Commission on Government Forecasting and Accountability

703 Stratton Ofc. Bldg., Springfield, IL 62706

MONTHLY BRIEFING FOR THE MONTH ENDED: APRIL 2015

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INSIDE THIS ISSUE

REVENUE: Fund Sweeps, Federal Source Gains, and Higher than Expected Income Tax Receipts Produce Jump in April Revenues

Jim Muschinske, Revenue Manager

Overall general funds revenues grew an impressive $1.354 billion in April. The significant improvement in receipts was made possible in large part to $1.074 billion in fund sweeps per recently enacted P.A. 99-0002. This infusion of cash into the State's coffers allowed for payment of a large amount of federally reimbursable bills i.e. Medicaid. The byproduct of those reimbursable expenditures resulted in a sharp reversal of what had been lagging federal source revenues, as receipts grew by $396 million, and are now close to being back on pace to meet expectations.

In addition, despite the current lower tax rate, April's personal income tax receipts experienced unexpected growth as receipts actually posted a modest gain. While it was always assumed that April would experience a more moderate falloff compared to recent months due to final payments still reflecting the earlier 5% tax rate, the actual increase in gross receipts was unanticipated. In fact, as late as midway through the month, receipts had experienced a decline fairly close to expectations. Then suddenly receipts gathered strength [coinciding with April 15th filing deadline] and jumped into positive territory. While the rate of growth did slow in the closing days of the month, the 3.8% increase in gross personal income tax was unexpectedly strong. The component breakdown of the monthly income tax receipts will not be known until the data are available mid-May. At this time, the abrupt turnaround experienced in the second half of the month is assumed to have resulted from strong final payments, likely the result of nonwage income such as capital gains and dividend earnings. If later confirmed, that would mean that the spike experienced in the second half of the month should be viewed in terms of one-time revenue, with exceptional market and investment returns in tax year 2014 the likely driver.

For the month, gross personal income taxes increased $96 million, or $74 million net of refunds. In addition, another $84 million was removed from general revenue and deposited into the Fund for Advancement of Education and the Commitment to Human Services Fund. As a result, net personal income taxes going to the general funds fell $10 million when compared to last year, but as discussed above, that small overall net drop still meant higher than expected performance.

A number of other sources posted gains in April. Sales taxes continued to do well and grew $31 million. Insurance taxes and fees increased $5 million, corporate franchise advanced $4 million, cigarette $2 million, other sources $2 million, liquor taxes $1 million, and interest income $1 million.

Only a few sources experienced declines in April. Gross corporate income tax dropped $94 million, presumably due to estimated payments reflecting the lower tax rate. Public utility taxes fell $19 million, while inheritance took a pause from what had been good year to date performance, dropping $18 million.

Overall transfers jumped $1.044 billion, due to the aforementioned $1.074 billion in fund sweeps. Relatedly and discussed earlier, the result of the fund sweeps was to make resources available to help close the FY 2015 budgetary gap. As a consequence, the Comptroller was able to direct a large amount of spending towards federally reimbursable expenditures. The resulting reimbursement allowed federal sources to experience a jump of $396 million in April. After suffering declines for most of the fiscal year, federal sources are now much closer to reaching projections.

Year to Date

With the significant surge in April revenues due to fund sweeps, federal reimbursements, and unexpected strong income tax performance, on a year to date basis, revenues are only down $68 million—despite the income tax rate change.

Through April, gross corporate income tax receipts are down $418 million, or $381 million net of refunds, that reflects not only the recent lowering of the tax rate but also the poor performance experienced earlier in the fiscal year. While gross personal income tax is down $160 million, down $221 million net of refunds, and down $487 million overall due to the two new fund distributions—as discussed, its performance in April exceeded expectations.

Some sources demonstrated good growth thus far in FY 2015. In particular, sales taxes have been able to maintain positive momentum and are up $333 million. Inheritance tax, after having a down month of April, is still up $36 million for the year.

With the infusion of $1.074 billion in fund sweeps, overall transfers are now up $661 million. The fund sweeps helped to offset the $334 million drop off in refund fund transfers and the falloff of $26 million in riverboat transfers. Lottery transfers managed to post $8 million in gains.

Despite the surge of federal sources in April, reimbursements are still $267 million behind the same levels of last year.

Commission Reports Upward Pressure on FY 2015 Revenue Estimate—Does Not Translate Into Change to the FY 2016 Estimate

On March 10th, the Commission released a revised forecast of FY 2015 general funds revenue totaling $34.099 billion, which was $30 million higher than the forecast released by the Governor in February. During the closing days of March, in order to address the budget gap that had developed in the current fiscal year, the General Assembly passed and the Governor signed into law P.A. 99-0002 which called for execution of approximately $1.318 billion in fund sweeps, bringing the Commission's expected revenue total to $35.417 billion.

As discussed above, the strong performance of April's income tax receipts have resulted in upward pressure on that forecast. During testimony provided to the Senate Revenue Committee on April 29th, the Commission discussed and assigned a value of upward pressure on the FY 2015 estimate in the range of $300 million to $500 million. However, and as discussed during the committee hearing, while revenues are expected to exceed earlier expectations for FY 2015, those additional revenues are considered to be one-time in nature, and as such, cannot be expected to repeat in FY 2016.

Item of Note—FY 2016 Federal Sources

Federal sources for FY 2016 are extremely difficult to predict, particularly given the Governor's announced spending plan. For now, the Commission will display a figure of $4.408 billion for FY 2016 which is the same as that being carried by the GOMB under their "Maintenance/Autopilot" budget scenario. Federal sources are governed by appropriation levels, available cash for spending, and what bills are paid by the Comptroller. Add to those considerable variables the additional ambiguity created by the significant programmatic Medicaid changes called for by the Governor, and it brews up a near impossible task of forecasting federal sources.

While the Commission's current estimate of FY 2016 federal sources utilizes the Governor's "maintenance/auto-pilot" forecast for federal sources of approximately $4.4 billion, that may prove to be too optimistic given the current federal reimbursement "offset" methodology being employed regarding Medicare premium payments. Essentially, instead of actually paying the State portion of Medicare premiums [as part of the Medicaid program], and then subsequently receiving the federal reimbursement—the Federal government is simply offsetting what they owe Illinois from other reimbursable spending by the amount we owe them related to Medicare premiums.

From an overall State budget perspective the two methods result in the same net result. However, from a strictly revenue viewpoint, the "offset" methodology does reduce federal sources received from reimbursable spending because no actual Medicare appropriation spending takes place. Since the Governor's FY 2016 federal source estimate of $4.4 billion assumed reimbursement based on the more traditional "pay then receive the federal reimbursement" method, if the current "offset" method were instead continued through FY 2016, the State would receive approximately $425 million less in federal source receipts. Again, on an overall net basis, the overall budgetary impact is the same employing the "offset" method because while the State doesn't receive the federal reimbursement, neither does it make the expenditure in the first place.

GENERAL FUNDS RECEIPTS: APRIL

FY 2015 vs. FY 2014

($ million)

Revenue Sources	April FY 2015	April FY 2014	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$2,634	$2,538	$96	3.8%
Corporate Income Tax (regular)	600	694	($94)	-13.5%
Sales Taxes	675	644	$31	4.8%
Public Utility Taxes (regular)	87	106	($19)	-17.9%
Cigarette Tax	31	29	$2	6.9%
Liquor Gallonage Taxes	13	12	$1	8.3%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax	16	34	($18)	-52.9%
Insurance Taxes and Fees	66	61	$5	8.2%
Corporate Franchise Tax & Fees	20	16	$4	25.0%
Interest on State Funds & Investments	2	1	$1	100.0%
Cook County IGT	0	0	$0	N/A
Other Sources	41	39	$2	5.1%
Subtotal	$4,188	$4,177	$11	0.3%
Transfers				
Lottery	53	52	$1	1.9%
Riverboat transfers & receipts	3	3	$0	0.0%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	0	$0	N/A
Other	1,138	95	$1,043	1097.9%
Total State Sources	$5,382	$4,327	$1,055	24.4%
Federal Sources	$957	$561	$396	70.6%
Total Federal & State Sources	$6,339	$4,888	$1,451	29.7%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($263)	($241)	($22)	9.1%
Corporate Income Tax	($84)	(93)	$9	-9.7%
Fund for Advancement of Education	($42)	0	($42)	N/A
Commitment to Human Services Fund	($42)	0	($42)	N/A
Subtotal General Funds	$5,908	$4,554	$1,354	29.7%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$5,908	$4,554	$1,354	29.7%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-May-15

GENERAL FUNDS RECEIPTS: YEAR TO DATE				
FY 2015 vs. FY 2014				
($ million)				
Revenue Sources	**FY 2015**	**FY 2014**	**CHANGE FROM FY 2014**	**% CHANGE**
State Taxes				
Personal Income Tax	$15,284	$15,444	($160)	-1.0%
Corporate Income Tax (regular)	2,667	3,085	($418)	-13.5%
Sales Taxes	6,653	6,320	$333	5.3%
Public Utility Taxes (regular)	852	880	($28)	-3.2%
Cigarette Tax	294	295	($1)	-0.3%
Liquor Gallonage Taxes	139	137	$2	1.5%
Vehicle Use Tax	25	24	$1	4.2%
Inheritance Tax	255	219	$36	16.4%
Insurance Taxes and Fees	286	267	$19	7.1%
Corporate Franchise Tax & Fees	178	176	$2	1.1%
Interest on State Funds & Investments	20	15	$5	33.3%
Cook County IGT	150	120	$30	25.0%
Other Sources	473	466	$7	1.5%
Subtotal	$27,276	$27,448	($172)	-0.6%
Transfers				
Lottery	531	523	$8	1.5%
Riverboat transfers & receipts	251	277	($26)	-9.4%
Proceeds from Sale of 10th license	10	10	$0	0.0%
Refund Fund transfer	63	397	($334)	N/A
Other	1,561	548	$1,013	184.9%
Total State Sources	$29,692	$29,203	$489	1.7%
Federal Sources	$2,906	$3,173	($267)	-8.4%
Total Federal & State Sources	$32,598	$32,376	$222	0.7%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($1,528)	($1,467)	($61)	4.2%
Corporate Income Tax	($376)	($413)	$37	-9.0%
Fund for Advancement of Education	($133)	$0	($133)	N/A
Commitment to Human Services Fund	($133)	$0	($133)	N/A
Subtotal General Funds	$30,428	$30,496	($68)	-0.2%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund Transfer	$0	$50	($50)	N/A
Tobacco Liquidation Proceeds	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$275	$275	$0	0.0%
Total General Funds	$30,703	$30,821	($118)	-0.4%
SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.				
CGFA				1-May-15

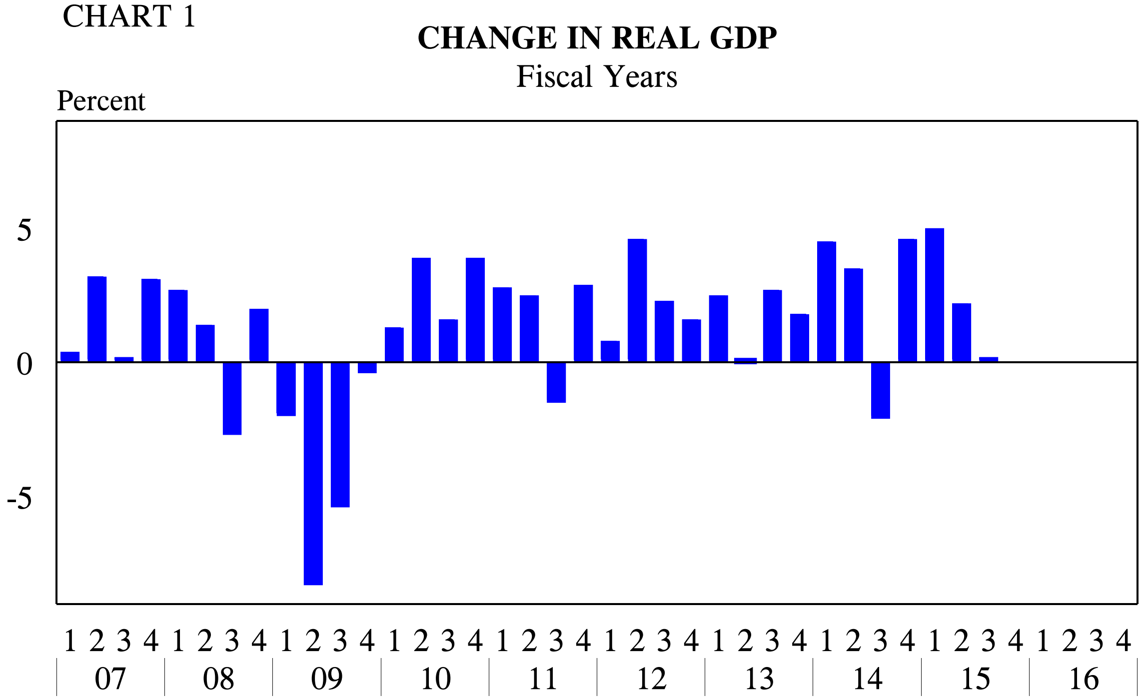
ECONOMY: Spring Forward, Fall Back?

Edward H. Boss, Jr., Chief Economist

Late this month the Commerce Department released its first estimate of three on the nation's economy as measured by its Gross Domestic Product. In this advance report, based on incomplete data, it shows the economy slowed sharply in the first quarter of 2015, barely growing at a modest annual rate of 0.2%, down from the 2.2% in the final quarter of 2014.

The pattern appears to be reminiscent of last year. As shown in the Chart below, a small rise in GDP initially reported for the first quarter of last year was followed by later revisions ultimately showing the economy actually declined at a 2.1% annual rate that quarter. Much of the contraction was blamed on the severe winter and growth rebounded, rising at an annual rate of growth of 4.6% in the second quarter followed by a 5% annual rate of gain in the third. Many observers concluded at the time that the economy finally had broken out of the sluggish expansion that had been the slowest in the post WWII period. However, following the growth spurt in spring and summer, the pace of the economy slowed again to a 2.2% rate in the final quarter. As a result, 2014 became the fifth consecutive year in which economic growth remained in a narrow range of 2% to 2 ½%, well below those rates shown in previous recovery periods following a recession.

CHART 1



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Once again, severe winter weather early this year is cited as a reason for the weak first quarter economic performance. Moreover one of the missing ingredients in the advance report are March data on net exports, which have been negatively affected by the strong dollar, and could possibly edge the overall rate even lower when the advance report is issued later. However, there may be factors other than the weather explaining the softening in growth. For example, there seems to be a pattern of weak first quarter economic performance not only last year but in several recent years. Because of this, some observers suggest that the manner in which the data are adjusted for seasonal variances also may be a factor. The Federal Reserve is looking into this pattern and it will be interesting to see if this seeming anomaly still exists in the historical GDP revisions to be released in July.

At the mid-March Federal Reserve meeting many observers interpreted their statement, which noted economic improvement, was on the cusp of finally edging interest rates up as soon as June. However, as more and more March data became available showing weakness, many of those same observers now have pushed back their expectations of an interest rise from June to September or even later. In assessing the unfolding March data, according to IHS Global Insight, "First and foremost, employment growth fell substantially and unexpectedly in March following some blistering strong months." It goes on to explain that employment was hard hit in the energy sector as oil prices fell sharply, supplies built, and workers were let go.

In addition to the employment situation, U.S. manufacturing production and demand for capital equipment have been faced with a strong dollar making U.S. goods less competitive. In March, industrial production dropped appreciably, recording the sharpest decline in six years. And, while the volatile durable goods orders series rose in March, the gain was concentrated in new orders for airplanes and autos. Orders outside of the transportation area fell for the sixth consecutive month. Consumer spending, the largest component of GDP, also has been soft as reflected by sluggish retail sales. While sales edged up in March, this followed three consecutive months of decline. Indeed retail sales not adjusted for inflation were up a scant 2.1% in the first three months of this year compared with last. Finally, housing construction has failed to make a significant comeback as the severe winter ebbed while new home sales plunged 11.4% in March.

As the weather warms, the strengthening of the dollar appears to have stabilized, and the decline in oil prices seems to have ceased and even edged up from its low, there appears to be less uncertainty in the markets. Indeed, most observers look for economic growth to rebound in the months ahead. As wages appear to have improved somewhat, housing activity picks up, and business conditions improve, the pace of growth is expected to improve. Whether this expected improvement in spring continues through the summer, setting the course to a faster growth path or, like last year, weakens again in the fall, keeping growth in the narrow range of 2% to 2 ½% like the previous five years remains to be seen.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	MAR 2015	FEB 2015	MAR 2014
Unemployment Rate (Average)	6.0%	6.0%	7.7%
Annual Rate of Inflation (Chicago)	8.7%	0.7%	-0.6%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (March)	6,503	-0.1%	-0.6%
Employment (thousands) (March)	6,112	-0.1%	1.1%
NonFarm Payroll Employment (March)	5,915,300	5,917,100	71,600
New Car & Truck Registration (March)	53,608	34.2%	13.6%
Single Family Housing Permits (March)	817	113%	-8.3%
Total Exports ($ mil) (February)	4,903	-6.4%	-7.5%
Chicago Purchasing Managers Index (April)	52.3	13.0%	-17.0%

* Due to monthly fluctuations, trend best shown by % change from a year ago

GROUP INSURANCE UPDATE

Anthony Bolton, Revenue Analyst

On April 14th, the Commission held its annual Group Insurance Vendor meeting to review existing contracts with vendors in the State Employee Group Insurance Program. This program has an estimated liability of approximately $2.8 billion in FY 2016. At this meeting, the issue was raised regarding interest on late payments to various vendors who are a part of the Group Insurance Program. Currently, the State of Illinois is late on payments to vendors in this program such that over $1.5 billion in claims are expected to be held by the end of FY 2015, with this total likely rising in FY 2016. Payment delays are currently 273 days for preferred providers (350 days for non-preferred providers) on the state's Quality Care Health Plan and seven months for providers on the state HMO and OAP plans.

As a result of the payment delay, the State of Illinois makes significant expenditures in interest on late payments to vendors. Currently, two separate types of late payment interest are applicable to the Group Insurance Program. Timely Pay Interest (TPI), provided for in the Insurance Code, is applicable to self-insurance claims such as CIGNA (Quality Care Health Plan), Open Access Plans (OAPs) and Medco (Pharmaceutical Drugs). This interest accrues at 9% after 30 days. Prompt Pay Interest (PPI), provided for in the State Prompt Payment Act, is applicable to fully-insured claim costs (HMOs), Administrative Service Cost fees, and other applicable invoices. This interest accrues at 12% after 90 days. Outlined on the table below is the amount of interest paid by the State of Illinois as a result of significantly delayed payments to vendors in the Group Insurance Program.

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016 Est.
Timely Pay Interest	$20.5	$32.9	$31.2	$56.5	$101.9	$54.5	$57.7
Prompt Pay Interest	$12.4	$16.0	$18.7	$35.5	$58.9	$42.4	$45.8
TOTAL	**$32.9**	**$48.9**	**$49.9**	**$92.0**	**$160.8**	**$96.9**	**$103.5**

*All numbers in Millions of Dollars

The accrual of Prompt Pay Interest and Timely Pay Interest are of interest to the Commission, as the interest rates of 12% and 9% are significantly higher than standard market expectations. Also, savings may be achieved if these rates can be lowered through legislation or if a lower rate of interest can be negotiated with vendors who have been designated as a "Qualified Purchaser" as part of the Vendor Payment Program administered by the Department of Central Management Services. In the case of Prompt Payment Interest, in FY 2014, each reduction of the interest rate paid out by one percent would produce approximately $5 million in savings for the state. If the Timely Payment Interest rate was reduced, it would produce approximately $11 million in savings for each percentage point lowered.