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ECONOMY: Economy Falters

Edward H. Boss, Jr., Chief Economist

Recently-released data by the Commerce Department shows that the U.S. economy, as measured by real gross domestic product (GDP), shrank in the third quarter (first quarter of FY 2002) at a 0.4% annual rate, the first decline in more than a decade. (See Chart 1). The decline comes on top of a slight 0.3% rise in the second quarter and, when coupled with what appears to be an even weaker fourth quarter will likely satisfy the duration qualification of what has been determined to be a recession.

Clearly the impact of the September 11th attacks on America have had a negative impact that, when placed upon an economy that was already struggling to stay above water, likely pushed it into recession. Still, while the decline in economic activity last quarter was not unexpected, the magnitude of the decline was far less than had been forecast by most economists. This is true even though the data are incomplete and will be revised based on more comprehensive data in a "preliminary" release due out on November 30th.

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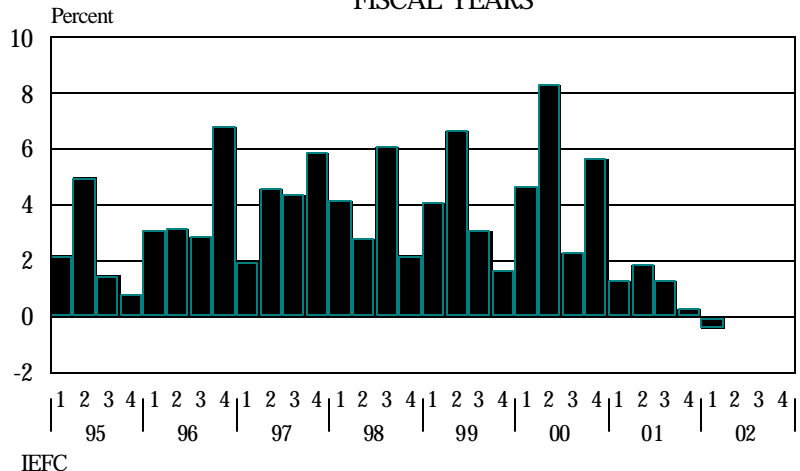
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CHART 1 CHANGE IN REAL GDP FISCAL YEARS



The major contributions to the drop in GDP last quarter were spending on exports, business equipment and nonresidential structures, and a reduction in inventories. Personal consumption expenditures and federal government spending rose despite a 1.8% drop in consumer spending in September following the attacks, the largest decline since January 1987.

This spending drop was particularly affected by a fall in auto sales as indicated by a 42.5% drop in September car and truck registrations in Illinois shown in the accompanying table. This led the major auto companies to introduce 0% financing packages, which in turn caused sales to soar this month.

The drop in inventory investment also could be a harbinger of better conditions ahead. Indeed, real final sales, which comprise GDP less the change in inventories, held unchanged last quarter. Thus, conditions seem ripe that any pick up in demand could

spark new activity in the future. At the same time, both monetary and fiscal policies have turned stimulative. With nine cuts in interest rates since the beginning of the year and more expected, coupled with a sharp increase in the money supply, tax rebates, increases in spending and an expected fiscal stimulus package, government policies have been beefed up to fight a recession.

The big uncertainty is the impact of uncertainty itself. To that extent recent stock market performance has been encouraging. Despite volatility, the market is up about 10% from its September 21st low and the tech-heavy NASDAQ is back to where it was before the attacks. If the stock market firmness holds, it could be a strong omen given its long-standing record of forecasting economic recoveries. Thus, while it appears the economy may be in a recession, at least there are some prospects that, barring any major setbacks, conditions may improve next year.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>Sept. 2001</u>	<u>August 2001</u>	<u>Sept. 2000</u>
Unemployment Rate (Average)	5.5%	5.5%	4.4%
Annual Rate of Inflation (Chicago)	10.7%	2.7%	2.8%
<hr/>			
	<u>LATEST</u>	<u>% CHG.</u>	<u>% CHG.</u>
	<u>MONTH</u>	<u>OVER PRIOR</u>	<u>OVER A</u>
		<u>MONTH</u>	<u>YEAR AGO</u>
Civilian Labor Force (thousands) (September)	6,393	0.7%	-0.3%
Employment (thousands) (September)	6,042	0.7%	-1.5%
New Car & Truck Registration (September)	39,074	-42.5%	-2.7%
Single Family Housing Permits (September)	3,104	-19.5%	-3.8%
Total Exports (\$ mil) (August)	2,610	7.5%	-1.4%
Chicago Purchasing Managers Index (October)	46.2	-0.8%	-5.1%

IMPORTANCE OF VEHICLE SALES

Mike Howard, Revenue Analyst

Sales taxes are an important component of the State's overall taxing structure. They are the general revenue fund's second largest revenue-generating source and comprise approximately 25 percent of total revenues. Given the importance of sales tax revenue, it is worthwhile to examine the impact that vehicle sales have on State sales tax revenue.

At the beginning of CY 2000, the National Automobile Dealers Association (NADA) reported that there were 1,093 franchised new car and truck dealerships located in Illinois. In 2000, these dealerships generated approximately \$25 billion in total sales. The total consisted of \$15 billion from new vehicle sales, \$7 billion from used vehicle sales, and \$3 billion from the sale of parts and service.

These figures are especially meaningful when comparing the size of the industry and its impact on State sales tax revenue. In 2000, NADA estimated that Illinois new car and truck dealerships comprised approximately 2.4 percent of total retail establishments in Illinois. Despite this small percentage, due to the relatively high prices associated with new and used vehicles, revenue generated via vehicle sales comprised roughly 18 percent of total sales tax revenues.

In CY 2000, NADA reported that the average selling price of a new vehicle

was \$24,923 and the average selling price of a used vehicle was \$13,648. Applying these averages, the State received approximately \$1,250 from the sale of every new vehicle and roughly \$680 from the sale of every used vehicle sold at a dealership.

Entering 2001, the U.S. auto industry was coming off back-to-back boom years having sold 17.0 million vehicles in 1999 and 17.4 million vehicles in 2000. These totals were record levels given that the industry's previous mark was barely 16 million. Despite this momentum, the slowing economy affected the auto industry and vehicle sales were down 5 percent through August. This decrease, however, was prior to the events of September 11th and the introduction of zero-percent financing.

U.S. vehicle sales are expected to decline by 4 percent in 2001 bringing vehicles sales to roughly 16.5 million; still, the third highest mark in U.S. history. Despite new incentive packages, forecasters remain skeptical of 2001 and 2002 sales predictions. Current 2002 estimates range anywhere from 13 million to 16.9 million units. The discrepancy is based on the uncertainty associated with the impact of the elimination of zero-percent financing, the status of the American consumer's long-term confidence, and the effect that rising unemployment rates will have on purchasing power. These uncertainties make it difficult to predict the impact that declining vehicle sales will have on total sales tax receipts.

REVENUE

Receipts Rise for First Time in FY 2002

Jim Muschinske, Unit Chief

Overall general revenue receipts rose by \$34 million in October. While a modest gain, it marked the first time in FY 2002 that revenues grew over the same month of a year earlier. Most of the larger revenue sources demonstrated decent growth for the month, but were in part offset by lower transfers, inheritance tax, and federal sources. October did benefit from one more receipting day than last year.

Public utility tax receipts led the sources experiencing increases for the month as receipts were up \$34 million. Gross personal income tax revenues grew by \$33 million while sales tax collections advanced \$23 million. Liquor and insurance taxes increased \$7 million each and other sources contributed \$4 million to the increase.

Revenue from inheritance tax declined \$31 million in October as last year's receipts were unusually high. Interest income continued to lag due to lower balances and interest rates were off \$14 million for the month. Finally, corporate franchise taxes experienced a \$2 million decline from last October.

Overall transfers were down \$15 million for the month. Despite a \$12 million increase in Gaming Fund transfers and a \$9 million increase in Lottery transfers, those items were more than offset by a \$36 million decline in other transfers. Federal

sources experienced a \$14 million decrease in October.

Year-to-Date

For the first third of FY 2002, overall general funds receipts have declined \$262 million or 3.5%. Despite an uptick in October, overall revenue performance has been disappointing. The weakened economy coupled with increased uncertainties have significantly dimmed the revenue picture.

Gross corporate income tax receipts were down by \$51 million through October. Interest income has fallen by \$37 million, while inheritance tax receipts are off \$29 million. Other State tax sources experiencing declines for the first four months totaled an additional \$27 million. While sales tax has increased by \$39 million for the year, it still has underperformed expectations. Not many other sources have demonstrated increases as together they only total another \$6 million. Overall transfers were down \$46 million through October, while federal sources were off by \$107 million.

Revised Forecast

On October 23rd, the Commission published a revised FY 2002 general revenue forecast. The estimate was reduced by \$300 million to \$24.526 billion and reflects an increase of only \$420 million or 1.7% over the previous fiscal year. Significant downward revisions were made to the largest

sources, i.e. income taxes and sales taxes. Those reductions totaled \$400 million and were partially offset by an increase of \$100 million in federal sources as the Administration has identified additional federal monies.

In order to reach the Commission's revised general funds estimate of

\$24.526 billion, receipts over the remaining two-thirds of the fiscal year have to increase 4.1%. For a detailed discussion of the revisions, please see the Commission's website at [**http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html**](http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html) or contact our office for a copy of the report at 217/782-5320.

GENERAL FUNDS RECEIPTS: OCTOBER

FY 2002 vs. FY 2001
(\$ million)

Revenue Sources	OCT. FY 2002	OCT. FY 2001	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$582	\$549	\$33	6.0%
Corporate Income Tax (regular)	42	31	\$11	35.5%
Sales Taxes	504	481	\$23	4.8%
Public Utility Taxes (regular)	115	81	\$34	42.0%
Cigarette Tax	33	33	\$0	0.0%
Liquor Gallonage Taxes	16	9	\$7	77.8%
Vehicle Use Tax	3	3	\$0	0.0%
Inheritance Tax (Gross)	24	55	(\$31)	-56.4%
Insurance Taxes and Fees	8	1	\$7	700.0%
Corporate Franchise Tax & Fees	14	16	(\$2)	-12.5%
Interest on State Funds & Investments	12	26	(\$14)	-53.8%
Cook County IGT	54	54	\$0	0.0%
Other Sources	18	14	\$4	28.6%
Subtotal	\$1,425	\$1,353	\$72	5.3%
Transfers				
Lottery	47	38	\$9	23.7%
Gaming Fund Transfer	45	33	\$12	36.4%
Other	32	68	(\$36)	-52.9%
Total State Sources	\$1,549	\$1,492	\$57	3.8%
Federal Sources	\$336	\$350	(\$14)	-4.0%
Total Federal & State Sources	\$1,885	\$1,842	\$43	2.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$44)	(\$39)	(\$5)	12.8%
Corporate Income Tax	(10)	(6)	(\$4)	66.7%
Total General Funds	\$1,831	\$1,797	\$34	1.9%
IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				
1-Nov-01				

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2002 vs. FY 2001

(\$ million)

Revenue Sources	FY 2002	FY 2001	CHANGE FROM FY 2001	% CHANGE
State Taxes				
Personal Income Tax	\$2,400	\$2,419	(\$19)	-0.8%
Corporate Income Tax (regular)	248	299	(\$51)	-17.1%
Sales Taxes	2,037	1,998	\$39	2.0%
Public Utility Taxes (regular)	348	347	\$1	0.3%
Cigarette Tax	133	133	\$0	0.0%
Liquor Gallonage Taxes	41	43	(\$2)	-4.7%
Vehicle Use Tax	13	12	\$1	8.3%
Inheritance Tax (Gross)	122	151	(\$29)	-19.2%
Insurance Taxes and Fees	56	52	\$4	7.7%
Corporate Franchise Tax & Fees	46	50	(\$4)	-8.0%
Interest on State Funds & Investments	62	99	(\$37)	-37.4%
Cook County IGT	130	130	\$0	0.0%
Other Sources	65	67	(\$2)	-3.0%
Subtotal	\$5,701	\$5,800	(\$99)	-1.7%
Transfers				
Lottery	165	140	\$25	17.9%
Gaming Fund Transfer	175	169	\$6	3.6%
Other	88	165	(\$77)	-46.7%
Total State Sources	\$6,129	\$6,274	(\$145)	-2.3%
Federal Sources	\$1,260	\$1,367	(\$107)	-7.8%
Total Federal & State Sources	\$7,389	\$7,641	(\$252)	-3.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$182)	(\$172)	(\$10)	5.8%
Corporate Income Tax	(57)	(57)	\$0	0.0%
Total General Funds	\$7,150	\$7,412	(\$262)	-3.5%

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

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GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2002 ESTIMATE vs. FY 2001 ACTUAL

(\$ million)

Revenue Sources	ESTIMATE FY 2002	FYTD 2002	AMOUNT NEEDED FY 2002 EST.	FYTD 2001	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	\$8,780	\$2,400	\$6,380	\$2,419	\$192	3.1%
Corporate Income Tax (regular)	1,252	248	\$1,004	299	\$24	2.4%
Sales Taxes	6,220	2,037	\$4,183	1,998	\$223	5.6%
Public Utility Taxes (regular)	1,180	348	\$832	347	\$33	4.1%
Cigarette Tax	400	133	\$267	133	\$0	0.0%
Liquor Gallonage Taxes	135	41	\$94	43	\$13	16.0%
Vehicle Use Tax	35	13	\$22	12	\$0	0.0%
Inheritance Tax (Gross)	376	122	\$254	151	\$44	21.0%
Insurance Taxes and Fees	260	56	\$204	52	\$10	5.2%
Corporate Franchise Tax & Fees	151	46	\$105	50	\$9	9.4%
Interest on State Funds & Investments	235	62	\$173	99	(\$2)	-1.1%
Cook County IGT	245	130	\$115	130	\$0	0.0%
Other Sources	497	65	\$432	67	\$92	27.1%
Subtotal	\$19,766	\$5,701	\$14,065	\$5,800	\$638	4.8%
Transfers						
Lottery	505	165	\$340	140	(\$21)	-5.8%
Gaming Fund Transfer	465	175	\$290	169	(\$1)	-0.3%
Other	465	88	\$377	165	\$90	31.4%
Total State Sources	\$21,201	\$6,129	\$15,072	\$6,274	\$706	4.9%
Federal Sources	\$4,280	\$1,260	\$3,020	\$1,367	\$67	2.3%
Total Federal & State Sources	\$25,481	\$7,389	\$18,092	\$7,641	\$773	4.5%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$667)	(\$182)	(\$485)	(\$172)	(\$46)	10.5%
Corporate Income Tax	(288)	(57)	(\$231)	(57)	(\$45)	24.2%
Total General Funds	\$24,526	\$7,150	\$17,376	\$7,412	\$682	4.1%
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