

## ISSUE BRIEF

### THE ILLINOIS STRUCTURAL DEFICIT

#### Context

*The State of Working Illinois* is an annual report that details the state's industry, job, wage and benefit changes over time prepared by Northern Illinois University and the Center for Tax and Budget Accountability. The most recent report documented a number of challenges for policymakers based on changes in the Illinois economy. Among other things, the report showed that:<sup>1</sup>

- Median income in Illinois declined by 12.2% over the last six years, the second worst decline in the nation;
- Since 1979, the percentage of Illinois workers with employer provided health insurance declined to 59.6% from 75.4%;
- Less than half of Illinois workers currently have any private, employer-provided retirement benefits;
- Illinois lost 224,000 high paying manufacturing jobs over the last 15 years; and
- Most job growth occurred in the lower paying, reduced benefit, service sectors.

Looking forward, *the State of Working Illinois* projected that almost 60% of all new jobs created in the state over the next 10 years will pay less than the current average of occupational wages, indicating median income may very well continue declining. Certainly, the Illinois economy is experiencing a transition that has major policy implications. From a demand for public services standpoint, the evolving wage and benefit trends are crucially important. To the extent that workers are realizing a decline in income over time, or a loss of health and/or retirement benefits, the corresponding demand for the public sector to fill benefit gaps, provide access to healthcare, childcare, housing assistance or even income supports grows. This in turn presents the fundamental question—can Illinois' current fiscal system be expected to generate enough revenue to meet this growing demand for services?

#### The State's Fiscal Capacity

Whether or not Illinois state government will have the capacity to meet the public service demands created by the state's changing economy depends on the health of the Illinois fiscal system. According to the Illinois Comptroller's Office, the state ran a \$3.1 billion GAAP<sup>2</sup> deficit in Fiscal Year 2005,<sup>3</sup> the largest such deficit of any state in the nation.<sup>4</sup> This may seem odd, given the state constitutional requirement that Illinois produce a balanced budget annually.<sup>5</sup> That requirement notwithstanding, there are numerous stratagems available that enable the state to deficit spend, while still technically complying with the balanced budget requirement.<sup>6</sup> These stratagems have been utilized by state government to varying degrees for decades, culminating in the accumulated GAAP deficit that exists today. They also have allowed the state to maintain public service levels that it does not have the fiscal capacity to afford. So, in Fiscal Year 2005, when state government effectively spent \$3.1 billion more on services than it had the revenue to cover, that deficit spending accounted for fully 13% of total Fiscal Year 2005 General Fund appropriations for all public services.<sup>7</sup> If state government does not have the fiscal capacity to provide the current level of public services it delivers without deficit spending, it cannot be expected to satisfy growing demand for public services that can be anticipated to develop from declining wage and benefit trends.

Illinois' deficit is not a one-time aberration resulting from unforeseen economic conditions, or the actions of any one administration or legislature. It is the result of a revenue system that has not grown with the economy for decades,<sup>8</sup> even

<sup>1</sup> Center for Tax and Budget Accountability and Northern Illinois University. *The State of Working Illinois*, 2005 and 2006.

<sup>2</sup> Generally Accepted Accounting Principles. A standard established by the Accounting Practices Board of the American Institute of Certified Public Accountants. These rules, conventions, and procedures define accepted accounting practices.

<sup>3</sup> State of Illinois, Office of the Comptroller, *Hynes Calls for Reforms to Address Medicaid Liabilities and Resulting Structural Deficit Problems*, 7/7/2006.

<sup>4</sup> A comparison of Comprehensive Annual Financial Reports for each state is available from the National Association of State Auditors, Comptrollers and Treasurers.

<sup>5</sup> IL Const. art. VIII, § 2. Note: 49 of the 50 states have balanced budget requirements.

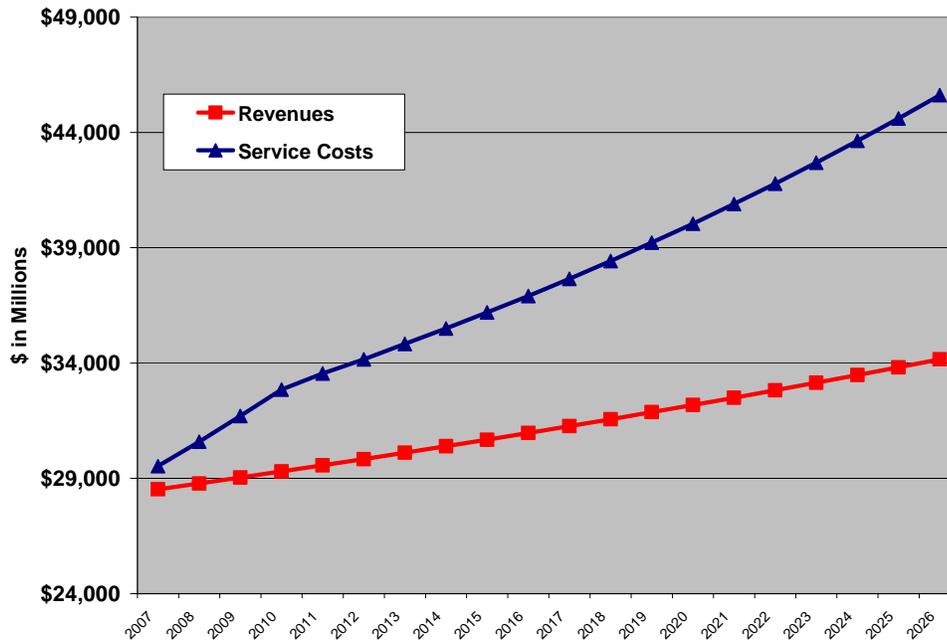
<sup>6</sup> E.g., the state is able to defer Medicaid payments to health care providers from one fiscal year to the next under 30 ILCS. 105/25.

<sup>7</sup> State of Illinois Fiscal Year 2005 Budget Book. The Fiscal Year 2005 General Revenue Fund budget was \$23.8 billion.

<sup>8</sup> Giertz, J Fred., Therese J. McGuire, and James D. Nowlan. 1995. 'The Illinois Structural Deficit Dilemma: The Growing Gap

though the cost of providing services has. This fiscal mismatch is called a “structural deficit”.<sup>9</sup> It results when a tax system does not generate enough revenue to continue funding the current level of public services into the future, adjusting solely for inflation and population growth. The Civic Committee of the Commercial Club of Chicago, an organization of 300 business leaders in Chicago, recently confirmed that this fiscal mismatch exists in Illinois. In its report, *Facing Facts*, The Civic Committee finds there is a significant, “gap between current state revenues and total state expenses” and that, “...to avoid collapse, a tax increase may be inevitable.”<sup>10</sup>

### The Illinois Structural Deficit (How Revenue Growth will not Keep Pace with the Cost of Current Services)



Put another way, even if Illinois does not expand, enhance or increase any existing services or provide any new services, and even if the state were starting with a balanced budget, the revenue system will *still* create a deficit over time. The graphic isolates how the state’s tax system fails to generate enough revenue to maintain current service levels over time, by ignoring the current, GAAP deficit that has accumulated over decades, instead starting the projection assuming the state actually had recurring revenues equivalent to its budgeted expenditures for Fiscal Year 2007.<sup>11</sup>

The projection of ongoing revenue shortfalls in the graph is a conservative estimate that assumes: (i) the economy will grow by four percent per year through 2026; and (ii) no new programs and no program expansions are passed, only current services under existing laws are maintained. The graph then compares the projected costs of maintaining current services over time against projected state revenue growth, adjusting solely for inflation based on the Bureau of Labor Statistics Consumer Price Index<sup>12</sup> and population growth. It does *not* include the state's GAAP deficit accumulated to date.

As the graph illustrates, even if Illinois started with a balanced budget and had an economy that grew at four percent annually, the state’s deficit will still increase by more than \$3 billion dollars over the next five years, without adding or expanding programs.

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Between State Expectations and Revenue Realities.” *State Tax Notes*. March 4, pp. 727-737.

<sup>9</sup> Ibid.

<sup>10</sup> The Civic Committee of the Commercial Club of Chicago, *Facing Fact*, December, 2006.

<sup>11</sup> Based on the modeling designed for CTBA by J. Fred Giertz, Professor of Economics, University of Illinois and faculty at the Institute of Government and Public Affairs.

<sup>12</sup> United States Department of Labor, Bureau of Labor Statistics, Consumer Price Index, CPI-U.