

***ILLINOIS ECONOMIC  
and  
FISCAL COMMISSION***

***FY 2002 GENERAL FUNDS REVENUE  
5-Year Outlook***



*AUGUST 2001  
703 STRATTON BUILDING  
SPRINGFIELD, ILLINOIS 62706*

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***ILLINOIS ECONOMIC  
and  
FISCAL COMMISSION***

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August, 2001

TO ALL MEMBERS OF THE ILLINOIS GENERAL ASSEMBLY

I am pleased to submit the FY 2002 General Funds Revenue 5-Year Outlook. The purpose of the report is to provide several plausible economic and subsequent revenue conditions the State may face over the next five years under the existing tax structure. The report includes three distinct five-year forecasts of economic factors as well as estimates of general funds revenue based on three different economic scenarios; Baseline, Pessimistic, and Late Recession. Each of these possibilities has been given a probability of occurring by DRI-WEFA, the Commission's forecasting source, with the Baseline a 50% probability; the Pessimistic a 40% probability; and, the Late Recession only a 10% probability.

While each of the three forecasts is unique in the factors used to determine the estimates, all three have revenue growth slowing in FY 2002 as a result of current economic conditions, as well as other factors not directly related to economic performance such as income tax refund percentages, Build Illinois general reserve transfers, and federal source receipting.

All three forecasts incorporate the recent change at the federal level that systematically will reduce and eventually eliminate revenue from the inheritance tax over this forecast period. In addition, all of the forecasts assume a significant drop off in Build Illinois general reserve transfers beginning in FY 2003. These items will serve to suppress annual rates of growth under all of the scenarios in the coming years.

To quickly summarize, the Baseline estimate assumes an improving economy beginning in the second half of FY 2002. After that, the forecast calls for modest, but sustainable, levels of growth for the larger sources impacted by economic conditions. The Pessimistic forecast has the economy slipping into recession very soon with a moderate recovery beginning in FY 2003 but not significantly rebounding until FY 2004. After skirting a near-term recession, the Late Recession scenario calls for a recession to occur in FY 2004. Recovery begins the following fiscal year, but receipt growth does not rebound significantly until FY 2006.

I invite you to consider these scenarios when reviewing future budgetary matters. If you have any questions, my staff and I would be glad to assist.

Sincerely,

A handwritten signature in black ink, appearing to read "Dan R. Long", with a long horizontal flourish extending to the right.

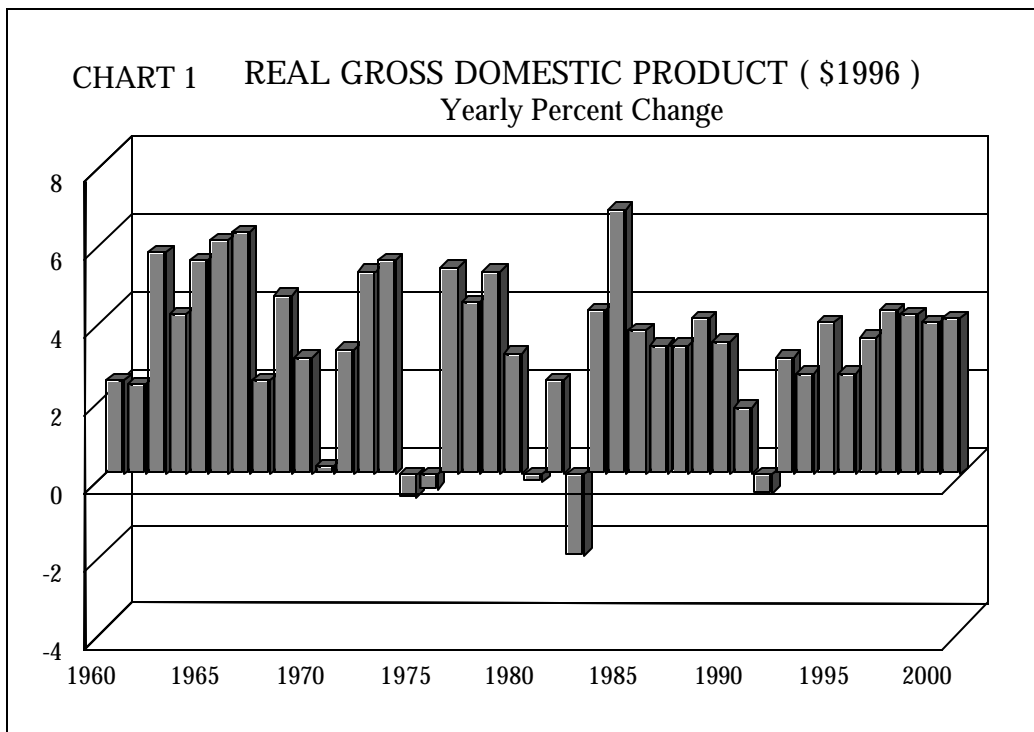
Dan. R. Long  
Executive Director

DRL:dkb

## GENERAL FUNDS REVENUE GROWTH: A Look to an Uncertain Future

All indicators suggest that we have entered into uncertain economic times. How and when we exit this period will have significant consequences on the State of Illinois' financial future.

The economy has been in a prolonged period of relatively stable, yet significant, growth, as shown in Chart 1. This is in sharp contrast to the 1970s and 1980s where growth was erratic and the economy experienced four recessions. Even so, this tranquil period came to an end toward the end of 2000 with real inflation-adjusted growth averaging 1% or less from the fourth quarter of 2000 through the second quarter of 2001. The key question remaining is whether the economy can skirt a recession or not and what follows. Complicating the picture is the backdrop of deteriorating economic conditions in Asia and Europe at the same time.



Some solace can be taken, as both monetary and fiscal policies have become proactive. The Federal Reserve has aggressively lowered interest rates over which it controls six times beginning in January and most observers expect more. From a fiscal policy standpoint, tax rebate checks already are being sent as a result of the significant tax relief passed by Congress, which should help sustain the consumer sector. To date, however, no significant economic improvement has been seen. Thus, we have provided the three most probable economic scenarios for the future together with other factors that will effect State revenues.

Table 1 below provides over a 20-year history of general funds revenue (excluding short-term borrowing). As shown, revenue growth in FY 2001 was a significant departure from the exceptional performance from the mid-1990s through FY 2000. From the period FY 1995 to FY 2000, annual general revenue growth averaged an increase of \$1.277 billion. For a more detailed history, see Table 2 on page 3. During this same period, we were enjoying a record economic expansion, the employment picture was bright, and inflation was tame.

Fiscal Year	Total General Funds	\$ Change	% Change
1981	\$8,100	\$658	8.8%
1982	\$8,265	\$165	2.0%
1983	\$8,287	\$22	0.3%
1984*	\$9,657	\$1,370	16.5%
1985	\$10,317	\$660	6.8%
1986	\$10,583	\$266	2.6%
1987	\$10,957	\$374	3.5%
1988	\$11,620	\$663	6.1%
1989	\$12,133	\$513	4.4%
1990	\$12,841	\$708	5.8%
1991	\$13,261	\$420	3.3%
1992	\$14,032	\$771	5.8%
1993	\$14,750	\$718	5.1%
1994	\$15,586	\$836	5.7%
1995	\$17,002	\$1,416	9.1%
1996	\$17,936	\$934	5.5%
1997	\$18,854	\$918	5.1%
1998	\$19,984	\$1,130	6.0%
1999	\$21,674	\$1,690	8.5%
2000	\$23,250	\$1,576	7.3%
2001	\$24,106	\$856	3.7%

\*Full fiscal year of temporary income tax increase

Then, rather abruptly, FY 2001 growth slowed significantly. In the middle of FY 2001 a dramatic slowing of the economy began to unfold. From a State revenue standpoint, sales tax revenue started to perform poorly and was never able to recover, corporate income tax receipts faltered badly at the end of the year, even personal income tax receipts, which had been holding up quite well, ended the fiscal year on a down note. While some of that slowdown can be attributed to a temporary suspension of the sales

tax on motor fuel, growth would have even been lower if not for significant one-time increases in some other areas.

What does the future hold for revenues? Regardless of the scenario that unfolds, it is unlikely that we will soon return to levels of growth experienced during the later half of the recent expansion. The route the economy takes in the near future will play a large role in determining revenue growth over the next five years.

<b>TABLE 2: GENERAL FUNDS REVENUE FY 1997 - FY 2001</b>					
<b>(\$ million)</b>					
<b>Revenue Sources</b>	<b>Actual Receipts FY 1997</b>	<b>Actual Receipts FY 1998</b>	<b>Actual Receipts FY 1999</b>	<b>Actual Receipts FY 2000</b>	<b>Actual Receipts FY 2001</b>
<b>State Taxes</b>					
Personal Income Tax	\$6,552	\$7,269	\$7,778	\$8,273	\$8,607
Corporate Income Tax (regular)	1,361	1,402	1,384	1,527	1,279
Sales Taxes	4,992	5,274	5,609	6,027	5,958
Public Utility Taxes (regular)	873	912	1,019	1,116	1,146
Cigarette Tax	300	346	403	400	400
Liquor Gallonage Taxes	57	57	57	128	124
Vehicle Use Tax	37	37	38	38	34
Inheritance Tax (Gross)	199	250	347	348	361
Insurance Taxes and Fees	146	91	208	209	246
Corporate Franchise Tax & Fees	121	118	117	139	146
Interest on State Funds & Investments	144	182	212	233	274
Cook County Intergovernmental Transfer	251	152	218	245	245
Other Sources	157	181	190	194	407
<b>Subtotal</b>	<b>\$15,190</b>	<b>\$16,271</b>	<b>\$17,580</b>	<b>\$18,877</b>	<b>\$19,227</b>
<b>Transfers</b>					
Lottery	590	560	540	515	501
Gaming Fund Transfer	185	170	240	330	460
Other	309	346	411	514	452
<b>Total State Sources</b>	<b>\$16,274</b>	<b>\$17,347</b>	<b>\$18,771</b>	<b>\$20,236</b>	<b>\$20,640</b>
<b>Federal Sources</b>	<b>\$3,269</b>	<b>\$3,323</b>	<b>\$3,718</b>	<b>\$3,891</b>	<b>\$4,320</b>
<b>Total Federal &amp; State Sources</b>	<b>\$19,543</b>	<b>\$20,670</b>	<b>\$22,489</b>	<b>\$24,127</b>	<b>\$24,960</b>
<b>Nongeneral Funds Distribution:</b>					
<b>Refund Fund</b>					
Personal Income Tax	(\$413)	(\$421)	(\$552)	(\$587)	(\$611)
Corporate Income Tax	(276)	(265)	(263)	(290)	(243)
<b>Total General Funds</b>	<b>\$18,854</b>	<b>\$19,984</b>	<b>\$21,674</b>	<b>\$23,250</b>	<b>\$24,106</b>
Change from Prior Year	\$918	\$1,130	\$1,690	\$1,576	\$856
Percent Change	5.1%	6.0%	8.5%	7.3%	3.7%
<b>IEFC</b>				08/08/01	

Table 3 provides an overview of general funds revenues, expenditures, and subsequent balances for the past five fiscal years. Included are lapse period spending figures and resulting after lapse balances. While the table only depicts general funds information, it is worth noting that \$225 million recently was transferred from the Tobacco Settlement Recovery Fund to the Budget Stabilization Fund (otherwise known as the Rainy Day Fund).

TABLE 3: GENERAL FUNDS OVERVIEW					
FY 1997 to FY 2001 (\$ in Millions)					
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Beginning Balance	\$426	\$806	\$1,202	\$1,351	\$1,517
Revenues	\$18,854	\$19,984	\$21,674	\$23,250	\$24,106
Expenditures	\$18,474	\$19,588	\$21,525	\$23,084	\$24,497
Ending Balance June 30th	\$806	\$1,202	\$1,351	\$1,517	\$1,126
Lapse Period Spending*	\$761	\$846	\$848	\$740	\$800
Balance After Lapse	\$45	\$356	\$503	\$777	\$326
*Estimated FY 2001 Lapse Spending					

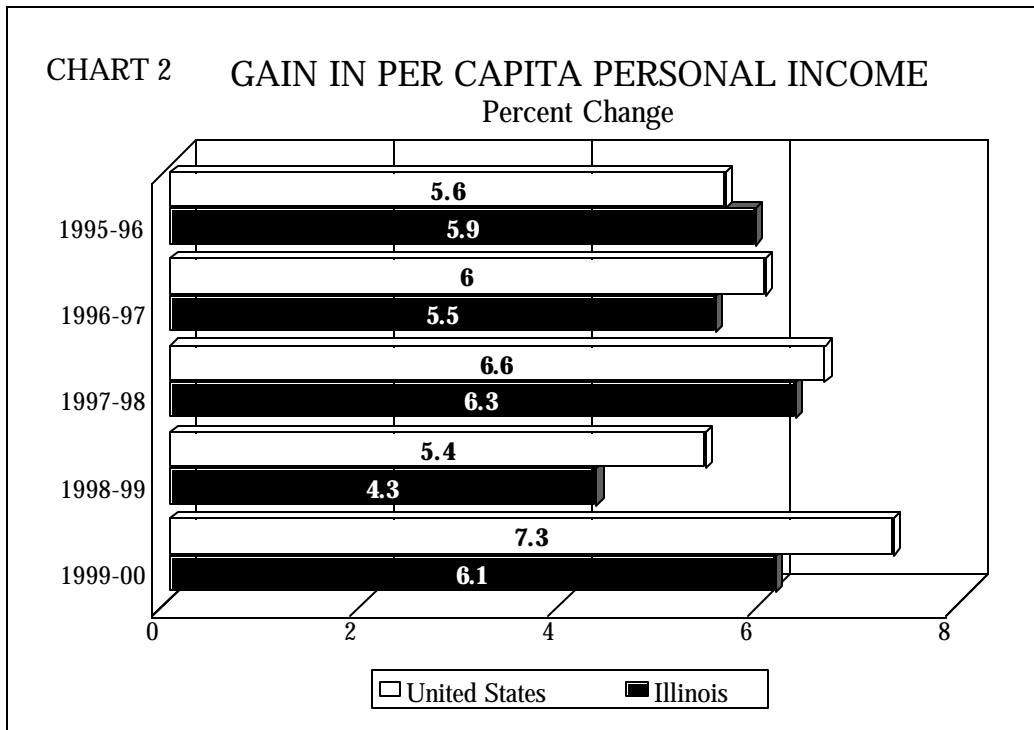


## ILLINOIS AND THE NATION

Illinois has a population of 12.4 million, ranking it fifth most populous among the 50 states. Even so, its growth of 8.6% over the last decade trailed the nation's overall population expansion of 13.2%, resulting in Illinois losing 1 seat in the U.S. House of Representatives for the 108<sup>th</sup> Congress. Illinois was not alone in losing representatives as the Midwest including Wisconsin, Michigan, Indiana and Ohio each also lost one representative as population growth shifted to South and West from North and East.

Within the State, population continued to shift from downstate to more urban areas, particularly the suburbs of Chicago. Fastest growing counties were Cook, Will, Lake, DuPage and Kane, respectively. Even the City of Chicago grew, rising 112,000 or 4% from 1990 to 2000, following a drop of 220,000 between 1980 and 1990.

Illinois is a comparatively wealthy state. At \$46,400, Illinois median household income was 14% higher than the national average and ranks 8<sup>th</sup> nationally. On a per-capita basis, income rose to \$32,259 in Illinois in 2000; up 55% from \$20,756 in 1990 and ranking 9<sup>th</sup> in the United States, up from its 10<sup>th</sup> position in both 1980 and 1990. Even so, as shown in Chart 2, growth in per-capita income has lagged behind that of the nation as a whole in recent years.



Illinois has a diversified economy with the lowest concentration of manufacturing jobs in the East North Central region. While the State also has a wide and diverse range of

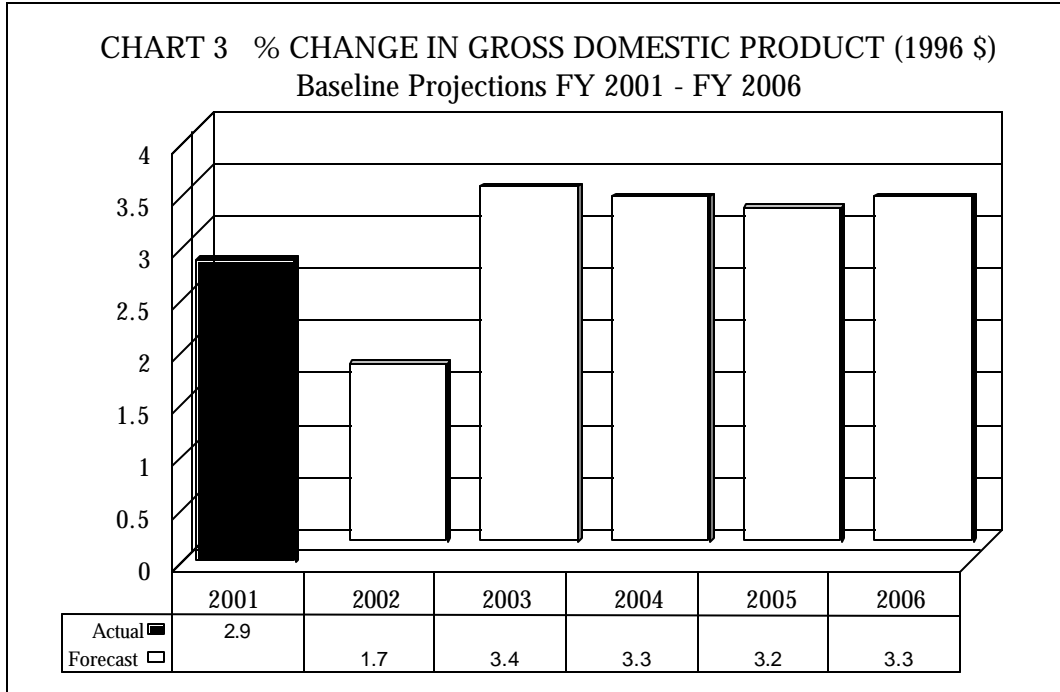
manufacturing, led by non-electrical machinery, electrical equipment, fabricated metals, and printing and publishing, it also has been hard hit by the recession underway in the manufacturing sector. Payroll employment rose 1.2% in 2000, about half the national pace. Strong gains in construction and business services jobs were largely mitigated by losses in manufacturing, mining, finance and insurance. Illinois farmers lead the nation in growing of soybean and corn for gain, but low prices have hurt the agricultural sector.

Chicago and the suburbs dominate the State's economy with an employment base of 4.2 million workers. Outside Chicago metro area, farming, food processing, government and service for those residences residing there characterize Southern Illinois. The western part of the State is closely tied to transportation and distribution centers served by the Mississippi River. On the eastern bank the river, Illinois' portion of the St. Louis metro area forms the State's second largest commercial center while Moline and Peoria have high concentrations of farm, construction, and heavy equipment manufacturing.

The outlook for Illinois is one of continuing to struggle to avoid recession followed by anticipated below-par growth. According to DRI/WEFA, employment growth will average just 0.9% a year from 2000 to 2005, 39<sup>th</sup> among the 50 states. Growth in consumer service industries will be held back as consumers rein in spending while the state's agricultural and farm equipment sectors will remain depressed until prices rebound, and this may be some time away given the overall weakness in the global economy. Only the business services sector looks likely to show any real signs of life.

**BASELINE PROJECTIONS: FY 2002 - FY 2006**

The Baseline Projections are based upon DRI-WEFA's latest control, or most likely economic forecast and is given a 50% chance of occurrence. The forecast calls for sluggish 1.7% growth in FY 2002, followed by average growth of 3.3% over the following four years. (See Chart 3).

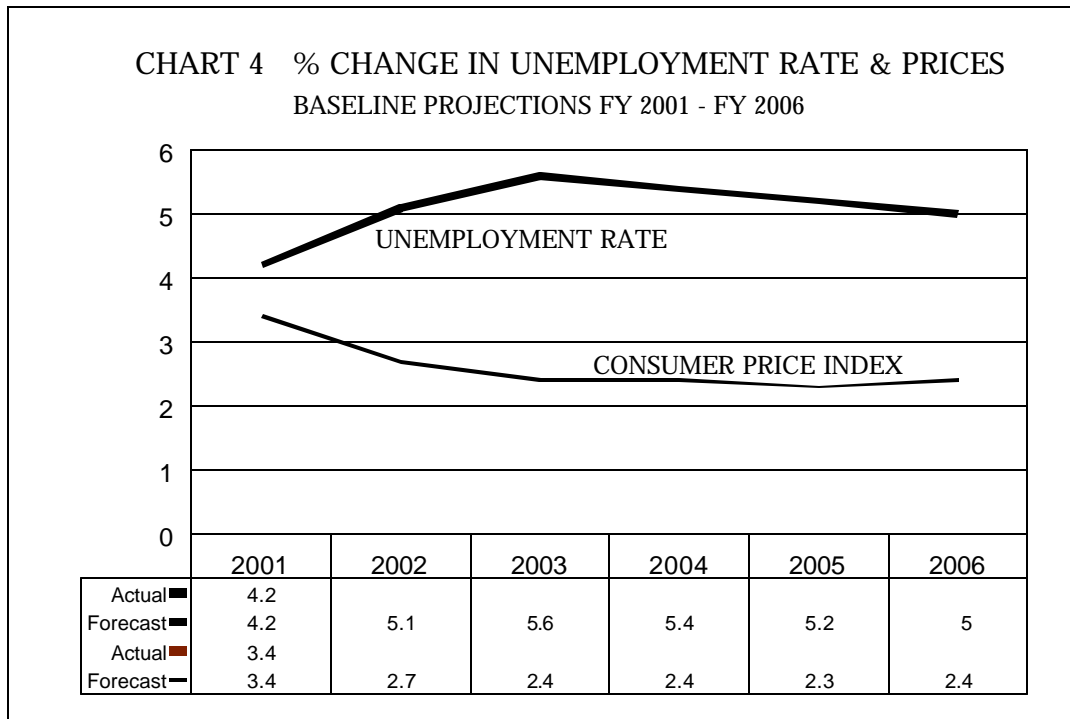


After 10 years of economic expansion, the economy reached a virtual halt at the end of FY 2001. Even while growth is expected to pick up in FY 2002, it is anticipated to record an overall gain for the year of only 1.7%, down from about 3% in FY 2001 and half the rate expected over the next four years.

While inflation edged up in FY 2001, a prolonged period of slow growth has lessened the ability for businesses to raise prices while depressed commodity prices coupled with reduced energy costs all suggest reduced price pressures in the period ahead. Given the flat economy and outlook for softening prices, the Federal Reserve is expected to lower the interest rates they influence further in the months ahead with possibly two more quarter-point rate reductions. This would be on top of the six reductions already made since the beginning of calendar 2001.

Consumer spending remains the major strength in the economy and will continue to be key in the period immediately ahead. Incomes are still rising, albeit at a reduced pace, but still generally exceed expectations. Lower energy prices coupled with the income tax rebates and lower borrowing rates are all factors holding up consumer spending.

And, while the latest measures of consumer confidence show some erosion, the sharp decline since last summer appears to have stabilized to modestly improved.



Labor conditions are expected to continue to erode under the Baseline scenario. The unemployment rate is anticipated to rise almost one full percent between FY 2001 and FY 2002, averaging slightly over 5% this fiscal year. A high is expected sometime during FY 2003 before a gradual reduction trend gets underway. Even so, the very low unemployment rates of the last four years will not be reached again during the 5-year forecast horizon. At the same time, as mentioned, inflation will remain tame, falling into FY 2003 before leveling out during the remainder of the forecast period.

Fiscal policy, which had been quite restrictive, already has begun to become more stimulative as spending has increased at a faster pace while tax rebates have reduced the budget surplus. This, of course, has been supportive to a weakened economy. The phase-in of income tax rate reductions and eventual elimination of the death tax, and other reduced pressures suggest further stimulation over the forecast horizon.

DRI-WEFA's control, or Baseline, solution implies that the current economic slowdown will end later this fiscal year followed by a restrained pick up through FY 2006. Table 4, shows the breakdown of the major GDP components and other economic measures on a fiscal year basis. The overall pattern is reminiscent of the more moderate growth rate experienced earlier in the 1990s rather than the more rapid rates of expansion seen in the few years prior to FY 2001.

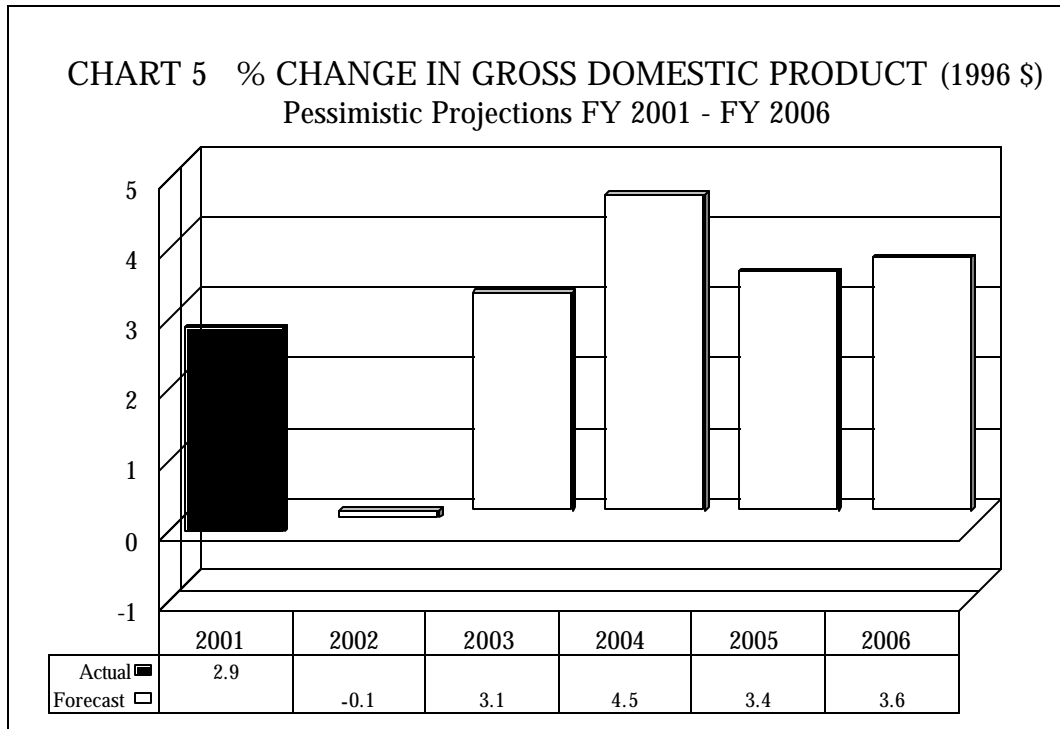
**TABLE 4. BASELINE FORECAST OF THE ECONOMY**

<b>REAL (1996 \$)</b>	<b><u>FY 01</u></b>	<b><u>FY 02</u></b>	<b><u>FY 03</u></b>	<b><u>FY 04</u></b>	<b><u>FY 05</u></b>	<b><u>FY 06</u></b>
Gross Domestic Product	2.9	1.7	3.4	3.3	3.2	3.3
Personal Consumption	4.1	2.8	3.5	3.0	3.1	3.2
Durables	5.5	3.0	6.6	3.9	3.9	4.2
Nondurables	3.7	2.5	3.0	2.7	2.7	2.7
Services	4.0	3.0	3.0	2.9	3.1	3.2
Fixed Investment	5.1	-2.3	4.2	6.2	4.4	4.4
Exports	5.7	-1.0	3.6	6.4	6.3	6.7
Imports	8.5	0.7	5.0	5.5	4.7	4.6
Government Purchases	2.2	2.6	2.2	1.8	1.7	1.6
Federal	0.8	2.8	2.2	1.2	1.1	1.1
State	3.0	2.6	2.2	2.1	2.0	1.9
<b><u>OTHER MEASURES</u></b>						
Personal Income	3.3	2.4	3.2	3.3	3.0	3.0
Disposable Income	2.4	4.2	2.8	3.3	3.3	3.2
Industrial Production	2.0	-2.3	4.1	4.1	3.0	3.1
Consumer Prices	3.4	2.7	2.4	2.4	2.3	2.4
Unemployment Rate (Avg.)	4.2	5.1	5.6	5.4	5.2	5.0

## PESSIMISTIC PROJECTIONS: FY 2002 - FY 2006

DRI-WEFA's second most-likely scenario is entitled Pessimistic Projections, with a 40% chance of occurrence. The scenario calls for a near-term recession as the slump in business spending and manufacturing creates a further upward spiral in layoffs, a renewed slide in consumer confidence, and a sputtering stock market. Moreover, with the global economy depressed and the dollar strong, foreign demand for U.S. products softens, depressing the demand for U.S. goods already sluggish due to weakened domestic demand.

The Federal Reserve responds to a steady stream of weak data, but the rate cuts cannot prevent a recession. As shown in Chart 5, the U.S. economy drops from real growth of almost 3% in FY 2001 to a negative slide of 0.1% in FY 2002.



This would be the first recession since the 1990-91 downturn and has almost as great a chance of occurring as the baseline.

In this scenario, the unemployment rate surges to over 7%, averaging 6.7% in FY 2002. Price increases respond even more sharply to the weak demand and, with a lag, average at or below 2% from FY 2003 through the forecast horizon. As more stimulative policies take effect, the economy eventually enters a recovery, which accelerates in FY 2004, before leveling out at a respectable 3.5% in the final two years of the forecast.



Table 5, shows a breakdown of GDP and the major components as well as other economic measures on a fiscal year basis. It should be pointed out that this Pessimistic solution has only a 10% less chance of occurring than the Baseline, or most likely, scenario.

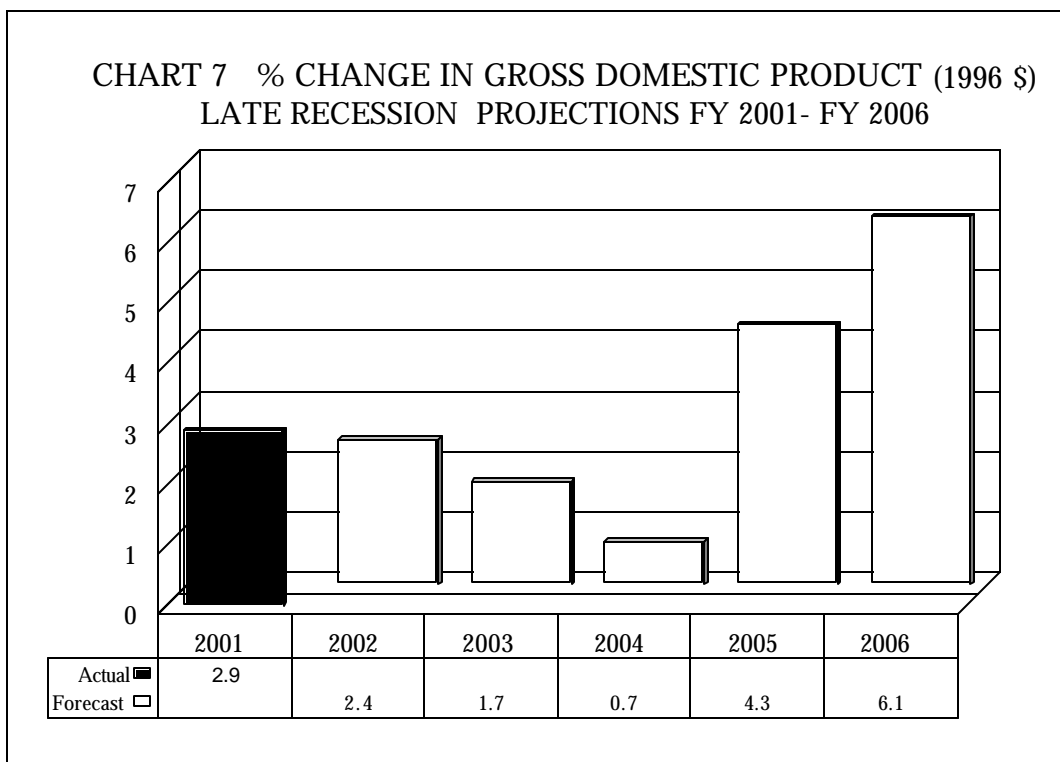
**TABLE 5. PESSIMISTIC FORECASTS OF THE ECONOMY**

<b>REAL (1996 \$)</b>	<b><u>FY 01</u></b>	<b><u>FY 02</u></b>	<b><u>FY 03</u></b>	<b><u>FY 04</u></b>	<b><u>FY 05</u></b>	<b><u>FY 06</u></b>
Gross Domestic Product	2.9	-0.1	3.1	4.5	3.4	3.6
Personal Consumption	4.1	0.9	2.9	4.1	3.6	3.7
Durables	5.5	-2.4	8.4	6.7	4.1	5.1
Nondurables	3.7	0.9	1.0	3.6	3.7	3.5
Services	4.0	1.9	3.1	3.0	3.5	3.5
Fixed Investment	5.1	-5.1	2.5	9.7	4.8	4.7
Exports	5.7	-2.6	3.7	7.7	6.6	6.5
Imports	8.5	-1.4	2.7	7.7	5.6	5.2
Government Purchases	2.2	2.6	2.0	1.8	1.8	1.7
Federal	0.8	2.8	2.2	1.3	1.2	1.1
State	3.0	2.5	1.9	2.1	2.1	2.0
<b><u>OTHER MEASURES</u></b>						
Personal Income	3.3	1.4	2.2	4.3	3.5	3.4
Disposable Income	2.4	3.2	2.2	4.3	3.5	3.6
Industrial Production	2.0	-4.6	3.7	6.1	3.1	3.2
Consumer Prices	3.4	2.7	1.9	2.0	1.9	1.9
Unemployment Rate (Avg.)	4.2	5.7	6.7	5.9	5.5	5.1

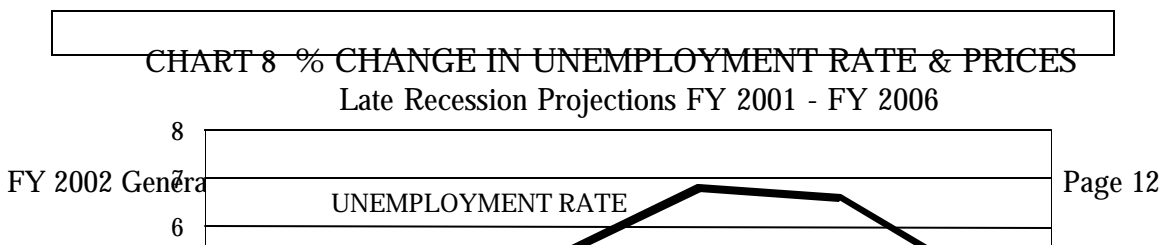
**LATE RECESSION PROJECTIONS: FY 2002 - FY 2006**

The Late Recession projections are based upon DRI-WEFA's third most-likely outcome of economic activity. In this scenario, the economy skirts a recession through the next few years with a soft landing, but the Federal Reserve goes too far in credit easing, setting off inflationary forces that culminate in a recession later. It should be stressed that this outcome, however, is given only a 10% chance of occurring.

As shown in Chart 7, the economy muddles through the next year and a half with GDP continuing to show modest gains. A recession then hits late in FY 2003 and extends into FY 2004 with overall growth in the economy dropping to 1.7% and 0.7%, respectively.



As the Federal Reserve over eases, prices begin to rise later this fiscal year and accelerate higher into FY 2004 before the effects of the late recession take hold. Unemployment continues to rise as the economy struggles to stay above water this fiscal year and then begins to go substantially higher as the late recession hits, rising above 7% in early FY 2004 and averaging 6.8% for the year. Unemployment begins to edge lower in FY 2005 and improves moderately in the final fiscal year of the forecast. (See Chart 8 on the following page).





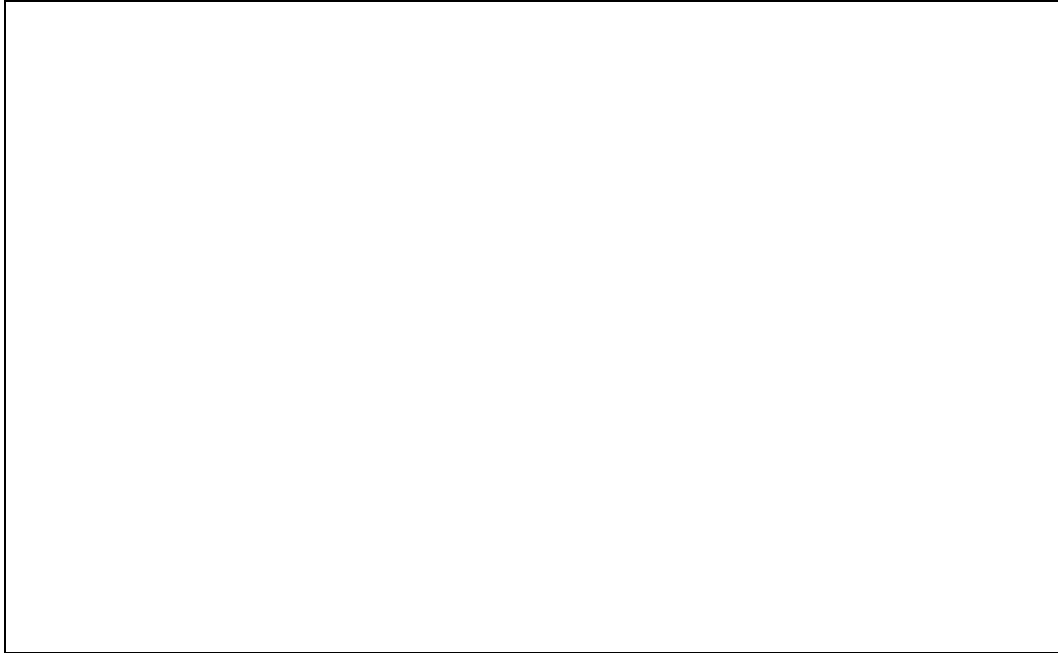
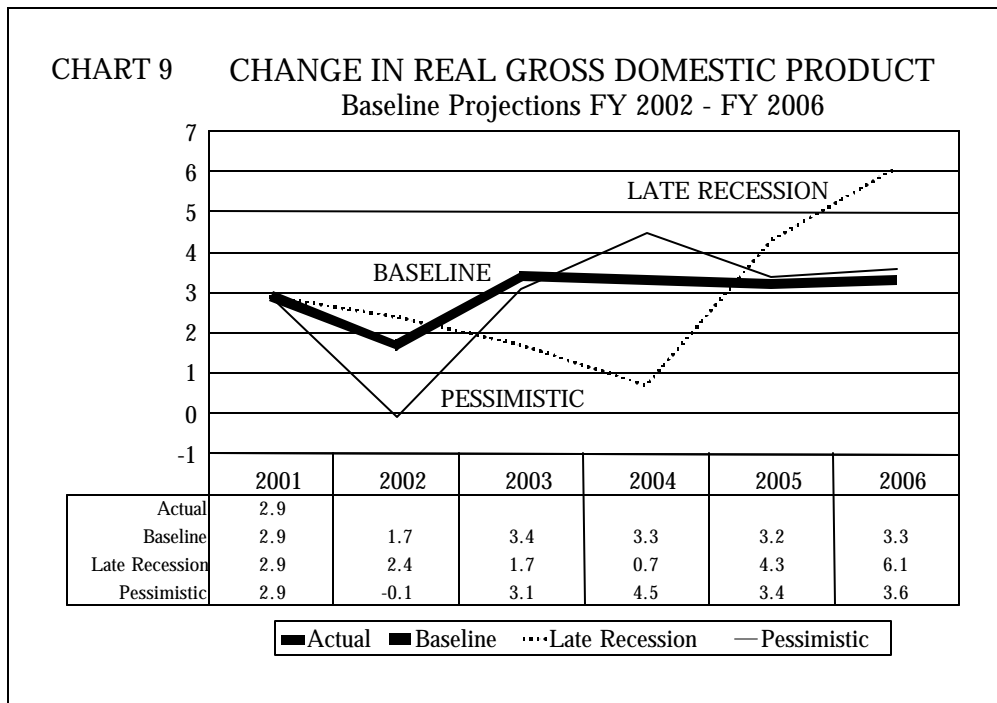


Table 6 shows the major components of the economy and the expected performance of these over the forecast horizon.

<b>TABLE 6. LATE RECESSION FORECASTS OF THE ECONOMY</b>						
<b>REAL (1996 \$)</b>	<b><u>FY 01</u></b>	<b><u>FY 02</u></b>	<b><u>FY 03</u></b>	<b><u>FY 04</u></b>	<b><u>FY 05</u></b>	<b><u>FY 06</u></b>
Gross Domestic Product	2.9	2.4	1.7	0.7	4.3	6.1
Personal Consumption	4.1	3.0	3.4	-0.8	3.2	5.1
Durables	5.5	3.7	6.2	-9.0	11.5	10.4
Nondurables	3.7	2.5	3.0	0.1	0.9	4.1
Services	4.0	3.4	2.9	0.7	3.1	4.0
Fixed Investment	5.1	-2.1	4.6	-4.6	5.3	13.0
Exports	5.7	-1.1	3.2	7.3	8.3	11.7
Imports	8.5	1.2	5.8	-2.6	0.5	9.1
Government Purchases	2.2	2.7	2.2	0.6	1.5	2.5
Federal	0.8	2.8	2.2	1.2	1.1	1.1
State	3.0	2.6	2.2	0.3	1.7	3.2
<b><u>OTHER MEASURES</u></b>						
Personal Income	3.3	2.5	3.0	0.5	2.2	5.4
Disposable Income	2.4	4.2	2.6	0.9	2.6	5.2
Industrial Production	2.0	-2.2	4.0	-1.1	4.8	9.1
Consumer Prices	3.4	2.7	2.8	3.0	2.1	2.3
Unemployment Rate (Avg.)	4.2	5.1	5.4	6.8	6.6	4.9

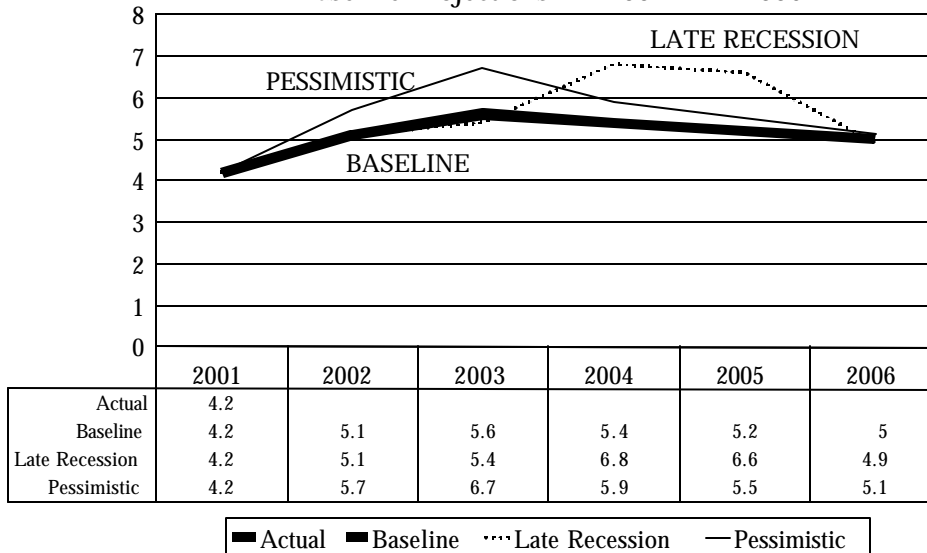
## COMPARISON OF ECONOMIC FORECASTS: FY 2002 - FY 2006

Chart 9 shows the change in real gross domestic product over the next five fiscal years for each of the three scenarios. The Baseline projection (50% probability) shows sharply reduced growth in the current fiscal year followed by improved trend growth averaging 3.3% in each of the final four years of the forecast. The Pessimistic projection (40% probability) shows a continued weakening in the economy with real growth declining this fiscal year and into next before a recovery ensures with strong growth in FY 2004 followed by trend growth of about 3.5% on average in the last two years of the forecast. Finally, the Late Recession projections (10% probability) shows continued weakening until late FY 2003 early FY 2004 when a recession finally hits, followed by rapid growth in the final two years coming out of the recession.

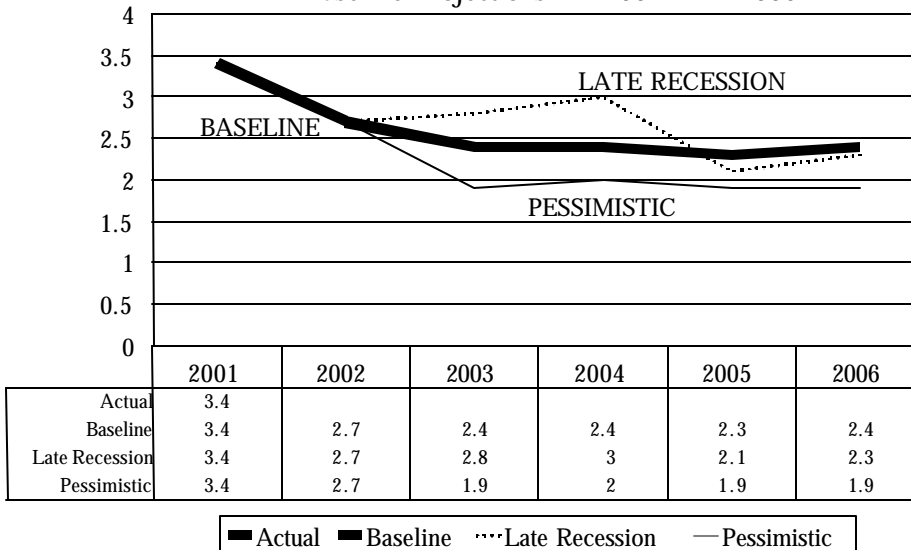


The three economic scenarios give distinctly different patterns for unemployment and inflation rates. (See Charts 10 and 11). The Baseline solution shows a moderate pickup in the unemployment rate this year and next before a gradual lowering trend sets in. Both the Pessimistic and Late Recession projections show the unemployment rate reaching higher levels at different times, with the Late Recession solution showing the highest rates, although all center on a 5% rate at the end of the five year period.

**CHART 10** CHANGE IN UNEMPLOYMENT RATES  
Baseline Projections FY 2002 - FY 2006



**CHART 11** CHANGE IN CONSUMER PRICES  
Baseline Projections FY 2002 - FY 2006



The inflation implications also show significant variations. The best price performance is in the Pessimistic scenario, but that also is the worst performing economy. The most volatile price pattern is the Late Recession scenario, although in none of the outcomes is inflation a major concern and in all are at rates lower than actually occurred in FY 2001.

## **BASELINE REVENUE PROJECTION**

The general funds revenue projections for FY 2002 to FY 2006, assuming the Baseline economic forecast, increase between 3.0% and 4.3% annually. Those growth rates equate into a range of new revenue (change from the prior year) of \$720 million to \$1.207 billion.

As shown in Table 7 on page 18, the smallest increase is forecast to occur in the current fiscal year. In addition to rather modest underlying economic assumptions used to project FY 2002 revenues, a couple of significant factors contribute to the relative modest growth. Specifically, as a result of an increase in federal reimbursements at the end of FY 2001, federal source receipts are forecast to be \$140 million less in FY 2002. In addition, a significant change in the percentage of income taxes deposited into the Income Tax Refund Fund will reduce net income tax receipts by approximately \$100 million in FY 2002. Overall growth increases slightly in FY 2003, despite several items which serve to suppress growth and will be discussed below. Growth rates from FY 2004 to FY 2006 are similar and range from 4.1% to 4.3% and have corresponding revenue growth of approximately \$1.1 billion to \$1.2 billion per year.

Several other assumptions unrelated to economic conditions include the continuation of the current intergovernmental transfer agreement with Cook County. The federal government continues to attempt to severely restrict or eliminate states' ability to take advantage of such agreements which serve to maximize federal reimbursement. If restrictions or elimination of the agreements occur, future revenue also would be jeopardized. In addition, in FY 2002, \$275 million in Build Illinois general reserve transfers are expected to occur and are included in the estimate of 'other sources'. The high transfer is due to the drawing down of an accumulated balance in the general reserve account. A transfer of \$200 million took place in FY 2001. After the FY 2002 transfer, the reserve balance will only be able to support annual transfers of approximately \$50-75 million. Finally, as mentioned earlier, the percentage of gross income taxes to be deposited into the Income Tax Refund Fund has increased. The new refund rates of 7.6% for individual income tax and 23.0% for corporate income tax are used throughout the forecast period. A significant change from the current rates could result in a large change for total net receipts.

### **State Taxes**

State taxes, which are comprised mostly of the income taxes as well as sales taxes, are expected to increase between a high of 5.0% in FY 2002 and a low of 3.6% in FY 2003. The dip in growth stems from a federal tax change that impacts on inheritance tax as well as an assumed reduction in Build Illinois reserve transfers.

Growth rates for gross personal income tax, after experiencing a low of 4.0% in FY 2002, increases to an average of 5.3% over the remainder of the forecast period. Gross corporate income tax receipts are estimated to continue to struggle through

FY 2002 before rebounding in FY 2003 at a rate of 8.0%. After that pick-up, gains are forecast to fall back to levels of 4.0%.

Sales tax receipts are estimated to grow 7.0% in FY 2002 as a result of the full-year return of the sales tax on motor fuel. The estimated impact of \$175 million, when added to the base growth of 4.0% yields the impressive FY 2002 growth rate. After that, rates return to average a decent 5.4%.

Other than public utility taxes, most of the other state tax sources exhibit little if any consistent annual growth. In fact, due to the recently-passed federal tax relief package, the State's inheritance tax will be eliminated over the next several years. In essence, the revenue the State receives from inheritance tax stems from a state credit allowed against the federal tax. The legislation will systematically cut this state credit beginning January 1, 2002 until it is totally eliminated in 2005. Due to a lag in the receipting of this tax, the actual impact will not be felt until FY 2003 at which time inheritance tax receipts will be trimmed by approximately \$75 million. Subsequent years also will experience additional losses until the tax effectively ceases to be receipted after FY 2006.

As mentioned earlier, Build Illinois transfers from the general reserve account will fall after FY 2002. After an estimated transfer of \$75 million in FY 2003, it is estimated that only \$50 million will be eligible for transfer each subsequent year. Cook County IGT levels are forecast to be static but could change significantly as the result of federal restrictions.

### **Transfers**

Overall transfers are forecast to increase between 1.6% and 3.1%. Lottery transfers are forecast to be flat and reflect a mature form of gaming. While riverboat transfers from the Gaming Fund are estimated to increase 4.0% over most of the period, obviously, any change in the taxing structure and/or the activation of the dormant 10<sup>th</sup> license could significantly impact receipts. Other transfers are forecast to rise approximately 5.0% after the current fiscal year, but are susceptible to swings due to occasional one-time transfers of funds.

### **Federal Sources**

After FY 2002, federal sources are estimated to grow annually by approximately 3.5%. As mentioned earlier, FY 2002 is forecast to actually decline \$140 million due to an impressive end to FY 2001. Any significant change in reimbursable programs such as Medicaid could significantly impact receipts.

### **Summary of Baseline Scenario**

The Baseline scenario begins by forecasting an improved economy beginning the second half of FY 2002. After that, the forecast calls for modest but sustainable levels of growth for the larger sources impacted by economic conditions. Future growth rates are lessened due to items such as the elimination of the inheritance tax as well as

reductions in Build Illinois general reserve transfers. Growth climbs from 3.0% in 2002 to 4.3% at the end of the period.

<b>TABLE 7: FY 2002 to FY 2006 "Baseline"</b>					
<b>Estimated General Funds Receipts</b>					
<b>(\$ million)</b>					
<b>Revenue Sources</b>	<b>Estimated FY 2002</b>	<b>Projected FY 2003</b>	<b>Projected FY 2004</b>	<b>Projected FY 2005</b>	<b>Projected FY 2006</b>
<b>State Taxes</b>					
Personal Income Tax	\$8,955	9,412	9,939	10,456	11,020
Corporate Income Tax (regular)	1,318	1,423	1,480	1,540	1,601
Sales Taxes	6,378	6,742	7,092	7,468	7,879
Public Utility Taxes (regular)	1,180	1,221	1,264	1,308	1,354
Cigarette Tax	400	400	400	400	400
Liquor Gallonage Taxes	135	135	135	135	135
Vehicle Use Tax	35	35	35	35	35
Inheritance Tax (Gross)	376	301	191	109	30
Insurance Taxes and Fees	260	273	287	301	316
Corporate Franchise Tax & Fees	151	156	162	167	173
Interest on State Funds & Investments	265	278	292	307	322
Cook County Intergovernmental Transfer	245	245	245	245	245
Other Sources	497	308	295	307	320
<b>Subtotal</b>	<b>\$20,195</b>	<b>\$20,930</b>	<b>\$21,817</b>	<b>\$22,778</b>	<b>\$23,831</b>
<b>Transfers</b>					
Lottery	505	505	505	505	505
Gaming Fund Transfer	465	484	503	523	544
Other	465	488	513	538	565
<b>Total State Sources</b>	<b>\$21,630</b>	<b>\$22,406</b>	<b>\$23,337</b>	<b>\$24,344</b>	<b>\$25,445</b>
<b>Federal Sources</b>	<b>\$4,180</b>	<b>4,326</b>	<b>4,478</b>	<b>4,634</b>	<b>4,797</b>
<b>Total Federal &amp; State Sources</b>	<b>\$25,810</b>	<b>\$26,732</b>	<b>\$27,815</b>	<b>\$28,978</b>	<b>\$30,242</b>
<b>Nongeneral Funds Distribution:</b>					
<b>Refund Fund</b>					
Personal Income Tax	(\$681)	(\$715)	(\$755)	(\$795)	(\$838)
Corporate Income Tax	(303)	(\$327)	(\$340)	(\$354)	(\$368)
<b>Total General Funds</b>	<b>\$24,826</b>	<b>\$25,690</b>	<b>\$26,720</b>	<b>\$27,829</b>	<b>\$29,036</b>
<b>Change from Prior Year</b>	<b>\$720</b>	<b>\$864</b>	<b>\$1,030</b>	<b>\$1,109</b>	<b>\$1,207</b>
<b>Percent Change</b>	<b>3.0%</b>	<b>3.5%</b>	<b>4.0%</b>	<b>4.1%</b>	<b>4.3%</b>
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**PESSIMISTIC REVENUE PROJECTION**

The Pessimistic scenario has the economy failing to avoid a recession, which has immediate impacts on revenues. Under this scenario, the aggressive action of the Fed over the last seven months is not enough to avoid recession. As a result, receipt growth falls to 1.4% or \$344 million for the current fiscal year. Recovery begins in FY 2003 but is not fully felt until FY 2004 when significantly higher growth is experienced. The remaining two years of the forecast period has growth settling down to more moderate levels.

### **State Taxes**

As before, the same issues of the elimination of the inheritance tax and reduction in Build Illinois reserve transfers applies here as well. Overall State tax revenue grows by 2.9% in FY 2002. Significant improvement is not felt until FY 2004 when recovery is in full evidence. While the recession is not of severe depth or duration, neither is the recovery very forceful. The forecast period ends with growth averaging 4.5% over the last two years.

Gross personal income tax receipts continue to stumble throughout FY 2002 and growth is only 2.5%. The subsequent recovery is slow and is not markedly felt until FY 2004 when receipts grow by 6.2%. Growth slows somewhat over the remaining years to a level of approximately 5.2%. Gross corporate income tax receipts continue to spiral in FY 2002 and suffer a 5.0% decline. Contrary to personal income, corporate receipts rebound quicker and experience a substantial gain of 9.0% in FY 2003. Growth moderates to 5.0% the following year and falls to 4.0% for the remainder of the forecast period.

Sales tax receipts follow the same pattern as individual income tax receipts, except are buoyed in FY 2002 by the annualizations associated with the return of motor fuel sales tax. After the FY 2002 recession, receipt growth picks up somewhat in FY 2003, but the recovery is not significantly felt until FY 2004 when sales revenues grow by 5.9%. The next two years have revenues moderating, although only slightly, averaging nearly 5.5%.

Other sources to the general funds grow by 3.8% in FY 2002 before falling 6.3% in FY 2003 as a result of the aforementioned reduction in inheritance tax as well as lower Build Illinois transfers. FY 2004 dips an additional 1.4% for the same reasons. Growth over the last two years of the forecast period is virtually flat.

### **Transfers**

The FY 2002 recession has a minor impact on transfers as lottery and Gaming Fund transfers are impacted resulting in no growth in overall transfers. FY 2003 is not much better as the maturing of both lottery and riverboat gambling tempts growth. Growth improves slightly to average 2.9% over the remainder of the forecast period.

### **Federal Sources**

Federal sources fall by 2.5% in FY 2002, a rate of decline slightly less than the Baseline scenario and reflects the growing impact of the recession on reimbursable programs. FY 2003 increases by 6.0% as spending pressures force increased attention to human service programs. Growth begins to fall somewhat in FY 2004 and returns to tamer rates of 3.5% over the remaining fiscal years.

### **Summary of Pessimistic Scenario**

The economy is unable to avoid recession in FY 2002. Receipts, after faltering at the end of FY 2001, continue to stumble throughout this period. The recovery begins in FY 2003, albeit at a rather moderate pace. Significant growth is not experienced until FY 2004 before more sustainable levels of growth are felt in FY 2005 and FY 2006. Overall rates of growth range from a low of 1.4% in FY 2002 to a high of 4.8% in the recovery year of FY 2004. Corresponding levels of new revenue range from \$344 million to \$1.194 billion.



**TABLE 8: FY 2002 to FY 2006 "Pessimistic"**  
**Estimated General Funds Receipts**  
(\$ million)

<b>Revenue Sources</b>	<b>Estimated FY 2002</b>	<b>Projected FY 2003</b>	<b>Projected FY 2004</b>	<b>Projected FY 2005</b>	<b>Projected FY 2006</b>
<b>State Taxes</b>					
Personal Income Tax	\$8,825	9,152	9,719	10,224	10,756
Corporate Income Tax (regular)	1,215	1,324	1,391	1,446	1,504
Sales Taxes	6,225	6,486	6,869	7,240	7,638
Public Utility Taxes (regular)	1,180	1,221	1,264	1,308	1,354
Cigarette Tax	400	400	400	400	400
Liquor Gallonage Taxes	135	135	135	135	135
Vehicle Use Tax	35	35	35	35	35
Inheritance Tax (Gross)	376	301	191	109	30
Insurance Taxes and Fees	255	260	274	288	303
Corporate Franchise Tax & Fees	147	147	154	160	165
Interest on State Funds & Investments	255	255	268	281	295
Cook County Intergovernmental Transfer	245	245	245	245	245
Other Sources	482	288	274	285	297
<b>Subtotal</b>	<b>\$19,775</b>	<b>\$20,250</b>	<b>\$21,219</b>	<b>\$22,157</b>	<b>\$23,157</b>
<b>Transfers</b>	<b>\$1,415</b>	<b>\$1,428</b>	<b>\$1,466</b>	<b>\$1,510</b>	<b>\$1,556</b>
Lottery	495	485	485	485	485
Gaming Fund Transfer	460	469	488	507	528
Other	460	474	493	517	543
<b>Total State Sources</b>	<b>\$21,190</b>	<b>\$21,678</b>	<b>\$22,685</b>	<b>\$23,667</b>	<b>\$24,714</b>
<b>Federal Sources</b>	<b>\$4,210</b>	<b>4,463</b>	<b>4,708</b>	<b>4,873</b>	<b>5,043</b>
<b>Total Federal &amp; State Sources</b>	<b>\$25,400</b>	<b>\$26,141</b>	<b>\$27,393</b>	<b>\$28,540</b>	<b>\$29,757</b>
<b>Nongeneral Funds Distribution:</b>					
<b>Refund Fund</b>					
Personal Income Tax	(\$671)	(\$696)	(\$739)	(\$777)	(\$817)
Corporate Income Tax	(279)	(305)	(320)	(333)	(346)
<b>Total General Funds</b>	<b>\$24,450</b>	<b>\$25,140</b>	<b>\$26,334</b>	<b>\$27,430</b>	<b>\$28,594</b>
<b>Change from Prior Year</b>	<b>\$344</b>	<b>\$690</b>	<b>\$1,194</b>	<b>\$1,096</b>	<b>\$1,164</b>
<b>Percent Change</b>	<b>1.4%</b>	<b>2.8%</b>	<b>4.8%</b>	<b>4.2%</b>	<b>4.2%</b>
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## **LATE RECESSION PROJECTION**

In the Late Recession scenario, receipts perform very similar to the Baseline for the first two fiscal years. However, receipt growth falters in FY 2004 as recessionary factors impact on revenues. While not a severe recession, recovery is not immediate and overall revenue growth continues relatively slow in FY 2005. The final year of the forecast period finds receipts rebounding nicely from the recession and recovery sends overall growth higher. The Late Recession scenario results in revenue growth falling to 2.0% at the time of the recession's effect on Illinois in FY 2004 before ending FY 2006 at 5.9%. Corresponding year-over-year changes range from \$519 million to \$1.607 billion. See Table 9 on page 23.

### **State Taxes**

State taxes are forecast to grow 4.9% to begin the forecast period before stumbling to 1.2% during the recession in FY 2004. Growth increases somewhat in FY 2005 before reaching a high of 6.6% in FY 2006 as the recovery intensifies.

Growth rates for gross personal income tax receipts are estimated to be similar to the baseline, 4.0% in FY 2002 and 5.3% in FY 2003, before dropping to 3.0% in FY 2004 as the recession slows revenues. FY 2005 shows some modest improvement, but the recovery in income tax receipts is not felt until FY 2006 when receipt growth tops 7.9%. Gross corporate income tax also bottoms in FY 2004, falling an estimated 10%. However, corporate revenues recover sooner than personal and rates of growth average 6.5% over the last two years of the forecast period.

Sales tax receipts, after growing 6.6% in FY 2002 due to the full year of sales tax on motor fuel, gain 5.0% in FY 2003 before falling to 2.9% the subsequent year. Receipt growth remains dull at 3.4% in FY 2005 but then jumps to 7.8% to end FY 2006.

Other sources to the general funds, despite the recession, experience growth similar to the baseline scenario, as most of those smaller sources are not as dependent on economic performance.

### **Transfers**

Transfers grow at a rather tepid pace in FY 2002 and FY 2003 before actually falling by 0.4% in FY 2004. Growth emerges at the subdued rate of 2.2% in FY 2005 and edges up slightly to 2.9% to conclude the forecast period.

### **Federal Sources**

Federal sources mimic the baseline forecast for the first two fiscal years before recessionary pressures on reimbursable programs cause spending to increase. As a result, federal sources actually rise 6.0% during FY 2004 before falling back to slightly over 4.0% over the last two years.

### Summary of Late Recession Scenario

The economy and subsequent revenue growth falls in FY 2004. Recovery begins in FY 2005, but receipt growth does not rebound significantly until FY 2006. Growth rates and new revenues are half of the baseline forecast during the recession, as growth rates trough at 2.0% and then later peak at 5.9% with corresponding revenue growth of \$519 million and \$1.607 billion, respectively.

<b>TABLE 9: FY 2002 to FY 2006 "Late Recession"</b>					
<b>Estimated General Funds Receipts</b>					
<b>(\$ million)</b>					
<b>Revenue Sources</b>	<b>Estimated FY 2002</b>	<b>Projected FY 2003</b>	<b>Projected FY 2004</b>	<b>Projected FY 2005</b>	<b>Projected FY 2006</b>
<b>State Taxes</b>					
Personal Income Tax	\$8,955	9,430	9,713	10,111	10,909
Corporate Income Tax (regular)	1,318	1,397	1,257	1,345	1,426
Sales Taxes	6,350	6,668	6,861	7,094	7,647
Public Utility Taxes (regular)	1,180	1,221	1,264	1,308	1,354
Cigarette Tax	400	400	400	400	400
Liquor Gallonage Taxes	135	135	135	135	135
Vehicle Use Tax	35	35	35	35	35
Inheritance Tax (Gross)	376	301	191	109	30
Insurance Taxes and Fees	260	273	278	288	304
Corporate Franchise Tax & Fees	151	156	159	164	172
Interest on State Funds & Investments	265	278	278	287	301
Cook County Intergovernmental Transfer	245	245	245	245	245
Other Sources	497	308	283	295	307
<b>Subtotal</b>	<b>\$20,167</b>	<b>\$20,847</b>	<b>\$21,100</b>	<b>\$21,817</b>	<b>\$23,267</b>
<b>Transfers</b>					
Lottery	505	505	485	485	485
Gaming Fund Transfer	465	484	484	496	513
Other	465	488	503	523	549
<b>Total State Sources</b>	<b>\$21,602</b>	<b>\$22,324</b>	<b>\$22,571</b>	<b>\$23,320</b>	<b>\$24,814</b>
<b>Federal Sources</b>					
<b>Total Federal &amp; State Sources</b>	<b>\$4,180</b>	<b>4,326</b>	<b>4,586</b>	<b>4,790</b>	<b>4,984</b>
<b>Total Federal &amp; State Sources</b>	<b>\$25,782</b>	<b>\$26,650</b>	<b>\$27,157</b>	<b>\$28,110</b>	<b>\$29,798</b>
<b>Nongeneral Funds Distribution:</b>					
<b>Refund Fund</b>					
Personal Income Tax	(\$681)	(\$717)	(\$738)	(\$768)	(\$829)
Corporate Income Tax	(303)	(321)	(289)	(309)	(328)
<b>Total General Funds</b>	<b>\$24,798</b>	<b>\$25,612</b>	<b>\$26,130</b>	<b>\$27,033</b>	<b>\$28,641</b>
<b>Change from Prior Year</b>	<b>\$692</b>	<b>\$814</b>	<b>\$519</b>	<b>\$903</b>	<b>\$1,607</b>
<b>Percent Change</b>	<b>2.9%</b>	<b>3.3%</b>	<b>2.0%</b>	<b>3.5%</b>	<b>5.9%</b>
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## COMPARISON OF REVENUE FORECASTS: FY 2002 - FY 2006

Chart 12 illustrates how growth rates differ for each of the three scenarios over the forecast period. As shown, over the first two fiscal years, the Baseline and Late Recession scenarios are very similar, averaging just over 3.1%. Conversely, the Pessimistic scenario shows a substantially lower increase, especially in FY 2002. Significant differences in growth are most evident in FY 2004 as the Baseline forecast of 4.0% is now exceeded by the recovery being experienced under the Pessimistic version, 4.8%. While at the same time, the late recession model is stumbling in comparison, at only 2.0%. Over the last two years of the forecast period the Baseline and Pessimistic scenarios both have very similar rates of growth, approximately, 4.2%. However, the Late Recession model continues to struggle somewhat in FY 2004 before recovery contributes to a much higher rate of growth of 5.9% in FY 2006.

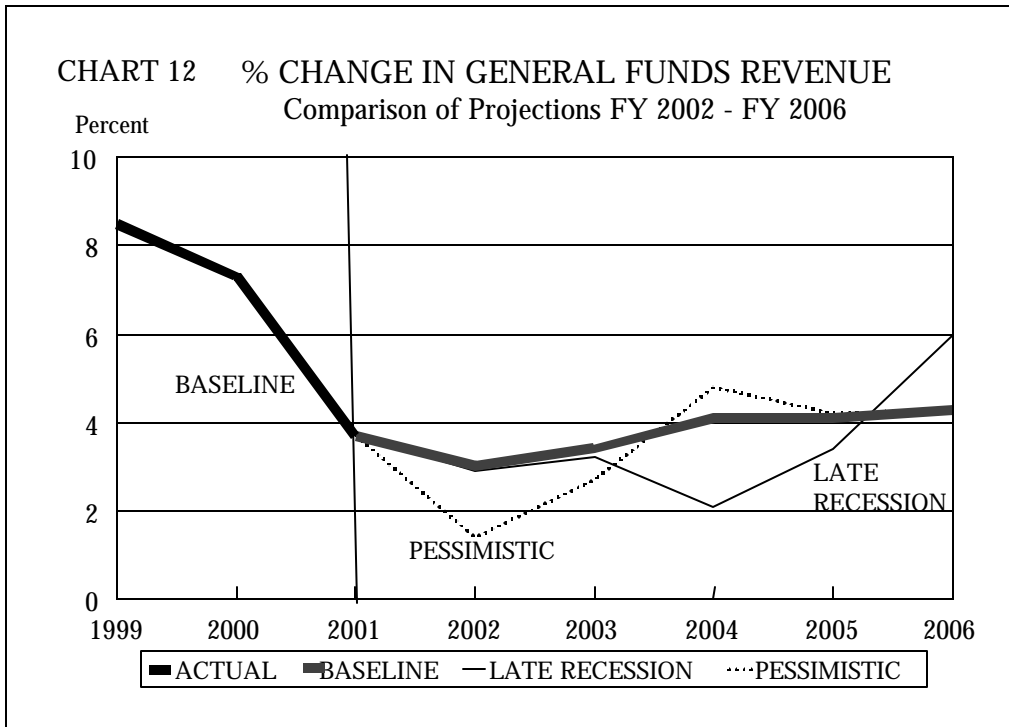


Chart 13, below, also depicts the difference in these scenarios, however, in this case, the dollar change is illustrated

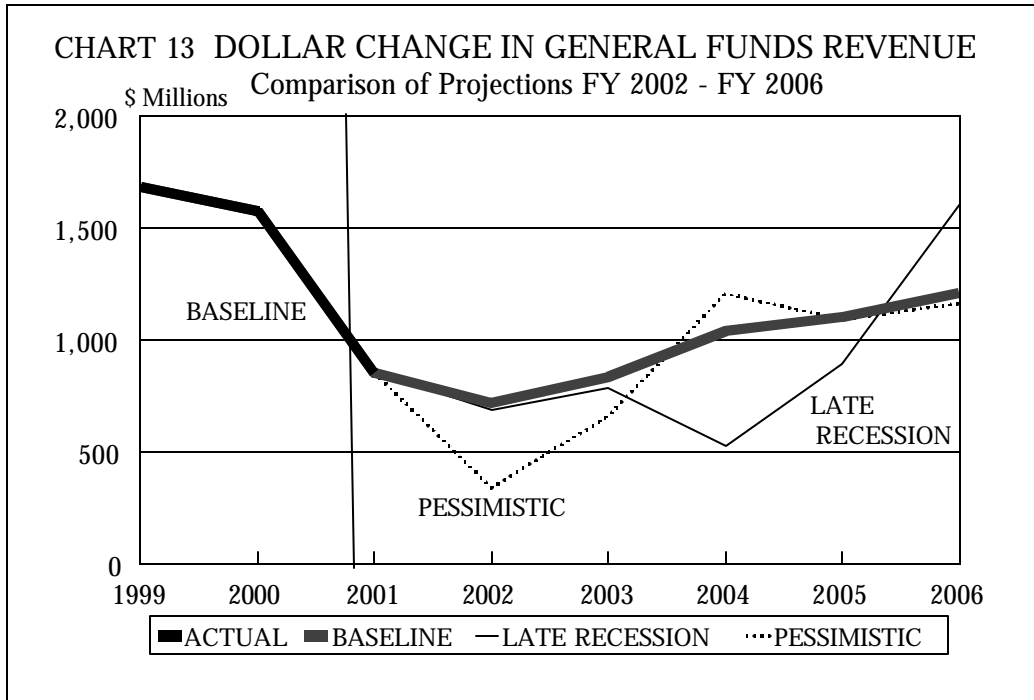


Table 10 on page 26 compares the three different scenarios and depicts total general revenue as well as the accompanying dollar and percentage growth figures as they relate to each version. In keeping with the likelihood of occurrence given each economic forecast, the Baseline revenue projection is given a 50% chance of occurrence, the Pessimistic 40%, and the Late Recession 10%.

In interpreting the scenarios, it would be prudent to realize that actual revenue performances will likely fall within the parameters set by these versions and not strictly follow one scenario. While a recession is forecast in two of the forecasts, if a recession does indeed occur, actual timing, duration, and severity may differ from those forecast. However, as alluded to earlier, these forecasts set realistic boundaries within which further discussions of revenue can begin. Obviously, any legislative changes in the various taxes, as well as other factors (i.e. Administration impacts, spending priorities, etc.) could significantly impact revenues.

<b>TABLE 10: COMPARISON OF GENERAL FUNDS FORECASTS</b>				
<b>Baseline, Pessimistic, and Late Recession</b>				
<b>(\$ in Millions)</b>				
<b>Fiscal Year</b>	<b>Forecast</b>	<b>Total General Funds</b>	<b>\$ Growth</b>	<b>% Growth</b>
2002	Baseline	\$24,826	\$720	3.0%
	Pessimistic	\$24,450	\$344	1.4%
	Late Recession	\$24,798	\$692	2.9%
2003	Baseline	\$25,690	\$864	3.5%
	Pessimistic	\$25,140	\$690	2.8%
	Late Recession	\$25,612	\$814	3.3%
2004	Baseline	\$26,720	\$1,030	4.0%
	Pessimistic	\$26,334	\$1,194	4.8%
	Late Recession	\$26,130	\$519	2.0%
2005	Baseline	\$27,829	\$1,109	4.1%
	Pessimistic	\$27,430	\$1,096	4.2%
	Late Recession	\$27,033	\$903	3.5%
2006	Baseline	\$29,036	\$1,207	4.3%
	Pessimistic	\$28,594	\$1,164	4.2%
	Late Recession	\$28,641	\$1,607	5.9%

## **BACKGROUND**

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

- 1) Preparation of annual revenue estimates with periodic updates;
- 2) Analysis of the fiscal impact of revenue bills;
- 3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;
- 4) Periodic assessment of capital facility plans; and
- 5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission  
703 Stratton Office Building  
Springfield, Illinois 62706  
(217) 782-5320  
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

[http://www.legis.state.il.us/commission/ecfisc/ecfisc\\_home.html](http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html)