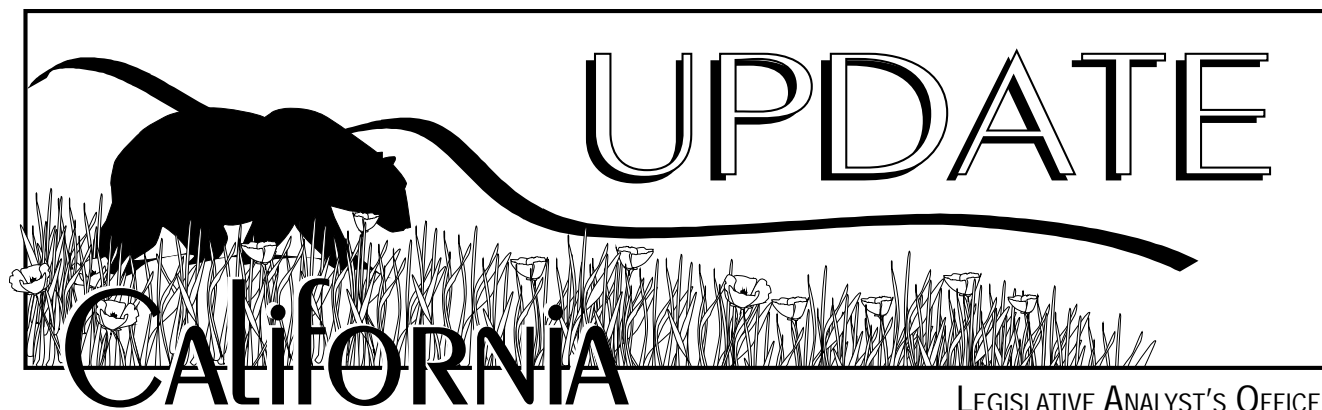


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LEGISLATIVE ANALYST'S OFFICE

California's Extraordinary Revenue Developments

General Fund revenues have been accumulating at a dramatic pace in early 2000—far outdistancing the Governor's January budget forecast, and substantially outpacing our own projections presented in our *Perspectives and Issues* released in February. Cash receipts during the December-through-March period were up from the budget by \$2.3 billion, reflecting particularly large gains in personal income tax receipts, but also sizable increases in sales and corporate tax collections. The revenue performance in recent months is the strongest since the early 1980s, and portends a dramatic upward revision to the revenue outlook in May.

In this update, we review recent positive economic and revenue developments, and discuss their potential implications for California's budget outlook. It should be noted that while recent California economic developments have been extremely positive, they do not fully explain the current extraordinary strength in revenue receipts.

Recent Economic Developments

Performance Outdistancing Expectations.

Economic activity at both the national and state levels is far surpassing earlier forecasts. Updated historical estimates indicate that U.S. real gross domestic product (GDP) increased at an annual rate of 7.3 percent in the fourth quarter of 1999, and more current monthly data on production, sales, and employment suggest that the pace of economic growth moderated only slightly in early 2000. As a result of these increases, the near-term economic forecasts of economists are being revised sharply upward, with the "consensus" projection for real GDP growth in 2000 nearing 5 percent—or two full percentage points more than the consensus forecast made in December 1999.

State Leading the Nation. Although comprehensive GDP data are not routinely produced at the state level, the available evidence suggests that California has been a leader in the recent national economic boom. For example, nonfarm payroll employment in the state has increased by more than 42,000 jobs per month since

November 1999. Similarly, taxable sales in the fourth quarter of 1999 were up by more than 10.7 percent, and home construction in early 2000 is up sharply from the prior year.

Employment-Related Withholding Soaring.

Probably the single most impressive economic-related indicator, however, has been state withholding payments, which are increasing at an unprecedented rate. While withholding payments are traditionally thought of in terms of their role as a key revenue source (see below), they also provide important and timely insights into the strength of the state's overall economy since they are reflective of both current job and income trends.

Withholding receipts would normally be expected to show year-over-year growth rates of roughly 8 percent to 10 percent during an economic expansion. However, in recent months, these payments have soared, increasing by 17 percent in the fourth quarter of 1999, and nearly 20 percent in the first quarter of 2000 (see Figure 1). This current perfor-

mance is all the more impressive in that this year's gain is "on top of" a very strong performance in 1999.

The strikingly strong withholding gains partly reflect rapid growth in high-wage jobs in the state's computer and software industries. However, the recent gains also are due to high volume and strong financial performance of initial public offerings for many companies, as well as more general increases in stock option-related income in late 1999 and early 2000 (both of which are subject to withholding).

Revenue Performance

The *2000-01 Governor's Budget* revenue projections incorporated actual revenue data through November 1999, and included monthly cash receipts estimates for the balance of 1999-00 and 2000-01. Based on preliminary data for March, it appears that actual revenues for the December-through-March period exceeded the budget's projections for these months by \$2.3 billion. While nearly two-thirds of the year-to-date increase is due to the personal income tax, all three of the state's major taxes are up substantially from their respective estimates (see Figure 2).

Personal Income Taxes. These revenues were up \$1.5 billion during the four-month period. The cumulative increase is partly due to much stronger-than-expected quarterly estimated tax payments in December and January. As indicated in our *Perspectives and Issues*, these payments were up by over 35 percent from the prior year, more than double the increase anticipated by the budget. In addition, withholding payments during the past four months have exceeded the budget forecast by \$780 million, due to particularly large gains in February and March.

Figure 1

Withholding Payments Soaring

Year-Over-Year Percent Growth in Personal Income Tax Withholding, by Quarter

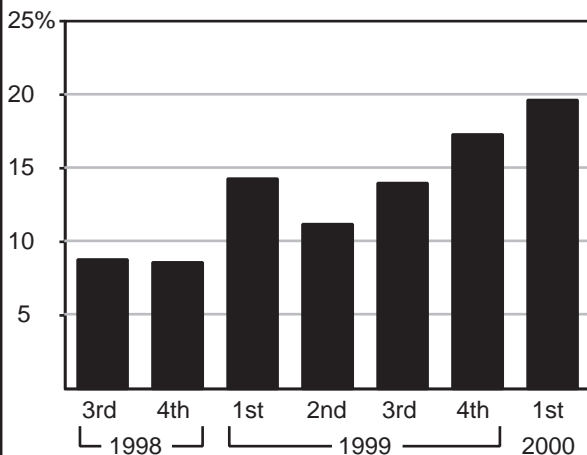


Figure 2

All Major Revenue Sources Up From Budget Forecast

(Dollars in Millions)

Revenue Source	Cumulative Increase December 1999 Through March 2000	
	Amount	Percent
Personal income tax	\$1,492	13.0%
Sales and use tax ^a	314	4.7
Bank and corporation tax	321	21.5
Other ^b	150	10.3
Totals	\$2,277	10.5%

^a Preliminary estimate.

^b Based on incomplete data for March.

Sales and Use Taxes. These receipts were up \$314 million during the four-month period. This increase reflects a very strong performance during the 1999 Christmas shopping season, as well as stronger-than-expected prepayments toward first quarter 2000 taxable sales activity. Clearly, the recent and current growth in household wealth and income is having a major effect on retail spending in California.

Bank and Corporation Taxes. These collections are up by \$321 million, primarily due to stronger-than-expected final payments on 1999 profits. The increase is an encouraging sign that the boom in business activity is finally being reflected in stronger taxable corporate earnings.

Outlook for the Remainder of 1999-00

The revenue performance for the full 1999-00 fiscal year will be determined not only by the strength in receipts to date, but also by developments during the crucial April-through-June period (when the state is expected to collect more than \$20 billion in revenues). Of particular importance will be the strength in final personal income tax payments during April. However, to provide an illustration of the potential full-year implications of recent developments, we estimate that if current strong trends continue through the end of the year, revenues in 1999-00 will exceed the administration's January budget forecast by more than \$4 billion.

We will incorporate current economic and revenue developments—as well as information on final payments in April—into our next forecast which will be presented following release of the May Revision. Our updated projections will take into account the effects of current strong trends on revenues during *both* the current year and the budget year.

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About the LAO

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