CALIFORNIA LEGISLATURE

1970 REGULAR SESSION

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1970, to June 30, 1971

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

STATE CAPITOL
Sacramento, March 1, 1970

THE HONORABLE STEPHEN P. TEALE, *Chairman*
and Members of the Joint Legislative Budget Committee
State Capitol, Sacramento

GENTLEMEN: In accordance with the provisions of Government Code, Sections 9140–9143, and Joint Rule No. 37 of the Senate and Assembly creating the Joint Legislative Budget Committee, defining its duties and providing authority to employ a Legislative Analyst, I submit an analysis of the Budget Bill of the State of California for the fiscal year July 1, 1970, to June 30, 1971.

The duty of the committee in this respect is set forth in Joint Rule No. 37 as follows:

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

I should like to express my gratitude to the staff of the State Department of Finance and the other agencies of state government for their generous assistance in furnishing information necessary for this report.

The staff of your committee has worked with extraordinary diligence to complete this comprehensive report within the brief time available, and to these men and women I am especially grateful.

Respectfully submitted,

A. ALAN POST
Legislative Analyst

INTRODUCTORY STATEMENT

of

BUDGET EXPENDITURES AND REVENUE

Form and Content of the Analysis

The Analysis of the Budget Bill is an annual report to the Legislature on the Budget of the State of California. It consists of two major sections.

The introductory section of the report contains a summary and general description of expenditures, particularly those of the General Fund, but also gives individual treatment to special and bond funds.

The section analyzes the estimated General Fund budget surplus and the cash position of that fund. It contains a review of the revenues to the General Fund, including an evaluation of the economic assumptions and individual tax estimates.

The amount of authorized and outstanding state bonds is described with particular reference to the state programs which are financed with bonds. Because of the special problem which currently exists arising out of the state's inability to sell bonds within existing interest rate limitations, we have discussed those fiscal implications in some detail.

Following this description of expenditures and revenues, each of the separate items in the Budget Bill is analyzed in detail with specific recommendations for economies or adjustments in expenditure. Because the Legislature is also able to affect the budget by revising statutory appropriations through legislation outside the Budget Bill, we include a number of recommended changes in the statutes.

Overall, this analysis will propose a large number of budget reductions and a small number of increases, with a net proposed overall reduction.

General Fund Budget Problem

As usual the 1970–71 budget problem is essentially a General Fund problem. The General Fund constitutes about $4.8 billion of the $6.5 billion budget (including bonds). Moreover, the income which flows into the General Fund primarily from the income, sales, bank and corporation, inheritance, liquor, cigarette, horseracing and insurance taxes fails to meet the expenditures budgeted from the fund. The General Fund is balanced only by

1. Consuming most of a beginning surplus of $112.7 million.
2. Assuming that revenues will accrue at the midpoint between a high and low economic assumption.
3. Assuming that Proposition No. 7 on the June ballot will be approved by the voters.

4. Reducing capital outlay to a level $133.7 million below that of 1969–70 to the lowest program level (including General Fund and bond funds) for capital outlay in at least 20 years.

The following table derived from the budget illustrates the General Fund budget problem.

General Fund Condition
(In Millions)

Beginning surplus (July 1, 1970)		$112.7
1970–71 income (includes revenues and transfers)		4,707.0
Total resources		$4,819.7
Proposed outgo	$4,796.9	
Less net expenditures of committed reserves (financed from prior appropriations)	—5.6	
Net outgo (as adjusted for committed reserves)		4,791.3
Ending surplus (June 30, 1971)		$28.4

This table illustrates the fact that the General Fund income is approximately $90 million less than outgo. While this is a substantial improvement over the deficit between income outgo in the current fiscal year, 1969–70, which is estimated to show a gap of approximately $274 million, it is based upon assumptions which could quickly change the assumed yearend surplus of $28.4 million into a significant deficit. Moreover, because of the slim beginning surplus and the characteristically slow flow of income into the General Fund in the first half of the fiscal year, the *cash* position of the General Fund reflects a deficit of $17.9 million under the budget assumption of a midpoint economic estimate, and a $72 million cash deficit if the budget's low estimate materializes.

A detailed analysis of the General Fund problem, including the major expenditure programs and revenue sources, is outlined more fully in the material which follows in this introductory section.

Program Budget Presentation

This year for the first time the printed budget submitted to the Legislature is limited to a program presentation. The 1969–70 budget was submitted in both the line item and program budget formats. However, assurance has been given by the Director of Finance to the Ways and Means Committee that line item detail will be furnished the committee prior to hearings on the budget.

The detail in the Program Budget falls far short of that which is needed to evaluate adequately either the program goals or proposed program levels, or the adequacy of funding requested for the program. It has, therefore, been necessary to depend almost entirely on backup information obtained directly from the agencies to support budget requests. The level of such information has not been consistently satisfactory. Many of the individual item analyses in this report comment on the specific lack of information.

If the Legislature is to properly evaluate programs before it decides how the state's limited tax resources are to be allocated, and if it is to rely on a program budget for that purpose, it seems clear that it should have available the same information that the executive points up as necessary. This is outlined in general terms by Section 6830.2 of the State Administrative Manual as follows:

"PROGRAM BUDGET Format (Revised 10/31/69) 6830.2

Program budgets must answer a number of important questions about each program, program element and component. The format suggested is designed to systematically direct attention to:

1. *Need*—Why is the program, element, or component needed?
2. *Objective*—What is to be accomplished? How do the program objectives relate to the need for the service?
3. *Output*—What product is delivered? How may the effectiveness of the program be measured?
4. *Authority*—By what or how is the program authorized?
5. *General Description*—How will activities and tasks be used to accomplish the objectives?
6. *Input*—What will the program cost?
7. *Workload Information*—What changes are made in order to accomplish objectives? Are positions being deleted or added, changes being made in program mix and operational needs changing?"

Clearly documented and detailed answers to these questions are essential for legislative review. Also, since the printed budget document as amended by legislative action and finally signed by the Governor represents the working budget for the succeeding fiscal year, the Legislature must determine the extent of detail in the printed document necessary to insure program control consistent with legislative action.

Preliminary design specifications for the Budget Data System have recognized the necessity, on a program and element basis, of providing historical fiscal information and what in effect is line item detail related to personnel and operating costs. Workload must be identified, and measurable units established, so that meaningful output data can be related to cost or input, and thus evaluated. We recognize that it will take several years of developing statistical information and accounting records before the program budget can become an effective tool for either the executive or the Legislature. However, we believe the present budget plus the supporting detail furnished this year falls short of that required for an adequate legislative evaluation, and deficiencies must be corrected if the program budget format is to be an effective tool for legislative budget review.

EXPENDITURE SUMMARY

Expenditure Program

State expenditures as proposed by the Governor total $6,480.3 million for 1970–71, including bond funds. State agencies will administer or subvene an additional $2,891.1 million in federal grants-in-aid and $492.6 million in federal reimbursements and special projects. The combined total state expenditures from all these sources is $9,864.0 million.

Although bond expenditures and federal funds are not included in budget totals under standard state accounting procedures, they finance significant elements in many programs included in the budget, and the amounts from these sources are separately identified in these budget programs. In order to present the total financial impact of the state budget, the combined expenditure level is presented in Table 1 for the 1968–69, 1969–70 and 1970–71 fiscal years.

Table 1

Combined Expenditure Summary

	1968–69	*1969–70*	*1970–71*
State budget expenditures	$5,266,651,000	$6,073,313,518	$6,152,982,902
Bond fund expenditures			
State construction program	62,448,590	43,037,460	4,780,906
Central Valley Water Project Construction Fund	116,694,422	187,584,933	77,861,495
California Water Resources Development Bond Fund	210,189,786	172,890,860	243,417,457
State Beach, Park, Recreational and Historical Facilities Fund	16,868,177	40,643,966	1,282,894
Total bonds	$406,200,975	$444,157,219	$327,342,752
Overall state expenditures	$5,672,851,975	$6,517,470,737	$6,480,325,654
Expenditures of federal funds			
Grants-in-aid, reimbursements and special projects	2,843,151,520	3,192,655,792	3,383,715,294
Combined expenditure level	$8,516,003,495	$9,710,126,529	$9,864,040,948

We have included bond funds and federal funds in the above overall expenditure summary only for information purposes. The following sections exclude bond and federal funds and include only General Fund and special fund expenditures which are the components of the so-called state budget program.

State Budget Program

State budget expenditures comprising General Fund and special funds components are proposed at $6,153.0 million for 1970–71. This is up $79.7 million or 1.3 percent over the $6,073.3 million estimated for 1969–70. The 1970–71 total is $886.3 million or 16.8 percent higher than the $5,266.7 million in the last year of actual expenditures, 1968–69. The total amounts as well as expenditures in the major functional categories are detailed below for these three years.

	1968–69	*1969–70*	*1970–71*
State operations	$1,578,594,031	$1,701,244,126	$1,821,036,741
Local assistance	3,180,638,933	3,750,489,163	3,976,725,070
Capital outlay	507,418,036	621,580,229	355,221,091
Total budget expenditure	$5,266,651,000	$6,073,313,518	$6,152,982,902

Comparing the above expenditure components, it is evident that the local assistance category is by far the largest in the budget. It is also the fastest growing budget component. For example, local assistance expenditures increased by $569.9 million or 17.9 percent from 1968–69 to 1969–70 and are expected to increase by $226.2 million or 6.0 percent from 1969–70 to 1970–71.

Expenditures for state operations increased $122.7 million or 7.8 percent between the earlier years, and an increase of $119.8 million or 7.0 percent is anticipated between 1969–70 and 1970–71.

Total capital outlay comparisons in the years shown by the budget are relatively meaningless since they are not in fact indicative of actual expenditures. This results because the middle year amount (in this case 1969–70) includes amounts in fund balances that will not be expended. This is an unrealistic budgeting procedure in that the basis for comparison with expenditures in other years is therefore distorted. The budget for the State Highway Program is the largest individual budget in which this has been a continuing practice.

The inclusion of these fund balances in the middle year estimate has been a regular budgeting procedure in the past. We recommend that the Auditor General determine what alternative accounting and reporting procedures are available so that the budget can be altered to present a more realistic picture of expenditures in the capital outlay category.

One important fact does emerge, however, from analysis of budget figures for capital outlay. The budget has been balanced largely by reducing General Fund capital outlay programs to bare minimums, and the small budget increase over last year is largely the result of such reductions as well as the more illusory budgeted reduction in highway construction.

General Fund Budget

The General Fund comprises approximately 78 percent of state budget expenditures and 74 percent of overall state expenditures when bond funds are included. The major budget problems are centered in or directly involve the General Fund. For instance, the state's inability to sell state bonds is requiring emergency loans from the General Fund to continue construction programs until bonds can be sold. Also most of the rapidly expanding major state budget programs receive all or nearly all financing from the General Fund. These include public schools, higher education, welfare and medical assistance, mental hygiene and correctional facilities.

General Fund Expenditures

The Governor has proposed $4,796.9 million in General Fund expenditures for 1970–71. This is $180.8 million, or 3.9 percent, higher than the $4,616.1 million estimated to be spent in 1969–70. By comparison, actual expenditures in 1968–69 were $3,908.8 million and the two-year increase to 1970–71 is therefore $888.1 million, or 22.7 percent. The budget totals and the distribution by functional categories is shown below.

	1968–69	*1969–70*	*1970–71*
State operations	$1,253,785,312	$1,338,515,630	$1,431,962,071
Local assistance	2,634,123,587	3,096,162,748	3,317,210,605
Capital outlay	20,874,048	181,451,371	47,715,901
Total General Fund expenditures	$3,908,782,947	$4,616,129,749	$4,796,888,577

Local assistance is the largest and fastest-growing category of General Fund expenditures. Increases of $462.0 million, or 17.5 percent, are estimated from 1968–69 to 1969–70, and $221.0 million, or 7.1 percent from 1969–70 to 1970–71. The two-year growth in this category during the period 1968–69 to 1970–71 is $683 million, or 25.9 percent.

State operations has risen by $84.7 million, or 6.8 percent, between 1968–69 and 1969–70, and by $93.4 million, or 7.0 percent from 1969–70 to 1970–71. Growth over the two-year period beginning in 1968–69 at $178.1 million, or 14.2 percent, was much lower comparably than for local assistance.

Capital outlay expenditures exhibit a very erratic pattern during the three-year period. Expenditures increased nearly nine times from $20.9

million in 1968–69 to $181.5 million in 1969–70. There is a decrease of $133.7 million, or 73.7 percent, from 1969–70 to an expenditure level of $47.7 million anticipated for 1970–71. The 1969–70 expenditure estimate is inflated because of a large carryover of $53 million from 1968–69 in unspent funds for higher education capital outlay. The 1969–70 total also includes $26.9 million resulting from a one-time special appropriation for Community Colleges capital outlay because financing from bond funds was unavailable.

Major Programs

The data in Table 2 indicate that the local assistance programs, comprised of social welfare, medical assistance, and property tax relief, are the fastest-growing state programs. Capital outlay and local assistance for education are the two most significant programs with expenditures in 1970–71 below the 1969–70 level.

Table 2

1970–71 Selected General Fund Budget Program Changes from the 1969–70 Expenditure Level (In Millions)

	1970–71, amount and percent of increase over 1969–70	
	Amount	*Percent*
Total increase in expenditures	$180.8	3.9%
Major program increases		
Local Assistance for Social Welfare	80.0	14.0
Medical Assistance	65.3	16.8
Trustees of the State Colleges	25.9	9.0
University of California	3.3	1.0
State Scholarship and Loan Commission	3.0	22.1
Debt Service [1]	15.9	11.7
Mental Hygiene—Support and Local Assistance	15.8	5.7
Salary Increases	60.0 [3]	3.1 [3]
Property Tax Relief	75.1	30.7
Major program decreases		
Local Assistance for Education [2]	—13.8	—0.9
Capital Outlay	—133.7	—73.7
Flood Control, Department of Water Resources	—8.3	—80.6
Industrial Relations	—2.8	—10.7

[1] Includes debt service on public school building bonds.
[2] Excludes debt service on public school building bonds.
[3] The salary increase amount approved for 1969–70 was $58.2 million.

Numerous adjustments between 1969–70 and 1970–71 in the level of other programs, both increases and decreases, account for the remainder of the change in General Fund expenditures in two years.

The following section indicates some of the economic, population and other factors that directly affect the major individual budget program needs and in turn influence the level of General Fund expenditures.

Workload Elements in General Fund Programs

State growth reflects directly in state budget increases to provide services at an authorized level to an expanding population and at increasing prices.

The major elements that influence General Fund expenditures are as follows:

1. State Population. The state civilian population will increase by an estimated 341,000, or 1.7 percent, from 19,796,000 on July 1, 1970

to 20,137,000 on this date in 1971. The gradually diminishing rate of population growth characteristic of the recent past appears to be reversing with the rate of growth again increasing slightly. Not all population segments grow at the same rate; for instance, college-age youth (19–24 years), which reflects in the enrollments of and expenditures for higher educational institutions, is expected to increase from 1,909,400 on July 1, 1970 to 1,997,200 a year later. This is an increase of 87,800, or 4.6 percent.

2. Salaries and Wages. This is the largest single element of direct state costs in the General Fund. An estimated $1,171.1 million, including the $60 million earmarked for salary increases, will be expended for salaries and wages in 1970–71. This amount is about 82 percent of total General Fund state operations expenditures. In addition, large portions of local assistance expenditures ultimately are expended for salaries and wages. For instance, it has been estimated that about 85 percent of school apportionments go to pay for these services. Salary and wage costs have recently been rising very rapidly in public programs and in private industry.

3. Price Increases. Prices of the goods and services the state purchases have been increasing very rapidly. Needs in state programs are heavily weighted toward services. Such services constitute one of the most rapidly increasing components of consumer prices. A comparison of price changes between December 1968 and December 1969 is made below for the U.S. Consumer Price Index and two important categories of that index.

	Percent of Increase
Consumer Price Index (all items)	6.1%
Services, less rent (U.S.)	10.8
Medical care (U.S.)	6.0

4. Social Needs. The expenditure level required for mental health, public health, medical assistance, corrections, and other social programs is subject to legislative appropriation, but the incidence of disease, crime, delinquency, and other social problems have a direct influence on the budget as reflected in admissions, institutional populations, and caseloads. These factors limit the legislative options for budget action and unless the level of services provided is reduced by specific legislative action expenditures increase each year.

The 1970–71 General Fund budget as proposed by the Governor does not fully reflect the workload growth in some programs and, therefore, if approved at that level will set new workload standards. These may be more or less appropriate than the previous standards. In some cases, additional federal funds will be available to provide for program expansion. A discussion of the various specific workload elements which affect the major General Fund programs is contained in the following section.

Specific Program Elements

The influence of the economic, population, legal, and other factors presented in the prior section is centered in the major General Fund programs. The specific reasons for expenditure adjustments are illustrated in the following program summaries. The 1970–71 program amounts do not include salary increase funds. These are proposed in separate items in the budget.

More detailed information can be obtained by referring to the discussions of these programs in the appropriate sections of this analysis.

Education

	Estimated 1969–70	*Proposed 1970–71*	*Increase*	*Percent*
Local assistance[1]	$1,615,921,471	$1,602,106,983	—$13,814,488	—0.9%
School apportionments	1,446,674,922	1,432,627,000	—14,047,922	—1.0
Average daily attendance				
K–8	3,247,767	3,235,000	—12,767	—0.4
9–12	1,292,861	1,345,000	52,139	4.0
13–14	341,482	385,000	43,518	12.7
Adults	133,188	140,000	6,812	5.1
Total a.d.a.	5,015,298	5,105,000	89,702	1.8

[1] Includes school apportionments, teachers retirement, free textbooks, special elementary school reading instruction, children's centers, compensatory education and other programs. Excludes debt service on School Building Aid Bonds.

A decrease of $13.8 million is proposed in local assistance for education (excluding debt service). This amount is the net of a decrease in the amount authorized for public school apportionments and other programs and an increase in state contributions to the teachers' retirement system. In 1969–70, the statutory authorization per unit of average daily attendance was set at $279.94 by Budget Act language and raised to $287.57 by Chapter 784, Statutes of 1969 (AB 606), based on an anticipated surplus. This year's budget proposes to return to the budget authorization of $279.94. As a result of this change, total General Fund authorization to the State School Fund will be reduced by $14 million. The other major program changes are shown below.

Other Major Changes, Local Assistance Education

	1969–70	*1970–71*	*Change*	*Percent*
Teachers' Retirement	$80,254,895	$92,400,000	$12,145,105	15.1%
Educational Improvement Act	5,000,000	--	—5,000,000	—100
Special Elementary School				
Reading Instruction Program	23,974,324	18,000,000	—5,974,324	—24.9
Children's Centers Construction	2,000,000	--	—2,000,000	—100
Free Textbooks	22,989,357	21,300,000	—1,689,357	—7.4

Higher Education	*1969–70*	*1970–71*	*Increase*	*Percent*
University of California	$329,679,000	$333,000,000	$3,321,000	1.0%
Average Annual Student				
Enrollment (F.T.E.)				
Lower Division	29,370	28,975	—395	—1.4
Upper Division	39,335	41,928	2,593	6.6
Graduate	32,776	30,830	—1,946	—5.9
Total	$101,481	$101,733	$252	0.2%

As shown above, University enrollments are projected to increase by 0.2 percent between 1969–70 and 1970–71. This relatively small increase is due to restrictions on enrollments in the graduate division and the abolishment of the summer quarter. The proposed budget is $3.3 million or 1.0 percent higher than the estimated 1969–70 expenditure. The above total for 1970–71 does not include funds for proposed salary increases which are included in a separate item.

	1969–70	*1970–71*	*Increase*	*Percent*
State Colleges	$288,115,503	$314,000,000	$25,884,497	9.0%
Enrollment (F.T.E.)	180,815	198,015	17,200	9.5

State college enrollments (F.T.E. basis) are continuing to expand as indicated by the 9.5 percent increase between 1969–70 and 1970–71. This increase is predicated on planned changes in admissions policies, procedures and student fees which had they not been changed would have resulted in an additional enrollment of 5,600 F.T.E. students.

Of the budget increase, $20.1 million is for instruction and relates directly to increased enrollments. The remaining $5.7 million is spread over research, student services and institutional services. The expenditure amounts for 1970–71 do not include funds for proposed salary increases which are included in a separate item.

Social Welfare	*1969–70*	*1970–71*	*Increase*	*Percent*
Department of Social Welfare State General Fund only				
Total local assistance	$573,042,975	$653,008,869	$79,965,894	14.0%
Total public assistance	$552,862,300	$642,166,900	$89.304,600	16.2
Major program changes:				
Aid to Families with Dependent Children [1]	$250,790,300	$320,648,000	$69,857,700	27.9
Family group—recipients average caseload	1,107,100	1,317,600	210,560	19.0
Amount per recipient—average monthly grant	$51.96	$56.62	$4.66	9.0
Foster home—recipients average caseload	32,050	34,500	2,450	7.6
Amount per recipient—average monthly grant	$131.00	$142.50	$1,150	8.8
Aid to Needy Disabled	$92,944,300	$107,543,200	$14,598,900	15.7
Average caseload	168,860	188,650	19,790	11.7
Average monthly grant amount including cost-of-living increase	$108.30	$111.96	$3.66	3.4
Special Social Service Program	$19,012,294	$9,673,588	—$9,338,706	—49.1

[1] Includes family group, unemployed, and foster home care categories.

General Fund expenditures for public assistance programs are budgeted to increase from $552.9 million in the 1969–70 fiscal year to $642.2 million in the 1970–71 fiscal year as shown above. This is an increase of $89.3 million or 16.2 percent; most of which can be attributed to two programs, Aid to Families with Dependent Children (AFDC), and Aid to the Disabled (ATD). The AFDC program accounts for $69.9 million of the total increase while ATD comprises $14.6 million. The remaining $4.8 million is composed of small increases in the Old Age Security Program, Aid to the Blind and Attendant Care and Out of Home Care. There is also a significant decrease of $9.3 million in proposed state expenditures for Special Social Service Programs, which represents a shift to federal funds.

The increases in both the AFDC programs and the ATD program are based on higher caseloads and on higher average monthly payments. The average AFDC caseload is expected to increase by 210,560 over the current year. This is 61.7 percent as much as the total state civilian population increase of 341,000 expected between July 1, 1970 and July 1, 1971. The average monthly grant is budgeted to increase by

$4.66. The average caseload in the ATD program is projected to be 188,650, or 19,790 higher than in the 1969–70 fiscal year. The average ATD monthly grant, reflecting cost-of-living increases, will be $3.66 higher than in the current year.

Health Care Services

	1969–70	*1970–71*	*Increase*	*Percent*
Department of Health Care Services	$387,654,043	$452,977,364	$65,323,321	16.9%
Medical eligibles	1,856,900	2,119,600	262,700	14.1

Caseload in the medical assistance program is continuing to expand at a rapid rate. The General Fund portion of the program is budgeted to increase by $65.3 million in the 1970–71 fiscal year relating to a 14.1 percent increase in the number of medical eligibles.

Mental Hygiene

	1969–70	*1970–71*	*Increase*	*Percent*
Support	$123,086,526	$118,526,669	—$4,559,857	—3.7%
Local assistance	152,252,647	172,616,872	20,364,225	13.4

The budget shows a decrease in the support costs for mental hygiene of $4.6 million and an increase in expenditures for local health programs of $20.3 million. The $4.6 million decrease in support actually represents a $6.6 million increase in administration research, and training, combined with a $10.1 million decrease in the cost of operating hospitals for the mentally ill, and slight decreases in funds for neuropsychiatric institutes and hospitals for the mentally retarded.

The increase of $20.3 million in local assistance is composed of a decrease of $1.7 million in the cost of operating state hospitals and an increase of $22.0 million for local mental health programs. A breakdown of this increase is shown as follows:

	Millions
New programs	$5.0
Fourth quarter adjustment	5.0
Full year costs of newly implemented programs	5.3
Inflation	5.2
Transfer to Health Care Deposit Fund	0.8
One cent per $100 assessed valuation	0.7
	$22.0

Corrections

	1969–70	*1970–71*	*Increase*	*Percent*
Correctional Programs				
1. Support				
Department of Corrections	$98,665,429	$100,152,018	$1,486,589	1.5%
Average daily population [1]	28,195	29,000	805	2.9
The Youth Authority	$47,268,122	$47,400,348	$132,226	0.3
Average daily population	5,531	5,456	—75	—1.4
2. Local Assistance				
Assistance to counties for special supervision programs	$17,452,900	$19,413,615	$1,960,715	11.2

[1] Includes reception centers and institutions.

The average daily population in correctional institutions is expected to rise approximately 2.9 percent in 1970–71. Similarly, the budget for the Department of Corrections is slated to increase by 1.5 percent from $98.7 million in 1969–70 to $100.2 million in 1970–71. The relatively small increase in the program is based upon the assumption that the rate of admissions to correctional institutions will not increase as fast as in previous years and that the number of releases will remain constant.

The average daily population in Youth Authority facilities is estimated to decline by 1.4 percent in fiscal 1970–71. This is partially the result of the state's continued expansion of the local assistance Probation Subsidy Program. This program is budgeted to increase by $2.0 million, or 11.2 percent. By the end of the 1970–71 fiscal year this program will emcompass 48 of the 60 county probation departments and include 99 percent of the state's population.

Property Tax Relief

	1969–70	*1970–71*	*Increase*	*Percent*
Property tax relief	$244,592,857	$319,642,857	$75,050,000	30.7%

The budget proposes a 30-percent increase in property tax relief. A large part of this increase, $53.3 million, is for reimbursement to local governments for losses resulting from the 30-percent exemption on business inventories in the 1970–71 fiscal year. Reimbursements for homeowner's property tax are proposed to increase by $20 million.

Salary Increases

	1969–70	*1970–71*	*Increase*	*Percent*
Salary increases	$58,216,430	$60,000,000	$1,783,570	3.1%

A general 5 percent salary increase is proposed in the General Fund budget. The above amount would be distributed as follows: (In addition $21 million is proposed for special fund salary increases.)

	Millions
State service	$30.0
University of California	
Nonfaculty positions	6.7
Faculty and related positions	8.6
State Colleges	
Nonfaculty positions	4.7
Faculty and related positions	10.0
Total	$60.0

Debt Service	*1969–70*	*1970–71*	*Increase*	*Percent*
Bond interest and redemption [1]	$133,521,788	$138,710,705	$5,188,917	3.9%
Payment of interest on General Fund loans	2,500,000	13,200,000	10,700,000	428.0

[1] Includes School Building Aid, State Construction program, Higher Education construction, State Beach, Park, Recreational, and Historical Facilities, and Junior College Construction bonds.

The large increase in General Fund interest payments on General Fund loans is attributable to the fact that the General Fund is anticipated to require much larger borrowings in the 1970–71 fiscal year. According to budget estimates 1970–71 will begin with $42 million in outstanding loans and remain in a borrowed position all during the year. The debt position is partly due to General Fund advances to programs which are normally funded through bond sales.

Until such time as state bonds are salable, the budget proposes to continue loaning to these bond programs from the General Fund. This results in greatly increased interest costs to the General Fund because it must borrow at interest from other funds to supply the funds for these and other commitments.

Increases in bond interest and redemption payments are not as great as in prior years because the state is having difficulty selling bonds.

Capital Outlay	*1969–70*	*1970–71*	*Decrease*	*Percent*
Capital Outlay as budgeted	$181,451,371	$47,715,901	$133,735,470	—73.7%

The budget proposal for capital outlay shows a decrease of $133.7 million. However, this figure is not an accurate portrayal of prospective expenditures. The 1969–70 budget figure includes a $109.2 million transfer to the Capital Outlay Fund for Public Higher Education (COPHE) which has been authorized but will probably only be partially expended in 1969–70. The $109.2 million is composed of a $53 million transfer from Item 321 of the Budget Act of 1968 and a $56.2 million augmentation from Item 376 of the Budget Act of 1969.

In comparison to the expenditure of $109.2 million as shown above for 1969–70, the cash flow statement (page 1,303 of the 1970–71 budget document) shows an expected cash transfer to the COPHE fund of only $17.1 million in 1969–70. Transfers are made usually upon actual expenditure to conserve cash. Assuming only $17.1 million is therefore actually transferred from the General Fund to the COPHE fund, then $92.1 million, or $109.2 million less $17.1 million, will be carried forward into 1970–71 instead of being expended in 1969–70. Thus, the $47.7 million proposed for 1970–71 does not appear to be a realistic expenditure estimate and will probably be augmented by carrying forward unexpended funds from 1969–70 fiscal year. A larger cash deficit than shown in the budget would result if these funds are actually expended in 1969–70 instead of being carried into 1970–71. Inconsistent data give an inaccurate picture of the budget situation.

Department of Water Resources	*1969–70*	*1970–71*	*Decrease*	*Percent*
Flood Control	$10.312,785	$2,026,000	$8,286,785	—80.4%

These funds are used by the Department of Water Resources to pay its share of federal levee and channel flood control projects outside of the Central Valley. The $8.3 million decrease in these funds is fictitious and the result of a complex financial transaction which is described in detail in the analysis of this item (page 1024). In reality, the Department of Finance expects that $3 to $4 million of the 1969–70 appropriation will be carried forward into the 1970–71 fiscal year. If this balance is added to the $2 million proposed for the 1970–71 fiscal year, a total of $5 to $6 million will be available for the program in 1970–71.

Industrial Relations	*1969–70*	*1970–71*	*Decrease*	*Percent*
Department of Industrial Relations	$23,592,038	$20,768,273	$2,823,765	—12.0%

The Governor has proposed a reduction in 1970–71 General Fund expenditures for the Department of Industrial Relations of $2,823,765, or 12 percent as compared to 1969–70. The reduction is dispersed throughout the department. The largest decrease amounts to $548,622 in the program dealing with the enforcement of laws relating to wage payments, conditions of employment, licensing and adjudication.

Condition of the General Fund

Changes in 1968–69 Surplus Picture

The General Fund ended the 1968–69 fiscal year in a much better position than had been originally anticipated by the Department of

Finance when that budget was presented to the Legislature. The summary below shows the change in income and outgo during this period.

	In Millions			
	Budget as submitted	*Actual*	*Change*	*Percent*
Expenditures	$3,898.1	$3,908.8	+$10.7	+0.3%
Income	3,823.7[1]	4,135.9	+312.2	+8.2

[1] Adjusted for legislation enacted at the 1968 regular and special sessions.

Although numerous changes were made in the 1968–69 expenditure program after the budget was submitted, the additions and reductions largely canceled each other and the actual expenditures were only $10.7 million higher than originally proposed. On the other hand, income was greatly underestimated and rose $312.2 million above the original estimate as adjusted for legislation. The revenue miscalculation gave a misleading picture of available resources and created uncertainty in making expenditure commitments.

These adjustments and others had the effect of increasing free surplus at June 30, 1969 from an originally estimated $9.3 million to an actual $309.1 million. Part of the surplus ($92.7 million) the so-called "X" factor, is earmarked for expenditure in education programs in 1969–70 and 1970–71.

1969–70 Surplus Picture

The 1969–70 fiscal year therefore began with a large free surplus. This, together with anticipated General Fund income of $4,342.3 million after an $81 million one-time refund to taxpayers, is expected to fund an increased level of expenditure at $4,616.1 million. This results in a current deficit (the year's income versus outgo) of $273.9 million, but a so-called free surplus of $112.7 million on an accrual basis at year end—June 30, 1970. The ending *cash* balance on the other hand at June 30, 1970 is estimated at only $1.2 million with a $42 million loan outstanding owed by the General Fund. The above surplus amount is thus restricted in the sense that if spent in 1969–70 it would further deteriorate the already anticipated net borrowed position of the General Fund.

General Fund Condition in 1970–71

The carryover surplus from 1969–70 added to income during 1970–71 is expected to support budgeted expenditures and provide a free surplus of $28.4 million at year end on the accrual basis as shown in Table 3.

The estimate of General Fund condition is based on estimated income of $4,707.0 million during 1970–71 and proposed expenditures of $4,796.9 million, resulting in a current deficit of $89.9 million. The income total is comprised of $4,704.1 million in revenues and $2.9 million of transfers into the General Fund from other funds, almost all of it from the Employment Contingent Fund.

The Department of Finance is continuing the practice of adjusting accrual revenues by setting aside a so-called reserve for working capital. This is to prevent over-expenditure of General Fund cash. It has been the practice in the past to maintain this amount at $194 million. We pointed out in this analysis last year that that amont was insufficient to safeguard the cash position of the General Fund and that it should be increased. The Department of Finance has accordingly, this year, increased the amount to $228 million for each year 1968–69, 1969–70 and 1970–71. This is more realistic budget practice although the increased amount is insufficient to fully protect the 1969–70 and 1970–71 cash positions. We believe that the reserve should be reviewed and be adjusted each year to reflect changing needs.

These are the major factors comprising the current appraisal of the General Fund condition as made by the Department of Finance. The fund condition is subject to further change as a result of probable future changes. The most likely of such changes are:

1. Revised revenue estimates in both the current and the budget years.
2. Changes and adjustments in expenditures as a result of legislative action on the budget and because of program cost revisions.
3. New legislation which revises taxes or alters program costs.
4. Needs of the bond programs which require borrowing from the General Fund to continue the programs until bonds can be sold.
5. Changes in federal laws, procedures and regulations which affect the flow of grants-in-aid and other federal funds to California.

The state bond situation is particularly negative relative to General Fund conditions should proposition No. 7 fail to be approved at the June primary. There are both positive and negative implications in the other factors depending on how well expenditures are controlled and the validity of the revenue estimates.

In summary, the 1970–71 year-end free surplus on the accrual basis will total $28.4 million under the assumptions made by the Department of Finance as shown in Table 3. A discussion of some of the major elements involved in these assumptions is presented in following sections.

Table 3

Estimated General Fund Conditions 1970–71 Fiscal Year (Accrual Basis)

	Millions
1970–71 Income	$4,707.0
1970–71 Expenditures	4,796.9
Current Deficit	$—89.9
Prior year resources (including free surplus of $112.7 million)	348.3
Ending Resources	$258.4
Less:	
Reserve for Working Capital	$228.0
Committed reserves	2.0
Free Surplus June 30, 1971	$28.4

Appraisal of General Fund Surplus

In contrast to the estimated $28.4 million so-called free surplus on the accrual basis at June 30, 1971, the cash position at that date will be in deficit by $17.9 million. This reflects the proposed $60 million for salary increases in the budget which was not included in the cash flow calculation although it is in the budget totals. The estimated beginning cash balance, cash receipts and disbursements and the ending cash position is shown below.

	Millions
General Fund Cash Balance June 30, 1970	$1.2
Temporary loans owed to other funds	—42.0
Cash position June 30, 1970	$—40.8
Total Receipts, 1970–71	4,979.8
Total Disbursements, 1970–71	4,956.9
Cash Position June 30, 1971	$—17.9

On the basis of the above income and expenditure assumptions made by the Department of Finance, the General Fund will end the 1969–70 fiscal year in a borrowed position. Borrowings at the end of the 1970–71 fiscal year will also be necessary to provide funds in the treasury. Thus, the proposed budget is not fully financed from a cash standpoint. If, as suggested in the revenue section of our analysis, the legislature should use the lower of the two revenue assumptions employed in the budget, there would be a General Fund deficit of $26.1 million and a cash deficit of about $72 million. The bond situation which we discuss in a following section may add to this problem.

Appraisal of Budget Estimates

Although it has not been the case every year, there has been a continuing tendency on the part of the Department of Finance to underestimate General Fund revenue, and to overestimate expenditures. We indicated last year in this analysis that the mid-year estimates of expenditures (prepared about six months before the close of the fiscal year) had been below actual expenditures for the year in only two of the 18 years from 1950–51 to 1967–68.

This trend also characterized the 1968–69 fiscal year, but the estimating bias was larger than usual.

The major error in 1968–69 was in the revenue estimates. The original estimates were $312.2 million lower than the actual and the final reestimate prepared in May 1969 was $48.5 million lower than the Controller's final figure. On the expenditure side, the budget as submitted was $10.7 million lower partly due to legislation during the session and the May 1969 reestimate was $44.2 million higher than the Controller's actual figure.

The combination of the $48.5 million underestimate of income and the $44.2 million overestimate of expenditures in May formed the $92.7 million so-called X-factor surplus earmarked for education.

The need is evident for better estimates of both income and expenditures. Part of the estimating error in May resulted from differences in interpretation between the Department of Finance and the Controller and other agencies in accounting for accrual revenues and expenditures.

There appears to be no reason why the method of handling accrual adjustments cannot be largely determined and agreed upon between the agencies concerned by the end of April, rather than two months later. We recommend that the Department of Finance make a concerted effort to obtain a consensus among the various agencies on how these revenue and expenditure accounts will be handled at an earlier date.

Accounting practices should also be improved relative to the Department of Finance's handling of unencumbered balances of continuing appropriations (committed reserves). These are appropriations on which the unexpended balance is authorized to be carried forward into following years. Capital outlay is a major factor.

The amount of these carry forward balances has been regularly underestimated by the Department of Finance in the budget as submitted and in the midyear estimates. Therefore, expenditures for the current year and budget year are estimated too high. This was also part of the problem in the May 1969 estimate and a portion of the Controller's subsequent adjustments involved these committed reserves.

Table 4 indicates the regular pattern of underestimating this factor from 1964–65 to 1968–69.

Table 4
General Fund
Estimated and Actual Year-End Balances of Continuing Appropriations
1964–65 to 1968–69
(In millions)

	Mid-year estimate	*Actual*	*Difference*	*Percent change*
1964–65	$12.2	$55.3	$43.1	353.3%
1965–66	37.2	52.6	15.4	41.4
1966–67	11.3	46.9	35.6	315.0
1967–68	12.2	15.0	2.8	23.0
1968–69	15.6	85.0	69.4	444.9

The 1970–71 budget document is inconsistent in accounting for expenditures and committed reserves. For instance, as we pointed out in a previous section of this Analysis (page A-18) the General Fund 1969–70 budget on the accrual basis shows a much larger amount committed for capital outlay expenditure in 1969–70 than is shown in the cash accounts. This difference should not be so large if it is really intended to expend these funds as indicated in the accrual basis accounts. On the other hand, if large carryover balances occur the cash position is helped as is assumed in the cash accounts section. The Department of Finance should take steps to correct these inconsistencies which provide a misleading picture of what action is being proposed.

The expenditure estimates of the Department of Finance have usually been conservative, with resulting savings at yearend. This has provided a cushion against deficits in the General Fund. With current General Fund financing required for the bond programs and possible additional future such requirements, as well as a prospective cash deficit under current budget assumptions, any unscheduled 1969–70 savings will probably be needed to help cover the unfunded cash position of the General Fund.

STATE GENERAL OBLIGATION BONDS

Outstanding state general obligation bonds totaled $4,671,046,000 on December 31, 1969, a reduction of $126,888,000 as compared to $4,797,934,000 on that date in 1968. There are two types of general obligation bonds (1) those for which the debt service is paid from the General Fund, and (2) self-liquidating bonds in which interest and redemption is paid from project revenues to the extent these are available. In both cases the full faith and credit of the state is pledged and, in the event program revenues are insufficient, the General Fund would be responsible for any deficit.

Various state agencies also issue revenue bonds in which case only the revenues from the projects constructed are pledged for repayment.

Examples are University and state college housing, the California Exposition, water projects, and toll bridge bonds. The revenue bonds are not included in the above totals and are mentioned only to indicate the various types of bonds issued.

General obligation bonds are authorized for water resources development, veterans' farm and home purchases, school building aid, and other purposes. A proposal to authorize $246.3 million in bonds to construct health science facilities at the University of California will be on the June 1970 primary ballot. Table 5 provides detail on the individual bond programs now authorized and their status with respect to bonds sold (outstanding) and the amount of bonds unsold as of December 31, 1969.

Table 5

General Obligation Bonds of the State of California by Purpose
As of December 31, 1969

Purpose	*Unsold*	*Outstanding*
General Fund bonds		
California Tenth Olympiad of 1927 [1]	–	$50,000
State construction	$30,000,000	853,000,000
Beaches, parks, recreational and historical facilities	75,000,000	68,300,000
State higher education construction	75,460,000	148,140,000
Junior College Construction Act	50,000,000	15,000,000
School building aid	266,470,000	1,165,230,000
Totals	$496,930,000	$2,249,720,000
Self-liquidating bonds		
Water resources development	$600,000,000	$1,150,000,000
Veterans' farm and home	200,000,000	1,209,900,000
Harbor bond funds	697,000	61,426,000
Totals	$800,697,000	$2,421,326,000
Totals, all bonds	$1,297,627,000	$4,671,046,000

[1] Although classified as a general fund bond program, debt service is actually being paid from sinking fund balances in the Olympic Bond Fund.

The state held $1,297,627,000 in authorized but unsold bonds on December 31, 1969. Sales of general obligation bonds came to a virtual halt in 1969 as market interest rates rose above the 5 percent maximum rate the state is currently authorized to pay. Sales were projected a year ago at $170 million between January and June 1969 and over $500 million during 1969–70. Only $50,570,000 has been sold since January 1, 1969, of which $13,070,000 in sales were made through special arrangements with buyers to promote local projects. This included $8,530,000 in school building aid bonds to construct local school projects and $4,540,000 in higher education bonds to purchase land for state college sites.

The state's construction programs financed from bond sale proceeds have been halted, or drastically curtailed where it was impractical or more expensive to close down the projects. As a short-term solution loans are being made from the General Fund to various bond funds to meet pressing cash needs. This began in April 1969 with a loan of $14.1 million to the State Construction Program Fund, which was repaid in May. From August 1969 to the end of January 1970, $17.5 million has been loaned from the General Fund to the State Construction Program Fund with no repayments and further loans are anticipated. Additional bond programs will also require emergency financing. The summary below indicates General Fund loans anticipated to be made to the various bond programs between February 1, 1970, and the end of June 1970.

	Millions
State construction program	$17.5
School building aid program	14.0
Water resources development program	100.0
Total	$131.5

Adding the $131.5 million in anticipated loans to the $17.5 million in loans already made indicates total loan balances will be $149 million on June 30, 1970.

Further loans are projected during 1970–71 with $15 million estimated by the Department of Finance to the State Construction Program and $6 million to the State School Building Aid Program. No further loans are scheduled to the water resources bond program after June 30, 1970, and the Department of Finance expects all loans to be repaid to the General Fund during 1970–71. These estimates assume that Proposition No. 7 will pass in June. Continuing loans will be necessary if it is not approved and taxes will have to be raised to meet the deficit.

Proposition No. 7 on the June primary ballot, if approved by the electorate, will ratify provisions of Chapter 740, Statutes of 1969 (SB 763) to increase the maximum interest rate that the state can pay on general obligation bonds from 5 percent to 7 percent and removes the present 5 percent ceiling on bond anticipation notes. In addition, if approved, the proposal will authorize the Legislature upon a two-thirds favoring vote in each house to raise the maximum interest rate that can be paid on general obligation bonds if they cannot be sold at 7 percent.

Therefore, if Proposition No. 7 is approved it should be possible to begin marketing state bonds again. Because of the backlog of needs and loans to be repaid to the General Fund it will require most of the available bond market sales capacity for Water Resources Development bonds or notes with School Building Aid bonds given next highest priority. Bond sales will probably not be available for other programs for six months or longer after passage of Proposition No. 7.

Should Proposition No. 7 fail in June or a similar proposal fail in November, the most likely alternative appears to be to increase General Fund taxes to cover cash flow and bond program deficits—unless bond market rates fall to the extent the state can again sell bonds at or below the 5-percent ceiling.

Bond debt service costs are regularly paid from the General Fund for state construction, parks and recreational facilities, higher education and junior college construction bonds. The state and local school districts share these costs for school building aid bonds. In 1970–71 the state share at $52.4 million is 52.7 percent of the state-local total of $99.3 million. After a period of rapid rise in debt service charges, which include payments on principal and interest, the year-to-year increase in these costs appears to be moderating as marketing difficulties have mounted. Table 6 shows the trend in these costs since 1960–61.

Table 6

Debt Service Costs to the General Fund for State General Obligation Bond Programs—1960–61 to 1970–71
(In thousands of dollars)[1]

	Total	*School Building Aid Bonds*[2]	*State Construction and Other Bonds*[3]
1960–61	$36,484	$20,387	$16,097
1961–62	42,877	26,401	16,476
1962–63	59,198	36,770	22,428
1963–64	62,694	35,690	27,004
1964–65	75,865	45,411	30,454
1965–66	87,402	50,110	37,292
1966–67	103,114	52,574	50,540
1967–68	115,429	52,452	62,977
1968–69	123,619	48,452	75,167
1969–70 (est.)	134,659	49,420	85,239
1970–71 (est.)	136,498	52,352	84,146

[1] Cash basis for all years.
[2] Includes only State General Fund portion of total debt service charges for these bonds.
[3] Includes State Construction Program bonds, State Higher Education Construction bonds, State Beach, Park, Recreational and Historical Facilities bonds, junior college construction bonds, and several small bonding programs that were paid off before 1966–67.

The interest portion of debt service charges for school building aid bonds in 1970–71 is estimated at $20.4 million, or 39 percent, of the $52.4 million General Fund debt service net cost. Interest on state construction program and other bonds will total $39.5 million, or 47 percent, of the $84.1 million total debt service charge for these bonds. The remaining portions of these costs are for bond redemption payments.

REVENUE ESTIMATES

The impact of economic conditions on California's General Fund revenues is forcefully illustrated in the Governor's Budget. There is a $109 million difference in revenue estimates between the low and the high economic forecasts. The taxes which are most dependent upon economic conditions are: retail sales, personal income, and corporate franchise. Inheritance and gift tax receipts also are affected, but to a lesser extent.

There are sharp differences of opinion on the economic outlook for 1970. Some economists are predicting a mild recession. Others contend that the economic expansion which started in February 1961 will continue through 1970, and become stronger in 1971. This difference in outlook can be traced back to the unsuccessful efforts of the national government in the fall of 1968 to control inflation. At the end of 1967–68, the federal budget had a deficit of over $25 billion. To control inflation, Congress enacted temporary tax increases and restricted the growth of expenditures. As a result, the 1968–69 federal budget had a surplus of a little over $3 billion. This dramatic shift, within one year, from a large deficit to a small surplus resulted from a massive dose of fiscal restraint which should have slowed the growth in inflation. Economists who are strongly influenced by monetary theory contend that fiscal restraint failed because the Federal Reserve Board substantially increased the money supply in the fall of 1968 to avoid an "overkill", and this action diluted the impact of fiscal restraint. These same economists now contend that the virtual freeze in the money supply since

June 1969 will and is having a depressing effect on the economy. Looking back at the results in 1968, the economists who give less weight to monetary factors believe the economy will continue to grow because national fiscal policy will at best be neutral, and more likely slightly expansionary, and the Federal Reserve Board will ease the money supply early in 1970 as unemployment increases. Only time will tell which of these two groups has a better insight into economic conditions during 1970.

This section of the analysis will review national and state economic conditions during 1969, and examine the Department of Finance's revenue forecasts for both the current and budget years.

The National Economy in 1969

Economic expansion which started in February 1961 continued through the first three quarters of 1969, and then faltered in the fourth quarter. GNP grew by $66.6 billion, or 7.7 percent, during 1969 to $932.3 billion. Price increases, the sharpest since 1951, accounted for 4.9 percent of this growth, while physical volume advanced only 2.8 percent. The sources of growth in 1969 were quite different from the experience in previous years. In current dollars, Table 1 shows that consumer expenditures accounted for the largest gain, but most of the increase was due to inflation. Private investment had its strongest upsurge since 1966, while governmental purchases, especially those for national defense, had sluggish growth rates.

Fiscal and monetary policy, working together, imposed strong pressures on the economy during 1969, but despite these restraints, price increases accelerated, and the low level of unemployment continued throughout the year. However, labor productivity declined, profits were squeezed, and by year end it was apparent that real growth in the economy was at a standstill. Incomes were growing barely fast enough to offset rising prices and consumer demand was sluggish.

Table 1

Sources of Growth in GNP During Last Four Years

Percentage growth in GNP	*1966*	*1967*	*1968*	*1969*
Real growth—constant dollars	6.5%	2.5%	4.9%	2.8%
Inflation	3.0	3.3	4.2	4.9
Current dollars	9.5%	5.8%	9.1%	7.7%
Sources of growth		*Current dollars*		
Consumer expenditures	4.9%	3.4%	5.6%	4.5%
Private investment	1.9	—0.7	1.3	1.5
Net exports	—0.2	--	—0.3	--
Government purchases	2.9	3.1	2.5	1.7
Total	9.5%	5.8%	9.1%	7.7%
		Constant 1958 dollars		
Consumer expenditures	3.3%	1.8%	3.3%	1.9%
Private investment	1.6	—1.3	0.7	0.8
Net exports	—0.3	—0.1	—0.4	—0.1
Government purchases	1.9	2.1	1.3	0.2
Total	6.5%	2.5%	4.9%	2.8%

Growth patterns were uneven during 1969. Table 2 shows that consumer expenditures advanced by $11.3 billion (at annual rates) in the first quarter. Sales of furniture and appliances were strong, reflecting gains in residential construction. Automobile sales also advanced but not at a spectacular rate. Nondurables recovered from their depressed level in the fourth quarter of 1968. Private investment, especially nonresidential, made a strong advance. Business inventories declined as a result of the increase in consumer expenditures. Federal purchases also dropped, while the state and local sector had its largest gain since the first quarter of 1968.

In the second quarter, nondurables softened, residential construction began to decline, inventories had a modest growth, and the continuation of the shrinkage in the federal sector depressed total governmental purchases. In June 1969, the Federal Reserve Board imposed a freeze on the money supply.

Consumer expenditures, especially durables turned sluggish in the third quarter. Sales of clothing also fell. By contrast, nonresidential structures made a strong advance, while residential building slumped. Business inventories grew because consumer sales were depressed. Federal purchases turned about as a result of the pay increase. The inability of state and local governments to sell bonds had a depressing impact on this sector.

Automobiles, furniture, clothing, and gasoline were all depressed in the fourth quarter. Nonresidential construction which had been buoyant during the first three quarters, turned sluggish. Automobiles were mainly responsible for the cutback in business inventories. National defense expenditures continued to decline. Personal incomes grew by only $10 billion in the fourth quarter, compared to advances of $16 billion in the second and third quarters. The money supply showed no growth following June 1969.

In summary, most sectors showed less strength in the second half of 1969. Not only were consumption and residential construction depressed, but capital spending also lost part of its strength.

A more detailed examination of each of the GNP components follows:

Table 2

Quarterly Changes in GNP During 1969

(In Billions—at Annual Rates)

	Quarter I	II	III	IV
Consumer expenditures:				
Durables	$2.1	$2.2	—$0.8	—$0.2
Nondurables	4.3	3.5	3.0	4.3
Services	4.9	5.1	4.8	5.3
Subtotal	$11.3	$10.8	$7.0	$9.4
Private Investment:				
Fixed investment	$5.2	$1.9	$2.0	$2.0
Nonresidential	3.8	2.5	3.3	1.9
Residential	1.4	—0.6	—1.3	0.2
Changes in business inventories	—3.9	0.3	3.8	—2.9
Subtotal	$1.3	$2.2	$5.8	—$0.9
Net exports	$0.3	$0.1	$1.1	—$0.1
Government purchases:				
Federal	—$0.3	—$1.0	$2.6	—$0.5
National defense	—0.3	—0.5	1.8	—1.1
Other	—	—0.5	0.8	0.6
State and local	3.7	3.8	1.5	2.4
Subtotal	$3.4	$2.8	$4.1	$1.9
Total GNP	$16.3	$15.9	$18.0	$10.3

Consumer Expenditures

Personal incomes rose by $59.2 billion, or 8.6 percent during 1969, but personal taxes grew by $19.5 billion, or 20 percent. As a result, disposable (after tax) income rose only $39.7 billion, or 6.7 percent, the smallest percentage advance in six years.

Consumer expenditures grew by $39.4 billion and this increase almost matched the growth in disposable incomes. Higher prices accounted for two-thirds of this increase in expenditures. Nondurables would have grown slightly over 1 percent had it not been for inflation. Table 3 shows that automobile sales rose by 8.9 percent, or less than half of the advance recorded in 1968. Furniture and household equipment also were sluggish. By contrast, the growth in services was slightly higher than 1968, but this increase was attributable to inflation.

The University of Michigan's survey of consumer intentions, which measures people's feelings about their own and the country's financial outlook, has been declining steadily since February 1969. In November 1969, the index fell close to the low that heralded the 1957–58 recession.

Table 3
Consumer Expenditures
(In Billions)

	1968	*1969*	*Percentage Increase*
Durables:			
Auto and parts	$37.0	$40.3	8.9%
Furniture and household equipment	34.2	35.9	5.0
Other	12.1	13.4	10.7
Subtotal	$83.3	$89.6	7.6%
Nondurables:			
Food and beverage	$115.0	$120.0	4.3%
Clothing and shoes	46.3	49.9	7.8
Gasoline and oil	19.1	21.3	11.5
Other	50.1	52.7	5.2
Subtotal	$230.6	$243.8	5.7%
Services:			
Housing	$77.4	$83.7	8.1%
Household operations	31.2	33.5	7.4
Transportation	16.1	17.5	8.7
Other	98.1	107.8	9.9
Subtotal	$222.8	$242.5	8.8%
Total Consumer Expenditures	$536.6	$576.0	7.3%

Private Investment

This sector includes business investments in plant and equipment, institutional construction such as hospitals, residential building and changes in business inventories.

Business demand for plant and equipment was strong throughout 1969 and offered stubborn resistance to inflationary restraint even though the rate of expansion moderated during the year. The 11.8 percent increase in this sector was the eighth annual advance in a row, marking the longest sustained increase since before World War I. The 1969 growth in capital spending was not due solely to price increases. Even after allowing for the effects of inflation, there was a moderate growth in the amount spent for structures, and a stronger rise in spending for equipment. The substantial increase in capital spending during 1969 was somewhat surprising considering the idle capacity of manufacturing plants (highest in seven years), the high cost and reduced availability of investment funds, and the weakening profit and sales outlook. A partial answer to this quandary is that about half of the 1969 capital spending was for modernization and cost reduction rather than for expansion. Also, the demand for capital goods by electric and gas utilities and telephone companies has been exceptionally strong. High interest rates have not seriously deterred these industries because they must meet demands for service and regulatory authorities permit such cost increases to be reflected in higher rates.

Table 4 shows that housing expenditures grew by 6.6 percent in 1969, but this increase was due almost entirely to higher prices. In terms of units, home building once again went into a steep decline in 1969, after only two years of recovery from the sharp contraction during 1966. Housing starts declined from 1.7 million units (annual rate) in the first quarter to 1.3 million units in the fourth quarter. Single family starts dropped early in the year, but multifamily units remained fairly strong until the fall, because apartment builders were more willing and able to pay the higher interest rates. The high interest costs, the reduced availability of mortgage credit, and the sharp rise in home prices, all contributed to the depressed housing market. As interest rates rose, there were substantial reductions in flows of savings to banks and other leading institutions because their interest rates were frozen. This decline in private mortgage funds was partially offset by increased FNMA purchases and a liberal Federal Home Loan Board lending policy. During the third quarter of 1969, half of the increase in home mortgage debt was financed by these government sponsored agencies.

Inventories accumulated at a relatively low rate in the first half of 1969 as final sales remained strong. When consumer sales turned sluggish in the third quarter, inventories rose and this buildup was partly responsible for the relatively large growth in GNP. By the end of the year, stock-building of durable goods had slowed as the production of autos was reduced and the economy felt the impact of the General Electric strike.

Table 4
Private Investment
(In Billions)

Nonresidential	*1968*	*1969*	*Percentage increase*
Structures	$29.3	$33.4	14.0%
Producers equipment	59.5	65.9	10.8
Subtotal	$88.8	$99.3	11.8%
Residential	30.2	32.2	6.6
Change in business inventories	7.3	8.0	9.6
Total	$126.3	$139.6	10.5%

Government Purchases

Federal government purchases of goods and services rose $2.5 billion in 1969, the smallest advance since the Vietnam buildup began in 1965. The spending rate declined throughout the year except for the third quarter when the pay raise boosted civilian and military employee compensation. Defense expenditures were up only $1.3 billion in 1969, compared to an average gain of $9 billion in the preceding three years. All of last year's growth was in employee compensation. The decline in other defense purchases, which include equipment, construction, research, etc., was the first since 1965. Nondefense expenditures grew only $1.3 billion compared to the record $3 billion in 1968. Public assistance grants, mainly for aid to dependent children and medical assistance, showed a big advance in 1969, reflecting a large increase in the number of recipients.

For the second year in a row, federal receipts grew about $25 billion, to over $200 billion in 1969. About $16 billion of this increase was attributable to increased yields from existing taxes; over $5.5 billion represented the surcharge on personal and corporate taxes, and the rest came from the increase in the Social Security tax rate.

State and local governmental purchases advanced nearly 12 percent. The rate of growth was slower in the second half of 1969 because some states (e.g., California) and localities were unable to sell bonds within their interest rate limits. Construction accounts for about one-fourth of state and local purchases, and it rose very little during the second half of 1969, after registering 10 percent annual gains in the three preceding years. Sales of state and local bonds totaled $16.4 billion in 1968, but declined to $11.4 in 1969.

Nearly 400,000 workers were added to state and local payrolls in 1969, largely for education. Transfer payments also had a rapid growth. Almost five million children, or 7 percent of all those under 18 years of age, and over two million elderly, or 10 percent of those 65 and over, were on the welfare rolls at mid-1969.

Table 5
Government Purchases
(In Billions)

	1968	*1969*	*Percentage increase*
Federal:			
National defense	$78.0	$79.3	1.7%
Other	21.5	22.8	6.0
Total federal	$99.5	$102.0	2.5%
State and local	100.7	112.7	11.9
Total Government Purchases	$200.2	$214.7	7.2%

Income and Savings

Table 6 shows that personal incomes rose by $13.2 billion in the first quarter, but consumption expenditures jumped $11.3 billion; therefore personal savings were reduced $5.3 billion. During the first half of 1969, the savings rate was very low, 5.3 percent compared to 7.1 percent in the first half of 1968. Incomes advanced by $16 billion in the second and third quarters, the rate of consumption expenditures declined, and the savings rate reached its highest point in the third quarter. The sluggish rate of income growth in the fourth quarter, combined with higher personal taxes and an increase in nondurable expenditures, caused another modest reduction in the savings rate.

Table 6
Income and Savings
(In Billions)

	1968	*1969*	*Percentage increase*
Personal income	$687.9	$747.1	8.6%
Minus personal income taxes	97.9	117.5	20.0
Equals disposable income	$590.0	$629.6	6.7%
Personal savings	38.4	37.6	—2.1
Savings as a percentage of disposable income	6.5%	6.0%	

Changes by Quarters During 1969
(Annual Rates)

	I	*II*	*III*	*IV*
Personal income	$13.2	$16.1	$16.0	$10.4
Minus personal taxes	—7.2	—4.3	+1.0	—2.3
Equals disposable income	$6.0	$11.8	$17.0	$8.1
Minus consumption expenditures	—11.3	—10.8	—7.0	—9.4
Equals change in personal savings	—$5.3	+$1.0	+$10.0	—$1.3
Savings as a percentage of disposable income	5.3%	5.3%	6.7%	6.4%

Employment and Profits

Employment. The increase of over 2 million persons in the civilian labor force during 1969, was not only 600,000 greater than the average rise of the five preceding years, but it also was the largest annual growth since 1946–47. With unemployment rates extremely low and labor force participation rates already high, adult men accounted for a significantly smaller proportion of the increase in total employment. Adult women and teenagers accounted for three-fourths of the employment growth in 1969, but a large portion of these jobs were part-time. Table 7 shows that all sectors registered employment gains during 1969, with construction and retail trade being the leaders. The rise in manufacturing employment was moderate, far below the advances in 1965 and 1966 when the buildup for Vietnam commenced.

Table 7
Wage and Salary Workers in Nonagricultural Establishments
(In Thousands)

	1968	*1969*	*Increase Amount*	*Increase Percent*
Manufacturing	19,768	20,121	353	1.8%
Mining	610	628	18	2.9
Construction	3,267	3,410	143	4.4
Transportation and utilities	4,313	4,449	136	3.2
Wholesale and retail trade	14,081	14,644	563	4.0
Finance, insurance and real estate	3,383	3,558	175	5.2
Services	10,592	11,102	510	4.8
Government				
Federal	2,737	2,756	19	0.7
State and local	9,109	9,471	362	4.0
Total	67,860	70,139	2,279	3.4%

Unemployment. Table 8 shows that unemployment rates for all groups declined in 1969. The rate for married men was one of the lowest of the postwar period. Although the demand for labor was strong throughout the year, it showed some easing after midyear. Also, the length of the workweek fell noticeably in the final quarter after remaining high and steady during the first three quarters. The unemployment rate rose from 3.3 percent in the first quarter, to 4 percent in September, and then it declined to 3.4 percent by December.

Table 8
Unemployment Rates—By Categories

	1961	*1965*	*1968*	*1969*
All workers	6.7%	4.5%	3.6%	3.5%
By Color				
White	6.0	4.1	3.2	3.1
Nonwhite	12.4	8.1	6.7	6.4
By Age				
16 to 19 years	16.8	14.8	12.7	12.2
Selected Groups				
Married men	3.7	2.4	1.6	1.5
Experienced workers	5.7	4.3	3.4	3.3

Wage Increases. In construction and mining, where demand for labor was extremely strong, hourly earnings during 1969 showed their sharpest gains since 1951. In manufacturing, where the demand for labor was more moderate, the rise in earnings fell short of the increases in 1968. Average gross hourly earnings in private nonagricultural production increased by 6.7 percent in 1969, compared to a 6.3 percent increase in 1968. The practice of "front loading," or the tendency to concentrate increases in the first year of long-term contracts also was common in 1969.

The combination of higher hourly compensation and no rise in productivity resulted in a 7-percent rise in labor costs per unit of output —the sharpest annual increase since 1951.

Corporate Profits. In 1968 corporate profits increased by over 11 percent, while last year the growth was less than 1 percent. Durable manufactures had a 15-percent increase in 1968, but a 3.3-percent reduction in 1969. Table 9 shows that financial institutions were the only large gainers last year.

Table 9
Corporate Profits Before Taxes
(In Billions)

	1968	*1969*	*Percentage increase*
Financial institutions	$11.5	$12.9	12.2%
Manufacturing			
Nondurables	19.9	20.2	1.5
Durables	24.5	23.7	—3.3
Transportation and utilities	11.6	11.9	2.6
All other	20.4	20.0	—2.0
Total corporate profits	$87.9	$88.7	0.9%
Compensation of employees	$300.6	$328.8	9.4%

Prices and Financial Conditions

Consumer Prices. As a result of last year's pressures in the economy, all major price indexes—the GNP deflator, the consumer price index, and the wholesale price index, rose more rapidly than in any year since 1951. Food prices, particularly meats, contributed to the large increases in consumer prices during 1969. Prices of nonfood commodities rose rapidly throughout the year, with nondurables—especially apparel prices—advancing sharply. Led by a continued rapid advance in medical costs, and a pronounced rise in homeownership costs, that was closely related to the climb in mortgage interest rates, the price index for consumer services rose 7 percent in 1969.

Table 10

Changes in Consumer Prices

A. Percentage Increase Over Prior Year

	1967	*1968*	*1969*
All items	2.8%	4.2%	5.4%
Food	0.9	3.6	5.2
Housing	2.9	4.2	6.4
Durables	1.6	3.1	3.8
Nondurables	3.1	4.1	4.5
All services	4.4	5.2	7.0
Medical services	8.7	7.3	8.1

B. Changes During 1969, by Quarter

	I	*II*	*III*	*IV*
All items	5.3%	6.9%	5.5%	5.7%
Food	4.0	7.0	6.6	7.5
Nonfood commodities	4.6	5.6	3.1	4.1
Services	7.5	8.3	6.6	6.8

Monetary Policy. A vigorous policy of credit restraint was imposed by the monetary authorities during 1969. In the first half of the year, the money supply (currency plus demand deposits) expanded at a 4.4-percent annual rate; a significant drop from the 7.2-percent growth rate in 1968. In the second half of 1969, the policy became even more restrictive and the money supply grew only 0.7 percent. Since June 1969 the Federal Reserve Board has imposed a virtual freeze on the money supply in order to control inflation. The board also took other actions to restrict credit such as increasing the discount rate, the reserve requirements on demand deposits, and refusing to change the interest rates (Regulation Q) which banks could pay on time deposits. This latter decision resulted in a large-scale runoff of time deposits, particularly at large commercial banks, and a buildup of severe pressures in member bank reserve positions. From December 1968 to December 1969, time deposits dropped $10.8 billion. Commercial banks offset these withdrawals by increasing their borrowing of Eurodollars, used repurchase agreements on their loans to corporations, and expanded the use of commercial paper issued by their subsidiaries and affiliates.

In the second half of the year the Federal Reserve Board took steps to make these sources more expensive to the banks. Repurchase agreements had to be treated as deposits and therefore were subject to reserve requirements and interest rate ceilings. Eurodollar borrowings also were subjected to reserve requirements. However, no action was taken to restrict the use of commercial paper.

As a result of this restrictive monetary policy, total bank credit rose only $9 billion, or 2.5 percent during 1969, less than one-fourth the increase in both 1967 and 1968. However, this curtailment of bank credit was offset by increased supplies of funds from all the private nonfinancial sectors.

Interest rates were the highest since the Civil War. At the end of 1969, they were about 4 percentage points above their 1965 level. The steepness of the advance in both long-term and short-term securities was unprecedented. The bond market provided the clearest indication of the pressures on the financial system. The yield index for Aaa corporate bonds reached 7.84 percent at the end of December, in contrast to a 6.45-percent rate the prior year, and 9-percent rates on new issues were common at the end of 1969.

The California Economy in 1969

Last year California outpaced the nation in employment growth and corporate profits, but registered a slightly lower growth in personal income and consumer price increases.

Employment

A comparison of Tables 7 and 11 indicates that in percentage terms California's employment growth was more rapid than the nation's in the trade, service and government sectors, but slower in construction and manufacturing. California's unemployment rate of 4.4 percent in 1969 was still higher than the national rate of 3.5 percent, but both rates declined by 0.1 of a point from the prior year.

A fascinating aspect about Table 11 is that California's civilian population (including new births) increased only 294,000 during 1969, or 1.5 percent, but employment grew 267,000, or 3.5 percent. This rapid growth in employment indicates that a higher percent of our population has entered the labor market.

Table 11
California Employment by Type of Industry
(In Thousands)

Industry	*1968*	*1969*	*Increase Amount*	*Increase Percent*
Mining	34	34	0	0%
Agriculture	320	318	—2	—0.6
Construction	354	366	12	3.4
Finance	389	409	20	5.1
Transportation and utilities	459	478	19	4.1
Government	1,334	1,387	53	4.0
Services	1,540	1,615	75	4.9
Trade	1,613	1,687	74	4.6
Manufacturing	1,685	1,701	16	0.9
Total employment	7,728	7,995	267	3.5%
Unemployment	366	372	6	1.6
Civilian labor force	8,094	8,367	273	3.4%

Residential Construction

The number of residential housing units increased by 17 percent during 1969, from 157,000 to 183,000. The growth in multiple units was especially strong, increasing from about 70,000 in 1968 to 104,000 in 1969 when they constituted 57 percent of total starts. By contrast, single family units declined from 87,000 in 1968 to 79,000 in 1969. A large part of the strength of the 1969 housing market was attributable to loan commitments made by banks late in 1968, when they had excess funds. As a result of the tight monetary condition in the fall of 1969, this pattern will not be repeated in 1970.

Retail Sales

Taxable sales advanced by 8 percent in 1969. Manufacturing, wholesaling and miscellaneous outlets led the advance with a 9.3 percent increase over the prior year. The building materials group had a good year with a 7.4 percent increase, but this was only one-third of the growth rate in 1968. Table 14 shows that automobiles increased only 6.5 percent, compared to a 16.1 percent growth rate in 1968.

Income and Profits

Personal income in California advanced 8.3 percent during 1969, which was slightly lower than the gain registered nationally. This pattern has existed since 1965.

Taxable corporate profits in California increased by $115 million, or 1.6 percent, during 1969. In the prior year the increase was over 11 percent. Financials, including both banks and savings and loan associations, made the largest gain with a 16.4-percent increase. A comparison of Tables 9 and 12 indicates that California's corporate profits increased slightly faster than the national growth, but both had mediocre increases.

Table 12

Taxable Corporate Income in California (In Millions)

Industry	*1968*	*1969*	*Percent change*
Agriculture	$75	$76	1.3%
Mining and oil production	336	257	—23.5
Construction	197	199	1.0
Manufacturing	2,941	2,995	1.8
Trade	1,394	1,403	0.6
Service	446	459	2.9
Financials subject to bank tax	495	576	16.4
Real estate and other financials	458	438	—4.4
Utilities	989	1,043	5.5
Other	4	4	–
Totals	$7,335	$7,450	1.6%

Agriculture

California's farm production in 1969 was the second largest on record at 39.7 million tons, down 2 percent from the 1968 harvest of 40.6 million tons. Aggregate production for fruit and nut crops was the largest in the state's history, and vegetable production was second only to the 1968 harvest.

Total cash receipts in 1969 are estimated at $4.5 billion (including $121 million in government payments), up $130 million, or 3 percent from the $4.37 billion realized a year ago. Most of the increase in gross income can be attributed to higher receipts from marketings of livestock and livestock products, particularly cattle and eggs.

The harvested acreage of principal crops totaled 8.30 million in 1969, down 2 percent from 8.50 million acres harvested a year ago. Field crop acreage showed the largest decline, with most of the reduction coming in barley, wheat and rice. Vegetable acreage also declined, largely in canning tomatoes. By contrast, fruit and nut acreage continued its upward trend from the low point reached in 1957, with most of the increase coming in almonds, oranges, clingstone peaches, and walnuts.

A Review of the Department of Finance's 1969 Economic Forecasts

There are two distinct steps in the revenue estimating cycle of the Department of Finance. The first and most critical step consists of preparing economic forecasts for both the national and state economies, covering such elements as personal income, employment, corporate profits, taxable sales, housing construction, automobile sales and the general price level. In the second step, these economic data are fed into a variety of mathematical equations which produce the individual revenue estimates.

Table 13 shows the Department of Finance's original forecast which was published in the 1969–70 Budget, and the revised estimates used for the May 26, 1969, revenue adjustments. These estimates are compared with the actual results for 1969, and they show that the department's original estimates were slightly low, but the increases made in May resulted in a very accurate forecast, especially of national data. The only segment of national data which had a wide error margin was corporate profits. The California estimates were less accurate. Housing starts, new car sales, and consumer prices, all were underestimated.

Table 13

Comparison of Department of Finance's Original and Revised Economic Forecasts for Calendar Year 1969 with Actual Results (In Billions of Dollars)

	Department of Finance estimates			*UCB* **
	Feb. 1969 *	*May 1969* *	*Actual*	*Dec. 1968* *
Gross national product	$921.3	$929.4	$932.3	$925.3
Personal consumption expenditures	566.4	572.7	576.0	571.1
Private investment	135.0	139.5	139.6	131.7
Net exports	2.4	1.6	2.1	5.2
Government purchases	217.5	215.5	214.7	220.5
Federal	106.0	104.0	102.0	
National defense	81.1	80.7	79.3	
Other	25.0	23.3	22.8	
State and local	111.5	111.6	112.7	
Personal income	732.7	740.3	747.1	735.3
Disposable income	619.3	623.1	629.7	623.9
Savings	37.6	37.9	38.0	35.1
Corporate profits	94.1	95.8	88.6	
Consumer price index	125.7	126.7	127.7	125.0
Employment (000)	76,880	77,200	77,921	77,500
California Data:				
Personal income	$82.0	$83.2	$83.0	$82.6
Disposable income	71.1	--	71.7	
Corporate profits	7.6	--	7.4	
Employment (000)	7,940	7,965	7,995	
Housing starts (000)	167	167	183	192
New car sales (000)	896	911	976	
Taxable sales	41.0	--	42.1	
Consumer price index	127.4	--	129.3	

* Adjusted for changes made in these series by the U.S. Department of Commerce, as reported in the July 1969 issue of the Survey of Current Business.
** United California Bank forecast.

Analysis of 1969–70 General Fund Revenue Estimates

Total General Fund revenues for the current fiscal year, as revised in the proposed budget, are $45.5 million above the original (February 1969) estimates after adjusting for 1969 tax legislation. The continued growth of inflation was the main factor causing the upward revision.

The Department of Finance, in its May 1969 revenue changes, accounted for 86 percent of the total revisions.

Personal income taxes had the largest upward revision, a total of $45 million. Most of this increase was recognized in May 1969, and is attributable to higher wages and salaries. The new estimate also includes a $15 million increase in audit assessments by the Franchise Tax Board, a $14 million reduction in the taxes on capital gains (as a result of the drop in the stock market), and a series of other minor changes among the components of this tax.

Retail sales were up in the third and fourth quarters of calendar 1969, but the department expects a slowdown in the first half of 1970. It also should be noted that the sales tax estimate for the current year is based on the midpoint between the low and the high economic forecasts for 1970. If the reader believes the low economic forecast is more reasonable, then the sales tax estimate should be reduced by $6 million. Table 14 compares the estimated and actual taxable sales for calendar year 1969.

Table 14
Taxable Sales in California
(In Millions)

		1969			
Category	*1968*	*Dept. of finance estimate Feb. 1969*	*Increase over prior year*	*Actual*	*Increase over prior year*
Retail stores	$18,077	$19,150	5.9%	$19,504	7.9%
Auto and parts	6,669	6,650	—0.3	7,105	6.5
Building materials	4,047	4,300	6.3	4,346	7.4
Manufacturing and wholesaling and miscellaneous outlets	10,214	10,900	6.7	11,159	9.3
Total	$39,007	$41,000	5.1%	$42,114	8.0%

Horseracing revenues were reduced by a net of $6.8 million as a result of the labor dispute which started in December 1969. However, the labor dispute was shorter than the department estimated, therefore these revenues are probably understated by about $2 million.

The combination of a slower population growth rate and the continual decline in per capita cigarette consumption is responsible for the reduction in this tax source.

Corporate taxes were increased by $10 million in the May revisions. Most of this increase reflects higher 1968 profits on returns of taxpayers who have a fiscal rather than a calendar year reporting period.

The apparent decline in inheritance tax receipts is merely a postponement of tax collections until the budget year. There has been a pronounced decline in the number of taxpayers who pay within six months in order to receive the 5-percent tax discount, and a substantial increase in the number who wait until the 24-month delinquency date. The 5-percent discount is not a strong inducement for early payment at today's interest rates.

The most notable change in the other revenues is the $9.7 million increase from interest on investments. Practically all of this gain is attributable to higher rates rather than an increase in the amount invested. Table 15 contains a history of the 1969–70 General Fund revenue estimates.

Table 15

History of Department of Finance's 1969–70 General Fund Revenue Estimates
(In Thousands)

		Revisions during 1969			1969–70 As Revised in the 1970–71 Budget		
Taxes	*Original budget estimate Feb. 1969*	*May 1969*	*Legislation*	*Total Dec. 1969*	*Amount*	*Change from Dec. 1969 estimate*	*Change from original estimate after legislation*
Alcoholic Beverage	$111,350	$—1,000	$60	$110,410	$112,200	$1,790	$790
Bank and Corporation	539,000	10,000	56,995	605,995	607,500	1,505	11,505
Cigarette	169,400	—2,200	150	167,350	163,530	—3,820	—6,020
Horseracing	53,814	--	--	53,814	47,005	—6,809	—6,809
Inheritance and Gift	171,000	—2,000	--	169,000	168,900	—100	—2,100
Insurance	137,000	1,500	—400	138,100	137,500	—600	900
Personal Income	1,223,000	35,000	—87,020	1,170,980	1,181,000	10,020	45,020
Private Car	4,100	200	--	4,300	3,739	—561	—361
Sales and Use	1,730,000	—8,000	396	1,722,396	1,734,000	11,604	3,604
Total Taxes	$4,138,664	$33,500	$—29,819	$4,142,345	$4,155,374	$13,029	$46,529
Other Revenues							
Interest on Investment	$45,555	$4,700	--	$50,255	$55,292	$5,037	$9,737
Penalties on Traffic Violation	14,100	--	--	14,100	15,300	1,200	1,200
Receipts from Health Care Deposit Fund	55,524	—2,500	--	53,024	50,725	—2,299	—4,799
Pay Patient Board Charges	18,485	--	--	18,485	16,641	—1,844	—1,844
All Other	50,766	3,400	$882	55,048	46,189	—8,859	—5,459
Total Other Revenues	$184,430	$5,600	$882	55,048	46,189	—8,859	—5,459
Total Revenues	$4,323,094	$39,100	$—28,937	$4,333,257	$4,339,521	$6,264	$45,364

Analysis of the Department of Finance's 1970 Economic Forecasts

Economists disagree sharply over the business outlook for 1970. One group consisting of such prominent men as Walter Heller, Arthur Okun, and Otto Eckstein (all former members of the President's Council of Economic Advisers) predict a GNP of about $990 billion. Others, who are more influenced by monetary policy, predict a GNP of about $970 billion. Included in this last group are the forecasts of UCLA, and the United California Bank. In November 1969, the Wharton economic forecast predicted a $980 GNP, but on January 27, 1970, it lowered its prediction to $970.4 billion.

The Budget reflects this economic uncertainty. For the first time, the Department of Finance has included *two* economic forecasts in the Budget. The low forecast has a GNP of $970 billion, reflecting the monetary approach, while the high forecast has a GNP of $990 billion. These two forecasts are *not* the high and low of a possible range of economic conditions. Instead, they are the midpoints of two different interpretations on what could happen to the economy depending upon the success or lack thereof of controlling inflation during 1970.

The low economic forecast assumes the virtual freeze in the money supply since June 1969 will have a depressing impact on growth during 1970, and will result in a slowdown in the rate of inflation, especially by the end of the year. This forecast predicts a very modest growth in current dollars and no growth in constant dollars (a technical recession) during the first three quarters of this year. There would be some improvement by the fourth quarter and the outlook for 1971 is more favorable. As a result of this slowdown, the national unemployment rate would increase from 3.5 percent in 1969 to 4.7 percent in 1970. While this is a significant increase, it does not match the 6.7-percent unemployment rate in the 1961 recession. Part of the reason for this more optimistic outlook on unemployment is the expectation that many part-time workers will drop out of the labor force during this recession, and as a result, they will not be counted as unemployed. Corporate profits, also are expected to decline during 1970. The Department of Finance's national estimate assumes a 6.3 percent decline. Other economists are more pessimistic and predict about a 10 percent decline. Table 16 shows that residential construction will be depressed even under the higher economic forecast by the President's Council of Economic Advisers.

The Department of Finance's forecasts, both high and low, were prepared in December 1969, and therefore lacked information in the President's Budget for 1970–71, especially the national defense portion. As a result, these forecasts overstate the defense contribution to the 1970 economy, and this could have a depressing impact on California's defense related employment.

The high economic forecast assumes that the federal government will be either unwilling or unable to control inflation during 1970. Consumer prices are expected to increase another 5.4 percent, unemployment would be up slightly, and corporate profits would have a modest decline. If this forecast becomes a reality, and the economy is more buoyant in 1971, then inflation will be a serious national problem for several years.

Table 16 shows a comparison of five economic forecasts. Both the UCLA and the United California Bank forecasts are in the low range. This table also includes selected estimates that were published in the 1970 Economic Report of the President. As a matter of policy, the Council of Economic Advisers does not publish a complete list of its economic projections. We had intended to include the Wharton economic forecast in this table, because the State Controller hired a member of that faculty to review the revenue estimating techniques of the Department of Finance, and his report was released in January 1970. However, the latest Wharton estimates are so similar to the Department of Finance's low forecast, its inclusion would be repetitious.

Table 16
Comparison of 1970 Economic Forecasts
(In Billions of Dollars)

National Data	*Department of Finance Low Estimate*	*UCLA* *	*UCB* **	*CEA* ***	*Department of Finance High Estimate*
Gross National Product	$970.0	$971.2	$975	$985	$990.0
Consumer expenditures	606.5	605.5	608	616	616.0
Durables	89.5	92.0	91	--	93.5
Nondurables	256.0	252.8	256	--	260.0
Services	261.0	260.7	261	--	262.5
Private investment	133.1	135.0	144	144	143.5
Fixed investment	130.4	132.0	135	136	137.5
Residential	29.3	31.5	34	30	30.0
Other	35.1	34.7	36	--	37.5
Producers' durables	66.0	65.8	65	--	70.0
Change in inventories	2.7	3.9	9	8	6.0
Net exports	3.4	3.3	2	3	3.5
Government purchase	227.0	227.4	221	222	227.0
Federal	103.0	103.8	98	98	103.0
Defense	77.5	79.0	73	74	77.5
Other	25.5	24.8	25	24	25.5
State and local	124.0	123.6	123	124	124.0
Personal income	786.0	785.0	790	--	801.5
Disposable income	667.4	665.7	680	--	679.4
Savings	43.9	43.9	48	--	46.1
Corporate profits	83.0	81.3	87	--	86.0
Consumer price index	134.1	134.0	132	--	134.6
Wholesale price index	117.1	116.5	115	--	117.5
Industrial production index	168.0	173.0	172	--	174.2
Employment (000)	78,125	78,100	78,800	--	78,925
Unemployment (000)	3,815	4,100	3,450	--	3,375
Unemployment rate	4.7%	5.0%	4.2%	--	4.1%
California Data					
Personal income	$88.1	$88.3	$88.8	--	$89.4
Disposable income	76.7	--	--	--	77.8
Taxable corporate profits	7.1	--	--	--	7.4
Employment (000)	8,030	8,095	--	--	8,175
Unemployed (000)	450	--	--	--	405
Unemployment rate	5.3%	5.3%	4.8%	--	4.7%
Number of building permits (000)	130	--	165	--	140
New car sales (000)	915	--	930	--	925
Taxable sales	43.2	--	--	--	44.1
Consumer price index	135.6	135.1	--	--	136.2

* University of California at Los Angeles
** United California Bank
*** President's Council of Economic Advisers

CALIFORNIA REVENUE ESTIMATES, 1970–71

Table 18 shows that General Fund revenues are estimated to increase by $364.6 million, or 8.4 percent during 1970–71. However, this amount is based on the midpoint between the high and low economic forecasts. If the low forecast materializes, then the Department of Finance estimates that revenues will be $54.5 million below the midpoint presented in the budget, and conversely, they could be $54.5 million higher if the $990 billion GNP forecast becomes a reality.

Several of the percentage figures in this table are deceiving. For example, the 1969–70 personal income tax estimates are $81 million below their normal level as the result of 1969 legislation which granted a one-time 10-percent rebate. Comparing this low base with any of the projections for 1970–71 distorts the magnitude of the percentage increase. Horseracing revenues also are depressed in 1969–70 as a result of the labor dispute which started in December 1969. This low base distorts the percentage increase in these revenues in the budget year. Insurance and inheritance taxes appear overly buoyant in the budget year. However, about $5 million in inheritance tax proceeds which will be received in the budget year represents postponed collections from 1969–70. Legislation which changed insurance tax prepayments lowered accruals in 1969–70 and increased them in 1970–71.

Table 17 compares the Department of Finance's estimate of taxable sales under both the low and high economic forecasts. These data indicate wider variations among the 1970 estimates, particularly in the retail store and manufacturing, etc., groups.

Table 17
Estimated Taxable Sales in California
(In Millions)

	1970		*1971*	
Group	*Low forecast*	*High forecast*	*Low forecast*	*High forecast*
Retail stores	$20,655	$21,030	$22,350	$22,610
Autos and parts	7,020	7,175	7,600	7,700
Building materials	4,100	4,180	4,330	4,410
Manufacturing, wholesaling, and miscellaneous outlets	11,475	11,715	12,420	12,580
	$43,250	$44,100	$46,700	$47,300

There is a spread of $254 million between the low and high estimates of corporate profits for 1970. As would be expected, manufacturing accounts for the major part of this difference.

After adjusting for the one-time tax credit, personal income taxes are estimated to increase by 10.3 percent under the low economic forecast, 12.3 percent (which is an average growth rate) based on the midpoint estimate, or 14.2 percent under the high forecast. All of these estimates assume a turnabout in the stock market (which affects capital gains) and a higher level of audit assessments by the Franchise Tax Board.

The drop in per capita cigarette consumption is expected to continue which will lower the receipts from this tax source.

Table 18
Estimated State Revenue Collections During 1970–71
(In Millions)

		1970–71					
		Low Economic Estimate		*Midpoint*		*High Economic Estimate*	
General Fund	*1969–70*	*Amount*	*Percent Increase*	*Amount*	*Percent Increase*	*Amount*	*Percent Increase*
Sales and use	$1,734.0	$1,830.0	5.5%	$1,848.5	6.6%	$1,867.0	7.7%
Personal income	1,181.0	1,393.0	17.9	1,418.0	20.1	1,443.0	22.2
Bank and corporation	607.5	573.0	—5.7	583.0	—4.0	593.0	—2.4
Inheritance and gift	168.9	183.0	8.3	184.0	8.9	185.0	9.5
Cigarette	163.5			159.9	—2.2		
Insurance	137.5			151.8	10.4		
Alcoholic beverage	112.2			116.3	3.7		
Horseracing	47.0			59.6	26.8		
Other sources	187.9			183.0	—2.6		
Total General Fund	$4,339.5	$4,649.6	7.1%	$4,704.1	8.4%	$4,758.6	9.7%
Special Fund							
Motor Vehicle							
Fuels	$655.5			$671.2	2.4%		
Registration, weight	265.5			276.0	4.0		
License (in lieu)	235.0			250.0	6.4		
Transportation	23.0			25.0	8.7		
Cigarette	69.9			68.1	—2.6		
Alcoholic beverage	12.6			12.9	2.4		
Horseracing	8.8			8.8	0		
Other	123.1			107.4	—12.8		
Total Special Funds	$1,393.4			$1,419.4	1.9%		
Totals	$5,732.9			$6,123.4	6.8%		

Special Fund revenues are expected to increase by only $26 million, or 1.9 percent. Most of these levies are based upon specific rather than ad valorem rates, and therefore they do not benefit from inflation.

Due to the uncertainties in projecting economic conditions during 1970, we believe the Legislature should rely upon the $970 billion GNP forecast (with its $54.5 million lower revenue estimate) when formulating the budget and other spending proposals for 1970–71. Over the last decade, there has been a pronounced tendency for actual revenues to exceed original budget estimates. This is a common occurrence during periods of economic expansion. However, in an economic downturn there is a built-in bias to underestimate its severity. As a result, the low revenue estimates contained in this budget could be on the high side and it would be more prudent to use them rather than the midpoint estimates. By June 1970, the economic picture should be sufficiently clear for the Legislature to make a more realistic appraisal of the revenue potential in the budget year.