

Controller *John Chiang*

California State Controller's Office



July 2008 Summary Analysis

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Statement of General Fund Cash Receipts and Disbursements

Tax Revenue in June 2008

- ⇒ General Fund revenue in June 2008 was \$744 million above (7.3%) the Governor's May Revision estimate for the month. Likely due in part to the economic stimulus checks from the federal government that began to arrive in May, retail sales taxes came in \$258 million above (10.2%) the Governor's May Revision. Personal income taxes were \$43 million above estimate (0.8%) and corporate taxes were above estimate by \$196 million (12.1%). Together the three largest taxes (income, sales, and corporate) were \$498 million above (5.2%) the May Revision. Insurance company taxes also were higher, coming in at \$116 million above (37.5%) the May estimate.
- ⇒ Revenue in June was \$835 million below (-7.1%) the 2007-08 Budget Act estimate. The largest discrepancy

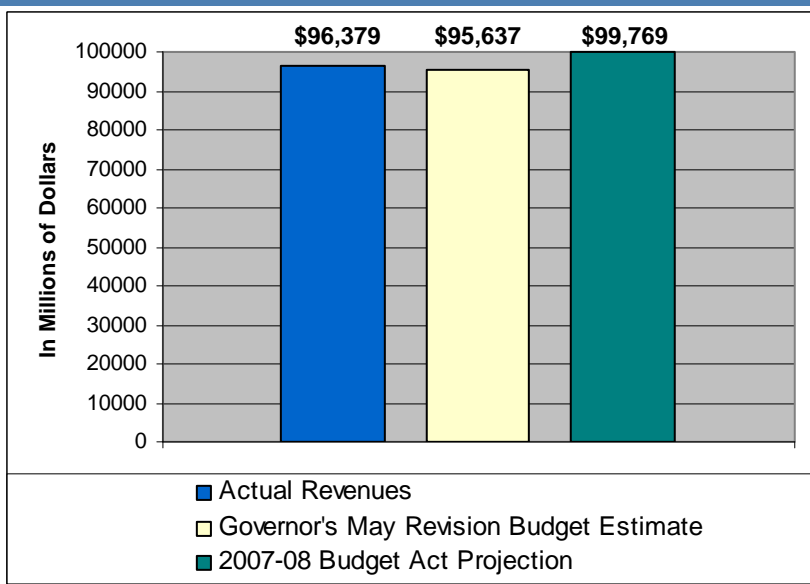
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The State Controller's Office is responsible for accounting for all State revenues and receipts and for making disbursements from the State's General Fund. The Controller also is required to issue a report on the State's actual cash balance by the 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 June 2008 and for the Fiscal Year 2007-08 that ended on June 30. 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.

Table 1: General Fund Revenues: July 1, 2007–June 30, 2008 (in Millions)



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was in the “Not Otherwise Classified” category. Actual revenue in that category was \$793 million lower (-70.2%) than the Budget Act envisioned. The Budget Act had anticipated the \$500 million sale of California’s EdFund as well as more optimistic estimates of tribal gaming revenues. Income taxes were \$74 million lower (-1.3%) than the Budget Act’s figures, while corporate taxes were \$80 million higher (4.6%). Retail sales revenue was above estimates by \$25 million (0.9%). In total, the three major taxes were \$32 million above (0.3%) the Budget Act estimate for June.

⇒ Compared to June 2007, General Fund revenue in June 2008 was higher by \$268 million (2.5%). The largest contribution was from “Not Otherwise

Classified” revenue and was due to the transfer of unclaimed property that was delayed this year to extend ownership searches. Retail sales provided the next largest contribution, coming in \$111 million above (4.2%) June 2007. Corporate taxes were higher than last June by \$70 million (4%). Personal income taxes were below June 2007 by \$61 million (-1.1%). In total, the three largest taxes were higher than June 2007 by \$121 million (1.2%). Estimated income tax payments in June came in just below last year’s receipts by 0.3% — indicating that individual taxpayers could face lower income prospects this year. However, corporate estimated taxes in June were 6.4% above June 2007.

Table 2: General Fund Receipts, July 1, 2007-June 30, 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	\$10,124	\$10,018	\$106	\$10,882	(\$758)
Personal Income Tax	\$54,849	\$54,523	\$326	\$55,226	(\$377)
Retail Sales and Use Tax	\$26,837	\$26,702	\$134	\$28,222	(\$1,385)
Other Revenues	\$4,569	\$4,394	\$175	\$5,439	(\$871)
Total General Fund Revenue	\$96,379	\$95,637	\$741	\$99,769	(\$3,391)
Non-Revenue	\$7,037	\$6,543	\$494	\$1,534	\$5,503
Total General Fund Receipts	\$103,416	\$102,180	\$1,236	\$101,304	\$2,112

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

Tax Revenue Fiscal Year to Date

⇒ For the fiscal year ending June 30, 2008, General Fund revenue was \$741 million above (0.8%) the Governor’s May Revision estimate. Personal income taxes were \$326 million above (0.6%) the estimate. Sales taxes were \$134 million above (0.5%) the estimate, while corporate taxes were \$106 million above (1.1%) the estimate. Together, the three largest taxes were \$567 million higher (0.6%) than anticipated in the Governor’s May Revision for the fiscal year.

⇒ General Fund revenue for Fiscal Year 2007-08 was \$3.4 billion below (-3.4%) the Budget Act estimate. Retail sales were the largest disappointment, yielding \$1.4 billion less in revenue (-4.9%) than anticipated in the Budget Act. Corporate taxes were \$758 million lower (-7%) than expected. Personal income taxes were below the fiscal year estimate by \$377 million (-0.7%). In total, the three largest

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taxes were \$2.5 billion below (-2.7%) the level expected in the Budget Act.

- ⇒ In comparison to Fiscal Year 2006-07, General Fund revenue was \$714 million higher (0.7%). For the big three taxes, the year-over-year growth was \$1.2 billion, a growth rate of 1.3%. This is the weakest growth rate since the recession of 2001.
- ⇒ Corporate taxes had the largest decline, down 6% from last fiscal year (-\$643 million). Sales taxes had the largest absolute drop, coming in \$679 million less (-2.5%) than in Fiscal Year 2006-07. Income tax receipts were \$2.5 billion higher (4.8%) than the prior fiscal year.
- ⇒ Payroll withholding provided most of the increase in income tax revenue, yielding \$1.5 billion more (4.6%) than last fiscal year. In the second quarter of 2008, payroll withholding growth slowed to 2.7% compared to the second quarter of 2007, reflecting the slowdown in job growth in the state. In the second quarter of 2008, the state lost more than 22,000 jobs.
- ⇒ Estimated taxes paid by individuals also slowed near the end of the fiscal year. In June these revenues were down 0.3% compared to June 2007. For the quarter ending in June 2008, estimated payments were 0.5% above the same period in 2007. This

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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 2008 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 June 30, 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	(\$3,914)	(\$7,261)	\$3,348	(\$6,675)	\$2,761
Cash Balance June 30, 2008	(\$1,452)	(\$4,799)	\$3,348	(\$4,213)	\$2,761

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compares to a year-over-year growth rate of 6.5% for Fiscal Year 2007-08.

⇒ Corporate estimated taxes were stronger. In June 2008, corporate estimated taxes were 6.4% higher than in June 2007. For the quarter ending in June, estimated taxes were up just 0.6%. However, that is an improvement over the entire Fiscal Year 2007-08, when corporate estimated taxes were down by 6.3% compared to the prior fiscal year.

Table 4: General Fund Disbursements, July 1, 2007-June 30, 2008 (in Millions)

Recipient	Actual Disbursement	Governor's Budget Estimate	Actual Over (Under) Estimate	Budget Act Projection	Actual Over (Under) Projection
Local Assistance	\$76,698	\$78,086	(\$1,388)	\$75,851	\$847
State Operations	\$26,834	\$27,191	(\$357)	\$26,993	(\$159)
Other	\$3,798	\$4,165	(\$367)	\$5,135	(\$1,337)
Total Disbursements	\$107,330	\$109,442	(\$2,112)	\$107,979	(\$649)

Summary of Net Cash Position as of June 30, 2008

- ⇒ In June, the State had total receipts of \$10.9 billion and incurred expenditures of \$4.7 billion. Total receipts for Fiscal Year 2007-08 were \$103.4 billion (see Table 2), while total expenditures were \$107.3 billion (see Table 4). Of the largest expenditures, \$76.7 billion went to local assistance and \$26.8 billion went to State operations (See Table 4).
- ⇒ The two main sources of the \$7.04 billion in non-revenue receipts in Table 2 were from \$3.3 billion in Economic Recovery Bond (ERB) 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.
- ⇒ On paper, the Fiscal Year 2007-08 spending deficit was \$3.9 billion. However, without counting \$3.3 billion from the Economic Recovery Bond sale, the spending deficit rose to \$7.2 billion for the year.
- ⇒ Total year-end receipts were \$1.2 billion higher than anticipated in the May Revision. Disbursements, primarily in the area of June payments for K-12, were \$2.1 billion lower than expected. This amount remains an outstanding expenditure attributed to the 2007-08 fiscal year, and to be distributed in the 2008-09 fiscal year.

Borrowable Resources

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

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- ⇒ The State began the fiscal year with a cash balance of \$2.5 billion, but ended with a net cash deficit of \$1.45 billion. The \$7 billion Revenue Anticipation Note (RAN) issued last Fall has been repaid, and the \$1.45 billion shortfall is covered by internal borrowing. Internal loans will be repaid according to cash management procedures as resources are available. The State has \$12.8 billion remaining in borrowable resources.
- ⇒ The Special Fund for Economic Uncertainties is a fund established in the Budget Act as a reserve for economic uncertainties and emergency situations, such as the fires that are currently raging across California. That fund ended the fiscal year with a balance of \$925 million.

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for June 2008 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 by Nancy Bolton, Chair 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.

Peak Oil or Just Peak Price?

By Nancy Bolton
Chair, Controller's Council of Economic Advisors

Oil prices have doubled in the past year causing anxiety among consumers, slim profits for businesses and consternation in Congress. Is this another speculative bubble -- the result of geopolitical tensions and a declining dollar -- or have we reached the limits of oil production? Shell Oil geologist M. King Hubbert theorized in 1956 that oil production in the lower 48 states would peak between 1965 and 1970. His so-called "peak theory" was close: the actual peak occurred in 1971. Hubbert also expected world-wide oil production would peak in the year 2000, while it actually hit a plateau in 2005. Does this represent a limit to oil production or just a limit to the willingness of oil producers to supply the market?



Because U.S. producers regularly report reserves and production capacity, it was possible to verify that the cause of U.S. oil production's peak was a physical limit on the amount of oil that could be pumped from American oil fields. However, the

reason for world-wide production's plateau is less clear. Many producing countries keep a cloak around their oil statistics. Saudi Aramco, the national oil company of Saudi Arabia, is the world's largest exporter and also has the world's largest known reserves. However, that country does not report on reserves and production capacity in a verifiable manner.

There is a large divide between those who think that we have probably located all the large oil fields and those who think there is still much oil to be discovered. This was summarized in a June 27 *Wall Street Journal* article

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which profiled the outlook for oil production as seen by former high level Saudi Aramco officials Sadad al Hussein and Nansen Saleri: “Mr. Hussein, Aramco’s second-in-command until 2004, says the world faces a brute reality of depleting resources and ever rising prices. Mr. Saleri, until recently the company’s oil-reservoir manager, insists that with enough ingenuity and investment, plenty more oil can be found.”

What is likely indisputable is that we have discovered all the cheap oil. Even if new fields are discovered, the cost of bringing that oil to market will be expensive and, hence, oil prices will stay high. In the last two years, Brazil has announced the discovery of two large offshore oil fields. The Tupi field lies under 7,060 feet of water and almost 16,600 feet of sand and rock. The second field, less documented though potentially larger, is again several miles below the ocean surface. Even in Saudi Arabia where oil was once available by merely punching a hole in the ground, the cost of pumping new oil is escalating. Aramco is reportedly spending \$15 billion on a network of deep horizontal wells, water injection systems and a vast array of pipes and treatment facilities that were required to bring its new Khurais field online. The escalating cost of oil extraction is reducing the Energy Return on Energy Investment (EROEI), a ratio measuring the usable energy acquired from a particular resource against the amount of energy expended to obtain it. In the early days of oil production, larger fields yielded 50 to 100 barrels of oil for every barrel consumed in discovery, extraction, transport and refining. The EROEI has steadily declined and today it ranges from about 3 to 10 barrels recovered for every barrel used in the process. Every oil field still has oil left when it ceases production, but when the EROEI ratio approaches 1, it is no longer economically feasible to extract the oil.

Many countries aside from the U.S. have apparently reached and passed their peak production. These include Indonesia, the United Kingdom, Malaysia, Syria, Australia, Venezuela



and Mexico. While demand is currently declining in the U.S. as prices soar, the same is not true of much of Asia and the Middle East. Rapid economic development and population growth in those areas of the world are driving demand higher. In less-developed countries, especially those that also are oil producers, governments subsidize oil for domestic consumers. Thus, demand is not tempered by the price shocks seen in more developed regions of the world.

If we have reached a global “peak oil” point, importing countries such as the U.S. and Europe will feel the pain first. Exporters facing the downward slope of production will almost certainly stop exporting as their supplies begin to fall below domestic needs. This could affect the economic relationship between the U.S. and Mexico. Mexican production in its giant Cantarell oil field fell by a third in the past year and net exports fell by 15%. Unless Mexico develops new fields or better extraction methods, Mexico will probably stop exporting oil within the next 7 years. Mexico subsidizes domestic consumption and as the differential between oil costs in the U.S. and Mexico grows, it is possible that we will see energy-intensive production shift from the U.S. to Mexico. This could include manufacturing, petrochemical industries and perhaps agriculture.

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If the current economic slowdown in the U.S. spreads to the rest of the world, world wide oil demand will likely decline, and we will see the price of oil stabilize or even decline. The high price of oil will undoubtedly spur research in both alternative fuels and oil exploration and extraction techniques. A pause in demand will give the world time to investigate the issue of “peak oil.”



We have seen the effect of oil price increases on transportation and food costs. The efficiency of our agricultural sector in California is driven by energy, because oil and natural gas power more than tractors. These fossil fuels also provide the fertilizers and insecticides that increase production and the plastics that we use to store and transport food. Pharmaceutical, textile and cosmetics industries are directly reliant on fossil

fuels as inputs. The time and resources required to replace oil in our economy is substantial and understanding when and if we must make the transition is critical to both our state and our nation. The question of “peak oil” is too important to ignore.

California Economic Snapshot

New Auto Registrations Fiscal Year to Date	1,588,320 through May 2007	1,419,317 through May 2008
Median Home Price for Single Family Homes	\$594,530 in May 2007	\$384,840 in May 2008
Single Family Home Sales (Annualized Rate)	358,640 In May 2007	423,700 in May 2008
CA Foreclosures Initiated Notices of Default	46,760 In First Quarter 2007	113,676 In First Quarter 2008
Total State Employment (Seasonally adjusted)	15,161,700 in May 2007	15,143,100 in May 2008

Data Sources: California Department of Motor Vehicles, California Association of REALTORS (sales data), DataQuick (foreclosure data), California Employment Development Department.