Controller *John Chiang*

California State Controller's Office

November 2007 Summary Analysis | Volume 1, Issue 9

Statement of General Fund Cash Receipts and Disbursements

Tax Revenue in October 2007

⇒ General Fund revenue in October was $303 million (-5.9%) below the Budget Act estimate. Retail sales accounted for the largest portion of the shortfall, coming in $159 million (-13.9%) below the Budget Act estimate. Income tax revenue was below the estimate by $148 million (-4.4%). Corporate tax revenue was above the estimate by $3 million (0.8%).

⇒ Total General Fund revenue for the month was up $347 million (7.8%) from October 2006. This year-over-year spike was primarily caused by a reported increase of $281 million in insurance company tax receipts this October, compared to October 2006. However, an accounting error resulted in insurance receipts in October 2006 being reported much lower than they actually were. Had the error not occurred, the actual year-over-year increase would have been $72 million (1.5%). Income tax receipts for October 2007 were $144 million (4.7%) higher than last October. Corporate taxes were $22 million (6.2%) above October 2006. Retail sales tax receipts were $94 million (-8.7%) below last October.

Tax Revenue Fiscal Year to Date

⇒ The Budget Act included actual receipts – not revenue estimates – for July and August. Consequently, fiscal year-to-date revenue

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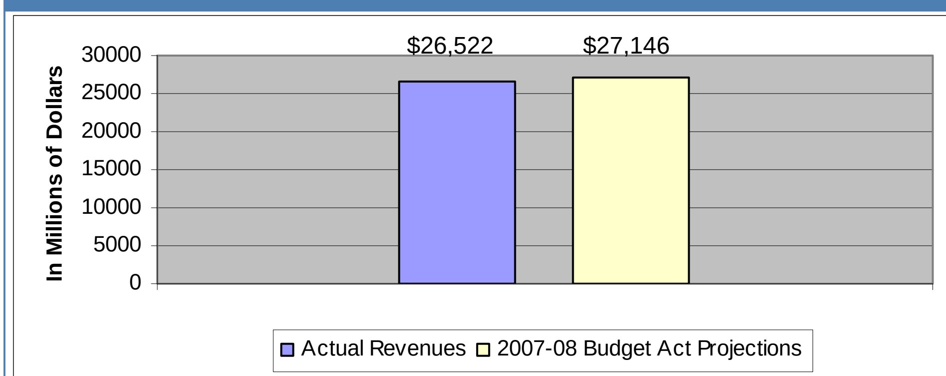
Table 1: General Fund Revenues: July 1–October 31, 2007 (in millions)



The State Controller's Office is responsible for collecting 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 November Summary Analysis covers actual receipts and disbursements for October 2007. 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. Our current point of comparison is the 2007-08 Budget Act passed in August 2007.

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comparisons to Budget Act estimates reflect only the September and October differences.

⇒ Total General Fund revenue was $625 million (-2.3%) below the Budget Act estimate for the year-to-date (see Table 2). Retail sales receipts were $340 million below (-4.3%) the Budget Act year-to-date estimate, while income taxes trailed the estimate by $125 million (0.8%). Corporate taxes were below the year-to-date estimate by $34 million (-1.1%). Insurance company taxes were below the Budget Act year-to-date estimate by $100 million (-14.8%).

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

Revenue Source	Actual Receipts To Date	Budget Act Projections	Actual Over (Under) Estimate
Bank And Corporation Tax	$3,141	$3,175	($34)
Personal Income Tax	$14,687	$14,811	($125)
Retail Sales and Use Tax	$7,490	$7,830	($340)
Other Revenues	$1,204	$1,330	($126)
Total General Fund Revenue	$26,522	$27,146	($625)
Non-Revenue	$1,032	$995	$37
Total General Fund Receipts	$27,553	$28,141	($588)

*Note: Some totals may not add, due to rounding

⇒ Compared to 2006, year-to-date General Fund receipts were $147 million higher (0.6%). Of the three major taxes, sales tax receipts continue to be the weakest, coming in at $198 million (-2.6%) below the year-to-date total seen in October 2006. Income taxes were $559 million (4%) higher than last year at this date, and corporate taxes were $23 million (0.7%) higher than last year.

Table 3: General Fund Disbursements, July 1-October 31, 2007 (in Millions)

Recipient	Actual Disbursement	Estimated Disbursement	Actual Over (Under) Estimate
Local Assistance	$31,708	$30,447	$1,260
State Operations	$10,392	$10,195	$197
Other	$1,455	$2,449	($993)
Total Disbursements	$43,555	$43,091	$464

⇒ The "miscellaneous" category of income tax was $364 million (-26.6%) below the Budget Act projection for the fiscal year-to-date, and $307 million (-23.4%) below last year at this date. Estimated taxes on personal income through October were $54 million (-1.5%) below the Budget Act estimate and $263 million (8.1%) above last year at this date. Payroll withholding taxes for individuals were $77 million (0.7%) above the Budget Act estimate and $781 (7.8%) above last year at this date.

⇒ Through October, estimated taxes from businesses and corporations were below Budget Act estimates by $160 million (-5.4%) and $11 million (-0.4%) lower than last year at this date.

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Estimated Taxes

Estimated tax payments are generally filed quarterly to pay taxes due on income that is 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. Estimated tax payments are one indication of future state revenues.

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Summary of Net Cash Position as of October 31, 2007

⇒ In October, the State spent $5.8 billion more than it received in revenue. Expenditures were $10.8 billion and receipts totaled $5 billion.

⇒ For the fiscal year-to-date, the State has spent $16 billion more than it has received in revenue. Total receipts were $27.6 billion, and expenditures were $43.6 billion.

Table 4: General Fund Cash Balance As of October 31, 2007 (in Millions)

	Actual Cash Balance	Budget Act Estimated Cash Balance	Actual Over (Under) Estimate
Beginning Cash Balance July 1, 2007	$2,462	$2,462	$0
Receipts Over (Under) Disbursements to Date	($16,002)	($14,950)	($1,052)
Cash Balance September 30, 2007	($13,540)	($12,448)	($1,052)

⇒ 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, $31.7 billion have gone to local assistance and $10.4 billion to State operations (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 October is $13.5 billion, which has been covered by internal borrowing. The State still has $2.5 billion in unused borrowable resources available and the proceeds of a $7 billion Revenue Anticipation Note (RAN) were deposited to the General Fund in the first week of November.

Borrowable Resources

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

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.

The Components of the Personal Income Tax

⇒ The Franchise Tax Board reports income taxes collected from individuals in four categories. These categories are useful in tracking various segments of the revenue stream and, in some cases, indicate future tax growth.

⇒ **Withholding taxes** are income taxes that employers withhold from salaried employees each month. Withholding taxes increase as the number of salaried workers increases and/or the wages of those employees rise. **Estimated taxes** are typically collected from non-wage income. Self-employed people pay estimated taxes and stock sales often trigger an estimated tax payment. **Final returns** comprise payments submitted with the individual's completed 540 tax form. The final category is **miscellaneous taxes**. In the spring of each year, this category is primarily made up of payments submitted by individuals

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who are requesting an extension of the April deadline for filing tax returns. But at other times of the year, non-owner occupied real estate sales make up a significant portion of this category. The miscellaneous taxes category was likely affected by the recent slow-down in housing sales by investors.

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for October 2007 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, the Controller asked Julie Cullen, Associate Professor of Economics at the University of California, San Diego, to provide an essay on public sector health programs.

Health Benefits for Retired Employees

By Julie Cullen
Associate Professor of Economics, University of California, San Diego.

The high and growing costs of health care are presenting a nationwide challenge. Public and private employers alike are feeling the pinch of rising insurance premiums. For states, concern has most recently been focused on the budgetary implications of medical benefits for state government retirees.

What explains this concern? First, state health plans have traditionally been viewed to be more generous, and hence more costly, than the plans available to private sector workers. Further, older workers dedicate a much higher proportion of health care expenses to prescription drugs, which is a category of health care that has experienced particularly high cost growth. And, older workers are living longer than they used to, so are retired for longer periods. Most importantly, though, the baby boom generation is moving into retirement and the numbers of retired workers is swelling relative to the taxpaying population as a whole. The annual costs of providing retiree health benefits under state plans will grow rapidly in coming years due to this demographic shift.

Up until this year, this looming fiscal liability was largely invisible, despite being quite predictable. Most states fund these expenses on a year-by-year or pay-as-you-go basis. Given current ratios of retirees to taxpayers, these expenses are not an extraordinary share of annual state budgets. Projecting forward, though, it is easy to see that these expenses will impose significant stresses on government budgets to maintain year-by-year balance between revenues and expenditures, or will crowd out spending on other activities. This impending fiscal imbalance had been outside of the typical state budget planning window, however recent changes in accounting rules require state governments to measure the implicit unfunded liabilities for future retiree medical benefits to which state workers are entitled, just as they do for pensions. As states are beginning to quantify these shortfalls, they are becoming publicly visible and are forcing and/or facilitating fiscal reform.

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How does California fare? The premiums for California's state health plans had been growing by more than 20 percent annually, but have slowed to a rate closer to the national average (about 10 percent annually).[1] This year, CalPERS was able to contain premium increases to less than 7%. Even with this slowing due to recent cost-saving measures, retiree health benefit expenditures have grown 17 percent per year. This is more than five times as fast as overall state spending over the past five years. As an actuarial report commissioned by Controller John Chiang revealed in May, under the current pay-as-you-go system, California's potential liability for funding retirees' health benefits is $47.88 billion. In order to pay off this debt and sustain future benefits (i.e., fully fund the program), annual revenues dedicated to retiree health benefits would have to be approximately double what they currently are.

What are other options?[2] One is to partially fund these benefits, bearing lower taxes (or borrowing less) today but higher taxes in the future relative to fully funding the program. States that have or are in the process of setting up trust funds to meet future obligations (e.g., South Carolina, Georgia, Vermont, Virginia) have taken this approach, which defers some of the pain to future generations. The alternative to raising revenue to shrink the debt is to alter the cost of the program. There are a variety of ways this can be done. For example, North Carolina has recently extended the years required to fully vest in retiree health benefits from five to twenty years. West Virginia has shifted prescription drug coverage to Medicare Part D, effectively moving those costs from the state to the federal budget, for retirees over the age of 65. Other states (e.g., Massachusetts, Minnesota, Washington, and Wisconsin) are attempting to lower health care costs by giving consumers incentives to use cost-effective providers and engaging in pooled negotiations to increase bargaining power.

In both the more distant and recent past, California has implemented several cost saving measures, including changing vesting rules, shifting retirees over age 65 to Medicare, and dropping high cost providers. Tinkering with the program has and will help, but even great success in lowering expected retiree health costs per state employee by these means is not likely to win out against the aging of the population. More dramatic alternatives that eliminate or greatly reduce post-employment health benefits would require a better functioning private health care insurance market for retirees under the age of 65 than currently exists. Absent that, some form of pre-funding is required to slow or eliminate the growing debt.

This budgetary problem that California now faces is shared by all other states and every level of government in the nation. As we have learned from the projections for Social Security and Medicare, pay-as-you-go old-age benefit plans are a losing proposition when the number of retirees is growing faster than the number of workers. And, the problems get worse the longer they remain unaddressed. It may be fortunate that the new accounting rules are forcing states, at least, to take notice of and respond to this growing fiscal burden.

Notes:

[1]The source for the figures in this paragraph is the Legislative Analyst's Office 2006 report "Retiree Health Care: A Growing Cost for Government."

[2]The source for information about states' state employee health programs is National Conference of State Legislatures "State Employee Health Benefits" (http://www.ncsl.org/programs/health/statemploy.htm).