

CALIFORNIA LEGISLATURE

ANALYSIS OF THE BUDGET BILL

of the

STATE OF CALIFORNIA

for the

Fiscal Year July 1, 1976, to June 30, 1977

Report of the Legislative Analyst

to the

Joint Legislative Budget Committee

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LETTER OF TRANSMITTAL

925 L Street, Suite 650
Sacramento, California 95814
February 9, 1976

THE HONORABLE DONALD L. GRUNSKY, *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, 1976, to June 30, 1977.

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 revenue, 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.

Respectfully submitted,

A. ALAN POST
Legislative Analyst

PRELIMINARY STATEMENT

In the 1976-77 budget, the Governor is continuing his stated policy of a year ago.

"The basic fiscal policy of this administration is to redirect efforts without escalating costs. New programs which cost money require corresponding reductions in other programs."

Within this framework, the new budget is essentially a minimum workload proposal with selected workload cut and trimmed to fit the new "era of limits." For instance, in place of increases based on comparative wages, a flat salary increase of \$65 a month is proposed for all state workers (excepting state traffic officers) "from judges to janitors." In some instances, programs are underfunded. For example, no funding is provided for full-time equivalent (FTE) enrollment growth at the University of California, which the University estimates at about 2,300 above the estimates in the budget. Funding does not match budgeted population growth in the Department of the Youth Authority.

On the other hand, the Governor proposes to expand the level of service for several programs. Early childhood education is up \$34.5 million or 54.6 percent. Educational opportunity programs and the school nutrition program are also up significantly. Two programs are consolidated to create a California Conservation Corps with additional funding to provide public service jobs. Increased funding is proposed to redirect the child care program based on, as yet, undetailed legislation. The capital outlay budget reflects a return to the policy of constructing state office buildings in lieu of renting. A total of \$21.8 million is budgeted in the General Fund to start the new building program.

In totals, the budget is well within the Governor's stated policy. Revenues and transfers amount to \$10,391.8 million and expenditures are some \$45 million less at \$10,346.0 million. The budget also anticipates that 1976-77 will begin with \$271.7 million in unrestricted General Fund surplus from the prior year, and end with a General Fund unrestricted surplus of \$339 million, a gain of \$67.3 million during the budget year.

It should also be noted that in addition to these beginning and ending balances, other amounts are available for appropriation. The Federal Revenue Sharing Fund balance at the close of fiscal year 1976-77 is shown to be \$180.3 million. There is also \$78 million of tidelands oil revenues in the Capital Outlay Fund for Public Higher Education (COFPHE) at the end of 1976-77. These balances are in special funds which require legislative appropriation to transfer them to the General Fund. They can, however, be appropriated by the Legislature for any purpose. The total amount available to the General Fund at the end of 1976-77, therefore, is \$597.3 million. (Detail is provided in the statement of surplus, as shown on page A-6 of this Analysis.) The major components of the total amount available are:

	<i>(Millions)</i>
General Fund unrestricted surplus.....	\$339.0
Federal revenue sharing	180.3
Tidelands oil revenues (COFPHE)	78.0
Total Available June 30, 1977	\$597.3

The budget anticipates that General Fund income will rise \$1,205 million or over 13 percent from 1975-76, reaching \$10,391.8 million in 1976-77. No new taxes are proposed. In fact, certain low-income tax brackets would be abolished and others lowered in the personal income tax, providing selective tax relief.

In all respects, the projected revenue increase is substantial. The amount is probably unmatched in previous budgets without a change in the tax base. We are probably in the most favorable stage of the economic cycle to anticipate a large increase in tax receipts. However, an increase of this magnitude should be viewed with extra caution because of the uncertainty in the economic assumptions on which the revenue estimates are based. A key threat to continuing recovery remains a resurgence of inflation which could weaken real incomes and threaten consumer spending. Continuing high unemployment as well as the possibility of higher interest rates are other considerations.

In our Analysis of the Budget Bill, we have assessed each program with the objective of indicating all areas in which we think appropriate economies or reductions can be made. The recommendations are not tailored to achieving any specific budget figure, but the reductions we have recommended will effectively reduce proposed expenditure levels. We have not recommended reductions which would reduce effective levels of service below those required to achieve the basic objectives and performance of the programs. Conversely we have recommended increases or policy review in instances where we feel that program objectives differ from those intended by the Legislature. Also, some augmentations were recommended where we felt the impact of inflation or of workload elements was not sufficiently recognized.

In the pages that follow, we have incorporated a series of charts and tables which show the principal financial features and elements of the Governor's Budget. In addition, there is a brief review of the economic assumptions and the associated revenue estimates supporting the budget.

Expenditure Summary

The elements of the overall expenditure program are:

	<i>(Millions)</i>
Total program	\$20,358
Composed of:	
1. General Fund	10,346
2. Special funds	1,981
3. Bond funds	282
4. Federal funds expended or subvented by the state	7,749

Table 1 shows the combined expenditure program for the past and current fiscal years and the budget year, 1976-77.

Table 1
State of California
Combined Expenditure Summary for Indicated Years

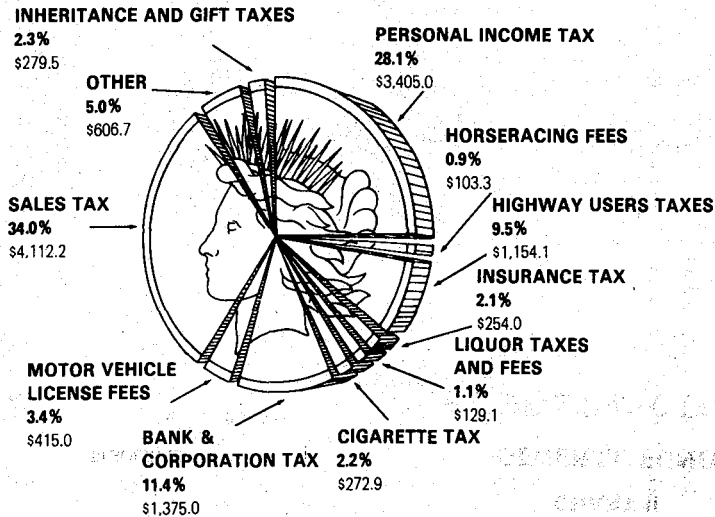
	<i>1974-75</i>	<i>1975-76</i>	<i>1976-77</i>
General Fund	\$8,348,642,330	\$9,544,479,205	\$10,346,008,489
Special funds	1,680,499,736	2,048,672,207	1,981,347,391
State Budget Expenditures	<u>\$10,029,142,066</u>	<u>\$11,593,151,412</u>	<u>\$12,327,355,880</u>
Bond funds	<u>247,348,108</u>	<u>394,565,814</u>	<u>281,746,868</u>
Overall state expenditures	<u>\$10,276,490,174</u>	<u>\$11,987,717,226</u>	<u>\$12,609,102,748</u>
Expenditure of federal funds ^a	<u>\$6,482,191,335</u>	<u>\$8,036,935,784</u>	<u>\$7,748,747,187</u>
Combined Total Expenditures	<u><u>\$16,758,681,509</u></u>	<u><u>\$20,024,653,010</u></u>	<u><u>\$20,357,849,935</u></u>

^a Includes grants-in-aid, reimbursements and special projects.

CHART I
STATE BUDGET PICTURE
1976-77 FISCAL YEAR
(Dollars in Millions)

TOTAL REVENUES

\$12,106.8	100.0%
215.3	(Transfers)
\$12,322.1	(Total Income)



TOTAL EXPENDITURES
(Excluding Selected Bond Funds)

\$12,327.4	100.0%
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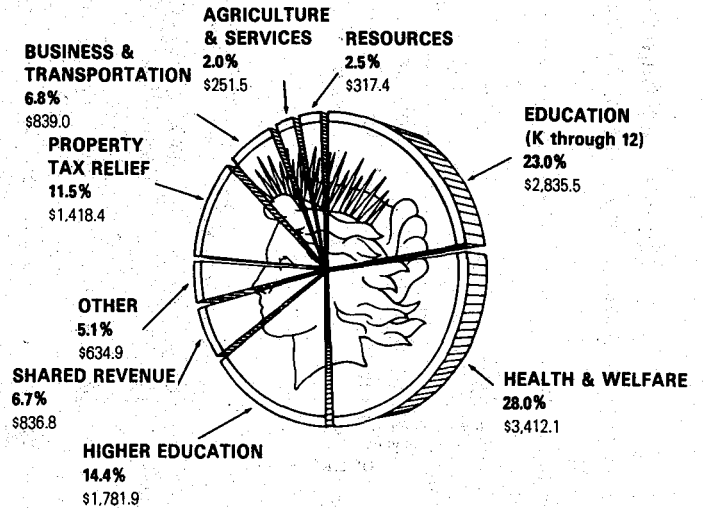
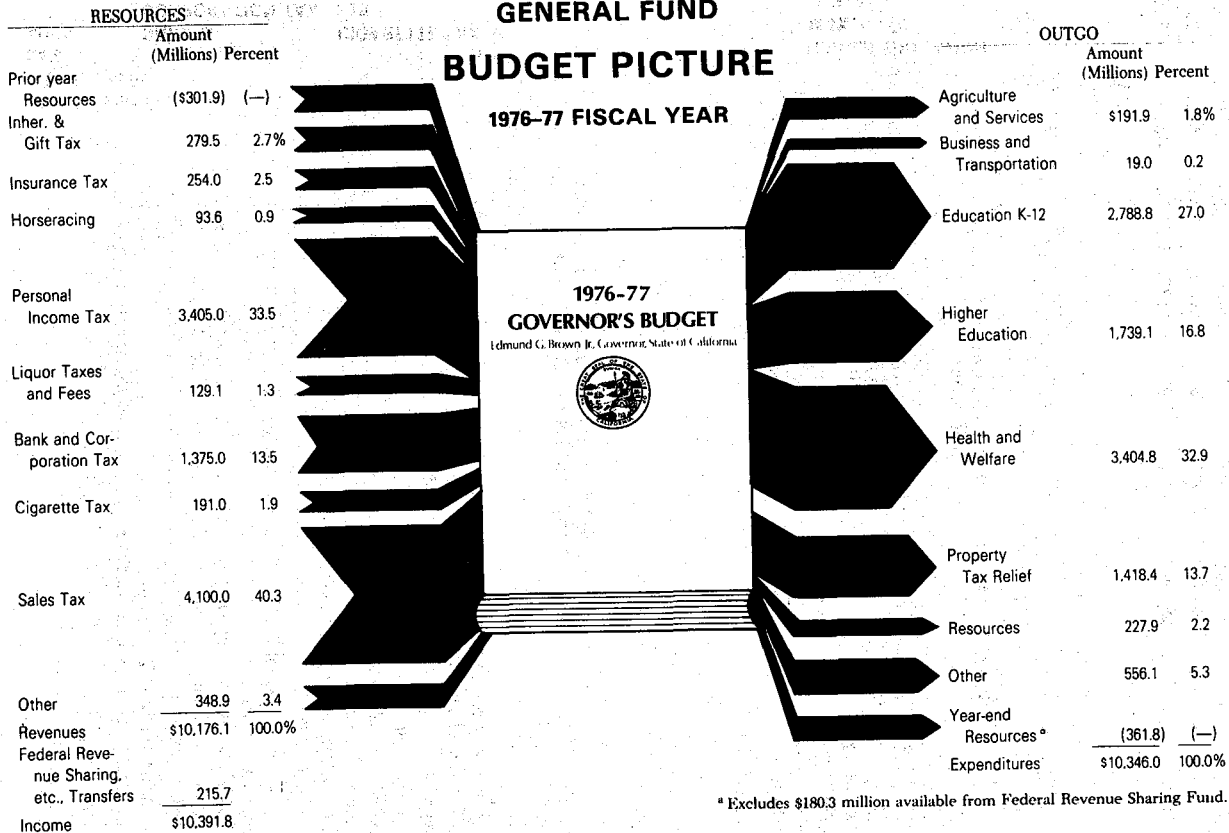


CHART II

GENERAL FUND

BUDGET PICTURE



General Fund Budget Expenditures and Yearly Increases
(Millions)

	Actual 1974-75	Estimated 1975-76	Change from 1974-75		Proposed 1976-77	Change from 1975-76	
			Amount	Percent		Amount	Percent
State operations.....	\$2,028.1	\$2,343.4	\$315.2	15.5%	\$2,598.8	\$255.4	10.9%
Capital outlay.....	17.5	60.5	43.0	245.7	40.6	-19.9	-32.9
Local assistance.....	6,303.0	7,140.6	837.6	13.3	7,706.6	566.0	7.9
Totals.....	\$8,348.6	\$9,544.5	\$1,195.8	14.3%	\$10,346.0	\$801.5	8.4%

Special Fund Budget Expenditures and Yearly Increases
(Millions)

	Actual 1974-75	Estimated 1975-76	Change from 1974-75		Proposed 1976-77	Change from 1975-76	
			Amount	Percent		Amount	Percent
State operations.....	\$566.4	\$681.8	\$115.4	20.4%	\$722.3	\$40.5	5.9%
Capital outlay.....	288.1	472.9	184.8	64.1	347.4	-125.5	-26.5
Local assistance.....	826.0	893.9	67.9	8.2	911.6	17.7	2.0
Totals.....	\$1,680.5	\$2,048.6	\$368.1	21.9%	\$1,981.3	\$-67.3	-3.3%

**General Fund Surplus, Revenue Sharing and
Tidelands Oil Revenues Available**

	Amounts in Millions	
	1975-76	1976-77
Prior-year resources available.....	\$660.2	\$301.9
(Unrestricted surplus, prior year).....	(554.7)	(271.7)
Income (adjusted to exclude special accounts).....	9,161.8	10,368.4
Total Available.....	\$9,822.0	\$10,670.3
Expenditures (adjusted to exclude special accounts).....	\$9,520.1	\$10,319.7
Reserves.....	-30.2	-11.6
Current surplus (adjusted to exclude expenditures from reserves ^a).....	(-283.0)	(67.3)
Year-end General Fund Unrestricted Surplus.....	\$271.7	\$339.0
Other Funds Available:		
Federal revenue sharing balances available.....	\$214.3	\$180.3
Tidelands oil money in Capital Outlay Fund for Public Higher Education.....	83.8	78.0
Total Available Year-end.....	\$569.8	\$597.3

^a Expenditures from reserves are \$75.3 million in 1975-76 and \$18.6 million in 1976-77.

MAJOR GENERAL FUND PROGRAM ELEMENTS

This summary presents a brief overview of major expenditure programs such as health, education, benefit payments and capital outlay. These major programs comprise 87.1 percent of the \$10,346.0 million in General Fund expenditures proposed for 1976-77.

Detailed information on each of the programs can be obtained by referring to the appropriate budget item in following sections of this Analysis.

Table 2 indicates the major program changes in General Fund expenditures.

Table 2
1976-77 Selected General Fund Budget Program Changes
From 1975-76 Expenditure Level
(In Millions)

	<i>Amount of Change</i>	<i>Percent of Change</i>
Major Program Increases:		
Health (excluding Medi-Cal).....	\$12.2	1.7%
Medi-Cal	54.5	6.1
Benefit Payments	99.1	8.0
K-12 Education (total education)	161.3	5.8
University of California.....	31.9	5.4
California State University and Colleges	34.3	6.3
California Community Colleges—apportionments.....	79.7	20.9
Property Tax Relief	103.5	7.9
Major Program Decreases:		
Salary Increases.....	-25.5	-19.7
Employee Benefits (TEC)	-10.3	-31.9
Capital Outlay	-19.9	-32.8

Department of Health

	<i>Estimated 1975-76</i>	<i>Proposed 1976-77</i>	<i>Increase</i>	<i>Percent</i>
General Fund.....	\$717,472,437	\$729,668,269	\$12,195,832	1.7%

A total 1976-77 General Fund Expenditure of \$729.7 million is proposed for the Department of Health, an increase of \$12.2 million or 1.7 percent over the current year. Medi-Cal is excluded from this total except for \$29.2 million which is for price and provider rate increases to be transferred to it upon order of the Department of Finance. The net effect therefore is a decrease of \$17.0 million in proposed expenditures from the General Fund for the Department of Health, excluding Medi-Cal.

The Social Services Program (Homemaker/Chore) reflects a proposed augmentation of \$10 million for the current year which is to be carried forth in the budget year. The General Fund support for the narcotics and drug abuse program is proposed at \$10.7 million in the budget year, a reduction of approximately \$1.4 million below the current year expenditures of \$12.1 million. This reduction is due to fewer anticipated referrals for drug diversion for marijuana offenders. Currently, state funds for the alcoholism program are reflected in the Department of Health's budget. However, effective July 1, 1976, these funds will be appropriated directly

to the proposed Department of Alcoholic Beverage Control to be located within the Health and Welfare Agency.

Total average population at the state hospitals is estimated to increase by 533 or 3.1 percent between the current year and the budget year. The average population at the hospitals for the mentally disabled is estimated to increase by 357 or 5.4 percent, while the average population at the hospitals for the developmentally disabled is estimated to increase 176 or 1.7 percent. The following summary shows the changes in average populations at the state hospitals between 1975-76 and 1976-77.

Average Populations at the State Hospitals

	1975-76	1976-77	Change	Percent
Hospitals for the developmentally disabled ..	10,253	10,429	176	1.7%
Hospitals for the mentally disabled.....	6,581	6,938	357	5.4
Totals.....	16,834	17,367	533	3.2%

California Medical Assistance Program (Medi-Cal)

	Estimated 1975-76	Proposed 1976-77	Increase	Percent
General fund	\$888,683,170	\$943,255,620	\$54,572,450	6.1%

A total 1976-77 General Fund expenditure of \$943.3 million is proposed for the Medi-Cal Program. This is an increase of \$54.6 million or 6.1 percent over 1975-76. County participation in program costs will increase \$29.5 million or 9 percent over 1975-76 due to estimated increases in counties' modified assessed values. Proposed Medi-Cal eligibility simplification will cost \$4,820,000 (assumed to be approved through legislation effective July 1, 1976). The medical component of the Homemaker/Chore Program will be shifted to the Medi-Cal Program to increase federal participation. Estimated cost to Medi-Cal will be \$4.5 million from the General Fund.

The medical assistance budget proposal reflects *no change* in provider rates for 1976-77. Adjustments are to be made, however, in accordance with funding for price and provider rate increases and is reflected elsewhere (\$29.2 million for Medi-Cal) in the Department of Health budget. This additional amount is to be transferred to the medical assistance program upon order of the Department of Finance.

The average monthly caseload is projected to increase by 2.7 percent. However, the components of this increase vary from a 17.9 percent increase for medically indigent to a 0.2 percent increase for cash grant eligibles.

Medi-Cal Average Monthly Caseload

	Estimated 1975-76	Proposed 1976-77	Increase	Percent
Cash grant eligibles	\$2,209,900	\$2,214,900	5,000	0.2%
Medically needy	193,000	216,300	23,300	12.1
Medically indigent	245,800	289,800	44,000	17.9
Total	\$2,648,700	\$2,721,000	72,300	2.7%

Department of Benefit Payments

	<i>Estimated</i> 1975-76	<i>Proposed</i> 1976-77	<i>Increase</i>	<i>Percent</i>
General Fund	\$1,238,993,362	\$1,338,065,845	\$99,072,483	8.0%

A total General Fund expenditure of \$1,338.1 million is proposed for the Department of Benefit Payments. This is an increase of \$99.1 million or 8.0 percent over the current year. The increase is primarily attributable to cost-of-living adjustments to grant levels. The Welfare Local Assistance Program consists of the following five elements:

Welfare Operations Program Costs (General Fund)

	<i>Estimated</i> 1975-76	<i>Projected</i> 1976-77	<i>Change</i>	<i>Percent</i>
Payments for children.....	\$525,999,949	\$573,616,435	\$47,616,486	9.1%
Payments for adults	637,669,068	679,925,792	42,256,724	6.6
Special adult programs	3,916,034	4,400,965	484,931	12.4
Food stamps.....	2,010,903	2,298,471	287,568	14.3
County administration.....	66,474,100	74,500,500	8,026,400	12.1
Federal programs.....	191,937	—	-191,937	-100.0
Total ^a	\$1,236,261,991	\$1,334,742,163	\$98,480,172	8.0%

^a Does not include state operations budget.

The total caseload based on monthly average persons aided is estimated to increase 2.7 percent. This is largely due to the increase in the disabled category which is a result of a more liberalized definition of disabled (HR 1 and Chapter 1216, Statutes of 1973 (AB 134)) and also because the discontinuance rate is below what it has been in the past, due to the federal government being unable to redetermine eligibility on an annual basis.

Caseload Estimates

Monthly Average Number of Persons Aided:	<i>Estimated</i> 1975-75	<i>Proposed</i> 1976-77	<i>Change</i>	<i>Percent</i>
AFDC	1,436,400	1,424,755	-11,645	-0.8%
Aged	335,100	350,300	15,200	4.5
Blind	12,800	12,900	100	0.8
Disabled	318,000	371,300	53,300	16.8
Totals.....	2,102,300	2,159,255	56,955	2.7%

The total number of persons receiving food stamp assistance in 1976-77 is estimated at 1,656,200. This represents an increase of 23,900 or 1.5 percent over 1975-76.

Food Stamp Caseload Estimates

	1975-76	1976-77	Increase	Percent
Totals	1,632,300	1,656,200	23,900	1.5%

Education (K-12)

California Community Colleges

	Estimated 1975-76	Proposed 1976-77	Increase	Percent
Local Assistance ^a	\$2,179,045,468	\$2,289,721,711	\$110,676,243	4.83%
Total Education ^b	\$2,600,104,917	\$2,761,358,099	\$161,253,182	5.84%

^a General Fund only.

^b Excludes debt service on school building air bonds.

Total General Fund expenditures for education for 1976-77 are projected at \$2,761.4 million, an increase of \$161.3 million or 5.8 percent over 1975-76. A significant portion of the increase is for expansion of Early Childhood Education—a proposed increase of \$34.5 million or 54.6 percent from \$63.2 million in 1975-76 to \$97.7 million in 1976-77. The budget includes a \$10.8 million or 31.7 percent increase to \$44.7 million for 1976-77 for the Child Nutrition Program.

The budget also shows a \$13.7 million or a 133 percent increase to \$24.0 million for the Master Plan for Special Education. This, however, merely represents an accounting change. In the 1975-76 fiscal year, the \$24 million local assistance is composed of (1) \$10 million from Chapter 1532, Statutes of 1974 (AB 4040) and (2) \$14 million from the State School Fund Special Education Apportionments Account. In the budget year the entire \$24 million is appropriated in Item 324, Budget Act of 1976. Thus, there is no actual increase in state support for this program.

Chapter 277, Statutes of 1975, (SB 220) added \$21 per pupil to the Foundation Program for a total increase of \$84 for both elementary and high school levels for inflation in fiscal year 1975-76. This statute also provided for a return to the previous inflationary computation of \$66 per pupil for 1976-77 which was established by Chapter 208, Statutes of 1973 (SB 90).

A comparison of the estimated ADA in 1975-76 and 1976-77 is shown by school level as follows:

Estimated Average Daily Attendance^a

	1975-76	1976-77	Change	Percent
Elementary.....	3,071,000	3,027,900	-43,100	-1.4%
High school	1,565,900	1,598,800	32,900	2.1
Adults, high school	77,300	82,300	5,000	6.1
Totals	4,714,200	4,709,000	-5,200	-0.1%

^a Average Daily Attendance (ADA) for both the 1975-76 and 1976-77 fiscal years reflects the imposition of a 5 percent growth limitation on nonmandatory adult and ROC/ROP ADA for purposes of state support.

The total average daily attendance is projected to decrease by 0.1 percent between 1975-76 and 1976-77. However, the elements of this decrease vary from a 1.4 percent decline among elementary school students to a 6.1 percent increase in the adults, high school program.

California Community Colleges

	<i>Estimated 1975-76</i>	<i>Projected 1976-77</i>	<i>Increase</i>	<i>Percent</i>
Apportionments	\$381,161,799	\$460,880,413	\$79,718,614	20.9%

Expenditures for California Community Colleges apportionments are projected to increase by \$79.7 million. This includes a gain of \$15.4 million (from \$2.1 million to \$17.5 million) for assistance to new community colleges. Extended Opportunity Programs and Services (EOPS) are also budgeted to increase by \$3.8 million or 50.0 percent from \$7.7 million to \$11.5 million.

Total average daily attendance is projected to increase by 4.9 percent for 1976-77.

Estimated Average Daily Attendance

	<i>1975-76</i>	<i>1976-77</i>	<i>Increase</i>	<i>Percent</i>
Community Colleges	592,400	621,800	29,400	5.0%
Adults, community colleges	149,750	157,050	7,300	4.9
Totals.....	742,150	778,850	36,700	4.9%

University of California

	<i>Estimated 1975-76</i>	<i>Projected 1976-77</i>	<i>Increase</i>	<i>Percent</i>
General Fund appropriation.....	\$587,095,381	\$619,042,922 ^a	\$31,947,541	5.4%

^a Excludes 1976-77 salary increase.

General Fund expenditures for the University of California are proposed at \$619.0 million for fiscal year 1976-77. This is an increase of \$31.9 million or 5.4 percent over the 1975-76 level. Significant increases include \$10.2 million for merit salary adjustments, \$5.0 million for deferred maintenance, \$3.9 million for instructional support enrichment, \$4.3 million for utility price increases, \$3.6 million for enrollment related costs, \$3.7 million for social security coordination, \$3.5 million for general price increases, and \$1.5 million for malpractice insurance increases.

Various measurement criteria are used to determine the appropriate level of funding for each function of the University. One such measurement is the enrollment in terms of full-time equivalents (FTE). The Governor's Budget projects the 1976-77 FTE enrollment to increase 775 FTE or 0.7 percent over 1975-76. University estimates for the same year show an increase of 3,097 FTE or 2.6 percent. The difference of 2,322 FTE is not explained in the Governor's Budget which only provides funding to match the lower estimate. A comparison of the FTE enrollment in 1975-76 and 1976-77 is as follows:

Estimated Full-Time Equivalent Enrollment

	<i>Estimated in Budget 1975-76</i>	<i>Proposed in Budget 1976-77</i>	<i>Budget Change</i>		<i>UC Estimates 1976-77</i>	<i>UC Change</i>	
			<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>	
General Campuses	106,672	106,987	315	0.3%	109,173	2,501	2.3%
Health Sciences.....	10,642	11,102	460	4.3	11,238	596	5.6
Totals.....	117,314	118,089	775	0.7%	120,411	3,097	2.6%
Extended University ^a	1,206	1,300	94	7.8%	1,187	-19	-0.5%

^a Not budgeted.

The largest numerical enrollment increase will occur in the general campuses category, under the UC estimates, while the largest percentage increase will occur in the health sciences category (the Governor's Budget estimated a 4.3 percent increase and the University of California estimated a 5.6 percent increase).

California State University and Colleges

	<i>Estimated 1975-76</i>	<i>Projected 1976-77</i>	<i>Increase</i>	<i>Percent</i>
General Fund.....	\$542,057,016	\$576,326,165 ^a	\$34,269,149	6.3%
Enrollment (full-time equivalents)	236,800	239,410	2,610	1.1%

^a Excludes 1976-77 salary increases.

The proposed California State University and Colleges (CSUC) General Fund support budget totals \$576.3 million for 1976-77. This represents an increase of \$34.3 million or 6.3 percent over 1975-76. A significant augmentation (4.1 percent) in CSUC faculty from 12,900.6 in 1975-76 to 13,427.0 in 1976-77 is an important factor in the increase. This in turn is a reflection of the FTE enrollment increase in 1976-77 over 1975-76.

Enrollment was originally budgeted at 230,005 FTE, including 375 FTE in the international program, in 1975-76. These enrollment projections have subsequently been revised to 236,800 FTE. This is an increase of 6,795 FTE students or 3.0 percent over the original estimate. Section 28.9 of the 1975 Budget Act permits additional funding for enrollments which exceed 2.0 percent. CSUC thus qualifies to receive a deficiency appropriation of \$2,195,000 in 1975-76 for the additional 1.0 percent (2,195 FTE students).

To accommodate the increased enrollment in 1976-77, an additional \$8,615,974 has been proposed in the Governor's Budget. Other significant increases in 1976-77 include \$6.7 million for merit salary adjustments, \$4.0 million for an increase in PERS contributions, and \$6.7 million for price increases.

Salary Increases

	<i>Estimated 1975-76</i>	<i>Proposed 1976-77</i>	<i>Change</i>	<i>Percent</i>
General Fund	\$129,533,000	\$104,067,000	-\$25,466,000	-19.7%

A 1976-77 General Fund expenditure of \$104.1 million is proposed for salary increases. This is a decrease of \$25.5 million or 19.7 percent below the estimate for the current year.

The projected 1976-77 budget represents the amount necessary to provide an increase of \$65 per month for all state employees including faculty and nonfaculty positions at the University of California, the California State University and Colleges, and the judicial and statutory and exempt officers and employees. The only group for which additional salary increase funds are budgeted is the highway patrol for which a total of \$125 per month is proposed. This is in the special funds category.

The comparative program distribution of the 1975-76 and 1976-77 General Fund salary increases is shown as follows:

	1975-76	1976-77
Civil service, and related.....	\$59,056,000	\$50,882,000
University of California	35,079,000	25,243,000
Faculty	18,597,000	10,854,000
Nonfaculty	16,482,000	14,389,000
California State University and Colleges.....	32,925,000	27,402,000
Instructional	21,936,000	14,537,000
Noninstructional.....	10,989,000	12,865,000
Judicial ^a	2,473,000	540,000
Total General Fund Increase	\$129,533,000	\$104,067,000

^a Government Code Section 68203 provides that the salaries of judges and justices be adjusted on September 1 of each year by the percentage change in the California Consumer Price Index for the previous calendar year. However, the 1976-77 budget is based on repealing that section of the code and providing the same \$65 a month increase as all other state employees except for highway patrolmen.

Employee Benefits—Total Equivalent Compensation (TEC)

	Estimated 1975-76	Proposed 1976-77	Change	Percent
General Fund	\$32,300,000	\$22,000,000	\$-10,300,000	-31.9%

The 1976-77 budget proposes a \$22.0 million General Fund expenditure for employee benefits—TEC. This is \$10.3 million or 31.9 percent below current year estimates. The proposed budget will provide for employee benefits including special adjustment funds for identified inequities. The University of California and the California State University and Colleges are included in the proposed amount. The budget does not list any specific benefit proposals.

Capital Outlay

	Estimated 1975-76	Proposed 1976-77	Change	Percent
General Fund capital outlay expenditures	\$60,459,904	\$40,601,451	\$-19,858,453	-32.8
Major Programs				
Department of General Services		21,774,100		
Department of Conservation ..		1,929,841		
Department of Parks and Recreation.....		1,950,376		
Department of Water Resources.....		3,335,700		
Department of Health		6,673,000		
Department of Corrections		2,866,100		
Department of Youth Authority		1,240,000		

Expenditures for capital outlay from the General Fund are budgeted to decrease by \$19.9 million between the 1975-76 and 1976-77 fiscal years. This comparison is distorted, however, because the 1975-76 amount includes expenditures from appropriations authorized in prior years and the

1976-77 total represents only appropriations proposed in 1976-77. On a comparable appropriations basis the 1976-77 budget is up about \$20 million over appropriations in the 1975-76 Budget Act.

The major component of the \$21.8 million proposed for the Department of General Services is for new state buildings in Sacramento. The major projects are:

- \$17.2 million for new state office building
- \$542,000 for planning a second new state office building
- \$1.4 million for additions to the Central Plant
- \$500,000 for planning a new Department of Justice building.

The \$6.7 million proposed for the Department of Health includes \$5 million for a statewide Fire and Safety Program, \$1 million for Phase II of a statewide emergency power program and \$673,000 for a Public Health Building in Berkeley.

Property Tax Relief

	<i>Estimated 1975-76</i>	<i>Proposed 1976-77</i>	<i>Change</i>	<i>Percent</i>
Senior citizens' property tax assistance	\$51,400,000	\$51,200,000	\$-200,000	-0.4%
Personal property tax relief	362,750,000	412,000,000	49,250,000	13.6
Homeowners' property tax relief	755,400,000	798,000,000	42,600,000	5.6
Open space	15,500,000	17,000,000	1,500,000	9.7
Payment to local governments for sales and property tax revenue loss	4,840,000	5,207,000	367,000	7.6
Renters' Tax relief	125,000,000	135,000,000	10,000,000	8.0
Totals	\$1,314,890,000	\$1,418,407,000	\$103,517,000	7.9%

The state's Property Tax Relief Program provides reduced property taxes to homeowners', personal property owners (business inventories), senior citizen homeowners' and renters. The subvention for open space and payments to local governments for sales and property tax revenue losses are also included as a category of property tax relief.

The largest program, Homeowners' Property Tax Relief, with proposed expenditures of \$798 million in 1976-77, is up \$42.6 million or 5.6 percent over 1975-76. The largest amount of growth between the two years, however, is proposed for the Personal Property Tax Relief Program which is up \$49.3 million or 13.6 percent to the \$412 million level in 1976-77.

California Conservation Corps

	<i>Estimated 1975-76</i>	<i>Proposed 1976-77</i>	<i>Change</i>	<i>Percent</i>
General Fund	—	\$9,330,000	\$9,330,000	—

This is a new program proposed by the Governor to begin July 1, 1976. It will, however, replace two current programs in the Department of Conservation, the Youth Conservation Corps and the Ecology Corps which are funded at approximately \$4.9 million.

The California Conservation Corps has the objective of providing public service opportunities for young men and women in health, social services, urban services and in natural resources. Immediate objectives are directed toward work projects in the natural resources category.

GENERAL OBLIGATION BONDS

State general obligation bonds outstanding on December 31, 1975 totaled \$5,529,016,000, an increase of \$108,186,000 or 2.0 percent over the \$5,420,830,000 outstanding on December 31, 1974.

State general obligation bonds unsold on December 31, 1975 totaled \$1,295,900,000, a decrease of \$375 million or 22.4 percent over the \$1,670,900,000 outstanding on December 31, 1974.

General obligation bonds are those bonds in which the debt service obligation (which includes interest and redemption payments) is either paid from the General Fund or the General Fund is pledged as guaranty against a possible default in payment from program revenues.

There are three categories of general obligation bonds: (1) General Fund Bonds—those bonds in which the debt service obligation is fully paid from the General Fund, (2) Partially Self-Liquidating Bonds—those bonds in which the debt service obligation is partially paid from the project or program revenues and the remainder from the General Fund, and (3) Self-Liquidating Bonds—those bonds in which the debt service obligation is entirely paid from the project or program revenues. The full faith and credit of the state is pledged to make payment from the General Fund in the event that the program or project revenue is insufficient to cover these costs in the latter two categories.

Revenue bonds are also issued by state agencies. These are for specific projects in which only the revenue generated from the program is pledged for payment of the bonds. Revenue bonds have been issued for the University of California and State University and Colleges dormitories and parking lots, Cal-Expo facilities, pollution control, bridges and other construction projects and purposes. The revenue bonds are not included in the totals of this summary but are mentioned here merely to contrast the different debt instruments with which the state is involved.

Table 3 indicates the amount by program for bonds which have been approved but not sold as well as bonds sold and outstanding on December 31, 1975. Each of the programs listed was approved by a majority of the electorate after having been passed with at least a two-thirds majority in each house of the Legislature.

Table 3
General Obligation Bonds of the State of California
by Purpose as of December 31, 1975

<i>Purpose</i>	<i>Unsold</i>	<i>Outstanding</i>
General Fund Bonds:		
State Construction	—	\$648,750,000
Beaches, parks, recreational and historical facilities	\$175,000,000	182,100,000
Higher education construction	—	169,710,000
Junior college construction	—	50,300,000
Community college construction	20,000,000	134,750,000
Clean water	300,000,000	180,000,000
Recreation and fish and wildlife	—	54,500,000
Health science facilities	100,900,000	53,500,000
Totals	<u>\$595,900,000</u>	<u>\$1,473,610,000</u>
Partially Self-Liquidating Bonds:		
School building aid ^a	<u>\$325,000,000</u>	<u>\$1,162,690,000</u>

Totals	\$325,000,000	\$1,162,690,000
Self-Liquidating Bonds:		
Water resources development	\$200,000,000	\$1,540,800,000
Veterans' farm and home	175,000,000	1,307,950,000
Harbor implementation and India Basin	—	4,511,000
Harbor development	—	39,455,000
Totals	\$375,000,000	\$2,892,716,000
Totals, All bonds	\$1,295,900,000	\$5,529,016,000

^a School districts bear part of the debt service. The General Fund contributes the remainder.
Source: State Treasurer

California State Bond Fund expenditures in those programs separately identified in Schedule 3 of the 1976-77 budget document are estimated at \$281.7 million for the 1976-77 budget year. This is a decrease of \$112.8 million or 28.6 percent from the estimated \$394.6 million in expenditures for 1975-76. Bond Fund expenditures in 1974-75 through 1976-77 are listed in Table 4.

Table 4
State of California
Bond Fund Expenditures, 1974-75 Through 1976-77^a

	1974-75	1975-76	1976-77
California Water Resources Development	\$105,624,818	\$109,697,404	\$122,574,700
Central Valley Water Project	9,365,099	16,680,145	2,675,000
Community College Construction (1976) ^b	—	—	34,059,600
Health Science Facilities	16,595,801	31,040,000	32,874,000
Recreation and Fish and Wildlife	12,950,778	15,687,600	365,509
Beaches, Parks Recreational and Historical Facilities	25,081,107	153,006,657	20,907,890
Clean Water	30,664,215	67,108,898	68,290,169
State Construction Program	47,066,290	1,345,110	—
	\$247,348,108	\$394,565,814	\$281,746,868

^a Includes only expenditures from selected bond programs separately identified in Schedule 3 of the Governor's Budget.

^b Anticipated expenditures from a proposed bond issue to be voted on by the people in June 1976.

Six major general obligation bond issues have been approved by the Legislature and are pending vote by the electorate. These proposals total \$1,663,100,000 in general obligation authority and include the following programs:

Legislation	Program	Vote by Electorate	Amounts (In Millions)
Chapter 152, Statutes of 1972 (SB 220)	Health Science Facilities	November 1976	\$138.1
Chapter IX, Statutes of 1975 (AB 1X)	Housing	November 1976	500.0
Chapter 982, Statutes of 1975 (AB 1732)	Veterans	June 1976	500.0
Chapter 1007, Statutes of 1975 (AB 32)	School Lease Purchase	June 1976	200.0
Chapter 1008, Statutes of 1975 (AB 121)	Safe Drinking Water	June 1976	175.0
Chapter 1066, Statutes of 1975 (SB 156)	Community College Construction	June 1976	150.0

Bond sales totaling \$170 million are anticipated in 1976-77 for programs currently authorized as shown in Table 5.

Table 5
General Obligation Bond Sales
1974-75 to 1976-77
(In Millions)

	<i>Actual</i> 1974-75	<i>Estimated</i> 1975-76	<i>Projected</i> 1976-77
Community colleges	\$100	—	\$20
Health science facilities	40	\$50	—
Recreation and fish and wildlife	15	10	—
Beaches, parks, recreational and historical facilities.....	25	50	50
Clean water	100	40	—
State school building aid ^a	50	125	100
Veterans ^b	175	175	—
Water resources development ^b	—	10	—
Totals.....	\$505	\$460	\$170

^a Debt service partially paid by school districts.

^b Debt service paid from project or program revenues.

If the issues pending voter approval are authorized during 1976, additional sales during 1976-77 are anticipated as follows:

Community college construction	\$50,000,000
California safe drinking water	25,000,000
Veterans	200,000,000
Housing	50,000,000
School lease purchase	50,000,000

General Fund Debt Service

Table 6 projects the total General Fund debt service for the period 1974-75 through 1978-79. The data indicate that debt service charges will be \$192,906,441 in fiscal year 1976-77 and increase to \$212,546,167 in 1978-79. The table includes all bond debt service fully funded from the General Fund and the General Fund portion of school building aid bond debt service as shown separately in Tables 7 and 8. These estimates are based only on currently authorized bond issues and do not include those issues yet to be voted on by the electorate. Should these new issues be authorized and sales from them made, the cost to the General Fund will increase accordingly.

Table 6
Estimated Total General Fund Debt Service

	<i>General Fund</i> <i>Bonds</i>	<i>School Building</i> <i>Aid Bonds</i>	<i>Total</i> <i>Debt Service</i>
1974-75	\$125,768,482	\$42,769,524	\$168,538,006
1975-76	151,705,590	32,690,811	184,396,401
1976-77	165,093,258	27,813,183	192,906,441
1977-78	167,546,288	27,296,473	194,842,761
1978-79	183,810,448	28,735,719	212,546,167

Tables 7 and 8 divide the General Fund debt service into its two major components. Table 7 projects the debt service on those programs fully funded from the General Fund and Table 8 projects debt service costs for

school building aid bonds including the estimated portion projected to be contributed from the General Fund. The General Fund portion of total debt service for School Building Aid Bonds shown in Table 6 has been decreasing significantly. In 1974-75, the portion borne by the General Fund was 33.5 percent and is estimated at 19.7 percent in 1976-77.

Table 7
Estimated Interest and Redemption Charges on General Fund Bonds Fully Funded by the State 1974-75 to 1978-79^a

<i>Fiscal Year</i>	<i>Total Debt Service</i>	<i>Debt service on bonds sold as of Dec. 31, 1975</i>	<i>Debt service on anticipated sales^b</i>
1974-75	\$125,768,482	\$125,768,482	—
1975-76	151,705,590	151,705,590	—
1976-77	165,093,258	155,193,258	\$9,900,000
1977-78	167,546,288	150,216,288	17,330,000
1978-79	183,810,448	147,061,448	36,749,000

^a Cash basis. Includes state construction; state beach, park, recreational and historical facilities; clean water; state higher education; community college construction; recreation and fish and wildlife; and health science facilities.

^b Estimated debt service on anticipated \$90 million in sales during the last half of 1975-76 fiscal year; \$70 million in sales during 1976-77; \$180.9 million during 1977-78; and \$120 million during 1978-79. Does not include debt service for proposed bond issues to be placed before the electorate in 1976. Assumes a 6.0 percent average interest rate on bonds sold.

Table 8
Estimated Interest and Redemption Charges on State School Building Aid Bonds Partially Funded by the State 1974-75 to 1978-79^a

<i>Fiscal Year</i>	<i>Total Debt Service</i>	<i>Debt Service on bonds sold as of Dec. 31, 1975</i>	<i>Debt service on anticipated sales^b</i>	<i>General Fund portion of total debt service^c</i>
1974-75	\$127,842,260	\$127,842,260	—	\$42,769,524
1975-76	132,497,180	132,497,180	—	32,690,811
1976-77	141,220,683	131,470,683	\$9,750,000	27,813,183
1977-78	143,665,647	124,715,647	18,950,000	27,296,473
1978-79	151,240,626	118,815,626	32,425,000	28,735,719

^a Cash basis.

^b Estimated debt service on anticipated \$75 million sales during the last half of 1975-76 fiscal year; \$100 million during 1976-77; \$100 million during 1977-78; and \$100 million during 1978-79. Assumes a 6.0 percent average interest cost on bonds sold.

^c General Fund portion of debt service is projected at 19.7 percent for 1976-77 and 19.0 percent for 1977-78 and 1978-79.

ECONOMIC OUTLOOK AND REVENUE ANALYSIS

Summary

The severe recession that began in late 1973 came to an end during the second quarter of 1975. As the year closed, the recovery that began in May, and showed unexpected strength in the third quarter, was beginning to slow. Although uncertainty continues to characterize the economic climate, there is a widespread concensus that both California and the nation will experience moderate, sustained recovery through 1976 and hopefully into 1977. The Department of Finance projections for 1976 compare favorably with those of other forecasters for such variables as national consumer price inflation (6.9%), unemployment (7.8%), housing starts (1.45 million units), California personal income growth (10.2%), unemployment (9.2%) and new housing permits (175,000). The department's estimate of real growth for the nation (5.4%) appears to be toward the conservative end of the range into which most other forecasters fall.

The key threat to continuing recovery remains a resurgence of inflation, which could weaken real incomes and undermine the strength in consumer spending. An additional concern is high interest rates later in 1976 due to restrictive monetary policy (aimed at discouraging inflation) and substantial federal deficit spending (encouraged by election year politics). Higher interest rates would especially hurt the housing market, which is already expected to remain sluggish throughout most of the year. Business investment is also anticipated to remain weak well into 1976 for, despite a healthy profit outlook associated with rising productivity, much excess productive capacity remains. Although strong employment gains will be continuing, the unemployment rate will drop very slowly since previously discouraged workers are re-entering the labor force. Lastly, the recovery could be somewhat stronger than predicted if the President's proposed mid-year tax cut addition is adopted.

On the basis of this forecast, General Fund revenues are estimated to be \$9 billion in the current year, 6.6 percent above 1974-75 and \$170 million above May 1975 revised estimates. For the budget year, revenues are projected at \$10.2 billion, 13.5 percent over 1975-76 (14.1 percent *before* the \$50 million impact of a proposed increase in the 100 percent income tax credit available to low-income taxpayers). This high rate of growth in 1976-77 reflects anticipated substantial gains in all three major taxes, with sales taxes up 10.8 percent, personal income taxes up 18.7 percent and bank and corporation taxes up 23.3 percent. We believe these estimates are consistent with the underlying economic forecast.

Personal income taxes projected for 1976-77 of \$3.45 billion include the estimated impact of Chapter 1033, Statutes of 1975, (\$31 million), which significantly increased taxes on preference income. Bank and corporation taxes of \$1.38 billion in 1976-77 include the effect of Chapter 75, Statutes of 1975, (\$34 million), which limited oil depletion allowances. Because the pattern of fiscal year corporation tax receipts causes fluctuations which are significantly greater than corresponding changes in calendar year profits, the 23.3 percent growth in 1976-77 revenues exceeds the 13.2 percent projected annual growth in profits in 1976. Budget year sales tax revenue

estimates are based on an expected 11.3 percent growth in taxable sales in calendar 1976. This increase, which is significantly above a projected 9.4 percent increase in disposable income for the year, assumes (1) a drop in the savings rate, (2) a probable increase in the percentage of income spent on taxable goods, and (3) a significant growth in automobile sales.

1975 ECONOMIC TURNAROUND

Recession Hits Bottom

The severest recession since the Great Depression turned around in the second quarter of 1975. Unemployment rates reached peaks in May 1975 of 9.2 percent for the nation and 10.6 percent for California. Industrial output declined by more than 12 percent between September 1974 and May 1975, while total employment fell by 2.5 million workers from its September 1974 high to its March 1975 low. The downturn spread into essentially all corners of the economy. Few occupational or demographic groups were able to escape its unemployment and income effects.

The 1973-75 recession, which began in November 1973 and lasted some 18 months, began partly as a result of government attempts to reduce an inflation rate which by 1974 had reached 12 percent. Recessionary problems were further fueled by the oil embargo of 1973-74. Inventories in 1974 reached excessive levels due initially to fears of shortages and later to declining aggregate demand, thereby setting the stage for sharp production and employment cutbacks from autumn 1974 through early 1975. When the recessionary trough finally arrived, real gross national product was nearly eight percent below its late 1973 level, corporate profits were depressed, automobile sales and housing starts had deteriorated, and productivity had seriously declined. Although inflation had begun to moderate significantly in early 1975 and monetary and fiscal policies became more expansionary, early 1975 witnessed industrial output plunging at nearly a 30 percent annual rate accompanied by a massive inventory liquidation. Over one-quarter of available productive capacity lay dormant.

Economy Recovering But Uncertainties Remain

Just as the recession proved more severe than originally expected, the early recovery phase proved more robust than anticipated. Although real GNP for 1975 fell below 1974 levels, positive real growth occurred in each of the last three quarters. Tax cuts and monetary expansion in the spring of 1975 combined with declining inflation rates to stimulate consumer demand, thereby allowing for substantial inventory liquidation and setting the stage for a dramatic third quarter performance. Both real gross national product and industrial production exploded at record rates, and unemployment began to drop from its recession high. Real growth continued through the end of the year, although at sharply reduced rates. The foundation of the economic resurgence in the last half of 1975 was consumer spending, particularly on nondurable goods and services. Corporate profits strongly rebounded as 1975 progressed due to rising post-recession productivity and declining unit labor costs. In addition, the economy's international trade performance exceeded expectations, with

record trade surpluses in 1975. Among the earlier fears that failed to materialize were "crowding out" of private borrowers in the credit markets by the federal government, shortages and sky-rocketing prices for energy, financial market disruptions associated with New York's fiscal problems, and spiraling grain prices due to shortages abroad.

Despite the recovery strengths, some clear weaknesses were evident at year end. Aggregate demand had not been exceptionally strong during the year, and much of 1975's growth rebound was due to termination of inventory liquidation. While consumer spending on nondurables has "carried the ball", automobile sales remain well below their pre-recession levels. The same is true for housing starts, especially multi-family units, where the recovery is sluggish. Continued caution by consumers is evident from the 8.4 percent average 1975 savings rate, highest in 30 years. Business investment and capital expenditures have shown little recovery, having registered their greatest percentage declines in almost two decades. Lastly, unemployment remains in excess of eight percent. Despite these weaknesses, 1975 viewed in retrospect will be remembered as a turnaround year with an impressive early phase recovery and the potential for continuing economic rebound.

1976 NATIONAL FORECAST

Cautious Optimism for the Year Ahead

We expect the economy to experience moderate, though sustained, recovery through calendar 1976 and *hopefully* well into 1977. Although this anticipation reflects the consensus view, considerable uncertainty and caution have been expressed by many forecasters. In reviewing the projections of forecasters for 1976 and beyond, we have seen the current recovery pattern described by a wide range of terms including modest, steady but not sensational, hesitant, brisk, sluggish, lacking ebullience and exuberance, and gradual. Business Week's survey of forecasts by economists and econometric models for Gross National Product (GNP) averages between \$1,650 billion and \$1,660 billion with a high of \$1,692 billion and low of \$1,607 billion for 1976. The range for general price inflation (GNP deflator) in 1976 is about four percent to more than 7½ percent, with an average of 5.9 percent. Forecasts of real GNP growth average roughly 6 percent and range from 5 percent to 7 percent, whereas unemployment rate predictions average 7.8 percent and range from 7 percent to about 8½ percent. The Department of Finance budget forecast lies in the middle of this range of predictions, although lower than the average for real growth. Table 1 compares the department's budget forecast for 1976 with the two prior years. When compared to the forecasts for selected key variables made by leading California banks in Table 2, the department's projections are again generally consistent. One interesting difference, however, is that the department projects *both* a lower real growth rate and savings rate than each of the California banks.

Pluses Should Outweigh Minuses

The key driving force behind sustained recovery in 1976 will be rising real income associated with slowly tapering inflation rates, increasing

Table 1
National Economic Data
(dollars in billions)

	Actual 1974	Estimated 1975 ^a	Percent Change	Budget	
				Forecast 1976 ^a	Percent Change
Gross National Product	\$1,397.4	\$1,477.0	5.7%	\$1,650.0	11.7%
GNP in 1958 dollars	\$821.2	\$796.5	-3.0%	\$839.4	5.4%
GNP price deflator	170.2	185.4	8.9%	196.6	6.0%
Personal income	\$1,150.5	\$1,241.0	7.9%	\$1,370.0	10.4%
Disposable income	\$979.7	\$1,071.5	9.4%	\$1,175.0	9.7%
Savings	\$77.0	\$90.4	17.4%	\$87.5	-3.2%
Corporate profits (before taxes)	\$140.7	\$121.5	-13.7%	\$145.0	19.3%
Consumer Price Index	147.7	161.4	9.3%	172.5	6.9%
Employment (thousands)	85,936	84,850	-1.3%	87,400	3.0%
Unemployment (thousands)	5,076	7,900	55.6%	7,400	-6.3%
Unemployment rate	5.6%	8.5%	—	7.8%	—
Housing starts (millions)	1.338	1.150	-14.1%	1.450	26.1%
New car sales (millions)	8.9	8.8	-1.1%	10.0	13.6%
Savings rate	7.9%	8.4%	—	7.4%	—
Net exports	2.1	11.8	—	5.0	—

^a By the Department of Finance.

Table 2
Comparison of National Economic Forecasts for 1976^a

	Dept. of Finance	Univ. of Calif. Los Angeles	Wells Fargo Bank	United Calif. Bank	Security Pacific National Bank	Crocker Bank
Percent changes in:						
Gross National Product	11.7%	11.1%	11.4%	13.0%	11.7%	11.9%
Due to real growth	5.4%	5.6%	5.7%	6.0%	5.7%	5.5%
Due to price level	6.0%	5.2%	5.5%	6.7%	5.7%	6.1%
Personal income	10.4%	10.3%	N.A.	12.1%	11.0%	N.A.
Consumer prices	6.9%	6.5%	6.3%	7.6%	6.5%	N.A.
Unemployment rate	7.8	8.1	7.8	7.6	7.7	7.7
Housing starts (millions)	1.45	1.46	1.54	1.45	1.59	1.51
Savings rate	7.4	8.0	7.8	8.4	8.1	8.2

^a All forecasts as of December 1975.

employment levels and higher wages. Rising real income is necessary for consumer spending to remain strong and will be aided by the pent-up demand for consumer durables and the recent lightening of consumer debt burdens. Automobile sales are thus expected to exhibit healthy increases in 1976. Consumer spending will be further stimulated if the administration's tax cut proposals are implemented in mid-year. Uncertainty remains concerning the specific path of future food and energy prices, but sky-rocketing prices and severe shortages are not expected.

Because the major threat to continued recovery remains a resurgence of inflation, monetary policy will be only moderately accommodative to expansion. Although the availability of mortgage money is expected to be adequate, the housing sector will remain somewhat weak. The rather bleak record of business investment and capital spending in 1975 will continue well into 1976 despite healthy profit performance. On the inter-

national trade front 1975's record trade surpluses will erode during 1976, both because U.S. recovery will boost imports, and economic rebounds in foreign nations are lagging.

Adding these pluses and minuses together we see the national economy in 1976 pursuing a moderate, "middle of the road" path to higher ground, at a five percent to six percent real growth rate. The recovery will not be without its hesitant moments. However, there seems little chance of seeing the 1976 recovery aborted by inflation, monetary policy stringencies or capital market disruptions. Both inflation and unemployment levels should slowly recede. The near term economic outlook is thus predominately optimistic.

Consumer Still Quarterbacking Recovery

As with the 1975 recovery experience, consumer spending is viewed as the cornerstone of a sustained 1976 expansion. The Department of Finance forecasts personal consumption expenditures to rise at a more rapid rate than personal income. Particular stress is placed on consumer purchases of durable goods due to pent-up demand and deferred replacement buying, and is projected to rise over 15 percent. New car sales are expected to increase nearly 14 percent.

Supporting the prediction of strong consumer performance are the assumptions of declining inflationary expectations, reduced consumer debt burdens, and rising personal income. Most important of all is the expectation that consumer confidence, which could be damaged dangerously by a rekindling of price inflation, will improve during the year. Although inflation entered 1976 on a downward drift, several danger signals concerning the strength of consumer spending have recently surfaced. The advance in real consumer outlays in 1975's closing months showed considerably smaller gains than earlier in the upswing. In addition, U.S. Commerce Department opinion in early 1976 was that most of the thrust in consumer sales had passed, and that the burden of propelling further recovery would have to be shifted to other components of demand such as outlays for producer durables. Nevertheless, strength in consumer spending associated with rising real income will be a necessary ingredient for continued 1976 recovery. Particularly important are automobile sales, which fluctuate considerably with changes in real disposable income and consumer confidence. Although 1975 ended with automobile sales well below 1973 levels and manufacturers extremely cautious about holding inventories, the closing months of 1975 saw sales recording increasingly large percentage gains over corresponding 1974 months. Our view of this industry is thus one of cautious optimism.

Business Spending to Lag

One of the most encouraging characteristics of the early 1976 economy is the impressive strength developing in corporate finances. Corporate profits have been expanding both in quantity and quality and are forecast to expand in 1976 by nearly 20 percent following a 14 percent decline in 1975. In 1974, inflationary inventory gains accounted for as much as one-third of pre-tax profits versus less than 10 percent late in 1975. Corporations are presently reducing their debt-to-equity ratios, improving liquidi-

ty, and replacing short-term borrowings with longer term debt, thus creating the best opportunity in a decade for internal financing of business investment.

Despite the improved profit picture, and the need for productivity improvements and plant modernization to support economic growth, business spending is not expected to contribute significantly to the recovery in 1976 except possibly through inventory re-building later in the year. The Department of Finance forecasts increases of only 9.1 percent for producers' durable equipment and 6.4 percent for nonresidential structures. Compared to a decline in real capital spending in 1975 of roughly 10 percent, 1976 is expected to experience little if any real rise due to existing excess capacity, high vacancy rates for industrial office space and uncertainty concerning inflation and long-term growth prospects. Whatever increases in real capital spending that do occur will wait until after mid-year, with the possible exception of the utilities industries. Most of the real gains in 1976 capital spending are expected to be associated with energy-related industries, while overall manufacturing spending will be anemic. Gains are probable in such industries as petroleum, mining, chemicals, food and beverages, paper and pulp, and gas utilities. Losses in real terms are expected in rubber, automobiles, airlines, aerospace manufacturing and office building construction.

Housing—Boomless Upswing

Even though the supply of mortgage funds should be adequate in 1976, housing starts are only forecast to reach between 1.4 million and 1.6 million units. Builders are being squeezed by rising costs and buyer resistance, while mortgage rates remain relatively high. In addition, there remains a residue of unsold inventory from the speculative overbuilding period of 1971-73 when annual new units exceeded 2 million. While the single-family sector has rebounded quite briskly, multi-family housing remains extremely depressed due to both high vacancy rates and lagging rents. Although rising real incomes and availability of mortgage money will encourage residential construction in 1976, expected growth performance in this market is sluggish at worst and steady but unspectacular at best.

Inflation Prospects Improving

Consumer price inflation has been receding in recent months and the odds are that it will drop into the six percent to seven percent range for 1976. Inflation nevertheless remains the major threat to the recovery since its resurgence could lower real personal income, increase inflationary expectations and uncertainty, and induce precautionary savings. Factors suggesting reduced inflation include widespread capacity underutilization and weak domestic aggregate demand, as well as moderating worldwide monetary expansion and excess demand. Although 1976 movements in food and fuel prices are uncertain, the Department of Agriculture has been anticipating only moderate food price increases through the first half of the year. An oil embargo and further increases in OPEC oil prices are not expected, while oil prices under the new energy bill will rise by probably no more than 10 percent annually. The dominant factors will be wage and productivity trends which, at present, suggest a rise in unit labor

costs of five percent to seven percent. Although labor contract negotiations loom ahead in 1976 for key industries including automobiles, rubber and construction, hopes are high that wage demands will be somewhat muted due to declining inflationary expectations and fears for job security. Nevertheless, most forecasters are expecting a year of average settlements given current inflationary expectations, the improving corporate profit picture, and the election year atmosphere.

Unemployment—Hidden Improvements

The Department of Finance projects 1976 unemployment at 7.8 percent, down from 8.5 percent in 1975 but well above 1974's 5.6 percent. Although the department predicts a further decline to 6.6 percent in 1977, this continued improvement could be retarded later in 1976 due to further productivity increases, labor force growth and any slowing in the recovery's pace. The relatively high 1976 unemployment forecast masks an expected strong improvement in employment. The return of discouraged workers to the labor force following the recession, a rising average workweek, and increasing productivity will prevent a rapid decline in the unemployment rate. In addition, declines in the average length of unemployment are not reflected in the overall statistic. Because of changes in the composition of the labor force and increased participation by women and young people, the percentage of the population which is employed is currently higher than in most other postwar recession periods. A stabilizing influence on aggregate consumption expenditures continues to be the extension of unemployment insurance benefit coverage to more workers for longer periods of time. Extensions beyond those now in effect, however, are doubtful for the near term recovery situation.

Government Policies to Provide Critical Ingredients

The main goal of fiscal and monetary policies in 1976 will be to sustain recovery, reduce unemployment, and diminish the inflation rate and inflationary expectations. Monetary authorities are aiming for a target monetary growth rate of five percent to 7.5 percent annually which would be moderately accommodative to recovery. The actual growth in money in the forecast year could be in the seven percent to eight percent range, however, due to election year pressures for further economic stimulation, upward movement in short term interest rates later in the year, and the need to "monetize" part of the federal government's borrowing. Fiscal policy will be characterized by an extension of the 1975 tax reductions through mid-1976, with a high probability of additional tax reductions later in the year. The Administration has proposed these additional tax reductions in conjunction with a federal spending ceiling, and election year political strategies will be a key determinant of the fiscal program chosen. The income base for social security taxes will also rise in both 1976 and 1977, as will probably the 1977 tax rate itself. Also noteworthy are the enormous fiscal year deficits anticipated for 1976 (over \$70 billion) and 1977 (over \$40 billion), which could possibly cause higher interest rates later in 1976 as private sector credit demands expand with the recovery. However, adverse credit conditions are not generally anticipated to abort the recovery in the near term even though the housing sector could be

somewhat affected. Long term interest rates, however, are not expected to experience significant increases. The major fear concerning the application of fiscal and monetary policies in the forecast period centers around excessive election year economic stimulation. Such stimulation would run the risk of aggravating inflation in 1977 and possibly lead to a subsequent economic downturn. Disagreement will continue to exist on the "proper" level of government stimulation in 1976 needed to encourage non-inflationary recovery.

Although state and local government spending will contribute modestly to economic recovery as tax receipts rise, a real growth of only two percent to three percent will lie much below the trend of such outlays over the past decade.

1976 CALIFORNIA FORECAST

As for the nation, California's continuing recovery will hinge upon inflation, credit market conditions, food and energy price developments, and consumer and business confidence. Evidence of the turnaround in California can be seen in such areas as car sales, housing permits and workers hired, and a gradual but steady rebound is expected to last through 1976 and *hopefully* well into 1977. The state's recovery will be similar to the nation's, although less robust since California's industry mix was not as prone to the severe recessionary declines experienced by durable goods manufacturing industries. The Department of Finance forecast in Table 3 shows that the state will see personal income rise 10.2 percent, inflation moderating to 7.6 percent and a 30 percent increase in residential building permits. The upswing in residential construction is far from spectacular and will only moderately contribute to the recovery in 1976. Although multi-family housing has remained especially weak, positive signs for this sector come from steadily declining vacancy rates, an upward trend in rents, and diminishing fears concerning availability of mortgage funds. Non-residential construction, which experienced a particularly severe setback in 1975, still remains weak. The strong gains in personal income

Table 3
California Economic Data
(dollars in billions)

	Actual 1974	Estimated 1975 ^a	Percent Change	Budget Forecast 1976 ^a	Percent Change
Personal income.....	\$126.1	\$137.1	8.7%	\$151.0	10.2%
Disposable income ^b	\$111.3	\$122.1	9.7%	\$133.6	9.4%
Taxable corporate profits.....	\$11.9	\$11.4	-4.1%	\$12.9	13.2%
Taxable sales.....	\$68.1	\$73.7	8.2%	\$82.0	11.3%
Employment (thousands).....	8,526	8,505	-0.3%	8,750	2.9%
Unemployment (thousands).....	670	930	38.8%	890	-4.3%
Unemployment rate (%).....	7.3%	9.9%	—	9.2%	—
Number of residential building permits (thousands).....	128	135	5.5%	175	29.6%
New car sales (thousands).....	831	825	-0.7%	935	13.3%
Consumer Price Index.....	143.5	158.5	10.5%	170.5	7.6%

^a By the Department of Finance.

^b Represents personal income for California residents less federal and state personal income taxes. Other personal tax and non-tax payments have not been deducted.

expected due to increases in wages and employment levels will stimulate consumer spending, although a historically high savings rate will moderate the recovery of durable goods despite strong replacement needs and deferred demand. Table 4 shows that the department's California forecast for key variables is consistent with those of leading California banks, while Table 5 compares selected economic indicators for the state to those of the nation.

Unemployment Improves

At year end California's unemployment rate finally broke through the 10 percent barrier following a recession high of 10.6 percent in May 1975. Long term unemployment as a share of total unemployment declined by roughly one fourth over the same period. Despite continuing employment gains, however, the California unemployment rate is estimated to drift down rather slowly to only a 9.2 percent average in 1976 due to normal labor force growth and the return of discouraged workers following the recession. The California labor force is nevertheless projected by the Department of Finance to grow at a slower rate in 1976 than 1975, whereas the reverse is true nationally.

Nonagricultural wage and salary employment is projected to rise three percent in 1976, led by gains in construction, mining and selected manufacturing areas which were hit particularly hard by the downturn. Overall manufacturing employment will rise only gradually for a 1976 gain of 2.8 percent, although steady expansion is anticipated for such activities as non-electrical machinery, fabricated metal products, transportation equipment, and apparel. Aerospace employment may exhibit some loss, with declines in aircraft and parts manufacturing offsetting increases in the electrical equipment sector. Table 6 displays California employment by type of industry for 1975 and the forecast for 1976. Although trade, services and finance related employment is expected to gain significantly, government employment will provide only very modest improvement as noted in the national forecast.

Table 4
Comparison of California Economic Forecasts
for 1976^a

	<i>Dept. of Finance</i>	<i>Univ. of Calif. at Los Angeles</i>	<i>Wells Fargo Bank^b</i>	<i>United Calif. Bank</i>	<i>Security Pacific National Bank</i>	<i>Crocker Bank^b</i>
Percent change in:						
Personal income.....	10.2%	9.8%	9.0%	11.6%	10.2%	10.2%
Employment.....	2.9%	2.0%	2.0%	3.2%	N.A.	2.1%
Building permits.....	29.6%	48.9%	34.9%	15.4%	38.5%	26.8%
New car sales.....	13.3%	N.A.	13.5%	9.7%	N.A.	N.A.
Consumer prices.....	7.6%	7.2%	6.3%	7.6%	7.3%	7.5%
Unemployment rate.....	9.2%	9.4%	9.0%	9.2%	9.3%	9.6%
Building permits (thousands) ..	175	198	170	150	180	164

^a All forecasts as of December 1975 unless otherwise noted.

^b Forecast as of October 1975.

Table 5
Selected Economic Indicators, California and United States

	1975		1976	
	U.S.	California	U.S.	California
Percent growth in:				
Labor force	1.9%	2.6%	2.2%	2.2%
Civilian employment.....	-1.3%	-0.3%	3.0%	2.9%
New car sales.....	-1.1%	-0.7%	13.6%	13.3%
Personal income	7.9%	8.7%	10.4%	10.2%
Corporate profits	-13.7%	-4.1%	19.3%	13.2%
Unemployment rate	8.5%	9.9%	7.8%	9.2%
Increase in consumer prices	9.3%	10.5%	6.9%	7.6%

Table 6
California Employment by Type
(in thousands)

	Level		Percent Change	
	1975	1976	1975	1976
Mining	32	34	0.0%	6.2%
Construction	292	315	-11.0%	7.9
Finance—insurance—real estate	444	456	0.7	2.7
Transportation and utilities.....	466	470	-2.1	0.9
Government	1,645	1,675	4.7	1.8
Services	1,574	1,640	2.5	4.2
Trade	1,777	1,830	1.0	3.0
Manufacturing	1,586	1,630	-6.0	2.8
Aerospace	473	460	-6.5	-2.7
Other manufacturing	1,113	1,170	-5.8	5.1
Other	689	700	-0.7	1.6
Total civilian employment	8,505	8,750	-0.3%	2.9%
Civilian labor force	9,435	9,650	2.6%	2.2%
Civilian unemployment	930	890	38.8	-4.3
Unemployment rate	9.9%	9.2%	—	—

REVENUE ANALYSIS

1975-76 Revenue Growth Dampened by Economic Downturn

General Fund revenues in 1975-76 are currently estimated by the Department of Finance to be \$8,967 million. Table 7 compares revenues in 1974-75 to those expected in the current year. Before taking into account the effects of 1975 legislation, estimated 1975-76 revenues indicate a modest 5.7 percent growth over those received in 1974-75.

Table 7
Growth in General Fund Revenues
1974-75 to 1975-76
(in millions)

	1974-75	1975-76	Change	
	Actual	Estimated	Amount	Percent
Taxes:				
Sales and use.....	\$3,369	\$3,696	\$327	9.7%
Personal income.....	2,582	2,885	303	11.7
Bank and corporation.....	1,254	1,066	-188	-15.0
Other taxes	826	888	62	7.5
Interest income	169	127	-42	-24.9
Other revenues	212	227	15	7.1
Total, before legislation	\$8,411	\$8,889	\$478	5.7%
Legislation		78	78	
Total revenues	\$8,411	\$8,967	\$556	6.6%

As shown in Table 7, the major factors in the increase in current-year revenues are gains totaling \$630 million in sales and personal income taxes, with respective growth rates of 9.7 percent and 11.7 percent. The increase in revenues from these sources, however, is due primarily to inflationary gains in taxable retail sales and personal income, and not to "real" economic growth. Substantially offsetting the growth in sales and income tax revenues is an estimated \$188 million, or 15 percent, decrease in bank and corporation taxes. This loss reflects a four percent decline in 1975 calendar-year profits, which is compounded in the 1975-76 fiscal year by the cash-flow effects of corporate prepayments of estimated tax. Although the reduction in 1975 corporate income averaged four percent, substantially higher losses in that year are estimated for the mining and oil production industries (-36%) and for utilities (-34%).

After adding \$78 million to reflect 1975 legislative action, total General Fund revenues are estimated to grow by \$556 million, or 6.6 percent, in the current year.

Rapid Changes in Economy Complicate Current-Year Estimates

Table 8 provides a review of Department of Finance estimates of current-year revenues. As shown in this table, total 1975-76 General Fund revenues were forecast to be \$8,959 million in January of 1975. This figure was revised downward by \$161 million in May of 1975 and then back up by nearly \$91 million in January of 1976. In arriving at the department's current estimate of \$8,967 million, sales, income and corporation tax revenues were further increased by a total of \$78 million to reflect the effect of 1975 legislation which increased the rates imposed on preference income, limited oil and gas well depletion allowances, and increased the interest rate applicable to delinquent taxes.

Table 8
History of Department of Finance 1975-76 General Fund Revenues Estimates
(in millions)

	Original Estimate January 1975	Revisions			Current Estimate January 1976
		May 1975	January 1976	Legislation ^a	
Taxes:					
Sales and use	\$3,681.0	\$-61.0	\$76.0	\$4	\$3,700.0
Personal income	2,950.0	-125.0	60.0	25	2,910.0
Bank and corporation	1,045.0	7.0	14.0	49	1,115.0
Inheritance and gift	233.0	18.5	6.4		257.9
Cigarette	192.6	-1.6	-3.0		188.0
Insurance	223.5	—	6.5		230.0
Alcoholic beverage	135.0	-1.2	-9.1		124.7
Horse racing	73.8	10.7	2.4		86.9
Total taxes	\$8,533.9	\$-152.6	\$153.2	\$78	\$8,612.5
Interest income	\$140.2	\$-16.7	\$3.5		\$127.0
Other revenues	285.1	8.0	-66.0		227.1
Total revenues	\$8,959.2	\$-161.3	\$90.7	\$78	\$8,966.7

^a Assembly Bill No. 1206 (Chapter 1033, Statutes of 1975) revised the "minimum tax" applicable to items of preference income (e.g., capital gains and accelerated depreciation); Assembly Bill No. 177 (Chapter 75, Statutes of 1975) limited depletion allowances for large oil and gas producers; and Assembly Bill No. 2306 (Chapter 661, Statutes of 1975) increased the interest rate on delinquent taxes.

Table 8 further shows that, in January 1976, the department *increased* its May estimates of the three largest General Fund taxes (i.e., sales, income and corporation taxes) by a total of \$150 million, almost reversing May revisions which *reduced* the original estimates for these tax revenues by \$179 million. These largely offsetting adjustments are explained primarily by the climate of economic pessimism which prevailed when the May 1975 revisions were developed. In January of 1975, real GNP was forecast to decline through the second quarter of that year, at which time a moderate recovery was expected. However, by May first quarter data indicated a much sharper decline than was originally forecast. Although a gradual recovery beginning in mid-1975 was still predicted, many of the economic variables upon which revenue forecasts are based were adjusted downward to reflect the steeper-than-expected economic decline in early 1975. Current economic data now indicate that a higher rate of economic recovery occurred in the second half of 1975 than was forecast in May, and current estimates of 1975-76 General Fund revenues have been revised upward accordingly.

Table 8 also shows a \$66 million downward revision in estimates of "other" 1975-76 General Fund revenues was made in January of this year. This revision is due largely to the disallowance by the Legislature of an intended transfer from the Capital Outlay Fund for Public Higher Education to the General Fund of \$77 million in oil and gas royalties from state-owned lands.

1976-77 Revenues—Substantial Growth Projected

Total state revenues (all funds) in the 1976-77 budget year are estimated at \$12,157 million, up 11.8 percent over the \$10,876 million expected in the current year. General Fund revenues projected for 1976-77 of \$10,226 million will exceed those estimated in the current year by \$1,259 million, or 14.1 percent. This substantial increase is due primarily to (1) a 23 percent gain in bank and corporation tax revenues, as they rebound from an 11 percent *decline* (after adjusting for legislation) in 1975-76, and (2) a 19 percent growth in personal income taxes. General Fund gains are tempered somewhat by a net growth in Special Fund revenues of only 1.1 percent, due largely to lower motor vehicle registration fees and oil and gas revenues. Table 9 compares, by source, state revenue collections estimated in 1975-76 with those projected for 1976-77.

Sales and Use Taxes

General Fund sales and use tax revenues are projected to be \$4.1 billion in 1976-77, a 10.8 percent increase over the \$3.7 billion estimated in 1975-76. The budget-year projection includes the impact of 1975 legislation which will increase sales tax revenues by approximately \$20 million in 1976-77. Significant legislative changes included (1) an increase in the interest rate on delinquent taxes (\$6 million), (2) the exemption of master sound tapes and recordings (-\$2.5 million) and (3) a postponement of the transfer made to the state Transportation Fund (\$16 million).

The 10.8 percent increase in sales tax collections expected in the budget year reflects an 11.3 percent growth in taxable sales in the 1976 calendar

Table 9
Estimated 1976-77 State Revenue Collections
(in millions)

	1975-76	1976-77	Change	
			Amount	Percent
<i>General Fund</i>				
Taxes:				
Sales and use.....	\$3,700.0	\$4,100.0	\$400.0	10.8%
Personal income.....	2,910.0	3,455.0 ^a	545.0	18.7
Bank and corporation.....	1,115.0	1,375.0	260.0	23.3
Inheritance and gift.....	257.9	279.5	21.6	8.4
Insurance.....	230.0	254.0	24.0	10.4
Cigarette.....	188.0	191.0	3.0	1.6
Alcoholic beverage.....	124.7	129.1	4.4	3.5
Horsereading.....	86.9	93.6	6.7	7.7
Total taxes.....	\$8,612.5	\$9,877.2	\$1,264.7	14.7%
Other sources:				
Health care deposit fund.....	\$87.7	\$92.4	\$4.7	5.4%
Interest on investments.....	127.0	115.0	-12.0	-9.5
Other.....	139.4	141.5	2.1	1.5
Total General Fund.....	\$8,966.7	\$10,226.1	\$1,259.4	14.1%
<i>Special Funds</i>				
Motor vehicle:				
Fuel taxes.....	\$767.0	\$791.0	\$24.0	3.1%
License fee (in lieu).....	370.0	415.0	45.0	12.2
Registration, weight and miscellaneous fees.....	374.0	363.1	-10.9	-2.9
Cigarette tax.....	80.6	81.9	1.3	1.6
Sales and use tax.....	24.2	12.2	-12.0	-49.6
Oil and gas revenues.....	101.5	81.8	-19.7	-19.4
Other.....	191.7	185.7	-6.0	-3.1
Total Special Funds.....	\$1,909.0	\$1,930.7	\$21.7	1.1%
Total state revenues.....	\$10,875.7	\$12,156.8	\$1,281.1	11.8%

^a Does *not* include effect of proposed extension of low-income tax credit (estimated to be \$-50 million in 1976-77).

year and a 10.3 percent gain in 1977. Table 10 summarizes the Department of Finance's estimates of taxable sales by category along with its projections of California disposable income and the U.S. savings rate.

Realization of the expected high level of growth in taxable sales relative to disposable income will depend on (1) reduced savings and a corresponding increase in total expenditures as a percent of income and (2) a shift in the composition of expenditures towards taxable items such as autos and other durable goods.

Personal Income Tax

Personal income tax revenues in 1976-77 are estimated to be \$3,455 million, or 18.7 percent above the \$2,910 million which will be collected in the current year. The budget-year figure does *not* reflect an estimated \$50 million reduction which would result from the expansion of the 100 percent low-income tax credit as proposed in the Governor's Budget. A major legislative change which *is* reflected in the projection will increase

Table 10
Calendar-Year Taxable Sales in California
(in millions)

	1975	1976	Percent Change	1977	Percent Change
Retail stores	\$31,692	\$34,806	9.8%	\$38,137	9.6%
Autos, other vehicles and service stations ..	15,418	17,608	14.2	19,711	11.9
Building materials	6,635	7,630	15.0	8,500	11.4
Manufacturing, wholesaling and miscellaneous	19,930	21,946	10.1	24,092	9.8
Total Taxable Sales:					
Current dollars	\$73,675	\$81,990	11.3%	\$90,440	10.3%
Constant dollars	49,546	51,372	3.7	53,578	4.3
California Disposable Income	\$122,107	\$133,630	9.4%	\$147,490	10.4%
U.S. savings rate	8.4%	7.4%	—	7.5%	—

income tax revenues by an estimated \$31 million in 1976-77. This legislation, enacted in 1975, will substantially increase the tax rates applicable to items of preference income. The growth in 1976-77 fiscal-year income tax collections generally parallels the growth in self-assessed taxes imposed for the 1976 and 1977 calendar years, as shown in Table 11. This table also illustrates the responsiveness of the income tax to a change in personal income, which results from the progressiveness of the tax rate structure (for example, in 1976 a 10.2 percent change in personal income will produce an 18.2 percent increase in tax). As shown in Table 11, increased income tax assessments in 1976 and 1977 will reflect significant "real" gains in personal income of 2.4 percent and 5 percent, respectively.

Table 11
California Self-Assessed Income Tax—Calendar Year Data
(in millions)

	1975	1976	Percent Change	1977	Percent Change
Tax Attributable to:					
Ordinary income	\$2,592	\$3,064	18.2%	\$3,641	18.8%
Preference income ^a	38	46	21.1	51	10.9
Total self-assessed tax	\$2,630	\$3,110	18.3%	\$3,692	18.7%
California Personal Income:					
Current dollars	\$137,080	\$151,000	10.2%	\$167,360	10.8%
Constant dollars	86,486	88,563	2.4	92,978	5.0

^a Certain "preference" income items (e.g., capital gains and accelerated depreciation) are taxed apart from "ordinary" income according to a separate rate schedule. The figures shown include the effect of 1975 legislation which significantly increased preference income tax rates.

Bank and Corporation Taxes

The Department of Finance projects bank and corporation tax revenues of \$1,375 million in 1976-77, up a dramatic 23.3 percent from the current-year estimate. This projection includes the effect of legislation which (1) limited percentage depletion allowances for large oil and gas producers (\$34 million), (2) increased the interest rate on delinquent taxes (\$10 million) and (3) required banks and other financial institutions to pay motor vehicle fees (\$500,000).

The substantial increase in bank and corporation tax revenues in the budget year reflects corporate profit gains projected for California of 13.2 percent and 13.6 percent, respectively, in the 1976 and 1977 calendar years. Year-to-year fluctuations in corporation tax collections are greater than corresponding changes in calendar-year profits because of the cash flow of tax receipts. Comparable estimates for the nation indicate that U.S. corporate profits will increase by 19.3 percent in 1976 and 15.9 percent in 1977. Typically, corporate profits in California respond more slowly to changes in general business conditions than do profits for the nation as a whole because a smaller percentage of California corporate income is associated with the more volatile heavy manufacturing sector.

Other General Fund Revenues

Total General Fund revenues from other taxes are estimated to be \$947 million in 1976-77, representing an increase of 6.7 percent over revenues from these sources in 1975-76. Inheritance and gift taxes and the insurance tax are expected to show the largest gains, with respective increases of 8.4 percent and 10.4 percent. Non-tax revenues, projected to be \$349 million in 1976-77, will be down by 1.5 percent from the current year, primarily due to a 9.5 percent drop in interest income.

Special Fund Revenues

Total special fund revenues are projected to be \$1,931 million in 1976-77, a 1.1 percent increase over the \$1,909 million estimated for 1975-76. Estimates of motor vehicle fuel taxes (\$791 million) are 3.1 percent higher in the budget year and reflect a moderate growth in gasoline and diesel fuel consumption. Motor vehicle license (in lieu) fees are estimated at \$415 million in 1976-77, 12.2 percent above 1975-76. On the other hand, registration, weight and miscellaneous fees of \$363 million will be *down* by nearly three percent. Both the substantial growth in license fees and the decline in registration fees reflect the impact on the timing of receipts from a shift to year-round registration on December 1, 1975. Adjusting for the cash-flow effects of this change, the "normalized" growth rates for motor vehicle license and registration fees in the budget year are estimated to be approximately 9 percent and 4.5 percent, respectively, generated by an expected 13.3 percent increase in the number of new cars sold and higher average base prices for all vehicles subject to these fees.