IEFC

Illinois Economic and Fiscal Commission

MONTHLY REVENUE BRIEFING **MARCH 2002**

INSIDE THIS ISSUE

703 Stratton Ofc. Bldg.
Springfield, IL 62706
217/782-5322

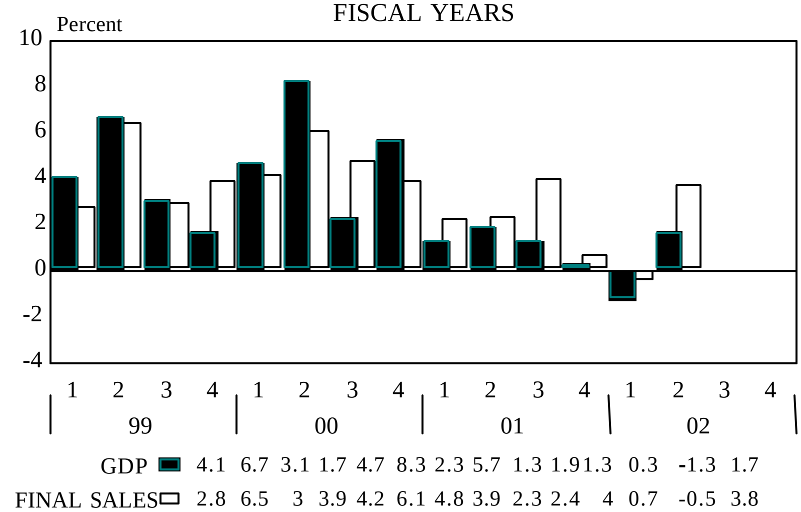
ECONOMY: How Strong a Recovery?

Edward H. Boss, Jr., Chief Economist

It is increasingly clear that the U.S. economic recession, which begun a year ago this month, is over and that the recovery phase of the business cycle is under way. The key question is how strong the rebound will prove to be. The strength of the economy can be measured in terms of the growth rate of real gross domestic product (GDP) –– the sum of consumer, business, net exports, and government spending –– and in terms of final sales –– real GDP less the change in inventories.

As shown in Chart 1, both measures resumed growth in the final quarter of fiscal 2002, with revised real GDP up at a 1.7% annual rate and final demand rising at a strong 3.8% annual pace. Moreover, monthly data suggest growth in the quarter just ending is likely to accelerate, with real GDP up in the 3% to 5% range and final sales rising at a somewhat lesser annual rate as the expected decrease in inventories should lessen.

CHART 1 CHANGE IN REAL GDP & FINAL SALES
FISCAL YEARS



In retrospect, the past recession has proven to be the mildest in the post war period. This was largely due to persistent spending by consumers, who generally account for two-thirds of total GDP. While this has been the key factor in keeping the recession mild, because the consumer has remained strong, it cannot be counted on to give the recovery a significant boost, as has occurred in past recoveries. At the same time, business spending, which has been the weakest sector, is unlikely to surge any time soon given still large amounts of capacity and severely weak corporate profits. Thus, a case can be made that growth may be moderate somewhat during the spring and early summer.

To be sure, there are many signs of economic strength. Housing starts have risen sharply, consumer confidence, measured by both the Michigan and Conference Board surveys, rose sharply and is on a clear upward path, and even the manufacturing sector has improved. Industrial production increased in January and February for the first back-to-back monthly gains since the summer of 2000, and the Chicago Purchasing Manager's Index expanded reaching 55.7% in March, the first two-month consecutive improvement since the summer of 2000. While these sectors confirm an economic turnaround, others suggest that the recovery may be less vigorous than in the past.

Earlier declines in initial unemployment claims have stalled, suggesting future gains in the labor market may be more restrained; oil prices have begun to rise again reversing earlier declines; gold prices have risen; and the stock market, while swinging widely, has shown no sustained upward trend. Indeed, even the leading economic indicators held flat in February, although up 2.4% from six months earlier and 3.1% from a year ago.

While it is clear that the economic recovery is under way, several signs are emerging suggesting that the pace of advance may be less robust than in the past. This implies that the hoped-for rise in State revenues stemming from improved economic conditions may be painfully slow in surfacing.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	February 2002	January 2002	February 2001
Unemployment Rate (Average)	5.8%	5.9%	5.0%
Annual Rate of Inflation (Chicago)	5.4%	0.0%	0.1%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (February)	6,381	0.2%	0.1%
Employment (thousands) (February)	6,014	0.3%	-0.7%
New Car & Truck Registration (February)	43,888	-11.1%	N/A
Single Family Housing Permits (February)	2,557	10.9%	13.0%
Total Exports ($ mil) (January)	2,487	-7.1%	-6.7%
Chicago Purchasing Managers Index (March)	55.7	4.9%	59.1%

IMPACT OF THE FEDERAL ECONOMIC STIMULUS PACKAGE ON ILLINOIS

Eric Noggle, Revenue Analyst

In March of 2002, the federal government approved an economic stimulus package aimed at boosting the nation's anemic economy. The President signed this legislation into law on March 9, 2002. Among the items included in the package is a tax deduction provision that could have a significant impact on state revenues throughout the nation. This deduction allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of certain qualified property. The deduction allows businesses to write off more quickly the cost of various purchases and investments.

The depreciation deduction is retroactive to September 11, 2001 and is set to expire in September of 2004. The additional depreciation deduction provision is estimated to cost the federal government approximately $96.9 billion over the three-year span of the provision.

Not only will the legislation affect federal revenues, but this federal tax provision will significantly impact state revenues as well. This is because most state corporate tax codes are tied to the federal code. Based on a state-by-state analysis from the Center on Budget and Policy Priorities (CBPP), it is estimated that the State of Illinois could lose approximately $900 million over the three-year period of the provision due to the additional depreciation deduction. Depending on the assumptions used, first year cost estimates range from $300 to $400 million. Based on Illinois' corporate income tax structure, nearly two-thirds of that loss would be State revenue and the remainder a loss to local governments.

The Joint Committee on Taxation estimates that much of the federal losses will occur in the first year of the provision, and will decrease slightly in the following two years. The assumption here is that companies will immediately take advantage of the bonus depreciation provision for qualified purchases made since September 11, 2001. Some argue, though, that corporations may wait and take the deduction in future years in order to utilize the deductions in years when profits are higher. It is impossible to know how companies will react to the new depreciation provision during the current volatile economy. Because of this, estimating how the revenue losses will be spread over the three-year span of the business depreciation bonus cannot be precisely determined.

Although the federal stimulus package provision is set to expire in 2004, some observers caution that the provision could be extended to future years. This is because the provision would be slated to expire less than two months before the 2004 election, virtually ensuring there would be maximum political pressure to continue this tax break for future years. The Joint Tax Committee estimates that continuing the measure would cost the federal government more than $200 billion over the decade.

The loss in State revenue from the federal stimulus package will worsen the fiscal situation of Illinois and other states throughout the nation which, according to the National Governors Association, are already facing budget deficits totaling $40 billion to $50 billion. The CBPP reports that one way states can protect themselves from the revenue losses associated with the federal stimulus package is to "decouple" their business depreciation rules from the federal rules for the period of time that the bonus depreciation is in effect.

The State of California already uses its own depreciation schedules. In the short time since the federal legislation passed, it is reported that legislators in Indiana, Maryland, Virginia, and Wisconsin have voted to decouple from the federal legislation. In the early 1980s, responding to a similar federal change, some 21 states decoupled from federal depreciation rules. (Illinois was not one of those states).

While the exact cost that this depreciation provision will have on Illinois may never be known, from a state fiscal perspective, the timing of the federal change will further exacerbate budgeting problems facing virtually all states.

REVENUE

Revenues Continue to Decline

Jim Muschinske, Unit Chief

Revenues suffered another down month in March with receipts falling $149 million compared to the same month one year earlier. The March decline marked the third consecutive monthly retreat as third quarter revenues fell a total of $328 million. The fall off in March revenues resulted primarily from decreases in federal sources as well as income tax receipts. One less receipting day for the month also contributed to the decrease.

Corporate income tax receipts led the monthly State tax decliners, with gross receipts off $47 million. Gross personal income taxes were not far behind as receipts fell $43 million. Sales tax was also down for the month as receipts fell $18 million. Clearly, despite signs that a recovery is under way, those economic signals have yet to manifest themselves into increased tax revenues. Interest income from State investments declined by $14 million, while corporate franchise taxes and fees fell by $5 million.

Despite the drop in monthly revenues, several smaller sources did manage to post minimal gains totaling $11 million. For the most part, however, other tax sources were basically flat.

Overall transfers were up $24 million in March. Lottery transfers were up $22 million and other transfers gained $7 million. Those gains were partially offset by a $5 million decline in Gaming Fund transfers. As mentioned, federal sources significantly contributed to the monthly decline in revenues as receipts dropped $58 million in March.

Year-to-Date

Over the first three-quarters of FY 2002, absent the $226 million transfer from the Budget Stabilization Fund, total general funds revenue is down $413 million from the same period last year. The poor showing in March dealt another significant blow to FY 2002 revenues.

Corporate income tax revenue continues to lead the yearly decliners with gross receipts down by $156 million. The decline in personal income tax revenues is not far behind, falling $111 million. Interest income earnings continue to free fall and are off by $106 million. All other tax sources experiencing declines total $58 million. In addition, total transfers are off by $52 million, and federal sources are down $39 million.

Despite total revenues being down, several sources have managed to post positive, albeit rather modest, gains thus far in FY 2002. Sales tax revenues, aided by the return of the tax on motor fuel, managed to gain $97 million. Insurance taxes and fees increased $18 million while corporate franchise taxes and fees are up $10 million.

In order to reach the Commission's current base general funds estimate of $24.196 billion, receipts over the remaining quarter would have to increase $503 million or 7.0%. While the Commission's February forecast called for only a $90 gain over last year, with the disappointing month of March, it is very likely that FY 2002 base revenues will actually fall below last year's totals. April will play a key role in determining any future adjustments to the forecast. A revision is scheduled for early May, at which time updated forecasts for FY 2002 and FY 2003 will be released.

GENERAL FUNDS RECEIPTS: MARCH

FY 2002 vs. FY 2001
($ million)

Revenue Sources	MARCH FY 2002	MARCH FY 2001	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$608	$651	($43)	-6.6%
Corporate Income Tax (regular)	199	246	($47)	-19.1%
Sales Taxes	453	471	($18)	-3.8%
Public Utility Taxes (regular)	113	111	$2	1.8%
Cigarette Tax	33	32	$1	3.1%
Liquor Gallonage Taxes	8	8	$0	0.0%
Vehicle Use Tax	3	2	$1	50.0%
Inheritance Tax (Gross)	24	23	$1	4.3%
Insurance Taxes and Fees	46	43	$3	7.0%
Corporate Franchise Tax & Fees	9	14	($5)	-35.7%
Interest on State Funds & Investments	9	23	($14)	-60.9%
Cook County IGT	23	23	$0	0.0%
Other Sources	16	13	$3	23.1%
Subtotal	$1,544	$1,660	($116)	-7.0%
Transfers				
Lottery	45	23	$22	95.7%
Gaming Fund Transfer	30	35	($5)	-14.3%
Other	36	29	$7	24.1%
Total State Sources	$1,655	$1,747	($92)	-5.3%
Federal Sources	$348	$406	($58)	-14.3%
Total Federal & State Sources	$2,003	$2,153	($150)	-7.0%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($46)	($46)	$0	0.0%
Corporate Income Tax	(46)	(47)	$1	-2.1%
Subtotal General Funds	$1,911	$2,060	($149)	-7.2%
Budget Stabilization Fund Transfer	**$0**	**$0**	**$0**	**N/A**
Total General Funds	$1,911	$2,060	($149)	-7.2%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Apr-02

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2002 vs. FY 2001

($ million)

Revenue Sources	FY 2002	FY 2001	CHANGE FROM FY 2001	% CHANGE
State Taxes				
Personal Income Tax	$5,710	$5,821	($111)	-1.9%
Corporate Income Tax (regular)	690	846	($156)	-18.4%
Sales Taxes	4,557	4,460	$97	2.2%
Public Utility Taxes (regular)	821	846	($25)	-3.0%
Cigarette Tax	300	299	$1	0.3%
Liquor Gallonage Taxes	92	94	($2)	-2.1%
Vehicle Use Tax	27	25	$2	8.0%
Inheritance Tax (Gross)	254	277	($23)	-8.3%
Insurance Taxes and Fees	165	147	$18	12.2%
Corporate Franchise Tax & Fees	117	107	$10	9.3%
Interest on State Funds & Investments	112	218	($106)	-48.6%
Cook County IGT	177	177	$0	0.0%
Other Sources	139	147	($8)	-5.4%
Subtotal	$13,161	$13,464	($303)	-2.3%
Transfers				
Lottery	376	352	$24	6.8%
Gaming Fund Transfer	345	340	$5	1.5%
Other	227	308	($81)	-26.3%
Total State Sources	$14,109	$14,464	($355)	-2.5%
Federal Sources	$2,945	$2,984	($39)	-1.3%
Total Federal & State Sources	$17,054	$17,448	($394)	-2.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($434)	($413)	($21)	5.1%
Corporate Income Tax	(159)	(161)	$2	-1.2%
Subtotal General Funds	$16,461	$16,874	($413)	-2.4%
Budget Stabilization Fund Transfer	**$226**	**$0**	**$226**	**N/A**
Total General Funds	$16,687	$16,874	($187)	-1.1%

SOURCE Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.

IEFC- 1-Apr-02

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2002 ESTIMATE vs. FY 2001 ACTUAL

($ million)

Revenue Sources	ESTIMATE FY 2002	FYTD 2002	AMOUNT NEEDED FY 2002 EST.	FYTD 2001	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$8,655	$5,710	$2,945	$5,821	$159	5.7%
Corporate Income Tax (regular)	1,152	690	$462	846	$29	6.7%
Sales Taxes	6,190	4,557	$1,633	4,460	$135	9.0%
Public Utility Taxes (regular)	1,160	821	$339	846	$39	13.0%
Cigarette Tax	400	300	$100	299	($1)	-1.0%
Liquor Gallonage Taxes	125	92	$33	94	$3	10.0%
Vehicle Use Tax	35	27	$8	25	($1)	-11.1%
Inheritance Tax (Gross)	361	254	$107	277	$23	27.4%
Insurance Taxes and Fees	270	165	$105	147	$6	6.1%
Corporate Franchise Tax & Fees	166	117	$49	107	$10	25.6%
Interest on State Funds & Investments	180	112	$68	218	$12	21.4%
Cook County IGT	245	177	$68	177	$0	0.0%
Other Sources	490	139	$351	147	$91	35.0%
Subtotal	$19,429	$13,161	$6,268	$13,464	$505	8.8%
Transfers						
Lottery	530	376	$154	352	$5	3.4%
Gaming Fund Transfer	475	345	$130	340	$10	8.3%
Other	455	227	$228	308	$84	58.3%
Total State Sources	$20,889	$14,109	$6,780	$14,464	$604	9.8%
Federal Sources	$4,230	$2,945	$1,285	$2,984	($51)	-3.8%
Total Federal & State Sources	$25,119	$17,054	$8,065	$17,448	$553	7.4%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($658)	($434)	($224)	($413)	($26)	13.1%
Corporate Income Tax	(265)	(159)	($106)	(161)	($24)	29.3%
Subtotal General Funds	$24,196	$16,461	$7,735	$16,874	$503	7.0%
Budget Stabilization Fund Transfer	$226	$226	$0	$0	$0	N/A
Total General Funds	$24,422	$16,687	$7,735	$16,874	$503	7.0%
IEFC						1-Apr-02