

Controller *John Chiang*

California State Controller's Office



October 2008 Summary Analysis

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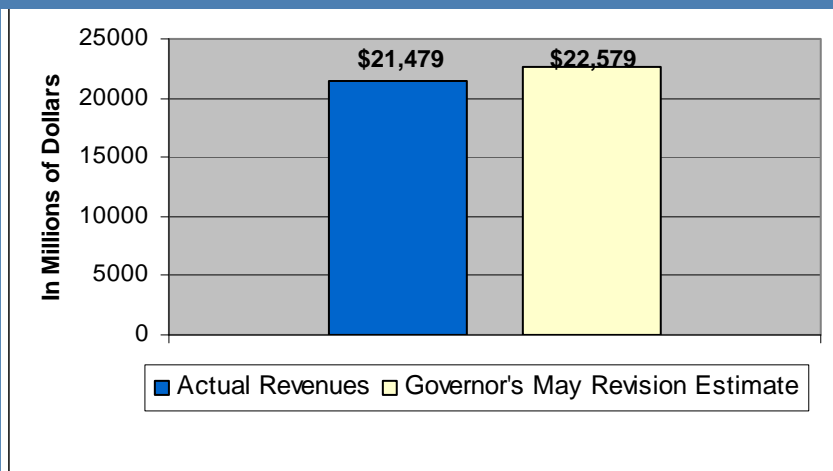
Statement of General Fund Cash Receipts and Disbursements

Tax Revenue in September 2008

- ⇒ In September 2008, General Fund revenue was \$540 million below (-5.1%) the May Revision estimate for the month. Corporate taxes were \$416 million below (-18.6%) estimate. Personal income taxes were \$270 million below (-4.6%) estimate while sales taxes were \$128 million below (-5.7%) estimate. Together the three largest taxes (income, sales, and corporate) were \$814 million below (-7.9%) the May Revision estimate. Insurance tax receipts were above estimate by \$288 million, but that increase represents only a timing issue. Insurance tax receipts that were expected in August did not post until the first few days of September.
- ⇒ Compared to September 2007, General Fund revenue in September 2008 was down by \$465 million (-4.4%). Corporate taxes were below estimate by \$485 million (-21.0%), and personal income taxes were below last September by \$26 million (-0.5%). Sales taxes were \$71.7 million greater (3.5%) than last year. The total for the three largest taxes was below 2007 levels by \$440 million (-4.4%).

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Table 1: General Fund Revenues: July 1, 2008–Sept. 30, 2008 (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 September 2008 and year to date for the first three months of Fiscal Year 2008-09. Data are shown for total cash receipts and disbursements, the three largest categories of revenues, and the two largest categories of expenditures.

Absent a Budget Act, previous reports compared monthly cash flows to the most recent projections, which are found in the Governor's May Revision. Because the Budget Act was not signed until September 23, this report will continue to use the Governor's May Revision because its set of estimates is the only one to provide a full month of expectations for September. The Budget Act will be used for comparison with the October figures, which will be reported next month.

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- ⇒ September is a seminal month for both income and corporate taxes. Estimated payments are a signal as to the size of tax revenue receipts the State can expect when annual taxes are paid next spring.
- ⇒ Estimated income tax payments — the largest component of income taxes in September — were 4.6% below September 2007. Payroll withholding taxes, the second most important component of income taxes in September, were 5.5% higher compared to a year ago.
- ⇒ Quarterly estimated corporate taxes in September were extremely weak, 26% below last September.

Tax Revenue Fiscal Year to Date

- ⇒ For the first three months of the fiscal year, revenue was \$1.1 billion below (-4.9%) the May Revision estimate. Retail sales taxes have experienced the largest decline at \$594 million under (-8.7%) the year-to-date estimate. Corporate taxes were under estimate by \$420 million (-15.8%), while income taxes were short by \$125 million (-1.1%). The three largest taxes were collectively \$1.1 billion (-5.4%) below estimate for the first three months of the fiscal year.
- ⇒ Compared to this date in September 2007, revenue receipts are down \$238 million (-1.1%). All revenue receipts except the “Not Otherwise Classified” category were negative on a year-over-year comparison. That category’s receipts were higher in 2008 because it contained unclaimed property collections that were halted in 2007 as new rules for locating owners were instituted. Those receipts are now being collected, boosting the year-over-year comparison by \$648 million.
- ⇒ Year-to-date collections for the three major taxes are \$828 million below (-4%) last year. Retail sales are \$260 million below (-4%) last year at this date. Corporate taxes are \$522 million (-18.9%) below last year and income taxes are \$46 million lower (-0.4%) than last year at this date.
- ⇒ Withholding taxes are 2.5% ahead of last year on a year-to-date comparison. Employment continues to decline in California, with 60,200 jobs lost in the first eight months of the calendar year. The September employment report for the nation showed a loss of 159,000 jobs, indicating an acceleration from the rates of decline seen earlier in the year. It is likely California’s job loss trend continued in September, which means the weakness in tax withholding receipts may worsen.
- ⇒ Estimated payments on income taxes for the first three months of the fiscal year are 3.8% below last year

Table 2: General Fund Receipts, July 1, 2008-September 30, 2008 (in Millions)

Revenue Source	Actual Receipts To Date	May Revision Budget Estimate	Actual Over (Under) Estimate
Bank And Corporation Tax	\$2,239	\$2,659	(\$420)
Personal Income Tax	\$11,407	\$11,532	(\$125)
Retail Sales and Use Tax	\$6,247	\$6,841	(\$594)
Other Revenues	\$1,587	\$1,547	\$40
Total General Fund Revenue	\$21,479	\$22,579	(\$1,099)
Non-Revenue	\$344	\$774	(\$430)
Total General Fund Receipts	\$21,824	\$23,353	(\$1,529)

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

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at this date. Corporate estimated payments to date in this fiscal year are 25% below where they were last September. These numbers could mean greater revenue deterioration in the months ahead.

Summary of Net Cash Position as of Sept. 30, 2008

- ⇒ Through September, the State had total receipts of \$21.8 billion (Table 2) and disbursements of \$27.5 billion (Table 4). The deficit of \$5.7 billion was covered by internal borrowing.
- ⇒ Of the largest expenditures, \$19.1 billion went to local assistance and \$7.2 billion went to State operations (See Table 4).
- ⇒ Total receipts were \$1.5 billion lower (-6.5%) than anticipated in the May Revision. Revenue receipts were low by \$1.1 billion (-4.9%), and nonrevenue receipts were down by \$430 million (-55.5%). Nonrevenue receipts are primarily transfers from other funds.
- ⇒ Disbursements through September were

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Table 3: General Fund Cash Balance As of September 30, 2008 (in Millions)

	Actual Cash Balance	Governor's May Revision Budget Estimate	Actual Over (Under) Estimate
Beginning Cash Balance July 1, 2008	(\$1,452)	(\$4,799)	\$3,347
Receipts Over (Under) Disbursements to Date	(\$5,707)	(\$7,432)	\$1,724
Cash Balance September 30, 2008	(\$7,158)	(\$12,231)	\$5,072

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

Recipient	Actual Disbursement	May Revision Budget Estimate	Actual Over (Under) Estimate
Local Assistance	\$19,097	\$23,468	(\$4,370)
State Operations	\$7,213	\$7,284	(\$71)
Other	\$1,220	\$32	\$1,188
Total Disbursements	\$27,531	\$30,785	(\$3,253)

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.

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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\$3.3 billion (-10.6%) lower than estimated in the May Revision. The net savings is related to payments not made in the first part of September due to the lack of a budget, which distorts the comparisons to expected disbursements. The \$4.4 billion smaller payment to local assistance was partially offset by a \$1 billion dollar advance to MediCal providers. The delayed payments are being paid in October.

⇒ The State ended last fiscal year with a net cash deficit of \$1.45 billion. That deficit was covered by internal borrowing. The year-to-date deficit of \$5.7 billion is also covered by internal borrowing. Loans from internal sources now total \$7.2 billion. At the end of September, the State had \$7.6 billion remaining in borrowable resources. Internal loans will be repaid according to cash management procedures as resources are available.

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for September 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.

Any questions concerning this Summary Analysis may be directed to Hallye Jordan, Deputy Controller for Communications, at (916) 445-2636.

California Economic Snapshot

Median Home Price (for Single Family Homes)	\$588,670 In August 2007	\$350,140 In August 2008
Single Family Home Sales (Seasonally Adjusted Annual Rate)	313,310 In August 2007	490,850 In August 2008
California Foreclosures Initiated (Notices of Default)	53,943 In 2nd Quarter 2007	121,341 In 2nd Quarter 2008
Total State Employment (Seasonally Adjusted)	15,181,700 In August 2007	15,109,000 In August 2008
Newly Permitted Residential Units (Seasonally adjusted Annual Rate)	124,200 In August 2007	53,400 In August 2008

Data Sources: California Association of REALTORS (sales data), DataQuick (foreclosure data), California Employment Development Department, Construction Industry Research Board

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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.

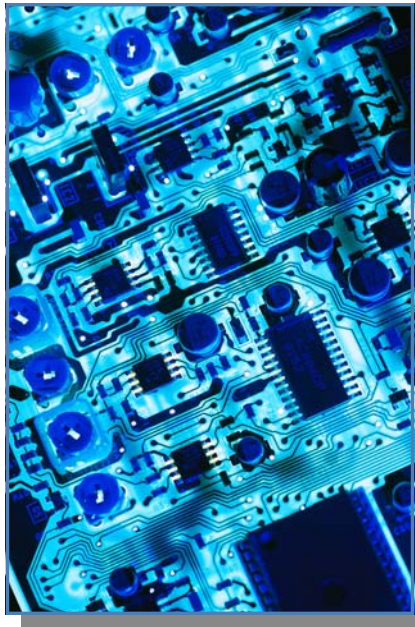
The advisors also contribute monthly articles on issues regarding California's economy. The opinions in the articles are presented in the spirit of spurring discussion and reflect those of the authors and not necessarily the Controller or his office. This month's report includes a report summary from Ross DeVol, Director of Regional Economics at the Milken Institute.

California's Future as a High-Tech Leader

Ross DeVol, Director of Regional Economics,
Milken Institute
Member, Controller's Council of Economic Advisors

The Milken Institute recently issued its *State Technology and Science Index 2008*, analyzing California's strengths and challenges in maintaining and developing its future science, technology, and other knowledge-driven industries. The following summarizes California's position in the index and examines **five categories** to find how well the state is performing in the highly competitive intangible economy. A perfect score on each index is 100.

California slips to 3rd position in our **Research and Development Inputs Composite Index**, which measures the ability to attract various types of federal, industry and academic funding. The state's composite score remains statistically unchanged at 80.12, down from 80.3 in 2004, but California lost its hold on the 2nd-place ranking it achieved in 2004. A troubling decline was found in California's federal research and development (R&D) funding, possibly due to other states' efforts to lure this funding as a part of their technology-based economic-



development strategies. California also declined in academic R&D — slipping to 19th place from 15th in 2002. This lackluster performance is a serious long-term concern for the state.

To be successful over the long haul, a state needs capable entrepreneurs and the risk capital to support the conversion of research into commercially viable technology products and services. California scores 81.2 on the **Risk Capital and Entrepreneurial Infrastructure (RCEI) Composite Index**, placing it squarely in 1st place in the nation and remaining the dominant state for venture capital (in 2006, 48 percent of all venture capital dollars went to California). California's most glaring difference with other states is its lack of business incubators. Ignoring this aspect of business development may place too much reliance on the established venture capital model. Although investment in the state is high, its growth is slowing relative to other states.

California plummets to 13th position in the

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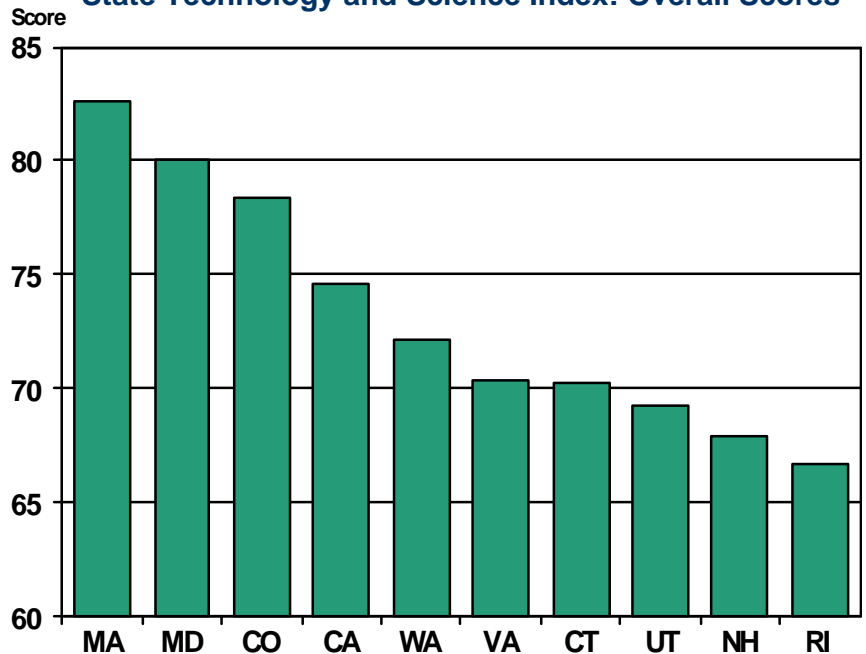
Human Capital Investment Composite Index, with an overall score of 64.1, the state's lowest score on the five indexes. As recently as 2002, California was 4th in this category, which measures stock of human capital and rate of investment by gauging the concentration and momentum of various science and engineering fields. Despite its industrial and financial might, California's weak standardized test scores and small percentage of individuals holding bachelor's degrees means the state could find itself without the skilled workforce necessary to propel its economy.

In the composite measure of its **Technology and Science Workforce**, California ranks 6th in the nation. Even though this is a strong showing, it represents a slide from years past. The state's strongest performances were in its intensity of biomedical, electrical and computer hardware engineers. The greatest hit was the low intensity of information science experts. The tech slump in the Silicon Valley and international outsourcing has limited the demand for these experts in California. Limitations on H1B visas have also slowed growth of this workforce.

California ranks 7th in the nation for **Technology Concentration and Dynamism**. This is a loss of three spots from the 4th-place position the state occupied in the 2004 index. The state ranks high in the measure of high-tech industries with a concentration of employment in California but had low scores in net formation of high-tech startups per 10,000 business establishments. The state also received high marks for its share of individuals involved in high-tech industries, its number of Inc. 500 companies, and number of Technology Fast-500 companies.

Combining the five indexes, California places 4th with an overall score of 74.6. While it remains a

State Technology and Science Index: Overall Scores



Source: Milken Institute.

national leader, the state continues to falter. Once only 5.5 index points behind 1st-place Massachusetts in the 2004 index, it has fallen eight points behind in 2008.

With the world's eighth-largest economy, California might appear immune from challenges to its innovation and technology leadership. The state enjoys considerable advantages, including the nation's preeminent entrepreneurial ecosystem, outstanding public universities, and private-institute research complemented by cutting-edge industry R&D. California's entrepreneurs and venture capitalists provide the necessary social and financial capital to transform research into the inventions and innovations upon which new firm formation is based. This environment is always capable of producing the next Intel, Sun Microsystems, Cisco, Amgen, Qualcomm, or Google.

The main threat to California's status as a top-tier performer in technology and science can be seen in the severe deterioration of its measures of

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human capital. The state faces serious challenges due to its growing undereducated and unskilled labor force, a struggling K-12 system, and the rising cost of doing business. California's ability to meet these challenges will determine the state's future as a leading center of high-technology industries.

A new problem that must be addressed is the falloff in graduate student enrollment in the University of California (UC) system and in other leading private universities across the state. The UC system is also losing its competitive edge due to large increases in non-resident tuition rates in recent years. We would do well to learn the lessons of price elasticity of demand in the graduate student market.

The other major human capital challenge is that California simply isn't producing enough college-ready high school graduates. Our public schools are failing many Latino and African-American children. Given that California's future workforce will be increasingly Latino, this is an ominous trend. This gap in educational attainment can be seen in the large variance in the percentage of the population age 25 and over that has obtained a bachelor's degree: 37 percent of California's non-Hispanic whites hold at least a bachelor's degree,

as compared to only 9 percent of the state's Hispanic population. The gap lessens in statistics for second- and third-generation Hispanics, but the variance still remains large.

A hopeful sign is in the number of California's high-tech industries with location quotients exceeding the average of all 50 states, an indicator showing how many high-tech industries are densely concentrated in a state. These relationships, combined with strong industry R&D funding, help to fuel the California economy. In technology, achieving critical mass is the key to continued momentum, and its sheer breadth of components keeps California ahead in developing new technology-based industries. But relying on industry ties to the state and hoping that the benefits of agglomeration will overcome California's deterioration in human capital is a huge gamble. Maryland and Colorado, states with more attractive cost structures and newly established high-tech economies, have already surpassed California since the 2004 report. It is not unrealistic to conjecture that Virginia and Utah, two strong performers in the Technology Concentration and Dynamism Composite Index, may also rally past California in the near future if the state cannot manage to staunch the outflow of high-tech workers and shore up its educational base.