per year (from $1,194 to $1,344), providing an additional $14.8 million in revenues.

- ***California State University.*** Student fees would be increased by $230 per year (from $441 to $671), providing an additional $73.6 million in revenues. In addition, the budget would eliminate General Fund support for summer quarters at the San Luis Obispo, Pomona, Los Angeles, and Hayward campuses, for a savings of $13.6 million.
- ***California Community Colleges.*** For the first time, community college students would be required to pay a statewide fee of $100 per year, which would provide $109.5 million in revenues. The budget does not provide for growth in average daily attendance (ADA) or a COLA.

7. ***Capital Outlay*** expenditures in 1983–84 are funded exclusively from bond and special funds. Proposed capital outlay expenditures from all sources total $568.4 million in the budget year.

8. ***Department of Corrections*** expenditures are proposed to increase by $114.6 million in the budget year, due primarily to the growth in the state's prison population.

9. ***Unidentified Savings*** of $260 million, primarily from the establishment of government efficiency teams, are proposed in the budget. These teams, composed of individuals from the public and private sectors, are expected to submit recommendations for inclusion in the budget before it is enacted. At the time this *Analysis* was prepared, however, no individuals had been named to serve on this task force. Due to the lack of specific information on these proposals, which the budget states will save $200 million, we recommend the Legislature *not* rely on the achievement of these savings, in doing its fiscal planning. In addition, the budget anticipates further unidentified savings of $60 million.

10. ***Merit Salary Adjustments*** for state employees are not funded in the Governor's Budget. Although funding for these adjustments (almost $60 million from the General Fund) is included within the individual appropriation requests, these funds are proposed for reversion by Control Section 9.25 of the 1983–84 Budget Bill. In addition, the budget proposes that $211 million be expended for additional employee compensation, but the administration has identified these funds as part of its Phase II options for use in eliminating the 1982–83 budget deficit.

## III. REVENUES

### A. OVERVIEW

The various expenditure programs discussed in the *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 is 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—15 percent of the total—are placed into special funds to support specific programs and activities, including highway maintenance and various construction projects.

The availability of revenues is the key determinant of how much the state can afford to spend in the budget year. Consequently, in analyzing the Governor's Budget for 1983–84, it is important to consider whether the state will collect sufficient revenues to fund the proposed spending plan. 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* affect the size of the 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 *legislation* to increase revenues in 1983.

This section examines the Department of Finance's forecast for revenues in the current and budget years, 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. In 1982, both the national and California economies were in the midst of a serious recession. Nationally, real Gross National Product (GNP) declined in two of the four quarters, "real" interest rates remained high throughout the year, unemployment reached record levels, housing starts sagged to a 36-year low, personal income grew at its slowest rate in 20 years, and corporate profits fell for the third straight year. California's economic performance in 1982 was also poor. Job growth in the state was negative for the first time since 1971, the unemployment rate at year-end was the highest in the postwar period, and new residential building permits (79,000) were at their lowest level in over two decades. At year-end, it appeared that the economy was still in a recession.

The Department of Finance's economic forecast for 1983 and 1984 generally reflects the consensus of other economists, in that it calls for a modest recovery. In the near term, the economy is expected to remain relatively weak, with only a very small increase in real GNP in the first quarter of 1983. As the year progresses, however, the forecast shows the economy improving gradually, led by consumer spending and improved levels of housing starts and car sales. On the positive side, inflation is expected to remain low (in the 4 to 6 percent range), and interest rates are anticipated to decline further from current levels.

As the economy moves into 1984, the recovery is projected to continue and pick up momentum. The department predicts that the rate of job growth in California will climb from only 0.7 percent in 1983 to 3.3 percent in 1984, resulting in a fall in the unemployment rate from 10.2 percent in 1983 to 8.5 percent in 1984.

No one can say whether the department's economic forecast will prove to be accurate. Economic forecasters have compiled 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; decisions by both the Reagan Administration and the Congress during 1983 and 1984 affecting taxes, spending and the federal deficit; and the reactions of businesses and financial markets to future trends in interest rates and inflationary expectations. We believe that because of these factors, and the precariousness with which the state's budget is to be balanced over the next 18 months, 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 22 summarizes the Governor's Budget estimates of total, General Fund, and special fund revenues. The table shows that:

- *Prior year* (1981–82) total revenues were $23.6 billion (a growth of $1.5 billion, or 6.8 percent, over the preceding year). This amount included about $21 billion in General Fund revenues (a growth of $1.9 billion, or 10.2 percent), and $2.6 billion in special fund revenues (a decline of $440 million, or 14.3 percent).
- *Current year* (1982–83) total revenues are estimated to reach $23.8 billion (a growth of $168 million, or 0.7 percent), including revenues of $20.5 billion to the General Fund (a decline of $471 million, or 2.2 percent). Revenues to special funds are estimated at $3.3 billion, or $638 million (24.2 percent) above the prior year amount.
- *Budget year* (1983–84) total revenues are projected at $26.0 billion ($2.3 billion, or 9.5 percent, above the estimated current-year level). This amount includes $22.5 billion in General Fund revenue (a growth of $2.0 billion, or 9.7 percent), and $3.5 billion in special fund revenues (a growth of $267 million, or 8.2 percent).

**Table 22**
**Summary of General Fund and Special Fund Revenue Performance**
**1981–82 to 1983–84**
**(in millions)[a]**

| | *Prior Year (1981–82)* | *Current Year (1982–83)* | *Budget Year (1983–84)* |
|---|---|---|---|
| General Fund Revenue | | | |
| Amount | $20,960 | $20,490 | $22,479 |
| Dollar Change | $1,937 | −$471 | $1,990 |
| Percent Change | 10.2% | −2.2% | 9.7% |
| Special Fund Revenues | | | |
| Amount | $2,641 | $3,279 | $3,546 |
| Dollar Change | −$440 | $638 | $267 |
| Percent Change | −14.3% | 24.2% | 8.2% |
| Total, General Fund and Special Fund Revenues | | | |
| Amount | $23,601 | $23,769 | $26,026 |
| Dollar Change | $1,497 | $168 | $2,257 |
| Percent Change | 6.8% | 0.7% | 9.5% |

[a] 1983–84 Governor's Budget. Detail may not add to totals due to rounding. Figures include effects of all revenue-enhancing measures proposed in the budget.

As discussed later, the General Fund and special fund growth rates for the prior, current and budget years have been significantly distorted by a number of factors. These factors include tax accelerations, other revenue enhancements and special fund transfers into the General Fund that were enacted in 1981 and 1982, or have been proposed in the Governor's Budget for 1983–84. In our more detailed discussion of revenues which follows, we show what the "underlying" growth rate of General Fund revenues would be if these factors are excluded.

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

- Growth in total *current dollar* revenues over the 11-year period from 1970–71 through 1980–81 averaged over 14 percent, compared to 6.8 percent for 1981–82, 0.7 percent for 1982–83, and 9.5 percent for 1983–84; and
- Growth in total *constant dollar* revenues (that is, revenues adjusted for inflation) averaged 5.5 percent over this 11-year period, compared to declines of about 1.1 percent in 1981–82 and 4.9 percent in 1982–83, and an increase of 3.3 percent in 1983–84.
- Growth in total *constant dollar per capita* revenues (that is, revenues adjusted for both inflation and population increases) averaged 3.7 percent over the 11-year period, versus declines of 2.8 percent in 1981–82 and 6.5 percent in 1982–83, and an increase of 1.6 percent in 1983–84.

The two main reasons for these historically-low rates of revenue growth in the past three years are (1) the weaknesses in the economy in the past several years, and (2) the revenue effects of income tax indexing. According to the Department of Finance, the latter will reduce 1983–84 General Fund revenues by $3.5 billion below what revenues would have been without indexing. Our estimate of indexing's effect on revenues is even larger—$3.6 billion.

Revenue growth during the period covered by the budget would be even weaker, relative to historical standards, were it not for the following factors:

- *First,* total revenues over the period 1981–82 through 1983–84 reflect the effects of numerous enacted and proposed revenue enhancements. These enhancements were achieved by accelerating the collection of certain taxes, increasing the interest penalties on late tax payments, levying certain fees and user costs, increased tax auditing, and repeal of certain tax credits. These factors are detailed below.
- *Second,* SB 215 (Ch 541/81) and AB 202 (Ch 933/81) increased gasoline and diesel taxes, motor vehicle registration fees, truck weight fees, and drivers' license fees. The result was to increase special fund revenues from motor vehicle user taxes and fees by $205 million in 1981–82, $380 million in the current year and over $630 million in the budget year. In addition, the budget proposes to increase fuel tax revenues by $85 million in the budget year by moving-up the due dates for tax payments.

It is also important to recognize that the prior, 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, have been packaged with the other revenue-enhancing measures mentioned above in order to balance the 1981–82 General Fund budget, reduce the current year General Fund deficit and balance the 1983–84 General Fund budget. They total over $800 million in 1981–82, and over $550 million in both 1982–83 and 1983–84. If the Department of Finance's economic forecast for 1983 and beyond comes true, a continuation of these transfers would not be necessary after 1983–84. 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 (1981–82), current year (1982–83), and budget year (1983–84). 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 1982 ECONOMY IN RETROSPECT

### A Bad Year for California

For the third year in a row, the economy performed very poorly in most respects. Table 23 summarizes how the California economy fared during the year, relative to the Department of Finance's projections. It indicates that:

- Employment growth fell below expectations, even though the original projections were not very high. Civilian employment rose by only 0.3 percent, compared to the 1.1 percent increase expected one year ago. Wage and salary job growth was even worse (a decline of 1.4 percent), and this was also a poorer performance than predicted (a gain of 1.1 percent).
- Unemployment averaged 9.9 percent compared to the 8.1 percent expected last year, and ended the year at 11.1 percent. The annual rate was as bad as that reached in 1975, during the last recession. The December rate, however, was the highest December rate on record for the postwar period, indicating that the unemployment situation was actually *worsening* at year-end.

**Table 23**

**Summary of 1982 Economic Performance for California [a]**

| *Economic Indicators* | *Original January 1982 Forecast* [b] | *Revised May 1982 Forecast* | *January 1983 Estimated Actual* [c] |
|---|---|---|---|
| Percent change in: | | | |
| —Personal income | 10.3% | 8.5% | 7.8% |
| —Civilian employment | 1.1% | 0.8% | 0.3% |
| —Wage and salary employment | 1.1% | 0.3% | −1.4% |
| —Consumer prices | 11.3% | 7.5% | 6.9% |
| Unemployment rate (%) | 8.1% | 9.1% | 9.9% |
| Residential building permits (thousands) | 125 | 86 | 79 |
| New car sales (thousands) | 975 | 890 | 840 |

[a] Forecasts and estimates by the California Department of Finance.
[b] 1982–83 Governor's Budget.
[c] 1983–84 Governor's Budget.

- Residential building permits were reported at only 79,000, compared to the predicted level of 125,000. This performance was the worst in decades, even though population has increased;
- New car sales totaled 840,000, some 135,000 less than projected;

- "Real" personal income (that is, income adjusted for inflation) rose only 0.8 percent using the Consumer Price Index (CPI) as a measure of inflation. Thus, per capita real income did not rise; and
- Taxable sales fell by 0.5 percent, the first time a decline has occurred since 1958.

Table 24 summarizes how successful forecasters other than Finance were in predicting California's economic performance. Like the department, these other forecasters all appear to have expected a better performance by the state's economy than the economy was able to achieve. For example, all but one forecaster overestimated personal income growth, all overestimated the level of employment, and no forecaster came even remotely close to foreseeing the collapse of the residential housing sector. Likewise, all forecasters underpredicted the unemployment rate, and all but the department overstated the growth of real personal income. The one bright spot in the state's economic performance during 1982 involved inflation (6.9 percent on an annual average basis), which was less than what all but one forecaster anticipated.

**Table 24**

**Accuracy of 1982 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 | 10.3% | 11.3% | −0.9% | 1.1% | 8.1% | 125 |
| First Interstate Bank [c] | 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 |
| UCLA | 7.8 | 5.7 | 2.0 | −0.5 | 8.8 | 133 |
| Crocker Bank | 9.0 | 7.8 | 1.1 | 0.2 | 8.4 | 138 |
| Average of All Forecasters | 9.7% | 8.1% | 1.5% | 0.9% | 8.2% | 133 |
| Actual [e] | 7.8% | 6.9% | 0.3% | −1.4% | 9.9% | 79 |

[a] Forecasts as of approximately year-end 1981.

[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" 1982 personal income would be 1.8 percent instead of 0.3 percent.

[c] Formerly United California Bank (UCB). Forecast as of October 1981.

[d] Civilian employment growth estimate.

[e] As estimated in the 1983–84 Governor's Budget.

### Economic Weaknesses a Nationwide Problem

California's economic problems in 1982 were, to a large extent, reflections of economic weaknesses in the nation's economy generally. For instance:

- The *nation's real GNP* in the fourth quarter of 1982 was 1 percent *lower* than it was in the fourth quarter of 1979, three years earlier. On five occasions during this period, quarterly real GNP actually declined, including twice during 1982;
- U.S. before-tax *corporate profits* fell in each of the past three years,

even after adjusting for 1981 federal law changes regarding the treatment of depreciation allowances;

- ***Housing starts*** in 1982 averaged only 1.1 million for the year as a whole, the worst performance since 1945;
- ***Capacity utilization*** averaged only 70 percent for 1982, lowest in the postwar period. By December, the rate had slipped to only 67 percent, also a record low;
- ***Business investment expenditures*** on producers' durable equipment in 1982 fell by nearly 2 percent in current dollars, and by 6.5 percent in "real" terms. Adjusted for inflation, total nonresidential investment expenditures in the economy at year-end 1982 were 6.6 percent below their level three years earlier;
- ***Personal income*** increased only 6.4 percent in 1982, the smallest rise in 20 years; and
- ***Interest rates*** declined throughout the latter half of the year. However, although "real" short-term interest rates are now near normal historical levels, "real" long-term interest rates, which are important determinants of investment, continue to remain relatively high.

**What Has Gone Wrong?**

The economy's poor 1982 performance was essentially a continuation of a generally unhealthy performance by the economy in both 1980 (when real GNP fell by 0.4%) and 1981 (when real GNP rose by only 1.9 percent). Last year at this time, most economists expected a recovery from the recession to begin in 1982, but this did not happen. What has gone wrong?

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 1982's poor performance in terms of output and employment is most directly attributable to tight monetary policies pursued by the Federal Reserve Board (FED) in 1981. During 1981, these policies tended to restrict credit availability, put upward pressures on interest rates, and thereby discourage borrowing to finance home buying and business investment. Although nominal interest rates have since declined, the economy has yet to recover in terms of production and employment.

The FED's original purpose in attempting to reduce monetary growth in 1981 stemmed 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 in 1981, but at the cost of higher inflation in 1982. The monetary authorities feared that such inflation could, after a lag, result in an even weaker economy and stifle recovery. While the FED's monetary actions clearly succeeded in reducing inflation in 1982, the cost of this success was significant losses in production, income, and jobs.

Many economists question whether the benefits of past federal monetary policies have been worth the costs. Others maintain that the nation was destined to pay this price ultimately, due either to the FED's actions or the debilitating effects of inflation on the economy over time. At any rate, selecting the proper policy prescription to rectify today's economic problems is another difficult and, as of yet, unresolved issue.

As 1983 begins, it is not at all apparent whether brighter days for the economy are just ahead. There have been a number of positive developments recently, such as an upswing in housing starts, continuing declines in interest rates, and some improvements in consumer spending. These developments, by themselves, however, are not sufficient to guarantee a first quarter recovery. Indeed, softness in many other sectors of the economy, such as excess inventories, low capacity utilization rates, reduced spending by state and local governments, a deteriorating international trade situation, an increasing federal budget deficit, and declines in planned business investment spending, all argue against any quick rebound in business activity. Because of preliminary data showing that real GNP declined at a 2.5 percent annual rate in the fourth quarter of 1982, and the high probability that the current quarter will be weak, many economists believe that we may still be in the midst of a recession. Thus, the economy closed 1982 and began 1983 on a fairly negative note, and the outlook for recovery is still rather "iffy".

## 2. THE ECONOMIC OUTLOOK FOR 1983 AND 1984

Economic activity in calendar 1983 will account for about one-third of current-year (1982–83) General Fund revenues and about two-thirds of budget-year (1983–84) General Fund revenues. The remaining one-third of budget-year revenues will be determined by 1984 economic conditions. Table 25 summarizes the Department of Finance's economic projections for 1983 and 1984 for both the nation and California.

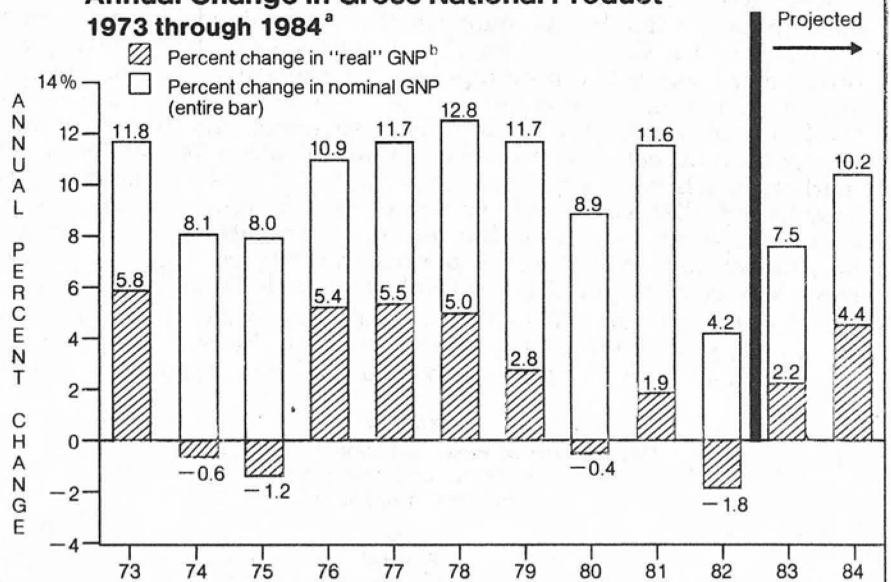
### The Nation—From Recession to Recovery

The department's forecast reflects the consensus view that the current recession will end sometime in early 1983, and that the recovery is expected to be moderate, though sustained, carrying forward beyond 1983 and throughout 1984. For the nation as a whole:

- ***Real GNP*** is projected to rise by a modest 2.2 percent in 1983, and then rise by a somewhat stronger 4.4 percent in 1984. This upswing, however, will be weaker than that which followed the 1973–75 recession (See Chart 11).
- ***Pre-tax corporate profits*** are expected to post a 10.7 percent gain in 1983. Despite this rise, however, the level of profits in 1983, after adjusting for recent federal tax law changes regarding treatment of depreciation allowances, will still be below that of 1978, even before adjusting for inflation. In 1984, profits are predicted to register a 17 percent gain.
- ***Unemployment*** is expected to average 10.0 percent in 1983, an increase over the record 9.6 percent rate of 1982. This rise will occur, despite the projected economic recovery, because businesses will add workers too slowly to offset the normal growth in the labor force and the reentrance into the job market of previously discouraged workers. In 1984, the unemployment rate is predicted to fall to 8.7 percent, which would still be above its 1981 level (See Chart 12).
- ***Employment growth*** is expected to be negligible in 1983, rising only 0.2 percent for wage and salary workers and 1 percent for all civilian workers. In 1984, moderate gains of about 3 percent for each employment category are projected.
- ***Housing starts*** will rise in 1983 to 1.34 million units. While this is an improvement over 1982, it is still a relatively depressed level. In 1984, starts are projected to rise to 1.63 million units.
- ***Car sales*** are projected to improve, reaching 8.6 million units in 1983. In 1984, a further increase, to 10.2 million units, is projected.

**Chart 11**

## Annual Change in Gross National Product
### 1973 through 1984[a]

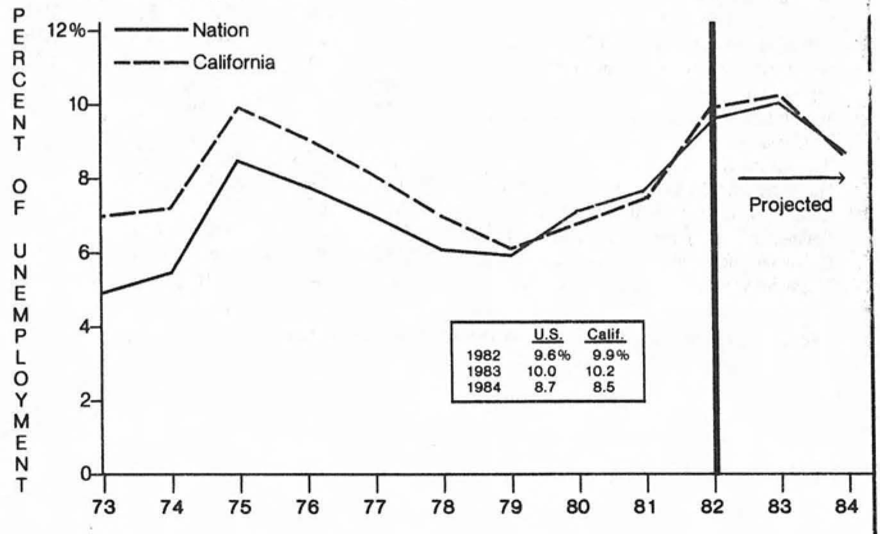



[a] California Department of Finance. 1981 figures are preliminary

[b] "Real" GNP is defined as current dollar nominal GNP deflated by the U.S. GNP price deflator

**Chart 12**

## Unemployment Rates for California and the Nation
### 1973 through 1984[a]




| | U.S. | Calif. |
|---|---|---|
| 1982 | 9.6% | 9.9% |
| 1983 | 10.0 | 10.2 |
| 1984 | 8.7 | 8.5 |

[a] California Department of Finance

### California—Similar Expectations for a Modest Recovery

Most economists who study the California economy agree with the department's belief that the state will begin a sustained period of economic recovery in 1983. In addition, the consensus is that this recovery could proceed at a somewhat more-rapid pace in California than for the nation at large. There are several reasons for this. One involves the benefits to California of increased federal defense spending. Another involves the improved prospects which declining interest rates offer for the housing market, which is an especially important sector of the economy in a growth state like California. Nevertheless, it is important to stress that economic performance in California, as for the nation, is expected to be only moderate over the forecast period, especially compared to past post-recession recovery periods. For California, Table 25 indicates that:

- ***Employment growth*** in 1983 is projected to rise only very slowly. Civilian employment growth is forecast to be only 1.5 percent. As shown in Chart 13, California wage and salary job growth is projected

**Table 25**
**Department of Finance Economic Outlook for California and the Nation (dollars in billions)** [a]

| | 1982 Estimated | | 1983 Forecast | | 1984 Forecast | |
|---|---|---|---|---|---|---|
| A. *The Nation* | *Level* | *Percent Change* | *Level* | *Percent Change* | *Level* | *Percent Change* |
| GNP in current dollars | $3,060.1 | 4.2% | $3,288.4 | 7.5% | $3,623.9 | 10.2% |
| GNP in 1972 dollars | $1,475.9 | −1.8 | $1,508.0 | 2.2 | $1,574.0 | 4.4 |
| Personal income | $2,572.2 | 6.5 | $2,763.2 | 7.4 | $3,030.1 | 9.7 |
| Corporate profits (pre-tax) | $176.9 | −23.8 | $195.8 | 10.7 | $229.0 | 17.0 |
| Wage and salary employment (in thousands) | 89,686 | −1.6 | 89,863 | 0.2 | 92,569 | 3.0 |
| Civilian employment (in thousands) | 99,605 | −0.8 | 100,617 | 1.0 | 103,733 | 3.1 |
| Housing starts (millions of units) | 1.04 | −5.3 | 1.34 | 28.7 | 1.63 | 21.3 |
| New car sales (millions of units) | 7.8 | −8.8 | 8.6 | 10.9 | 10.2 | 18.2 |
| GNP price deflator (1972=100) | 207.3 | 6.0 | 218.0 | 5.2 | 230.2 | 5.6 |
| Consumer price index (1967=100) | 289.5 | 6.3 | 305.4 | 5.5 | 323.8 | 6.0 |
| GNP consumption deflator (1972=100) | 205.9 | 5.9 | 216.5 | 5.1 | 228.3 | 5.5 |
| Unemployment (%) | 9.6% | — | 10.0% | — | 8.7% | — |
| Savings rate (%) | 6.7% | — | 6.8% | — | 6.4% | — |
| B. *California* | | | | | | |
| Personal income | $311.0 | 7.8% | $337.6 | 8.5% | $370.3 | 9.7% |
| Wage and salary employment (in thousands) | 9,901 | −1.4 | 9,974 | 0.7 | 10,300 | 3.3 |
| Civilian employment (in thousands) | 10,940 | 0.3 | 11,110 | 1.5 | 11,579 | 4.2 |
| Residential building permits (in thousands) | 79 | −25.8 | 125 | 58.8 | 150 | 20.0 |
| Consumer price index | 295.5 | 6.9 | 308.4 | 4.4 | 329.1 | 6.7 |
| Unemployment rate | 9.9% | — | 10.2% | — | 8.5% | — |

[a] Source: Department of Finance and 1983–84 Governor's Budget.

to be even less—only 0.7 percent in 1983, representing just 73,000 new jobs. As a result, employment in 1983 will still be lower than it was in 1981.

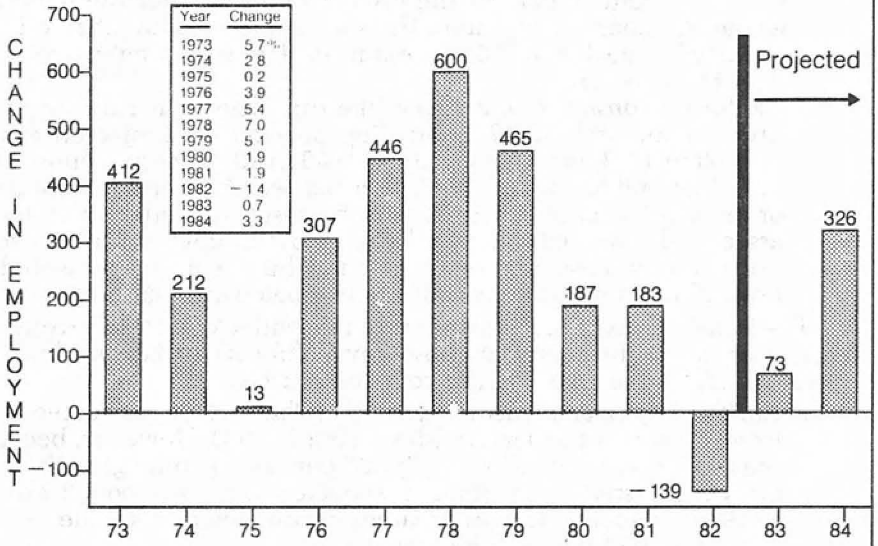
- ***The unemployment rate*** is expected to rise from 9.9 percent in 1982 to 10.2 percent in 1983, or slightly above the rate for the nation as a whole. As Chart 12 indicates, the state's unemployment rate is then expected to decline to 8.5 percent in 1984, or somewhat more rapidly than the nation's.
- California ***construction activity,*** like the nation's, is expected to improve moderately in 1983. Building permits are projected to reach 125,000 in 1983, before rising to 150,000 in 1984. 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, in-migration, and replacement. Thus, even the projected 1984 level of building permits represents a below-normal level.

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 14) is projected to rise from 7.8 percent in 1982 to 8.5 percent in 1983. However, because of the projected fall in inflation, "real" personal income growth (that is, growth adjusted for inflation) is expected to rise by about 3.2 percent in 1983, or about twice as great an improvement over the 1982 rate as for nominal personal income growth.
- ***Taxable corporate profits*** are forecast to rise 8.1 percent in 1983 and 15 percent in 1984, following declines of 3.6 percent in 1982 and 5.4 percent in 1981, and a rise of only 1.7 percent in 1980 (See Chart 19 on page 84). The projected 1983 gain is relatively mild, given the poor profit performance in the previous three years, and would leave the level of profits in 1983 only slightly above the 1979 level. The projected 1983 and 1984 gains are far below the 20-percent-plus increases experienced from 1976 through 1978, after the last recession ended, and indicate the generally poor state of corporate balance sheets.
- ***Taxable sales*** are predicted to rise 8.9 percent in 1983 and 13.6 percent in 1984. The 1983 increase, while in line with projected personal income growth (8.5 percent), is far from robust for a recovery year. For example, the 1983 increase in "real" taxable sales (that is, taxable sales adjusted for inflation) is 3.5 percent. This will not be sufficient to bring real taxable sales back to their 1979 level, since real sales fell by 1.7 percent in 1980, rose by only 0.1 percent in 1981, and declined by 6 percent in 1982 (see Chart 18 on page 82). By comparison, real taxable sales in 1976, the year following the 1973–75 recession, rose 8.6 percent, and in the subsequent year, they rose 12.2 percent.

**Chart 13**

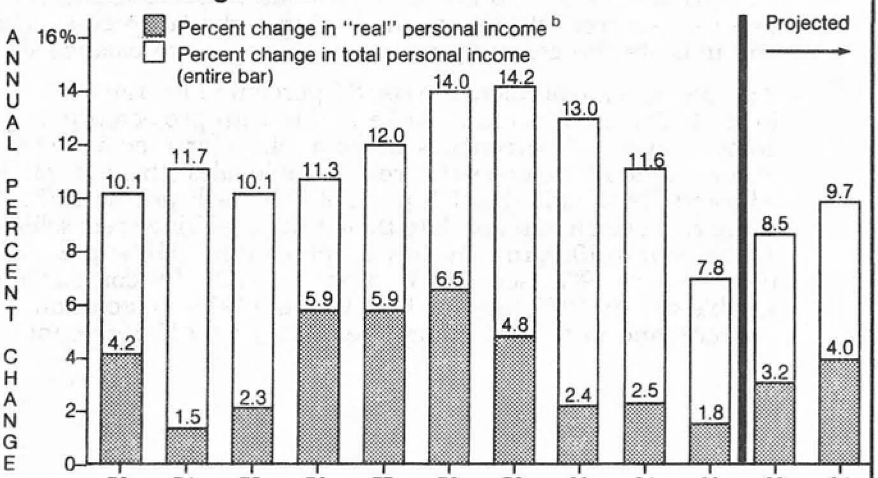
## Annual Growth in California Wage and Salary Employment 1973 through 1983 (in thousands)[a]




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

**Chart 14**

## Annual Growth in California Personal Income 1973 through 1984[a]




[a] Department of Finance estimate for 1982 and projections for 1983 and 1984.
[b] Real personal income is defined as total personal income deflated by the GNP Consumption Expenditures Deflator.

These projections are all consistent with the consensus view of economists that the projected recovery in 1983 will be relatively mild, and that although the recovery will gain momentum in 1984, it will still be only moderate by historical standards. It is primarily because of this moderate economic recovery that only relatively modest gains in state revenues are anticipated for 1982–83 and 1983–84.

**Inflation Outlook Moderately Favorable**

Chart 15 shows the trend of inflation faced by consumers over the past 10 years, and the department's projected rates of inflation for 1983 and 1984.

As Table 24 shows, California's inflation experience during 1982—an average rate of 6.9 percent—was far better than what the department projected 12 months ago—11.3 percent. In fact, most forecasters overestimated the rate of inflation in 1982. There were a number of reasons for this. The most important of these was the recession. The unprecedented level of excess productive capacity and the high rate of unemployment combined to lessen upward pressures on wage rates, input costs and the prices of final outputs. Other factors contributing to the surprisingly low rate of inflation were the oil surplus on world markets, which held down the rate of increase in petroleum and energy-related prices, declining interest rates, and only moderate increases in food prices. Also important was the reduction in the rate of monetary expansion in 1981.

For 1983, the department projects a further easing of inflation, due to the softness in the economy. In 1984, however, the rate of inflation is projected to rise somewhat, as the economy gains strength and begins to put pressure on the prices of certain inputs and outputs. The department's general inflation projection—between 4½ percent and 5½ percent in 1983 and between 5½ percent and 6½ percent for 1984, depending on the measure of inflation used—reflects the consensus view of economic forecasters at this time. This forecast assumes that the federal monetary authorities will "ease up" enough in controlling the growth rate of the money supply to accommodate a moderate recovery, but not so much as to rekindle inflationary expectations.

**Interest Rates—Continued Declines Hoped For**

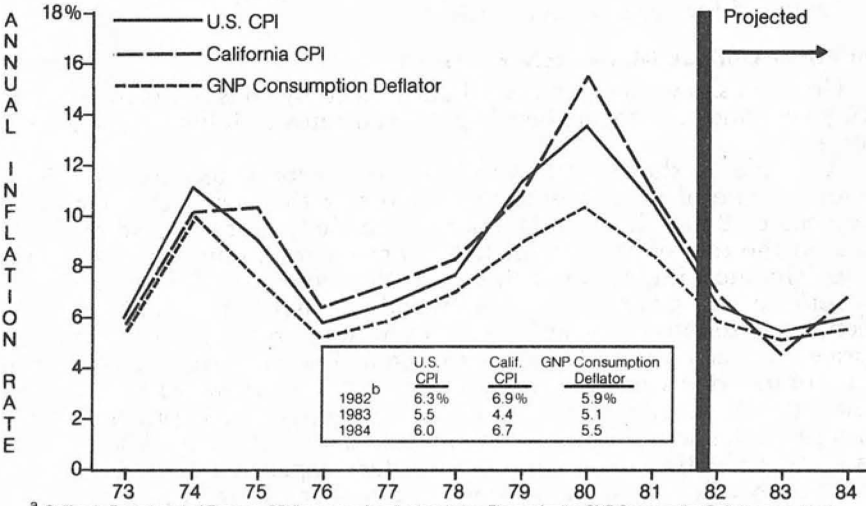
One of the most critical elements in the economic forecast for 1983 and 1984 is the behavior of interest rates. This is because the pace of economic activity is very much influenced by the behavior of credit-sensitive sectors —namely, housing, automobiles and business investment. Unfortunately, however, the future path of interest rates is subject to considerable uncertainty, especially in light of the need to finance a federal deficit exceeding $200 billion.

Chart 16 shows the pattern of short-term and long-term interest rates over the past 10 years and projections for 1983 and 1984. Beginning in about 1976, interest rates generally began an upward climb, peaking at record levels in 1981. The 1981 escalation was primarily due to a combination of restrictive monetary policies followed by the FED and high rates of inflation. During the first six months of 1982, neither short-term nor long-term rates changed much. After mid-year, however, less restrictive monetary policies, declining rates of inflation and a weak economy resulted in rather sharp drops in rates. As of year-end 1982, these declines already appeared to have given some boost to consumer purchases of

**Chart 15**

## Inflation Faced by Consumers in California and the Nation

### 1973 through 1984[a]



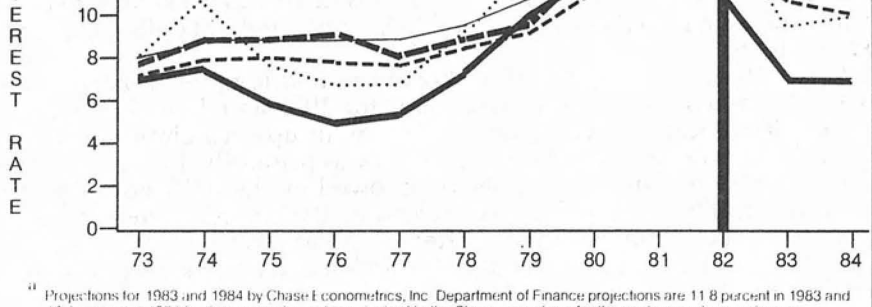

| | U.S. CPI | Calif. CPI | GNP Consumption Deflator |
|---|---|---|---|
| 1982[b] | 6.3% | 6.9% | 5.9% |
| 1983 | 5.5 | 4.4 | 5.1 |
| 1984 | 6.0 | 6.7 | 5.5 |

[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.

**Chart 16**

## Trends in Interest Rates

### 1973 through 1984[a]




[a] Projections for 1983 and 1984 by Chase Econometrics, Inc. Department of Finance projections are 11.8 percent in 1983 and 10.1 percent in 1984 for the prime rate, and are identical to the Chase projections for the mortgage rate in each year.

automobiles, and to housing starts.

The department predicts that interest rates will continue to drift downward in 1983 and 1984, with a prime rate of 10 percent and a mortgage rate of 12 percent at year-end 1984. This projection is shared by most other forecasters. Thus, the most common outlook for interest rates is a relatively favorable one which, if realized, will be a positive influence on both consumer and business spending decisions. The basis for this outlook is the belief that interest rate-reducing factors will be fairly strong in the months ahead. These factors include a very mild economic recovery, low inflation rates and weak private sector credit demands.

It must be stressed, however, that this optimistic forecast for interest rates could be "off target". Two factors, in particular, could cause interest rates to turn up and thereby jeopardize the recovery. These factors involve (1) the degree to which federal monetary authorities restrict the growth in the money supply, and (2) the impact on the credit markets of the federal government's need to finance an enormous deficit.

**Federal Policies—More Important Than Ever**

There are two general categories of federal policies that can influence the level and composition of economic activity. First, there are the taxing and spending policies of the federal government, which are generally referred to as *fiscal policies.* 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.* The future course of federal monetary and fiscal policies represents the single biggest uncertainty in the economic outlook for 1983 and beyond, and will probably exert the greatest influence on the economic performance of both the nation and California.

***Monetary Policy:*** As discussed earlier, monetary policies exert an important influence on a great many economic variables, including inflation, interest rates and spending by consumers and businesses. Most economists share the department's assumption that the FED has somewhat changed its policy recently, by moving away from a strict focus on the rate of growth in various types of "money", and toward recognition that it must take specific actions aimed at reducing and stabilizing the level of interest rates. The challenge for the FED will be the same one that it always faces—can the money supply be increased at a rate which is high enough to accommodate a healthy pace of economic activity, and yet not so high as to ignite inflation? In past years, the FED's track record in achieving this goal has not been very good. Only time will tell if it will be more successful this time around. Its task will be more difficult than ever because of the need to help finance the huge federal deficit.

***Fiscal Policy:*** The major fiscal policy issue is well-known—can the government control the size of the federal budget deficit, and can the deficit be financed without impeding the ability of the economy to recover from the recession?

In many respects, fiscal policy is "between a rock and a hard place." On the one hand, the federal government could attempt to reduce the deficit

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immediately by increasing taxes and lowering spending. This approach, however, could also slow the pace of economic activity in the near term by lowering total spending, and thereby reducing output and employment. On the other hand, the government could continue to follow the "supply-side" course of action espoused by the President in 1981, when he proposed a tax-reduction plan to stimulate private sector activities. While this approach has the potential to offer significant long-term benefits, it has had the effect in the short-run of enlarging the budget deficit.

Most economists agree that the federal deficit as a percentage of the GNP will reach unprecedented levels in the next several fiscal years, and that the deficit will not be eliminated easily. In the near term, financing the deficit may not significantly escalate interest rates, primarily because of the relatively weak demand for credit on the part of the private sector, due to the recession. Considerable uncertainty exists, however, over what the effects of financing these deficits will be in the last half of 1983 and beyond on monetary growth, inflation, interest rates, and consumer and business confidence. The worst case would be if financing the deficit "crowded out" private sector borrowing and thereby aborted the recovery.

One thing does appear clear—there is no simple, obvious, agreed-upon way out of the federal government's current budgetary problems. As a result, the exact course which fiscal and monetary policies will take in 1983 and 1984 remains rather clouded.

**Finance Versus Other Forecasters**

Tables 26 and 27 compare the Department of Finance's national and California economic forecasts for 1983 with those which were made at approximately year-end 1982 by other economists. The department's economic forecast is about where most other public and private forecasters were when the department prepared its forecast (November-December 1982). Since then, some forecasters have revised their projections downward. Nevertheless, the department's forecast is not out of line. Rather, most of the forecasters envision the same general type of economy in 1983 as Finance does—very modest economic growth, reduced inflation, and only moderate levels of profits, home building, and car sales. In the case of California, the department's projected 1983 personal income growth rate—8.5 percent—reflects the consensus, and is below that of some forecasters (Bank of America, for example, predicts a growth rate of 10.0 percent) and above that of others (UCLA, for example, predicts an increase of 7.4 percent).

Our discussions with these forecasters indicate that they all are considerrably uncertain about exactly what will happen over the next two years, and expect that they will 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. This is *not* to say, of course, that the Legislature can be confident that the forecast will, in fact, prove to be accurate. In fact, the odds are low that it, or any of the other forecasts shown in Tables 26 and 27, will turn out to be exactly on target. There is simply too much uncertainty regarding the future to allow *anyone* to be confident about *any* forecast. What we are suggesting is simply that the department's economic forecast appears to be neither excessively optimistic nor excessively pessimistic, relative to the views of the economic forecasting community at large.

## Table 26
## Comparison of 1983 National Economic Outlook for Selected Forecasters

| *Forecaster* | *Percent Change in:* *Real GNP* | *GNP Prices* | *Consumer Prices* | *Before-Tax Profits* | *Personal Income* | *Unemployment Rate* | *New Car Sales (millions of units)* | *Housing Starts (millions of units)* |
|---|---|---|---|---|---|---|---|---|
| Department of Finance | 2.2% | 5.2% | 5.5% | 10.7% | 7.4% | 10.0% | 8.6 | 1.34 |
| *Other Forecasters* [a] | | | | | | | | |
| Date Resources | 1.6 | 5.3 | 5.1 | 8.5 | 7.4 | 10.7 | 8.7 | 1.48 |
| UCLA | 1.9 | 5.1 | 3.9 | 7.0 | 7.1 | 10.9 | 8.9 | 1.41 |
| Evans Economics | 0.9 | 5.0 | 4.7 | 11.9 | 5.6 | 11.4 | 8.4 | 1.35 |
| Security Pacific Bank | 2.1 [b] | 5.3 | 5.1 | 22.2 | 7.3 | 10.6 | 8.9 | 1.48 |
| Citibank | 3.1 | 5.4 | 5.2 | 15.9 | 8.3 | 9.9 | 9.4 | 1.50 |
| Crocker bank [c] | 3.2 | 5.7 | 5.8 | N/A | N/A | 9.3 | 9.1 | 1.38 |
| First Interstate Bank [c,d] | 3.6 | 5.8 | 5.6 | 19.8 [e] | 9.5 | 9.5 | 9.0 | 1.31 |
| Conference Board | 2.4 | 5.2 | 5.3 | 23.1 | 6.8 | 10.5 | 8.9 | 1.33 |
| Chase Econometrics | 2.1 | 5.0 | 4.8 | 14.6 | 7.2 | 10.3 | 9.3 | 1.39 |
| Wharton | 2.4 | 5.2 | 4.9 | 10.2 | 7.1 | 10.5 | 9.6 | 1.47 |
| Bank of America | 1.3–2.5 | 5.3 | 4.9 | 2.0 | 6.8 | 10.3 | 8.5 | 1.39 |
| Blue Chip Consensus [f] | 2.5 | 5.1 | 5.0 | 17.5 | 7.6 | 10.3 | 9.2 | 1.45 |
| Commission on State Finance | 2.2 | 5.2 | 5.2 | 10.3 | 7.5 | 10.1 | 8.6 | 1.41 |
| Average of "Other" Forecasters | 2.3% | 5.3% | 5.0% | 13.6% | 7.4% | 10.3% | 9.0 | 1.41 |

[a] Forecasts as of approximately year-end 1982.
[b] In January 1983, this forecast was revised upward to 2.6 percent.
[c] Forecast as of October 1982.
[d] Formerly United California Bank (UCB).
[e] Projection of corporate operating profits.
[f] Consensus forecast for approximately 40 private sector forecasters collected monthly by Eggert Economic Enterprises, Inc.

**Table 27**
**Comparison of 1982 California Economic Outlook for Selected Forecasters**

| | *Percent Change in:* Personal Income | Consumer Prices | Real Personal Income[a] | Civilian Employment | Wage and Salary Employment | Unemployment Rate | New Residential Building Permits (thousands) |
|---|---|---|---|---|---|---|---|
| Department of Finance | 8.5% | 4.4% | 3.9% | 1.5% | 0.7% | 10.2% | 125 |
| *Other Forecasters*[b] | | | | | | | |
| First Interstate Bank[c] | N/A | N/A | N/A | N/A | 0.7 | N/A | 110 |
| Security Pacific Bank | 9.4 | N/A | N/A | N/A | 1.4 | 10.0 | 102 |
| Bank of America | 10.0 | 6.2 | 3.6 | 1.6 | N/A | 9.6 | 80 |
| Crocker Bank | 8.4 | 4.1 | 4.1 | 2.1 | 1.3 | 10.2 | 125 |
| UCLA | 7.4 | 2.9 | 4.4 | 0.6 | 0.2 | 11.6 | 114 |
| Commission on State Finance | 8.1 | 4.3 | 3.6 | N/A | 0.8 | 10.8 | 114 |
| Average of "Other" Forecasters | 8.7% | 4.4% | 3.7% | 1.4% | 0.9% | 10.4% | 108 |

[a] Defined as personal income growth adjusted for consumer price inflation.
[b] Forecasts as of approximately year-end 1982.
[c] Formerly United California Bank (UCB). Forecast as of October 1982.

## C. PRIOR YEAR (1981–82) REVENUES

Table 28 summarizes 1981–82 General Fund revenue collections. These receipts totaled $20,960 million, an increase of $1,937 million (10.2 percent) over 1980–81. As Table 28 shows:

- ***Sales and use taxes*** increased 7.8 percent, or $543 million;
- ***Personal income taxes*** rose 13.0 percent, or $864 million;
- ***Bank and corporation taxes*** declined 3.0 percent, or $82 million;
- ***Interest income*** fell by $128 million, reflecting both the decline in the size of the General Fund budget surplus available for investment, and the tapering-off of market interest rates;
- ***Transfer income*** to the General Fund rose by $747 million, from $315 million to $1,062 million; and
- Collections from *all other sources,* including taxes and licenses, were essentially unchanged, declining by about $7 million.

### Special Factors—Accounted for $1.3 billion or Two-Thirds of Revenue Growth

A number of special factors accounted for $1.3 billion, or two-thirds of the total growth in General Fund revenues during 1981–82.

- ***Tax Collections were Accelerated.*** These accelerations totaled $315 million, including $155 million for the personal income tax under AB 6x (Ch 2x/82), and $160 million for the sales and use tax under AB 1253 (Ch 115/82) and AB 8x (Ch 5x/82).
- ***Interest Penalties on Delinquent Taxes were Raised.*** These penalties brought in approximately $65 million in additional revenues from the personal income tax, the sales tax, and the bank and corporation tax (AB 8x).
- ***Revenues were Transferred from Special Funds to the General Fund.*** Because of legislative action taken in both 1981 and 1982, General Fund transfer income was raised by nearly $870 million. Most of these transfers (over $600 million) represented revenues from the state's tidelands, which are normally put into special funds to support

a variety of capital outlay programs. The General Fund also received approximately $150 million in transfer income from the Vehicle License Fee Account and other sources which normally would have gone to local governments.

### Weak Underlying Revenue Growth Trend

Had these special factors not been present, General Fund revenue growth in 1981–82 would have been only 3.2 percent ($612 million). This would have been the *lowest* rate of growth in General Fund revenues since 1970–71.

The recession was the major factor responsible for this anemic underlying growth rate. Especially important in this regard was the drop in California corporate profits (−5.4% in 1981 and −3.6% in 1982), and the fall in the portion of personal income which consumers spent on taxable items (the ratio of taxable to personal income fell from over 55 percent in 1980 to under 50 percent in 1982).

**Table 28**
**Growth of Prior Year (1981–82)**
**General Fund Revenues by Type**
**(in millions) [a]**

| *Income Source* | *Actual 1980–81* | *Actual 1981–82* | *Change Amount* | *Change Percent* | *Percent Change Which Would Have Occurred in the Absence of Special Factors* [b] |
|---|---|---|---|---|---|
| Three major taxes: | | | | | |
| Sales and use tax | $7,006 | $7,549 | $543 | 7.8% | 5.2% |
| Personal income tax | 6,629 | 7,493 | 864 | 13.0 | 10.2 |
| Bank and corporation tax | 2,731 | 2,649 | −82 | −3.0 | −5.4 |
| Other major taxes and licenses | 1,442 | 1,418 | −24 | −1.7 | 5.9 |
| Total, major taxes and licenses | $17,808 | $19,109 | $1,301 | 7.3% | 5.5% |
| Interest income | 464 | 336 | −128 | −27.6 | −27.6 |
| Transfers | 315 | 1,062 | 747 | 137.1 | −10.8 |
| Other revenues | 436 | 453 | 17 | 3.9 | −0.2 |
| Total General Fund Revenues and Transfers | $19,023 | $20,960 | $1,937 | 10.2% | 4.3% |

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

[b] One-time transfers and revenue enhancements in 1981–82 totalled approximately $1.3 billion and included (1) $179 million in increased transfers and other revenues associated with SB 102 (Ch 101/81), (2) $400 million in transfers associated with the 1981 Budget Act, (3) $25 million in U.C. profit transfers, (4) $399 million in increased sales tax, personal income tax and bank and corporation tax revenues associated primarily with tax accelerations and interest penalties under AB 6x (Ch 2x/82), AB 7x (Ch 4x/82), AB 8x (Ch 5x/82) and AB 1253 (Ch 115/82), and (5) $322 million in increased transfers under the 1982 Budget Act and trailer legislation. In addition, General Fund revenue sharing transfers declined from $276.2 million in 1980–81 to $179.5 million in 1981–82, or by $97 million, and AB 2092 (Ch 634/80) reduced inheritance and gift tax receipts by approximately $1.2 million in 1980–81 and $109.3 million in 1982–83. The increase in 1981–82 revenues would have been $817 million instead of $1,937 million had none of these special factors occurred.

Other factors also contributed to the sluggish growth in revenues during 1981–82. They include the decline in interest income (brought about primarily by the decline in the General Fund surplus), the phasing-out of federal revenue sharing for state governments, and the phasing-in of AB 2092 (Chapter 634/80), which exempted spouses from inheritance and gift taxes. Table 28 shows that even if the effects of these factors are ignored, underlying revenue growth in 1981–82 is still less than 5 percent.

### Weak Economy Caused Record Downward Revenue Revisions

Table 29 shows how the Department of Finance revised its original 1981–82 revenue forecast between January 1981 and the end of the fiscal year. The table indicates that:

- Actual revenues were *less* than the original estimate presented in the Governor's Budget (January 1981) by over $1.3 billion, or 6.4 percent. This amount, which excludes the effects of 1981 tax legislation, reflects downward adjustments of $605 million for the sales and use tax, $126 million for the personal income tax, and $450 million for the bank and corporation tax.
- Actual revenues were also nearly $1.6 billion, or 7.5 percent, *less* than the May 1981 revenue revision provided to the Legislature before it acted on the 1981–82 budget.
- Actual revenues were $723 million, or 3.4 percent *less* than the mid-year estimate prepared in January 1982 for the 1982–83 Governor's Budget.

Table 30 compares the department's revenue estimating errors for 1981–82 to those over the preceding eight-year period beginning with 1973–74. Several important points emerge from this table:

- ***First,*** in *dollar* terms, the 1981–82 errors were the *largest on record.*
- ***Second,*** in *percentage* terms, the error made in May 1981 was also the *largest on record.* This is especially significant because the May revision immediately preceding the start of the budget year provides the data used by the Legislature when it takes action on the budget (in this case, the 1981–82 budget). It was this inability in May to foresee the trend in revenues that, more than any other factor, necessitated the enactment in 1982 of tax accelerations and special transfers in order to balance the budget on June 30, 1982.

These record downward revenue revisions illustrate the tremendous impact which the recession had on the state's fiscal position.

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. Given the record for 1980–81 and 1981–82, and the downward revisions already made in the 1982–83 revenue estimate, no such bias is evident today. At this time, we see no indication that the state can count on any significant revenue "windfalls" as a result of an inherent conservative bias in estimating revenues.

## D. CURRENT YEAR (1982–83) REVENUES

### Special Factors Again Hold Up Revenues

Table 31 summarizes the Department of Finance's General Fund revenue projections for 1982–83. Before turning to a discussion of these figures, however, it is important to note that the current-year estimates include

## Table 29

### 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 | 1981 Legislation | January 1982 Baseline Revision [b] | March Revision | May Revision | 1982 Legislation [c] | January 1983 [d] | Actual | Total Revisions Adjusted For Legislation |
|---|---|---|---|---|---|---|---|---|---|---|
| Bank and corporation tax [e] | $3,035.2 | $244.8 | $28.0 [f] | −$288.0 | −$255.0 | −$50.0 | $35.0 | −$101.3 | $2,648.7 | −$449.5 |
| Personal income tax | 7,435.0 | 100.0 | −0.8 | −184.2 | −97.0 | 65.0 | 185.0 | −10.0 | 7,493.0 | −126.2 |
| Sales and use tax | 8,000.7 | −40.7 | −26.3 | −358.7 | −140.0 | −25.0 | 179.0 | −40.3 | 7,548.7 | −604.7 |
| Other taxes | 1,563.7 | −97.8 | −0.3 | −48.9 | 17.3 | — | — | −15.0 | 1,419.0 | −144.4 |
| Total taxes | $20,034.6 | $206.3 | $0.6 | −$879.8 | −$474.7 | −$10.0 | $399.0 | −$166.6 | $19,109.4 | −$1,324.8 |
| Interest income | 326.6 | 48.4 | — | −61.3 | — | — | — | 22.1 | 335.8 | 9.2 |
| Other revenue | 401.7 | −4.0 | $17.4 | 95.0 | — | −$30.0 [g] | — | −27.0 | 453.1 | 34.0 |
| Total, revenues | $20,762.9 | $250.7 | $18.0 | −$846.2 | −$474.7 | −$40.0 | $399.0 | −$171.5 | $19,898.4 | −$1,281.7 |
| Transfers | 256.8 [h] | — | 546.6 | −26.4 | — | — | 322.0 | −37.0 | 1,062.0 | −63.4 |
| Total, General Fund revenues and transfers | $21,019.7 | $250.7 | $564.6 [i] | −$872.6 | −$474.7 | −$40.0 | $721.0 | −$208.5 | $20,960.3 | −$1,345.1 |

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

[b] Excludes proposed enhancements to revenues and transfers totaling $519 million contained in the 1982–83 Governor's Budget and 1982 Budget Bill, and includes certain unidentified revisions to estimated fiscal effects of 1981 legislation.

[c] Major items of legislation included accelerated sales tax receipts of $160 million (AB 8x and AB 1253), accelerated income tax receipts of $155 million (AB 6x), revenues from higher interest penalties on delinquent taxes of $65 million (AB 8x), and one-time transfers ($322 million), primarily associated with tidelands oil revenues ($211 million).

[d] Revenue receipts in May and June of 1982 fell short of projected receipts by $185.2 million. This shortfall accounts for most of the January 1983 revision.

[e] 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.

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

[g] Includes $29 million downward adjustment for accrued Health Care Deposit Fund receipts.

[h] 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.

[i] 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 were originally estimated to total $26 million in 1981–82; and (4) other legislation enacted during 1981 (−$3.1 million).

### Table 30
**General Fund Revenue Estimating Errors, 1973–74 through 1981–82 [e]**

| | *Errors made in Original January Budget* [b] | | *Errors Made in May* [c] | | *Errors Made in Midyear* [d] | |
|---|---|---|---|---|---|---|
| | *Dollar Error* | *Percent* | *Dollar Error* | *Percent* | *Dollar Error* | *Percent* |
| 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 |
| 1981–82 | 1,345 | 6.4 | 1,596 | 7.5 | 723 | 3.4 |

[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.

over $1 billion in "new" and primarily "one-time" General Fund monies. *Thus, the revenue figures published in the budget for 1982–83, as was the case for 1981–82, provide a distorted picture of the underlying growth trend in the state's General Fund revenue base.*

This $1 billion in new or one-time revenues includes:

- Over $500 million in various types of *tax accelerations* due to revisions in tax prepayment dates and regulations, including a $230 million acceleration in insurance taxes, a $140 million acceleration in sales taxes, and a $40 million acceleration in bank and corporation taxes;
- Nearly $400 million in General Fund *transfers* from special funds, including $261 million from the Motor Vehicle License Fee Account and $80 million from the California Water Fund; and
- About $185 million in "other revenues," including over $130 million in tidelands oil revenues.

About $170 million of the $1 billion amount will be ongoing, representing primarily the permanent year-to-year gains in revenues from the revised tax payment dates and the increased penalties from delinquent tax payments. The remainder—nearly $830 million—represents "one-time" revenues.

#### Limited Strength in Underlying Revenue Trend

Table 31 indicates that General Fund revenues in 1982–83 are estimated to total about $20.5 billion, including $7.6 billion from the sales and use tax (a 0.4 percent gain), $7.3 billion from the personal income tax (a 2.9 percent reduction), and $2.6 billion from the bank and corporation tax (a 0.3 percent reduction). This represents a *loss* in General Fund revenues of almost $500 million (−2.2 percent) from 1981–82, or a decline of nearly

8 percent in constant dollars and 10 percent in constant dollars per capita. Had the special funds transfers and revenue enhancements provided for in both 1981–82 and 1982–83 not occurred, revenue growth still would have been *negative* (−1.1 percent), and General Fund revenues would have declined by over $200 million.

Part of the weak revenue performance in 1982–83 is explained by the phasing-out of inheritance and gift taxes and the termination of federal revenue sharing with the states. However, Table 31 shows that even after adjusting for all special factors—the special fund transfers, revenue enhancements, and the phasing-out of inheritance and gift taxes and federal revenue sharing—the underlying revenue growth trend for 1982–83 is still only about 1.2 percent.

**Table 31**
**Growth of Current Year (1982–83)**
**General Fund Revenues by Type**
**(in millions) [a]**

| *Revenue Source* | *Actual 1981–82* [b] | *Estimated 1982–83* [c] | *Change* *Amount* | *Change* *Percent* | *Percent Change in the Absence of Special Factors* [d] |
|---|---|---|---|---|---|
| Sales and use tax | $7,549 | $7,578 | $29 | 0.4% | 1.1% |
| Personal income tax | 7,493 | 7,275 | −218 | −2.9 | −1.3 |
| Bank and corporation tax | 2,649 | 2,640 | −9 | −0.3 | −0.7 |
| Other major taxes and licenses | 1,418 | 1,646 | 228 | 16.1 | 18.9 |
| Total Major Taxes and Licenses | $19,109 | $19,139 | $30 | 0.2% | 1.3% |
| Interest income | 336 | 229 | −107 | −31.8 | −31.8% |
| Other revenues | 453 | 682 | 229 | 50.6 | 14.3 |
| Transfers [e] | 1,062 | 440 | −622 | −58.6 | 23.3 |
| Totals General Fund Revenues and Transfers | $20,960 | $20,490 | −$470 | −2.2% | 1.2% |

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

[b] Includes approximately $1.3 billion in revenue enhancements and special one-time General Fund transfers from special funds. Revenue enhancements include the acceleration of personal income taxes and sales and use taxes ($315 million) and increased revenues due to higher interest penalties on delinquent tax payments ($65 million). Transfers include nearly $870 million, composed of (1) nearly $550 million associated with 1981 legislation regarding the distribution of tidelands oil revenues and SB 102 (Ch 101/81), and (2) $322 million associated with the 1982 Budget Act, trailer bills and other 1982 legislation.

[c] Includes approximately $1 billion in enhancements, including accelerations of tax collections (over $500 million), General Fund transfers (about $400 million), and $156 million in tidelands oil revenues.

[d] Based upon data from Department of Finance and Commission on State Finance. Excludes one-time gains associated with "cost recovery" oil (see footnote e) and adjusts for one-time $31 million loss in insurance tax receipts due to court case involving principal office deduction. Other adjustments include the special funds transfers and revenue enhancements detailed in footnotes b and c, the decline in federal revenue sharing receipts from $180 million in 1981–82 to zero in 1982–83, and reductions in inheritance and gift tax revenues due to AB 2092 (Ch 634/80) and Proposition 6 (June 1982) of $109 million in 1981–82 and $348 million in 1982–83.

[e] General Fund "other revenues" from tidelands oil and gas receipts increased by approximately $139 million in 1982–83 over 1981–82. Included in this amount is an approximately $80 million one-time gain in state revenues due to federal tax law changes involving application of the windfall profits tax to "cost recovery" oil.

This weak revenue trend can be explained by three main factors:

- ***First,*** and most important, revenue growth in 1982–83, as in 1981–82, has slowed significantly due to the recession. For example, taxable sales actually *fell* in 1982—by 0.5 percent—for the first time since 1958. This occurred despite an increase of 7.8 percent in personal income.

- ***Second,*** the adjustment factor in 1982 for indexing the personal income tax brackets for inflation is 9.3 percent. Because this factor exceeds the average rate of income growth in 1982, this will have the effect of moving many taxpayers "backward" through the state's progressive income tax schedules, thereby limiting the growth in tax liabilities to only about 5 percent.
- ***Third,*** interest income is projected to fall by $107 million in the current year, due to the decline in the General Fund surplus available for investment and the fall in interest rates.

### Current Year Revenues—Largest Downward Revision on Record

Table 32 presents the history of General Fund revenue estimates for 1982–83. The table clearly demonstrates the dramatic negative impact which the recession has had on the current year's revenues. It shows that:

- Since the *original* preliminary estimate of 1982–83 revenues was made approximately 21 months ago in May 1981, total General Fund revenues have been revised downward by nearly *$3.4 billion.* This reflects a $4.1 billion reduction due strictly to *economic factors,* plus reductions of $375 million due to the adoption of June 1982 ballot measures reducing personal income and inheritance and gift taxes, offset by $1.1 billion in revenue enhancements due to legislation enacted in 1981 and 1982.
- Since the *May 1982* revenue forecast, the last forecast available to the Legislature before it acted on the 1982–83 budget, revenues have been revised downward by over $1.3 billion. This January 1983 revision, which adjusts for legislation and initiatives, is the *largest downward revision recorded at midyear for any fiscal year in history.* It includes downward adjustments for the bank and corporation tax ($235 million), the personal income tax ($330 million) and, most importantly, the sales and use tax ($811 million). When this revision is combined with the downward revisions made in March 1982 ($805 million) and May 1982 ($408 million), the result is a drop in "baseline" revenues to about $19.8 billion, or nearly $2.6 billion below what was projected just 12 months ago in the 1982–83 Governor's Budget.

### Latest Cash-Flow Data Support Revenue Estimates

January 1983 was the latest month for which data on General Fund revenue collections ("agency cash") were available before this *Analysis* went to print. During January, revenue collections were $24 million *above* the forecast for January contained in the 1983–84 Governor's Budget. Because December 1982 revenues were $103 million above the budget forecast, revenues are $127 million above the budget forecast for the two months combined.

It is difficult to be certain from January's revenue performance, however, the extent to which revenues are really running ahead of the forecast. This is because much of the money due in January was due on January 31, and thus "spills over" into February. Preliminary data for the first week in February gives a mixed picture, with income tax withholding collections running ahead and sales tax collections running behind the budget

## Table 32

**1982–83 General Fund Revenues and Transfers**
**History of Department of Finance Estimates**
**(in millions)** [a]

| | *Original Estimate in May 1981* | Revisions | | | | | | | *January 1983 Totals* |
|---|---|---|---|---|---|---|---|---|---|
| | | *1981 Legislation* | *January 1982* | *March 1982* | *May 1982* | *1982 Legislation* [b] | *1982 Ballot Initiatives* [c] | *January 1983* | |
| Bank and Corporation Tax | $3,755.0 | 34.0 | −$334.0 | −$330.0 | −$325.0 | $75.0 | $0.0 | −$235.0 | $2,640.0 |
| Personal Income Tax | 8,670.0 | −1.0 | −659.0 | −195.0 | −40.0 | 60.0 | −230.0 | −330.0 | 7,275.0 |
| Sales and Use Tax | 9,060.0 | 0.0 | −465.0 | −290.0 | −40.0 | 124.0 | 0.0 | −811.3 | 7,577.7 |
| Other Taxes | 1,558.0 | 22.0 | −63.0 | 10.0 | −3.0 | 199.0 | −145.0 | 68.4 | 1,646.4 |
| Total Taxes | $23,043.0 | $55.0 | −$1,521.0 | −$805.0 | −$408.0 | $458.0 | −$375.0 | −$1,307.9 | $19,139.2 |
| Interest Income | 375.0 | 0.0 | −71.2 | 0.0 | 0.0 | 0.0 | 0.0 | −74.3 | 229.4 |
| Other Revenue | 397.0 | 0.0 | 139.4 [d] | 0.0 | 0.0 | 143.0 [e] | 0.0 | 2.0 | 681.4 |
| Total Revenues | $23,815.0 | $55.0 | −$1,452.8 | −$805.0 | −$408.0 | $601.0 | −$375.0 | −$1,380.1 | $20,050.0 |
| Transfers | 60.0 | 0.0 | −53.2 | 0.0 | 0.0 | 436.0 [e] | −0.0 | −2.8 | 440.0 |
| Totals, General Fund Revenues and Transfers | $23,875.0 | $55.0 | −$1,506.0 | −$805.0 | −$408.0 | $1,037.0 | −$375.0 | −$1,383.3 | $20,489.7 |

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

[b] Major legislation affecting 1982–83 revenues included (1) AB 6x (Ch 2x/82), which accelerated personal income tax collections ($10 million); (2) AB 8x (Ch 5x/82) which in conjunction with AB 1253 (Ch 115/82) accelerated sales tax collections ($15 million) and imposed higher interest payments on delinquent tax payments ($65 million); (3) SB 1326 (Ch 327/82), which further accelerated sales tax collections ($125 million), (4) provisions in the 1982–83 Budget Act and trailer bills which increased General Fund transfers ($449 million), accelerated insurance tax collections ($230 million) and bank and corporation tax collections ($40 million), and raised Public Utility Commission assessments ($24 million); and (5) other legislation including miscellaneous sales tax exemptions enacted subsequent to the 1982–83 budget package (−$20 million). Adjustments shown in this column also include a $31 million loss in insurance tax revenues due to a court decision on the principal office deduction, plus various tidelands oil adjustments (see footnote e).

[c] Department of Finance estimates. Includes Proposition 6, which eliminated the current inheritance and gift tax and imposed a "pick-up" tax, and Proposition 7, which provided for permanent "full" indexing of the marginal personal income tax brackets.

[d] Includes effect of change in treatment of General Fund tidelands oil monies from "transfer income" to "other revenues". The "other revenues" category excludes what was a *proposed* increase of $20 million in General Fund income from tidelands revenues.

[e] Adjusts for change in treatment of $42 million in tidelands oil revenues, which in January 1981 were classified as "other revenues" but were reclassified as "transfers" in the Governor's budget. "Other revenue" changes include $80 million from a federal law change affecting tax treatment of "cost recovery oil", $53 million in additional tidelands monies and $52 million in other changes. Changes in transfers include $261 million in Vehicles License Fee transfers and $80 million in California Water Fund transfers.

estimate for that week.

It does appear, however, that on balance overall revenue collections currently are basically in line with—if not somewhat above—the estimate, thus giving some additional credibility to the department's forecast.

### Revenue Picture Still Uncertain

We have taken the Department of Finance's economic assumptions and inserted them into our own revenue estimating equations in order to determine whether the revenue forecast for 1982–83 is consistent with the department's economic forecast. In general, we conclude that it is. Our computations produce a level of current-year revenues which is about $100 million below the Finance estimates. This is not a significant difference, given the complications involved in estimating revenues and the fact that we are dealing with over $20 billion in collections during the current year.

The 1982–83 revenue picture, however, is still far from clear. Approximately $9.0 billion in revenues must be collected between February and June in order to reach the total projected for 1982–83, and economic conditions during the first half of 1983 can exert a considerable influence on the exact amount actually collected. Thus, developing alternative revenue estimates based on different economic scenarios is important in order to facilitate the Legislature's fiscal planning, especially given the state's tight budget situation.

In discussing the problem of revenue estimating error margins, the budget suggests that current-year revenues could differ from the department's estimate by plus-or-minus 2 percent to 2.5 percent, or about $400 million to $500 million. This is certainly possible, given the size of revisions to the mid-year estimates shown in Table 30. In fact, the mid-year estimating error made 12 months ago with respect to 1981–82 revenues ($723 million, or 3.4 percent) exceeded this error range. 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 1982–83 revenue forecast in the coming months, as additional economic and revenue data become available, and alert the Legislature to any significant changes in the outlook.

## E. BUDGET YEAR (1983–84) REVENUES

## 1. GENERAL FUND REVENUES

### Special Factors Again Bolster Revenues

Table 33 presents the department's estimates of General Fund and special funds revenues for the budget year (1983–84), and compares these estimates with revenues for the current and prior years.

As with prior year and current year revenues, the department's budget-year estimates include certain General Fund revenues from special funds transfers and tax enhancements.

Specifically, the budget proposes to:

- Increase tax revenues by $120 million through *repeal* of the solar energy and energy conservation *tax credits* which are claimed by individuals ($110 million) and businesses ($10 million);
- Increase tax revenues by an additional $50 million by increased *tax auditing* activities;

- Transfer $300 million from the *Motor Vehicle License Fee Account* to the General Fund. This $300 million normally would go to cities and counties. As in both 1981–82 and 1982–83, transfers from this account are the means by which localities are sharing in the state's spending reductions in 1983–84.
- Increase in General Fund income through transfers of (1) tidelands oil revenues ($192 million), and (2) Transportation, Planning and Development Account revenues ($42 million).
- Continue approximately $100 million in on-going revenue gains from tax accelerations and other legislation enacted in 1982.

These special factors—which together are projected to raise revenues by over $750 million in 1983–84—though important pieces of the revenue picture, are less significant than they were in both 1981–82 and 1982–83.

### More Rapid Growth Expected in Underlying Revenue Trend

Table 33 shows that General Fund revenues in the budget year are forecast to reach nearly $22.5 billion in 1983–84, a gain of $2.0 billion. Thus, the rate of revenue growth projected for 1983–84 (9.7 percent) dramatically exceeds that of 1982–83, when revenues actually declined by −2.2 percent. The 1983–84 revenue amount includes $8.5 billion in sales and use tax revenues (a gain of 11.6 percent), $8.7 billion in personal income tax revenues (a gain of 19.7 percent), and $2.8 billion in bank and corporation tax revenues (a gain of 6.4 percent). However, because of the various revenue-enhancing proposals, special funds transfers, and other special factors in both the current and budget years, the percentage rates of increase shown in the table for 1983–84 do not give a valid picture of the underlying growth in either the total revenue base or many of its individual components.

Computing the "underlying" revenue trend is difficult because of the many types of changes that have been made to the revenue base in recent years. Nevertheless, at least two types of adjustments clearly are needed to derive this trend:

- Revenues must be adjusted to exclude the tax revenue-enhancing proposals and one-time special funds transfers discussed earlier for both the current year (about $1 billion) and budget year (over $750 million);
- The fiscal effects in 1982–83 ($348 million) and 1983–84 ($680 million) of phasing out the inheritance and gift taxes must be removed.

Table 34 shows that once these adjustments are made, revenue growth amounts to 13.6 percent in the budget year. This compares to an adjusted rate of growth of only 1.2 percent for the current year, and is well in excess of projected personal income growth in both 1983 (8.5 percent) and 1984 (9.7 percent).

If only the effects of the revenue enhancements and special funds shifts are eliminated, underlying budget year revenue growth is 11.7 percent, compared to a 1.1 percent decline in 1981–82. Thus, by any measure the underlying revenue trend in 1983–84 is up.

One reason for this involves the extremely rapid projected growth rate for personal income tax receipts (19.7 percent), which even after adjustment for proposed tax law changes and recently enacted tax accelerations, is quite high (17.9 percent). As discussed below, there are several reasons for this high rate of growth, including the effects of indexing and shifts in cash-flow patterns. Because of these factors, the rate of personal income tax growth shown in Table 34 is not really an "underlying" rate, in that it doesn't represent a rate that can be sustained. Nevertheless, the budget year's "underlying" rate of revenue growth—however defined—is clearly stronger than in the preceeding several years. This reflects the department's projection that economic recovery will begin in the first half of 1983 and continue throughout 1984.

**Table 33**
**State Revenue Collections**
**1981–82 to 1983–84**
**(in millions) [a]**

| *General Fund* | *Actual 1981–82* | *Estimated 1982–83* | *Projected 1983–84* | *Change 1982–83 to 1983–84 Amount* | *Percent* |
|---|---|---|---|---|---|
| Taxes: | | | | | |
| Sales and use | $7,548.7 | $7,577.8 | $8,453.1 | $875.3 | 11.6% |
| Personal income | 7,493.0 | 7,275.0 | 8,710.0 [b] | 1,435.0 | 19.7 |
| Bank and corporation | 2,648.7 | 2,640.0 | 2,810.0 [c] | 170.0 | 6.4 |
| Inheritance and gift [d] | 495.3 | 508.0 | 229.0 | −279.0 | −54.9 |
| Insurance [e] | 484.2 | 703.0 | 450.0 | −253.0 | −36.0 |
| Cigarette | 194.3 | 190.5 | 188.0 | −2.5 | −1.3 |
| Alcoholic beverage | 139.6 | 138.0 | 141.0 | 3.0 | 2.2 |
| Horse racing | 105.7 | 107.0 | 112.0 | 5.0 | 4.7 |
| Total Taxes | $19,109.5 | $19,139.2 | $21,093.1 | $1,953.9 | 10.2% |
| Other Sources: | | | | | |
| Oil and gas revenues | $18.5 | $157.0 | $215.7 | $58.7 | 37.4% |
| Health Care Deposit Fund | 250.3 | 309.8 | 342.0 | 32.2 | 10.4 |
| Interest on investments | 335.8 | 229.4 | 253.7 | 24.3 | 10.6 |
| Federal revenue sharing transfer | 179.4 | – | – | – | – |
| Other revenues and transfer [f] | 1,106.7 | 654.3 | 574.9 | −79.4 | −12.1 |
| Totals, General Fund | $20,960.3 | $20,489.7 | $22,479.4 | $1,989.7 | 9.7% |
| *Special Funds* | | | | | |
| Motor vehicle: | | | | | |
| Fuel tax [g] | $833.4 | $900.3 | $1,135.9 | $235.6 | 26.2% |
| License fee (in lieu) [g] | 706.4 | 741.0 | 815.0 | 74.0 | 10.0 |
| Registration, weight and miscellaneous fees [g] | 636.2 | 812.1 | 841.0 | 28.9 | 3.6 |
| Other Sources: | | | | | |
| Oil and gas tax revenues | 470.9 | 342.0 | 159.0 | −183.0 | −53.5 |
| Sales and use [h] | 140.3 | 152.3 | 162.9 | 10.6 | 7.0 |
| Interest on investments | 83.6 | 83.6 | 71.3 | −12.3 | −14.7 |
| Cigarette tax | 82.5 | 85.5 | 79.5 | −6.0 | −7.0 |
| Other | −312.8 [i] | 162.1 | 281.6 | 119.5 | 73.7 |
| Totals, Special Funds | $2,640.5 | $3,278.9 | $3,546.2 | $267.3 | 8.2% |
| Totals, State Funds | $23,600.9 | $23,768.6 | $26,025.6 | $2,257.0 | 9.5% |

[a] Details may not add to totals due to rounding. Figures for 1981–82, 1982–83 and 1983–84 include the effects of a variety of measures, either enacted in 1981 and 1982 or proposed in the 1983–84 Governor's Budget, to augment General Fund revenues and transfers. For *1981–82,* these factors amount to approximately $1.3 billion, and include provisions to accelerate tax collections (about $380 million) and to transfer monies to the General Fund from special funds (about $870 million). For *1982–83,* these factors amount to about $1 billion, and include about $400 million in tax accelerations and $450 million in special fund transfers to the General Fund. For *1983–84,* the budget proposes increases in tax revenues of $167 million from repeal of energy-related tax credits and increased auditing esti-

mates, a $300 million transfer to the General Fund from the Motor Vehicle License Fee Account, and placement of $192 million of tidelands oil revenues into the General Fund. For a more detailed explanation of these factors, see discussion in text.

[b] Includes $110 million for the proposed repeal of the solar energy credit and energy conservation credit, and $27 million for proposed audit activities.

[c] Includes $10 million for the proposed repeal of the solar energy credit and energy conservation credit, and $20 million for proposed audit activities.

[d] 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 $1.2 million in 1980–81, $109 million in 1981–82, $203 million in 1982–83, and $230 million in 1983–84. In addition, Proposition 6 (June 1982) is projected to reduce inheritance and gift tax revenues by $145 million in 1982–83 and $450 million in 1983–84.

[e] SB 1326 (Ch 327/82) changed prepayment dates for insurance companies and reduced the insurance tax rate for 1982 through 1986. This bill will have the effect of accelerating $230 million in tax receipts into 1982–83, and reducing 1983–84 receipts by $110 million.

[f] See text for a discussion of legislative action in the prior, current, and budget years to increase General Fund income from special fund transfers. The 1981–82 figure includes transfers of $84.9 million from the Capital Outlay Fund for Public Higher Education, $95.8 million from the Energy and Resources Fund, $131.6 million from the Motor Vehicle License Fee Account, $125.3 million from the Special Account for Capital Outlay (SAFCO), $53.8 million from the State parks and Recreation Fund, and $252 million from the State School Building Lease-Purchase Fund. The 1982–83 figure includes transfers of $261 million from the Motor Vehicle License Fee Account, $42 million from the SAFCO, and $80 million from the California Water Fund. The 1983–84 figure includes a proposed transfer of $300 million from the Motor Vehicle License Fee Account.

[g] SB 215 (Ch 541/81) increased gasoline and diesel taxes, vehicle registration fees, weight fees, and drivers' license fees, and AB 202 (Ch 933/81) increased registration fees further. These measures increased motor vehicle user taxes and fees by $205 million in 1981–82, an estimated $469 million in 1982–83, and a projected $633 million in 1983–84. The 1983–84 fuel tax revenue estimates also include a proposed one-time revenue increase of $85 million from accelerating the due date for fuel tax payments to the state. Trailer coach fees ("in lieu" tax) are included under "other" revenues.

[h] 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).

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

**Table 34**
**Comparisons of Income Trends for the Current and Budget Years 1982–83 and 1983–84**

| | *Percent Change in Revenues and Transfers* | | | |
|---|---|---|---|---|
| | *1982–83* | | *1983–84* | |
| *Income Source* | *Increase Published in Budget* | *Change Adjusted for Special Factors* [a] | *Increase Published in Budget* | *Change Adjusted for Special Factors* [a] |
| Sales and use tax | 0.4% | 1.1% | 11.6% | 13.2% |
| Bank and corporation tax | −0.3 | −0.7 | 6.4 | 5.6 |
| Personal income tax | −2.9 | −1.3 | 19.7 | 17.9 |
| Other major taxes | 16.1 | 18.9 | −32.0 | 12.5 |
| Totals, Major taxes and licenses | 0.2% | 1.3% | 10.2% | 13.9% |
| Interest Income | −31.8 | −31.8 | 10.6 | 10.6 |
| Transfers | −58.6 | 23.3 | −15.9 | - |
| All other revenues | 50.6 | 14.3 | 11.7 | 3.4 |
| Totals, General Fund Revenue and Transfers | −2.2% | 1.2% | 9.7% | 13.6% |

[a] Removes the effects on revenue growth of all one-time special funds transfers, tax accelerations, one-time state revenue gains from federal tax law change involving "cost recovery oil," shifts in classification of certain tidelands oil monies from a "transfer" in 1982–83 to "other revenue" in 1983–84, and a $31 million insurance tax reduction in 1982–83 relating to a court case involving the principal office deduction.

**Personal Income Taxes to Lead Revenue Growth**

As noted above in Tables 33 and 34, personal income taxes are projected to rise by 19.7 percent when the Governor's proposals for increasing revenues are reflected in the estimates. These proposals include repeal of the solar energy tax credit and the energy conservation tax credit ($110 million), and increased auditing activities ($27 million). Table 34 also shows that revenue growth is 17.9 percent when these proposed changes and the tax accelerations enacted in 1982 are excluded. In contrast, anticipated receipts from this source in 1982–83 *declined* by 2.9 percent without adjustments for tax enhancements, and by 1.3 percent with such adjustments. As discussed below, this volatile pattern of revenue growth results from a combination of cash-flow factors and the impact of indexing.

The projection of personal income tax receipts involves two steps—projecting *calendar-year tax liabilities,* and allocating (or "cash-flowing") of these liabilities into *fiscal year receipts.*

1. ***Calendar Year Liabilities:*** The main determinants of calendar-year tax liabilities are growth in taxable income, the distribution of this income among tax brackets, and the inflation adjustment factors used to index the personal income tax. Table 35 shows both the department's estimates of these liabilities and our estimates of these liabilities (using the department's economic assumptions). The table indicates that personal income tax liabilities grew more slowly than personal income in 1982, and are projected to grow faster than personal income in 1983, and at about the same rate as income in 1984. One reason for these year-to-year differences involves the impact of indexing. For 1982, the tax brackets will be indexed by 9.3 percent (that is, by *more* than personal income growth), whereas the projected adjustment for 1983 is only 3.2 percent (that is, considerably *less* than projected personal income growth). In fact, recent trends in the California CPI suggest that the 1983 adjustment factor could be even less than the 3.2 percent assumed in the budget.

**Table 35**
**Estimated Personal Income Tax Liabilities**
**Using Department of Finance Economic Assumptions**
**1982 to 1984**
**(in millions)**

| | *Department of Finance* | | *Legislative Analyst* | | *Percent Change in* |
|---|---|---|---|---|---|
| *Calendar Year* | *Amount* | *Percent Change* | *Amount* | *Percent Change* | *Personal Income* |
| 1982 | $7,318 | 4.1% | $7,389 | 5.2% | 7.8% |
| 1983 | 8,232 | 12.5 | 8,237 | 11.5 | 8.5 |
| 1984 | 9,120 | 10.8 | 9,055 | 9.9 | 9.7 |

Because the growth in tax liabilities is greater when the indexing adjustment factor is less, indexing served to depress personal income tax liabilities in 1982 to a much greater extent than it is expected to in 1983 or 1984. Growth in liabilities in 1982 was also slowed because the rate of income growth itself was relatively low, whereas it is expected to be higher in 1983 and 1984.

2. ***Fiscal Year Collections:*** Estimates of fiscal year collections are derived by apportioning income from adjacent calendar-year tax liabilities into different fiscal years, depending on (1) the pace of economic activity

throughout the year and (2) when taxpayers are required to make their payments. Normally, about 35 percent of an income year's liabilities (for example, the 1983 income year) are allocated to the first fiscal year (for example, 1982–83), with the remaining 65 percent showing up in the second fiscal year (for example, 1983–84). Thus collections in 1982–83 are derived primarily from the payment of 1982 liabilities and thus are heavily affected by the depressed level of activity in that year. In contrast, collections in 1983–84 are derived from the payment of 1983 and 1984 liabilities, and reflect a more-rapidly-growing level of economic activity. The relatively high rate of revenue growth that this produces for 1983–84 is further accentuated because the pace of income growth was slowing throughout 1982 and is expected to accelerate in 1983 and 1984, thereby pulling down revenues in 1982–83 and pushing them up in 1983–84. Thus, a variety of factors—proposed and enacted legislation, income tax indexing, the overall pattern and pace of economic activity, and cash-flow shifts—combine to explain the 19.7 percent growth projection for personal income tax collections in 1983–84.

### Effects of Income Tax Indexing

Chart 17 summarizes the fiscal effects of income tax indexing in California. The chart shows that over the period 1978–79 through 1983–84, income tax indexing will have reduced personal income tax revenues by $12.1 billion, or over 22 percent of revenues which would have been collected without indexing during these years. Because indexing is cumulative, its effect on revenue increases over time. In 1982–83 and 1983–84, for example, indexing will reduce revenues by $3.1 billion and $3.6 billion, respectively, or by about 30 percent. These reductions include the effects of Proposition 7 (June 1982), which provided for permanent full indexing of the marginal income tax brackets beyond 1981. We estimate that Proposition 7 will reduce General Fund revenues by $210 million in 1982–83, and by $420 million in 1983–84.

### Taxable Sales Also to Strengthen

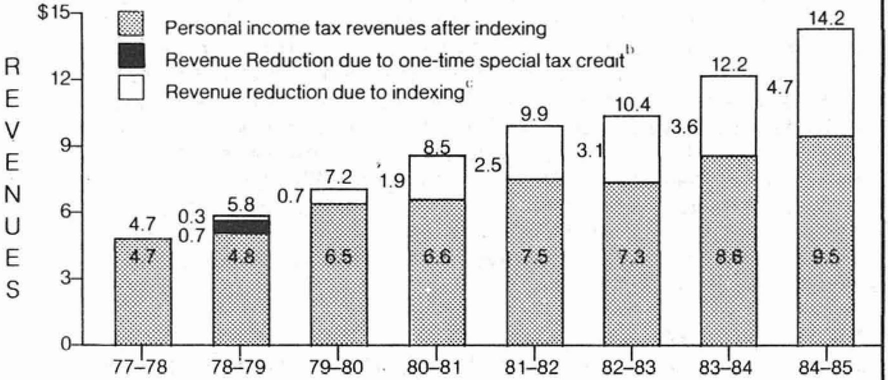
As shown in Table 34, sales and use taxes are projected to increase by 11.6 percent in the budget year, or 13.2 percent when the distorting effects of tax accelerations and other revenue-enhancing measures are eliminated. This is in marked contrast to 1982–83, when sales tax collections were essentially flat.

The projected rate of growth in sales tax revenues during 1983–84 means that growth in taxable sales is expected to out-distance growth in personal income in both the second half of 1983 and throughout 1984. This is confirmed by looking at the ratio of taxable sales-to-personal income contained in the department's economic forecast. As Table 36 shows, this ratio dropped from 53.8 percent in 1981 to 49.6 percent in 1982, but is predicted to rise slightly to 49.8 percent in 1983 and then increase to 51.6 percent in 1984. As shown in Chart 18, taxable sales growth is expected to be especially strong in 1984 (up 13.6 percent), led by increases in sales tax receipts from such industries as motor vehicles (up 22 percent) and building materials (up 24 percent). Of course, the high rates of growth for the building and automobile industries are partly due to the fact that they are expected to be recovering from extremely depressed recession levels.

**Chart 17**

## Effects of Indexing on California Personal Income Tax Revenues.

### 1977–78 through 1984–85 (in billions)[a]




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

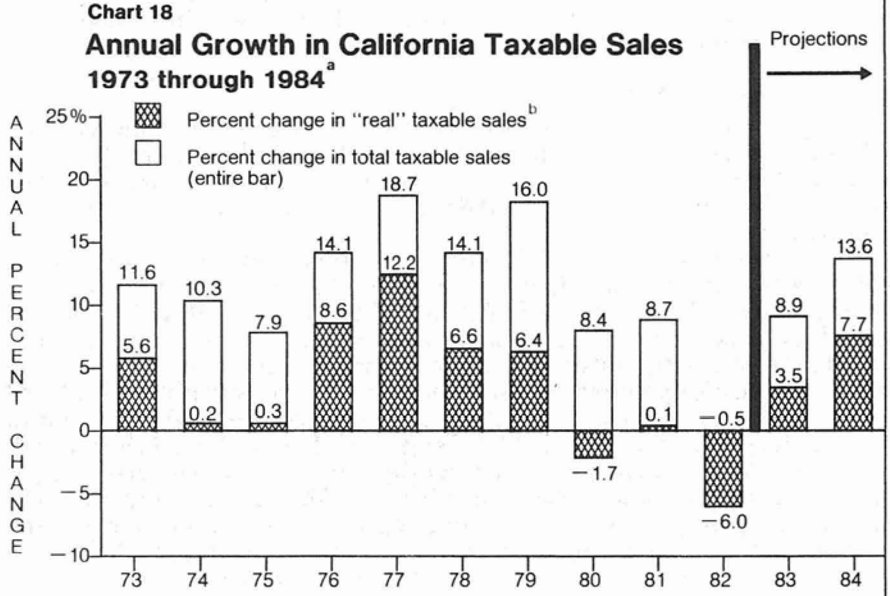
[b] AB 3802 (Ch 569/78) increased the personal income tax credit for 1978 by $75 for single return taxpayers and by $150 for joint return taxpayers.

[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. Proposition 7 (June 1982) provided for *permanent* full indexing of marginal tax brackets beyond 1981. Revenues shown for 1983–84 exclude the revenue increases proposed in the budget, which amount to approximately $140 million.

**Chart 18**

## Annual Growth in California Taxable Sales

### 1973 through 1984[a]




[a] California Department of Finance

[b] "Real" taxable sales equal total taxable sales (current dollars) deflated by the GNP price deflator for consumption expenditures.

The upturn projected for taxable sales, while impressive in comparison to the growth in recent years, is *not* overly strong in light of the depressed level of sales that has prevailed during the recession. For example, the projected ratio of taxable sales-to-personal income in 1984 (51.6 percent) is considerably below what the department predicted 12 months ago (56.2 percent), and even further below the 1979 peak (57.5 percent), as shown in Table 36. In fact, the taxable sales-to-income ratio is even below what it was in 1975, during the low point of the 1973–75 recession.

Likewise, although the department forecasts growth in real taxable sales both in 1983 (3.5 percent) and 1984 (7.7 percent), the gains are not very robust given that real taxable sales fell by close to 8 percent between 1980 and 1982. The 1982 decline was especially deep—6 percent in real terms—because nominal dollar taxable sales *declined* for the first time since 1958.

Thus, although the growth in taxable sales is expected to play an important role in generating General Fund revenue gains during 1983–84, the rate of growth will be fairly modest given the extent to which consumers have cut back on their buying during the recession.

The budget proposes several changes in the collection dates for sales taxes. These proposals will enable the state to accelerate its collection of receipts from certain retailers. Thus, the state's cash position *within* the 1983–84 fiscal year will be improved if these measures are adopted. The proposals, however, will have no impact on sales tax receipts for the year as a whole.

**Table 36**
**Ratios of Taxable Sales to Personal Income in California 1973 to 1984**

| *Calendar Year* | *Ratio of Taxable Sales to Personal Income* |
|---|---|
| 1973 | .538 |
| 1974 | .531 |
| 1975 | .521 |
| 1976 | .534 |
| 1977 | .566 |
| 1978 | .566 |
| 1979 | .575 |
| 1980 | .552 |
| 1981 | .538 |
| 1982 (Estimated) | .496 |
| 1983 (Projected) | .498 |
| 1984 (Projected) | .516 |

### Moderate Corporate Profits Improvement to Produce Revenue Gain After Two Years of Declines

Revenues from the bank and corporation tax are more difficult to project from year-to-year than revenues from any other source. This is because of the inherent volatility of corporate profits, the wide variety of factors which influence profits, the complex prepayment patterns which firms use to remit funds to the state, and the lengthy time lags required before actual data on past corporate profits become available.

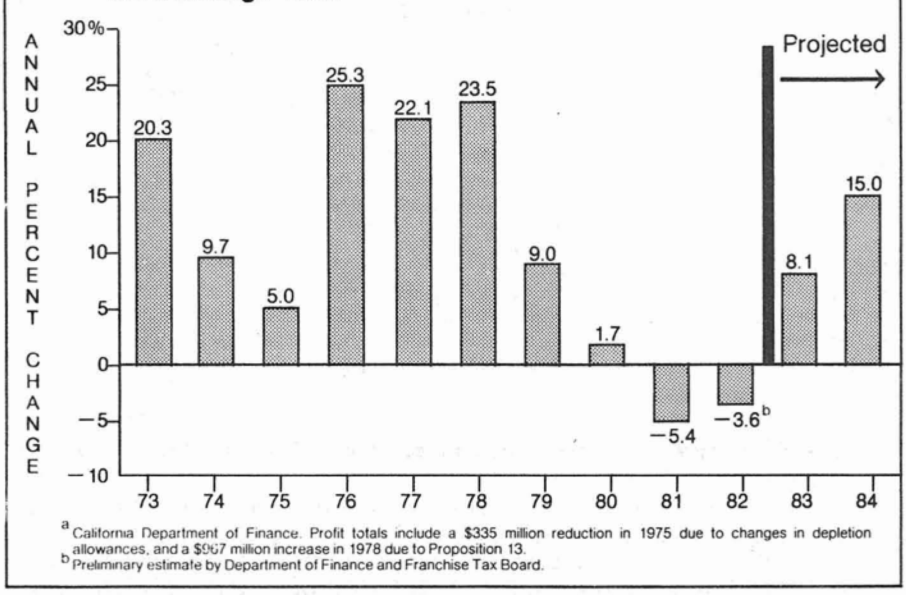
This year the problem of projecting corporate tax revenues is especially difficult because recent federal tax law changes have distorted historical relationships between California and U.S. profits. The problem has also been exacerbated by the recession, high interest rates, and the deterioration in corporate balance sheets, all of which affect profits.

Table 34 shows that revenues from the bank and corporation tax are projected by the department to rise by 6.4 percent in 1983–84, or by 5.6 percent when adjustments are made for previously enacted tax acceleration increases and proposals to enhance revenues in the budget year. The proposed changes total $30 million, consisting of $20 million from increased auditing activities and $10 million from repeal of the solar energy and energy conservation tax credits. The projected budget-year revenue gain contrasts with the decline in bank and corporation revenues which occurred in 1981–82 and is projected to occur again in 1982–83.

Projected 1983–84 corporate tax revenue growth reflects predicted increases in corporate profits of about 8.1 percent in 1983 and 15.0 percent in 1984. These gains, which are shown in Chart 19, follow three consecutive years of weak profit performance—a 1.7 percent gain in 1980, a 5.4 percent decline in 1981, and an estimated 3.6 percent decline in 1982.

**Chart 19**

**Annual Growth in California Taxable Corporate Profits 1973 through 1984[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.

In developing its corporate profits forecast for 1983 and 1984, the department has relied on a survey of corporations to determine their 1982 profits. This is necessary because data on 1982 taxable profits in California is not yet available from any other source. In fact a solid estimate of taxable profits in 1982 will not be available until later in 1983, when tax return data become available. The department's survey covers firms which account for slightly over ⅓ of the corporate tax base. According to this survey, 1982 profits in the state were $1.4 billion (3.6 percent) lower than they were in 1981. With the single exception of utility companies, *every* industry grouping reported negative profit growth in the 1982 survey.

Exactly how accurate the 1982 profit survey—and thus the estimate of 1983 and 1984 profits, and of 1982–83 and 1983–84 revenues—will turn out to be remains to be seen. This is especially true because, although the department's survey has a relatively good response rate as far as surveys go, its coverage is far too small to determine the state's actual level of profits with any degree of certainty. Based on our examination of historical profit relationships between the nation and California, for example, there appears to be some possibility that California profits could be weaker in 1982 than the department is assuming. The department predicts that U.S. profits will fall by nearly 24 percent under current law, and by nearly 19 percent when adjusted for recent federal tax law changes regarding depreciation allowances. The department's resulting state-national profit growth rate differential for 1982—15.3 percentage points—is well in excess of any experienced in the past two decades.

In any event, there is a fairly large error margin surrounding *anyone's* corporate profit estimates, especially those made for California.

### Other Major Taxes

Tables 33 (page 78) and 34 (page 79) show that General Fund revenues from taxes other than the three major levies are projected to reach $1.1 billion in the budget year, a decrease of $526 million (32 percent) below the current year. These taxes include the insurance tax ($450 million), the inheritance and gift taxes ($229 million), the cigarette tax ($188 million), alcoholic beverage taxes ($141 million), and horse racing-related revenues ($112 million). For two of these revenue sources—the insurance tax and the inheritance and gift taxes—the budget estimates reflect special factors as discussed below. After adjusting for these factors, Table 34 shows that budget-year revenues from other major taxes are projected to rise by 12.5 percent over the current-year level.

### Major Cash-Flow Shifts in Insurance Tax Collections

The *insurance tax* estimate for 1983–84—$450 million, a decline of $253 million from the 1982–83 estimated level—reflects a number of changes in the statutory provisions governing the collection of this tax that were made by SB 1326 (Ch 327/82). This bill:

- Increased the number of annual tax prepayments required of insurers from 3 to 4, and increased the total percent of prior year tax liabilities which must be remitted through prepayments from slightly under 80 percent to 100 percent;
- Raised the portion of each year's prepayments that are due in the first half of the calendar year from one-third to one half.
- Required an additional, one-time tax prepayment due on January 1, 1983; and
- For the years 1982 through 1985, reduced the insurance premiums tax rate from 2.35 percent to 2.33 percent.

The net impact of these provisions is to *raise* revenues by $230 million in 1982–83. In the budget year, the impact of the SB 1326 changes is to *reduce* revenues by $110 million. Thus, had these changes not been enacted, 1982–83 revenues would have been about $473 million and 1983–84 revenues would have been about $560 million, implying an underlying growth in revenues from this source of about $87 million (18.4 percent) in the budget year. The estimate of 1982–83 revenues, however, has been reduced by $31 million to reflect a recent court decision regarding the principal office deduction allowance that the voters repealed in 1976. Taking this one-time factor into account, underlying budget-year revenue growth is 11.1 percent over the current-year level.

The department's revenue projections for the insurance tax are based on a survey of California insurance companies that account for 55 percent of all insurance premiums written. According to the survey, insurance premiums subject to the 2.33 percent gross premiums tax are expected to rise by 3.9 percent in 1982 (the year on which 1983 tax prepayments are based), and 9.1 percent in 1983 (the year on which 1984 tax prepayments are based). Taxes on these premiums account for about 97 percent of all insurance tax collections.

The estimated 1982 premiums increase of 3.9 percent, which affects revenues in both the current and budget years, is the lowest annual increase in the past decade. For example, premiums during the mid-1970's rose by more than 20 percent in some years. The 1982 slowdown is attributable to the depressing effects of the current recession on income, employment, construction and car sales.

### Phasing-out of Inheritance and Gift Tax Underway

Inheritance and gift tax receipts are projected to decline to $229 million in the budget year, a fall of $279 million (54.9 percent) from the current year. This decline, as well as the weak 2.6 percent growth in current-year receipts over prior-year receipts, is due to two law changes:

- ***First,*** revenues have been reduced because of the phasing-in of AB 2092 (Ch 634/80), which increased inheritance tax exemptions.
- ***Second,*** revenues have been reduced because of the phasing-in of Proposition 6 (June 1982), which repealed the state's inheritance and gift tax. (Proposition 6 became effective for estates and decedents and for gifts made on or after June 9, 1982. The initiative also established a "pick-up" estate tax, which allows the state to receive a portion of the revenue stemming from the federal estate tax, at no increased cost to taxpayers.)

**Table 37**
**Effects of Tax Law Changes on Inheritance and Gift Tax Revenues 1980–81 to 1983–84 (in millions)**

| | *Effects of* | | *Total Reduction* | |
|---|---|---|---|---|
| | *AB 2092* | *Proposition 6* | *Amount* | *As % of Prior Law Revenues* |
| 1980–81 | −$1 | — | −$1 | −0.2% |
| 1981–82 | −109 | — | −109 | −19.2 |
| 1982–83 | −203 | −$145 | −348 | −40.7 |
| 1983–84 | −230 | −450 | −680 | −73.4 |

Table 37 shows that the combined effect of AB 2092 and Proposition 6 is to reduce inheritance and gift tax revenues by approximately $110 million in 1981–82, $350 million in 1982–83, and $680 million in 1983–84. Thus, by the end of the budget year, nearly three-fourths of the prior-law tax base will have been eliminated. The budget-year revenue total includes $114 million from the inheritance and gift tax, and $115 million for the "pick-up" estate tax under Proposition 6.

#### Interest Income to Stabilize

The General Fund can receive 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 that are idle because of the time lag between when revenues are collected and disbursements are made. Of these three, the last currently is the most important source of interest income.

The budget projects that General Fund interest on investments will be about $254 million in 1983–84, of which $250 million represents returns on the PMIA. The level of investment income projected for 1983–84 compares to about $229 million projected for 1982–83 and $336 million in 1981–82, and assumes that:

- ***The average fiscal year balance*** in the PMIA for 1983–84 will be somewhere in the vicinity of $5.75 billion. This average balance has declined significantly in recent years because the state spent more than it received in revenues, causing the budget surplus to disappear. The average balance 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 PMIA will be about 44 percent.
- ***The average interest yield*** on PMIA investments in 1983–84 will be in the vicinity of 10 percent. This compares to an actual average yield for the first half of 1982–83 of about 11.4 percent, and of about 10.5 percent as of year-end 1982.

The estimates of interest income are subject to a large margin of error, due to the number of assumptions that must be made in preparing the estimate. The most obvious assumption involves the average balance in the PMIA during the year. The budget assumes that a $750 million deficit will be carried over from 1982–83 into 1983–84, and that by year-end 1983–84, the budget will be in balance. However, should the carryover deficit from 1982–83 exceed $750 million, or should the deficit not be completely eliminated in 1983–84, the average PMIA balance and thus interest income would be less. And, of course, the estimates are obviously at the mercy of conditions in financial markets that determine the rate at which the state will earn interest income. Our analysis indicates that the estimates of interest income do not appear to have explicitly incorporated the effects of the Governor's proposed cash management plan on the PMIA balance. Other things constant, this plan should increase the PMIA balance and thus raise interest earnings.

## 2. ALTERNATIVE GENERAL FUND REVENUE ESTIMATES

### Estimates Consistent with Assumptions, but Future Revisions Inevitable

As we did 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 an economy along the lines projected by the department could generate an additional $230 million in 1983–84 General Fund revenues above what is forecast. Because our analysis also results in about $100 million less in 1982–83 revenues than Finance projects, the net difference for the current and budget years combined is only about $130 million. This is a very small difference, in light of the complexities of revenue estimating.

The closeness of our estimates to Finance's should *not* be interpreted as indicating that the outlook for revenues is predictable. It is not. In fact, the outlook is extremely *uncertain*. As evidence of the effect that economic forecasting errors can have on projected revenues, the department's current-law 1982–83 revenue estimate is $1.3 billion lower than the estimate made last May (Table 32, Page 75). Clearly the department's 1983–84 revenue estimates will be subject to considerable revision over the next 18 months.

### Alternative General Fund Revenue Scenarios

Given the history of revenue estimating errors, and the considerable uncertainty about exactly how the economy will perform in 1983 and 1984, 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. It is especially important to do this now, given the extremely tight state and local government fiscal picture.

Revenue-estimating errors can result from a variety of factors. For example, the underlying data on which forecasts are based often are revised at later dates. It is likely that, had the "true" data been known earlier, the forecasts themselves would have been different. In addition, there are normal errors of a statistical nature that always accompany projections of future events. It appears, however, that the most important cause of revenue-estimating errors is errors in economic forecasting.

Given this, the department has constructed two alternative economic scenarios which can provide some insight into the type of revenue estimating errors which could show up if the economic forecast is wrong. One scenario is based on a more optimistic set of economic assumptions than Finance used for its standard budget forecast; the other is based on more pessimistic assumptions. We believe that these alternative forecasts provide a good illustration of how the paths taken by the national and state economies in 1983 and 1984 could depart from the department's forecast. These scenarios, however, by no means bracket the range of possible outcomes. Table 38 summarizes the key features of these alternative economic forecasts.

We have taken the key variables in these economic scenarios and used them to project the main determinants of General Fund revenues—taxable income, California taxable profits and taxable sales. Table 39 indicates what we estimate would be the effect on state revenues in the current and budget years if each of the department's alternative forecasts were borne out. These effects are in the same general range as are those estimated by the department and published in the budget.

**Table 38**
**Alternative Economic Outlooks**
**Prepared by the Department of Finance**
**1983 and 1984**

| | *Pessimistic Forecast* | | *Optimistic Forecast* | |
|---|---|---|---|---|
| *Economic Variable* | *1983* | *1984* | *1983* | *1984* |
| 1. National Data: | | | | |
| Real GNP growth | −0.2% | 2.5% | 3.2% | 5.9% |
| Profits growth | −7.6% | 16.7% | 21.1% | 18.5% |
| Car sales (millions) | 8.0 | 9.1 | 9.1 | 11.3 |
| Housing starts (millions) | 1.12 | 1.34 | 1.38 | 1.76 |
| Unemployment rate | 10.5% | 9.7% | 9.8% | 8.1% |
| 2. California Data: | | | | |
| Personal income growth | 6.7% | 7.4% | 9.8% | 11.9% |
| Wage and salary employment growth | −0.9% | 1.7% | 2.2% | 5.6% |
| Building permits (thousands) | 90 | 125 | 145 | 190 |
| Unemployment rate | 11.1% | 9.4% | 10.0% | 8.0% |

**Table 39**
**Revenue Effects of Alternative Department of Finance Economic Forecasts**
**1982–83 and 1983–84**
**(in millions) [a]**

| | *1982–83* | | *1983–84* | |
|---|---|---|---|---|
| *Source of Income* | *Pessimistic Forecast* | *Optimistic Forecast* | *Pessimistic Forecast* | *Optimistic Forecast* |
| Personal income tax | −$50 | $50 | −$235 | $250 |
| Sales and use tax | −215 | 150 | −690 | 560 |
| Bank and corporation tax | −50 | 50 | −395 | 225 |
| Total, Major Three Taxes | −$315 | $250 | −$1,320 | $1,035 |

[a] Estimates by Legislative Analyst.

Table 39 shows that these alternative economic scenarios produce 1982–83 General Fund revenue estimates for the three major taxes which range from $250 million (1.4 percent) above to $315 million (1.8 percent) below Finance's forecast. For 1983–84, the estimates range from $1 billion (5.2 percent) above to $1.3 billion (6.7 percent) below Finance's projection. (The December revenue estimates prepared by the Commission on State Finance—$61 million above the department's current-year estimate and $715 million below its budget-year estimate—fall well within these margins.) These margins are consistent with the historical errors reported earlier in Table 30, page 72, and it is probably possible to find economists at 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 could occur in both 1982–83 and 1983–84.

### 3. SPECIAL FUND REVENUES

Table 33 (page 78) shows that combined revenues to all state special funds are projected to reach over \$3.5 billion in 1983–84. Table 40 summarizes the share of special fund revenues accounted for by each of the major special fund revenue sources.

**Table 40**
**Summary of Special Fund Revenues**
**1983–84**
**(in millions)**

| | *Amount* | *Percent Of Total* |
|---|---|---|
| 1. *Motor Vehicle Taxes and Fees* | | |
| License fees | \$815[a] | 23.0% |
| Fuel taxes | 1,136 | 32.0 |
| Registration and other fees | 841 | 23.7 |
| Trailer coach fees | 27 | 0.8 |
| Subtotal | \$2,819 | 79.5% |
| 2. *Tidelands Oil and Gas Revenues* | 159[b] | 4.5 |
| 3. *Retail Sales Taxes ("spill over" revenues)* | 163 | 4.6 |
| 4. *Cigarette Taxes* | 80 | 2.3 |
| Subtotal | \$3,221 | 90.8% |
| 5. *All Other* | 325 | 9.2 |
| Total | \$3,546[c] | 100.0% |

[a] Existing law; does not reflect budget proposal to transfer \$300 million of this amount to the General Fund.
[b] This is the net amount after the budget proposal which would transfer \$192 million of these revenues to the General Fund.
[c] Includes reduction of \$300 million due to proposed transfer from the Motor Vehicle License Fee Account to the General Fund.

The major source of special fund income is motor vehicle-related levies, which include gasoline taxes (\$1,136 million), vehicle license and trailer coach fees (\$842 million) and registration fees (\$841 million). These vehicle-related levies are expected to total over \$2.8 billion in the budget year, an increase of 13.6 percent (\$338 million) over 1982–83. Other major sources of special fund income include tidelands oil and gas tax revenues (\$159 million), sales and use tax revenues (\$163 million), cigarette tax receipts (\$80 million), and interest on investments (\$71 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 total collections from this tax.

### Revenue Trends Distorted by Major Legislation and General Fund Transfers

Table 33 (page 78) shows that special fund revenues in 1983–84 are expected to be 8.2 percent above the 1982–83 level. This rate of growth is distorted by the following special factors:

- ***First,*** major legislation was enacted in 1981 which increased motor vehicle-related receipts in 1981–82, 1982–83 and 1983–84. This legislation included (a) SB 215 (Ch 541/81), which increased vehicle registration, weight and drivers license fees (as of January 1, 1982), and increased the fuel tax from 7 cents to 9 cents per gallon (as of January 1, 1983), and (b) AB 202 (Ch 933/81), which provided for further increases in vehicle registration fees. Together, the estimated effects of these measures are an increase in motor vehicle-related collections of $205 million in 1981–82, $469 million in 1982–83 and $633 million in 1983–84.

- ***Second,*** the budget proposes to change the date on which motor vehicle fuel tax collections must be remitted to the state. This, would produce a one-time revenue gain of $85 million in 1983–84.
- ***Third,*** the 1983–84 budget proposes to transfer $300 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 lieu of activating the deflator in both 1981–82 ($131 million) and 1982–83 ($261 million).
- ***Fourth,*** as in 1982–83, the General Fund is to receive a special one-time allocation of tidelands oil revenues. This amounts to $192 million in the budget year. The current-year amount is over $175 million, which includes a transfer for energy tax credit funding and an $80 million one-time tidelands oil revenue gain due to a recent federal law change regarding assessment of the windfall profits tax on "cost recovery" oil. By comparison, tidelands oil revenues transferred into the General Fund in 1981–82 totaled over $600 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, fuel tax revenues will go up by $79 million in 1982–83 and $233 million in 1983–84. As shown in Table 33 (page 78), when fuel tax revenues are adjusted for this legislation and the tax due-date changes proposed in the budget go into effect, resulting budget-year revenues ($818 million) are essentially unchanged from the current year ($821 million), and are actually *below* revenues in the prior year ($873 million). This represents the sixth year in a row that the underlying revenue trend has not been upward. This reflects such factors as changes in the automobile mix, increasing fuel economies, reduced demand due to slow economic growth, and the impact of gasoline prices on consumption. The department's fuel tax estimate assumes that average gasoline consumption per vehicle will drop from 595 gallons in 1981–82 to 585 gallons in 1982–83 and 570 gallons in 1983–84.

Vehicle-related registration and license fees are projected at almost $1.4 billion in the budget year, including the effects of new legislation. This projection assumes increases in new vehicle registrations of 12.3 percent and 16.3 percent in 1983 and 1984, respectively. These relatively strong rates of increase reflect the department's projection for an upswing in consumer spending on new automobiles during the next 24 months.

**Tidelands Oil and Gas Revenues—A Potentially Important Balancing Factor**

Total revenues collected by the State Lands Commission from oil, gas, geothermal, and other sources are projected in the Governor's Budget to reach $350 million in 1983–84, down $124 million (26 percent) from the current year. Of this decline, $55 million is due to the difference between the revenue-increasing effects of the Technical Corrections Act of 1982 in 1982–83 ($80 million) and 1983–84 ($25 million). This federal legislation revised the way in which windfall profit taxes are levied on oil produced on state-owned properties. The remaining decline in oil and gas and other revenues from state lands ($69 million) is in part due to declining oil and gas production at the state's fields. The most important factor in the decline, however, has been the drop in oil prices, due to excessive stocks in the world's crude oil markets.

Most of these oil and gas 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 $335 million in 1983–84.

These funds traditionally have been used along with bond proceeds to finance state capital outlay projects. As discussed earlier, however, tidelands oil revenues played a major role in balancing the General Fund budget in 1981–82, and are providing the General Fund with $175 million

**Table 41**
**Proposed Distribution of Special Fund Revenues From Four Major Sources 1983–84 (in millions)**

| *Source* | *Amount* | *Distribution* | *Amount* |
|---|---|---|---|
| I. *Motor Vehicle Taxes and Fees* | | | |
| 1. License fees [a] | $815 | To cities | $125 |
| | | To counties | 335 |
| | | For DMV administration | 62 |
| | | To General Fund | 300 [b] |
| 2. Fuel Taxes | 1,136 | For city streets | 177 |
| | | For county roads | 243 |
| | | To cities and counties for streets and roads | 113 |
| | | To Caltrans for state highways | 570 |
| | | Other | 33 |
| 3. Registration and other fees | 841 | To DMV | 177 |
| | | To CHP | 329 |
| | | To Caltrans | 256 |
| | | To other state agencies | 59 |
| | | Other | 20 |
| 4. Trailer coach fees | 27 | To Counties | 26 |
| | | Other | 1 |
| II. *Tidelands Oil and Gas Revenues* [c] | 159 | Energy and Resources Fund | 31 |
| | | COFPHE | 57 |
| | | SAFCO | 38 |
| | | Parks and Recreation Fund | 10 |
| | | All other | 23 |
| III. *Retail Sales (spill over) Taxes* | 163 | *State agencies* | 27 |
| | | Support for mass transit, etc. (27) | |
| | | *Local Agencies* | 77 |
| | | Special transit ($75) [d] | |
| | | Others ($2) | |
| | | *General Fund* | 42 |
| | | *Other* | 17 |
| IV. *Local Cigarette Taxes* | 80 | To cities | 65 |
| | | To counties | 15 |

[a] License fees generate an additional $7 million in interest income which support their proposed distribution.

[b] Proposed transfer. Under current law, these monies would be distributed to cities and counties.

[c] Total tidelands oil and gas revenues are projected to total $335 million in 1983–84. The budget proposes to put $192 million of the amount directly into the General Fund. Under current law, the General Fund would receive none of these monies.

[d] Under current law, this amount would be $103 million.

in revenues in the current year. In the budget year, the Governor proposes to place an additional $192 million of tidelands oil revenues into the General Fund. In Part III of this volume, we discuss the policy 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.

### How Special Fund Revenues are Distributed

Table 41 identifies how the budget proposes to allocate special fund revenues from the four major sources among different programs and levels of government. Specifically, it shows:

- Cities and counties receive about half of the motor vehicle fuel tax revenues;
- Under current law, cities and counties receive all of the proceeds from vehicle license fees, after deduction of administrative and certain other costs. For 1983–84, however, the budget proposes to transfer $300 million of these funds to the General Fund to help balance the budget. Similar (although smaller) transfers occurred in both 1981–82 and 1982–83.
- Motor vehicle registration fees are used to support the Department of Motor Vehicles and the California Highway Patrol, with most of the remainder going to the Department of Transportation for highway maintenance and construction;
- Under current law, tidelands oil revenues are allocated mainly for capital outlay purposes. Most of these revenues normally are divided among six special funds (including ERF, COFPHE, and SAFCO). The 1983–84 budget, however, proposes that a significant portion ($192 million) of these revenues be transferred to the General Fund to help balance the budget. The distribution of oil revenues shown in Table 41 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.

## IV. STATE AND LOCAL BORROWING

### Overview

The State of California and its localities borrow monies in a variety of ways and for a variety of reasons.

One type of borrowing is short-term in nature, and is often used to cope with cash-flow problems caused by differences between when expenditures are made and when revenues are received. Such borrowing may take the form of temporary loans from the state's special funds, or may involve the issuance of short-term debt instruments such as secured or unsecured notes or warrants.

A second general type of borrowing is long-term in nature. This form of borrowing is accomplished through the issuance of long-term bonds. The State of California and its localities issue both general obligation bonds and revenue bonds. These two categories of bonds have the following general characteristics: