenues reduced because the 1982–83 budget proposes a special one-time allocation of $61.7 million in tidelands oil receipts directly into the General Fund "other revenue" category.

[i] Reflects sales and use tax receipts to the Transportation Planning and Development Account in the Transportation Fund as specified under SB 620 (Ch 161/79) and SB 215 (Ch 541/81).

[j] Negative sign indicates net transfers to the General Fund.

The remainder of the $1.2 billion in revenue adjustments includes proposed increases in user fee assessments levied by the California Public Utilities Commission ($24 million) and savings under certain Department of Industrial Relations programs that would be achieved by putting the workers' compensation program on a self-supporting basis ($27 million). Both of these revenue effects would be ongoing.

More Rapid Growth Expected in Underlying Revenue Trend

Table 25 shows that General Fund revenues in the budget year are forecast to reach nearly $23.6 billion, a gain of $2.1 billion (9.8 percent) over the current year. This amount includes $8.9 billion in sales and use tax revenues (a gain of over 17 percent), $8.1 billion in personal income tax revenues (a gain of only 6 percent), and $3.6 billion in bank and corporation tax revenues (a gain of nearly 19 percent). However, because of the large and primarily one-time revenue enhancing proposals and special funds transfers in both the current and budget years, the percentage rates of increase for 1982–83 shown in the table do not give a valid picture of the underlying growth in either the total revenue base or many of its individual components.

In order to identify the underlying revenue trend, it is necessary to make three types of adjustments:

- Revenues must be adjusted to exclude the tax revenue-enhancing proposals and one-time special funds transfers discussed earlier for both the current year ($1.1 billion) and budget year ($1.2 billion);
- The fiscal effects in 1981–82 (–$100 million) and 1982–83 (–$150 million) due to continued phasing-in of the inheritance provisions of AB 2092 must be removed; and
- The termination of federal revenue sharing must be accounted for.

Table 26 shows that once these adjustments are made, underlying revenue growth is 10.3 percent in the budget year, or equivalent to the projected rate of personal income growth in 1982. This compares to an 8.2 percent underlying revenue growth trend in the current year. If only the effects of the revenue-enhancements and special funds shifts are eliminated, underlying budget year revenue growth is 9.7 percent, compared to 7.1 percent in 1981–82. Thus, the underlying revenue trend in 1982–83 is forecasted to exceed that for 1981–82.

Table 26
Comparisons of Revenue Trends for the Current and Budget Years

	Percent Growth in Revenues					
	1981-82			1982-83		
		Increase Adjusted for:			Increase Adjusted for:	
Income Source	*Increase Published in Budget*	*Tax Enhancements and Special Funds Transfers*	*Plus: Revenue Sharing and Inheritance Tax Reduction*	*Increase Published in Budget*	*Tax Enhancements and Special Funds Transfers*	*Plus: Revenue Sharing and Inheritance Tax Reductions*
Sales and use tax	8.4%	8.1%	8.1%	17.2%	13.5%	13.5%
Bank and corporation tax	11.9	9.5	9.5	18.8	14.5	14.5
Personal income tax	14.3	10.9	10.9	6.3	9.0	9.0
Other major taxes	2.4	–1.7	5.1	10.7	5.2	8.1
All other revenues and transfers	46.7	–13.8	–5.9	–23.7	–20.4	–11.4
Total, General Fund Revenue and Transfers	12.9%	7.1%	8.2%	9.8%	9.7%	10.3%

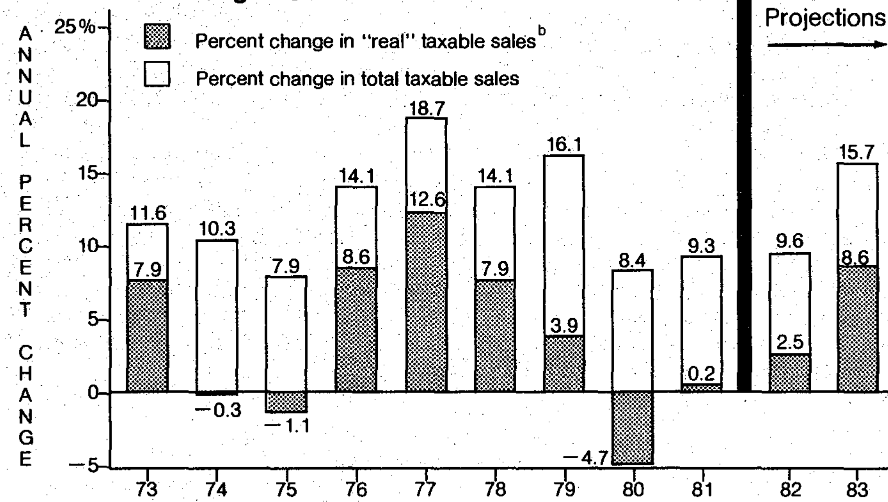
Taxable Sales to Spur Revenue Growth

As noted in Table 26, sales and use taxes are projected to increase by 17.2 percent when the Governor's proposed enhancements are included, and by 13.5 percent without these enhancements. This means that the growth in taxable sales is expected to exceed personal income growth during the second half of 1982 and thereafter. This is confirmed by the ratio of taxable sales-to-personal income contained in the department's economic forecast, which drops from 53.6 percent in 1981 to 53.3 percent in 1982, but then rises to 55.2 percent in 1983 and 56.2 percent in 1984. As shown in Chart 15, taxable sales growth in 1983 is expected to be especially strong (a 15.7 percent rise), led by increases in sales tax receipts from such industries as motor vehicles (22 percent) and building materials (21 percent). Of course, the high rates of growth for the building and automobile industries are largely due to the fact that they are expected to be recovering from extremely depressed recession levels.

Chart 15

Annual Growth in California Taxable Sales

1973 through 1983[a]



[a] California Department of Finance.

[b] "Real" taxable sales equal total taxable sales (current dollars) deflated by the national CPI for all items less food. Projections of the CPI are by Chase Econometrics as of January 1982.

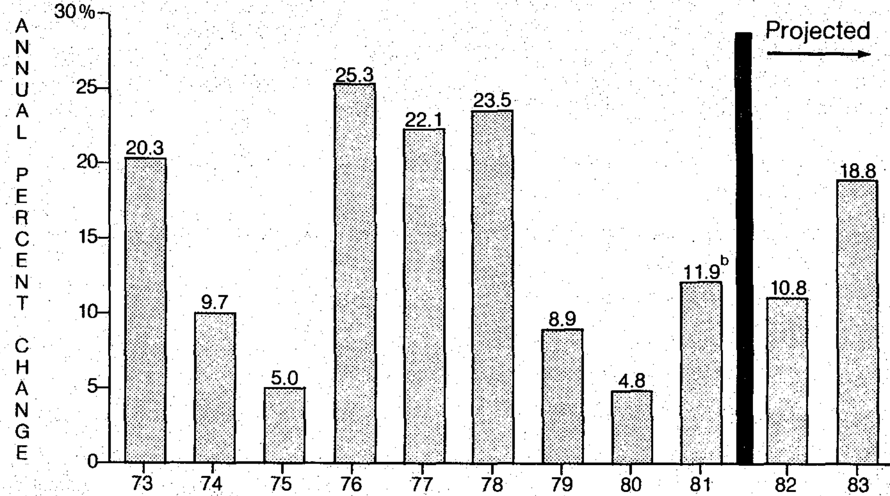
Optimistic Corporate Profits Outlook

Growth in 1982–83 corporate tax revenues—18.8 percent with revenue enhancements and 14.5 percent without such enhancements—reflects projected increases in corporate profits of about 11 percent in 1982 and 19 percent in 1983 (Chart 16). It is not possible to directly compare these profit growth assumptions with those of other forecasters, because private forecasters do not generally predict California corporate profits. However, one can compare the *U.S.* profits projections of these forecasters to the department's, in order to get a feel for how different their underlying profits growth outlooks are.

As shown earlier in Table 18, the department's forecast for U.S. corporate profits growth in 1982 (1.2 percent) is, on balance, an *optimistic* one relative to other forecasters. This is particularly true if the forecast by First Interstate Bank, which is about five months old, is excluded. The remaining forecasts show profits declining anywhere from −3.5 percent to −15.9 percent, or a downward differential of between about 5 and 15 percentage points relative to Finance's U.S. profit forecast. U.S. profit growth will automatically be higher in 1982 than profit growth for California, regardless of the forecaster, because of new federal tax law provisions. However, the U.S. profit growth forecasts may be compared as a means of shedding

Chart 16

Annual Growth in California Taxable Corporate Profits 1973 through 1983[a]



[a] California Department of Finance. Profit totals include a $335 million reduction in 1975 due to changes in depletion allowances, and a $967 million increase in 1978 due to Proposition 13.
[b] Preliminary estimate by Department of Finance and Franchise Tax Board.

some light on the degree of optimism exhibited by the Department of Finance in its California profits forecast. If the department's *California* profits growth forecast for 1982 is reduced by the average differential between the department's *U.S.* profit growth forecast and these of other forecasts—about 10 percentage points—the revenue implications would be extremely significant. In fact, we estimate that General Fund revenues in 1982–83 and 1983–84 combined could be $735 million less than the amount shown in the budget. The exact distribution of the two-year loss between fiscal years would depend on decisions made by corporations regarding their tax prepayment patterns.

Effects of Income Tax Indexing Rapidly Growing

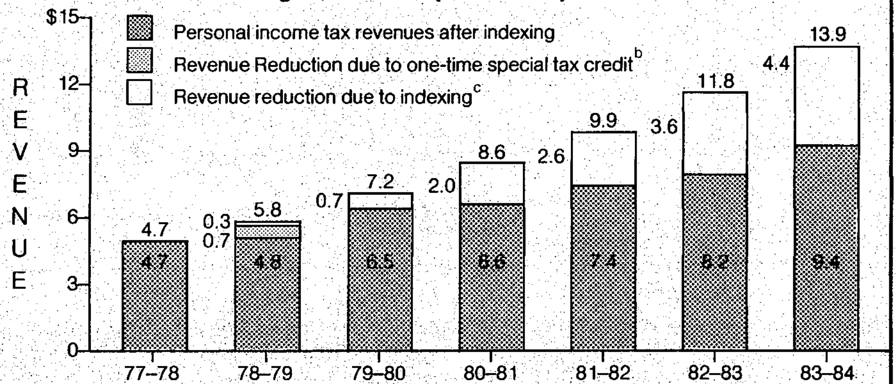
Personal income tax revenues are projected to increase by 6.3 percent in 1982–83, or 9 percent in baseline terms (that is, after excluding the tax revenue-enhancing proposals for both the current and budget years). This increase is less than the projected 1982 growth in personal income of 10.3 percent, even though under current law "full" indexing of the state's income tax brackets (that is, indexing using the full rise in the California CPI) will be replaced by "partial" indexing (using the CPI minus three percentage points) in 1982. Without the return to partial indexing, revenues from the personal income tax in 1982–83 would be about $230 million lower than projected. The reason why revenue growth is so low, despite a return to partial indexing, is that the department projects a June 1981-to-June 1982 CPI increase, which is used for indexing, of 12.8 percent, or far in excess of income growth. In fact, the tax bracket indexing adjustment factor projected under partial indexing in 1982 (12.8 percent minus 3 percent, or 9.8 percent) *exceeds* the factor used in 1981 for full indexing (8.3 percent), even though 1981 income growth exceeded the rate of growth projected for 1982.

Chart 17 summarizes the fiscal effects of income tax indexing from 1978–79 through 1983–84 (projected). It indicates that indexing reduced General Fund revenues by about $2 billion in 1980–81, and that it is projected to reduce revenues by $2.6 billion in the current year and $3.6 billion in the budget year. Thus, by 1982–83 the cumulative revenue reduction due to indexing will reach $9.2 billion.

Chart 17

Effects of Indexing on California Personal Income Tax Revenues.

1977–78 through 1983–84 (in billions)[a]



[a] Estimates by Legislative Analyst. Entire height of bars shows revenues without indexing.

[b] AB 3802 (Ch 569/80) increased the personal income tax credit for 1978 by $75 for single return taxpayers and by $150 for joint return taxpayers.

[c] AB 3802 provided that income tax brackets be indexed by the amount of inflation *above* 3 percent beginning in 1978, and also that the standard deduction, personal credits and dependent credit be *fully* indexed beginning in 1979. AB 276 (Ch 1198/79) provided that income tax brackets be *fully* indexed by the inflation rate, but only for the 1980 and 1981 income years. If this full indexing were continued in 1982 and thereafter, revenues would be reduced below those shown in the table by about $230 million in 1982–83 and $445 million in 1983–84. Revenues shown for 1981–82 through 1983–84 exclude the tax law changes proposed in the budget.

Other Major Taxes

Table 25 shows that General Fund revenues from taxes other than the three major levies are projected to reach $1.6 billion, an increase of $158 million (10.7 percent) over the current year. These taxes include the insurance tax ($660 million), the inheritance and gift taxes ($503 million), the cigarette tax ($204 million), alcoholic beverage taxes ($147 million), and horse racing-related revenues ($117 million). For two of these revenue sources—the insurance tax and inheritance and gift tax—the budget estimates reflect special factors:

- The *insurance tax* estimate for 1982–83 includes a proposed enhancement of $120 million that results from requiring insurers to make four tax prepayments per year instead of three. About $100 million of this amount is a one-time gain. After adjusting for this proposal, the insurance tax revenue increase in 1982–83 drops from over 33 percent in the budget to 8.9 percent.

- The *inheritance and gift tax* estimate for 1982–83 includes $25 million in revenues due to a proposal to increase the interest rate charged on delinquent tax payments. (In 1981–82, this proposal increases revenues by $60 million.) Secondly, 1982–83 revenues are $150 million lower because of the phasing-in of AB 2092 (Ch 634/80), which increased tax exemptions. (The revenue loss in 1981–82 is $100 million.) Thus, compared to the budget's growth of −4.7 percent shown for this source, revenue growth is 2.1 percent when the proposed interest penalty provision is excluded, and 10.6 percent when the effects of AB 2092 are also compensated for.

Revenues from the alcoholic beverage and cigarette taxes are expected to grow much more slowly—by under 3 percent. This is because the revenue base for these taxes tends to increase primarily as a result of population growth and is fairly insensitive to general economic conditions.

Continued Decline in Interest Income

The General Fund receives interest income from three primary sources: (1) the investment of surplus monies left over from the prior year, (2) earnings on those balances in the Pooled Money Investment Account (PMIA) which are not General Fund balances per se but which the General Fund nevertheless earns interest income on, and (3) the balance of General Fund monies being held idle at any one moment because of the time lag between when revenues are collected and disbursements are made. Of these three, the last is currently the most importance source of interest income.

The budget projects that General Fund interest on investments will be about $304 million in 1982–83, of which $300 million represents returns on the PMIA. This investment income compares to about $314 million in 1981–82 and $464 million in 1980–81, and assumes that:

- ***The average fiscal year balance*** in the PMIA for 1982–83 will be somewhat over $4.6 billion. This average balance has declined in the past several years because the state has been spending more than it receives in current revenues. It should be more stable in the future, however, assuming that annual revenues and expenditures are brought into alignment.
- ***The General Fund share*** of funds in the Pooled Money Investment Account will be about 52 percent.
- ***The average interest yield*** on PMIA investments in 1982–83 will be about 11.75 percent. This compares to an actual average yield for the first half of 1981–82 of about 12.3 percent, and of about 11.9 percent as of year-end 1981.

Federal Revenue Sharing Has Ended

In September 1980, the federal revenue sharing program for states terminated. The General Fund received a transfer of $180.3 million from the state's Federal Revenue Sharing Fund in 1981–82, an amount which will exhaust the revenue sharing monies available to the state. Thus, the General fund will receive no revenue sharing transfers in the budget year. Since 1973–74, the state government has received nearly $2.2 billion under this program.

Estimates Consistent with Assumptions, but Future Revisions Inevitable

As with the current year revenue estimates, we have taken the department's economic assumptions and used our own revenue-estimating equations to determine whether Finance's budget year projections are consistent with its economic assumptions. Our analysis suggests that these assumptions could possibly generate an additional $200 million in 1982–83 General Fund revenues *above* what is forecast. However, because our analysis also results in about $100 million *less* in 1983–84 revenues than Finance projects, about half ($100 million) of the budget year difference could merely reflect cash-flow assumptions.

Given the extremely uncertain economic outlook, however, the closeness of our estimates to Finance's should not be interpreted as indicating that the outlook for revenues is at all certain. In fact, the outlook is quite uncertain. As evidence of this, the department's current law 1982–83 revenue estimate is approximately $1.5 billion lower than the original estimate made last May. Clearly, the department's 1982–83 revenue estimates will be subject to considerable revision over the next 18 months.

2. Special Fund Revenues

Table 25 shows that combined revenues to all state special funds are projected to reach nearly $3.4 billion in 1982–83, while Table 27 summarizes the relative shares of special fund revenues accounted for by the major special fund revenue sources.

Table 27
Summary of Special Fund Revenues in 1982–83

	Millions	Percent
1. *Motor Vehicle Taxes and Fees*		
License fees	$770 [a]	
Fuel taxes	915	
Registration and other fees	855	
Trailer coach fees	34	
Subtotal	$2,574	67.0%
2. *Tidelands Oil Revenues*	$458	11.9%
3. *Retail Sales Taxes* ("spill over" revenues)	$155	4.0%
4. *Cigarette Taxes*	$86	2.2%
Subtotal	$3,273	85.1%
5. *All Other*	571	14.9%
Totals	$3,844 [a]	100.0%

[a] Existing law; does not reflect budget proposal to reduce these transfers by $450 million.

The major source of special fund income comes from motor vehicle-related levies, which include gasoline taxes ($915 million), vehicle license and trailer coach fees ($804 million) and registration fees ($855 million). These vehicle-related levies are expected to total almost $2.6 billion in the budget year, for an increase of 15.9 percent ($354 million) over 1981–82. Other major sources of special fund income include tidelands oil and gas tax revenues ($458 million), sales and use tax revenues ($155 million), cigarette tax receipts ($86 million), and interest on investments ($97 million). The special fund sales and use tax revenues reflect monies which go to the Transportation Planning and Development Account, while the cigarette tax monies represent local governments' statutory 30 percent share of collections.

Revenue Trends Distorted by Major Legislation and General Fund Transfers

Table 25 shows that special funds revenues in 1982–83 will increase 23 percent over 1981–82. This growth rate is distorted by the following special factors:

- ***First,*** major legislation was enacted in 1981 which increased motor vehicle-related receipts in both 1981–82 and 1982–83. This legislation included (a) SB 215 (Ch 541/81), which increased vehicle registration, weight and drivers license fees (as of January 1, 1982), and increases the fuel tax from 7 cents to 9 cents per gallon (as of January 1, 1983) and (b) AB 202 (Ch 933), which provided for further increases in vehicle registration fees. Together, these measures will increase motor vehicle-related collections by $200 million in 1981–82 and $475 million in 1982–83.
- ***Second,*** the 1982–83 budget proposes to transfer $450 million out of the Motor Vehicle License Fee Account and into the General Fund on a one-time basis, as a means of applying state spending cuts to local governments. This transfer is in lieu of activating the AB 8 deflator mechanism. A similar type of one-time transfer was made in 1981–82 by SB 102 (Ch 101/81) in lieu of activating the deflator, although it is smaller than the 1982–83 transfer—$131 million.
- ***Third,*** the General Fund is to receive special one-time tidelands oil revenues in both the current and budget years. The budget year amount is about $20 million (excluding a $42 million reimbursement provided in current law for energy tax credits), while the current year amount is much larger—over $400 million.

Fuel Tax Revenues—Underlying Trend is Level

Because of the 1983 increase in the fuel tax from 7 cents to 9 cents per gallon under SB 215 (Ch 541/81), fuel tax revenues will be increased by $78 million in 1982–83. As shown in Table 25, budget year fuel tax revenues are essentially unchanged in the current year after adjusting for this legislation. This represents the fifth year in a row that the underlying revenue trend has not been upward. This failure of gasoline consumption to rise reflects such factors as changes in the automobile mix, increasing fuel economies, reduced demand due to slow economic growth, and the impacts of gasoline prices on consumption. The department's fuel tax estimate assumes that average gasoline consumption per vehicle will drop from 590 gallons in 1979–80 and 570 gallons in 1980–81 to 565 gallons in 1981–82 and 555 gallons in 1982–83. Vehicle-related registration and license fees are projected at almost $1.7 billion in the budget year, including the effects of new legislation. This projection assumes 5.9 percent and 11.8 percent increases in vehicle registrations in 1982 and 1983, respectively.

Oil and Gas Revenues—A Potentially Important Balancing Factor

Total oil and gas tax revenues are projected in the Governor's Budget to reach $542 million in 1981–82, up 5.3 percent from the current year. Although this is a relatively small increase, it still is an improvement over the projection for the current year that shows a *dip* in these revenues below the 1980–81 level. This modest growth rate reflects in part the recent softness in prices due to excessive stocks in the world's crude oil markets.

Most of these revenues represent direct earnings received by the state from the sale of oil and gas produced from tidelands (principally located adjacent to the City of Long Beach). Tidelands oil revenues are expected to total $510 million in 1982–83.

These funds have traditionally been used along with bond proceeds to finance state capital outlay projects. As discussed earlier, tidelands oil revenues are expected to pay a major role in achieving a balanced General Fund budget in 1981–82. In 1982–83, their role in this regard is not as significant. However, given the state's tight fiscal situation, these monies could be called on again to assist the General Fund. In the B-pages of this analysis, we discuss the issue of whether these tidelands revenues should be shifted on a permanent basis to the General Fund to help support the overall programs of the state government.

Table 28
Distribution of Special Fund Revenues From Four Major Sources 1982–83 (in millions)

Source		*Distribution*	
I. *Motor Vehicle Taxes and Fees*			
1. License fees	$770	To cities	$370
		To counties	$370
		For DMV administration	$30
2. Fuel Taxes	$915	For city streets	$132
		For county roads	$206
		To cities and counties for streets and roads	$106
		To Caltrans for state highways	$443
3. Registration and other fees	$855	To DMV	$184
		To CHP	$337
		To Caltrans	$322
		To other state agencies	$12
4. Trailer coach fees	$34	To cities	5
		To counties	15
		To schools	14
II. *Tidelands Oil and Gas Revenues*	$458	Energy and Resources Fund	$120
		COFPHE	$116
		School Lease Purchase Fund	$100
		SAFCO	$78
		Energy tax credits	$62
		Parks and Recreation Fund	$11
		All other	$23
III. *Retail Sales (spillover) Taxes*	$155	*State agencies*	$76
		Support for mass transit, etc. ($47)	
		Capital outlay/mass transit ($29)	
		Local agencies	$116
		Mass transit ($35)	
		Special transit ($75)	
		Others ($6)	
IV. *Local Cigarette Taxes*	$86	To cities	$71
		To counties	$17

How Special Fund Revenues are Distributed

Table 28 shows how special fund revenues from the four major sources are allocated among different programs and levels of government. The table indicates that cities and counties receive all of the proceeds from vehicle license fees, after DMV deducts its administrative costs. Cities and counties also receive about half of the motor vehicle fuel tax revenues. Motor vehicle registration fees are used to support the Department of Motor Vehicles, the California Highway Patrol, with the remainder going to the Department of Transportation for highway maintenance and construction.

Tidelands oil revenues are allocated mainly for capital outlay purposes. Most of these revenues are divided among five special funds (ERF, COFPHE, SAFCO, etc.). The 1982–83 budget proposes that a portion ($62 million) of these revenues be transferred to the General Fund to offset the revenue loss from the energy and solar tax credits. The distribution of oil revenues is based on the proposals in the budget, and does not reflect the distribution called for by existing law.

The "spill over" sales tax revenues are used mainly for mass transit and special transportation programs, and are allocated to both state and local agencies.

F. ALTERNATIVE GENERAL FUND REVENUE FORECASTS

Because of the history of revenue estimating errors, and the considerable uncertainty about exactly how the economy will perform in 1982 and 1983, it is important to make some estimate of the margin by which actual revenues in the current and budget years could differ from the department's forecasts. This is especially important this year because of the tight state and local fiscal picture.

In the *1982–83 Governor's Budget,* the Department of Finance indicates that revenues could be between *$1.2 billion less* and *$1.1 billion more* than projected in 1982–83. This range is based on the *assumption* that there could be an error in the budget year revenue forecast of up to 5 percent. The department also indicates that it is reasonable to assume that an error of up to 3 percent (or about $650 million) could be made in the current year revenue forecast. As shown in Table 22 earlier, errors of these magnitudes have occurred in previous years, and certainly could be repeated.

What would it take to produce such errors? Revenue estimating errors can result from a variety of causes. For example, the underlying data on which forecasts are based are often revised at later dates. Thus, had the "true" data been known earlier, the forecasts themselves would often have been different to begin with. In addition, there are normal errors of a statistical nature that accompany all estimates, and thus estimates generally are understood to be within a certain *range* of possible values, any of which could occur. However, it appears that the most important cause of revenue estimating errors involves errors in *economic forecasting.*

Given this, we have constructed two alternative revenue scenarios which can provide some insight as to the type of revenue estimating errors which could currently occur due to wrong economic forecasts. One scenario is based on more optimistic and the other on more pessimistic groups of economic assumptions than Finance used in the budget. In structuring these scenarios to be as realistic as possible, we examined the range of actual 1982 forecasts reported by different economists in Tables 18 and 19 above, identified the optimistic and pessimistic extremes, and then projected each into 1983. This projection into 1983 was necessary because most outside forecasters do not themselves project that far into the future, at least not publicly. We also made assumptions about certain economic variables—such as California taxable sales and corporate profits—which are not generally predicted by most private economists.

- The ***high revenue scenario*** assumes that California personal income growth will reach 12 percent in 1982 and 13 percent in 1983, that California corporate profits will rise at rates of 15 percent in 1982 and 20 percent in 1983, and that the ratio of taxable sales to statewide income will expand from 53.6 percent in 1981 to 55 percent in 1982 and 57 percent in 1983. Thus, by 1983, the taxable sales ratio would be nearing the levels it had achieved in 1978 and 1979.
- The ***low revenue scenario*** assumes that California personal income will grow by only 8 percent in 1982 and 9 percent in 1983, that the state's profits will experience no growth in 1982 and rise by a modest 10 percent in 1983, and that the ratio of taxable sales to income will further erode to 52.5 percent in 1982 before rising modestly back to 54 percent in 1983.

Table 29 shows that these economic scenarios produce 1981–82 General Fund revenue estimates for the three major taxes which range from $325 million (1.5 percent) *above* to $250 million (1.2 percent) *below* Finance's forecast. For 1982–83, the estimates range from $1.2 billion (5.1 percent) *above* to $1.2 billion (4.9 percent) *below* Finance's projection. These error margins are consistent with the historical errors reported earlier in Table 22. It is probably possible to find economists to support either end of this range. In addition, it is of course possible that actual economic performance could be such that revenues could fall *outside* of these ranges. The scenarios do illustrate, however, that significant revenue estimating errors in dollar terms could easily occur for both 1981–82 and 1982–83.

Table 29
Effects of Alternative Revenue Scenarios
(dollars in millions)

	1981–82		*1982–83*	
Revenue Source	*High Revenue Scenario*	*Low Revenue Scenario*	*High Revenue Scenario*	*Low Revenue Scenario*
Personal Income Tax	$85	−$85	$490	−$330
Sales and Use Tax	100	−65	250	−430
Bank and Corporation Tax	140	−100	460	−400
Total Revenue Difference, Major Three Taxes	$325	−$250	$1,200	−$1,160
Difference as a Percent of Finance Estimates	1.5%	1.2%	5.1%	4.9%

V. CONDITION OF THE GENERAL FUND

Table 30 presents the budget estimates of the General Fund condition in both 1981–82 and 1982–83.

As Table 30 indicates, revenues in 1981–82 will be $415.7 million less than expenditures, after adjusting for the revenue enhancements and capital outlay transfers proposed by the administration. For 1982–83, the *baseline* budget gap widens to $1.8 billion, because (1) revenue growth is adversely affected by the recession, and (2) approximately $777 million of the revenue enhancements and expenditure savings reflected in the 1981–82 estimates are one-time.

Table 30
Summary of General Fund Condition
During 1981–82 and 1982–83
(in millions)

	1981–82	*1982–83*
Funds Available, start of year:		
Reserve for economic uncertainties	$349.0	$116.0
Uncommitted General Fund surplus	—	—
Revenues and transfers	21,481.4	23,580.3
Current expenditures	21,897.1	23,195.7
(Difference)	(−415.7)	(384.6)
Funds available, end of year:		
Reserve for economic uncertainties	116.0	500.0
Uncommitted General Fund Surplus	—	$0.7

The 1982–83 budget proposes to close this gap between baseline expenditures and revenues by:

1. Increasing revenues on an ongoing basis ($299 million)
2. Accelerating revenue collections from 1983–84 into 1982–83 (one-time revenue increase of $397 million)
3. Transferring special fund resources to the General Fund on a one-time basis ($450 million)
4. Limiting expenditure growth to 5.3 percent ($1,497 million)

In effect, the budget reduces the level of expenditures in real terms (that is, expenditures adjusted for inflation), and thereby provides for a reduction in state-funded services below 1981–82 levels. In the aggregate, the reduction in real General Fund expenditures is about 3 percent. If the Governor's $696 million revenue enhancement program is not enacted, the reduction in real expenditures would be 4.4 percent.

As a result of the revenue enhancements and expenditure reductions, the budget makes $730.6 million available for the following purposes:

- $246 million in budget change proposal augmentations for existing programs;
- $100 million in unallocated funds which have not been budgeted for any specific program or agency; and
- $384.6 million to partially replenish the Reserve for Economic Uncertainties, bringing it up to $500 million. This is $200 million less than the 3-percent-of-appropriations minimum established by the Legislature in both the 1980 and 1981 Budget Acts.

The budget shows a nominal General Fund surplus of $0.7 million on June 30, 1983.

VI. STATE BORROWING

Overview

The State of California issues both general obligation bonds and revenue bonds. These two categories of bonds have the following general characteristics:

- ***General obligation bonds*** are backed by the full faith and credit of the state. That is, when it issues a general obligation bond, the state pledges to use its taxing power to pay off the bond (both principal and interest). These bonds must be authorized by a two-thirds vote of both houses of the Legislature, and then must be approved by a majority of the voters at a statewide election. Under existing law, the interest rates on state general obligation bonds cannot exceed 11 percent.

- *Revenue bonds* are *not* backed by the full faith and credit of the state. Instead, they are secured by the revenues from the projects which are financed by the bond proceeds. Revenue bonds must be authorized by a majority vote of both houses of the Legislature, but they do not require voter approval. Some revenue bonds have interest rate ceilings, while others do not.

This section provides information on the sales and outstanding volumes of these two types of state bonds. In addition, this section discusses bond sales by California's local governments, with particular emphasis on the rapidly growing volume of housing bonds. Lastly, this section discusses some of the problems currently facing state and local governments who wish to finance projects by issuing tax-exempt municipal debt.

A. GENERAL OBLIGATION BONDS

Bond Categories

California's general obligation bonds are grouped into three categories, depending on the extent to which debt service (that is, payment of interest and repayment of principal) is assumed by the state. These categories are:

(1) *General Fund Bonds.* The debt service on these bonds is *fully* paid by the General Fund.

(2) *Partially Self-Liquidating Bonds.* The only program falling into this category is school building aid. Prior to 1978–79, debt service on these bonds was paid in part by the state and in part by local school districts, depending on local assessed valuations. Assessed valuations have now reached such a level, however, that the state has been relieved of any debt service payments.

(3) *Self-Liquidating Bonds.* Redemption and interest costs on these bonds are paid *entirely* from project revenues. However, should such revenues ever be inadequate to cover the required debt service, the state would be obligated to make up the shortfall.

Status of Bonds Authorized

Table 31 provides detail on these three categories of general obligation bonds. As of December 31, 1981, the state had over $1.4 billion in unsold bonds, compared to over $1.8 billion at the end of 1980. Of the authorized bonds already sold ($10.3 billion), the state has retired nearly $4.0 billion, leaving $6.3 billion outstanding. During the 1981 calendar year, no new state general obligation bond issues were approved by the voters. However, the Legislature did authorize a $495 million state general obligation bond issue for the purpose of financing new prison facilities in California. This issue will be voted upon by the electorate at the June 1982 election.

Bond Program Sales

Table 32 provides data on general obligation bond sales in 1979–80 through 1981–82. Of total sales in 1980–81 ($385 million), almost 80 percent ($300 million) were made under the Veterans' Farm and Home Building program. This program is also expected to account for nearly 65 percent ($450 million) of total general obligation bond sales in 1981–82 ($715 million). The Treasurer will attempt to market the remaining volume of

Table 31
General Obligation Bonds of the State of California
As of December 31, 1981
(in millions) [a]

	Authorized	*Unsold*	*Redemptions*	*Outstanding*
General Fund Bonds:				
State construction	$1,050.0	—	$668.1	$381.9
Higher education construction	230.0	—	124.1	105.9
Junior college construction	65.0	—	34.1	30.9
Health science facilities construction	155.9	—	35.1	120.8
Community college construction	160.0	—	51.2	108.8
Beach, park, recreational, and historical facilities	400.0	$20.0	130.2	249.8
Recreation and fish and wildlife	60.0	—	23.5	36.5
State, urban, and coastal parks	280.0	90.0	19.3	170.8
Parkland acquisition and development	285.0	255.0	—	30.0
Clean water	875.0	360.0	114.3	400.8
Safe drinking water	175.0	125.0	0.2	49.8
Subtotals	($3,735.9)	($850.0)	($1,200.1)	($1,685.8)
Partially Self-Liquidating Bonds:				
School building aid	$2,140.0	$40.0	$1,212.5	$887.5
Self-Liquidating Bonds:				
Water resources development	1,750.0	180.0	86.9	1,483.2
Harbor bonds	89.3	—	63.3	26.0
Veterans' farm and home building	4,000.0	350.0	1,424.1	2,225.9
Subtotals	($5,839.3)	($530.0)	($1,574.2)	($3,735.1)
Totals	$11,715.2	$1,420.0	$3,986.9	$6,308.4

[a] California State Treasurer. Detail may not add to totals due to rounding.

Table 32
General Obligation Bond Sales
1979–80 Through 1982–83 [a]
(in millions)

	Actual 1979–80	*Actual 1980–81*	*Estimated 1981–82* [b]	*Proposed 1982–83* [b]
Beach park, recreational and historical facilities	$30	$10	$15	$10
Clean water	100	—	100	100
Parklands acquisition and development program	—	—	60	70
Safe drinking water	—	20	50	25
State, urban, and coastal parks	20	30	40	45
Subtotals, General Fund Bonds	($150)	($60)	($265)	($250)
School building aid [c]	—	$25	—	—
Veterans' farm and home building [d]	$475	300	$450	—
Totals	$625	$385	$715	$250

[a] 1982–83 Governor's Budget and California State Treasurer.
[b] Estimates by California State Treasurer. Through December 1981, $225 million in bonds had been sold during 1981–82, including $100 million in veterans' bonds. The remaining $490 million in anticipated 1981–82 sales, including $350 million in veterans' bonds, were expected to be sold between January and June 1982. However, financial market conditions could limit the actual amount of future 1981–82 bond sales to less than this amount.
[c] Debt service presently paid entirely by school districts.
[d] Debt service paid from program or project revenues.

unsold bonds authorized under the Veterans' Bond Act of 1980 during the current year.

The additional sales estimated in 1981–82 and 1982–83 are associated with five programs: beach park, recreational and historical facilities (totaling $25 million in the two years); clean water ($200 million); parklands acquisition and development ($130 million); safe drinking water ($75 million); and state, urban and coastal parks ($85 million). Of course, whether the proposed bond sales actually occur will depend on financial market conditions.

General Fund Debt Service

Table 33 projects the amount of debt service to be paid on bonds fully supported by the General Fund through 1983–84. Debt service for the budget year ($259 million) will increase by $40.1 million (or 18.3 percent) over the current year. All of the debt service estimates in Table 33 are based on specific estimates of anticipated future bond sales. If the volume of sales is greater (less) than the estimated level, the amounts needed to service General Fund debt will increase (decrease) accordingly. Also, interest rates paid on future bond sales are very difficult to predict at this time, due to the uncertainty about the course of future federal monetary policies, the impacts of President Reagan's tax plan on the market for municipal debt, and the path of the economy generally. In Table 33, we have assumed that interest rates for new bond sales will be 10 percent. It is very possible, however, that rates could be higher than this. Whether interest rates on state bonds will exceed the current statutory ceiling of 11 percent if economy-wide interest rates trend upward will, in part, depend on how the bond issues are structured. In November 1981, for example, a $100 million general obligation issue which had been turned down the month before sold at about 10.2 percent after a number of modifications had been made in the terms of the bond, such as the removal of "call provisions" and a shortening of the maturity structure.

Table 33
General Fund Debt Service
1980–81 to 1984–85
(in millions)

	Debt Service[a]	*Percent Change from Previous Year*	*Anticipated Future Sales*[b]
1980–81	$210.5	6.9%	—
1981–82	218.7	3.9	$135.0
1982–83	258.8	18.3	250.0
1983–84[c]	291.8	12.8	350.0
1984–85[c]	308.1	5.6	350.0

[a] Includes estimated debt service *only* on bond issues presently authorized by the electorate. Figures through 1982–83 from Governor's Budget.

[b] An average interest rate of 10.0 percent is assumed on anticipated future sales. Projected sales for 1981–82 and 1982–83 from the 1982–83 Governor's Budget. Projections for 1983–84 and 1984–85 from California State Treasurer.

[c] Projections reflect interest paid on anticipated future sales and service on existing debt. Data assume that an average of one-half year's interest is paid on bonds during their year of sale.

Selected Bond Fund Expenditures

After General Fund bonds are sold, the proceeds from the sales are allocated to be spent on specific projects. These selected bond fund expenditures are identified in Schedule 3 of the Governor's Budget, by administering agency. Table 34 groups them according to the bond source of funding for the prior, current, and budget years.

Each of the last six midyear budget estimates of bond fund expenditures has turned out to be too high. For example, the 1978–79 and 1979–80 midyear estimates were $406 million and $347 million, respectively, while actual expenditures in those years were $196 million and $193 million, respectively. In 1980–81, the estimate ($273 million) was $128 million over the actual ($145 million). The single largest component of the 1980–81 difference involved the state, urban, and coastal parks program, where estimated expenditures were more than $66 million above actual expenditures.

The failure of the budget to give a realistic picture of bond expenditures makes inter-year bond expenditure program comparisons invalid and distorts total expenditure comparisons. More realistic scheduling of new projects and projects already authorized, particularly those in the parks and recreation area, would result in more accurate midyear estimates and, consequently, improved interyear comparisons.

Table 34
Selected Bond Fund Expenditures
1980–81 Through 1982–83 [a]
(in thousands)

	Actual 1980–81	*Estimated 1981–82*	*Proposed 1982–83*
Higher education construction	$8	—	—
Health science facilities construction	1,340	$4,009	$542
Community college construction	—	664	427
Beach, park, recreational, and historical facilities	21,408	14,749	176
New prisons	—	—	161,800
Recreation and fish and wildlife	38	575	3,866
State, urban, and coastal parks	35,795	70,746	6,627
Parklands acquisition and development	—	142,725	74,983
Clean water	57,533	71,755	96,389
Safe drinking water	28,549	36,925	25,906
Totals	$144,672	$342,148	$370,716

[a] 1982–83 Governor's Budget, Schedule 3. Includes bond fund expenditures for state operations, local operations and capital outlay. Detail may not add to totals due to rounding.

B. STATE REVENUE BONDS

Bond Categories

Agencies of the state also issue revenue bonds. These are fundamentally different from general obligation issues, because only the revenue generated from the financed project is pledged as security. This type of debt instrument has been used by the state in the past to finance the construction of bridges, fair facilities, and higher education dormitories and parking lots. Recently, the state has been increasing the use of revenue bonds, especially to finance housing, pollution control, and health facilities.

Table 35 provides detail on the fourteen different types of state revenue bonds and their current authorizations. As of December 31, 1981, there were $3,636 million in state revenue bonds outstanding. As shown in the table, three housing programs account for $1,446 million, or 40 percent, of the outstanding bonds: California Housing Agency ($936 million), Veterans Revenue Debenture ($485 million), and California National Guard ($25 million). Seven of the fourteen bond programs in Table 35 have no statutory limitation as to the amounts that can be issued.

Table 35
State Revenue Bonds
As of December 31, 1981
(in thousands) [a]

Issuing Agency	*Authorization Limits—If Any*	*Outstanding*	*Remaining authorization*
California Education Facilities Authority	$300,000	$286,190	$13,810
California Housing Finance Agency	1,500,000	935,805	564,195
California Pollution Control Financing Authority	(no statutory limits)	615,662	N/A
Transportation Commission	(no statutory limits)	129,282	N/A
Department of Water Resources	(no statutory limits)	695,840	N/A
Trustee's California State Colleges and Universities	(no statutory limits)	140,838	N/A
Regents University of California	(no statutory limits)	165,200	N/A
State Public Works Board	(no statutory limits)	15,587	N/A
Hastings College of Law	(no statutory limits)	—	N/A
Veterans Revenue Debenture	1,000,000	485,000	515,000
California National Guard	100,000	25,000	75,000
California Health Facilities Authority	767,000	141,245	625,755
California Student Loan Authority	150,000	—	150,000
California Alternate Energy Source Financing Authority	200,000	—	200,000
Subtotals:			
Bonds With Statutory Authorization Limits	$4,017,000	$1,873,240	$2,143,760
Bonds Without Statutory Authorization Limits	N/A	$1,762,409	N/A
Totals, All State Revenue Bonds	N/A	$3,635,649	N/A

[a] California State Treasurer.

Growth in Revenue Bonds

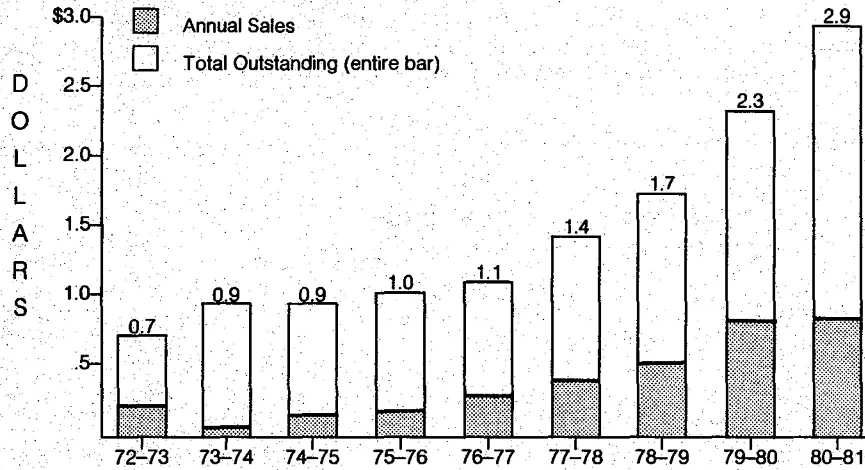
In recent years, the outstanding volume of revenue bonds has risen dramatically. Chart 18 shows the increase in revenue bonds outstanding from 1972–73 through 1980–81. The volume of these bonds has risen from $0.7 billion in 1972–73 to $2.9 billion in 1980–81. Between the end of 1980–81 and January 1982, the total rose an additional $740 million, to over $3.6 billion.

Bond Sales

Table 36 shows revenue bond sales for the past four years. Estimates of current- and budget-year sales are not available at this time. This is primarily because revenue bond issues are not scheduled as far in advance as are general obligation bond sales.

Chart 18

California State Revenue Bonds
Annual Sales and Total Outstanding Volume
1972–73 through 1980–81 (in billions)[a]



[a] California State Treasurer.

Table 36
State Revenue Bond Sales
1977–78 to 1980–81
(in millions) [a]

Issuing Agency	*1977–78*	*1978–79*	*1979–80*	*1980–81*
California Education Facilities	$45.3	$12.1	$24.5	$88.2
California Housing Finance Authority	172.4	250.0	371.7	161.8
California National Guard	—	—	—	25.0
California Pollution Control Financing Authority	40.2	107.8	44.5	165.6
Transportation Commission	20.0	—	—	25.0
Department of Water Resources	—	—	95.8	—
University of California Regents	2.6	—	28.8	4.7
Veterans Revenue Debenture	—	—	200.0	300.0
Totals	$280.6	$369.9	$765.3	$770.3

[a] California State Treasurer. Detail may not add to totals due to rounding.

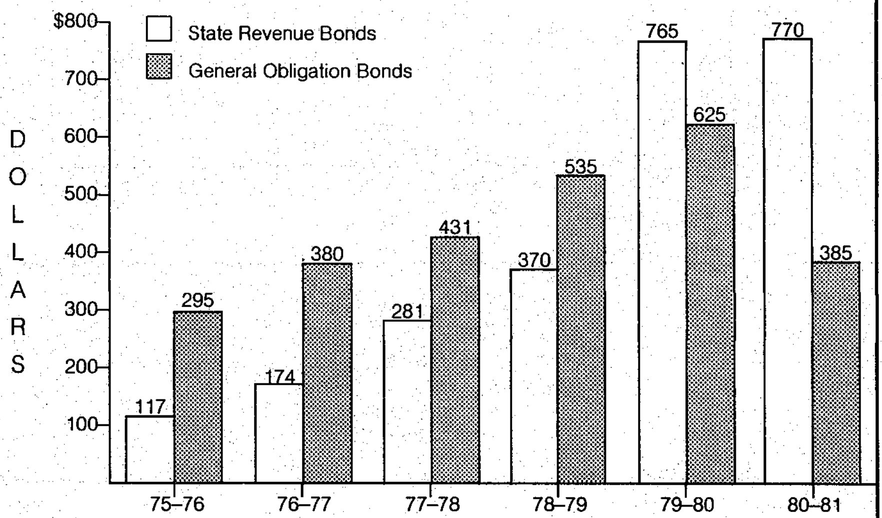
Two housing programs—California Housing Finance Agency and Veterans revenue bonds—accounted for 60 percent of 1980–81 sales. The remaining sales were accounted for primarily by the California Pollution Control Financing Authority. Since June 1981, there have been additional state revenue bond sales not shown in Table 36 of over $740 million. This upsurge appears to have partly reflected simply the timing of bond sales during calendar 1981. As discussed later, housing bond sales slowed in the first half of 1981 due to some uncertainty about exactly how new federal regulations affecting tax exempt housing bonds would be administered. When this uncertainty was removed later in 1981, bond sales accelerated.

Chart 19 compares the sales of state general obligation and revenue bonds since 1975–76. It shows that state revenue bond sales have significantly exceeded general obligation bond sales for the past two years. This is partly because the sale of most revenue bonds is not restricted by statutory interest rate ceilings. Because of high interest rates during the past year, these ceilings have often made it difficult to sell general obligation bonds.

Chart 19

Annual Sales of State Bonds

1975–76 through 1980–81 (in millions)[a]



[a] California State Treasurer. Data as of June 30 of each fiscal year.

C. LOCAL BORROWING

While the State of California does not regulate most local borrowing, the marketability of state bonds depends, in part, on the total volume of tax-exempt state *and* local bonds offered for sale. Because of this, the state certainly has an interest in local borrowing activities.

Table 37 shows local bond sales for the last four years, by type of local government. The table indicates that between 1977–78 and 1980–81, the volume of local nonhousing bonds sold actually declined. The table also indicates, however, that a tremendous increase in housing bond sales, especially by redevelopment agencies, occurred between 1977–78 and 1979–80. During this period, housing bonds increased from 5 percent to 45 percent of total local bond sales. In 1980–81, however, housing bonds' share of the total stabilized, partly due to the effects of federal legislation (discussed below) limiting such housing bonds.

Table 37
Annual Local Bond Sales
1977–78 to 1980–81
(in millions) [a]

Type of Local Government	*1977–78*	*1978–79*	*1979–80*	*1980–81*
1 Counties:	$60.5	$13.7	$9.0	$214.1
Housing	(28.2)	(12.4)	(8.6)	(194.8)
Other	(32.3)	(1.3)	(0.4)	(19.3)
2. Cities:	462.9	358.0	488.9	632.6
Housing	(—)	(111.2)	(211.9)	(124.1)
Other	(462.9)	(246.8)	(277.0)	(508.5)
3. Special Districts:				
Schools	129.8	58.7	95.9	52.6
4. Redevelopment agencies:	507.3	448.1	1,150.4	587.6
Housing	(0.9)	(241.3)	(948.3)	(446.7)
Other	(506.4)	(206.8)	(202.1)	(140.9)
5. Other special districts	670.1	623.5	814.0	267.8
Housing	(64.1)	(—)	—	(27.0)
Other	(606.0)	(623.5)	(814.0)	(240.8)
Subtotals	*$1,830.6*	*$1,502.0*	*$2,558.2*	*$1,754.6*
Housing	(93.2)	(364.9)	(1,168.8)	(792.6)
Other	(1,737.4)	(1,137.1)	(1,384.4)	(962.1)
6. Special Assessments	29.5	14.0	54.6	77.3
Overall Totals	$1,860.1	$1,516.0	$2,612.8	$1,831.9
Housing	(93.2)	(364.8)	(1,168.8)	(792.6)
Other	(1,766.9)	(1,151.2)	(1,444.0)	(1,039.3)
Housing Bonds as a Percent of All Bonds	5.0%	24.1%	44.7%	43.3%

[a] Office of Planning and Research. Detail may not add to totals due to rounding.

D. COMBINED STATE AND LOCAL BORROWING

Chart 20 shows the composition of tax-exempt bonded municipal debt outstanding at the end of 1980–81, by level of government and by category of bonds. It indicates that state bonds accounted for about one-third and local bonds accounted for two-thirds of all bonds, while general obligation bonds accounted for 46 percent and all other bonds accounted for 54 percent.

Combined state and local borrowing undertaken in recent years is shown in Table 38. Between 1977–78 (the first year for which we have been able to obtain relatively complete data on local government bond sales) and 1979–80, the annual volume of state and local bond sales in California increased by $1,431 million, or 56 percent. The largest relative increase was in the volume of state revenue bonds, which increased over 170 percent. Although the volume of local bond sales remained much larger than combined state sales during this period, annual sales by the state grew much faster.

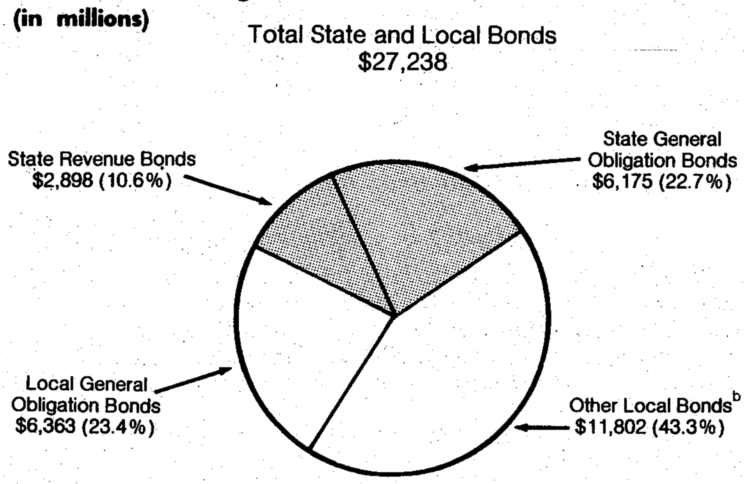
In 1980–81, however, a sharp break occurred in the upward trend of bond sales. Total state and local sales fell by 25 percent, or over $1 billion. This reflected declines of 17 percent for state sales and 30 percent for local sales. In the state's case, this was due to a 38 percent decline in General Obligation bond sales and essentially flat level of revenue bond sales. This drop off in bond sales reflected unusually negative financial conditions—especially high interest rates—in the municipal market during 1981.

Table 38
Annual Sales of State and Local Bonds
1975–76 to 1980–81
(in millions)

	Total All Bonds	State of California[a] Total State	General Obligation	Revenue	Local Bonds[b]
1975–76	$412[a]	$412	$295	$117	N.A.
1976–77	554[a]	554	380	174	N.A.
1977–78	2,572	712	431	281	$1,860
1978–79	2,421	905	535	370	1,516
1979–80	4,003	1,390	625	765	2,613
1980–81	2,987	1,155	385	770	1,832

[a] California State Treasurer.
[b] Office of Planning and Research. Data on local bond sales unavailable for years before 1977–78.

Chart 20
Total Outstanding State and Local Bonded Debt[a]
(in millions)



[a] California Municipal Statistics, Inc. Data as of June 30, 1981.
[b] Includes revenue bonds ($5,683), lease bonds ($2,273), mortgage revenue bonds ($2,247), redevelopment tax allocation bonds ($1,029) and 1915 Act special assessment bonds ($570). Data does not include (a) issues guaranteed by any branch of the Federal government (b) 1911 Act special assessment bonds (c) escrowed or pre-funded bonds or (d) industrial development bonds.

Housing Bonds Sales

Table 39 and Chart 21 show the sale of state and local housing and nonhousing bonds. From 1977–78 through 1979–80, combined state and local housing bond sales increased 439 percent. Local housing issues showed the largest increase—over 1,100 percent. In contrast, nonhousing bonds declined by 15 percent during this same period. In 1980–81, sales of both housing and nonhousing bonds fell significantly. However, housing bonds continued to maintain the same high share of total sales. As a result, the share of state and local bonds that are sold for housing rose from 5 percent in 1977–78 to 56 percent in 1979–80.

This rise in housing bond sales is attributable to several factors:

- Chapter 1, First Extraordinary Session-1975 (the Zenovich-Moscone-Chacon Housing and Home Finance Act), established the California Housing Finance Agency and authorized the sale of up to $1.5 billion in tax-exempt state revenue bonds. As of December 31, 1981, $936 million in bonds were outstanding under this program.
- Ch 1069/79 (AB 1355) authorized local housing finance agencies to sell tax-exempt revenue bonds in order to finance low-interest loans for low and moderate income housing. There is no statutory limit on the amount of bonds issued under this program, although the State Housing Bond Credit Committee has the authority to review, disapprove, and/or reduce bond issues.

Table 39
California State and Local Bond Sales
1977–78 to 1980–81
(in millions) [a]

	1977–78	*1978–79*	*1979–80*	*1980–81*
State Bonds:				
Housing	$322.4	$625.0	$1,071.7	$861.8
Nonhousing	396.2	250.5	303.0	310.2
Subtotals	$718.6	$875.5	$1,374.7	$1,172.0
Local Bonds:				
Housing	$93.2	$364.9	$1,168.8	$792.6
Nonhousing	1,766.9	1,151.1	1,444.0	1,039.3
Subtotals	$1,860.1	$1,516.0	$2,612.8	$1,831.9
State and Local Bonds:				
Housing	$415.6	$989.8	$2,240.5	$1,654.4
Nonhousing	2,163.1	1,401.7	1,747.0	1,349.5
Totals	$2,578.7	$2,391.5	$3,987.5	$3,003.9

[a] Office of Planning and Research. State bond totals for 1980–81 are approximately $17 million more than estimated by the California State Treasurer.

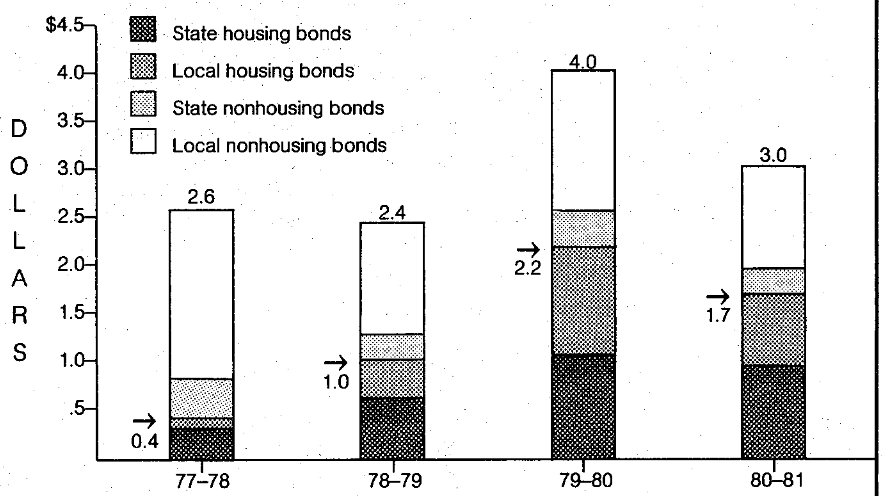
Future Housing Bond Growth

Both the state and federal governments have expressed concern about the rapid growth in the sale of housing revenue bonds, primarily out of fear that such bonds will increase the interest costs and limit the market for other tax-exempt bonds sold for more traditional purposes, such as to finance highway projects, construction of prisons, development of water projects, and so forth. In December 1980, the U.S. Congress decided to stem the growth in housing bonds when it enacted the Mortgage Subsidy Bond Act of 1980. This act restricts the use of these bonds, and eliminates their tax-exempt status when sold to finance single-family housing, beginning December 31, 1983. The threat of federal action and uncertainty about what its exact form might be, had caused a dramatic rise in the number of local housing bond issues proposed during late 1980. During this period, in fact, the State Housing Bond Credit Committee recommended postponement of several local housing bond sales in order to prevent a flood of issuances to the bond market.

Passage of the act also helps to explain why housing bond sales for 1980–81 as a whole dropped off so dramatically. Specifically, there was

Chart 21

California State and Local Bond Sales Highlighting Housing Bonds 1977–78 through 1980–81 (in billions)[a]



[a] Office of Planning and Research as published in "Mortgage Revenue Housing Bonds: California's 1980 Frenzy", November 1980, updated through December 1981 using data from Office of Planning and Research.

considerable uncertainty after December 1980 as to the conditions under which the tax-exempt status on housing bonds issued after that date could be voided due to the failure of housing agencies to adhere to the act's various regulations governing use of bond proceeds. This uncertainty was removed after mid-1981 when more detailed federal regulations were issued.

Between now and December 1983, there could be a resurgence of housing bond sales, subject to the contraints on volume imposed by the federal government, and assuming that conditions in the financial markets will permit bonds to be sold at reasonable interest rates. Beyond December 1983, however, the rate of growth in housing bonds will be less, because the tax-exempt status of issues used to finance single-family home purchases will be eliminated. How much this might reduce the future interest rates for other tax-exempt state and local debt is not known at present.

E. CURRENT PROBLEMS FACING THE STATE AND LOCAL TAX-EXEMPT BOND MARKET

1981—A Year of Setbacks

1981 was a disappointing year for the tax-exempt municipal bond market. While some of the problems facing the market are short-term in nature, a number are more fundamental, longer-term problems which may not disappear very quickly. Because of this, both the near-term and future outlook for tax-exempt bonds is quite uncertain at this time. Some of the major problems facing the market include the following:

- Because of current monetary policies and continuing inflation, *interest rates* have reached very high levels. This is especially true of municipal bond interest rates. In January 1982, for example, the widely-used 20-Bond Buyer Index of national municipal bonds stood at over 13.4 percent, compared to 9.6 percent 12 months before. Such high interest rates limit the ability of states and local governments to sell general obligation bonds because of statutory interest rate ceilings, and also impair the sale of revenue bonds because of the high debt servicing costs which governments must bear.
- Bond prices and interest rates have been negatively affected by both *basic supply and demand factors.* On the *supply side,* increased supplies of bonds, particularly bonds sold for "nontraditional" purposes, such as financing activities like housing that historically have been financed in the taxable market, have tended to drive prices down and yields up. On the *demand side,* organizations such as banks and insurance companies which traditionally buy tax-exempt bonds are not as active in purchasing these bonds because of reduced needs for tax-sheltered income. Casualty insurance companies, for instance, currently are at a low ebb of their earnings cycle. This, too, has driven prices down and yields up.
- The *Economic Recovery Tax Act of 1981* (ERTA) will exert a significantly negative impact on the tax-exempt bond market. For instance, ERTA reduces maximum individual marginal tax rates from 70 percent to 50 percent, thereby reducing the need by high-income individuals—who often buy municipal bonds—for tax shelters. ERTA also liberalizes the rules for tax-free retirement savings accounts and provides for tax-exempt "all savers" certificates.

The plight of the tax-exempt market, if not resolved, could result in very negative consequences for state and local governments. For most issuers, the sale of bonds represents the only feasible means for financing large capital outlay expenditures. There is evidence that the current state of the bond market has kept many governments from raising the funds they need. There is also evidence that, in order to sell bonds, some governments have had to shorten maturity structures and eliminate "call" provisions. This tends to reduce budgetary flexibility in the future.

Under such conditions, the bond-dependent capital infrastructure of governments may not only fail to keep pace with the needs of a growing population; it may actually erode. Ultimately, this could create significant economic and social problems for our society.

In California, the problems facing *local* governments in the municipal market are especially significant, because of the limitations which Proposition 13 placed on property tax revenues. Because these revenues traditionally have been pledged to service general obligation bonds, the ability of local governments to issue new general obligation debt has essentially been eliminated. No longer can a local government temporarily increase the property tax rate for the sole purpose of amortizing a bond. The reduction in the volume of local general obligation bond sales caused by the combination of negative conditions in the bond market and Proposition 13 has been partly offset, at least in the case of some localities, by increased use of revenue bonds, including those whose debt service relies on lease-purchase arrangements. Such revenue bonds, however, tend to impose higher interest costs on localities than do general obligation bonds.

What Can Be Done?

In 1981, several measures were enacted in California to address some of the problems the state and local governments face in raising money for capital outlay projects. These included:

- SB 121 (Ch 1098/81), which increases from 10 percent to 12 percent the maximum interest per year which can be paid on bonds issued by redevelopment agencies, housing authorities, industrial development authorities, and other local governmental agencies, unless otherwise excepted. The higher limit will expire on January 1, 1984, and revert to its original level.
- AB 176 (Ch 42/81), which increases from 9 percent to 11 percent the maximum interest per year which can be paid on state general obligation bonds.
- SB 152 (Ch 951/81), which gives cities the authority to share the city sales tax with redevelopment agencies. Sales tax revenues could then be pledged to support tax-allocation bonds for redevelopment purposes.

The overall issue of how best to deal with the underlying problems of tax-exempt bond financing, however, is the subject of considerable debate but little agreement. In general, some consensus has emerged that the market could benefit from restrictions on the proliferation of nontraditional uses of the tax-exempt borrowing privilege, such as the issuance of tax-exempt bonds to finance projects of private industry and housing. As noted earlier, the federal government has already enacted legislation to limit the use of tax-exempt revenue bonds for single-family housing. Exactly what the quantitative costs and benefits of such restrictions would be in terms of reduced government borrowing interest rates, however, remains unclear, although some reduction would be likely.

Other actions have been proposed which are much more controversial. Some economists and policy makers, for example, are in favor of eliminating tax-exempt bonds altogether, and replacing them with direct subsidies to issuers. This view is based on the well-known fact that the current exemption oversubsidizes high income investors to purchase tax-exempt bonds.

Another suggestion has been to have the state government become more involved in the capital outlay financing activities of local governments. This involvement could range anywhere from collecting and disseminating information on bond-related matters, to becoming directly involved in the approval and marketing of local debt issues. One step in the direction of greater state involvement in local debt was taken under AB 1192 (Ch 1088/81), which established the California Debt Advisory Commission for the purpose of providing *advisory* assistance on the marketing of bond issues for both the state and individual local governments. At present, this commission is still in a start-up mode, and it will be some time before its exact role is defined and the effects of its activities can be evaluated.

State and local government access to long-term financial capital through efficient bond markets is critical. While some of the markets' problems (such as the current state of the economy) are out of the state's direct control, others (such as state laws governing the conditions under which tax-exempt financing is used) are not.

We plan to provide the Legislature with a report later this year, which identifies the major problem areas in debt financing, and the policy options that are available to address these problems.

VII. STATE EMPLOYMENT

The budget estimates that there will be 231,375 state employees in 1982–83, an increase of 2,276 personnel-years, or 1.0 percent above the current-year level.

Table 40
Total Number of State Employees, by Function
(in personnel-years)
1978–79 through 1982–83

	1978–79	*1979–80*		*1980–81*		*1981–82*		*1982–83*	
Function	*Actual Positions*	*Actual Positions*	*Percent Change*	*Actual Positions*	*Percent Change*	*Estimated Positions*	*Percent Change*	*Proposed Positions*	*Percent Change*
Legislature	338.1	337.4	(−0.2%)	332.6	(1.4%)	361.8	(8.8%)	399.2	(10.3%)
Judicial	989.7	1,051.0	(3.3)	1,083.7	(3.1)	1,156.1	(6.7)	1,234.0	(6.7)
Executive	7,247.7	7,325.3	(1.1)	7,716.0	(5.3)	8,101.9	(5.0)	8,172.8	(0.9)
State and Consumer Services	10,402.7	10,671.3	(2.6)	11,023.2	(3.3)	11,721.1	(6.3)	11,917.2	(1.7)
Business, Transportation and Housing	30,867.6	31,293.4	(1.4)	31,955.0	(2.1)	32,200.4	(0.8)	33,365.3	(3.6)
Resources	14,167.9	13,779.5	(−2.7)	13,889.2	(0.8)	14,578.6	(5.0)	14,947.2	(2.5)
Health and Welfare	40,460.9	42,325.2	(4.6)	43,320.7	(2.4)	41,921.7	(−3.2)	41,493.7	(−1.0)
Education:									
Education	2,650.3	2,665.0	(0.6)	2,746.5	(3.1)	2,985.9	(8.7)	2,964.7	(−0.7)
Higher Education	90,152.0	89,840.5	(−0.3)	91,629.0	(2.0)	92,047.3	(0.5)	92,177.2	(0.1)
Youth and Adult Correctional	12,805.6	12,548.6	(2.0)	13,118.3	(4.5)	14,516.7	(10.7)	15,110.5	(4.1)
General Administration	8,447.6	8,355.3	(−1.1)	8,752.4	(4.8)	9,508.0	(8.6)	9,593.5	(0.9)
Totals	218,530.1	220,192.5	(0.8%)	225,567.4	(2.4%)	229,099.5	(1.6%	231,375.3	(1.0%)

As Table 40 shows, the major staffing increases for the budget year will occur in Business, Transportation and Housing, and in the Youth and Adult Correctional programs. In the former category, the budget proposes an increase of 1,165 personnel-years. Within this category, the major increases are in staffing for the Department of Motor Vehicles (414), the Department of Transportation (330) and the California Highway Patrol (458). The increase for the patrol results from Ch 933/80, which increase vehicle registration fees by one dollar to augment the patrol's staffing by 670 uniformed positions over a four-year period.

The increase in Youth and Adult Correctional programs, for which the budget proposes 594 new positions, is primarily due to the population increases in the state correctional system.

The only major reduction in state employees, 428 positions, will occur in the Health and Welfare Agency. This reduction reflects reductions in staffing at the state hospitals (−148), and transfers of state functions to regional developmental disability centers (−100). Federally funded positions are also included in these reductions. The Employment Development Department is proposing to eliminate 277.6 personnel-years, a reduction of 2.2 percent in 1982–83. This is a result of reductions in federal funded positions for administration of employment and unemployment insurance programs.

Table 40 shows an increase of 12,845, or 5.9 percent, personnel-years from 1978–79 through 1982–83.

During the past three years, the rate of increase has slowed from 2.4 percent in 1980–81 to 1.6 percent in 1981–82, to 1.0 percent in 1982–83. The major reduction during this period occurred in the Employment Development Department (Health and Welfare), which eliminated 1,000 positions (personnel-years not available) during the current year. This is a direct result of reductions in Federal funding to the department.

Table 41 shows the growth in the number of state employees from 1973–74 to 1982–83. While General Fund expenditures increased 185 percent during this period, the number of state employees increased 19.9 percent. The rate of growth in later years is much less than in earlier years.

A year ago, the budget estimated that there would be 226,743 positions in 1981–82, but the revised estimate shows a total of 229,100 positions, or 2,357 more than the budget forecast. Increases in corrections (608) and higher education (1,892) account for the growth during the current year.

Table 41
Trends in Total State Employee Growth
(in personnel-years)
1973–74 through 1982–83

	Employees	*Percent Change*
1973–74	192,918	2.4%
1974–75	203,548	5.5
1975–76	206,361	1.4
1976–77	213,795	3.6
1977–78	221,251	3.5
1978–79	218,530	−1.2
1979–80	220,193	0.8
1980–81	225,567	2.4
1981–82 (estimated)	229,100	1.6
1982–83 (proposed)	231,375	1.0
Increase from 1973–74 to 1982–83	38,457	19.9%