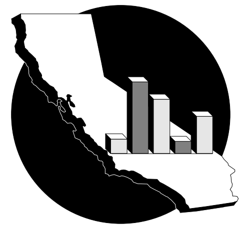
III

Perspectives on State Revenues



BACKGROUND

California state government will collect an estimated $77.4 billion in taxes and other revenues in 1999-00. These collections fall into two broad categories—General Fund revenues and special funds revenues. Revenues deposited into the General Fund are allocated through the budget process each year to support a variety of state programs, including K-12 education, higher education, criminal justice, and health and social services. In contrast, special funds revenues are earmarked for specific purposes. For example, motor vehicle fuel taxes support transportation programs, most tobacco taxes support a variety of targeted health programs, and vehicle license fees support local governments. Some taxes, such as the sales and tobacco taxes, are allocated among both the General Fund and special funds. Figure 1 (see next page) shows that slightly over three-fourths of total state revenues in 1999-00 will be received by the General Fund, while slightly less than one-fourth will be received by special funds.

The great majority of General Fund revenues are attributable to three major taxes—the personal income tax (PIT), the sales and use tax, and the bank and corporation tax (BCT). Together, these three sources are expected to account for well over 90 percent of the General Fund revenue total in 1999-00, with the PIT alone accounting for over one-half of the total. The remaining General Fund receipts are related to numerous smaller taxes, fees, and investment earnings. The smaller taxes include the insurance, estate, cigarette, and alcoholic beverage taxes.

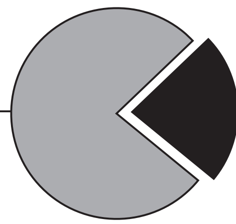
Figure 1

State Revenues in 1999-00

(In Billions)

General Fund Revenues		Special Funds Revenues	
Personal Income Tax	$30.2	Motor Vehicle-Related Taxes	$8.1
Sales and Use Tax	19.7	Sales and Use Tax[a]	4.1
Bank and Corporation Tax	6.3	Tobacco-Related Taxes	1.1
All Other[b]	4.1	All Other[b]	3.8
Total	**$60.3**	**Total**	**$17.1**

Total State Revenues $77.4 Billion



[a] Includes $2 billion to Local Revenue Fund and $0.2 billion for transportation-related purposes. Also includes $2 billion allocated to Local Public Safety Fund, which is not included in the Governor's budget totals.

[b] Includes transfers and loans.

Revenue Performance Over Time

Figure 2 provides a longer term perspective on state revenues, by showing total revenues in both current and constant dollar terms (that is, after eliminating the effects of inflation). It shows that total revenues have increased from $43.3 billion in 1988-89 to $73.3 billion (estimated) in 1998-99, an average annual increase of 5.4 percent. In constant dollar terms, the average annual increase is 2.6 percent. Within this ten-year period, there have been a number of both tax increases (mostly in the early 1990s) and tax decreases (mostly in the late 1990s).

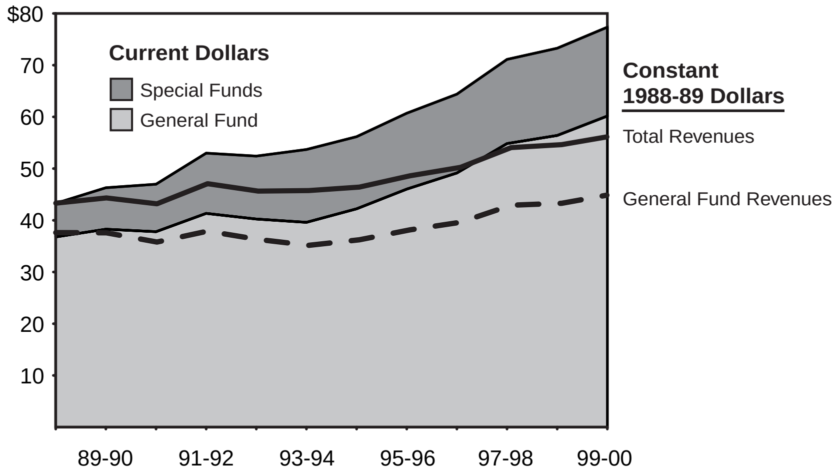
Despite the healthy increases in General Fund revenues in recent years, special funds revenues have increased by more than General Fund revenues during the past decade. The difference is primarily related to legislative and voter-approved changes which have raised various special funds taxes. These include the voter approval of gasoline tax increases in 1990, the creation of the one-half-cent Local Revenue Fund sales tax in 1991, and voter approval of a one-half-cent sales tax for local public safety in 1993.

The figure also shows the effects of the early 1990s' recession and the more recent economic expansion on state revenues. It shows that rev-

Figure 2

Historical Trends in State Revenues[a]

General and Special Funds, 1988-89 Through 1999-00
(In Billions)



[a] Excludes transfers, bond funds, and federal funds. Includes Local Public Safety Fund.

enues were flat from 1991-92 through 1993-94, but then resumed an upward trend in 1994-95 as the state's economic recovery took hold. Large revenue increases have occurred in recent years, reflecting the healthy economic expansion and particularly large increases in General Fund personal income tax collections. We expect revenue growth to continue during the current and budget years, albeit at a slower pace than previously, due to recently enacted reductions in state income taxes and the vehicle license fee (VLF).

Tax Relief Measures

In both 1997 and 1998, the state enacted significant tax relief legislation. The fiscal impacts of these measures are summarized in Figure 3 (see next page).

The VLF Reduction. Legislation signed into law in 1998 (Chapter 322, Statutes of 1998 [AB 2797, Cardoza]) reduced the VLF by 25 percent beginning on January 1, 1999. This reduction is estimated to lower VLF revenues by $557 million in 1998-99 (half-year effect) and $1,080 million in 1999-00 (full-year effect), and by slowly expanding amounts thereafter. Chapter 322 also specifies that additional VLF reductions could occur

Figure 3

1997 and 1998 Tax Relief Packages

(Dollars in Millions)

	1998-99	1999-00	2000-01
1997 Tax Relief Package			
Increased dependent credit	$295	$780	$800
Other changes	298	306	263
Totals	**$593**	**$1,086**	**$1,063**
1998 Tax Relief Package			
Revenue Provisions:			
Further increase in dependent credit	$612	$22	$23
Renters' credit	133	141	144
Targeted tax reductions	106	157	172
Totals	**$851**	**$320**	**$339**
Expenditure Provisions:			
VLF	$557	$1,080	$1,134
Senior citizens	—	70	71

beginning in 2000-01 if General Fund revenues exceed the Department of Finance's May 1998 revenue forecast for those years by at least $1.5 billion. Based on our current forecast (discussed below), however, revenues will be well below the amount needed to trigger additional VLF rate cuts in 2000-01. Thus, based on our projections, additional reductions would *not* occur.

Other Measures. In addition to the VLF reduction, the Governor and Legislature adopted a number of other tax relief measures. These include increases in the personal income tax dependent credit, the restoration of an income-limited renters' credit, various federal income tax conformity items, reduced horse racing fees, and targeted tax relief for senior citizens and businesses. The combined effect of those measures affecting General Fund revenues is $1.4 billion per year beginning in 1998-99.

THE BUDGET'S GENERAL FUND REVENUE OUTLOOK

Figure 4 summarizes the budget's General Fund revenue forecasts for 1998-99 and 1999-00. It shows that revenues are projected to increase

Figure 4

Summary of Department of Finance's General Fund Revenue Forecast

1997-98 Through 1999-00
(Dollars in Millions)

Revenue Source	Actual 1997-98	1998-99 Amount	1998-99 Percent Change	1999-00 Amount	1999-00 Percent Change
Personal Income Tax	$27,925	$28,526	2.2%	$30,175	5.8%
Sales and Use Tax	17,583	18,620	5.9	19,680	5.7
Bank and Corporation Tax	5,837	5,926	1.5	6,295	6.2
Insurance Tax	1,221	1,238	1.4	1,232	-0.5
Other taxes	1,293	1,307	1.1	1,301	-0.5
Other revenues[a]	979	793	-18.9	1,482	86.9
Transfers	135	-117	—	107	—
Totals	**$54,973**	**$56,293**	**2.4%**	**$60,272**	**7.1%**

[a] 1999-00 amounts include $562 million in tobacco settlement receipts and $261 million from one-time asset sales.

from $55 billion in 1997-98 to $56.3 billion in 1998-99 (a 2.4 percent increase), and further to $60.3 billion in 1999-00 (a 7.1 percent increase).

The revenue totals for both the current and budget years are affected by the recently enacted tax relief packages discussed above. In addition, while the budget does not include any new tax-related proposals, it does assume new revenues in 1999-00 from (1) the state's receipt of the first two payments related to the tobacco settlement reached late last year ($562 million), (2) the sale of state assets ($261 million), and (3) additional tax assessments from proposed increases in auditing-related activities at the Franchise Tax Board (FTB) and Board of Equalization (BOE).

After adjusting for these and related factors, the budget's projected underlying growth rates are about 5.5 percent in both the current and budget years, or similar to the gains it projects for statewide personal income.

Recent Trends Have Been Positive

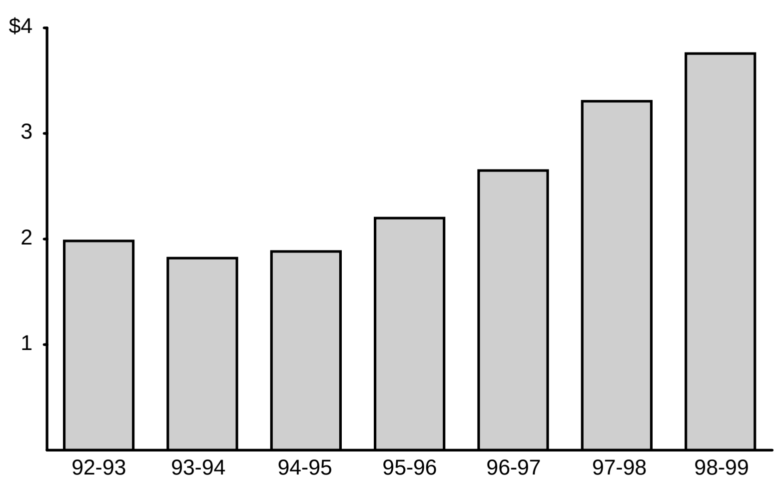
Positive developments relating to the economy, financial markets, and year-end cash receipts suggest that the current revenue trend is *significantly above* the budget's forecast. As indicated in Part Two of this volume, the economy is currently stronger than anticipated in the budget, and most forecasters are raising their economic projections for this year. In addition, the stock market rally at the end of 1998 will likely raise the amount of capital gains income reported on final 1998 income tax returns filed this spring.

Consistent with these economic and financial developments, recent PIT receipts have been strong. Specifically, as shown in Figure 5, year-end quarterly PIT prepayments were up again in 1998, by over 13 percent from the prior year. While the rate of increase this year is somewhat less than occurred in 1996 and 1997, it nevertheless has positive implications for the revenue outlook for the balance of 1998-99. This is because much of the year-end payments are related to capital gains, bonuses, stock options, business earnings, and other volatile sources of income. In recent years, the strength of these payments has consistently been a very good indication of the strength of final payments that come in during April.

Figure 5

Strong Year-End Receipts Occurred Again in 1998

Personal Income Tax Revenues Collected in December and January (In Billions)



THE LAO'S GENERAL FUND REVENUE OUTLOOK

Figure 6 provides the LAO's updated General Fund revenue outlook for 1998-99, 1999-00, and 2000-01. These revenue forecasts are based on our economic forecast presented in Part Two of this volume, and also take into account the recent positive PIT cash revenue trends. Our estimates incorporate the administration's assumptions regarding new revenues in 1999-00, with one primary exception—namely, we have reduced the administration's estimate of revenues from one-time asset sales by $78 million in the budget year, to adjust for the budget's double counting of proceeds from the sales.

Forecast for 1998-99. We forecast that General Fund revenues and transfers will total $57.1 billion in 1998-99, a 3.8 percent increase from the prior year. Our estimate is $758 million above the budget forecast, largely due to our higher estimate of personal income tax receipts. The higher PIT estimate reflects the positive cash trends and economic developments during the past two months.

Forecast for 1999-00. We forecast that General Fund revenues and transfers will increase in the budget year to $60.8 billion, a 6.6 percent increase from the current year. Our forecast is $558 million above the budget projection, reflecting offsetting factors. Specifically, our forecast of PIT

Figure 6

Summary of LAO's General Fund Revenue Forecast

1998-99 Through 2000-01
(Dollars in Millions)

	1998-99		1999-00		2000-01	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
Personal income tax	$29,300	4.9%	$30,940	5.6%	$32,870	6.2%
Sales and use tax	18,630	6.0	19,625	5.3	20,705	5.5
Bank and corporation tax	5,880	0.7	6,195	5.4	6,525	5.3
Insurance tax	1,240	1.6	1,250	0.8	1,280	2.4
Other taxes	1,316	1.7	1,312	-0.3	1,347	2.7
Other revenues	802	-18.1	1,401	74.7	1,114	-20.5
Transfers	-117	—	107	—	100	-6.5
Totals	**$57,051**	**3.8%**	**$60,830**	**6.6%**	**$63,941**	**5.1%**

revenues is up from the budget forecast by $765 million, reflecting the ongoing effects of the higher current-year revenue trend. Partly offsetting the PIT increase, however, is our estimate that revenues from all other sources will come in $207 million below the budget forecast.

Forecast for 2000-01. We project that total General Fund revenues will increase to $63.9 billion in 2000-01, a 5.1 percent increase from 1999-00. Our estimate for that year is consistent with our forecast for continued moderate economic growth. We also assume that California will receive a single tobacco settlement payment of $442 million (scheduled to be made in 2001) during the 2000-01 fiscal year.

The LAO's Forecast for Major Revenue Sources

Given that a great majority of General Fund revenues are related to the state's "big three" taxes, the state's fiscal outlook is highly dependent on the performance of these revenue sources. In the following sections we provide a detailed discussion of the outlook for the personal income, sales, and corporation taxes.

The Personal Income Tax

Background

The PIT is by far the General Fund's largest revenue source, accounting for about one-half of total receipts in 1998-99. The tax is levied on income that is attributable to California. In general, the tax is patterned after federal income tax law with respect to the definition and treatment of most types of income, deductions, exemptions, exclusions, and credits. Taxable income is subject to marginal tax rates ranging from 1 percent up to 9.3 percent.

Importance of Different Types of Income. Figure 7 shows that wages and salaries account for the majority of income declared on California PIT returns, representing about 60 percent of the estimated total in 1999. The next largest source is capital gains, which now accounts for about 17 percent of the total. Other significant sources are business income—which includes earnings of partnerships and sole proprietors—interest, and dividends.

PIT Liabilities Continue to Soar

The key factor in the outlook for PIT receipts is the strength in income-year tax liabilities. Figure 8 shows that these liabilities have grown at a

Figure 7

Personal Income Tax Liabilities By Source Income

1999 Income Year

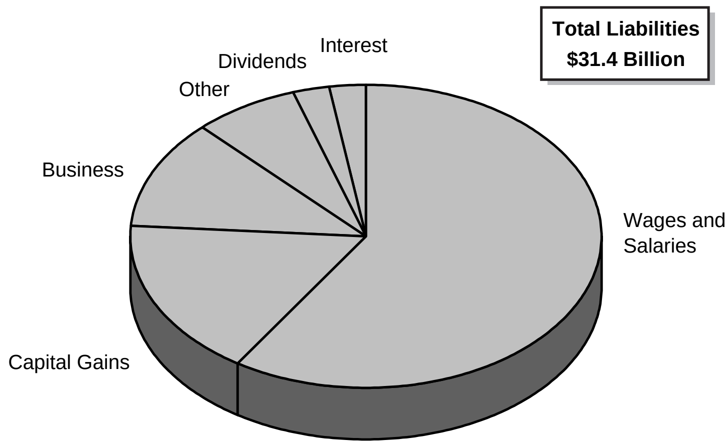
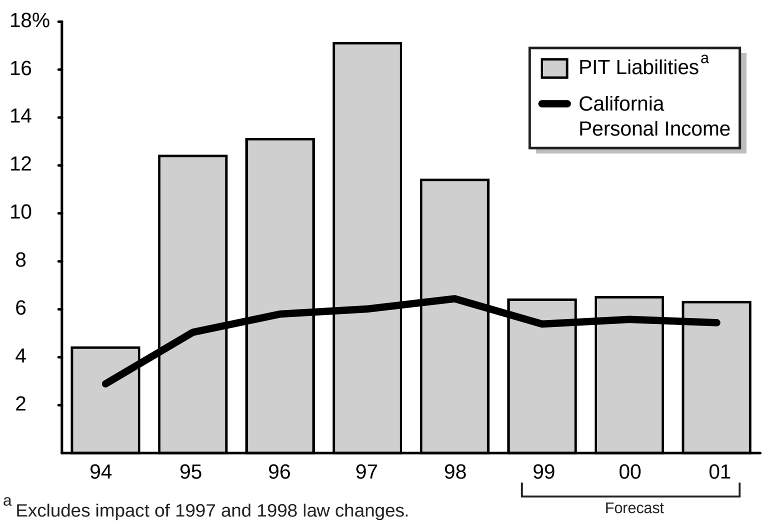


Figure 8

Income Tax Liabilities to Slow Following Strong 1998

Percent Change



[a] Excludes impact of 1997 and 1998 law changes.

very rapid pace in recent years. For example, the average annual increase from 1994 to 1997 (the most recent year for which actual data are available) was nearly 14 percent, or more than double the growth in statewide personal income. Excluding the effects of the scheduled increases in the dependent credit, we estimate that underlying PIT liabilities increased by more than 11 percent in 1998, again a much larger increase than statewide personal income.

Capital Gains a Key Factor

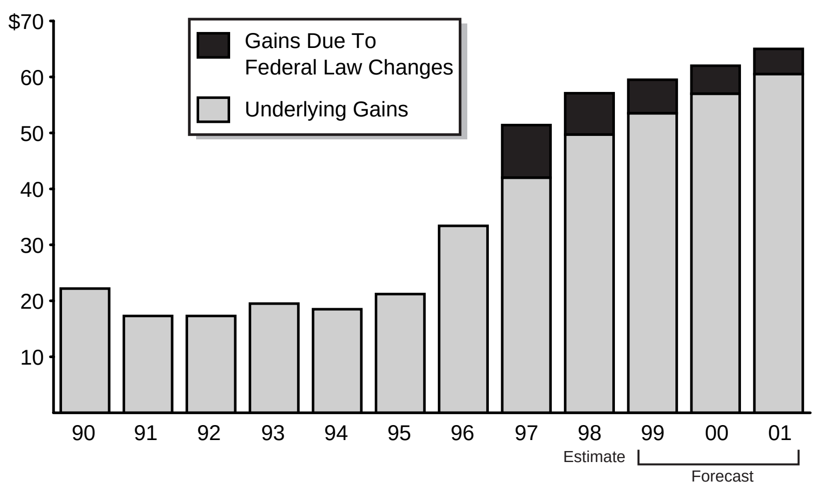
The rapid gain in PIT liabilities reflects healthy growth in taxes attributable to all of the major income sources shown in Figure 6. For example, taxes attributable to wages jumped by an average of 10 percent per year between 1994 and 1998, partly reflecting increases in bonuses and stock options, both of which accrue to taxpayers in high marginal tax brackets. Business and dividend income also increased sharply over the past four years, further adding to tax liability growth. *The main reason for the extraordinary growth in PIT liabilities, however, has been an unprecedented increase in capital gains* (see Figure 9).

Capital gains are related to the sales of stocks and other assets which have increased in value. This increased value is subject to PIT when the

Figure 9

Capital Gains Growth– Strong Again in 1998, Modest Thereafter

Capital Gains Realizations (In Billions)



assets are sold. Capital gains are especially important in the revenue picture because they can be volatile from year to year. This is because they are related to the performance of stocks and other financial assets, which themselves are quite volatile. Moreover, the level of gains in a given year can also be significantly affected by taxpayer decisions regarding the timing of asset sales. Finally, capital gains accrue disproportionately to high-income taxpayers, and thus are generally subject to marginal tax rates which are much higher than for other forms of income.

It is also important to note that while capital gains comprise a part of income reported on tax returns, they are *not* included in national and state personal income accounts, since they are not related to the current production of goods or services. This accounts for a significant part of the discrepancy between statewide personal income growth and tax liability growth in recent years.

Recent Performance. Capital gains realizations totaled less than $20 billion annually during the first half of the 1990s. However, they have soared in the second half of the decade. As shown in Figure 9, capital gains more than doubled between 1995 and 1997—reaching $51 billion—and we estimate that they increased by another 11 percent in 1998, to $58 billion. Most of the growth has been related to the major increases in the U.S. stock market. However, we also believe that the reduction in the maximum federal tax rate on capital gains also played a role, especially in 1997, by leading certain investors to "cash out" their gains.

As an indication of how significant the recent rise in capital gains has been, we estimate that each $10 billion change in capital gains realizations translates into about $900 million in PIT liabilities. Using this "rule-of-thumb," the jump in gains between 1995 and 1998 has translated into a well-over $3 billion increase in state PIT liabilities.

The level of gains in 1999 and 2000 will likely play a major role in the revenue outlook for 1999-00 and the following year. However, given that the estimate of such gains is dependent on the future direction of the stock market, as well as assumptions about future taxpayer behavior, *any* estimate of the future strength of such gains is subject to considerable risk. Our outlook assumes that, after a healthy increase in 1998, capital gains will increase by about 4 percent in each of the next two years. Our estimates assume that stock market valuations will increase at much more subdued rates than in the recent past. We also assume that the federal tax rate reductions will have somewhat smaller incremental effects in 1999 and 2000 than they did in the past two years.

The slower expected growth in capital gains, coupled with smaller anticipated increases in other forms of earnings such as stock options and business income, will lead to more restrained increases in overall PIT liabilities during 1999 and 2000. We specifically project that PIT liabilities will grow in the range of 6 percent during the next two years.

Personal Income Tax Revenue Forecast. Taking into account both the effects of healthy underlying liability growth in 1998 and the tax relief packages enacted in 1997 and 1998, we forecast that PIT collections will increase from $27.9 billion in 1997-98 to $29.3 billion in 1998-99, a growth rate of 4.9 percent. We further forecast the PIT revenues will reach $30.9 billion in 1999-00 (a 5.6 percent increase) and $32.9 billion in 2000-01 (a 6.2 percent increase), roughly in line with the growth in liabilities we project for the next three years.

The Sales and Use Tax

Background

The sales and use tax is the General Fund's second largest revenue source, accounting for about one-third of the revenue total. There actually are two taxes involved—a "sales" tax and a "use" tax.

The *sales* tax is imposed primarily on the retail sales of tangible goods purchased in California. Taxable sales encompass a wide range of expenditures by individuals and businesses. They include, for example, retail spending on clothing, furniture, appliances, automobiles, and motor vehicle fuel. They also include purchases of building materials that go into the construction of residential and nonresidential structures, as well as purchases by businesses of computers and other capital equipment. Food and services are generally exempt from the sales tax, as are goods purchased for resale.

The *use* tax is imposed on products bought from out-of-state firms by California residents for use in the state. Such purchases are difficult to monitor, and the state is prohibited by the federal government from requiring out-of-state mail-order firms to collect the use tax for California. As a result, only a small percentage of total sales and use tax revenues is from this source.

Sales and Use Tax Rates

Although the sales tax is the General Fund's second largest revenue source, it is the largest single revenue source in California when both state and local taxes are taken into account. As indicated in Figure 10, the total tax rate levied on products is actually the combination of several individual rates imposed by the state and various local governments. These can be divided into three categories:

Figure 10

Sales and Use Tax Rates in California

	Current Rate
State	
General Fund	5.00%
1991 program realignment (Local Revenue Fund)	0.50
Local Public Safety Fund[a]	0.50
Total	**(6.00%)**
Local	
Uniform local taxes[b]	1.25%
Optional local taxes	1.50[c]
Total	**(2.75%)**
Statewide Maximum Rate	**8.75%**

a These revenues are not shown in the Governor's budget totals.
b Levied in all counties.
c Maximum allowable rate, except maximum rate is 1.75 percent in San Francisco City and County, 2 percent in San Mateo County, and 1 percent in San Diego County.

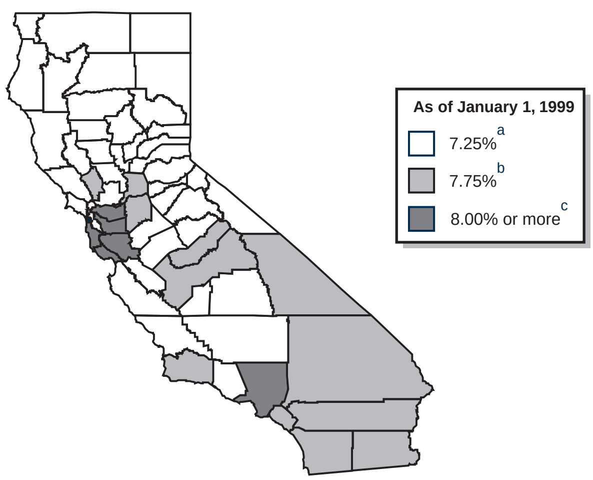
- *State Tax Rates*. These include a 5 percent General Fund rate, plus two one-half-cent rates whose revenues go into special funds that support local programs. The special funds portion includes a 0.5 percent tax to the Local Revenue Fund (which supports health and social services program costs associated with the 1991 realignment legislation) and a 0.5 percent tax to the Local Public Safety Fund (which was approved by the voters in 1993 for support of local criminal justice activities). The public safety sales tax monies are directly provided to localities, and the administration has chosen not to display them in the budget. However, they represent state tax receipts and we report them as such.
- ***Uniform Local Tax Rate.*** A 1.25 percent uniform local sales tax rate is levied in all counties (this is the so-called Bradley-Burns rate). Of this total, .25 percent is deposited in county transportation funds, while the remaining 1 percent is allocated to city and county governments for general purposes. Cities receive the proceeds collected within their boundaries, while counties receive the proceeds from unincorporated areas.

- ***Optional Local Tax Rates.*** Local governments are authorized to levy additional local sales taxes for a variety of purposes. These taxes, which require local voter approval, are normally levied on a countywide basis, primarily for transportation. These taxes can be levied in .25 cent or .50 cent increments, and cannot exceed 1.5 percent (except in San Francisco and San Mateo Counties).

Combined State and Local Tax Rates. The combined state and local sales and use tax rate varies significantly across California. As shown in Figure 11, the combined rate currently ranges from 7.25 percent for counties that impose no optional sales taxes, up to 8.5 percent in the City and County of San Francisco. No county currently imposes the maximum allowable 8.75 percent rate.

Figure 11

Sales Tax Rates Vary by County



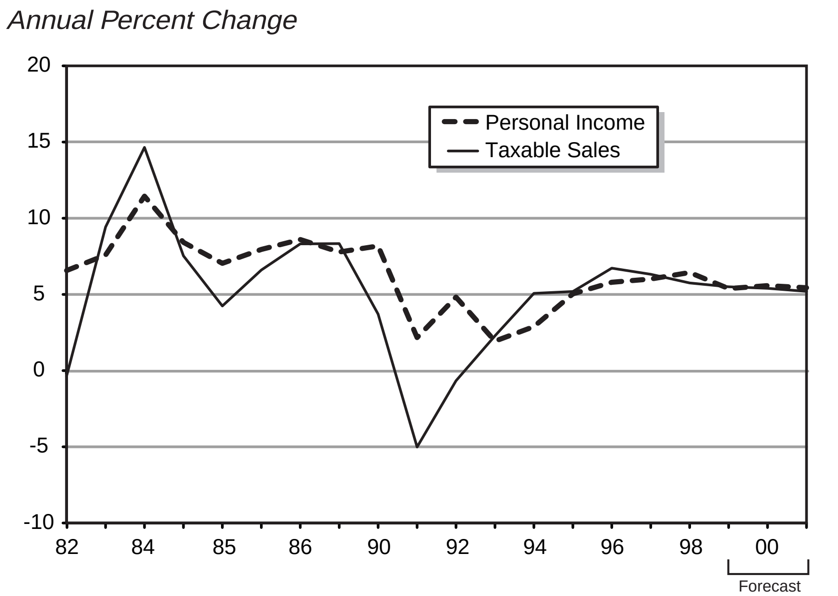
[a] Includes Stanislaus, Nevada, and Solano (7.38 percent); and Sonoma (7.50 percent).
[b] Includes Fresno (7.88 percent).
[c] Includes Santa Cruz (8.00 percent); Alameda, Contra Costa, Los Angeles, San Mateo, and Santa Clara (8.25 percent); and San Francisco (8.50 percent).

Taxable Sales Growth Stable in Recent Years

The main element in the outlook for sales tax receipts is the strength in California taxable sales. Figure 12 compares the annual percentage change in taxable sales to the annual percentage change in California personal income. It shows that during the 1980s and early 1990s, sales were quite volatile, booming during the early stages of the 1980s' expansion, but

Figure 12

Taxable Sales Growth to Mirror Personal Income



falling sharply during the early 1990s' recessionary period. In the more recent recovery, however, taxable sales growth has been relatively stable—and *less* robust than in the past.

This slower growth is partly a reflection of the moderate nature of California's economic expansion in the 1990s, especially in its early stages. However, the somewhat restrained increase can also be attributed to two other factors:

- First, although home construction activity is currently on the rise, its total increase in the current economic expansion is still well below that which occurred in the 1980s. This smaller increase has produced correspondingly less gains from building materials and related sales than occurred in the 1980s.
- Second, the prices of many goods subject to the sales tax—ranging from gasoline to clothing to computers—have been flat or down during the current expansion. Thus, while the *physical quantity* of sales in these categories has been growing strongly, their *dollar-value* has been increasing more slowly.

Outlook—Continued Moderate Growth

We expect that taxable sales will continue to expand at a moderate pace during the next three years. Specifically, after increasing by 5.8 percent in 1998, we project that taxable sales will grow by 5.5 percent in 1999, 5.4 percent in 2000, and 5.2 percent in 2001. As indicated in Figure 12, we expect sales to increase at about the same pace as personal income through the forecast period. Our projections assume that inflation-adjusted spending on autos and other durable goods will subside from their recent rates of increases. However, sales of building materials will continue their strong growth, consistent with our projected increases in residential construction activity during the forecast period.

Based on our projections for moderate taxable sales growth, we forecast that sales tax receipts will grow from $17.6 billion in 1997-98 to $18.6 billion in 1998-99, $19.6 billion in 1999-00, and $20.7 billion in 2000-01.

The Bank and Corporation Tax

Banks and corporations are subject to a general tax rate of 8.84 percent on their California taxable profits. Corporations that qualify for California Subchapter "S" status are subject to a 1.5 percent corporate rate. The income of these companies also is "passed through" for tax purposes to their shareholders, where it is subject to the California PIT. Banks and other financial corporations pay an additional 2 percent tax, which is in lieu of all other state and local levies except taxes on real property, motor vehicle-related levies, and business licenses.

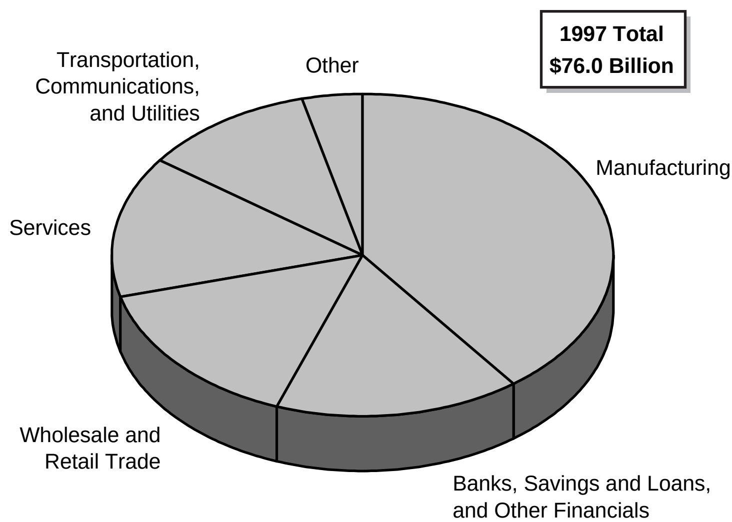
Figure 13 shows the distribution of corporate profits by industry during 1997. It shows companies in the manufacturing sector accounted for about one-third of total statewide profits during the year. Within manufacturing, a large share of earnings is attributable to companies in the computer and electronics industries. Other industries with significant shares of overall earnings are finance, services, trade, and transportation/public utilities.

Earnings Have Slowed Recently

Following the early 1990s' recession, California taxable corporate profits jumped by about 20 percent in both 1994 and 1995. However, earnings growth subsided in the subsequent three years—even as California's broader economic expansion was accelerating. The profit slowdown in 1996 was partly due to consolidations and restructurings in the utilities, telecommunications, and banking industries. The continued slowdown in 1997 (the most recent year for which industry earnings data are avail-

Figure 13

Manufacturing Accounts for One-Third of California Corporate Profits



able) also reflected declining earnings in the state's computer and electronics manufacturing industries.

Corporate tax prepayments in 1998 suggest that earnings growth remained modest last year, increasing by an estimated 4.5 percent from 1997. A key factor depressing profit growth in 1998 was likely the impact of Asia's economic problems on the sales and earnings of California's high-tech manufacturing companies.

Outlook—Profits Growth to Slowly Improve After 1999

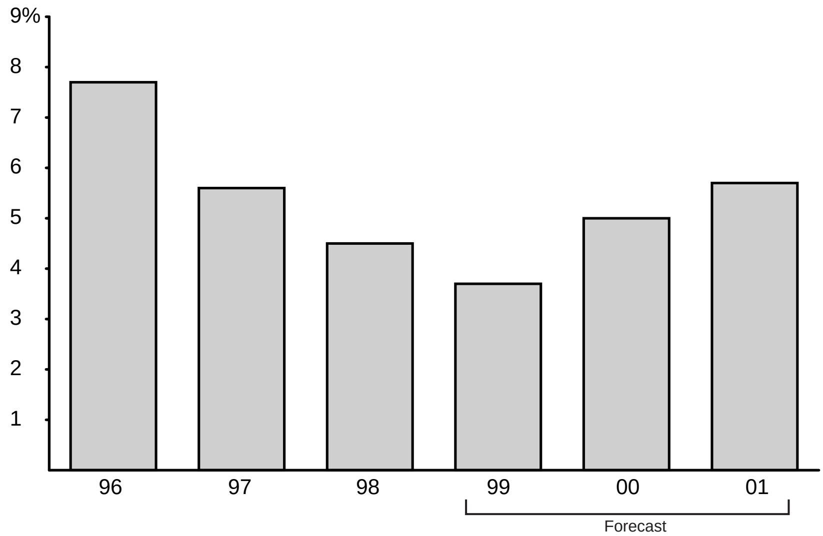
Our outlook calls for continued modest profits growth in 1999 and a mild acceleration thereafter, as shown in Figure 14 (see next page). We specifically forecast that profits will increase by 4 percent in 1999, 5 percent in 2000, and 5.4 percent in 2001. Underlying this aggregate forecast is the assumption that most sectors will experience moderate profit growth over the next three years, but that earnings in 1999 will be held down by continued softness in the high-tech manufacturing sector.

Forecast of Receipts. We forecast that corporate tax receipts will rise just 0.7 percent in the current year, to $5.9 billion. This modest gain reflects our forecast of modest profits growth, as well as three other specific

Figure 14

Profit Growth–Partial Rebound in Store

Percent Change in California Taxable Profits



factors: (1) a large amount of corporate tax refunds processed in November and December of last year, (2) the continued phase-in of the 5 percent corporate tax rate reduction enacted in 1996, and (3) revenue reductions related to the targeted tax cuts enacted last year.

We forecast that BCT receipts will increase to $6.2 billion in 1999-00 and to $6.5 billion in 2000-01. These increases are consistent with the profit gains we forecast for 1999 through 2001.

Outlook for Other General Fund Revenue Sources

The remaining 7 percent of General Fund revenues consists of the insurance, estate, tobacco, and alcoholic beverage taxes, along with a variety of smaller taxes, fees, interest earnings, and transfers from special funds.

We forecast that revenues from all these other sources combined will be $3.2 billion in the current year, an 11 percent decline from 1997-98. The decline reflects a reallocation of trial court revenues from the General Fund to a special trust fund (pursuant to financial court restructuring legislation passed in 1997), and a transfer of $117 million from the General Fund to various special funds in response to a court decision last year.

Other Revenues Include Funds From Tobacco Settlement and One-Time Asset Sales. We forecast that combined revenues from these other sources will jump to $4.1 billion in 1999-00 before falling back to $3.8 billion in 2000-01. The major increase in 1999-00 reflects the assumed receipt of (1) $562 million in tobacco settlement monies and (2) about $180 million in one-time receipts related to the sale of state lands.

The decline between 1999-00 and 2000-01 reflects our assumption that the state will receive tobacco settlement payments in 2000-01 of $442 million–down $120 million from the budget year. Our forecast for 2000-01 also does not assume any revenues related to one-time asset sales.

Excluding the effects of the tobacco settlement, proposed asset sales, and transfers, the underlying trend for the nonmajor General Fund revenue sources is basically flat between 1998-99 and 2000-01. We forecast that insurance and estate taxes will increase modestly during the forecast period. However, these gains will be offset by *declines* in cigarette and alcoholic beverage taxes, as well as for interest earnings on pooled money investments. In particular, we expect that revenues from the 10-cent-per-pack levy on cigarettes will fall significantly, due to the effects of both the tobacco settlement and Proposition 10 on the quantity of cigarettes sold in this state.

THE BUDGET FORECAST FOR SPECIAL FUNDS REVENUES

Special funds revenues support a wide variety of state and local government programs. As shown in Figure 15 (see next page), nearly one-half of special funds revenues are related to motor vehicle-related taxes and fees. These include motor vehicle license fees (which are distributed to local governments for general purposes), and fuel taxes and registration fees (which support transportation-related projects). Other major special funds revenues include sales taxes and tobacco-related taxes.

Special funds revenues are projected to grow from $16.2 billion in 1997-98 to $17 billion in 1998-99, and $17.1 billion in 1999-00. The current-year and budget-year revenue totals are affected by two special factors. The first is the VLF measure, which lowers special funds revenues (and increase General Fund costs) by about $557 million in the current year and $1,080 million in 1999-00. The second factor is the voter's approval of Proposition 10 on the November 1998 ballot. This measure provides for a 50-cent-per-pack increase in cigarette taxes (and an equivalent increase in taxes on other tobacco products) beginning in January 1999. The new tobacco tax proceeds are earmarked for childhood development programs. The measure will result in increased special funds revenues of

$360 million in 1998-99 and about $690 million in 1999-00, with declining amounts thereafter due to declining consumption.

Special funds revenues from other sources are projected to increase at slow-to-moderate rates. Motor vehicle fuel taxes are projected to increase 2.2 percent in 1999-00, reflecting modest gains in fuel consumption. Registration, weight, and miscellaneous fees are projected to rise 1.7 percent in the budget year, reflecting slow growth in overall vehicle registrations, and zero growth in new vehicle registrations in the state. Special funds sales tax receipts are expected to increase at slightly more than 5 percent next year, the same as for General Fund receipts from this source.

Figure 15

Special Funds Revenues and Transfers

1997-98 Through 1999-00
(Dollars in Millions)

			1999-00	
Revenue Source	**Actual 1997-98**	**Estimated 1998-99**	**Forecast Amount**	**Percent Change**
Motor Vehicle Revenues				
License fees (in lieu)[a]	$3,841	$3,549	$3,256	-8.3%
Fuel taxes	2,854	2,951	3,015	2.2
Registration, weight, and miscellaneous fees	1,741	1,794	1,824	1.7
Subtotals	($8,436)	($8,294)	($8,095)	(-2.4%)
Other Sources				
Sales and use tax[b]	$3,758	$3,915	$4,118	5.2%
Cigarette and tobacco taxes[c]	483	802	1,091	36.0
Interest on investments	185	176	171	-2.8
Other revenues	3,424	3,681	3,712	0.8
Transfers and loans	-49	123	-57	—
Totals	**$16,237**	**$16,991**	**$17,130**	**0.8%**

[a] Includes impact of Vehicle License Fee rate reduction.
[b] Includes Local Public Safety Fund revenues. These amounts are not included in the Governor's budget totals.
[c] Includes impact of Proposition 10, which was approved by voters in November 1998.