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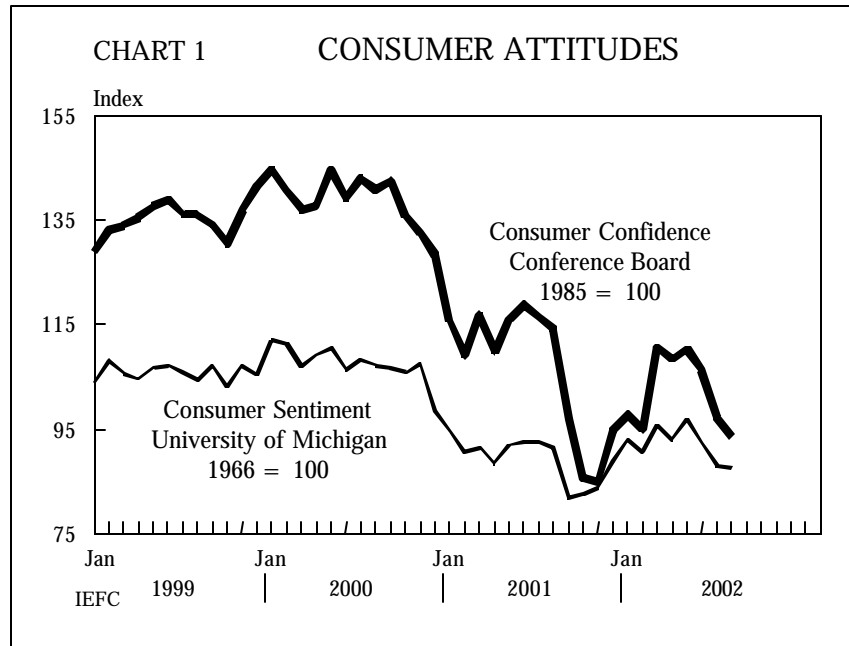


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ECONOMY: Consumers Worry But Continue To Spend Edward H. Boss, Jr., Chief Economist

The economy's future is tied to concerns over whether the consumer will continue to fuel the economic recovery which likely began at the end of last year. As shown in Chart 1, consumer confidence, as measured by both the Conference Board and University of Michigan surveys, turned down again in the past three months after a sharp recovery from the low reached after September 11, 2001.

Since the consumer typically makes up two-thirds of total spending, a retrenchment could lead to the dreaded double-dip recession scenario. Most economists, however, give very low odds of this happening, somewhere in the 0% to 20% range.



As shown, the decline in the University of Michigan survey for August seems to have leveled off and the drop in the Conference Board measure slowed its rate of descent. The biggest drop in these measures occurred in July, reflecting the sharp sell-off in the stock market. In August, the stock market as measured by the DOW showed some improvement, rising from a near-term low

closing of 7,489 on July 24th to 8,663 at month's end. Even so, September historically is the worst month for the market and stocks took another tumble as the month began. Despite this, spending has continued.

The Commerce Department reported personal spending jumped a full 1.0% in July, the largest rise since October 2001, after 0.5% gain in June. Much of July's spending gain reflect the aggressive incentives from the automakers, including zero-percent financing on new models. Indeed, durable goods spending rose 3.7% in July, up from 1.6% in June. Historically-low mortgage interest rates also continue to buoy the housing market as sales of new homes rose 6.7% in July, the highest monthly level on record, while sales of existing homes rose above the year-earlier pace.

Still a worry is that personal incomes are not rising as fast as spending, which could slow purchases in the future. At the same time, other sectors of the economy,

which had weakened, have shown some renewed life.

Manufacturers' new orders for durable goods jumped 8.7% in July, more than erasing June's 4.5% drop and allaying worries of a recessionary lapse. This renewed strength in manufacturing was echoed in the Chicago Purchasing Manager's Index which rose to 54.9 in August after falling in June and again in July to 51.5. At the same time, the national manufacturing index held unchanged at 50.5 in August. Any reading above 50 denotes expansion while any reading below 50 denotes contraction.

Although business reports have been mixed this summer, there have been some positive developments heading into the fall. While consumers turned less optimistic, they continue to spend, in some cases setting records. At the same time, business conditions seem to have improved after an early summer set back. Thus, the economic recovery appears sustainable, if not robust, as we head into the fall.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>July 2002</u>	<u>June 2002</u>	<u>July 2001</u>
Unemployment Rate (Average)	6.7%	6.3%	5.4%
Annual Rate of Inflation (Chicago)	-5.9%	4.6%	2.0%
—————			
	<u>LATEST</u>	<u>% CHANGE</u>	<u>% CHANGE</u>
	<u>MONTH</u>	<u>OVER PRIOR</u>	<u>OVER A</u>
		<u>MONTH</u>	<u>YEAR AGO</u>
Civilian Labor Force (thousands) (July)	6,280	-0.1%	-1.0%
Employment (thousands) (July)	5,862	-0.5%	-2.3%
New Car & Truck Registration (July)	66,780	12.9%	4.3%
Single Family Housing Permits (July)	3,674	-5.6%	0.3%
Total Exports (\$ mil) (June)	2,702	-0.4%	-1.0%
Chicago Purchasing Managers Index (August)	54.9	6.6%	26.2%

REVENUE

Jim Muschinske, Unit Manager
Revenues Fall in August

The one-month trend of positive revenue performance experienced in July was short-lived as August receipts returned to negative territory. For the month, receipts were down \$150 million with the bulk of that decline attributed to lower federal sources. Also negatively impacting on August receipts was the loss of one receipting day for the month.

Most of the State tax sources experienced declines with gross personal income tax the victim of the largest dollar drop off as receipts fell \$20 million. Public utility taxes suffered a similar fate, falling \$19 million. Inheritance tax receipts contributed \$15 million to the monthly decline, while interest earnings suffered yet another poor month, falling \$13 million. Other sources were off \$4 million and both gross corporate income taxes and vehicle use tax were each down \$1 million.

Insurance taxes and fees were one of only a few sources able to eek out gains for the month as revenues were up \$3 million. In addition, liquor taxes and corporate franchise taxes were each able to manage a \$1 million increase.

Overall transfers were essentially flat, growing only by \$1 million in August. While the Gaming Fund transfer was up \$10 million for the month, virtually all of that gain was wiped out by an \$8

million drop in lottery transfers and a \$1 million dip from all other transfers. Again, federal sources suffered the most as receipts fell \$83 million in August.

Year to Date

Despite a drop in August receipts, through the first two months of FY 2003 (excluding short-term borrowing and Budget Stabilization Fund transfers), overall revenues are up \$300 million. However, as discussed in last month's briefing, most if not all of that increase is the result of strong July federal sources and interfund transfers. Excluding federal sources and other transfers, year-to-date revenues would be essentially flat.

Through August, revenues from interest on State funds and investments have fared the worst, dropping \$24 million. Both inheritance tax and gross personal income tax were off \$10 million, respectively. Other sources experiencing declines totaling \$6 million.

Sales taxes have managed to post \$16 million in gains, while gross corporate income taxes have picked up \$5 million. Other sources experiencing gains totaling \$9 million.

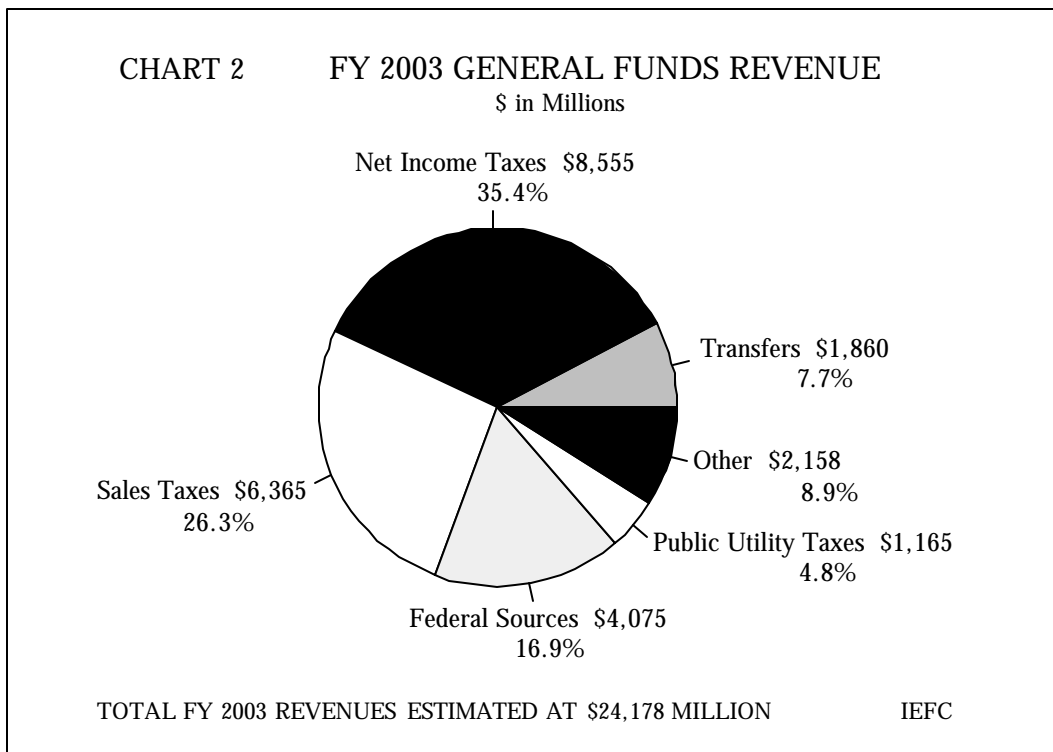
Excluding short-term borrowing and Budget Stabilization Fund transfers, revenues need to grow 2.5% over the remaining ten months of the fiscal year to reach the Commission's estimate.

**Composition of Estimated
FY 2003 General Funds Revenues**

Components of the general funds include: the General Revenue Fund, the Education Assistance Fund, the Common School Fund and the General Revenue-Common School Special Account Fund. General funds revenues are comprised of a number of revenue sources. Revenues directed to

the general funds are used for the regular operating and administrative expenses of most State agencies.

Chart 2 illustrates the composition of the Commission's FY 2003 general funds estimate. Figures do not reflect \$700 million in short-term borrowing or \$226 million in Budget Stabilization fund transfers. A brief description of each of the major areas follows.



Income Taxes

As shown, total income tax revenues (net of refunds) account for \$8,555 million or 35.4% of total estimated FY 2003 revenues. Of that amount, \$7,733 million or 32.0% will come from personal income tax and the

remainder, \$822 million or 3.4%, from corporate income taxes. Both personal and corporate income taxes performed extremely poor in fiscal year 2002, with net personal income tax falling \$525 million or 6.6% and net corporate income tax crashing \$233 million or 22.5%.

While in FY 2003 gross personal income tax is forecast to increase by 3.9% and gross corporate income tax by 8.0%, an increase in the percentage set aside for income tax refunds will reduce those effective growth rates to 3.5% for personal and 2.4% for corporate. In FY 2003 the percentage of gross personal income tax directed to the Refund Fund is 8.0% and corporate income tax 27.0%.

Effective January 1, 1989, P.A. 85-1414 removed income tax refunds from the appropriation process by establishing a formula by which a percentage of income tax dollars would be deposited into the Income Tax Refund Fund for the sole purpose of paying refunds. Initially, the percent was established at 6% for personal and 18% for corporate. The refund percentage is set by the Department of Revenue on the last business day of each fiscal year, and is based on a formula detailed in statute. However, in recent fiscal years from 1999 through 2003, the percentage has been set statutorily rather than by formula.

In FY 2002, the poor performance of income tax revenues, coupled with the continuing rise in the average refund which has grown to approximately \$215, significantly contributed to a delay in the State's ability to issue income tax refund checks. The State ended the fiscal year owing approximately \$200 million in refunds. In fact, and as mentioned in last month's briefing, of the \$1 billion in short-term borrowing, \$150 million was deposited into the Refund Fund to help

speed payment to owed taxpayers. In all likelihood, this pressure will continue to grow in future fiscal years, which may result in significant increases in the amounts needed to pay refunds owed.

Included in the forecast for corporate income taxes is the impact of P.A. 92-603, which decouples the State's business depreciation rules from the bonus depreciation provision recently passed at the federal level. It is estimated that the change will allow the State to retain approximately \$161 million in FY 2003 which would have been lost if the decoupling had not occurred.

For a much more detailed discussion of Illinois income taxes, please see the Commission's May 2002 report on individual income tax and the July 2002 report on corporate income tax.

Sales Taxes

Sales taxes are forecast to comprise 26.3% of total general funds revenues in FY 2003. Like income taxes, sales taxes performed very poorly in FY 2002. Despite rising by \$93 million or 1.6%, base growth would have been negative if it were not for the six month suspension on motor fuel sales tax in FY 2001. Sales tax revenues are forecast to grow by \$314 million or 5.2% in FY 2003, although part of that growth will be due to a change in the reallocation in sales tax collections that will equate into an additional \$25 million in general revenues.

For a much more detailed discussion of Illinois sales taxes, please see the Commission's October 2001 report on sales taxes.

Federal Sources

Federal sources are monies received from the federal government either in the form of grants or reimbursements on approved spending. The largest component of federal source receipts, usually about 75% of the total, results from reimbursable spending on the Medicaid program. Federal receipts are quite volatile and really do not follow any specific trend. Budgetary decisions impacting on appropriation levels and subsequent spending are usually the largest determining factor of federal revenues.

While Federal sources are forecast to comprise \$4,075 million or nearly 17% of total receipts in FY 2003, it will mark the second consecutive fiscal year of declining federal source receipts as revenues are expected to decline by \$183 million or 4.3%.

Transfers In

It is estimated that \$1,860 million or 7.7% of total revenues will be transferred into the general funds from a number of other non-general funds. The two largest transfers are expected to be from revenues generated from legalized forms of Illinois gaming. The largest transfer is expected to come from the State Gaming Fund to the Education Assistance Fund and is forecast to be \$625 million. This total

includes the impact of the recently restructured riverboat taxes, valued at \$142 million in FY 2003. The second largest transfer, totaling an estimated \$585 million, will come from the State Lottery Fund to the Common School Fund. Of the remaining \$650 million in other transfers, \$165 million in one-time transfers will occur as a result of interfund transfers allowed under P.A. 92-600.

For a much more detailed discussion of legalized wagering and resulting tax revenues, please see the Commission's latest report on wagering issued in August 2002.

Public Utility Taxes

The State's public utility taxes are estimated to be \$1,165 million in FY 2003, which represents 4.8% of total general funds revenues. Public utility taxes are comprised of taxes on telecommunications, electricity, and natural gas. Nearly 60% of public utility taxes are raised through the telecommunication tax, about 30% from the electricity tax, and about 10% from the natural gas tax.

All Other Revenues

After accounting for all of the above revenue sources, a mixture of remaining sources are expected to comprise an additional \$2,158 million or 8.9% in FY 2003 general revenues. The largest components would include cigarette taxes, inheritance taxes, insurance taxes and intergovernmental transfers.

GENERAL FUNDS RECEIPTS: AUGUST

FY 2003 vs. FY 2002

(\$ million)

	AUG. FY 2003	AUG. FY 2002	\$ CHANGE	% CHANGE
Revenue Sources				
State Taxes				
Personal Income Tax	\$559	\$579	(\$20)	-3.5%
Corporate Income Tax (regular)	14	15	(\$1)	-6.7%
Sales Taxes	525	525	\$0	0.0%
Public Utility Taxes (regular)	84	103	(\$19)	-18.4%
Cigarette Tax	33	33	\$0	0.0%
Liquor Gallonage Taxes	10	9	\$1	11.1%
Vehicle Use Tax	3	4	(\$1)	-25.0%
Inheritance Tax (Gross)	28	43	(\$15)	-34.9%
Insurance Taxes and Fees	7	4	\$3	75.0%
Corporate Franchise Tax & Fees	13	12	\$1	8.3%
Interest on State Funds & Investments	8	21	(\$13)	-61.9%
Cook County IGT	0	0	\$0	0.0%
Other Sources	17	21	(\$4)	-19.0%
Subtotal	\$1,301	\$1,369	(\$68)	-5.0%
Transfers				
Lottery	35	43	(\$8)	-18.6%
Gaming Fund Transfer	50	40	\$10	25.0%
Other	21	22	(\$1)	-4.5%
Total State Sources	\$1,407	\$1,474	(\$67)	-4.5%
Federal Sources	\$245	\$328	(\$83)	-25.3%
Total Federal & State Sources	\$1,652	\$1,802	(\$150)	-8.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$45)	(\$44)	(\$1)	2.3%
Corporate Income Tax	(3)	(4)	\$1	-25.0%
Subtotal General Funds	\$1,604	\$1,754	(\$150)	-8.6%
Short-Term Borrowing	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$0	\$0	\$0	N/A
Total General Funds	\$1,604	\$1,754	(\$150)	-8.6%
IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				4-Sep-02

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2003 vs. FY 2002

(\$ million)

Revenue Sources	FY 2003	FY 2002	CHANGE FROM FY 2002	% CHANGE
State Taxes				
Personal Income Tax	\$1,095	\$1,105	(\$10)	-0.9%
Corporate Income Tax (regular)	49	44	\$5	11.4%
Sales Taxes	1,054	1,038	\$16	1.5%
Public Utility Taxes (regular)	160	165	(\$5)	-3.0%
Cigarette Tax	67	67	\$0	0.0%
Liquor Gallonage Taxes	22	19	\$3	15.8%
Vehicle Use Tax	6	7	(\$1)	-14.3%
Inheritance Tax (Gross)	55	65	(\$10)	-15.4%
Insurance Taxes and Fees	9	6	\$3	50.0%
Corporate Franchise Tax & Fees	21	19	\$2	10.5%
Interest on State Funds & Investments	14	38	(\$24)	-63.2%
Cook County IGT	54	54	\$0	0.0%
Other Sources	33	32	\$1	3.1%
Subtotal	\$2,639	\$2,659	(\$20)	-0.8%
Transfers				
Lottery	79	73	\$6	8.2%
Gaming Fund Transfer	100	80	\$20	25.0%
Other	195	40	\$155	387.5%
Total State Sources	\$3,013	\$2,852	\$161	5.6%
Federal Sources	\$731	\$586	\$145	24.7%
Total Federal & State Sources	\$3,744	\$3,438	\$306	8.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$87)	(\$84)	(\$3)	3.6%
Corporate Income Tax	(13)	(10)	(\$3)	30.0%
Subtotal General Funds	\$3,644	\$3,344	\$300	9.0%
Short-Term Borrowing	\$700	\$0	\$700	N/A
Budget Stabilization Fund Transfer	\$226	\$0	\$226	N/A
Total General Funds	\$4,570	\$3,344	\$1,226	36.7%
SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.				
IEFC				4-Sep-02

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2003 ESTIMATE vs. FY 2002 ACTUAL

(\$ million)

Revenue Sources	July-02 ESTIMATE FY 2003	FYTD 2003	AMOUNT NEEDED FY 2003 EST.	FYTD 2002	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	\$8,405	\$1,095	\$7,310	\$1,105	\$329	4.7%
Corporate Income Tax (regular)	1,126	49	\$1,077	44	\$78	7.8%
Sales Taxes	6,365	1,054	\$5,311	1,038	\$298	5.9%
Public Utility Taxes (regular)	1,165	160	\$1,005	165	\$66	7.0%
Cigarette Tax	400	67	\$333	67	\$0	0.0%
Liquor Gallonage Taxes	125	22	\$103	19	\$0	0.0%
Vehicle Use Tax	39	6	\$33	7	\$2	6.5%
Inheritance Tax (Gross)	270	55	\$215	65	(\$49)	-18.6%
Insurance Taxes and Fees	280	9	\$271	6	\$5	1.9%
Corporate Franchise Tax & Fees	169	21	\$148	19	\$8	5.7%
Interest on State Funds & Investments	160	14	\$146	38	\$48	49.0%
Cook County IGT	395	54	\$341	54	\$150	78.5%
Other Sources	320	33	\$287	32	(\$193)	-40.2%
Subtotal	\$19,219	\$2,639	\$16,580	\$2,659	\$742	4.7%
Transfers						
Lottery	585	79	\$506	73	\$24	5.0%
Gaming Fund Transfer	625	100	\$525	80	\$135	34.6%
Other	650	195	\$455	40	\$42	10.2%
Total State Sources	\$21,079	\$3,013	\$18,066	\$2,852	\$943	5.5%
Federal Sources	\$4,075	\$731	\$3,344	\$586	(\$328)	-8.9%
Total Federal & State Sources	\$25,154	\$3,744	\$21,410	\$3,438	\$615	3.0%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$672)	(\$87)	(\$585)	(\$84)	(\$54)	10.2%
Corporate Income Tax	(304)	(13)	(\$291)	(10)	(\$61)	26.5%
Subtotal General Funds	\$24,178	\$3,644	\$20,534	\$3,344	\$500	2.5%
Short-Term Borrowing	\$700	\$700	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$226	\$226	\$0	\$0	(\$226)	N/A
Total General Funds	\$25,104	\$4,570	\$20,534	\$3,344	\$274	1.4%
IEFC						3-Sep-02