

# Controller *John Chiang*

## California State Controller's Office



June 2008 Summary Analysis

Volume 2, Issue 6

## Statement of General Fund Cash Receipts and Disbursements

### Tax Revenue in May 2008

- ⇒ General Fund revenue in May 2008 was \$1 million below (0.0%) the Governor's May Revision estimate for the month. An unexpected \$283 million (12.1%) in income taxes were offset by drops in sales, corporate and insurance taxes. Sales taxes were \$124 million lower (-3.5%) than expected, corporate taxes were below estimate by \$90 million (-36.1%) and insurance company taxes were lower than estimated by \$85 million (-63.6%). May is not a significant month for either corporate or insurance tax collections. Together the three largest taxes (income, sales, and corporate) were over the May Revision estimate by \$69 million (1.1%).
- ⇒ Revenue in May was \$514 million below (-7.4%) the 2007-08 Budget Act estimate. Income taxes were \$34 million lower (-1.3%) than the Budget Act's figures. Retail sales revenue was below estimates by \$417 million

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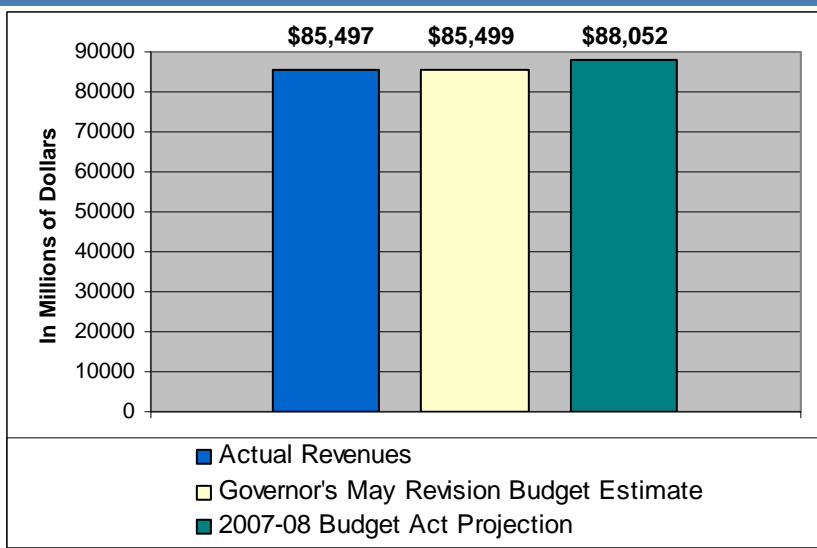
The State Controller's Office is responsible for accounting for all State revenues and receipts and for making disbursements from the State's General Fund. The Controller also is required to issue a report on the State's actual cash balance by the 10th of each month.

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 May 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 contained updated revenue projections for the remainder of the fiscal year. The budget proposal was revised in May and it is the May Revision that we now use as a comparison. We also continue to include a comparison to the 2007-08 Budget Act passed in August 2007.

Compared to the Governor's January Budget proposal, the May Revision budget increased the amount of revenue expected from the three major taxes (income taxes, sales taxes and corporate taxes) in 2007-08 by \$551 million. Projected income tax revenue was raised by \$1.7 billion while sales tax was reduced by \$714 million and corporate taxes by \$405 million.

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



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(-10.9%). Corporate taxes were \$121 million lower (-43.1%) than the Budget Act estimate. In total, the three major taxes were \$572 million below (-8.5%) the Budget Act estimate for May.

⇒ Compared to May 2007, General Fund revenue in May 2008 was lower by \$464 million (-6.7%). Income taxes were higher by \$358 million (15.8%) while sales taxes lagged by \$672 million (-16.5%). Corporate taxes were below last May by \$154 million (-49%). In total, the three largest taxes lagged last May by \$468 million (-7.0%). The gains in May income tax receipts appear to be related to extension payments that were not processed in April. These payments are often from high income taxpayers and reflect 2007 income.

**Table 2: General Fund Receipts, July 1, 2007-May 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	\$8,302	\$8,392	(\$90)	\$9,140	(\$838)
Personal Income Tax	\$49,425	\$49,142	\$283	\$49,728	(\$303)
Retail Sales and Use Tax	\$24,055	\$24,179	(\$124)	\$25,466	(\$1,411)
Other Revenues	\$3,715	\$3,786	(\$71)	\$3,718	(\$3)
Total General Fund Revenue	\$85,497	\$85,499	(\$2)	\$88,052	(\$2,555)
Non-Revenue	\$6,982	\$6,748	\$234	\$1,482	\$5,501
Total General Fund Receipts	\$92,479	\$92,248	\$232	\$89,534	\$2,946

Note: Some totals may not add, due to rounding

## Tax Revenue Fiscal Year to Date

⇒ For the fiscal year through May 31, 2008, General Fund revenue was \$2.3 million lower (0.0%) than the Governor's May Revision estimate. Sales taxes were \$124 million below (-0.5%) the estimate, corporate taxes were \$90 million under the estimate (-1.1%), while income taxes were \$283 million above (0.6%) the estimate. Together, the three largest taxes were \$69 million above (0.1%) the Governor's May Revision for this date.

⇒ Through May, General Fund revenue was \$2.6 billion below (-2.9%) the Budget Act year-to-date estimate. Retail sales receipts were \$1.4 billion below (-5.5%) the Budget Act's figures, while corporate taxes were \$838 million lower (-9.2%) than expected. Personal income taxes were below the year-to-date estimate by \$303 million (-0.6%). In total, the three largest taxes were \$2.6 billion below (-3.0%) the level expected in the Budget Act.

⇒ Total General Fund revenue was \$445 million higher (0.5%) on May 31 compared to the same time last fiscal year. For the big three taxes the year over year growth was \$1 billion, a growth rate of 1.3%.

⇒ Corporate taxes showed the weakest growth rate in a year-over-year comparison, having dropped 7.9%

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below (-\$713 million) the levels seen last year. Sales taxes had the largest absolute drop, yielding \$790 million less than in the same period during the last fiscal year, but the percentage drop was only -3.2%. Income tax receipts were \$2.6 billion higher (5.5%) than last year at this date. Payroll withholding continued to provide most of the increase in income tax revenue, yielding \$1.5 billion more (4.9%) than last fiscal year at this time.

- ⇒ The disparity between rising income tax receipts and sinking sales and corporate taxes this year has been puzzling. Income tax payments through April 2008 were strongly impacted by income received in 2007. The 15% of taxpayers with incomes over \$100,000 pay 84% of income taxes, so the growth of income taxes may indicate that those taxpayers were not significantly impacted by the economic slowdown in 2007. The estimated income tax payments due in June will offer a better glimpse of tax payments related to the 2008 economy.

## Summary of Net Cash Position as of May 31, 2008

- ⇒ In May, the State had revenue receipts of \$6.6 billion and incurred expenditures of \$7.3 billion, increasing the year-to-date deficit by \$720 million. The year-to-date spending deficit is now \$10.2 billion.
- ⇒ The two main sources of the \$6.98 billion in non-revenue receipts in Table 2 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 May Revision of the budget included these monies, but the August 2007 Budget Act did not.
- ⇒ For the fiscal year to date, the State has spent \$10.2 billion more than it received in revenue (see Table 3). Total receipts were \$92.5 billion (see Table 2),

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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 May 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	(\$10,198)	(\$10,609)	\$411	(\$12,012)	\$1,814
Cash Balance May 31, 2008	(\$7,736)	(\$8,147)	\$411	(\$9,550)	\$1,814

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while total expenditures were \$102.7 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 May was \$7.7 billion. The \$7 billion Revenue Anticipation Note (RAN) issued last Fall and internal borrowing are covering this short-term deficit. The cash report shows an outstanding loan balance of \$8.1 billion, which includes the \$7 billion RAN as well as a \$1.1 billion loan from special funds, of which \$380 million was retained as cash. The RAN will be repaid by the end of the fiscal year with a combination of available cash and borrowable resources. Internal loans will be repaid according to cash management procedures as resources are available.

⇒ Of the largest expenditures, \$74.3 billion went to local assistance and \$25.2 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	\$74,256	\$74,353	(\$96)	\$72,617	\$1,639
State Operations	\$25,238	\$25,219	\$18	\$24,717	\$521
Other	\$3,184	\$3,285	(\$101)	\$4,212	(\$1,028)
<b>Total Disbursements</b>	<b>\$102,678</b>	<b>\$102,857</b>	<b>(\$179)</b>	<b>\$101,546</b>	<b>\$1,132</b>

### 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 May 2008 is available on the State Controller's Web site at [www.sco.ca.gov](http://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](http://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.

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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 by Ross DeVol, Director of Regional Economics and the Center for Health Economics at the Milken Institute, and member of the Controller's Council of Economic Advisors.

To further illustrate the state's economic position, this section also includes a "California Economic Snapshot" table of various indicators such as employment growth, housing and vehicle registrations.

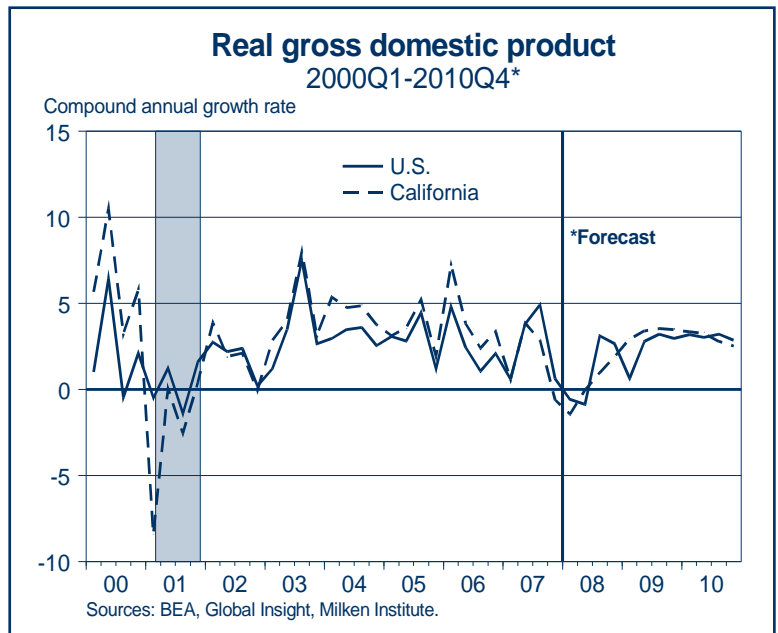
# The Economic and Budget Outlook for California

By Ross DeVol  
 Director of Regional Economics and the Center for Health Economics at the Milken Institute  
 Member, Controller's Council of Economic Advisors

## California's Economic Outlook

We believe the U.S. economy tipped into a mild recession in the first half of 2008. A severe correction in housing markets, oil prices that breached the one hundred dollars a barrel barrier, the weakening labor market, overextended consumers, and a continuing credit crunch have overwhelmed the underlying strength of export markets. The result will be a modest decline in overall economic activity.

California will experience a more severe recession than the nation overall, but the recession will still be mild by historical standards. Just as in the 2001 recession, it was the bursting of a bubble - this time in housing, then in the dot-com and high-tech industries - that played the lead role in deflating the economy. The state's housing market correction will be substantially more pronounced - in fact, among the most acute in the



nation - and will affect a much broader swath of the employment base. The large share of subprime mortgages (as a percentage of all home mortgages) and the high concentration of both subprime and traditional mortgage originators will cause greater ripple effects as jobs are slashed in California.

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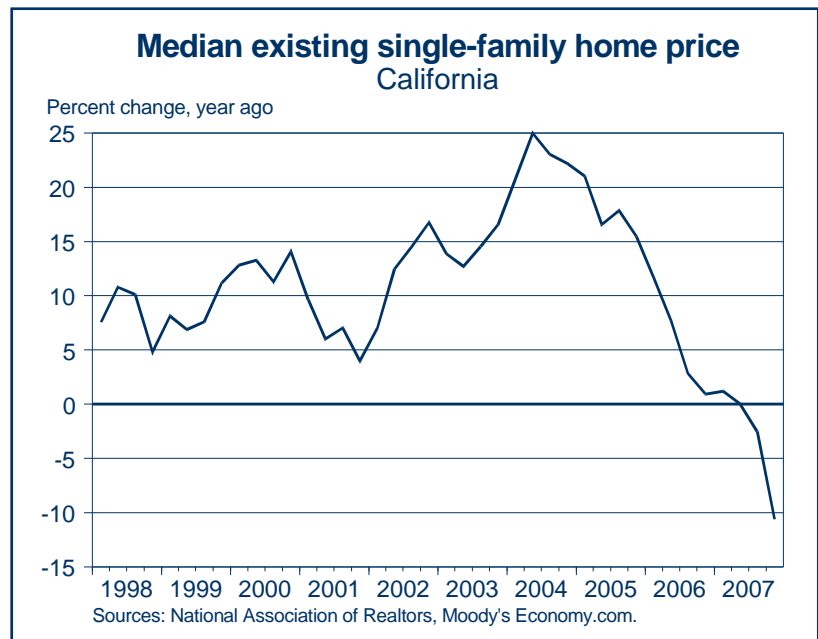
Because California is the most energy-efficient state in the union, higher oil prices won't affect its businesses as much as those elsewhere in the country; but higher gasoline prices will cause deleterious financial impacts at the consumer level.

Slowing import growth rates will help the rest of the United States, but the slowdown in imports from China and elsewhere in Asia will curtail port- and logistics-related activity in California. Rising exports will help California but won't provide nearly the same stimulus as they will in the rest of the country. This is because the dollar has fallen most precipitously against the Euro and the Canadian dollar, and California's share of exports to Europe and Canada isn't as high as that of other states. Another negative factor for the California economy is the recently ended writers' strike. Although the strike ended in February, it had a large impact on the Los Angeles economy in the first quarter and will have a lingering effect throughout the year. The State's economy will benefit from rising tourism as the weaker dollar proves attractive to international travelers.

Consumer spending will be depressed in 2008. California is projected to lose 39,100 jobs in 2008, a decline in employment of 0.3%. These job losses will be concentrated in construction (57,900 jobs), financial services (38,600), and manufacturing (33,600). Professional and business services employment will manage a modest gain, with education and health services being the biggest creators of jobs for the year. We expect the unemployment rate to peak at 6.6% in the fourth quarter of 2008. Wage and income growth adjusted for inflation will be very weak. California retail sales are projected to decline 0.3%, and when adjusted for inflation, the decline is 3.8%. This weak performance is already cutting sales tax collections at local and state levels. Given the stress on homeowners and other consumers, car sales will drop in 2008. New-car registrations are forecast to decline 2.5% for the year.

By 2009, a bottoming-out in housing markets, growing exports, greater expansion in business investment, and some improvement in consumer balance sheets will lead to a 0.7% increase in employment (106,900 jobs). Job growth should accelerate to 1.5% in 2010. Retail sales are projected to rise 2.8% in 2009 and 5.8% in 2010. Car sales will recover as well.

California's real GSP (gross state product) declined at an estimated annual rate of 0.6% in the fourth quarter of 2007, and by 1.4% in the first quarter of 2008. A resumption of film and television production activity in



the second quarter of 2008 will result in real GSP that remains at first-quarter levels. Tax rebates will aid the State's economic recovery in the second half of 2008; however, these rebates won't provide the same stimulus to consumer spending as they do elsewhere in the country. A greater percentage of the rebates will be used for mortgage payments or to pay down other consumer-installment debt. California's real GSP is projected to increase 0.4% in 2008, 2.5% in 2009, and 3.3% in 2010.

### California's Budget Outlook

Recent economic developments stemming largely from the subprime mortgage meltdown and housing downturn will adversely affect California's budget. The

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slowdown in the State's economy will affect major revenue-producing sources, resulting in a further widening of the budget deficit.

Personal income tax revenues will be negatively affected by a slowdown in the realization of capital gains and the exercising of stock options. We project personal income tax revenues apportioned to the general fund to fall by 4.2% in 2007–2008 and 3.5% in 2008–2009. Sharp declines in the stock markets will depress potential capital gains and profits. Job losses tied to the real estate sector will result in lower overall personal income tax revenue in the state. As credit becomes less available and adjustable mortgages continue to reset into higher monthly payments, purchases of big-ticket items, such as automobiles, home furniture and appliances, and electronics, will drop, resulting in lower sales tax receipts.

If further action is not taken to reduce expenditures, the 2007–2008 General Fund will be \$9.7 billion in deficit. Similarly, if we continue on the current spending path, the deficit between General Fund revenues and expenditures in Fiscal Year 2008–2009 could reach \$20.2 billion.

### California exports to top destinations

US\$ billions

Rank	Country	2007 value	Share of CA exports
1	Mexico	\$18.3	13.7%
2	Canada	\$16.1	12.0%
3	Japan	\$13.5	10.0%
4	China	\$10.6	7.9%
5	Korea (ROK)	\$7.4	5.5%
6	Taiwan	\$5.8	4.3%
7	Germany	\$5.6	4.1%
8	United Kingdom	\$5.2	3.9%
9	Hong Kong	\$4.9	3.7%
10	Singapore	\$4.3	3.2%
California total		\$134.2	

Sources: U.S. Census Bureau, Moody's Economy.com.

To avoid further deterioration of the budget shortfall, the state government will need to reduce spending significantly or find alternative methods to finance some programs. Voters are unlikely to accept the draconian expenditure cuts that would be necessary to close the anticipated budget gap. Some revenue enhancements, such as closing tax exemptions or increasing taxes, may be necessary in order to achieve a budget compromise.

### California Economic Snapshot

<b>New Auto Registrations</b> Fiscal Year to Date	<b>1,299,314</b> thru March 2007	<b>1,169,235</b> thru March 2008
<b>Median Home Price</b> for single family home	<b>\$594,110</b> in April 2007	<b>\$403,870</b> in April 2008
<b>Total State Employment</b>	<b>15,138,900</b> in April 2007	<b>15,162,300</b> in April 2008

Data Sources: California Department of Motor Vehicles, California Association of REALTORS, California Employment Development Department