



UPDATE ON ILLINOIS' ECONOMIC AND FISCAL CHALLENGES

PRESENTATION TO THE BOARD OF TRUSTEES
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OUTLINE

- IGPA activities on fiscal topics
- Economic Overview
 - Illinois Unemployment
 - Labor Force
- Fiscal Overview
 - January 1, 2015 income tax rate reduction
 - Large and growing structural deficit
 - Illinois' Bond Rating
- Summary



IGPA ACTIVITIES ON FISCAL TOPICS

- Recent
 - Fiscal Futures Model projections of Dec. 2013 pension law
 - Study: Effect of 2011 IL tax increase on economic indicators
 - Study: Borrowing cost penalty of IL's poor fiscal reputation
- Upcoming
 - Annual update of data and model
 - Analysis of state's capacity to issue debt
 - Budget transparency initiative



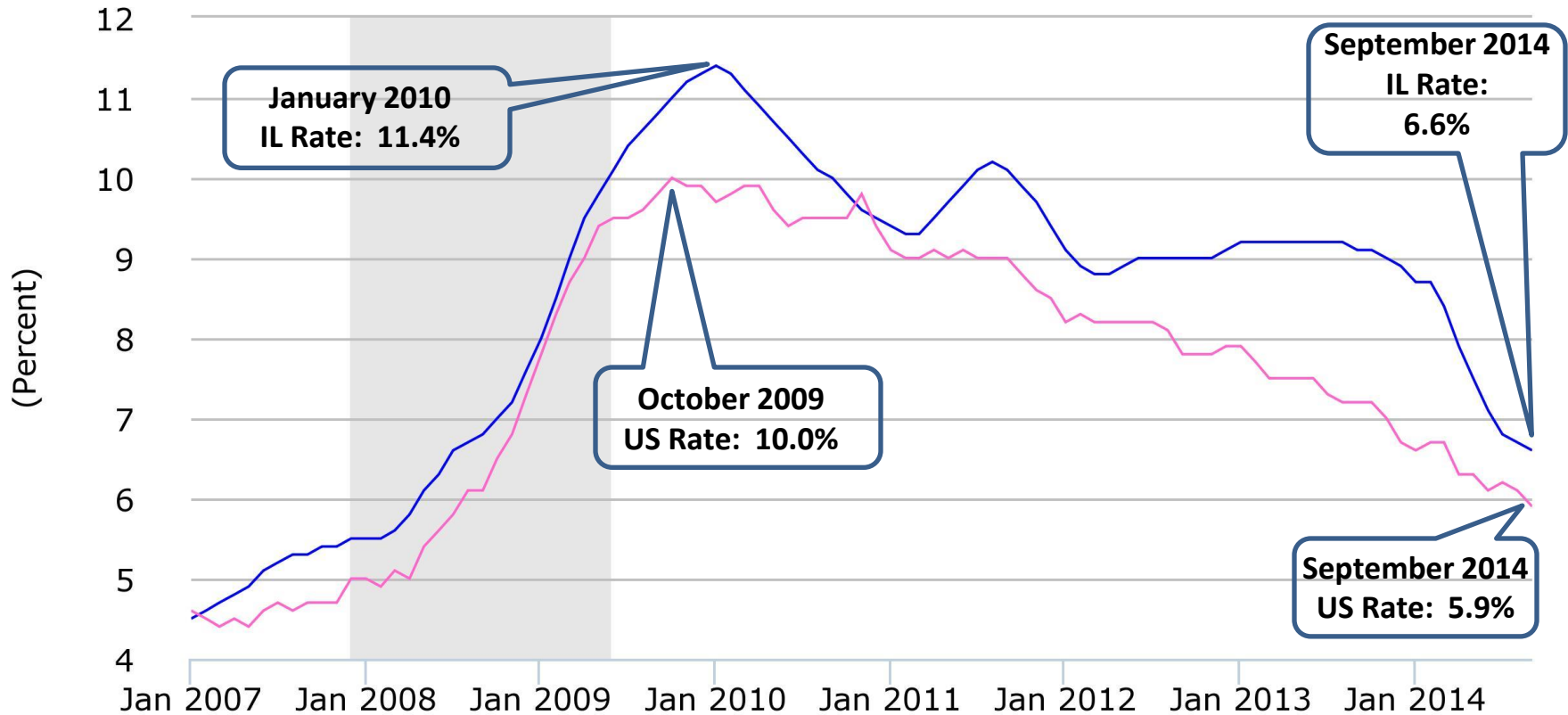


ECONOMIC OVERVIEW

FIGURE 1: ILLINOIS V. US UNEMPLOYMENT



— Unemployment Rate in Illinois
— Civilian Unemployment Rate



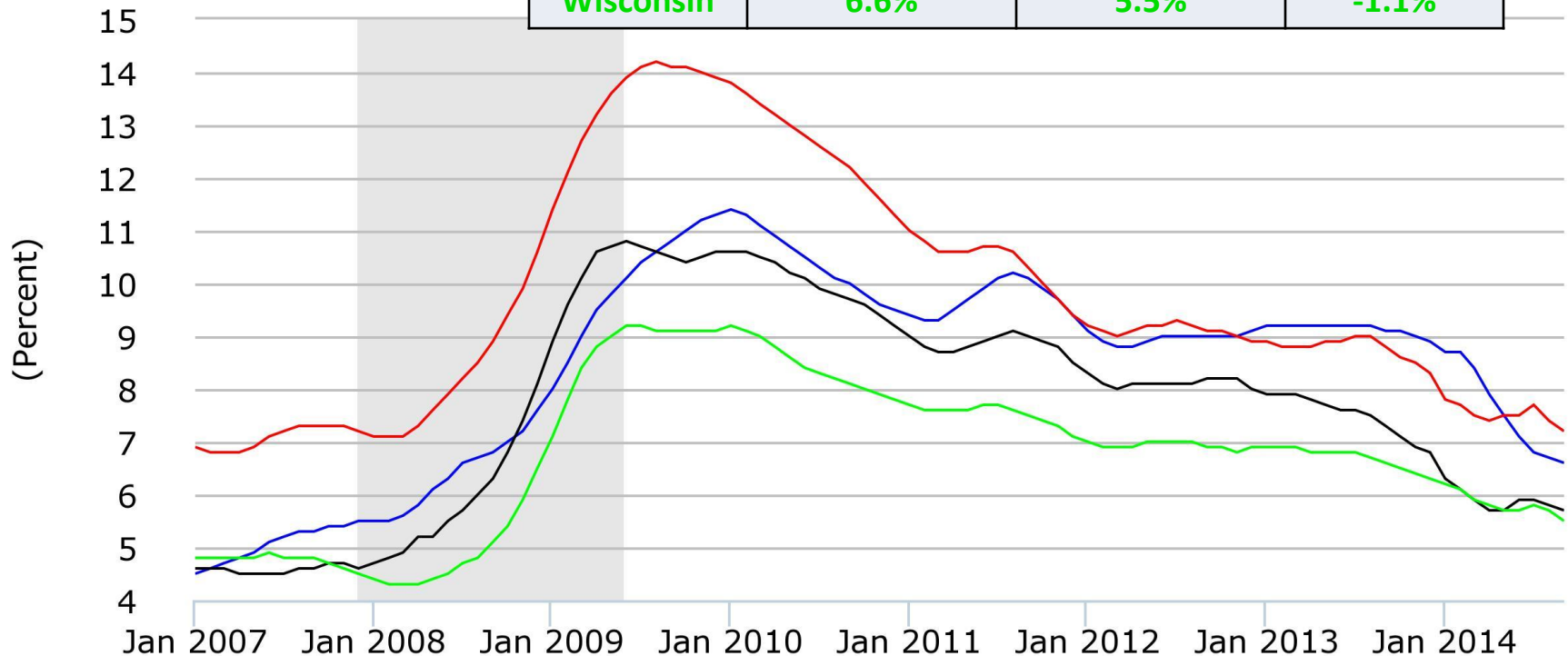
Shaded areas indicate US recessions - 2014 research.stlouisfed.org



FIGURE 2: MIDWESTERN STATE UNEMPLOYMENT



State	Sept. 2013	Sept. 2014	Change
Illinois	9.1%	6.6%	-2.5%
Michigan	8.8%	7.2%	-1.6%
Indiana	7.3%	5.7%	-1.6%
Wisconsin	6.6%	5.5%	-1.1%



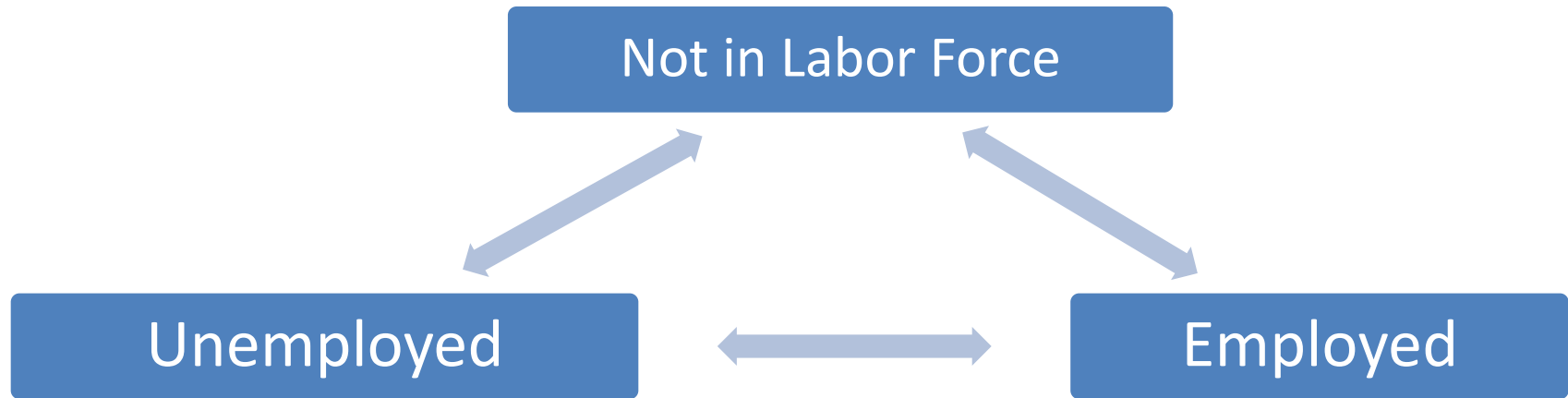
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UNEMPLOYMENT RATE IS AN IMPERFECT MEASURE OF ECONOMIC CONDITIONS

$$\textit{Unemployment rate} = \frac{\# \textit{Unemployed}}{\# \textit{Employed} + \# \textit{Unemployed}}$$

- Working-age population is divided into

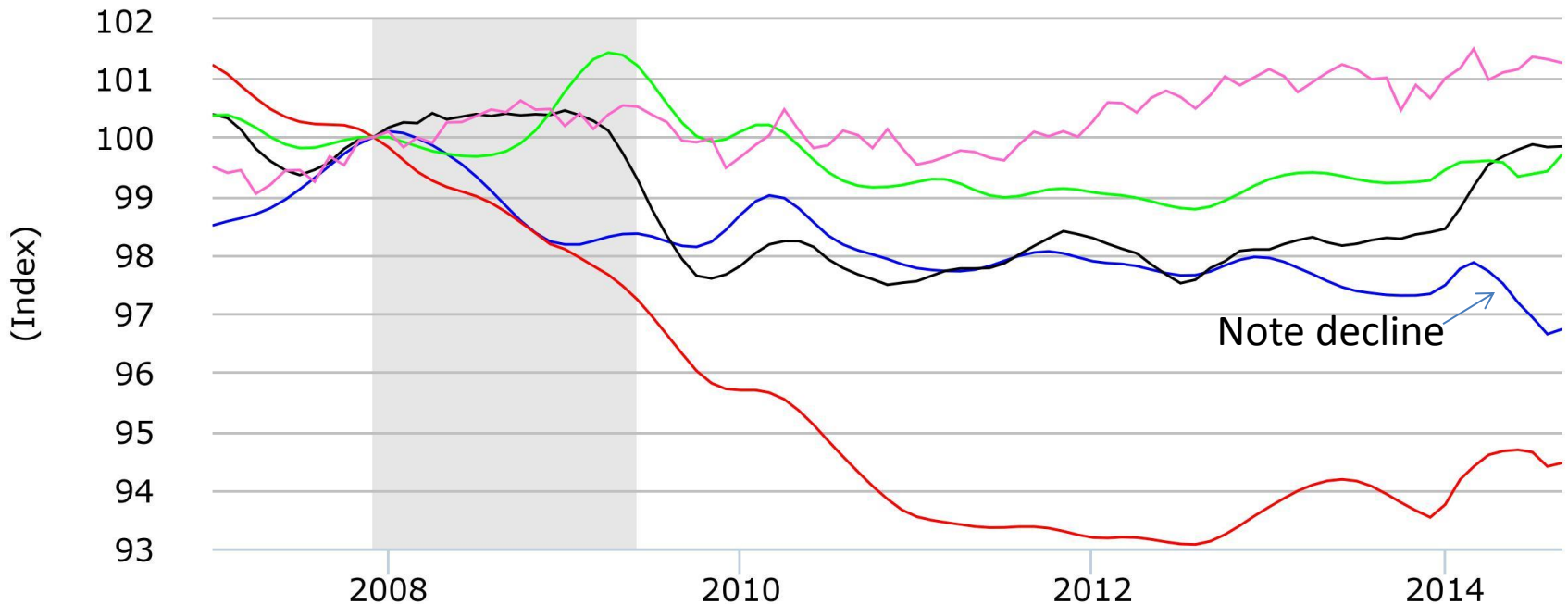


- Flows in and out of labor force complicate interpretation

FIGURE 3: LABOR FORCE IN IL, US, IN, MI & WI (AS PERCENT OF DECEMBER 2007 LEVELS)



- Civilian Labor Force in Illinois, 2007-12=100
- Civilian Labor Force in Michigan, 2007-12=100
- Civilian Labor Force in Indiana, 2007-12=100
- Civilian Labor Force in Wisconsin, 2007-12=100
- Civilian Labor Force, 2007-12=100



Shaded areas indicate US recessions - 2014 research.stlouisfed.org



RELATIVE CHANGE IN NUMBER EMPLOYED & UNEMPLOYED FROM SEPT. 2013 TO SEPT. 2014

Area	Change in number of persons		
	Unemployed	Employed	Labor Force
Illinois	-10	+8	-2

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United States	-10	+12	+2

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Illinois	-10	+8	-2
United States	-10	+12	+2
Michigan	-10	+14	+4
Wisconsin	-10	+15	+5

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Wisconsin	-10	+15	+5
Indiana	-10	+20	+10



FISCAL OVERVIEW

FY 2015 BUDGET

- Temporary income tax increase to phase out:

Calendar Year	Pre-2011	2011-14	2015-24	Post-2024
Personal Rate	3.0%	5.0%	3.75%	3.25%
Corporate Rate	4.8%	7.0%	5.25%	4.8%

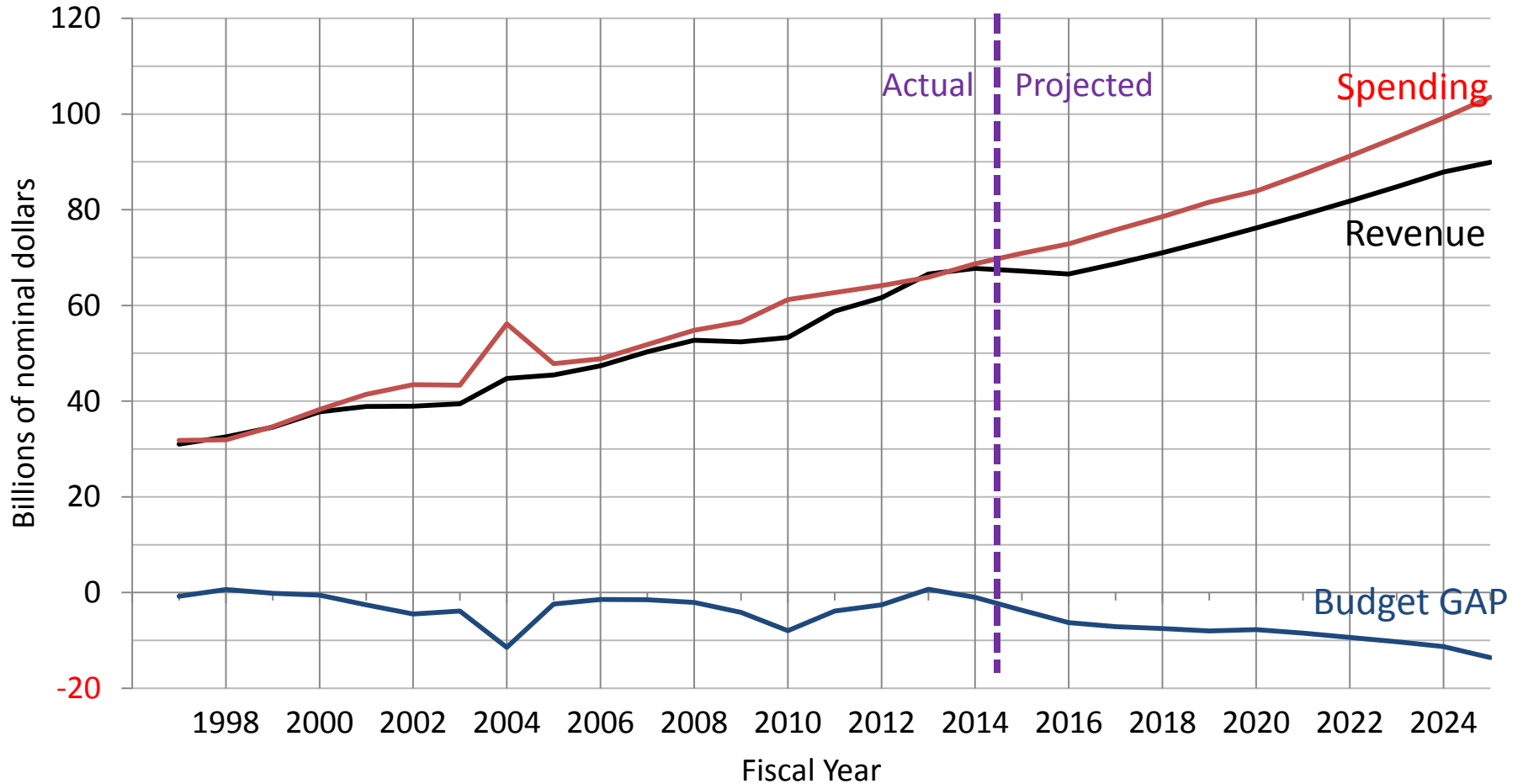
- Gov. Quinn proposed permanent extension for FY 2015
 - Would raise about \$2 billion in FY2015 & \$4 billion in FY2016
- General Assembly did not pass income tax extension in FY 2015 budget, rather
 - Borrow from future years with “fund sweeps”
 - “Borrow” by allowing unpaid bills to increase
 - Allocate “surplus” from FY2014



IGPA'S FISCAL FUTURES MODEL

- **Forward-Looking:** projects out 10+ years
- **Broad-based:** “All Funds” budget measure eliminates distortions from fund shifting
- Focus on ***Structural Budget Gap***
 - = *Total Revenue – Total Spending*
 - Want ***sustainable*** Total Revenue so *do not count* new borrowing or other one-time sources
- Our most recent projections:

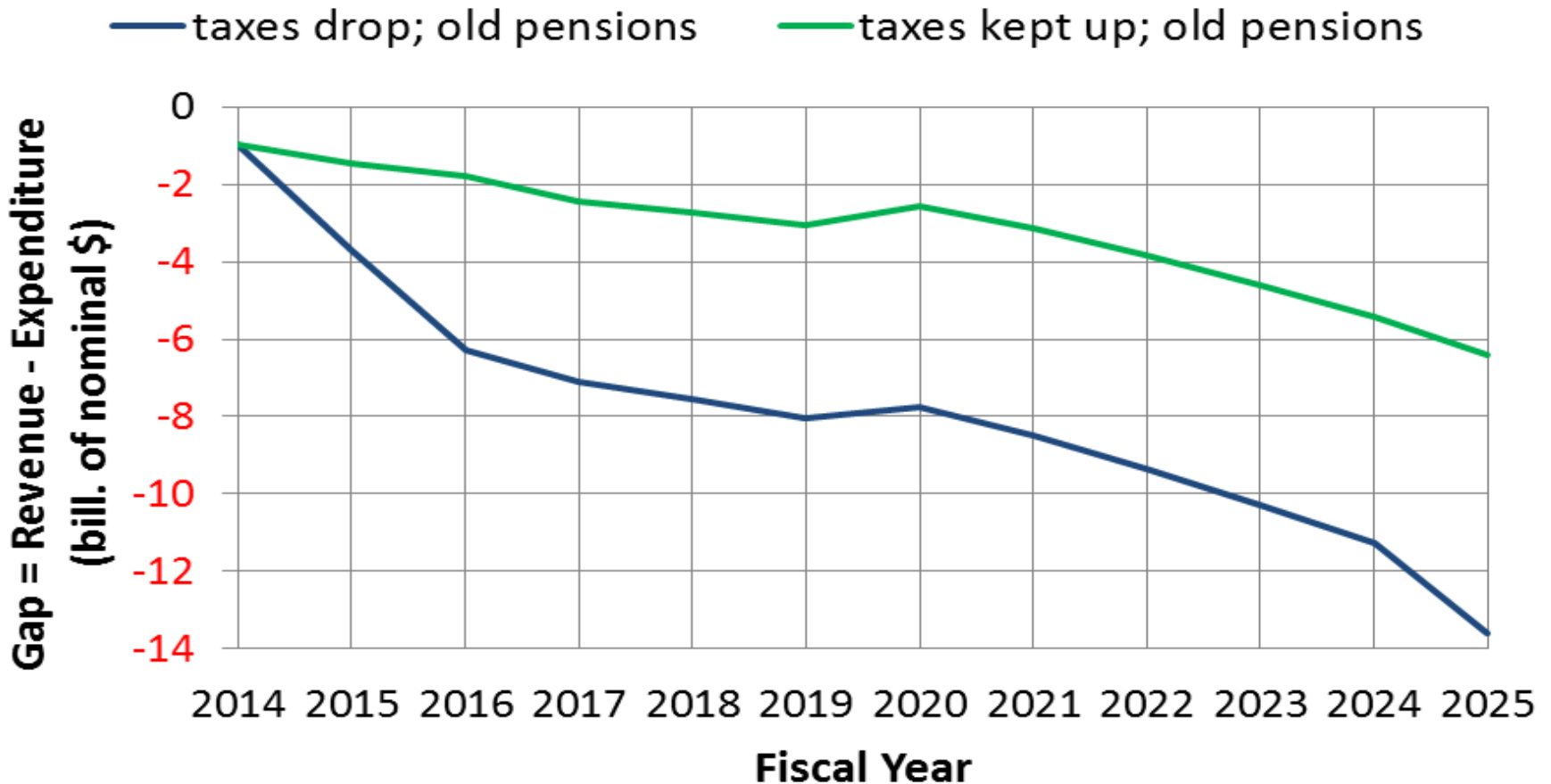
FIGURE 4: ILLINOIS ALL-FUNDS REVENUE, SPENDING, AND BUDGET GAP (= REVENUE – SPENDING) PROJECTIONS



Source: IGPA Fiscal Futures Model, May 2014.

Note: Revenue excludes new borrowing.

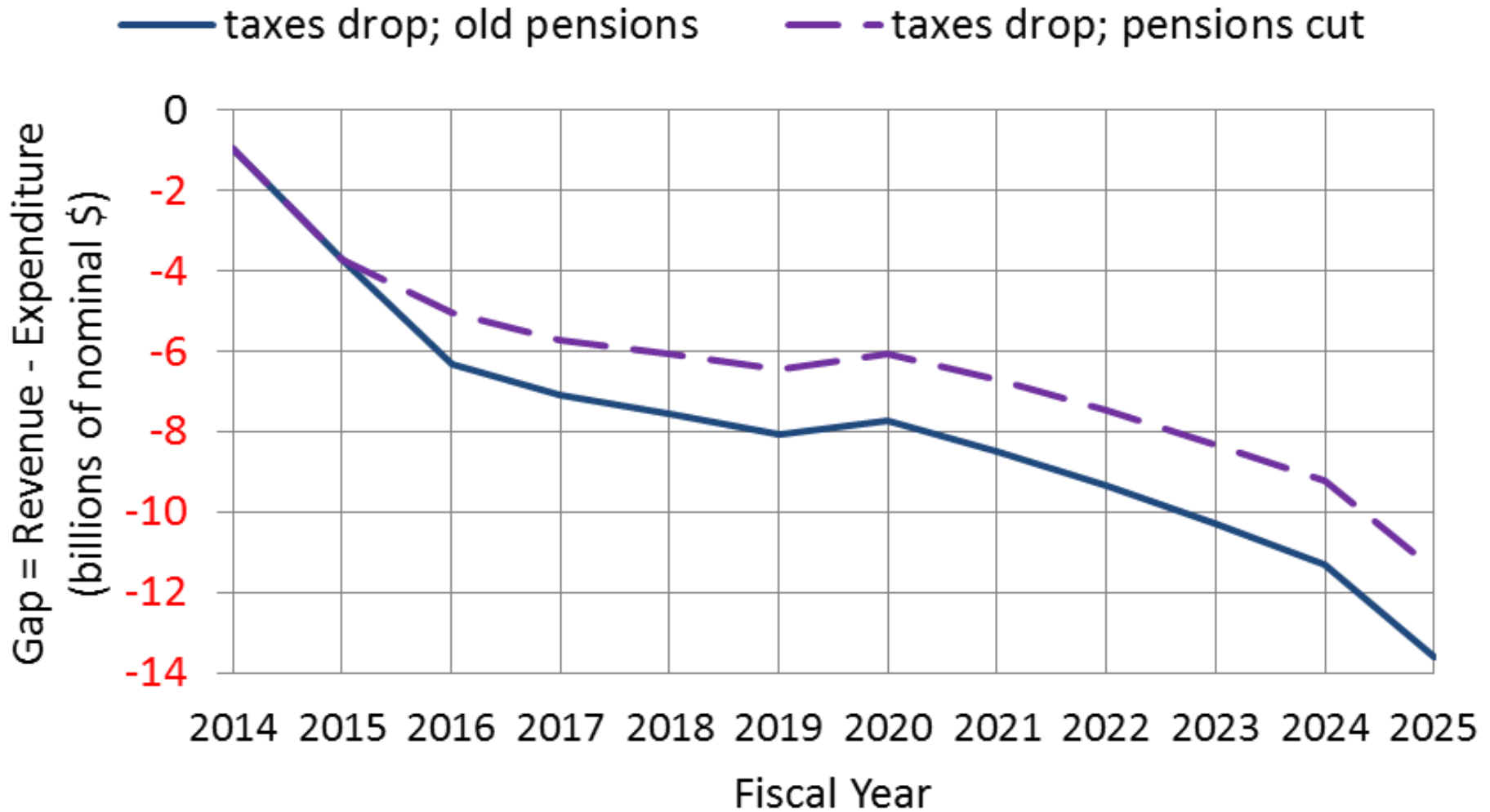
FIGURE 5: ILLINOIS ALL-FUNDS BUDGET GAP PROJECTIONS WITH & WITHOUT PHASE-OUT OF HIGHER TAX RATES AFTER 2014 & 2024



Source: IGPA Fiscal Futures Model, May 2014

Note: Revenue excludes new borrowing

FIGURE 6: ILLINOIS ALL-FUNDS BUDGET GAP PROJECTIONS WITH & WITHOUT DECEMBER 2013 PENSION LAW CHANGES



Source: IGPA Fiscal Futures Model, May 2014

Note: Revenue excludes new borrowing

MORE DIMENSIONS TO ILLINOIS' BUDGET CRISIS THAN LARGE AND GROWING DEFICITS

- Decreases in fund balances & other state assets
- Large liabilities for
 - Unfunded pension obligations (\$100 billion)
 - Unfunded retiree healthcare obligations (\$34 billion)
 - Unpaid bills (\$4.9 billion as of end of September)
- Illinois Supreme Court ruling in July
 - Voids 2012 law shifting retiree health costs
 - Poses threat to Dec. 2013 pension reduction law

ILLINOIS BOND RATINGS

- Illinois has worst ratings of 50 states
 - *S&P* A- with negative outlook
 - *Moody's* A3 with negative outlook
 - *Fitch* A- with negative outlook
- Lower ratings mean higher borrowing costs
- Recent IGPA study: IL borrowing costs higher than low ratings justify, a “penalty for IL’s poor fiscal reputation”
- S&P July 2014: “could lead to downgrade” if
 - pension reform is found invalid or delayed
 - lack of action on structural budget gap and payables

ILLINOIS BOND RATINGS WARNING FROM S&P

- July 23, 2014: Standard & Poor's dropped Illinois' credit outlook to “negative.” Saying:
- “If the pension reform is declared unconstitutional or invalid, or implementation is delayed and there is a continued lack of consensus and action among policymakers on the structural budget gaps and payables outstanding, **we believe there could be a profound and negative effect on Illinois' budgetary performance and liquidity over the next two years and that this could lead to a downgrade**”

Source: <http://www.chicagotribune.com/business/breaking/chi-illinois-credit-rating-negative-outlook-20140723-story.html>



SUMMARY

- **Illinois is still lagging significantly behind the Midwest** in economic conditions
 - despite the recent “improvement” in Unemployment rate
- **Illinois has a large and growing structural deficit**
 - larger than proposed higher tax rates and legislated lower pension costs together would eliminate
- **Illinois has huge liabilities from past deficits**
 - payoff of liabilities will crowd-out future spending
- **Illinois’ bond ratings threatened by fiscal inaction**
 - increased borrowing costs will affect state, related entities (e.g., universities), and local governments



FOR MORE INFORMATION:

IGPA.UILLINOIS.EDU