

LEGISLATIVE ANALYST'S OFFICE

## Revenues Up Sharply

*On May 14, the administration is scheduled to release the May Revision to its January budget proposal for 1998-99. The updated plan traditionally contains revisions to the revenue forecast and the expenditure plan, taking into account such factors as economic developments and revised caseload projections. In this update, we highlight recent economic and revenue developments that will significantly affect the May Revision proposal.*

For the third year in a row, the state's General Fund fiscal picture will show a major improvement in the May Revision. This is primarily because revenues in 1997-98 and 1998-99 will be up sharply, largely reflecting dramatic increases in personal income tax revenues.

### **State's Economy Strong**

California's economy is growing at the fastest pace since the mid 1980s, with

personal income now showing year-over-year gains of 8 percent. While Asia's economic problems have affected businesses and industries exporting to that region, the broad negative impacts on California that some had feared have not materialized so far. Other industry sectors are strengthening in California in 1998—particularly in such areas as home sales, new construction, and retail spending—giving the economy an added boost in the current year.

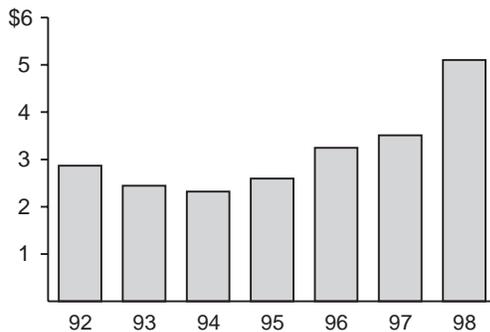
### **Revenues Exceed Expectations**

General Fund revenues from the state's major taxes exceeded the January budget forecast by \$1.3 billion in April, primarily reflecting much stronger-than-expected final personal income tax payments. As Figure 1 (see page 2) shows, income tax payments in April totaled \$5.1 billion, and dramatically exceeded the amounts re-

**Figure 1**

## **Personal Income Tax Payments Soar in 1998**

*April Deposits to the Franchise Tax Board  
(In Billions)*



corded in April in prior years. Cumulative revenue receipts through the first ten months of this year are running approximately \$1.6 billion above the January budget estimate. Based on the ongoing positive trends in the economy and related gains in withholding and sales tax payments, the state will likely experience further revenue increases in May and June.

***How Much of the Current-Year Revenue Increase Is Ongoing?*** A major issue affecting the revenue forecast for 1998-99 is the extent to which the extraordinary increase in current-year personal income taxes is due to one-time versus ongoing factors. While the continued economic expansion and stock market gains are

clearly positive factors for next year's revenues, it also seems likely that at least some of the extraordinary increase in this April's final payments was due to a one-time "unlocking" of gains in response to last year's federal tax rate reduction on long-term capital gains. Thus, a key issue for the May Revision is the extent to which the current-year revenue gain is assumed to be repeated in the budget year.

***Proposition 98 Interaction.*** In contrast to the previous two years, when upward revenue revisions were matched by equally large increases to the formula-driven Proposition 98 minimum funding guarantee, it appears that the revenue increases in the current and budget years will not increase the guarantee. (This is primarily due to the fact that the operative funding formula for the current year is "Test 2," which is dependent on personal income growth, and therefore, is not affected by the increase in revenues.) Thus, most or all of the new revenues will be available for non-Proposition 98 purposes.

We will provide our review of the May Revision, including its economic, revenue, and expenditure assumptions, following its release next week.

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