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CALIFORNIA UPDATE

LEGISLATIVE ANALYST'S OFFICE

California's Cash Crunch

The state's ongoing fiscal crisis has focused attention on the annual enactment of the budget. After enactment of the budget, however, the state must arrange the financing to carry out the budget plan, including funding for deficits carried over from prior years.

$3.2 Billion Warrant Sale Helps Finance State Deficit

On February 15, the State Treasurer and the State Controller sold a total of $3.2 billion of revenue anticipation warrants (RAWs) in order to help finance General Fund spending into 1994-95. This amount consists of $2 billion that will mature on July 26, 1994 and $1.2 billion that will mature on December 21, 1994. In addition to these RAWs, the state has $4.7 billion of other loans outstanding in March, for a combined total of $7.9 billion in short-term financing. This other $4.7 billion consists of $2 billion of 1993-94 revenue anticipation notes (RANs) maturing in June and about $2.7 billion of loans from special funds. The RAWs and special fund loans will cover an estimated $5.3 billion cash shortfall at the end of the current fiscal year.

The Role of Cash Borrowing. Traditionally, the state has used short-term, cash borrowing to help finance spending in the earlier part of the fiscal year, when revenues are low, until the latter part of the year, when revenue flows pick up. Over the last several years, the state also has used cash borrowing to finance its annual budget deficits.

There are two primary types of short-term, cash borrowing. "Internal" borrowing from other state funds is a flexible and readily available source of financing. The amount of available fund balances ranges between $2.5 billion to $3.5 billion in any month. Larger cash shortfalls, such as those that the state currently faces, require "external" borrowing by selling RANs or RAWs to investors. The state generally issues RANs after a budget has been enacted and repays them during the same fiscal year. RAWs generally extend into the next fiscal year and are issued before a budget has been enacted for that year.

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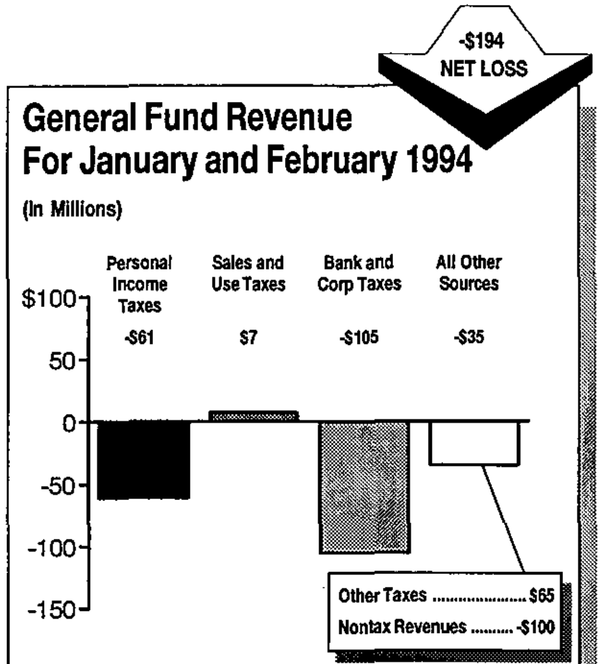
Revenues Through February Below Forecast

This report evaluates revenue collection data for the two months since publication of the Governor's Budget in early January. At the end of February, General Fund revenues were a cumulative $237 million below (-0.9%) the Department of Finance's latest forecast for the 1993-94 fiscal year. For January and February combined, revenues were $194 million, or 2.9%, below Finance's forecast for the two months. The other $43 million shortfall in the cumulative total reflects adjustments to initial estimates of December receipts. The majority of the shortfall reflects cash flow issues that have temporarily reduced revenues. Consequently, revenues are running only slightly behind Finance's forecast.



[a] Detail may not add to totals due to rounding.

Personal Income Tax Shortfall. Revenues for January and February were $61 million below forecast for the Personal Income Tax (PIT). Although receipts were down overall, withholding collections, which represent two-thirds of income tax collections and closely track the state economy, were slightly above the forecast. The shortfall resulted primarily from below-forecast estimated and final payments on 1993 liabilities. The March 15-April 15 period will essentially determine whether PIT revenues for the current fiscal year meet budget projections.

Sales Tax Revenues on Target. Revenues for January and February were $5 million above forecast. However, because of post-budget adjustments to estimated December receipts, cumulative revenues to date are slightly below forecast. January was $172 million above forecast, while February was $165 million below forecast. These large monthly divergences from forecast may have been due to the ongoing impacts on monthly collections of electronic funds transfer (begun last year).

Bank and Corporation Revenues Weakest. Revenues for January and February were $106 million below forecast. Around $89 million of this shortfall was attributable to faster-than-expected refund processing at the Franchise Tax Board and should be offset by lower refund payments later in the year.

Remaining Revenue Sources Below Target. Revenues for January and February were $34 million below forecast. Most of the shortfall appears to be based on cash flow issues.

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Cash Borrowing No Longer Just Temporary

Figure 1 shows monthly General Fund cash borrowing from internal and external sources for 1992-93, 1993-94 and through December 1994. Outstanding loans are about twice the amount of monthly General Fund spending. Monthly borrowing averaged $7 billion in 1992-93, and is projected to average $6.5 billion in 1993-94 and $8.8 billion in the first half of 1994-95, based on estimates by the State Controller from the *Official Statement* for the February RAW sale.

The 1994-95 borrowing estimates are larger than those in the Governor's Budget, as they assume that the state will realize only $600 million of $3.7 billion assumed in the Governor's Budget from new federal funds and a favorable U.S. Supreme Court decision in the *Barclays* tax case. Although the estimates do not extend past 1994, when all of the new RAWs will be paid off, the Treasurer's Office indicates that the amount of anticipated borrowing will increase even further in 1995.

The figure also shows that the state's monthly loan balance never falls below $4.4 billion during this two-and-a-half-year period. In effect, a significant portion of the state's cash borrowing is being "rolled over" from one fiscal year to the next. The state also is becoming more dependent on external borrowing because budget problems also have reduced available special fund balances.

Borrowing Costs Are Significant. The state sold the $3.2 billion of February RAWs at effective average interest rates of about 2.8 percent for the July RAWs and about 3.0 percent for the December RAWs. Thus, external borrowing currently costs the state about $30 million annually for each billion dollars of average monthly borrowing. Including the cost of internal borrowing, interest on the average loan balance in 1993-94 ($6.5 billion) will cost about $200 million this year. Increasing the average loan balance to $8.8 billion, as estimated for the first half of 1994-95, could increase borrowing costs by roughly $70 million annually. Large amounts of borrowing also expose the state to the risk of increases in short-term interest rates. An increase of one percentage point in interest rates could increase borrowing costs by up to $80 million in 1994-95, depending on the amount of borrowing.

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Figure 1

General Fund Cash Borrowing Outstanding Loan Balances by Month

(In Billions)