Commission on Government Forecasting and Accountability

MONTHLY BRIEFING — **DECEMBER 2008**

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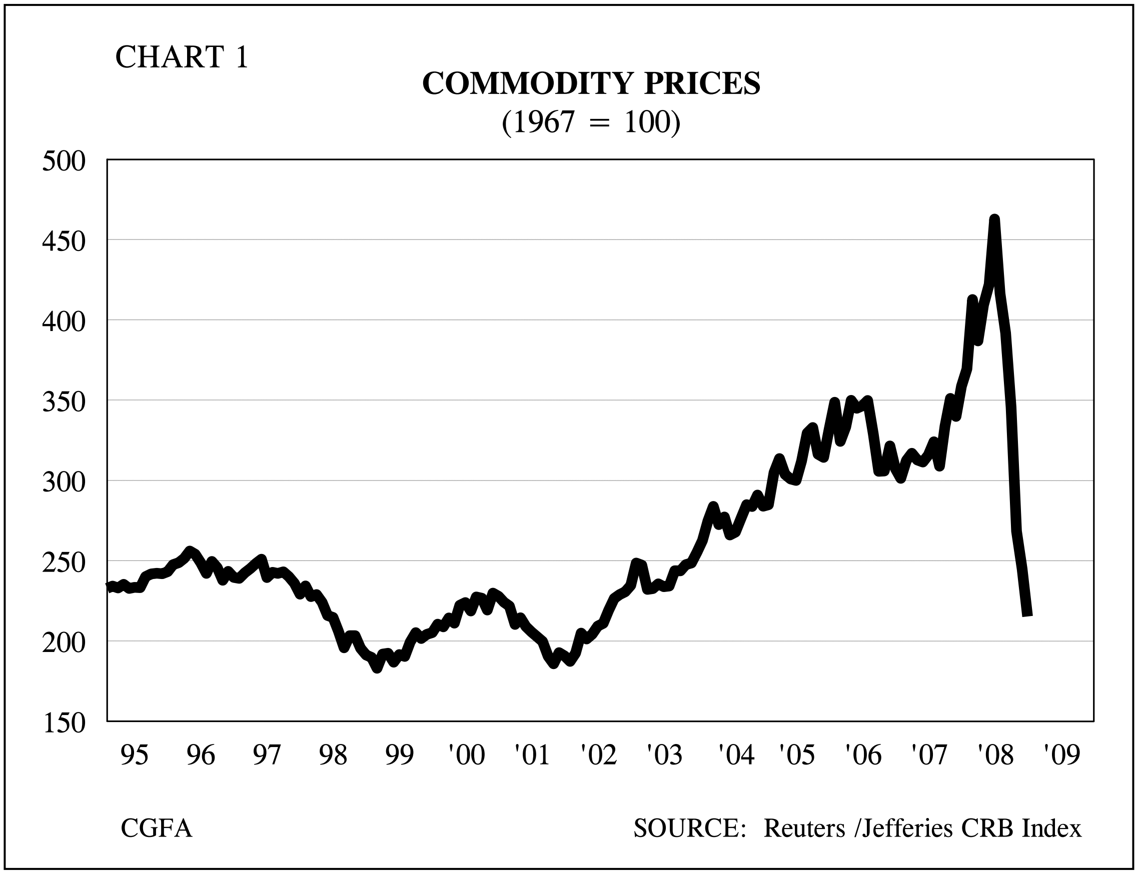
ECONOMY: Commodities Price Bubble Bursts

Edward H. Boss, Jr., Chief Economist

Commodity prices have plummeted in recent months in a manner not seen in modern times. As shown in Chart 1 on the top of the following page, after more than doubling between mid-2002 and mid- 2008, the Reuters/Jefferies CRB Index fell from a high in the middle of the year to less than half that value by year-end, an unprecedented rate of descent.

The previous surge was noted in last April's ***MONTHLY BRIEFING*** entitled, **"Commodities, the Next Bubble?"** While basic commodity prices continued to accelerate from that time till mid year, as pointed out in last April's report, *"If the economy is already in recession as some economists believe... the recent performance of commodity prices would be at variance with what occurred in similar periods. Indeed, the prolonged period of soft consumer prices in the early 2000s even brought up concerns of deflation..."* Once again such deflation concerns have surfaced.

The rapidity of the fall in the commodity price index reflects not only the recession in the U.S., as this has been going on for a year now, and similar down-turns abroad, but also the emergence of the global financial crisis of 2008. This started with failing sub prime loans as home prices declined and rapidly evolved into a global crisis resulting in a number of European bank failures, declines in various stock markets, and a loss of confidence in financial markets with banks unwilling to lend. To stem fears of a possible depression-like environment, a myriad of stimulus plans from the federal government, the bail out of many investment banks and funds to the auto industry, coupled with extreme liquidity measures taken by the Federal Reserve were instituted with further simulative actions likely in the New Year.



In addition to the global credit crises and world recessions, the sharp fall in the commodity price index reflects the makeup of the index itself. The Reuters/Jefferies CRB Index is comprised of 19 commodities, each weighed by its importance. The measure includes oil and related products (crude oil, natural gas, heating oil, and unleaded gasoline); metals (aluminum, copper, nickel and precious metals, gold and silver); agricultural products (corn, soybeans, wheat, cotton, sugar, cocoa, coffee and orange juice); and meats (live cattle and related products and lean hogs).

A significant factor in the divergence of commodity prices this time verses similar periods in the past can be attributed to the relative weights, or importance, given to its components. There can be little doubt that a major factor is the wild swings in oil prices that have occurred. Crude oil prices have a weight of 23%, unleaded gas 5%, and heating oil 5%. Thus, oil prices directly impact a third of the entire index. And oil prices have fallen from a high of $147 a barrel in July to around $35-$40 recently, a drop of 76%, while the national average gasoline price has fallen from a peak of over $4 per gallon in July to $1.60 recently. These declines were disproportionably large in comparison to most of the declines in other components of the Index. This is not to say that there have not been other large declines, but rather that as a category they would not be as great as the energy sector. For example, copper prices have fallen from a high of about $4 per pound to about $1.30 currently, although other metal prices, particularly precious metals, while down have shown significantly lesser percentage declines. Similarly, prices on many agricultural products have moved off from their highs, but again to a lesser degree than energy prices.

While most consumers bathe in the excitement of lower gasoline prices, one must be careful of what they wish for. The plunge in commodity prices is a symptom of the dire economic conditions that exist today. Now that we have returned to lower price levels, it is hoped that some stability can be achieved so that the economy can resume growth in the future without the deleterious effects of deflation.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	NOV. 2008	OCT. 2008	NOV. 2008
Unemployment Rate (Average)	7.3%	7.3%	5.3%
Annual Rate of Inflation (Chicago)	-2.0%	-11.7%	-24.2%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (November)	6,641	-1.0%	-1.4%
Employment (thousands) (November)	6,155	-0.1%	-3.5%
New Car & Truck Registration (November)	28,077	-36.2%	-23.5%
Single Family Housing Permits (November)	662	-34.9%	-52.0%
Total Exports ($ mil) (October)	4,784	-0.9%	5.8%
Chicago Purchasing Managers Index (December)	34.1	0.9%	-38.2%

Short-Term Borrowing

Lynnae Kapp, Bond Analyst

Cash Flow Pressures: The State competitively bid $1.4 billion in General Obligation Certificates in December 2008. Proceeds were deposited into the General Revenue Fund to relieve cash flow pressures. The certificates will be paid back in three installments, in April, May and June of 2009. The competitive bid process was extended until December 16, 2008, to allow for language to be rewritten concerning the federal complaint against the Governor and possible litigation, to be signed off by the Attorney General. Due to lowered ratings on the G.O. Certificates and the State's G.O. bonds, the Governor's arrest, the State's $2 billion deficit, and the economy, broker-dealer interest in the Certificate sale declined. Of the few bids, J.P. Morgan won the three maturities at an average yield to the State of 3.99%, a large increase compared to the 1.94% and 2.1% paid on last Spring's $1.2 billion G.O. Certificate sale. Debt service will be approximately $26.7 million for the $1.4 billion Certificates compared to only $3.5 million for the April 2008 $1.2 billion Certificates.

G.O. Bond Ratings In December 2008, Fitch Ratings downgraded Illinois' G.O. bonds from an AA to an AA- with a stable outlook, stating that "the rating downgrade reflects deterioration of the state's fiscal position and a continuing inability to achieve solutions…given the controversy and uncertainty surrounding the Governor's situation, as well as the inability last fiscal year, and so far this year, to achieve a consensus on corrective measures, it is unclear at this time how budgetary solutions will move forward and be implemented". [www.fitchratings.com, "Fitch Downgrades Illinois' GO Bonds to 'AA-'; Outlook Stable", December 15, 2008]

Also in December, Standard and Poor's put Illinois' G.O. bonds on its credit ratings watch list for a possible negative downgrade. "The CreditWatch placement reflects our opinion of the state's growing budgetary shortfall, now projected at $2.0 billion for the current fiscal year, and our concern that the legal charges now facing the governor and his chief of staff may challenge the state to respond to this fiscal situation on a timely basis." [www.ratingsdirect.com, S&PCORRECTED: "Illinois' GO Rating Placed On CreditWatch Negative", December 11, 2008].

Moody's reaffirmed the State's Aa3 rating with a stable outlook, while giving the State's G.O. Certificates a MIG 2 rating, lower than the MIG 1 ratings given to the G.O. Certificates of April 2008 and September 2007.

HISTORY OF SHORT TERM BORROWING			
Date Issued	Amount (millions)	Purpose	Date Retired
June-July 1983	$200	To maintain adequate cash balances caused by revenue shortfalls	May 1984
February 1987	$100	To improve the cash position of the General Funds	February 1988*
August 1991	$185	For cash flow purposes	June 1992
February 1992	$500	To pay Medicaid providers through the Medicaid Developmentally Disabled Provider Participation Fee, Medicaid Long-Term Care Provider Participation Fee, and Hospital Services Trust Funds	October 1992*
August 1992	$600	To improve the payment cycle to Medicaid service providers	May 1993
October 1992	$300	For cash flow purposes	June 1993
August 1993	$900	For cash flow to pay Medicaid service providers through the Hospital Provider Fund	June 1994
August 1994	$687	To pay Medicaid service providers through the Long-Term Care and Hospital Provider Funds	June 1995
August 1995	$500	To GRF for cash flow and payment to Medicaid service providers through the Long-Term Care Provider Fund and Hospital Provider Fund	June 1996
July 2002	$1,000	For Cash Flow; payments for medical assistance; to medical providers for long-term care; to pay Income Tax Refunds	June 2003
May 2003	$1,500	For Cash Flow; payments for medical assistance; to medical providers for long-term care; for Income Tax Refunds; for State Aid to K-12 school districts	May 2004*
June 2004	$850	For Medicaid service providers and the Children's Health Insurance Program	October 2004*
March 2005	$765	For Cash Flow; for payments to Medicaid Service Providers through the Hospital Provider Fund.	June 2005
November 2005	$1,000	For Cash Flow; for payments for Medicaid and the Children's Health Insurance Program.	June 2006
February 2007	$900	For the Hospital Provider Assessment Tax Program; health care related funds; General Revenue Fund liquidity.	June 2007
September 2007	$1,200	For the Hospital Provider Assessment Tax Program; health care related funds; General Revenue Fund liquidity.	November 2007
April 2008	$1,200	For the Hospital Provider Assessment Tax Program; health care related funds; General Revenue Fund liquidity.	June 2008
December 2008	$1,400	To relieve General Revenue Fund cash flow pressures.	June 2009
Source: Office of Management & Budget *Across fiscal year borrowing			

Update on the 10th Riverboat License

Eric Noggle, Sr. Revenue Analyst

On December 22nd, the Illinois Gaming Board announced that they have awarded its 10th gambling license to Midwest Gaming LLC, which plans to build their casino in Des Plaines. The location in Des Plaines was chosen over two other finalist bidders in Rosemont and Waukegan.

The Illinois Gaming Board's five-member board voted 3-1 for the Des Plaines location with one member voting for Waukegan and one member declining to vote because he felt that all of the proposals were "unacceptable". The Des Plaines proposal includes $704 million worth of investments that will consist of a casino, four restaurants, a parking garage, and eventually a 10,000-square-foot night club.

Midwest Gaming was selected despite the fact that their proposal offered the lowest upfront bid of the three finalists. Des Plaines pledged to pay $125 million, which was higher than their $100 million initial offer, but significantly lower than the other finalists (Waukegan at $225 million and Rosemont at $435 million). However, Midwest also agreed to pay the State an additional $300 million to be paid at about $10 million per year over 30 years.

The value of the winning bid is noteworthy because of how it compares to bids from the previous application process. In 2004, the Isle of Capri Casinos Inc. was selected to operate the 10th riverboat license with a winning bid of $518 million, which is significantly higher than Des Plaines' upfront pledge of $125 million. Furthermore, according to the FY 2009 Budget Book, "a one-time payment of $575 million is anticipated in fiscal year 2009 in payment for the license fee from the 10th riverboat license." Therefore, Des Plaines' upfront pledge will be well short of the $575 million estimate to which the FY 2009 Budget was predicated upon.

While the new revenues that will be generated from this 10th license will be indeed welcomed, it may be several months or perhaps years before any new revenues will be receipted. This is because Gaming Board investigators must first conduct a six to twelve month review of the winning bid to make sure all Midwest Gaming's investors and key employees meet State regulation guidelines. Even after final approval is granted, reports are that it will take approximately 15 months for the new riverboat to be built and become active. And this, of course, assumes that no new lawsuits regarding this 10th riverboat selection appear.

Assuming, then, that the investigative process lasts more than 6 months, it appears that the initial bid amount of $125 million will not be paid in FY 2009 and will be paid in FY 2010 instead, adding another obstacle to the FY 2009 budget. The new recurring revenues generated by the new Des Plaines casino likely, then, will not be anticipated until some time in FY 2011.

Streamlined Sales and Use Tax

Benjamin Varner, Revenue Analyst

The Streamlined Sales and Use Tax (SST) Agreement was a reaction by the States to attempts by Congress to prohibit states from collecting taxes on on-line sales in early 2000. Tax collections from on-line sales were seen as not required due to the complexity of doing so as outlined in a 1992 Supreme Court ruling (Quill Corp. V. North Dakota, 504 U.S. 298) related to mail order sales.

As described by the Streamlined Sales Tax Governing Board, the purpose of the Streamlined Sales and Use Tax Agreement (SST) is to provide a road map for states who want to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance. The Agreement focuses on improving sales and use tax administration systems for all sellers and for all types of commerce through all of the following:

A. State level administration of sales and use tax collections.
B. Uniformity in the State and local tax bases.
C. Uniformity of major tax base definitions.
D. Central, electronic registration system for all member states.
E. Simplification of State and local tax rates.
F. Uniform sourcing rules for all taxable transactions.
G. Simplified administration of exemptions.
H. Simplified tax returns.
I. Simplification of tax remittances.
J. Protection of consumer privacy.

In short, the SST agreement is a voluntary sales and use tax collection system that allows sellers to collect the required taxes on their sales based on a destination based sourcing scheme. The agreement was to take affect in member states once ten states had passed laws to come into compliance with the agreement. The SST agreement went into affect in October of 2005.

The SST agreement essentially does three things that simplify the collection of sales and use tax from sellers.

1. The SST contains thorough tax base definitions that makes these definitions uniform from state to state.

2. The SST sets up three technology models using certified sales tax administration software with which sellers can pay required taxes to all the member states in the SST. The three technology models are:

<u>Model 1</u>

A certified Service Provider performs all the seller's sales and use tax functions. The Streamlined Sales Tax Governing Board lists four companies as Certified Service Providers. These providers include Avalara, Exactor, ADP Taxware, and SpeedTax.

<u>Model 2</u>

A Certified Automated System which uses third party sales tax software that is certified under the SST that allows sellers to remit sales and use tax on their own.

Model 3

The final model allows sellers to develop their own sales and use tax software which is certified by the SST.

3. The SST requires registered sellers to source sales of property, services and digital goods on a destination basis. This means that tax revenue would be remitted to the local and state tax districts where the property is delivered or where a service is performed, not where the seller is located.

According to the Streamlined Sales Tax Governing Board, there are nineteen full member states and three associate member states. A full member state is a state that is in compliance with the Streamlined Sales and Use Tax agreement through its laws, rules, regulations, and policies.

An associate member state is either (a) a state that is in compliance with the Streamlined Sales and Use Tax Agreement except that its laws, rules regulations and policies to bring the state into compliance are not in effect but are scheduled to take effect on or before July 1, 2009, or (b) a State that has achieved substantial compliance with the terms of the Streamlined Sales and Use Tax Agreement taken as a whole, but not necessarily each provision, and there is an expectation that the state will achieve compliance by July 1, 2009.

Full Member States

Arkansas	North Carolina
Indiana	North Dakota
Iowa	Oklahoma
Kansas	Rhode Island
Kentucky	South Dakota
Michigan	Vermont
Minnesota	Washington
Nebraska	West Virginia
Nevada	Wyoming
New Jersey	

Associate Member States

Ohio
Tennessee
Utah

As of February 2008, the National Conference of State Legislatures (NCSL) states that six other states had legislation introduced to have those states come into compliance with the Streamlined Sales and Use Tax Agreement. Those states were Florida, Illinois, Hawaii, Massachusetts, Missouri, and Wisconsin.

Streamlined Sales and Use Tax legislation has been introduced numerous times in recent years in Illinois. The latest attempt was in SB 1429 of the 95th General Assembly. Due to changes in definitions and new taxation of E-commerce in this legislation, the Department of Revenue predicted additional sales and use tax revenue on:

1. Prewritten Computer Software ($0 to $20 million),
2. Grooming and Hygiene products ($5 million to $10 million),
3. Soft Drinks ($11.4 million),
4. Internet Sales (unknown).

Prior internet sales studies by Ernst and Young and university researchers have shown a wide range of potential tax revenue loss to states. While research is limited, it is believed that University of Tennessee researchers are expected to update a 2004 study in the near future. Recent discussions with the National Conference of State Legislatures (NCSL) indicated that the previous studies estimates were on the high side.

REVENUE
December Revenues Grow Due To Federal Sources
Other Sources Mixed

Jim Muschinske, Revenue Manager

December revenues grew $275 million as higher reimbursable spending made possible by $1.4 billion in short-term borrowing caused federal sources to jump $379 million. Most of the other revenue sources were mixed; although on balance were negative. December had the same number of receipt days as last year.

Gross personal income tax managed to post a $75 million gain, or $67 million net of refunds. Insurance taxes and fees increased $37 million, in part due to the timing of receipts. Public utility taxes grew by $21 million, while inheritance managed to post a $4 million gain.

Despite the overall monthly increase, a number of sources experienced declines in December. Gross corporate income taxes fell $89 million, or $74 million net of refunds. However, part of that decline can be attributed to last year's receipt activity which saw a stronger month due to a computer system conversion at the Department of Revenue. Similarly, the $68 million decline in sales taxes reflects last year's reconciliation due to a previous misallocation of sales tax revenues. The Cook County IGT fell $16 million due to timing issues, interest income dropped $13 million due to lower rates of return and investable balances, and liquor taxes dipped $2 million.

Overall transfers fell $60 million in December. Riverboat transfers continued their disappointing performance, falling $40 million. Other transfers dropped $10 million, while Lottery transfers eked out a $1 million gain. As mentioned, $1.4 billion in short-term borrowing enabled significant reimburseable spending in December, which resulted in a $379 million gain in Federal sources.

Year to Date

Through the first half of the fiscal year, overall base revenues are down $477 million. The majority of the decline is attributed to much lower transfers—down $256 million as well as overall weakness in a number of sources. In fact, only three sources have been able to post a year to date gain over the previous year, underlining the weakness in the revenue picture.

To date, interest income is down $84 million, as much lower rates of return have decimated this source's performance. Sales tax is down $81 million, and continues to reflect lackluster performance amid troubling auto sales and consumer sentiment. Gross corporate income tax is down $32 million, or $27 million net of refunds. The Cook County IGT is down $22 million, while other sources are off by $14 million. Corporate franchise is behind by $10 million and the vehicle use tax has dipped $3 million.

The sources experiencing gains over the first half of the fiscal year are few. Public utility taxes are doing well and are up $45 million. Gross personal income tax is up a very modest $33 million, or $30 million net of refunds. Lastly, insurance taxes and fees are ahead by $25 million.

Through December, overall transfers continue to lag last year's levels. Other transfers are off $123 million, gaming transfers are down by $120 million, and lottery transfers by $13 million. Federal reimbursements, after surging in December due to the short-term borrowing, still are behind last year's pace by $24 million.

GENERAL FUNDS RECEIPTS: DECEMBER

FY 2009 vs. FY 2008
($ million)

Revenue Sources	Dec. FY 2009	Dec. FY 2008	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$848	$773	$75	9.7%
Corporate Income Tax (regular)	231	320	($89)	-27.8%
Sales Taxes	646	714	($68)	-9.5%
Public Utility Taxes (regular)	106	85	$21	24.7%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	12	14	($2)	-14.3%
Vehicle Use Tax	2	2	$0	0.0%
Inheritance Tax (Gross)	32	28	$4	14.3%
Insurance Taxes and Fees	58	21	$37	176.2%
Corporate Franchise Tax & Fees	15	15	$0	0.0%
Interest on State Funds & Investments	2	15	($13)	-86.7%
Cook County IGT	0	16	($16)	-100.0%
Other Sources	27	27	$0	0.0%
Subtotal	$2,008	$2,059	($51)	-2.5%
Transfers				
Lottery	60	59	$1	1.7%
Riverboat transfers & receipts	20	60	($40)	-66.7%
Other	20	41	($21)	-51.2%
Total State Sources	$2,108	$2,219	($111)	-5.0%
Federal Sources	$612	$233	$379	162.7%
Total Federal & State Sources	$2,720	$2,452	$268	10.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($83)	($75)	($8)	10.7%
Corporate Income Tax	($41)	(56)	$15	N/A
Subtotal General Funds	$2,596	$2,321	$275	11.8%
Short-Term Borrowing	$1,400	$0	$1,400	N/A
Hopital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$3,996	$2,321	$1,675	72.2%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 5-Jan-09

GENERAL FUNDS RECEIPTS: YEAR TO DATE FY 2009 vs. FY 2008 ($ million)				
Revenue Sources	**FY 2009**	**FY 2008**	**CHANGE FROM FY 2008**	**% CHANGE**
State Taxes				
Personal Income Tax	$4,564	$4,531	$33	0.7%
Corporate Income Tax (regular)	743	775	($32)	-4.1%
Sales Taxes	3,645	3,726	($81)	-2.2%
Public Utility Taxes (regular)	559	514	$45	8.8%
Cigarette Tax	175	175	$0	0.0%
Liquor Gallonage Taxes	82	82	$0	0.0%
Vehicle Use Tax	15	18	($3)	-16.7%
Inheritance Tax (Gross)	144	200	($56)	-28.0%
Insurance Taxes and Fees	139	114	$25	21.9%
Corporate Franchise Tax & Fees	106	116	($10)	-8.6%
Interest on State Funds & Investments	33	117	($84)	-71.8%
Cook County IGT	65	87	($22)	-25.3%
Other Sources	182	196	($14)	-7.1%
Subtotal	$10,452	$10,651	($199)	-1.9%
Transfers				
Lottery	294	307	($13)	-4.2%
Riverboat transfers & receipts	250	370	($120)	-32.4%
Other	178	301	($123)	-40.9%
Total State Sources	$11,174	$11,629	($455)	-3.9%
Federal Sources	$2,343	$2,367	($24)	-1.0%
Total Federal & State Sources	$13,517	$13,996	($479)	-3.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($445)	($442)	($3)	0.7%
Corporate Income Tax	($130)	($135)	$5	-3.7%
Subtotal General Funds	$12,942	$13,419	($477)	-3.6%
Short-Term Borrowing	$1,400	$1,200	$200	N/A
Hospital Provider Fund (cash flow transfer)	$0	$300	($300)	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	0.0%
Total General Funds	$14,618	$15,195	($577)	-3.8%

SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.
CGFA 5-Jan-09