Update on Illinois' Economic and Fiscal Challenges and Responses

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of the University of Illinois
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Overview

- Recent IGPA activities
- Brief Economic Overview
  - The U of I Flash Index
  - Illinois Unemployment ; Employment Growth Comparison
  - Projections for 2013
- Fiscal Overview: Highlights of Fiscal Futures' *Illinois Report* 2013 chapter
- Summary

RECENT IGPA ACTIVITIES

- *The Illinois Report* 2013
  - IGPA's signature publication, in its 7th edition for 2013
  - Examination of the state of Illinois' performance on several critical issues
  - Fiscal Futures chapter: **And Miles to Go Before It's Balanced: Illinois Still Faces Tough Budget Choices**
    - Highlighted in coming slides

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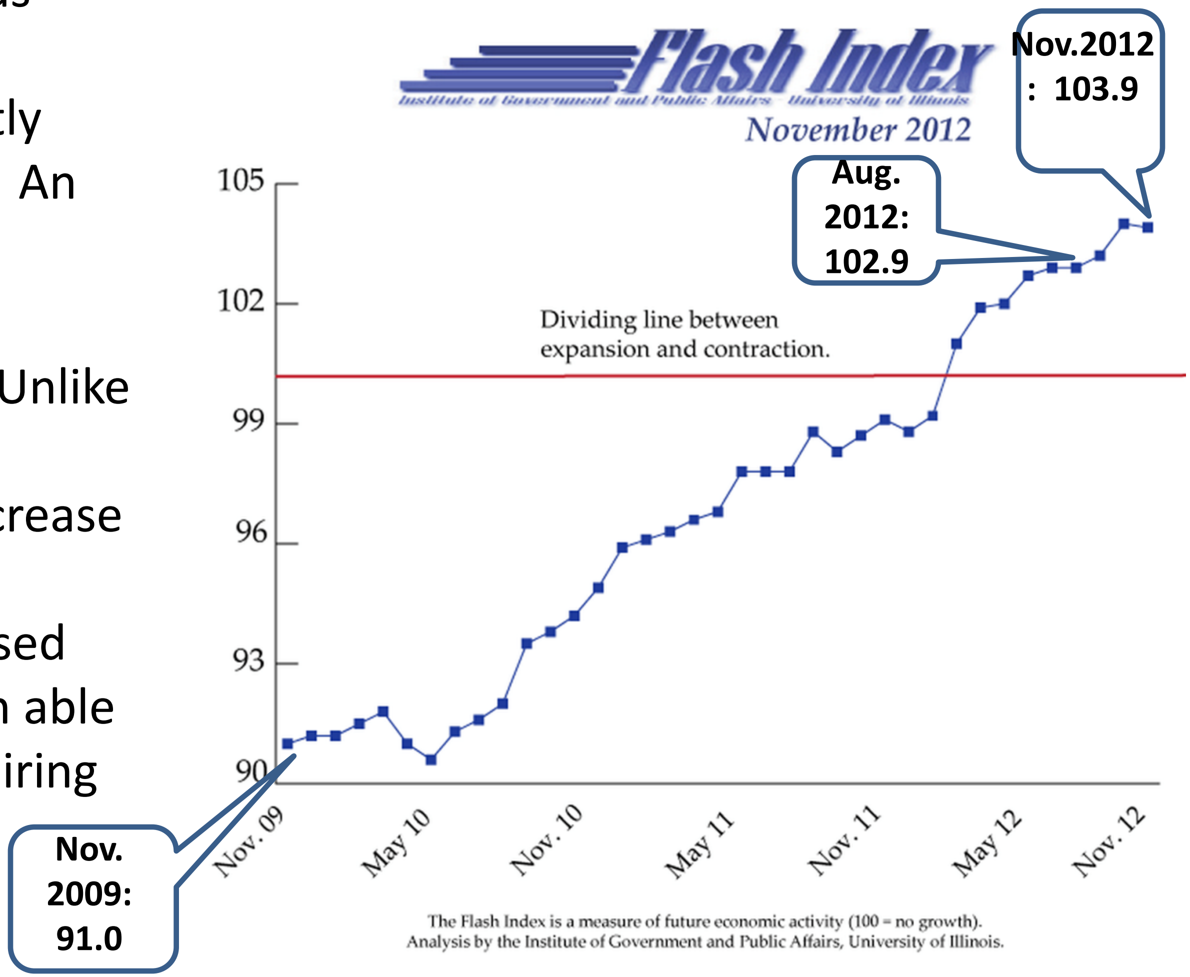
ECONOMIC OVERVIEW

THE STATE ECONOMY AS A WHOLE – NOVEMBER 2012 IGPA FLASH INDEX

- Up from 102.9 at the previous board meeting and 91.0 in November 2009; down slightly from 104.0 in October 2012. An index over 100 indicates the economy is expanding.
- IGPA Director Giertz notes, "Unlike most previous recessions, productivity continued to increase during and after the recent recession. Because of increased productivity, firms have been able to increase output without hiring many additional workers"



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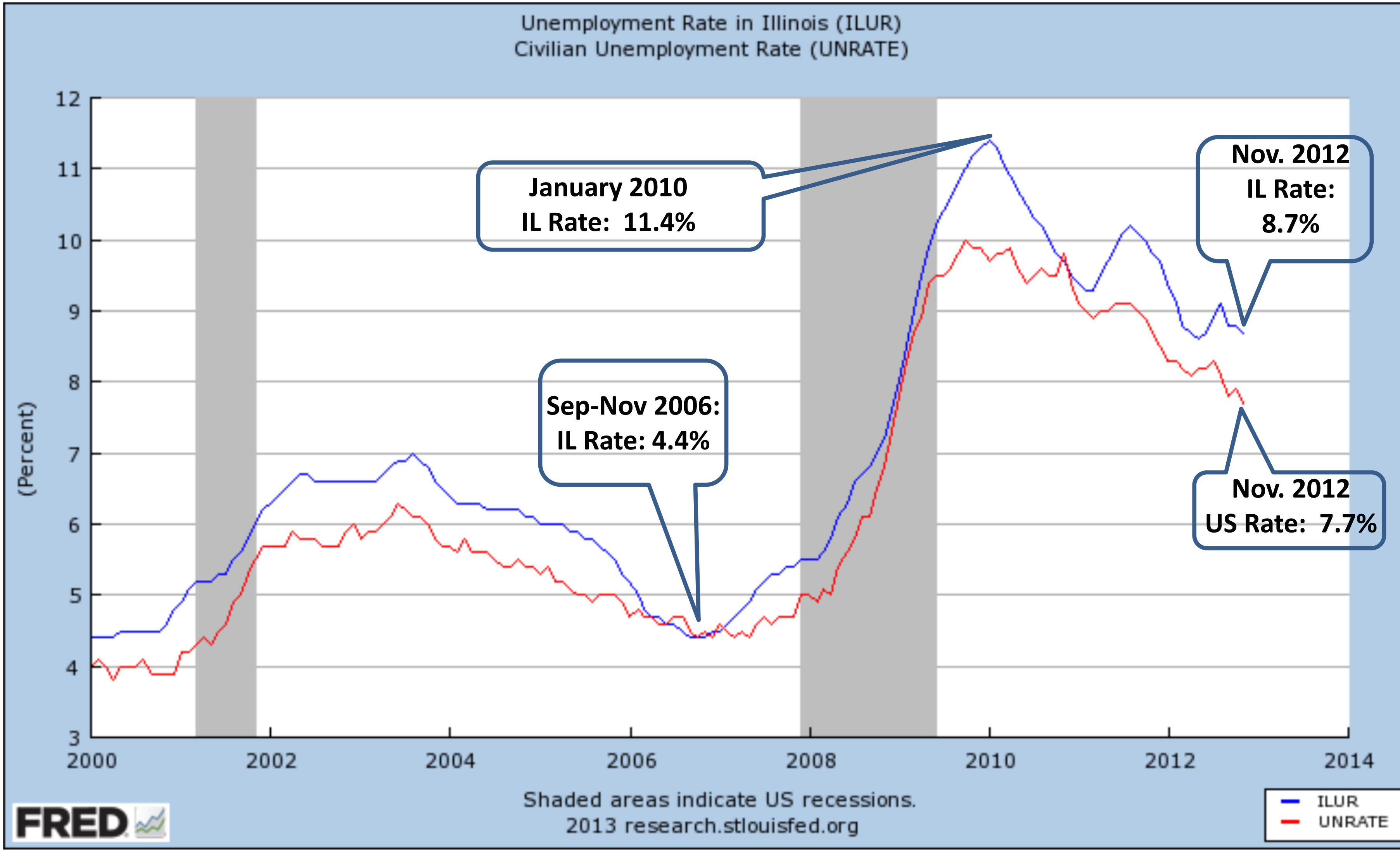
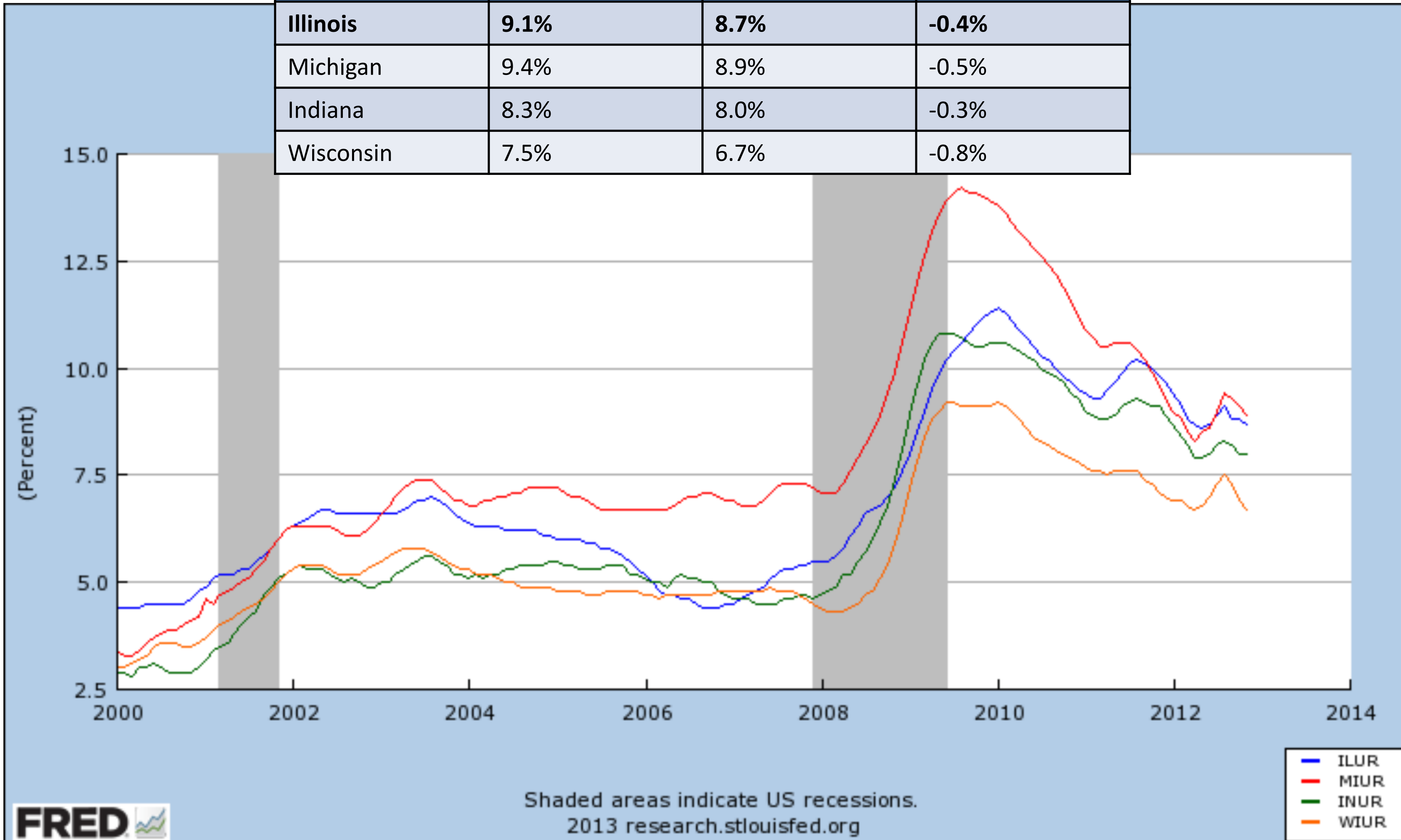
ECONOMIC OVERVIEW – ILLINOIS UNEMPLOYMENT



Economic Overview – Unemployment

State	August 2012	November 2012	Change
Illinois	**9.1%**	**8.7%**	**-0.4%**
Michigan	9.4%	8.9%	-0.5%
Indiana	8.3%	8.0%	-0.3%
Wisconsin	7.5%	6.7%	-0.8%



Are there Still Risks from the Fiscal Cliff?

- Increased taxes and other provisions in the fiscal cliff deal will still create some drag on the economy (initial estimates range from 0.4 to 0.6 percent of GDP), although less than initial "cliff" projections
- "The main risk at this point is that Congress fails to effectively tackle the spending side of the equation in the next two months. Under this scenario, the budget sequester would kick in, possibly some retroactive consequences."
  - Another "cliff" is possible March 1
- A possible showdown over the debt limit could cause additional fiscal changes

Source: Izzo (2013), "Academic Economists React: Shortfalls of Fiscal Cliff Deal," *The Wall Street Journal*, January 2, 2013 http://blogs.wsj.com/economics/2013/01/02/academic-economists-react-shortfalls-of-fiscal-cliff-deal/; Khimm (2013), "Forget the market rally. The fiscal cliff deal is still a drag on growth." *The Washington Post*, http://www.washingtonpost.com/blogs/wonkblog/wp/2013/01/03/forget-the-market-rally-the-fiscal-cliff-deal-is-still-a-drag-on-growth/

WHAT ABOUT THE FISCAL CLIFF?
POTENTIAL IMPACTS ON FEDERAL REVENUES

SELECTED INDICATORS OF STATES' POTENTIAL VULNERABILITIES TO SPENDING CUTS IN THE FISCAL CLIFF

	Federal Grants Subject to Sequester as a Percentage of State Revenue (2010)**	Federal Spending on Procurement, Salaries, and Wages as a Percentage of State GDP (2010)	Federal Defense Spending on Procurement, Salaries, and Wages as a Percentage of State GDP (2010)	Federal Nondefense Spending on Procurement, Salaries, and Wages as a Percentage of State GDP (2010)	Federal Nondefense Workforce as a Percentage of Total Employed in State (2012)
National Average	6.6%	5.3%	3.5%	1.8%	1.0%
Illinois	8.5%	2.5%	1.5%	1.0%	0.6%

Source: Pew Center on the States, "The Impact of the Fiscal Cliff on the States: Illinois" http://www.pewstates.org/uploadedFiles/PCS_Assets/State_Factsheet_Graphics/Fiscal%20Cliff%20Factsheet_Final_illinois.pdf (Archived by WebCite® at http://www.webcitation.org/6DPdGoUVL)

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What about the Fiscal Cliff? Potential Impacts on Tax Revenues

DIRECT IMPACT OF THE FISCAL CLIFF ON STATE TAX REVENUES

Tax Categories:	Personal Income Tax[a]				Corporate Income Tax[e]	Estate Tax
Federal changes under the fiscal cliff:	Increase total federal tax liability	Reduce certain federal personal deductions	Reduce certain federal credits		Reduce certain federal business deductions	Reduce federal exclusion and reinstate federal credit
State linkage to federal policy:	State allows deduction for federal income taxes[b]	State linked to those deductions[c]	State linked to the Earned Income Tax Credit[d]	State linked to the Child and Dependent Care Credit[d]	State linked to those deductions[f]	State linked to those changes[g]
Illinois	N/A	△	△	N/A	△	N/A

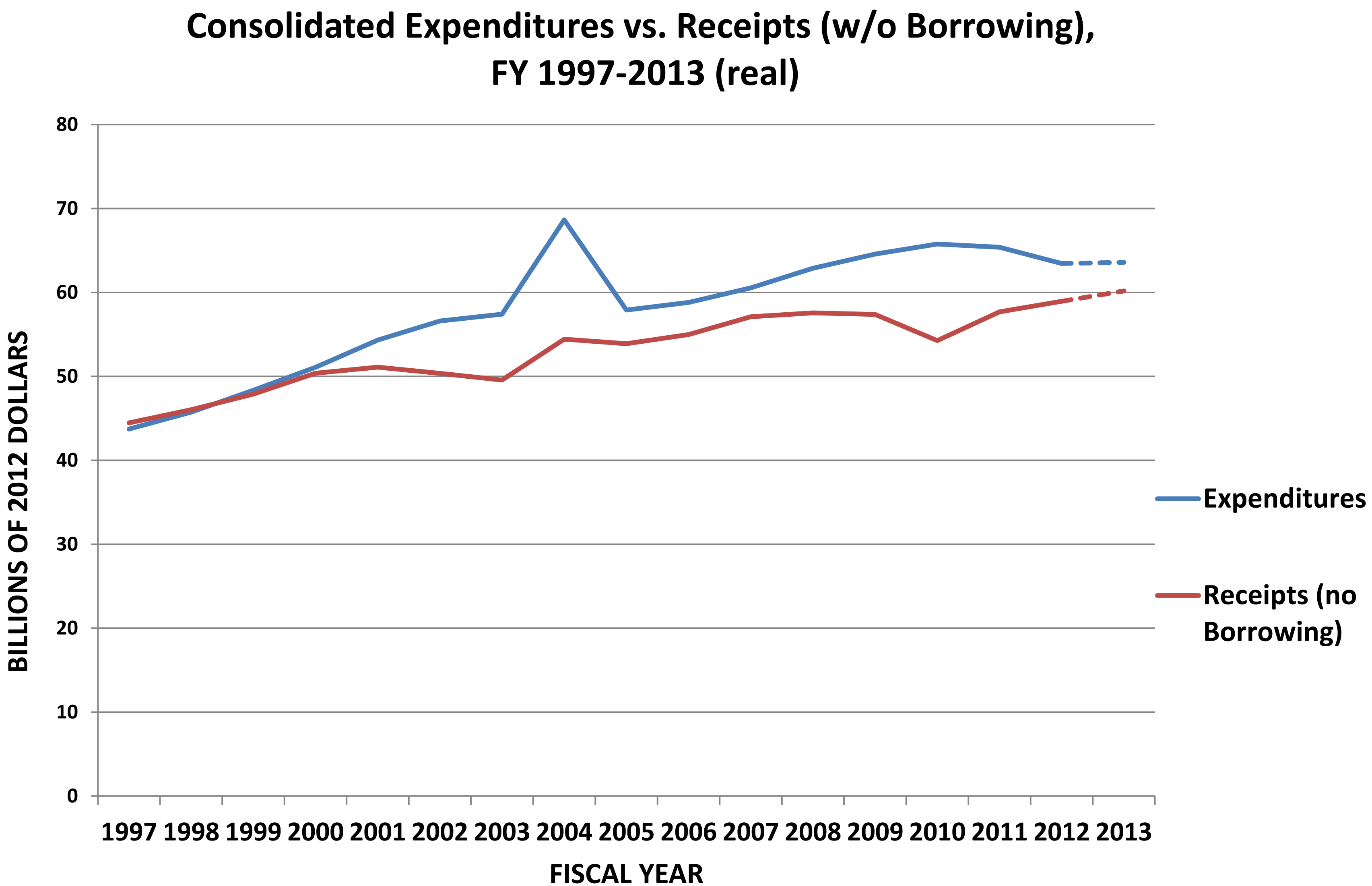
△ indicates an expected increase in state revenue
▼ indicates an expected decrease in state revenue

N/A indicates the state is not linked to the federal provision or does not levy this tax
UNKNOWN indicates any potential impact could not be identified at the time of writing

Source: Pew Center on the States, "The Impact of the Fiscal Cliff on the States: Illinois" http://www.pewstates.org/uploadedFiles/PCS_Assets/State_Factsheet_Graphics/Fiscal%20Cliff%20Factsheet_Final_illinois.pdf (Archived by WebCite® at http://www.webcitation.org/6DPdGoUVL)

FISCAL OVERVIEW

ILLINOIS FINANCES OVER TIME



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AND MILES TO GO BEFORE IT'S BALANCED: ILLINOIS STILL FACES TOUGH BUDGET CHOICES

2013 *ILLINOIS REPORT*

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Careening Toward a Date with Fiscal Reality

- Late 2010: Fiscal Futures calls Illinois' fiscal condition "Titanic…and Sinking"
- Two years later, we see signs of progress, but we have a long way to go.

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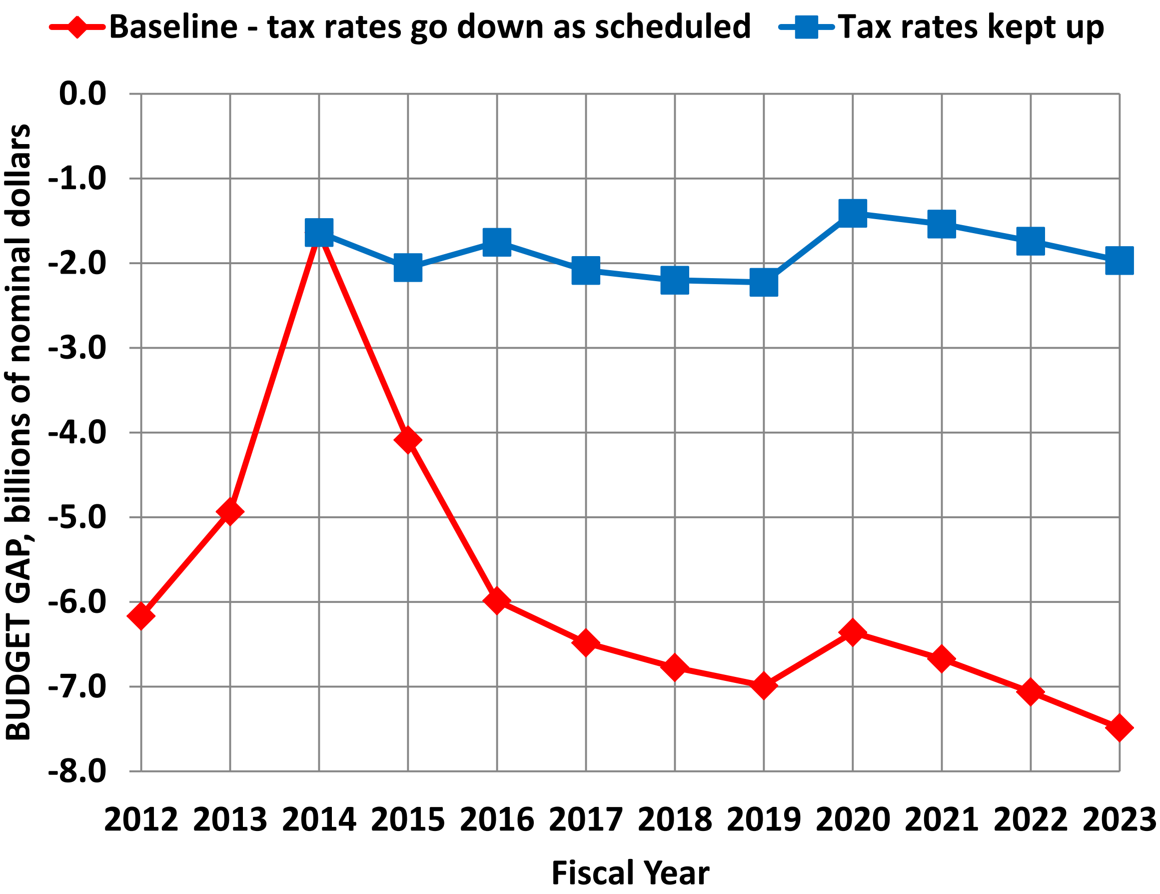
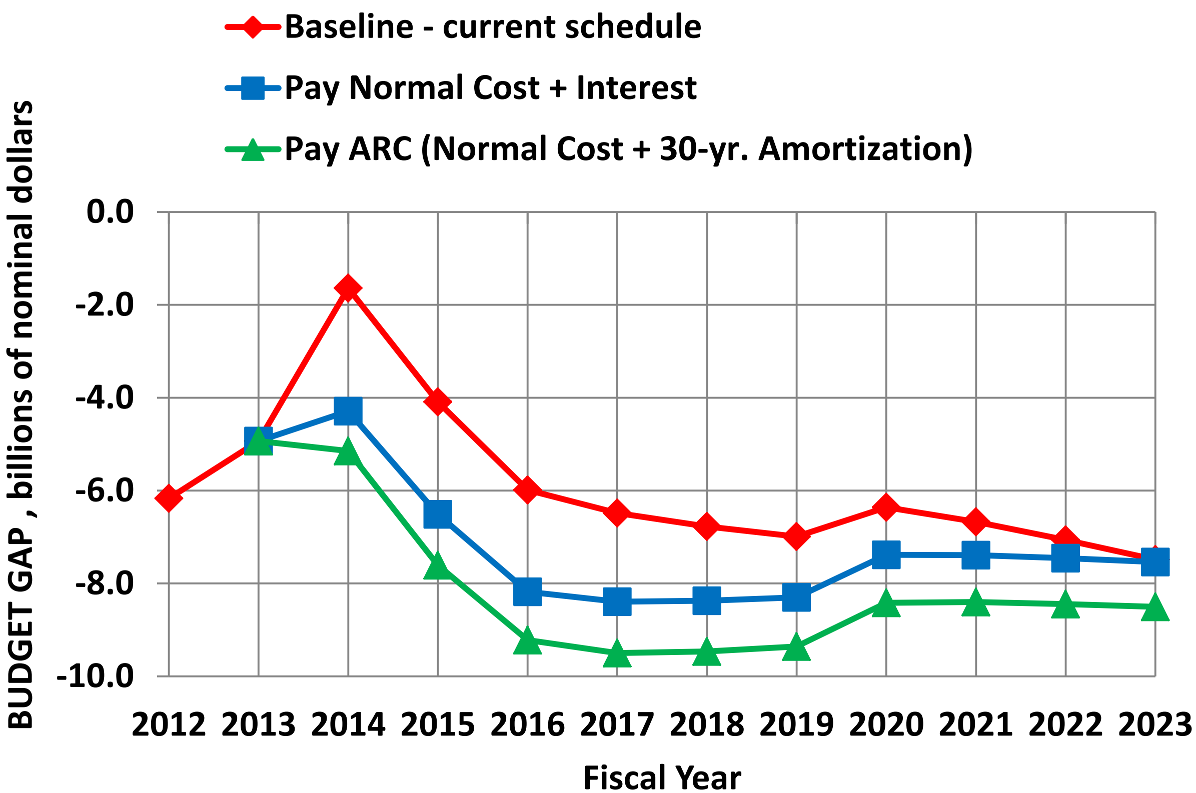
Updated Fiscal Futures Projections

- If higher tax rates expire in 2014, the State will face a deficit of **$4 billion in 2015** and nearly **$7 billion by 2019**
- Even if tax rates kept up, Illinois will have a deficit of **approximately $2 billion**



Pensions: A Looming Crisis

- The State continues to get into a deeper pension hole by not paying normal cost plus interest
- Existing schedule shows pension payments would increase from $5.9 billion in FY 2013, to $9.2 billion in FY 2023, to $11.5 billion in 2030, and to $17.6 billion in 2045



ILLINOIS' BOND RATING

ILLINOIS' G.O. BOND RATINGS OVER TIME			
Year	**S&P**	**Moody's**	**Fitch**
1998	AA	Aa2	AA
1999	AA	Aa2	AA
2000	AA	Aa2	AA+
2001	AA	Aa2	AA+
2002	AA	Aa2	AA+
2003	AA	Aa3	AA
2004	AA	Aa3	AA
2005	AA	Aa3	AA
2006	AA	Aa3	AA-
2007	AA	Aa3	AA
2008	AA	Aa3	AA-
2009	A+	A2	A
2010	A+	A1	A
2011	A+	A1	A
2012	A (neg.)	A2 (neg.)	A (stable)

1. *Chicago Sun-Times*, "Moody's lowers Illinois' credit outlook." December 14, 2012. http://www.suntimes.com/business/17001449-420/moodys-lowers-illinois-credit-outlook.html (Archived by WebCite® at http://www.webcitation.org/6CzXqk1s1).

- Moody's issued a negative outlook for Illinois' bonds on December 13, 2012 warning "fiscal 2014 marks the last year before Illinois' 2011 income tax increases are partly unwound, putting the state on track to deal with simultaneous growth in pension funding needs and loss of revenue." [1]
- If Moody's were to downgrade Illinois to A3, it would be not only the lowest rating in the nation, but two steps below the next lowest state, California (rated A1).

SOURCES:

2012 Data:	http://www.ioc.state.il.us/index.cfm/fiscal-condition/bond-ratings/
2011 Data:	Standard and Poor's Brief History of US State Credit Ratings, July 2011; Moody's Investors Service; Fitch Ratings; http://www.ioc.state.il.us/index.cfm/fiscal-condition/bond-ratings/
2010 Data:	http://www.census.gov/prod/2011pubs/12statab/stlocgov.pdf
2009 and Earlier Data:	http://www.census.gov/compendia/statab/past_years.html

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SUMMARY

- State economic conditions continue to improve slowly
- A phase-out of tax increases after 2014 would create a large deficit, and even keeping the rates higher will not solve Illinois' budget woes
- Pensions are a looming problem that continues to grow as the state pays less than normal cost plus interest
- Illinois' bond rating continues to be threatened by fiscal inaction.

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GOMB PROJECTIONS: 2014-2016 REVENUE

($ in Millions)	Actual 2012	Enacted 2013	Forecast 2014	Forecast 2015	Forecast 2016
RESOURCES					
Base Resources					
Individual Income Tax	15,512	15,273	15,717	14,255	12,188
Corporate Income Tax	2,461	2,513	2,871	2,116	1,708
Sales Tax	7,226	7,335	7,385	7,570	7,765
All Other State Sources	3,051	3,047	3,043	3,073	3,106
State Sources	28,250	28,168	29,015	27,014	24,767
Federal Sources	3,682	4,231	4,222	4,441	3,981
Transfers In	1,763	1,962	1,723	1,749	1,775
TOTAL RESOURCES	33,695	34,360	34,960	33,203	30,523

- New GOMB forecast assumes phase-out of January 2011 tax increases, and an income tax revenue decline of more than $4 billion from 2012 amounts by 2016 ($17.97 billion vs. $13.89 billion)

Source: Governor's Office of Management and Budget: http://www.state.il.us/budget/Financial%20Reports/3%20Year%202013%20FINAL.pdf (Archived by WebCite® at http://www.webcitation.org/6Dj56uT1H)

GOMB Projections: 2014-2016 Expenditures

- Education (before pensions) would face cuts of more than $2.1 billion from 2012 levels by 2016
- More than $7.4 billion in unpaid bills would remain with no plan to address them

	Actual 2012	Enacted 2013	Forecast 2014	Forecast 2015	Forecast 2016
1. Education (including pensions)	12,073	12,551	12,999	12,755	11,835
Education (before pensions)	8,843	8,521	8,127	7,735	6,690
K-12 Education Pensions	2,480	2,777	3,513	3,621	3,753
State Universities' Pensions	750	1,253	1,360	1,399	1,392
TOTAL EXPENDITURES	33,801	33,986	34,860	33,203	30,523
Repay Interfund Borrowing & Budget Stabilization Fund	632	132	-	-	-
General Funds Surplus/Deficit	(738)	242	100	0	0
General Fund Balance (Accounts Payable less cash)	(5,361)	(5,119)	(5,019)	(5,019)	(5,018)
Section 25 Bills	(3,966)	(3,169)	(2,405)	(2,405)	(2,405)
GROSS BILL BACKLOG AT END OF FISCAL YEAR	(9,327)	(8,288)	(7,424)	(7,424)	(7,423)

* Fiscal year 2014 growth makes up for previous underappropriation.

Source: GOMB, 2013 (please see previous slide for URL)

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MEDICAID: PROMISING, BUT SHORT TERM

- If growth continues at historical rates, 2012 cuts will hold spending below its inflation-adjusted 2012 level for **only about 5 years.**
- Cuts needed to keep Medicaid at zero growth in real dollars would be significant **and still would not balance budget**