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REVENUE: Revenues Mixed in June, but Still Decline FY 2002 Revenues Disastrous Jim Muschinske, Revenue Manager

Revenues ended FY 2002 on a mixed note. While overall receipts performed slightly better than expected, June still suffered a monthly decline of \$55 million. June marked the sixth consecutive month of revenue decline further illustrating that, despite being in an economic recovery mode, receipts have yet to reflect that condition. June receipts also were hampered by one less receipting day when compared to last year.

Personal income tax receipts once again led the monthly State tax decliners, with gross receipts off \$63 million. Interest income was down \$12 million in June while inheritance tax revenue fell \$7 million. Finally, sales tax, after holding up pretty well throughout most of the month, faded at the end and finished off \$2 million.

While mostly minor, a number of sources experienced gains in June. One source that had an expectedly big month was other sources as receipts were up \$110 million in large part due to the Build Illinois General Reserve transfer. Corporate income taxes finally posted a positive month as gross receipts were up \$9 million. Insurance taxes and fees rose \$8 million while both public utility and corporate franchise taxes managed each to increase \$3 million. Finally, vehicle use tax finished up \$1 million for the month.

June transfers fared quite well in the last month of the fiscal year rising by \$18 million. Other transfers accounted for \$11 million of that increase and lottery transfers comprised the other \$7 million. Federal sources, despite falling \$116 million for the month, actually exceeded expectations.

Year-End

larger ones such as income and sales taxes performed terribly for most of the year. In the end, excluding \$226 million in Budget Stabilization Fund transfers, general funds revenues totaled \$23.379 billion, which reflected a decline of \$727 million from last fiscal year. Clearly, FY 2002 will go down in the record books as a disastrous year for State revenues. In total, receipts were down \$1.621 billion from revenues assumed at the time of the budget's passage approximately one year ago.

Personal income tax revenues never could recover, and numerous months of decline caused gross receipts to plummet \$521 million. Corporate income tax, despite having a positive month to end the year, was dismal most of the time as gross receipts fell \$236 million. Interest income, as a result of significantly lower rates of return as well as low balances, was in free fall the entire fiscal year and finished down \$139 million. Public utility taxes added \$42 million to the yearly decline and inheritance taxes contributed \$32 million to the loss.

As stated earlier, revenue bright spots were few and far between. While other sources gained \$105 million, absent increases due to the Build Illinois General Reserve transfer, that source would also have experienced a down year. In fact, despite sales tax revenues being up \$93 million for the year, base growth also would have been negative if it were not for last year's six-month suspension of the sales on motor fuel. Insurance taxes and fees rose \$26 million for the year and corporate franchise taxes managed to increase \$13

million. Finally, vehicle use tax added a \$4 million contribution.

Overall transfers were up \$66 million for the year as one of the few positive surprises was lottery transfers, which posted a gain of \$54 million. Gaming Fund and other transfers combined added another \$12 million. Federal sources, despite experiencing a yearly decline of \$62 million, actually exceeded earlier projections.

During the month of July, the Commission will be examining and recalculating our forecast for FY 2003 taking into account the recently-established FY 2002 base, new income tax refund percentages, and new federal source estimates based on final appropriation levels. In addition, a number of significant legislative actions were taken which will need to be incorporated into the forecast. Brief descriptions of those legislative actions are explained in the following section.

FY 2003 Budget to Include Significant Revenue Changes

A number of legislative changes were made during the last couple of days of the Spring Session that will have the effect of raising revenues in FY 2003. The following section briefly explains the major changes.

- HB 539 (P.A. 92-536) – Beginning July 1, 2002, HB 539 imposed an additional 40 cent per pack tax on cigarettes, bringing the total per pack tax to 98 cents. It is estimated that this additional tax will generate approximately \$230 million annual-

ly. Beginning April 1, 2003, \$5 million per month of the additional tax revenue will be directed to the School Infrastructure Fund, with the remainder being deposited into the Long Term Care Provider Fund.

In addition, HB 539 also reallocates the distribution of revenues from the real estate transfer tax so that 25% is directed into the General Revenue Fund. This reallocation of the current tax, which generates approximately \$60 million a year, will result in the General Revenue Fund realizing \$15 million.

- HB 5686 (P.A. 92-600) is one of the budget implementation bills passed by the General Assembly. While a multitude of changes are made in the implementation bills two changes will result in significant additional revenues in FY 2003.

The bill allows for \$165 million in interfund transfers to take place from a variety of funds into the General Revenue Fund. In addition, the bill eliminates the distribution of 0.4% of the State portion of sales taxes to local governments. This

portion, which constitutes approximately \$25 million a year, had been directed to local governments to make up for sales tax lost as a result of a 1988 exemption of photo processing products. As a result of HB 5686, that 0.4%, or approximately \$25 million, will be retained as general revenue.

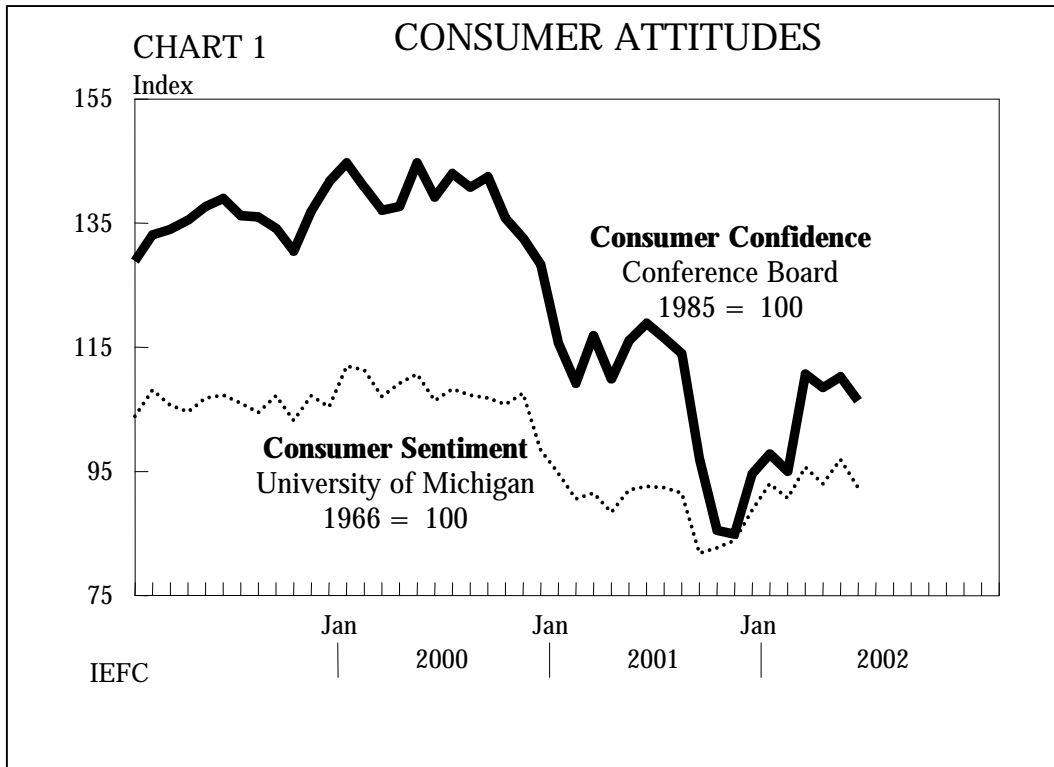
- HB 2381 (P.A. 92-595) increases taxes associated with riverboat gambling activities. Specifically, the bill increases the admission tax from \$2 to \$3 as well as restructures the current graduated tax brackets. It is estimated that the changes, which are effective July 1, 2002, would generate an additional \$142 million in FY 2003.
- SB 1543 (P.A. 92-603) will decouple the State's business depreciation rules from the bonus depreciation provision recently passed at the federal level. By doing so, the Commission estimates that \$161 million in net income tax revenues will be retained in FY 2003, rather than being lost as a result of the federal provision.

ECONOMY: Mid-Year Hesitation
Edward H. Boss, Jr., Chief Economist

Just as final data on the economy became available showing an acceleration in economic activity in the first quarter of the year, it also became increasingly clear that some hesitation in the pace of advance had developed since. Final data for the first quarter of 2002 now show the economy grew at an annual rate of 6.1% in inflation-adjusted terms, up from a preliminary estimate of 5.6%, and compared to a meager 1.7% pace in the final quarter of 2001. This was the fastest rate of improvement in activity since the final quarter of 1999 when the economy was humming along.

The acceleration in real GDP growth during the first quarter primarily

reflected upturns in inventory investment, personal consumption spending and housing. Indeed, it has been the continued strength shown by the consumer that not only kept the past recession modest, but was responsible for the pickup in activity early this year. Because the consumer never retreated his spending habits during the recession, however, the usual spurt in renewed spending during the early stages of the recovery also cannot be expected. What will be needed is increased spending by business. This has yet to surface, and at a time when there is increasing concern over the sustainability of continued strong consumer spending. This latter concern was highlighted in data released on Friday showing that personal consumption expenditures fell by 0.1% in May, the weakest reading since November.



As shown in Chart 1 on the previous page, after a substantial pickup in consumer attitudes following September 11th, there has been some retrenchment in attitudes in June as measured by both the University of Michigan and Conference Board surveys. This renewed pessimism in part can be explained by the sharp plunge in the equity market and consequent deterioration in the net wealth position of consumers. This stock market deterioration is unprecedented during the early stage of an economic recovery, when there typically has been an improving stock market as the recovery continues and the market anticipates continuing improved profit positions.

One major reason for the deterioration in equity values is the growing distrust

of business. The collapse of ENRON, the problems associated with Global Crossing, TyCo, Arthur Anderson and, most recently, WorldCom, have devastated trust in business leadership and the accuracy of the numbers they report. It will take some time for trust to be reestablished.

Not only have these events caused the consumer to be more cautious but, given the stock market deterioration, it will inhibit businesses from increasing capital spending which is so necessary for a stronger economic recovery to evolve. Thus, the recent hesitation seen in the pace of economic activity is likely to continue in the months ahead. The resulting moderate pace of the advance suggests that State revenue improvement also is likely to show only a gradual improvement as the new fiscal year unfolds.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>May 2002</u>	<u>April 2002</u>	<u>May 2001</u>
Unemployment Rate (Average)	6.3%	6.4%	5.2%
Annual Rate of Inflation (Chicago)	3.3%	7.3%	0.9%
—————			
	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (May)	6,311	-0.3%	-0.7%
Employment (thousands) (May)	5,916	-0.2%	-1.8%
New Car & Truck Registration (May)	81,060	25.9%	19.9%
Single Family Housing Permits (May)	4,075	-10.5%	-1.1%
Total Exports (\$ mil) (April)	2,697	-4.4%	0.7%
Chicago Purchasing Managers Index (June)	58.2	-4.3%	30.2%

GENERAL FUNDS RECEIPTS: JUNE

**FY 2002 vs. FY 2001
(\$ million)**

Revenue Sources	JUNE FY 2002	JUNE FY 2001	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$697	\$760	(\$63)	-8.3%
Corporate Income Tax (regular)	151	142	\$9	6.3%
Sales Taxes	513	515	(\$2)	-0.4%
Public Utility Taxes (regular)	96	93	\$3	3.2%
Cigarette Tax	33	33	\$0	0.0%
Liquor Gallonage Taxes	11	11	\$0	0.0%
Vehicle Use Tax	4	3	\$1	33.3%
Inheritance Tax (Gross)	29	36	(\$7)	-19.4%
Insurance Taxes and Fees	56	48	\$8	16.7%
Corporate Franchise Tax & Fees	19	16	\$3	18.8%
Interest on State Funds & Investments	6	18	(\$12)	-66.7%
Cook County IGT	23	23	\$0	0.0%
Other Sources	340	230	\$110	47.8%
Subtotal	\$1,978	\$1,928	\$50	2.6%
Transfers				
Lottery	56	49	\$7	14.3%
Gaming Fund Transfer	50	50	\$0	0.0%
Other	82	71	\$11	15.5%
Total State Sources	\$2,166	\$2,098	\$68	3.2%
Federal Sources	\$470	\$586	(\$116)	-19.8%
Total Federal & State Sources	\$2,636	\$2,684	(\$48)	-1.8%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$53)	(\$54)	\$1	-1.9%
Corporate Income Tax	(35)	(27)	(\$8)	29.6%
Subtotal General Funds	\$2,548	\$2,603	(\$55)	-2.1%
Budget Stabilization Fund Transfer	\$0	\$0	\$0	N/A
Total General Funds	\$2,548	\$2,603	(\$55)	-2.1%
IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				1-Jul-02

GENERAL FUNDS RECEIPTS: YEAR END
FY 2002 vs. FY 2001
(\$ million)

Revenue Sources	FY 2002	FY 2001	CHANGE FROM FY 2001	% CHANGE
State Taxes				
Personal Income Tax	\$8,086	\$8,607	(\$521)	-6.1%
Corporate Income Tax (regular)	1,043	1,279	(\$236)	-18.5%
Sales Taxes	6,051	5,958	\$93	1.6%
Public Utility Taxes (regular)	1,104	1,146	(\$42)	-3.7%
Cigarette Tax	400	400	\$0	0.0%
Liquor Gallonage Taxes	122	124	(\$2)	-1.6%
Vehicle Use Tax	38	34	\$4	11.8%
Inheritance Tax (Gross)	329	361	(\$32)	-8.9%
Insurance Taxes and Fees	272	246	\$26	10.6%
Corporate Franchise Tax & Fees	159	146	\$13	8.9%
Interest on State Funds & Investments	135	274	(\$139)	-50.7%
Cook County IGT	245	245	\$0	0.0%
Other Sources	512	407	\$105	25.8%
Subtotal	\$18,496	\$19,227	(\$731)	-3.8%
Transfers				
Lottery	555	501	\$54	10.8%
Gaming Fund Transfer	470	460	\$10	2.2%
Other	454	452	\$2	0.4%
Total State Sources	\$19,975	\$20,640	(\$665)	-3.2%
Federal Sources	\$4,258	\$4,320	(\$62)	-1.4%
Total Federal & State Sources	\$24,233	\$24,960	(\$727)	-2.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$614)	(\$611)	(\$3)	0.5%
Corporate Income Tax	(240)	(243)	\$3	-1.2%
Subtotal General Funds	\$23,379	\$24,106	(\$727)	-3.0%
Budget Stabilization Fund Transfer	\$226	\$0	\$226	N/A
Total General Funds	\$23,605	\$24,106	(\$501)	-2.1%
SOURCE Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.				
IEFC- 1-Jul-02				