VOICES FOR ILLINOIS CHILDREN

SPECIAL REPORT

Budget & Tax Policy Initiative

ROOTS OF THE STATE FISCAL CRISIS

BUDGETARY MYTHS AND REALITIES IN ILLINOIS

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May 2009

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EXECUTIVE SUMMARY

State government in Illinois faces a severe and deepening fiscal crisis. The most recent revenue projections suggest that the cumulative General Funds budget deficit for FY 2009 and FY 2010 will exceed $12 billion. Fiscal assistance from the federal government will offset the deficit by about $4 billion, but that would still leave a huge budget gap. Unfortunately, public debate over the state fiscal crisis is distorted by a set of widespread myths about budget and tax policy in Illinois. The central myth is that the state's massive budget deficit was created by runaway spending. A corollary myth is that unrestrained spending growth has put an increasingly heavy burden on Illinois taxpayers. The misguided conclusion is that the deficit can be closed by cutting expenditures for "bloated programs" and by eliminating waste and fraud.

This report shows why such assumptions are fundamentally misleading and explains the complex realities underlying the state fiscal crisis:

- *Spending growth*: Elementary-secondary education and medical assistance are the only major program areas that have seen significant spending growth since FY 2000. Over the same period of time, funding for human services, higher education, and most other parts of the General Funds budget has not kept pace with inflation.

- *Revenue growth*: The state has a chronic "structural deficit" because the revenue produced by its tax system does not keep pace with underlying economic growth and cannot support established levels of services and other ongoing obligations over the long term. From FY 2000 to FY 2008, GF revenue from state sources grew at an average annual rate of 3.3 percent — a rate lower than the growth of personal income in Illinois (4.2%) and only slightly higher than the rate of inflation (2.8%). Moreover, the combined state and local tax burden in Illinois remains modest in comparison with other midwestern states.

- *Understanding the deficit*: Almost 60 percent of the $12.3 billion budget gap reflects declining revenues caused by the recession. Most of the remainder is related to the structural deficit — increased payments for state retirement systems and the backlog of unpaid Medicaid bills.

- *Reducing the deficit*: Federal fiscal assistance will be used to maintain funding levels for elementary-secondary education, higher education, and Medicaid — which comprise more than half of the General Funds budget. Various statutory commitments would bring mandated spending to two-thirds of the budget. Trying the close the remaining $8.3 billion budget gap with spending reductions alone would entail cutting the rest of the budget by *at least 75 percent*.

Given the fiscal realities, closing the deficit in a responsible way will require some combination of revenue increases and spending restraints. Those who want "spending cuts first" or "spending cuts only" are either ignoring fiscal realities or asking the state to abdicate its social responsibilities. The state must raise a substantial amount of new revenue without putting an unfair burden on low- and moderate-income families. If budget cuts are necessary, they should be carefully targeted and fairly distributed. Especially in the midst of a recession, we must protect essential programs for children, families, and communities that have the greatest needs and the fewest resources. A solution to the current crisis must incorporate both fiscal responsibility and social responsibility.

ROOTS OF THE STATE FISCAL CRISIS*

In his first budget address to the General Assembly, Governor Quinn declared that "our state is facing the greatest crisis of modern times." Illinois is indeed in the midst of a severe economic and fiscal meltdown. Between March 2007 and March 2009, the state's unemployment rate rose from 4.7 percent to 9.1 percent — higher than at any time during the last recession and the highest rate in more than 20 years. During 2008, state personal income rose by only 4 percent, compared with 7.2 percent in 2007.

In the first nine months of fiscal year (FY) 2009, General Funds (GF) revenues from state sources were down more than $1 billion from the previous year.[1] Revenues for the entire fiscal year are likely to be $1.4 billion lower than in FY 2008 and $2.6 billion below original expectations. The GF budget deficit for the *current* fiscal year exceeds $4 billion. As a proportion of its budget, Illinois has the largest FY 2009 deficit in the nation.[2] The most recent revenue projections suggest a cumulative deficit of more than $12 billion for FY 2009 and FY 2010. The federal American Recovery and Reinvestment Act will provide fiscal relief of about $4 billion for the state's General Funds, but that will still leave a budget gap of at least $8 billion.

Governor Quinn has proposed a budget that would reduce the deficit through a combination of tax increases, spending cuts, and restructuring of state-funded pension systems. Unfortunately, public discussion of the state fiscal crisis and the Governor's budget plan has been distorted by a set of widespread myths about budget and tax policy in Illinois. The central myth is that the state's massive budget deficit was created by runaway spending. A corollary myth is that unrestrained spending growth has put an increasingly heavy burden on Illinois taxpayers. The misguided conclusion is that the deficit can or should be closed by cutting expenditures for "bloated programs" and by eliminating waste and fraud.

This special report demonstrates that such assumptions are fundamentally misleading. Fiscal realities are much more complex than the public mythology would depict. The state fiscal crisis has two components — a "cyclical deficit" caused primarily by the recession and a long-term "structural deficit" arising from the state's revenue system. Illinois has a chronic structural deficit because the revenue produced by its tax system does not keep pace with underlying economic growth and cannot support established levels of services and other ongoing obligations over the long term. The current fiscal crisis is a product of the deteriorating economy and the cumulative effects of failing to address the structural deficit.

This report begins with an examination of major spending pressures on the state's General Funds from FY 2000 to FY 2008 — with particular attention to elementary and secondary education and medical assistance. The discussion then turns to major state revenue trends over the same period of time. The concluding section focuses on the structural and cyclical dimensions of the state fiscal crisis. More than half of the two-year deficit reflects declining revenues caused by the recession, while most of the remainder is related to the structural deficit. Given the fiscal realities, closing the deficit in a responsible way will require some combi-

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* Maneesha Date Jacoby made significant contributions to the early development of this report.

[1] Illinois Office of the Comptroller, "Recession Impacts Revenues — Fiscal Position Deteriorates," *Comptroller's Quarterly*, April 2009.

[2] National Conference of State Legislatures, "State Budget Update: April 2009."

nation of revenue increases and spending restraints. The critical challenge for policymakers is coming to agreement on a solution that meets both the fiscal and social responsibilities of the state of Illinois.

MAJOR SPENDING PRESSURES

The General Funds — which include the General Revenue Fund, the Common School Fund, and the Education Assistance Fund — support the regular operating and program expenses of most state agencies.[3] GF spending, which represents about half of total state spending from all appropriated funds, has increased at an average annual rate of 3.6 percent since FY 2000. The growth rate has been 4.3 percent for awards and grants to school districts, health care providers, and other service providers but only 1.3 percent for state operations. Almost half of GF expenditures in FY 2008 were used for two major purposes: elementary and secondary education (23%) and medical assistance (23%). Since FY 2000, the prevailing trend has been steady spending growth for these program areas but very little real growth for higher education, human services, and most of the rest of the GF budget (see Tables 1 and 2).

Table 1: Major Areas of General Funds Spending (in $ millions)

	FY 2000	Share	FY 2008	Share
State Board of Education	4,850	21.1%	6,995	23.0%
DPA/DHFS medical assistance programs	4,760	20.7%	6,956	22.9%
Department of Human Services	3,437	15.0%	4,086	13.5%
Higher education (excl. State Universities Retirement System)	2,115	9.2%	2,190	7.2%
Department of Corrections & Department of Juvenile Justice*	1,113	4.8%	1,329	4.4%
Department of Children and Family Services	920	4.0%	887	2.9%
Department on Aging	213	0.9%	457	1.5%
Teachers' Retirement System	613	2.7%	1,110	3.7%
Employee group insurance	589	2.6%	1,055	3.5%
Transfers to Local Government Distributive Fund	889	3.9%	1,348	4.4%
Debt service for General Obligation Bonds	516	2.2%	694	2.3%
Debt service for Pension Obligation Bonds	-----	------	470	1.5%
All other	2,961	12.9%	2,853	9.4%
Total base expenditures	22,976	100.0%	30,358	100.0%

DPA = Department of Public Aid
DHFS = Department of Healthcare and Family Services

* In FY 2000, Juvenile Justice was a division of the Department of Corrections.

Source: Illinois Office of the Comptroller.

[3] Throughout this report, total General Funds spending refers to "base expenditures," and total GF revenue refers to "base revenue," both of which exclude short-term borrowing and cash-flow transfers.

Table 2: Growth of General Funds Spending, FY2000 to FY 2008 (in $ millions)

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Avg. annual change
Total base spending	22,976	24,583	24,899	23,925	25,149	26,224	27,162	28,473	30,358	
Percentage change	-------	7.0%	1.3%	-3.9%	5.1%	4.3%	3.6%	4.8%	6.6%	3.6%
Awards & grants	14,567	15,676	15,731	15,400	16,207	16,217	17,687	18,785	20,208	
Percentage change	-------	7.6%	0.4%	-2.1%	5.2%	0.1%	9.1%	6.2%	7.6%	4.3%
Operations	6,298	6,630	6,956	6,466	6,434	6,303	6,399	6,696	6,937	
Percentage change	-------	5.3%	4.9%	-7.0%	-0.5%	-2.0%	1.5%	4.6%	3.6%	1.3%
Board of Education	4,850	5,074	5,292	5,133	5,471	5,751	6,045	6,472	6,995	
Percentage change	-------	4.6%	4.3%	-3.0%	6.6%	5.1%	5.1%	7.1%	8.1%	4.7%
DHFS medical asst.	4,760	5,249	5,038	4,998	5,595	4,906	6,251	6,596	6,947	
Percentage change	-------	10.3%	-4.0%	-0.8%	11.9%	-12.3%	27.4%	5.5%	5.3%	5.4%
DHS	3,437	3,728	3,668	3,502	3,597	3,747	3,817	3,885	4,086	
Percentage change	-------	8.5%	-1.6%	-4.5%	2.7%	4.2%	1.9%	1.8%	5.2%	2.3%
Higher education*	2,115	2,244	2,402	2,215	2,059	2,090	2,100	2,147	2,190	
Percentage change	-------	6.1%	7.0%	-7.8%	-7.0%	1.5%	0.5%	2.2%	2.0%	0.6%
Dept. of Corrections**	1,113	1,188	1,243	1,162	1,183	1,198	1,170	1,230	1,327	
Percentage change	-------	6.7%	4.6%	-6.5%	1.8%	1.3%	-2.3%	5.1%	7.9%	2.3%
DCFS	920	920	904	824	795	754	803	771	887	
Percentage change	-------	0.0%	-1.7%	-8.8%	-3.5%	-5.2%	6.5%	-4.0%	15.0%	-0.2%
Dept. on Aging	213	232	239	242	256	331	352	421	458	
Percentage change	-------	8.9%	3.0%	1.3%	5.8%	29.3%	6.3%	19.6%	8.8%	10.4%

DHFS = Department of Healthcare and Family Services
DHS = Department of Human Services
DCFS = Department of Children and Family Services

* Excluding State Universities Retirement System.

** Includes Juvenile Justice, which became a separate agency in FY 2007.

Source: Illinois Office of the Comptroller.

State Board of Education

Nearly all spending by the Illinois State Board of Education (ISBE) involves the distribution of aid to local school districts. Since FY 2000, ISBE expenditures from the General Funds have grown at an average annual rate of 4.8 percent. In FY 2008, more than 60 percent of this spending was for General State Aid (GSA), which funds the "foundation level" established by the state as the minimum per-pupil education expenditure from state and local sources (see Table 3). The growth in GSA spending largely reflects periodic increases in the foundation level, which rose from $4,325 in FY 2000 to $5,734 in FY 2008. Nonetheless, the FY 2009 foundation level of $5,959 remains well short of the inflation-adjusted level recommended by the Education Funding Advisory Board, which would be $7,388.

Table 3: State Board of Education, General Funds Spending (in $ millions)

	FY 2000	Share	FY 2008	Share
General State Aid	3,030.5	62.5%	4,445.0	63.5%
Mandated categorical grants				
Special education programs	657.1	13.5%	963.6	13.8%
Transportation - disabled students	181.4	3.7%	355.7	5.1%
Transportation - regular/vocational	195.7	4.0%	305.9	4.4%
Other grants	34.2	0.7%	32.5	0.5%
Early Childhood Block Grant	169.6	3.5%	340.9	4.9%
Reading Improvement Block Grant	83.0	1.7%	75.7	1.1%
ADA Block Grant*	40.6	0.8%	74.8	1.1%
Bilingual education	55.5	1.1%	74.6	1.1%
All other	402.4	8.3%	326.3	4.7%
Total	4,850.0	100.0%	6,994.9	100.0%

* School Safety and Educational Improvement Block Grant, allocated on basis of average daily attendance (ADA).

Source: Illinois Office of the Comptroller.

General State Aid also includes "poverty grants," which provide additional funding to school districts based on their concentration of students from low-income households. Beginning in FY 2004, the basis for calculating a school district's low-income concentration level was changed from decennial census data on family income to program data on the number of children enrolled in Medicaid, KidCare, TANF, or Food Stamps. As a result, the low-income pupil count in many school districts has risen sharply. Statewide, poverty grants accounted for 18 percent of GSA in FY 2008, compared with less than 10 percent in FY 2000.

The second largest portion of ISBE spending from the General Funds involves mandated categorical grants, most of which support special education programs that serve more than 300,000 students with specific learning disabilities, speech and language impairments, mental impairments, and other disabilities. In FY 2008, categorical grants for special education, including transportation for disabled students, accounted for about one-fifth of ISBE's budget.

The Early Childhood Block Grant (ECBG) supports preschool services for children ages 3-to-5, as well as developmental services for even younger children. The Chicago Public Schools receive 37 percent of ECBG appropriations through a block grant. In the rest of the state, grants are distributed on a competitive, request-for-proposal basis to public school districts, private preschool programs, day care centers, and other community organizations. GF spending for early childhood education has doubled since FY 2000, although it still accounts for less than 5 percent of the ISBE budget.

The most recent comparative data show that Illinois remains a laggard in state funding for public schools. In FY 2007, combined state and local revenue per pupil in Illinois was close to the nationwide average. However, *state revenue* per pupil was 36 percent below the U.S. average and lowest among midwestern states. *Local revenue* per pupil in Illinois was 41 percent

above the average and highest in the Midwest. The state share of state-and-local revenue for public schools was only 33 percent in Illinois, compared with 52 percent nationwide. On this measure of state support, Illinois ranked last in the Midwest and next to last among the 50 states (see Table 4).

Table 4: State and Local Revenues Per Pupil for Public Elementary and Secondary Education, Midwestern States, FY 2007

	State and local	As pct. of U.S. average	State	As pct. of U.S. average	Local	As pct. of U.S. average	State share	Local share
Illinois	10,460	101%	3,454	64%	7,006	141%	33%	67%
Indiana	8,851	86%	5,119	95%	3,732	75%	58%	42%
Iowa	9,573	93%	4,735	88%	4,838	98%	49%	51%
Michigan	10,502	102%	6,697	125%	3,805	77%	64%	36%
Minnesota	10,858	105%	7,720	144%	3,138	63%	71%	29%
Missouri	9,515	92%	3,459	64%	6,056	122%	36%	64%
Ohio	11,249	109%	5,386	100%	5,863	118%	48%	52%
Wisconsin	10,897	106%	5,967	111%	4,930	99%	55%	45%
U.S. total	10,322	100%	5,365	100%	4,956	100%	52%	48%

Source: National Center for Education Statistics.

DHFS Medical Assistance

The Department of Healthcare and Family Services (DHFS), formerly the Department of Public Aid (DPA), has principal responsibility for the state's medical assistance programs.[4] About 95 percent of total medical assistance spending is funded through Medicaid, with the federal government covering half of the costs. Most of the remainder is jointly financed through the Children's Health Insurance Program (CHIP), which involves a higher federal matching rate of 65 percent. A small portion of medical assistance spending is funded entirely by the state.

Within DHFS, about 40 percent of GRF spending for medical programs in FY 2008 went to hospital services. Long-term care, prescription drugs, and physician services each accounted for about 12 percent. A substantial amount of DHFS medical assistance spending is financed through various non-GRF funds. For many of these special state funds, the non-federal share of Medicaid costs is covered not by state revenue but by provider assessments or intergovernmental transfers (see Table 5).

[4] DHFS accounts for about 80 percent of total Medicaid spending in Illinois. Another 15 percent involves Medicaid funding for the Department of Human Services, which has responsibility for long-term care and community-based services for people with developmental disabilities, mental health services, rehabilitation services, and other programs for special-needs populations.

Table 5: Department of Public Aid / Department of Healthcare and Family Services, Expenditures for Medical Assistance Programs (in $ millions)

	FY 2000 (DPA)	Share	FY 2008 (DHFS)	Share
General Revenue Fund				
Hospital services	1,625.0	34.1%	2,820.6	40.6%
Long-term care	1,171.8	24.6%	854.5	12.3%
Prescribed drugs	790.0	16.6%	837.7	12.1%
Physicians	380.9	8.0%	822.1	11.8%
Medicare premiums	100.0	2.1%	290.5	4.2%
Community health centers	74.3	1.6%	265.1	3.8%
HMOs and managed care	218.9	4.6%	205.5	3.0%
Dentists	58.7	1.2%	187.4	2.7%
Transportation	58.5	1.2%	97.8	1.4%
Appliances	34.5	0.7%	71.2	1.0%
Home health care	54.2	1.1%	66.0	0.9%
All other	192.5	4.0%	428.4	6.2%
Total	4,759.3	100.0%	6,946.8	100.0%
Selected special funds				
Hospital Provider Fund	-------		2,409.5	
Cook County Provider Trust Fund	1,112.6		1,282.1	
Long Term Care Provider Fund	260.5		820.6	
Tobacco Settlement Recovery Fund (Rx drugs)	-------		497.8	
Drug Rebate Fund (Rx drugs)	-------		356.9	
University of Illinois Hospital Services Fund	130.3		244.9	

Source: Illinois Office of the Comptroller.

Between FY 2000 and FY 2008, DPA/DHFS medical assistance spending from GRF increased at an average annual rate of 5.4 percent. A key factor in this spending growth was increased enrollment among all major eligibility groups. Average monthly enrollment in the state's medical assistance programs rose from about 1.4 million in FY 2000 to 2.4 million in FY 2007. Much of the enrollment growth resulted from expanded eligibility for children under CHIP and the “All Kids” health insurance program, as well as for low-income parents under “FamilyCare.” In addition, the state raised its Medicaid income eligibility limit for the elderly and disabled from 41 percent to 100 percent of the federal poverty level. Finally, during this same period, Illinois established the state-funded "SeniorCare" prescription drug program (now “Illinois Cares Rx”).

The most visible enrollment growth involves children, but their impact on spending is much more limited. In FY 2007, children represented 60 percent of medical assistance enrollment but less than 30 percent of spending. By contrast, disabled adults and the elderly accounted for one-fifth of enrollment but more than half of total expenditures (see Table 6). All Kids expansion, which covers uninsured children who are not eligible for Medicaid or CHIP, accounted for less than 3 percent of total medical assistance enrollment in FY 2008. The cost of All Kids expansion was $22.8 million in FY 2007 and about $36 million in FY 2008.[5]

[5] For a discussion of the impact of the All Kids program, see “All Kids Health Insurance: Progress and Challenges” (Budget & Tax Policy Initiative, Voices for Illinois Children, November 2008).

Table 6: Medical Assistance Enrollment and Spending by Eligibility Group, FY 2007

	Enrollment	Spending
Children	60%	28%
Non-disabled adults	22%	18%
Disabled adults	11%	34%
Elderly	7%	20%
Total	100%	100%

Source: Illinois Department of HealthCare and Family Services (based on GRF and related funds).

Although medical assistance spending has been increasing at a somewhat faster rate than ISBE spending, the impact of Medicaid on the state budget is often misunderstood. For most state programs, including aid to school districts, federal revenue is kept separate from the General Funds, whereas federal matching funds for Medicaid and CHIP are not. In FY 2008, ISBE and DHFS medical assistance each represented 23 percent of total GF spending, but when federal revenue is excluded, ISBE accounts for 28 percent of spending, compared with 13 percent for Medicaid. Similarly, from FY 2000 to FY 2008, ISBE and Medicaid each accounted for nearly 30 percent of spending growth. If federal funds are subtracted, the estimated shares of growth are 33 percent for ISBE and 18 percent for Medicaid. In short, while the growth of Medicaid spending is part of the structural deficit problem, spending for elementary and secondary education has a much greater impact on the state's own fiscal resources (see Table 7).

Table 7: General Funds Spending Growth for Education and Medicaid (in $ millions)

	FY 2000	Share	FY 2008	Share	Growth	Share
General funds spending	22,976	100.0%	30,358	100.0%	7,382	100.0%
State Board of Education	4,850	21.1%	6,995	23.0%	2,145	29.1%
DPA/DHFS medical assistance	4,760	20.7%	6,947	22.9%	2,187	29.6%
Adjusted GF spending	18,704	100.0%	25,241	100.0%	6,537	100.0%
State Board of Education	4,850	25.9%	6,995	27.7%	2,145	32.8%
DPA/DHFS medical asst. (est.)	2,000	10.7%	3,172	12.6%	1,172	17.9%
Adjustments						
Federal grants	3,892		4,815			
Cook County intergovernmental transfer	245		302			
Prescription drug rebate	135		0			

Department of Human Services

The Department of Human Services (DHS) covers a wide range of program areas. The largest of these is the Division of Developmental Disabilities, which accounts for one-third of the DHS General Funds spending (see Table 8). Developmental disability services include both public and private long-term care, much of which is covered by Medicaid. Since FY 2000, DHS expenditures have increased at an average rate of only 2.3 percent. Almost all of this limited spending growth has come from developmental disability services, home services for the disabled, and child care assistance. Funding for income assistance, employment services, and social services has declined substantially. Most other programs have had virtually flat funding.

Table 8: Department of Human Services, GRF Spending (in $ millions)

	FY 2000	Share	FY 2008	Share
Development disabilities	1,023.0 *	29.8%	1,338.8	32.8%
Awards and grants	739.7	21.5%	996.2	24.4%
Operations	283.3 *	8.2%	342.6	8.4%
Human capital development	1,136.5	33.1%	1,057.1	25.9%
Child care services	468.1	13.6%	593.0	14.5%
Income assistance and social services	368.9	10.7%	216.0	5.3%
Operations	299.5	8.7%	248.1	6.1%
Mental health	536.7 *	15.6%	600.3	14.7%
Awards and grants	289.9	8.4%	358.9	8.8%
Operations	246.8 *	7.2%	241.4	5.9%
Home services for the disabled	166.7	4.9%	430.3	10.7%
Community health, prevention, and youth services	187.9	5.5%	260.6	6.4%
Addiction prevention and treatment	130.4	3.8%	172.1	4.2%
All other	253.8	7.4%	217.2	5.3%
Total	3,435.0	100.0%	4,085.7	100.0%

* Estimate

Sources: Illinois Office of the Comptroller and Illinois Department of Human Services.

Higher Education

Higher education agencies include the Illinois Board of Higher Education, state universities, the Illinois Community College Board, and the Illinois Student Assistance Commission. GF expenditures for higher education (excluding the Universities Retirement System) increased by 14 percent between FY 2000 and FY 2002, then declined by 13 percent through FY 2005, and increased 5 percent from FY 2005 to FY 2008. Higher education spending has grown at an average annual rate of only 2 percent since FY 2000. Most of the growth during this period has been for community colleges and student financial assistance (see Table 9).

Table 9: Higher Education Agencies, General Funds Expenditures (in $ millions)

	FY 2000	Share	FY 2008	Share
University of Illinois	712.5	33.7%	722.3	33.0%
Other state universities	617.2	29.2%	634.7	29.0%
Illinois Student Assistance Commission	374.0	17.7%	425.9	19.4%
Illinois Community College Board	300.7	14.2%	354.9	16.2%
All other	110.3	5.2%	52.5	2.4%
Total (excl. State Universities Retirement System)	2,114.8	100.0%	2,190.3	100.0%

Source: Illinois Office of the Comptroller

Other State Agencies

For most other state agencies, GF expenditures have not kept pace with inflation. Since FY 2000, average annual growth has been negative (-0.2%) for the Department of Children and Family Services. Combined spending for the departments of Corrections and Juvenile Justice has increased at an annual rate of 2.3 percent.[6] One exception is the Department on Aging, a relatively small agency where spending has more than doubled since FY 2000. Most of this growth comes from the Community Care Program, which provides homemaker services, emergency home response, and adult day services. About one-fourth of program costs are covered by federal Medicaid funds.

State Spending in Perspective

Elementary-secondary education and medical assistance are the only major program areas in the GF budget that have grown substantially since the beginning of this decade. GF spending for nearly everything else has not kept pace with inflation. The primary manifestation of the structural deficit is not runaway spending, but rather deferred spending commitments for Medicaid and state pensions.

Medicaid Liabilities

The Illinois Medicaid program has long been plagued by delays in payments to service providers, largely because of inadequate appropriations. Under Section 25 of the State Finance Act, payments to health care providers for services within a given fiscal year can be deferred to the subsequent fiscal year. The statute puts no limit on the dollar amount of these liabilities.[7] Deferred GRF liabilities for Medicaid increased from about $680 million at the end of FY 2000 to over $1.3 billion at the end of FY 2003. In FY 2004, there was a supplemental appropriation to take advantage of a temporary increase in the federal matching rate, which reduced the backlog to about $800 million. In FY 2005, however, appropriations for medical assistance were far below actual service costs, and deferred liabilities jumped to almost $2 billion. Despite some improvement in the following two years, the Medicaid backlog exceeded $2 billion at the end of FY 2008 (see Table 10).

Table 10: Section 25 Deferred Liabilities for Medical Assistance (in $ millions)

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	Est. FY 2008
DHFS (GRF)	680.9	737.4	950.8	1,347.4	753.2	1,884.7	1,760.2	1,734.1	1,939.0
DHS (GRF)	0.0	9.8	14.6	13.2	46.4	84.5	80.4	80.4	95.0
Total	680.9	747.3	965.3	1,360.7	799.6	1,969.2	1,840.6	1,814.5	2,034.0

Source: Illinois Office of the Comptroller.

[6] Department of Juvenile Justice was separated from the Department of Corrections in FY 2007.

[7] See Illinois Office of the Comptroller, "The Section 25 Budget Loophole," *Fiscal Focus*, July 2008.

Pension Obligations

Decades of chronic underfunding of pension obligations have contributed significantly to the state's structural deficit. State-funded programs include retirement systems for public school teachers, state employees, state universities, judges, and members of the General Assembly. The largest of these is the Teachers' Retirement System, which accounts for more than half of annual state contributions.[8]

In 1995, the state enacted a 50-year plan to achieve adequate funding of pension obligations. The plan included a 15-year ramp-up period, after which the state's annual contributions would remain at a level percentage of payroll. Meeting the funding schedule during the ramp-up period has been very difficult, however. In 2003, the state issued $10 billion in pension obligation bonds (POBs), part of which was used to cover contributions for FY 2003 and FY 2004. Scheduled payments were reduced again in FY 2006 and FY 2007 (see Table 11).

The combination of state pension contributions and POB debt service payments has put intense pressure on the General Funds, which cover about 90 percent of annual contributions and about 85 percent of POB debt service. State spending for the retirement systems from all appropriated funds increased 36 percent in FY 2008 and is expected to grow by 28 percent in FY 2009 and 37 percent in FY 2010, which is supposed to be the last year of the pension ramp (see Table 10). From FY 2011 through FY 2045, the state is required to make contributions at a level percentage of payroll (an average of about 23% across the retirement systems). This funding schedule, together with employee contributions and investment, is designed to gradually increase the ratio of assets to liabilities from its current level of 55 percent to 90 percent.[9]

Table 11: State Spending for Retirement Systems, All Appropriated Funds (in $ millions)

	Regular state contrib.	POB debt service	Total	Change	Pct. change
FY 2000	1,230.1	------	1,230.1	-------	--------
FY 2001	1,351.1	------	1,351.1	121.0	9.8%
FY 2002	1,473.4	------	1,473.4	122.3	9.1%
FY 2003	1,631.9	------	1,631.9	158.5	10.8%
FY 2004	1,864.3	------	1,864.3	232.4	14.2%
FY 2005	1,640.9	496.2	2,137.1	272.8	14.6%
FY 2006	944.9	496.2	1,441.1	-696.0	-32.6%
FY 2007	1,389.2	496.2	1,885.4	444.3	30.8%
FY 2008	2,022.9	546.2	2,569.1	683.7	36.3%
FY 2009 (est.)	2,752.5	545.0	3,297.5	728.4	28.4%
FY 2010 (est.)	3,971.0	543.6	4,514.6	1,217.1	36.9%

Source: Commission on Government Forecasting and Accountability.

[8] The Teachers' Retirement System of Illinois is separate from the Chicago Teachers' Pension Fund, which receives a relatively small amount of state revenue.

[9] Commission on Government Forecasting and Accountability, *Pensions: Report on the Financial Condition of the State Retirement Systems as of June 30, 2008* (February 2009).

MAJOR STATE REVENUE SOURCES

Almost two-thirds of General Funds revenue comes from four sources: individual income taxes, corporate income taxes, sales taxes, and public utility taxes. The amount of revenue generated by these taxes is affected by various dimensions of tax policy (e.g., tax rates and definitions of the applicable tax base), as well as by economic conditions. The four major tax sources differ in their stability over the course of business cycles and their responsiveness to long-term economic growth. Stable taxes provide more predictable revenue streams that are less impacted by an economic downturn. But stable revenue sources are also less likely to keep pace with economic growth over time (see Tables 12 and 13).

Table 12: Major Sources of General Funds Revenue (in $ millions)

	FY 2000	Share	FY 2008	Share
Individual income tax	7,686	33.1%	10,320	34.8%
Sales taxes	6,027	25.9%	7,215	24.3%
Corporate income tax	1,237	5.3%	1,860	6.3%
Public utility taxes	1,116	4.8%	1,157	3.9%
Inheritance tax (gross)	348	1.5%	373	1.3%
Cigarette taxes	400	1.7%	350	1.2%
Investment income	233	1.0%	212	0.7%
State lottery	515	2.2%	657	2.2%
Riverboat gambling	330	1.4%	564	1.9%
Other state sources	1,466	6.3%	2,280	7.7%
Federal sources	3,892	16.7%	4,815	16.2%
Total base revenue	23,250	100.0%	29,659	100.0%

Source: Illinois Office of the Comptroller.

Individual Income Tax

The individual income tax is the state's single largest source of revenue, accounting for more than one-third of total GF revenue in FY 2008. The Illinois constitution requires that any state income tax be levied at a flat rate. The individual income tax has been set at 3 percent for individuals since the beginning of FY 1990 (July 1, 1989). Among the 41 states that impose taxes on earned income, only six have flat rates — ranging from 3 percent in Illinois to 5.3 percent in Massachusetts. In addition to its low rate, the Illinois income tax has a low threshold for taxable income; the state has a small standard exemption ($2,000 for each household member) and no standard deduction or itemized deductions.

Between FY 2000 and FY 2008, revenue from the individual income tax grew at an average annual rate of 3.9 percent, while personal income in Illinois grew at a slightly higher rate of 4.2 percent. Beginning in FY 1999, the state gradually raised the standard exemption from $1,000 to $2,000, which slowed the growth of income tax revenue by about $300 million over a three-year period. The recession in the early part of this decade had a major impact on income tax revenue, which declined for three consecutive years (FY 2002-2004) but increased by 42 percent from FY 2004 to FY 2008.

One reason why income tax revenue lags somewhat behind the growth of personal income is that the state's income tax base excludes private pensions, public pensions, and Social Security benefits that are subject to federal taxation. Among states with income taxes, a majority do exclude all Social Security benefits from taxation. Eight states exclude public pensions, but only two other states exclude all private retirement income. Illinois "tax expenditures" resulting from the exclusion of retirement income has increased at an average annual rate of more than 6 percent since FY 2000, reaching almost $1 billion in FY 2007.

Table 13: Growth of General Funds Revenue from State Sources (in $ millions)

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Avg. annual change
Total state sources	19,358	19,786	19,121	19,146	21,634	21,903	22,634	23,937	24,844	
Pct. change	-------	2.2%	-3.4%	0.1%	13.0%	1.2%	3.3%	5.8%	3.8%	3.3%
Indiv. income tax	7,686	7,996	7,471	7,341	7,272	7,979	8,635	9,408	10,320	
Pct. change	-------	4.0%	-6.6%	-1.7%	-0.9%	9.7%	8.2%	9.0%	9.7%	3.9%
Sales taxes	6,027	5,958	6,051	6,059	6,331	6,595	7,092	7,136	7,215	
Pct. change	-------	-1.1%	1.6%	0.1%	4.5%	4.2%	7.5%	0.6%	1.1%	2.3%
Corp. income tax	1,237	1,036	803	738	936	1,172	1,428	1,750	1,860	
Pct. change	-------	-16.2%	-22.5%	-8.1%	26.8%	25.2%	21.8%	22.5%	6.3%	7.0%
Public utility taxes	1,116	1,146	1,104	1,006	1,079	1,056	1,074	1,131	1,157	
Pct. change	-------	2.7%	-3.7%	-8.9%	7.3%	-2.1%	1.7%	5.3%	2.3%	0.6%

Changes in economic indicators (calendar years)

	2000	2001	2002	2003	2004	2005	2006	2007	Avg.
State personal income	7.2%	1.7%	1.6%	3.2%	4.3%	4.2%	5.7%	5.6%	4.2%
State GDP	4.6%	2.6%	2.2%	4.8%	4.7%	3.7%	5.4%	4.4%	4.0%
Consumer price index	3.4%	2.8%	1.6%	2.3%	2.7%	3.4%	3.2%	2.8%	2.8%

Sources: Illinois Office of the Comptroller; Commission on Government Forecasting and Accountability; U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics.

Sales Tax

Sales taxes represent about one-fourth of GF revenue. Illinois has a statewide sales tax of 6.25 percent; the state keeps 5 percent, and the remainder is distributed to local governments based on point of origin. Most of the state share of the revenue goes into the General Funds; there are also statutory transfers to three regional transportation funds, the Build Illinois Fund (for purposes of promoting tourism and paying off bond debt), and several other small funds.

All but five states impose general sales taxes. The statewide rate in Illinois is one of the highest in the nation; only seven states have higher rates. The Illinois sales tax also has a very narrow base — with most consumer services excluded entirely. Only a handful of states apply their sales taxes to a comprehensive set of services, but Illinois covers an exceptionally short list.

In recent years, the sales tax has been more stable than the income tax, but it is less responsive to long-term economic growth. Consumption tends to increase at a slower rate than income, and excluding services from the sales tax base results in even less capacity to capture growth in the economy. Between FY 2000 and FY 2008, the growth rate for sales tax revenue was only 2.3 percent, which lagged considerably behind the growth in personal income (4.2%) and was even lower than the increase in the consumer price index (2.8%). Sales tax revenue was basically flat in 2000-2003 and again in 2006-2008.

Corporate Income Tax

Under the state constitution, the corporate income tax rate cannot exceed the individual rate by a ratio of more than 8 to 5. Since FY 1990, the regular corporate income tax has been 4.8 percent.[10] (Thirty other states also use flat-rate corporate income taxes.) In contrast to the state's individual income tax, which is based on federal adjusted gross income, the corporate income tax is applied to federal taxable income (i.e., net income after deductions). Consequently, the corporate tax base is affected by both federal and state tax policy. In some instances, state law provides for additional exclusions from taxable corporate income; in other instances, the state has "decoupled" its corporate income tax from certain provisions of the federal tax code.

The corporate income tax captures long-term economic growth, but it is very unstable over the course of a business cycle. At the beginning of this decade (FY 2000-2003), plummeting corporate profits resulted in a 40 percent decline in income tax revenue. As the economy improved over the next five years, revenue from the corporate income tax more than doubled. (In FY 2004, a tax amnesty program produced an extra $272 million.) Since FY 2000, the corporate income tax share of GF revenue has fluctuated between 3 percent and 6 percent.

Public Utility Taxes

Public utility taxes in Illinois include taxes on telecommunications, electricity, and natural gas. Most of this revenue is used for the General Funds. The telecommunications tax has been set at 7 percent since 1998. Electricity taxes are based on kilowatt hours for residential use and 5.1 percent of the purchase price for non-residential use. Since 1985, the tax on natural gas utilities has been 2.4 cents per therm or 5 percent of gross revenue, whichever is less. In FY 2008, the General Funds received $637 million from telecommunications taxes, $469 million from electricity taxes, and $193 million from natural gas taxes. Revenues from public utility taxes are often unstable over the business cycle and do not grow in tandem with the state's economy. Since FY 2000, these revenues have increased at an annual rate of only 0.6 percent.

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[10] There is an additional Corporate Personal Property Replacement Tax of 2.5 percent. This revenue goes into a special state fund and is distributed to local units of government, including municipalities, counties, special districts, school districts, and community college districts.

Gambling Revenue

In FY 2008, about 4 percent of GF revenue came from gambling. The largest sources of gambling revenue were the Lottery Fund ($657 million transferred to the Common School Fund) and the State Gaming Fund, which consists of taxes and fees from licensed riverboat gambling ($564 million transferred to the Education Assistance Fund). The lottery has not been a stable revenue source, and average annual growth since FY 2000 has been 3.3 percent. General Funds revenue from riverboat gambling increased steadily from FY 2000 to FY 2005 and then leveled off for several years. In FY 2008, a combination of factors — including a new statewide ban on smoking in public places and changes in economic conditions — resulted in an 18 percent drop in transfers from the State Gaming Fund.

State Revenues in Perspective

Among the major GF revenue sources, the individual income tax is relatively stable and the most responsive to economic growth. Sales taxes do not keep pace with growth in personal income, and the corporate income tax is very unstable. Revenue from public utility taxes has been virtually flat. Neither the state lottery nor riverboat casinos are reliable sources of revenue. From FY 2000 to FY 2008, GF revenue from state sources grew at an average annual rate of 3.3 percent — a rate lower than the growth of personal income in Illinois (4.2%), lower than the growth of state GDP (4.0%), and only slightly higher than the rate of inflation (2.8%).

By comparative standards, Illinois does not impose a heavy tax burden, even when combined state and local revenues are considered. In FY 2006, Illinois ranked 40th among the 50 states and second-to-last in the Midwest in state and local own-source revenue as a proportion of personal income. On this same measure, income tax revenue in Illinois was lowest among midwestern states, while property tax revenue was among the highest (see Table 14).

Table 14: State and Local Own-Source General Revenue as Pct. of Personal Income, FY 2006

	State & local total	Individual income taxes	Corporate income taxes	Sales taxes*	Property taxes
Illinois	15.00%	1.81%	0.50%	3.75%	4.10%
Indiana	19.32%	2.52%	0.53%	3.86%	4.24%
Iowa	16.83%	2.59%	0.30%	3.49%	3.54%
Michigan	16.02%	1.98%	0.56%	3.50%	3.99%
Minnesota	16.44%	3.51%	0.55%	3.80%	2.73%
Missouri	14.38%	2.58%	0.20%	3.78%	2.67%
Ohio	16.83%	3.68%	0.30%	3.47%	3.37%
Wisconsin	16.73%	3.16%	0.43%	3.36%	4.30%
U.S. total	16.30%	2.52%	0.50%	3.87%	3.38%

* Includes general sales taxes, selective sales taxes (e.g., public utility taxes, motor fuel taxes, cigarette taxes), and gross receipts taxes.

Source: U.S. Bureau of the Census.

THE STRUCTURAL DEFICIT AND THE CYCLICAL DEFICIT

The state fiscal crisis involves both a short-term cyclical deficit and a long-term structural deficit. Even before the current recession, the state's revenue system was not keeping pace with underlying economic growth. Revenue from the individual income tax has generally grown at the same pace as personal income. The corporate income tax is responsive to long-term economic growth, but it is also very volatile. Revenues from the sales tax and most other state sources have lagged behind the growth of personal income and economic activity in Illinois. Consequently, "normal" revenue growth — that is, growth stemming from economic factors rather than from tax increases or other policy changes — has chronically lagged behind spending pressures.

The myth of runaway spending was exemplified in a recent *Chicago Tribune* editorial, which asserted that state spending has been growing at double the rate of inflation for two decades.[11] This claim is fundamentally misleading. From FY 1990 to FY 2008, the consumer price index rose at an average annual rate of 2.9 percent, while growth of GF spending was 4.8 percent — slightly below "double the rate of inflation." The relevant point of comparison, however, is not inflation but aggregate personal income, which reflects real income and population growth, as well as inflation. Over the past two decades, personal income in Illinois has increased at an average annual rate of 4.7 percent, roughly parallel to the growth of state GF spending. Total growth between FY 2000 and FY 2008 was 130 percent for both personal income and state spending (see Table 15).

Table 15: Growth Rates of General Funds Spending and Revenue, FY 1990 to FY 2008

	Average annual growth			Total growth
	1990-2000	2000-2008	1990-2008	1990-2008
General Funds spending	5.7%	3.6%	4.8%	130%
General Funds revenue from state sources	5.9%	3.3%	4.7%	127%
Economic indicators (calendar years 1989-2007)				
State personal income	5.2%	4.2%	4.7%	130%
Consumer price index	3.0%	2.8%	2.9%	67%

Understanding the Current Deficit

The FY 2009 budget presented by then-Governor Blagojevich in February 2008 had a GF shortfall of $1.7 billion and did not include specific measures for closing the gap. In May, the General Assembly passed a set of appropriations bills with additional funding for education, human services, and health care, which expanded the deficit to $2.1 billion. In July, the Governor used his veto authority to cut more than $1.4 billion. This included $585 million for DHFS medical programs, but in the absence of policy changes in eligibility standards or provider reimbursement, reducing appropriations for medical assistance simply adds to the backlog of unpaid bills. Moreover, for every dollar in reduced Medicaid spending, the state loses 50

[11] "Taxing Opportunities," *Chicago Tribune*, April 22, 2009.

cents in federal matching funds. Consequently, the vetoes actually reduced the budget gap to about $1.1 billion, not including deferred Medicaid liabilities.[12] Since last summer, however, projected deficits for both FY 2009 and FY 2010 have increased dramatically:

- Through the first nine months of FY 2009, GF receipts from state sources were down by $1.1 billion (or 6.5%) from the previous year. The most recent projections suggest that state revenues for the entire fiscal year will be $2.6 billion below expectations.

- The FY 2009 budget assumed $575 million from the sale of a new riverboat casino license, but the proceeds were much smaller than expected — $125 million, with only $50 million to be paid by the end of FY 2010.

- In FY 2010, continued deterioration of the economy is likely to depress state revenues by another $1.2 billion.

- Legislatively mandated pension contributions were scheduled to increase by $700 million from FY 2009 to FY 2010, but major losses of investment income will require an additional $500 million.

The state faces a General Funds budget deficit of more than $4 billion for FY 2009. Even if we assume only 3 percent spending growth in FY 2010 for everything except the state retirement systems, there would still be an additional shortfall of almost $7 billion. The state share of the estimated Medicaid backlog (about $1.25 billion) would bring the two-year deficit to $12.3 billion.[13] This relatively conservative estimate of the cumulative deficit can be understood in terms of several major contributing factors (see Table 16). Nearly 60 percent of the deficit represents declining revenue because of the recession. Two other factors are related to the structural deficit: payments for state retirement systems (about 20%) and the backlog of unpaid Medicaid bills (about 10%). The remainder consists of the "inherited deficit," which includes the estimated shortfall at the beginning of FY 2009 and the loss of expected revenue from the new casino license.

Federal Fiscal Assistance

The American Recovery and Reinvestment Act (ARRA) provides two forms of federal funds that are designated for deficit reduction.[14] Illinois is eligible to receive more than $2 billion from the State Fiscal Stabilization Fund, which is administered by the U.S. Department of Education. The state's allocation consists of an education block grant and a flexible block grant (although ARRA does not use those terms). The education block grant (about $1.7 billion for

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[12] In September, the General Assembly authorized the transfer of excess balances from special state funds ("fund sweeps") into a new FY09 Budget Relief Fund, which was used to restore $205 million of the budget cuts. In November, the Governor exercised his veto to reduce these new appropriations by $55 million.

[13] This figure is somewhat higher than the $11.6 billion estimate from the Governor's Office of Management and Budget. For an explanation of the differences, see the Appendix.

[14] For a more detailed discussion, see "The Federal Economic Recovery Plan and the State Fiscal Crisis" (Budget & Tax Policy Initiative, Voices for Illinois Children, February 2009).

Illinois) is earmarked for both elementary-secondary education and higher education. The "first use" of these funds must be the restoration of state formula aid to public schools to the FY 2008 or FY 2009 level, whichever is greater. The flexible block grant ($374 million for Illinois) can be used for education or other purposes. In the Governor's budget, all of this fiscal relief is being used to maintain funding for public school districts and state universities.

The other major source of fiscal relief, which is designed to protect and maintain state Medicaid programs during the recession, is a temporary increase in the Federal Medical Assistance Percentage (FMAP). For Illinois, the FMAP was raised from 50 percent to 60.48 percent, retroactive to October 2008. The Governor's Office estimates that the state will receive $1.9 billion in additional federal revenue for FY 2009 and FY 2010. In order to qualify for the enhanced FMAP, the state cannot make its eligibility standards or enrollment procedures more restrictive, and it must assure prompt payments to Medicaid service providers (in most cases, within 30 days). Consequently, the state will be compelled to clear its Medicaid backlog.

Table 16: Components of the Two-Year General Funds Deficit (in $ millions)

Effects of the recession		
FY 2009		
Base revenue estimate (CGFA, Aug. 2008)	25,082	
Revised revenue estimate (CGFA, Mar. 2009)	22,471	
Shortfall	2,611	
FY 2010		
Base revenue estimate (3% increase)	25,834	
Revised revenue estimate (CGFA, Mar. 2009)	21,313	
Shortfall	4,521	
Subtotal: revenue shortfall	**7,132**	**58.0%**
Pension contributions		
FY 2009 increase over FY 2008	650	
FY 2010 increase over FY 2008	1,750	
Subtotal: pension contributions	**2,400**	**19.5%**
Medicaid backlog (estimated state share)	**1,300**	**10.2%**
Inherited FY 2009 deficit		
Estimated deficit in July 2008	1,000	8.1%
Loss of one-time revenue (casino license)	525	4.3%
Subtotal: inherited deficit	**1,525**	**12.4%**
Total estimated deficit	**12,307**	**100.0%**

CGFA = Commission on Government Forecasting and Accountability.

Fiscal Responsibility and Social Responsibility

Federal fiscal assistance will reduce the General Funds deficit to about $8.3 billion — a two-year budget gap that must be closed in just one fiscal year. Governor Quinn's plan for reducing the deficit includes new revenue from state income taxes and other sources ($4.5 billion), reductions in pension contributions ($2.8 billion), and other spending cuts ($1.5 billion).[15] The largest share of new state revenue would come from increasing the individual income tax from 3 percent to 4.5 percent. In addition, the Governor proposes to raise the standard exemption from $2,000 to $6,000. Critics have characterized this plan as a 50 percent tax hike, but the higher exemptions mean that average increase in tax liability would be closer to 30 percent and that no individual taxpayer would see a 50 percent increase. For many households, the larger exemption would offset the higher tax rate, resulting in lower taxes than they pay now.

According to conventional wisdom, raising state income taxes in a time of recession would be counterproductive.[16] Some prominent economists, however, have offered a very different perspective on this issue. According to Peter Orszag, former director of the Congressional Budget Office and current director of the U.S. Office of Management and Budget, and Joseph Stiglitz, recipient of the Nobel Prize in economics, a tax increase during a recession can have adverse economic effects, but spending cuts could be more harmful. Some portion of an income tax increase would result in lower savings rather than lower consumption, but certain types of spending cuts would reduce consumption directly on a dollar-for-dollar basis. In addition, more of the burden of an income tax increase would likely fall on households and businesses outside the state.[17]

A related objection is that any tax increase during a recession would result in the loss of more jobs. Employment trends, however, are driven more by macroeconomic conditions than by state tax policy. At the height of the recession of the early 1980s, Illinois increased both individual and corporate income taxes for an 18-month period. In the 18 months prior to the tax increase, the state's unemployment rate had climbed from 8.2 percent to 12.8 percent. During the period of higher taxes, unemployment declined to 8.8 percent.

Opponents of higher taxes typically maintain that the deficit can or should be closed by cutting spending for "bloated programs" and by eliminating waste and fraud. But those who want "spending cuts first" or "spending cuts only" are either ignoring fiscal realities or asking the state to abdicate its social responsibilities. Elementary and secondary education, higher education, and Medicaid, which comprise more than half of the GF budget, will be protected by federal ARRA funds. Various statutory commitments – for example, pension contributions, long-term debt service, and income-tax sharing with local governments – would bring mandated spending to two-thirds of the budget. Consequently, trying to close an $8.3 billion gap

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[15] The Governor's income tax and spending proposals will be examined more closely in forthcoming reports.

[16] See, e.g., Civic Committee of the Commercial Club of Chicago, "Facing Facts 2009: An Updated Report on the State of Illinois' Fiscal Crisis" (February 2009) p. 13; Institute for Illinois' Fiscal Sustainability at the Civic Federation, "A Fiscal Roadmap for Creating a Sustainable State Budget: Actionable Recommendations for Governor Pat Quinn and the Illinois General Assembly" (March 2009), p. 18.

[17] Nicholas Johnson, "Budget Cuts or Tax Increases at the State Level: Which Is Preferable During a Recession?" (Center on Budget and Policy Priorities, Updated January 12, 2009).

(after accounting for federal ARRA funds) with spending reductions alone would entail cutting the remaining third of the budget (about $11 billion) by *at least 75 percent*.

Even with a substantial amount of new revenue, some spending reductions will be necessary, but they should be carefully targeted and fairly distributed. Especially in the midst of a recession, we must protect essential programs for children, families, and communities with the greatest needs and the fewest resources. A solution to the current crisis must incorporate both fiscal responsibility and social responsibility.

APPENDIX: ESTIMATING THE BUDGET DEFICIT

In March, the Governor's Office of Management and Budget (GOMB) projected a cumulative deficit of $11.6 billion for FY 2009 and FY 2010. The two-year deficit estimated by the Budget & Tax Policy Initiative (BTPI) is somewhat larger ($12.3 billion). In early February, the Illinois Office of the Comptroller (IOC) published an estimate of $11.6 billion.[18] If the IOC estimates are adjusted with updated revenue projections from the Commission on Government Forecasting and Accountability (CGFA), the result is a two-year deficit of $12.1 billion. Table 17 presents a detailed comparison of these different approaches.

FY 2009 spending: The GOMB and BTPI spending estimates are identical. The IOC estimate is substantially higher, primarily because it includes $975 million in "lapse-period" spending from FY 2008 appropriations.[19]

FY 2009 revenue: The BTPI and the adjusted IOC revenue estimates are both based on CGFA projections. GOMB uses a slightly lower projection.

FY 2010 spending: The GOMB appropriations baseline of $31.5 billion is 11 percent higher than the FY 2009 level. This increase appears to include the mandated increase in pension contributions ($1.2 billion) and some reduction in the Medicaid backlog. BTPI estimates have a 3 percent increase in baseline appropriations, while the IOC assumes flat funding for most programs. Both estimates include the additional $1.2 billion for pension contributions. The Medicaid backlog is estimated at $1.95 billion by IOC and $2.5 billion by BTPI. The IOC spending estimate is reduced by $975 million in lapse-period spending to be paid with FY 2001 revenues.

FY 2010 revenue: For state revenue, the BTPI and adjusted IOC estimates are based on CGFA projections, which are slightly lower than GOMB's figures. BTPI's estimate of federal revenue is 3 percent higher than the FY 2009 level, while the adjusted IOC estimate is the same as FY 2009. GOMB assumes that federal revenue will increase by $894 million, most of which would presumably involve Medicaid matching funds. The federal share of reducing the Medicaid backlog is presented separately by both IOC ($975 million) and BTPI ($1.2 billion).

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[18] Illinois Office of the Comptroller, "Transitional Fiscal Report/FY 2010 Budgetary Outlook" (February, 2009).

[19] The lapse period refers to two months (July and August) during which expenses incurred in one fiscal year are paid with revenue from the following fiscal year. A certain level of lapse-period spending is inevitable, and the amount carried into FY 2009 ($975 million) was not unusually high. The IOC estimate assumes a comparable level of lapse-period spending at the beginning of FY 2011.

Table 17: Different Estimates of the General Funds Budget Deficit (in $ millions)

	IOC (Feb. 2009)	IOC (adjusted)	GOMB (Mar. 2009)	BTPI (Apr. 2009)
Fiscal Year 2009				
Estimated expenditures				
Lapse-period spending for FY 2008 appropriations	975	975	--------	--------
FY 2009 appropriations	28,800	28,800	28,306	28,306
Continuing appropriation for pensions	---------	---------	381	381
Statutory transfers to other funds	2,881	2,881	2,804	2,804
Pension Obligation Bond debt service	469	469	469	469
Interest on short-term borrowing	--------	27	27	27
Estimated unspent appropriations	-515	-515	-500	-500
Total expenditures	32,610	32,637	31,487	31,487
Estimated revenue				
Receipts from state sources	--------	21,079 *	20,886	21,079 *
Transfers from other funds	--------	1,577 *	1,585	1,577 *
Federal sources	--------	4,700	4,700	4,700
Total revenue	28,325	27,356	27,171	27,356
Estimated FY 2009 deficit	**4,285**	**5,254**	**4,316**	**4,131**
Fiscal Year 2010				
Estimated expenditures				
FY 2010 appropriations	28,800	28,800	31,506	29,155 **
Mandated increase for state pension systems	1,200	1,200	-------	1,200
Statutory transfers to other funds	2,808	2,788 *	2,788	2,788
Pension Obligation Bond debt service	467	467	467	467
Medicaid backlog	1,950	1,950	------	2,500
Estimated unspent appropriations	-415	-415	-500	-500
Lapse-period spending paid in FY 2001	-975	-975	-------	-------
Total expenditures	33,835	33,815	34,261	35,610
Estimated revenue				
State sources from General Funds	--------	19,704 *	19,699	19,704 *
Transfers from other funds	--------	1,559 *	1,603	1,559 *
New casino license	--------	50	50	50
Federal sources	--------	4,700	5,594	4,841 **
Additional Medicaid matching funds	--------	975	-------	1,250
Total revenue	29,175	26,988	26,946	27,404
Estimated FY 2010 deficit	**4,660**	**6,847**	**7,315**	**8,206**
Estimated two-year deficit	**8,945**	**12,108**	**11,631**	**12,337**

IOC = Illinois Office of the Comptroller
GOMB = Governor's Office of Management and Budget
BTPI = Budget and Tax Policy Initiative

* Estimate from Commission on Government Forecasting and Accountability.

About Voices for Illinois Children

Voices for Illinois Children works across issue areas to improve the lives of children of all ages throughout our state so they grow up healthy, nurtured, safe, and well-educated. For 20 years, Voices has been helping opinion leaders and policymakers understand the issues facing children and families. The Voices network weaves through the state, engaging community leaders and people who care passionately about children.

About the Budget & Tax Policy Initiative

The Budget & Tax Policy Initiative (BTPI) provides information and analysis to advocates and policymakers on a wide range of spending and revenue topics that have direct impact on the lives of children and families in Illinois. BTPI is part of the State Fiscal Analysis Initiative, a network of organizations coordinated by the Center on Budget and Policy Priorities in Washington, D.C.

The Budget & Tax Policy Initiative is funded by the Annie E. Casey Foundation, the Ford Foundation, and the Chicago Community Trust. We thank them for their support but note that the findings and conclusions presented here are those of Voices for Illinois Children alone and do not necessarily reflect the views of these foundations.

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