Commission on Government Forecasting and Accountability

MONTHLY BRIEFING *NOVEMBER 2009*

http://www.ilga.gov/commission/cgfa2006/home.aspx

INSIDE THIS ISSUE

703 Stratton Ofc. Bldg.
Springfield, IL 62706

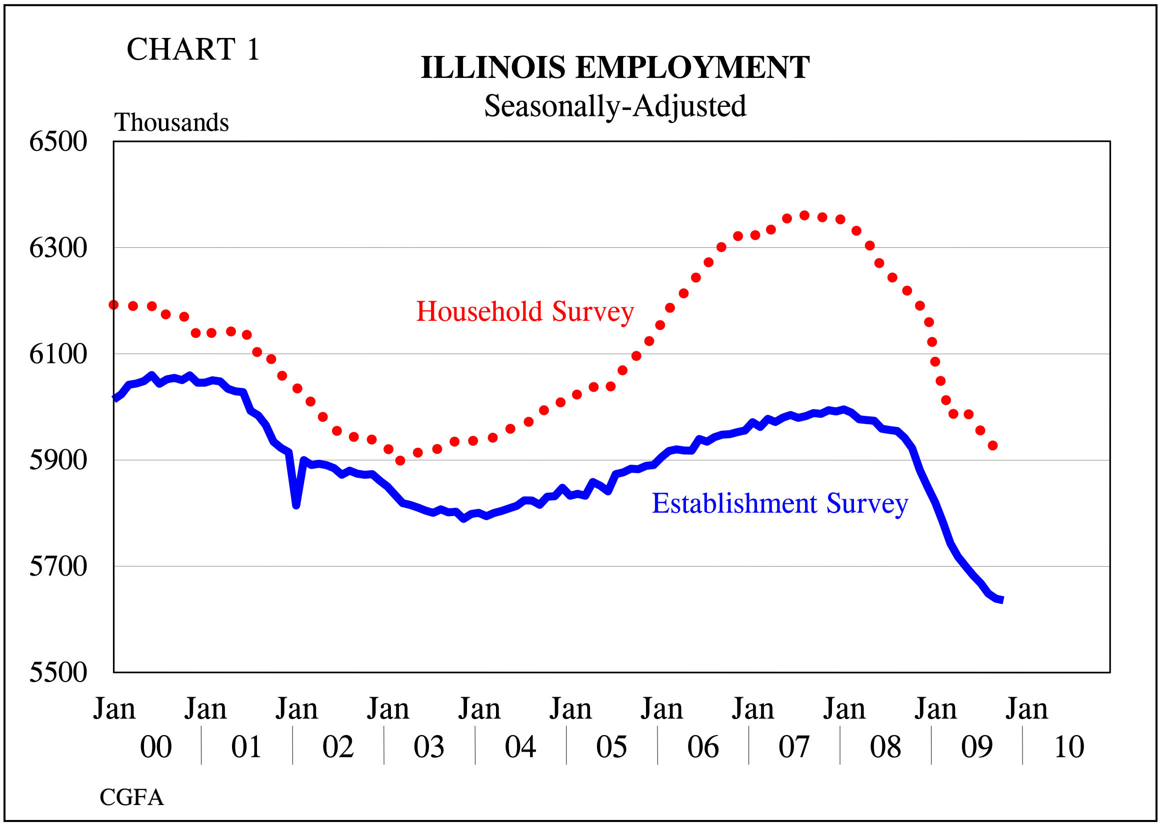
ECONOMY: Illinois' Employment Continues to Weaken

Edward H. Boss, Jr., Chief Economist

October data display an employment situation in the State that has continued to deteriorate. This is true not only when measured by its past performance but also when compared to other groupings. The national unemployment rate rose to 10.2% in October, while Illinois' unemployment rate hit 11%, the highest since August 1983. Moreover within the State, the unemployment rate in the highly populated metropolitan area, consisting of Chicago, Joliet and Naperville, reached 11.2%. In the past 12-months alone Illinois lost 286,300 jobs.

Among the nine geographic divisions reported by the Bureau of Labor Statistics the highest unemployment rate of 11.8% was recorded in the Pacific States, but the East North Central area (consisting of Illinois, Indiana, Michigan, Ohio, and Wisconsin) recorded the second highest rate of 11.2%. Within the East North Central area, Michigan continued to have the highest unemployment rate of 15.1% in October. Even so, this was lower than the 15.3% rate reached in September as the state actually increased employment by 38,600 last month. Excluding Michigan, Illinois' 11% unemployment rate was the highest in this division followed by Ohio with a 10.5% rate, Indiana with a 9.8% rate, and Wisconsin at an 8.4% rate.

It has been widely documented that the unemployment rate tends to lag economic activity and that the lag has been even longer historically in the case of Illinois. Thus, even though it is quite likely that the recession that began at the end of 2007 ended last summer, it is not surprising that unemployment rates have continued to rise and are likely to continue to do so in the months ahead. There are several reasons why unemployment rates lag even as a recovery is underway. First, businesses are reluctant to hire new employees until the recovery appears sustainable. Second, as



economic conditions improve, discouraged workers re-enter the labor force. And finally, not only must new jobs be created but the rate of gain also must exceed labor force growth from a rising population to reduce the unemployment rate.

Chart 1 shows Illinois employment as measured both by the Household Survey, used to calculate the unemployment rate, and the Establishment, or payroll, Survey. The former is a survey of individuals' employment status whereas the latter is derived from employers' payroll records. While there are positives and negatives to each of the data series, normally the more extensive Establishment Survey is used in depicting the jobs situation. Because that survey doesn't catch current changes in employment from small businesses where most jobs are created, however, the Household Survey may be a better indicator of job improvement at this stage of the business cycle. Indeed, its pattern often precedes that of the Establishment Survey. As a result, when referring to the chart, the near-term outlook is not encouraging.

The current unemployment situation in Illinois as we end 2009 in is in sharp contrast to that only a few years earlier when Illinois' unemployment rate, generally slightly above the U.S. rate, actually held below the national rate during the last eight months of 2006 and compared favorably within its Midwest grouping. According to the Establishment Survey, the level of Illinois' payroll employment fell by 424,300 since a recent peak in June 2000 with almost 85% of that loss, or 359,700 jobs, coming since January 2008 as the recession got underway.

The longer-term unemployment outlook also is not inspiring. According to a recent study done by Global Insight, a service used by the Commission, *"Though employment will start to expand across most of the country in the first half of 2010, it will take another three years, to the second quarter of 2013, before half the states have recovered their job losses and regained their previous peak employment levels."* The data presented in the study showed, however, that Illinois would not recover its peak employment level until 2014 or 2015. Moreover, because the labor force will have expanded further, the unemployment rate for most states will only edge below 8%, but ten states, including Illinois, are expected to suffer unemployment rates in excess of 9%.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	OCT. 2009	SEPT. 2009	OCT. 2008
Unemployment Rate (Average)	11.0%	10.5%	6.8%
Annual Rate of Inflation (Chicago)	2.1%	-0.5%	-0.8%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (October)	6,642	0.3%	-0.2%
Employment (thousands) (October)	5,910	-0.2%	-4.7%
New Car & Truck Registration (October)	33,717	-34.5%	-23.4%
Single Family Housing Permits (October)	879	4.5%	-13.5%
Total Exports ($ mil) (September)	3,484	2.6%	-27.8%
Chicago Purchasing Managers Index (November)	56.1	3.5%	65.9%

REVENUE

Monthly Revenues Rise Again on the Strength of Federal Sources – Economic Sources Continue Weak

Jim Muschinske, Revenue Manager

Another comparatively strong month for federal sources offset a falloff in most other revenue areas. As a result, the month of November finished up $156 million. Despite the monthly gain, the economically related sources show little evidence that the recovery has manifested in positive receipt performance. In fact, since the month benefited by two extra receipting days, weakness in nonfederal areas was likely somewhat worse than reported.

For the month, sales tax dropped $54 million reflecting continued consumer hesitation to spend. Gross corporate income taxes fell $30 million, or $24 million net of refunds, while public utility receipts were down $8 million. Liquor taxes declined $8 million, but the falloff wasn't surprising as it appeared consumers stocked up a couple of months prior in anticipation of higher liquor taxes. Interest earnings were again down, off $6 million, corporate franchise taxes dropped $3 million, and inheritance tax dipped by $1 million.

A few sources posted minor gains in November. Gross personal income tax was up $3 million, or $2 million net of refunds [although prior to the two extra receipting days it was running well below last year]. The Cook County IGT posted a $3 million increase and other sources grew $2 million.

Overall transfers fell $6 million in November. While the lottery was flat for the month, riverboat gaming transfers dropped $5 million and other transfers fell by $1 million. As mentioned, federal sources posted a sizable gain, up $259 million due mostly to a comparatively very weak November last year.

Year to Date

Through the first five months of the fiscal year overall base revenues are down $52 million. However, tremendous growth in federal sources masks the extremely poor performance of the other revenue areas. Despite being in the early stages of a recovery, the larger economically related sources such as income and sales continue to suffer from the recession's effect. As continually mentioned in previous revenue briefings, it will be some time before improvement in receipts can be expected. If $735 million in federal source gains are excluded, the falloff in receipts would be a much more worrisome $787 million.

Through November, sales tax is down $388 million, while gross personal income tax has declined $338 million, or $305 million net of refunds. Gross corporate income tax is off $118 million, or $97 million net of refunds. Public utility taxes are down $57 million, while all remaining sources contributed with a net drop of $51 million.

With the second quarter funds sweeps, overall transfers are up $111 million. Other transfers are up $141 million, while riverboat transfers are down $30 million. After enjoying four consecutive months of significant growth due to reimbursable spending, federal sources are up $735 million.

GENERAL FUNDS RECEIPTS: NOVEMBER
FY 2010 vs. FY 2009
($ million)

Revenue Sources	Nov. FY 2010	Nov. FY 2009	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$584	$581	$3	0.5%
Corporate Income Tax (regular)	20	50	($30)	-60.0%
Sales Taxes	489	543	($54)	-9.9%
Public Utility Taxes (regular)	66	74	($8)	-10.8%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	7	15	($8)	-53.3%
Vehicle Use Tax	2	2	$0	0.0%
Inheritance Tax (Gross)	19	20	($1)	-5.0%
Insurance Taxes and Fees	0	0	$0	N/A
Corporate Franchise Tax & Fees	21	24	($3)	-12.5%
Interest on State Funds & Investments	1	7	($6)	-85.7%
Cook County IGT	56	53	$3	5.7%
Other Sources	25	23	$2	8.7%
Subtotal	$1,319	$1,421	($102)	-7.2%
Transfers				
Lottery	45	45	$0	0.0%
Riverboat transfers & receipts	40	45	($5)	-11.1%
Other	9	10	($1)	-10.0%
Total State Sources	$1,413	$1,521	($108)	-7.1%
Federal Sources	$404	$145	$259	178.6%
Total Federal & State Sources	$1,817	$1,666	$151	9.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($57)	($56)	($1)	1.8%
Corporate Income Tax	($3)	(9)	$6	-66.7%
Subtotal General Funds	$1,757	$1,601	$156	9.7%
Short-Term Borrowing	$0	$0	$0	N/A
Hopital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$130	$0	$130	N/A
Total General Funds	$1,887	$1,601	$286	17.9%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Dec-09

GENERAL FUNDS RECEIPTS: YEAR TO DATE				
FY 2010 vs. FY 2009				
($ million)				
Revenue Sources	**FY 2010**	**FY 2009**	**CHANGE FROM FY 2009**	**% CHANGE**
State Taxes				
Personal Income Tax	$3,378	$3,716	($338)	-9.1%
Corporate Income Tax (regular)	394	512	($118)	-23.0%
Sales Taxes	2,612	3,000	($388)	-12.9%
Public Utility Taxes (regular)	396	453	($57)	-12.6%
Cigarette Tax	146	146	$0	0.0%
Liquor Gallonage Taxes	68	70	($2)	-2.9%
Vehicle Use Tax	13	13	$0	0.0%
Inheritance Tax (Gross)	87	112	($25)	-22.3%
Insurance Taxes and Fees	92	82	$10	12.2%
Corporate Franchise Tax & Fees	88	91	($3)	-3.3%
Interest on State Funds & Investments	15	31	($16)	-51.6%
Cook County IGT	56	65	($9)	-13.8%
Other Sources	149	155	($6)	-3.9%
Subtotal	$7,494	$8,446	($952)	-11.3%
Transfers				
Lottery	233	233	$0	0.0%
Riverboat transfers & receipts	200	230	($30)	-13.0%
Other	299	158	$141	89.2%
Total State Sources	$8,226	$9,067	($841)	-9.3%
Federal Sources	$2,467	$1,732	$735	42.4%
Total Federal & State Sources	$10,693	$10,799	($106)	-1.0%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($329)	($362)	$33	-9.1%
Corporate Income Tax	($69)	($90)	$21	-23.3%
Subtotal General Funds	$10,295	$10,347	($52)	-0.5%
Short-Term Borrowing	$1,250	$0	$1,250	N/A
Hospital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$446	$276	$170	61.6%
Total General Funds	$11,991	$10,623	$1,368	12.9%
SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.				
CGFA				2-Dec-09

PENSIONS

Pension Modernization Task Force Concludes its Business

Dan Hankiewicz, Pension Manager

The Pension Modernization Task Force was created pursuant to House Joint Resolution 65. The Resolution called for the creation of a 19-member task force to be charged with the following tasks:

- Analyze the public policy implications of changing pension benefits on the State of Illinois' ability to attract and retain public employees, teachers, and University professionals;

- Analyze the level of the current pension benefit structure in Illinois as it compares to other states in the geographical region and to other states that have systems that are not coordinated with Social security;

- Analyze the level of benefit programs currently being offered in the private sector;

- Analyze the long-term costs of our current systems, including the expected increase in benefit payments, the effects of continued underperformance in the funds' investment portfolio, and the effects of increasing life expectancies on our State-funded systems; and

- Analyze which pension benefits in Illinois should be modernized.

In light of the complexity of the issues to be studied, the task force formed four subcommittees in order to provide for an in-depth examination of the Illinois pension crisis. The four subcommittees were: benefits, collective bargaining, funding, and investments. The subcommittees met on a bi-monthly basis between June and October. Pursuant to the resolution, the staff of the Commission on Government Forecasting and Accountability was charged with providing staff support to the task force, in conjunction with the State-funded retirement systems actuaries and staff.

The task force heard testimony from a number of experts in many areas of concern to the State pension systems, including investment consolidation, asset transfers, and two-tier pension plans. While the meetings were informative, the task force was unable to reach a consensus on a set of recommendations to the legislature and Governor Quinn. At its final meeting on November 9th, the task force decided to conclude its business without a majority-approved report.

The task force report, which is now available on the Commission's web-site, contains the following highlights. (The Collective Bargaining Sub-committee produced no findings).

<u>Investments</u>

- Based upon AON Consulting's study of the Treasurer's investment consolidation proposal, the task force voted to recommend that the legislature not pursue investment consolidation. AON found that a likely outcome of such a consolidation would be a first year asset manager fee savings of approximately $21 to 35 million, with transition costs ranging from $31 to 48 million in the first two years of the consolidation.

- AON Consulting found the State systems' assumed actuarial rates of return (currently between 8-8.5%) to be reasonable, but noted that the 2007 Public Fund Survey of 125 public pension plans found a median return assumption of 8.0%; of the 125 plans surveyed, the highest investment return assumption is 8.5%, which was used by 20 of the plans. While the investment return assumption used by Illinois' plans is not unreasonable, AON concluded that an assumption of 8.25% or 8.0% might be considered more reasonable.

Benefits

- The task force studied 85 public employee retirement systems surveyed in the Wisconsin Legislative Council's 2006 Comparative Study of Major Public Employee Retirement Systems in order to determine whether Illinois' current level of benefits is in line with other states. The task force studied the age and service provisions of the 85 systems in the Wisconsin report, as well as employee contribution rates, retirement formulas, and post-retirement annuity cost-of-living adjustments. In these categories, Illinois' state-funded retirement systems were generally found to be in the statistical median.

- CGFA's actuary studied the individual components of Gov. Quinn's two-tier pension proposal and found that significant savings could be achieved over the life of the current funding plan. The areas where the most savings could be achieved are increasing the retirement age ($88.3 billion), and making salary over $150,000 not pensionable ($33.1 billion). These changes would apply to future hires only.

Funding

- The task force found that the State's failure to make its required employer contributions to the five pension systems can be traced to one simple cause: a State fiscal system that is so poorly designed that it failed for decades to generate enough revenue growth to both maintain service levels and cover the State's actuarially required employer contributions to the pension funds.

- The task force recommends that, at a minimum, the State adhere to the 1995 funding law.

- Pension Obligation Bonds should be used only when market conditions are favorable and only as a debt swap to refinance a portion of the existing unfunded liability. Repayments to bond holders should be done on a level-dollar basis and never back-loaded.

FY 2010 Investment Return Update
State Retirement Systems

FY 2010 Investment Returns - State Retirement Systems			
	October	Fiscal Year-to-date	POB Annualized Returns*
ISBI**	-1.46%	8.59%	4.77%
SURS	-1.25%	12.10%	6.25%
TRS	-0.60%	10.30%	4.70%

* Annualized returns for the period July 2003 - October 2009

** ISBI investment return figures do not include Sept. 2009 real estate, private equity, or infrastructure values