UPDATE ON ILLINOIS’ ECONOMIC AND FISCAL CHALLENGES AND RESPONSES

PRESENTATION TO THE BOARD OF TRUSTEES OF THE UNIVERSITY OF ILLINOIS
SEPTEMBER 14, 2012

DAVID MERRIMAN, PROFESSOR AND ASSOCIATE DIRECTOR
INSTITUTE OF GOVERNMENT AND PUBLIC AFFAIRS
OVERVIEW

• Recent IGPA activities
• Economic Overview
  – The U of I Flash Index
  – Illinois Unemployment ; Employment Growth Comparison
  – Projections for 2013
• Fiscal Overview
  – Bill Payment Backlog and what it means for U of I
  – Fiscal Conditions and Projections for FY2013 and beyond
  – Illinois’ Bond Rating
• Summary
RECENT IGPA ACTIVITIES

• State Budget Crisis Task Force (lead by Paul Volcker and Richard Ravitch)
  – Presentation in July in Washington, DC
  – National media coverage (NY Times, WSJ, etc.)
  – Illinois presentation in Chicago on October 24.
Task Force Findings

Six Major Threats to Fiscal Sustainability (all with some applicability to Illinois)

1. Medicaid Spending Growth
2. Federal Deficit Reduction
3. Underfunded Retirement Promises
4. Narrow, Eroding Tax Bases and Volatile Tax Revenues
5. Local Government Fiscal Stress
ECONOMIC OVERVIEW
THE STATE ECONOMY AS A WHOLE – AUGUST 2012 IGPA FLASH INDEX

- Index is based on growth rates in receipts from the personal and corporate income tax and the sales tax.
- Up from 101.9 at the previous board meeting and 90.0 in September 2009; unchanged from July 2012. An index over 100 indicates economy is expanding.
- Highest reading since April 2008.
- “Modest growth not sufficient enough to both reduce the backlog of the unemployed and accommodate new entrants into the work force.”

Index:
- September 2009: 90.0
- April 2012: 101.9
- August 2012: 102.9

The Flash Index is a measure of future economic activity (100 = no growth). Analysis by the Institute of Government and Public Affairs, University of Illinois.
**ECONOMIC OVERVIEW – ILLINOIS UNEMPLOYMENT**

Unemployment Rate in Illinois (ILUR)
Civilian Unemployment Rate (UNRATE)

- **January 2010**
  - IL Rate: 11.4%

- **Sep-Nov 2006:**
  - IL Rate: 4.4%

- **August 2012**
  - US Rate: 8.1%

- **July 2012**
  - IL Rate: 8.9% (Preliminary)

Shaded areas indicate US recessions.
2012 research.stlouisfed.org
## Economic Overview — Unemployment

<table>
<thead>
<tr>
<th>State</th>
<th>March 2012</th>
<th>July 2012</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois</td>
<td>8.8%</td>
<td>8.9%</td>
<td>+0.1%</td>
</tr>
<tr>
<td>Michigan</td>
<td>8.5%</td>
<td>9.0%</td>
<td>+0.5%</td>
</tr>
<tr>
<td>Indiana</td>
<td>8.2%</td>
<td>8.2%</td>
<td>0%</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>6.8%</td>
<td>7.3%</td>
<td>+0.5%</td>
</tr>
</tbody>
</table>

Shaded areas indicate US recessions. 2012 research.stlouisfed.org
In January 2013, under current law ("fiscal cliff"): 

- Provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 are set to expire, including:
- Sharp reductions in Medicare’s payment rates for physicians’ services are scheduled to take effect.
- Automatic enforcement procedures established by the Budget Control Act of 2011 (P.L. 112-25) to restrain discretionary and mandatory spending.
- Extensions of emergency unemployment benefits and a reduction of 2 percentage points in the payroll tax for Social Security are scheduled to expire.

2013 Economic Outlook (CBO): Impact of Impending Policy Changes

- Baseline projection (assumes current law):
  - Fiscal tightening will lead to economic conditions in 2013 that will probably be considered a recession
    - real GDP declining by 0.5 percent between the fourth quarter of 2012 and the fourth quarter of 2013
    - unemployment rate rising to about 9 percent in the second half of calendar year 2013.
FISCAL OVERVIEW
UNPAID BILLS: SITUATION IS SLIGHTLY IMPROVED

Comparison of General Revenue Fund Daily Cash Balances
FY 2010-FY 2013 Adjusted to Reflect Unpaid Bills

Source: Illinois Comptroller, August 2012
WILL FISCAL CONDITIONS IMPROVE?

• In FY 2013, revenue will not grow much
  – Personal income tax projected to rise 2.2 percent
  – Corporate income tax projected to be flat
  – Sales tax projected to rise 1.6 percent

• "After exceeding expectations in FY 2012, the largely economically related sources are forecast to slow significantly as the recovery appears to be stalling out," -Jim Muschinske, COGFA

WHAT IS THE STATE DOING TO FIX ITS PROBLEMS?

• Medicaid reform
  – Projected $2.7 billion in program changes and tax increases
  – Combination of:
    • Tighter eligibility enforcement (e.g. state residency)
    • Reduced reimbursement rates
    • Optional service elimination (e.g. adult dental care)
    • Cigarette tax increase of $1 per pack

• Long term problems not solved

• One of the largest issues that remains: Pensions
As growing pension costs crowd out other state spending, higher education funding will continue to be cut.

Quinn administration: Comprehensive pension reform with gradual normal cost realignment of 0.5% would effectively alleviate funding pressures for Universities.

ILLINOIS’ BOND RATING

- Standard & Poor’s downgraded Illinois on August 29, noting, “the downgrade reflects the state's weak pension funding levels and lack of action on reform measures intended to improve funding levels and diminish cost pressures associated with annual contributions.”

- Moody’s warned on August 23 it may downgrade Illinois further as well, explaining “inaction on the state's pension liabilities will further strain this lowest-rated state's finances.”

### SOURCES:

SUMMARY

• State economic conditions continue to improve slowly, but not enough to reduce unemployment
• 2013 policy changes could lead to a further slowing economy, and potentially another recession
• Some important strides in state policy have been made, but big issues (e.g. pensions) are still unaddressed, and this is costing the state – and U of I – a large amount of money
• Unpaid bill backlog may increasingly affect U of I in the upcoming year
FOR MORE INFORMATION:

IGPA.UILLINOIS.EDU