



National Economy

In fiscal year 2005-06 the national economy had average growth despite rising interest rates, increasing energy prices, and the disruptions caused by Hurricane Katrina and other major hurricanes along the Gulf Coast. The economy was also characterized by relatively high inflation, increasing employment, high profits, and declining residential building activity. The unemployment rate fell slightly during the year.

Gross Domestic Product

Real gross domestic product (GDP)—the broadest measure of the nation's output of goods and services—increased 3.2 percent in 2005, down from 3.9 percent growth in 2004. This real GDP growth was close to its ten-year average of 3.3 percent. Nonagricultural employment increased 1.5 percent, up from 1.1 percent in 2004.

Real GDP by Sector

Investment spending led all other categories in 2005. Real domestic fixed investment spending, which made up 16 percent of total real GDP, grew 7.5 percent in 2005. Major components of investment had varying growth rates. The largest component, equipment and software, jumped 8.9 percent in 2005. Strong profits growth and the need to replace aging equipment were major factors behind the rapid increase in equipment spending. Residential investment increased 8.6 percent in 2005, but declined in the first half of 2006. Increases from historically low interest rates in 2004 discouraged home building activity by late 2005 and into early 2006. Investment in nonresidential structures, such as office buildings, increased 1.1 percent.

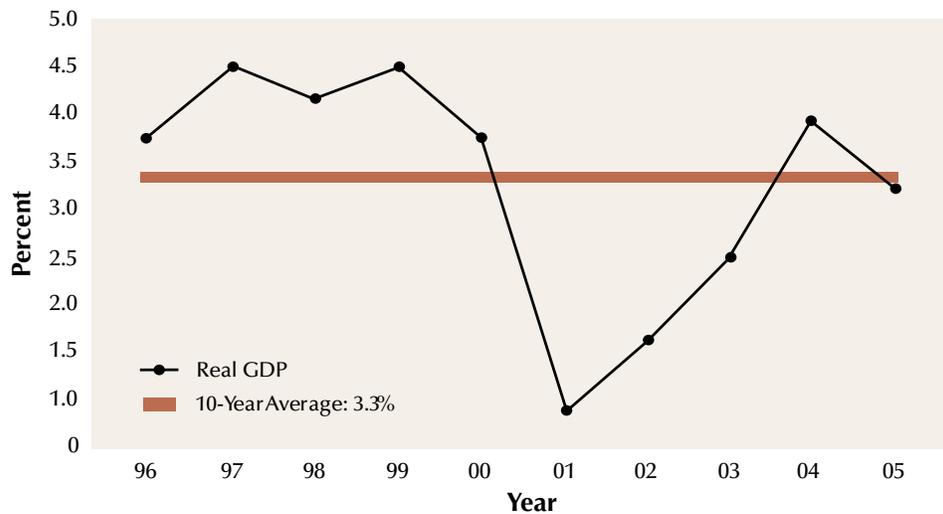
Real exports increased 6.8 percent in 2005, reflecting continued growth in the economies of our major trading partners. Despite rising crude oil prices, real imports increased somewhat slower, 6.1 percent, resulting in a slightly improving trade balance.



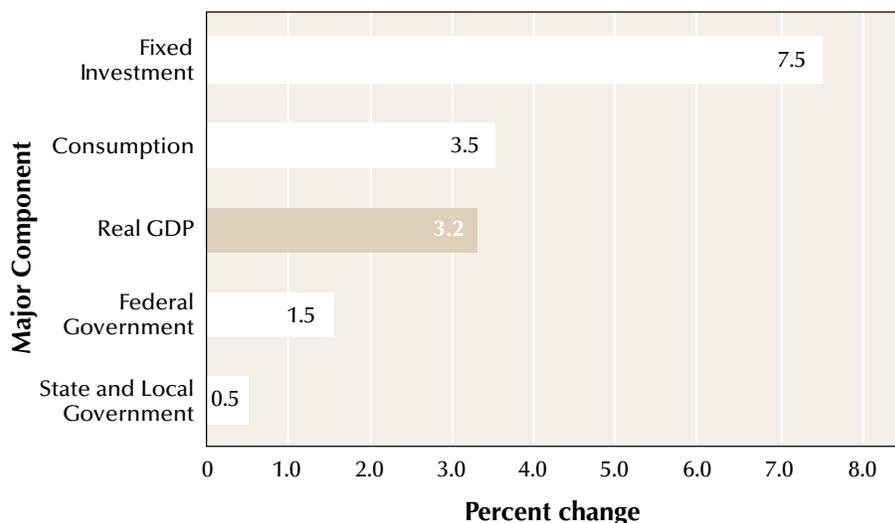
Real consumer spending increased by 3.5 percent, a growth rate slightly above real GDP. Consumer spending is very important to GDP growth, since it accounts for 70 percent of total GDP. The fastest growing component of consumer spending was durable goods, which increased 5.5 percent, followed by nondurable goods at 4.5 percent and services at 2.6 percent.

Real government spending on goods and services grew by just 0.9 percent in 2005, pulling down real GDP growth. Federal government spending increased 1.5 percent, much faster than state and local government spending, which inched up 0.5 percent.

Growth in Real GDP, 1996–2005



2005 Growth in Real GDP and Major Components



Real national defense spending rose 1.7 percent, while nondefense grew 1.1 percent.

The Unemployment Rate

The U.S. unemployment rate averaged 5.1 percent in 2005, lower than the 5.5 percent rate of 2004. This was well below the 5.8 percent average for the decade of the 1990s.

Corporate Profits

Corporate profits increased 12.5 percent in 2005. This was the fourth straight year of double-digit gains in profits.

Productivity and Consumer Prices

Business productivity increased 2.3 percent in 2005. This was the weakest growth in several years, continuing a trend of slower growth since 2002. Business productivity expanded an average of 3.0 percent per year over the past 10 years.

The U.S. consumer price index rose 3.8 percent in fiscal year 2005-06, up from 3.0 percent in fiscal year 2004-05. Rising energy prices were a major cause of the higher inflation rate. This was the fastest increase in consumer prices since fiscal year 1990-91, the year of the Persian Gulf War.

Interest Rates and the Federal Budget Deficit

The Federal Reserve Board raised interest rates by increments of 0.25 percent each of the eight times that the Board met in 2005-06. The federal funds rate increased from an average of 3.0 percent for June 2005 to an average of 5.0 percent for June 2006. Long term interest rates also rose throughout the fiscal year, but less rapidly. Conventional fixed mortgage rates for new homes averaged 6.2 percent in 2005-06, up from 5.9 percent in 2004-05. Although mortgage rates increased, they were still relatively low by historical standards. Thirty-year conventional fixed mortgage rates averaged 8.1 percent over the decade of the 1990s.

With strong growth in corporate and personal income taxes, the federal budget deficit decreased from \$319 billion in federal fiscal year 2004-05 to \$248 billion in 2005-06 (October 1 to September 30). The 2005-06 deficit was about 2.0 percent of GDP. The deficit was lower in relation to GDP than it has been in several years. The highest ratio of the past 50 years was fiscal year 1982-83, when the federal budget deficit was 6.0 percent of GDP.



California Economy

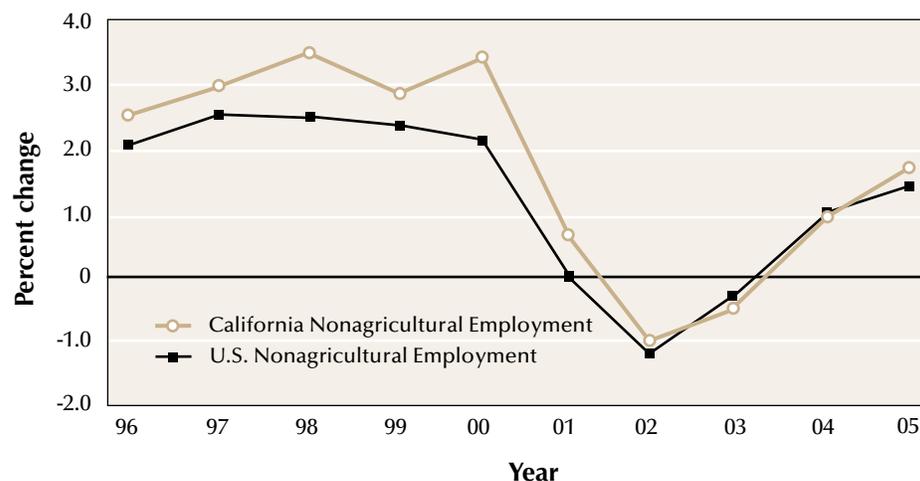
The California economy grew briskly in 2005, faster than the U.S. economy. California real gross domestic product rose 4.3 percent in 2005, above the U.S. real GDP growth rate of 3.2 percent. Personal income rose 5.4 percent in 2005, more than keeping pace with the state's 3.7 percent increase in consumer prices. The California unemployment rate was 5.4 percent in 2005, down from 6.2 percent in 2004. Contrary to most of the rest of the economy, both new home building and existing home sales began to decline in late 2005 as consequences of rising interest rates over the past two years.

Employment and Income Growth

California nonagricultural employment increased 1.8 percent in 2005, as payrolls expanded by 255,000 jobs. California jobs increased somewhat faster than U.S. payroll growth of 1.5 percent. All major industries had gains in jobs except for manufacturing and information services, which had small declines. The average annual unemployment rate was 5.4 percent in 2005, 0.3 percent above the U.S. rate.

California personal income increased by 5.4 percent, slightly above a national personal income increase of 5.2 percent. This nearly matched the 5.2 percent average growth of the 1990s.

Growth in California and U.S. Nonagricultural Employment, 1996–2005



Employment Sectors

Professional and Business Services. The professional and business services category is the state's third largest sector, employing 15 percent of Californian nonagricultural workers. This sector gained 62,600 jobs, more than any other major sector. This was a 3.0 percent increase. Professional services such as management and scientific consulting, architectural design and computer systems design added the most jobs.

Trade, Transportation and Utilities. This is the state's largest employment sector, accounting for about 19 percent of all nonfarm jobs. In 2005, about 58,800 jobs were added, the second largest employment gain of any industry and a 2.1 percent increase. Most of the new jobs were in retail trade, particularly general merchandise and apparel stores.

Construction. About 6 percent of nonfarm jobs are in construction. In 2005 construction employment increased by 51,400 jobs or 6.0 percent. Many of the additional jobs were associated with more home building activity, which slowed in early 2006.

Leisure and Hospitality. Leisure and hospitality industries, such as restaurants and hotels, employ about 10 percent of nonfarm Californian workers. Employment increased 2.4 percent in 2005, a gain of 35,000 jobs. The jobs created were widespread within this industry.

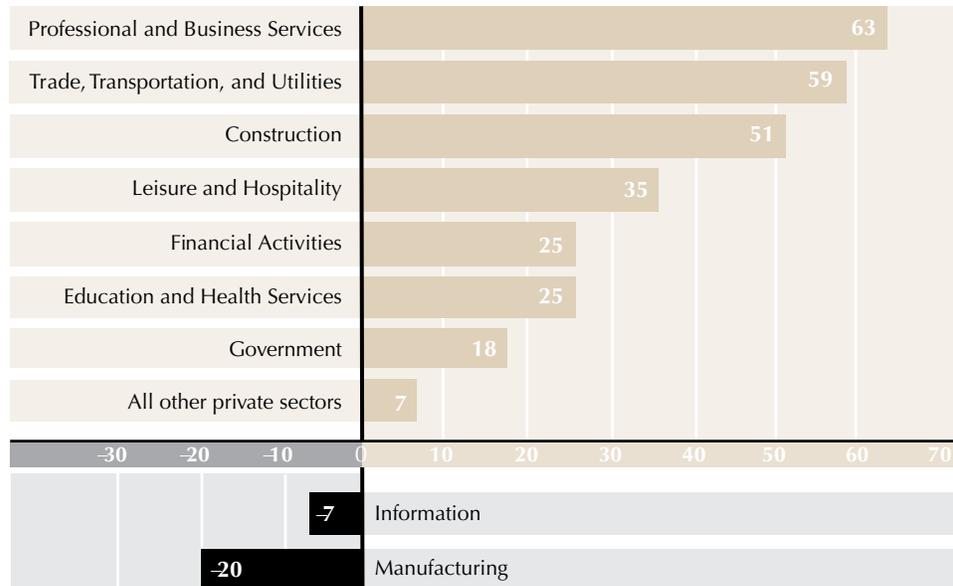
Financial Activities. Employment in financial activities—which includes lenders, insurance agents, and real estate brokers—accounts for about 6 percent of nonfarm Californian jobs. Financial activities increased by 24,600 jobs, a gain of 2.4 percent.

Educational and Health Services. Private educational and health services are a relatively large sector, accounting for about 11 percent of nonfarm employment. This sector gained 24,500 jobs, a 1.6 percent increase.

Government. Government is California's second largest sector, with 16 percent of all California nonagricultural jobs. About 18,400 new government positions were filled—a 0.8 percent increase. Federal payrolls decreased, while state and local government hiring increased in 2005. Employment among Indian tribes, defined as part of the government sector, jumped by 13.3 percent, largely as a consequence of casino expansions.



2005 California Growth in Nonagricultural Employment by Employment Sector (Thousands of Jobs)



Other Sectors. The remaining private industry sectors (other services, mining and natural resources) provide employment for 4 percent of nonagricultural workers. Employment in this group increased by 1.4 percent.

Information. Information providers—publishing, motion pictures, broadcasting, telecommunications and Internet services—lost 7,400 jobs, a 1.5 percent decrease. Job losses for information providers were widespread, as most sectors except for broadcasting and Internet service providers reduced payrolls. Information jobs account for a relatively small share of state jobs, about 3 percent.

Manufacturing. The manufacturing sector, which employs 10 percent of workers on nonagricultural payrolls, had the largest jobs decline of any private sector of the California economy. A total of 20,400 jobs were lost in manufacturing in 2005, a 1.3 percent reduction from 2004. Jobs losses were widespread among many durable goods and nondurable goods manufacturing industries.

Building Construction and Home Prices

The value of all private building construction permits issued in California increased by just 1.6 percent in 2005 (measured in inflation-adjusted 2005 dollars). The value of residential construction permits

issued decreased 0.9 percent, while nonresidential building construction permit values rose 8.8 percent. Values of all major types of nonresidential building permits (industrial buildings, offices, stores and hotels) expanded in 2005. Home building permits decreased from 213,000 units in 2004 to 209,000 in 2005. Though home permits declined, this was the second largest number of homebuilding permits issued since 1989.

Monthly year-over-year home prices increased rapidly throughout most of 2005, then started slowing in early 2006. The slowdown was largely the result of increases in mortgage interest rates. In fiscal year 2005-06 statewide median home prices rose 14 percent, with the median price of an existing single-family detached California home averaging \$553,400. Monthly existing single-family detached home sales generally declined throughout the fiscal year with the increases in mortgage rates. Statewide sales of homes totaled about 558,900 in fiscal year 2005-06, a 12 percent decrease from 2004-05. Despite the declines, home sales were still relatively high relative to historical norms. During the decade of the 1990s an average of about 403,000 existing California homes were sold each year.

Consumer Prices

Following the national trend, California consumer prices rose faster in 2005, largely because of higher energy costs. Statewide consumer prices for all urban consumers rose 3.7 percent in 2005, up from 2.6 percent increase in 2004. At the national level, the consumer price index increased by 3.4 percent in 2005, up from 2.7 percent in 2004.

Taxable Sales Activity

Transactions subject to the sales and use tax totaled \$553.5 billion during the 2005-06 fiscal year. This was an increase of \$38.2 billion, or 7.4 percent, over 2004-05. Taxable sales grew in every quarter, starting with a 10.1 percent increase in the third quarter of 2005 and ending with an increase of 5.4 percent in the second quarter of 2006 ([see table, on the next page](#)).

Taxable sales increased by 4.7 percent over the previous fiscal year when measured in constant dollars. The California Taxable Sales Deflator—an index that tracks price changes only for commodities subject to the sales and use tax—showed annual inflation of 2.6 percent. By quarter, the Deflator indicated inflation for tax-



able goods within a range of 2.1 percent to 3.2 percent throughout the fiscal year. The 2.6 percent inflation rate shown by the Deflator contrasted with the 4.2 percent rate indicated by the California Consumer Price Index, which also measures price increases for housing costs and services, which are not subject to the sales and use tax.

California retail stores reported taxable receipts of \$386.6 billion in 2005-06, an increase of 7.2 percent over the prior fiscal year.

“Business and personal service establishments” had taxable transactions amounting to \$23.6 billion, an increase of 4.1 percent. This category comprises businesses whose tax liability is based mainly on the sale of materials and parts. Much of their income comes from nontaxable service and repair labor.

Taxable sales for the “All Other Outlets,” category totaled \$143.4 billion, an 8.6 percent increase from 2004-05. This category is made up of diverse manufacturers and wholesalers, construction contractors, petroleum producers, publishers, and a multitude of part-time permittees. The bulk of their business is not taxable.

Appendix Table 19, on [page A-24](#), shows details on sales tax activity and the number of sales tax permittees by business type. Of the 37 retail business types listed in that table, all but two experienced increases over the previous year. Of major sectors, the greatest increase in sales was in service stations, while the most significant percentage decrease was in new motor vehicles.

2005-06 Taxable Sales
Growth in Actual Dollars Compared to Growth
in Constant-Value Dollars

Quarter	Taxable Transactions		Percent Change from Prior Year in		
	Amount	Percent of Total	Actual Dollars	Constant Value Dollars	California Taxable Sales Deflator
July-Sept	\$139,230,558,000	25.2	10.1	6.7	3.2
Oct-Dec	\$143,553,106,000	25.9	6.6	4.4	2.1
Jan-March	\$128,778,913,000	23.3	7.9	5.7	2.1
April-June	\$141,957,258,000	25.6	5.4	2.3	3.1
Fiscal Year	\$553,519,835,000	100.0	7.4	4.7	2.6

2005-06 Taxable Sales of Service Stations Compared to Gasoline Distributions

Quarter	Taxable Transactions		Gasoline Distributions			
	Amount	Percent Change Year to Year	Gallons	Percent Change Year to Year	Estimated Expenditure	Percent Change Year to Year
July-Sept	\$10,900,545,000	29.7	4,071,793,275	0.2	\$10,437,720,332	28.3
Oct-Dec	\$9,959,930,000	15.6	3,954,942,237	-0.1	\$9,535,705,999	13.6
Jan-March	\$9,465,815,000	18.5	3,873,495,149	0.8	\$9,077,732,336	17.1
April-June	\$12,050,106,000	24.0	3,973,513,120	-1.9	\$11,689,628,088	24.2
Annual	\$42,376,396,000	22.0	15,873,743,781	-0.3	\$40,740,786,755	20.9

Retailers specializing in nondurable goods outperformed stores dealing mainly in durable goods, with taxable sales increases of 9.6 percent and 4.8 percent, respectively.

Nondurable goods

Service stations. Service station sales increased dramatically for the fourth year in a row. Their taxable transactions grew by 22.0 percent in 2005-06 to total \$42.4 billion. While today's service stations are often minimarts that sell a variety of products, gasoline is still their main stock in trade. In 2005-06, consumption of gasoline decreased by 0.3 percent, remaining at 15.9 billion gallons. At the same time, the average yearly price of gasoline jumped 21.2 percent, growing from \$2.116 per gallon in 2004-05 to \$2.565 in 2005-06.

Other retailers. Other nondurable goods retailers also saw their sales increase during the fiscal year. General merchandise stores reported taxable sales of \$52.0 billion, a 6.0 percent increase over 2004-05. Restaurants' taxable sales totaled \$47.9 billion, an increase of 7.1 percent.

Durable goods

New car dealers. New car dealers reported a small sales decline this year. Their taxable sales decreased by 1.1 percent over the previous fiscal year, to \$60.7 billion. In comparison, the number of vehicles sold in 2005-06 increased by 1.2 percent compared to 2004-05.

According to the Department of Motor Vehicles, new vehicle registrations in 2005-06 totaled 2,275,337. This was an increase of



2005-06 New Vehicle Registrations and Taxable Sales of New Car Dealers

Quarter	New Vehicle Registrations						Taxable Sales of New Car Dealers	
	Automobiles		Trucks		Total		Amount	Percent Change Year to Year
	Number	Percent Change Year to Year	Number	Percent Change Year to Year	Number	Percent Change Year to Year		
July-Sept	478,741	7.0	134,672	16.3	613,413	8.9	\$17,226,356,000	7.9
Oct-Dec	418,549	-2.3	96,699	-7.1	515,248	-3.2	13,924,662,000	-6.1
Jan-March	461,932	1.5	101,801	0.7	563,733	1.4	14,255,338,000	-1.2
April-June	480,287	-0.7	102,656	-9.4	582,943	-2.4	15,298,577,000	-5.1
Fiscal Year	1,839,509	1.4	435,828	0.3	2,275,337	1.2	\$60,704,933,000	-1.1

26,235 registrations, or 1.2 percent, from 2004-05. New automobile registrations rose 1.4 percent, totaling 1,839,509. New truck registrations rose 0.3 percent, to 435,828.

Construction and home-related businesses. California's construction industry provided above average growth in most related business categories. Construction contractors posted taxable sales of \$24.8 billion, an increase of 14.1 percent. Sales for the building material group rose by 9.0 percent to total \$37.1 billion. That group includes lumber and building material stores, hardware stores, plumbing and electrical supply stores, and paint, glass, and wallpaper stores.

In contrast to construction materials sales, household and home furnishings stores and household appliance dealers both had below average increases in taxable transactions. Household and home furnishings stores' taxable sales totaled \$13.1 billion, an increase of 5.4 percent, while household appliance dealers' sales reached \$4.5 billion, an increase of 1.2 percent.

Specialty stores. Another group of durable goods retailers, specialty stores, experienced close to average growth during the fiscal year. Specialty store sales were \$54.2 billion, up 7.9 percent from 2004-05. The specialty store group includes retailers who specialize in sales of sporting goods, jewelry, musical instruments, office and school supplies, toys, books, and other products. Every specialty retailer type except photographic equipment dealers reported taxable sales growth in 2005-06.

Revenue Growth

Tax programs administered by the Board of Equalization produced state and local revenues totaling \$52,984,773,000 during fiscal year 2005-06. This was an increase of \$3.0 billion, or 6.1 percent, from 2004-05. Growth in the California economy was primarily responsible for the increased revenues.

Revenues from each tax are presented in the text table on [page 79](#). Additional detail and historical comparisons are found in Appendix Table 2, on [page A-2](#).

Sales and Use Taxes

Sales and use taxes contribute 84 percent of the revenue from Board-administered tax programs. Combined revenue from all state and local sales and use taxes totaled \$44,300,734,000 in 2005-06, an increase of 6.8 percent from 2004-05. The state's portion of the sales tax was \$29,331,848,000 (including the fiscal recovery fund). The portion allocated to other jurisdictions—cities, counties and special districts—totaled \$14,968,886,000, including allocations to the Local Revenue Fund and the Public Safety Fund. Sales and use tax details are provided in Appendix Tables 19 through 23B, beginning on [page A-24](#).

By the end of the fiscal year, special district taxes were being levied by 77 jurisdictions in 35 counties (see “District Transactions (Sales) and Use Tax,” on [page 33](#)). These counties are the source of 91 percent of all taxable sales in the state. Some districts cover entire counties while others are restricted to city limits or other legal boundaries. Special district information is located in Appendix Table 21C, on [page A-30](#). Appendix Table 23B, on [page A-34](#), lists total sales and use tax rates by county.

Special Taxes

Fuel taxes. In 2005-06, the state's fuel tax revenues totaled \$3,425,886,000, a 0.9 percent increase from the previous fiscal year. Distribution of gasoline for highway use decreased 0.3 percent to 15.9 billion gallons. Historical fuel tax data are presented in Appendix Tables 24–26, beginning on [page A-35](#).

Alcoholic beverage tax. The state's excise tax revenues from alcoholic beverages increased 1.3 percent from 2004-05 levels to total \$318,282,000 for the fiscal year. Revenues from beer and wine increased to \$157,627,000, while revenues from distilled spirits



decreased to \$160,654,000. Tax rates range from twenty cents a gallon for wine to \$3.30 per gallon for distilled spirits. For historical data on taxes, total apparent consumption, and per-capita apparent consumption by major type of beverage, see Appendix Tables 27-29, beginning on [page A-39](#).

Cigarette and tobacco taxes and fees. Revenue from excise taxes on cigarettes and other tobacco products totaled \$1.09 billion in 2005-06, an increase of just 0.2 percent from the previous year. For more information on these taxes, see Appendix Tables 30A and 30B, which begin on [page A-42](#).

Insurance taxes. Insurance taxes were \$2,001,281,000 in 2005-06, a 1.4 percent increase. For more information on these taxes, see Appendix Tables 31-33, which begin on [page A-44](#).

Electricity, telephone, and natural gas surcharges. The electrical energy surcharge, levied on the use of electricity in California, produced \$51,638,000 in 2005-06, a 19.9 percent decrease from the previous year. A decrease in the tax rate caused much of the decline. The natural gas surcharge produced \$346,172,000, an increase of 14.9 percent. The emergency telephone users surcharge, which funds the 911 statewide emergency number system, totaled \$130,911,000, an increase of 1.9 percent. Additional detail and historical comparisons are provided in Appendix Table 2, on [page A-2](#).

Hazardous substance taxes and other environmental fees. Revenues from hazardous substance taxes and other environmental fees totaled \$559,835,000, an 18.8 percent increase from 2004-05. These taxes and fees are used to fund specific environmental programs.

Property Taxes

Locally collected property taxes on state-assessed properties amounted to \$733,150,000, an increase of 2.5 percent. The timber yield tax, which is levied when timber is harvested to substitute for an annual value-based property tax, totaled \$16,145,000. This was a 13.2 percent increase. The private railroad car tax, levied on railroad cars owned by firms that do not operate railroads, produced \$6,950,000, an increase of 5.7 percent.

Comparison of Revenues 2004-05 and 2005-06

In Thousands of Dollars

Revenue Source	2004-05	2005-06	Percent Change
Sales and Use Taxes			
State tax (5.00%)	\$26,180,129	\$27,936,047	6.7
Local revenue fund state sales tax (0.50%)	2,635,571	2,811,773	6.7
Public safety fund sales tax (0.50%)	2,635,803	2,811,773	6.7
Fiscal recovery fund sales tax (0.25%) ¹	1,187,425	1,395,801	17.5
City and county sales tax ²	4,053,961	4,199,969	3.6
County transportation tax (1/4 of 1%)	1,312,438	1,401,329	6.8
Special district taxes	3,469,334	3,743,610	7.9
Other taxes and fees	425	431	1.4
Totals	41,475,086	44,300,734	6.8
Fuel Taxes and Fees			
Gasoline and jet fuel	2,864,865	2,875,079	0.4
Diesel and use fuel ³	532,063	550,806	3.5
Totals	3,396,928	3,425,886	0.9
Alcoholic Beverage Taxes	314,275	318,282	1.3
Cigarette and Tobacco Products Taxes			
Cigarette tax	119,056	118,026	-0.9
Cigarette and tobacco products surtax	330,887	334,713	1.2
Breast cancer research cigarette stamp tax	28,840	28,161	-2.4
California children and families first cigarette stamp tax	609,503	611,031	0.3
Cigarette and tobacco products licensing fee ⁴	2,938	1,859	-36.7
Totals	1,091,224	1,093,789	0.2
Insurance taxes			
Electrical energy surcharge ⁵	64,427	51,638	-19.9
Natural gas surcharge	301,376	346,172	14.9
Emergency telephone users surcharge ⁶	128,463	130,911	1.9
Hazardous substances taxes and other environmental fees ⁷	471,177	559,835	18.8
Local taxes on state assessed properties⁸			
Timber yield tax	14,267	16,145	13.2
Private railroad car tax	6,577	6,950	5.7
Grand Totals	\$49,953,095	\$52,984,773	6.1

¹ This tax became effective July 1, 2004.

² City and county sales tax rate, 1.00% through June 30, 2004; 0.75% effective July 1, 2004.

³ Includes diesel fuel taxes collected under the International Fuel Tax Agreement (IFTA) implemented on January 1, 1996.

⁴ This tax became effective January 1, 2004.

⁵ Effective January 1, 2005, the tax rate was decreased to \$0.00022 per kilowatt hour from \$0.0003.

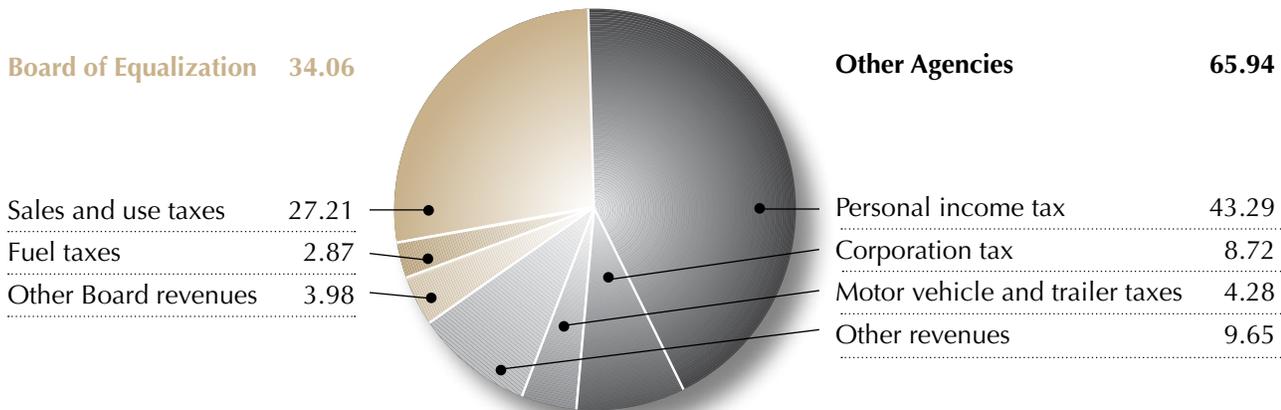
⁶ Effective November 1, 2004, the tax rate was lowered to 0.65% from 0.72%.

⁷ Includes revenues from the hazardous substances tax, integrated waste management fee, underground storage tank maintenance fee, tire recycling fee, oil spill prevention and administration fee, oil spill response fee, childhood lead poisoning prevention fee, occupational lead poisoning prevention fee, marine invasive species control fee, water rights fee, and electronic waste recycle fee.

⁸ Collected by county tax collectors.

Sources of State Revenue July 1, 2005–June 30, 2006

Percentage of Total State Revenue



Revenue Source		Revenue (in thousands)	Percent Change from 2004-05	Percentage of Total State Revenue
Board of Equalization	<i>Major Taxes and Licenses</i>			
	Sales and Use Tax ¹	\$32,199,800	7.45	27.21
	Gasoline and Jet Fuel Tax	2,842,953	.30	2.40
	Diesel and Use Fuel Taxes	550,428	3.54	.47
	Insurance Gross Premiums Tax	2,202,327	-1.37	1.86
	Cigarette and Tobacco Products Tax	1,088,703	-.69	.92
	Alcoholic Beverage Tax	318,276	1.28	.27
	<i>Totals, Major Taxes and Licenses</i>	\$39,202,487	6.02	33.13
<i>Totals, Minor Revenues ²</i>	1,095,506	12.70	.93	
Grand Total	\$40,297,993	6.19	34.06	
Other Agencies	<i>Major Taxes and Licenses</i>			
	Personal Income Tax	\$51,219,823	19.14	43.29
	Corporation Tax	10,316,467	18.99	8.72
	Motor Vehicle "in lieu" Tax	2,226,494	4.35	1.88
	Trailer Coach Fees "in lieu" Tax	27,280	13.79	.02
	Motor Vehicle Registration and Other Fees	2,811,928	3.53	2.38
	Estate, Inheritance and Gift Tax	3,786	-98.22	.00
	Horse Racing (Parimutuel) License Fees	38,018	-1.23	.03
<i>Totals, Major Taxes and Licenses</i>	\$66,643,796	17.36	56.32	
<i>Totals, Minor Revenues</i>	11,382,031	16.93	9.62	
Grand Total	\$78,025,827	17.29	65.94	
TOTAL STATE REVENUE		\$118,323,820	13.26	100.00

Source: 2007-08 Governor's Budget

¹ Includes revenues from the state sales tax, the state disaster relief tax, the local revenue fund state sales tax, and the fiscal recovery fund sales tax.

² Includes private railroad car, electrical energy, natural gas, emergency telephone, and environmental taxes and fees.

Note: Percentage detail may not compute to totals due to rounding.