Controller *John Chiang*
California State Controller's Office

January 2008 Summary Analysis | Volume 2, Issue 1

Statement of General Fund Cash Receipts and Disbursements

Tax Revenue in December 2007

⇒ December revenue exhibited the same sluggish performance that we have seen for much of the budget year.

⇒ General Fund revenue in December was $545 million (-5.8%) below the Budget Act estimate. Corporate taxes were the weakest of the three major taxes, coming in $666 million (-32.2%) below the Budget Act's figures. Retail sales revenues were below estimates by $120 million (-5.5%). Income tax revenue was the bright spot in the report, coming in $315 million (6.9%) above the Budget Act estimate for the month.

⇒ Together, the three largest taxes (personal income, corporate and sales taxes) were $471 million (-5.4%) below the Budget Act estimate for December.

⇒ Total General Fund revenue for the month was $814 million (-8.4%) below the revenue seen in December 2006. All revenue sources except personal income taxes were below December 2006 levels. Corporate tax receipts were $649 million (-31.6%) less than last December. Sales taxes were $40 million (-1.9%) below last December. Income taxes were above last December by $329 million (7.3%). The total for the three largest taxes fell short of the December

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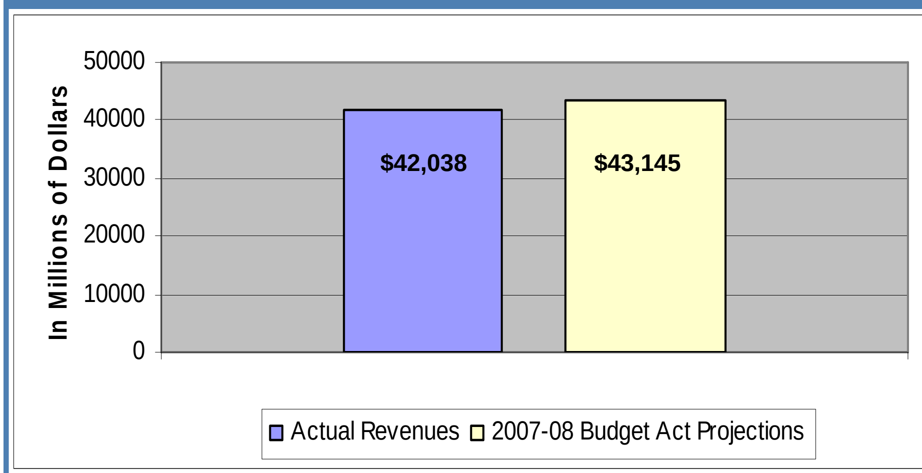
Table 1: General Fund Revenues: July 1–December 31, 2007 (in Millions)



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 December 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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2006 totals by $359 million (-4.1%).

⇒ The category "Not Otherwise Classified" reported $331 million less than in December 2006. Although 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.

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

Revenue Source	Actual Receipts To Date	Budget Act Projections	Actual Over (Under) Estimate
Bank And Corporation Tax	$4,583	$5,170	($588)
Personal Income Tax	$22,127	$21,961	$166
Retail Sales and Use Tax	$13,191	$13,806	($615)
Other Revenues	$2,137	$2,208	($71)
Total General Fund Revenue	$42,038	$43,145	($1,107)
Non-Revenue	$1,624	$1,170	$454
Total General Fund Receipts	$43,663	$44,315	($652)

Note: Some totals may not add, due to rounding

⇒ Sales tax figures do not reflect consumers' purchase of gift cards during the 2007 holiday season. Sales tax is paid when the card is used to purchase merchandise, not when the card itself is sold.

Non-Revenue

The "non-revenue" category of receipts includes transfers from existing funds and miscellaneous receipts.

Tax Revenue Fiscal Year to Date

⇒ From July 1, 2007, through December 31, 2007, General Fund revenue was $1.1 billion (-2.6%) below the Budget Act estimate (see Table 2). Retail sales receipts were $615 million (-4.5%) below the Budget Act year-to-date estimate, while corporate taxes were $588 million (-11.4%) lower than expected by this time. Personal income taxes were above the year-to-date estimate by $166 million (0.8%). In total, the three largest taxes were $1.037 billion (-2.5%) below the level expected in the Budget Act by December 31.

⇒ Compared to 2006, year-to-date General Fund revenue was $63 million (-0.1%) lower. Of the three major taxes, corporate receipts were the weakest: $444 million (-8.8%) below the year-to-date total seen in December 2006. Sales taxes were $110 million (-0.8) below last year at this date, while income taxes were up by $1.1 billion (5.1%). In total, the three largest tax revenue sources were $523 million (1.3%) higher than at the end of December last year.

⇒ Corporate taxes were decidedly weaker than last year at this time. Estimated payments were 16.1% below estimates, and 12% below the levels seen during the same period in 2006.

⇒ The majority of December's income tax receipts can be broken down into three components: estimated payments, withholdings, and "miscellaneous" payments. The following gives a detailed analysis of each component:

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Table 3: Year over Year Growth by December 31

Tax, Component	YTD 2007	YTD 2006
Personal Income Tax		
Withholding	8.1%	5.6%
Estimated Tax	9.4%	12.4%
Miscellaneous	-21.8%	-0.9%
Corporate Tax		
Estimated	-12.0%	8.8%
Miscellaneous	9.0%	31.5%

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.

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- Personal income estimated tax payments were 4.6% below the Budget Act estimate, but 9.4% above December 2006. Many taxpayers send their final estimated payment in late December in order to maximize federal tax deductions for the year. These estimated payments are typically received in late December and early January, making them important months for estimated income tax revenues. These payments are one indication of future state revenues, because they reflect what taxpayers think they will owe on their final annual returns.
- Considering the weak employment growth seen recently, the year-to-date receipts for withholding held up surprisingly well (8.1% over last year). The number of jobs in California increased by only 0.6% between November 2006 and November 2007. This indicates that withholding growth is being caused by bonuses, stock option income, or other wages.
- The "miscellaneous" category has declined 21.8% when compared to this time last year — a likely result of the slow-down in housing sales by investors. At this time of the year, non-owner occupied real estate sales make up a significant portion of the "miscellaneous" category. December 2006 "miscellaneous" receipts were low, but declined only 0.9% from 2005.

Summary of Net Cash Position as of December 31, 2007

⇒ In December, State expenditures were $1 billion less than receipts. Expenditures were $8 billion and receipts totaled $9 billion.

⇒ For the fiscal year-to-date, the State spent $15.8 billion more than it received in revenue. Total receipts were $43.7 billion, while total expenditures were $59.4 billion (see Table 4).

Table 4: General Fund Cash Balance As of December 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	($15,760)	($15,226)	($534)
Cash Balance December 31, 2007	($13,298)	($12,764)	($534)

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⇒ The State began the fiscal year with a cash balance of $2.5 billion. The net cash deficit at the end of December was $13.3 billion. The State issued a $7 billion Revenue Anticipation Note (RAN) in October to cover a portion of this short-term deficit. The remaining $6.3 billion shortfall is being covered by internal borrowing. As of December 31, the State still had $9.1 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, $43.2 billion went to local assistance and $14.7 billion to State operations (see Table 5).

Table 5: General Fund Disbursements, July 1-December 31, 2007 (in Millions)

Recipient	Actual Disbursement	Estimated Disbursement	Actual Over (Under) Estimate
Local Assistance	$43,190	$42,647	$543
State Operations	$14,683	$14,434	$250
Other	$1,550	$2,460	($910)
Total Disbursements	$59,423	$59,541	($118)

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.

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 December 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's report includes an article from Council Member Esmael Adibi.

Recession or No Recession?

By Esmael Adibi
Director of the Anderson Center for Economic Research at Chapman University

A sharp drop in home sales, decreasing mortgage originations, and subsequent declines in new residential construction are leading to a sharp downturn in jobs in real estate-related sectors. In addition, the slowdown in the construction and financial services sectors is indirectly affecting job growth in the retail and wholesale sectors causing broad-based weakness in overall job growth.

California's payroll job growth declined from 1.7 percent in the first quarter to 0.6 percent in the fourth quarter of 2007. Although employment statistics are subject to large revisions and the benchmark adjustments due in early 2008 will, in all likelihood, revise the job numbers, the declining trend in job growth will remain intact.

In addition to the weakness in payroll job growth, many self-employed such as mortgage brokers, real estate agents, and small construction contractors have experienced sharp declines in their business activity and sharp job losses. As a result, California's unemployment rate increased from a low of 4.8 percent in the fourth quarter of 2006 to 5.6 percent in the fourth quarter of 2007. And projected layoffs in the construction and mortgage industry will continue to place upward pressure on unemployment rates.

With so many sectors of the economy experiencing weakness, will there be enough strength in the other sectors such as professional & business, leisure & hospitality, and education & health services to avoid recession? Our index of employment indicator is a useful tool to analyze the overall job outlook.

This series is a weighted composite index of all the major economic forces that explain job creation in the state. These forces include lagged percentage changes in real GDP, construction spending, U.S. export activity, the stock market, and our California purchasing managers index. Of these variables, changes in real GDP and construction spending have the highest weights in our indicator series. Projected downward trends in these two variables offset the improvement in real exports, the California's purchasing managers index and the performance of the stock market.

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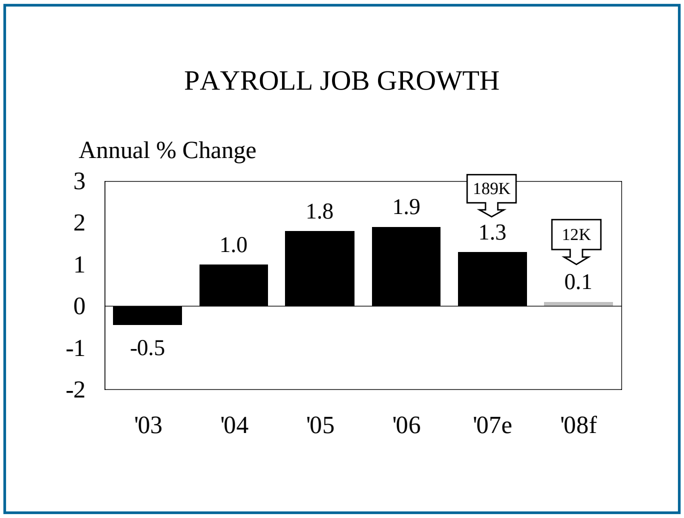
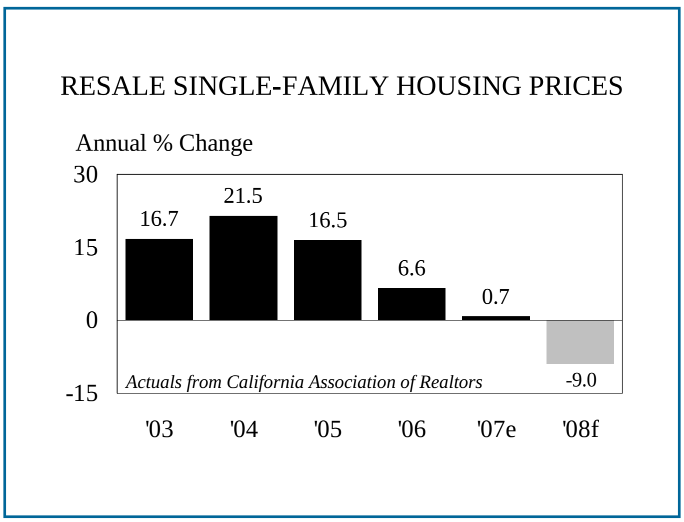
Our forecast points to job growth on a quarterly basis to turn negative beginning the second quarter of 2008 and remain negative through the third quarter of the year. This trend indicates that the state will experience recession, based on our definition. On an annual basis, California is forecasted to generate about 12,000 jobs in 2008, an increase of only 0.1 percent.



With such weak payroll job growth and higher unemployment, total personal income will increase at a slow rate of only 3.1 percent in 2008. Income growth, along with darker consumer sentiment is obviously bad news for consumer spending and the housing market.

Total taxable sales is projected to increase at an annual average rate of 2.7 percent in 2008, slightly lower than the projected inflation rate of 2.9 percent.

As for housing, sluggish demand will extend into 2008. Clearly, affordability problems, which were ignored by borrowers and lenders using creative financing, are now hurting both groups. The recent decline in short-term interest rates engineered by the Federal Reserve Board will not remedy borrowers' problems who are facing interest rate resets on their mortgages. First, those borrowers who want to refinance need to obtain an appraisal for their property matching or exceeding their current mortgage. This will not be possible for those borrowers who used 100 percent loan-to-value mortgages and are faced with declining home prices. Second, tighter lending standards require borrowers to document income and many potential borrowers will lack sufficient income to justify size of their mortgages.



The outcome is pretty obvious. Notices of defaults and foreclosures will continue to be around for a while. Although builders are very careful in managing the inventory of unsold new homes, a much larger supply of unsold resale housing units will continue to increase. With weak demand, the total inventory of unsold housing units will remain at high levels. The combination of these factors will place further downward pressure on home prices well through 2008.

Our forecast calls for a decline of 9.0 percent in the median resale single-family home prices, as measured by the California Association of Realtors, in 2008.

With sharp declines in job, income and spending growth, the state and local governments are facing large budget deficits. At the state level, our projections point to a structural deficit of about $10.0 billion in the fiscal year 08-09. And, it is very unlikely that additional borrowing options will be available to cover this shortfall.

These outcomes should not be surprising. After several years of excessive risk taking and spending bonanza, the economy will be going through this painful adjustment process and unfortunately, any short-term fixes will only postpone but not cure the inevitable.