IEFC

Illinois Economic and Fiscal Commission

MONTHLY REVENUE BRIEFING **JUNE 2003**

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703 Stratton Ofc. Bldg.
Springfield, IL 62706

REVENUE: Receipts Tail off in June; Revenues Fall for the Second Year

Jim Muschinske, Revenue Manager

General funds revenues ended FY 2003 on a down note as poor federal source and other source receipting significantly contributed to base revenues falling $567 million in June. As anticipated, $300 million was transferred in from the Pension Contribution Fund as the result of the recent sale of $10 billion in pension obligation bonds. If that transfer were included, overall revenues would have fallen by $267 million in June. The monthly decline would have been marginally worse if not for this June having one more receipting day than last.

As expected, a decline of $276 million in other sources was the primary reason that revenues fell in June due to an extremely large Build Illinois general reserve account transfer experienced last year. Public utility taxes declined $43 million for the month, while inheritance tax dropped $12 million. Gross personal income tax receipts dipped $11 million ($13 million net of refunds) and corporate franchise taxes tumbled $9 million. Finally, liquor tax and vehicle use tax each had a minor $1 million loss in June.

Only a few sources demonstrated gains this past month as sales tax revenues rose by $10 million and insurance taxes by $5 million. Gross corporate income taxes managed a $5 million increase, although on a net of refund basis, corporate income tax actually dipped $2 million.

Excluding the $300 million in Pension Contribution Fund transfers, overall base transfers were down $24 million. While Lottery transfers rebounded in June, rising $16 million, the Gaming Fund transfer fell $6 million and other transfers declined $34 million. As mentioned earlier, federal sources were a significant reason June revenues fell so dramatically, as these receipts tumbled by $201 million.

Year-End

For a second consecutive year, general funds revenues declined from the previous year. Excluding $1.675 billion in short-term borrowing, $226 million in Budget Stabilization Fund transfers, and $300 million in Pension Contribution Fund transfers, overall base general revenues totaled $22.786 billion, which represents a $593 million decline from the previous fiscal year. For much of the year, the major revenue sources most closely tied to the economy continued to sputter as the economy struggled to recover from recession.

Other sources to the general funds fell $163 million for the year, due primarily to significantly less Build Illinois general reserve transfers. Gross personal income tax receipts fell $107 million ($130 million net of refunds), while public utility taxes dropped by $98 million. Inheritance tax receipts, impacted by the continued phase-out of the federal tax, fell $92 million for the year. Interest income suffered another disastrous year as rates of returns hit record lows contributing to a decline of $69 million. Gross corporate income taxes were down $32 million ($65 million net of refunds). All other sources experienced losses totaling $21 million.

Revenue sources that actually demonstrated gains for the year were few and far between as insurance taxes and fees rose $41 million, sales taxes by a modest $8 million, and Cook County intergovernmental transfers by $110 million.

Overall transfers rose $204 million for the year. While Lottery transfers fell by $15 million, Gaming Fund transfers rose by $84 million (due to the restructured graduated tax), and other transfers gained $135 million (due to one-time interfund transfers). Federal sources suffered a greater than expected decline, as yearly receipts fell $318 million.

The decline in base revenues of $593 million was $168 million more than the Commission's May 2003 estimate anticipated and $337 million more than the Governor's Office of Management and Budget's (GOMB) last official estimate. If federal sources were excluded, the Commission's estimate was only $33 million higher than actuals, while the GOMB forecast missed by $202 million.

During the month of July, the Commission will be examining and recalculating our forecast for FY 2004 taking into account the recently-established FY 2003 base, new income tax refund percentages, and new federal sources estimates. In addition, a number of significant legislative actions were taken which will need to be incorporated into the forecast. The Commission has tentatively scheduled a meeting for August 20, 2003 to present and discuss the revenue picture for FY 2004.

FY 2004 Budget to Include Significant Revenue Changes

A number of legislative changes were made during the last few days of the spring Session that will have the effect of raising revenues in FY 2004. The following section briefly explains the major changes.

- SB 719 (P.A. 93-0019) – SB 719 allows for the sale, sale-leaseback or mortgage of the James R. Thompson Center, the Illinois Toll Highway Authority headquarters, and Elgin Mental Health Center, with proceeds going into the General Revenue Fund. Since the introduced budget, the Governor's Office of Management and Budget had assumed that $233 million would be generated.

- SB 774 (P.A. 93-0022) – SB 774 increases the retailer liquor license fee, increases liquor tax compliance, and requires cigarette distributors pay for cigarette stamps by means of electronic transfer. Preliminary estimates indicate that revenues will increase approximately $89 million.

- SB 841 (P.A. 93-0023) – SB 841 changes the rolling stock exemption and creates a commercial distribution fee. Those changes are anticipated to generate approximately $92 million. In addition, the bill creates the Transportation Employee Credit, which would offset somewhat the above revenue gain, although estimates are not yet available.

- SB 842 (P.A. 93-0024) – SB 842 sunsets a number of sales tax exemptions and is estimated to result in approximately $60 million in additional revenue.

- SB 969 (P.A. 93-0026) – SB 969 creates the Tax Delinquency Amnesty Act that directs the Department of Revenue to establish a tax amnesty program for all taxpayers owing any taxes to the Department (excludes motor fuel use tax). The Department estimates that approximately $40 million in new revenues will result that otherwise would not be collected in FY 2004.

- SB 1606 (P.A. 93-0027) – SB 1606 increases the graduated tax structure on riverboat gaming as well as increases the admissions tax. All told, the Commission estimates that $187 million more in gaming revenues will result.

- SB 1607 (P.A. 93-0028) – SB 1607 allows for a competitive bidding process to occur for the dormant 10th license (or re-issued license). In addition, the bill allows the Gaming Board to determine if it would be in the best interest if the State were to control the license and bid out a manager's license. The Administration has estimated that the dormant 10th license would generate bids of $350 million.

- SB 1634 (P.A. 93-0029) – SB 1634 eliminates a number of corporate income tax exemptions and credits. Preliminary estimates of those changes are approximately $65 million. In addition, the bill reduces the carry forward of net operating losses to 12 years (under current law, losses can be carried back 2 years and carried forward 20 years). An estimate of this component of the bill has yet to be determined.

- SB 1725 (P.A. 93-0030) – SB 1725 essentially decouples Illinois estate tax from the federal tax, which is in the process of being phased out. This decoupling measure will increase revenue by approximately $45 million in FY 2004.

- SB 1733 (P.A. 93-0031) – SB 1733 creates the Natural Gas Use Tax Law and imposes a tax on the privilege of using natural gas purchased out-of-state. A number of groups would be exempt from this new tax, including local governments and charitable and religious organizations. The Department of Revenue, which would administer this natural gas use tax, estimates that this legislation would increase State revenues by approximately $40 million.

- SB 1903 (P.A. 93-0032) – SB 1903 transfers specific amounts from a number of funds into the General Revenue Fund; with certain limitations, allows the Director of the Bureau of the Budget (now the Governor's Office of Management and Budget) to direct the State Treasurer and Comptroller to transfer other specified amounts from any fund held by the Treasurer into the General Revenue Fund to help defray the State's operating costs for the fiscal year; and, increases hundreds of various fees and penalties.

  While the bill lists the specific transfer of $159 million from a number of State funds into the GRF, the Administration has yet to release a detailed estimate of other transfers anticipated to be made as the result of these "administrative chargebacks". When the Governor's budget was presented in April, these "chargebacks" were estimated to total approximately $330 million. In addition, no official revised estimate is available regarding the fee increases. In April, the Administration estimated fee increases would total nearly $350 million.

  SB 1903 significantly increases the discretionary authority of the Director of the Office of Management and Budget to move funds into the General Revenue Fund. From the Commission's perspective, this will make estimating such transfers very difficult. The Commission has requested that at the same time notice is given to the Treasurer and Comptroller, the Commission also be notified in writing of the proposed transfer amounts.

- In addition to the above legislative changes, as the result of the recent $10 billion sale of Pension obligation bonds, $1.86 billion is reserved to be transferred into the General Revenue Fund (for payment into the designated retirement system).

ECONOMY

Will 13 Be The Lucky Number?

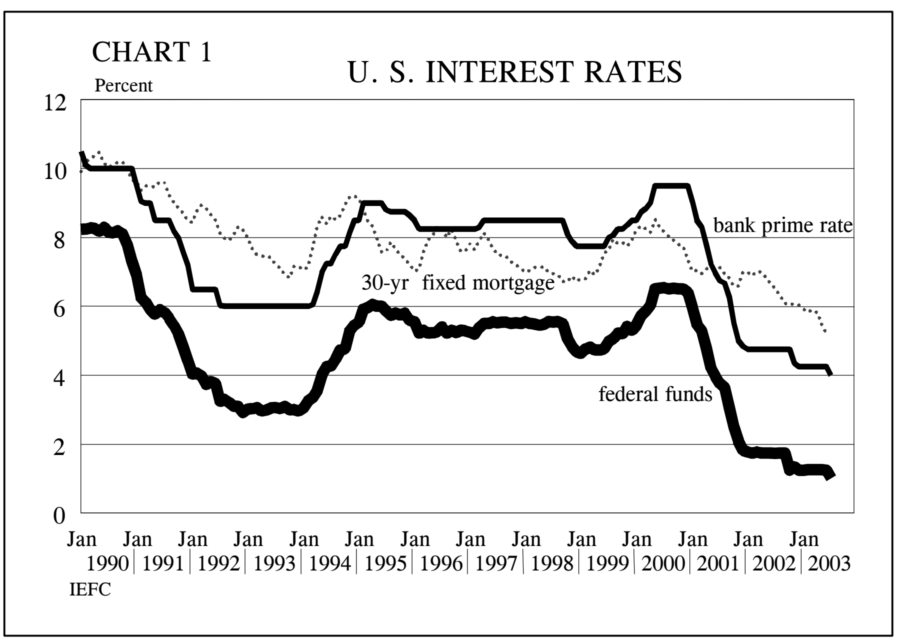
Edward H. Boss, Jr., Chief Economist

The Federal Reserve Open Market Committee voted on Wednesday, June 25th to reduce the key federal funds rate by 25 basis points from 1.25% to 1%. This was the thirteenth reduction in this key monetary rate in the past two and a half years and brings the rate to its lowest level in 45 years.

As shown in the accompanying chart, the rate has gone through periods of prolonged stability, such as in the mid 1990s, and periods of frequent change, such as occurred in the early 1990s and again early in this decade. The rate level itself also has varied greatly over time. For example, the federal funds rate averaged a low 0.8% in July 1954, and a high 19.1% in June 1981--- both periods of unusual economic conditions.

A key question is what is the Fed trying to accomplish with this rate change? Certainly, while a reduction was well anticipated in the market place, there was not unanimity among analysts. Indeed, one of the members of the Open Market Committee voted against the move, preferring instead a larger 50 basis point decline. At the same time, several analysts suggested such a rate reduction was unnecessary given signs that the economy already was improving and that a decline now would merely lead to a reversal later.

The principal tool of the Federal Reserve in implementing monetary policy is the purchase or sale of government securities, known as open market operations and, hence the name the Open Market Committee. The purchase or sale of government securities affects the level of reserves in the banking system. The more reserves in the system, the greater the liquidity and ability of banks to lend. To judge the desired level of reserves in the market place, the Fed sets a specific federal funds rate, or price banks pay to borrow the excess reserves of other



banks. It then buys or sells government securities until it achieves the federal funds rate it has decided to target.

Whether or not the latest move will be sufficient to stimulate growth only will be answered over time. In announcing the policy change, the Federal Reserve stated that "while recent signs point to a firming in spending.... the economy, nonetheless, has yet to exhibit sustainable growth." Also it pointed out that the risk of falling prices, or deflation, while currently unlikely, outweigh the risk of inflation. The Fed apparently views its latest move as an "insurance policy" and has implied that further actions would be taken if growth does not improve.

The Federal Reserve could reduce the federal funds rate again--a more traditional approach--or directly buy long-term Treasury bonds in the open market to reduce the supply and drive up prices (lower interest rates) in the longer end of the market--a more unusual approach. It could also reduce the discount rate or lower reserve requirements. The point is the Fed has not run out of ammunition to further stimulate the economy.

At the current time, however, it likely will wait to see the outcome of its latest move. The next FOMC meeting will be held on August 12th. In the meantime, the economy should be aided by the recently-enacted income tax cuts which will lower income tax withholding schedules starting next month and hopefully stimulate spending. Even should growth begin to improve, the Fed has implied it likely would keep interest rates low for a prolonged period ahead.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	May 2003	April 2003	May 2002
Unemployment Rate (Average)	6.1%	6.3%	6.5%
Annual Rate of Inflation (Chicago)	0.0%	-9.1%	1.1%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (May)	6,380	0.0%	0.0%
Employment (thousands) (May)	5,988	0.2%	0.4%
New Car & Truck Registration (May)	56,547	7.2%	N/A%
Single Family Housing Permits (May)	3,905	-8.2%	-4.2%
Total Exports ($ mil) (April)	2,212	-2.8%	2.5%
Chicago Purchasing Managers Index (June)	52.5	0.6%	-9.8%

GENERAL FUNDS RECEIPTS: JUNE

FY 2003 vs. FY 2002
($ million)

Revenue Sources	JUNE FY 2003	JUNE FY 2002	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$686	$697	($11)	-1.6%
Corporate Income Tax (regular)	156	151	$5	3.3%
Sales Taxes	523	513	$10	1.9%
Public Utility Taxes (regular)	53	96	($43)	-44.8%
Cigarette Tax	33	33	$0	0.0%
Liquor Gallonage Taxes	10	11	($1)	-9.1%
Vehicle Use Tax	3	4	($1)	-25.0%
Inheritance Tax (Gross)	17	29	($12)	-41.4%
Insurance Taxes and Fees	61	56	$5	8.9%
Corporate Franchise Tax & Fees	10	19	($9)	-47.4%
Interest on State Funds & Investments	6	6	$0	0.0%
Cook County IGT	23	23	$0	0.0%
Other Sources	64	340	($276)	-81.2%
Subtotal	$1,645	$1,978	($333)	-16.8%
Transfers				
Lottery	72	56	$16	28.6%
Gaming Fund Transfer	44	50	($6)	-12.0%
Other	48	82	($34)	-41.5%
Total State Sources	$1,809	$2,166	($357)	-16.5%
Federal Sources	$269	$470	($201)	-42.8%
Total Federal & State Sources	$2,078	$2,636	($558)	-21.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($55)	($53)	($2)	3.8%
Corporate Income Tax	($42)	(35)	($7)	20.0%
Subtotal General Funds	$1,981	$2,548	($567)	-22.3%
Short-Term Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$300	$0	$300	N/A
Total General Funds	$2,281	$2,548	($267)	-10.5%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Jul-03

GENERAL FUNDS RECEIPTS: YEAR END

FY 2003 vs. FY 2002

($ million)

Revenue Sources	FY 2003	FY 2002	CHANGE FROM FY 2002	% CHANGE
State Taxes				
Personal Income Tax	$7,979	$8,086	($107)	-1.3%
Corporate Income Tax (regular)	1,011	1,043	($32)	-3.1%
Sales Taxes	6,059	6,051	$8	0.1%
Public Utility Taxes (regular)	1,006	1,104	($98)	-8.9%
Cigarette Tax	400	400	$0	0.0%
Liquor Gallonage Taxes	123	123	$0	0.0%
Vehicle Use Tax	34	38	($4)	-10.5%
Inheritance Tax (Gross)	237	329	($92)	-28.0%
Insurance Taxes and Fees	313	272	$41	15.1%
Corporate Franchise Tax & Fees	142	159	($17)	-10.7%
Interest on State Funds & Investments	66	135	($69)	-51.1%
Cook County IGT	355	245	$110	44.9%
Other Sources	349	512	($163)	-31.8%
Subtotal	$18,074	$18,497	($423)	-2.3%
Transfers				
Lottery	540	555	($15)	-2.7%
Gaming Fund Transfer	554	470	$84	17.9%
Other	589	454	$135	29.7%
Total State Sources	$19,757	$19,976	($219)	-1.1%
Federal Sources	$3,940	$4,258	($318)	-7.5%
Total Federal & State Sources	$23,697	$24,234	($537)	-2.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($638)	($615)	($23)	3.7%
Corporate Income Tax	($273)	($240)	($33)	13.8%
Subtotal General Funds	$22,786	$23,379	($593)	-2.5%
Short-Term Borrowing	$1,675	$0	$1,675	N/A
Budget Stabilization Fund Transfer	$226	$226	$0	0.0%
Pension Contribution Fund Transfer	$300	$0	$300	N/A
Total General Funds	$24,987	$23,605	$1,382	5.9%

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

IEFC 2-Jul-03