IEFC

Illinois Economic and Fiscal Commission

MONTHLY REVENUE BRIEFING JULY 2003

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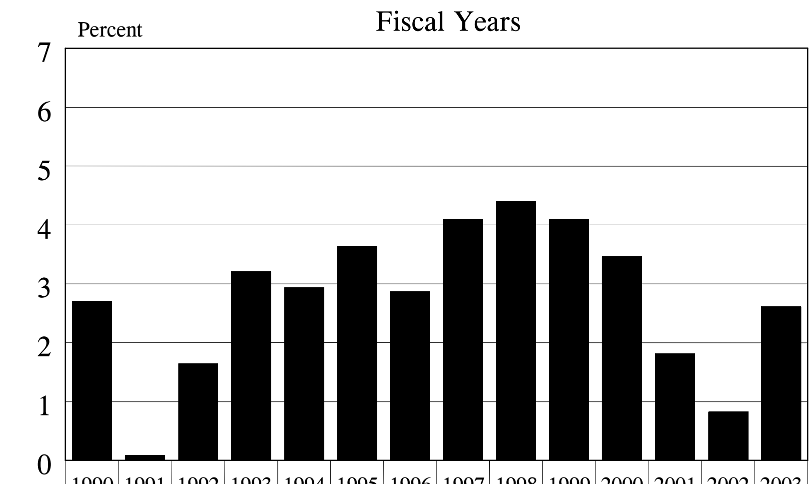
ECONOMY: Crying Wolf?

Edward H. Boss, Jr., Chief Economist

The Commerce Department released data on the performance of real gross domestic product on Thursday for the second quarter of 2003. This measure of overall economic activity in the United States rose at a 2.4% annual rate in the three months ended June 2003, modest but somewhat more than expected. For fiscal 2003, the economy rose at an inflation-adjusted 2.6%, up from 0.8% in FY 2002 and 1.8% in FY 2001, but well below the 4% rate recorded on average during the previous four fiscal years. (See Chart 1.) Even before the data were released, however, economists and other financial analysts were talking about a major rebound in economic activity during the second half of calendar 2003. The latest data added to that argument. Sound familiar? Seems like the same story heard last year and the year before that. Are analysts crying wolf again?

A major contributor to growth last quarter was once again the consumer as real consumption expenditures rose at an inflation-adjusted annual rate of 3.3%, up from a 2% rate in the previous

CHART 1 CHANGE IN REAL GDP
Fiscal Years



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
GDP	2.71	0.09	1.65	3.21	2.94	3.64	2.87	4.1	4.4	4.1	3.46	1.81	0.83	2.62

quarter. Indeed it has been the consumer that has remained the engine behind economic growth. There is some question, however, with longer-term interest rates rising, home refinancing slowing, the likelihood that the days of zero percent financing are numbered, and weak employment, whether the consumer can continue to carry the load.

An anomaly in the data was federal expenditures. Largely due to the war in Iraq, federal government consumption expenditures and investment soared at a 25.1% annual rate last quarter, the fastest rise since the Korean War. The rise in the national defense portion increased at a 44% annual rate compared to a decrease of 3.3% in the previous quarter. Again, this pace is unlikely to be sustained. Real non-defense expenditures actually declined at a 4.1% rate while budget-strapped state and local government expenditures dipped at a 1.5% rate after being virtually flat the previous quarter.

Reducing GDP growth were a reduction in business inventories and a faster rise in U.S. imports, which subtract from GDP, while U.S. exports declined. Inventories appear low relative to recent sale and could provide a lift to future growth--***should demand hold up.*** GPD less the change in inventories, real final sales rose at a 3.2% annual rate compared with a 2.3% rate last quarter. The big uncertainty, as it has been, is what will be the role of business spending. While the consumer has remained the engine of growth, business spending has been providing the brake.

Real business spending rose at a 6.9% annual rate last quarter in contrast to a 4.4% rate of decline in the previous quarter. The question remains if this is the beginning of renewed spending or just a quarterly aberration. There are some positive signs. New orders for durable goods, a precursor of business spending, rose last month and there was a faster-than-expected rise in the Chicago Purchasing Manager's Index, an apparent improvement in the long-ailing manufacturing sector, not to mention last quarter's improvement in business capital spending reported Thursday.

In looking ahead, it appears there are some positive factors that may well prove the analysts correct this time in projecting a stronger second half of a year. The tax cut has reduced withholding increasing disposable income, checks have been mailed to millions of families with children, the Iraq War has ended successfully despite disturbing continued casualties, and the stock market has improved sharply since its recent lows. While all these suggest near-term strength, it will take improvement in business hirings if improved economic growth is to occur. There has been a two-week reduction in initial unemployment claims, layoffs have slowed, and the unemployment rate fell in July. Even while jobs continued to decline, the number of jobs lost was reduced in July while temporary employment, a leading indicator of future job strength, increased. These trends will have to continue and be sustained if the wolf is to be avoided.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	June 2003	May 2003	June 2002
Unemployment Rate (Average)	6.3%	6.2%	6.5%
Annual Rate of Inflation (Chicago)	4.6%	0.0%	1.1%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (June)	6,403	0.3%	0.6%
Employment (thousands) (June)	5,997	0.1%	0.8%
New Car & Truck Registration (June)	58,403	3.3%	-1.3%
Single Family Housing Permits (June)	4,543	16.3%	16.8%
Total Exports ($ mil) (May)	2,346	6.1%	5.3%
Chicago Purchasing Managers Index (July)	55.9	6.5%	4.9%

REVENUE

As Expected, Revenues Fall to Begin FY 2004

Jim Muschinske, Revenue Manager

July general revenue receipts, excluding short-term borrowing and Pension Contribution Fund transfers, fell $269 million primarily due to much lower federal sources. This decline was anticipated as $700 million in short-term borrowing in July 2003 significantly increased Medicaid spending and subsequent federal reimbursement. In contrast, cash flow difficulties this July constrained such spending resulting in a dramatic fall-off in federal receipts. If short-term borrowing and Pension Contribution Fund transfers are included, overall general funds revenues were down $766 million. July had the same number of receipting days as last July.

While overall receipts were down, a number of sources experienced increases, albeit relatively modest. Gross personal income tax receipts were up $15 million, however, due to the significant increase in the refund percentage (the amount set aside for the payment of owed refunds), net personal income taxes actually fell $7 million. Similarly, while gross corporate income taxes were up $3 million, on a net of refund basis, receipts were flat. Public utility taxes rose $9 million and sales taxes increased $5 million. Both liquor taxes and interest income gained $4 million, while corporate franchise advanced $3 million and vehicle use rose by $1 million.

A few sources started the fiscal year on a down note as inheritance tax continued to fall with receipts off $11 million. Other sources lost $2 million and insurance taxes and fees dipped $1 million.

Overall transfers were up $46 million in July. While lottery transfers fell $13 million, riverboat transfers and receipts were up $8 million and other transfers gained $51 million. Riverboat revenue was up due to the recent change in the taxing structure. *Technically, most of the new revenues attributed to the changes could be counted under "other sources" as they are more of a receipt than a transfer. However, for the ease of presentation, the Commission will include that revenue under transfers so all riverboat money to the general funds can be easily identified.* Other transfers were up due to the planned "funds sweep" which was part of the FY 2004 budget ("fund chargebacks", which the Administration estimates will be approximately $350 million have yet to occur, but are anticipated to begin shortly). As explained earlier, federal sources fell off dramatically, with July receipts down $320 million. A combination of last July's short-term borrowing and this year's cash flow difficulties resulted in the decline.

As expected, once again $226 million in Budget Stabilization fund monies were tapped to help ease cash flow. In addition, as part of the plan related to last fiscal year's $10 billion sale of pension bonds, monies will be routinely transferred from the Pension Contribution Fund to the General Revenue Fund. In July, $203 million of such transfers took place of an anticipated $1.6 billion over the entire fiscal year.

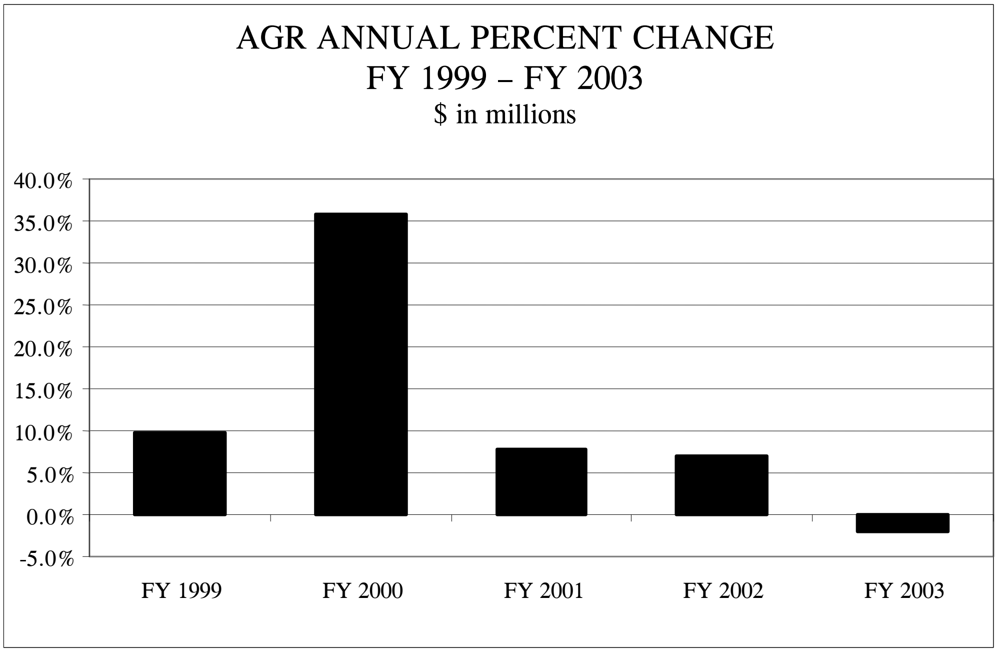
A previously scheduled Commission meeting for late August has been moved to September 5th, 2003. At that time the Commission will present and discuss the State's revenue picture. In the interim, the Commission will continue to gather information and form more detailed analysis on the many revenue changes and assumptions used to craft the FY 2004 budget.

Riverboats Running Aground?

Eric Noggle, Sr. Revenue Analyst

Illinois receives several kinds of revenue from licensed riverboat gambling in the State: wagering taxes, license fees and admissions tax. The wagering tax is imposed on a graduated tax system based on the adjusted gross receipts (AGR) of a riverboat. Because of Illinois' riverboat tax structure, the AGR and admissions figures are the principal components that determine that amount of revenue collected from this significant source.

A disturbing trend may be developing in the riverboat industry pertaining to these important components. In FY 2003, State revenue generated from Illinois riverboats increased $105 million, or 22.8 percent. However, this increase was not as high as originally expected as Adjusted Gross Receipts (AGR) in FY 2003 fell nearly 2 percent compared to FY 2002 figures (see below). This decline followed years of significant growth, which was mainly due to Illinois' change to dockside gambling in FY 2000. Illinois riverboat admissions also declined, falling 4.6 percent from FY 2002 levels.



What are the reasons for these declines? Many casino operators believe that the graduated tax increase for FY 2003 may be a major contributing factor for these declines. Other possible factors include strong competition from bordering states, congestion deterrents at some locations due to Illinois' limited number of gaming positions per facility, or simply that the novelty of dockside gambling in Illinois has worn off. Regardless of the reason or reasons, the fact remains that AGR and admissions have taken a downward turn. The recent graduated tax increase for FY 2004 will result in additional revenue growth for the immediate future. However, the growth may not be as strong as expected if the AGR and admissions decline experienced last fiscal year is repeated. The Commission is currently conducting further research on State gaming, including riverboats, horse racing, and lottery, and hopes to release Wagering in Illinois: 2003 Update by the beginning of September.

Illinois Riverboat Casino Comparison
AGR Percentage Change by Riverboat

	2000	2001	2002	2003
Elgin	39.87%	6.58%	5.61%	-9.13%
Aurora	25.52%	4.78%	12.89%	11.86%
Joliet Harrah's	48.20%	9.21%	10.68%	-4.14%
Joliet Empress	33.03%	11.78%	-0.28%	-5.28%
East St. Louis	27.60%	0.91%	-0.05%	1.29%
East Peoria	25.44%	5.41%	7.95%	-0.63%
Metropolis	31.32%	6.07%	19.79%	1.20%
Alton	44.05%	13.87%	3.35%	-4.36%
Rock Island	83.84%	35.65%	10.08%	4.29%
TOTAL	**35.75%**	**7.77%**	**7.06%**	**-1.97%**

GENERAL FUNDS RECEIPTS: JULY

FY 2004 vs. FY 2003

($ million)

<u>Revenue Sources</u>	JULY FY 2004	JULY FY 2003	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$551	$536	$15	2.8%
Corporate Income Tax (regular)	38	35	$3	8.6%
Sales Taxes	534	529	$5	0.9%
Public Utility Taxes (regular)	85	76	$9	11.8%
Cigarette Tax	33	33	$0	0.0%
Liquor Gallonage Taxes	15	11	$4	36.4%
Vehicle Use Tax	4	3	$1	33.3%
Inheritance Tax (Gross)	17	28	($11)	-39.3%
Insurance Taxes and Fees	1	2	($1)	-50.0%
Corporate Franchise Tax & Fees	12	9	$3	33.3%
Interest on State Funds & Investments	10	6	$4	66.7%
Cook County IGT	54	54	$0	0.0%
Other Sources	14	16	($2)	-12.5%
Subtotal	$1,368	$1,338	$30	2.2%
Transfers				
Lottery	31	44	($13)	-29.5%
Riverboat transfers & receipts	58	50	$8	16.0%
Other	225	174	$51	29.3%
Total State Sources	$1,682	$1,606	$76	4.7%
Federal Sources	$166	$486	($320)	-65.8%
Total Federal & State Sources	$1,848	$2,092	($244)	-11.7%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($65)	($43)	($22)	51.2%
Corporate Income Tax	($12)	(9)	($3)	33.3%
Subtotal General Funds	$1,771	$2,040	($269)	-13.2%
Short-Term Borrowing	$0	$700	($700)	N/A
Budget Stabilization Fund Transfer	$226	$226	$0	N/A
Pension Contribution Fund Transfer	$203	$0	$203	N/A
Total General Funds	$2,200	$2,966	($766)	-25.8%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Aug-03