A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

California Fiscal Focus

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CA Controller's April Cash Report Shows State Revenues Lagging

April state revenues fell short of estimates in Gov. Jerry Brown's proposed 2016-17 budget by $1.19 billion, mostly the result of lower-than-expected receipts from the personal income tax in one of the most important months for collections, State Controller Betty T. Yee reported.

"We know that state revenues cannot defy gravity forever," said Controller Yee, the state's chief fiscal officer. "It is too early to call this a trend rather than a one-time occurrence. However, we should always expect peaks and valleys in the state's financial performance."

Most Californians file their tax returns in April, and the month's total is closely watched as a possible bellwether of the state's fiscal fortunes. April personal income tax revenues of $13.40 billion fell short by $1.22 billion, 8.4 percent less than projected in the January proposed budget. Retail sales and use tax revenues of $816.1 million lagged by $53.9 million, or 6.2 percent. Only the corporation tax beat estimates, with revenues of $1.98 billion coming in $95.4 million higher than expected, or 5.1 percent.

Overall, April's total revenues of $16.78 billion fell short of the January estimate by 6.6 percent.

April's collections drove revenues for the fiscal year to date into negative territory compared to the January projections. For the fiscal year that began July 1, overall revenues of $95.15 billion are off by $680.5 million, or 0.7 percent. The personal income tax and the sales tax are falling short by $1.16 billion and $217.6 million, respectively. The corporation tax for the fiscal year to date is surpassing expectations by $476.3 million.

Compared to actual revenues in the prior fiscal year, April revenues were $215.0 million lower. However, for the fiscal year to date, revenues are still outpacing the previous fiscal year by $4.99 billion, or 5.5 percent.

The state ended the month of April with unused borrowable resources of $25.59 billion, which was $1.85 billion more than expected in the governor's proposed budget. Outstanding loans of $7.34 billion were $1.07 billion less than projected. This loan balance consists of borrowing from the state's internal special funds.

For more details, read the monthly cash report.

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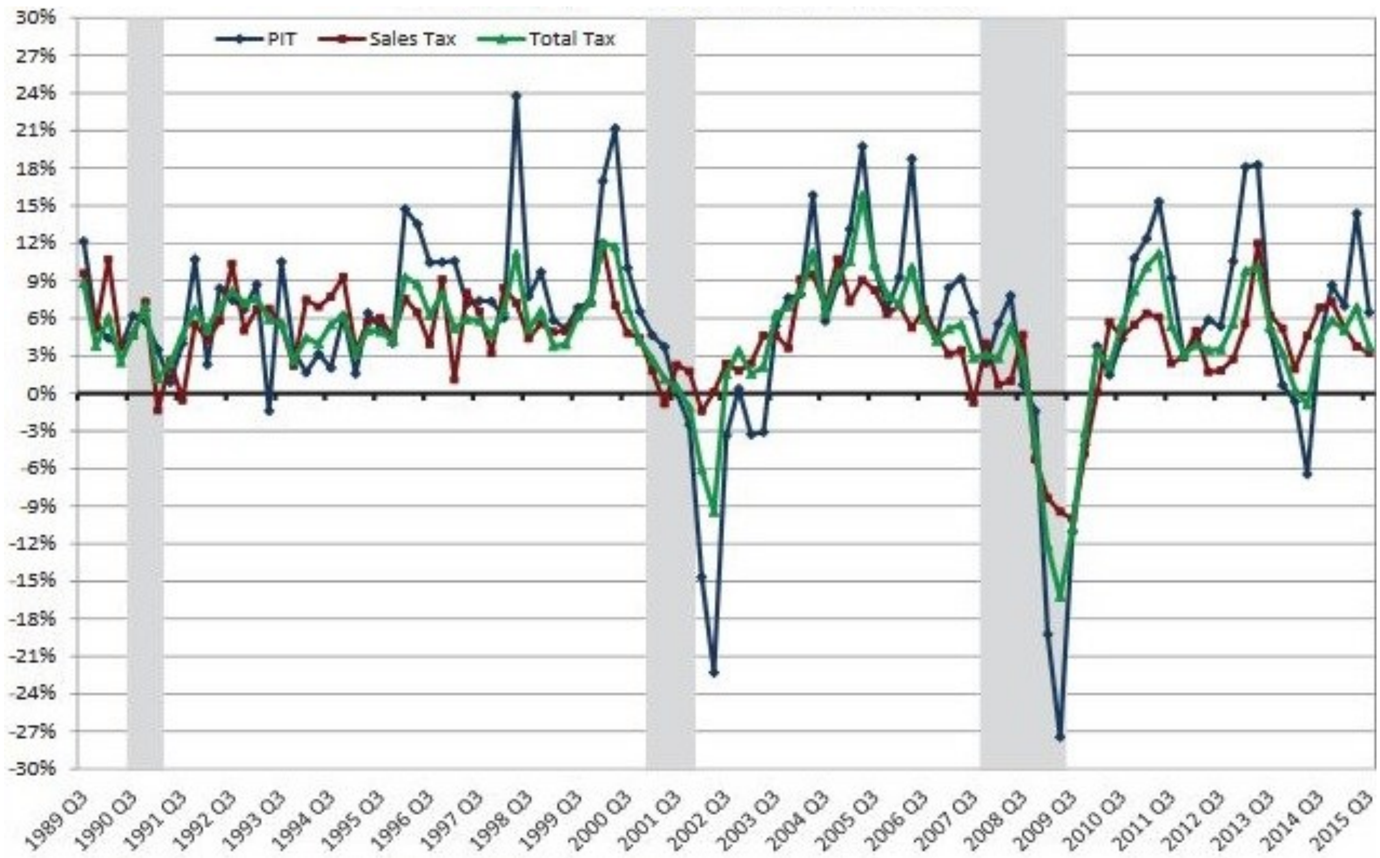
Nationwide, States Face Fiscal Stresses

Figure 1

Year-Over-Year Change in Nominal State Tax Collections



Source: Nelson A. Rockefeller Institute of Government, based on data from U.S. Census Bureau.

This spring, federal and state fiscal conditions seem more precarious than usual. Three recent reports help define this uncertainty.

Pew: Rationalizing economic development decisions. Since 2012, more than one-fifth of states and the District of Columbia have adopted statutory requirements intended to improve the effect of economic development incentives by collecting annual data on their impacts. After evaluating the data from 11 jurisdictions, the Pew Research Center recommends that states adopting development incentives require regularly scheduled evaluations, preferably through the budget process; identify who will conduct the evaluations; and focus on how state laws (or regulations, presumably) affect the state's economy and budget.

Congressional Budget Office: Federal budget outlook worsens. Economists Alan Auerbach and William Gale report a deteriorating medium- and long-term fiscal outlook to the Congressional Budget Office. Compared to estimates made last September, they forecast a higher debt ratio in 2025 (from 81 percent to 91 percent) and 2040 (120 percent to 152 percent). The current-year value is 76 percent. The causes of the downgrade? The report identifies changes in federal policy, economic outlook, and technical factors.

Rockefeller Institute: States predict revenue growth for 2016 and 2017. The institute warns that states will face steady budget stress through 2017. Most states expect

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One Way to Avoid Federal Tax Penalties

The Internal Revenue Service receives tax payments (generally from Western states) at a San Francisco postal address but processes them across the bay in Hayward.

On September 11, 2005, a truck on the way to the Hayward facility overturned on the San Mateo Bridge. Tax remittances from at least 13 states—Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Ohio, Oregon, Utah, Virginia, Washington, and Wyoming—sprawled onto the bridge and into the bay.

The IRS recovered about 15,000 items from the roadway and bay, about one-third of the tax returns in the truck. The remainder, representing less than 2 percent of the tax remittances sent to the Hayward facility that September, were lost.

The IRS waived late-payment penalties for taxpayers whose paperwork went through San Francisco that September.

(UNCERTAINTY, continued from page 2)

personal income tax and sales tax revenue to grow more slowly in 2016 and 2017 than in 2015. Figure 1 shows long-term trends in state tax collections.

Though revenue forecasts vary across states, most expect revenues to fall short of spending. The variation reflects regional differences in cyclical business conditions, real estate markets, and capital gains taxes. The report also notes that some states have adopted changes in spending and tax policy that could cause budget pressure.

Governor Reagan's Mid-Year Budget Correction: Proposing Systemic Change

When should a leader propose systemic fiscal change?

Nearly 50 years ago, Governor Ronald Reagan—faced with persistent annual budget deficits—proposed a mid-year budget correction to address issues eerily familiar in the recent decade: chronic carry-over deficits and shortfalls in funding for K-12 schools, health care, and higher education.

On March 8, 1967, he proposed a change so big that he apologized. "I wish the [proposal] could be smaller," he wrote, "but the responsibilities which we share for sound financial management of the state's government demand that we confront and solve the fiscal problem…"

The letter specifically identified difficulties managing cash flow, increasing assistance to local governments, and the costs of Medi-Cal, higher education, employee compensation, and K-12 schools.

Governor Reagan proposed to cover these costs with rate increases of as much as 33 percent in the state sales, personal income, bank, and corporation taxes.

According to biographer Lou Cannon "Reagan's proposal had the distinction of being the largest tax hike ever proposed by any governor in the history of the United States."

After negotiating a package of tax and budget reforms, Governor Reagan signed legislation to raise the following taxes: state sales tax from 3 to 5 percent, personal income tax top rate from 7 to 10 percent, bank and corporate tax from 5.5 to 7 percent, cigarette tax from 3 cents to 10 cents per pack, and alcohol tax from $1.50 to $2.00 per gallon.

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