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California State Controller's Office

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State Finances in January 2013

January 2013 compared to monthly estimates in the **2013-14 Governor's Budget**	January 2013 compared to monthly estimates in the **2012-13 Budget Act**	January 2013 monthly totals compared to **January 2012**
Total Revenues: $4.3 billion (39.1%)	**Total Revenues: $3.9 billion (36.9%)**	**Total Revenues: $6.3 billion (70%)**
Sales Tax: -$582.7 million (-27%)	**Sales Tax: -$316.8 million (-35.5%)**	**Sales Tax: $766.4 million (94.6%)**
Income Tax: $4.8 billion (54.7%)		**Income Tax: $5.6 billion (72%)**
Corporate Tax: $11.4 million (45.5%)		**Corporate Tax: -$97.7 million (-72.9%)**

January Adjustments

About $1 billion of sales tax was deposited into the Board of Equalization's agency bank account on Dec. 31, but not transferred to the General Fund until Jan 3. Numbers compared above to the 2012-13 Budget Act have been adjusted for that significant timing anomaly.

The Impact of the 1 Percent

Occupy Wall Street popularized the idea that the "99 percent" are different than the country's wealthiest persons. In California, data compiled by the Franchise Tax Board indicate some distinguishing characteristics of the top 1 percent that may validate this notion, and have consequences for Califor-

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What the Numbers Tell Us

January saw a strong inflow of revenues into state coffers as the economy continued to expand and the impact of the higher tax rates approved by voters last November took effect. Total revenues exceeded new projections contained in the Governor's 2013-14 Budget published last month by $4.3 billion, or 39.1%. They also surpassed the prior year's collections by $6.3 billion, although about $1.0 billion of that was due to a delay in depositing sales tax receipts into the General Fund. When compared against the 2012-13 Budget Act, January revenues exceeded expectations by $3.9 billion, or 36.9%, after accounting for December sales tax recorded in early January.

A robust performance of personal income tax receipts, which now account for two-thirds or more of total revenue, drove January's strong performance. They were about $4.8 billion above the revised estimate contained in the Governor's 2013-14 Budget and $5.6 billion above the prior year's figure. Gains in jobs, incomes, and stock prices have underpinned the rise. In addition, the fact that higher personal income tax

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What the Numbers Tell Us

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rates are retroactive to January 1, 2012 is causing an increase in withholding rates and estimated taxes.

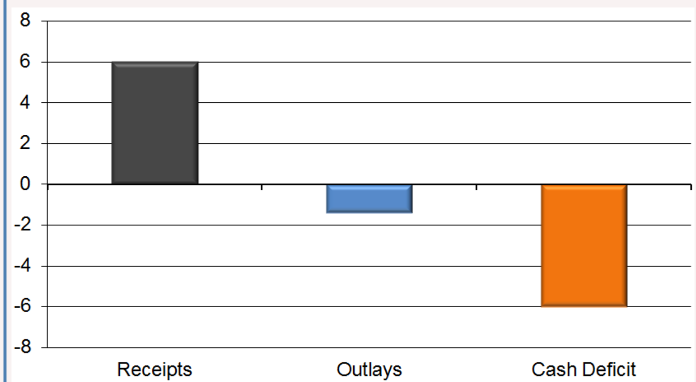
Corporate taxes remain the primary weak link although they typically account for 10% or less of total revenues. While January's total exceeded that contained in the current Governor's Budget, that estimate has been revised sharply downward from that published last spring as part of the 2012 Budget Act. January's corporate tax collection was only about a quarter of the prior year's figure.

Assessing developments for the total first seven months of Fiscal 2012-2013, total General Fund receipts were $4.4 billion above estimates in the Governor's current Budget and $6.0 billion above the prior year's seven-month tally. (See Table 1.) Personal income taxes have driven the favorable showing, with receipts continuing to surprise on the upside. In contrast, retail sales receipts are now running both below expectations and the prior year's performance, while corporate payments remain soft.

On the spending side, total disbursements out of the General Fund for the first seven months of Fiscal 2012-13 were reported as about $500 million below the Governor's new budget released in January. However, approximately $500 million in transfers to the Special Fund for Economic Uncertainties were not anticipated. Total actual spending for the first seven months was thus $1.0 billion below the estimate contained in the Governor's 2012-13 Budget and $1.4 billion less than the prior year's seven-month sum. (See Table 2.)

On balance, the state's overall fiscal position is beginning to look much brighter. (See Figure 1.) Although spending has continued to outstrip revenues during the last seven months, the cash deficit has been cut in half from $13.0 billion last year to less than $6.0 billion so far this year. More work clearly is needed, but we are beginning to make progress.

Figure 1: Deficit Shrinks on Higher Revenues and Less Spending
July – Jan., FY 2012-13 vs. prior year, billions of dollars*



*FY 2012-13 figures corrected for unexpected transfers

Table 1: General Fund Receipts

July 1, 2012 – Jan. 31, 2013 (in Millions)

Revenue Source	Actual Revenues	2013-14 Governor's Budget		2011-12 Year-To-Date	
		Estimate	Actual Over (Under)	Actual	Actual Over (Under)
Corporation Tax	$2,148.5	$2,137	$11.5	$3,261.4	($1,112.9)
Personal Income Tax	$38,868.5	$34,114.9	$4.753.7	$29,686.4	$9,182.2
Retail Sales and Use Tax	$9,969.6	$10,553.6	($584)	$10,601.6	($632.1)
Other Revenues	$2,489.4	$2,384.4	$105.1	$2,667.6	($178.2)
Total General Fund Revenue	**$53,476**	**$49,189.8**	**$4,286.2**	**$46,217**	**$7,259**
Non-Revenue	$1,842.3	$1,775.1	$67.3	$3,058.3	($1,216)
Total General Fund Receipts	$55,318.3	$50,964.8	4,353.5	$49,275.3	$6,043

The Impact of the 1 Percent

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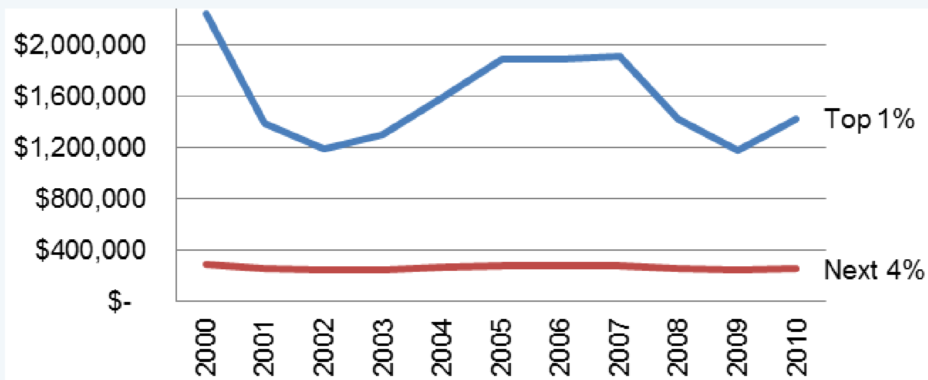
nia's tax receipts. Looking at the adjusted gross income (AGI) of the top 1 percent of Californians, the board's data show that the income reflected in their tax returns can vary by as much as 45 percent over three years.

In 2000, the top 1 percent reported an average AGI around $2.2 million, but this income fell to about $1.2 million two years later. If this experience is compared to the next "wealthiest" group of taxpayers—those taxpayers in the next 4 percent of AGI—it appears that lower-income taxpayers have considerable more stability in their AGI (varying between a low of $245,000 and high of $294,000). (See Figure 2.)

The individual taxpayers in the top 1 percent may not be the same in each of these years. The variation in income can be attributable to many factors that may cause an individual to have an extraordinarily good year of income in one year, but not the next.

The variability of the average income for the top 1 percent has consequences for the state's revenue. Compared to other taxpayers, the state's wealthiest typically have a greater capacity for tax planning and can adjust their year-to-year California liability. With California's progressive tax rates, tax receipts will tend to accentuate changes in the AGI of the 1 percent.

Figure 2: Average AGI by Income Group
Top 1 Percent and Next 4 Percent 2000 to 2010



Source: Franchise Tax Board

Table 2: General Fund Disbursements

July 1, 2012 – Jan. 31, 2013 (in Millions)

Recipient	Actual Disbursements	2013-14 Governor's Budget		2011-12 Year-To-Date	
		Estimates	Actual Over (Under)	Actual	Actual Over (Under)
Local Assistance	$46,967	$47,591.9	($624.9)	$48,083.2	($1,116.2)
State Operations	$13,291.5	$13,574.1	($282.6)	$14,261.4	($969.9)
Other	$699.4*	$754	($54.6)*	($19.3)	$718.7*
Total Disbursements	**$60,957.9***	**$61,920**	**($962.1)***	**$62,325.3**	**($1,367.4)***

* Adjusted for a $474.8 million transfer to Special Fund for Economic Uncertainties correction to be reflected in February 2013 activity.

Headwinds Ahead

Esmael Adibi
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Chapman University

Since 1990, California's payroll employment grew by 12.6% compared to the U.S. growth rate of 20%. California's job growth outpaced the nation's only over the 1996-2000 expansion and matched or underperformed the U.S. job growth in all the other years by an appreciable margin. The relatively faster California job growth of the late 1990s was mainly due to the high-tech boom in that period where California had a comparative advantage.

With California's massive job losses during the recession and slower growth than the U.S. over the recovery period, it should not be surprising that the unemployment rate in California is significantly higher than the U.S. Fueled by job growth in the leisure & hospitality, professional, business, and health care sectors, California's overall job growth accelerated in 2012. There are, however, clear signs that California's economy will be facing headwinds in the coming year that may derail the recent pickup in job creation. Slower export growth and higher taxes — sales, income and payroll — are the primary concerns.

California's merchandise exports showed a steady increase since the end of recession. Total exports increased from $28.7 billion in the second quarter of 2009 to $39.2 billion in the third quarter of 2012—an increase of 36.6 percent over three years. The slowdown in China,

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California's third largest trading partner, along with Germany, the Netherlands and France will cut into the export growth in the coming year.

On the bright side, the Anderson Center's California Consumer Sentiment Index increased to 92.7 in the fourth quarter of 2012, a level not seen since the third quarter of 2007. An uptick in job creation, a lower unemployment rate, a stronger stock market and stable-to-higher home prices all are serving to improve consumers' sentiment.

Another positive development is the rebound in construction spending. The total value of housing permits has been steadily increasing since the low of 2009. Hence, construction spending, which is derived from the changing average of total permit valuation over the last two years, is projected to grow by 7.6 percent in 2013.

The pronounced multiplier effects emanating from the pick up in construction spending will more than offset the weakness in export growth. But real GDP, the most important variable affecting job growth in California, is projected to increase by 2.1 percent, slightly lower than the anemic growth rate of 2.3 percent in 2012. Overall, our forecast calls for an increase of 1.6 percent in total payroll employment in California in 2013. This represents an average annual gain of 234,000 payroll jobs.

The combination of job and real income growth, along with historically-low mortgage rates, bodes well for the housing market. The sharp improvement in affordability and rapid increases in rents are tilting the home purchase versus the rent decision towards purchase. This, in part, explains why home-buying activity picked up steam in 2012. The increase in sales is welcome news and is helping to reduce inventories of unsold homes. Steady improvement is reflected by the number of months it would take to sell the existing inventory of unsold homes at the current sales rate.

Of course, the supply of new homes is increasing and that should put upward pressure on the inventory of unsold homes in 2013. But recent statistics regarding shadow inventory, foreclosures and notices of default all are encouraging. Notices of defaults that are a prelude to short sales and foreclosures activity declined sharply in the third quarter of 2012, compared to a year ago. Overall, our forecast calls for California home prices, measured by the median price of a single-family housing unit as reported by the California Association of Realtors, to increase by 6.7 percent in 2013, slightly lower than the estimated appreciation rate of 8.9 percent in 2012.

Improvements in home prices along with gains in the stock market are generating positive wealth effects that influence consumers' spending. In addition, continued job and income growth should benefit taxable sales spending. Overall taxable sales spending is projected to increase by 5 percent in 2013, lower than the projected 6.0 percent increase in 2012. Contributing factors to the slowdown in taxable sales relate to the fact that the pent-up demand built up during the recession was mostly satisfied in 2011 and 2012, and a quarter percent increase in sales tax will negatively affect taxable sales spending growth in 2013.

California Economic Snapshot

New Light Vehicle Registrations	**1,290,920** 2011	**1,617,103** 2012
Median Home Price (for Single-Family Homes)	**$246,000** In December 2011	**$299,000** In December 2012
Single-Family Home Sales (Houses and Condos)	**37,734** In December 2011	**39,760** In December 2012
Foreclosure Filings (Notices of Default)	**17,021** In December 2011	**10,254** In December 2012
Non-Farm Payroll Employment	**14,172,900** In December 2011	**14,398,800** In December 2012
Newly Permitted Residential (Single and Multifamily) Units	**45,471** 2011	**58,540** 2012

Data Sources: New Car Dealers Association, DataQuick, California Employment Development Department, Census Bureau, Foreclosure Radar