Commission on Government Forecasting and Accountability

MONTHLY BRIEFING *JANUARY 2009*

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703 Stratton Ofc. Bldg.
Springfield, IL 62706

REVENUE: Revenue Check-Up – "The Patient has Taken a Turn for the Worse"

Jim Muschinske, Revenue Manager

As the State closes the chapter on a very difficult period in its history, Governor Quinn and the General Assembly will have little time to catch their collective breaths before addressing the State's mounting fiscal crisis. In November, 2008, the Commission presented a sobering outlook for the FY 2009 revenue picture, warning that budgetary pressures would continue to build as the recession started to manifest in reduced tax collections and lower rates of growth. At that time, it was estimated that general funds revenues would fall $550 million below the previous year, or $1.342 billion less than budgeted levels.

Unfortunately, given the November forecast included an assumed $435 million for the sale of the 10th riverboat license, even that rather dismal projection has worsened. As noted in last month's briefing, the 10th license was awarded for $125 million, well short of FY 2009 budget expectations of $575 million. To compound the shortfall, virtually none of that one-time revenue will be received this fiscal year, in fact the Gaming Board now indicates that around $50 million of the bid amount will be received at the end of the review process (likely FY 2010), with the remainder not coming to the State until operation of the 10th license commences (which likely will not occur until FY 2011 at the earliest).

As a result, the FY 2009 revenue picture worsened virtually overnight to nearly $1 billion less than the previous year, and this before any further erosion in the economic sources is factored in. While the Commission is not scheduled to update its official forecast until mid to late March, even previously assumed conservative rates of growth are quickly coming under pressure, portending additional downward corrections which could potentially bring the falloff from last year to $1.6 billion…or even more.

Not surprisingly, most of those revenue sources likely to experience further reductions are most closely tied to economic conditions such as income and sales taxes. On a cumulative year-over-year by month basis, rates of change have turned decidedly negative for gross personal and corporate income taxes, as well as sales taxes. While monthly data can be quite volatile for a number of reasons (i.e. number of receipt days, timing of receipts, data irregularities), combining actual receipt performance over seven months with mounting evidence that the recession's impact is worsening, the revenue picture continues to grow bleaker by the month.

The one positive on the State's near-term fiscal horizon are certain elements of the federal stimulus package that is being debated in Washington D.C. While far from final, most versions have a significant package for the states in the form of direct grants and increased Medicaid match. Accounts vary as to how much each state will receive, but Illinois's share is expected to be substantial. Economists and politicians may disagree on the packages priorities, size, and true stimulative effects; however, given the current fiscal crisis most states find themselves in, any assistance will be welcomed.

A View of the Budget Gap

Much recent discussion has revolved around the size of the "Budget Gap". While opinions may vary, one way to view the magnitude of the current problem is presented as follows:

According to the Comptroller's FY 2008 Traditional Budgetary Financial Report, the budgetary basis to begin FY 2009 was a negative $834 million. Utilizing CGFA's November 2008 revenue estimate for FY 2009 (less 10th license assumptions, or $28.674 billion), coupled with spending assumptions outlined in the latest GOMB Official Statement, or $31.440 billion, creates an additional budgetary gap of $2.766 billion, which would bring the total FY 2009 deficit to approximately $3.6 billion. Now add to that a preliminary figure of $600 million for additional revenue failures that appear to be lurking on the near horizon, and the total quickly grows to approximately $4.2 billion. It's at this stage that one may elect to also include at a minimum of $1.5 billion in Medicaid bills that have been carried forward from one year into the next for the last several years. Doing so would increase the total budgetary hole to a staggering $5.7 billion.

View of Budget Shortfall
$ in millions

($834)	Budgetary Basis to Begin FY 2009, per Comptroller		
$28,674	CGFA Nov. 2008 Revenue Estimate (Less Sale of 10th License)		
($28,307)	Appropriations		
		($469)	Pension Obligation Bond Debt Service
		($381)	Continuing Pension Approp.
		($2,782)	Legislatively Required Transfers
($3,632)	Transfers Out		
$500	Unspent Appropriations		
($600)	Additional Revenue Shortfalls (Preliminary)		
($4,200)	**Anticipated FY 2009 Budget Shortfall**		
($1,500)	Additional Medicaid Liabilities Carried Forward (Recent Average)		
($5,700)	**Total Estimated Budget Hole**		

REVENUE

January Revenues Collapse – Weakness Widespread

January revenues fell $565 million as weakness in virtually all categories resulted in the downturn. A continued falloff in the economic related sources reaffirmed the expectation that the worst of the recession's impact has yet to be felt. A significant slowing in federal receipts contributed to the monthly decline, as did timing aspects from last year's passage of the FY 2008 BIMP legislation. January had one less receipting day than last year.

Gross personal income tax dropped $85 million, or $195 million net of refunds. The large net falloff is attributed to passage of P.A. 95-707 in January 2008, which resulted in six and a half months of refund percentage adjustments that caused net income tax receipts to jump. Sales tax receipts continued to be mired down, falling $51 million and reflecting consumer hesitation to spend amid employment concerns. Public utility tax receipts were down $37 million due mostly to the timing of receipts. Insurance taxes and fees were off $34 million, also likely due to timing of receipts. Gross corporate income taxes fell $15 million, or $30 million net of refunds. The Cook County IGT dropped $13 million, interest income continued to be virtually nonexistent and fell $12 million, liquor taxes and other sources each dipped $2 million, and vehicle use tax eased $1 million.

Only a meager $2 million increase in inheritance tax provided a monthly gain.

Overall transfers fell $15 million in January. While Riverboat transfers enjoyed a $12 million increase, it appears merely due to timing as some of December's transfers fell into this month. Lottery transfers fell a disappointing $19 million, while other transfers dipped $8 million. As mentioned, federal sources weakened in January, falling $176 million, and continuing its seesaw receipt pattern.

Year to Date

Through the first seven months of the fiscal year, overall base revenues are down $1.042 billion. The declines are attributed to much lower transfers—down $272 million, lower federal sources--off $200 million, and weakened economic sources such as income and sales tax. In fact, only one source, public utility tax, was able to post a year to date gain over the previous year, underlining the widespread weakness in the revenue picture.

Sales tax was down $132 million, leading all decliners and reflecting continued lackluster performance amid troubling auto sales and consumer sentiment. To date, interest income is down $98 million, as much lower rates of return have decimated this source's performance. Gross personal income tax is down $53 million, or down $165 million net of refunds. Inheritance tax is down $53 million, while gross corporate income tax is off $48 million, or down $57 million net of refunds. The Cook County IGT is down $34 million, while other sources are off by $15 million. Corporate franchise is behind by $10 million and the vehicle use tax has dipped $4 million. As mentioned, only public utility taxes have earned a year to date increase, and only by $8 million.

Other transfers are off $131 million, gaming transfers are down by $108 million, and lottery transfers fell by $33 million. Federal reimbursements, after surging in December due to the short-term borrowing, faltered again and are lagging last year's pace by $200 million.

GENERAL FUNDS RECEIPTS: JANUARY

FY 2009 vs. FY 2008
($ million)

Revenue Sources	Jan. FY 2009	Jan. FY 2008	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,267	$1,352	($85)	-6.3%
Corporate Income Tax (regular)	71	86	($15)	-17.4%
Sales Taxes	571	622	($51)	-8.2%
Public Utility Taxes (regular)	104	141	($37)	-26.2%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	16	18	($2)	-11.1%
Vehicle Use Tax	1	2	($1)	-50.0%
Inheritance Tax (Gross)	23	21	$2	9.5%
Insurance Taxes and Fees	5	39	($34)	-87.2%
Corporate Franchise Tax & Fees	17	17	$0	0.0%
Interest on State Funds & Investments	1	13	($12)	-92.3%
Cook County IGT	0	13	($13)	-100.0%
Other Sources	51	53	($2)	-3.8%
Subtotal	$2,156	$2,406	($250)	-10.4%
Transfers				
Lottery	46	65	($19)	-29.2%
Riverboat transfers & receipts	55	43	$12	27.9%
Other	16	24	($8)	-33.3%
Total State Sources	$2,273	$2,538	($265)	-10.4%
Federal Sources	$256	$432	($176)	-40.7%
Total Federal & State Sources	$2,529	$2,970	($441)	-14.8%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($123)	($14)	($109)	N/A
Corporate Income Tax	($13)	2	($15)	N/A
Subtotal General Funds	$2,393	$2,958	($565)	-19.1%
Short-Term Borrowing	$0	$0	$0	N/A
Hopital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,393	$2,958	($565)	-19.1%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 3-Feb-09

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2009 vs. FY 2008

($ million)

Revenue Sources	FY 2009	FY 2008	CHANGE FROM FY 2008	% CHANGE
State Taxes				
Personal Income Tax	$5,830	$5,883	($53)	-0.9%
Corporate Income Tax (regular)	813	861	($48)	-5.6%
Sales Taxes	4,216	4,348	($132)	-3.0%
Public Utility Taxes (regular)	663	655	$8	1.2%
Cigarette Tax	204	204	$0	0.0%
Liquor Gallonage Taxes	99	100	($1)	-1.0%
Vehicle Use Tax	16	20	($4)	-20.0%
Inheritance Tax (Gross)	168	221	($53)	-24.0%
Insurance Taxes and Fees	144	153	($9)	-5.9%
Corporate Franchise Tax & Fees	123	133	($10)	-7.5%
Interest on State Funds & Investments	33	131	($98)	-74.8%
Cook County IGT	65	99	($34)	-34.3%
Other Sources	234	249	($15)	-6.0%
Subtotal	$12,608	$13,057	($449)	-3.4%
Transfers				
Lottery	339	372	($33)	-8.9%
Riverboat transfers & receipts	305	413	($108)	-26.2%
Other	194	325	($131)	-40.3%
Total State Sources	$13,446	$14,167	($721)	-5.1%
Federal Sources	$2,599	$2,799	($200)	-7.1%
Total Federal & State Sources	$16,045	$16,966	($921)	-5.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($568)	($456)	($112)	24.6%
Corporate Income Tax	($142)	($133)	($9)	6.8%
Subtotal General Funds	$15,335	$16,377	($1,042)	-6.4%
Short-Term Borrowing	$1,400	$1,200	$200	N/A
Hospital Provider Fund (cash flow transfer)	$0	$300	($300)	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	0.0%
Total General Funds	$17,011	$18,153	($1,142)	-6.3%

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

CGFA 3-Feb-09

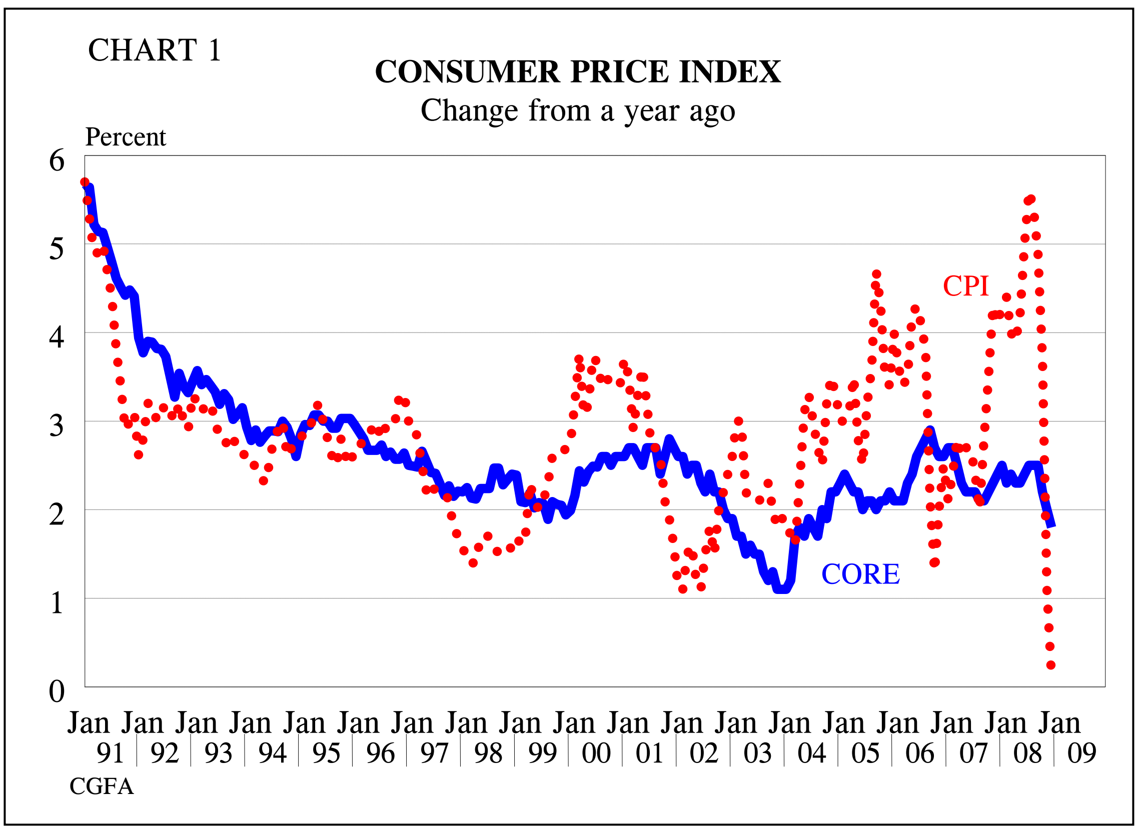
ECONOMY: Prices Seesaw

Edward H. Boss, Jr., Chief Economist

Consumer prices as measured by the Consumer Price Index (CPI) have seesawed, going from rising on a year-over-year basis at an average of 5.2% last summer, to a meager 0.1% increase by December. (See Chart 1). Much of the turnaround in price increases can be explained by the rapid rise and then reversal in energy prices. Perhaps most striking was the performance of oil prices that after reaching a high of $147 a barrel on July 11th traded below $40 a barrel on the last day of 2008. Energy prices fell at a compound annual rate of 76.6% in the latest 3-months and for the year, which incorporates both the run up and falloff, declined 21.3%.

Excluding the volatile food and energy sectors, price gains also slowed, albeit not as dramatically as the overall CPI. Energy prices comprise about 10% of the CPI and food accounts for 14%, thus together they make up almost 24% of the consumer price index. When these items are eliminated the CPI excluding food and energy category, the so-called **core rate,** slowed from a 2.5% rate of increase on a year-over-year basis last summer to 1.8% in December. It has been generally thought that the Federal Reserve's goal for stable prices was an increase in the 1% to 2% range. Thus it would seem that a core rate up 1.8% from December 2007 to December 2008 would be a satisfactory condition. However, this does not seem to be the case.

It is now quite clear that the Fed is more concerned about deflation, or a decline in the level of prices, than inflation, or a general rise in prices. At the latest Federal Reserve Open Market Committee Meeting held on January



27th and 28th 2009, while the Fed decided to hold key monetary policy rates unchanged at extremely low levels, it clearly cited its price concerns. As stated in its minutes, *"In light of the declines in the prices of energy and other commodities in recent months and the prospects for considerable economic slack, the Committee expects the inflation pressures will remain subdued in coming quarters.* ***Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term."***

While deflation has not occurred in the United States since the late 1920s and early 1930s, this is the second time in recent years that concerns over declining prices have arisen. (See the Commission's ***MONTHLY REVENUE BRIEFING, MAY 2003***). The response to the earlier concerns over deflation from the Federal Reserve was to sharply lower key monetary policy interest rates with the targeted federal funds rate, or rate banks can borrow the reserves of other banks, lowered to 1% that was the lowest since the mid 1950s. Similarly, the same anti deflationary medicine has been employed today with the latest targeted federal funds rate in a range from 0 to ¼%. This time the economy has been facing even more severe problems. With the Federal Reserve having done all it can do in targeting interest rates and other creative measures in conjunction with the Treasury, solving the deflationary pressures that abound in a severe economic downturn have been left to fiscal policy.

Thus far $350 billion in stimulate money has been allocated with the remaining $350 billion of the original $700 billion passed authorized to be spent. In addition, the President and Congress are currently negotiating an $800+ billion in measures to stimulate the sagging economy and create jobs. Indeed, the latest Commerce Department preliminary GDP report showed real economic growth contracted at a 3.8% annual rate in the final quarter of 2008, following a 0.5% rate in the previous quarter. While last quarter's economic decline was less than had been expected, it was the sharpest decline in 27 years. Moreover, expectations are for an even larger contraction in the current quarter. Most agree additional stimulus is needed and it should have its major impact soon to end the recession and create jobs.

According to an analysis by the Congressional Budget office, however, the current House-passed stimulus program would have as much as a quarter of the proposed money not taking effect until after 2010 with less than half the money dedicated to highways, school construction and other infrastructure projects spent in the next two years. Many feel the recession will be long over by then, and that such added spending would come at the wrong time, leading to renewed upward pressure on prices that would call for additional credit restraint and continuing the seesaw pattern of prices seen in recent years. The Senate has yet to provide its input, however, and thus a final compromise bill has yet to evolve.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	DEC. 2008	NOV. 2008	DEC. 2007
Unemployment Rate (Average)	7.6%	7.3%	5.3%
Annual Rate of Inflation (Chicago)	-17.6%	-24.2%	-0.6%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (December)	6,640	-0.1%	-1.5%
Employment (thousands) (December)	6,135	-0.4%	-3.8%
New Car & Truck Registration (December)	32,422	15.5%	-25.5%
Single Family Housing Permits (December)	389	-41.2%	-57.5%
Total Exports ($ mil) (November)	4,450	-7.0%	8.0%
Chicago Purchasing Managers Index (January)	33.3	-5.1%	-35.3%

Update on the Closure of Howe Developmental Center and Tinley Park Mental Health Center

Michael Moore, Revenue Analyst

The Commission on Government Forecasting and Accountability met on January 12, 2009 to continue the discussion regarding the closure of Howe Developmental Center (HDC) and Tinley Park Mental Health Center (TPMHC). Given the severity of the charges brought against former Governor Rod Blagojevich, the Commission voted to temporarily withhold final action until the impeachment proceedings were concluded in the Illinois Senate. The Illinois Senate voted to remove Governor Rod Blagojevich from office on Thursday, January 28, 2009.

The Commission wishes to give Governor Pat Quinn and the Department of Human Services time to review this decision and determine whether or not to proceed with these closures. The Commission will issue a more definitive opinion regarding the closure of HDC and TPMHC no later than April 27, 2009 (60 business days from the conclusion of Senate Trial).

PENSIONS

Pensions Bills Passed During Lame Duck Session

Dan Hankiewicz, Pension Manager

During the recent lame duck session of the 95th General Assembly, two pieces of pension legislation were passed by both chambers and sent to the Governor's desk. Both bills are summarized below:

SB 1985

Sponsors: Raoul (Mautino)

Passed Senate:	56-1-1
Passed House:	113-0-0
Senate Concurrence:	53-1-0

Removal of Social Security Offset in SERS

When SERS became coordinated with Social Security in 1969, a reduced benefit formula for Social Security-covered members was implemented to reflect that a benefit would be provided through Social Security. While the same approach could have been utilized to determine widows' and survivors' annuities, an offset was adopted. The offset reduces widows' and survivors' annuities by ½ of the Social Security survivor benefit.

Prior to 1983, survivor benefits were based primarily on a percentage of the active salary, which was the same regardless of whether or not the member was covered by Social Security. However, in 1983, legislation was passed which established a minimum survivor annuity equal to 50% of the earned retirement benefit. Thus, even though survivor benefits for members covered by Social Security are computed based on a benefit formula already reduced to reflect Social Security, the Social Security offset continued, resulting in a double reduction for survivors of Social Security-coordinated members.

SB 1985 provides that, beginning on July 1, 2009, the Social Security offset will no longer apply to any widow's or survivor's annuity for any person who began receiving a widow's or survivor's annuity prior to January 1, 1998. Also on July 1, 2009, the Social Security offset will no longer be applied to a widow's or survivor's annuity for a person who began receiving such an annuity on or after January 1, 1998 and before the effective date of this Act. SB 1985 allows retired employees to file an election during a specified period after the effective date which will reduce their retirement annuity by 3.825% in exchange for not having the Social Security offset applied to their widow or survivors' annuities. Members not yet retired on the effective date may file this election at the time of their retirement.

FISCAL IMPACT: SERS' actuary analyzed SB 1985 and estimated it would result in no increase in the total state contributions required for the period FY 2008 – FY 2045, and the funded ratio would still reach 90% in FY 2045. There would be an identical percentage increase in Assets, Liabilities and Unfunded Liabilities for FY 2045, resulting from a slight demographic difference between current law and SB 1985. Specifically, under SB 1985, the total amount of system payout in the early years is slightly lower due to the reduction in payment amounts to retirees who opt to have the Social Security offset removed for their spouses, and total system payout is slightly higher in the later years due to higher payment amounts to surviving spouses for whom the offset is removed. The former results in slightly higher early asset values that are carried throughout the period under review, while the latter results in slightly higher liabilities in the later years. These identical percentage changes in assets and liabilities effectively offset and thereby do not result in any change in the funded ratio for FY 2045.

The actuary for the Commission on Government Forecasting and Accountability reviewed the methods and assumptions utilized by SERS' actuary in the completion of this cost study and found them to be reasonable.

SB 2362

Sponsors: Cronin (Saviano)

Passed Senate:	58-0-0
Passed House:	109-4-0
Senate Concurrence:	57-0-0

Purchase of Optional Service Credit for Military Service – Downstate Fire Article

Currently, firefighters who are called into active duty in the military, naval, or air force may establish service credit equal to the amount that would have been contributed had the member been a regular contributor while away on active duty, up to a limit of 5 years. SB 2362 allows members of Downstate Firefighters' Pension Funds who served in the military prior to municipal employment to establish up to 24 months of military service credit. The employee must make contributions to the fund equal to (i) employee contributions that would have been required had service been rendered as a member, plus (ii) an amount determined by the fund to be equal to the employer's normal cost of the benefits accrued for that military service, plus (iii) interest at the actuarially assumed rate provided by the Department of Financial and Professional Regulation, compounded annually from the first date of membership in the fund to the date of payment on items (i) and (ii). These provisions apply to employees in service on or after the effective date of this Act.

FISCAL IMPACT: The statewide fiscal impact of SB 2362 cannot be calculated as the number of firefighters who would become eligible to purchase additional military service credit is unknown. The Public Pension Division of the Department of Financial and Professional Regulation does not keep data on the number of firefighters who had military service prior to employment as a firefighter.

The Commission's actuary analyzed membership data for 72 members of the Springfield Fire pension fund who would be eligible to purchase military service credit if SB 2362 becomes law. The results of this cost study are summarized in the following table:

Required Employee Contributions	$2,798,047
Increase in Total Actuarial Liability	$2,466,607
Decrease in Unfunded Liability	$331,440

The actuary notes that under proposed benefit changes of this type, the required employee contributions are generally less than the estimated increase in actuarial liability. This is because employees who purchase optional service credit are generally older than the average active member of the pension fund and are frequently close to retirement. However, the Springfield Fire pension fund has a relatively high number of younger employees who have military service, and the cost of purchasing the military service is relatively low for younger employees in comparison with those closer to retirement. Thus, the total required employee contributions for Springfield are estimated to slightly exceed the total cost of providing the military service credit.