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California State Controller's Office

June 2010 Summary Analysis Volume 4, Issue 6

Statement of General Fund Cash Receipts and Disbursements

State Finances in May 2010

⇒ After a sour month of receipts in April, the State's General Fund revenues improved slightly in May 2010. Compared to the 2010-11 May Revision Estimates, total General Fund revenues were $592.2 million higher (9.8%) than expected. Sales tax revenues were $72.6 million better (2.1%) than anticipated, corporate tax revenues came in above the estimates by $84.3 million (37.6%), and personal income taxes beat the expectations by $392.5 million (19.7%). When compared to the Governor's January budget estimates, May revenues were up $518 million (8.3%).

⇒ Compared to May 2009, General Fund revenue in May 2010 was up $1.3 billion (25.0%). The total for the three largest taxes was above 2009 levels by $1.25 billion (25.1%). This was driven by sales taxes that were $395.2 million higher (12.5%) than last year. Corporate taxes were up $65.2 million (26.8%), and personal income taxes came in well above last May by $792.4 million (49.8%).

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Budget vs. Cash

The State's budget is a financial plan based on estimated revenues and expenditures for the State's fiscal year, which runs from July 1 through June 30.

Cash refers to what is actually in the State Treasury on a day-to-day and month-to-month basis.

Monitoring the amount of cash available to meet California's financial obligations is the core responsibility of the State Controller's office. On average, the Controller's office issues 182,000 payments every day.

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 2010 and year to date for the first eleven months of Fiscal Year 2009-10. Data are shown for total cash receipts and disbursements, the three largest categories of revenues, and the two largest categories of expenditures.

This report compares actual receipts against historical figures from 2008-09 and the statement of estimated cash flows from the 2010-11 May Revision Estimates.

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Tax Revenue Fiscal Year to Date

⇒ Compared with 2010-11 May Revision estimates, General Fund revenues in May were above the year-to-date estimate by $592.2 million (0.8%). Because the 2010-11 May Revision Estimates contained actual revenue through April, this revenue improvement occurred in May. When compared to the Governor's January budget estimates, revenue totals were down $782 million (1.0%) by the end of May.

⇒ The three largest sources of revenue were higher than the May estimates by $549.3 million (0.8%). Income taxes were $392.5 million above (1.0%) estimates. Corporate tax collections year to date were up $84.3 million (1.1%) and sales taxes also came in better than expected by $72.6 million (0.3%).

⇒ Compared to this date in May 2009, revenue receipts were up by $2.62 billion (3.6%). This was driven by sales taxes, which came in $2.93 billion above (13.8%) the same time last year.

⇒ Year-to-date collections for the three major taxes were $2.29 billion higher (3.4%) than last year at this time. However, personal income taxes were down $372.1 million (-0.9%) and corporate taxes were down $268.8 million (-3.5%) from last year's total at the end of May.

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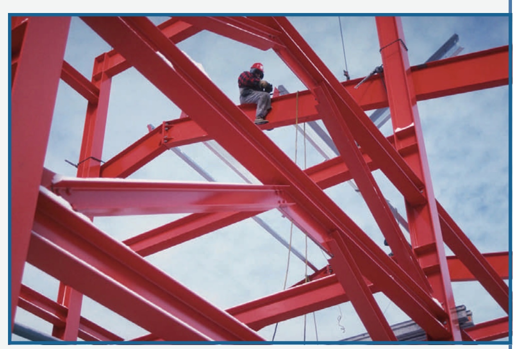
What The Numbers Tell Us

While sales tax revenues have been on the rise during the first half of calendar year 2010, weaker performances in personal income and corporate taxes were causing overall General Fund revenue to drag. However, both personal and corporate tax revenues increased in May on a year-over-year basis by more than $850 million combined. In addition, May's personal income and corporate tax revenues came in nearly $500 million higher than the new estimates from the 2010-11 May Revision, which came out last month.

Part of the reason California personal income taxes did not suffer the dismal performance of recent months is because estimated tax payments did not fall substantially in May as they had previously. In fact, estimated tax payments in May 2010 were up 12.5% from May 2009, according to the Franchise Tax Board. Withholdings on personal income continue to increase as well and rose 17.7% from last May.

These developments have helped the General Fund rise above its 2008-09 levels on a year-to-date basis. However, it is important to view these numbers with some caution, as California still has a long way to go before it can declare a full recovery. Both corporate and personal income taxes remain below their 2009 levels on a year-to-date basis, although the gap is closing.



The State has managed to make some progress on the labor side, adding 14,200 jobs in April on a seasonally adjusted basis. Although this is an encouraging sign, many of the new workers were in the Federal Government sector, which ramped up employment by 13,600 in April — mainly to conduct the 2010 Census. Many of these new jobs do not represent permanent positions, and will likely go away in the coming months.

Despite the fact that many risks remain for California, these are nonetheless positive signs. Some private-sector industries did manage to expand their job base in April, including leisure and hospitality, and administrative and waste services. The State is definitely on the road to recovery, albeit a long and arduous one as the economy regains its footing.

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Summary of Net Cash Position as of May 31, 2010

⇒ Through May, the State had total receipts of $77.2 billion (Table 1) and disbursements of $83.8 billion (Table 2).

⇒ The State ended the last fiscal year with a cash deficit of $11.9 billion, so the combined current year deficit stands at $18.6 billion (Table 3). Those deficits are being covered with $12.6 billion of internal borrowing and $6.0 billion in external borrowing.

⇒ Of the largest expenditures, $59.9 billion went to local assistance and $22.0 billion went to State operations (See Table 2).

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Borrowable Resources

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

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.

Revenue Anticipation Notes

Traditionally, the State bridges cash gaps by borrowing money in the private market through Revenue Anticipation Notes (RANs). RANs are repaid by the end of the fiscal year.

Non-Revenue Receipts

Non-revenue receipts are typically transfers to the General Fund from other State funds.

Table 1: General Fund Receipts, July 1, 2009 - May 31, 2010 (in Millions)*

Revenue Source	Actual Receipts to Date	2010-11 May Revision Estimate	Actual Over (Under) Estimate
Corporate Tax	$7,502	$7,418	$84
Personal Income Tax	$38,824	$38,431	$392
Retail Sales and Use Tax	$24,143	$24,071	$73
Other Revenues	$4,780	$4,737	$43
Total General Fund Revenue	$75,249	$74,657	$592
Non-Revenue	$1,907	$1,898	$9
Total General Fund Receipts	$77,156	$76,555	$601

***Note:** Some totals on charts may not add up, due to rounding.*

Table 2: General Fund Disbursements, July 1, 2009-May 31, 2010 (in Millions)

Recipient	Actual Disburse-ments	2010-11 May Revision Estimate	Actual Over (Under) Estimate
Local Assistance	$59,900	$60,883	($983)
State Operations	$22,041	$22,172	($131)
Other	$1,899	$1,940	($41)
Total Disbursements	$83,839	$84,994	($1,155)

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⇒ Local assistance payments were $984 million lower (-1.6%) than the 2010-11 May Revision Estimates, and State operations were down $131 million (-0.6 %).

Table 3: General Fund Cash Balance As of May 31, 2010 (in Millions)			
	Actual Cash Balance	2010-11 May Revision Estimate	Actual Over (Under) Estimate
Beginning Cash Balance July 1, 2009	($11,908)	($11,908)	$0
Receipts Over (Under) Disbursements to Date	($6,683)	($8,439)	($1,756)
Cash Balance May 31, 2010	($18,591)	($20,348)	($1,756)

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for May 2010 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:

http://www.sco.ca.gov/ard_monthly_cash_email.html

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California Economic Snapshot

New Auto Registrations (Fiscal Year to Date)	**808,074** Through March 2009	**787,554** Through March 2010
Median Home Price (for Single Family Homes)	**$221,000** In April 2009	**$255,000** In April 2010
Single Family Home Sales	**37,967** In April 2009	**37,481** In April 2010
Foreclosures Initiated (Notices of Default)	**135,431** In 1st Quarter 2009	**81,054** In 1st Quarter 2010
Total State Employment (Seasonally Adjusted)	**14,221,300** In April 2009	**13,866,000** In April 2010
Newly Permitted Residential Units (Seasonally Adjusted Annual Rate)	**39,883** In April 2009	**37,345** In April 2010
Data Sources: DataQuick, California Employment Development Department, Construction Industry Research Board, State Department of Finance		

Featured Articles on California's Economy

The opinions in these 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 By Ross DeVol, Executive Director, Economic Research Centers for Regional, California and Health Economics at the Milken Institute, and member of the Controller's Council of Economic Advisors.
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Tax Policy in the Global Economy

By Ross DeVol
Executive Director, Economic Research Centers for Regional, California and Health Economics at the Milken Institute

The U.S. and California economies appear to be emerging from recession, but the severity of this downturn has left substantial underutilized resources in labor and product markets. To close the gap between actual and potential Gross Domestic Product (that is, the full-employment level of output) as quickly as possible, economic growth must accelerate beyond current expectations. Unless sustainable growth is achieved, the unemployment rate will elevate in the immediate future and a portion of our manufacturing capacity will continue to sit idle. Economic and tax policy changes could effectively stimulate the economy in the near term while positioning the nation and state for sustained higher economic growth over the medium and long term.

Improving Economic and Tax Policy

Globalization has forever changed the international competitive landscape. Cross-border transactions, from trade to foreign direct investment, are now the norm. Given these developments, the United States must re-evaluate its policies relative to other nations on a regular basis. California has a greater economic stake in these policies than any other state. California's trade with the outside world supports thousands of manufacturing, transportation, and wholesale jobs. California is America's gateway to the vast Asian markets. As U.S. trade with Asia expanded over the past two decades, California's ports disproportionately benefited greatly because of their geographic proximity to Asia. The bulk of California's exports are information technology and other high tech goods and services.

Specifically, we analyzed the potential effect of changing U.S. corporate tax rates, expanding the Research and Development (R&D) tax credit, and modernizing controls on exports of commercially available products to a representative group of countries. While the response to altering these policies would not be immediate, economic growth would improve during the second year of their enactment.

Key Findings
Economic and Tax Policy

- Reducing the U.S. corporate income tax rate to match the Organization for Economic Co-operation and Development (OECD) average would trigger new growth. By 2019, it could boost real GDP by $375.5 billion (2.2 percent), create an additional 350,000 manufacturing jobs, and increase total employment by 2.13 million.

- Increasing the R&D tax credit by 25 percent and making it permanent could boost real GDP by $206.3 billion (1.2 percent), generate 270,000 manufacturing jobs, and raise total employment by

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510,000 within a decade.

- Modernizing U.S. export controls could increase exports in high-value areas. By 2019, these policy adjustments could enhance real GDP by $64.2 billion (0.4 percent), create 160,000 manufacturing jobs, and heighten total employment by 340,000.

Corporate Income Tax Policy Simulation

International differences in corporate income tax rates are a factor when firms determine where to locate their corporate headquarters, R&D activities, production facilities, and distribution networks — and today, the U.S. corporate income tax rate is the second-highest among nations belonging to the OECD. With that in mind, we ran a simulation in which the U.S. federal corporate income tax rate was cut by 13 percentage points to 22 percent, with the reduction being phased in over a five-year period. This new rate would match the current OECD average.

Our results show that a lower corporate tax rate makes the United States a more attractive location for business investment by filtering through a reduction in the user cost of capital. After a rate cut is implemented, existing productive capacity in the U.S. is initially more heavily utilized to fulfill domestic final demand and boost exports. In today's economic climate, there are few capacity constraints that would restrict production from rising to meet increased demand. The impacts on annual economic growth in 2010 are not as large as in subsequent years, as it would take time for businesses to adjust their investment and production plans.

R&D Tax Credit Simulation

Although the United States pioneered the R&D investment tax credit in 1981, most other advanced economies have implemented their own more aggressive versions of this policy. Based on OECD calculations, the United States ranks 17th among member nations on the effective rate of the R&D tax credit. Furthermore, the U.S. has kept the R&D tax credit "temporary" for 29 years (in fact, it was recently allowed to expire again on December 31, 2009) and has imposed restrictions on qualifying. Many other OECD countries appear to have created a more attractive landscape for innovation and sustainable growth.

We evaluated the economic impact of increasing the R&D tax credit by 25 percent and making it permanent. In this scenario, businesses increase their research and development spending, therefore creating new products and services; enhancing productivity growth; expanding investment in technology-intensive capital equipment; spurring greater exports, production, employment, and incomes; and boosting overall real GDP growth.

Modernization of Export Controls Simulation

Here we assess the possible economic impacts of modernizing export controls on commercially available technology products for a representative group of countries. Proponents of modernization argue that "many current controls (outside of narrowly defined military niches) aimed at protecting national security harm U.S. innovation and competitiveness in global markets, thereby reducing economic prosperity, which is an essential element of U.S. national security."

It is not in our best economic interest to preclude the export of technology products that are legally available from other advanced and NATO member nations. The logic is that if the United States will not supply the desired technology, another country will. For example, some multilateral agreements on export controls afford member countries the latitude to exercise their own discretion; this sometimes undermines the intent of such trade agreements. Because purchasing nations are able to obtain this technology elsewhere, U.S. policy is not ultimately effective — It simply prevents American firms from accessing new markets.

We assume that a responsible modernization of export controls for certain goods and certain countries would narrow the gap between U.S. market share in these nations and its share in the total world market by 50 percent.

California would benefit more than any other state from these economic and tax policy changes given the role of innovation, technology and exports in the state's economy.