

## PRELIMINARY STATEMENT

The purpose of this report is to provide the Legislature with an analysis of the Budget of the State of California for the Fiscal Year 1955-56 with recommendations. Certain basic instructions from the Joint Legislative Budget Committee have been followed in making recommendations. These are:

1. That the report show how the budget can be balanced without additional taxes in 1955-56.
2. If policies previously established by the Legislature are not followed in the Governor's Budget, mention shall be made of this fact.
3. All reasonable measures designed to secure efficiency and economy shall be followed.
4. Review shall be made of all funds and reserves which might be made available for budget purposes.

In making this review of the budget, distinction must be drawn between the *budget* as the financial plan of the Governor, including all authorized or proposed expenditures, and the *Budget Bill*, which is that proposed legislation required to authorize expenditures, as proposed in the budget, which are not already authorized by Constitution or statute.

Pursuant to Section 34, Article IV of the Constitution, the Governor is required to submit to the Legislature not only a complete plan of all expenditures of the State but also an estimate of all revenues and recommendations for the source of additional revenues to the extent that they are required to balance the budget.

In order to provide a more complete picture of the nature of the budget and its content, this report is divided into four major sections:

- I. The budget and Budget Bill.
- II. Revenues and revenue estimates.
- III. Balancing the budget.
- IV. An item by item analysis of the Budget Bill.

### I. THE BUDGET AND BUDGET BILL

The budget, in conformity with Section 34, Article IV of the Constitution, is required to be a complete plan of all expenditures of the State and all estimated revenues. If the proposed expenditures for the ensuing fiscal year exceed the estimated revenues therefor, the Governor is required to recommend sources from which these additional revenues shall be provided.

The proposed expenditures contained in the Governor's Budget total \$1,529,768,426. A comparison of expenditures classified by the three major divisions of state operations, capital outlay, and local assistance is as follows for the last completed year, the current year, and the proposed budget year:

	<i>Millions of dollars</i>		
	<i>Actual</i>	<i>Estimated</i>	<i>Proposed</i>
	<i>1953-54</i>	<i>1954-55</i>	<i>1955-56</i>
State Operations -----	\$346.9	\$376.6	\$414.5
Capital Outlay -----	286.9	313.3	292.9
Local Assistance -----	747.6	783.4	822.4
Totals -----	\$1,381.4	\$1,473.3	\$1,529.8

State Operations consist of the expenditures of the Legislature, the courts, the day-to-day cost of operating all departments, boards, commissions, and institutions (excluding those state agencies which operate from utility funds and working capital and revolving funds), and the payments required on state debt (excluding debt service on the state school building bonds which is carried under local assistance). For 1955-56 it is proposed that these will total 414.5 million dollars.

Capital Outlay includes the construction of new buildings at state institutions, the construction of highways, and the acquisition of land and equipment for such purposes. Capital Outlay is budgeted for 1955-56 at 292.9 million dollars.

Local Assistance comprises funds subvned to local governments for a number of functions, primarily school support, aid to the needy, public health departments and services, and the sharing of highway users taxes with the cities and counties of the State, and other local activities. This is the major portion of the budget, amounting to 822.4 million dollars in 1955-56.

In considering the budget, the Legislature will be concerned primarily with the two categories of *State Operations* and *Capital Outlay* for the reason that the major portion of the local assistance category is appropriated by constitution or by existing statutes. Several items of local assistance are included in the Budget Bill, and in this *Analysis* recommendations are made to the Legislature concerning changes in existing law which can revise the cost of other local assistance items.

Capital Outlay is divided into two major categories—institutional construction and highway construction. Primary concern will be given to the former since highway construction, under existing law, is determined by the amount of revenues available as budgeted by the Highway Commission, and the proposed program for 1955-56 is placed in the budget document only for the purpose of informing the Governor and the Legislature of the program approved by the Highway Commission. Under the provisions of the code, this program may not be changed by either the Governor or the Legislature.

Distinction is made in the budget between General Fund and special fund revenues and expenditures. The State's General Fund consists of money received by the State which is not by law designated to be credited to other funds. Out of a total of \$1,362,187,237 in revenues for 1955-56, \$845,680,535 go into the General Fund. From this fund are supported the major portion of all school expenditures, institutional requirements, aid to the needy, and general administrative expenses.

Special funds are created for the purpose of earmarking revenues for special dedicated purposes. The major special funds are those relating to highway expenditures, fish and game, regulation of business and professions, fairs and expositions, and alcoholic beverage control license revenues subvned to local jurisdictions.

The principal budget problem of the Legislature is to balance General Fund income with General Fund outgo, and special attention will be given in Part III of this analysis to the current deficit between General Fund income and outgo, and alternative proposals for balancing this portion of the budget.

Distinction is made in the budget between so-called controllable and fixed costs. In a large measure the budget costs are fixed because of constitutional provisions over which the Governor and the Legislature have no control except through the process of submitting proposed constitutional amendments. Primarily these fixed costs consist of \$427,482,804 in apportionments to public schools pursuant to Section 6, Article IX of the Constitution. However, to a considerable extent those costs which are classified as noncontrollable in the budget *can* be changed by the Legislature through amending the statutes.

In recent years, the Legislature has directly increased the cost of subventions for education by liberalizing the definition of pupil in average daily attendance and by assisting the local school districts in construction programs. The Legislature has also indirectly increased the costs by instituting the excess cost programs for driver education, for the mentally retarded, physically handicapped and severely mentally retarded; paying on the basis of the current average daily attendance rather than the prior year's attendance; expanding the county school service fund; approving the large growth in adult education costs; and providing transportation allowances to school districts. The Legislature could reduce the 1955-56 subventions to education by shifting the cost of teachers' retirement to local school districts, or by reducing the amount available for a specific purpose such as the County School Service Fund and including in the \$180 mandatory apportionment some equivalent amount now financed outside the \$180. The Legislature can also make changes in certain programs and in the definition of a pupil in average daily attendance that would result in reduced costs not in 1955-56 but in subsequent years. Additional reference to this is made in the section preceding the education budgets in Part IV.

Likewise in the field of social welfare subventions, revisions in the statutes can revise costs. This can be done either by adjusting the amount of the benefit payments or by changing eligibility requirements for assistance or by recovery from the estate of a deceased beneficiary. Specific recommendations on possible revision of so-called fixed costs are contained in Section III, Balancing the Budget.

## II. REVENUES AND REVENUE ESTIMATES

Total revenues for the State of California for 1955-56 are estimated at \$1,362,000,000. This compares with \$1,397,000,000 estimated for the current fiscal year, or a reduction of approximately \$35,000,000. The estimates are based upon substantially the same revenue structure. The apparent drop for 1955-56, however, is due to the receipt, during the current fiscal year, of approximately \$66,000,000 in tidelands oil royalties which had been impounded. The tax sources anticipate a moderate increase over 1954-55.

General Fund revenues for 1955-56 are estimated at \$845,700,000 in comparison with \$827,000,000 for 1954-55. Since the impounded oil royalties were credited to special and reserve funds, this comparison

TABLE 1  
SOURCE OF INCOME TO CALIFORNIA'S GENERAL FUND—1946-47 TO 1955-56

	(In millions)									
	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	1954-55 <sup>a</sup>	1955-56 <sup>a</sup>
Alcoholic Beverage Control taxes and licenses -----	\$24.4 <sup>a</sup>	\$16.9	\$17.6	\$16.4	\$19.9	\$18.2	\$19.7	\$19.5	\$20.4	\$20.7
Bank and corporation franchise and income taxes -----	59.2	69.2	75.8	74.8	98.2 <sup>c</sup>	120.1	119.1	125.0	129.2	131.6
Inheritance and gift tax -----	20.1	20.5	21.8	19.9	21.7	29.2	23.5	24.1	30.3	30.5
Insurance tax -----	14.5	17.3	20.2	22.9	23.9	25.7	29.2	34.3	38.5	39.0
Personal income tax -----	51.2	50.2	50.1	60.5 <sup>c</sup>	75.9	90.9	94.6	96.2	100.1	104.3
Retail sales and use tax -----	241.5	275.6	294.6	325.5 <sup>c</sup>	399.2	417.7	460.1	465.1	473.1	484.8
Other -----	36.4 <sup>b</sup>	22.0	30.3	33.3	33.7	32.4	27.8	33.9	35.4	34.8
	<u>\$447.3</u>	<u>\$471.7</u>	<u>\$510.4</u>	<u>\$553.3</u>	<u>\$672.5</u>	<u>\$734.2</u>	<u>\$774.0</u>	<u>\$798.1</u>	<u>\$827.0</u>	<u>\$845.7</u>

<sup>a</sup> Includes General Fund share of \$4,451,000 in liquor license fees. Changes in law precluded subsequent sharing with the General Fund.

<sup>b</sup> Includes General Fund share of approximately \$8,000,000 in motor vehicle transportation tax and fees. Changes in law precluded subsequent sharing with the General Fund.

<sup>c</sup> Revenues affected by tax rate increases.

<sup>d</sup> Estimated.

indicates largely the estimated trend in tax collections. We have reviewed the details of the revenue estimates and believe they are reasonable estimates for 1955-56.

The degree of success in revenue estimating in recent years can be illustrated by the following table which shows, for the three major General Fund tax sources: (a) the estimate as originally submitted with respect to the fiscal year for which the budget was presented, (b) the estimates as subsequently revised during the fiscal year to which the estimates were applicable, and (c) the actual revenues produced.

**ESTIMATES OF 1952-53 REVENUE**

	<i>Original estimates (000,000)</i>	<i>Revisions in subsequent year (000,000)</i>	<i>Actual (000,000)</i>
Sales and use tax -----	427.1	451.8	460.1
Franchise tax -----	118.5	118.3	119.1
Personal income tax -----	91.5	100.1	94.5

**ESTIMATES OF 1953-54 REVENUE**

Sales and use tax -----	465.4	467.1	465.0
Franchise tax -----	118.5	128.0	125.0
Personal income tax -----	104.1	102.0	96.1

**ESTIMATES OF 1954-55 REVENUE**

Sales and use tax -----	455.1	473.1	---
Franchise tax -----	126.6	129.2	---
Personal income tax -----	99.2	100.1	---

General Fund tax collections by source and the trend in tax collections since 1946-47 are shown in the table on page 4. These tax collections have been under substantially the same tax structure since July 1, 1949.

California, again this year, as it has been within recent years, is highest among all of the 48 states in amount of state taxes collected. The table which follows shows amount of state taxes collected and tax collections per capita for the fiscal year ending in 1954 for the five states with the highest tax collections.

**TABLE 2  
STATE TAX COLLECTIONS, 1953-54**

<i>State</i>	<i>Tax collections (millions)</i>	<i>Tax collections per capita</i>
48-state total -----	\$11,072	\$70.31
California -----	1,242	101.92
New York -----	1,134	74.46
Pennsylvania -----	617	57.90
Michigan -----	616	89.95
Illinois -----	546	60.63

SOURCE: "State Tax Collections in 1954," Bureau of the Census, release dated August 28, 1954.

**III. BALANCING THE BUDGET**

In balancing the budget for the 1955-56 Fiscal Year, one major policy question stands out. Should taxes be increased for support of the expenditure program in the budget year, 1955-56, leaving substantial reserves intact, or should additional taxes be deferred until the 1956-57 or even the 1957-58 Fiscal Year, using a major portion of accumulated

reserves and reducing expenditures? It should be thoroughly understood that the expenditure and tax program proposed by the Governor will in any case require the use of a major portion of the reserves for the following, or 1956-57 Budget, unless taxes are again increased in the next session, and will not provide for a balanced budget beyond that year. The real question is *when* reserves will be used, plus the fact that if taxes are increased in the current budget year rather than being deferred for one or more years, it is probable that the close of the Fiscal Year 1956-57 will find the State with a somewhat larger portion of its reserves intact but with a possible higher level of authorized expenditures to deal with in the subsequent year. This is because the presence of reserves results in a less rigid review of expenditures by the state agencies, the Governor, and the Legislature. Moreover, we believe that a thoughtful review of the entire budget will show many places where reasonable reductions in cost and in program can be made.

We repeat the point that if it is considered to be desirable to maintain the so-called Rainy Day Fund intact, and avoid the necessity of raising taxes in a Budget Session, rather than this year, the Governor's Budget proposals will not accomplish this. Moreover, even if the Governor's proposals are adopted and taxes are enacted in this session and major reserves drawn down to balance the budget the following year, it will be necessary to again revise the tax structure in the next General Session. This emphasizes the need for a careful review of existing programs, and for study of a tax system adequate to provide for the continuing expenditure requirements of the State.

The basic objective of a budget is to provide the Legislature with a program of recommended and estimated expenditures and related revenues which will afford the people of the State with adequate programs in those areas of responsibility which clearly belong to State Government under basic definitions established by the Legislature and in the Constitution, with such recommended changes in policy as are proposed by the Governor.

At the present time there would appear to be inconsistencies in responsibility, in program emphasis, and there are many outmoded or unnecessary procedures which warrant legislative review. Throughout this *Analysis* it is our purpose and duty to point out what in our opinion are inconsistencies, or deficiencies in terms of a total program which can be financed from the best possible allocation of current revenues available under the law, without the necessity of imposing additional taxes in this Budget Year. It should be made clear from the outset that a balanced budget without new taxes cannot be achieved for more than one year without changes both in law and in previously established legislative policy.

A clearer picture of the financial problem can be seen from the chart and tables which follow, showing General Fund revenues and expenditures since 1946-47 and projected to 1955-56.

It will be seen that since 1945-46 there have been only three years in which the state revenues were sufficient to balance the outgo. In all other years, which is seven including the Budget Year 1955-56, outgo has been substantially in excess of current income. This situation has been possible only because of large surpluses produced during the war and immediate post-war years plus surpluses developed during the

TABLE 3  
CALIFORNIA'S GENERAL FUND—INCOME, OUTGO AND SURPLUS—1946-47 TO 1955-56

	Revenue	Expenditures	Outgo		Current revenue surplus (+) or deficiency (—)	Adjustments <sup>2</sup>	Cumulative surplus
			Transfers <sup>1</sup> to reserves	Total outgo			
July 1, 1946 -----	-----	-----	-----	-----	-----	-----	\$175,839,186
1946-47 -----	\$447,288,354	\$274,826,836	\$237,446,250 <sup>3</sup>	\$512,273,086	—\$64,984,732	+ \$3,963,818	114,818,272
1947-48 -----	471,696,706	412,588,912	29,275,000 <sup>4</sup>	441,863,912	+29,832,794	—1,554,676	143,096,390
1948-49 -----	510,440,640	507,625,919	79,975,867 <sup>5</sup>	587,601,786	—77,161,146	—9,366,383	56,568,861
1949-50 -----	551,240,969	577,171,910	---	577,171,910	—25,930,941	+6,214,151	36,852,071
1950-51 -----	672,064,783	588,508,776	---	588,508,776	+83,556,007	+437,815	120,845,893
1951-52 -----	734,025,725	637,038,802	49,258,938 <sup>6</sup>	686,297,740	+47,727,985	+1,406,542	169,980,420
1952-53 -----	773,977,227	716,575,373	129,739,439 <sup>7</sup>	846,314,812	—72,337,585	—253,532	97,389,253
1953-54 -----	798,083,615	810,662,483	33,192,465 <sup>8</sup>	843,854,948	—45,771,333	+2,186,055	53,803,975
1954-55 (est.) -----	827,026,446	862,661,437	16,655,065 <sup>9</sup>	879,316,502	—52,290,056	+29,207,514 <sup>10</sup>	30,721,433
1955-56 (est.) -----	845,680,535	925,904,863	19,710,193 <sup>11</sup>	945,615,056	—99,934,521	(deficit) <sup>12</sup>	—69,213,088

<sup>1</sup> Transfers to the legislative contingent funds treated as expenditures. Miscellaneous minor transfers treated as expenditures or adjustments to surplus. With the exception of \$50,000,000 transferred to the School Bond Retirement Fund, the transfers of 1951-52 and subsequent years represent transfers for expenditure in the year in which transferred rather than sums reserved for expenditure in future years.

<sup>2</sup> Includes adjustments for prior years and changes in methods of accounting for revenues and expenditures.

<sup>3</sup> \$162,446,250 transferred to the Postwar Employment Reserve and \$75,000,000 transferred to the Revenue Deficiency Reserve.

<sup>4</sup> \$26,800,000 transferred to the Postwar Employment Reserve and \$2,475,000 transferred to the Highway Fund.

<sup>5</sup> \$59,206,003 transferred to the Postwar Employment Reserve, \$13,445,883 transferred to the State Beach and State Park Funds and \$7,323,981 transferred to the Postwar Unemployment and Construction Fund.

<sup>6</sup> \$49,258,938 transferred to the Capital Outlay and Savings Fund.

<sup>7</sup> \$79,739,439 transferred to the Capital Outlay and Savings Fund and \$50,000,000 transferred to the School Bond Retirement Fund.

<sup>8</sup> \$33,192,465 transferred to the Capital Outlay and Savings Fund.

<sup>9</sup> \$12,805,528 transferred to the Capital Outlay and Savings Fund and \$3,849,537 transferred to the Flood Control Fund of 1946.

<sup>10</sup> The sums of \$27,369,821 and \$1,837,693 were transferred from the School Bond Retirement Fund and the Employment Contingent Fund, respectively, to the General Fund to offset an anticipated deficit. New estimates of revenues and savings in appropriations together with the two transfers are expected to leave a surplus of approximately \$30,700,000 instead of a deficit for the 1954-55 Fiscal Year.

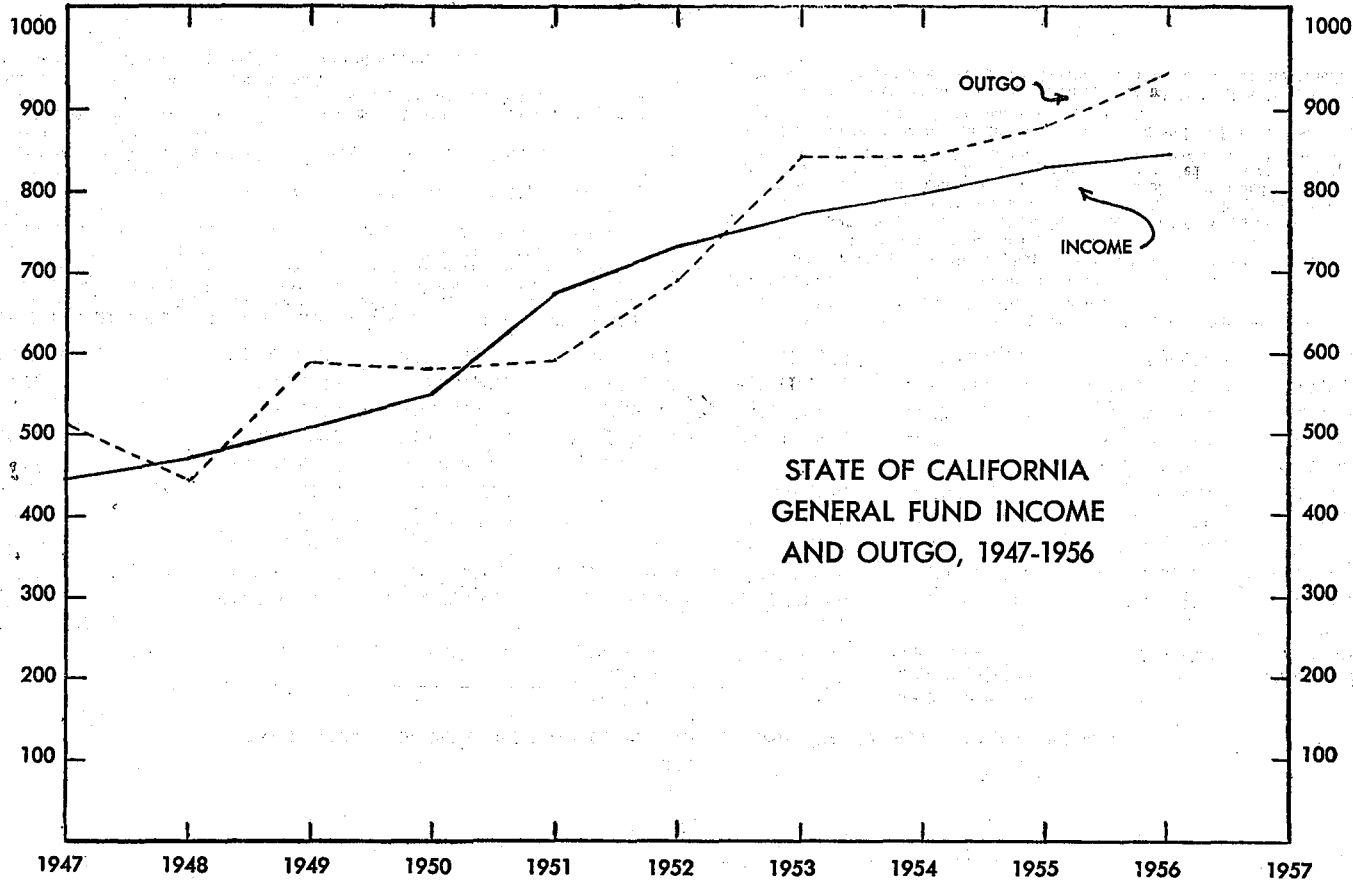
<sup>11</sup> \$16,301,184 to be transferred to the Capital Outlay and Savings Fund and \$3,409,009 to be transferred to the Flood Control Fund of 1946.

<sup>12</sup> New tax sources estimated to yield approximately 70.4 million dollars in general revenue for 1955-56 are proposed by the Governor to offset the prospective deficit.

MILLIONS OF DOLLARS

### CHART I

MILLIONS OF DOLLARS



STATE OF CALIFORNIA  
GENERAL FUND INCOME  
AND OUTGO, 1947-1956



TABLE 4  
**COMPARISON OF CALIFORNIA'S PROPOSED EXPENDITURES AND ESTIMATED REVENUES FOR  
 1955-56 WITH ACTUAL EXPENDITURES AND ACTUAL REVENUES FOR 1946-47**

<i>Fiscal year</i>	<i>Estimated population</i>	STATE EXPENDITURES							
		<i>Total expenditures</i>		<i>General Fund expenditures</i>		<i>Special Fund expenditures</i>		<i>Reserve Fund expenditures</i>	
		<i>Amount</i>	<i>Per capita</i>	<i>Amount</i>	<i>Per capita</i>	<i>Amount</i>	<i>Per capita</i>	<i>Amount</i>	<i>Per capita</i>
1955-56 -----	13,000,000	\$1,529,768,400	\$117.7	\$924,024,900	\$71.08	\$527,381,300	\$40.57	\$78,362,200	\$6.28
1946-47 -----	9,700,000	469,680,000	48.42	274,830,000	28.33	176,100,000	18.15	18,750,000	1.94
<i>Increase</i>									
Amount ---	3,300,000	\$1,060,088,400	\$69.28	\$649,194,900	\$42.75	\$351,281,300	\$22.42	\$59,612,200	\$4.34
Percent ---	34.0%	225.7%	143.1%	236.2%	150.9%	199.5%	123.5%	(317.9%)	(223.7%)
		STATE REVENUES							
		<i>Total revenues</i>		<i>General Fund revenues</i>		<i>Special Fund revenues</i>		<i>Reserve Fund revenues*</i>	
		<i>Amount</i>	<i>Per capita</i>	<i>Amount</i>	<i>Per capita</i>	<i>Amount</i>	<i>Per capita</i>	<i>Amount</i>	<i>Per capita</i>
1955-56 -----	13,000,000	\$1,362,187,200	\$104.78	\$845,680,500	\$65.52	\$515,556,700	\$39.66	\$950,000	\$0.07
1946-47 -----	9,700,000	604,950,000	62.37	447,300,000	46.11	157,400,000	16.23	250,000	0.03
<i>Increase</i>									
Amount ---	3,300,000	\$757,237,200	\$42.41	\$398,380,500	\$19.41	\$358,156,700	\$23.43	\$700,000	\$0.04
Percent ---	34.0%	125.2%	68.0%	89.1%	42.1%	227.5%	144.4%	(280.0%)	(133.3%)

\* Revenue represents interest on investment of money in the funds. Transfers from General Fund not included.

Korean military period. Unless bolstered by inflationary federal budgets, which have the result of increasing state revenues, the State has been unable to meet its current obligations.

**TABLE 5**  
**CHANGE BY MAJOR EXPENDITURE GROUPINGS—1946-47 TO 1955-56**

<i>Expenditure groupings</i>	<i>1946-47</i>	<i>1955-56</i>	<i>Increase</i>	
	<i>(millions)</i>	<i>(millions)</i>	<i>Amount</i>	<i>Percent</i>
State Operations -----	\$142.2	\$414.5	\$272.3	191.5
Subventions:				
Education -----	112.7	469.1	356.4	316.2
Social welfare and health -----	55.2	160.1	104.9	190.0
Other -----	12.5	16.7	4.2	33.6
Shared Revenues				
Highway and liquor -----	61.1	176.6	115.5	189.0
Capital Outlays				
Highways -----	53.0	210.7	157.7	297.5
Other -----	33.0	82.1	49.1	148.8
<b>Total expenditures -----</b>	<b>\$469.7</b>	<b>\$1,529.8</b>	<b>\$1,060.1</b>	<b>225.7</b>

The current General Fund deficit proposed in the Budget for 1955-56 is the largest to date. Whereas revenues have increased almost double from 447 million dollars in 1946-47 to an estimated 845 million dollars in 1955-56, outgo has increased from almost 275 million dollars to over 945 million dollars in the same period of time. The approximately 100 million dollar gap between the proposed outgo of over 945 million dollars for 1955-56 and revenues of over 845 million dollars clearly indicates that even though existing reserves are used for the purpose of balancing the budget in 1955-56 in lieu of new taxes, it will be necessary to increase taxes for the following year unless costs are reduced along lines recommended in our *Analysis*, or unless serious inflation is encountered resulting in extraordinarily heavy state revenues.

The projection of budgeted outgo and revenues to 1957-58 as shown in Table 6 reveals that even though the Governor's tax proposals are adopted by the Legislature, a reduction in reserves will be required to balance the budget for 1956-57, and the budget for the Fiscal Year 1957-58 will be faced with a problem of meeting estimated outgo of \$1,057,000,000 with projected revenue of only \$897,000,000.

If the suggested program reductions are made in 1955-56 and certain available reserves are used, that year can be financed without new taxes. With the same program reductions, it is possible to finance even the following year by either (1) the use of the balance of available reserves or (2) taxes similar to those proposed by the Governor. Thus, with program reductions and the use of the balance of available reserves, it will be possible to delay until the general session of 1957 a consideration of major tax revisions.

Moreover, with (1) the adoption of our recommendations, (2) the use of all available reserves, and (3) the adoption of the Governor's tax proposals in 1956-57, it would be possible to balance the budget through 1957-58. At this point, however, the current deficit, increasing, as it will, with public school and other fixed charges, will have grown to a size to require consideration of additional tax revision.

In our opinion, it would be desirable that tax changes be considered on a longer range basis, in the light of anticipated General Fund re-

quirements and as an integrated tax program, rather than on a piecemeal basis.

A comparison of the projected financial condition of the State on the basis of (1) the Governor's Budget, (2) using reserves for 1955-56 and taxes in 1956-57, and (3) our recommendations plus the Governor's taxes in 1956-57, is shown in the following tables. The detail of our major budget balancing recommendations is explained in the section following the tables.

**TABLE 6**  
**ASSUMPTIONS AS TO GENERAL FUND OUTLOOK**

	<i>General Fund (in millions)</i>		
	<i>1955-56</i>	<i>1956-57</i>	<i>1957-58</i>
<b>Schedule I—Revenues and expenditures projected through the 1957-58 Fiscal Year</b>			
Revenues -----	\$845.7	\$871.0	\$897.0
Expenditures -----	945.6	1,009.0	1,057.0
Current deficiency -----	-99.9	-138.0	-160.0
<b>Reserves—"Rainy Day" and School Bond</b>			
Retirement Funds -----	69.2	23.9	--
Beginning surplus (+) or deficit (-) -----	+30.7	--	-114.1
Prospective deficit -----	--	-114.1	-274.1
<b>Schedule I(a)—Budget projection showing effect of new tax levies proposed by the Governor—without the use of reserves</b>			
Prospective current deficiency -----	-99.9	-138.0	-160.0
New tax levies -----	70.4	80.2	80.2
Beginning surplus (+) or deficit (-) -----	+30.7	+1.2	-56.6
Prospective surplus (+) or deficit (-) at end of year -----	+1.2	-56.6	-136.4
<b>Schedule I(b)—Effect of new tax levies—with the use of "Rainy Day" Fund and School Bond Retirement Fund</b>			
Prospective current deficiency -----	-99.9	-138.0	-160.0
New tax levies -----	70.4	80.2	80.2
Application of reserves -----	--	56.6	36.5
Beginning surplus (+) or deficit (-) -----	+30.7	+1.2	--
Prospective surplus (+) or deficit (-) at end of year -----	+1.2	--	-43.3
<b>Schedule I(c)—Effect of Legislative Auditor's Recommendations for balancing the 1955-56 Budget—without new tax levies but using reserves and balances</b>			
Prospective current deficiency -----	-99.9	-138.0	-160.0
Legislative Auditor's recommendations for reductions and use of reserves and transfers -----	194.7	20.0	20.0
Beginning surplus (+) or deficit (-) -----	+30.7	+125.5	+7.5
Prospective surplus (+) or deficit (-) at end of year -----	+125.5	+7.5	-132.5
<b>Schedule I(d)—Effect of Legislative Auditor's Recommendations for balancing the 1955-56 Budget and application of new tax levies similar to Governor's in 1956-57</b>			
Prospective current deficiencies -----	-99.9	-138.0	-160.0
Legislative Auditor's recommendations for balancing the budget -----	194.7	20.0	20.0
New tax levies -----	--	70.4	80.2
Beginning surplus (+) or deficit (-) -----	+30.7	+125.5	+77.9
Prospective surplus (+) or deficit (-) at end of year -----	+125.5	+77.9	+18.1

NOTE: Revenues and expenditures 1955-56 and 1956-57 as shown in Budget Message.

RECOMMENDATIONS

A statement outlining the Legislative Auditor's recommendations for balancing the budget for 1955-56 is shown below, related to the Governor's Budget totals for the General Fund. Following this tabulation is an analysis of the factors involved in each of the enumerated balancing items in the tabulation. The analysis of each item is numbered to correspond with the number which identifies it in the following tabulation:

**TABULATION OF LEGISLATIVE AUDITOR'S RECOMMENDATIONS  
RELATED TO GOVERNOR'S BUDGET**

Governor's Budget General Fund Expenditure Program for 1955-56 -----		\$945,615,000
Less Recommended Reductions in Programs:		
1. Budget Bill reductions—General Fund -----	\$29,170,000	
2. Social Welfare—"lien law" -----	9,500,000	38,670,000
Net Expenditure Program for 1955-56 -----		\$906,945,000
Estimated General Fund revenues for 1955-56 -----		845,680,500
3. Fairs revenues transferred to General Fund -----		4,000,000
Current deficiency -----		—57,264,500
Less beginning surplus—July, 1955 -----		30,721,400
Prospective deficit June 30, 1956 -----		—\$26,543,100
<b>Funds Recommended for Balancing the Budget</b>		
4. Fairs—surpluses -----	\$9,500,000	
5. State Fair site -----	3,000,000	
6. State College Fund -----	2,863,100	
7. Division of Architecture Public Building Fund -----	2,158,100	
8. Redemption Tax Fund -----	670,800	
9. Employment Contingent Fund -----	2,761,500	
10. Postwar Unemployment and Construction Fund -----	3,000,000	
11. University of California—reserves -----	(8,718,000)	
12. School Bond Retirement Fund -----	18,136,100	42,089,600
Prospective surplus June 30, 1956, estimated -----		\$15,546,500
<b>Additional Funds Available for Balancing the Budget</b>		
13. Revolving funds -----		\$1,000,000
14. Tidelands revenues -----		34,000,000
15. Revenue Deficiency Reserve (Rainy Day Fund) -----		75,000,000
<b>Funds Not Recommended as Available</b>		
16. Teachers' Permanent Fund (special appropriation) -----		\$40,000,000
17. Unemployment Compensation Disability Fund -----		145,161,800
18. Unemployment Fund -----		774,212,600
19. Bond Sinking Fund of 1943 -----		5,564,268
20. Flood Control Fund of 1946 -----		40,000

**Recommended Reductions in Program**

The program reductions in the Governor's Budget as recommended by the Legislative Auditor fall into two main categories: (1) the total of reductions proposed in the Budget Bill, described individually by item number in Part IV of this Analysis, and (2) the continuing reduction in program costs of aged aid which would result from enactment of a recovery or lien law. Along with these reductions in cost, the transfer of four million dollars in horse racing revenues to purposes other than encouragement of fairs, will reduce other budget requirements correspondingly. These recommendations will serve to reduce

the continuing cost of government from General Fund sources and will eliminate the need for additional taxes therefor.

**1. Budget Bill Reductions**

These are described in detail in Part IV of this *Analysis*. Although in balancing the budget we refer only to \$29,170,000 in General Fund reductions, a total of \$37,670,000 is recommended including special fund appropriations. In addition some more Capital Outlay cost reductions can be expected upon completion of our review.

**2. Social Welfare Lien Law**

California's subvention for old age assistance purposes is approximately 120 million dollars *more* than the next highest state (Texas) pays and 140 million dollars more than the third highest state (New York) pays for their aged. This fact combined with the leadership which California maintains in free public education largely accounts for the size of the State Budget. We recommend that the Legislature enact provisions which would enable the State to recover from the estates of deceased recipients those amounts paid to them in aged aid.

In March, 1953, a survey was completed by our office which indicated that some 33 states and the District of Columbia had such a procedure in effect. Recovery provisions were adopted by 23 of these states at the beginning of their assistance program. The following table indicates the effective date of the statute and the type of recovery provisions in effect at the time of our survey.

**EFFECTIVE DATES AND TYPES OF RECOUPMENT PROVISION AFFECTING STATE OLD AGE ASSISTANCE PROGRAMS, MARCH, 1953**

State	I Effective date of law			II Type of recovery law		
	From beginning of aid program and		1950 to 1952	Unsecured claim against estate	Secured claim against estate	Lien agreement quired before aid is granted
	prior to 1940	1940 to 1950				
Arizona		X		X		
Connecticut	X			X		
Idaho			X			X
Illinois	X			X		
Indiana		X <sup>1</sup>			X	
Iowa	X			X		
Kentucky			X		X	
Maine	X			X		
Maryland	X			X		
Massachusetts			X			X
Michigan		X		X		
Minnesota	X				X <sup>2</sup>	
Montana	X			X		
Nebraska	X				X <sup>2</sup>	
Nevada	X			X		
New Hampshire	X				X	
New Jersey	X					X
New York	X					X
North Carolina			X		X	
North Dakota	X					X
Ohio	X				X <sup>2</sup>	
Oregon			X	X		
Pennsylvania	X					X <sup>2</sup>
Rhode Island	X				X <sup>3</sup>	
South Dakota	X				X	

**EFFECTIVE DATES AND TYPES OF RECOUPMENT PROVISION AFFECTING STATE  
OLD AGE ASSISTANCE PROGRAMS, MARCH, 1953—Continued**

State	I Effective date of law			II Type of recovery law		
	From	1940 to 1950	1950 to 1952	Unsecured claim against estate	Secured claim against estate	Lien claim agreement re- quired before aid is granted
	beginning of aid program and prior to 1940					
Tennessee	---	X	---	X	---	---
Utah	---	X <sup>1</sup>	---	---	---	X
Vermont	X	---	---	X	---	---
Virginia	X	---	---	X	---	---
West Virginia	X	---	---	---	---	X
Wisconsin	X	---	---	---	X	---
Wyoming	---	X	---	X	---	---
Number of states	21	6	5	14	10	8

<sup>1</sup> Property lien provisions were part of original old age assistance program; subsequently lien provisions were repealed but more recently were re-enacted.

<sup>2</sup> Recovery provisions were part of original old age assistance program but property lien statutes have been added to strengthen recovery laws.

<sup>3</sup> Regulations of the Rhode Island Department of Social Welfare require all applicants to give written consent to a lien on real property as a part of establishing eligibility.

The estimates of savings which could be secured from enactment of a recovery law are as follows:

(a) Case load decline

Estimated case load, 1955-56	\$272,500
One-third of case load estimated to have property	90,833
Thirty percent of property holders (10 percent of total case load estimated to drop from rolls)	27,250
Total savings from dropped cases to be realized annually after June 30, 1957	
$27,250 \times \$67.50 \times 12$	\$22,072,500
State	\$9,745,009
Federal	10,709,577
County	1,617,914

(b) Deterred case load

Estimated additions to case load which would have been realized annually after June 30, 1957, if no lien law.	
3,000 per month $\times 12$	36,000
One-third estimated to have property	12,000
One-half of property owners estimated not to apply	6,000
Estimated savings $6,000 \times \$67.50 \times 12$	\$4,860,000
State	\$2,145,690
Federal	2,358,072
County	356,238

(c) Recovery (annual after June 30, 1958)

Estimated market value of property (average)	\$3,000
Estimated allowances for death on encumbrance	1,000
Estimated recoverable amount	2,000
Estimated deaths 7 percent of case load	19,075
One-third estimated to have property	6,358
Less one-third voluntary drops (deterred and declining case load)	2,119
Estimated number of recoveries	4,239
Savings $4,239 \times \$2,000$	\$8,478,000
State	\$3,743,037
Federal	4,113,526
County	621,437

Allowance for a later claim for the estate is necessary in some cases because about one-half of the cases will have a spouse. Assuming that one-half of the property held by a spouse will revert to the State, we are estimating three-fourths of the above amount to be the annual yield.

Modified savings -----	\$6,358,500
State -----	\$2,807,278
Federal -----	3,085,144
County -----	466,078

(d) Summary of estimated savings (\$000,000 omitted). The distinction between case drop and deterred case load is eliminated after 1956-57 and a decreased level of aid amounting to \$10,000,000 annually is estimated.

Item	1955-56	1956-57	1957-58	1958-59	1959-60
(a) -----	\$8.0	\$9.5	\$10	\$10	\$10
(b) -----	1.5	2.1			
(c) -----			1	1.8	2.8
Total -----	\$9.5	\$11.6	\$11	\$11.8	\$12.8

Recognizing intangibles, we believe these estimates, which are based on California's own case load, are conservative. *It will be noted that for the 1955-56 Fiscal Year it is estimated that savings from the enactment of a recovery law will be \$9,500,000, and in 1956-57 they will be \$11,600,000.*

### 3. Horse Racing Revenues and Fairs

From the beginning of legalized horse racing in California in 1933, a substantial part of the revenues derived from this source has been earmarked to special funds for allocation to state, county and district fairs. The availability of large amounts of revenue from this source and its earmarking under fixed apportionments for fair purposes have led to a failure to accomplish adequate review of budgets of the county and district fairs or a consideration of the entire fair program in relationship to other needs of the State.

As a necessary step to place support for fairs in proper relationship to other state needs, we recommend *that the Fair and Exposition Fund be abolished and that revenue (equivalent to 4 percent of the pari-mutuel pool) which now goes into the Fair and Exposition Fund in accordance with Section 19620, Business and Professions Code, be channeled into the State's General Fund.* We further recommend (a) that this same action be taken with regard to breakage revenues that go into the State College Fund and (b) that all activities now supported from horse racing revenues, to the extent that they are deemed necessary by the Legislature, be supported on the basis of annual budget justifications and annual appropriations from the General Fund.

Further reasons for this basic recommendation are as follows:

- (a) The creation of special funds and the appropriation of fixed amounts or fixed percentages from these special funds is unsound budgetary and fiscal policy. It obscures the State's financial position, limits the Legislature's ability to consider the relative needs of fairs and related activities in terms of other programs, or the over-all financial condition of the State, and tends to remove selected activities of government from general public scrutiny in terms of the general tax burden of the State.

- (b) Revenues from horse racing have become substantial and may be regarded as a permanent part of California's tax program. In amount they exceed several other General Fund taxes including those on alcoholic beverages.
- (c) Except for the relatively small amount appropriated annually for support of the Horse Racing Board, there appears to be no significant connection between horse racing and the activities for which Fair and Exposition Fund moneys are appropriated.
- (d) While several of the activities supported from the Fair and Exposition Fund are in the nature of "encouragement to agriculture," the primary efforts of the State to promote and assist agriculture are carried on through another department (Agriculture) and largely from the General Fund of the State.
- (e) Revenues to the Fair and Exposition Fund have increased tremendously over the years since pari-mutuel betting was legalized. This increase has resulted primarily from economic factors, yet the needs of those activities supported out of the Fair and Exposition Fund have no particular relationship either to economic conditions or to the amount of money in the fund.

Effectuation of this primary recommendation would shift the support of necessary activities from the Fair and Exposition Fund to the General Fund. Basic to a reasonable determination of necessity would be the need for a complete appraisal of the State, district and county fair program with a view to determining long range goals and a policy for continued State support under varying conditions.

Any one or a combination of the following steps would have the effect of placing support for fairs on a more realistic basis:

- (a) Legislation to recover for the State, and for appropriation for other purposes, unused surpluses accumulated by county and district fairs. These surpluses amount to more than 9½ million dollars.

To the extent that steps are not taken in this Session to utilize unbudgeted surpluses of the district and county fairs, there is evidence that much of this money will be committed immediately or at an early date for relatively low priority capital outlay expenditures by the fairs. This fund of 9½ million dollars could provide substantial assistance to the development of some of the State's critical state college and university needs, for example, in place of establishing new fair facilities which will result only in a continuing liability for annual support from the Fair and Exposition Fund.

- (b) Without changing the nature of the Fair and Exposition Fund and the basic legislative apportionments that are made from that fund, the Legislature could reduce the amounts made available to the county and district fairs and at the same time increase the amount of revenues available to the General Fund by changing the law to reduce from 4 percent of the total pari-mutuel



pool to 2 percent of the total pari-mutuel pool, the amount to go to the Fair and Exposition Fund. This would produce \$8,400,000 additional to the General Fund for 1955-56. However, some of the Fair and Exposition allocations are made to programs which would otherwise be supported from the General Fund, so that net recovery to the General Fund is \$4,000,000.

- (c) A method having somewhat the same effect would be for either legislation or a budget item to appropriate approximately \$8,000,000 from the Fair and Exposition Fund to the General Fund, leaving the balance in the Fair and Exposition Fund to be apportioned according to the existing statutory formula and individual budget items of appropriation. These budget items could be augmented to provide the budgeted amount of support and capital outlay for the two educational institutions which receive money from the Fair and Exposition Fund (California Polytechnic College and the University of California) and still provide a net gain to the General Fund of at least \$4,000,000.
- (d) The amount annually allocated to county and district fairs from the Fair and Exposition Fund could be reduced by an amendment and clarification of Section 19624 of the Business and Professions Code and Section 92 of the Agricultural Code, which would limit each fair to the maximum base of allocation which was apparently intended by the original law.
- (e) In addition to these methods, the amount of apportionments from the Fair and Exposition Fund, which are now subject only to allocation by the Department of Finance for capital outlay for fairs, could be amended to make all of these amounts subject to specific appropriation by the Legislature.

The dedication of approximately \$11,000,000 annually for fair purposes is, we believe, in excess of the amount needed, and a reasonable state-wide fair program geared to fundamental fair and exposition objectives can be carried out with far less money than the amount currently appropriated. The analysis which follows of the budgeting processes, accumulated reserves, and operating costs of the district and county fairs indicates the need, we believe, for a revision in the budget procedure and in the basis for apportionment.

#### **Powers of the Department of Finance Over Fair Operations**

The Department of Finance is authorized to apportion money appropriated for the encouragement of county and district fairs on the basis of the amount each fair actually paid in premiums. Such money may be expended for premiums, purchase of land, construction, improvements, equipment, or for the acquisition, installation, maintenance, and operation of recreational facilities or support of county or district fairs pursuant to a budget submitted to and approved by the Department of Finance, subject to Sections 13320 to 13324, inclusive, of the Government Code. (Section 92, Agricultural Code.)

Six thousand dollars shall be the maximum base of allocation paid any fair for its first year of operation and thereafter, in each subsequent year in which a fair is held, the maximum base of allocation shall increase by 10 percent over the maximum base for the year in which a fair was last held. (Section 92, Agricultural Code.)

Forty percent of the first balance of the Fair and Exposition Fund shall be apportioned to fairs by the Department of Finance and expended under its supervision in the manner and for the purpose prescribed by Section 92 of the Agricultural Code, but no fair in any one year shall receive a sum in excess of \$65,000 under Section 92 of the Agricultural Code. (Section 19624 (b) Business and Professions Code.)

The directors of each district agricultural association shall annually make to the Department of Finance such report as the department may direct. (Section 91, Agricultural Code.)

The Department of Finance, in its discretion may at any time examine the books and records of any fair to determine the correctness of any statement or report filed with the Department of Finance. (Section 92, Agricultural Code.)

The Department of Finance may authorize the Board of Directors of Fairs to:

- (a) Fix the term of office, the amount of bond, salary, prescribe the duties of the secretary and of the treasurer.
- (b) Manage the affairs of the association.
- (c) Make all necessary by-laws, rules and regulations for the government of the association.
- (d) Arrange for and conduct any activity as they may deem advisable upon its property.
- (e) Delegate to its officers or employees any of the powers vested in the board. (Section 87, Agricultural Code.)

Of the second balance remaining each year in the Fair and Exposition Fund, 25 percent is allocated to California Polytechnic College, 33 percent to the University of California. The remaining 42 percent is allocated by the Director of Finance in his discretion, with the approval of the State Public Works Board, to the various fairs for permanent improvements. (Section 19626(c), Business and Professions Code.)

Notwithstanding any other provision of law, Agricultural District 1A may, with the approval of the Department of Finance, expend any money made available to it for construction, repairs and equipment. (Section 19626.5, Business and Professions Code.)

The Department of Finance prescribes rules and regulations for the judging of exhibits, and the maximum amount of premiums which may be offered and paid for all classes, sections and types of exhibits. (Section 92, Agricultural Code.)

#### Procedures for Fair Budgets

Under present procedures, the individual fairs submit budgets to the Division of Fairs and Expositions, Department of Finance. The division reviews them, making such revisions as seem necessary to make them compatible with the needs of the respective fairs. This is not a very critical review.

These budgets are not reviewed by the Legislature either as to line items or totals, and at least with respect to district fairs, there is some question as to the legality of this budgeting procedure.

In the paragraph of Section 92 of the Agricultural Code which authorizes the Department of Finance to apportion money for the support of the fairs, it is provided that the money is apportioned (pursuant to a budget submitted to and approved by the Department of Finance *subject to Sections 13320 to 13324*, inclusive, of the Government Code). (Emphasis added.)

These Government Code sections provide the machinery whereby the Governor may comply with the constitutional requirement of annually presenting a prepared budget of expenditures for legislative consideration as contained in Article IV, Section 34. It is of interest to note that this section requires that the Legislature be given "a budget containing a *complete plan* and *itemized statement* of all proposed expenditures of the State provided by existing law or recommended by him, and of all its institutions, departments, boards, bureaus, commissions, officers, employees and other agencies \* \* \*."

The fairs would seem to come under one of these designations. However, if it is believed that the language is not broad enough to accomplish this result, it would appear to be a relatively simple alternative to amend the statute to specifically include these fairs.

#### Support Allocations From Fair and Exposition Fund, First Balance

As noted above, the Agriculture Code provides that \$6,000 shall be the maximum base of allocation to each fair augmented by 10 percent for each year of its operation. The Business and Professions Code also authorizes the allocation of these funds to fairs "in the manner \* \* \* prescribed by Section 92 of the Agriculture Code but no fair in any one year shall receive a sum in excess of \$65,000 under Section 92 of the Agriculture Code."

In our opinion, the maximum base of allocation, expressed above, was originally intended to operate as a limitation upon the apportionments to new fairs otherwise it would not have been expressed as a "maximum base" but rather as a "base" of allocation, and it appears to be the opinion of both the Legislative Counsel and the Attorney General that this construction could have been given to the section administratively when it became apparent that revenues were sufficient to provide \$65,000 for each fair, instead of the construction now given to the section.

If the Fair and Exposition Fund is not abolished as a special fund for support of the fairs, it is our opinion that at least this section should be amended to put into effect a maximum base of allocation based upon age of fairs and amount of premiums paid.

The payment of \$65,000 annually to all fairs without regard to age, amount of premiums paid, or operating expenses, has resulted in the creation of excessive surpluses within the individual fairs. The total of all of these as of December 31, 1953, was approximately \$9,500,000.

Some of the larger of these surpluses are shown below for the following fairs:

Los Angeles County Fair.....	\$1,057,949
22d District—Del Mar .....	490,494
San Francisco County—Flower Show .....	383,489
21st District—Fresno .....	334,734
Alameda County .....	317,009
19th District—Santa Barbara .....	250,833
Marin County—Art and Garden Show .....	222,303
26th District—Plymouth .....	174,480
33d District—Hollister .....	173,484
45th District—Imperial .....	165,733
48th District—Los Angeles Livestock Show .....	161,832
National Orange Show—San Bernardino .....	152,278
35th District—Merced .....	150,586
42d District—Orland .....	141,627
Shasta County .....	135,102
Solano County .....	134,240
52d District—Sacramento .....	132,153
41st District—Crescent City .....	129,092
San Benito County .....	127,890
San Joaquin County .....	119,175
24A District—Hanford .....	115,263
Lassen County .....	114,263
37th District—Santa Maria .....	112,639
10th District—Yreka .....	111,174
21A District—Madera .....	108,879
Mendocino County .....	107,694
17th District—Grass Valley .....	107,461
39th District—Angels Camp .....	106,995
10A District—Tulelake .....	106,955
38th District—Turlock .....	106,519
20th District—Auburn .....	106,195
Trinity County .....	105,889
Santa Clara County .....	102,934
Riverside County .....	102,248
Placer County .....	102,116
Butte County .....	101,131
27th District—Anderson .....	101,050
Sixth District Agricultural Association, Los Angeles .....	47,314
1-A District Agricultural Association, San Francisco .....	11,104

The total of the surplus for all fairs as of December 31, 1953, approximately 9½ million dollars, if pooled in one fund, would be sufficient to pay the premiums and operating deficits of all the fairs for two years without any further allocations from the Fair and Exposition Fund. The surplus in the San Francisco County Fair Fund would carry their flower show without further allocations for 51.8 years. San Benito County, with a population of 14,330, has two annual fairs—county and district. The combined surpluses of the two fairs total \$301,374 or \$21.03 for every person.

In addition to, or independent of, the law changes which are recommended above, it is our recommendation that allocations for fairs be placed on a more realistic budget basis by the following steps:

- a. That the present method of allocating funds for capital outlay be abandoned; that no further commitments be made by the Department of Finance until the Legislature shall have had the opportunity to review the program in its entirety and to lay down such policy as may seem appropriate; that the Director of Finance submit a long-range construction program with a master plan for legislative approval.

- b. That each fair be required to submit a detailed budget both for support and for capital outlay following the format of the State Fair and other state agencies.
- c. That the budget for each fair be included in the regular annual State Budget and come up for review by the Legislature on the same basis as the State Fair and all other state agencies' Support and Capital Outlay Budgets.
- d. That the Division of Fairs and Expositions, as such, in the Department of Finance, be abolished.
- e. That the Division of Budgets and Accounts staff be augmented to provide the same type and degree of review of support and capital outlay. Expenditures for all district and county fairs' budgets as now prevails for other state agencies. That this augmentation consist of three budget analysts, one senior accountant and one clerical position. Actual dollar and cents savings to be effected by such an over-all staff reduction is reviewed in our analysis of the budget of the Division of Fairs and Expositions elsewhere in this report.

**Reserves, Funds, and Surplus Available for Consideration  
in Balancing the Budget**

Since 1943, the Legislature has set aside as special reserves a total of approximately \$900,000,000 of General Fund money. Those reserves in which there still remains unexpended balances together with certain special funds in which there are surpluses are outlined in the following text. We do not have the exact status of fund balances to date, but we have indicated estimated amounts for the respective dates shown.

*Special Note:* While the balance of the original appropriation of \$10,000,000 for the Central Valley Project which is presently earmarked in the General Fund is not listed in the foregoing schedule, we wish to explain its status in relation to the General Fund surplus on hand at the beginning of the 1955-56 Fiscal Year.

Chapter 3, Statutes of 1952, earmarked \$10,000,000 in the General Fund to provide for studies and surveys to determine the feasibility of purchasing the Central Valley Project, and as an initial down payment.

The appropriation language provides, in part, that the money is available for the express purposes without regard to fiscal years, but that the unexpended balance at June 15, 1955, shall revert to the General Fund in the event that no contract to purchase the project from the Federal Government is consummated prior to that time.

*The Governor's Budget for the 1955-56 Fiscal Year contemplates the reversion of the balance so earmarked in accordance with the terms of the appropriation language. This means that the sum of \$3,632,265 will revert and is included in the \$30,721,433 beginning General Fund surplus for the 1955-56 Fiscal year. This is shown in Schedule I, page A-4 in the forepart of the 1955-56 budget document. Consequently, this sum of money is not included in our list and comments on funds available for balancing purposes.*

#### **4. Fairs—Surpluses**

The county and district fairs currently have approximately 9½ million dollars in surpluses which have accrued as the result of prior state allocations of funds in excess of current expenditures. These are exclusive of the amounts budgeted for allocation in 1955-56. These can be returned to the General Fund by legislative action. We recommend that this be done. A full statement with details as to balances, has been shown under item 3 above.

#### **5. New Fair Site**

In 1950, the State acquired 1,063 acres of land for a new State Fair site. The purchase price was approximately \$850,000, or about \$800 per acre financed out of the General Fund. To date, the Legislature has refused expenditures for construction on the site. Estimates of the cost of developing the Fair site at the time of purchase were as high as \$30,000,000 and at present costs might run considerably higher. In our opinion, the development of the new site is not essential, and we believe that the present State Fair facilities should be considered as adequate to the public need. Consequently, we recommend that the new Fair site be sold. Although we do not have an appraisal of the present value of this land, we believe that based on recent sales of land in the area of the site, and other considerations, the State might realize in excess of \$3,000,000 from the sale of the site. This would provide additional money toward balancing the budget, and at the same time, would put this land back on the tax rolls. It would also forestall possible expenditure of many additional millions for the development of a new State Fairgrounds.

#### **6. State College Fund**

The State College Fund was established in Chapter 1477, Statutes of 1947, for the purpose of providing revenue to construct facilities for and to support an agricultural department as a responsibility of the Fresno State College.

Chapter 1477 provided the source of revenue for the fund by a continuous appropriation of breakage on horse race pari-mutuel wagering. A fund statement on page 1030 of the budget shows an estimated accumulated surplus as of June 30, 1956, amounting to \$2,863,167. Of this total, \$900,000 is shown to be reserved for a new polytechnic college and \$1,963,167 is shown as an unrestricted reserve.

We do not believe that this basis for financing one part of the state college program is sound. We believe that the entire state college program should be on a General Fund financial basis. We therefore recommend that the unbudgeted surpluses and reserves in this fund be placed in the General Fund and that the State College Fund be abolished, with breakage revenues accruing henceforth to the General Fund.

#### **7. Division of Architectural Public Building Fund**

This fund provides sources of revenue to defray the cost of state supervision of public school building construction. Revenues are derived chiefly from examination and plan approval fees. A fund statement on page 776 of the budget shows an estimated accumulated surplus as of June 30, 1956, amounting to \$2,158,135.

We find no real reason for maintaining a special fund for the stated purpose and therefore recommend that the unencumbered balance of this fund be transferred to the General Fund and that the fund be abolished.

**8. Redemption Tax Fund**

This fund is shown on page 415 of the budget. Its main source of revenue is derived from redemption fees assessed on the sales of state tax-deeded lands. The fund supports the operations of the Tax-deeded Lands Division in the Office of the Controller. A statement of the fund condition as of June 30, 1956, shows an estimated accumulated surplus of \$670,835. We find here another special fund, the revenues of which, in our opinion, rightfully should accrue to the General Fund. Consequently, we recommend that the unencumbered balance of the Redemption Tax Fund be transferred to the General Fund and that the fund be abolished.

**9. Employment Contingent Fund**

This fund was created for the purpose of providing a source of moneys in the event congressional appropriations for administering the State's unemployment insurance program were not sufficient. However, since Congress has always provided additional funds to meet deficiencies, the fund has been used for other purposes, mainly for acquisition of sites and construction of office buildings for the Department of Employment, although the sum of \$1,837,693 is shown to have been transferred to the General Fund in 1954-55.

The sources of revenue to the Employment Contingent Fund are derived from interest, penalties and fines imposed on late tax payments of employers, and from building rentals. A statement of this fund is shown on page 1098 of the budget which reflects a net accumulated surplus of \$2,261,511. In addition to this sum, Chapter 1776, Statutes of 1953, authorizes the transfer of \$500,000 to this fund from the Unemployment Disability Fund for repayment of a portion of the cost of plans for the Employment Building in Sacramento.

We recommend that the \$500,000 be transferred to the Employment Contingent Fund and the total amount in the fund be transferred to the General Fund. This recommendation would provide approximately \$2,761,511 toward balancing the General Fund in the 1955-56 Fiscal Year.

**10. Postwar Unemployment and Construction Fund**

Chapter 47, Statutes of 1944 (4th Ex. Session), appropriated \$10,000,000 of General Fund money for state aid to cities and counties on a matching basis for preparation of surveys and plans and specifications for proposed public works and acquisition of rights of way for major streets, roads, bridges, sewage, and other public facilities.

Chapter 648, Statutes of 1945, created the Postwar Unemployment and Construction Fund, and \$90,000,000 appropriated by Chapter 20, Statutes of 1946 (1st Ex. Session), was transferred from the General Fund to the Postwar Unemployment and Construction Fund. Of the \$90,000,000 appropriated, one-half was allocated to the cities and one-half to the counties of the State, with allocations to be made on a matching basis.

The status of appropriations from these chapters as of December 31, 1954, shows that there was on that date, a combined total of \$101,971,936 in appropriations, of which \$98,872,267 had been allotted, leaving a total of \$3,099,669 unallotted with applications for allotments pending in the amount of \$491,416. *Of the total sum allotted, there were unclaimed moneys totaling \$3,185,627, making a combined total of \$6,285,296 in unallotted and unclaimed money with \$491,416 in applications pending.*

The provisions of the act have been amended several times to extend the availability of the money in these appropriations. The Legislature, at the 1953 Session, extended the date for which applications may be made to June 30, 1955, at which time all unobligated and unallocated money is to revert to the General Fund. Provisions, however, are contained in the act whereby encumbrances made against the money during its availability may be paid at any time until June 30, 1956.

If the Legislature so desired, it would appear that some portion of this fund could be returned to the General Fund to provide additional money to meet the demands on the General Fund. This can be accomplished by allowing the terms of the acts to expire on the dates presently set forth in the acts.

If the periods of availability of money are not again extended, it appears reasonable to assume that at least \$3,000,000 of this money will revert to the General Fund in the 1955-56 Fiscal Year. We recommend that this money be reverted.

#### **11. University of California—Reserves for Dormitory Construction**

The university's request for state funds to finance its capital outlay program for the 1955-56 Fiscal Year amounts to \$12,347,063. Of this amount, \$900,000 is budgeted for real property acquisition, \$10,715,513 is budgeted for major construction, and \$731,550 is budgeted for minor construction. To finance the program, the sum of \$8,718,000 is requested from the State's Capital Outlay and Savings Fund.

We recommend that the university give the program for capital outlay, budgeted from state funds, priority over the proposed program of constructing dormitories and other projects from university reserves. If this recommendation is adopted, it will mean that the sum of \$8,718,000 requested from the State's Capital Outlay and Savings Fund will not be needed and the proposed transfer of \$16,301,184 of General Fund money to the Capital Outlay and Savings Fund will be reduced by \$8,718,000, thereby adding to the General Fund.

Further discussion of this recommendation is contained in our analysis on the State's Capital Outlay Program for the 1955-56 Fiscal Year in Section IV.

#### **12. School Bond Retirement Fund**

In Chapter 3, Statutes of 1952, the Legislature set aside \$50,000,000 of General Fund money in this fund to meet, in part, the annual debt service on the state school building bonds which cannot be met otherwise except from the General Fund. Estimates indicate a balance of \$18,136,142 as of June 30, 1956. The sum of \$27,369,821 was returned to the General Fund in the current year to meet an anticipated deficit which apparently is not now expected to occur.



In looking at the State's bonded debt position, as of *October 1, 1954*, it is noted that of a total of \$435,000,000 in school bonds authorized, there was a total of \$311,400,000 in bonds outstanding and a total of \$110,000,000 in bonds unsold. These figures, of course, do not include the additional sum of \$100,000,000 in school bonds authorized by the voters at the November, 1954, general election.

The bonds were authorized for the purpose of assisting school districts in financing adequate school facilities. The proceeds from the sale of the bonds are to be loaned to school districts which qualify for assistance under the provisions of law.

The State does not expect a full return of money advanced to the school districts, as some of them will not, under existing law, probably be in a position to repay their obligations in full. While it is not possible to predict the exact sum that the State might expect in the way of repayments, the Legislature did set aside a reserve to provide, in part, for the funding of the debt service on bonds.

The effect of returning the balance of the School Bond Retirement Fund to the General Fund would mean that the General Fund would have to meet the unfunded part of the annual debt service on the school bonds from current revenues. There is considerable logic to meeting current debt service from current revenues inasmuch as the use of schools constructed from such funds will provide benefits to taxpayers during the entire period of debt service. If the Legislature is faced with the choice of increasing taxes rather than using this reserve, we believe that it would be proper to use the reserve for General Fund purposes at that time and spread the burden of school construction cost over the period during which debt service will be required.

### **13. Revolving Funds**

A. *Educational Agency for Surplus Property.* The State Educational Agency for Surplus Property was established in 1946 to distribute surplus property of all federal agencies as well as surplus foods to schools and other eligible institutions. Since its establishment it has distributed close to \$50,000,000 worth of food and hardware. To provide the initial working capital, \$100,000 was advanced from the General Fund at the beginning of the 1947-48 Fiscal Year. An additional \$150,000 was advanced in 1948-49 and was repaid during the same year.

The fund maintains sufficient reserves to cover any obligations and maintains the \$100,000 working capital advanced from the General Fund. There is no doubt that it is necessary to maintain some working capital. However, it does not appear to be a necessity to keep the original \$100,000 General Fund advance in the revolving fund. Consequently, we recommend that the \$100,000 be repaid to the General Fund. The Director of Finance may, by executive order, return any portion of the revolving fund to the unappropriated moneys in the State Treasury.

Further discussion on this fund is contained in our analysis of the support budget for the Department of Education.

B. *State Water Pollution Control Fund.* This revolving fund was created by Chapter 1551, Statutes of 1949, to provide loans to districts and municipalities for sewage and storm drain facilities. The sum of \$1,000,000 was appropriated to this fund from the Postwar Unemployment and Construction Fund which was created with appropriations from the General Fund. There appear to be no allocations made in the current year nor are there any proposed for the 1955-56 Fiscal Year according to a statement on the fund shown on page 1350 of the budget. In view of the inactivity of this fund, as indicated above, we recommend that it be abolished and that the sum of \$230,198 in surplus estimated to be on hand as of June 30, 1956, or so much that is on hand and unencumbered as of that date, be transferred to the General Fund, and future interest and principal payments on existing loans be paid into the General Fund.

C. *Revolving Fund Refund.* In our analysis of the Budget Bill for the 1954-55 Fiscal Year, we recommended that the surplus in the Purchasing Revolving Fund be apportioned to the funds from which services charges were paid. The Department of Finance was to make a study of the Purchasing Revolving Fund to determine whether the money could be refunded and by what method.

The total surplus or accumulated overcharges to agencies in the Purchasing Revolving Fund, totaled \$777,761 as of June 30, 1954. These overcharges have accumulated to three operations in the following amounts:

Purchasing Division—stores .....	\$275,494
State garage—automotive pool.....	32,186
Radio maintenance operations.....	470,081
Total .....	\$777,761

Within the amount of \$470,081 which is overcharges for radio maintenance operations, General Fund agencies have been overcharged approximately \$412,350. The Division of Forestry has experienced the highest accumulated overcharges amounting to \$398,970. Other significant overcharges are: Department of Fish and Game, \$58,460; Bureau of Narcotic Enforcement, \$7,670; and the Office of Civil Defense, \$4,545.

The surplus has been used to supplement the working capital of the Revolving Fund. The fund now requires the use of these moneys or others if it is to continue to operate at its existing level assuming that the existing level is necessary and the operations are running efficiently. Serious consideration should be given to reducing the amount of working capital in the stores operation by reducing the inventory and thereby requiring the inventory to turnover more frequently. It is, however, necessary if part of these funds are to be returned to the overcharged agencies, to provide other funds for the Revolving Fund.

We recommend that the accumulated overcharges be refunded as soon as possible. In order to provide sufficient working capital in the Revolving Fund we suggest the following:

1. That statutory amendments be obtained, if necessary, to permit the charging in advance for services such as radio maintenance, and, if possible, stores sales, garage storage and such other services.

2. Obtain the necessary statutory amendments to allow the loaning or investing of funds from the Surplus Money Investment Fund or other funds. Government Code Section 16474 now restricts the investment of money in the Surplus Money Investment Fund to bonds and obligations of the United States.

D. *Correctional Industries Revolving Fund.* This fund is shown in the Budget at page 1326. It is noted that the budget (cash) surplus is estimated to be \$932,745 as of June 30, 1956. It is noted further that the budget cash surplus as of June 30, 1954, was \$1,069,353, of which \$200,000 was returned to the General Fund, and with steel purchases for the 1956 license plates, and the purchase of initial inventory of supplies for the new cotton textile mill and other factors, this sum was drawn down to \$610,547 at June 30, 1955, but for 1955-56 there is expected to be a net gain of \$322,198, bringing the cash surplus up to \$932,745 as of June 30, 1956.

In view of the foregoing and need for further justification of maintaining a large cash surplus, we recommend that an additional \$200,000 be returned to the General Fund as required to assist in balancing the Budget.

#### 14. *Tidelands Revenues*

It is our recommendation that legislation be enacted placing all revenues from the leasing of offshore reserves, including formerly em-pounded balances, in the General Fund. Development and maintenance of state parks and beaches would henceforth be financed entirely out of the General Fund. This would not mean that funds received from this source would not largely be used for the development of natural resources. On the contrary, a major portion of the State General Fund expenditures will continue to be for the development of economic enterprise in California. If it is the intent of the Legislature to use these funds to replace the depletion of natural resources, i.e., oil reserves, there are better ways than earmarking the money for beaches and parks.

The purpose to be served in financing these expenditures from the General Fund rather than special funds is two-fold: first, it assures that expenditures for these purposes will receive consideration on the same footing as the State's expenditure program for other vital functions when the latter is being formulated by the Governor and the Legislature. This provides for a more orderly budget process and more careful examination of expenditure programs than will be the case where specific amounts are earmarked for beaches and parks. Secondly, where in all probability the burden of maintaining state beaches and parks will ultimately fall upon the General Fund due to anticipated decline in revenues from oil reserves, it is sound practice to provide for the development of these resources on the basis of the same fundamental financial considerations which must be recognized when operations are financed from the General Fund.

To create contingent General Fund expenditures on the basis of a standard of expenditure which is based upon extraordinary or wind-fall revenues from a temporary or diminishing special source is poor

financial planning. The major portion of the State's financial problems arise from the fact that there is an excessive number of uncontrolled expenditures. The development of beaches and parks of necessity involves creating future expenditure obligations. However, the obligations created will be much less of a future budget problem if they are established in accordance with the kind of considerations which govern expenditures from the State's General Fund than if they are the product of an earmarked fund.

Accumulated surpluses in the beach and parks funds are shown in the Budget at page 715. The estimated combined total of accumulated surpluses at June 30, 1955, is shown to be \$40,900,021. If these surpluses are transferred to the General Fund, and if the same expenditure program as is budgeted for the 1955-56 Fiscal Year is allowed, the General Fund would gain approximately \$34,000,000 in the 1955-56 Fiscal Year as this amount represents the total of the combined surpluses as of June 30, 1956.

#### **15. Revenue Deficiency Reserve**

In Chapter 958, Statutes of 1947, the Legislature set aside \$75,000,000 of General Fund money as a reserve to provide a cushion in the event revenues dropped below budget estimates. The money is also available for disaster relief in the event of a state of extreme emergency. The total sum of \$75,000,000 is still intact in the reserve fund. Interest earned through investment of this sum accrues to the General Fund and is taken into account in the General Fund surplus each year.

The keeping of a reserve against revenue decline is a poor substitute for budget flexibility which allows the executive to depress expenditures as necessary to meet obligations. To the extent that this is not possible of accomplishment, the use of credit is available. If this reserve is maintained the next session of the Legislature will have to deal with the problem of revising the revenue program of the State again or cutting expenses. This latter is difficult to do with surpluses available.

The Governor's Budget, if adopted, will draw down this reserve in 1956-57. We believe this reserve should be used in balancing the Budget.

#### **16. General Fund Appropriation to Teachers' Retirement System**

In 1944 the Legislature appropriated the sum of \$30,000,000 from the General Fund to be deposited in the Teachers' Permanent Fund. This is contained in Chapter 13, Statutes of 1944, and was intended as a reserve for future state contributions. The availability of this sum with any increment through the investment of the money is subject to further legislative action.

It is estimated that this reserve will amount to approximately \$40,000,000 by June 30, 1956, by virtue of the appropriation of \$30,000,000 and an increment of \$10,000,000 derived from investments of the money in the reserve.

The State Teachers' Retirement System cannot be said to be on a full reserve basis, as the State's contributions to the system are made as liability matures and not as it accrues. In effect, this reserve is to assist the General Fund in future years the same as other reserves set aside for such purpose.

Since 1944, member contributions have been on a full reserve basis. State contributions, as pointed out, are appropriated in amounts required to liquidate the amount of maturing liabilities not funded. The sums requested from the General Fund to meet these liabilities for the 1955-56 Fiscal Year amount to a total of \$25,585,000.

An actuarial valuation of the system is in progress, and although we are without firm figures at the present time, it is anticipated that estimates of the State's liability will be available to the Legislature during the session. We do know that the unfunded liability will amount to hundreds of millions.

Estimated figures of surpluses as of June 30, 1956, in the three funds within the system show in round numbers \$116,404,250 in the Teachers' Permanent Fund (this includes the restricted sum of \$40,000,000), \$171,277,300 is shown as unbudgeted in the Retirement Annuity Fund, and approximately \$3,600,000 is estimated to be unbudgeted in the Annuity Deposit Fund.

Inasmuch as the \$40,000,000 reserved in the Teachers' Permanent Fund represents a reserve for future state contributions and may not be spent without further legislative enactment, it appears that the return of the sum to the General Fund to meet the current expenses of the State would simply increase General Fund requirements in the future in the same way as would the depletion of other reserves set aside to meet future General Fund requirements.

On the other hand it must be recognized that there is a very sound basis for retaining reserves for a retirement system, including a real argument for economy. The real purpose in establishing an actuarial basis for a retirement system, with accumulation of reserves, is to assess the cost of the program, and pay for it, at the time that the employees' service is rendered. In other words since the obligation is created pursuant to expenditures authorized by the Legislature and under a retirement law controllable by that Legislature, that same Legislature should see that revenues are sufficient in that same year to support the obligations created. This tends to discourage the creation of obligations, through overbudgeting of personnel or overliberalization of the retirement law, which will not be determined and paid for until years later.

The present system of state contributions, which is to pay only when the obligation matures, minimizes the obligation incurred today and passes the burden on to future years.

Although it is not practical to fund the State's already incurred obligation, it would be prudent to establish an actuarially sound basis for the State's future contributions to the Teachers' Retirement System in the same way that has been done with the State Employees' Retirement System. In this way any steps to increase benefits will be measured against the actuarially determined costs of the liberalization. It will also provide equity to future taxpayers who cannot be held accountable for the budget decisions of today or the retirement law currently in effect.

The importance of giving very careful consideration to the actuarial soundness of the Teachers' Retirement System is illustrated by the fact that the costs of the State's participation are mounting very rapidly and will continue to do so.

**17. Postwar Employment Reserve Fund and the Capital Outlay and Savings Fund**

Since 1943 the Legislature has appropriated a total of approximately \$600,000,000 to the two funds combined to meet the cost of the state construction program for state buildings and facilities, apart from highways.

The Capital Outlay and Savings Fund is the successor to the Postwar Employment Reserve Fund, all money in the latter fund having been transferred to this fund. With the exception of transfers of tideland revenues due to this fund, the money in the fund has been almost entirely appropriated for capital outlay projects.

The release of the impounded tidelands revenues to the State, and the transfer of approximately \$37,000,000 of this revenue into the Capital Outlay and Savings Fund means that the General Fund is relieved of that extent in meeting the capital outlay program for state facilities in the 1955-56 Fiscal Year, since the Capital Outlay and Savings Fund is the active transfer fund from which the State's institutional construction program is financed. For this reason we would eliminate the fund from consideration as a reserve.

**18. Unemployment Compensation Disability Fund**

In 1946 the Legislature added to the Unemployment Insurance Act Article 10, which established a system of unemployment compensation disability benefits within the unemployment insurance plan. This act became effective May 1, 1946.

A fund statement on page 1398 of the budget shows an estimated accumulated surplus amounting to \$145,161,815 as of June 30, 1956. Of this sum, \$10,750,000 are shown to be reserved as investments in Department of Employment buildings.

In addition to the \$145,161,815 of surplus, there is on deposit in an Unemployment Trust Fund in the Federal Treasury a principal amount of \$103,243,116 representing wage-earner contributions, and in addition to the principal amount there is shown a sum of approximately \$18,135,183 representing interest, or a total of \$121,378,299 in accumulated reserves in the Unemployment Trust Fund, which may be withdrawn for payments of disability benefits. The present ratio of worker contributions to benefit payments would indicate that there is little likelihood for need for withdrawal from this trust fund in the immediate future for payment of disability benefits. This sum might with legislative clarification also be available for payment of unemployment benefits, as mentioned in the following comments on the Unemployment Fund.

The contributions of employees and employers for unemployment compensation should not, in our opinion, be used for balancing the General Fund budget.

**19. Unemployment Fund**

This fund was established for the purpose of providing a depository to receive the proceeds from the tax assessed on pay rolls of employers and up to March 12, 1946, wage earner contributions, and to disburse benefit payments to claimants.

A fund statement on page 1398 of the budget shows an estimated accumulated surplus amounting to \$774,212,593 as of June 30, 1956, of which a total of \$768,487,593 is estimated to be in the Federal Treasury on that date. This sum includes also the \$121,378,299 in accumulated reserves mentioned under the comments on the Unemployment Compensation Disability Fund. A detailed analysis of the Unemployment Fund is contained in the report of the Legislative Auditor to the Assembly Interim Committee on Finance and Insurance, dated April 26, 1954.

We do not believe that this fund should be considered as available for General Fund purposes.

**20. Bond Sinking Fund of 1943**

Chapter 611, Statutes of 1943, and Chapter 1492, Statutes of 1945, provided for the transfer of \$26,239,738 from the General Fund to the Bond Sinking Fund of 1943 to meet future debt service on the General Fund obligation bonds which, at the time, were unfunded.

Estimates of the fund condition at June 30, 1956, indicate a balance of \$5,564,268. However, \$5,000,000 of this sum, pursuant to Chapter 1505, Statutes of 1945, was transferred to the State Highway Fund to provide funds to the Golden Gate Bridge Highway District whereby they would be able to contract for the construction of highway as a new approach to the bridge. The loan is to be repaid to the Bond Sinking Fund from toll revenues after the bonded debt of the bridge has been satisfied, which will be in 1971. This means that debt service on the state bonds will have to be met from the General Fund from the 1956-57 Fiscal Year to maturity of the bonds. This fund should not, we believe, be used for purposes other than those for which created.

**21. Flood Control Fund of 1946**

The Flood Control Fund of 1946 was created by Chapter 142, Statutes of 1946. The purpose of the fund was to provide state moneys for allocation to public agencies to defray the costs of local cooperation on federal flood control projects as required by federal act. Chapter 142, Statutes of 1946, and Chapter 1520, Statutes of 1947, appropriated a total of \$25,000,000 to the fund from General Fund money which had been previously set aside in the Postwar Employment Reserve Fund.

The fund has been augmented at various times through transfers from the General Fund. The 1955 Budget Bill provides for an additional transfer of \$3,409,009 from the General Fund to this fund to carry on various projects.

While the exact status of allocations and commitments of money in this fund are not shown, it is pointed out that, with the exception of \$40,000, the fund has been appropriated in full. We recommend that the money in this fund be not considered for the purpose of balancing the General Fund.