

SECTION II

ANALYSIS OF THE GOVERNOR'S BUDGET MESSAGE 1947-48 FISCAL YEAR

Introduction

Following is an analysis of the Governor's Budget Message found on pages iii to ix, inclusive, of the 1947-48 Budget Document.

Budget Does Not Present Governor's Full Spending Program

In presenting this Budget the Governor states that it is in accordance with the Constitution and with the needs of the State, and it represents his estimate of expenditures for the fiscal year. We have already pointed out that in our opinion it does not comply completely with the constitutional provision requiring the Executive Budget for it does not include all of the recommendations that the Governor makes for state expenditures for the fiscal year; nor does it include the new taxes that he has recommended for the prepaid health program nor how the deficit on this, if any, will be made up or the tax source therefor; nor does it include all the expenditures provided by law which may be made under existing appropriations.

The Governor does not include in his Budget anything for expanding the highway construction program, although he has endorsed and recommended the same. The Budget does not include a large number of items which we have previously mentioned. We do wish to state, however, that the Budget and Appropriation Bill do include a great deal more than the current Budget. It is a distinct improvement in this respect.

Expenditure Program If All Expenditures Included

If all of the recommendations for state expenditures made by the Governor were included in the Budget, the entire budget picture would be changed as follows:

1. The total of the Budget would be much larger.
2. The final surplus would be much smaller and possibly a deficit would be shown—depending on how far the Governor recommends to go in the several items of expenditure and the diversion of taxes.
3. If recommendations for expenditures actually should be as large as has been estimated tax reduction is not possible. Increased taxes in addition to the pay roll tax for the health plan will have to be found to finance the highway program. At best there will be no net tax reduction, but only a tax shifting.
4. The fixed charges of the State will be materially increased, particularly through the establishment of the highway program.

5. Some departmental budgets will be found to be too small if the recommendations for added taxes and new services and new agencies of the State are established. For example, if 600 or 700 or 2,000 or more new state employees are to be employed to collect more taxes and build more highways, administer the health plan, set up a Division of Recreation, buy parks, expand labor relations, inspect and license all hospitals, expand service to veterans, etc., the Personnel Board will require more money and more personnel for their operations. The Employees' Retirement Board will likewise need more money and help—and more money will go into the Retirement Fund—the Controller and the Department of Finance will need more money for auditors, etc. More office space will be required at premium prices. So the pyramiding of costs goes on with each new service that is added, and existing services must be expanded.

This is almost a repetition of what we stated on pages 31 and 32, Item 5, of our previous report. When such expansions were proposed in the previous biennium, only a part of them were carried into effect, and yet the expansion predicted for the Personnel Board, the Employees' Retirement System, the Controller, the Department of Finance, and the Governor's Office itself has actually occurred during the current Biennium. Moreover, further expansion of these agencies beyond what is in the Budget will be required if these additional services, and expenditures recommended by the Governor, that are not included in the Budget, are made effective.

6. Such expansion at this time when there is still a shortage of skilled help and a shortage of materials, and high prices for building, will result in further competition with private enterprise. The State will be paying maximum prices for what it gets.
7. Tax reduction for the one year 1947-48 for General Fund purposes will be available even if these added expenditures are made effective, but it will require a much greater cutting into the surpluses than the Governor has recommended. Moreover, these surpluses will not then be available for expenditure in the future should there be a reduction in the State's income. Net tax reduction will not be possible but merely a shifting of taxes to levies on other values.
8. If these added expenditures are made and an enlarged expenditure program on the part of the State is established, the surplus which is estimated to be available June 30, 1948, will be materially reduced and possibly may fail to materialize at all.
9. The one certain result of the approval of these expenditures will be not only a proposed increase in taxes to support the enlarged highway program, which includes a diversion of approximately \$14,000,000 a year in taxes to highway purposes which now go to the General Fund, but also the imposition of a new tax to support the health plan, and within the near future added taxes to carry the State's increased obligations.

Some of the details listing these proposed expenditures not included in the Budget were presented in our introduction and will be further explained in subsequent parts of this report.

The Total Budget

The total Budget for the one Fiscal Year 1947-48 is stated by the Governor to be \$641,599,026. This he states is greater than the actual and estimated expenditures of the current Fiscal Year 1946-47 by \$153,741,225. Therefore the actual and estimated expenditures for the current fiscal year amount to \$487,857,801.

We are using these figures as found in Schedule I, page A-3 and throughout the Budget.

In our opinion these figures should be adjusted for certain large items included in the Budget and charged as expenditures for the current Fiscal Year 1946-47 which will not be spent until 1947-48. These items for capital outlay alone total \$10,000,000 in round figures so that the final total of the Budget for 1945-47 should be reduced \$10,000,000 to \$820,000,000 in round figures, that is, without considering possible additional adjustment and the addition of appropriations for this period made by this session of the Legislature. This adjustment will increase the total of the Budget for 1947-48 to \$651,000,000 in round figures for the one year.

The results of these adjustments will be to change the entire budget picture as presented by the Governor. It will change the percentages for the distribution of the Budget for the several classes of expenditure.

This \$10,000,000 amount is made up largely of capital outlay items, such as approximately \$400,000 for the Division of Beaches and Parks for residences; \$1,080,000 for Folsom Prison for new buildings; \$141,000 unallocated for the Lancaster School for Boys; over \$1,000,000 for various buildings at the California Polytechnic School; \$500,000 for the School for the Deaf at Berkeley; \$3,000,000 for the University of California and many other similar items of smaller amount.

The building situation is such and prices so excessive that it is not being realistic to say that these sums will be expended between now and June 30, 1947. This is exactly the same situation that we pointed out on page 31 of our report covering the Budget for 1945-47, and the final results turned out to be almost exactly as we then stated. It is our recommendation that where conditions are such that it is evident that items of expenditure of this sort which clearly cannot be made effective before the close of a budget period should be carried forward and allocated to the actual budget period when they will be spent.

Surplus Not Affected

These adjustments, which we suggest will actually occur when the expenditures are made, are inside of the Governor's Budget estimates. They therefore do not affect the estimated surplus as of June 30, 1948. Subsequently items will be presented which are actually appropriated in addition to the amount stated as the total of the Governor's Budget.

Expenditures for 1947-48 Will Greatly Exceed Budget

There is no doubt in our mind but that the actual expenditure for this Fiscal Year will greatly exceed the Budget estimates. It will exceed \$750,000,000 if all the recommendations for expenditure made by the Governor in his Budget and in his message to the Legislature are made effective.

We would like to support our conclusions that the actual expenditure program for the 1947-48 Fiscal Year will greatly exceed the Budget by reviewing the financial program of the State for the past two bienniums.

The Governor's Budget for 1943-45 as found in the Budget Document totaled \$463,947,005, which he then stated was approximately \$100,000,000 less than the expenditure for the prior Biennium 1939-41. However, the actual and estimated expenditures for 1943-45 as found on page A-3, Schedule I of the Budget for 1945-47 are placed at \$587,347,003, so that in place of there being a reduction of \$100,000,000 below the expenditures for 1939-41, it turned out that there was an excess of a little over \$23,000,000.

The Budget for 1945-47 as presented on page iii of the Budget is given as \$683,710,643. This the Governor stated was \$96,364,640 more than the actual and estimated expenditures for the previous biennium. The actual and estimated expenditures for the 1945-47 Biennium as shown on page A-3 of the Budget for 1947-48, however, amounted to \$830,032,450, or \$146,321,812 more than the Governor's Budget as presented to the Legislature.

Savings for 1946-47 Fiscal Year Possible

We do not agree that all of the amounts set up under actual and estimated expenditures for the Fiscal Year 1946-47 will be or should be expended.

We have already mentioned some \$10,000,000 that will not be spent. In our opinion many of the budget allotments for the several agencies and departments of the State should be reduced and definitely controlled for 1946-47 as the estimates of expenditures for the second year of the biennium are frequently just the balances remaining in appropriations for the several agencies.

An examination of these estimates and comparison with the actual expenditures for 1945-46, which are shown in the Budget in the next column to the left, will indicate without any other evidence the truth of our contention.

Open the Budget at random to any division showing operating expenses, and this is what is frequently found as we now discover by opening the Budget at random to page 225, Department of Education, Audio-Visual Education. Office expense actually spent 1945-46, \$351.25; estimated for 1946-47, \$850; proposed for 1947-48, \$800. Postage actually spent for 1945-46, \$179.06; estimated 1946-47, \$575; proposed 1947-48, \$500. We might turn to page 41 of the Budget dealing with the Secretary of State and look over operating expenses. The actual for office expense for 1945-46 was \$2,914.89; estimated for 1946-47, \$2,200; and proposed 1947-48, \$2,400, both a reduction below the actual expenditures. Telephone and telegraph was actually for 1945-46, \$2,074.23, estimated for

1946-47, \$1,800; proposed for 1947-48, \$2,200. Postage actually was for 1945-46, \$4,772.50; estimated for 1946-47, \$7,000; proposed for 1947-48, \$7,000. Photographic copying is actually for 1945-46, \$2,841.21; estimated 1946-47, \$6,000; proposed 1947-48, \$6,000.

In many instances where there has been an increase of personnel which will travel; adjustments have been made in travel allowances, and where specific reasons were presented, adjustments were made in the estimated 1946-47 expenditures and in the proposed for 1947-48. In innumerable cases specific adjustments were not made. We believe that these can be made and will be made by the Director of Finance in exercising budgetary control, and that from these regular operations of the agencies of the State a substantial saving can be made.

First Annual Budget

Where Are the Advantages and the Dangers?

As the Governor states in his message, this is the first California State Budget ever prepared on an annual basis. It is for this reason that it is essential that we orient ourselves in our thinking so as to remember that when we compare this Budget with prior Budgets that we are comparing with a Budget for two years. We should then in effect multiply this Budget by two. We find when we make such a comparison that this Budget of \$641,000,000 is only \$42,000,000 less than the previous Governor's Budget for a two-year period. Multiplying it by two makes a \$1,282,000,000 Budget for two years.

We should also remember that the revenue accruals in the past which have built up the surpluses and reserves were accumulated over a six-year period of time, and that budget estimates of revenue accruals for the future are based on a single year. They are not on a long-time basis.

In considering this Budget we should continually ask, "Where are the benefits which we were told would accrue from the Annual Budget?" Have closer and more accurate estimates of need been made with closer budgeting on the expenditure side? Or has the opposite occurred, with more liberality on the expenditure side for the reason that there is a closer estimate of revenue accruals? Are we not now budgeting expenditures right to the income? Should we not consider what we will have in the way of future income and relate this to future fixed expenditures which arise from any expenditure program adopted today on a short-time one-year appropriation?

First Peacetime Budget Continues Wartime Services

The Governor calls attention to the fact that this is the first peacetime Budget he has submitted. One he states which reflects the preparations made during the war for catching up with peacetime needs and reflects the services required by a population in excess of 9,000,000 people, as well as reflecting the "inflated dollar." These factors are certainly reflected in the Budget, but the Budget fails to recognize completely that we are on a peacetime basis but with revenues still inflated from wartime shortages.

The Budget goes much further than merely presenting the services required by a population in excess of 9,000,000 people. Although it is

claimed all of the services of government provided as wartime services have been eliminated, a considerable number of the expansions made in the state departments as a result of wartime expansion have been continued. Some of these have been continued on the argument that they never had enough money in peacetime, the departments and agencies being forgetful of the fact that they had more than the State could pay for from 1930 to 1941. Some of these services grew to be valuable to certain groups and are being continued in the Budget. For example, the wartime expansion of the Division of Forestry and of the Department of Industrial Relations, and certain activities of the Adult Authority, certain research functions of the Reconstruction and Remployment Commission are all continued. Other wartime services not continued in the Budget are being proposed in special bills, such as the continuance of child care centers, the agricultural employment service, and others. Wartime services of government, like emergency services in peace, have a habit of being continued forever. The only way to get rid of them is to cut off the appropriation.

The Budget includes not only ample allowance for expanded services due to population, but it also adds many new services and refinements of services already offered over and beyond what the State previously supplied.

The Cheapened Dollar

It is true that the Budget reflects inflation, both in revenue and expenditures, but it does not realistically consider the possibility of a deflated economy beginning sometime during the budget fiscal year. Deflation has followed the inflation of each major war in which we have been engaged from 1812 through the first world war. The Governor shows that he recognizes the possibility of this by urging in his Message that additional large amounts be added to the Postwar Building Reserve and that there be established a Revenue Deficiency Reserve of \$75,000,000, pointing out that a 20 percent decline in business activity would reduce state income by \$100,000,000 for the year. In this we concur and further add that such a decline in business activity would at the same time almost immediately present added charges on the State for relief and assistance over and beyond what was provided in this Budget. In fact already the Supervisor's Association have a definite proposal for the State to assume a large part of this cost.

State's Largest Budget

The Governor plainly states that for the reasons above mentioned this Budget provides for the largest expenditure in any year of the State's history. This is quite evident from the total. The Governor does not state that despite the rapid growth in population it also calls for the largest per capita expenditure for State Government.

However, we must recognize that a part of this proposed expenditure is to catch up with capital outlay which has been deferred during the war period and which, if proper adjustments were made, would be charged to prior fiscal years.

Reasons for Tremendous Increase in the Cost of State Government

The Governor gives the following reasons for the increase in the cost of State Government.

1. The growth of population requiring services for in excess of 9,000,000 people.
2. A Budget which reflects the preparations made during the war to catch up with peacetime needs.
3. A Budget reflecting the "inflated dollar."
4. A continued increase in Constitutional fixed charges and continuing appropriations.
5. Added costs resulting from war-induced changes in our economy.
6. Increases providing for the needs of veterans.
7. Budget provisions for accumulated demand for education at our State University and colleges.
8. The restoration of all essential peacetime services.
9. To keep pay scales on a parity with those of private and public employment and to meet increased cost of living.
10. An increase in the total payments made to local government.

Cost of Government Has Grown Much Faster Than Population

While the population of the State has grown much more rapidly than that of any other state in the Union, and this has had a decided effect upon the increase in the cost of State Government, population growth has in no way been comparable with the increase in the cost of government. A comparison of population growth with the increased cost of State Government not only shows there has been a startling up-swing in the cost of government, but, what is more significant, the per capita cost of State Government has increased more than twice as fast as population. If State Government expenditures only increased at the rate of population growth, it would have gone up only 56.9 percent from 1933-34 to 1947-48. The increase in the cost of State Government would have been \$110,524,754 and the cost for 1947-48 for the State would have been only \$304,768,610 in place of a Budget of \$641,599,026. In other words had the cost of government from 1933-34 to 1947-48 increased at the same rate as population, the Budget for the coming fiscal year would have been considerably less than half what the Budget actually is.

We have already pointed out that the actual expenditure program for 1947-48 will be much in excess of the Governor's Budget.

The table on the following page shows the increase in population and the increase in the cost of State Government for the period 1933-34 to 1947-1948, and reveals the following striking comparisons:

1. During this period the population of the State increased 56.9 percent, but state expenditures, including subventions to local government, increased 230.3 percent. At the same time, per capita expenditures for the State increased from \$32.29 for the year 1933-34 to \$67.97 for the budgeted year

1947-48 based on the Governor's Budget alone. This is an increase for the annual cost of State Government of \$447,355,170 or an increase of 110.5 percent on a per capita basis.

2. The appropriations made by the State for subventions to local government demonstrated the most startling increase in this period. These showed an increase of 251.0 percent, while the per capita expenditures of the State for all other purposes showed an increase of \$16.82 for 1933-34 to \$33.36 for 1947-48, or a per capita increase of only 98.3 percent.
3. The state expenditures actually made for state purposes alone show the smallest percentage of increase, amounting to 211.2 percent. The per capita costs for this purpose alone increased from \$16.82 for 1933-34 to \$33.36 as provided in the Budget for 1947-48, or an increase of 98.3 percent.

We wish to again point out that these comparisons are not entirely valid, for they are comparing the actual expenditures for the Fiscal Year 1933-34 with the budgeted items for 1947-48. We are well aware of the fact that the actual expenditures for 1947-48 will exceed the Budget unless the Legislature makes material reductions.

Increased Cost of State Government on Estimate That Cost for 1947-48 Will Exceed Budget by \$100,000,000

The second one-half of our table, Part B, makes the same comparisons as the first half, but it adds \$10,000,000 for expenditures for state purposes for 1947-48. In this comparison, the percentage in the per capita increase for subventions remains the same. A striking increase, therefore, occurs in the state expenditures for state purposes. The adjusted figures now show an increase in amount for the period for State purposes of 310.1 percent, while the per capita costs increase from \$16.82 to \$43.95, or an increase of 161.3 percent. We wish to emphasize that Part B of this table is added for the purpose of indicating what will happen should the Governor's Budget figure be exceeded by as much as \$100,000,000, and if this is all for strictly state purposes. There are, of course, bills in the Legislature which would increase the Budget by more than the \$100,000,000 assumption we have made.

It is clear from these figures that population growth cannot be given as the major cause for the tremendous increase in the cost of State Government. It is an important factor and contributes to the pyramiding costs of government, but the other reasons previously listed are the actual cause of the tremendous increase in the costs built upon an increased population base. The cost of government works like compound interest. Services once established, in a very minor way have the habit of mushrooming. Even emergency services become fixed and permanent. President Andrew Jackson's homely saying concerning federal employees, applies to governmental departments and agencies in general, "few die and none resign." It seems that almost every agency and activity of government has an organization supporting programs requiring further additional expenditures.

The tremendous increase in expenditures for our mental institutions is based on a continued desire to try to reach the standards set by the American Psychiatric Association. Increase of educational expenditures are based on trying to be rated in first place by the National Educational Association, which uses as an index, "the best schools are

those which spend the most money." Many other associations and organizations are working for increased expenditures for practically every activity of government.

In addition, as soon as local government finds it difficult to perform a service, or new services are demanded, the administrators thereof immediately look to the State to see if there are not some of these services they can shift to the State.

In the present Budget we have a further shifting of costs borne by local government to the State. The Governor recommends the further shifting of the cost of the care of tubercular patients. This one item requires an additional appropriation of \$1,550,000 for the one year. In the same connection, the Governor recommends a \$2,000,000 appropriation to assist local agencies in hospital construction, an entirely new service to local government.

The people by their vote on November 5, 1946, shifted further educational costs to the State in the sum of \$54,000,000 for the one year 1947-48.

The significance of the present situation of the State Budget is that coupled with the sudden population increase due to wartime growth and the establishment of new state expenditures based upon swollen wartime revenues, we are making a transition from a biennial to an annual budget, so that it is easy to see surpluses and flush revenues for one year sufficient to meet expenditures, but it is not easy to view the future and the possibility of declining revenues insufficient to meet the present standard of expenditures.

FISCAL TRENDS, STATE OF CALIFORNIA—1933-34 AND 1947-48 FISCAL YEARS
A. Comparison of Budgeted Expenditures for 1947-48 With Actual Expenditures for 1933-34

<i>Fiscal year</i>	<i>Estimated population</i>	<i>State expenditures and subventions to local government</i>		<i>State subventions to local government from state sources</i>		<i>State expenditures for state purposes</i>	
		<i>Amount</i>	<i>per capita</i>	<i>Amount</i>	<i>per capita</i>	<i>Amount</i>	<i>per capita</i>
1947-48 -----	9,440,000 *	\$641,599,026 ‡	\$67.97	\$326,672,857	\$34.60	\$314,926,169	\$33.36
1933-34 -----	6,015,000 †	194,243,856	32.29	93,068,856	15.47	101,175,000	16.82
INCREASE							
Amount -----	3,425,000	447,355,170	35.68	233,604,001	19.13	213,751,169	16.54
Percent -----	56.9	230.3	110.5	251.0	123.7	211.2	98.3

* Estimate for December 31, 1947, in Governor's Budget for 1947-48.

† California Taxpayers' Association estimate for July 1, 1934.

‡ Proposed and estimated expenditure figure given in Governor's Budget for 1947-48.

B. Comparison of Predicted Expenditures of \$100,000,000 in Excess of Budgeted Figure for 1947-48 With Actual Expenditures for 1933-34

<i>Fiscal year</i>	<i>Estimated population</i>	<i>State expenditures and subventions to local government</i>		<i>State subventions to local government from state sources</i>		<i>State expenditures for state purposes</i>	
		<i>Amount</i>	<i>per capita</i>	<i>Amount</i>	<i>per capita</i>	<i>Amount</i>	<i>per capita</i>
1947-48 -----	9,440,000 *	\$741,599,026 ‡	\$78.55	\$326,672,857	\$34.60	\$414,926,169	\$43.95
1933-34 -----	6,015,000 †	194,243,856	32.29	93,068,856	15.47	101,175,000	16.82
INCREASE							
Amount -----	3,425,000	547,355,170	46.26	233,604,001	19.13	313,751,169	27.13
Percent -----	56.9	281.7	143.2	251.0	123.6	310.1	161.3

* Estimate for December 31, 1947, in Governor's Budget for 1947-48.

† California Taxpayers' Association estimate for July 1, 1934.

‡ Predicted figure of actual expenditures based on knowledge the Budget fails to include all expenditure items.

Revenue Decline Predicted at End of War Not Yet Manifest

The drop in revenues, which it was predicted would follow the end of the war, has not yet occurred. This, however, is merely a postponement for eventually deflation will begin.

The Budget Committee consistently maintained that expenditures should be held down during the war, and the war effort furthered. This was accomplished in a large measure. The committee further held that expenditures for war agencies and services should be eliminated at the end of the war, and the surplus preserved to help meet the time of declining revenue and increasing cost of government brought about by reconversion. So far revenues have not declined, but some further inflation has taken place so that the State is collecting more dollars, but in turn due to inflation has had to increase salaries and pay higher prices for commodities. This condition cannot continue when our production greatly exceeds our effective demands. It is recognized that our potential production is far in excess of our ability to purchase.

Increased Costs State Government Not Justified Merely Because War Ended

The Budget Committee has also held that a large increase in the cost of State Government need not necessarily follow merely because the war ended. The committee proposed that each additional position considered for the state pay roll, and each new expenditure, should have to be justified of itself. There should not be the restoration of a position of service merely because of the fact it existed prior to the war. A provision was written into the Budget Bill for the current biennium providing a salary restoration fund on this basis, which could not be transferred for positions except on specific approval of the Department of Finance and on proper showing. This operated successfully and resulted in substantial savings. A similar provision could very well be included in the Budget Bill for 1947-48 covering all new positions.

Majority of People Have Not Demanded Increase in Government

There has been some demand on the part of the people for additional governmental services following the closing of the war. These demands generally, however, have been promoted by interested groups and in the past two years primarily by the state departments concerned. Seldom are such demands supported by the majority of the people.

Costs of Government Up With Rise in Living Costs

One reason given by the Governor for the increase in the cost of State Government, that of the continuous increase in the cost of living, deserves some explanation. Increases have occurred due to inflation resulting from the war activity and inflation subsequent to the war. Some increase in the cost of living occurred suddenly and for a short period of time resulting from the decontrol of prices. These increases have largely been adjusted. It does not appear to us to be valid to hold that there will be a material increase in the Budget for 1947-48 over 1946-47 due to the continued increase in the cost of living. That increase

occurred in the current biennium. Costs may continue on the same high plane for a time, but in our mind even this is doubtful. We believe such costs will show a material drop during 1947-48.

State Government Has Assumed Local Government Functions

We have already indicated some of the costs of local government that the State has assumed and which are included in the Budget.

The Budget Message shows that there has been a 35 percent increase in the total payments to local government included in the Budget for the one year. These amount to \$326,672,857, or 50.9 percent of the Governor's figure for the total Budget. The Budget Message for the 1945-47 Budget stated that the total payments to local government amounted to \$416,885,916 for the full two years. This was 61 percent of the state expenditures as budgeted.

The following schedule shows the increase in such payments by the State for five bienniums 1905-07 to 1945-47 and what the payments would have been for the biennium 1947-49 at just twice the amount in the Budget for 1947-48:

PAYMENTS AND GRANTS TO LOCAL GOVERNMENTS

1905-1907-----	\$11,976,062
1915-1917-----	18,685,475
1925-1927-----	74,589,404
1935-1937-----	211,312,917
1945-1947-----	416,885,916 ¹
1947-1948-----	326,672,857 ²
1947-1949-----	653,345,714 ³

¹ This includes the extra \$10 per month for the aged, voted in 1943, and is incorrectly included as a continuing appropriation. The 1943 law specifically provided for two years only. The Budget on page 786 indicates this. The inclusion of this results in an overstatement of fixed charges by \$30,901,650. The amended total of fixed charges would be \$455,090,940 or 66.2 percent of the Budget instead of \$485,792,590 or 71 percent as indicated in the Budget.

² One year.

³ If on biennium.

We believe that this is the most significant reason for the increased cost of State Government.

The two largest amounts included in the payments to local government in the 1947-48 Budget are for the public schools in the sum of \$171,145,167 and \$59,169,300 for the care of the needy aged, blind and children. This social welfare item for the categorical items shows an increase of \$6,150,425 over the current fiscal year. Most of this has been brought about by the increase in the need to the needy aged. The needy aged roll now stands at 166,988 and is increasing at the rate of approximately 400 per month. The number of applications filed in January, 1947, has been the largest since the law was enacted.

Increase in Fixed Charges for Schools

The largest item assumed by the State has been the added cost for schools. In 1933 the State took over a continually increasing cost starting at \$80,000,000 for the first biennium for elementary schools. No. 9 on the ballot in November, 1944, further increased fixed obligations for the support of education by \$33,000,000 for the 1945-47 Biennium. No. 3 on the November 5, 1946 ballot, added \$54,000,000 for school support for

the year 1947-48. This amount will be doubled in some eight years due to the population increase in our schools.

The Budget Message illustrates the increase in the payments to local government by stating that one of the major increases in the Budget is that amounting to \$85,016,661 in the payments to local government, including the \$53,423,000 increase for public schools adopted by the voters as an initiative measure in November, 1946.

Aid for Needy Aged

The State increased its support of the needy aged in 1943 following the recommendation of the Governor, first on a wartime basis and then by action of the Legislature in January, 1945, on a permanent basis. The State assumed the obligation to pay all but \$5 per month of the \$30 which the State and county had formerly shared.

Streets and Highways

The next great increase is in the subventions to local government for streets and highways. From a small beginning this has grown until now some counties levy no local taxes for highways and state subventions are a major source of revenues for both counties and cities.

Tuberculosis Subsidies

There is included in the total of payments to local government \$1,550,000 to cover an increase in state subsidies for the treatment of tuberculosis under a new schedule recommended by the Governor previously explained. This is Item 332 in the Budget Bill. There is also included \$2,000,000 for the assistance to local agencies in the construction of hospitals which is Item 334 in the Budget Bill.

The first is an additional assistance to local government for care of the tubercular, over and beyond the increased assistance voted at the last session of the Legislature which doubled the State's obligation. The determination as to whether or not the State will assume this added burden is purely one of legislative policy.

The Governor does not give specific reasons for this increase, nor does he indicate that this is a definite and specific procedure as part of a well worked-out plan for the eradication of human tuberculosis to the point where it is no longer a menace and it can be easily and readily controlled by the local health authorities. When this goal is reached, the State can practically withdraw from this activity.

The Director of the Department of Public Health of the State of California was asked by the Legislative Auditor before the Ways and Means Committee when the present Biennial Budget was being considered, if such a plan was feasible for human tuberculosis as was carried out in relation to bovine tuberculosis, a program which was set up in 1931 when revenues were exceedingly short. He replied that he believed such a plan feasible.

In this program it was planned to endeavor to eradicate bovine tuberculosis from the State so as to establish what is considered a 100 percent tuberculosis free area by the close of the Fiscal Year 1941. The cost was to be paid jointly by the State, Federal Government, and the

owners of animals having bovine tuberculosis. The plan proved to be successful, and the Governor in his message to the Legislature in 1941 announced that the State of California was a 100 percent bovine tuberculosis free area.

The Director of Public Health of the State pointed out in 1945 that some states in the Union had undertaken a similar program in relation to human tuberculosis and had achieved comparable results.

It is our recommendation that in considering Item 332 in the Appropriation Bill increasing the subsidy for tuberculosis care that the Legislature consider what will be necessary on the part of the State and local government to institute a plan for the accomplishment of the same ends for human tuberculosis in California and its subsequent control, and that the Legislature appropriate enough money to definitely start this plan and carry it forward for the Fiscal Year 1947-48. It is recommended that this appropriation item be amended in accordance with this plan, and if necessary, appropriations for other items of less importance to the welfare of the people of the State be reduced accordingly.

It is clear that the Governor's suggestion of merely allocating additional funds to local government on the basis of bed patients does not comprehend carrying into effect a plan for the practical eradication of and the ultimate control of human tuberculosis in the State of California.

Subsidy for Local Hospital Construction

The \$2,000,000 appropriation by the State for use by local government in matching federal grants for hospital construction is also purely a matter of legislative determination. It is a new item of assistance to local government. It comes from the State at the same time that the Federal Government is assisting local communities with grants for hospitals. The proposal does not provide in itself an equitable method of assisting local communities with hospital construction. This is for the reason that some communities have at their own expense provided adequate hospital facilities. They have taxed themselves to do so, and in some instances are still paying on bonds. Other communities have not assumed such a financial burden, or at least not to the same degree, and in many such instances they lack adequate hospital facilities. To provide at the expense of the State for districts that are financially capable of helping themselves, but who have not done so though levy of a tax which will be paid by all the people including those taxpayers who have already been taxed for facilities they have provided, is certainly inequitable. The person who has assumed such a burden is taxed for the benefit of the person who has avoided it. We believe this should be taken into account in considering the limitation placed upon this appropriation so that, if it is approved, it will be distributed so as to produce an equity in relation to the tax burden.

There are those who will contend that these payments to local government are not all subventions for the performance of functions of county, city and district governments. Some will contend vigorously that they are for state services which local government performs as an agency. For comparative purposes, however and to be consistent, we are following the old terminology.

Page A-11, Schedule IIb of the Budget shows the comparative summary of estimated and proposed expenditures for 1946-47 and 1947-48 Fiscal Years under the head "Payments to Local Government." The total State Government expenditures for state purposes is \$314,926,169, while payments to local government amount to \$326,672,857. In other words payments to local government are still 50.9 percent of the total Budget. In order to show for what purposes these payments are made, we present the following schedule of items:

Public Schools:

- Elementary Schools;
- High Schools;
- District Junior Colleges;
- Vocational Education;
- Contribution to Teachers' Retirement System;
- Free Textbooks.

Social Welfare and Public Health:

- Aid to Needy Aged;
- Aid to Needy Blind;
- Aid to Needy Children;
- Subsidies to Tuberculosis Sanatoria.

Highways and Streets:

- Apportionments to Counties for County Roads;
- Plans and Rights of Way for Postwar County Highway Construction;
- Allocation to Cities for City Streets.

Other Purposes:

- Salaries of Superior Court Judges;
- Apportionment to County Agricultural Fairs;
- Apportionment of Liquor License Fees;
- Apportionment of Motor Vehicle License Fees (in lieu tax).

Education

There are those who will argue that public education, since it is provided for in the Constitution, is a state and not a local responsibility. The expenditures for the public schools, however, are controlled and made by local government, and the State, up to the present time, although largely supporting these financially, has not even the authority to make a complete audit to determine if the State is contributing the proper sum of money or more than is required, or if the State is receiving full value for money expended.

Free Textbooks

The free textbooks supplied in California are printed in the State Printing Plant and are paid for out of a revolving fund. The revolving fund is reimbursed by an appropriation out of the State Treasury. The employees are all state employees and working under Civil Service Law. The texts are selected by a state agency, the paper is bought by a state agency. What is to be printed is determined by a state agency. It appears

that those who contend that this is not a subvention to local government but rather a state activity, have strong arguments to support this contention.

Teachers' Retirement

Now that the State matches the teachers' retirement payments, and has assumed the obligation of meeting the deficit in the retirement plan, and no longer is the State free from all obligation other than the contribution of 5 percent of the revenue from the inheritance tax, there is a question whether this is now a subvention or a state governmental obligation.

Aid to Needy Aged

There is also a question as to whether the aid to the needy aged can any longer be considered a county obligation rather than that of the State. The State holds the final decision as to whether a recipient will be paid and determines how much, and the counties claim that they have little or no discretion in the matter.

Salaries of Superior Court Judges

Under other subventions are included three items which have already been seriously questioned as to whether they constitute a subsidy to local government. The first is the salaries of superior court judges. These courts are considered in every respect state courts. While the judges are elected by counties, a set part of their annual salaries is paid by the State. The judges are transferred from one court to another at the direction of the State Judicial Council. The Judges' Retirement System is supported by the State, on a matching basis, and is managed by the State.

Liquor Licenses

The apportionment of liquor license fees to local government is supposedly for the purpose of law enforcement in relation to the liquor business. The license is collected by the State. The costs of enforcement results from the liquor business which the State licenses. Local government urges that this allocation is only to assist them in enforcing the law which is entirely a state law. The local communities are now urging that all of the liquor licenses be turned over to local government and become a part of their revenue. Bills have been introduced in the Legislature for that purpose.

Motor Vehicle License Fee

The apportionment of the motor vehicle license fee is open to more serious question for this license fee is an "in lieu" tax levied by the State through the Department of Motor Vehicles in lieu of the old personal property tax on automobiles which was a source of revenue for local government. The taxation of motor vehicles was taken over by the State because of the possibility of more equitable enforcement and more economy in the collection of the tax. It is now proposed that this fee or tax will be transferred entirely to local government. If this is done, there

will be diverted from the General Fund some \$6,269,000 a year in revenue. This has the recommendations of two legislative tax committees and bills are in the Legislature to make it effective.

Increase in the Budget to Catch Up With Peacetime Needs

It is true that a very large amount in the Budget for 1947-48 is represented in expenditures to catch up with peacetime needs. As far as this covers capital outlay alone, we concur with the Governor's statement. Where it includes an expansion of services we cannot agree in the majority of instances.

There is included in the Budget but not in the Appropriation Bill for 1947-48, a capital outlay expenditure in the sum of \$144,089,629. This is an increase of \$39,588,000 over the actual and estimated for 1946-47 of \$104,501,433. Practically all of this is from earmarked funds for postwar construction and, therefore, does not appear in the Appropriation Bill. There is, however, an item in the Appropriation Bill, Section 4, appropriating \$128,446,250 from the General Fund to the Postwar Employment Reserve Fund, to augment the appropriation made in Section 6 of Chapter 145, Statutes of 1946. This is in the nature of a transfer, and it is not set up in the Budget for expenditures during the coming fiscal year with the exception of \$1,000,000 for armories. It is clearly an appropriation and it can be spent.

Capital Outlay 1946-47 Will Not Be Spent

We wish to point out that the actual and estimated total of capital outlay for 1946-47 is given on the above referred to page of the Budget at \$104,501,433. We have previously pointed out that in our opinion a large part of this cannot and will not be expended in the fiscal year ending June 30, 1947. Whatever is not expended will reduce the actual and estimated expenditure for this fiscal year, and it will be carried forward to 1947-48 and will go toward increasing the Budget and the expenditure program for the Fiscal Year 1947-48. Since the present price of building, as stated in the Governor's Budget and also by the State Architect, reaches an index number of 500, based on 100 at 1913, it does not appear to be good business for the State to build anything other than that which is called for by the gravest emergency. The State should not spend any of this money for capital outlay during the remaining part of the present Fiscal Year 1946-47, or for the budgeted year 1947-48. At the present inflated prices and the present exorbitant costs the State will only get from one-third to one-half of what it would get for the same money at prewar prices. It appears that the prudent business man would not make such an expenditure if he could avoid it. The State has even more reason to avoid making such expenditures, for not only will it secure less for the taxpayer for the money expended, but the State will, at the same time, compete for materials and labor with private enterprise and industry, which in building and expanding, will itself give rise to employment and a place for workers to be employed in the future. It is also desirable for the State to consider conserving these building funds and to delay building where possible, and use this as a backlog for providing work and relief when and if unemployment conditions might develop.

Controllable Expenditures for the State Government

It is stated in the Budget that the total amount expended for State Government, including both fixed and controllable charges, is only \$314,926,169. This is 49.1 percent of the total Budget as given by the Governor of \$641,599,026.

CURRENT OPERATING EXPENSE OF THE STATE

The current operating expense of the State for the one year 1947-48 is provided by an allotment of \$161,688,344. This is only 25.2 percent of the Governor's stated amount of the Budget of \$641,599,026. In other words, the State of California could operate for a full year on \$161,688,344, or a per capita cost of \$17.12. Therefore, the operating costs of the State are not particularly burdensome. The real burden of State Government comes from providing these many other services.

Operating Expense Increase

The Governor lists as one of the larger increases in the cost of State Government, a \$27,863,867 increase in the operating expense. He states this is "brought about by higher costs and resumption of normal peacetime activities, expanded services necessitated by increased population and the necessary replacement of worn out equipment which has heretofore been unobtainable." We concur that there have been expanded services necessitated by increased population. There has also arisen the necessity of replacing some worn out equipment, also, certain normal peacetime activities suspended during the war should be resumed. However, this is supposedly balanced off to a degree by the elimination of the Farm Production Council, the Reconstruction and Reemployment Council, wartime activities by the Division of Forestry, wartime activities in the Bureau of Criminal Identification, Department of Social Welfare, Department of Public Health, Division of Highways, Department of Education, Department of Agriculture, Department of Motor Vehicles and in almost every other department of the State Government. This increase mentioned is over and above all of the savings that have accrued through the reduction of wartime activities.

Worn out equipment has had to be replaced and at higher costs and much of that has been allocated to the current biennium. Also there has been some saving through buying war surplus material. See report of this activity in the Department of Finance.

In the matter of higher costs, we do not agree that there will be average replacement costs for commodities for the Fiscal Year 1947-48 higher than exists at the present time. We believe that there will be a decided recession in many costs. In fact already there are downward adjustments in many items which the State buys.

Added Services of Government

Furthermore, an examination of the Governor's Budget in detail will show that a portion of increase in operating expense represented in this \$27,863,867 increase for one year is brought about by expansion of services and new services which appear for the first time in this Budget.

These expansions of service and new services appear throughout the Budget. They are made up of both large and small items.

Amongst the larger items is the replacement of the State Guard by the National Guard. This is not merely on the basis of a comparable force or limited even to the size of the National Guard in the prewar period, but rather it is being established on an expanded basis approaching what the Federal Government desires as part of the program of national defense.

Likewise, in the Department of Mental Hygiene, the department's requests were made on the basis of improving services to try to reach the standard of excellence set by the American Psychiatric Society. No analysis was made of just where the best results could be secured and where the greatest efficiencies lay. More of everything seemed to be the approach by the Department.

Expansion by the Division of Forestry to include new services rather than an expansion of old services, including some services never previously considered by the Legislature, added materially to their budget rather than increases due to rising costs for old services.

Considering some of the smaller increases due to new services, we find, for example, for the Judicial Council a requested increase in staff from 8 to 12. This expands the research by 50 percent in one year. In the Governor's office we find that the staff has been increased during the current fiscal year by nine persons, giving the Governor a Research Division, although he has at his command the research services of every department. We find now a Research Secretary, a Research Unit Secretary and a Governor's Council Secretary. The War Council ended in 1946 and in that year spent \$15,733. The Disaster Council took over part of its functions spending \$11,632 in 1945-46. It is budgeted for \$7,350 in 1947-48. The Personnel Board asked for additional money to carry on the added load due to reconversion and boosted operating expenses from \$595,000 for 1945-46 to \$919,000 for 1946-47, and has been budgeted for \$1,129,000 for 1947-48.

The Department of Corrections, Mental Hygiene and the institutions under the Department of Education not only show a large dollar increase, but they also show a relatively large per inmate or per capita increase in costs. On the other hand the University of California shows a decrease per student cost with increased enrollment. The increases in the institutions under the Department of Mental Hygiene and Corrections are not due solely to population increase, for if this were so, there would be a reduction per inmate cost. However, the institutions are showing an increase in the per inmate cost for the reason that they are providing new and expanded services.

Distribution of the Budget Dollar

The Governor points out that the largest expenditure proposed in the Budget is for educational purposes. Over 36 cents of each dollar budgeted will be for the support of education. This percentage will move downward if the enlarged highway program is approved.

Some 19 cents of each budgeted dollar is allocated to roads, streets, highways and motor vehicle regulation. This 19 cents will be materially increased if the enlarged highway program is expanded as approved by the Governor.

We wish to call attention to the fact that expenditures for these two purposes, education and highways, make up more than one-half the Budget, in fact 55 percent of the entire State Budget. Only 17 cents of each dollar of expenditures is allocated for what we would call the normal management functions of government. This includes the support of the Legislature, the Governor, the Controller, the State Treasurer, the Secretary of State, the Courts, the Adjutant General and most of the departments whose heads are appointed by the Governor and that have to do with regulation of the State Government itself, such as the Director of Finance, the several divisions of financial institutions, etc. These activities have not in general shown as rapid an increase as have the other expenditure items.

Uncontrollable Items of Expenditure

The Budget states that a major portion of the Budget is made up of fixed charges and continuing appropriations required by the provisions of the Constitution and existing statutes. It is stated these items total \$373,138,372, an increase of \$57,858,826 or an 18 percent increase over the current year. These fixed charges include school support, and support of the categorical aids including the needy blind, needy aged, needy children and orphans. These fixed charges as defined by the Governor, amount to 58 percent of the entire Budget. It is interesting to note in the Budget for the Biennium 1945-47 that such items amounted to 71.05 percent of the Governor's Budget so that the relative position appears to be much better in this Budget, the uncontrollable items having dropped down to 58 percent. The truth of the matter is that the total fixed charges have not shown an actual decline, but have had a material increase as we have indicated. On the other hand, the controllable items have increased faster than the uncontrollable, despite the fact that in educational alone, No. 3 on the last election ballot, added over \$53,000,000 increase in fixed charges.

A large part of this changed situation results from the very large allotment for capital outlay which, of course, is controllable by the Legislature. On the face of it, it appears as if the Governor and the Legislature now can control a much larger percentage of the State Budget. Based on the figures, it is true that some 13 percent more of this Budget falls in the category of controllable expenditures under the Governor's definition than for the current Budget. Some of the items which make up this change are new and are distinctly controllable by the Legislature. In fact the Legislature has never acted on some of them, and should very definitely consider them before the services are made an obligation of the State.

The use of the term "uncontrollable" or fixed charges and continuing appropriations is not quite accurate. All of these matters are controllable either by the people through constitutional amendment or by the Legislature. It is true that some of them are provided by the Constitution and can only be altered by constitutional change. However, all the items represented in continuing legislation are subject to control by the Legislature. It seems clear that some of them definitely should be controlled. Many of them can be controlled merely by including the items in the Appropriation Bill as has been suggested before. For

example, a full control of the expenditures of the Division of Highways can be made by merely setting up the appropriation and the controls and limitations in the Budget Bill.

Legislature Can Control Some Expenditures Called Constitutional

We do not concede that the Legislature cannot control any of the expenditures that are set up by constitutional requirement. In fact we pointed out in our prior report, and we wish to reiterate here that the Legislature can provide many controls for the money spent for schools. The Legislature can say definitely how this money will be allocated within the limits of the Constitution. It can define average daily attendance, the number of hours of instruction, the subjects to be taught, define the results to be secured and can certainly determine whether or not the money is being spent as the Legislature intended. Frequently there is distributed for school purposes more money than the Constitution calls for, and certainly there has never been a distribution of less than this amount. In our prior report we went into this matter quite thoroughly, and since the same procedure and principles apply, we will merely make reference to pages 42 to 46 in that report.

Continuing Appropriations by Statutes

The Governor gives as the second group of uncontrollable items those consisting of continuing appropriations by statutes. We have stated that all of these can actually be controlled by the Legislature, but they have not been for many years. There are practical limitations in setting up such controls, but to do so undoubtedly would produce large economies and more careful planning and spending. If these agencies supported by continued appropriations had to budget annually their proposed expenditures as do other departments of the State, and if they had to justify all of these expenditures, more government for the money would result. It is true some of them are budgeted, but they do not have a review by the Legislature and do not have to balance up bare necessities with that of some other department. In fact an examination of their expenditures will in many instances show a greater liberality and greater looseness than in those appropriations considered specifically by the Legislature.

There are a number of continuing appropriations which have existed over a long period of years and the law concerning them has been so modified, or the appropriations made by the Appropriation Bill have been made to control, or these appropriations are so small a percentage of the total appropriation required, that there seems to be no real reason for allowing these continuing appropriations to remain in the statute books. It appears to be more logical to have these appropriations in their entirety appear in the Annual Budget.

The Legislative Auditor, on instructions from the Budget Committee, has prepared a number of bills to eliminate such continuing appropriations. Such elimination will improve the procedure of budgeting and will place all of the requirements for the department or agency in the items that appear in the Appropriation Bill. It will eliminate small divisions in the Budget. It will eliminate certain accounts in the offices of the Controller and Director of Finance. It will eliminate some

accounting in the agency itself. It will improve in general, in a small way, financial procedure.

It is our recommendation that further progress be made in this respect, in better budgetary control, and in particular, that more control of the purse strings by the Legislature be reestablished.

Legislative Control of Expenditures Recommended

We have recommended in Part 1 that the Legislature exercise a much greater control over a number of items that are included as uncontrollable in the Governor's Budget. In particular, we recommend that the Legislature provide for direct control of highway expenditures. We further recommend that in making effective the distribution of funds to the public schools and carrying into effect the will of the people as expressed in the initiative Constitutional Amendment No. 3 on the November 5, 1946, ballot, that a direct and understandable method of appropriating this money be enacted. An effective equalization plan should be provided, and all of this can be done within the amount of money required by the Constitution and without automatically appropriating an excess. This can be accomplished now without hardship to any school district since under this amendment the public school system will receive an increase of approximately \$53,000,000 for the one year.

Equalization of Educational Opportunity

The general welfare of the State calls for a full equalization of educational opportunity. The Legislature is the only body that can provide for the distribution of this money to accomplish this purpose. To keep this program current, it seems desirable that the results secured should be reviewed by the Legislature annually.

Auditing of School Expenditures Recommended

We again recommend that the State audit the expenditure of all state money allotted for education, particularly on the basis of average daily attendance. The State should determine if these allotments are all made as required by law and that they are equitable and based on reliable figures.

It is clear that such audits of educational expenditures should be made by a body independent of the Department of Education and of the spending party, the administrators of education, so as to determine impartially if allocations made were proper and if this money was spent according to law.

Such audits will save the State Treasury many hundreds of thousands of dollars and will guarantee to the school districts of the State a more equitable distribution of funds.

The audit of expenditures for vocational education and amounts subvented to local government for education appears to be particularly necessary.

An independent audit by the State would have prevented the irregularities which have recently been disclosed at the Grant Union High School.

Major Budget Increases

Education

The Governor's Budget Message on page v states that the appropriation for education shows the greatest budget increase. The total recommended in the Budget amounts to \$234,570,996, or an increase of \$83,872,253. Of this increase \$58,207,645 is represented in payments to local government, while capital outlay comprises \$35,164,304, or an increase of \$21,198,906.

While this increase in expenditures for education is very large, some of the increase is due to the exceptional demands for the education of veterans. It appears that this unusual demand will continue for several years. In our opinion, however, it will level off somewhat immediately following the close of the Budget Year 1948.

Increased Educational Costs for Universities, Colleges and Junior Colleges

The Budget makes provision for enrollment of 40,575 for the State University. This is an increase of more than 30,000 over the minimum wartime enrollment of 10,211 and an increase of more than 14,000 over the highest prewar enrollment of 26,162.

The budget of the University reflects this increase. Reference to this budget will indicate that there has been a remarkable and realistic drop in the per student cost for education by the University. This is reflected in the budget of the University which shows more improvement in its preparation than any other budget considered. The improvement resulted in one of the best supported budgets for requesting appropriations.

Veterans in University

The major increase in enrollment is not only due to an increase in population but reflects the wartime accumulation resulting from the withdrawal of our soldiers from schools with consequent decline in wartime registration which is now being caught up.

It appears from a study made in other parts of the United States, entitled "An Analysis of the Need for Facilities to Provide Adequate Higher Educational Opportunities for Veterans and Graduates of Secondary Schools," that this demand may show some further increase for the next two or three years and then a rather rapid decrease. See Charts No. 8, page 25, and No. 14, page 37, in the above publication by Dean C. E. Partch of the School of Education, Rutgers University, published July, 1946.

The total number of veterans in training July 1, 1946, has already reached 1,024,281 in the United States which greatly accelerated the rate previously predicted. California has experienced a higher percentage of veterans seeking a university education than other states, so that the peak will probably be reached earlier and the consequent decline come earlier. We must, however, figure on expenditures to care for this increased enrollment for at least 1948-49 and possibly through 1950.

State Colleges

A similar increase in enrollment in state colleges was experienced. This Budget places the enrollment at 16,040 as against the highest prewar total of 9,493. This is up from a wartime low of 3,667.

A similar situation exists in the junior colleges with allowance for average daily attendance of 58,740, an increase from the wartime low of 23,817. We can expect these enrollments to continue to increase approximately parallel with that of the state universities for at least two years.

The state colleges, like the University, show a decline in the per student cost for education from the wartime high. However, they change the trend and show increases except for one college for 1947-48. While this reduction is not as great in percent from the wartime high, it is realistic, based on the fact that their per student costs were already relatively lower. We feel this decline in per student costs with further enrollment should be continued.

The State does not enjoy any benefit from the same reduction in the junior colleges per student cost, for due to the often mentioned Amendment No. 3 on the 1946 ballot, the required appropriation for junior colleges was increased on the average daily attendance basis to \$120 as the State's share. With an increased enrollment in the already established junior colleges, it should have been possible in a great many of them to materially reduce the per student cost with an increase in the size of classes and other units of service.

Highway Maintenance and Construction

The Governor states in his Budget Message in regard to highways the following, "also recommended is the fullest use of all existing funds available for highway maintenance and construction * * *."

We presume from this that the program subsequently found in the Budget on pages 869 to 885 was prepared in conformity with the Governor's instructions.

This contains more detail than has appeared in prior budgets and is a decided improvement. However, this Budget has no effect at law and the allocation for projects set up therein can be changed or abandoned at any time by the Highway Commission. In fact, subsequent to the preparation of this schedule the Highway Commission amended the program January 22, 1947, by adding \$3,500,000 to the expenditure schedule for the 1946-47 Fiscal Year.

This was due to the accrual of revenues beyond what they anticipated. This is consistent with their previous practice of underestimating revenues and actually enjoying more funds than they included in the Budget. Our report for the current Biennial Budget on page 51 states the following:

HIGHWAY REVENUE UNDERESTIMATED

"In our opinion the Department of Finance has underestimated these revenues by at least \$5,000,000. The Division of Highways has made an estimate of revenue and gets an even smaller amount. We believe that the revenues from these sources available to the Division of Highways for the next biennium will be at least \$77,650,000. Page 713 shows that the total of the so-called postwar

reserve and estimated revenues will be \$109,366,843. We believe that this will be at least \$5,000,000 more or \$114,366,843.

The next division sets up the proposed expenditures for 1945-47 under the different categories, including the grants to local government. The total is placed at \$69,366,843. This is the amount that the Administration has agreed can be effectively spent during the next biennium under the budget conditions assumed. It is all that is proposed to be spent according to the Governor's Budget. The remaining amount, or the excess over this sum above stated, is an even \$40,000,000. This is found under the fourth division as the estimated surplus to June 30, 1947. This is taken out of the Governor's Budget total, although it is automatically appropriated by law and it is labeled "Estimated Reserve for Postwar State Highway Construction." It is divided into two parts, "Reconditioning, resurfacing, and construction of roads and bridges, State highways, \$34,000,000, and for state highways in cities \$6,000,000."

In this instance the actual receipts were considerably in excess of our estimates. This was in part due to the fact that gasoline rationing was removed a little earlier than the close of the first fiscal year. In our opinion, their revenue estimates in the 1947-48 Budget will also be exceeded.

The Governor's statement concerning highway expenditures merely covers existing funds and does not encompass a greatly expanded program for the rest of the current biennium and for the budgeted year 1947-48.

It does include what the Governor designated in his 1945-47 Budget on page 713 as a Postwar Highway Construction Fund which he estimated at \$40,000,000 and which, based upon our estimate of revenue, would have been at least \$50,000,000. Actual accruals were in excess of our revenue estimates so that the amount available for expenditure of this character materially exceeds this amount. This large sum has been available ever since V-J Day for postwar highway construction, but nowhere in the Budget is an account given of what was constructed or how much of the so-called critical deficiency has already been provided.

It is our recommendation that when such reserves are set up by the Governor in one Budget, that subsequently these reserves should be reported and accounted for in the next Budget.

We have previously stated under the constitutional provision requiring the Executive Budget that the enlarged highway program as suggested by the Governor in his message to the Legislature should have been included in the Budget. If this had been done with a definite and specific program of need and an estimate of cost including a statement recommending the source of revenue as is required by the Constitution, the confusion which has existed through the failure to have a definite plan and an estimated cost thereof for state highways would not have arisen. The Constitution says clearly that this should be done in the following terms, "If the proposed expenditure * * * shall exceed the estimated revenue therefor, the Governor shall recommend the sources from which the additional revenues shall be provided."

It is recognized that if this had been done as the provision of the Constitution states, this matter would have been controlled by other constitutional requirements which would have included the highway plan as a part of the financial program of the State for the current biennium and for the budgeted fiscal year. This procedure would have shown the Legislature just where this expenditure fitted into the overall financial program. It would have shown how the reduction in the tax burden was being continued on certain classes of taxpayers but was being increased on other classes of taxpayers to carry a part of the expenditure program of the State. The Legislature would then have had the advice of the Chief Executive on the over-all spending of the State. He could have determined just what part of it he would approve and the resultant tax burden imposed thereby.

If the Governor is in accord with the original highway program as proposed to the Collier Fact-Finding Committee by their tax and engineering experts, which program does not contemplate an expenditure of highway funds during 1947-48 in excess of available reserves and revenues which will accrue, then the Governor's recommended procedure under the terms contained in the above quotation are clearly in order. If subsequently he has departed from this recommendation, then it appears that under the constitutional requirement of Article IV, Section 34, the Governor should amend his Budget and his Budget Bill. The Governor still has ample time to do this before the adjournment of the Legislature. Undoubtedly such action will do much to clarify the situation.

HIGHWAY EXPENDITURES ACCELERATED

Due to the ending of the war, the expenditure program for highways for the Biennium 1945-47 is greatly accelerated, particularly for the current Fiscal Year 1946-47. Reference to page 869 of the Budget will show that the total expenditure from state highway funds for state highways alone for 1945-46 amounted to \$41,824,197. The actual and estimated expenditures for 1946-47, \$74,100,507, and the amount allocated for the same purpose for 1947-48 is given at \$63,952,933, or a decline of \$10,147,574.

The estimate for 1946-47 has already been adjusted upward \$3,500,000 since the preparation of the Budget by the Highway Commission due to the fact that revenues accrued faster than was first estimated. In our opinion some of the money allocated for expenditures for 1946-47 will remain unexpended at the end of the fiscal year and will be carried over for 1947-48. It is apparent also that the revenue estimates for highway purposes are quite conservative in light of the Motor Vehicle Gas Tax collections which have been made subsequent to the preparation of the Budget in December, 1946.

Almost all of the decline in highway expenditures of 1947-48 below 1946-47 is in capital outlay in the sum of \$10,510,733.

This apparent decrease gives an erroneous picture for it is a decrease from an accelerated highway building program resulting from the expenditure of wartime accumulated funds through bending every effort to buy rights of way and to let contracts in the months subsequent to V-J Day. Although these contracts are let within the current Fiscal Year 1947, a large volume of them will not be completed until well into the

Budgeted Year 1947-48. Some of them will not be completed until the next Fiscal Year 1948-49.

A considerable portion of the rights of way being secured represents a large expenditure, for it includes right of way for the Hollywood Freeway and other such items which will not be made use of until 1950 or later.

Highway Contracts Let at the Highest Price in the History of the State

The contracts that have been let subsequent to V-J Day and those that will be let during the remainder of this fiscal year and probably for the first half of the budgeted year 1947-48, will be at a much higher index price than has ever before been paid by the State, with perhaps the possible exception for a short period of time in the 1920's, subsequent to the first World War. It appears that highway construction costs will continue at approximately a 174 construction index according to the Kennedy Report of the Collier Fact-Finding Committee until about the middle of 1947. Construction costs will then decline to an index number of 124. It is clear, therefore, that letting the maximum number of contracts now means expenditures of state money at the highest price and securing smaller results than should be secured for construction let subsequent to mid-year 1947. The volume of construction is such at present that they compete with private enterprise for construction work and construction equipment.

Accident Statistics Used Improperly—Misleading

The Governor has stated that more highways should be built immediately because of the great loss of life that is occurring on our highways, and points to the percentage increase which has been shown since V-J Day. He further stated that California shows the largest number of accidents and deaths on the highways per 100,000 of population of any state in the Union. This statement is true, but it is an improper measurement for, in fact, while California's record is deplorable, based upon a fair and equitable measurement, it is not as bad as other populous states. The true measurement to determine whether our highways are the cause of accidents would be to determine the ratio of deaths in relationship to the motor vehicle registrations and use; that is, the number of self-propelled motor vehicles and per miles of highway driven. When we use this measurement, we find that the death rate on our highway is one plus per year per one hundred thousands of self-propelled motor vehicles. About this same percentage with very little variation has been maintained over the entire period for which records are available. When we furthermore consider that each motor vehicle in California is driven more miles per year than in any other place in the world, we find that our fatalities in relationship to exposures is relatively lower than is found in other states.

There is no evidence to show that the construction of more highways or better highways will materially reduce the number of accident fatalities on highways.

The human element is the controlling factor in motor vehicle accidents. Second in importance is the nature of the motor vehicle, while third in importance are the hazards due to faulty highway construction.

Improving highways and reducing physical hazards without at the same time correcting the human element and improving conditions of automobiles will do little towards reducing the accident and fatal accident ratios or totals. In fact in our opinion, the construction of more and better highways without correcting these two other conditions will result in an accelerated death and accident rate. In other words, even with poor highways the fatal accidents and accidents in general attributed to motor vehicles can be materially reduced by dealing effectively with the human element and the condition of motor vehicles. These two elements are not now receiving proper attention. The plea to build highways to reduce motor vehicle fatalities and accidents is approaching the subject by making a minor premise appear to be a major one. It calls for billions of dollars of expenditures when millions properly directed would secure much larger results.

There is a stronger argument on the economic side to the effect that to relieve the cost of congested traffic is such a time saver that it is good economy to build highways. We will not develop this matter further here for it is not presented in the Governor's Budget Message.

There should be a more judicious expenditure of state highway funds with better business management and more control thereof by the Legislature. If this had been effective the recently disclosed irregularities in securing rights of way for the Hollywood Freeway would not have occurred. It appears the State and the taxpayer have lost a considerable amount of money in this instance by detouring from a well-established practice, that state property should not be disposed of except by competitive bidding unless there be compelling reasons to the contrary in rare and isolated instances. We believe that all the houses and other movable property on any rights of way secured by the State should be disposed of by competitive bidding if they are secured in fee simple by the State and the transfer thereof is not a part of the purchase price.

We have previously presented in this report a recommendation that all highway funds be budgeted and subjected to proper budgetary control under a definite procedure set up by the Legislature. We furthermore recommend that a complete review and report be rendered to the Legislature in each budget of just what money was spent and what was secured for such expenditure. In our prior report on page 49, we recommended exercise of budgetary control and the noted lack thereof. We are repeating this Section for it is as pertinent now as it was then.

BUDGETARY CONTROL BY DEPARTMENT OF FINANCE OVER HIGHWAYS NIL

Little or no budgetary control has been exercised by the Department of Finance over the Division of Highways. For some peculiar reason they have been exempt from the normal budgetary control exercised over the other departments and divisions of the State. For example, the Department of Finance has not exercised budgetary control over their expenditures for personnel. There has not been applied to the division the code numbering system for controlling personnel which has been applied to other depart-

ments. They give various excuses for this but the real reason is that they do not wish the Department of Finance to in any way control their financial operations.

There is a similar lack of control in relation to their contracts, their purchasing, their accounting, and in the control of their equipment. There appears to be no reason why the financial officers of the State should not exercise the same budgetary control over this division as is applied to other divisions of the State Government.

Highway Budget Improved

In our prior report we recommended that the information in the Budget Document on highways be enlarged and be made more adequate. This has been accomplished to a degree in the current budget. We believe that in subsequent budgets further improvements can be made.

Essential Peacetime Services Restored

The Governor states in his message that in this Budget it is sought to restore all essential peacetime services expected of the State Government, many of which he claims were sharply curtailed of necessity during the war. There is no listing of what peacetime services were restored, nor is there any indication of those that were curtailed during the war so we are not able to make an analysis of specific items.

In the Budget hearings it was frequently urged that certain services, which were curtailed during the war, should be restored. Most of them were curtailed for three reasons: (1) personnel could not be secured, (2) supplies could not be secured and (3) improvements and construction could not be carried out.

There were some instances where services were curtailed because personnel could not be secured. These were not, however, very serious when thoroughly analyzed. State Government did not break down. There were some instances, such as the inability to fully audit sales tax and income tax returns because of inability to secure personnel where the State may have suffered a loss. There was some decline in the quality of services rendered to patients in the state institutions for the same reasons. However, they were still cared for in an adequate fashion. It is interesting to note that in most of the instances where certain classes of personnel could not be obtained, the total amount of money spent for salaries and wages was increased. The departments complained that the quality of personnel was much lower than prewar and lower than is now being secured.

Wherever there was an actual decrease in service that was essential, it has been restored in the Budget and we are raising no objection, but there are other instances in our opinion where it was not demonstrated that the services restored were essential peacetime services. These will be pointed out in our detailed analysis. In addition there was an expansion of services during the war based upon wartime services which have been continued. These likewise will be pointed out in our detailed presentation.

It is stated in the budget that there has been applied the test of administrative efficiency as well as the need for each item proposed, and that recent Legislative authorization for a number of departmental reorganizations is making effective testing easier.

We wish to affirm that a degree of testing for administrative efficiency has been applied but that the tests in our opinion are far from adequate and that in numerous instances we believe such tests would have dictated a reduction, particularly in higher administrative personnel. *Due to the process of budgeting and budgetary control and the failure of performance reports to function, we can not recommend a reduction in appropriation for salaries and wages as we feel desirable, for the reason that it would result in retaining the inefficient and prevent the securing of more efficient people. Remedy cannot be provided for this situation until the Personnel Board and administrative officers make the performance reports realistic and see that they function.* There has been an endeavor to accomplish this purpose as indicated with the tools that are available. Strengthening of the budgeting procedure and providing definite requirements for performance so that it will be operated in an overall way is the only complete solution.

The reorganization of a department does not necessarily increase administrative efficiency.

For example, the reorganization of the Department of Employment has not increased its efficiency and the present reorganization in our opinion is so illogical that it should be changed and an administrator with full responsibility be placed in charge. The reorganization of the Department of Mental Hygiene has not in our opinion increased its efficiency, but it has materially increased the overhead.

The reorganization of any department which merely adds to overhead with new executive positions, but without any increase in the quality of services rendered or improvement in the object to be secured, is not proof of increased administrative efficiency.

Some of the governmental reorganizations made in the past five years have not as yet had a real test during wartime conditions to determine whether they are more or less efficient under normal peacetime conditions. This is particularly true of the Department of Corrections. The real test as to whether or not ample protection is given to society and a higher degree of cures accomplished with less recidivism is just beginning to be subject to measurement with the first small appearance of difficulty in keeping inmates on parole. If under the new system and new administrative organization with its large increased costs substantially better results can be secured under adverse economic conditions than was secured under the old system which operated at a fraction of the cost and at a time of greater economic stress, then it can be said that the new system is more efficient.

Nowhere does the budget indicate a reflection of reduced costs through greater efficiency produced through reorganization even with proper allowances made for the cheapening of the dollar. In fact better results, as measured by costs, are secured in some of the departments where there has been little or no reorganization. We would not infer from this that reorganizations for the purpose of greater efficiency and economy are not in order, or that all reorganizations should result in reducing the cost of services, for frequently they are justified on the basis of increasing the quality of service. This latter we believe has been manifest by the reorganized Board of Forestry although costs have been

substantially increased. Replacement of poor administrators and managers with competent ones produces far better results than does reorganization.

Cost Factors in the Budget

We concur that the cost of goods required by the State is dependent upon current prices, but we hold that the State should be as conscious of high prices and the possibility of substitutions as the individual family. We do not find that this is the case in regard to many purchases, notably the purchase of automobiles and the use thereof.

The purchase of high priced foods by the State frequently includes items that the ordinary family hesitates to buy. The statement is made in the Budget that in providing for wards and patients, the State is subject to the same cost increases which must be met by the average housekeeper. This is true, but our examination of many purchases does not show the same careful discrimination used by the average housekeeper. The statement of Warden Duffy concerning the objection raised by San Quentin prisoners in the recent prisoners' strike as to quality of food supplied, was to the effect that it was better food than he had. An examination of the butcher shop of any of the institutions during the war years would have convinced anyone that the quality of meat supplied was generally superior to that which the average housewife could purchase.

The inmates in our institutions and our wards should receive adequate care and proper feeding. Should the taxpayer supply them with better commodities than he can afford for his own family?

A recent agricultural survey of all the state institutions indicates that some institutions, notably where they have good managers, produced better results at less cost than was accomplished in other comparable institutions.

Salary Scales

It is pointed out in the Budget Message that the State has had to increase salary scales on a parity with those of private and other public employment and to meet increased cost of living. In fact, out of \$122,000,000 budgeted for salaries and wages for the next fiscal year, it is found that \$28,550,000 results from salary increases granted since the beginning of the war.

It was not pointed out that this increase was made during a shortage of labor and when there was an employees' market. Economic conditions are now gradually changing and it is becoming possible to make some selection of employees on the basis of efficiency and their return in services to the State. It is, therefore, now possible to weed out the inefficient and to secure replacements of greater efficiency and thereby increase the services rendered and also possibly reduce the salary bill. It is found that there is little incentive on the part of administrators to do this unless there is a limitation in the Budget in the amount allowed for salaries and wages. The budgeted amount for salaries and wages does not give any consideration to this possibility.

A survey of the Budget will indicate that in almost every instance, not only is there provision for increased personnel, but there is included sufficient money to automatically increase the salary of every employee

on the basis of what is termed 1947-48 merit salary adjustments. It is suggested that all such salary adjustments be truly based on merit and that the Department of Finance insist that such increases shall only be allowed where there is a demonstration of merit. The automatic salary increase should be revised accordingly. There should also be a revision of the performance rating system and this should be made effective.

Where pay roll records show that an employee has no regard for working hours or absences from work, or insists on vacations during time of peak load, or has unauthorized absences, something should be done about it.

The State is now paying scales of wages, that with few exceptions are equal to that paid in public and private employment, and in addition, the State offers many other advantages of employment, including desirable working conditions, a generous retirement system, and overly generous sick leave with pay, 15 working days a year vacation, generous number of holidays, a five-day week and all sorts of liberalities for time off. The conscientious employee will have no objection to having the State insist on a fair day's work and a reasonable limitation on the other benefits above enumerated. It is only the minority who abuse these privileges who will object.

Capital Outlay Expenditures

The total figure for capital outlay in the Budget is given as \$144,089,629. While this is a rather large figure and out of line with previous expenditures, we recognize that it is increased because the State has been unable to build to any great extent during the war and subsequently. We have already recommended that all of this building be deferred until later when the cost of building index drops materially.

The majority of capital outlay expenditures included in the budget have already been authorized by the Legislature. Few of them, therefore, appear in the Appropriation Bill. Funds for these expenditures come largely from the Postwar Employment Reserve Fund as provided in Section 6 of Chapter 145 of the Statutes of 1946. We have already called attention to the fact that the Legislature has not approved specific items by this appropriation.

The Governor states that each item spent for capital outlay is recommended only after careful consideration of needs and with the policy in mind that the State should not compete for materials and labor except in matters of urgency. With this in mind, the total recommended for 1947-48 is \$69,252,180. This sum apparently includes \$1,000,000 from the \$128,000,000 plus appropriated by Section 4 of the Budget Bill for 1947-48 for the building of National Guard Armories and \$125,000 for plans for new public health building, for the reason that these two items are not now authorized by existing law but are in the schedule in Section 4 of the Budget Bill above referred to. This then clearly provides for an expenditure from the appropriation set up in Section 4 although this is in fact a transfer in accordance with provisions of Chapter 145 of the Statutes of 1946. For detailed schedule of the Postwar Construction Program see Budget, page 949, and for the detail of the Postwar Construction Program added by Section 4 of the Budget Bill, see the last column of the tabulation on page 951 of the Budget Bill.

In light of the fact that the most recent bids for buildings for the University were so high as to be equivalent to an index number of over 600 and the normal building index number as stated by the Department of Finance is now 500, it does not appear that the State should make any expenditures from this \$69,252,180 except for items of extreme emergency and keep within the Governor's announced principles to determine when buildings should be built. The State would secure very little return for its money. It is certainly questionable if the State should build anything when such prices prevail, and when the average veteran cannot afford to build a house no matter how dire the need. In our opinion the State should defer as near 100 percent of its building as possible until the construction price index falls below 400 and then only emergency building should be constructed until the index further declines to 350, where it was when the Legislature approved the allocation of \$154,000,000 plus for postwar building. We recognize that in the meantime the needs of the State are becoming more pressing and are ever increasing. This, however, is also true with the private citizen who must defer his building. There is also indication that the State is paying much more for its building than is being paid by industry. There also is indication that there are already some recessions in the price of materials and some classes of building trade workmen are easier to employ. A reasonable delay in building appears to be economical.

Debt Service—Fixed Cost

The payment of \$6,648,196 of the Budget total on existing debt is in the nature of a fixed charge. The payment on General Fund debt obligations is made from the Bond Sinking Fund set up by the Legislature in 1943 and 1945. This fund is sufficient to meet the interest and retire all General Fund obligations.

Reserves for Unforeseen Contingencies

The Governor has requested \$2,500,000 reserves for unforeseen contingencies. These are made up of Item 325 in the Budget Bill in the amount of \$1,000,000 for the Director of Finance's Emergency Fund, and Item 326 in the amount of \$1,500,000 for a Salary Increase Fund to be allocated upon authorization of the Department of Finance to pay any increased salaries established by the Personnel Board.

The Director of Finance's Emergency Fund in the Budget Bill as amended for 1945-46, was Item 275 in the amount of \$1,750,000. This was the amount allowed for a two-year period and for a Biennial Budget. Now with an Annual Budget, which the Governor has endorsed as making possible closer estimates and better budgeting, there is still requested \$1,000,000 or more than one-half the amount in the current Biennial Budget. However, when we consider that the Annual Budget as presented by the Governor is almost as large as the Biennial Budget for 1945-47, we must agree that on this basis the Emergency Fund request is comparable.

A comparable item to the Salary Increase Fund of \$1,500,000 is not found in the Appropriation Bill for 1945-47. The Salary Increase Fund, Item 276.6 in the 1945-47 Budget Bill was in the sum of \$10,940,322. This covered increases made by the Personnel Board and other

increases in compensation as provided in the item. This, however, was approved under entirely different circumstances. The war was still continuing and salary scales had not yet received complete overhauling from the Personnel Board. The war is now over, salary scales have been adjusted to a point where the State in practically every instance is paying wages equivalent to that of private enterprise and other public employment. It appears to be more likely that salaries will go down for the budgeted year rather than up.

Although the \$10,000,000 plus provided to cover General Fund salary adjustments during the current biennium proved insufficient, it was possible to meet a substantial part of the additional cost from salary savings accruing as a result of vacant positions. No additional appropriations will be necessary.

If the Legislature approves the \$1,500,000 for salary adjustments for the one year, it is suggested that specific limitations be placed on it, and that if there are any salary savings that these be transferred to this fund. If there are any salary reductions made by the Personnel Board in line with their authority to reduce salaries as they are reduced in private enterprise and public employment, that the savings therefrom likewise be transferred to this fund and that it be placed under control similar to the Salary Restoration Fund, Item 276.5 in the 1945-47 Appropriation Bill. This legislative requirement proved satisfactory, as the Director of Finance reports in the letter of transmittal in the Budget. Less than one-half of the sum was used and \$1,872,000 will be returned to the General Fund.

Larger Budget Increases

The Governor states that in preparation of this Budget, particular attention has been given to the programs for education, social welfare, health and protection. He summarizes the larger budget increases for the following departments which we will only list here for we have treated each of these items in detail as they appear in the Appropriation Bill. We will make only such brief comments under each as will serve to indicate the overall direction of our analysis of the detail:

- Education;
- Social Welfare;
- Mental Hygiene;
- Public Health;
- Veterans' Affairs;
- Corrections;
- Industrial Relations;
- Highway Safety;
- Natural Resources;
- Agriculture;

Streets, Roads, Highways and Local Public Works (this grouping is purely an arbitrary one for it includes the streets, highways and roads, assistance to local agencies and the construction of postwar public works and veterans' housing. The veterans' housing item should be placed under Veterans' Affairs. The lumping of these functions do not make possible definite consideration of totals.)

Revenue and Surplus

The revenue estimates and the surplus therefrom are derived from the Department of Finance estimate. This is included in the estimated revenue section of the Budget, pages A-4 to A-9. We will reserve our specific comments for this section of our analysis. We do wish to point out the fact that the revenue and surplus statement is based solely on the expenditure program set forth in the Budget and there are some possible deviations that should be noted.

The Governor assumes and states that the total Budget will be \$641,599,026, and his estimate of surplus is based upon this total and the several fund expenditure requirements he sets up in the Budget. This we have pointed out does not cover his entire expenditure program. Both the expenditure program and the surplus must be modified by whatever changes or deviations are made in the Governor's assumptions.

The expenditure program in the Budget while it does not cover nearly all the Governor's suggestions for appropriations and does not include any legislative appropriations, in our opinion can be reduced and adjusted materially.

Surplus—General Fund

The statement of the Governor on page viii that the accumulated General Fund surplus will amount to \$318,567,265 as of June 30, 1947, is contingent on the Legislature's refusal to make any additional appropriations effective between now and that date or to make any further tax reductions other than continue those in effect, or tax diversions effective before that date. On these assumptions we concur generally with this estimate. In fact, we believe that it could run over this somewhat from increased revenues and also from any increased savings by a more strict control of expenditures for the remainder of this fiscal year.

The General Basis of the Revenue Forecast

The Governor states clearly that the revenue forecasts are predicated upon the belief that business conditions will continue at a high level during the remainder of 1947 and the first part of 1948. These estimates contemplate some recessions during 1947 but that the whole period will show business conditions comparable with 1946. An allowance has been made for a 10 percent decline in the volume of revenue due to unforeseen contingencies.

The Governor points out correctly that a 20 percent decline in business activity will reduce state income by \$100,000,000 for the year. This assumes that the business decline would extend through practically all of the fiscal year.

Should a business decline of major proportions develop, the revenue estimated will not accrue. It is possible that under such circumstances those who make these estimates will be criticized as having been too optimistic, just as they are now being criticized for having been too conservative in making estimates for the revenue accruals early in 1945 for the Biennium 1945-47.

The estimates made by the Department of Finance in the Budget for 1945-47 was that on June 30, 1947, the surplus would be in the neighborhood of \$144,786,000. This was based on an expenditure program of \$683,710,643. The actual expenditures turned out to be \$830,000,000 in round numbers, or \$147,000,000 more than the Budget had originally presented which would have then left a deficit as of June 30, 1947 of approximately \$4,000,000 according to the Department of Finance. It turns out, however, that even with some additional expenditures, an appropriation for a State Postwar Building Fund of \$154,000,000, \$90,000,000 for public works for cities and counties and some \$11,000,000 to the Bond Sinking Fund of the State, the General Fund surplus is now estimated to be in excess of \$318,000,000 as of June 30, 1947. If these above appropriations are all added together and compared with the total estimate of surplus we find an underestimate of revenue of around \$675,000,000 for the two years.

Your Legislative Auditor arrived at approximately the same estimate of revenue as the Department of Finance with the exception that he estimated the General Fund revenue at \$9,000,000 less than the Department of Finance.¹ However, on the other side he estimated the actual expenditure program at \$834,000,000² as a minimum or less than \$4,000,000 more than it actually turned out to be.³ Our actual estimate of the deficit in the General Fund made at that time for the reason that we estimated expenditures closer was much more accurate than that of the Department of Finance. Our underestimate of \$9,000,000 of General Fund revenues for the period below the Department of Finance is not out of line based upon the assumption that the war would last an additional full year and there would be some considerable unemployment at the end of the war.

On the other hand, we estimated that the highway funds would show approximately \$5,000,000 more than the Department of Finance estimated, and our estimate was some \$12,000,000 more than the Division of Highways. The actual accruals were in excess of the highest estimate, which in this instance was made by the Legislative Auditor. Here again all estimates made were exceeded because of the ending of the war earlier than expected and the removal of gasoline rationing.

Subsequently, near the adjournment of the regular session of the Legislature, the Department of Finance and the Legislative Auditor both adjusted their estimates based on changing conditions and both raised their estimates of revenue accruals materially. At subsequent dates as more information was available further upward adjustments were made. The uncertainties of reconversion were taken more seriously by the Legislative Auditor than they were by the Department of Finance and the State Controller. However, all estimates proved to be below actual accruals.

The national income paid to individuals rose in 1946 to an unprecedented annual rate of \$174,000,000,000. This, of course, represented cheaper dollars. As a result the accruals of revenues exceeded the last estimate given out by all parties.

¹ See page 74, Report of Legislative Auditor, 1945.

² Ibid. page 8.

³ Governor's Budget 1947-8, page A3, Schedule I. Total \$830,032,455.

The estimate of the Legislative Auditor as to the surplus June 30, 1947, issued November 25, 1946, was that it would be \$155,000,000. This apparently will prove to be an understatement of \$163,000,000 if no further appropriations are made resulting in transfers therefrom.

We call attention to the fact, in interpreting these estimates that they were made at various periods of time ranging from two and one-half years downward to approximately seven months before the close of the biennium, June 30, 1947, which still has four months to run.

The estimates of revenue which have been made in the Budget for the fiscal year beginning July 1, 1947, to June 30, 1948, were finally revised early in January, 1947, and they therefore cover only an 18-month advance period with some of the business actually done on which taxes will be levied for 1947-48. However, in reviewing these estimates in the future, out of fairness to those who are required to make them consideration should be given to the assumptions that are used as the basis for these estimates; that is, that business conditions will start off at a high point in the fiscal year and that they will decline toward the end of the year and that the average will be approximately that of 1946 but with the high point reversed.

We concur that if business conditions begin to decline prior to the estimated period or if they decline faster and drop to a lower level than has been used in making the estimate that revenues will fall materially below the estimates, and if the total decline represents approximately 20 percent of business activity that the state income will fall at least \$100,000,000 below estimates. We wish to state further that declining business conditions are reflected more quickly in a decrease in revenue than increases in revenue are reflected through increasing business activity.

We join with the Governor in pointing out that the surpluses of the General Fund for the past five years resulted from war induced activity and that the General Fund free surplus as of June 30, 1947, in our opinion still results from a carryover of the war induced activity. We believe that we can see signs of the beginning of the decline in such activity.

Continuance of Tax Reduction Possible

The Governor recommends the continuance of the present reduced tax levies for another year, which will produce a saving to the taxpayers of approximately \$96,650,000. This will be the saving if the continuance is made effective concurrent with the ending of the present reduced rates and if the volume of business on which the taxes are levied continues at the estimated level. If business conditions fall off the tax savings, of course, will decline accordingly.

We point out that this tax reduction plus the additional appropriations for reserves and postwar building and the recommended revenue deficiency reserve of \$75,000,000 cannot all be made effective if all of the Governor's recommendations for appropriations are approved or if the Legislature makes the normal amount of special appropriations. We believe, however, that the tax reduction can be continued and a satisfactory expenditure program for the State provided.

We have pointed out that if the proposed increased taxes are levied and other taxes diverted as proposed in Senate Bill No. 5 (Extraordinary Session), that there will not be a net tax reduction, but there will actually be a tax increase in that the taxpayers will be required to pay more in the new and additional taxes than they will save through the continuance of tax reduction.

The Governor's Recommendations

The Governor's recommendations for use of the surplus as of June 30, 1947, will be found in Section 4 appropriating \$128,446,250 from the General Fund to the Postwar Employment Reserve, and Section 5 of the Appropriation Bill appropriating \$75,000,000 to the Revenue Deficiency Reserve. These have been discussed to some extent previously and will be given further consideration in our analysis of the various items in that Bill.

There is the further recommendation that a bookkeeping transfer of \$34,000,000 be made from the General Fund to the Postwar Employment Reserve representing that part of the \$154,000,000 construction program provided in Section 6, Chapter 145 of the Statutes of 1946. This is provided for in Section 3 of the Appropriation Bill. We concur in this suggestion unless the Legislature wishes to resume control over the entire unexpended balance of moneys appropriated by Section 6, Chapter 145, Statutes of 1946.

The Governor gives three reasons for the creation of a \$75,000,000 Revenue Deficiency Reserve:

- (1) That a 20 percent decline in business will reduce state income by \$100,000,000.
- (2) That fixed charges against the General Fund now amounting to \$231,000,000 annually continue to increase.
- (3) That a substantial reversal in business conditions will create the need for unemployment relief.

We concur in these statements and would further emphasize them and point out that fixed charges will be increased materially by the approval of some of the items of expenditure proposed by the Governor but not included in his Budget. We would also note that already the Supervisor's Association is suggesting that the State undertake at once assistance in meeting relief.

The Governor rightfully points out that the State had 10 years of deficit financing prior to the war-induced business activity beginning in 1941. History indicates that after every major war creating inflation, there followed a serious period of deflation. We cannot discern what methods have been evolved which will make it possible to avoid this, but the State has already taken steps to ease the blow in California by creation of a number of reserves to pay specific obligations. Other steps are available to the State to further soften the effect of declining business conditions and a reversal of the trend of increasing revenue accruals.

Reserve Necessary to Meet Future Expenditures and Appropriations Already Voted

It is not generally understood that appropriations that are made in one year remain available for expenditure for three years unless specific reversion is provided for prior to that time. There are appropriations effective which must be held beyond June 30, 1948, in the sum of approximately \$29,000,000.

Intent of Legislature

The Governor closes his message to the effect that he has followed the intent of the Legislature and has interpreted the fiscal policies as determined by the Legislature, both in letter and in spirit. We have previously stated and we can testify from our close observation that this has been done to a greater degree than has been experienced since the State has operated under an Executive Budget. We have already indicated where there have been what we considered exceptions. Since we more intimately interpret the Legislature's intent by a continuous close contact, our interpretation is undoubtedly stricter than that of the Chief Executive.

If a more definite statement of the intent of the Legislature was included in the Budget Bill and in other appropriations it would make possible a clearer understanding on the part of the administrative officers. It would insure a greater control of expenditures, which is generally admitted as being more effective with an Annual Budget. We suggest that the Legislature in making appropriations clearly indicate its intent, and where there is any possibility of ambiguity that the intent be specifically expressed.