Controller *John Chiang*

California State Controller's Office

February 2008 Summary Analysis — Volume 2, Issue 2

Statement of General Fund Cash Receipts and Disbursements

Tax Revenue in January 2008

⇒ General Fund revenue in January was $171 million below (-1.7%) the January Governor's Budget estimate for the month. This was primarily due to income taxes coming in $231 million below (-2.7%) the estimate. Corporate taxes were $47 million above (15.4%) the estimate and sales taxes were $8 million below (-0.8%) estimate.

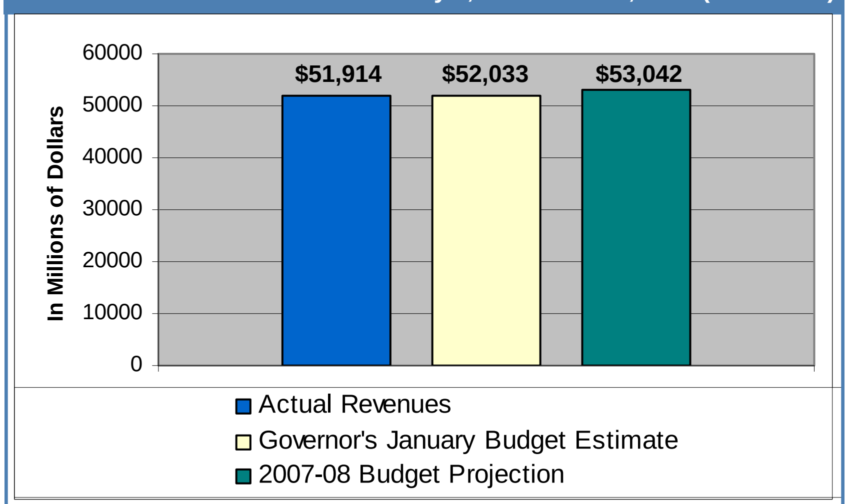
⇒ Revenue in January was $21 million below (-0.2%) the Budget Act estimate. Income taxes were $66 million below (-0.8%) the Budget Act's figures. Retail sales revenues were above estimates by $38 million (4.0%). Corporate taxes were $8 million above (2.4%) the Budget Act estimate.

⇒ Together, the three largest taxes (personal income, corporate and sales taxes) were $191 million below (-1.9%) the Governor's January budget estimate and $19 million below (-0.2%) the Budget Act estimate for January.

⇒ Total General Fund revenue for the month was $119

(Continued on page 2)

Table 1: General Fund Revenues: July 1, 2007–Jan. 31, 2008 (in Millions)



The State Controller's Office is responsible for accounting for all State revenues and receipts and for making disbursements from the State's General Fund. The Controller also is required to issue a report on the State's actual cash balance by the 10th of each month.

As a supplement to the monthly *Statement of General Fund Cash Receipts and Disbursements*, the Controller issues this Summary Analysis for California policymakers and taxpayers to provide context for viewing the most current financial information on the State's fiscal condition.

This Summary Analysis covers actual receipts and disbursements for January 2008. Data are shown for total cash receipts and disbursements, the three largest categories of revenues, and the two largest categories of expenditures. This report also provides the state's latest revenue projections as points of comparison. In January, the Governor released his 2008-09 budget proposal, which contains updated revenue projections for the remainder of the fiscal year. A comparison to those projections is now included. We also continue to include a comparison to the 2007-08 Budget Act passed in August 2007. For the three largest sources of revenue (income taxes, corporate taxes and sales taxes), the January Governor's budget reduced revenue expectations in fiscal 2007-08 by $3.6 billion. The largest reduction was a $2.4 billion reduction in expected income taxes, with April and May receipts expected to be down by almost $2 billion from the projections given in the Budget Act.

(Continued from page 1)

million above (1.2%) the revenue seen in January 2007.

Sales taxes had the weakest revenue growth, falling $106 million below (-9.7%) last January. Income taxes were higher by $177 million (2.2%) and corporate taxes were higher by $12 million (3.5%). The total for the three largest taxes was $83 million higher (0.9%) than last January.

⇒ While payroll withholding has recently been a bright spot for personal income tax – contradicting the slowdown in California job growth that we have observed over the past 18 months – January payroll withholding began to show some weakness. While one month does not make a trend, payroll withholding in January was $35 million below the level of last January.

Table 2: General Fund Receipts, July 1, 2007-January 31, 2008 (in Millions)

Revenue Source	Actual Receipts To Date	Governor's Budget Estimate	Actual Over (Under) Estimate	Budget Act Projections	Actual Over (Under) Projection
Bank And Corporation Tax	$4,938	$4,989	($51)	$5,517	($579)
Personal Income Tax	$30,438	$30,461	($23)	$30,337	$101
Retail Sales and Use Tax	$14,183	$14,262	($79)	$14,758	($576)
Other Revenues	$2,355	$2,321	$34	$2,430	($74)
Total General Fund Revenue	$51,914	$52,033	($119)	$53,042	($1,128)
Non-Revenue	$3,200	$3,046	$154	$1,187	$2,013
Total General Fund Receipts	$55,114	$55,079	$35	$54,229	$885

Note: Some totals may not add, due to rounding

Tax Revenue Fiscal Year to Date

⇒ From July 1, 2007, through January 31, 2008, General Fund revenue is $119 million below (-0.2%) the January Governor's Budget estimate for the year to date. Sales taxes are $79 million below (-0.6%) estimate, corporate taxes are $51 million under (-1.0%) the estimate and income taxes are lagging by $23 million (-0.1%).

⇒ General Fund revenue was $1.1 billion below (-2.1%) the Budget Act estimate. Retail sales receipts were $576 million below (-3.9%) the Budget Act year-to-date estimate, while corporate taxes were $579 million lower (-10.5%) than expected by this time. Income taxes were above the year-to-date estimate by $101 million (0.3%). In total, the three largest taxes were $1.05 billion below (-2.1%) the level expected in the Budget Act by January 31.

Non-Revenue

The "non-revenue" category of Receipts includes transfers from existing funds and miscellaneous receipts.

⇒ Compared to last year, General Fund revenue as of January 31 was $56 million higher (0.1%). The three major taxes were $606 million higher than at this date last fiscal year, but this was largely offset by a decline of $488 million in receipts in the "not otherwise classified" category. Although this category includes

(Continued on page 3)

(Continued from page 2)

an assortment of revenues from various state programs such as horse racing and alcoholic beverage licenses, this shortfall is most likely due to newly-adopted reporting and remitting schedules for the State's Unclaimed Property Program. The Budget Act trailer bill, SB 86, requires banks, financial institutions and other holders to maintain property until June of 2008, when owners have been notified and given the opportunity to claim it before it is sent to the State.

⇒ Corporate taxes continue to be weak. Collections year to date are $432 million lower (-8.0%) than last year at this time. Estimated payments for corporations are $488 million below (-9.0%) the levels seen during the same period last fiscal year.

⇒ Personal income tax receipts are $1.3 billion higher (4.3%) than last year at this date. Withholding is 6.2% above last fiscal year and estimated taxes are 9.1% higher. Estimated payments are also 1.3% above what the January Governor's Budget had projected. Although January's estimated payments are often an indicator of April receipts, plenty of uncertainty remains this budget year due to the sluggish state and national economy.

⇒ Higher withholding and estimated income tax payments are being partially offset by higher refunds (10.9%) and fewer receipts in the "miscellaneous" category (-22%), probably related to diminished real estate transactions. Taxes related to sales of non-owner occupied real estate sales show up in the "miscellaneous" category.

Estimated Taxes

Estimated tax payments are generally filed quarterly to pay taxes due on income not subject to withholding. This can include income from self-employment, interest, dividends, gains from asset sales, or if insufficient income tax is being withheld from a salary, pension, or other income.

Payroll Withholding Taxes

"Payroll Withholdings" are income taxes that employers send directly to the state on their employees' behalf. Those amounts are withheld from paychecks during every pay period throughout the calendar year.

Summary of Net Cash Position as of January 31, 2008

⇒ In January, State expenditures were $2.5 billion less than receipts. Expenditures were $8.9 billion and receipts totaled $11.4 billion.

⇒ For the fiscal year-to-date, the State has spent $13.2 billion more than it received in revenue. Total receipts were $55.1 billion, while total expenditures were $68.3 billion (see Table 3).

⇒ The State began the fiscal year with a cash balance of $2.5 billion. The net cash deficit at the end of January was $10.8 billion. The State issued a $7 billion Revenue Anticipation Note (RAN) in October to cover a portion of this short-term

(Continued on page 4)

Table 3: General Fund Cash Balance
As of January 31, 2008 (in Millions)

	Actual Cash Balance	Governor's Budget Estimate	Actual Over (Under) Estimate	Budget Act Projection	Actual Over (Under) Projection
Beginning Cash Balance July 1, 2007	$2,462	$2,462	$0	$2,462	$0
Receipts Over (Under) Dis-bursements to Date	($13,225)	($14,852)	$1,627	($14,804)	$1,579
Cash Balance Jan. 31, 2008	($10,763)	($12,390)	$1,627	($12,342)	$1,579

(Continued from page 3)

deficit. The remaining $3.8 billion shortfall is being covered by internal borrowing. As of January 31, the State still had $10.6 billion in unused borrowable resources.

⇒ A deficit at this point is not unusual. A disproportionate share of the state's revenue arrives during the last four months of the fiscal year, while a large percentage of disbursements occur during the first eight months.

⇒ Of the largest expenditures, $49.6 billion went to local assistance and $16.8 billion to State operations (see Table 4).

Table 4: General Fund Disbursements, July 1, 2007-January 31, 2008 (in Millions)

Recipient	Actual Disburse-ment	Governor's Budget Estimate	Actual Over (Under) Estimate	Budget Act Projection	Actual Over (Under) Projection
Local Assistance	$49,604	$50,673	($1,070)	$48,942	$661
State Operations	$16,824	$16,456	$368	$16,299	$525
Other	$1,912	$2,802	($890)	$3,792	($1,880)
Total Disburse-ments	$68,339	$69,931	($1,592)	$69,034	($695)

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for January 2008 is available on the State Controller's Web site at www.sco.ca.gov. To have the monthly financial statement and summary analysis e-mailed to you directly, sign up at www.sco.ca.gov/ard/cash/email-sub.shtml.

Any questions concerning this Summary Analysis may be directed to Hallye Jordan, Deputy Controller for Communications, at (916) 445-2636.

Revenue Anticipation Notes

Traditionally, to bridge cash gaps the state borrows money in the private market by issuing Revenue Anticipation Notes (RANs). RANs are repaid by the end of the fiscal year.

Borrowable Resources

State law authorizes the General Fund to internally borrow on a short-term basis from specific funds, as needed.

California State Controller John Chiang:

300 Capitol Mall, Suite 1850
Sacramento, CA 95814

P.O. Box 942850
Sacramento, CA 94250

Telephone: (916) 445-2636
Fax: (916) 445-6379

777 S. Figueroa Street, Suite 4800
Los Angeles, CA 90017

Telephone (213) 833-6010
Fax: (213) 833-6011

Web: *www.sco.ca.gov*

Featured Articles on California's Economy

This month's report includes an article by Controller John Chiang on California's budget and revenue situation.

Current Crisis Should Pave Way For Real Budget Reform

By John Chiang
California State Controller

Real budgetary reform is now among the most important issues pending in Sacramento. The Governor and our Legislature are making it a top priority to find positive solutions to our increasingly painful fiscal and economic problems. As the State Controller responsible for making sure the State can pay its bills, I believe we must put in place a workable, long-term plan to ensure a brighter – and steadier – fiscal future for California.

The time is now. The need for long-term reform has been made painfully clear by the terrible financial toll proposed by the Governor's new budget. To bridge a projected $14.5 billion budget gap, the Governor has proposed a 10 percent across-the-board cut, which I do not believe is a fiscally prudent or responsible way to cut State spending. Public service and program cuts would be felt throughout the state and in our communities. California's school funding would be slashed and our most vulnerable residents, including low-income families, foster children, seniors and the disabled, would face the loss of critical services on which they depend. Public safety, health programs, higher education, our State park recreational jewels – you name it, all would be dramatically and painfully affected.

You've seen the numbers: For our schools alone, the Governor plans on cutting $400 million mid-year, followed by $4.4 billion dollars more in education funds next year. That is the equivalent of showing more than 107,000 California teachers the door. Proposed cuts in health care would be equally debilitating, including chopping $1.1 billion from Medi-Cal. The specific fall-out would include elimination of hearing and vision services for adults, and $11 million in reductions from AIDS programs that would take medications out of the hands of the neediest patients.

Mere numbers and statistics cannot adequately illustrate the horrific fiscal toll this proposed spending plan would exact from our great state and its people.

California's budget relies heavily on the personal income taxes paid by our wealthiest residents. In 2005, the richest 13.5% of California taxpayers

(Continued on page 6)

(Continued from page 5)

earning more than $100,000 paid 83% of all income tax revenues. However, revenues derived from capital gains rely even more on our richest taxpayers. That same year, capital gains from the top five percent of taxpayers comprised $100 billion out of the $111 billion in total capital gains reported – an extraordinary 90%. Those revenues rise and fall dramatically with the stock market, resulting in California's unstable and volatile revenue stream.

To illustrate this volatility, in 2000, state revenues derived from capital gains amounted to $10.7 billion. Two years later, in 2002, capital gains only delivered $3 billion to the State's coffer, a drastic decline of more than 70%.

To address California's many public needs, lawmakers historically have used unexpectedly high revenues to justify new and expanded programs during good years, and then are forced to slash spending when a bear market dries up revenues. That volatility may be expected on Wall Street, but it should not play a role in California's budget process. We must find a way to capture non-sustainable revenues in the flush years to tide us over when the economy sours.

I have long supported a rainy day fund for use in tough fiscal times. But we must target what makes the budget flush with cash one year, and drowning in red ink the next.

While the Governor's budget stability proposal is on the right track, I believe we should target the core cause of the volatility and tap and store excess capital gains revenue during good years for use in the next economic downturn. Programs may not get as big a bump during the flush years, but they would less likely face the huge cuts the governor is now proposing.

As both Controller and Chairman of the Franchise Tax Board, I have asked my staff experts to work closely together to detail how we can hold these volatile funds in the good years for use as an insurance policy in times like this.

Although my plan would address California's future budget problems, we must also immediately face the current crisis. The Governor has declared a fiscal emergency, and I believe the special legislative session is helping to bring the budget problems into focus. Everything should be on the table. But if we talk about raising taxes, we must ensure the State's spending plan is accountable to the taxpayers who are footing the bill, and that Californians are confident they are getting at least a dollar's worth of service for every tax dollar they pay.

We also should look at tax breaks. Five years ago, the Department of Finance reported that California provided $24 billion in tax breaks. This year, tax breaks total $50 billion. Many of the tax breaks are found in the personal income tax, with costs increasing from $18.5 billion if the 2002-2003 fiscal year to $37 billion in the 2006-2007 fiscal year.

While many of these breaks may be fiscally sound, I propose that we conduct periodic reviews of all new tax breaks. We need to determine whether they are indeed producing the intended benefits and whether they should be continued, cut or expanded.

For example, is a tax break creating new jobs or another tangible economic benefit, or is it obsolete and simply adding to someone's financial bottom line with an insignificant direct benefit to everyone else? Making government accountable to the public it serves will go a long way in inspiring taxpayers' confidence and their support during these tough fiscal times.

All of this illustrates why we need not just short-term "quick fixes" to our fiscal house, but long-term budget reform.

I'll say this as succinctly as I can: We need to put an end to California's boom-and-bust budgeting. As painful as the current situation may be, I will do everything I can to help turn it into an opportunity for consensus on real, long-term solutions.