A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

# California Fiscal Focus

Volume 1, Issue 12

June 2016

## CA Controller's May Cash Report Shows Lower-than-Expected Revenues

May state revenues fell short of projections in Gov. Jerry Brown's revised budget proposal by $154.3 million, weighed down by corporation tax refunds far higher than expected, State Controller Betty T. Yee reported.

"The state's other major taxes came close to or exceeded estimates in May, so we should not jump to conclusions about a downturn," said Controller Yee, the state's chief fiscal officer. "However, it is worth noting that this is the second month in a row in which overall revenues have fallen short. At this point, the signals are mixed."

In his May revision of the 2016-17 budget, Gov. Brown anticipated $152.0 million from the corporation tax. Instead, the state paid out more in refunds than it brought in, resulting in a net loss of $281.4 million.

By contrast, the personal income tax, the state General Fund's biggest revenue source, generated $3.88 billion, surpassing estimates by $273.2 million, or 7.6 percent. The retail sales and use tax fell short of May revision estimates, but not by much. Collections adding up to $3.47 billion were $64.7 million, or 1.8 percent, less than projected.

Overall, May revenues of $7.43 billion fell short by 2.0 percent.

Compared to projections included in the state budget signed almost a year ago, May revenues were short by $560.9 million, or 7.0 percent. However, revenues for the first 11 months of the fiscal year are ahead. Overall collections of $102.57 billion are outstripping estimates by $1.70 billion, or 1.7 percent. While the corporation and sales taxes have lagged for the fiscal year to date, the personal income tax has surpassed expectations by $2.06 billion, or 3.1 percent.

Revenues look even healthier compared to actual collections in the prior fiscal year. With only one month remaining in the fiscal year, revenues are higher by $5.06 billion, or 5.2 percent.

The state ended the month of May with unused borrowable resources of $28.13 billion, which was $3.86 billion more than expected in the May budget revision. Outstanding loans of $7.39 billion were $852.9 million less than projected. This loan balance consists of borrowing from the state's internal special funds.

For more details, read the cash report.

***Inside this issue***



## Looking Ahead: State Treasurer Identifies Budget Risks

In the official statement for the state's March 2016 General Obligation bond sale, State Treasurer John Chiang identified five medium- to long-term risks to state finances.

***Recession***—Although there are few signs of an immediate economic contraction, the Treasurer notes that a recession is inevitable. State budget balances tend to deteriorate in recessionary times.

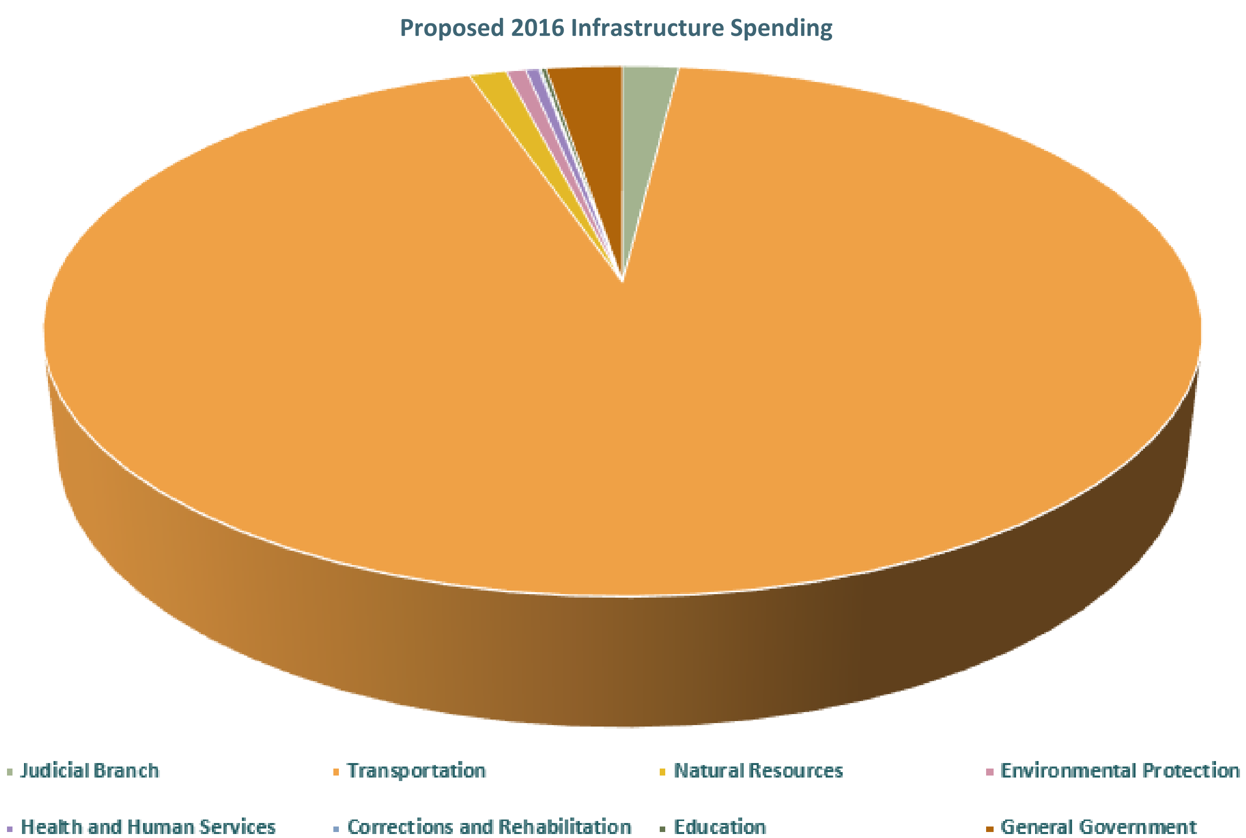
***Federal Cost Shares***—The federal government could increase state costs with policy changes such as reducing its participation in shared programs. Federal administrators also could reject waivers to state health and human services programs. These waivers help the state control costs.

***(See FIVE RISKS, page 3)***

## If You Build It, Repair Costs Will Come

In its 2016 Five-Year Infrastructure Plan, the California Department of Finance (DOF) states that "investment in physical infrastructure is a core function of state government." However, the report notes that there are "critical deficiencies in the state's infrastructure, including a significant backlog of maintenance on existing facilities that

***(See INFRASTRUCTURE, page 3)***




*Source: California Department of Finance*

**(FIVE RISKS, continued from page 2)**

***Anticipating Revenues from Capital Gains***—The Treasurer notes that capital gains are the state's most volatile revenue source. State budgetary reserve requirements may help fiscal managers address year-to-year revenue uncertainty. However, revenue volatility associated with capital gains remains a risk.

***Health Care Inflation***—State finances are sensitive to the effects of health care inflation in both the Medi-Cal program and the provision of health benefits to employees and retirees. Increased health care costs, expected to outpace overall inflation, are likely to create ongoing budget pressure.

***Debts, Deferrals and Long-Term Liabilities***—According to the Treasurer, "the state's budget challenges have been exacerbated by an unprecedented level of debts, deferrals, and budgetary obligations accumulated over the prior decade…the state faces hundreds of billions of dollars in other long-term cost pressures, debts, and liabilities, including state retiree pension and health care costs."

**(INFRASTRUCTURE, continued from page 2)**

has built up over years of underfunding."

To address the state's capital needs, DOF proposes financing from the General Fund, special funds, lease revenue bonds, general obligation bonds, federal funds, high-speed rail bonds, and reimbursements and other non-governmental sources. Most of the proposed funding—91 percent—is dedicated to the state's transportation system.

# Cautions about Potential Effect of Federal Tax Reform

*For state and local chief executives, increased borrowing costs are the biggest concern about recent federal tax proposals.*

Scott Pattison of the National Governor's Association recently observed that proposals by presidential candidates to reduce federal tax rates could undermine the incentive for buying municipal debt. If federal tax rates fall, the effective cost for tax-exempt debt would rise. Pattison stated that for state and local chief executives, increased borrowing costs are the biggest concern about recent federal tax proposals. *(Tax Policy Center, Note to Federal Tax Reformers: Don't Forget the States*, March 31, 2016).

In a report for the Tax Policy Center, Frank Sammartino and Kim Rueben caution that proposals to reduce or eliminate federal deductions for state and local taxes generally raise their effective rates *(Revisiting the State and Local Tax Deduction, March 31, 2016)*.

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