A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

California Fiscal Focus

Volume 1, Issue 3
September 2015

CA Controller's August Cash Report Shows Strong Retail Sales and Use Tax Revenues

Boosted by strong retail sales and use tax revenues, the state in August brought in $637.8 million more than expected when the 2015-16 budget was finalized two months ago, according to State Controller Betty T. Yee's monthly report of California's cash balance, receipts, and disbursements.

For more than a year, personal income tax drove state revenues to surpass expectations. In August, by contrast, retail sales and use tax took the lead, exceeding estimates by $127.2 million, or 4.3 percent. Personal income tax continued to show strength, beating projections by $39.7 million, or 1.0 percent. The last of the state's "big three" revenue sources — the corporation tax — also came in higher than anticipated by $35.7 million, or 28.9 percent.

After July revenue came in close to expectations, the strong August numbers pushed overall receipts for the 2015-16 fiscal year to $674.7 million, or 5.0 percent, above projections. For the fiscal year to date, all three major sources of revenue are surpassing expectations.

They also are beating totals from the prior fiscal year, with August receipts $1.5 billion higher than a year ago, and year-to-date receipts $1.9 billion higher. August retail sales and use tax revenues of $3.1 billion beat those from a year ago by 36.7 percent, while personal income tax revenue of $4.2 billion came in 6 percent higher, and corporation tax revenue of $159.1 million was 26.2 percent higher.

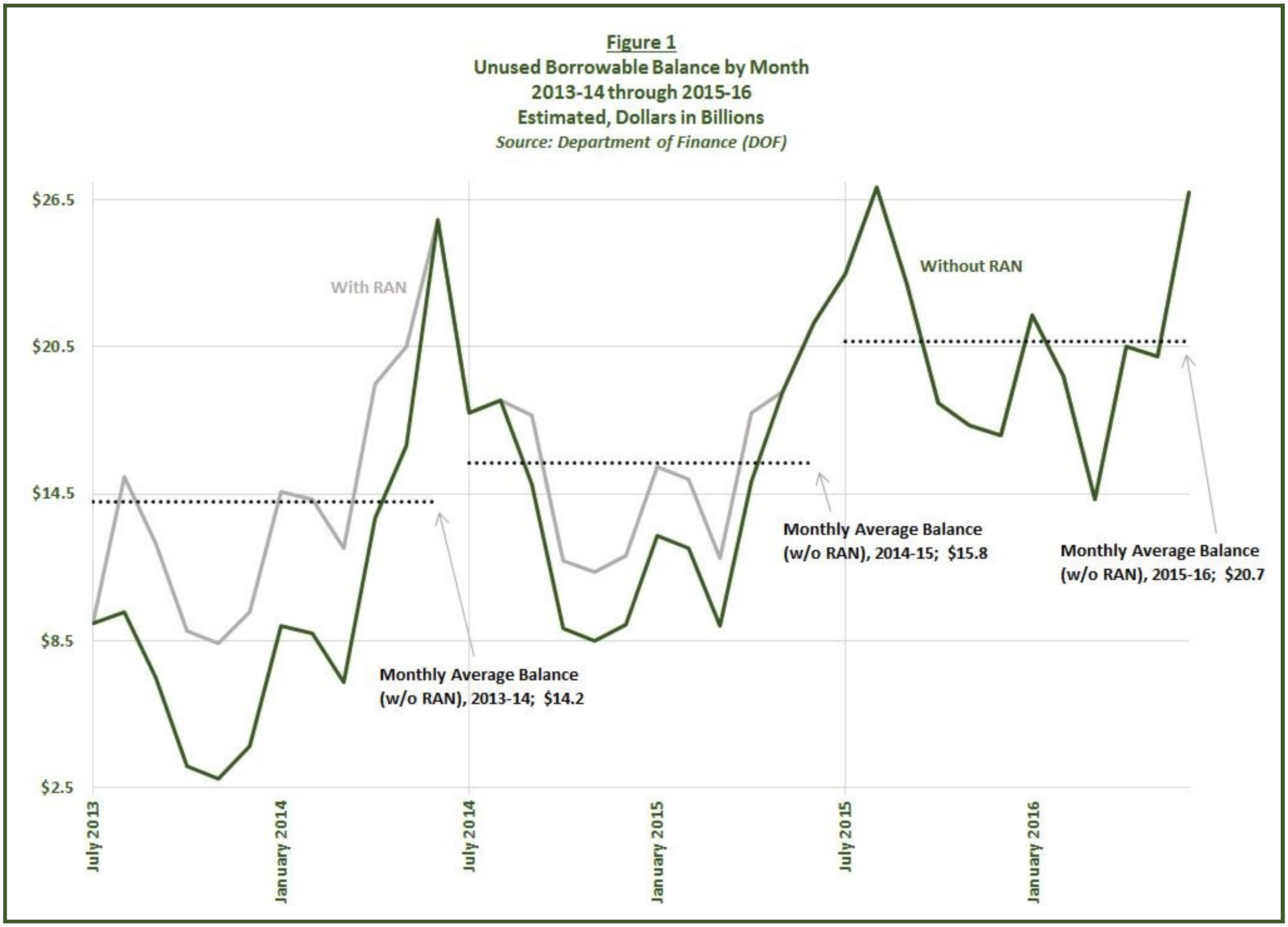
The state ended the month of August with unused borrowable resources of $29.8 billion, which is 10.1 percent more than anticipated when the budget was signed. The General Fund, the source of most state spending, may borrow from other funds to even out variability in revenue and disbursement patterns.

For many years, the Controller pursued external borrowing when cash available from these special funds was projected to fall short of General Fund obligations. However, this year, because of the state's improved fiscal position, the Controller anticipates internal borrowing will be sufficient to meet cash flow without having to issue revenue anticipation notes (RANs).

For more details, read the monthly report.

Inside this issue

Cash Management: The Decreasing Need for External Borrowing



How have the state's cash balances varied over the years? Have overall cash management practices changed recently?

The darker line in Figure 1 shows how borrowable resources dip in certain months, including October, November, December, and February, requiring careful monitoring to assure that the state's books don't fall into a negative balance.

It shows the state hit its lowest balance point (about $2.5 billion) in November 2013. Since then, the balance rose and peaked at $26.5 billion in August 2015.

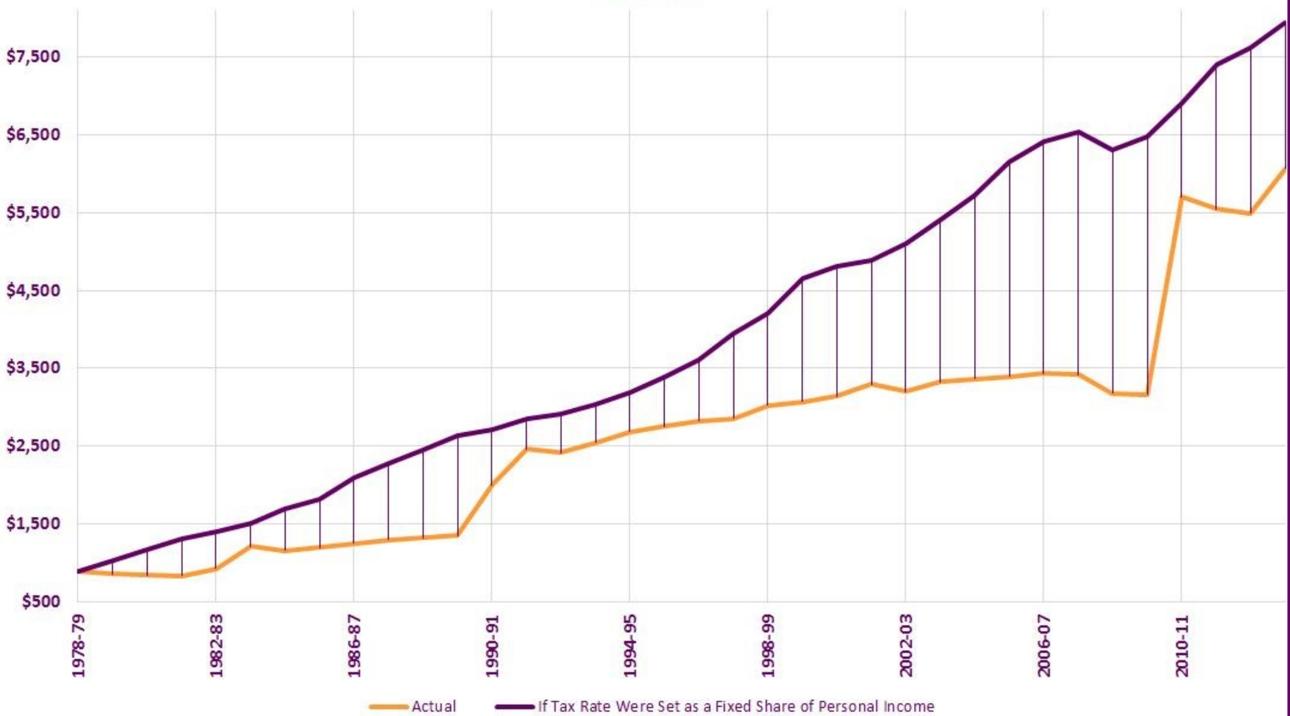
In the years following the credit crunch and recession, the state expanded its access to internal cash by delaying tax refunds, deferring payments to schools and universities, and accelerating tax due-dates. It borrowed from more special funds and plumped up its reserve.

In 2013, California issued a $5.5 billion RAN with an 11-month term. In the next year, the state borrowed $2.8 billion from private investors for roughly nine months. The state will not issue a note in the current year.

The three broken horizontal lines display the average monthly cash balance by fiscal year. There has been a large increase, from $14.2 billion in 2013-14 to $20.7 billion in the current year.

Designing California's Tax Structure: Should We Expect Revenues to Keep Up with the Economy?

Figure 2
Fuel Tax Revenue
Shortfalls Compared to Growth in Personal Income
1978-79 through 2013-14
Dollars in Millions
Source: DOF



The state imposes a tax on the volume of certain fuels, primarily gasoline, diesel, and jet fuel. Drivers pay this tax each time they fill up with gasoline and diesel. The fuel-tax levy is in addition to the sales tax they pay on fuel purchases.

Because it's imposed on each gallon of fuel, the tax rises and falls with changes in consumption. While Californians are driving more than they did a generation ago, the increased fuel efficiency of our cars suppresses the growth of consumption—and therefore revenue.

Another factor affecting fuel tax revenues is the rate, which has been raised by voters or the legislature several times in the past 20 years.

According to Department of Finance data, Californians paid about $900 million in fuel taxes in the year after Proposition 13 passed. Thirty-five years later, they paid about $6.1 billion, an average annual growth rate of about 5.6 percent.

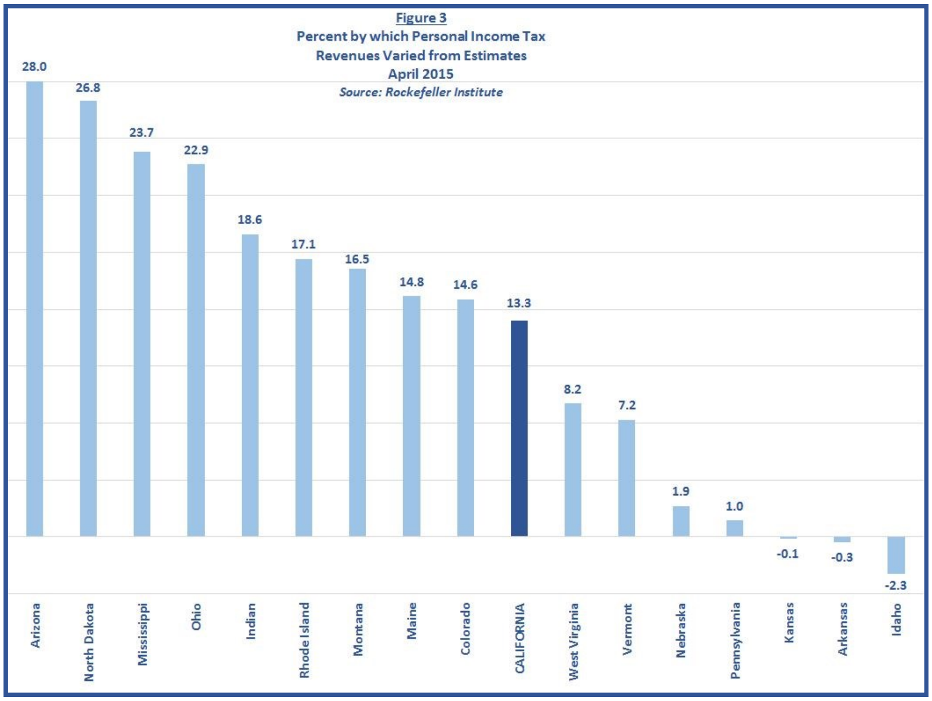
By comparison, California's personal income grew by 6.4 percent on average each year during the same period. The difference in growth rates shows that, even after accounting for episodic increases in the tax rate, today's Californians are spending a smaller share of income on fuel taxes than they did a generation ago.

Put another way, if fuel taxes had risen at the same rate as personal income since 1978-79, the state would have collected about $47 billion more than it did — an average of $1.3 billion each year.

Should we expect the fuel tax — or any tax — to keep pace with growth in personal income? The adequacy of a particular tax may depend on its place in the overall tax structure and the extent to which it helps the state achieve its overall tax policy goals.

The Inexact Science of Estimating Revenues

Revenue estimators must be getting used to regular surprises. Even when their best models are finely tuned, they can expect that their annual estimates will be off by 5 percent most of the time. With the economy and taxpayer behavior so unpredictable in recent years, many state models have been exceeding even that margin of error.



April is a big month for states that rely on the personal income tax (PIT). Typically, in that month, taxpayers make final payments for the prior year's taxes, as well as big estimated payments for this year's taxes. As a result, the month's collections have a disproportionate effect on whether states meet their revenue estimates. That's why some estimators dread the last two weeks of April, when states tally April receipts.

Recently, the Rockefeller Institute reported many states surpassed revenue estimates for April 2015. Of the 17 states that estimate monthly revenues, 14 received more than they had expected. Seven of these — including Arizona, Ohio, and Indiana — exceeded their estimates by at least 15 percent.

California's April surprise seemed modest by comparison, as PIT revenues exceeded the forecast by a mere 13.3 percent.

Estimating errors are likely to be higher for individual months than for a full year, and error rates for the performance of individual taxes will be higher still. As a result, the five states with error rates less than 5 percent might feel that their models performed within estimating tolerances.

Undoubtedly, states whose April collections exceeded their estimates were relieved. But what caused the revenue gain? Should they reconsider their estimating models?

We won't know until states conduct an analysis of the components of their collections.

Sacramento Headquarters

P.O. Box 942850
Sacramento, California 94250-5872
(916) 445-2636 Office
(916) 322-4404 FAX

Sco.ca.gov