

Los Angeles County,  
which totals 915 freeway and highway  
miles within its boundaries, contains  
seven of the ten busiest freeway  
interchanges in the nation.



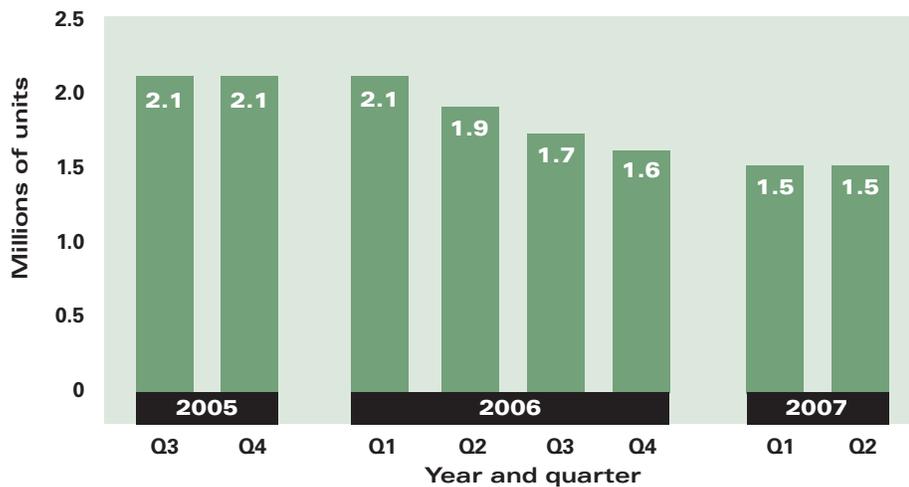


## National Economy

In fiscal year 2006-07, the national economy had below average growth, brought about by large declines in housing activity. Home building dropped sharply following a period of overbuilding between 2003 and early 2006. Housing starts declined from an annual rate of over 2 million units in early 2006 to less than 1.5 million units by the second quarter of 2007. During the fiscal year interest rates were stable, inflation was moderate, productivity and employment growth slowed, and the unemployment rate fell slightly.

### U.S. Housing Starts

(Millions of units, seasonally adjusted annual rate)



## Gross Domestic Product

Real gross domestic product (GDP)—the broadest measure of the nation’s output of goods and services—increased 2.1 percent in fiscal year 2006-07, down from 3.2 percent growth in fiscal year 2005-06. Real GDP growth was well below its ten-year average of 3.0 percent. Nonagricultural employment increased 1.6 percent, down from 1.9 percent the previous fiscal year.

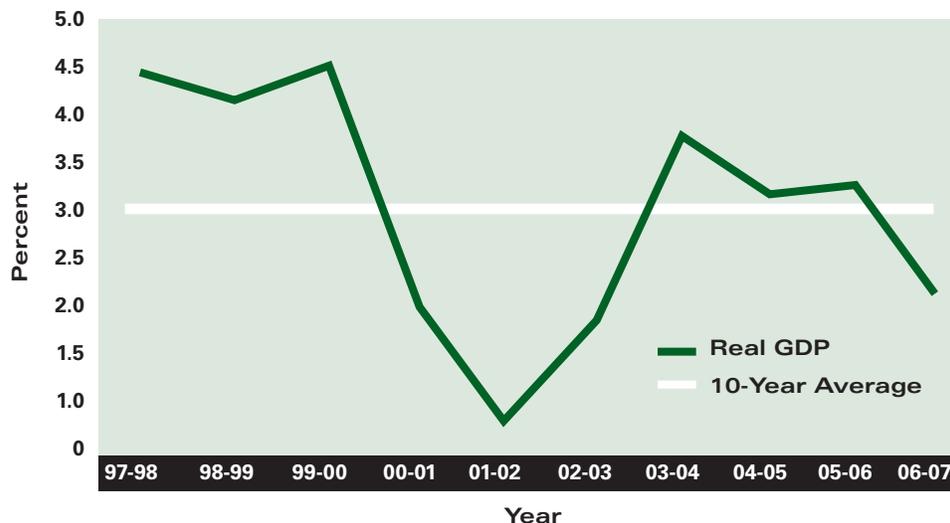
## Real GDP by Sector

Investment spending declined in fiscal year 2006-07, an unusual development in a nonrecession year. Real domestic fixed investment spending, which made up 16 percent of total real GDP, decreased 2.2 percent. Major components of investment had widely varying rates of change. Steep declines in construction activity resulted in a 13.5 percent decrease in real residential investment spending. In contrast, investment in inflation-adjusted nonresidential structures, such as office buildings, jumped 11.7 percent. Increasing employment and low vacancy rates spurred nonresidential investment spending. Spending on equipment and software, the largest investment component, increased 1.8 percent.

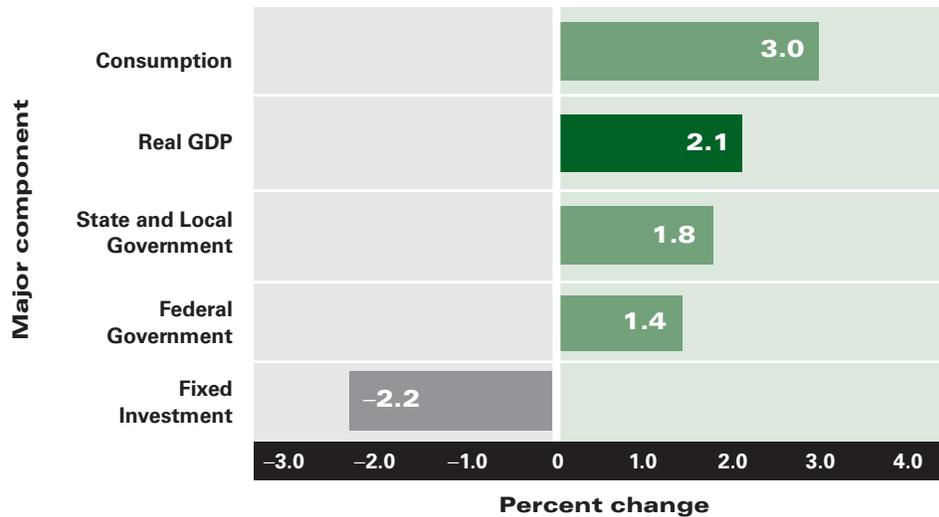
Inflation-adjusted exports increased 7.8 percent in 2006-07, reflecting continued strength in the economies of our major trading partners. With slowing U.S. economic growth, real imports increased less rapidly, 3.9 percent. Since exports grew faster than imports, the nation’s trade balance improved.

Real consumer spending rose by 3.0 percent, very close to its growth rate of 2005-06. Consumer spending is very important to GDP growth, since

## Growth in Real GDP, 1997–2006



## 2006-07 Growth in Real GDP and Major Components



it accounts for 70 percent of total GDP. The fastest growing component of consumer spending was durable goods, which increased 4.5 percent, followed by nondurable goods at 3.2 percent and services at 2.7 percent.

Government spending on goods and services grew by 1.7 percent in 2006-07 after adjusting for inflation. Federal government spending increased 1.4 percent, while state and local government spending rose 1.8 percent. All the federal government growth was in defense spending, which increased 2.1 percent. Federal government nondefense spending was unchanged.

### The Unemployment Rate

The U.S. unemployment rate averaged 4.5 percent in 2006-07, slightly lower than the 4.8 percent rate of 2005-06. Unemployment rates in recent years have been well below the 5.8 percent average for the decade of the 1990s.

### Corporate Profits

Despite the slowing economy corporate profits continued to experience strong growth, posting a 9 percent gain in fiscal year 2006-07. This increase followed several years of double-digit gains.

### Productivity and Consumer Prices

Business productivity inched up just 0.5 percent in 2006-07. This was the weakest growth since the mid-1990s, continuing a trend of slower growth since 2002. Business productivity expanded an average of 2.7 percent per year over the past ten years.

The U.S. consumer price index rose 2.6 percent in fiscal year 2006-07, down from 3.8 percent in fiscal year 2005-06. Moderating energy prices were a major cause of the lower inflation rate.

### **Interest Rates and the Federal Budget Deficit**

The Federal Reserve Board did not change interest rates in 2006-07, keeping the federal funds rate at 5.25 percent. Long term interest rates were fairly stable throughout the year. Conventional new home mortgage rates averaged 6.5 percent in 2006-07, close to the 6.3 percent average for 2005-06. Mortgage rates were relatively low by historical standards. Conventional new home mortgage rates averaged 8.0 percent over the decade of the 1990s.

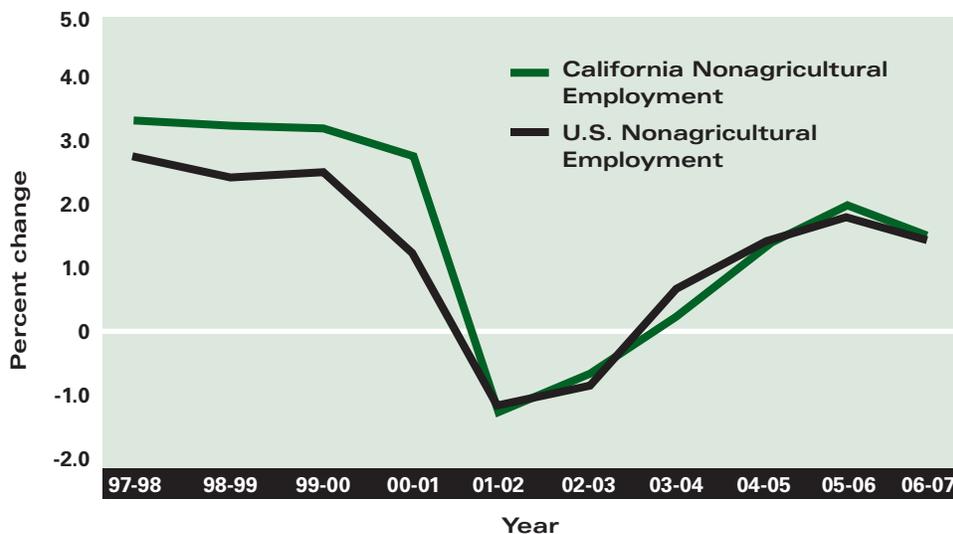
Despite slower economic growth, the federal budget deficit improved. The federal budget deficit decreased from \$248 billion in federal fiscal year 2005-06 to \$163 billion in 2006-07 (October 1 to September 30). Strong growth in personal income taxes was responsible for much of the reduction in the deficit. The 2006-07 deficit was about 1.2 percent of GDP, 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**

While the U.S. economy slowed sharply, available data indicate that California economic growth in fiscal year 2006-07 slowed only slightly from fiscal year 2005-06. Real California personal income increased 3.4 percent in fiscal year 2006-07, close to the 3.6 percent growth of 2005-06. California nonagricultural payroll employment increased 1.7 percent over the 2006-07 fiscal year, compared to 2.0 percent the prior fiscal year. California employment rose at nearly the same rate as U.S. employment, which grew 1.6 percent in fiscal year 2006-07. Since the early part of the decade California employment growth has closely tracked U.S. employment. Real gross domestic product for California (which is only available for calendar years) rose 4.2 percent in 2006, well above the U.S. real GDP growth rate of 2.9 percent.

California personal income (unadjusted for inflation) increased 5.8 percent in fiscal year 2006-07, down from 6.9 percent growth in the prior fiscal year. While growth in personal income was lower than the previous two fiscal years, it was above the 5.2 percent average growth of the 1990s. California personal income rose slower than the 6.4 percent growth in U.S. personal income in 2006-07, which was unusual compared to their historical relationships.

## Growth in California and U.S. Nonagricultural Employment, 1997–2006



The California unemployment rate was 4.9 percent in fiscal year 2006-07, slightly lower than the 5.1 percent rate for 2005-06. The California unemployment rate was 0.4 percent above the U.S. rate in 2006-07.

### Employment and Income Growth

California nonagricultural employment increased 1.7 percent in fiscal year 2006-07, as payrolls expanded by 252,000 jobs. All major industries had gains in jobs except for manufacturing, which had a small decline.

### Employment Sectors

**Professional and Business Services.** Professional and business services gained 69,300 jobs, more than any other major sector and a 3.2 percent increase. Many of the added jobs in this sector were in architectural and engineering services, computer systems design, and management and scientific consulting. The professional and business services category is the state's third largest sector, employing 15 percent of Californian nonagricultural workers.

**Leisure and Hospitality.** Employment in leisure and hospitality industries, such as restaurants and hotels, increased 2.9 percent in 2006-07, a gain of 43,500 jobs. Most of the job gains were in food services. Leisure and hospitality industries employ about 10 percent of nonfarm Californian workers.

**Trade, Transportation, and Utilities.** In 2006-07, about 42,500 trade, transportation, and utilities jobs were added, the third largest employment gain of any industry and a 1.5 percent increase. This is the state’s largest employment sector, accounting for about 19 percent of all nonfarm jobs.

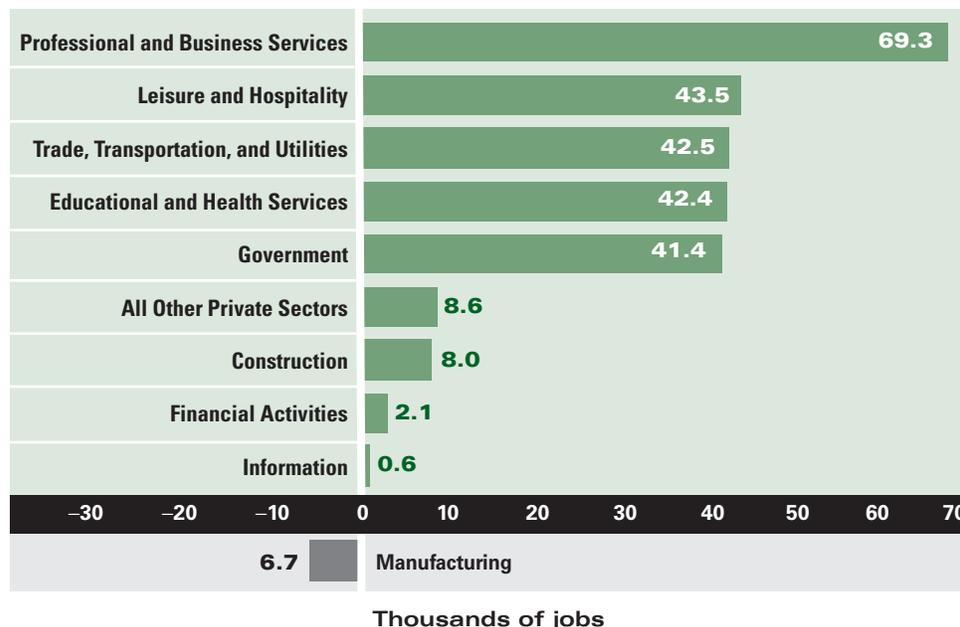
**Educational and Health Services.** Private educational and health services gained 42,400 jobs, a 2.6 percent increase. This is a relatively large sector, accounting for about 11 percent of nonfarm employment.

**Government.** About 41,400 new government positions were filled—a 1.7 percent increase. Federal payrolls decreased, while state and local government hiring increased in 2006-07. Over 40 percent of the increase in government jobs was in education. Government is California’s second largest sector, with 16 percent of all California nonagricultural jobs.

**Other Sectors.** The remaining private industry sectors (other services, mining, and natural resources) provided employment for 4 percent of nonagricultural workers. Employment in this group increased by 1.6 percent (8,600 jobs).

**Construction.** With the slowdown in housing activity in 2006-07, construction employment increased by just 8,000 jobs, or 0.9 percent. About 6 percent of nonfarm jobs are in construction.

**2006-07 California Growth in Nonagricultural Employment by Employment Sector**  
(Thousands of Jobs)



**Financial Activities.** Employment in financial activities—which includes lenders, insurance agents, and real estate brokers—increased by 2,100 jobs, a gain of 0.2 percent. These industries are closely associated with residential real estate activity and consequently had low growth. Financial activities account for about 6 percent of nonfarm Californian jobs.

**Information.** Information providers—publishing, motion pictures, broadcasting, telecommunications, and Internet services—gained about 600 jobs, a 0.1 percent increase. Print publishing and telecommunications reduced payrolls, while other information sectors increased them. Information jobs account for a relatively small share of state jobs, about 3 percent.

**Manufacturing.** The manufacturing sector lost about 6,700 jobs in 2006-07, a 0.4 percent reduction. Jobs losses were widespread among many durable goods and nondurable goods manufacturing industries. Manufacturing employs 10 percent of workers on nonagricultural payrolls.

## **Building Construction and Home Prices**

The value of all private building construction permits issued in California fell by 17 percent in fiscal year 2006-07 (measured in inflation-adjusted 2006 dollars). The value of residential construction permits issued decreased 28 percent, while nonresidential building construction permit values rose 7 percent. A total of 132,000 home building permits were issued in fiscal year 2006-07, well below the ten-year average of 162,000.

With the cooling of residential real estate markets, existing home sales plummeted 24 percent to 427,000 units in fiscal year 2006-07. Despite the drop, home sales were above the average as compared to the 1990s. During the decade of the 1990s, an average of about 403,000 existing California homes were sold each year.

As a result of high inventories of homes for sale, home prices moderated in fiscal year 2006-07 following several years of double digit increases. In fiscal year 2006-07 statewide median home prices rose 3 percent, with the median price of an existing single-family detached California home averaging \$571,000.

## **Consumer Prices**

Following the national trend, California consumer prices rose more slowly in fiscal year 2006-07. Statewide consumer prices for all urban consumers rose 3.3 percent in 2006-07, down from a 4.3 percent increase in 2005-06. At the national level, the consumer price index increased by 2.6 percent in 2006-07, down from 3.8 percent in 2005-06.

## Taxable Sales Activity

Transactions subject to the sales and use tax totaled \$564.8 billion during the 2006-07 fiscal year. This was an increase of \$11.3 billion, or just 2.0 percent, over 2005-06. Growth was small but positive in every quarter (see table, below). With the weaker economy taxable sales increased much more slowly than in fiscal year 2005-06, when they rose 7.4 percent.

Taxable sales increased by 1.2 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 0.8 percent. By quarter, the Deflator indicated inflation for taxable goods within a range of 0.1 percent to 2.0 percent throughout the fiscal year. The 0.8 percent inflation rate shown by the Deflator contrasted with the 3.3 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.

In early 2007, the Board of Equalization began a process of converting business codes of sales and use tax permit holders to North American Industry Classification System (NAICS) codes. Over one million permit holders will be converted over time from the previous business coding system to the NAICS codes. As a result of the coding change process, industry data for 2007 are not comparable with data from 2006. Therefore, we will not publish percentage changes by industry until the coding process has been substantially completed.

Appendix Table 19, on [page A-24](#), shows details on sales tax activity and the number of sales tax permittees by business type. The NAICS coding

### 2006-07 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	\$142,411,630,000	25.2	2.3	0.2	2.0
Oct-Dec	\$146,504,636,000	25.9	2.1	1.9	0.1
Jan-March	\$132,750,022,000	23.5	3.1	2.3	0.8
April-June	\$143,170,584,000	25.3	0.9	0.5	0.4
Fiscal Year	\$564,836,872,000	100.0	2.0	1.2	0.8

process has also caused us to change the format of this table from those of previous annual reports. We will continue to follow the general structure of our tables in past reports. However, some industries were previously listed within categories that no longer exist, and others have been combined into new ones.

## Revenue Growth

Tax programs administered by the Board of Equalization produced state and local revenues totaling \$53,867,057,000 during fiscal year 2006-07. This was an increase of \$0.9 billion, or 1.7 percent, from 2005-06. Weak growth in the California economy was primarily responsible for the small increase in 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 \$45,105,793,000 in 2006-07, an increase of 1.8 percent from 2005-06. The state's portion of the sales tax was \$29,802,290,000 (including the fiscal recovery fund). The portion allocated to other jurisdictions—cities, counties, and special districts—totaled \$15,303,020,000, 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, there were 87 special district taxes in effect in 37 counties (see “District Transactions (Sales) and Use Tax,” on [page 33](#)). These counties are the source of 92 percent of all taxable sales in the state. Some districts cover entire counties while others are restricted to city limits and one covers three counties. 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 2006-07, the state's fuel tax revenues totaled \$3,423,538,000, a 0.1 percent decrease from the previous fiscal year. Distribution of gasoline for highway use decreased 0.4 percent to 15.8 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 4.9 percent from 2005-06 levels to total \$333,806,000 for the fiscal year. Revenues from beer and wine increased to \$169,372,000, while revenues from distilled spirits decreased to \$164,434,000. 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 \$1.08 billion in 2006-07, a decrease of 0.9 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 \$1,982,588,000 in 2006-07, a 0.9 percent decrease. 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 \$56,357,000 in 2006-07, a 9.1 percent increase from the previous year. The natural gas surcharge produced \$440,430,000, an increase of 27.2 percent. The emergency telephone users surcharge, which funds the 911 statewide emergency number system, totaled \$112,154,000, a decrease of 14.3 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 \$565,423,000, an 1.0 percent increase from 2005-06. These taxes and fees are used to fund specific environmental programs.

## **Property Taxes**

Locally collected property taxes on state-assessed properties amounted to \$740,861,000, an increase of 1.1 percent. The timber yield tax, which is levied when timber is harvested to substitute for an annual value-based property tax, totaled \$15,301,000. This was a 5.2 percent decrease. The private railroad car tax, levied on railroad cars owned by firms that do not operate railroads, produced \$6,703,000, a decrease of 3.6 percent.

## Comparison of Revenues 2005-06 and 2006-07

In thousands of dollars

<i>Revenue Source</i>	<i>2005-06</i>	<i>2006-07</i>	<i>Percent change</i>
<b>Sales and Use Taxes</b>			
State tax (5.00%)	\$27,936,047	\$28,396,242	1.6
Local revenue fund state sales tax (0.50%)	2,811,773	2,850,488	1.4
Public safety fund sales tax (0.50%)	2,811,773	2,850,488	1.4
Fiscal recovery fund sales tax (0.25%)	1,395,801	1,406,048	0.7
City and county sales tax (0.75%)	4,199,969	4,264,888	1.5
County transportation tax (0.25%)	1,401,329	1,419,150	1.3
Special district taxes	3,743,610	3,918,005	4.7
Other taxes and fees	431	482	11.8
<i>Totals</i>	44,300,734	45,105,793	1.8
<b>Fuel Taxes and Fees</b>			
Gasoline and jet fuel	2,875,079	2,848,664	-0.9
Diesel and use fuel <sup>1</sup>	550,806	574,874	4.4
<i>Totals</i>	3,425,886	3,423,538	-0.1
<b>Alcoholic Beverage Taxes</b>			
	318,282	333,806	4.9
<b>Cigarette and Tobacco Products Taxes</b>			
Cigarette tax	118,026	115,370	-2.2
Cigarette and tobacco products surtax	334,713	335,893	0.4
Breast cancer research cigarette stamp tax	28,161	27,273	-3.2
California children and families first cigarette stamp tax	611,031	603,385	-1.3
Cigarette and tobacco products licensing fee	1,859	2,183	17.4
<i>Totals</i>	1,093,789	1,084,103	-0.9
Insurance taxes	2,001,281	1,982,588	-0.9
Electrical energy surcharge	51,638	56,357	9.1
Natural gas surcharge <sup>2</sup>	346,172	440,430	27.2
Emergency telephone users surcharge <sup>3</sup>	130,911	112,154	-14.3
Hazardous substances taxes and other environmental fees <sup>4</sup>	559,835	565,423	1.0
Local taxes on state-assessed properties <sup>5</sup>	733,150	740,861	1.1
Timber yield tax	16,145	15,301	-5.2
Private railroad car tax	6,950	6,703	-3.6
<b>Grand Totals</b>	<b>\$52,984,773</b>	<b>\$53,867,057</b>	<b>1.7</b>

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

<sup>2</sup> Rates increased effective January 1, 2006.

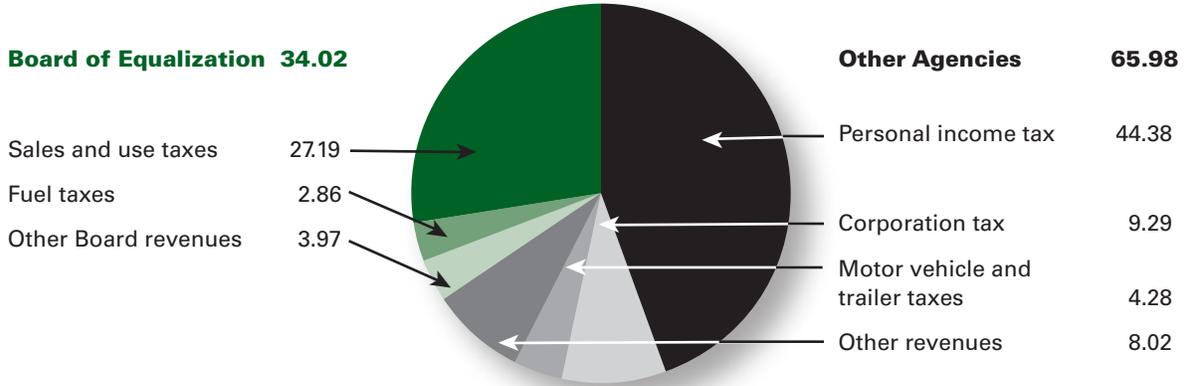
<sup>3</sup> Effective November 1, 2006, the tax rate was lowered to 0.5% from 0.65%.

<sup>4</sup> 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.

<sup>5</sup> Collected by county tax collectors.

## Sources of State Revenue July 1, 2006–June 30, 2007

Percentage of Total State Revenue



	Revenue Source	Revenue (in thousands)	Percent Change from 2005-06	Percentage of Total State Revenue
<b>Board of Equalization</b>	<i>Major Taxes and Licenses</i>			
	Sales and Use Tax <sup>1</sup>	\$32,669,175	1.46	27.19
	Gasoline and Jet Fuel Tax	2,851,631	.31	2.37
	Diesel and Use Fuel Taxes	580,896	5.54	.48
	Insurance Gross Premiums Tax	2,178,336	-1.09	1.81
	Cigarette and Tobacco Products Tax	1,078,536	-.93	.90
	Alcoholic Beverage Tax	333,789	4.87	.28
	<i>Totals, Major Taxes and Licenses</i>	\$39,692,363	1.25	33.04
<i>Totals, Minor Revenues <sup>2</sup></i>	1,181,067	7.81	.98	
	<b>Grand Total</b>	<b>\$40,873,430</b>	<b>1.43</b>	<b>34.02</b>
<b>Other Agencies</b>	<i>Major Taxes and Licenses</i>			
	Personal Income Tax	\$53,318,287	4.10	44.38
	Corporation Tax	11,157,898	8.16	9.29
	Motor Vehicle "in lieu" Tax	2,268,019	1.87	1.89
	Trailer Coach Fees "in lieu" Tax	29,370	7.66	.02
	Motor Vehicle Registration and Other Fees	2,849,952	1.35	2.37
	Estate, Inheritance, and Gift Tax	6,348	67.67	.01
	Horse Racing (Parimutuel) License Fees	37,527	-1.29	.03
<i>Totals, Major Taxes and Licenses</i>	\$69,667,401	4.54	57.99	
<i>Totals, Minor Revenues</i>	9,591,871	-15.73	7.98	
	<b>Grand Total</b>	<b>\$79,259,272</b>	<b>1.58</b>	<b>65.98</b>
<b>TOTAL STATE REVENUE</b>		<b>\$120,132,702</b>	<b>1.53</b>	<b>100.00</b>

Source: 2008-09 Governor's Budget

<sup>1</sup> 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.

<sup>2</sup> 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.