Bureau of Finance | Office of the Chief Financial Officer
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MEMORANDUM

Date: November 06, 2019

To: Honorable Alma E. Anaya, Cook County Board of Commissioners
Honorable Cook County Board of Commissioners

CC: Lanetta Haynes Turner, Chief of Staff
John Roberson, Legislative and Governmental Affairs
Tanya Anthony, Budget Director

From: Ammar M. Rizki, Chief Financial Officer, Bureau of Finance

Subject: **FY2020 Budget Questions**

Dear Honorable Commissioner Anaya,

Please find below the responses to your questions regarding the FY2020 Budget from the Bureau of Finance.

Question 1: This past Summer, your office presented a revenue forecast to the Independent Revenue Forecasting Commission that shows stagnant revenues over the next five years. Our analysis of this (including sales taxes) shows an average increase of slightly more than 1% or $20M per year for the top nine revenue sources in aggregate. That is not sufficient to meet even normal growth in salaries and costs of supplies and maintenance. What is your plan for addressing this problem?
The purpose of the Independent Revenue Forecasting Commission was to provide objective analysis of our revenue. It has shown a real problem that needs to be addressed.

Response:
The County's general fund revenues are expected to increase at a compound annual growth rate of just 0.8% between FY20 and FY24 while expenses are expected to increase at a compound annual growth rate of 2.2%. For more details, the full long-term forecast can be reviewed on pages 16 to 21 in Volume I of the FY2020 Executive Recommendation.

The Bureau of Finance has several controls it uses to address the fact that costs are rising at a higher rate than revenues.

- As part of the budgeting process, we will re-evaluate estimated revenues and set targets for the departments to achieve during the department request phase. Over the years, efforts to reduce the County's structural deficit have resulted in progressively lower gaps with correspondingly less austere targets for departments to achieve each year.

- The budget office may implement, if necessary, holdbacks and hiring freezes in order to make mid-year corrections if anticipated revenues are expected to fall short of projected end of year expenses.
- However, as indicated in the narrative of the long-term financial forecast, "Cook County will either need to reduce expenses, identify new revenues or replace existing revenues with ones that grow at the rate of inflation in order to maintain a balanced budget" (P18, Executive Budget Recommendation Volume I)

In the coming year the Bureau of Finance expects to work with all stakeholder to address long term revenue challenges, which continue to result in out year deficits. The Bureau of Finance always addresses these challenges through structural measures, rather than one-time solution; hence, we will continue to advocate for such structural solutions to address the County's long-term fiscal challenges.

Question 2: Your projections and the Independent Revenue Forecasting Commission's projections do not assume any recession in the next five years. How likely will that be in your opinion? Also, even a modest recession next year or the year after, according to the forecasting model your office presented, will result in a decrease in AT LEAST the sales tax projections**. Given that sales tax is the only revenue source that you project to reliably increase each year, how are you preparing and monitoring for any sales tax shortfalls?**

We will address this question in two parts.
A) Your projections and the Independent Revenue Forecasting Commission's projections do not assume any recession in the next five years. How likely will that be in your opinion?

RESPONSE 2A: A recession is defined as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."[i] For our purposes, we will focus on the concept of Real GDP which is the Gross Domestic Product less the increase in inflation. In contrast, Nominal GDP is a combination of Real GDP plus inflation. The below table provides three forecasts from independent reputable sources, the Federal Reserve, The Survey of Professional Forecasters and the Wall Street Journal's Economic Survey.

	Federal Reserve[ii]			**Survey of Professional Forecasters[iii]**			**WSJ Economic Forecasting Survey[iv]**		
	Inflation	**Real GDP**	**Nominal GDP**	**Inflation**	**Real GDP**	**Nominal GDP**	**Inflation**	**Real GDP**	**Nominal GDP**
2020	1.9%	2.0%	3.9%	2.1%	1.9%	4.0%	2.0%	1.9%	3.9%
2021	2.0%	1.8%	3.8%	2.2%	2.3%	4.5%	2.2%	2.0%	4.1%

According to the National Bureau of Economic Research's (NBER) definition a forecasted recession would show a 0.0% or less Real GDP growth so that total growth or Nominal GDP would be equal to or lower than inflation. Among these three sources, 2020 inflation is around 2.0% and real GDP is around 1.9%, for a combined nominal increase of approximately 3.9%. On a nominal basis, Cook County Sales tax (which is closely corelated to National GDP) is estimated to increase over the FY19 estimate by 2.8%. While not quite a recession, the sales tax estimate does suppose a slowdown in Real GDP, which we believe is fiscally prudent and the most likely scenario for FY20 despite being more conservative than the forecasts above. The nominal increase in sales tax in FY21 over FY20 is 2.4%.

B) Also, even a modest recession next year or the year after, according to the forecasting model your office presented, will result in a decrease in AT LEAST the sales tax projections. ***Given that sales tax is the only revenue source that you project to reliably increase each year, how are you preparing and monitoring for any sales tax shortfalls?***

Response 2B: As indicated above, a modest recession would not necessarily result in a decrease in sales tax, as inflationary forces may be enough to keep the growth in sales tax revenue higher than the prior year. Over the course of the year, the CFO's Office is continuously monitoring revenues and expenses as compared to budget as well as monitoring and recording macroeconomic trends and reports that may indicate the beginnings of a recession. In the event of a recession, it is likely that the County would experience a slight delay in its effect in part due to a lag in processing of sales tax revenue from the State to the County (three months). If necessary, the County would be able to utilize our reserves or any of the bulleted items outlined in 1A to offset the decrease in revenues. In the event of a more prolonged recession, structural adjustments to revenues and expenses may be required.

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[i] http://www.nber.org/cycles/jan08bcdc_memo.html
[ii] https://www.federalreserve.gov/monetarypolicy/files
[iii] https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters/2019/survq219
[iv] https://www.wsj.com/graphics/econsurvey/