

Controller *John Chiang*

California State Controller's Office



April 2008 Summary Analysis

Volume 2, Issue 4

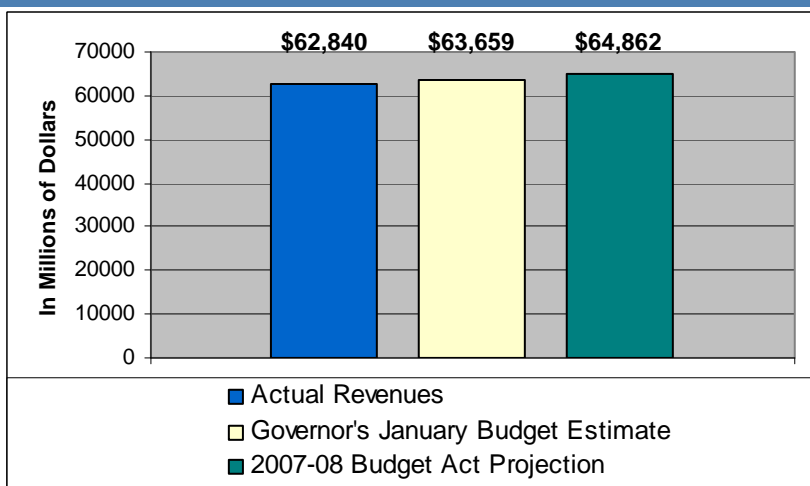
Statement of General Fund Cash Receipts and Disbursements

Tax Revenue in March 2008

- ⇒ General Fund revenue in March was \$618 million below (-10.3%) the Governor's Budget estimate for the month. Corporate taxes were the largest contributor to this loss, coming in \$266 million under (-16.1%) the estimate. Sales taxes were below estimate by \$164 million (-7.5%) while income taxes were \$9 million above (0.5%) the Governor's Budget estimate. Together, the three largest taxes (personal income, corporate and sales taxes) were \$421 million below (-7.6%) the Governor's January Budget estimate for March. Insurance tax receipts were below the estimate by \$173 million (-70%).
- ⇒ Revenue in March was \$833 million below (-13.4%) the 2007-08 Budget Act estimate. Income taxes were \$311 million lower (-15.2%) than the Budget Act's figures. Retail sales revenue was below estimates by \$189 million (-8.5%). Corporate taxes were \$138 million below (-9.0%) the Budget Act estimate. In total, the three major taxes

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Table 1: General Fund Revenues: July 1, 2007–March 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 March 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 proposals, which contain updated revenue projections for the remainder of the fiscal year. A comparison to those projections is 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 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.

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were \$638 million below (-11.0%) the Budget Act estimate for March.

⇒ Total General Fund revenue for March 2008 was \$375 million below (-6.5%) the revenue seen in March 2007. Sales taxes and corporate taxes accounted for most of the decline. Sales taxes were below March 2007 by \$167 million (-7.6%) while corporate taxes lagged by \$166 million (-10.7%). Income taxes were \$70 million (4.2%) above last March. In total, the three largest taxes were \$263 million lower (-4.9%) than March 2007.

Tax Revenue Fiscal Year to Date

⇒ For the fiscal year through March 31, 2008, General Fund revenue was \$819 million below (-1.3%) the January Governor's Budget estimate for the year to date. Sales taxes were \$434 million below (-2.1%) the estimate, corporate taxes were \$342 million under the estimate (-5.0%), and income taxes were \$249 million above (0.7%) the estimate. Together, the three largest taxes were \$527 million below (-0.9%) the Governor's Budget estimate for this date. Insurance company taxes year-to-date were under the January Budget estimate by \$308 million (-20.1%).

⇒ Through March, General Fund revenue was \$2.0 billion below (-3.1%) the Budget Act estimate. Retail sales receipts were \$940 million below (-4.5%) the Budget Act year-to-date estimate, while corporate taxes were \$747 million lower (-10.3%) than expected. Income taxes were below the year-to-date estimate by \$101 million (-0.3%). In total, the three largest taxes were \$1.8 billion below (-2.9%) the level expected in the Budget Act.

⇒ Of the three largest taxes, corporate taxes have shown the weakest growth in a year-over-year comparison, having dropped \$573 million below (-8.1%) the levels seen last year. Sales taxes were also weak, yielding \$441 million less (-2.2%) than in the same period during the last fiscal year. Personal income tax receipts were \$1.4 billion higher (4.3%) than last year at this date. Withholding continued to provide most of the increased revenue, yielding \$1.3 billion more (5.2%) than last fiscal year.

Table 2: General Fund Receipts, July 1, 2007-March 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	\$6,500	\$6,841	(\$342)	\$7,246	(\$747)
Personal Income Tax	\$33,811	\$33,562	\$249	\$33,911	(\$101)
Retail Sales and Use Tax	\$19,757	\$20,191	(\$434)	\$20,696	(\$940)
Other Revenues	\$2,773	\$3,065	(\$292)	\$3,008	(\$235)
Total General Fund Revenue	\$62,840	\$63,659	(\$819)	\$64,862	(\$2,022)
Non-Revenue	\$6,739	\$6,509	\$231	\$1,341	\$5,398
Total General Fund Receipts	\$69,580	\$70,168	(\$588)	\$66,204	\$3,376

Note: Some totals may not add, due to rounding

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⇒ Compared to last fiscal year at this date, General Fund revenue was down by \$309 million (-0.5%), with the “Not Otherwise Classified” category of general fund revenues \$510 million (-36.7%) below this time last year. While this category includes 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.

Summary of Net Cash Position as of March 31, 2008

- ⇒ In March, State expenditures were \$1.8 billion higher than receipts. Expenditures were \$7.3 billion and receipts totaled \$5.4 billion.
- ⇒ Most of the non-revenue receipts in Table 2 (\$6.7 billion) were from \$3.3 billion in Economic Recovery Bond proceeds in February and the transfer of \$1.4 billion from the Budget Stabilization Account in January. The Governor’s January Budget included these monies, but the August 2007 Budget Act did not.
- ⇒ For the fiscal year to date, the State has spent \$17.6 billion more than it received in revenue (see Table 3). Total receipts were \$69.6 billion (see Table 2), while total expenditures were \$87.1 billion (see Table 4).
- ⇒ The State began the fiscal year with a cash balance of \$2.5 billion. The net cash deficit at the end of March was \$15.1 billion. The State has already issued a \$7 billion Revenue Anticipation Note (RAN) in October to cover a portion of this short-term deficit.

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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.

Economic Recovery Bonds

Voters approved \$15 billion in recovery bonds for State operations when they adopted Proposition 57 in 2004. The final \$3.3 billion were sold in February to cover projected shortfalls in future budget years.

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.

Table 3: General Fund Cash Balance As of March 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) Disbursements to Date	(\$17,564)	(\$19,693)	\$2,130	(\$20,995)	\$3,431
Cash Balance March 31, 2008	(\$15,102)	(\$17,231)	\$2,130	(\$18,533)	\$3,431

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The remaining \$8.1 billion shortfall is being covered by internal borrowing. As of March 31, the State still had \$4.8 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, \$64.1 billion went to local assistance and \$21 billion went to State operations (See Table 4).

Recipient	Actual Disbursement	Governor's Budget Estimate	Actual Over (Under) Estimate	Budget Act Projection	Actual Over (Under) Projection
Local Assistance	\$64,142	\$66,114	(\$1,973)	\$62,830	\$1,312
State Operations	\$21,042	\$20,902	\$140	\$20,551	\$491
Other	\$1,959	\$2,845	(\$885)	\$3,817	(\$1,858)
Total Disbursements	\$87,143	\$89,861	(\$2,718)	\$87,198	(\$55)

Borrowable Resources

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

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for March 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.

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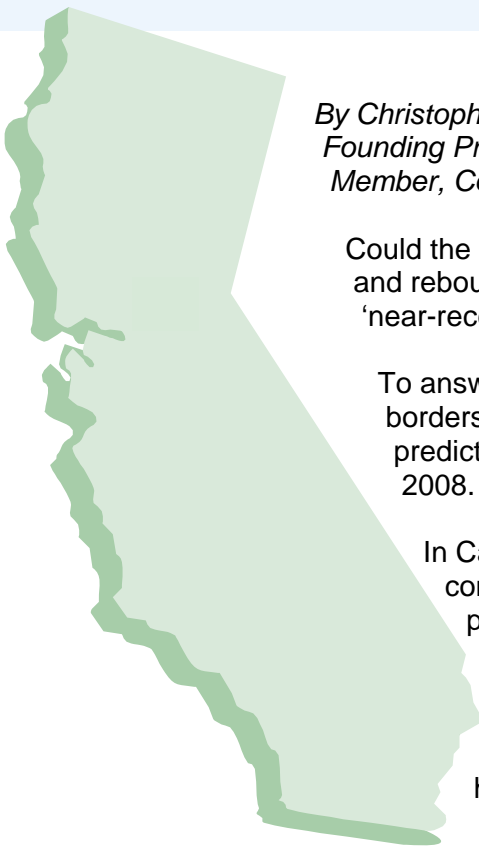
Featured Articles on California's Economy

Controller John Chiang's Council of Economic Advisors informs the Controller on emerging strengths and vulnerabilities in California's economy, major issues and trends that may affect the State's fiscal health, and how to make the best use of limited government revenues and resources.

The advisors also contribute monthly articles on issues regarding California's economy. The opinions in the articles are presented in the spirit of spurring discussion and reflect those of the authors and not necessarily the Controller or his office.

This month's report includes an article from Christopher Thornberg, Founding Principal, Beacon Economics, LLC, and member, Controller's Council of Economic Advisors.

California on Leading Edge of U.S. Recession A Turbulent Road Ahead



*By Christopher Thornberg
Founding Principal, Beacon Economics, LLC
Member, Controller's Council of Economic Advisors*

Could the optimists be right? Will the U.S. economy pull out of its nose-dive and rebound by the end of 2008? Will the national economy have only a 'near-recession experience'?

To answer that question we need look no farther than California's own borders, a state that is unfortunately leading the U.S. into what we predict will be a serious, but hopefully not record breaking, recession in 2008.

In California we have already experienced a sharp decline in consumer spending, and unemployment has surged almost 1.2 percent over the past year. Recent revisions to estimates of non-farm payroll employment now show that losses in the second half of 2007 offset gains from the first half, and are starting to pick up speed. The real estate crisis is only escalating, with price declines accelerating and foreclosures already reaching record high levels without any sign of stability in the near future. Real

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estate price declines also look to be intensifying as we continue into the second quarter of 2008. Moreover, the decline is broad based with every region in the state experiencing difficulties.

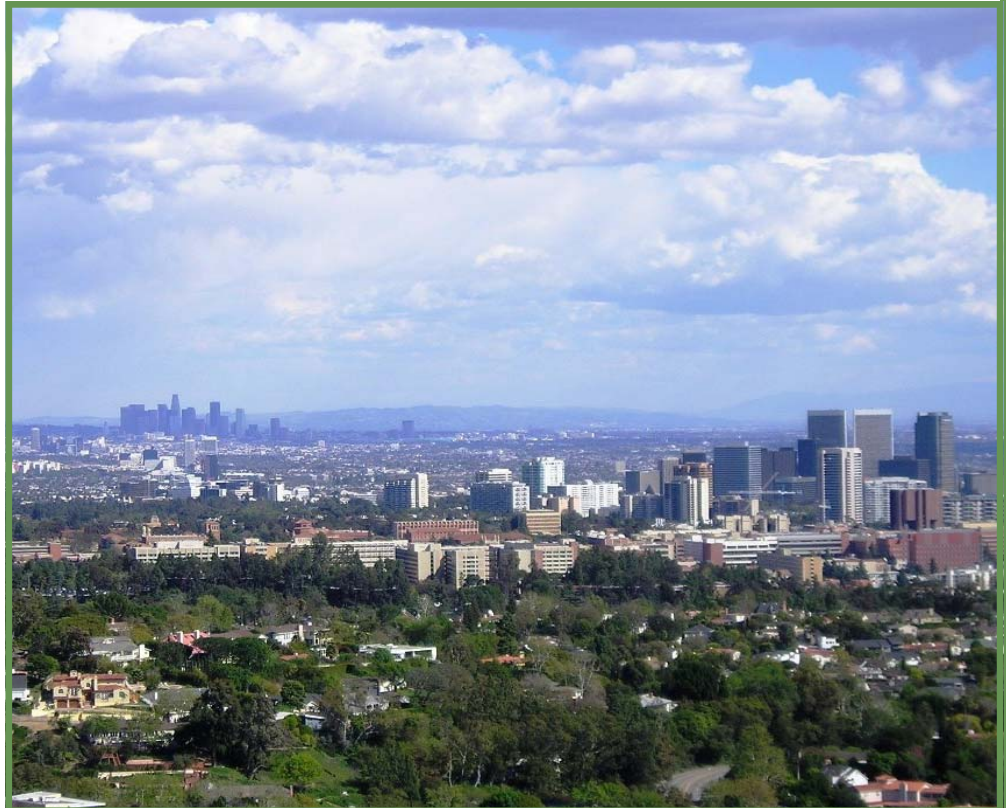
The reason the U.S. economy is slumping, and the reason California is on the leading edge, boils down to the consumer. This not an issue of confidence or interest rates, but is due to the troublingly simple fact that over the past decade Americans have been on a spending binge of epic proportions. Fueled first by a stock market boom, and then by one of the largest land price increases in U.S. economic history, consumers have ramped up spending to unsustainable levels given their incomes.

Nowhere could the imbalance be seen more clearly than in the massive U.S. trade deficit: Between 1997 and 2007 the U.S. economy was consuming nearly a trillion dollars more per year than it was producing. We Americans have been borrowing from the rest of the world on an enormous scale based on a misguided estimate of our own financial worth.

Unfortunately, the reality of falling land values is now crashing down on consumers' heads, and spending must similarly fall back to a level proportionate with income.

The problem is starting in California because we had some of the greatest increases in home values. And we are now experiencing some of the most precipitous drops in prices.

And what of the optimists – who once said we had no housing bubble, then when it popped said it would be a soft landing, and now claim that most of the issues have been dealt with and the U.S. economy will quickly toss these problems aside? Whether it be wishful thinking or denial, all the evidence points to an acceleration of the current slowdown through 2008 – not that we are coming in for a soft landing.



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What to expect in 2008:

- The U.S. economy will follow California into a recession. Look for a deeper downturn than the comparatively mild recession the nation experienced in 2001, and more on par with what occurred in 1990. Growth will be negative for at least three quarters this year. Expect the national unemployment rate to shoot above seven percent.
- Most of California, with the notable exception of the San Francisco Bay Area, got off relatively easily in the economic downturn of 2001. Unemployment rates never hit 7 percent in the state largely because the slump was business-led and housing and consumer spending never slowed. This time things will be different. Expect the state unemployment rate to climb to 8 percent or higher before dropping back down.
- The capital markets will continue to play hide and seek. They will hide their losses as they seek outside capital to keep them upright. Many of the losses are still being hidden because of accounting rules that allow firms to only re-price the value of low liquidity assets upon sale. We are only seeing the losses in the large investment banks because their hedge funds have been forced to sell assets by wary investors. There is a lot of bad paper still out there.
- The stock markets will continue their jitters, and volatility will be the word of the year. Yet beyond financial firms, there is little reason to believe the market is overvalued, unlike some of the foreign exchanges, particularly in Asia. The bond markets will remain a mess, but the equity markets should not experience any more precipitous losses.
- Look for California's budget deficit to grow worse. The number \$16 billion has been used as a baseline figure. The true number is likely much higher because that \$16 billion relies on

positive growth in the state's three major sources of income: income taxes, business taxes, and sales taxes. It is highly probable that one or more of these revenue sources will actually fall next year – making the gap even larger. Finally, there will be no bounce in revenues the way there was back in 2003. There are no more bubbles in the works to provide another round of windfall gains. To their credit, state leaders have already made substantive moves to tackle the problem - about half the budget gap has been addressed. Unfortunately it's the remainder that is likely to be the most painful.

- Local governments will face major challenges this year. Cities and counties rely heavily on property taxes, real estate transfer taxes, and sales taxes to fund their budgets. All three will take a sizeable hit this year – unlike in 2001 when real estate and spending remained stable. This in turn will put additional pressure on the state government. If local governments cannot fund their share of Proposition 98 support for local education, the state is obligated to step in.

Believe it or not, there are a few bright spots for the state. California is likely to continue receiving a fair amount of foreign tourism while the U.S. dollar remains weak. Additionally, foreign demand for now-cheap U.S. goods will bolster the state's huge export sector and provide some stability. More importantly the state's growing tech sectors – while likely to hit a pothole in mid-2008 due to the slowing economy – will recover quickly in 2009 and continue to move the state's economy forward in a very positive way.

Finally, although it's a bitter pill, in the end, recessions are necessary pauses in growth as an economy reorganizes itself in the midst of a major change in the way things operate. The path from here to there may be difficult, but once there, the economy will ultimately be healthier and growth will once again be solid.