

## SECTION III

### REPORT TO THE LEGISLATIVE BUDGET COMMITTEE

ON

### THE 1945-47 BUDGET AND THE BUDGET BILL

"Analysis of the Estimates of Revenue of the 1945-47 Budget"

By ROLLAND A VANDEGRIFT, Legislative Auditor

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#### Analysis of the Estimates of Revenue of the 1945-47 Budget

(Pages A-6 to A-9, and Schedule 5, Pages A-14 to A-23)

##### Introduction

The Legislative Auditor has analyzed the estimates of revenue in the 1945-47 Budget and in general concurs in these estimates. We agree with the Budget Officers that it is exceedingly difficult at any time to forecast State revenues 30 months into the future. In this period of transition it is particularly difficult.

##### Revenues Depend on Economic Conditions—War Influences

Following the general assumption on which the Budget has been made, previously outlined, we feel that during the continuation of the war, revenues will be maintained on approximately the same level as they have existed for the 1943-44 Fiscal Year. That is, they will continue through the fiscal year ending June 30, 1945, and into the next biennium on about the same basis until the war conditions change. There will be some falling off in certain specific taxes for the 1944-45 Fiscal Year, and one particular item, "Return from Race Track Taxes," will show a material drop which will be continued probably into the 1945-46 Fiscal Year, or until the Federal ban on horse racing is removed.

##### Revenues Decline

If the war ends during the first year of the biennium, as has been estimated throughout the Budget, certain revenue receipts will probably show material decline, particularly during the reconversion period. There will undoubtedly be a decline in the sales tax receipts, personal income tax receipts, and the corporate income tax receipts with any material increase in unemployment. This will not show itself immediately for the reason that accumulated savings and other reserves will be called upon for some time to meet the expenditures of those who are unemployed.

##### Gasoline Taxes

The gasoline tax will be held down as long as there is strict rationing of gasoline and tires and a limited supply of new passenger cars and trucks for private use. We feel that there will be some lessening in these particular controls with the end of the war with Germany, so that

while other taxes that depend on business volume and employment may fall off, the reverse will occur with the lessening of restrictions affecting motor vehicles and taxes from these sources will increase. It is significant that during the years of greatest unemployment and largest payments for relief, motor vehicle registration and gasoline taxes not only held up but increased. Automobiles and the use thereof and life insurance are the last things Californians give up in financial stringency so we can expect tax receipts from these sources to be maintained and even increased in the period of reconversion.

The recent increase in gasoline consumption and upswing in traffic flow in the State is also significant as affecting the tax yield. The condition is explained in the January, 1945, Report of the Director of Motor Vehicles to the Governor, on page 7, in the following words:

“Final figures on gasoline consumption for the year 1944 indicate that during the year there was approximately an *11 per cent increase* in the general *flow of traffic* throughout the State. According to reports from the field, *this increase is continuing currently*. Traffic counts taken at points on the State Highways System show that during January 1945, the number of vehicles counted were 8.8 per cent in excess of counts made at the same stations in January of 1944.

A peculiar aspect of this increase in travel was a 13.3 per cent increase in passenger cars counted and a decrease of 3.2 per cent in freight vehicles counted. The number of freight vehicles represented, roughly, 21 per cent of all the traffic.”

*(Italics ours.)*

We recognize the fact that with the end of the war with Germany and the concentration on the war against Japan, there will be a shifting of certain military activities to the Pacific Coast. This may temporarily cause an upswing in all tax receipts for a short period of time but this should level off, and no particular adjustments of figures has been made for this situation.

#### Reconversion and Taxes

We do not agree with the Budget assumption that conversion from war production to the making of civilian goods in California will surpass the reconversion rate in the nation as a whole. This is for the reason that California, through conditions beyond our control, will be the center of intense war activity while other localities will have a lessening of such activity. Even after the war ends with Japan, we will have a condition of extraordinary activity in our ports—returning personnel and material, and in our shipyards in repairing and servicing ships engaged in this activity. In addition, our larger wartime industries have been connected with ship building and aircraft production. These industries cannot reconvert for they never engaged in any other activity. They must either reduce their activity to postwar aircraft and ship building, or use their excess plants and personnel in producing some commodity which they have never produced and have no organization to market. This condition will produce a greater degree of disturbance and unemployment than where actual reconversion is possible. This will cause, in California, a material reduction in purchasing and in tax

receipts from persons and businesses so drastically affected by ending of war production.

The estimates in the Budget have been made taking some note of these conditions and have adjusted revenue receipts accordingly. We believe, however, that in some places the estimates have been a little overly optimistic and in other places they have estimated changes more rapidly than they will take place.

We feel that whenever the adjustments of the postwar period are accomplished, the State will return to economic conditions and tax receipts that will parallel closely those of 1940. We believe that individual "take-home" income will suffer a material reduction at that time. We are not ready to predict that this will be markedly manifest during the coming biennium.

#### **Reconstruction and Reemployment Commission Estimates**

Like the fiscal officers of the State, we have examined critically the report prepared by the Reconstruction and Reemployment Commission on "Postwar Civilian Income," and we believe that the present basic wage rates will be maintained for the next two years. We believe, however, that there will be increasing unemployment amongst the women who are now working, the less skilled, the more elderly workers, and the less efficient. We already find this trend manifesting itself from about the beginning of 1944 continuously to the present date. In fact, the situation is presented in California Labor Statistical Bulletin No. 246 for January, 1945, page 2, in the following words. "Including force-account construction workers and administrative, supervisory, sales, technical, and office personnel, it is estimated that 971,000 persons were employed in manufacturing plants in California in January 1945. This compares with 983,000 in December 1944 and 1,125,000 in January 1944." This is a drop in factory employment of 154,000 in one year.

#### **Federal Activities Affect California Tax Receipts**

We also believe that the continuation of high Federal taxes will eventually have a measurable effect upon business and tax receipts to the State of California. We are also of the opinion that the withdrawal of the Federal Government from purchasing of many commodities in large amounts will have a material influence on California's specialty products. For example, a reduction in the purchase of canned fruits and vegetables will immediately produce surpluses in one canning season. The maximum production in such items as peaches for one season would immediately produce a surplus affecting this whole industry and a considerable area of the State. It is our thought that this condition will not develop until the war with Japan has closed. Also, there will probably be an accumulated backlog of commodities beginning with the ending of the war with Germany. Competition and reduced purchase of other more limited crops, such as olives, will probably be manifest earlier. While this will produce difficulties with individual groups, it will not be widespread enough to materially affect the total tax yield to the State.

#### **Tax Receipts 1944-45, 1945-46, 1946-47**

Our estimates of tax collections show approximately \$9,000,000 less receipts for the General Fund and approximately \$5,000,000 more for gasoline and motor transportation tax for the biennium 1945-47. There

are other differences from the Budget estimate of minor amounts. Some of these estimates cannot be based on any actual measurements but can only be based on certain assumptions drawn from business trends and a personal evaluation of the incidence of certain taxes. For example, the inheritance tax receipts depend entirely on the number of sizeable and taxable estates that are passed by inheritance. We feel that the Budget estimates are a little high in relation to this tax. We feel that the gas tax estimates are certainly minimum and that the trends are favorable for an upturn of sizeable proportions in receipts from this tax.

Following is a tabulation giving estimated tax collections as shown in the Budget for the three fiscal years, 1944-45, 1945-46, and 1946-47, and estimates made by the Legislative Auditor for the same taxes for these fiscal years.

ESTIMATED STATE OF CALIFORNIA TAX COLLECTIONS  
JULY 1, 1944 TO JUNE 30, 1947

	As shown in 1945-47 Budget			As estimated by Legislative Auditor		
	1944-45 Fiscal Year	1945-46 Fiscal Year	1946-47 Fiscal Year	1944-45 Fiscal Year	1945-46 Fiscal Year	1946-47 Fiscal Year
Inheritance tax	\$10,000,000	\$10,000,000	\$10,000,000	\$9,000,000	\$9,000,000	\$9,000,000
Insurance premium tax	11,654,250	12,922,500	12,995,000	11,600,000	12,000,000	11,500,000
Motor vehicle licenses	13,725,000	13,800,000	14,300,000	13,725,000	13,800,000	14,800,000
Gasoline tax	41,520,000	45,020,000	50,020,000	43,000,000	46,500,000	53,500,000
Motor transportation tax	6,200,000	5,100,000	3,900,000	6,200,000	5,200,000	4,600,000
Liquor taxes	17,075,000	15,725,000	14,325,000	18,000,000	16,000,000	15,000,000
Liquor licenses	6,250,000	6,275,000	6,475,000	6,250,000	6,275,000	6,475,000
Retail sales and use taxes	138,600,000	117,500,000	119,500,000	139,500,000	117,500,000	117,500,000
Race track taxes	4,196,575	none	6,939,000	4,196,575	2,500,000	4,000,000
Motor vehicle "in lieu tax"	14,250,000	15,500,000	17,500,000	14,250,000	14,500,000	15,500,000
Personal income tax	45,000,000	35,000,000	27,000,000	44,000,000	38,000,000	28,000,000
Corporation income tax	350,000	300,000	200,000	350,000	300,000	200,000
Diesel fuel tax	1,590,000	1,750,000	1,930,000	1,590,000	1,750,000	1,930,000
Private car tax	464,000	475,000	425,000	464,000	475,000	425,000
Gift tax	600,000	600,000	600,000	600,000	600,000	600,000
Regulatory taxes	1,353,900	1,418,300	1,344,300	1,353,900	1,418,300	1,344,300
Bank and corporation tax	57,000,000	53,000,000	43,000,000	57,000,000	52,000,000	40,000,000
<b>Total</b>	<b>\$269,828,725</b>	<b>\$234,385,800</b>	<b>\$230,453,300</b>	<b>\$271,079,475</b>	<b>\$237,818,300</b>	<b>\$224,374,300</b>

The total receipts for the taxes indicated for 1945, with only four months to run, are given in the Budget, as of the date that estimate was made, at \$269,828,725. Our estimates, some of which were made subsequent to the Budget estimates, place the figure at \$271,079,475. The Budget estimates for 1945-46 are placed at \$234,385,800. Our estimate for this fiscal year places the figure at \$237,818,300 or almost three and one-half million more. Budget estimates for 1946-47 are placed at \$230,453,300, while our estimate is \$224,374,300 or approximately \$6,000,000 less. Both of these estimates, as pointed out in the Budget, can be distinctly in error as economic changes occur either way which are not now contemplated.

#### **Difference in Tax Receipts Not Material for Budget Purposes**

For Budget purposes the difference in the two estimates, in so far as General Fund receipts are concerned, are relatively unimportant for the reason that there is no particular shortage of general funds. The same is relatively true as far as special funds are concerned, with one exception that if tax receipts available for the Department of Motor Vehicles are considerably greater than estimated, there will be no necessity of allocating funds to meet their Budget which will reduce allotments to counties for highway purposes. Also, *if receipts for highway purposes are larger than estimated, the Postwar Highway Reserve recommended by the Governor can be larger by the excess receipts above what were estimated in the Budget.* We have already recommended that the bill setting up these reserves be drawn so as to include all receipts above the amounts budgeted for expenditure.

We wish to point out that our differences in revenue estimates are not sufficiently large as to cause us to recommend to the Legislature any additional tax adjustments, either upward or downward, to meet the requirements of the Budget other than the reserve above mentioned.

#### **Tax Reduction Continuance Possible Only If Budget Not Materially Increased**

The continuance of the tax reduction enacted by the 1943 Legislature, which has saved the taxpayers of the State approximately \$115,000,000 for the current biennium, is possible for the biennium 1945-47 with an estimated saving of \$105,000,000 if the Governor's Budget is not materially exceeded. It cannot be continued if the Budget is materially increased, and still retain sufficient reserves for an ample safety margin if economic conditions are more unfavorable than are anticipated.

Tax reduction is not possible if the expenditure program of the State for the 1945-47 greatly exceeds the Budget as presented by the Governor by any one or a combination of four possible events listed below:

1. If all of the recommendations for expenditures made by the Governor are enacted into law, this will consume all of the available unbudgeted and unallocated reserves, and in addition to the pay roll tax of 3

per cent recommended by the Governor to support his health plan, it will still leave a deficit for the biennium approaching \$200,000,000, if we allow at the same time for setting up of the reserves recommended by the Governor. The Governor has recommended that \$119,651,490 of the surplus be allocated as reserves as follows:

a. Transfer to postwar employment reserves.....	\$ 40,000,000
b. To a new unemployment relief fund.....	50,000,000
c. For interest and redemption on certain general obligation bonds due between now and 1965.....	11,651,490
d. For a fire and earthquake reserve fund.....	3,000,000
e. For acquisition of beaches.....	15,000,000
	<hr/>
Total of additional reserves.....	\$119,651,490

2. If the Legislative appropriations that are already in bills before the Legislature for other items not recommended by the Governor are passed in major proportions, tax reduction is not possible and at the same time reserves recommended, and that appear desirable, are to be maintained.

3. A combination of the two above classes of appropriations will produce likewise an expenditure demand which cannot be met out of established reserves.

A fourth condition could likewise produce a deficit. This would be a distinct decline in economic conditions which does not appear to be likely.

We recommend that the tax reduction be continued, for we believe the Budget can be reduced materially without curtailing seriously any vital State services and, at the same time, still assist and encourage the war effort and maintain sufficient reserves. The degree to which the Legislature approves special appropriations will be the determining factor as to whether the continuance of tax reduction is possible or not. Our recommendation is made solely in considering the Budget and the Governor's recommendations for expenditures which, under our interpretation of the constitutional requirement for the Executive Budget, we feel should be considered as a part of the Budget. No consideration is given herein to other special appropriation measures.

CALIFORNIA STATE BUDGET—COMPARATIVE SUMMARY OF ESTIMATED REVENUES  
FOR THE BIENNIUMS 1945-1947 AND 1943-1945

(Source: California Taxpayers' Association, February, 1945)

Source	Total Revenues			Biennium 1945-1947		Biennium 1943-1945	
	Biennium 1945-1947	Biennium 1943-1945	Increase or decrease (—) from 1943-1945	General Fund	Special <sup>5</sup> and Reserve <sup>4</sup> Funds	General Fund	Special <sup>5</sup> and Reserve <sup>4</sup> Funds
<b>General Taxes</b>							
Retail Sales and Use Tax	\$237,000,000	\$275,109,180	—\$38,109,180	\$237,000,000	-----	\$220,087,344	\$55,021,836 <sup>1, 4</sup>
Bank and Corporation Franchise Tax <sup>3</sup>	96,500,000	124,797,115	—28,297,115	93,700,000	\$2,800,000 <sup>1, 4</sup>	111,740,837	13,056,278 <sup>1, 4</sup>
Personal Income Tax	62,000,000	93,360,394	—31,360,394	62,000,000	-----	93,360,394	-----
Inheritance Tax	20,000,000	19,761,538	238,462	20,000,000	-----	19,751,538	-----
Gift Tax	1,200,000	1,148,157	51,843	1,200,000	-----	1,148,157	-----
Insurance Gross Premiums Tax	25,700,000	20,829,566	4,870,434	25,700,000	-----	20,829,566	-----
<b>Alcoholic Beverage Taxes:</b>							
Excise Tax on Distilled Spirits	24,800,000	26,040,370	—1,240,370	24,800,000	-----	26,040,370	-----
Excise Tax on Beer and Wines	5,250,000	6,465,403	—1,215,403	5,250,000	-----	6,465,403	-----
Liquor Licenses	12,750,000	12,405,513	344,487	6,375,000	6,375,000 <sup>5</sup>	6,202,757	6,202,757 <sup>5</sup>
Motor Vehicle Transportation License Tax	9,000,000	11,912,485	—2,912,485	9,000,000	-----	11,912,485	-----
Motor Vehicle License (in Lieu) Fees	33,000,000	23,764,728	4,235,272	11,413,228	21,586,772 <sup>5</sup>	10,861,596	17,903,131 <sup>5</sup>
Private Car Tax	900,000	914,300	—14,300	900,000	-----	914,300	-----
<b>Totals—General Taxes</b>	<b>\$528,100,000</b>	<b>\$621,508,750</b>	<b>—\$93,408,750</b>	<b>\$497,338,228</b>	<b>\$30,761,772</b>	<b>\$529,324,748</b>	<b>\$92,184,002</b>
<b>Special Taxes</b>							
Motor Vehicle Fuel Tax	\$95,000,000	\$83,955,647	\$11,044,353	-----	\$95,000,000 <sup>5</sup>	-----	\$83,955,647 <sup>5</sup>
Use Fuel Tax	3,680,000	3,079,899	600,101	-----	3,680,000 <sup>5</sup>	-----	3,079,899 <sup>5</sup>
Motor Vehicle Registration Fees	28,100,000	27,850,608	249,392	-----	28,100,000 <sup>5</sup>	-----	27,850,608 <sup>5</sup>
Horse Racing (pari-mutuel) License Fees	6,939,000	6,568,967	370,033	\$1,382,000	5,556,200 <sup>5</sup>	1,384,785	5,184,183 <sup>5</sup>
<b>Totals—Special Taxes</b>	<b>\$133,719,000</b>	<b>\$121,455,122</b>	<b>\$12,263,878</b>	<b>\$1,382,800</b>	<b>\$132,336,200 <sup>5</sup></b>	<b>\$1,384,785</b>	<b>\$120,070,337 <sup>5</sup></b>
<b>Other Sources</b>							
Interest on Investments	\$4,819,000	\$2,173,110	\$2,745,890	\$4,513,000	\$406,000 <sup>4</sup>	\$1,816,870	\$356,240 <sup>2, 4</sup>
Interest on Treasury deposits in banks	355,000	330,424	24,576	355,000	-----	330,424	-----
Charges for care of inmates in State Institutions	6,467,900	5,830,091	637,809	6,467,900	-----	5,830,091	-----
<b>Oil and mineral royalties:</b>							
From State lands	8,345,000	6,888,378	1,456,622	2,371,500	5,973,500 <sup>5</sup>	1,965,000	4,923,378 <sup>5</sup>
From Federal lands, for Junior College Fund	1,500,000	1,955,189	—455,189	-----	1,500,000 <sup>5</sup>	-----	1,955,189 <sup>5</sup>
Interest, rentals, royalties, for School Fund	1,325,000	1,446,919	—121,919	-----	1,325,000 <sup>5</sup>	-----	1,446,919 <sup>5</sup>
Sundry departmental revenues	27,682,965	27,025,136	657,829	5,655,629	22,027,336 <sup>5</sup>	6,272,800	20,752,336 <sup>5</sup>
Miscellaneous	508,000	662,361	—154,361	508,000	-----	662,361	-----
<b>Totals—Other Sources</b>	<b>\$51,102,865</b>	<b>\$46,311,606</b>	<b>\$4,791,259</b>	<b>\$19,371,029</b>	<b>\$31,231,836</b>	<b>\$16,877,545</b>	<b>\$29,434,061</b>
<b>Grand Totals—Revenues</b>	<b>\$712,921,865</b>	<b>\$789,275,478</b>	<b>—\$76,353,613</b>	<b>\$518,592,057</b>	<b>\$194,329,808</b>	<b>\$547,587,078</b>	<b>\$241,688,400</b>

<sup>1</sup> Revenue earmarked for Postwar Employment Reserve.

<sup>2</sup> Revenue for the Bond Sinking Fund of 1943.

<sup>3</sup> Including Corporation Income Tax.

<sup>4</sup> Reserve Funds.

<sup>5</sup> Special Funds.

NOTE.—Figures rounded to nearest dollar; may not add.



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