

***ILLINOIS ECONOMIC
and
FISCAL COMMISSION***

***A Report to the Joint Committee
On Legislative Support Services***

***SUSPENSION OF MOTOR
FUEL SALES TAX***



NOVEMBER 2000
703 Stratton Office Building
Springfield, Illinois 62706

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MOTOR FUEL GAS TAX SUSPENSION

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GENERAL ASSEMBLY
STATE OF ILLINOIS

June 29, 2000

Mr. Dan R. Long, Executive Director
Illinois Economic and Fiscal Commission
703, Stratton Office Building
Springfield, IL 62706

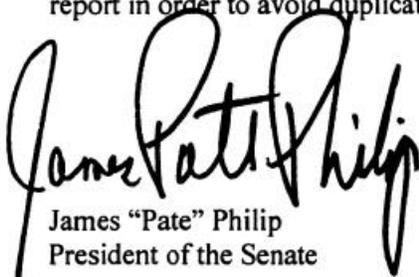
Dear Mr. Long:

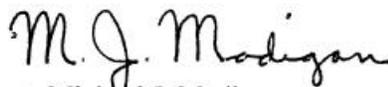
The Joint Committee on Legislative Support Services is directing the Economic and Fiscal Commission to report to the General Assembly no later than November 14, 2000 on the impact of the 5% Sales Tax reduction in Motor Fuel. The report should include and not be limited to the following:

- a) if the reduction in the State Sales Tax was passed through to motorists;
- b) if the reduction was maintained throughout the period;
- c) if the Sales Tax reduction resulted in an increase in total gallons of motor fuel sold and whether or not there was an increase in ancillary sales (food, beverages, lottery tickets, etc.) at retail motor fuel establishments; and
- d) whether the 5% State Sales Tax reduction can be reflected on any receipt provided to the consumer.

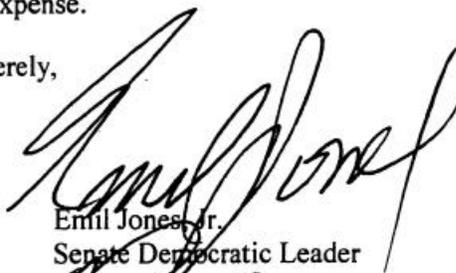
As outlined in 25 ILCS 155/6, all State officers and agencies shall provide to the Commission any assistance that may be required by the Commission in preparing the report.

The Commission should, to the fullest extent possible, utilize the services, facilities, and information of other government agencies and of private research agencies in preparation of this report in order to avoid duplication of effort and expense.


James "Pate" Philip
President of the Senate


Michael J. Madigan
Speaker of the House of Representatives

Sincerely,


Emil Jones, Jr.
Senate Democratic Leader


Lee A. Daniels
House Republican Leader

Executive Summary

The following summarizes the Commission's findings regarding the Joint Committee's request for information pertaining to the six-month suspension of the State's 5% sales tax on motor fuel. While the Committee's request was quite specific as to what issues should be examined, we have supplied additionally in the report a rather in depth analysis as to factors which led up to the motor fuel price emergency in late spring.

As the Committee will note, data limitations, both in terms of quantity and quality restricted the Commission's ability to draw substantial conclusions at this time. Several more months of data would be required before any sustainable trends could be verified and, even then, data problems likely would still exist. With these caveats, please find the following executive summary. A more extensive discussion of the various elements may be found in the body of the report.

Was the reduction in the State sales tax passed on through to motorists?

While our findings are inconclusive as to whether the total savings in sales taxes were immediately passed on to motorists, data suggest that the suspension of the tax did contribute to the lowering of pump prices at the time the sales tax suspension took place. However, the degree to which the reduction was passed on to motorists cannot be precisely measured. A mitigating factor that severely limits this analysis is the fact that wholesale prices were falling at the same time the sales tax suspension went into effect. It is not possible to accurately assign what amount of that price change was due to the tax suspension and what amount was due to lower wholesale prices.

In addition to the complications associated with a simultaneous drop in wholesale price, several other limiting factors include significant swings in wholesale as well as retailer margin (gross profits), and retailer fuel capacity. These items will be discussed in more detail within the report.

It should be noted that in a survey conducted by the Commission on Illinois motor fuel retailers, approximately 90% responded that they decreased their fuel price at least 6 cents after July 1, 2000. Due to the vested interest of these retailers, interpretation of the survey findings must be done cautiously. However, the high percentage indicating a price reduction due to the sales tax suspension indicates that some reduction was passed on to motorists.

Was the reduction in sales tax maintained throughout the period?

Many of the same limiting factors pointed out above, namely swings in wholesale and retailers margin, again limit the ability to reach definite findings. However, based on the available wholesale and margin data, it would appear that whatever impacts the

suspension of the sales tax on motor fuel had on the price of fuel, it has been maintained thus far.

Did the sales tax suspension on motor fuel result in an increase in total gallons of motor fuel sold?

Of the limited data that exist, no identifiable relationship is evident thus far. Clearly several more months of data are needed before even preliminary conclusions can be drawn as the availability of gallonage data lags by approximately two months.

While 35% of survey respondents indicated that their fuel volume increased between 5 and 10% and another 25% indicated an increase in the amount of fuel sold by 0 to 5%, those claims cannot thus far be substantiated. Indeed, if gallonage increases did take place, it would likely occur near border locations where competition between other states commonly occur. The Commission's survey was targeted at those types of locations for the most part, and as a result, the respondents' claims would not necessarily be similarly reflected in aggregate gallonage reports.

Was there an increase in ancillary sales (food, beverages, lottery tickets, etc) at motor fuel establishments?

While only a couple of months of data exist, the largest drawback is that prior to the sales tax suspension on motor fuel, motor fuel sales were part of the sales figures reported on the retailers sales tax return. (After the tax suspension, motor fuel is now broken out separately from other sales.) As a result, there is no way to accurately compare periods before and after the tax suspension.

According to the survey of motor fuel retailers, approximately 31% responded that their ancillary sales increased between 0 and 5%, while another 27% said they increased 5 to 10%. Again, interpretation of the survey data is difficult given the vested interest these station owners have.

However, it's very possible that some establishments, particularly located on the border, may have seen a noticeable increase in sales. Unfortunately, at this time little data exist that would substantiate those claims. In fact, based on the estimated impact of \$175 million in lost sales tax over the six-month period, overall sales tax revenues have performed very close to projections. As a result, it does not appear that a measurable impact on ancillary sales has been felt.

Can the 5% State sales tax reduction be reflected on any receipt provided to the consumer?

It would be possible to indicate on a receipt what the savings were based on the suspension of the tax. However, in order to do so, retailer software would have to be modified to calculate the differential between what the total sale was versus what the sale would have been had the State's 5% sales tax still been imposed.

Introduction

On July 1st, 2000, the State of Illinois temporarily suspended the 5% State Sales Tax on Motor Fuel. This reduction was enacted to help alleviate the record high costs of motor fuel seen in Illinois during the late spring and early summer. The reasons for these high costs stemmed from a number of factors including: supply shortages, pipeline problems, and the disruptions stemming from the process of transitioning to a new form of gasoline.

The 5% reduction in the State sales tax, estimated to cost approximately \$175 million, was intended to lower the cost of motor fuel between 6 and 10 cents per gallon. Though prices did decline as the tax break took effect, there were questions on whether this reduction was actually passed on to the consumer. If passed on to the consumers, many questioned whether the reduction would be maintained throughout its existence. Proponents felt that eliminating the State portion of the motor fuel sales tax would not only assist consumers, but would increase motor fuel sales, as well as ancillary sales at retail motor fuel establishments in the State of Illinois.

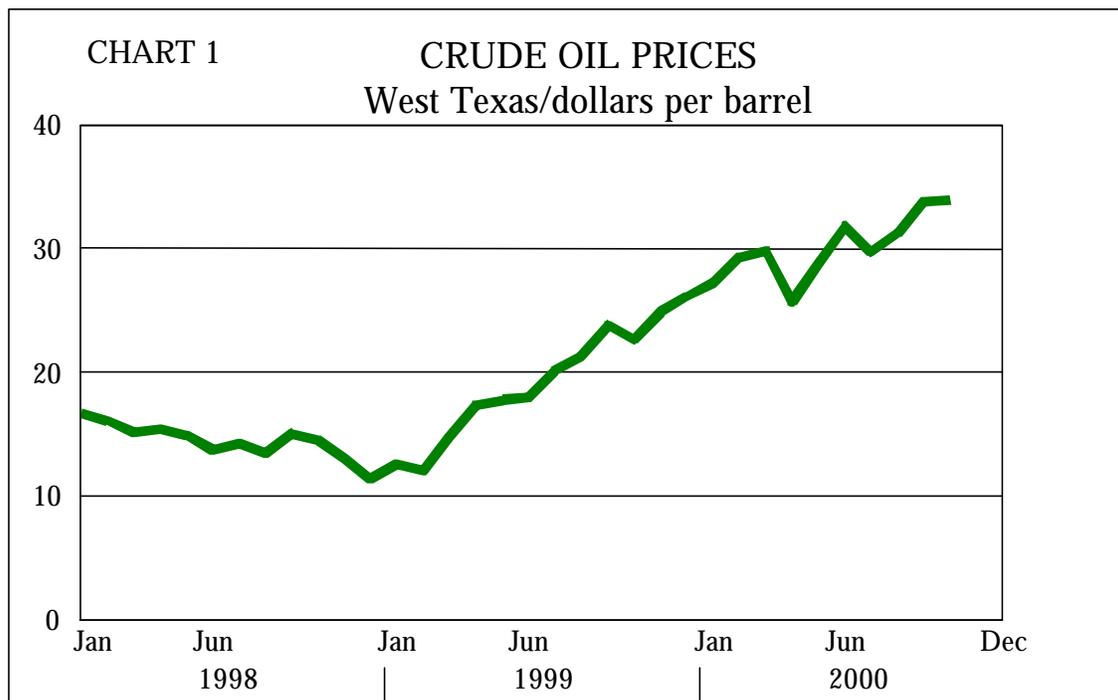
In response to these issues, the Illinois Economic and Fiscal Commission, as directed by the Joint Committee on Legislative Support Services, completed the following. The report gives a brief description on the economic impact of rising oil prices, explains how crude oil becomes gasoline, and discusses what effects each stage of this process has on the price of gasoline. Relevant information from the Federal Trade Commission's investigation on the causes of the sharp rises in gasoline prices in the Midwest also will be presented.

Finally, the report examines the specific issues outlined in the Joint Committee's directive. It should be noted that the Department of Revenue, as well as the Illinois Lottery provided expert assistance to the Commission in several areas. Their assistance was greatly appreciated. In addition, the Commission conducted a survey of motor fuel retail establishments. While some findings will be discussed throughout the report, entire results of the survey are provided in a separate section.

The Economic Impact of Rising Oil Prices

It is difficult to assess with any degree of accuracy the ultimate impact of the current disruption on the economy caused by widely fluctuating world oil prices. Much of the final effect will depend not only on how high oil prices go, but how long they are sustained at high levels, as well as what responses or disruptions are forthcoming.

As shown in Chart 1, oil prices have been on an almost continuous rise since early 1999, hitting a 10-year high of \$37.20 per barrel on the day of September 20, 2000. In response to high prices and concerns about sharply increasing home heating costs, particularly in the Northeast this winter, the Administration announced plans to release oil from the U.S. strategic petroleum reserve. This would be only the second time these reserves were tapped since being established by the Ford Administration, the first time occurring during the Gulf War.



Following the U.S. announcement of its intentions, world oil prices eased with the benchmark West Texas Intermediate Crude falling from its high of \$37.20 on Wednesday, September 20th to \$30.83 on Friday, September 29th. Oil prices firmed again in October as Europe announced it had no plans to follow the U.S. by cutting into its reserves and hostilities in the Middle East brought worries over possible disruptions to the flow of oil. Thus, WTI oil prices averaged just below \$34 a barrel during October.

While Saudi Arabia has pledged to supply more oil if needed to stabilize prices, other OPEC members have been less enthusiastic. Many blame high fuel taxes leveled by industrialized nations as the cause for high consumer prices and the need for a **fair** oil price for producers. At the extreme, reports from Iran threaten to match any further U.S. oil release from its strategic reserves by reducing their production.

Oil and the Economy

Each of the last three recessions has been caused, in part, by oil-related developments. Moreover, DRI/McGraw Hill, IEF's forecasting service, has increased its probability of a near-term recession to 25% from 15% last month and only 10% where it had been as recently as July. Thus, a jump in energy prices is certainly a concern.

Part of the oil price shock relates to its current price relative to its price in early 1999 when the Asian crisis slashed demand and brought oil prices down to about \$11 to \$12 a barrel. Thus, we have seen more than a tripling of that price, although since 1985 oil prices have averaged \$23 per barrel, as measured by DRI who uses refiners' acquisition cost measured in 2000 prices, deflated by the core CPI.

Also, it should be pointed out that while we are more and more dependent upon oil imports to meet U.S. demand, overall, oil is less important today as we shift from a manufacturing to service-based economy. According to DRI, the nation's crude oil bill was 6.5% of gross domestic product (GDP) in 1981 whereas today, even with currently higher prices, its share is expected to be 2% of GDP in 2000.

Data Resources recently has run a simulation using different oil price assumptions. In its baseline, or most-likely scenario, oil prices fall back to the \$25 range and the real economy grows 3.6% from the fourth quarter of 2000 to the fourth quarter of 2001. In its second alternative, it assumes oil prices rise to \$40 (WTI basis) per barrel and hold there. Under this scenario, higher oil prices reduce real growth in 2001 from 3.6% to 2.7% - a significant, but not catastrophic event.

Oil and the Consumer

Much attention is focused on the effect rising energy prices will have on the consumer. After all, two thirds of total spending that makes up GDP consists of consumer spending. Again, consumer reaction to higher energy prices is dependent upon both the extent as well as sustainability of the energy price increase. According to DRI, consumers bought 1.5% less gasoline in the first half of 2000 compared to the same period a year earlier, but spent one-third, or \$40 billion, more for it. This represents only 0.6% of total consumer spending, although that's \$40 billion not spent at retail stores.

The first consumer reaction to oil above \$25 a barrel was that, based upon recent fluctuations, it would be temporary and, therefore, there was no need to adjust family

budgets. Indeed, despite rising gasoline prices, a flat stock market, and slower income growth, consumer confidence remained strong and only slightly off its peak according to recent surveys. More worrisome is the recent threat of soaring home heating oil prices which some project to rise by 40%, 50%, or even double this winter. Moreover, even with the release of U.S. energy oil reserves there is no assurance that supplies of home heating oil will increase much given the declining number of U.S. refineries, which already are operating in excess of 95% capacity, and that only a small percentage of that is distilled for home heating oil.

Sharply rising oil prices have been a factor in reducing corporate profit projections as firms cannot pass on higher energy prices because of competitive markets which then eat into profit margins. This, in turn, has had a negative effect on the stock market which has cut in consumer wealth positions and is likely to worsen confidence and retard spending further.

The effect on the economy and consumer of higher energy prices depends on the degree of the increase in oil prices and how long the high prices remain. Whether recent jawboning and government actions do more than ease prices in the short-term or are offset by a negative response from the oil-producing nations is unclear.

While oil prices have tripled since early 1999, in real terms they are still well below their peak price of the 1980s. Also, oil as a portion of the economy has lessened and is somewhat less important than twenty years ago. At the same time, U.S. refining capacity is topped out and exploration and drilling dried up, so we as a country are relying more on imported oil than at any time in our history. Furthermore, there have been no efforts to date to provide incentives to domestic supplies which will be needed in the long run to prevent recurrence of the current oil situation as well as supply the energy for continued growth in the economy.

Finally, the effect on the high oil price on the economy cannot be discussed in isolation. The higher prices act like a tax increase on consumers at a time when the economy is already showing signs of slowing due to more restrictive fiscal and monetary policies.

From the Well to the Pump

Understanding the fluctuation of gasoline prices requires a basic knowledge of the oil production cycle process. Gasoline is made up of various hydrocarbons derived from petroleum. Petroleum can be found all over the world, but is heavily produced in the Middle East. It can be found either on land or off shore. Though the exploration technology of petroleum has improved over the years, it still can be affected by natural occurrences, such as storms, hurricanes, or even difficult terrain. These problems can cause difficulty in exploration, resulting in higher-than-normal exploration costs.

Once the petroleum has been located, the substance must be transported to the next stage of the gasoline process. The movement of crude oil is accomplished through various means of transportation. Crude oil from overseas is transported through the shipping process. After the Exxon Valdez disaster in 1989, the shipping of crude oil has seen many improvements such as double hulls, segregated ballast tanks, and redundant steering systems. These changes have made oil tankers safer and more reliable. However, these improvements are costly, which can affect the price structure of gasoline.

When transporting petroleum over land, trucks can be utilized, but much of the petroleum is moved by pipeline. This is considered the most cost-effective means of transferring crude oil from port facilities to tankers. Although cheaper, pipeline operators still incur operating and labor costs, as well as various maintenance fees. If a pipeline should break, the cost of gasoline can be significantly affected. An example of this will be discussed later in the report.

Transportation costs can vary depending on the distance from place to place. Obviously, it costs more to ship oil from the Middle East to the U.S. than it does from countries in South America. There are also added costs if a tanker is too large to dock and must be unloaded at an offshore facility.

Another factor that can affect the cost of transporting fuel is war. For example, fighting in the Middle East or even the threat of war can cause insurance rates to dramatically increase due to the higher likelihood that oil shipments could be interrupted. Higher insurance rates equate to higher oil prices. War can also affect gasoline prices in situations where a large-scale military operation is underway, and there is a high demand for jet fuel. A high demand for fuel relative to its availability causes prices to increase.

Once the petroleum has been transported, it is ready to be produced into gasoline. There are many hydrocarbons in petroleum, but only the ones that can evaporate under engine conditions can be used in gasoline. Because crude petroleum consists of hydrocarbons that are both more and less volatile than gasoline, gasoline must be separated from petroleum through a process called distillation. Distillation, however, provides an amount and quality of gasoline that is considered insufficient. Therefore,

gasoline production must be supplemented with more sophisticated refinery processes. These processes take the less and more volatile petroleum hydrocarbons and turn them into hydrocarbons that have the correct volatility. The refinery process also adds specialty chemicals to the blend to enhance the performance of the hydrocarbons. Through this, gasoline can be created to have the desirable characteristics necessary for good engine performance.

Basic refining costs can run anywhere from 50 cents to \$3 a barrel. However, when refining the gasoline, environmental laws add additional costs to this process. In order to have cleaner exhaust emissions, hazards such as lead and benzene must be removed from the fuel. Removing lead costs approximately 2 to 3 cents a gallon of gas. There is also discussion on a new regulation that would require the removal of sulfur from gasoline. The estimated cost of this process is anywhere from 1 to 5 cents per gallon.

Once the gasoline is produced, it is ready to be distributed to retailers. Again, transportation is needed for this to be accomplished. Ironically, the cost of transporting gasoline through fuel trucks depends on the cost of gasoline. If gasoline prices increase, the cost of transporting the gasoline also increases, resulting in the costs being passed on to the consumer. Again, the cheapest way to transport gasoline in the United States is through the dozens of pipelines that crisscross the country. The 5,349-mile Colonial pipeline system between New York and Houston carries approximately 80 million gallons of petroleum products a day.

Once at the retailers, even more costs are added to the price of gasoline. There are several factors that contribute to these added costs. The first is for the general upkeep of running a gasoline station. This would include costs for maintenance, employee salaries, insurance, property taxes, as well as profit margins. The amount of this added cost varies from retailer to retailer.

For example, according to a MSNBC.com report entitled "Gasoline Price Mysteries Revealed," three gas stations within a mile of each other in the State of Washington were selling self-serve regular gasoline at different rates. One independent owner-operator was selling self-serve regular for \$1.61 a gallon, while a dealer owned station was charging 4 cents a gallon more for the same octane. The reason for the difference was that the independent pays a mortgage for the property, purchases his gas from a third-party supplier, offers auto repair, and has no staff on duty after 11 p.m. The dealer owned station pays a maintenance fee for the brand name gas, buys the gas directly from the company, runs a convenience store, and keeps on a late night staff. Down the road another station was only charging \$1.51 for the same octane. He kept his prices down "...by not accepting credit cards – which companies pay a commission on – and by using an ethanol mixture, which is partially subsidized and thus less expensive."

The article points out that these gas stations, nevertheless, are dependent on the decisions of foreign oil producers thousands of miles away. Refining cost and profits

make up approximately 20% of the retail price of gasoline. Distribution and marketing make up a little less than 10%, while the actual price of crude oil makes up a little over 40% of the costs. The rest of the retail cost that consumers pay stems from taxes.

According to a CNN.com report, "...U.S. consumers pay 18.4 cents per gallon in Federal taxes and 23.1 cents per gallon, on average, in state taxes. Add local sales taxes and a 'severance tax' assessed when oil is taken from the ground, and taxes typically will account for 30% of the cost of a gallon of gasoline..."

The State of Illinois imposes several taxes on motor fuel that affect the retail price, aside from the 18.4 cents per gallon Federal tax. The first of which is the Motor Fuel Tax. The current rate and base of this tax is as follows:

| | |
|--|---|
| <i>Gasoline:</i> | <i>19 cents/gallon, plus (a) and (b)</i> |
| <i>Diesel (Special Fuel):</i> | <i>21.5 cents/gallon, plus (a) and (b)</i> |
| Additional levies on gasoline, special fuel, aviation fuel (unless sold at Midway or O'Hare Airports), kerosene, and home heating oil: | |
| <i>Underground Storage Tank Fund (USTF):</i> | <i>(a) 0.3 cents/gallon tax (until 2013)</i> |
| <i>Environmental Impact Fee for USTF:</i> | <i>(b) 0.8 cents/gallon (until 2002)</i> |

The temporary tax of 0.3 cents per gallon was added in 1990. This tax is used to pay for leaking underground storage tanks. The temporary tax of 0.8 cents per gallon was added in 1996. This tax is used as an environmental impact fee.

The most highly publicized tax on gasoline in Illinois of late is the sales tax. Before July 1st, a State sales tax of 6.25% was imposed on motor fuel. Of that amount, 5.0% was the State portion, while 1.25% was the Local tax portion. On July 1st, the 5.0% State portion was suspended for six months.

Finally, there also can be a local tax imposed on the same transaction. Home-rule units can collect taxes on motor fuel by the gallon. Cook County collects 6 cents per gallon, and the city of Chicago 5 cents. DuPage, Kane, and McHenry Counties can impose motor fuel taxes up to 4 cents per gallon without referendum approval. DuPage County collects 4 cents; Kane and McHenry each collect 2 cents. Any city of over 100,000 can also impose a tax of 1 cent per gallon by referendum. Rockford imposes a tax under this provision. In addition, 18 home-rule cities in Illinois impose taxes of various amounts.

So how does Illinois compare to other states when taxing motor fuel? Forty-two states tax motor fuel at fixed rates per gallon, ranging from 8 cents in Alaska and New York to 32 cents in Connecticut. (Again, Illinois is at 19.0 cents for gasoline and 21.5 cents per diesel fuel). Seven other states periodically reset rates per gallon based on the retail or wholesale price of motor fuel, or other factors. These states are Florida, Kentucky, Massachusetts, Nebraska, North Carolina, Ohio, and Wisconsin. According to *State Rankings 2000*, Illinois ranks fifth, behind California, Texas, Florida, and Ohio, in the

amount of State revenue collected for the Motor Fuel Sales Tax with a 1998 amount of \$1.3 billion. (California was first at \$2.9 billion.) However, Illinois ranked 33rd in the nation when the motor fuel was on a per capita basis. Besides Illinois, only eight other states also collect general sales taxes on motor fuel. These states are California, Florida, Georgia, Hawaii, Indiana, Michigan, New York, and West Virginia.

Another factor that contributes to the differences in the cost of gasoline is the grade of gasoline sold at the stations. Higher graded gasoline costs more to make and, therefore, is sold at a higher price. But many times retailers will use the selling of premium gasoline as a way to gain some profit. There is a common feeling among many motorists that premium gasoline is the best fuel for their car. These motorists are willing to pay premium's higher cost, rather than unleaded gasoline's lower costs, in order to obtain maximum performance for their automobile. However, an article in the *Wall Street Journal* entitled, "Disputing Oil Giants' Claims, Car Maker Say Premium Is Often a Waste of Money" may change the opinion of some consumers. The article states that even though premium gasoline prices increased to extremely high levels, loyal premium consumers were unwilling to change to lower graded gasoline because "they believe oil-company advertising and family lore that premium gasoline yields much better gas mileage and quicker acceleration..." and that "...it keeps their engines cleaner." But the article states that, "Today, however, what premium gasoline drives best is profit for refiners and gas stations, analysts say. The performance advantages of the gasoline burned out a generation ago because U.S. auto makers now tailor the vast majority of their engines for regular-grade gasoline."

The article goes on to discuss that Daimier Chrysler AG claims that only two-tenths of 1% of its vehicles need premium gasoline, excluding Mercedes-Benz. Ford Motor Corp. reports that 5% of the vehicles it sold last year required premium gasoline, including the luxury Lincoln Town Car. Most of the new cars that still require premium unleaded gasoline come from Europe, because these cars are generally built with higher compression engines to take advantage of a higher-octane gasoline pool. Though many refiners and oil companies believe that cars do run better on the extra "oomph" of premium unleaded gasoline, "...there has not been adequate research done to show what true impact the loss of octane has on performance." This was the response of the manager of product engineering at Chevron Corp.

Knowing that some motorists will pay the added costs of buying premium, gasoline retailers will use a "historical marketing practice" to add a little profit for their business. According to the same *Wall Street Journal* article, "Premium gasoline costs about five cents to seven cents more per gallon to make than regular gasoline, refiners say. But it is sold to dealers at 11 cents to 13 cents more than regular grade. Gas stations typically sell premium at 15 cents to 20 cents more a gallon than regular. After taxes, dealers get about a nickel more a gallon in extra profit, says Bruce Sirchio, director of the Illinois Gasoline Retailers Association."

Why the Large Price Increase?

As previously shown, there are many factors that make up the retail cost of motor fuel. In recent years the fluctuation of motor fuel prices was stable enough and low enough to avoid much attention from consumers and the media. But as prices continued to increase in the spring of 2000, questions began to surface regarding the cause of these rising prices.

Retail gasoline prices in the Midwest hit their peak during the week of June 18-24. According to AAA's Motor Fuel Gauge Report, on June 21st Illinois' downstate average self serve regular unleaded price was \$2.01, while Cook County had an average price of \$2.17. Cook County's price was up \$0.54 from the previous month and up \$0.90 from the June 1999 price. By comparing Cook County and downstate Illinois' average prices on June 21st with the national average of \$1.65, the dramatic situation Midwest gasoline consumers was clearly evident.

Because of this unique situation, many questions arose regarding the reason for these high prices and whether these prices were caused in whole or in part by antitrust violations. Since that time, several ideas have formed; some of which are to be considered factual, while others are just speculation at this point. There is likely no one reason for the sharp rises in price, but rather a combination of different factors.

Price increases during this time period are not uncommon. Gasoline prices have a seasonal nature to them, whereupon prices tend to rise in the late spring and early summer as the demand for gasoline increases with the onset of the summer driving season. However, according to the Interim Report of the Federal Trade Commission Midwest Gasoline Price Investigation, "the increases this year in some local markets, particularly in the Midwest, eclipsed those experienced in past years, and were much greater than those experienced in other U.S. markets."

So what were the reasons for such a dramatic difference? One explanation is the introduction of EPA Phase II regulations for summer-blend reformulated gasoline in high ozone urban areas. The regulations for this new blend of gasoline, commonly referred to as RFG, went into effect in the Chicago and Milwaukee areas on May 1, 2000. St. Louis also entered the RFG program in 2000, placing Illinois in the middle of a transitional period. The introduction of RFG created shortages throughout the Midwest, causing prices to increase.

There were several reasons for these shortages. One was due to the process of replacing the winter-blend gas with the new summer-blend Phase II RFG. The winter-blend gasoline had to be drained from the storage tanks before the new gasoline could be added, which led to lower than usual inventory levels. Also, the process of making the RFG turned out to be more difficult than expected which led to lower than expected refinery yields.

One article from the Energy Information Association entitled, "Supply of Chicago/Milwaukee Gasoline Spring 2000," states that the Midwest region produces much of the RFG by using ethanol as the oxygenate, where most other RFG areas use the substance MTBE. As a result, not many refineries outside the Chicago/Milwaukee area were prepared to produce the base RFG materials needed to blend with ethanol. This caused marketers scrambling for limited supplies of both RFG and conventional gasoline. As the demand for gasoline in the Midwest went up, so did prices.

Though the new reformulated gasoline explained some of the price differences, it did not "provide a complete explanation for recent Midwestern gas price increases, because in the Midwest as a whole, conventional gasoline prices rose more dramatically than RFG prices from May to the end of the June." This was the response of the Federal Trade Commission in their Midwest Gasoline Price Investigation report.

Aside from the RFG transition, another contributor to the price increases was due to pipeline problems in the Midwest. As stated earlier, pipeline is the major means of transporting gasoline products all over the United States, but this distribution method can occasionally encounter significant maintenance problems. This was the case for the 1,400-mile Explorer pipeline, which supplies gasoline to St. Louis and Chicago. In March, this pipeline sprang a leak, which led to a five-day shutdown causing pressured supplies. An MSNBC.com article entitled, "Gasoline Price Mysteries Revealed," reports that "...pipeline shutdowns are particularly disruptive because companies have adopted policies of keeping only small inventories on hand as a means of saving on storage costs. As a result, there is little in the way of a cushion if pipelines fail..." The shortage of gasoline due to the Explorer's leak led to a higher demand for fuel, resulting in increases in the price of gasoline.

As seen in the previous examples, shortages of motor fuel cause prices to rise. Though the RFG gasoline transition and the pipeline leaks caused shortages in the Midwest, shortages already were occurring all over the United States due to the reduced global supply of crude oil. In the second half of 1999, members of the Organization of Petroleum Exporting Countries (OPEC), along with several non-OPEC oil exporting countries decided to curtail the global supply of crude oil. At the same time the demand for petroleum products increased significantly worldwide. This was due to the economic recoveries in Asia and Europe and continued strong economic growth in the United States. As a result, the consumption of crude oil exceeded production, and inventories were drawn down in the U.S. and all over the world. This high demand caused prices to rise.

In response to the price increases, refiners cut gasoline production and used inventories of gasoline to meet demand in the expectation that inventories could later be replenished when the price of crude oil dropped. But, according to MSNBC.com, "refineries appear to have been slow to rev up production in anticipation of lower world oil prices that have not materialized." These series of events contributed to exceptionally tight supply situations all over the world, especially in the United States. The worldwide

production of crude oil was a significant cause of the high gasoline prices throughout the U.S., but only a portion of this can be contributed to the price increases seen in Illinois and throughout the Midwest.

Since that time, Saudi Arabia and other OPEC countries have agreed to increase production in an effort to moderate the price of crude oil. But as an article entitled, "Petro Politics – July, 2000 – a Comment" from energyindustry.about.com points out that a production increase that drops the price of crude from \$30 to \$25 per barrel is "really pretty small potatoes." The article uses an example where a person drives 15,000 miles per year with a vehicle whose gas mileage is 20 miles per gallon. Under these conditions the person uses 750 gallons per year or 62.5 gallons per month (15,000 miles per year / 20 miles per gallon / 12 months). In July of 1999, crude oil at \$17.60 per barrel equated to a price of gas of \$1.12. In July of 2000, crude oil at \$34.00 per barrel equated to a price of gas of \$1.60. The result: a decrease of \$1.00 per barrel in the price of crude equates to about a 3 cent decrease in the price of gasoline ($(\$1.60 - \$1.12) / (\$34.00 - \$17.60)$). Therefore a \$5 drop in the price of crude oil results in a monthly savings of only around \$9.40 per month ($\$.03$ per gallon x \$5 change x 62.5 gallons per month).

Another factor that compounded the shortage problem was the transfer of fuel out of the Midwest to other locations. According to a report commissioned for The Foundation For Taxpayer and Consumer Rights entitled "The Causes and Effects of the Price Spike in the Midwest during 2000", 375 million gallons of gasoline was transferred out of Midwest storage to other parts of the nation during the first quarter of 2000.

The reasons for the supply problems in the U.S. have been blamed on EPA Phase II regulations, pipeline problems, OPEC, as well as gasoline retailers. But one CNN.com article entitled "On Fluctuating Gasoline Prices and American Independence" points out that vehicle popularity can contribute to the supply problems. The article states that just before the mid-1970s oil crisis, Americans were in love with big, gas-guzzling vehicles. In the 1980s, economical cars tended to be in style. Now entering the 21st century, Americans popularity has shifted to sports utility vehicles, vans, and pickup trucks, all of which have lower fuel economy. In 1980, these vehicles accounted for less than 20% of new vehicle sales; now they make up almost half of the sales, according to the U.S. Department of Transportation. As the popularity of these vehicles continues to grow, as well as the love for travel, so does the demand for gasoline. The article states, "According to the government's Energy Information Administration, demand hit a record 8.5 billion barrels of gasoline a day in April."

Because of the aforementioned supply problems, there is ample evidence why gasoline prices increased in the Midwest. However, there are questions on the extent to which they increased. U.S. Senators and Representatives strongly urged the Federal Trade Commission to take a closer look at the gasoline prices and to report to them of their findings. In their interim report, the FTC writes, "The sheer magnitude of the price increases, their particular intensity in one section of the country, and their occurrence

in conventional gasoline as well as in RFG, prompted the Commission's Bureau of Competition to consider the reasons for the price increases and, specifically, whether price fixing or other illegal activity might have occurred."

The objective of their investigation is to "consider the causes of the price increases, and determine whether there was any illegal contact, communication, signaling, or understandings among competitors. With regard to proving illegal conduct, the Commission must show more than parallel behavior among market participants. Standing alone, proof that all companies raise prices at the same time is not sufficient evidence of collusion. The courts have held that some 'plus factor' must be present to demonstrate that an agreement was reached. Behavior that would be unprofitable 'but for' collusion may be evidence that such an agreement exists." At the time of this report, no conclusions from the FTC have been released to the public.

Illinois' Response: Suspending Motor Fuel Sales Tax

Regardless of why motor fuel prices increased, the fact remained that Illinois consumers were getting hit hard at the pump. There was a public outcry that something be done to lower these outrageous prices. In response, a special session of the Illinois General Assembly was called in late June to address the issue. From this, an agreement came (P.A. 91-0872) to temporarily suspend the 5% State portion of the sales tax applied to motor fuel for the period July 1, 2000, through December 31, 2000. Therefore, the sales tax rate on motor fuel was reduced from 6.25% to 1.25%. The 1.25% represents the local government rate component. Due to the dramatic fluctuations of gas prices at that time, estimating the precise cost of eliminating the 5% portion proved difficult. However, the Illinois and Economic and Fiscal Commission (IEFC) estimated that the State cost for six months would be approximately \$175 million, in line with most other projections ranging from \$150 million to \$180 million.

Shortly after P.A. 91-0872 was passed, the Joint Committee on Legislative Support Services directed the IEFC to report to the General Assembly no later than November 14, 2000 on the impact of the 5% Sales Tax reduction in Motor Fuel. The following is the list of issues that the Joint Committee asked to be addressed:

- A) if the reduction in the State Sales Tax was passed through to motorists;
- B) if the reduction was maintained throughout the period;
- C) if the Sales Tax reduction resulted in an increase in total gallons of motor fuel sold and whether or not there was an increase in ancillary sales (food, beverages, lottery tickets, etc.) at motor fuel establishments; and
- D) whether the 5% State Sales Tax reduction can be reflected on any receipt provided to the consumer.

While definitive conclusions were not possible for most of these items, the Commission has gathered large amounts of information that provide significant insight to each of the requested subjects.

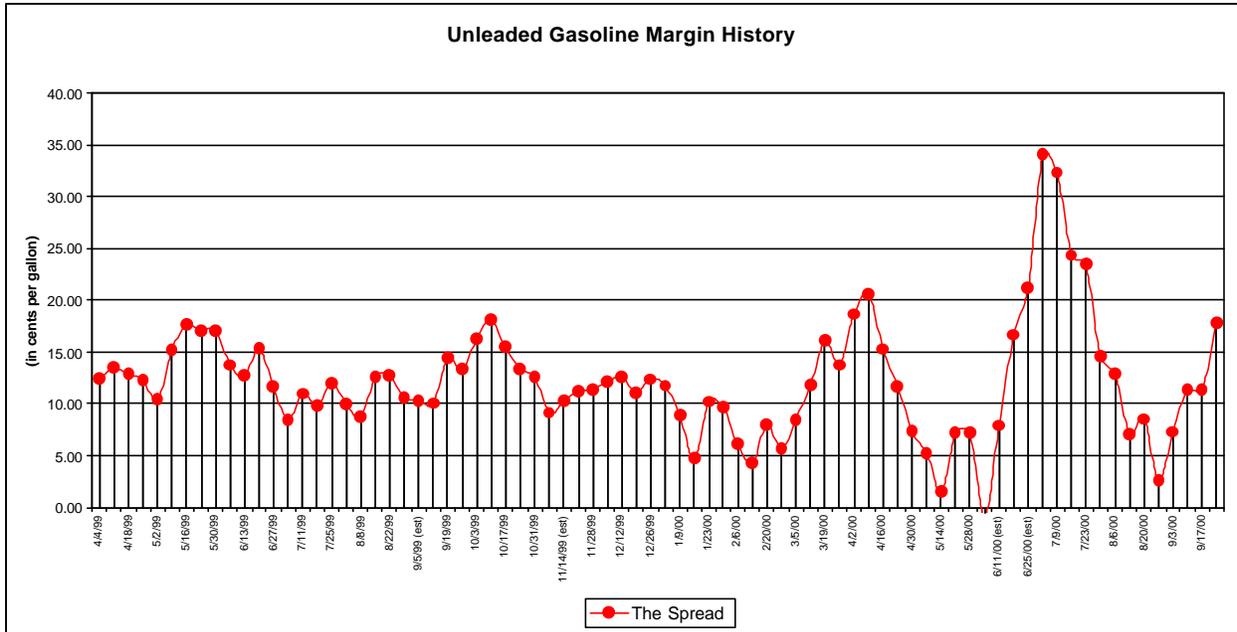
Was the suspension of State sales tax passed through to motorists?

To find out if motorists actually benefited from removing the sales tax on motor fuel, the Commission searched for data that showed the price retailers were paying for gasoline, as well as the amount they charged the consumer. The AAA Motor Club website includes the “Daily Fuel Gauge Report”, which shows the pump price that motorists are paying at different locations all over the United States. This, however, does not show what the retailers purchased the gasoline for before they sold the product to the motorists. Therefore, the Commission turned to the Oil Price Information Service (OPIS), which is AAA’s source for data.

OPIS proclaims themselves as the leading provider of news and prices for the downstream U.S. petroleum market. After consulting with them, the Commission obtained weekly data on nine Illinois cities located throughout the State for several months before and after the elimination of the State sales tax on motor fuel. The cities utilized in this data sample were Aurora, Carbondale, Chicago, Collinsville, Danville, Elmhurst, Quincy, Rockford, and Springfield. Along with that information, the Commission received the estimated “rack price” that retailers paid for that motor fuel as well as the taxes and freight charges applied to those prices. From that, a “spread” could be calculated which takes the retail price and then subtracts the rack price, the various taxes, and the freight charges. This “spread” should be what retail stations are collecting as gross profit, otherwise known as “margin”.

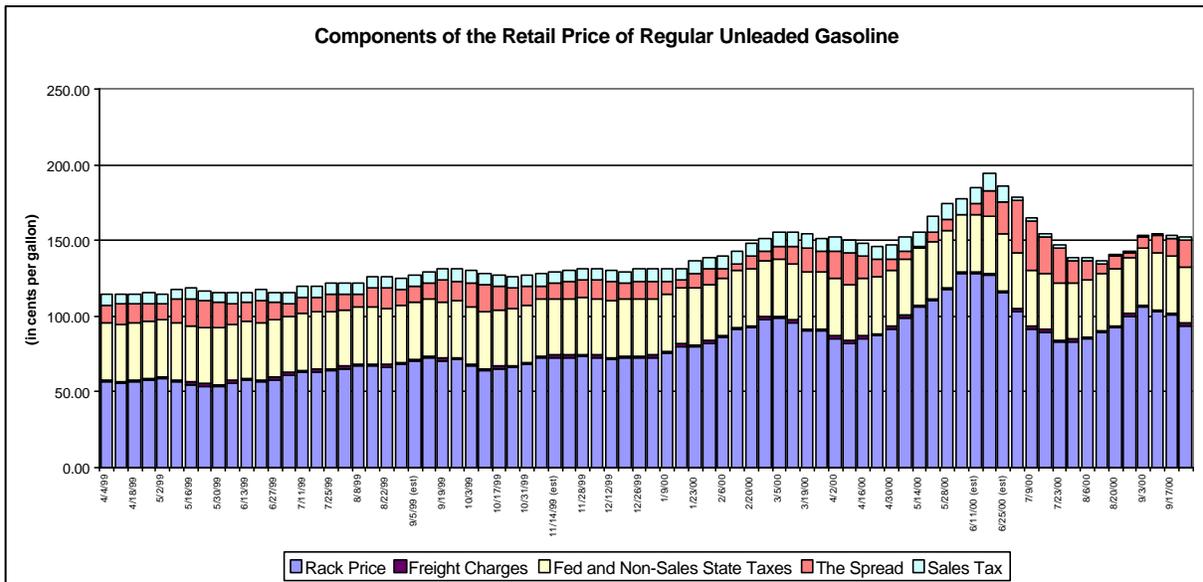
Chart 2, on the following page, shows the price margin history for unleaded gasoline in the State of Illinois. The data accompanying this graph was created by taking OPIS’s average retail prices of the nine Illinois cities and then subtracting out the average rack prices and the various taxes and freight charges. As seen in the graph, the price margin for unleaded gasoline has a history of significant fluctuations. But the period just before and after the suspension of the sales tax on July 1, 2000 is where dramatic fluctuations took place. For the week of June 4, 2000, the average price margin actually dipped below zero at -0.88 cents per gallon. This is the lowest level that the price margin reached in the 17 months of data that we received. This is in contrast to the high-level average price margin of 34.04 cents per gallon that took place on July 2, 2000.

CHART 2



Potential reasons for these price margin fluctuations can be seen below in Chart 3. This chart shows the components of the average retail price of regular unleaded gasoline in Illinois for the weeks of April 1999 through September 2000. From this graph several basic observations can be made. First, the breakout of each component of the retail price of unleaded gasoline can be seen. Obviously, as the rack prices of

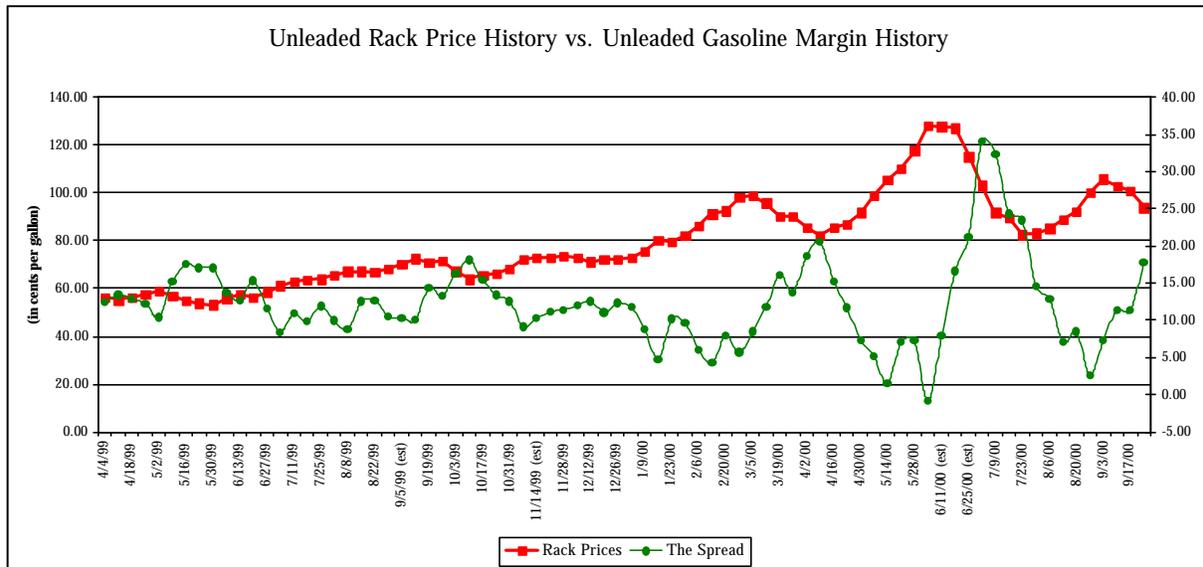
CHART 3



gasoline increase, the percentage federal and state taxes make up of the total retail price decrease, and vice versa. Secondly, the effect suspending the State sales tax had on the retail price of gasoline can be viewed by looking at the uppermost component. After July 1st, 2000, the State sales tax portion becomes noticeably smaller, reflecting the remaining 1.25% local sales tax. A third observation focuses in on the price margin fluctuations. Notice, as the rack price of gasoline increases, the price margins tend to decrease. Conversely, as the average rack price of gasoline decreases, the average price margins tend to increase.

An extreme example of this can be seen for the period shortly before and after the suspension of the sales tax on July 1, 2000. As rack prices climbed to record high levels in May and June, the price margins fell to lower than normal levels. But after the rack prices abruptly fell, the price margins also changed directions and approached higher than normal levels. Chart 4 shows in greater detail the inverse relationship that the average price margin has with the average rack price.

CHART 4



The reason for this inverse relationship is likely due to competition. As rack prices increase, so does the pressure to raise retail prices. But, rising prices cause consumers to look elsewhere to purchase their motor fuel. Therefore, to keep the business of the motorists, retailers will sacrifice some of their price margins in order to keep the retail cost down. This is likely why margins tend to decrease as rack prices increase. The larger the increase in rack price, the bigger the hit they must take on their profit margins. However, when rack prices decline, it is at this time that price margins tend to increase, likely because it gives retailers the opportunity to gain back some of the profit that they lost during the time of increasing rack prices.

As stated earlier, one factor that could influence the amount of the spread is the economic force of competition. Profit margins seldom stay consistent because gas stations are constantly fighting for the business of the consumer. For example, retailers may target their profit margin to be 10 cents per gallon. If a competitor down the road is selling fuel at a cheaper price, they may have to sacrifice their targeted profit margin, in order to get the business of the motorists. This competition causes fluctuations in the spread that make the data very inconsistent. In a survey conducted by the IEFEC, 58% of the respondents indicated that competition with retailers affects the pump price the most, even more than wholesale prices.

An example of this was seen in the Springfield area shortly after the elimination of the motor fuel sales tax. As supplies were replenished, prices that were near \$2.00 per gallon, dropped to more normal levels near the middle of July throughout Illinois. In Springfield, the prices dropped to as low as \$1.11 a gallon for regular unleaded. The reason: a new superstore opened up on the south side of town along with a related gas station. To bring people to the superstore, fuel was sold well below the average selling price at that time. This, in essence, caused a gasoline price war, sending prices that were once among the highest in the country to one of the lowest. The superstore could afford to sell gasoline at prices that brought in little to no profit because they had other merchandise to sell to make up for their loss. Other gasoline stations did not have this luxury. Therefore, they took a hit to remain competitive. This is how margins in the provided data can dip below zero. As the superstore's prices increased to "normal" levels, the competitors quickly followed suit, in order to regain the profit margin they needed. It is at this point that many retailers may exceed their normal profit margin levels in order to gain back some of the profit that they lost during a price war. This situation is a possible contributor to why margins tend to increase temporarily as rack prices decrease.

Another factor that may influence the price margin is the amount of fuel remaining in the retailer's tank at the time of a price increase. For example, let's say that a retailer has to pay a high price to fill his storage tanks. If the rack price of gasoline drops twenty cents the next day, the retailer is stuck with more expensive gasoline in his tanks. In order to pay for this gas, he has to charge the consumer the price that he paid for the fuel that he has in his storage tanks, not the current price of gasoline. This could be another reason for the appearance that profit margins tend to grow as the rack prices decrease.

Much of this price change is also dependent on the size of the storage tanks and how often they are filled. If retailers have tanks that are relatively small and they have good business, they may have their tanks refilled frequently and be able to change prices relative to the market value. But if stations have large tanks with little turnover, they may only be able to charge what the gasoline in their tank is worth. The problem for these retailers is that they may have paid for gasoline at a high rate, but may have to lower prices to stay competitive. The luxury they have is if they paid for gasoline at a lower rate, they would have the ability to charge the current higher price to make back

some profit, or charge the gasoline purchase price, which could cause the competitors to lower their prices.

As seen, there are many factors that contribute to the profit margin. But, without knowing the exact factors that influence the profit margins and spreads of each week's data makes coming to any conclusions a very difficult task. The main problem in answering the question of whether the State sales tax was passed on to the consumer or not is that rack prices decreased at the same time the State sales tax was suspended. If rack prices had stayed constant, it would have been much easier to tell if the tax suspension was passed on. However, this was not the case as the average rack price dropped 34.6% between the weeks of June 18th and July 23rd. Though prices were expected to drop during this time period, it is unclear if the extent of the decline was where it should have been to account for the suspension of the sales tax. At the time, most estimates were that the pump price should fall anywhere from 5 to 10 cents per gallon due to the sales tax suspension.

In an attempt to define the sharp pump price decline more clearly, the IEFC extrapolated data that suggest that the sales tax reduction was, at least in part, passed on to the consumer. Chart 5, on the following page, shows the weekly average price difference of the retail and rack prices of unleaded gasoline. The graph indicates that the retail prices closely resemble the behavior of the rack prices, but in a slightly lagged manner. To further illustrate this, we compared the retail price to the rack price one week prior. The results of this adjustment can be seen on Chart 6. Here, a strong correlation exists between the two variables, which leads to the assumption that any change in the rack price of gasoline takes approximately one week before the change is seen in the pump price. (It should be noted that the prices accompanying the dates on this graph and all previous graphs are the weekly averages for the week prior to the date shown. Therefore, 7/09/00 data is the weekly average of the period July 3rd through July 9th).

CHART 5

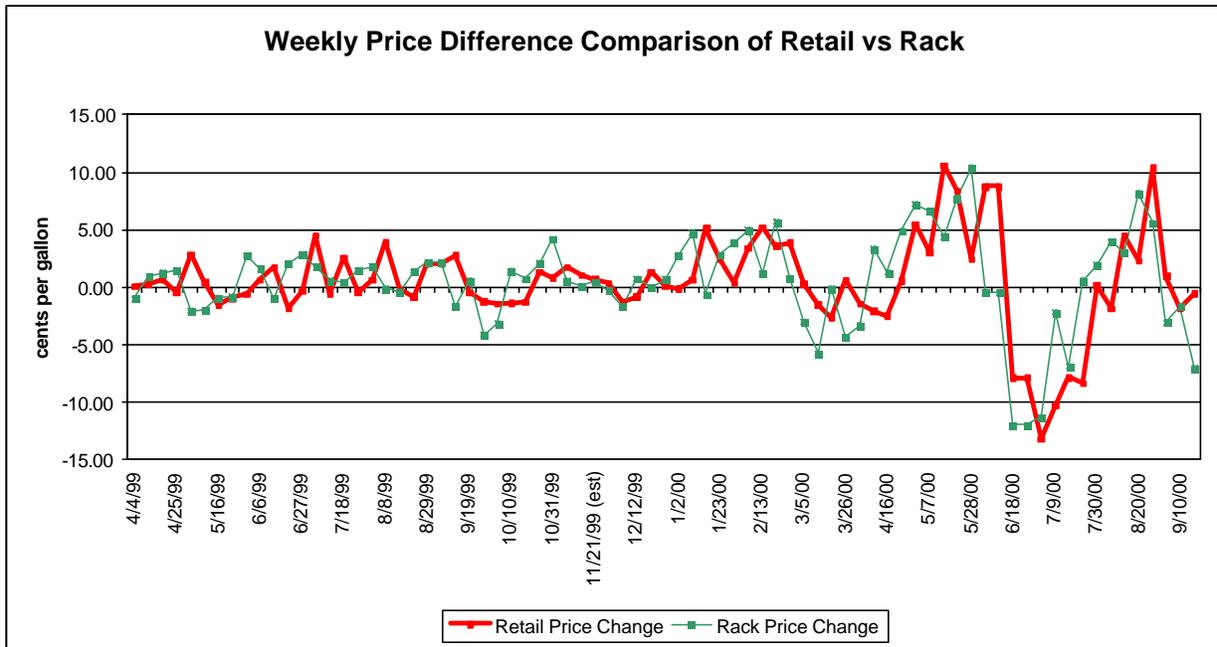
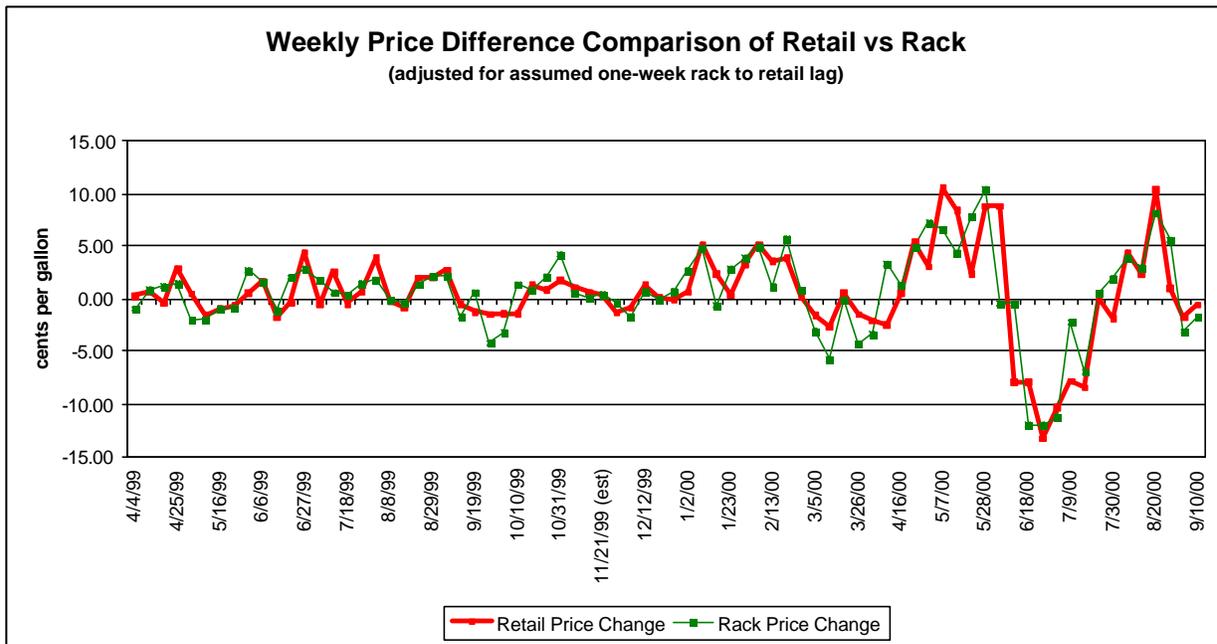


CHART 6



Also from this graph, we are able to see a notable change shortly after the July 1st sales tax reduction took place. Here, the graph indicates that for 7/9/00 data, retail prices dropped approximately six cents lower than the corresponding rack prices (an eight versus a two-cent decline). Because rack prices do not seem to provide reasoning for the dramatic drop that took place leads to the assumption that there was another reason for this drop, or more specifically, this increased drop was likely due to the reduction

in the sales tax. For the period after this approximate 6-cent difference, the retail and rack price differences returned to a more consistent correlation, which suggests that a one-time phenomenon occurred, such as the sales tax reduction. (On this graph, the 6-cent difference does not continue to exist after the reduction took place because this graph only indicates the price changes from week to week. For periods after the reduction was enacted, the price shift has already been accounted for, thus, no new large differences between the rack and retail price changes relative to the tax suspension would exist).

A survey of 48 Illinois motor fuel retailers seems to confirm this analysis. The survey, conducted by the IEFEC, found that approximately 90% of the motor fuel retailer respondents said that they decreased their fuel price at least 6 cents after July 1, 2000, while 60% indicated that they decreased their fuel price between 6 and 8 cents. It should be noted that due to the vested interest of these retailers, interpretation of the survey findings must be done cautiously. However, the high percentage indicating a price reduction due to the sales tax suspension does indicate that it is likely some reduction was passed on to motorists.

In summary, data suggests that the suspension of the tax did contribute to the lowering of pump prices at the time the sales tax suspension took place. However, the degree to which the reduction was passed on to motorists cannot be precisely measured. A mitigating factor that severely limits this analysis is the fact that wholesale prices were falling at the same time the sales tax suspension went into effect. It is not possible to precisely assign what amount of that price change was due to the tax suspension and what amount was due to lower wholesale prices.

Was the reduction maintained throughout the period?

The second topic that the Commission was asked to look at was whether the sales tax reduction was maintained throughout the period. For many of the same reasons pointed out earlier, a cut and dry answer cannot be accomplished. However, one of the graphs used previously can shed some light on this issue.

In Chart 2, on page 15, the profit margins are shown to be higher shortly after the sales tax reduction took place. As noted before, many factors could have contributed to these high margins, including competition and the frequency that retailers refill their tanks. But in the three months of data that are available following the July 1st transition, price margins appear to have returned to a historically normal range. Between the last week of July and the last week of September in 1999, the average price margin was 11.25 cents per gallon. For this same period in 2000, the average price margin was slightly lower at 10.37 cents per gallon. Because the current profit margins are similar to the margins seen before the reduction took place, it would appear that the tax suspension has been maintained throughout the period. Had retailers pocketed the 5% tax suspension, margins after the change would have likely remained higher than prior to the change.

Based on the available rack and margin data, it would appear that whatever impacts the suspension of the sales tax had on the price of fuel has been maintained thus far.

Has the sales tax reduction resulted in an increase in total gallons of motor fuel sold and whether or not there was an increase in ancillary sales at retail motor fuel establishments?

Motor Fuel

In an attempt to answer this question, the IEFC gathered gallonage and ancillary sales data through the assistance of the Department of Revenue. In order to see if there was an increase in total gallons of motor fuel sold after the reduction took place, the Department of Revenue sampled 13 gasoline distributors who represented 57% of the total gasoline distributed during the period January 1999-September 1999. From this sampling, the Department gathered the following information:

***The Monthly Year over Year Increases for Gasoline Distribution
January-August***

| | | | |
|------------------------|---------------|----------------------|---------------|
| <i>January</i> | 0.84% | <i>May</i> | -4.15% |
| <i>February</i> | -5.07% | <i>June</i> | -0.13% |
| <i>March</i> | -2.46% | <i>July</i> | -1.00% |
| <i>April</i> | -0.14% | <i>August</i> | 0.83% |

The Month over Month Increases for Gasoline Distribution

| | 1999 | 2000 |
|--------------------------------|---------------|---------------|
| <i>February/January</i> | 1.90% | -4.1% |
| <i>March/February</i> | 5.63% | 8.52% |
| <i>April/March</i> | -4.08% | -1.81% |
| <i>May/April</i> | 6.69% | 2.41% |
| <i>June/May</i> | -4.82% | -0.82% |
| <i>July/June</i> | 3.28% | 2.38% |
| <i>August/July</i> | 2.86% | 4.77% |

***Three Month Moving Average for Gasoline Distribution
(in millions of gallons of gasoline)***

| | 1999 | 2000 | % Change |
|------------------------------|--------------|--------------|-----------------|
| <i>January-March</i> | 235.8 | 230.5 | -2.2% |
| <i>February-April</i> | 238.3 | 232.2 | -2.6% |
| <i>March-May</i> | 244.6 | 238.9 | -2.3% |
| <i>April-June</i> | 242.4 | 238.7 | -1.5% |
| <i>May-July</i> | 246.3 | 241.9 | -1.8% |
| <i>June-August</i> | 274.2 | 247.0 | 0.0% |

The first table shows that the total gallonage distributed in 2000 was less than the amount that was distributed in 1999 for most of the period between January and

August. The second table shows the month over month increases for the same period of time. In 1999, gallonage increased 3.28% from June to July, but in 2000, the increase was only 2.38%. However, from July to August, the gallonage percentage change in 1999 was 2.86%, while in 2000, it was 4.77%. (Due to timing issues, data after August was not available to be added to this report).

The third table takes a closer look at these numbers by looking at a three month moving average to dampen the month to month variation. This table reemphasizes that the amount of gallons distributed in Illinois during the first part of 2000 was consistently less than in 1999. However, the most recent period (between June and August) shows that gasoline sold in Illinois appears to be back at the levels of a year ago. However, it is clear that not enough months of data are available yet to conclude that any change in motor fuel sales has occurred as a result of the tax suspension.

A similar sample was taken of 33 diesel distributors who represented 44% of the State's total distribution during the period between January 1999 and September 1999. The results of this sampling are as follows:

***The Monthly Year over Year Increases for Diesel Distribution
January-August***

| | | | |
|------------------------|---------------|----------------------|---------------|
| <i>January</i> | 25.48% | <i>May</i> | 22.70% |
| <i>February</i> | 10.07% | <i>June</i> | 6.36% |
| <i>March</i> | -0.66% | <i>July</i> | -6.89% |
| <i>April</i> | 2.31% | <i>August</i> | 4.87% |

The Month over Month Increases for Diesel Distribution

| | <i>1999</i> | <i>2000</i> |
|--------------------------------|--------------------|--------------------|
| <i>February/January</i> | -7.78% | -19.11% |
| <i>March/February</i> | 13.68% | 2.60% |
| <i>April/March</i> | -4.99% | -2.14% |
| <i>May/April</i> | 6.12% | 27.27% |
| <i>June/May</i> | -1.17% | -14.34% |
| <i>July/June</i> | 9.11% | -4.49% |
| <i>August/July</i> | 1.32% | 14.12% |

***Three Month Moving Average for Diesel Distribution
(in millions of gallons of gasoline)***

| | <i>1999</i> | <i>2000</i> | <i>% Change</i> |
|-----------------------------|--------------------|--------------------|------------------------|
| <i>January-March</i> | 40.267 | 41.745 | 3.7% |
| <i>March-May</i> | 42.097 | 45.573 | 8.3% |
| <i>April-June</i> | 42.046 | 46.518 | 10.6% |
| <i>May-July</i> | 43.997 | 47.090 | 7.0% |
| <i>June-August</i> | 45.324 | 45.923 | 1.3% |

These tables dealing with diesel distribution do not reveal any consistent trends. Therefore, any analysis dealing with these tables would be purely speculation. Diesel prices during the time of the high gasoline prices in Illinois did not see near the large increases that gasoline prices saw. However, the reduction of the sales tax was enacted for diesel prices as well to allow Illinois diesel retailers the chance to be more competitive with other states. The third table does show that more diesel fuel has been distributed in 2000 than in 1999, but it does not appear that the reduction in the sales tax had much of an influence on the amount of diesel that was distributed in Illinois. Again, more monthly data are needed before any conclusion can be reached.

Other information dealing with the effects of the sales tax reduction on motor fuel gallonage come from the Commission's motor fuel retailer survey. From this, it was found that 35% of survey respondents indicated that their fuel volume increased between 5 and 10% and another 25% indicated an increase in the amount of fuel sold by 0 to 5%. Those claims, however, cannot be substantiated. Indeed, if gallonage increases did take place, it would likely occur near border locations where competition between other states commonly occur. The Commission's survey was targeted at those types of locations for the most part, and as a result, the respondents' claims would not necessarily be similarly reflected in aggregate gallonage reports.

In summary, of the limited data that does exist, no identifiable relationship is evident thus far between the tax suspension and fuel sales. Clearly, several more months of data are needed before even preliminary conclusions can be drawn as gallonage data lags approximately two months.

Ancillary Sales

Again, the Department provided the IEFEC with data obtained from a sample of thirteen motor fuel retailers' representing sixteen Illinois locations. Calendar year 1999 and 2000 June, July, and August taxable motor fuel sales, ancillary sales, and food and drug sales were provided for analysis.

Prior to the July 1, 2000 sales tax suspension, both motor fuel and ancillary sales were subject to the State's sales tax and thus the two figures were combined and reported to the Department of Revenue. As is depicted in the table on the following page, prior to July 20, 2000 it is impossible to accurately distinguish between fuel and ancillary sales.

Since Illinois' suspension of sales tax on motor fuel, returns collected by the Department of Revenue delineate between ancillary sales and motor fuel sales. This is because ancillary goods are still subject to the State's sales tax, while motor fuel is not.

While at the end of the six-month suspension, a trend analysis may be derived for fiscal year 2001, it is not possible to complete a comparable month-over-month analysis with the prior fiscal year. This is because fiscal year 2000 contains combined figures for

motor fuel and ancillary sales (which cannot be accurately separated), while fiscal year 2001 distinguishes between the two items. With that severe limitation mentioned, the following table shows several months of taxable sales for the Department of Revenue's sampled retailers.

| TABLE: SAMPLING OF ANCILLARY SALES | | | | | | | | | |
|------------------------------------|---------------------|---------------------|------------------|---------------------|---------------------|------------------|---------------------|---------------------|------------------|
| | June <u>1999</u> | June <u>2000</u> | % <u>Chg.</u> | July <u>1999</u> | July <u>2000</u> | % <u>Chg.</u> | Aug. <u>1999</u> | Aug. <u>2000</u> | % <u>Chg.</u> |
| Total Taxable Sales | 8,906,750 | 9,385,019 | 5.37% | 9,184,514 | 9,537,728 | 3.85% | 9,561,940 | 9,975,810 | 4.33% |
| Total Motor Fuel Sales | N/A | N/A | N/A | N/A | 6,608,234 | N/A | N/A | 7,146,320 | N/A |
| Total Ancillary Sales | N/A | N/A | N/A | N/A | 2,895,858 | N/A | N/A | 2,797,147 | N/A |

SOURCE: Illinois Department of Revenue

Data in the above table shows that of the establishments sampled by the Department of Revenue, total taxable sales appear to be increasing when comparing like months of fiscal years 2000 and 2001. In fact, both July and August increased by 3.85% and 4.33% respectively. However, it is unclear whether the increase comes from a rise in motor fuel sales, an increase in ancillary sales, or a combination of the two. In addition, June sales increased by 5.37% between fiscal year 1999 and fiscal year 2000. In other words, the increase in June sales, due at least in part by an increase in fuel price, is greater than both July and August, and occurred prior to the sales tax suspension. While only a limited amount of data has been examined, it would appear that no identifiable increase in sales can be substantiated.

According to the survey of motor fuel retailers, approximately 31% responded that their ancillary sales increased between 0 and 5%, while another 27% said they increased 5 to 10%. Although this is just a matter of opinion, it is very possible that some establishments, particularly on the border may have seen a noticeable increase in sales. Unfortunately, little data exist that substantiates the claims.

In summary, even preliminary findings are impossible given the lack of data, both in quantity and quality (comparable monthly data). While only a couple of months of data exist, the largest drawback is that prior to the sales tax suspension on motor fuel, motor fuel sales were part of the total sales figures reported on the retailers sales tax return. Even though now after the tax suspension motor fuel is broken out separately from other sales, there is no way to accurately compare the periods before and after the tax suspension.

Lottery Sales

To analyze whether lottery ticket sales were impacted by the sales tax suspension, Commission staff met with Illinois Department of Lottery officials to discuss the potential effects that the suspension of the sales tax would have on lottery sales. During this discussion, it was determined that, should this decision affect lottery sales, it would be most noticeable with lottery agents located within close proximity to one of Illinois' five bordering states—Indiana, Iowa, Kentucky, Missouri, and Wisconsin. As a result, Commission staff requested that Lottery officials identify these agents and monitor their sales during the months of July through September (the three months following the suspension of the motor fuel sales tax). These figures were then compared to a four week average of June sales (the month preceding the suspension of the sales tax) so as to provide comparative data. The data served as the basis for the findings and conclusions discussed below.

| TABLE: Illinois Lottery Sales Along State Border Regions | | | | | | | | |
|--|-------------------|-------------------|--------------|-------------------|---------------|-------------------|------------------|--|
| (June – September, 2000*) | | | | | | | | |
| | JUNE | | JULY | | AUGUST | | SEPTEMBER | |
| | Total | Total | % Chg. | Total | % Chg. | Total | % Chg. | |
| Indiana Border | 253,700.50 | 264,741.50 | 4.35% | 236,493.50 | -6.78% | 263,043.00 | 3.68% | |
| Iowa Border | 23,828.00 | 26,737.00 | 12.21% | 23,067.00 | -3.19% | 23,227.50 | -2.52% | |
| Wisconsin Border | 210,492.50 | 222,347.00 | 5.63% | 199,529.00 | -5.21% | 214,255.50 | 1.79% | |
| Missouri Border | 165,242.50 | 173,094.00 | 4.75% | 152,177.00 | -7.91% | 173,331.00 | 4.89% | |
| Kentucky Border | 22,463.50 | 20,342.50 | -9.44% | 18,959.50 | -15.60% | 21,485.00 | -4.36% | |
| TOTAL | 675,727.00 | 707,262.00 | 4.67% | 630,226.00 | -6.73% | 695,342.00 | 2.90% | |
| *All percentage change figures refer to the change experienced between the given month and June. SOURCE: Illinois Department of Lottery | | | | | | | | |

Upon the completion of the three-month examination, the Illinois Department of Lottery reported the following findings.

- In July, total lottery sales associated with all lottery agents increased by 5.57% while the overall average for the border agents increased by only 4.67%. In August, the overall sales increase for all lottery agents was 1.46% while the overall average for the border agents decreased by 6.73%. In September, overall sales decreased by 5.70% while the overall average for the border agents increased by 2.90%. (All percentage change figures refer to the change experienced between the given month and June.)
- There was no consistent change in sales between the five state borders from June to July, June to August, or June to September. In addition, there was no consistent change in sales within the individual agents grouped within a border region.

- The level of the Big Game jackpot distorts any comparison between June total sales and the total sales associated with July, August and September.

In the Commission's survey of motor fuel retailers, we asked how lottery sales changed since the sales tax suspension. One-third of the responders selling lottery tickets answered that there was no change while nearly another one-third said they had experienced a 0 to 5% increase.

In summary, it does not appear that the suspension of the motor fuel sales tax impacted lottery sales in Illinois. Although it may be too early to rule out a connection, recent data indicate that any impact would be minimal. This conclusion is based primarily on the fact that the total sales changes for border agents had no relation to the sales changes experienced by all lottery agents. In July, border agents experienced a smaller increase in sales than the increase for all lottery agents. In August, the border agents experienced a decrease in sales while total lottery sales experienced an increase. In September, the border agents had an increase in sales while there was a decrease in sales by all lottery agents. In addition, inconsistencies emerged regarding the sales changes among border agents. Furthermore, it is likely that the larger Big Game jackpots experienced in July and September were more responsible for total sales increases than was the temporary suspension of the motor fuel sales tax.

Can the 5% sales tax reduction be reflected on any receipt provided to the consumer?

It is possible to indicate on a sales receipt the savings that a consumer would receive as a result of the motor fuel sales tax suspension. However, in order to do so, retailer software would have to be modified to calculate the differential between what the total sale was versus what the sale would have been had the State's 5% sales tax still been imposed.

An estimate of a consumer's annual savings due to the suspension of the motor fuel sales tax can be achieved by making the following assumptions: a vehicle travels 12,000 miles per year, it gets 20 miles per gallon of fuel, the average price per gallon of fuel includes \$.07 a gallon of the State sales tax on the fuel. Utilizing the calculations provided below, a \$42 annual cost savings would be realized from the motor fuel sales tax suspension.

Calculation:

12,000 average miles traveled per year / 20 miles per gallon = 600 gallons per year
600 gallons per year * \$.07 State sales tax on fuel = \$42 savings per year

Assuming the same criteria as above and that a motorist fills his/her vehicle with 15 gallons of fuel, a sales receipt would indicate a \$1.05 savings. Accordingly, the savings reported to the consumer would increase or decrease in direct relation with the number of gallons purchased.

In summary, with the implementation of new retailer software, it would be possible to indicate on a sales receipt a consumer's savings due to the suspension of sales tax on motor fuel. The amount saved would greatly vary, but an average consumer would expect to see a savings of \$1.05 per fill-up or \$42 annually.

Survey Results of Illinois Gasoline Sales Tax Suspension

The IEFC conducted a survey of sixty retail motor fuel stations throughout the State, concentrating on border locations where interstate competition is most likely to occur. Of the sixty surveys sent, 48 responded, yielding an impressive 80% response rate. The Survey, provided in Appendix I, asked retailers' a wide variety of questions regarding their views of the sales tax suspension as it related to changes in fuel sales volume and price, ancillary sales, and lottery ticket volume. In addition, it questioned retailers about their opinions regarding what drives pump price, their main source of clientele, and how business was affected since the sales tax suspension on motor fuel.

While a majority of the retailers provided positive feedback pertaining to the motor fuel sales tax suspension, it is important to keep in mind that the respondents were simply providing an opinion on their performance and actual figures were not required or verified by the Commission. Although, drawing any conclusions from the data alone would be considered inaccurate, the survey information is helpful in obtaining the retailers' perceptions of how the suspension influenced their business.

Many retailers provided comments on the survey (which are shown in their entirety in Appendix II on page 35). Most of them encouraged the permanent suspension of the sales tax. It appears from the comments that the respondents felt if the fuel tax was permanently suspended, they would be much more competitive with neighboring States and would be able to generate and retain more business within Illinois.

Was the reduction in the State sales tax passed on through to motorists?

The Commission asked respondents how the motor fuel sales tax suspension affected their fuel price after July 1, 2000. Over 60% replied that the price per gallon decreased between \$.06 and \$.08, almost 30% believed that the price per gallon decreased over \$.08, and no one indicated that the price did not change.

Did the sales tax suspension on motor fuel result in an increase in total gallons of motor fuel sold?

According to the survey, 25% believed that fuel sales volume increased between 0% and 5%, over 35% stated that sales increased between 5% and 10%, and almost 19% indicated that sales increased more than 10%. Only 15% indicated that there was no change in sales volume.

Over 75% of those who replied believed that both in-state and out-of-state customer volume increased, while 19% indicated no change. Also, the respondents believed that they were more competitive with neighboring states. In fact, over 87% believed they were now somewhat to very competitive with neighboring states.

Finally, when asked how the suspension of the motor fuel sales tax affected business overall, almost 21% stated that business slightly improved, 29% said that business moderately improved, and 27% indicated that business significantly improved.

Was There An Increase In Ancillary Sales At Motor Fuel Establishments? (food, beverages, lottery tickets, etc)

Over 31% respondents believed merchandise sales increased between 0% and 5%, 27% indicated that sales increased between 5% and 10%, and over 16% said sales increased more than 10%. It appears that lottery sales were not as greatly impacted. Less than half (42%) of the respondents believed lottery sales increased.

APPENDIX I



ILLINOIS ECONOMIC and FISCAL COMMISSION **RESULTS OF SURVEY OF ILLINOIS GASOLINE SALES TAX SUSPENSION**

1. How have fuel sales (volume) changed since the sales tax suspension became effective July 1, 2000?

| | | |
|---------------|-----------|--|
| 14.58% | A. | Sales have not changed. |
| 25.00% | B. | Sales increased between 0% and 5%. |
| 35.42% | C. | Sales increased between 5% and 10%. |
| 18.75% | D. | Sales increased more than 10%. |
| 2.08% | | Other |
| 4.17% | | N/A |

2. On average, how did the motor fuel sales tax suspension affect your fuel price after July 1, 2000?

| | | |
|---------------|-----------|--|
| 0.00% | A. | The fuel price did not change. |
| 8.33% | B. | The price per gallon decreased by less than \$0.05. |
| 60.42% | C. | The price per gallon decreased between \$0.06 and 0.08. |
| 29.17% | D. | The price per gallon decreased over \$0.08. |
| 2.08% | | N/A |

3. In your opinion, what effects pump price the most?

| | | |
|---------------|-----------|-----------------------------------|
| 18.75% | A. | Wholesale fuel price |
| 58.33% | B. | Competition with retailers |
| 4.17% | C. | Profit Margin |
| 2.08% | D. | Other (please specify): _____ |
| 10.42% | | A/B |
| 2.08% | | B/D |
| 4.17% | | N/A |

4. Do you feel you are more competitive with neighboring states due to the recent repeal of the gasoline sales tax?

| | | |
|---------------|-----------|---|
| 8.33% | A. | I am not competitive with neighboring states. |
| 54.17% | B. | I am somewhat competitive with neighboring states. |
| 33.33% | C. | I am very competitive with neighboring states. |
| 4.17% | D. | I have not noticed a change in business. |
| 0.00% | | N/A |

5. How much have sales (in dollars) for all other goods (i.e. food, drink, merchandise, auto products, etc.) changed since July 1, 2000?
- | | | |
|---------------|-----------|---|
| 14.58% | A. | Sales have not changed. |
| 31.25% | B. | Sales increased between 0% and 5%. |
| 27.08% | C. | Sales increased between 5% and 10%. |
| 16.67% | D. | Sales increased more than 10%. |
| 4.17% | Other | |
| 6.25% | N/A | |
6. If you are a lottery vendor, how have your lottery sales (in dollars) changed since July 1, 2000?
- | | | |
|---------------|-----------|---|
| 33.33% | A. | Sales have not changed. |
| 31.25% | B. | Sales increased between 0% and 5%. |
| 10.42% | C. | Sales increased between 5% and 10%. |
| 0.00% | D. | Sales increased over 10%. |
| 25.00% | N/A | |
7. How do you perceive your clientele?
- | | | |
|---------------|-----------|---|
| 64.58% | A. | Less than 15% are out-of state customers |
| 18.75% | B. | Between 16% and 30% are out-of-state customers |
| 6.25% | C. | Between 31% and 50% are out-of-state customers |
| 10.42% | D. | Over 50% are out-of-state customers |
8. How has your customer volume changed since July 1, 2000?
- | | | |
|---------------|-----------|--|
| 18.75% | A. | The customer volume has not changed. |
| 35.42% | B. | In-State customer volume has increased. |
| 10.42% | C. | Out-of-State customer volume has increased. |
| 29.17% | D. | In-State and Out-of-State customer volume has increased. |
| 4.17% | Other | |
| 2.08% | N/A | |
9. How has the State's suspension of the motor fuel sales tax affected your business overall?
- | | | |
|---------------|-----------|--|
| 16.67% | A. | There is no change. |
| 20.83% | B. | Business has slightly improved. |
| 29.17% | C. | Business has moderately improved. |
| 27.08% | D. | Business has significantly improved. |
| 4.17% | Other | |
| 2.08% | N/A | |
10. How would you classify your business?
- | | | |
|--------|----|---|
| 12.50% | A. | Large capacity truck stop (i.e. services mostly interstate truckers, autos, may have a restaurant and grocery goods) |
| 14.58% | B. | Small capacity truck stop (i.e. services mostly interstate truckers, autos, does not have the facilities of a large truck-stop) |

| | |
|---------------|--|
| 41.67% | C. Large capacity auto stop (i.e. services mostly autos and some trucks, may contain an eatery and grocery goods) |
| 20.83% | D. Small auto station (i.e. services mostly autos) |
| 2.08% | B/D |
| 4.17% | Other |
| 4.17% | N/A |

11. What is your estimated average monthly gallonage sales for:
 Gas/gasohol: Various
 Diesel: Various

12. Please provide any additional comments as to how the suspension of the Illinois gasoline sales tax has affected your business.

SEE APPENDIX II

Optional:

Business Name: _____

Contact Person: _____

Mailing Address: _____

Telephone: _____

APPENDIX II

COMMENTS FROM SURVEY OF ILLINOIS GASOLINE SALES TAX SUSPENSION

QUESTION:

1. How have fuel sales (volume) changed since the sales tax suspension became effective?
 - Too early to tell.
 - Reduced slightly from last year on like for like basis.
 - Neighboring states also dropped sales tax.
 - Sales are down 16.49%.

2. On average, how did the motor fuel sales tax suspension affect your fuel price after July 1, 2000?
 - More than .08 cents per gallon.

3. In your opinion, what effects pump price the most?
 - Equally A & B, seems to pay attention to margin unless it gets a cost or below.
 - All blended into total.
 - Here on border, the state of Iowa was hurting us greatly with Illinois residents going to Iowa.
 - Including those in neighboring states with 10-cent advantages.
 - Refining and pipeline outages.
 - Including those who have tax advantages from one municipality or State tax body.
 - Taxes.
 - Taxes.

4. Do you feel you are more competitive with neighboring states due to the recent repeal of the gasoline sales tax?
 - Still due to taxes
 - We are close to Indiana. When their sales tax comes back on, we will be very competitive. I expect another 5% increase in sales.
 - Illinois still 4 cents disadvantage with Missouri even **after sales tax** suspension.
 - Iowa.
 - Still not even with.
 - Indiana also dropped the tax.
 - Indiana huge advantage.
 - Lower motor fuel tax to make us more competitive or take off remaining 1 1/4% sales tax.

5. How much have sales (in dollars) for all other goods (i.e. food, drink, merchandise, auto products, etc.) changed since July 1, 2000?
 - Too early to tell.
 - Talking to our customers and retailers.
 - Down 16%.

6. If you are a lottery vendor, how have your lottery sales (in dollars) changed since July 1, 2000?
 - Hard to tell with large jackpot in Big Game.

7. How do you perceive your clientele?
 - Has helped us hold on to our Illinois customers.
 - All truck stops.
 - Interstate locations only.
 - No lottery.

8. How has your customer volume changed since July 1, 2000?
 - Too early to tell.
 - Volume down 16.49%.

9. How has the state's suspension of the motor fuel sales tax affected your business overall?
 - Too early to tell.
 - NOTE: I interpret as 10-15% being moderately significant.
 - Volume down 16.49%.

10. How would you classify your business?
 - Distributor operating convenience stores/travel centers.
 - Convenience store supplier.

11. What is your estimated averaged monthly gallonage sales for:
Gas/gasohol
Diesel

12. Please provide any additional comments as to how the suspension of the Illinois gasoline sales tax has affected your business.
 - It is too soon to tell!
 - We need to be tax competitive with ALL neighboring states.
 - I believe it is a good start. I still believe that Indiana has a significant advantage due to their lower SMFT.
 - For the long-term health of motor fuel retailers, it is important that Illinois not reinstate the sales tax on gasoline and diesel fuel.

- I hope the suspension becomes permanent so we can compete with Indiana on a day to day basis. If we can, I expect a 15% increase in gallonage.
- Has brought Illinois closer to other states.
- You must realize that as gasoline prices increase, people slow down with their driving. With this in mind we have shown moderate increases in gasoline sales, and significant inside sales.
- We are only 24 miles from the Missouri border. We have a tremendous amount of residence, community and transit trade who work in the St. Louis Metropolitan area. Since we have been more competitive by the elimination of the 5% gasoline tax, we have seen our business grow.
- It has allowed a ripple effect of better volume in town and the center State locations. Especially southern tip of State (Paducah, KY and up).
- Please make the sales tax suspension Permanent!
- This data reflects only our truck stops.
- In general, the sales tax suspension is viewed as a political maneuver, probably more detrimental to the State than helpful to the consumer.
- I feel this is a good program and should be repeated indefinitely.
- The suspension has had a very positive impact but not all customers always come back. Yet we have only seen a 2-month effect, habits are hard to break!
- In long-term sales tax elimination will net out increase in total sales as we get closer to bordering state tax scenarios.
- Positively.
- Since the Governor signed the sales tax suspension, oil companies and retailers have been tripping over themselves to drive the price down. Extending the suspension for an additional six months, the state would be able to access the overall economic impact.
- It didn't help because Indiana did the same thing. Indiana has 4 cent per gallon less State motor fuel taxes which is tough on us. Eliminating the 5% State sales tax permanently would help us tremendously when Indiana puts theirs back on. Also, Illinois charges sales tax on top of the motor fuel taxes whereas Indiana doesn't
- My marketing area borders Indiana, with both State's suspension on tax has not helped that much. Indiana State tax is 5 cents less when Indiana implements their sales tax then theirs will be a more level playing field.
- It makes us more competitive with border states. It has lowered retail prices. I'm in favor of a permanent reduction of the total sales tax on gas.
- It makes fuel cost more in line with neighboring states.
- Has had very little affect. Price per gallon is still over \$1.50 because of high crude costs and other taxes, i.e. State Motor Fuel, County, Home Rule taxes, etc.
- The local customers are more appreciative that the gas/diesel is more affordable. Interstate truckers see Illinois as a better buy.
- We are able to sell to people who live here but work in Missouri. Before, they would buy all their gas in St. Louis, MO.

- I really have not seen much affect. In my opinion, the reason we have not seen much affect is the higher prices all around. People slow down when prices get high like this.
- The political pressure exerted through the media and governmental bodies with the reduction caused a cascading, “who can drop the price the most”. In addition, supplemental sales of cigarettes, lottery and snacks have increased. Gasoline at a \$1.50 vs. \$2.00 has had the psychological effect, I believe, of more disposable income to those ancillary goods. Also, in the automotive repairs business, I noticed people fearing gasoline price hikes to translate into runaway inflation, were reluctant to spending money and make repairs. Unusual as we were heading into the “vacation months.” After the drop, the sales immediately and substantially have jumped; a spiral upward and net downward.
- Volume down 16.49%.
- Customers feel that the State has overcharged on all taxes.
- We operate mainly in 3 counties. All boarding the Indiana State line. We estimate our gallonage would increase 40% if we had the same tax structure as Indiana.
- The State cannot expect business of any product to stay in business and be competitive with a 6 ½ to 7% tax difference. Especially gasoline.
- People are in a much better mood. They feel that finally the government has given back to the taxpayer a percentage. This will only help stir the economy and allow them a little more buying power.

BACKGROUND

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

- 1) Preparation of annual revenue estimates with periodic updates;
- 2) Analysis of the fiscal impact of revenue bills;
- 3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;
- 4) Periodic assessment of capital facility plans; and
- 5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html