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FUNDING OUR FUTURE

Reforming Illinois Tax Policy

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ABOUT CTBA

Founded in 2000, the Center for Tax and Budget Accountability is a non-profit, bi-partisan research and advocacy think tank committed to ensuring that tax, spending and economic policies are fair and just, and promote opportunities for everyone, regardless of economic or social status.

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1. *Why Illinois Cannot Invest in a Better Future Without Tax Reform*

(a) <u>Why Tax Policy Matters</u>. If you are like most people you view prospects for the future based on the quality of the community you live in today. So what exactly does Illinois tax policy have to do with building a better future for you—especially now, as the state and nation slowly emerge from the worst recession in generations?

The short answer is plenty. By investing in public goods and services, the state can develop needed infrastructure, promote an expanding economy, care for vulnerable members of society, provide a quality public education to children and otherwise contribute to creating safe, clean and vibrant communities. Many of the services state government delivers, like education, roads, public safety, economic development, parks and libraries, generally benefit everyone. Others, like job training, childcare assistance, affordable housing, healthcare and special services for senior citizens, low-income families and those with physical or mental disabilities, focus direct benefits on smaller segments of the population, while providing indirect benefits statewide by reducing crime, helping individuals stay employed and improving the overall quality of communities. The catch is, quality public services are possible only when the state raises adequate revenue through taxation to pay for them.

The societal need for taxation to fund core services is a significant catch indeed. After all, no one really enjoys paying taxes, and for that reason most politicians disdain dealing with the subject. Paradoxically, residents demand and government officials supply the public services tax revenue funds. A recent poll by the Paul Simon Public Policy Institute at Southern Illinois University confirms this disconnect between the expectation that public services be provided and the antipathy concerning the taxes needed to fund them. When queried about how the state should resolve its current General Fund deficit, the majority polled supported spending cuts.[1] However, in the very same poll, the majority also indicated they would not support cuts to education, healthcare, human services, or public safety, which collectively comprise over 90 percent of the public service expenditures made in the state's General Fund. [2]

This inability of the voting public to connect the taxes they pay to the services they demand and consume is one key reason tax policy is so controversial and politically distasteful. It also explains why tax policy is usually avoided or demagogued in policy debates. Rarely, if ever, is tax policy addressed in a comprehensive, analytic way. Allowing politics to impede the state's ability to construct a sound and fair tax system is short-sighted, irresponsible and counter-productive.

It is short-sighted because immediate political gain for particular elected officials is effectively being exchanged for creating long term, structural fiscal problems that ultimately impact everyone. It is irresponsible, because poor tax policy today frequently leads to pushing the real obligation to pay for current services down to future generations, making our children pay for the services we consume.

It is counterproductive, because it shortchanges the state's ability both to pay for essential services that meet the basic needs of society, like caring for low income, home-bound seniors or individual with disabilities for instance, and to contribute to Illinois' long-term economic competitiveness by creating an educated, skilled workforce and modern infrastructure.

(b) <u>Consequences of Poor Tax Policy</u>. Today, Illinois is experiencing the very real consequences of its short-sighted, irresponsible and counterproductive approach to tax policy. Of particular concern are the ongoing deficits that have plagued the state's General Fund budget for years. These deficits have grown and carried forward over time so much so that current Fiscal Year 2011 started $13.89 billion in the hole.[3] That created a significant problem indeed, since it represented over 52 percent of the $26.32 billion General Fund Budget initially appropriated for FY2011. This should alarm most voters and taxpayers, since over $9 out of every $10 of the General Fund is spent on the four, core public services of education, healthcare, human services and public safety most people expect, demand and, as indicated previously, least want to see cut.

Running annual budget deficits imperils the state's ability to provide these core public services for one simple reason, unlike the federal government, Illinois is not supposed to deficit spend, at least from a constitutional standpoint.[4] This in turn means that when confronted with a deficit, state decision-makers essentially have three options: cut spending on the core four services; raise tax revenue to continue paying for them; or borrow money, deferring the obligation to pay for current services into the future.

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Over the years, Illinois has increasingly relied on the third, irresponsible way to cover the cost of funding current services—*debt*. Obviously, borrowing money to provide current services is not just irresponsible—it is also unsustainable. Whatever is borrowed must be repaid—with interest. Moreover, the debt proceeds used to cover service delivery in a current fiscal year are one-time funds that are not available in following fiscal years, creating a vicious cycle of debt reliance.

There are limited circumstances when incurring debt to maintain service levels is appropriate. For instance, during recessionary periods, demand for public services generally increases, while revenues are decreasing. This creates a dilemma for the public sector that the private sector never faces. In the private sector, increased demand for a product or service means that product or service sells more, generating increased revenue. This increased revenue creates the financial capacity for private sector businesses to keep up with growing demand. The public sector, which must confront increasing demand during periods of declining revenue, either has to have some capacity to borrow to maintain core services, or cut those services when needed most. Hence incurring limited debt to cover operational expenditures on basics like education, health, human services and public safety could make some sense. That said, this option should be used sparingly, in limited amounts and during very difficult economic situations, because it is simply not sustainable.

The debt used by Illinois state government to finance current service delivery has come primarily in three forms. First, the state borrows money directly from financial institutions, and then uses the loan proceeds to cover the cost of delivering current services. This practice is irresponsible, as it not only creates an unsustainable way to fund services, but also misleads the public into believing they can have a greater level of services than what recurring tax revenue can support.

Second, for decades Illinois has borrowed against the five public employee pension systems[5] it is obligated to fund by not making its full annual employer contributions to those systems. Instead, decision makers have repeatedly diverted a portion of said required pension contributions to fund current services. In effect, then, for over 30 years Illinois used its pension systems like a credit card, creating a significant unfunded pension liability, just to avoid raising the tax revenue needed to maintain public service levels from one year to the next.[6]

Third, Illinois state government has delayed payments owed to service providers (primarily in the healthcare and human service fields) from the fiscal year in which they are due to the next fiscal year. This practice has so greatly increased in recent years that Illinois now ranks as the state with the greatest rate of late payments to human service providers in the nation.[7] By delaying payments owed to providers, Illinois effectively forces those providers to lend to the state the dollar value of the services they deliver. This in turn makes it difficult for providers to stay in business, as they have to meet payroll, cover rent and utilities and pay other operating costs, without receiving payment from the state for actually delivering services.

(c) **Neither the Great Recession nor Overspending is the Primary Cause of Illinois' Fiscal Problems.** The only way to break Illinois' unsustainable addiction to debt is to get state government's fiscal house in order. That in turn requires honestly determining the primary causes of its recurring deficit problems. There are three potential causes of the state's fiscal woes: (i) the Great Recession that began in November 2007 and officially ended in June 2009[8]; (ii) high, unsustainable spending on public services; or (iii) flawed tax policy.

Certainly, the Great Recession is the scapegoat many elected officials would like to blame for the state's recurring deficits. After all, if the deficits were primarily caused by the recent downturn in the economy, policymakers are off the hook. Simply wait for the economy to turn around, and Illinois' fiscal problems will disappear. Unfortunately, while the Great Recession exacerbated the state's fiscal problems, it did not cause them. Well before the Great Recession, Illinois' fiscal system was nonetheless generating ongoing deficits.[9]

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In fact, as Figure 1 illustrates, Illinois has run consistent General Fund deficits since FY1991, when the General Fund is analyzed using Generally Accepted Accounting Principles (GAAP).

Figure 1

General Fund Balance (Deficit)	
	GAAP Basis
FY 1991	($1,368)
FY 1992	($1,656)
FY 1993	($1,916)
FY 1994	($1,595)
FY 1995	($1,204)
FY 1996	($952)
FY 1997	($443)
FY 1998	($213)
FY 1999	($303)
FY 2000	($572)
FY 2001	($1,365)
FY 2002	($2,948)
FY 2003	($4,166)
FY 2004*	($2,495)
FY 2005	($3,064)
FY 2006*	($2,970)
FY 2007*	($4,171)
FY 2008*	($4,035)
FY 2009	($7,682)

** As restated.*
Source: Illinois Comptroller's Office[10]

Next for review is spending. Cutting spending would be a viable, responsible option if in fact Illinois was a profligate spending state or had been ramping up spending on services precipitously over the last decade. As more fully detailed in Section 3 of this study, the data unambiguously demonstrate that Illinois is a comparatively low spending state overall, and has actually been cutting spending in real, inflation-adjusted terms over the last 15 years.

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That leaves tax policy for consideration. As it turns out, Illinois fails to satisfy the principles of fair, responsive, stable and efficient tax policy essential to the proper functioning of a revenue system in a modern, capitalist economy.[11] The net result, flawed tax policy is the primary culprit responsible for creating the decades long, structural deficit problems that continue to plague Illinois' General Fund.

In the final analysis, the state cannot play its role in contributing to a better tomorrow, unless it gets its financial house in order today. That will require tax reform. Without comprehensive tax reform that modernizes tax policy in a manner that comports with the principles of sound taxation, the public services we all consume and millions rely on will deteriorate.

2. *Key Findings*

- The Illinois General Fund budget pays for what most taxpayers consider to be the bread and butter of public services, with over $9 out of every $10 spent on: education, healthcare, social services, and public safety.

- At the beginning of FY2011, the current fiscal year Illinois needed over $40 billion in total General Fund revenue to cover: bills remaining unpaid from FY2010 ($6.0 billion); repayment of debt ($4.61 billion); contributions to the five state pension systems ($3.52 billion); and the $26.32 billion initially appropriated to be spent on the four core public services. Unfortunately, it is estimated that FY2011 General Fund recurring revenues will total just $26.56 billion. This created an initial operating deficit of $13.89 billion, or 52.8 percent of the FY2011 General Fund.

- To reduce the FY2011 deficit, in July 2010, the governor cut $1.42 billion from the initial $26.32 billion appropriated to the FY2011 General Fund, and the General Assembly and Governor identified another $3 billion in one-time revenues for FY2011, thereby cutting the deficit from $13.89 billion to $9.47 billion. This new operating deficit represents 38 percent of the $24.9 billion in FY2011 appropriations for core services that remain after the July 2010 spending cuts.

- Running a deficit in the State's General Fund is nothing new. Illinois has run consistent General Fund deficits since at least FY1991, when the General Fund is analyzed using Generally Accepted Accounting Principles (GAAP).

- The state's deficit problems are not limited to its General Fund. Even when the state's total budget is considered on a consolidated basis, the trend of ongoing, year-to-year deficits remains.

- Claims that high spending by Illinois state government are the cause of these deficits are not substantiated by the facts. Illinois state government spending is low overall. According to the federal Bureau of Economic Analysis (**"BEA"**), despite ranking fifth in population and 13th in per capita state Gross Domestic Product, Illinois ranked 43rd in state spending as a percentage of GDP in FY2008, and 37th in per capita General Fund spending in 2008 (the most recent year for which complete data is available).

- Since Illinois ranks 13th among the states in per capita income, Illinois would be an "average" state in spending on a public service relative to its capacity if it ranked 13th among the states in per-capita spending on that service. But according to the National Association of State Budget Officers (NASBO), in FY2008 Illinois ranked below average in per-capita funding for: (i) education, ranking 40th among the states; (ii) human services, ranking 34th among the states; and (iii) even in Medicaid, ranking 21st among the states. To elevate its per-capita spending to average, in FY2008 Illinois would have had to have increased education spending by $2.89 billion, human services spending by $387 million and Medicaid expenditures by $1.2 billion.

- In additional to being low spending overall, Illinois has been cutting General Fund spending in real terms over time. After adjusting for inflation using the Midwest Consumer Price Index ("**MWCPI**") and population growth, Illinois General Fund spending was five percent (5%) lower in FY2011 under Democratic Governor Pat Quinn, than it was 16 years earlier in FY1995 under Republican Governor Jim Edgar.

- State General Fund spending on the four, core services has been cut even more over the last decade. After adjusting for inflation and population growth, the state's General Fund spending on public services was anywhere from $1.348 billion (using the MW CPI as the inflation metric) to $5.035 billion (using the Employment Cost Index as the inflation metric) less in Fiscal Year 2011 than it was a decade earlier in Fiscal Year 2000.

- Illinois is also a low public employee head count state, ranking 49th in the number of state workers per capita according to U.S. Census data. By FY 2008, Illinois had 17,000 less state workers than it did 28 years earlier, in FY 1980, a reduction in workforce of almost 25 percent.

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- Growth in spending on Medicaid is not crowding out other General Fund Expenditures. Total state expenditures on Medicaid increased from $9.6 billion in FY2003 to $14.4 billion in FY2009, a significant increase of $4.8 billion in six years. However, state own-source tax revenue used to fund Medicaid grew from $3.6 billion in FY2003 to just $4.3 billion in FY2009, a quite modest increase of $700 million. The vast majority of the state's increased Medicaid spending over this period came in the form of enhanced federal matching funds, which jumped from $4.5 billion in FY2003, to $7.8 billion in FY2009. That means almost 70 percent (68.7%) of the state's increased Medicaid expenditures over this period came in the form of federal matching dollars.

- One spending pressure that is a product of current law- and the consequence of past, irresponsible fiscal practices- does contribute to Illinois' recurring General Fund deficits: the "Pension Ramp," which became law in 1995, pursuant to Public Act 88-0593. The Pension Ramp created a 45-year payment period, during which the state would make annually increasing contributions to the five public employee pension funds. These ever increasing payments were designed to make up for Illinois' decades-long practice of using the pension systems like a credit card, by funding current services with a portion of the employer contributions the state owed to the pension system.

- During the first 15 years of the Pension Ramp, the state's employer contribution was set at levels which continued the practice of not making the full actuarially required employer contribution, thereby dramatically increasing the unfunded liability amount over that period by design. This backloading of costs in the Pension Ramp creates significant pressure on the General Fund. By FY2010, the state's pension payment was fully 392.2 percent greater than it was in FY1995—showing both a big increase in effort by the state to pay its bills, and why the Pension Ramp contributes materially to the state's ongoing General Fund deficits.

- Illinois is a low tax state. As of 2008, the last year for which there is comprehensive state and local tax burden data available, Illinois ranked 44th in total state and local tax burden as a percentage of income. This calculation is comprehensive, and includes all taxes (income, sales, excise, property) and fees (driver's license, fishing, etc.) charged by any unit of state or local government to support all state and local public services delivered in Illinois, versus the other states.

- Considering state tax levels in isolation, Illinois is tied with Missouri for the second lowest state-only tax burden as a percentage of income in the entire Midwest. If Illinois assessed the same level of state-based taxes and fees as a percentage of personal income as does any other of its neighboring Midwestern states besides Missouri, Illinois would be generating anywhere from $11.16 billion (Indiana and Iowa) to $16.48 billion (Kentucky) more in annual revenue.

- Illinois' status as a low tax state has not helped Illinois be very competitive from an economic growth standpoint. Going all the way back to 1990, Illinois has significantly lagged the nation in real GDP growth, despite being having a lower, comprehensive state and local tax burden than all but six states.

- Despite being low tax and low spending, Illinois continues to experience annual recurring deficits in both its General Fund and total budget, while its economic growth lags its higher tax neighbors and the higher tax nation as a whole. The uncomfortable truth that decision makers have refused to deal with for decades is that Illinois' flawed tax policy is the primary cause of the state's ongoing General Fund deficits.

- In fact, Illinois substantially fails to satisfy each of the four principles needed for good tax policy—i.e. that taxes be: fair, responsive, stable and efficient. Illinois tax policy is so fundamentally flawed that:
    - it materially fails to satisfy any of the principles needed for a sound revenue system:
    - it assesses tax burden in an unfair fashion that impedes revenue collection, constrains economic growth and worsens long-term income inequality; and
    - it ultimately creates a "structural deficit" that impedes the state's ability to continue providing today's level of public services tomorrow, even in good economic times and even if state government held spending on services flat from year to year in real terms.

- A "structural deficit" exists when a state's mix of taxes will not over time generate enough revenue growth to continue funding the services the state currently provides into the future, adjusting solely for inflation and population growth, and assuming normal economic expansion. Note that, the calculation of Illinois' structural deficit in this study does not even assume that General Fund spending on the core four services will continue to grow at historic rates. Instead, the analysis assumes SPENDING ON THE CORE FOUR PUBLIC SERVICES WILL REMAIN FLAT IN REAL TERMS—GROWING SOLELY WITH INFLATION AND POPULATION.

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- This means even if the current budget were balanced, the economy expanded as it did pre-Great Recession and Illinois did not improve or increase any existing services or provide any new services, the state would nonetheless *still* run a deficit in its General Fund. Put another way, Illinois, the state with the fifth largest population, fifth largest economy and 13th highest per capita income of any state, cannot afford to rank 43rd in spending on the core, four services of education, healthcare, human services and public safety, that collectively constitute over 90 percent of the state's General Fund expenditures.

- Illinois' low state level funding for education has shifted the primary responsibility for school funding from state revenues to local property tax revenues. This has: caused property taxes to grow at a rate that dramatically outpaces the rate of growth in income for most families; resulted in one of the most inequitable education funding systems in the nation; and particularly singled out low income, middle income, downstate and minority communities for low education funding levels.

- Despite being low tax and low spending, Illinois has cut its General Fund by more than $1.4 billion in the current Fiscal Year. Implementing more cuts this year is less than desirable as a deficit solution, because those cuts would have to be made in the four core services of education, health, human services, and public safety, which collectively account for over 90 percent of General Fund expenditures.

- Taking the preceding factors into account, it is clear Illinois cannot get its fiscal house in order without increasing recurring tax revenue through comprehensive tax policy reform. This tax reform should include the following elements:

  - To make Illinois tax policy both fairer and more responsive, and to generate enough state-based revenue to address the structural deficit and reduce the reliance on local property taxes to fund education, the Illinois individual income tax rate should be increased from 3% to 5%, with a corresponding increase in the corporate income tax rate from 4.8% to 8%. The state should also make the retirement income for tax filers with over $50,000 in Adjusted Gross Income subject to the state's personal income tax. This will only affect 18.48 percent of Illinois tax filers who report having retirement income.

  - To modernize the state's tax system while making it more stable—therefore better able to withstand tough economic times—the Illinois sales tax base should be expanded to include virtually all consumer services (other than medical and housing services).

  - To create necessary progressivity, any net tax increases created pursuant to the comprehensive tax reform recommendations identified in this study should be at least partially offset with tax relief specifically targeted to low and middle income taxpayers. To be most effective, this tax relief should be refundable—that is, an eligible taxpayer should receive the full dollar value of the targeted tax relief, even if it exceeds his or her state income tax liability. This refundability feature allows an income tax credit to offset other, regressive taxes paid by low and middle income families, like sales, excise and property taxes.

  - To make state and local tax policy more efficient and to improve school funding for poor, low income, middle income, minority, and rural areas of the state, without reducing funding for affluent areas, the state's reliance on property taxes to fund schools should be reduced, by using a portion of the new state-based revenues from the income and sales tax changes discussed above to enhance education funding.

  - Given the significant size of the current FY 2011 deficit – at least $9.47 billion – any education funding enhancement should be phased in over time, as the state's deficit problems are resolved.

  - The tax policy reform recommendations identified in this studywill: raise a net of $7.8 billion in new recurring General Fund tax revenue (after netting out the $1 billion plus tax relief it provides to low and middle income families and the $493 million in property tax relief it provides to homeowners); eliminate the structural deficit; enhance education funding; and maintain total state and local tax burden in Illinois in the bottom half of the nation.

  - Neither of the proposals offered by the two leading candidates for governor (Democrat Pat Quinn, Republican Bill Brady) will solve the state's fiscal problems.

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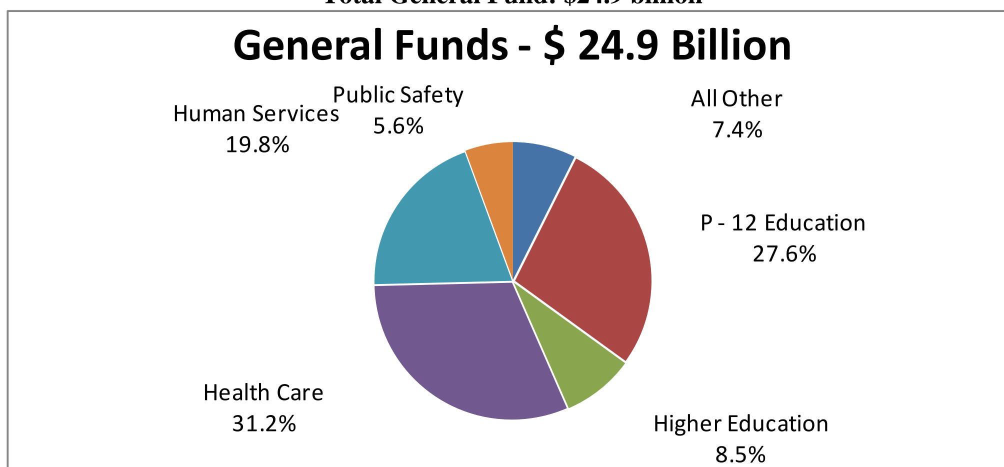
3. *Profligate Spending Did Not Cause Illinois' Deficit Problems*

(a) **Illinois' Current General Fund Deficit.** The General Assembly initially appropriated $26.32 billion to the state's General Fund in FY 2011.[12] Illinois operates on a fiscal, not calendar year basis. Each state fiscal year begins on a July 1st, and ends the following June 30th. That means Illinois' Fiscal Year 2011 began on July 1, 2010, and will continue until June 30, 2011.[13] As indicated previously, over $9 out of $10 spent through the General Fund pay for what most taxpayers consider to be the bread and butter of public services: education, healthcare, social services, and public safety. The General Fund is the largest portion of the state's total budget, which is $51.7 billion for FY2011, including the General Fund.[14] The remaining portions of the total budget are comprised primarily of special funds and bond proceeds that are separate from the state's General Fund. By law, these other funds and bond proceeds are not supposed to be available to reduce the state's operating deficit in its General Fund, and are not supposed to be within the General Assembly's discretion to appropriate for general purposes.[15] Instead, these other funds are intended to be used solely for the limited purposes of either the applicable special fund (say, environmental protection for instance) or the project funded by the applicable bond proceeds.

Governor Quinn cut the FY2011 appropriation level by $1.42 billion in July 2010,[16] reducing FY2011 General Fund appropriations from $26.32 billion to $24.9 billion. As Figure 2 demonstrates, after those cuts, Illinois will spend over 96 percent of its remaining FY 2011 General Funds on the four, core services of: education (preK-12, plus higher ed) – 36.1 percent; healthcare – 31.2 percent; human services (mental health, developmental disabilities, Department on Aging, DCFS, etc.) – 19.8 percent; and public safety (state police plus corrections) – 5.6 percent.[17]

Figure 2
General Funds Expenditures FY2011 After Cuts Announced July 2010
Total General Fund: $24.9 billion



Source: Governor Quinn final FY 2011 General Fund Appropriations presentation, June 30, 2010.

Given the core nature of the services it pays for, why did the governor cut $1.42 billion from the initial $26.32 billion appropriated to the FY2011 General Fund? The short answer is he had no choice – given the other bills the state has to pay with General Fund revenue. As Figure 3 illustrates, in addition to the $26.32 billion initially appropriated to the General Fund in FY2011, the state also has to pay the following from the revenues that feed the General Fund: (i) over $6 billion for General Fund services that were delivered by providers last year in FY2010 but remain unpaid;[18] (ii) $4.61 billion in debt service payments;[19] and (iii) $3.52 billion in pension contributions.[20]

Collectively then, in FY2011 the state needed $14.13 billion in General Fund revenue to cover old bills, bank debt and pension contributions, in addition to the $26.32 billion it initially hoped to spend on the four core public services. Unfortunately, as Figure 3 also shows, FY2011 General Fund recurring revenues are anticipated to total just $26.56 billion —leaving the $13 billion plus deficit that has received so much media attention. Note that much of this deficit—almost half—is comprised of the one-time cost of paying the $6 billion in past due bills left over from FY2010.

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Figure 3

Illinois FY2011 Walk Down of General Fund Revenue, Expenditures and Deficits[21]

(i) Revenue Needs in FY 2011	
• Carry Forward of Unpaid Bills from FY2010	$ 6.0 B
• Repayment of Debt/Prior Fund Transfers	$ 4.61 B
• Required Pension Payment	$ 3.52 B
• Initial General Fund Approps FY2011	$26.32 B
• **Total Revenue Initially Needed in FY 2011**	**$40.45 B**
(ii) Anticipated FY 2011 Recurring Revenue	
• Estimated 2011 Own Source Gen Fund Revenue	$21.26 B
• Estimated 2011 Federal Transfers	$ 5.30 B
• Total Recurring Revenue	$26.56 B
(iii) Initial FY2011 Operating Deficit	**(-$13.89 B)**
• Initial Operating Deficit as % of Initial GF Approps	**(-52.8%)**
(iv) Cuts From Initial GF Approps	
• Initial FY2011 Spending Cuts Announced in July 2010	$1.42 B
(v) FY2011 General Fund Approps Remaining after July 2010 Cuts	$24.9 B
(vi) FY2011 Operating Deficit After July 2010 Cuts	**(-$12.47B)**
• Remaining Operating Deficit as % of Revised GF Approps	50.1%
(vii) One-Time, Nonrecurring Revenue/Debt Created for FY2011 GF	
• Securitization of Tobacco Litigation Proceeds	$1.20 B
• Tax Amnesty Program	$ 0.25 B
• Raiding Special Funds	$1.00 B
• Carry Forward of Federal ARRA Transfers	$0.55 B
• **Total One-Time Nonrecurring Revenue**	**$3.00 B**
• One-Time Revenue as % of Revised FY2011 GF Approps	12.0%
(viii) Remaining FY2011 Deficit	**(-$9.47 B)**
• As Percentage of GF Approps (After July 2010 Cuts)	**(-38.0%)**

Hence, the initial operating deficit for current Fiscal Year 2011 was just over 52 percent of the General Fund. In the intervening months since the FY2011 General Fund budget was announced, the Governor cut appropriations for services by just over $1.4 billion, and agreed with the General Assembly to raise about $3 billion in one-time revenue that will be available in FY2011, but not thereafter. This leaves the FY2011 deficit at $9.47 billion—or still 38 percent of the General Fund, while the minimum, carry forward deficit into FY2012 will be $12.78 billion, or the sum of the FY2011 deficit ($9.47 B) plus the one-time revenue used in FY2011 ($3.0 B) that will not be available in FY2012, plus the loss of the revenue stream from the tobacco litigation settlement discussed below ($.315 B).

Use of one-time revenue to support spending on recurring services is one of the irresponsible fiscal practices Illinois has increasingly utilized. Obviously, one-time revenue is by definition not available in succeeding years. Even worse, gaining one-time revenue through practices like securitizing the tobacco litigation proceeds are doubly troubling. On the one hand, the $1.2 billion the state will receive for FY2011 from this securitization must be fully replaced in FY2012 from another source. On the other, Illinois has now lost the ongoing revenue stream of around $315 million per year it previously

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received from the tobacco litigation settlement, further worsening the mismatch between growth in recurring revenues and growth in the cost of providing services.

It should be noted that the state's deficit problems are not limited to its General Fund. Even when the state's total budget is considered as a whole, the trend of ongoing, year to year deficits remains. As Figure 4 illustrates, the respected Institute for Government and Public Affairs has calculated that from FY1997 through FY2009, on a consolidated basis the state has realized a significant deficit in its overall budget every year except FY1998.

Figure 4

IGPA Consolidated Budget Deficit Estimates
($ current billions)

Fiscal Year	With Borrowing Removed and Increased Pension Liability Added		
	Receipts	Expenditures	Surplus/Deficit
1997	43.1	33.1	10
1998	44.5	44.3	0.2
1999	46.5	47.5	-1
2000	49.4	49.5	-0.1
2001	49.6	63.4	-13.8
2002	48.8	65.9	-17.1
2003	49.1	63.1	-14.1
2004	53.6	56.8	-3.2
2005	52.9	58.6	-5.7
2006	53.8	57.4	-3.6
2007	55.9	58.5	-2.5
2008	56.4	70.2	-13.8
2009	55.1	64.6	-9.6
2010	54.1	71.6	-17.5

Source: Institute of Government and Public Affairs, Fiscal Futures Model, run October 21, 2010; for documentation see Appendix 4, "The Fiscal Futures Project: Project and Initial Results," Richard Dye and Nance Hudspeth, revised May 17, 2010.

(b) **Illinois Is Low Spending Overall**. If, as some contend, Illinois state government is spending like a drunken sailor, then cutting spending would be a responsible approach to reducing the General Fund deficit. Determining whether and to what extent General Fund spending patterns are to blame for generating the state's significant ongoing deficits involves a two-part inquiry. First, is Illinois either spending too much overall or ramping spending up at unsustainable rates over time? Second, even if overall spending is neither excessive nor increasing unduly, is Illinois nonetheless confronting legitimate spending pressures that contribute to the deficit and are difficult for the state's revenue streams to satisfy?

Claims that Illinois state government wildly overspends are simply not substantiated by the facts. Consider overall spending first. One common metric economists use to determine whether a state is high or low spending is to compare General Fund spending as a percentage of state Gross Domestic Product (**"GDP"**). According to the federal Bureau of Economic Analysis (**"BEA"**), despite ranking fifth in population, and 13th in per capita GDP, Illinois ranked 43rd in state spending as a percentage of GDP in FY2008, and 37th in per capita General Fund spending in 2008, the most recent year for which complete data is available.[22] It is difficult to claim that a top five population state that ranks 43rd in spending is a high spending state. If anything, the preceding demonstrates far from being high, Illinois General Fund spending is probably not sufficient to meet needs.

And no, Illinois' ranking as a low-spending state is not because of the spending cuts made after the Great Recession. Isolating state spending during the 10 years before the recession hit still indicates Illinois has consistently been very low spending overall. According to the BEA, in 2007, Illinois had a Gross Domestic Product of $610.4 billion.[23] The General Fund of the State of Illinois in 2007 was $28.45 billion (rounding up, based on the Comptroller's annual report).[24] That means General Fund spending accounted for just 4.6 percent of Illinois state GDP in 2007.

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According to the same BEA data, Illinois GDP was $403.9 billion ten years earlier in 1997.[25] The Illinois General Fund was $17.3 billion (rounding up, using the Comptroller's final annual report) in 1997.[26] That means General Fund spending accounted for 4.3 percent of the Illinois GDP in 1997. Hence, General Fund spending as a percentage of GDP increased by just three-tenths of one percent during the 10 year period from 1997-2007 that preceded the Great Recession. This, despite the shift of responsibility to cover healthcare costs from the private sector to the public sector—today, over 42% of Illinois workers who have jobs do not have employer-provided health insurance, and over 30% of the state's population is uninsured or on Medicaid[27]—plus the phase-in of the "Pension Ramp" (as defined in Section 3(e) below), which imposed significant, real annual cost increases on state government to make up for decades of underfunding its five pension systems. [28] In fact, virtually the entire increase in state spending over this period can be attributed to the Pension Ramp. [29] Appendix Table 4 similarly shows that Illinois' own-source General Fund revenue as a share of GDP and personal income was lower in FY2007 and FY2008 than FY2000.

Illinois is also a low spending state when the comparison considers the state's capacity to spend, based on per-capita income. According to 2009 BEA data, Illinois ranks 13th among the states in per capita income.[30] Hence, Illinois would be an "average" state in spending on a public service relative to its capacity if it ranked 13th among the states in per-capita spending on that service.

According to the National Association of State Budget Officers (NASBO) however, in FY2008 Illinois ranked below average in per-capita funding for: (i) education, ranking 40th among the states; (ii) human services, ranking 34th among the states; and (iii) even in Medicaid, ranking 21st among the states.[31] To just elevate its per-capita spending to average, in FY2008 Illinois would have had to have increased education spending by $2.89 billion, human services spending by $387 million and Medicaid expenditures by $1.2 billion. As shown in Section 3(c) below, however, Illinois has instead been cutting General Fund spending in real terms over the last decade.

(c) <u>Illinois Has Been Cutting Spending in Real Terms Over Time.</u> To evaluate accurately whether state General Funding spending, even if low in absolute terms is nonetheless ramping up over time at an unsustainable rate, spending on services must be adjusted for inflation and population growth. Why adjust General Fund spending for inflation? The answer is simple. It's the only way to determine whether spending on public services is increasing in real terms, just keeping pace with cost increases generated by the economy over time, or is falling behind cost increases caused by the economy, resulting in real spending cuts.

The most commonly used inflation metric is the "Consumer Price Index" or "CPI," published by the Federal Bureau of Labor Statistics (BLS). The CPI is the rate of inflation that accounts for the change in the cost of all goods and services that collectively constitute the U.S. consumer economy. Public services, however, whether education, police protection, healthcare or human service related, are labor intensive endeavors, with labor costs generally comprising 80 to 90 percent of total costs. Hence the CPI, which includes everything in the consumer economy – such as the price of pop tarts, bleach, and hair cuts – is not the best inflation metric for determining the increased cost of maintaining public service levels annually. Far better is the "Employment Cost Index" or "ECI," (also published by the BLS) which is tied directly to changes in the cost of labor over time.

As Figure 5 demonstrates, in real terms, that is, after adjusting for inflation using the Midwest Consumer Price Index ("**MWCPI**") and population growth, Illinois General Fund spending did not increase at all over the last 15 years.[32]

Figure 5

Change in General Fund Spending from FY1995 - FY2011, Adjusted for Inflation Based on Midwest CPI (compound)

Category	FY1995 Actual	FY1995-FY2011 Adj for MW CPI & Population	FY2011 After Cuts	Diff FY1995 Adj for CPI & FY2011	Percent Change
General Fund	$17.20 B	$26.13 B	$24.9 B	(-$1.23 B)	(-5%)

Source: Fiscal Focus, Table p. 7, December 1996, Illinois Comptroller's Office. Governor Quinn final FY2011 Appropriations presentation June 30, 2010. MWCPI and ECI indices from BLS. Estimates for FY 2011 based on growth from FY 2009 to FY 2010. DCEO Illinois population growth estimates.

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In fact, after adjusting for inflation and population growth, Illinois in real terms was spending less in FY2011 under Democratic Governor Pat Quinn, than it had been 16 years earlier in 1995, under moderate Republican Governor Jim Edgar, who was no spendthrift. Most people understand that the cost of providing services grows with inflation—and it costs more to serve more people over time. The hard cold facts are simple, state spending hasn't even kept up with inflation and population growth for over a decade and a half.

State General Fund spending on the four, core services over the last decade has been even more penurious, as Figure 6 shows. In Figure 6, pension spending was subtracted from total General Fund appropriations to isolate the applicable year's General Fund spending on current public services. In real terms then, the state's General Fund spending on public services was anywhere from $1.348 billion to $5.035 billion less in Fiscal Year 2011 than it was a decade earlier in Fiscal Year 2000, depending on whether General Fund spending is adjusted by the Midwest CPI or the more accurate ECI.

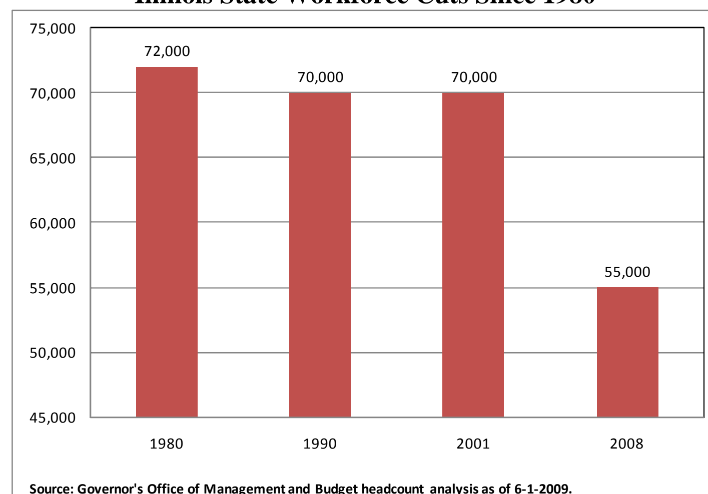
Figure 6
Change in General Fund Spending from FY2000 – FY2011,
Adjusted for Inflation Using both the Midwest CPI and the National ECI
(Dollars in Billions)

Category	FY 2000 Actual	FY2000 Adjusted to FY2011 for CPI & Population	FY2011 Enacted	Difference FY2000 - FY2011 CPI & Population	FY2000 - FY2011 ECI & Population	Difference FY2000 - FY2011 ECI & Population
General Fund	$21.29 B		$28.46			
-Pension	(- $1.23 B)		(- $3.520)			
General Fund/ Current Services	$20.06 B	$26.29	$24.94	(-$1.348 B) (-5.1%)	$29.98 B	(- $5.035 B) (-16.8%)

Source: CGFA FY 2001 and FY 2011 Budget Books (for Pension spending). Governor Quinn final FY2011 Appropriations presentation June 30, 2010. MWCPI and ECI indices from BLS. Estimates for FY 2011 based on growth from FY 2009 to FY 2010. DCEO Illinois population growth estimates.

This consistent pattern of cutting state spending in real terms over time has impacted Illinois' capacity to continue providing services. In fact, as Figure 7 illustrates, by FY2008 Illinois had 17,000 less state workers than it did 28 years earlier, in FY 1980. This is a reduction in workforce of almost 25 percent. Meanwhile, the state's population grew by 13 percent over that period. [33] Put those factors together, and Illinois now ranks 49th in the number of state workers per capita, according to U.S. Census data. [34] Keep that in mind the next time you stand in line for what seems like ages when trying to renew your driver's license.

Figure 7
Illinois State Workforce Cuts Since 1980



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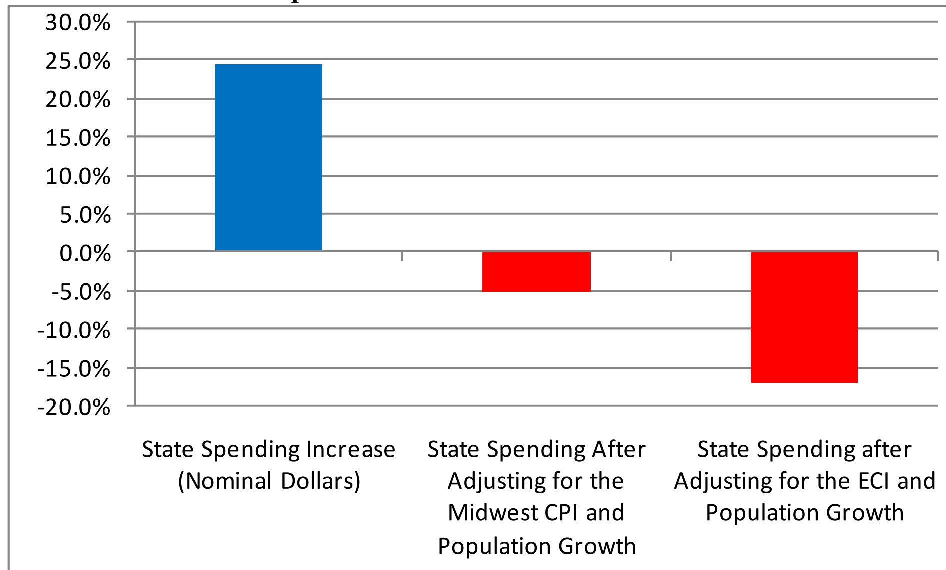
As Figure 8 illustrates, no matter which inflation metric is used, Illinois General Fund spending has declined in real terms over the last decade.

Figure 8
Percentage Increases in Illinois General Fund Spending (Net of Pension Ramp) versus Inflation and Population Growth FY2000 to FY2010



Source: Figure 9

Yet, despite this long-term pattern of reducing General Fund spending in real terms over time, Illinois has already implemented significant spending cuts in current Fiscal Year 2011, totaling $1.42 billion.[35] The impact of these cuts by core service area is delineated in Figure 9. Even after those cuts, Illinois still faces a General Fund deficit in excess of $9 billion in FY2011.

Figure 9
Illinois General Fund Appropriations by Major Category Adjusted for Inflation and Population Growth FY2000-FY2011

Category	% Change FY 2011 Actual & FY2000 Adj to FY2011 for MW CPI and Pop Growth	% Change FY 2011 MW - FY 2000 Adj for ECI and Pop Growth4
General Fund Excluding Pensions	-5.1%	-16.8%
K-12	8.3%	-5.0%
Higher Ed	-25.1%	-34.3%
Health Care[1]	18.2%	-7.9%
Human Services[2]	-18.2%	-28.3%
Public Safety	-4.8%	-16.6%

Notes: 1)DPH and HFS (Public Aid in 2000 and 2001)
2) Aging, DCFS and DHS
3) Department of Corrections and Illinois State Police

Sources: See Appendix Table 2

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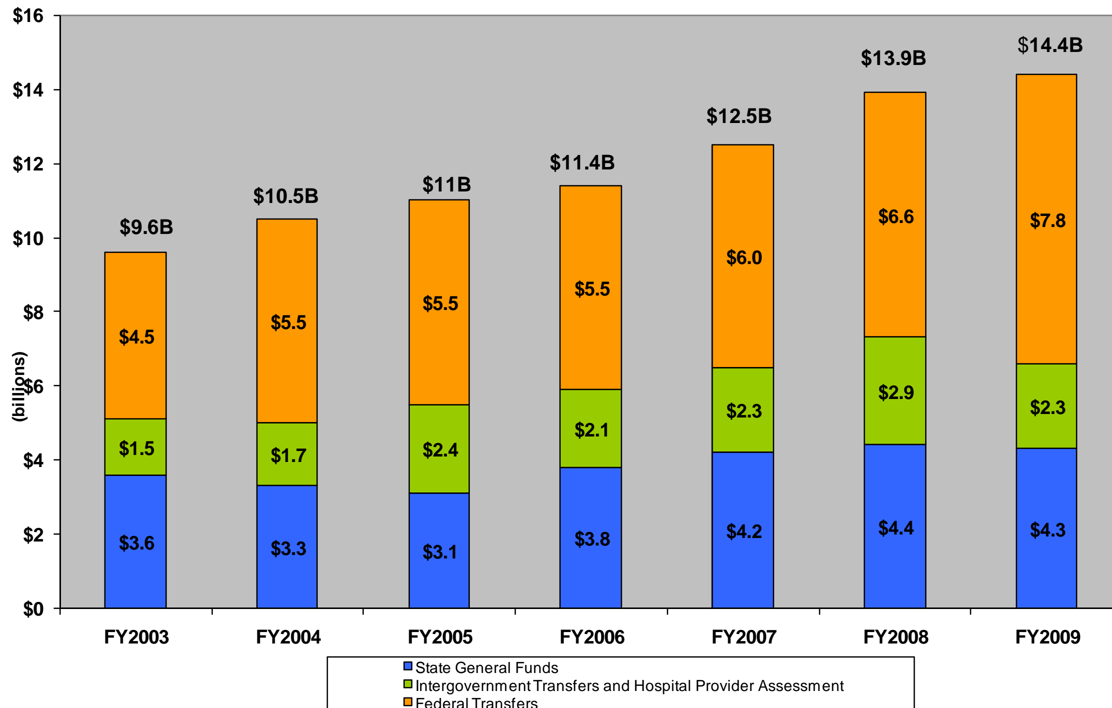
At the end of the day, for a low spending state like Illinois, there simply is not much left to cut that wouldn't cause a significant decrease in service levels. This reality has been recognized by legislative leaders in both parties, for a long time. Back in 2003, Republican State Representative Mark Beaubien (R-52, Barrington Hills) stated, "I don't see how much more we can cut. There's always room. But once you reduce employees, once you cut programs like we have there comes a point where you can't continue to do that."[36] Back then, the budgetary deficit was significantly less than today. More recently, former Republican Governor Jim Edgar described as "naive," a proposal by his party's current nominee for governor, Senator Bill Brady (R-44), to balance the state's budget by cutting spending by 10 percent "across the board".[37]

Since Illinois ranks near the bottom of all states in General Fund spending, and Illinois has been cutting that spending in real terms for over 15 years, it strains credulity to argue that the state's General Fund spending is at excessively high levels overall, is ramping up at unsustainable rates over time, or is the primary cause of Illinois' recurring deficits. Moreover, cutting spending by over $9 billion or 38 percent on basic necessities like schools, healthcare, public safety, childcare for single working parents and social services—which is what would be needed to balance the FY2011 budget with cuts—hardly seems like the responsible thing to do from a social policy perspective. Cuts of that magnitude would hurt millions of Illinois families and seriously degrade the state's long-term viability and attractiveness.

(d) **<u>Medicaid is Not Crowding out Other General Fund Expenditures</u>.** One oft-repeated claim that has gained much currency is the contention that growing General Fund expenditures on Medicaid are crowding out the other core service areas of education, human services and public safety covered by the General Fund. While it is true that Medicaid expenditures have increased significantly over the last few years, that increased spending has not come at the expense of other service areas – far from it. In fact, as Figure 10 shows, once state-own source revenue is isolated, it becomes quite clear that the material portion of the state's increased expenditures on Medicaid have been funded with federal matching funds, not state own-source tax revenue.

Figure 10
Illinois Medicaid Spending by Funding Source
(Federal, State and Local)



Data Source: National Association of State Budget Officers, Annual State Expenditure Reports.

Note that while total state expenditures on Medicaid increased from $9.6 billion in FY2003 to $14.4 billion in FY2009, a jump of almost $5 billion in six years, state tax revenue used to fund Medicaid grew from $3.6 billion in FY2003 to just $4.3

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billion in FY2009, a quite modest increase of $700 million. The vast majority of the state's increased Medicaid spending over this period came in the form of enhanced federal matching funds, which jumped from $4.5 billion in FY2003, to $7.8 billion in FY2009. That means almost 70 percent (68.7%) of the state's increased Medicaid expenditures over this period came in the form of federal matching dollars, while just 14.5 percent was paid for with state tax revenue.

Needless to say, leveraging federal dollars into Illinois to support our state's healthcare industry is good fiscal, healthcare and economic policy. Fiscally, the state receives significant federal investments to support Illinois' budget. From a healthcare standpoint, the state is able to leverage billions to provide needed healthcare services to the 2.9 million low income and poor Illinoisans who were eligible to participate in Medicaid as of the end of 2009.[38] Economically, billions of dollars of federal revenue is flowing into Illinois to support jobs in the state's healthcare industry. This has a strong, positive multiplier effect on the Illinois economy.

The benefits Illinois derives from enhanced federal Medicaid matching dollars will be especially strong for the period that began on October 1, 2008, and runs through the end of Fiscal Year 2011. During that period, under the American Recovery and Reinvestment Act ("**ARRA**"), the Medicaid expenditure matching rate for Illinois is increased from 50 percent to 61.88 percent.[39]

After the ARRA expires, it will continue to make no sense for the state to reduce the share of Medicaid expenditures covered by state, own-source revenue for two reasons. First, Illinois already stands to lose around 19 percent of the federal Medicaid matching funds it currently receives, when the matching rate is cut back to 50 percent. Based on the FY2009 federal matching funds Illinois received, that translates into a loss of $1.48 billion in federal funding annually for Illinois. Moreover, because every dollar in state own-source revenue spending on Medicaid that Illinois cuts costs the loss of an additional dollar in federal match, saving $50 million in state tax revenue would force a $100 million cut in Medicaid funding, compounding the lost revenue to the state's healthcare industry that will be caused by the decline in federal Medicaid matching rates post ARRA.[40] This would harm the state's economy, healthcare industry and millions of families who count on Medicaid for access to healthcare, without generating meaningful savings for the General Fund budget.

(e) **The Pension Ramp has Contributed to the Spending Pressure**. As shown above in this Section, none of the state's growing deficit has been caused by real growth in spending on bread and butter services that help build Illinois' infrastructure. However, one spending pressure that is a product of current law—and the consequence of past, irresponsible fiscal practices—does contribute to Illinois' recurring General Fund deficits: the "Pension Ramp." The Pension Ramp became law in 1995, pursuant to Public Act 88-0593.[41] At the time it was passed, the Pension Ramp was sold as a responsible solution to the state's historic practice of not making its full employer contribution to the five public employee pension systems for which it is responsible: the Teachers Retirement System; the State University Retirement System; the State Employees Retirement System; the General Assembly Retirement System; and the Judicial Retirement System.

The Pension Ramp created a 45-year repayment period, during which the state would make annually increasing contributions to the five pension funds to make up for the prior decades of underfunding. This begs the question—why was the state previously underfunding its pensions? Well, despite oft-repeated claims to the contrary, the primary cause of the state's pension funding woes historically has very little, if anything, to do with over-generous benefits, high employee head counts or inflated costs.

Consider, for instance, the popular belief that Illinois has an overly large public workforce. Nothing could be further from the truth. Despite having the fifth largest population of any state, Illinois ranks 49th among the states, next to last, in number of state employees per capita.[42]

Illinois also does not have overly generous benefits. The pension benefits provided to Illinois teachers, police officers and other public employees are average when compared to other states.[43] According to the Illinois State Comptroller, pension benefits paid to regular state employees in Illinois are low relative to benefits provided by other states.[44] Illinois actually ranks in the bottom one-fifth of all states for retirement benefits paid to an average state worker.[45] Moreover, 78 percent of Illinois' state retirement plan participants are not coordinated with Social Security, and hence do not get that benefit on retirement.[46] This is unlike workers in the private sector, who receive both Social Security and private retirement benefits.

Illinois also has a low-cost pension system. The weighted average normal cost across all five systems is 9.3 percent of payroll, which is 26 percent less than the national average of 12.5 percent.[47]

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The reality is that the primary cause of the state's unfunded pension liability is Illinois' decades-long failure to make its full, actuarially required normal cost employer contribution to the five pension systems.[48] This poor fiscal practice was actually codified in the 1995 Pension Ramp law. During the first 15 years of the Pension Ramp, the state's employer contribution was set at levels which continued the practice of not making the full actuarially required employer contribution for current workers, thereby dramatically increasing the unfunded liability amount—by law.

The reason decision makers in 1995 decided to codify underfunding the pension systems into law for 15 years is clear and compelling: state revenue growth from year to year was insufficient to maintain both the state's then current, low spending on services and fund the state's full employer contribution to its low head count, low cost and low to average benefit pension systems. In other words, Illinois, which has the fifth largest economy of any state, had a revenue system that could not support Illinois' historic status of ranking in the bottom 10 states in General Fund spending. But rather than raise adequate tax revenue to fund both the state's General Fund spending on core services and the actuarially determined employer contribution owed to the pension systems, decision makers chose to engage in the irresponsible practice of diverting payments due to pension systems to instead fund current services. That created, by design, an aggregate unfunded pension liability of over $40 billion by FY2008.[49] And then the markets crashed during the Great Recession, causing a concomitant crash in the value of the assets held in the state's five pension systems. This pushed the unfunded liability up to in excess of $80 billion.[50]

Figure 11 shows an inflation-adjusted comparison of the state's pension contributions to its five systems since 1995. Note that by FY2010, the state's pension payment was fully 392.2 percent greater than it was in FY1995—showing both a big increase in effort by the state to pay its bills, and why the Pension Ramp contributes materially to the state's ongoing General Fund deficits.

Figure 11

Real Changes in General Fund Spending FY1995 - FY2010 using Midwest CPI (compound)					
Category	**FY1995 Actual**	**FY1995 FY2010 Inflation Adjusted**	**FY2010 Actual**	**Diff FY1995 FY2010 Inflation Adjusted Increase**	**Percent Increase**
Pension	$519 M	$729 M	$3,587	$2,858	392.2%

The problem with that ever increasing payment schedule, of course, is that when the Pension Ramp was passed in 1995 no new revenue stream was established to fund it. Hence, as the Pension Ramp payments by law started to increase annually by amounts that vastly outstripped inflation, it created tremendous pressure on the state's fiscal system – pressure that grows annually.

4. *Illinois Is A Low Tax State*

There remains one more threshold question to answer before addressing whether decision makers should increase tax revenue to address Illinois' deficits: Is Illinois a high tax state? Intuitively, it would seem obvious that a low spending state is also low in overall tax, and the data bear this out. As of 2008, the last year for which there is comprehensive state and local tax burden data available, Illinois ranked 44th in total state and local tax burden as a percentage of income.[51] This calculation is comprehensive, and includes all taxes (income, sales, excise, property) and fees (driver's license, fishing, etc.) charged by any unit of state or local government to support all state and local public services delivered in Illinois and the other states.

That means Illinois has the sixth lowest comprehensive state and local tax burden in the nation. Illinois is also tied with Missouri for the second lowest state-only tax burden as a percentage of income in the entire Midwest.[52] As Figure 12

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shows, if Illinois' state-only tax burden as a percentage of income were the same as its neighboring Midwestern states, Illinois would be generating billions more in annual revenue, again except for Missouri.

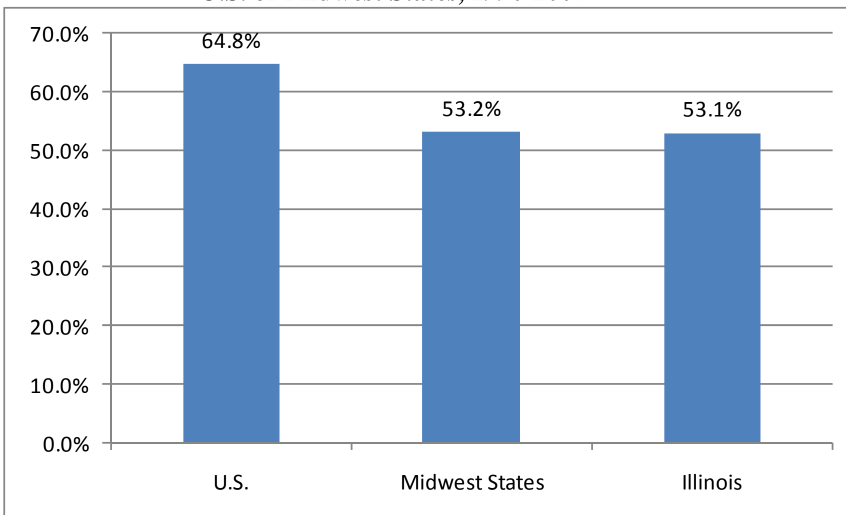
Figure 12

IL State Own-Source Revenue Under Neighboring State Revenue Shares FY2008 Current $ Billions		
	State Own-Source Revenue as a Percentage of Personal Income	**Increase or Decrease in IL GF Revenue if Illinois Had Equal State-Based Tax Burden as a Percentage of State Income**
Illinois	7.6%	
Indiana	9.7%	+ $11.16 B
Iowa	9.7%	+ $11.16 B
Kentucky	10.7%	+ $16.48 B
Missouri	7.6%	$0
Wisconsin	10.1%	+ $13.29 B

Sources:
1) 2008 State Revenue as a Percentage of Personal Income, Federation of Tax Administrators, updated July 19, 2010.
2) Increases based on BEA 2008 Illinois Personal Income of $531.591 B

One of the key arguments usually made in favor of a state maintaining low tax status compared to other states is to promote economic competitiveness. Unfortunately, Illinois' status as a low tax state has not helped Illinois be very competitive from an economic growth standpoint – in fact far from it. Based on BEA data, for the decade preceding 2008, Illinois ranked 45th among the states in percentage growth in state GDP.[53] Going all the way back to 1990, Illinois has lagged the nation in real GDP growth as Figure 13 shows, despite Illinois being lower tax than most of the nation and all its Midwest neighbors except Missouri.

Figure 13
Illinois Gross State Product Grew Less Than U.S. or Midwest States, 1990-2007



Source: Bureau of Economic Analysis, U.S. Department of Commerce

Note that Illinois' lack of economic competitiveness cannot be blamed on the Great Recession, since the dates in Figure 13 go through the end of 2007, which only includes one month of the recession.

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5. *Flawed Tax Policy is the Primary Cause of the State's Ongoing Deficit Problems*

(a) **Overview of Primary Revenue Sources Used to Fund State and Local Government.** Before analyzing how Illinois should reform its tax policy, a basic description of how state and local governments raise revenue to fund public services is in order. Revenues are typically generated in one of three ways: levying taxes, charging fees and issuing debt. Generally speaking, tax revenue is used for funding day-to-day public services (like education, healthcare, public safety and social services), fees are primarily intended to reimburse state or local government for the cost of specific services being provided or to build reserves for needed infrastructure development, maintenance and repairs (like the road fund), and bond revenue is used to build or maintain public works (like school buildings, water systems, etc.) that have a long useful life. With limited exceptions, fee and bond revenue is typically not available for funding day-to-day public services. Since tax revenues are what should appropriately fund public services, this study focuses on the paradigm established for combining the primary tax revenue sources into a fair and sound fiscal system.

The three primary taxes states levy are income, sales and excise. State income taxes are generally assessed against the taxable income of individuals and certain corporate taxpayers which remains after adjusting for deductions/exclusions of specified amounts or types of income from taxation. Some business entities, e.g. partnerships, "S"–corporations and limited liability companies, by law are not assessed any income taxes no matter how profitable. Instead, the owners of those businesses pay personal income taxes on the profits of the businesses they own, in accordance with their respective percentage ownership interests in the underlying business. Most states (including Illinois), piggyback to a great extent on federal law in defining what is and what is not included within taxable income, with some notable exceptions. For instance, while most retirement income is subject to the federal income tax, it is not subject to the Illinois state income tax.[54]

Sales taxes are generally based on a percentage of the final purchase price of those goods and services included within the sales tax "base." The "base" of a tax is simply what items the tax is assessed against.

Excise taxes are like sales taxes in that they apply to goods or services sold in the economy. They are unlike sales taxes, however, in one fundamental way. Instead of being based on a percentage of the price of the good or service sold, excise taxes are usually a fixed charge per unit. Examples of an excise tax would be, for example, a $1 tax per package of cigarettes, or $1 tax per gallon of gas.

While a few states levy a property tax (e.g. Michigan), in the vast majority of cases property taxes are purely a local revenue source levied by local governments such as counties, municipalities, school districts, park districts and the like. That said, state government does directly and indirectly pressure local governments to increase property tax levies. This is particularly true in those instances when a state either fails to pay its fair share of a crucial public service funded by both state and local revenue such as, say, education, or a state imposes unfunded mandates on local governments to provide services or pay for benefits. Because of this interrelationship between the primary state tax revenue sources and the property tax levied by local governments, property taxes are also analyzed in this study.

Unlike taxes, which generate general revenue states can typically use for any spending on services their General Assemblies deem appropriate, fee-based revenue is usually restricted to reimbursing a government entity for the cost of providing a specific service. Illinois is typical in this regard, in that in most cases it does restrict the value of fees to the amount reasonably necessary to reimburse the state for the cost of providing specific services.[55]

(b) **The Elements of a Sound and Fair Tax System.** Whether or not a state has a sound tax system depends on a number of factors, like whether or not it has a proper mix of tax revenue sources, the base of each tax, and how tax burden is distributed among taxpayers. There are basically four principles to use as guideposts for creating a sound tax system:[56]

(i) First, tax policy should be **fair**. "Fairness" is determined by how tax burden is assessed on various taxpayers. Fairness for tax policy purposes is measured in two ways: "horizontally", that is comparing the tax burden of different taxpayers with similar income levels, and "vertically", that is comparing the tax burden of taxpayers across different income levels.[57] Tax policy achieves horizontal fairness if taxpayers with similar incomes have similar tax burdens. A tax system will have horizontal fairness when it does not contain numerous tax breaks which favor one taxpayer

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over another similarly situated taxpayer. Tax policy achieves vertical fairness if the tax burden imposed across different income levels is "progressive", that is, it imposes a greater tax burden on high income taxpayers than low and moderate income taxpayers, when tax burden is measured as a percentage of income.[58] Progressive income tax rates are the favored method of creating vertical fairness in a tax system. A progressive income tax rate structure simply means the percentage income tax rate increases as taxpayer income increases.

(ii) Second, taxes should be assessed to **respond** to how growth is actually realized and distributed in the economy. That means taxes should be imposed where economic activity is significant and where it is increasing over time. A responsive tax system generates the fiscal capacity for revenue growth to keep pace with the inflationary cost growth of providing services overtime, since it responds to growing economic activity. The plus of a very responsive tax is during times of exceptional economic growth, it can generate significant revenue growth, that in turn can be placed in a rainy day fund to help get through down cycles. Establishing such a rainy day fund would indeed be a good idea, since the downside of a very responsive tax is that it tends to generate significantly diminished revenue during poor economic cycles. As with creating tax fairness, a progressive income tax structure that includes most forms of income is one of the best ways to ensure a tax system is responsive to income distribution in the modern economy.

(iii) Third, a tax system should have a **stable** revenue source. A stable tax maintains some decent base revenue generation even during poor economic cycles. Generally, having a sales tax that is imposed on a broad range of the transactions actually occurring in the consumer economy is the best way to bring some stability to a state-level tax system. Property taxes, which are also stable, typically are not levied by a state, but rather by local governments, and therefore provide stability in revenue collection to local, not state governments.

(iv) Fourth, tax policy should be **efficient.** An efficient tax system is one that has minimal impact on important economic decisions private taxpayers make, like where to purchase a home or locate a business.[59] In other words, for the most part a tax system should not inefficiently distort what should be private, market-based decisions. Generally, an efficient tax system is more reliant on state-based revenue sources, like income and sales taxes, than local revenue sources like property taxes, to fund public services. This is because unlike state-based taxes that are assessed at uniform rates throughout a state, local property tax rates vary across that state, resulting in tax competition between and among local governments.

Efficiently assessed property taxes should not unduly influence significant private sector location decisions because the demand for home ownership and/or commercial or industrial facilities is relatively constant over time,[60] so the decision to purchase or sell a tract of property is not greatly influenced by property tax rates, assuming they do not vary significantly from community to community. Moreover, once a taxpayer owns a residence or commercial or industrial facility, that taxpayer is likely to remain at such location for a significant period of time, and usually relocates for reasons that have nothing to do with tax burden, so long as property tax burden remains fair in light of the associated public services (such as education, health, sewer, water, transportation and security) it funds.

Over reliance on property taxes to fund major public services like education has the potential to be very inefficient – that is, to distort economic decisions made by taxpayers. This is because when property tax rates are high in comparison to the value of available local services, both businesses and individuals have an incentive to leave the area, and a disincentive to locate in that area. This results in a local community suffering a decrease in its property tax base and values, and forces that community to increase property tax rates even higher, as the services it can afford to provide decline. Frequently, the resultant higher tax rate is then assessed against the remaining lower income individuals, which, in addition to being inefficient, contributes to regressivity.

In addition to the aforesaid principles of sound, sustainable and fair taxation, it is also desirable that a tax system be **simple and transparent.**[61] An easy to understand system reduces costs of taxpayer compliance and chances of taxpayer error. A transparent tax system increases the confidence of taxpayers in their government, and allows voters to make intelligent choices about tax and spending policies. While simplicity and transparency are important characteristics of a fiscal system, they are not reviewed in this study. Instead, the focus of this analysis is on the other four principles of sound tax policy.

(c) **Current Illinois Tax Policy Fails to Satisfy the Principles of Sound, Sustainable Taxation**. As the data demonstrate, neither the economy nor out of control spending can be blamed as the primary causes of the state's long term fiscal problems. Moreover, Illinois has low overall state-only, and comprehensive state and local tax levels compared to the rest of the nation and its Midwestern neighbors. Yet despite being low tax and low spending, Illinois continues to

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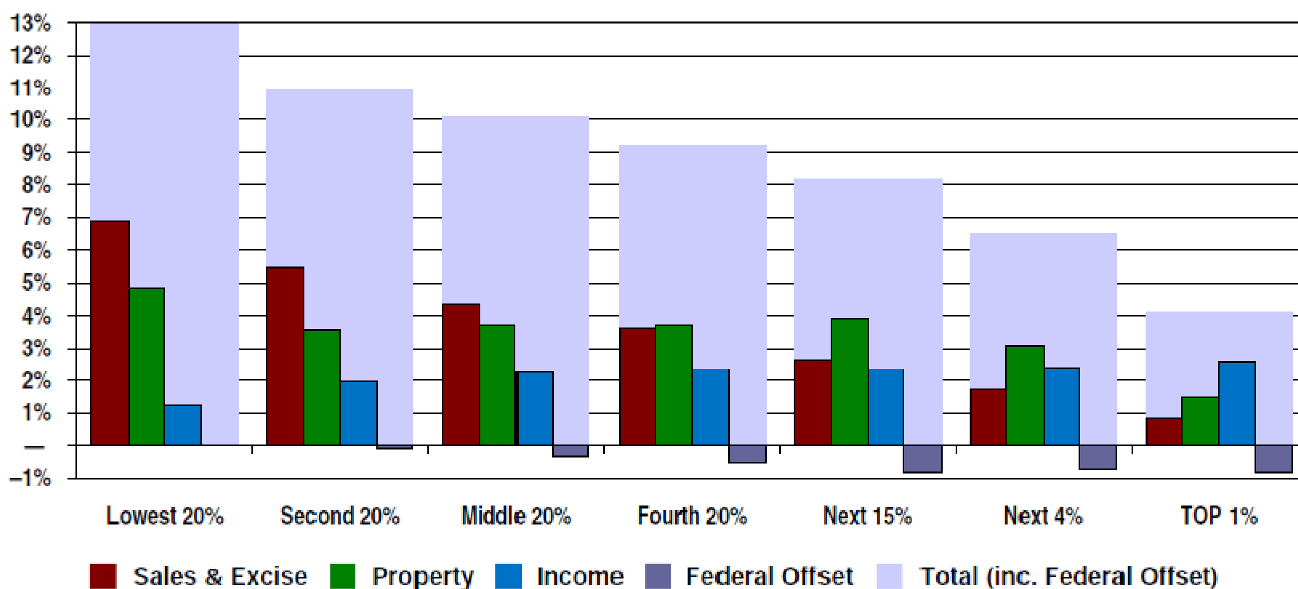
experience annual recurring deficits in both its General Fund and total budget, while its economic growth lags its higher tax neighbors and the higher tax nation as a whole. The uncomfortable truth that decision makers have refused to deal with for decades is that Illinois' flawed tax policy is the primary cause of the state's ongoing General Fund deficits.

In fact, Illinois tax policy substantially fails to satisfy each of the aforesaid four principles of tax policy. As a result, it is both unfair and unsound. The primary flaws in state tax policy are summarized in subparts 5(d) through 5(f) below. In simple terms, the very structure of the state's current tax system is unable to generate sufficient, sustainable revenue to continue funding today's level of public services into the future, even at the state's relatively low spending levels. This creates a "structural deficit", which is further explained in Section 6 below.

(d) **Illinois Tax Policy is Unfair and is Not Responsive to the Modern Economy.** Flaws in Illinois tax policy have created a system that is both unfair and nonresponsive to the modern economy. Illinois fails both the fairness and responsiveness principles primarily because it assesses a regressive, rather than progressive, tax burden across different income levels.[62] That simply means Illinois imposes a higher tax burden on low- and moderate-income families than it does on wealthy families, when tax burden is measured as a percentage of annual income. In fact, Illinois currently has the sixth most regressive tax structure of any state in the nation.[63] As Figures 14 and 17 show, low and middle income families have state and local tax burdens in Illinois that are two to three times greater than high income earners.

Figure 14
State & Local Taxes in 2007 – Shares of family income for non-elderly taxpayers[64]



The notion that regressive taxation is unfair taxation is venerable, going back to Adam Smith, the father of modern capitalism. In his seminal work, the Wealth of Nations, Smith contended that for a tax system to be fair in a capitalist society, it has to be progressive.[65] Smith's logic for reaching this conclusion was simple. He believed that in a capitalist society, the affluent will always benefit most and disproportionately from economic expansion, and therefore ought to have the greatest tax burden to support the government that delivers these disproportionately high economic benefits to them. According to Smith,

> "The subjects of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state ….[As Henry Home (Lorde Kames) has written, a goal of taxation should be to] 'remedy inequality of riches as much as possible, by relieving the poor and burdening the rich.'"[66]

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Figure 15-A

US Income Earned by Quintile, 1979 - 2008, Real 2009 Dollars

	Annual Income 1979	2008	Percentage Change
10th percentile (lowest income earners)	$17,368	$17,014	-2.0%
20th percentile	$19,802	$20,821	5.1%
30th percentile	$23,254	$24,461	5.2%
40th percentile	$27,352	$28,766	5.2%
50th percentile (Median)	$30,930	$33,467	8.2%
60th percentile	$35,880	$39,395	9.8%
70th percentile	$42,411	$47,008	10.8%
80th percentile	$49,400	$58,053	17.5%
90th percentile (Highest income earners)	$60,445	$78,083	29.2%

Source: Economic Policy Institute analysis of Current Population Survey data
Using CPI-U-RS and Congressional Budget Office estimate of 2.2% inflation for 2009.

Was Adam Smith right? A review of long-term trends in income distribution in America demonstrates that his reasoning was solidly on target. As Figures 15A and 15B illustrate, the vast majority of growth in the nation's economy over the last 30 years went disproportionately to the wealthiest 10 percent of income earners.

Figure 15-B

Distribution of US Income Growth Over Time

Families	1947 - 1979	1979 - 2007
	Percentage Income Growth Received	
Top 10%	34.10%	63.70%
Bottom 90%	65.90%	36.30%

Source: Piketty and Saez, "Striking it Richer: The Evolution of Top Incomes in the United States (Update with 2007 estimates)," August 5, 2009, U. C. Berkeley; Calculations from John Schmidt, *Challenge,* September - October 2010.

Income inequality looks even worse in Illinois over this period, as Figure 16 shows. In fact, the bottom 60 percent of income earners in Illinois actually took home less money on an inflation-adjusted basis in 2009 than they did in 1979. That means almost two-thirds (2/3) of workers in Illinois have not participated at all in our country's or state's long term economic growth.[67]

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Figure 16

Illinois Income Earned by Quintile, 1979 - 2008, Estimated 2009 Dollars

	Annual Income 1979	Annual Income 2008	Percentage Change
10th percentile (lowest income earners)	$18,158	$16,994	-6.4%
20th percentile	$22,006	$20,758	-5.7%
30th percentile	$26,291	$24,690	-6.1%
40th percentile	$30,243	$29,245	-3.3%
50th percentile (Median)	$34,757	$33,654	-3.2%
60th percentile	$40,539	$39,894	-1.6%
70th percentile	$46,530	$48,131	3.4%
80th percentile	$54,662	$60,320	10.4%
90th percentile (Highest income earners)	$65,874	$78,478	19.1%

Source: Economic Policy Institute analysis of Current Population Survey data
Using CPI-U-RS and Congressional Budget Office estimate of 2.2% inflation for 2009.

In light of what has really transpired in our economy, it is easy to understand why a regressive tax system is considered unfair. After adjusting for inflation, most low- and middle-income families in Illinois are realizing at best flat, at worst declining annual incomes over time. This means their purchasing power is declining as their earnings do not keep pace with inflation. Meanwhile, affluent families are realizing significant, real income growth over time. By imposing tax burden regressively, Illinois tax policy in effect further reduces the return on work for most Illinoisans, while contributing to the growing income inequity between the wealthiest in society and everyone else.

If the desire is to assess tax burden both fairly and responsively in a modern, capitalist society, Illinois should assess tax burden in a progressive manner, focusing on the wealthiest 20 percent, who have realized almost all the economic growth in America, with the greatest tax burden reserved for the wealthiest 1 percent, whose incomes expanded the greatest.

Unfortunately, as Figure 17 illustrates, tax burden in Illinois is the opposite of progressive. It is, in fact, regressive.

Figure 17

					Top 20%		
Income Group	**Lowest 20%**	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income Range	**Less than $18,000**	**$18,000 - $36,000**	**$36,000 - $58,000**	**$58,000 - $95,000**	**$95,000 - $196,000**	**$196,000 - $500,000**	**$500,000 or more**
Average Income in Group	**$10,000**	**$26,600**	**$47,000**	**$74,700**	**$128,900**	**$300,700**	**$2,084,700**
Sales & Excise Taxes	6.9%	5.5%	4.4%	3.6%	2.7%	1.7%	0.8%
Property Taxes	4.8%	3.6%	3.7%	3.7%	3.9%	3.1%	1.5%
Income Taxes	1.2%	1.9%	2.3%	2.4%	2.4%	2.4%	2.6%
TOTAL TAXES	**13.0%**	**11.0%**	**10.4%**	**9.7%**	**9.0%**	**7.2%**	**4.9%**
Federal Deduction Offset	0.0%	-0.1%	-0.3%	-0.5%	-0.8%	-0.7%	-0.8%
TOTAL AFTER OFFSET	**13.0%**	**10.9%**	**10.1%**	**9.2%**	**8.2%**	**6.5%**	**4.1%**

Source: Institute on Taxation & Economic Policy, *Who Pays? A Distributional Analysis of Tax Systems in All 50 States*, p. 42, Third Edition, November 2009.

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After adjusting for federal tax offsets, the bottom twenty percent of income earners in Illinois paid an average of 13 percent of their annual income in state and local taxes to support public services in 2007. This is the third highest tax rate on low-income individuals in the country. [68] The wealthiest one percent, on the other hand, paid an average of only 4.1 percent of their income in state and local tax to support services. That makes Illinois one of the six most regressive taxing states in the nation.[69]

Regressivity not only makes Illinois tax policy unfair, but also contributes to other problems for the state's fiscal system, economy and working families. Consider the fiscal system first. If the concept is to design a system that is responsive to the modern economy and generates adequate revenue to sustain funding of essential services over time, then focusing on low- and middle-income families makes no sense. From a fiscal standpoint, low- and middle-income families not only make less money than their affluent counterparts, historically they also do not gain anywhere near the share in the long-term economic growth that more affluent families gain. In bottom line economic terms, low and middle income taxpayers are a poor revenue source, that remains relatively poor over time.

Focusing tax burden on a demographic that has flat to declining incomes necessarily means annual revenue generation will be constrained over time. If the goal is to raise adequate, sustainable revenue for funding public services while maintaining low tax rates overall, then tax burden should be assessed primarily where income levels are high and expanding most generously over time. In essence, then, for Illinois to be "responsive" to how taxpayers' respective incomes actually grow (or don't) over time, tax burden should be progressive, focusing on affluent taxpayers, who not only have the most disposable income, but also realize a disproportionate share of the economic growth over time.

In addition to being unfair and not responsive, thereby impeding revenue collection, a regressive tax system also hinders economic growth. The reason for this is simple. Roughly 70 percent of the national economy is consumer spending.[70] Low and middle income families are great consumers. As they gain more income, they tend to spend most of it quickly, putting the money back into the local economy.[71] The reason for this tendency to consume rather than save is obvious, low and middle income families have more basic needs than affluent taxpayers, and much less income over time to cover those needs. Hence, the wealthy have the luxury of saving, while poor and middle income families consume. In economic terms, this means low and middle income families have a high marginal propensity to consume.[72] That is, for every additional dollar they receive in income, they are much more likely to spend it—and primarily in the local economy—than save it. This in turn stimulates economic growth, creating a multiplier effect throughout the economy.[73] In other words, each dollar spent by a low or middle income worker for say, car repairs, becomes a portion of the wage paid to the mechanic performing those repairs, who in turn goes out and spends her wage in the local economy generating wages for other workers, etc.

Since this is the case, designing tax policy that would least harm and in all likelihood would even stimulate the economy, that is, increase consumer spending, requires reducing tax burden for low and moderate income families. Instead, Illinois imposes a significant tax burden on low and middle income families, thereby hurting the state's economy by reducing the amount of money these families, our best consumers, actually have to spend. In the final analysis, the regressive nature of the Illinois fiscal system creates numerous impediments to building a bright future in this state and should not be tolerated.

Illinois has a regressive tax structure for a number of reasons, but key among them is the state's individual income tax is set at a flat rate across all income levels, rather than the fiscally preferable progressive rates. Illinois is in fact required by the state constitution to have this flat income tax rate structure,[74] thus denying policymakers an essential tool for creating a responsive and fair tax structure. It also makes Illinois stand out from most other states that impose an income tax.

Of the 41 states that have an income tax, Illinois is one of only seven that has a flat tax rate that applies to all taxpayers. The other six flat rate income tax states are: Colorado (4.63%), Indiana (3.4%), Massachusetts (5.3%), Michigan (4.35%), Pennsylvania (3.07%) and Utah (5.0%).[75] Every other state with an income tax has some progressivity built into its rate structure. Illinois, with its 3 percent rate, has the lowest flat rate of all states with a flat rate individual income tax, and the lowest overall effective rate of all states with an income tax—(note, some states with progressive rate structures have a lower initial rate for very low income individuals, but have a much greater overall effective rate after taking the progressivity into account.)

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Figures 18 and 19 show how low Illinois' personal income tax rate ranks when compared to the state's Midwest neighbors and other large population states that have an income tax.

Figure 18
Top Income Tax Rates in the Midwest

State	Rate
Iowa	8.98%
Minnesota	7.85%
Wisconsin	7.75%
Ohio	6.24%
Missouri	6.0%
Kentucky	6.0%
Michigan	4.35%
Indiana	3.4%
Illinois	3%

Figure 19
Top Income Tax Rates in Other Populous States

State	Rate
New Jersey	10.75%
California	9.55%
New York	8.97%
Illinois	3%

Source: State Individual Income Taxes (Tax Rates for Year 2010 as of January 1, 2010), Federation of Tax Administrators, February, 2010.

Another reason Illinois' personal income tax is not as responsive to the modern economy as it should be is that the personal income tax base fails to include any retirement income. Illinois is one of only three states with an income tax that excludes all retirement income from its base.[76] As the population grays, and more income in both absolute and proportional terms is comprised of retirement income, this exclusion becomes increasingly difficult to justify in fiscal or social policy terms.

(e) **<u>Illinois Tax Policy is Not Stable</u>.** Currently, Illinois is one of 46 states that impose a general state sales tax. The Illinois sales tax is based on the following statutes. The "Retailers Occupation Tax," which is assessed on the gross receipts retailers collect from selling tangible property in Illinois. The "Retailers' Use Tax," which is assessed on individuals who purchase property outside of Illinois but use it in the state. And finally, the "Service Occupation and Use Taxes," which interestingly are not imposed on most services, making the title of the act quite a misnomer. Instead, it imposes a sales tax primarily on tangible property acquired incident to purchasing a service. For example, when a car is repaired, the state sales tax applies only to the parts included in the repair, not to the cost of labor.

The Illinois state sales tax rate is five percent (5%), and the standard local government sales tax rate is an additional one and one quarter percent (1.25%), making the base, combined state and local sales tax rate six and one-quarter percent (6.25%).[77] Certain local governments have increased their sales tax rates, so that, for instance in Chicago, after adding on the city's rate and the Cook County rate, the total sales tax rate exceeds 10 percent.[78] The Illinois state rate of five percent is in the middle of the national range and consistent with our border states.[79] Specifically, Iowa and Wisconsin (like Illinois) both impose a five percent (5%) state sales tax rate, Missouri has a 4.225 percent (4.225%) state sales tax rate, while Indiana and Kentucky each assess a six percent (6%) state sales tax rate.[80]

If properly designed, sales taxes can make a state's fiscal system stable. That is, sales taxes can ensure revenue generation does not suffer inordinate declines in times of economic hardship. To achieve this stabilizing effect, the base of the sales tax (that is, the items the sale of which generate a tax) must be broad. The Great Recession demonstrates emphatically how a broad-based sales tax can bring stability to a fiscal system. Even though the economy overall went into deep recession, consumer spending remained relatively constant, with real personal consumption expenditures declining by less than one percent from the first quarter of 2008 through the second quarter of 2010.[81] Since consumer spending accounts for nearly 70 percent of all economic activity nationwide,[82] a broad-based sales tax ensures the relative stability of sales tax revenue.

Illinois does not have the needed stability in its tax revenue mix primarily for one reason: the state's sales tax is not broad-based, that is, it does not apply to most of the transactions that actually occur in the state's consumer economy.[83] The main problem with the Illinois state sales tax (known as the Retailers' Occupation and Use Tax and the "Service Occupation and Use Tax")[84] is that it does not apply to most services. In fact, of the 173 categories of taxable services recognized by the North American Industry Classification System, Illinois taxes only 17 – the narrowest base of all but four other states in the country.[85] As Figure 20 shows, services now account for more than 60% of Illinois' state GDP.[86] The next largest sector accounts for less than half that amount.

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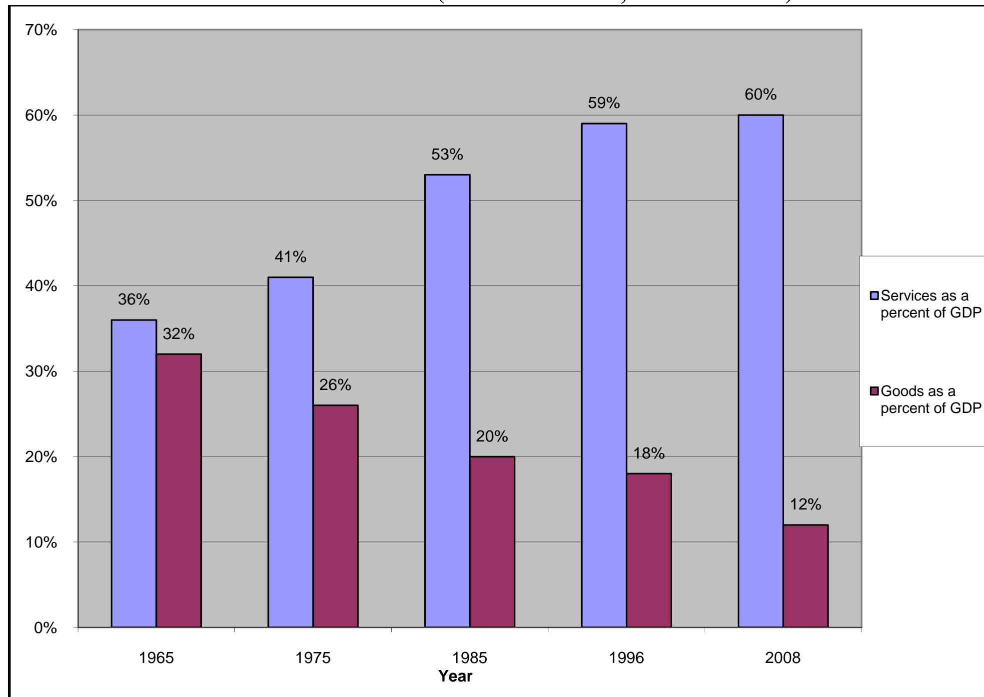
Figure 20
Sales of Goods and Services as a Percent of State Gross Domestic Products in Illinois (SIC: 1965-1996, NAICS: 2008)



Services are not only the largest sector of the state's economy, but also the fastest growing. Leaving the largest and fastest growing sector of the Illinois economy out of the state's tax base makes it impossible for the sales tax to bring needed stability to Illinois' fiscal system.

As Figure 21 shows, all of Illinois' neighboring states tax more consumer services than Illinois does. This is one key reason Illinois would generate so much additional revenue if it adopted the tax structure of its Midwest neighbors.

Figure 21
SALES TAXATION OF CONSUMER SERVICES*

© 2009 The Center for Tax and Budget Accountability	U.S.	Illinois	Border State Comparisons				
	# of States Taxing	IL* 5%	WI 5%	IN 6 %	KY 6%	MO 4.225 %	IA 5%
					"X" indicates current taxation		
STORAGE:							
Automotive storage/Fur Storage	19		X				X
Household goods storage	12						X
Marina service (docking, storage, cleaning, repair)	21		X			X	
SERVICES – PERSONAL SERVICES:							
Travel agent services							
Consumer electronics repair & maintenance	23		X				X
Personal & household goods repair & maintenance	23		X				X
Carpet and upholstery cleaning	15		X				X
Dating services	10						X
Hair, nail & skin care	6						X

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© 2009 The Center for Tax and Budget Accountability	U.S.	Illinois	Border State Comparisons				
	# of States Taxing	IL* 5%	WI 5%	IN 6 %	KY 6%	MO 4.225 %	IA 5%
					"X" indicates current taxation		
Health clubs, tanning parlors, reducing salons	20		X			X	X
Laundry and dry cleaning services, non-coined operated	21		X				X
Consumer goods rental	45		X	X	X	X	X
General goods rental	45		X	X	X	X	X
Diet & weight reducing services							
Private investigation (detective) services	13						X
Process server fees (Bail bonding)	6						X
Telephone answering service	19		X				X
Photographic studios, portrait	N/A						
Linen supply	32		X	X	X		X
Industrial launderers	32		X	X	X		X
Interior design services	9						X
Computer systems design & related services	16						
Credit bureaus	14						
Collection agencies	9						
Photocopying/Printing Services	42		X	X	X	X	X
AUTOMOTIVE SERVICES:							
Automotive repair & maintenance	23		X				X
Parking lots and garages	23		X				X
Motor vehicle towing	15		X				X
ARTS, ENTERTAINMENT, RECREATION							
Pari-mutual racing events	28		X		X	X	X
Amusement park admissions and rides	36		X		X	X	X
Bowling alleys	28		X			X	X
Cable TV services	24		X	X			X
Circuses and fairs – admission and games	34		X		X	X	X
Coin-operated video games/Pinball and other mechanical amusements	19		X			X	X
Golf courses and country clubs	22		X			X	X
Fitness and recreational sports centers	22		X			X	X
Admission to profession sports events	35		X		X	X	X
Performing arts companies	31		X		X	X	X
Miniature golf courses	N/A						
Scenic & sightseeing transportation	N/A						
LEASES AND RENTALS:							
Limousine service (with driver)	13						X
Unscheduled chartered passenger air transportation	10					X	
Motion pictures theaters (expect drive ins)	N/A						
Drive in motion picture theaters	N/A						
N/A = incomplete information							

State tax rates reflect total state/local portions collected by state. Rates do not reflect additional local options sales taxes.
Sources: Include Federation of Tax Administrators, and various State Department of Revenue Reports.

*Note, Illinois currently taxes 17 services, giving it the fourth most narrow sales tax base of any state. Those services Illinois taxes, as well as business, professional and utility services taxed by other states, are not covered in Figure 21.

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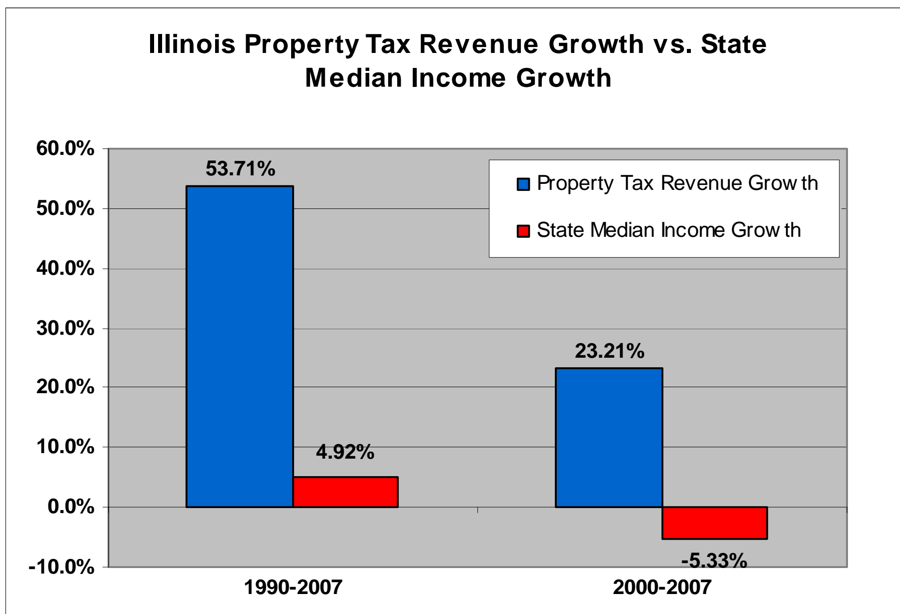
By failing to comport with the modern economy because it does not apply to most services, the Illinois sales tax is incapable of bringing needed stability to the fiscal system, limiting revenue generation and impeding the state's ability to weather economic downturns.

(f) **Illinois Tax Policy is Inefficient.** Illinois tax policy is inefficient in large part because it is over-reliant on property taxes. How over-reliant? Annually, more revenue is collected from property taxes at the local level in Illinois than the state collects from its sales and personal income taxes, *combined*.[87] Illinois is the sixth most reliant state on property tax revenue in the nation.[88] The state's over-reliance on property taxes has grown over the years for primarily one, key reason - funding education.[89] Since education is a high priority for both voters and elected officials, and since the state does not bear its fair share of school funding, local governments historically have increased property taxes to generate needed education funding. As a result, Illinois property tax burdens are heavy and disproportionate compared to national averages.[90]

Over-reliance on property taxes also contributes to the overall regressivity of the state's tax system.[91] At first, this may seem counter intuitive. After all, highly valued property ownership is concentrated in the hands of the wealthy, which would seem to indicate that property taxes should be relatively progressive, that is fair. But this is not true. Wealthier communities generally have lower property tax rates than poorer communities because high property values allow them to assess a lower property tax rate to generally fund their schools.

In addition, property taxes are paid in cash, not in property. Hence, property taxes absorb a higher percentage of income for families of low or moderate means than for a wealthy taxpayer, making property taxes regressive. As Figure 22 demonstrates, as property taxes continue to increase in real, inflation-adjusted terms over time, those with fixed or low incomes are disproportionately impacted. Note that from 1990 through 2007, before the Great Recession drove incomes down, real growth in property taxes outpaced real growth in median income for most Illinois families by over 10 times.

Figure 22



Property taxes also have a significantly negative impact on renters. Although renters do not receive any of the tax breaks associated with home ownership (such as the federal mortgage – interest deduction, the federal property tax deduction or the state property tax credit), they still pay property taxes as a flow-through component of their rent. Since most low income families cannot afford to own a home and have to rent, the property tax has a significant impact on their incomes.

Possibly the most undesirable consequence of Illinois' overreliance on property taxes to fund education, (which is discussed in more detail in Section 7(d) below), is that it denies most Illinois children the opportunity to receive a quality public education, and particularly singles out children of color and children living in downstate communities for an inferior education.[92]

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6. *Illinois' Flawed Tax Policy Creates a Structural Deficit*

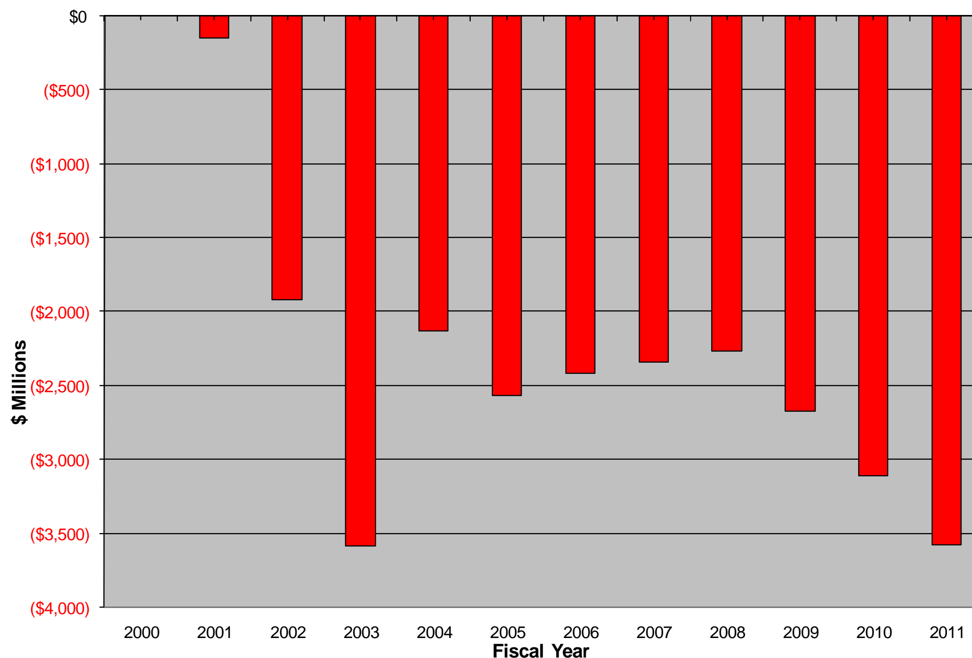
(a) <u>The Structural Deficit</u>. What happens when state tax policy fails to satisfy any of the principles necessary for a sound tax system? Not surprisingly, a lot of bad things happen. In the case of Illinois, one of the most significant negative consequences of its flawed tax policy is what economists call a "structural deficit." Governor Quinn recognized as much in the governor's summary of the Fiscal Year 2011 budget book, which provides: "In fiscal year 2010, many attempts to address problems – such as pension and tax reform – fell short, increasing the severity of the ***structural deficit*** (emphasis supplied) and delaying tough decisions that will affect our state for decades."[93]

So what precisely is a structural deficit? The term "structural deficit" simply means a state's mix of taxes will not over time generate enough revenue to continue funding the services the state currently provides into the future, adjusting solely for inflation and population growth, and assuming normal economic growth. Note that, the calculation of Illinois' structural deficit in this study does not even assume that General Fund spending on the core four services will continue to grow at historic rates. Instead, the following analysis assumes SPENDING ON THE CORE FOUR PUBLIC SERVICES WILL REMAIN FLAT IN REAL TERMS—GROWING SOLELY WITH INFLATION AND POPULATION.

This means even if the current budget were balanced, the economy expands as it did pre-Great Recession and Illinois does not improve or increase any existing services or provide any new services, the state will *still* run a deficit in its General Fund. Put another way, Illinois, the state with the fifth largest population, fifth largest economy and 14th highest per capita income of any state, cannot afford to rank 43rd in spending on the core, four services of education, healthcare, human services and public safety, that collectively constitute over 90 percent of the state's General Fund expenditures.

Figure 23 illustrates how the Illinois structural deficit would have grown in Illinois over the last decade, even if state funding of services remained flat in real terms and the Great Recession had not occurred.[94]

Figure 23
Illinois Structural Deficit
Assuming FY2000 to FY2008 Economic Conditions
and FY2000 Balanced Budget Appropriation
(Adjusted for Inflation and Population Growth)



Source: Appendix Table 3

As Figure 23 shows, over the last decade the state's ability to fund a basic package of core services has fallen dramatically. The bottom line is clear: the Illinois tax system cannot support current service levels.

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Note, the full structural deficit calculation is set forth in Table A in Appendix I to this study. What is particularly eye-opening is Illinois' structural deficit would have grown by over $3.5 billion in the last 10 years even if:

- The Great Recession never happened;
- There were no spending increases on any public services, other than those caused by inflation and population growth; and
- The state had a truly balanced budget in Fiscal Year 2000—that is, recurring revenues were equal to recurring expense and liabilities.

This structural deficit translates into no additional, and in all likelihood less ongoing funding for schools, early childhood education, caring for seniors and individuals with mental health or developmental disability issues, environmental protection, child care for single working parents, affordable housing, economic development or anything else. In simple terms, it means the state cannot continue to provide the same public service levels tomorrow it provides today. Eventually, unless eliminated through comprehensive tax reform, this structural deficit will force the state to scale back existing programs from their current, low funded levels.

(b) **After the Recession Ends, Illinois' Fiscal Problems will Continue.** Given the lack of job growth since the end of the Great Recession and the concomitant decline in personal income nationwide, it is difficult to project future state and national economic growth trends, including when or if historic rates of personal income and job growth will return. This makes it equally difficult to project state-own source tax revenue growth, which is in large part dependent on both how the private sector economy rebounds and how the economic benefits of that rebound will be distributed by income level. That said, using the economic trends of the last decade in state own-source revenue growth and in personal income growth as a guide, there are three likely scenarios for Illinois own-source tax revenue growth over the coming decades.

Under the best case scenario, Illinois will realize average, annual growth of two percent (2%) in its own-source revenue from FY2011 levels over the next 10 years. Under the more likely baseline scenario, revenue growth will be relatively flat in the coming decade, after adjusting for inflation and population growth. In the worst case scenario Illinois and the nation suffer a "double dip" recession, in which case all bets are off.

If the best case scenario materializes, Illinois own-source state tax revenue growth as projected in Figure 25 would be more than double the actual FY2000 to FY2011 average own-source annual revenue growth rate of 0.86% (see Figure 24) and more than 2.6 times greater than the current estimate of FY2011 own-source revenue growth over FY2010 of 0.75% made by the governor's Office of Management and the Budget (OMB).[95] As noted above, this would probably require not only significant increases in personal income but also a reversal of the recent Illinois trend (since FY2006) of declining own-source tax revenue as a *share* of personal income (see Figure 24).

Figure 24

Illinois Own Source Revenue as a Percent of GDP and Personal Income (millions of current dollars)

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average
GDP	$453,973	$470,328	$481,795	$498,713	$522,363	$543,693	$570,910	$625,553	$625,553				
Personal Income	$391,607	$413,308	$417,941	$428,639	$444,653	$464,099	$487,968	$518,871	$542,500	$540,053	$535,333		
Total Own-Source General Fund Revenue	$19,359	$19,786	$19,121	$18,846	$20,239	$23,257	$22,634	$23,937	$24,844	$22,577	$21,178	$21,262	
Year over Year Own-Source Revenue Growth Rate		2.21%	-3.36%	-1.44%	7.39%	14.91%	-2.68%	5.76%	3.79%	-9.12%	-6.20%	0.40%	0.86%
Own Source Revenue Percent of GDP	4.26%	4.21%	3.97%	3.78%	3.87%	4.28%	3.96%	3.83%	3.97%				4.01%
Own Source Revenue Percent of Personal Income	5.17%	4.99%	4.78%	4.61%	4.87%	4.90%	4.90%	4.88%	4.58%	4.18%			4.79%
Federal Revenue	$3,891	$4,320	$4,258	$3,940	$5,189	$4,691	$4,725	$4,703	$4,815	$6,567	$5,920	$5,850	
Year over Year Federal Revenue Growth Rate		11.03%	-1.44%	-7.47%	31.70%	-9.60%	0.72%	-0.47%	2.38%	36.39%	-9.85%	-1.18%	3.78%

Notes:
1) Fiscal Year Illinois GDP data estimated as average of consecutive calander year BEA Illinois GDP data.
2) Fiscal Year 2000 to 2010 Illinois Personal income data calculated by summing relevant quarterly BEA Illinois Personal Income data.
3) Fiscal Year 2010 Personal income estimated as average of annualized 2009 Q3 to 2010 Q1 data.
4) FY 2000 to FY 2010 Illinois Own Source Revenue (net of Refund Fund) and Federal Revenue from CGFA FY 2011 Budget Summary and March 16, 2010 FY 2011 Revenue Estimate.
5) FY 2011 Illinois Federal Revenue as estimated in "CTBA FY2011 Deficit Fact Sheet".
6) Averge 0wn-Source and Federal Revenue growth rates are geometric averages that take compounded growth into account.

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Figure 25 delineates the most optimistic scenario of Illinois own-source revenue growth for the next decade. Note that, despite flat, or very modest employment growth that barely exceeds or even fails to keep up with new labor force entrants, Illinois is nonetheless projected to realize overall personal income and GDP increases sufficient to raise own-source state revenue by an average of two percent (2%) per year.

As noted previously, CTBA assumes one percent (1%) and two percent (2%) nominal own-source revenue growth for the "Baseline" and "Optimistic" scenarios respectively. Given the uncertain ties about the economic conditions that would pertain in the event of a double dip recession, no worst case scenario is modeled. While the baseline own-source revenue growth estimate may seem low, one percent (1%) nominal growth is more than twice the current CGFA estimate of 0.4% for FY2011 over FY2010, and is also higher than the FY2000 to FY2011 average of 0.86% (see Appendix Table 3). And although nominal own-source revenue growth during the pre-Great Recession "bubble" years of FY2000 to FY2008 averaged 3.17%, inflation over this period averaged 2.53% a year, so that real own-source revenue growth was only about 0.64% a year.[96] From FY2009 to FY2010, there was no inflation at all—in fact there was deflation of about -0.64%. As is explained below, both the baseline and optimistic scenarios are based on continued low inflation rates over the next decade. Under these conditions two percent (2%) nominal own-source revenue growth would imply faster real own-source revenue growth than the 0.64% of the FY2000 to FY2008 period. If inflation picks up, the ECI estimates referenced below would have to be significantly higher, offsetting the deficit reduction impact of faster nominal own-source revenue growth.

It is also conservatively assumed that ECI will continue to grow at its FY2009 to FY2010 rate of 1.641% for the remainder of the decade. As noted (in Appendix Table 4, footnote 2): this is a very slow rate of ECI growth appropriate to a slow growing or stagnant economy.

Figure 25
(Dollars in Millions)

Illinois General Fund Optimistic Scenario (2% Own-Source Revenue Growth)

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,071	$6,301	$6,539	$6,786	$7,042	$7,309	$7,585	$7,872	$8,169
Total Revenue	$27,112	$27,758	$28,422	$29,102	$29,801	$30,517	$31,253	$32,008	$32,783	$33,579

Notes:

1) Own-source revenue growth set to 2%.

2) Federal Sources growth projected from FY2011 using 3.78% annual FY2000 to FY20011 average annual growth rate which includes FY 2010 34.83% increase.

Other Sources: See Figure 24

In the last decade economic growth was powered by a housing bubble and increased consumer debt, both of which are currently in "deflationary" and "de-leveraging" conditions.[97] In the absence of an economic revival generated by robust employment and income growth, it is unclear what will drive economic growth in the next decade. However, assuming that some source for growth materializes that is sufficient to grow own-source revenue at two percent (2%) per year on average during the next decade, Figure 26 provides a rough estimate of how such growth could impact the Illinois budget.

Unfortunately, as Figure 26 shows, even the most optimistic growth in own-source revenue will not be sufficient to eliminate the recurring General Fund deficits.

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Figure 26
Impact of Optimistic Revenue Growth on the Current General Fund Deficit, Holding Spending Constant in Real Terms[98]

Impact of Optimistic Revenue Growth on the Current Fund Deficit, Holding Spending Constant in Real Terms										
Fiscal Year	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,071	$6,301	$6,539	$6,786	$7,042	$7,309	$7,585	$7,872	$8,169
Total Revenue	$27,112	$27,758	$28,422	$29,102	$29,801	$30,517	$31,253	$32,008	$32,783	$33,579
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,356	$28,019	$28,698	$29,393	$30,105	$30,834
Pension Ramp Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,186	$34,108	$35,060	$36,041	$37,053	$38,105
Current Operating Deficit from Baseline Revenue Growth	($1,890)	($2,275)	($2,647)	($3,025)	($3,386)	($3,590)	($3,807)	($4,033)	($4,270)	($4,526)
Carry Over Accumulated Deficit	($7,581)	($12,471)	($14,747)	($17,394)	($20,420)	($23,807)	($27,398)	($31,207)	($35,241)	($39,513)
Total Deficit	($9,471)	($14,747)	($17,394)	($20,420)	($23,807)	($27,398)	($31,207)	($35,241)	($39,513)	($44,041)

Notes:
1) Current Operating Deficit is Total Revenue from previous figure minus Total Appropriations in this figure. FY 2012 Carry over accumulated deficit is FY 2011 Operating Deficit. See CTBA updated FY 2011 Operating and Total Deficit Fact Sheet.
2) Future ECI growth estimated as FY2010 over FY2009 ECI growth of 1.6% (pro-rating seasonalized 2010Q2/2009Q2 growth as equal to 2010Q1/2009Q1 growth rate). Data is from BLS, this is a very slow rate of ECI growth appropriate to a slowly growing or stagnant economy.
3) Future Illinois population growth from Illiniois DCEO population forecast for 2015 and 2020 averaged to annualized growth rates of 0.70% until 2015 and 0.81% from 2015 to 2020.
4) FY 2012 to Fy 2020 Appropriations are FY 2011 Appropriation adjusted by multiplying estimated future ECI by estimated future population growth rate.
5) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
6) Pension Debt Service from CGFA, June 30, 2009, "Report on Financial Condition of the State Retirement Systems," Appendix N, p. 100.
7) FY2011 Own Source and Federal Revenue from previous Figure.
8) Own-source revenue assumed to grow at 2% per year.
9) Federal Revenue assumed to grow at FY2000 to FY 2011 average of 3.78% per year.

As it turns out, it would take an average own-source revenue growth rate of 5.8 percent (5.8%) to erase the Illinois General Fund budget deficit by 2020.[99] Note that this would be almost seven times greater than the actual, 0.86 percent average, annual growth rate for Illinois own-source revenue from FY2000 to FY2011. Eliminating the Great Recession does not improve things nearly enough. During the most recent "optimal" national economic expansion years of 2002-2007, average annual Illinois own-source revenue grew at 4.6 percent, still below the 5.8 percent growth rate necessary to bring the Illinois operating budget deficit in to balance by 2020. Much of that average annual growth rate can be attributed to inflation, which averaged 2.5 percent over this period. It is highly unlikely that inflation will grow at similar rates over the next decade. Even if inflation did spike for some unforeseen reason, it would cause concomitant increases in the cost of delivering public services. It is even more unlikely that the state and nation will experience 10 consecutive years of uninterrupted economic expansion, since that would equal the longest post war expansion in U.S. history.[100]

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Obviously, if own-source revenue grows at a slower rate than the most optimistic projection, the state's fiscal problems become that much worse, as shown in Figure 27.

Figure 27
Impact of Baseline Revenue Growth on the Current Fund Deficit, Holding Spending Constant in Real Terms

Impact of Baseline Revenue Growth on the Current Fund Deficit, Holding Spending Constant in Real Terms

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Federal Sources	$5,850	$6,071	$6,301	$6,539	$6,786	$7,042	$7,309	$7,585	$7,872	$8,169
Total Revenue	$27,112	$27,546	$27,990	$28,445	$28,911	$29,389	$29,879	$30,381	$30,895	$31,423
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,356	$28,019	$28,698	$29,393	$30,105	$30,834
Pension Ramp Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,186	$34,108	$35,060	$36,041	$37,053	$38,105
Current Operating Deficit from Baseline Revenue Growth	($1,890)	($2,488)	($3,079)	($3,682)	($4,275)	($4,719)	($5,182)	($5,660)	($6,158)	($6,682)
Carry Over Accumulated Deficit	($7,581)	($12,471)	($14,959)	($18,038)	($21,721)	($25,997)	($30,717)	($35,900)	($41,562)	($47,722)
Total Deficit	($9,471)	($14,959)	($18,038)	($21,721)	($25,997)	($30,717)	($35,900)	($41,562)	($47,722)	($54,406)

Notes:
1) Current Operating Deficit is Total Revenue from previous figure minus Total Appropriations in this figure. FY 2012 Carry over accumulated deficit is FY 2011 Operating Deficit. See CTBA updated FY 2011 Operating and Total Deficit Fact Sheet.
2) Future ECI growth estimated as FY2010 over FY2009 ECI growth of 1.6% (pro-rating seasonalized 2010Q2/2009Q2 growth as equal to 2010Q1/2009Q1 growth rate). Data is from BLS, this is a very slow rate of ECI growth appropriate to a slowly growing or stagnant economy.
3) Future Illinois population growth from Illinois DCEO population forecast for 2015 and 2020 averaged to annualized growth rates of 0.70% until 2015 and 0.81% from 2015 to 2020.
4) FY 2012 to Fy 2020 Appropriations are FY 2011 Appropriation adjusted by multiplying estimated future ECI by estimated future population growth rate.
5) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
6) Pension Debt Service from CGFA, June 30, 2009, "Report on Financial Condition of the State Retirement Systems," Appendix N, p. 100.
7) FY2011 Own Source and Federal Revenue from previous Figure.
8) Own-source revenue assumed to grow at 1% per year.
9) Federal Revenue assumed to grow at FY2000 to FY 2011 average of 3.78% per year.

7. *The Road Map to Reform*

(a) <u>The state should resolve its deficit problems primarily by raising recurring, sustainable tax revenue through comprehensive tax policy reform that comports with the principles of sound taxation</u>.

In summary, Illinois tax policy is so fundamentally flawed that:

- it materially fails to satisfy any of the principles needed for a sound revenue system:
- it assesses tax burden in an unfair fashion that impedes revenue collection, constrains economic growth and worsens income inequality; and

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- it ultimately creates a structural deficit that impedes the state's ability to continue providing today's level of public services tomorrow, even in good economic times and even if state government held spending on services flat from year to year in real terms.

Moreover, as detailed previously, Illinois is both a low tax and low spending state,[101] and after adjusting for inflation and population growth has been cutting General Fund spending in real terms since at least 1995. Illinois has the second lowest state worker headcount per capita in the nation. Despite being low tax and low spending, Illinois has cut its General Fund by more than $1.4 billion in the current Fiscal Year. Taking all those factors into account, it becomes increasingly difficult to argue that more spending cuts are the best policy option for addressing the state's recurring deficits.

Implementing significant cuts becomes even less desirable as a deficit solution when one recognizes that those cuts would have to be made in the four core services of education, health, human services, and public safety, which collectively account for more than $9 out of every $10 spent in the General Fund. The inescapable conclusion, then, is that Illinois simply cannot get its fiscal house in order without increasing recurring tax revenue through comprehensive tax policy reform. Given the state's historic decision to force the responsibility to fund basic education down to the local level has contributed fundamentally to Illinois' overall fiscal problems, it would make sense to reform how the state funds education when implementing comprehensive tax policy reform.

So the challenge becomes the following: How should Illinois tax policy be reformed to make it fairer, and more responsive, stable and efficient, while eliminating the structural deficit and implementing school funding reform, and doing so in a way that maintains the state's status as an overall low tax burden state?

Following is the outline of the tax policy reforms Illinois needs—all of which are analyzed in more detail in Sections 7(b), (c) and (d) below.

- **To make Illinois tax policy both fairer and more responsive, and to generate enough state-based revenue to address the structural deficit and reduce local property taxes, the Illinois individual income tax rate should be increased to at least 5%, with a corresponding increase in the corporate income tax rate to 8%, and the state should include some retirement income in its personal income tax base.** Although it would be preferable to implement a progressive income tax rate structure than just increasing the state's flat rate from three percent to five percent, the Illinois Constitution mandates that the state have a flat income tax rate.[102] This prohibits legislators from using the type of progressive income tax rate structure that most effectively makes tax policy fairer and more responsive.

- **To create necessary progressivity then, any net tax increases created pursuant to comprehensive tax reform should be at least partially offset with tax relief specifically targeted to low and middle income taxpayers.** To be most effective, this tax relief should be refundable—that is, an eligible taxpayer should receive the full dollar value of the targeted tax relief, even if it exceeds his or her state income tax liability. This refundability feature allows an income tax credit to offset other, regressive taxes paid by low and middle income families, like sales, excise and property taxes.

- **To modernize the state's tax system while making it more stable- therefore better able to withstand tough economic times—the Illinois sales tax base should be expanded to include virtually all consumer services (other than medical and housing services) and possibly professional services**. Expansion of the sales tax base, however, is regressive, that is, it will consume more of a low or moderate income family's income than an affluent family's. Again, given the constraints of Illinois constitutional law, the best way to offset any regressive impact of a sales tax expansion is inclusion of a refundable income tax credit targeted to low and moderate income taxpayers in the reform package.

- **To make state and local tax policy more efficient and to improve school funding for poor, low income, middle income, minority, and rural areas of the state, without reducing funding for affluent areas, the state's reliance on property taxes to fund schools should be reduced, by using a portion of the new state-based revenues from the income and sales tax changes discussed above to enhance education funding.**

- **Given the significant size of the current FY2011 deficit – at least $9.47 billion – any education funding enhancement should be phased in over time, after the state's deficit problems are resolved.** Phasing in an enhanced investment in public education has the corollary benefit of allowing school districts to plan for how best to utilize the funding increase to generate desirable academic outcomes.

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The preceding structural changes are certain to generate political controversy. However, when placed in context of Illinois tax policy as it really exists, the case for implementing these reforms makes itself. The good news is, the tax adjustments suggested in this paper will not just generate the revenue necessary to eliminate the structural deficit and reform school funding, but will also maintain Illinois' status as a comparatively low tax and spend state, preserve jobs in local communities, and generate adequate revenue to avoid cutting human services for vulnerable populations. The end result of CTBA's recommendations would be tax reform that is good for our schools, children, state and future.

(b) Solution One – Increasing the Individual Income Tax Rate While Targeting Tax Relief to Poor, Low and Middle Income Families Will Make Illinois Tax Policy Fairer and More Responsive.

(i) Increase the Illinois individual income tax rate from 3 percent to at least 5 percent. When confronting a challenge as imposing as reforming Illinois tax policy, it makes sense to start with the reform that accomplishes the most. In Illinois, that means adjusting the state's individual income tax rate.

The good news is, there is room to increase Illinois' individual income tax rate without creating either an onerous tax burden or an income tax rate that is high compared to other states. After all, the Illinois individual income tax rate of three percent (3%) is the lowest combined state and local income tax rate of any state in the country that imposes an income tax, ranking 41st out of 41 states.[103] In fact, increasing the state's personal income tax rate to five percent (5%) would result in Illinois having the seventh lowest income tax rate on the national list, tied with Mississippi, Utah and Alabama.[104]

If done properly, increasing the individual income tax rate can make the state's fiscal system both fairer and more responsive by shifting tax burden from low and middle income taxpayers to affluent taxpayers, thereby comporting with two of the four key principles of a sound tax system. True, income taxes usually help make a tax system fair because marginal rates can be established to correspond to wealth – i.e. greater marginal rates for wealthier individuals and lower rates for individuals with less income. Setting marginal rates to increase along income levels would create the type of progressive tax system deemed fair by economists from Adam Smith, the father of modern capitalism, to Joseph Stiglitz, the winner of the 2001 Nobel Prize Award for economics. It would also allow a taxpayer's individual tax burden to increase or decrease annually in proportion to his or her income - and hence ability to pay - for the applicable year. This is particularly meaningful given the growth in income inequality over the last few decades.

Unfortunately, the Illinois Constitution prohibits the use of graduated income tax rates to achieve progressivity.[105] In an ideal world, the Illinois Constitution would be amended to allow use of graduated income tax rates across different levels of income. Attaining constitutional changes, however, is a difficult process that in all likelihood would take years to accomplish. Illinois has significant fiscal problems that simply cannot wait for constitutional change. So, while in the long term amending the Illinois Constitution to permit graduated income tax rates should be pursued, other, more practical and less time consuming tax policy reforms that can be enacted legislatively should be implemented as soon as possible.

So, the most practical income tax policy reforms that can be implemented expeditiously is increasing the individual income tax rate from its current level of 3 percent to at least 5 percent. This will generate approximately $5.2 billion in net recurring revenue to the Illinois General Fund annually, going a long way toward generating the revenue needed to address the structural deficit and implement education funding reform. It will not, however, make state tax policy more progressive, that is fairer. Hence any tax increases recommended in this study should be coupled with the type of targeted tax relief outlined in Section 7(b)(ii) below.

(ii) To make the Illinois tax system more progressive, the additional tax burden the preceding personal income tax rate increase—and the sales tax base expansion recommended in Section 7(c) of this study—would create for low and moderate income families should be reduced significantly or eliminated through tax relief targeted solely to the bottom 40-60 percent of income earners. Since the Illinois Constitution prohibits adjusting tax burden by simply employing different marginal income tax rates, the state must use an alternative method of providing targeted tax relief to low and middle income families. This tax relief could come in one or a combination of the following forms: (i) creating a new refundable tax credit, and/or increasing the value of the state's existing Earned Income Tax Credit (**EITC**); (ii) substantially increasing the standard exemption (e.g., from its current $2,000 level to $6,000), but reducing the value of that exemption as incomes increase; and/or (iii) increasing the minimum level at which personal income taxation begins.

(iii) Include Some Retirement Income in the State Income Tax Base. Adjusting the rate is the primary modification legislators should make to the state's personal income tax, but it isn't the only one. Under current law, there are significant exclusions from taxable income in Illinois which are neither fair nor rational, and result in millions of dollars of lost revenue. For instance, unlike the federal government, Illinois is one of only four states that excludes all pension and retirement income from taxation, regardless of the wealth or income level of the pensioner.[106] Hence, individuals of significant wealth who have large pensions are greatly favored under Illinois law.

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The rationale behind broad exclusion of all retirement income is laudable, avoiding over-taxing low and moderate income senior citizens. However the method is overbroad for this purpose. If the desire is to avoid creating inappropriately high tax burdens for low-income seniors, then it would be far better to exclude retirement income from taxation solely for those seniors who really have limited or low, fixed incomes. In fact, including some retirement income in the income tax base will help Illinois provide significant tax relief to those who truly need it, low-income seniors and other low-income taxpayers who are struggling to get by, while generating significant revenue for the state's General Fund.

Based on FY2008 data from the Illinois Department of Revenue, there are only 244,988 filers who report having retirement income who also have Adjusted Gross Incomes (**AGI**) of over $50,000. This is a very small amount—only 18.48 percent—of the total number of filers who report receiving retirement income. A three percent (3%) income tax on their retirement income would have netted $776.4 million in FY2008, while a five percent (5%) income tax on their retirement income would have generated a gross of $1.294 billion in FY2008.[107] After deducting the Refund Fund and the Local Government Distributive Fund, a five percent (5%) tax on retirement income for filers with over $50,000 in AGI would have generated a net of $905 million to the General Fund in FY2008.

(iv) Increase the Corporate Income Tax Rate from 4.8 percent up to as High as 8 percent. If the individual income tax rate is increased, it seems appropriate to increase the corporate income tax rate as well. After all, the state collects significantly more revenues from individual income taxes ($8.71 billion estimated for Fiscal Year 2011) than it does from corporate income taxes ($1.41 billion estimate for Fiscal Year 2011).[108] That said, implementing such a change is not as straight forward as it sounds. For one thing, constitutionally, Illinois can impose an income tax rate on corporate profits which is no more than 8/5ths greater than the income tax rate it assesses against individuals.[109] The current corporate income tax rate is 4.8 percent, which is 8/5th of the three percent (3%) personal income tax rate, the maximum allowed under constitutional constraints. If the personal income tax rate is increased to five percent (5%), then the new maximum corporate income tax rate would be eight percent (8%).

However, businesses pay another income based tax in Illinois, known as the "Corporate Personal Property Replacement Tax". This tax goes to local governments, and is set at 2.5 percent of corporate taxable income.[110]

Adding the existing state corporate income tax rate of 4.8 percent to the personal property replacement tax rate of 2.5 percent, means that the current, combined state and local income tax rate for corporations is actually 7.3 percent. This additional local tax burden should be considered when determining whether and how much the corporate income tax rate at the state level should be increased.

Another consideration that must be taken into account is the reduction in the number of businesses that are required to pay state income tax. An increasing number of businesses are being organized as limited liability companies or "S" corporations rather than traditional "C" corporations. By law, neither limited liability companies nor "S" corporations pay any corporate income tax. Rather, their profits (whether distributed or not) are taxed to the owners of those entities at the personal income tax rate. Today in Illinois only about one-third of all businesses are "C" corporations and hence required to pay state income taxes.

A final consideration involves reviewing corporate tax expenditures. These are tax breaks given to businesses in exchange for eligible businesses either delivering some public good back to the state, like, for instance, job creation or site location in economically distressed areas, or engaging in an activity that is anticipated to generate long-term benefits to the state, like research and development. The value of all corporate tax expenditures granted in FY2008 (the most recent year for which data is available) was $366.8 million.[111]

They are called tax "expenditures" because state government is effectively spending public tax dollars through the tax code. In this instance, however, the state does not cut a check like it does for direct expenditures. Instead, Illinois allows private businesses to keep tax dollars they otherwise would have to pay to the state, to compensate those businesses for delivering the bargained for public good. Thus, the state is foregoing receipt of tax revenue it could have collected and then spent on the four core services, in exchange for allowing private businesses to keep that tax revenue to fund their delivery of a different public good.

The problem is the state does not adequately review whether in fact businesses are delivering the expected public benefit back to the state. In this regard, tax expenditures are usually far less accountable and transparent than direct expenditures for services which have to be re-appropriated annually. Tax expenditures, on the other hand, are rarely re-evaluated once on the

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books. This is problematic because if a business is not living up to its end of the bargain, the state is effectively wasting tax dollars it could have used to fund one of the four, core services. Unaccountable tax expenditures are also problematic because they advantage one private sector business over another, violating the concept of "horizontal tax fairness" between similarly situated tax payers.

Given the size of the state's deficit, all corporate tax expenditures should be re-evaluated to ensure the state only keeps those that actually generate the expected public good.

(c) Solution Two - Expand the Illinois State Sales Tax Base to Include Most Consumer Services to make State Revenue Generation More Stable.

To bring needed stability to Illinois' tax policy, the state sales tax base should be expanded to include virtually all consumer services. This will generate approximately $2.4 billion in annual, recurring revenue, if the sales tax base expansion includes those services identified on Table 1 to Appendix A. To avoid tax pyramiding (which is discussed below in this Section), this base expansion should not include business to business services, healthcare or real estate services.

Making state tax revenue generation more stable is particularly important when you consider that a portion of the revenue increases outlined in this study are intended to be used to help reform education funding. Part of education funding reform will involve replacing a portion of the property taxes currently used to fund education with state-based revenues, as that is the only way to break the link between the affluence of the community in which a child lives and the quality of the public education the state can afford to provide that child. While the downside of over-reliance on property taxes is inequitable school funding, the upside of property taxes is that they produce very stable revenue at the local level. Hence, any comprehensive reform that replaces local property tax revenue with state-based revenues has to rely on a mix of state taxes that includes a stable revenue source, like a broad based sales tax. Otherwise, in down economic cycles there simply will not be adequate state-revenue generated to reduce the overreliance on local property taxes.

The downside of sales taxes is that they score poorly on the fairness meter. Low and moderate income families have to expend a larger portion of their total income on sales taxes than do the wealthy. Unfortunately, excluding too many items from the purview of the sales tax provides a tax break to both low income families, which is desirable, as well as to high income families, which is not desirable. It also weakens the overall fiscal system by making it more susceptible to revenue shortfalls during down economic cycles. This in turn usually creates very negative consequences for low-income and vulnerable populations. That is because when states like Illinois experience revenue shortfalls during economic downturns, they tend to balance the books by cutting spending that predominantly benefits low-income families and vulnerable populations, who have no economic capacity to replace lost services like child care, or assisting poor adults with developmental disabilities for instance. From a purely dollars and cents standpoint, the small benefit low income families receive from having a narrow sales tax base is greatly exceeded by the detriment they experience through public service losses caused by spending cuts- particularly to the General Fund.

As indicated previously, there is a way out of this conundrum that will allow Illinois to expand its sales tax base to bring needed stability to its fiscal system, while providing targeted tax relief to low and moderate income families that eliminates all or a significant portion of the tax burden from sales tax base expansion: Utilization of refundable tax credits targeted specifically to low and moderate income taxpayers. Hence, creating new or augmenting existing refundable tax credits available to low and moderate income families (through, for instance, expansion of the state's EITC) has to be part of comprehensive tax policy reform in Illinois.

Note that all recommended expansions of the state sales tax base cover consumer, rather than business transactions. This is because most economists consider imposing a sales tax on business transactions to be a bad idea, due to potential "tax pyramiding".[112] "Tax Pyramiding" is basically a form of double taxation. It works like this. If the state assesses a tax on a company's purchase of supplies, materials, inventory or services, which that company then incorporates into its end product or service, and then the state assess a sales tax again when that company sells its end product or service to a consumer, in effect the state has taxed the same transaction twice, at both the business input and output levels. Since businesses tend to pass on their costs to consumers, pursuing such a policy can result in consumers in effect paying sales taxes on sales taxes, i.e. tax pyramiding. Not only that, this double taxation is not very obvious - that is, is not transparent, to taxpayers, another significant fault. It is also highly regressive. In fact, CTBA opposed former Governor Blagojevich's gross receipts tax proposal in 2007 specifically because of the significant tax pyramiding and regressivity problems it created.

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It should be noted that in addition to sales taxes, Illinois imposes another tax on consumption, called "excise" taxes. Excise taxes are applied on a per unit basis rather than based on a percentage of sales price. Typical excise/consumption taxes in Illinois include the cigarette tax and gasoline tax, which are assessed as a fixed charge, such as 19¢ per gallon or 98¢ per pack.[113]

Excise taxes are poor candidates for being part of the comprehensive reforms outlined in this paper for one simple reason. The revenue excise taxes generate grow more slowly than the economy over time, because they are unit rather than price based. Hence, excise taxes tend to lose value over time in real inflation-adjusted terms, contributing to the structural deficit. The only way to maintain the real value of revenue from excise taxes is to make frequent changes in the per unit tax. This is both politically unlikely and creates uncertainty about tax policy.

The final category of consumption based revenue generators state governments levy are user fees, charged to individuals or businesses that obtain a specific government service or license right. While user fees serve a valuable function, reimbursing state government for costs of rendering a service or issuing a license, they are poor candidates to utilize for enhancing state revenues, primarily for two reasons. First and foremost, user fees are intended to reimburse government for the cost of providing specific services, like issuing a business or driver's license. If increased to a level in excess of the amount reasonably necessary to reimburse the state for such costs, i.e., used to generate General Fund revenue, they could be challenged in the courts as an illegal attempt at taxing.

Second, even if a particular user fee could be used to generate general operating revenue, it would still contribute to long term structural deficit problems. This is because like excise taxes, user fees lose their value over time, since they are a set charge that does not automatically increase annually, as opposed to sales taxes, which are based on a percentage of the price charged for a product or service in the consumer economy, and hence grow with the economy.

(d) Solution Three – Enhancing the State's Funding of Public Education should Reduce Property Tax Reliance making State and Local Tax Policy in Illinois More Efficient, and Promoting Equity in Education Funding. Overreliance on property taxes has made overall state and local tax policy in Illinois inefficient. It has also effectively tied the quality of the public education a child receives in Illinois to the affluence of the community in which that child lives. Because property taxes are a local rather than state-based revenue source, high property wealth school districts raise significantly more money than their less affluent counterparts, which translates to a higher quality of education offered to children in wealthy communities.[114] Less affluent districts, even when imposing property taxes to the limit of their capacity, frequently fail to raise enough revenue to fund even an adequate education. Since, local property tax wealth available to be taxed per student in Illinois varies from a low of about $250,000 to a high of over $1.78 million,[115] it is easy to see how the over-reliance on property taxes is the single greatest cause of the school funding disparities that exist across the state.

These disparities can be significantly reduced only if the state of Illinois assumes more direct responsibility for education funding. The best way to accomplish this is to increase state-based revenue from the income and sales taxes as recommended previously in this study, and use a portion of that new state revenue to: (A) increase, in real terms, the per student foundation level for school funding in Illinois to satisfy, at a minimum, the amount identified by the Education Funding Advisory Board as the minimum necessary to provide an adequate education; (B) provide some property tax relief; and (C) eliminate the structural deficit so that school funding gains implemented today are sustainable tomorrow.

If enough new state revenue is raised to offset some property tax reliance in education funding, how should property tax relief be designed and distributed? Answering this question usually generates a hornets' nest of controversy. The reasons for this controversy are three-fold. First, concern exists that the property tax relief be fairly apportioned. Second, taxpayers want assurance that property tax relief will actually be delivered. Third, families in affluent communities want confirmation that their schools will not lose any funding due to the structure of property tax relief. Indeed, many of these families choose to live in areas specifically because of the significant investment of local property tax revenue in their schools.

Two efficacious ways to structure property tax relief which address these concerns would be using state revenue either to: (i) increase the current property tax credit homeowners can claim against their state income taxes, from its current level of five percent of the property taxes paid to 10 percent (capping this relief and making a portion of it refundable would help make this credit even more progressive); or (ii) "abate" (that is replace) a guaranteed portion of local property taxes used to fund schools—without changing how local school districts levy their property taxes—and to mandate that the state annually fund the abatement through a continuing appropriation.

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Obviously doubling the existing property tax credits individuals may claim against their state income tax liability is the most facile approach to property tax relief. Since homeowners claim it themselves, there are no questions about whether the state will provide it. Since it is based on a percentage of the property taxes they pay, it automatically increase as property taxes increase, maintaining its value. The downside of this approach is renters, who also pay property taxes, would not gain any benefit. This may necessitate a credit targeted to low and middle income renters.

How an abatement would work is fairly simple. Under an abatement, local school districts would continue to assess property taxes as if no relief was coming from Springfield. The reform would then mandate that the state abate (that is, replace) a set percentage of the property taxes used to fund schools, and disburse the abatement directly to school districts prior to the date local property tax bills are transmitted to taxpayers by their respective county assessors. On the resulting property tax bill, each assessor would indicate the amount of property taxes assessed to the taxpayer that were already paid directly to their school district (hence "abated") by the state. The resulting property tax bill would look something like this:

Figure 28
Sample Property Tax Bill

Individual Property Tax Bill – River Forest, Illinois	
Total property tax assessed	*$16,700*
= > Portion of assessed property tax used to fund education	*$10,000*
= > Portion of assessed property tax paid by State of Illinois (20% of education assessments)	*($ 2,000)*
Net property tax bill	***$14,700***

Structuring property tax relief as an abatement addresses numerous concerns about school funding reform that have been raised in the past. First and foremost, no taxpayer would have to guess how much property tax relief he or she received, or be able to claim none was given at all. The amount of relief would appear directly on the taxpayer's property tax bill. This would bring complete transparency to the reform.

It also alleviates the concern that school funding equity will be obtained by bringing the top down, rather than the bottom up. Under this proposed structure, no school district in Illinois could lose any school funding. If the state fails to give the guaranteed amount of property tax relief, the school district is not impacted, because each school district continues to make its assessment as if nothing was coming from Springfield. So even if Springfield fails to satisfy its part of the bargain, local school districts will not be hurt. Elected officials might be, however, since the failure to provide the guaranteed property tax relief would have to be itemized on each taxpayer's property tax bill, voters would be able to hold elected officials accountable for failing to deliver.

(e) **Reform the Pension Ramp**. In addition to reforming state tax policy, Illinois should reform the Pension Ramp. Specifically, the Pension Ramp created a framework that substantially back-loaded costs, which in turn generates growing, annual pressure on the state's fiscal system that are difficult to resolve with tax policy reforms alone. Instead, the Pension Ramp itself should be recalculated and amortized in a manner that creates flat, annual payments for the state, much like a mortgage does for a homeowner.

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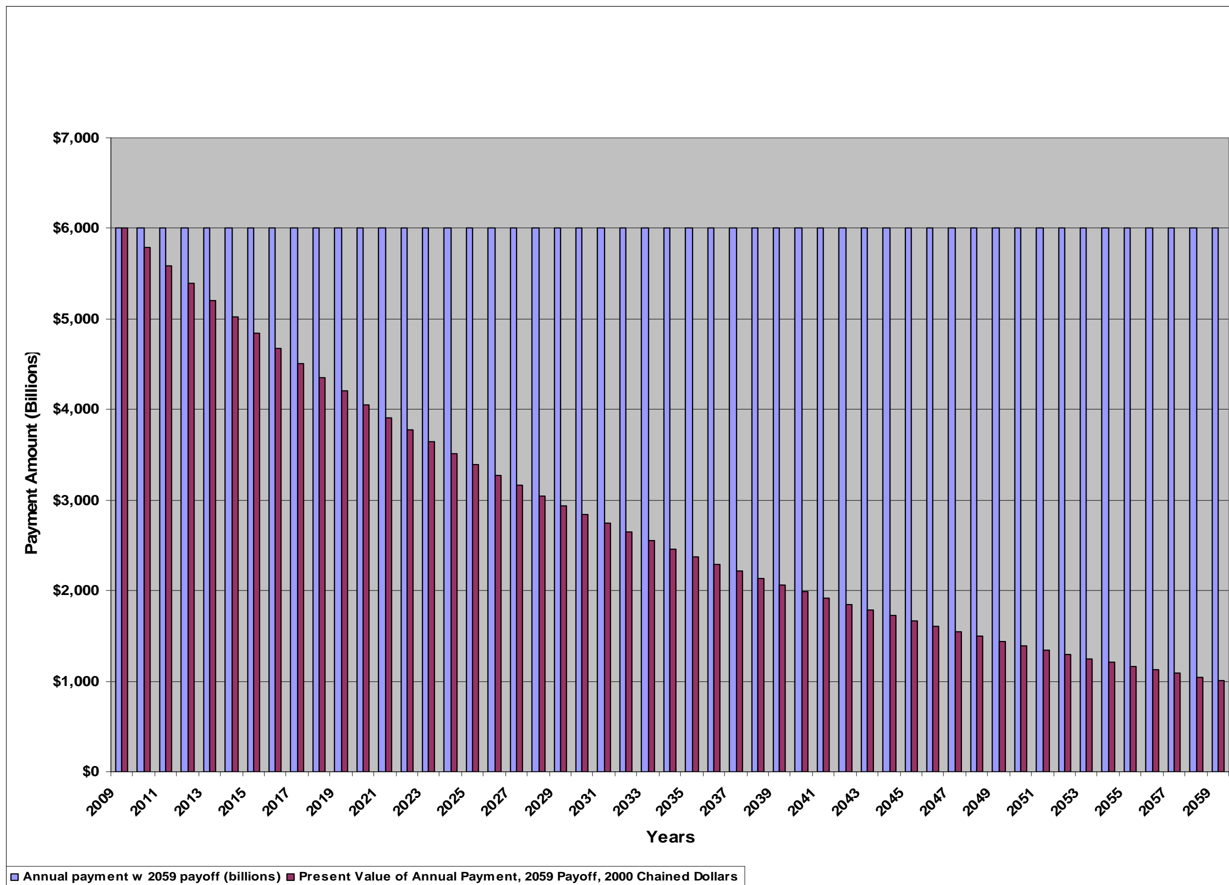
As Figure 29 shows, over time this approach would mean that, after accounting for inflation, the new payment schedule would actually create a diminishing General Fund liability for state government, permitting natural revenue growth from tax reform to be used primarily for funding delivery of the core four services.

Figure 29
Annual Payment Compared to Present Value of Annual Payment, 2059 Payoff



Note: this projection was made when the aggregate unfunded liability was $73.4 billion.

The actual duration of the new pension payment schedule as well as annual payment amounts would depend on a combination of data points (actual size of unfunded pension liability, new revenue available, length of payment term selected, discount rate used, etc.) that were not available as of the date of this study. Obviously, the shorter the payment period the less the state ultimately has to pay. However, the payment period has to be rational and attainable to avoid creating the same pressure on the fiscal system that lead to prior, irresponsible practices. Hence, paying a little more in nominal dollars over the long-term may be the better solution, so long as the payment schedule is attainable and does not back-load costs.

Currently, there is significant debate over defining the proper discount rate to use when evaluating unfunded pension liabilities and expected rates of return on funded pension assets. Certainly, some pension systems have significantly over-estimated their discount rates, thereby understating the aggregate amount of their unfunded liabilities. That said, estimates of discount rates in the public sector do not have to be quite as conservative as in the private sector, because there is little to no risk of actual bankruptcy for public sector entities. Ultimately, an appropriate date-based discount rate should be established for Illinois, and then rationally phased in to avoid unintended consequences to the fiscal system.

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(f) **Illinois would remain a low tax state after implementing CTBA's recommended changes.** The total net tax increase in Illinois after implementing the reforms recommended in this study would be $7.815 billion, after tax relief and school funding reform. While a large number in the abstract, it actually represents a relatively insignificant portion of the Illinois economy, accounting for less than 1.5 percent of the Illinois Gross Domestic Product of $633.7 billion.[116] Although representing only a small percentage of the state's economy, the reforms identified in this paper will eliminate the structural deficit by making tax policy fairer, and more stable, responsive and efficient, while also making education funding policy fairer, and enhancing education funding to levels that should promote better academic outcomes in most communities.

8. *Progressive Tax Increases are Better for the State's Economy and Job Creation than Spending Cuts.*

(a) **Is now the right time to raise taxes, when the state is pulling out of the Great Recession?** Of course, the state's need to increase tax revenue is not occurring in a vacuum. The Great Recession is barely in our rearview mirror, and the state has come nowhere near replacing the over 410,000 non-farm jobs it lost from the beginning of the recession through January 1, 2010. Truth be told, Illinois never recovered all the nonfarm jobs it lost in the previous, much milder recession of 2001.[117] Given that economic context, is now the right time to raise taxes, or will raising taxes hurt economic growth?

Despite all the data to the contrary, some will always argue that the best way to eliminate the state's deficit is simply to cut spending, as opposed to raising taxes. The problem is that spending cuts at the level needed to eliminate the state's General Fund deficit would likely cost Illinois thousands of lost, private sector jobs.[118]

Raising tax revenue in a progressive fashion, on the other hand, and maintaining or enhancing state spending is the best choice to counter recessionary cycles and generate job growth. That's because during a recession, the economy is already contracting. Cutting state government spending takes even more money out of local economies, worsening both the recession and job loss.[119] No one makes this point more clearly than Nobel prize winning economist Joseph Stiglitz, currently an economics professor at Columbia University.

Stiglitz pointed out that "in a recession, you want to raise (or not decrease) the level of total spending by households, businesses and government in the economy. That keeps people employed and buying things."[120] Simply stated, budget cuts reduce spending in the local economy, while state government spending boosts it.

In a letter to Governor Paterson of New York, Stiglitz emphasized the importance of state spending to counter the job loss generated by recessions. Among other things, Stiglitz used his letter to advise New York's elected officials that, "When faced with such an unpleasant choice, economic theory and evidence give a clear and unambiguous answer: it is economically preferable to raise taxes on those with high incomes than to cut state expenditures."[121]

The reason progressive tax increases work better during a recession than spending cuts becomes clear once you consider an individual's or family's "Marginal Propensity to Consume" or "MPC". "Marginal Propensity to Consume" simply measures the likelihood that a particular individual, given his or her overall income level, will choose to save or spend when they receive additional income.[122] Wealthy individuals have a lower MPC than other individuals, meaning they spend less of their overall income on consumption, and save more. Raising taxes on the affluent therefore generally results in them saving less, but with little to no change in their consumption. Stiglitz emphasized in his letter to the governor of New York, noting that although raising taxes on high income households may reduce spending some, it will certainly be less than the amount of the tax increase "since those with plenty of income typically spend only a fraction of their income—and some of what they spend is on luxury goods made abroad."[123] So, even though affluent individuals will have less money following a tax increase focused on them, there will not be a dollar-for-dollar loss in the economy. ***State budget cuts, however, do result in an immediate, dollar-for-dollar loss in economic activity***.

(b) **The Multiplier Effect.** How would Illinois benefit by taking the approach recommended by Stiglitz, and maintaining spending through progressive tax increases? Fortunately, Mark Zandi, the chief economist at Moody's.com and former economic advisor to Republican Senator John McCain during McCain's 2008 presidential campaign, has developed

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a simple metric for determining how certain public expenditures create an economic multiplier that generates more than a dollar-for-dollar benefit as those public expenditures move through a state's economy.

An economic multiplier, defined by economics textbooks such as Dornbusch and Fischer's *Macroeconomics*, is "the amount by which output changes when autonomous aggregate demand increases by one unit."[124] OK, what does that mean? The definition may sound arcane, but what happens is very straightforward. Say state government invests in a new road or in bridge construction. State government initially stimulates the economy by making a direct payment to contractors, construction workers, etc. for work and economic activity that otherwise would not take place. As these individuals then spend some of the money they earn from the state on other purchases in the economy, such as food, clothing or car repairs, a portion of the initial state investment made on construction becomes additional purchases in other sectors. One person's spending becomes another's income, who in turn spends that income on other purchases in the local economy and so on.

Zandi modeled the private sector dollar multiplier for public spending versus tax cuts, as detailed in Figure 30.

Figure 30

Government Action	
Tax Cuts	**Associated Multiplier**
Non-Refundable lump-sum tax rebate	1.02
Refundable lump-sum tax rebate	1.26
Temporary Tax Cuts	
Payroll Tax Holiday	1.29
Across the board tax cut	1.03
Accelerated Depreciation	0.27
Permanent Tax Cuts	
Extend alternative minimum tax patch	0.48
Make Bush income tax cuts permanent	0.29
Make dividend/cap gains tax cuts permanent	0.37
Cut in corporate tax rate	0.30
Spending Increases	
Extending Unemployment Insurance Benefits	1.64
Temporary increase in food stamps	1.73
General aid to state governments (for spending on items such as education, public safety, health and human services)	1.36
Increased infrastructure spending	1.59

As Figure 30 illustrates, the largest economic 'bang for the buck' comes from public spending, not tax cuts. Moreover, it is pretty clear that tax cuts, at any level, reduce the revenues coming into government. Given the size of the General Fund deficit Illinois faces (north of $9 billion), this is hardly a point in time when the state can afford revenue loss.

The flip side of a positive multiplier for maintaining spending is the potential negative impact of cutting state spending. In other words, if making $9 billion in expenditures on critical services such as education, healthcare and human services can be expected to generate a positive multiplier of 1.36 (that is, for every dollar spent by the state, Illinois' private sector economy gets a benefit of $1.36), then balancing the budget by cutting that amount of spending would hurt the economy by a similar multiple. The Center for Economic and Policy Research (**"CEPR"**), a national think tank, devised a method of applying Zandi's multipliers to state economies to determine the potential job impact of state government maintaining or cutting spending.[125]

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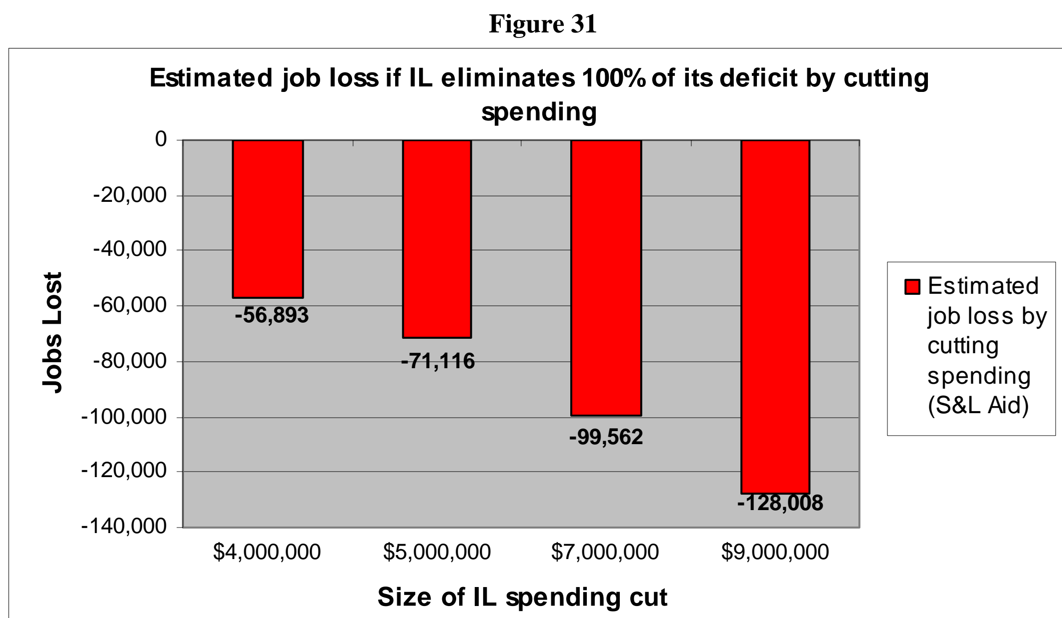
Figure 31 shows what the potential job impacts could be in Illinois if our state government elected to balance its budget deficit through spending cuts.

Figure 31



Note the potentially devastating economic impact of spending cuts. Cutting spending in the $9 billion range could cause the state to lose up to 128,008 private sector jobs—on the heels of the worst recession in generations.

9. *Evaluating Recent Major Tax and Budget Reform Proposals*

(a) <u>Overview</u>. Sections 9(b) through 9(g) below provide an analysis of the following six key proposals to address the state's deficit that were proffered in the past 18 months:

(i) The CTBA recommendations set forth in this study;

(ii) SB/HB750, which was introduced by Reverend Senator Meeks and has at various times passed out of committee in the House;

(iii) HB174, which was sponsored by Senate President John Cullerton and passed the full Senate;

(iv) The FY2011 "One percent (income tax rate) surcharge for education" proposal of Governor Quinn;

(v) The FY2011 spending cut and tax cut proposal put forth by Republican candidate for governor Senator Bill Brady; and

(vi) The tax increase, spending cut and pension cut proposal published by the Civic Federation earlier this year.

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(b) CTBA Recommendations Contained in this Study

(i) Short Summary. CTBA recommends that Illinois:

Tax Increases:

- Increase the state personal income tax rate from 3% to 5%;
- Include retirement income in the personal income tax base for filers with $50,000 per year or more in AGI, which is just the top 18% in income of all filers with retirement income;
- Increase the corporate income tax rate from 4.8% to 8%; and
- Expand the state sales tax base to include most consumer services (many of which are already taxed by Illinois' neighboring states), as identified in Table 1 to Appendix A.

Tax Relief:

- Create a new, refundable income tax credit targeted to low and middle income taxpayers to make overall taxation in Illinois more progressive, by helping offset the impact of the aforesaid personal income tax rate increases and sales tax base expansion on the bottom 60% of income earners;
- Quadruple the state's Earned Income Tax Credit to create more progressivity and hence tax fairness by offsetting tax burden of filers ranging from the working poor to lower-middle income; and
- Double the Illinois residential property tax credit from its current level of five percent (5%) of property taxes paid to ten percent (10%) of property taxes paid, cap the property tax relief at $1,500 (indexed annually to inflation) and make it a refundable income tax credit, so low and middle income families receive the full tax relief intended. Note, a corresponding refundable income tax credit targeted to low and moderate income renters may eventually be necessary. However, the quadrupling of the Illinois EITC coupled with the large, refundable income tax credit referenced above should be sufficient to offset enough tax burden to cover this concern.

Education Funding Reforms:

- Mandate an increase of $300 million in the annual General Fund appropriation for Higher Education (which amount would thereafter be increased annually by inflation);
- Increase Early Childhood education funding on a phased-in basis, from an additional $45 million in the first fiscal year after the bill passes to an additional $180 million per year four years later;
- Increase the state's per-student Foundation Level for K-12 education to the amount recommended by the Education Funding Advisory Board (EFAB) over four years (raising it to $8,410 from $6,100)—the Foundation Level and state Poverty Grants would also automatically receive minimum, annual increases to account for inflation (based on the ECI) after the first fiscal year the recommendation passes;
- Double the state's special education personnel reimbursement rate from $9,000 to $18,000 per certified special education instructor;
- Increase grants for high-poverty schools to the level needed to improve academic achievement and reduce achievement gaps, as supported by evidence-based research;
- Fund teacher and principal mentoring programs; and
- Provide additional funding for science, math and technology programs.

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Figure 32
Estimated FY2011 Net Revenue[126]
from CTBA Recommendations
(All Dollars in Millions)

Revenue Source/Adjustment	Revenue Impact
Increase Personal Income Tax Rate from 3% to 5% (Net of Refund Fund)	$5,806
Amount Local Government Distributive Fund (LGDF)	(-$581)
New General Fund Revenue from Personal Income Tax Rate Increase from 3% to 5% on Existing Income Tax Base	$5,225
Add Retirement Income of Filers with over $50,000 in Adjusted Gross Income (top 18% in income of such filers) Into Income Tax Base at 5% rate (Net of Refund Fund and LGDF)	$905
Net New Revenue from Personal Income Tax Changes	$6,130
Increase Corporate Income Tax Rate from 4.8% to 8% (Net of Refund Fund)	$937
Corporate Income Tax Revenue to LGDF	(-$94)
Net New Corporate Income Tax Revenue	$843
Revenue from Sales Tax Base Expansion	$2,400
GROSS NEW REVENUE TO GENERAL FUND	$9,373
Create Refundable Income Tax Credit to Offset Income and Sales Tax Increases for Bottom 60% in Household Income	(-$750)
Double Residential Property Tax Credit from 5% to 10%	(-$493)
Increase State EITC from 5% to 20% of Federal[127]	(-$315)
NET TAX INCREASE/REVENUE TO GENERAL FUND	$7,815

(ii) Do CTBA's Recommendations Comport with the Principles of Sound Tax Policy?

Yes. CTBA's recommendations would make state tax policy fairer, and more responsive and stable. They also should make Illinois tax policy more efficient in the long term. This is the probable outcome of CTBA's recommendation to shift more of the responsibility for education funding to state-based resources, thereby taking significant pressure off of local property taxes that is created by the state's current education funding policy.

(iii) Will the Recommendations Address the State Structural Deficit?

Yes, CTBA's recommendations will effectively eliminate the structural deficit, even if state revenue growth averages just one percent (1%) annually over the next decade as shown in Figure 33. Note, CTBA's proposal works even if the Pension Ramp is not reformed, and even after accounting for the enhanced funding of education CTBA recommends.

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Figure 33
CTBA Plan Baseline Scenario
Projected Impact on Illinois General Fund Budget

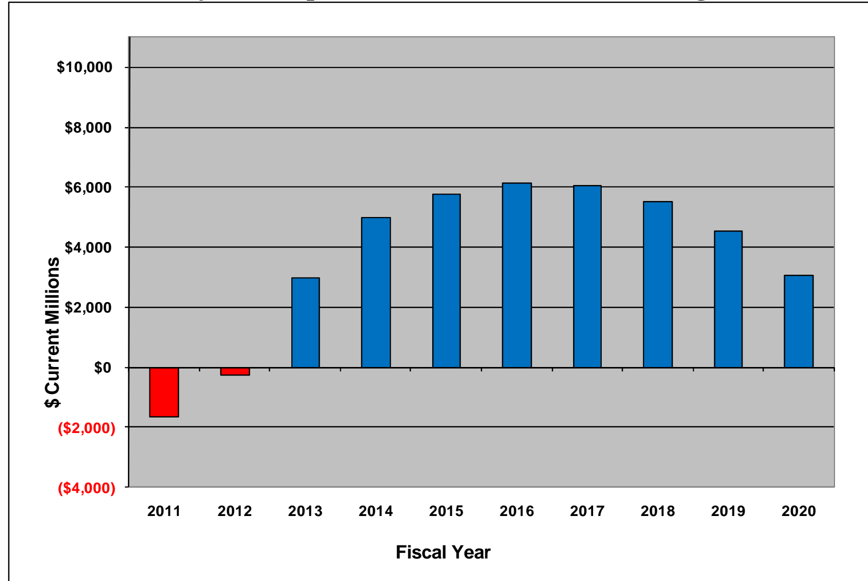
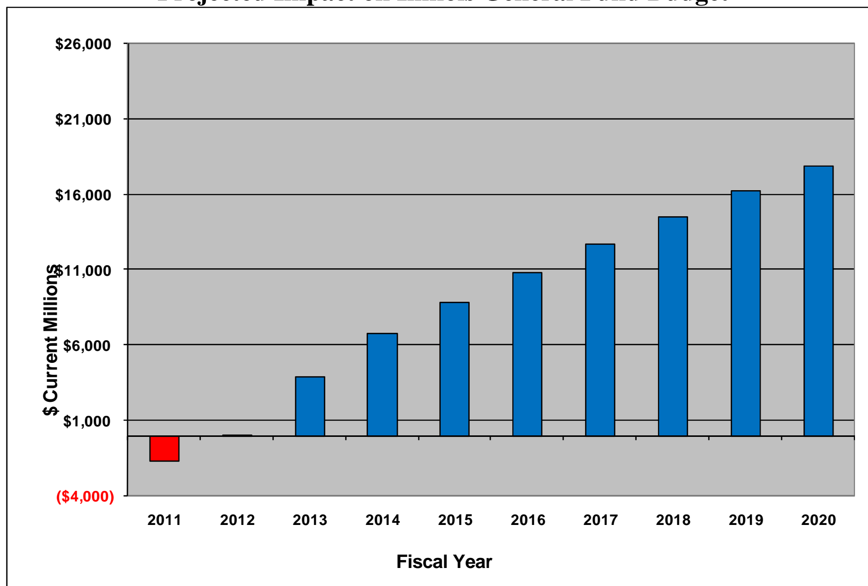


Figure 33 assumes that General Fund revenue from CTBA's recommended personal income tax enhancement will increase over time at the same rate as personal income tax revenue increased under the state's pre-existing tax policy. This is a conservative assumption given that the refundable income tax credit created in the recommendation, coupled with the enhancement of the state EITC, will make tax incidence more progressive than the pre-existing Illinois tax policy. If present trends in income inequality continue, income tax revenue growth after passage of CTBA's recommendation will therefore in all likelihood be at greater rates over time than under the state's prior, more regressive policy. Moreover, the income tax base is expanded to include some retirement income and as the population grays retirement income is growing in both proportional and absolute terms, which should also translate into stronger revenue growth rates than previously.

Obviously, then, if revenues grow at the far more optimistic two percent (2%) year rate, CTBA's proposal works even better, as shown in Figure 34.

Figure 34
CTBA Plan Optimistic Scenario
Projected Impact on Illinois General Fund Budget



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(iv) Potential Economic and Other Consequences. CTBA's recommendations should have positive impacts on the state's economy in both the short and long terms.

Short term, because the tax increases under CTBA's recommendations are progressive and will permit Illinois to balance its budget without implementing over $9 billion in spending cuts, it will save Illinois from losing up to 128,000 private sector jobs, based on CPER's methodology for applying the private sector multipliers created by Mark Zandi of Moody's.com.[128]

Long-term, the state should experience a modest boost in consumer spending from the targeted tax relief CTBA's recommendations provide to low and middle income taxpayers, who have a high marginal propensity to consume.[129] Also, because CTBA recommends enhancing school funding by putting a greater state investment in PreK-12 education, much of the pressure to increase local property taxes to fund schools will be alleviated, which should slow the growth in property tax reliance, and ultimately, property tax levies. By investing in education, Illinois will increasingly produce more skilled workers, potentially inducing higher-end businesses to locate or expand in Illinois, countering the state's decades-long trend of good job loss. This conclusion is supported by a study produced by Bensi, Black and Dowd in 2004, which found that, on average, increased real, inflation-adjusted state-level funding for K-12 education relative to other states over time, leads to increased real, disposable personal income growth relative to other states over time.[130]

CTBA's recommendations will also permit state government to invest more in human services, potentially meeting the needs of vulnerable populations which currently are ignored. Finally, CTBA's proposal maintains Illinois' status as a relatively low tax state. Using 2008 data, the last year for which complete state and local tax burden information is available, after CTBA's recommendation becomes law, Illinois would rank 28th in total state and local tax burden as a percentage of income, remaining in the bottom half of the nation.[131] In fact, Illinois' new state and local tax burden as a percentage of income (16.2%) would still be lower than its Midwestern neighbors Indiana (16.7%), Iowa (17.2%), Michigan (17.0%) and Wisconsin (16.7%), while moving just two-tenths of one percent (0.2%) ahead of Kentucky (16.0%).

It should be noted that the CTBA recommendation would permit Illinois to invest more in education and eliminate the structural deficit, without necessitating further General Fund spending cuts from the current, low levels. Certainly CTBA would support eliminating wasteful or unnecessary spending. Better yet, given how low spending levels currently are, any General Fund revenue that is being wasted on an unnecessary program would be far better utilized funding needed services that previously received the ax. The problem is most of the support for spending cuts is either very general in nature, failing to identify specific wasteful programs, or when specific is immaterial in amount.

In the highly politicized environment that always surrounds tax and budget discussion, it may be inevitable that that additional spending cuts become part of the final package. That said, it is valuable for decision makers to know that they can in fact solve the state's very difficult fiscal problems without resorting to cutting the four, core services more than they have already been cut in the current fiscal year.

(c) HB/SB 750

(i) Short Summary. As last introduced, Senate Bill 750 (on which CTBA worked as a technical advisor) would:

Tax Increases:

- Increase the personal income tax rate from 3% to 5%;
- Increase the corporate income tax rate from 4.8% to 8%; and
- Expand the state sales tax base to include most consumer services, (many of which are already taxed by Illinois' neighboring states) as identified on Table 1 to Appendix A.

Tax Relief:

- Create a new "Family Tax Credit" targeted to low and middle income taxpayers to make overall taxation in Illinois more progressive, by helping offset the impact of the aforesaid individual income tax rate increase and sales tax base expansion on the bottom 60% of income earners;

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- Triple the state's Earned Income Tax Credit to create more progressivity and hence tax fairness by offsetting tax burden of working poor filers up to lower-middle income filers; and
- Double the Illinois residential property tax credit from its current level of 5% of property taxes paid to 10% of property taxes paid.

Education Funding Reform:

- Mandate an increase of $300 million in the annual General Fund appropriation for Higher Education (which amount would be increased annually by inflation);
- Increase Early Childhood education funding on a phased-in basis, from an initial increase of $45 million in the first fiscal year after the bill passes to $180 million four years later;
- Increase the state's per-student Foundation Level for K-12 education to the amount recommended by EFAB over four years (raising it to $8,410 from $6,100)—the Foundation Level and state Poverty Grants also would automatically thereafter receive annual increases for inflation based on the ECI;
- Double the state's special education personnel reimbursement rate from $9,000 to $18,000 per certified special education instructor;
- Maintain and expand existing grants for high-poverty schools;
- Fund teacher and principal mentoring programs; and
- Provide additional funding for science, math and technology programs.

Figure 35
Estimated FY 2011 Net Revenue Impact of SB750[132]

Revenue Source/Adjustment (all $ in Millions)	Revenue Impact
Increase Personal Income Tax Rate from 3% to 5% (net of refund fund)	$5,806
Transfer to Local Government Distributive Fund (LGDF)	-($581)
Net Revenue from Personal Income Tax Rate Increase	$5,225
Increase Corporate Income Tax Rate from 4.8% to 8% (net of refund fund)	$937
Transfer to LGDF	-($94)
Net Revenue from Corporate Income Tax Rate Increase	$843
Sales Tax Base Expansion	$2,400
Double Residential Property Tax Credit from 5% to 10%	-($493)
Create Family Tax Credit to Offset Income and Sales Tax Increases for Bottom 60% in Household Income	-($600)
Increase State EITC from 5% to 15% of Federal	-($215)
Net Revenue to State General Fund (minus refund fund, Personal Exemption and tax relief)	$7,160

Sources: Illinois Department of Revenue sales tax expansion estimates obtained 10/2009; SB750 sales tax expansion and Family Tax Credit estimates provided by the Institute for Tax and Economic Policy (ITEP).

Figure 35 assumes that General Fund revenue from SB750 will increase over time at the same rate as General Fund revenue increased under the state's pre-existing tax policy. This is a conservative assumption given that the refundable Family Tax Credit created in SB750 and the enhancement of the state EITC will make tax incidence more progressive than the pre-existing Illinois tax policy. Thus, if present trends in income inequality continue, income tax revenue growth after passage of SB750 will in all likelihood be at greater rates over time than under the state's prior, more regressive tax policy.

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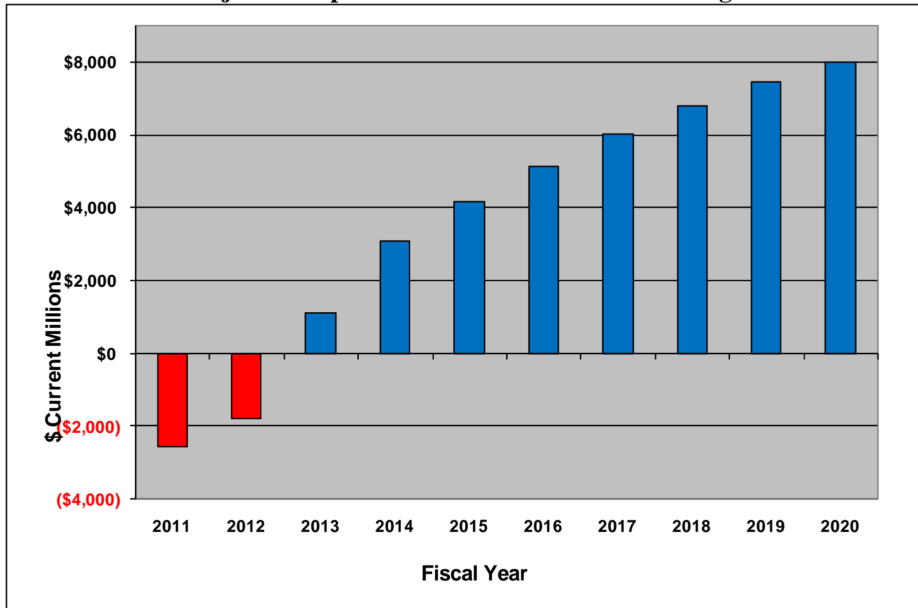
(ii) Does the Proposal Comport with the Principles of Sound Tax Policy?

Yes. SB750 would make state tax policy fairer, and more responsive and stable. It should also make Illinois tax policy more efficient in the long term, because it shifts significant responsibility for education funding to state revenue sources, thereby taking some of the pressure off of local property taxes that current education funding policy creates.

(iii) Will It Address the State Structural Deficit?

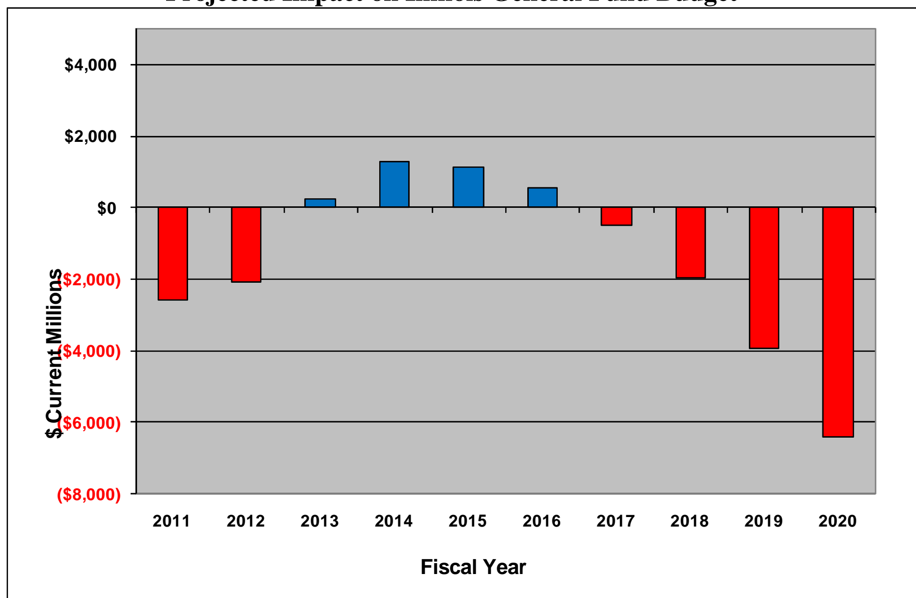
Yes, if Illinois' revenue grows at the more optimistic projection of two percent (2%) annually over the next decade, as shown in Figure 36. Note, SB750 would work in that instance—even if the Pension Ramp were not reformed and even after implementing education funding reform.

Figure 36
SB750 Optimistic Scenario
Projected Impact on Illinois General Fund Budget



Yes and no, if revenue growth is limited to one percent (1%) annually or less over the next decade, as shown in Figure 37.

Figure 37
SB750 Baseline Scenario
Projected Impact on Illinois General Fund Budget



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Note that, in the estimates of revenue growth for both HB/SB750 and the CTBA recommendations analyzed in Section 9(b) of this study, it is assumed that sales tax revenue will grow at a rate that is roughly 1.5 times greater than the historic rate of own-source sales tax revenue growth in Illinois. This adjustment is made because the expansion of Illinois' sales tax base to include most consumer services will enhance long-term performance of that revenue source over pre-existing levels. As shown in Figure 38, the 1.5 multiplier used for new revenue growth post sales tax base expansion is based on the average ratio of sales tax revenue growth to overall (sales and income) revenue growth in neighboring states that have similar, broader based sales taxes that include significantly more consumer services than does the current Illinois sales tax base.

Figure 38

Illinois and Neighboring State Sales and Overall Tax Revenue Growth

Revenue (Millions of Current Dollars)

	Sales Tax			**Total Sales and Income Tax**			**Ratio of Sales Tax to Overall Tax Growth**
	2000	**2010**	**Average Growth**	**2000**	**2010**	**Average Growth**	
IL	$6,027	$6,488	0.74%	$14,950	$15,970	0.66%	1.12
WI	$3,502	$4,011	1.37%	$10,109	$10,870	0.73%	1.88
IA	$1,663	$2,398	3.73%	$4,365	$5,757	2.81%	1.33
MO	$1,715	$1,861	0.82%	$5,629	$6,379	1.26%	0.65
KY	$2,171	$2,793	2.55%	$5,179	$6,175	1.77%	1.44
IN	$3,651	$5,932	4.97%	$8,389	$10,255	2.03%	2.45
				Average Ratio Excluding IL:			1.55

Source: CTBA Calculations from data from National Association of State Budget Officers, Fiscal Survey of the States, 2001 and 2010.

(iv) Potential Economic and Other Consequences. HB/SB750 should have positive impacts on the state's economy in both the short and long terms.

Short-term, because the tax increases under HB750 are progressive and will permit Illinois to balance its budget without cutting over $9 billion in spending, it will save the state from losing up to 128,000 private sector jobs, based on CPER's methodology for applying the private sector impact multipliers created by Mark Zandi of Moody's.com.[133]

Long-term, the state should experience a modest boost in consumer spending from the targeted tax relief HB750 provides to low and middle income taxpayers, who have a high marginal propensity to consume.[134] Also, because HB750 enhances school funding by putting a greater state investment in PreK-12 education, much of the pressure to increase local property taxes to fund schools will be alleviated, which should slow the growth in property tax reliance, and ultimately, property tax levies. By investing in education, Illinois will increasingly produce more skilled workers, potentially inducing higher-end businesses to locate or expand in Illinois, countering the state's decades-long trend of good job loss.[135]

If, however, state revenue growth is relatively flat over the next decade, HB750 will ultimately not generate enough tax revenue growth long-term to sustain education funding reform and cover the existing Pension Ramp. Reforming the Pension Ramp as recommended in this study could, however, alleviate this problem.

(d) Analysis of HB174

(i) Short Summary. HB174 is a modified version of SB750, sponsored by Senate President John Cullerton (D-6). CTBA worked as technical advisor on this legislation.

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While based on SB750, HB174 differs in a number of important ways. While the personal income tax rate increase remains the same as in SB750, going from three to five percent, the sales tax base expansion is significantly smaller, as is the increase in the corporate income tax rate. In addition, HB174 also increases the standard exemption by $1,000, which SB750 did not do. HB174 also redirects (in its first year only) $20.8 million per month into the Common School Fund from the Local Government Distributive Fund (state income tax funds which otherwise would flow to local governments, like municipalities).

Following are highlights of HB174:

Tax Increases:

- The Illinois personal income tax rate is increased from 3% to 5%;
- The Illinois corporate income tax rate is increased from 4.8% to 5%; and
- The Illinois sales tax base is expanded to include 39 different consumer services that previously were untaxed, such as travel agent services and scenic & sightseeing transportation. All 39 specific services that would be taxed are listed in Table 1 to Appendix I. Most of the services Illinois will tax under HB174 are already taxed by one or more of Illinois' neighboring states.

Tax Relief:

- The standard exemption an individual taxpayer can claim against the state personal income tax increases from $2,000 to $3,000;
- Property tax relief is provided by doubling the state personal income tax credit individuals may claim for the local property taxes paid on their principal residence in Illinois, from five percent (5%) to ten percent (10%). The value of this credit is capped at $1,500 (the $1,500 cap is then indexed to CPI in subsequent years). The bill also makes the tax credit for property taxes paid refundable (i.e., a homeowner will receive the full value of the credit up to the $1,500 maximum, even it if exceeds his or her state income tax liability, ensuring low and middle income families get the maximum property tax relief intended); and
- Tax fairness for poor up to lower-middle income working families comes from a tripling of the state's EITC from five percent (5%) to fifteen percent (15%) of the federal EITC claimed.

Education Funding Reform:

- Education funding would be enhanced starting in the first fiscal year after the bill passes and continuing thereafter, with 33 and 1/3 percent (33.3%) of all new revenues generated from the tax increases in HB174 annually going to the Common School Fund (this new revenue for education must be added to the appropriation amount from the previous year, hence it should enhance school funding, rather than merely replace existing revenue streams that already fund education).
- Similarly, commencing in the first fiscal year after the bill passes and continuing each year thereafter, 16 and 2/3 percent (16.6%) of all new revenues generated from the tax increases in HB174 are allocated to the Higher Education Fund. The rest of the new revenue from HB174 will go to the General Fund.

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Figure 39
Estimated FY2011 Net Revenue From HB174[136]

Revenue Source/Adjustment All $ in Millions	**HB174 At 5% (personal rate) and 5% (corporate rate)**
Individual Income Tax (net of refund fund)	**$5,806**
Local Government Distributive Fund LGDF	**(-$331.40)***
Personal Exemption Cost	**(-$1,047)**
Total Personal Income	**$4,427.60**
Corporate Income Tax (net of refund fund)	**$.53**
LGDF	**(-$.05)**
Total Corporate Income	**$4**
Sales Tax Base Expansion	**$515 - $723**
Double Residential Property Tax Credit from 5% to 10%	**-($493)*****
Increase State EITC from 5% to 15% of Federal	**-($215)**
Net Revenue to State General Fund (minus refund fund, Personal Exemption and tax relief)	**$4,235 - $4,440**

* In the first fiscal year the bill passes, $20.8 million per month will be diverted from the LGDF to the Common School Fund. Hence the LGDF cost will increase by $249 million starting in FY 2012.
** $500 cap not modeled.
*** $1,500 cap not modeled.

(ii) Does the proposal comport with the principles of sound tax policy?

Yes—in part. The tax increases in HB174 are moderately progressive after accounting for the increases made in both the standard exemption and the state EITC. This should make Illinois tax policy fairer and more responsive. Unfortunately, the sales tax base expansion is insufficient to make Illinois tax policy more stable. The enhanced education funding may not be sufficient to reduce the state's long-term reliance on property taxes, because it is probably not sustainable, as discussed in more detail in Section 9(d)(iii) below.

(iii) Will it address the structural deficit?

No. Even under the most optimistic assumptions, HB174 would still leave Illinois in a deficit position. The primary reasons for this are the sales tax base is not expanded sufficiently, the Pension Ramp is not replaced, and education funding under the bill is enhanced immediately, rather than being phased in after the deficit is under control.

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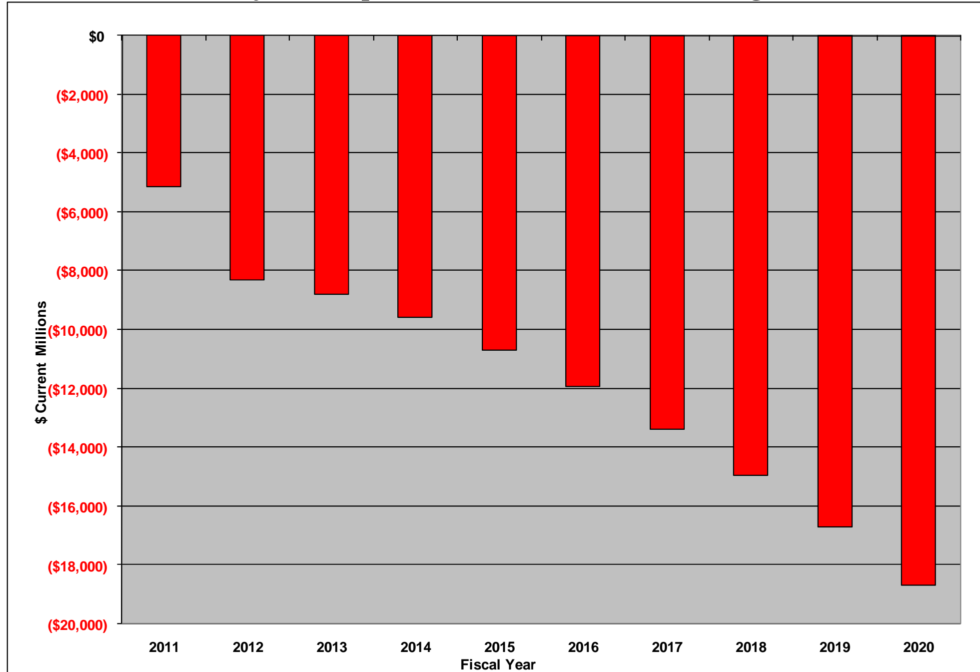
Figure 40
HB174 Optimistic Scenario
Projected Impact on Illinois General Fund Budget



The rate of growth projection for additional sales tax revenue under HB174 is not increased along the lines of the adjustments made to HB/SB750 and the CTBA recommendations, because unlike HB/SB750 and the CTBA recommendations, the sales tax base expansion for HB174 has a very narrow scope (to only 39 consumer services), and hence cannot be expected to generate nearly the same comparative enhancement to long-term revenue growth.

(iv) Potential Economic and Other Consequences. By reducing but not eliminating the state General Fund deficit, HB174 will force state decision makers either to cut service spending in areas other than education resulting in concomitant job loss, or raise additional revenue. Note that replacing the Pension Ramp and phasing in the education funding reforms over time would significantly reduce, if not eliminate, ongoing deficit programs under HB174.

(e) Governor Quinn's 1% Surcharge for Education

(i) Short Summary. Governor Quinn has made a number of revenue generating proposals. For this he should be applauded, as it is difficult for elected officials to tell voters what they need to hear—the state has to increase taxes—rather than what they want to hear—they can have services without paying for them.

His most recent proposal, and hence the one analyzed in this study, is to increase the personal income tax rate from three percent (3%) to four percent (4%) and the corporate income tax rate from 4.8 percent to 5.8 percent, to obviate the need to make significant cuts in FY2011 General Fund appropriations for education. This would raise about $2.9 billion in General Fund revenue.

However, Governor Quinn has also stated that a significant portion of the new revenue from this proposal should fund property tax relief.[137] Unfortunately, the Governor did not specify how much of the $2.9 billion in new revenue should be used for property tax relief. For purposes of the analysis in this study, then, it is assumed that none of the new revenue generated by the "one percent for education surcharge" is actually going to be used for property tax relief. To the extent it is, obviously, the proposal does less to reduce the state's ongoing General Fund deficits.

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Figure 41
Estimated FY2011 Net Revenue from
"Quinn 1% Surcharge for Education"
(Billions Current $)

	FY2011 Revenue Estimates[138] Current Law	Quinn's 1% Surcharge for Education
Personal Income Tax (Net of Refund Fund)	$8.709 B	$2.903 B
Local Government Distributive Fund	(-$.871 B)	(-$ .29 B)
Net Personal Income Tax Revenue to General Fund	$7.84 B	$2.869 B
Corporate Income Tax (Net of Refund Fund)	$1.406 B	$ .293 B
Local Government Distributive Fund	(-$ .141 B)	(-$ .029 B)
Net Corporate Income Tax to General Fund	$1.265 B	$ .264 B
TOTAL REVENUE TO GENERAL FUND	$9.105 B	$2.877 B

Note that, even after the most recent $1.4 billion round of General Fund cuts implemented in July 2010, if Governor Quinn's proposal were law, the state would still be facing an FY2011 deficit of roughly $6.6 billion. And that is with none of the revenue from this proposal being used to relieve property taxes. Hence, the roughly $2.9 billion in new revenue raised from Governor Quinn's "one percent for education" is nowhere near enough to fix the state's deficit problems, even if it were not dedicated exclusively to education funding.

(ii) Does the Proposal Comport with the Principles of Sound Tax Policy?

No. Because the "one percent for education" proposal is strictly a marginal tax rate increase which is not offset by any tax relief targeted to low and middle income families, it does not mitigate the regressivity and hence unfairness, nor enhance the responsiveness of Illinois tax policy. Everyone who pays state income taxes will pay the one percent increase proposed by Governor Quinn, even the lowest income households subject to the Illinois personal income tax.

Since it does not include any sales tax base expansion nor income tax base expansion to include some retirement income, this proposal also will not bring any stability to state tax policy. Although Governor Quinn has suggested that a portion of this tax increase be used to offset property tax burden, the proposal does not raise adequate revenue to accomplish that purpose, and Governor Quinn does not quantify the amount of property tax relief to be provided, nor specify how it would be structured.

(iii) Will it address the structural deficit?

No. Though the Governor has pledged to veto any bill that that raises taxes by more than one percent or uses the proceeds of a tax increase for purposes other than education,[139] CTBA assumes in Figure 42 that all the net new revenue from the "one percent surcharge for education" frees up revenue elsewhere in the budget (that would otherwise have to go to education) that could be used for other General Fund purposes.

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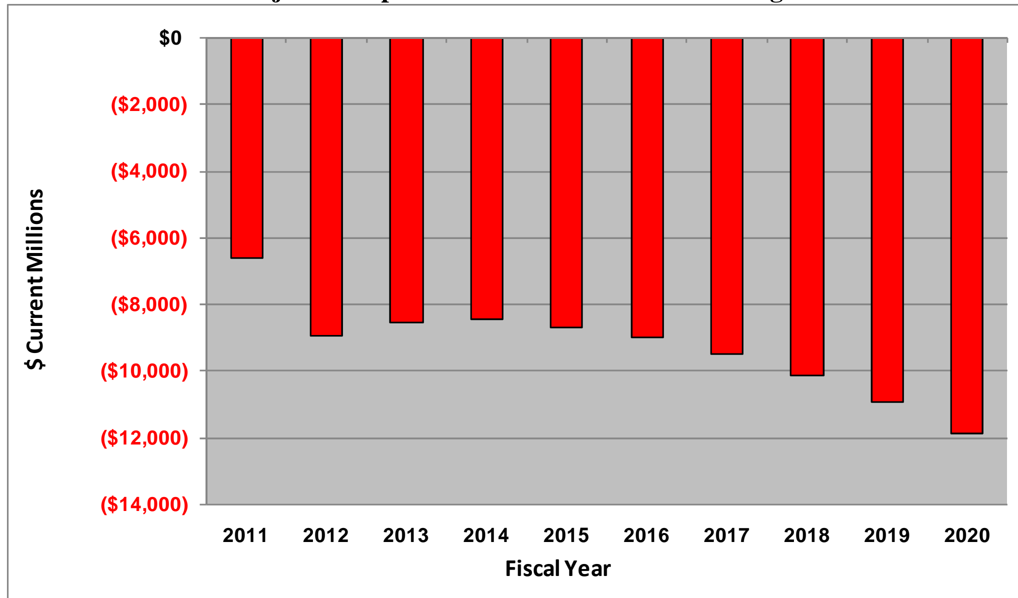
Figure 42
Quinn 1% for Education Optimistic Scenario
Projected Impact on Illinois General Fund Budget



(iv) Potential Economic and Other Consequences.

To the extent this proposal raises revenue that averts state spending cuts, it should have a positive impact on private sector jobs in the short-term. That said, because the tax increase is not progressive, low and middle income families that have a high marginal propensity to consume will pay it. This in turn means that the proposal will not have as high a positive multiplier on the economy as identifed by Mark Zandi of Moody's.com.

Moreover, it still leaves the state with a significant deficit of over $6 billion. If Illinois resolves that deficit primarily with spending cuts, then the net impact will be significant private sector job loss, of anywhere from 14,223 (if $1 billion is cut) to 85,339 jobs (if the full $6 billion is cut).

Finally, the proposal does not raise adequate revenue: to enhance K-12 education funding to the levels recommended by EFAB; to enhance Pre-K funding; to enhance higher education funding; nor to invest in infrastructure or eliminate the deficit. In all likelihood, then, that means the long-term shift in Illinois' economy from one that creates high paying jobs to one that primarily creates low paying jobs will continue, as will the state's overreliance on property tax revenue to fund schools, which is not only inefficient and regressive from a tax policy standpoint, but also creates significant educational opportunity inequities that significantly disadvantage minority, low income, middle income and downstate children.

(f) Republican Gubernatorial Candidate Senator Bill Brady's Budget Proposal

(i) Short Summary. Although sketchy on details, the budget plan of Republican candidate for Governor, Senator Bill Brady (R-44), consists of two key elements—spending cuts that he claims will total $5 billion (as will be shown below, this spending cut total is not realistic) coupled with $1 billion (Senator Brady's estimate) of tax cuts. According to Senator Brady, "I have to cut state spending by 10 percent if I'm going to pay for my tax breaks, if I'm going to reconcile the budget in a balanced way, and pay back the backlog of unpaid bills that Gov. Quinn and Gov. Blagojevich have accumulated."[140]

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Following is a short summary of Senator Brady's proposals:[141]

Spending Cuts:

- Cut state spending by ten percent "across the board," which Senator Brady claims will reduce General Fund spending by $5 billion. During an interview with Crain's editorial board, Senator Brady said he'd divide state government into five general areas, transportation, education, public safety, human services and healthcare, and subject each to cuts of "a dime on the dollar."[142]

- Unfortunately, Senator Brady based his $5 billion in savings claim on a 10 percent across the board cut on the state's FY2011 total operating budget of $51 billion, not the General Fund budget of $24.9 billion. Hence, much of what he wants to cut he either cannot legally cut (e.g. payments to bond holders); or even if he could legally cut the area, e.g. "transportation" spending cuts in the Road Fund, he would not save any General Fund revenue, because it is a non-General Fund expense and does not free up revenue that can be used in the General Fund.

- Moreover, more than $5.8 billion of the revenue that is spent through the $24.9 billion FY2011 General Fund comes from the federal government, and must be spent for the programs—primarily healthcare and education—delineated by the federal government. In other words, Senator Brady cannot cut spending on those items without losing the associated federal funding. That means if he does cut federal programs, it will not reduce the deficit by even one dollar, because he loses an amount of federal revenue that is equal to the spending cut to the program, generating zero net savings. Put another way, the state would lose the public service being cut, but keep its deficit intact.

- Taking programs funded with federal revenue transfers off the table, then, leaves a total of $19.1 billion in the FY2011 General Fund. But not all of that is available for cuts. Illinois has to maintain its state own-source revenue spending on Medicaid to receive the corresponding federal match that in turn feeds the General Fund. Moreover, under the federal ARRA program, Illinois loses its right to receive ARRA education funding if it cuts its education budget below last year's levels. In FY2010, the General Fund appropriations for PreK-12 totaled $7.03 billion. Taking that, and the need to maintain state own-source revenue spending on Medicaid to maintain federal match into account, means the total General Fund spending available to Senator Brady to cut in FY2011 is at most around $10 billion. We say "at most" because a number of the remaining programs are mandated by court order or other federal and state laws and therefore cannot be cut. However, since an exhaustive list of those programs was not available at the time of this study, the amount of General Fund spending available to be cut is not being reduced to account for them.

  So, without adjusting for the aforesaid court ordered or otherwise mandated spending, a ten percent across the board General Fund spending cut would save at most $1 billion. Recently, Senator Brady has acknowledged that 10 percent across the board cuts won't generate the $5 billion in savings he desires. In recognition of this, Senator Brady has suggested making cuts of 20 percent across the board.[143] That in turn would save at most $2 billion.

- Since Medicaid and education are not available to cut, virtually all of that $1-$2 billion in spending cuts would have to be taken from higher education, human services that care for the most vulnerable members of Illinois' society, and/or public safety. Note that in the aggregate, higher education has a $2.11 billion FY2011 appropriation, human services is now appropriated to receive $4.929 billion in FY2011 (after the cuts announced by Governor Quinn in July), and public safety is appropriated $1.4 billion. Collectively, then these three service areas account for just over 91 percent of General Fund spending actually available to be cut in FY2011.

- Senator Brady has also suggested that moving all Illinois Medicaid users into a private managed care system will save $1.2 billion. These estimated cost savings cannot be verified. In fact, more managed care may increase costs due to increased use of specialists. Moreover as discussed previously, to the extent Illinois cuts the amount of state dollars used to pay for Medicaid, it will lose federal matching funds, so it is unclear how much in net savings this would generate. In fact, loss of federal match could consume most or all of the savings generated by spending less state tax dollars. Because none of these claimed savings could be verified, they are not included in the analysis of Senator Brady's proposal.

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Tax Cuts[144]:

- Eliminate the state gasoline sales tax, causing Illinois to lose $409 million in revenue, based on FY2009, Illinois Department of Revenue reports.

- Repeal the Estate Tax, currently the only progressive tax in Illinois. This will cause the loss of $288 million in revenue, based on FY2009 Illinois Department of Revenue reports and the governor's OMB, FY2010 Illinois State Budget.

- Implement a $3,750 per-job created, two-year business tax credit, which would be allocated $2,500 in the first year and $1,250 in the second year. Senator Brady claims the full cost of the credit will be offset by taxes paid by the new workers hired. This claim could not be verified.

- Implement an energy tax credit for manufacturers. Senator Brady provides no cost estimate for this credit, and the proposal is not detailed enough to create an independent estimate.

- Make the Economic Development for a Growing Economy (EDGE) tax credit refundable. Senator Brady provides no cost estimate for making this credit refundable, and did not provide enough information about the proposal to create an independent cost estimate.

- Make the research and development tax credit permanent. No cost estimate was provided. According to the Comptroller's Office, in FY2008 this credit cost Illinois $29.46 million in lost revenue.[145]

- Cut other "business tax and fee increases imposed by the Blagojevich/Quinn administrations," which Senator Brady claims will cost Illinois around $300 million annually in lost revenue. This claim could not be verified.[146]

- Based on Senator Brady's estimates, the total cost in lost state revenue of his proposed tax cuts would be about $1.026 billion ($409 M + $ 288 M + $29.46 M + $300 M). This tracks Senator Brady's recent public statements claiming the total cost of his tax cuts (including those without estimate above) would be about $1 billion.[147] Although it is likely that Senator Brady's proposed tax cuts would cost more than the $1 billion amount estimated above, the analysis of his proposal in this study uses that estimate.

Moreover, as the preceding indicates, it is also highly unlikely that Brady can realize General Fund spending cuts of $5 billion in FY2011. But, given his insistence on implementing significant cuts, it is assumed Senator Brady will in fact cut General Fund spending by at least $2 billion in FY2011, the maximum cut that seems feasible based on the data. After accounting for the $1 billion in revenue lost from his proposed tax cuts, the net savings to the state's General Fund budget in FY2011 generated by Senator Brady's proposal would be $1 billion.

(ii) Does the proposal comport with the principles of sound tax policy?

No, his proposal does nothing positive to reform state tax policy. His promised repeal of the Illinois estate tax will actually make tax burden in Illinois even more regressive—that is, unfair. Senator Brady specifically repudiates making Illinois tax policy more progressive, and the gubernatorial hopeful even promises to oppose efforts to amend the Illinois Constitution to create a graduated income tax.[148] This will lock the state into having one of the most unfair tax systems for middle income and low income working families in the nation.

(iii) Will it address the structural deficit? No. In fact, as Figure 43 shows, even with the most optimistic projection of revenue growth, and even assuming Senator Brady is able to cut spending and taxes by the maximum amounts feasible, Senator Brady's proposal makes the state's General Fund deficit grow significantly over time.

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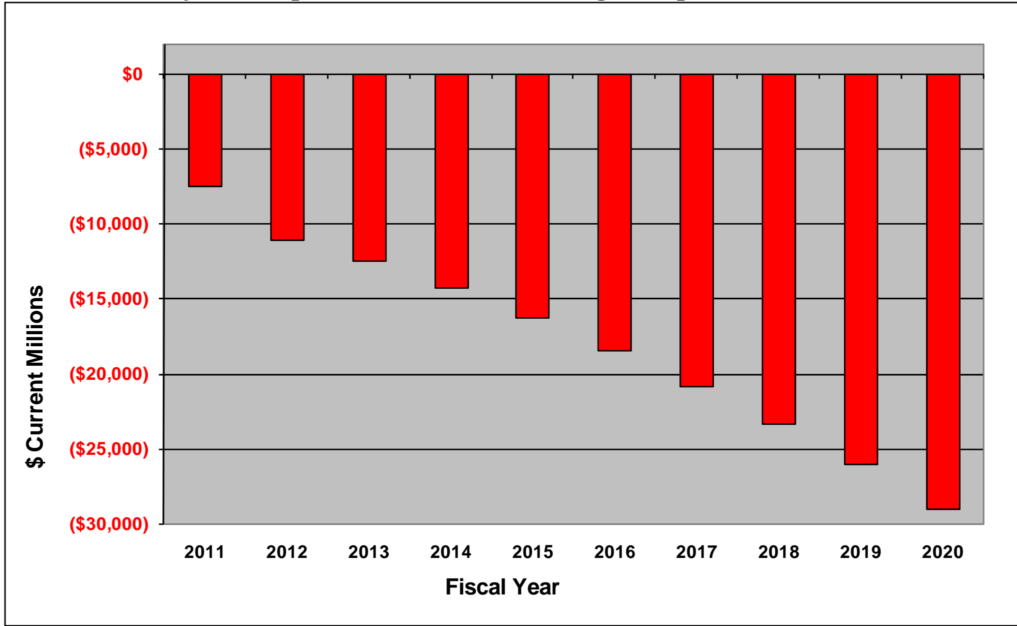
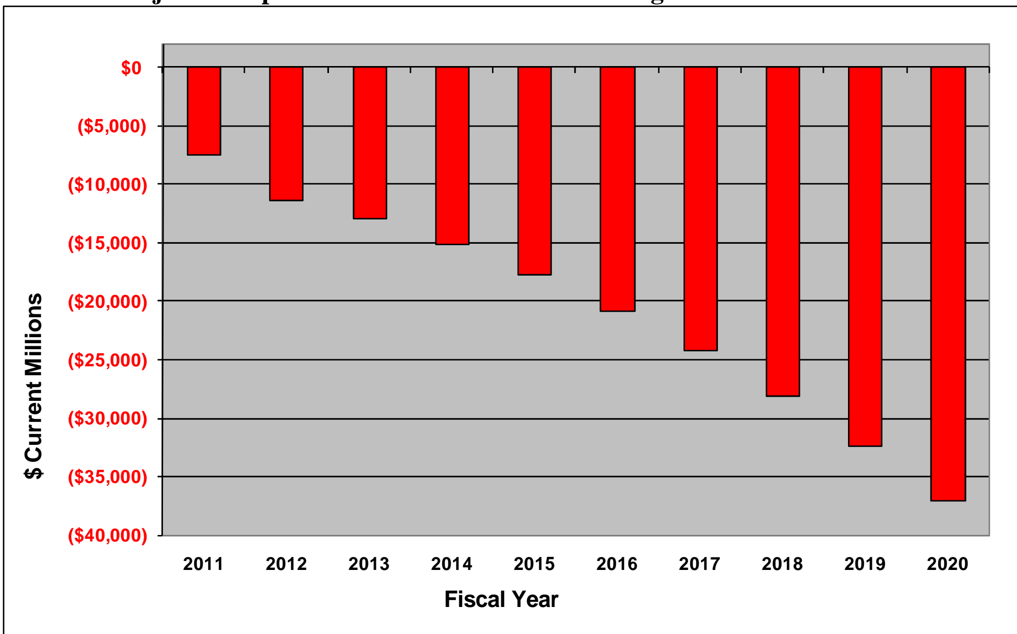
Figure 43
Senator Brady Budget Campaign Statements
Projected Impact on General Fund Budget—Optimistic Scenario



Note that Figures 43 and 44 both assume that state General Fund appropriations are cut by $2 billion from current FY2011 levels, and that taxes and fees are cut by the roughly $1 billion estimated by Senator Brady.

Figure 44
Senator Brady Budget Campaign Statements
Projected Impact on Illinois General Fund Budget—Baseline Scenario



(iv) Potential economic and other consequences.

To the extent Senator Brady's spending cuts are implemented, Illinois can anticipate significant private sector job loss, based on Mark Zandi's multipliers. If Senator Brady implements the $2 billion in General Fund spending cuts that appear feasible, Illinois stands to lose some 28,447 private sector jobs.

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Even after implementing his proposed spending cuts, the state will still have a significant deficit of over $8 billion. If the state resolves that deficit primarily with spending cuts, then the net impact of the proposal can be expected to be significant private sector job loss of anywhere from an additional 14,223 jobs (if $1 billion more is cut) to an additional 113,786 jobs if $8 billion is cut. These losses would come on top of the 28,447 jobs that can be expected to be lost from Senator Brady's $2 billion in General Fund spending cuts.

Finally, the proposal does not raise revenue: to enhance K-12 education funding to the levels recommended by EFAB; to enhance Pre-K funding; to enhance higher education funding; nor to invest in infrastructure or eliminate the deficit. In all likelihood, then, that means the long-term shift in Illinois' economy from one that creates high paying jobs to one that primarily creates low paying jobs will continue, as will the state's overreliance on property tax revenue to fund schools, which is not only inefficient and regressive from a tax policy standpoint, but creates significant educational opportunity inequities that significantly disadvantage minority, low income, middle income and downstate children.

(g) Estimate of Civic Federation Budget Proposal Impact on Illinois Deficit

(i) Short Summary. The Civic Federation has concluded that Illinois' problem with ongoing deficits cannot "be solved solely by budget cuts or tax increases."[149] The Civic Federation then goes on to identify a combination of income tax increases which are similar to those contained in HB/SB750 and the CTBA recommendations—but without any of the corresponding tax relief targeted to low and middle income families in HB/SB750 and the CTBA proposal—as well as spending cuts, it supports as a solution. These proposals are summarized below. However, The Civic Federation specifically makes its support of the tax increases it recommends contingent upon the state first enacting the General Fund spending cuts and retirement benefit cuts contained in The Civic Federation proposal.

The Civic Federation recommends that Illinois:

Tax Increases:

- Increase the personal income tax rate from 3% to 5%;
- Include all retirement income that is subject to the federal income tax in the Illinois personal income tax base;
- Increase the corporate income tax rate from 4.8% to 6.4%;
- Increase cigarette taxes by slightly more than double, from $0.98 per pack[150] to $1.98 per pack; and
- Repeal business tax deductions or credits that are outdated. The only specific credit The Civic Federation targets for elimination is the corporate income tax credit for research and development. This would save $29 million.[151]

In addition to the aforesaid specific tax increases, The Civic Federation suggests the state explore: expanding the sales tax base to include consumer services in a fashion similar to the CTBA recommendation and HB/SB750, (thereby both generating needed revenue and potentially reducing the sales tax rate in Cook County; and the merits of a constitutional amendment that would authorize a graduated personal income tax rate. The Civic Federation does not, however, recommend that those tax policy changes be implemented now.

Spending Cuts:

- The Civic Federation demands that in total, $2.5 billion in spending cuts and savings be made in the FY2011 General Fund.

- It further demands that spending cuts account for at least $2.1 billion of that $2.5 billion in savings. The Civic Federation suggests that the $2.1 billion in savings be generated by rolling back General Fund spending to FY2007 levels for all programs except Medicaid and General State Aid to elementary and secondary education. It exempts those programs from cuts to ensure no loss in federal revenue transfers.

- That effectively means that the full $2.1 billion in cuts be made primarily from rolling back General Fund Spending on higher education, human services and public safety to FY2007 levels. It should be noted that The Civic Federation proposal preceded the $1.4 billion in General Fund spending cuts Governor Quinn announced in July

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2010, so it is assumed that The Civic Federation is only demanding that an additional $700 million in spending cuts be made, to reach the $2.1 billion minimum in cuts The Civic Federation identified.

- In FY2007, the final General Fund appropriation budgeted for human services was $5.197 billion.[152] In FY2011, the current human services appropriation is just $4.929 billion[153]—which is already less than the FY2007 amount, so there are no longer any potential savings to be gained in this line item from rolling back to FY2007 levels.

- In FY2007, the final appropriation budgeted for General Fund spending on higher education was $2.154 billion,[154] compared to the $2.111 billion appropriated to higher education in the FY2011 General Fund,[155] Again, the state is already spending less in nominal dollars on higher education in FY2011 than it did back in FY2007, so there are no potential savings from rolling this line item back to FY2007 levels.

- In FY2007, the final appropriated budget for General Fund spending on public safety was $1.515 billion,[156] while in FY2011 it currently stands at $1.403 billion,[157] Again, Illinois is already spending less in nominal dollars on public safety in FY2011 than it did in FY2007.

- In fact, once K-12 education, Medicaid and pension payments are netted out of the FY2007 and FY2011 General Fund budgets, in nominal dollars the remaining FY2011 General Fund is $10.288 billion, while the remaining FY2007 General Fund was $10.185 billion. Hence, rolling all services The Civic Federation proposes be cut back to FY2007 levels would save at most $103 million. Therefore, the remaining $600 million in spending cuts The Civic Federation demands funding made in a manner that reduces service levels below FY2007 levels.

- On top of the preceding cuts, another $400 million in General Fund savings or cuts must be implemented to reach The Civic Federation's total target of $2.5 billion in savings and cuts. The Civic Federation estimates that this $400 million in savings can be reached through a combination of: requiring current public sector workers to increase the contribution that comes out of their pay to cover their retirement benefits and health insurance; and otherwise reducing retirement benefits for current and future public sector workers.

Figure 45
Estimated FY2011 Net Revenue[158]
from The Civic Federation Proposal (All Dollars in Millions)

Revenue Source/Adjustment	Revenue Impact
Increase Personal Income Tax Rate from 3% to 5% (Net of Refund Fund)	$5,806
Amount to Local Government Distributive Fund (LGDF)	(-$581)
New General Fund Revenue from Personal Income Tax Rate Increase from 3% to 5% on Existing Income Tax Base	$5,225
Add All Retirement Income Subject to the Federal Income Tax Into the State Income Tax Base, at the 5% rate (note, this is The Civic Federation's estimate and it may or may not include adjustment for the Refund Fund and/or LGDF)	$1,600
Net New Revenue from Personal Income Tax Changes	$6,825
Increase Corporate Income Tax Rate from 4.8% to 6.4% (Net of Refund Fund)	$468
Corporate Income Tax Revenue to LGDF	(-$47)
Net New Corporate Income Tax Revenue	$421
GROSS NEW REVENUE TO GENERAL FUND	$7,246

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(ii) Does the proposal comport with the principles of sound tax policy?

Yes and No. The focus on increasing Illinois' personal and corporate income tax rates is positive, since those increases at the levels recommended by The Civic Federation are essential to eliminating the structural deficit over time. Moreover, including retirement income in the personal income tax base also addresses a structural problem, helps modernize the state's tax policy, and brings some stability to revenue generation.

That said, the net impact of The Civic Federation's proposal will likely be to make overall tax policy in Illinois more regressive, that is unfair, for the following reasons: (A) there is no tax relief targeted to low and moderate income families in The Civic Federation's proposals, hence even the lowest income families will pay the marginal rate increases to the state's personal income tax; and (B) inclusion of all retirement income in the personal income tax base will be moderately regressive, and very difficult for lower, fixed income seniors.

The Civic Federation does suggest that Illinois explore amending the state constitution to permit a progressive income tax rate structure, which ultimately would be one of the most efficacious ways to make Illinois tax policy more progressive. Unfortunately, it will take years to accomplish that constitutional change, and the marginal income tax rate increases and inclusion of all retirement income in the personal income tax base will render state tax policy more regressive immediately.

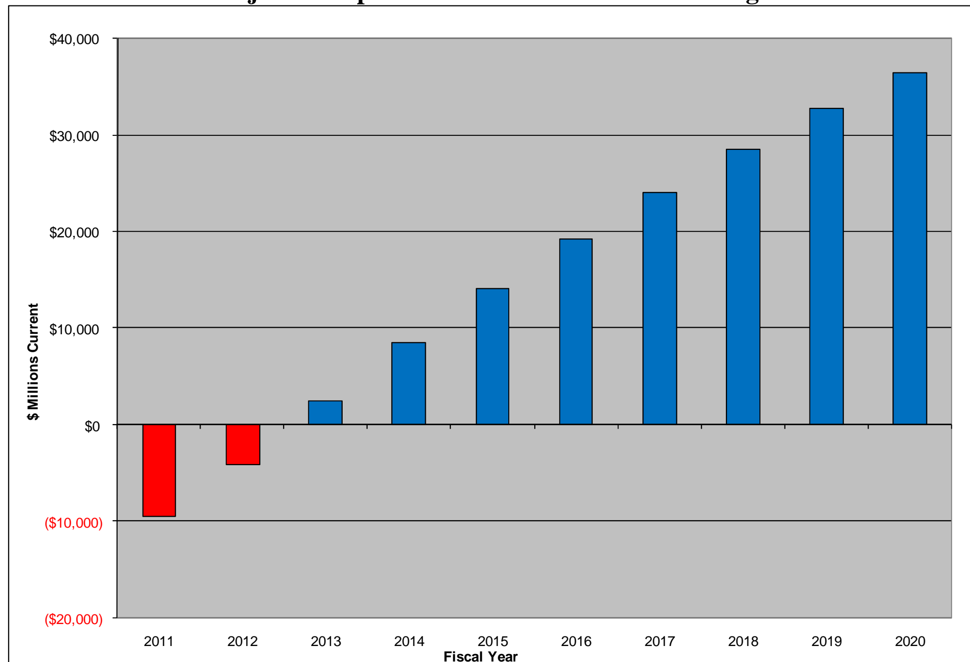
The Civic Federation's proposal does make state tax policy more stable by taxing all retirement income that the federal government taxes. But this does not have as much of a stabilizing impact as expanding the sales tax base to include consumer services, leaving Illinois revenue generation more volatile and susceptible to decline during poor economic cycles. Certainly The Civic Federation's suggestion that Illinois decision makers explore expanding the sales tax base to generate additional stability (and potentially reduce the outsized Cook County sales tax rate) is spot-on, but again implementation would be delayed if it comes at all—and The Civic Federation does not recommend the sales tax base be expanded now.

The Civic Federation proposal does not include any direct property tax relief nor any education funding reform needed to shift responsibility for school funding to the state and away from local property taxes. Hence, it can be expected that no reduction in the growth of local property tax levies will result from The Civic Federation's proposal, leaving state tax policy inefficient and education funding inequitable.

(iii) Will it address the structural deficit?

Yes. Even under the baseline scenario, the combination of tax increases and significant spending cuts recommended by The Civic Federation would eliminate the structural deficit.

Figure 46
Civic Federation Baseline Scenario
Projected Impact on Illinois General Fund Budget



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(iv) Potential economic and other consequences.

In the short-term, the $2.5 billion in FY011 spending cuts supported by The Civic Federation can be expected to cause Illinois to lose 35,558 private sector jobs, based on Mark Zandi's multipliers. The state would lose another 14,223 private sector jobs if the $1.124 billion FY2011 General Fund deficit remaining after implantation of The Civic Federation's proposals is resolved with spending cuts.

However, to the extent the net $7.246 billion in tax revenue raised under The Civic Federation's proposal is used to support General Fund spending on current services, up to 103,119 private sector jobs would be saved. It is probable that the positive private sector job multiplier generated by The Civic Federation's tax increases will be somewhat less than the multipliers developed by Mark Zandi of Moody's.com, because of the regressivity of the proposal.

Similarly, the long-term benefits of The Civic Federation's proposal can be expected to be somewhat less than under HB/SB750 or the CTBA recommendations, for two reasons: (A) the regressivity of the proposal will diminish purchasing by low to middle income earners in the state's local economies, especially if current income inequality trends continue; and (B) The Civic Federation's proposal does not reform or enhance education funding, hence the long-term benefit of comparatively higher real growth in personal income that states gain from making comparatively greater real investments in education than other states cannot be expected to materialize in Illinois.

10. *Conclusion*

To gain perspective on difficult public policy areas, like Illinois tax policy, it is frequently helpful to consider major reforms proposed in other states. In 2003, Governor Bob Riley of Alabama, a conservative Republican, advocated one of the most sweeping state tax reform initiatives in the nation. When he became governor, he looked around Alabama and found tax policy that was holding back his state and its citizens. He noted that Alabama had a regressive tax system, placing a much higher tax burden on low and moderate income families than on affluent families. Governor Riley decried the unfairness of the Alabama system as both unsound fiscal policy and immoral social policy. He also voiced strong concern over the disparity in school funding from district to district. Noting that this disparity was caused by Alabama's over-reliance on local, property taxes to fund schools, he proposed sweeping changes that would result in a fairer and more sound Alabama fiscal system, and more equitable school funding.

Now compare Illinois to Alabama. It is true that Alabama has an unfair, regressive tax system, the 10th most regressive in the nation. Illinois is worse, ranking as the 6th most regressive in America.[159] As for the school funding inequities that outraged Governor Riley, well in 2003 Alabama received a grade of "C" from Education Week in its school funding equity study, not great, but passing. Illinois is the only state that received the failing grade of "F" in 2003. Since 2003, Illinois' state-level commitment to funding education has declined. As for the capacity to reform things, Alabama has some significant constraints, ranking as the 7th poorest state in the nation according to U.S. Census data, Illinois, by the way, has the fifth largest economy and 13th greatest per capita income. If Governor Riley was so outraged in Alabama, what should we be in Illinois?

Illinois can and should do better. In spite of being one of the wealthiest states in the nation, it consistently ranks near the bottom in funding services for vulnerable populations, like individuals with mental health or developmental disability issues and funding for K-12 education. Illinois remains over-reliant on property taxes, a local revenue source, to fund education. This ties the quality of the public education delivered to a child to the affluence of the community in which the child lives. Illinois has regressive tax policy, which assesses tax burden unfairly by placing a disproportionate load on low and middle-income taxpayers. The problems with Illinois tax policy are so significant that Illinois suffers from a structural deficit.

At the end of the day, the reforms outlined in this paper would achieve a number of goals. They would: (i) make the state's overall tax policy fairer, and more responsive, stable and efficient; (ii) improve school funding equity by bringing the bottom up, not dragging the top down; (iii) shift the primary burden for school funding in Illinois from local districts to the state; (iv) be sustainable over the long term; and (v) maintain Illinois' status as an overall low-tax state.

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Appendix A

TABLE 1
SALES TAXATION OF CONSUMER SERVICES*

© 2009 The Center for Tax and Budget Accountability	U.S.	Illinois		Border State Comparisons				
	# of States Taxing	IL* 5%	IL Proposed	WI 5%	IN 6%	KY 6%	MO 4.225%	IA 5%
						"X" indicates current taxation		
STORAGE:								
Automotive storage/Fur Storage	19		X	X				X
Household goods storage	12		X					X
Marina service (docking, storage, cleaning, repair)	21		X	X			X	
SERVICES – PERSONAL SERVICES:								
Travel agent services			X					
Consumer electronics repair & maintenance	23		X	X				X
Personal & household goods repair & maintenance	23		X	X				X
Carpet and upholstery cleaning	15		X	X				X
Dating services	10		X					X
Hair, nail & skin care	6		X					X
Health clubs, tanning parlors, reducing salons	20		X	X			X	X
Laundry and dry cleaning services, non-coined operated	21		X	X				X
Consumer goods rental	45		X	X	X	X	X	X
General goods rental	45		X	X	X	X	X	X
Diet & weight reducing services			X					
Private investigation (detective) services	13		X					X
Process server fees (Bail bonding)	6		X					X
Telephone answering service	19		X	X				X
Photographic studios, portrait	N/A		X					
Linen supply	32		X	X	X	X		X
Industrial launderers	32		X	X	X	X		X
Interior design services	9		X					X
Computer systems design & related services	16		X					
Credit bureaus	14		X					
Collection agencies	9		X					
Photocopying/Printing Services	42		X	X	X	X	X	X
AUTOMOTIVE SERVICES:								
Automotive repair & maintenance	23		X	X				X
Parking lots and garages	23		X	X				X
Motor vehicle towing	15		X	X				X

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© 2009 The Center for Tax and Budget Accountability	U.S.	Illinois		Border State Comparisons				
	# of States Taxing	**IL* 5%**	**IL Proposed**	**WI 5%**	**IN 6%**	**KY 6%**	**MO 4.225%**	**IA 5%**
						"X" indicates current taxation		
ARTS, ENTERTAINMENT, RECREATION								
Pari-mutuel racing events	**28**		X	X		X	X	X
Amusement park admissions and rides	**36**		X	X		X	X	X
Bowling alleys	**28**		X	X			X	X
Cable TV services	**24**		X	X	X			X
Circuses and fairs – admission and games	**34**		X	X		X	X	X
Coin-operated video games/Pinball and other mechanical amusements	**19**		X	X			X	X
Golf courses and country clubs	**22**		X	X			X	X
Fitness and recreational sports centers	**22**		X	X			X	X
Admission to profession sports events	**35**		X	X		X	X	X
Performing arts companies	**31**		X	X		X	X	X
Miniature golf courses	**N/A**		X					
Scenic & sightseeing transportation	**N/A**		X					
LEASES AND RENTALS:								
Limousine service (with driver)	**13**		X					X
Unscheduled chartered passenger air transportation	**10**		X				X	
Motion pictures theaters (expect drive ins)	**N/A**		X					
Drive in motion picture theaters	**N/A**		X					
N/A = incomplete information								
*State tax rates reflect total state/local portions collected by state. Rates do not reflect additional local options sales taxes.								
Sources: Include Federation of Tax Administrators, and various State Department of Revenue Reports.								

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TABLE 2

Illinois General Fund Appropriations by Major Category
Adjusted for Inflation and Population Growth FY2000-FY2011

Category	FY2000 Adj to FY2011 for MWCPI and Pop Growth	FY2011 Proposed After $ 1.42 B in Cuts of July 2010	Diff FY 2011 Actual & FY2000 Adj to FY2011 for MW CPI and Pop Growth	%Change	FY2000 Adj for ECI and Pop Growth[4]	Diff FY 2011 MW - FY 2000 Adj for ECI and Pop Growth[4]	% Change
General Fund Excluding Pensions	$26,288	$24,940	($1,348)	-5.1%	$29,975	($5,035)	-16.8%
K-12	$6,347	$6,875	$528	8.3%	$7,237	($362)	-5.0%
Higher Ed	$2,819	$2,111	($708)	-25.1%	$3,215	($1,103)	-34.3%
Health Care[1]	$6,580	$7,777	$1,197	18.2%	$8,444	($667)	-7.9%
Human Services[2]	$6,025	$4,929	($1,096)	-18.2%	$6,870	($1,941)	-28.3%
Public Safety	$1,475	$1,403	($72)	-4.8%	$1,682	($278)	-16.6%

Notes: 1)DPH and HFS (Public Aid in 2000 and 2001)
2) Aging, DCFS and DHS
3) Department of Corrections and Illinois State Police
4) Employee Cost Index of total compensaion for all civilian employees.
Index value for FY 2000 has been approximated by pro-rating ECI growth from 2001 to 2002.
5) Healthcare is adjusted for Health Care Medical Care Midwest CPI (MCMWCPI)

Sources: IGPA FY 2001 and FY 2011 Budget Books (for Pension spending). Governor Quinn final FY2011 appropriations presentation June 30, 2010. MWCPI and ECI indices from BLS. Estimates for FY 2011 based on growth from FY 2009 to FY 2010. DCEO Illinois population growth estimates.

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TABLE 3

Illinois Structural Deficit Assuming FY2000-FY2008 Economic Conditions ($ millions)

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Recurring GF Own-Source and Federal Revenue	$23,250	$24,106	$23,379	$22,786	$25,428	$26,160	$27,359	$28,640	$29,659	$30,575	$31,520	$32,494
Assumed FY2000 Balanced GF Appropriation Adjusted for Inflation and Population Growth	$23,250	$24,254	$25,301	$26,375	$27,557	$28,732	$29,780	$30,982	$31,927	$33,252	$34,632	$36,070
Operating GF Deficit	$0	($148)	($1,922)	($3,589)	($2,129)	($2,572)	($2,421)	($2,342)	($2,268)	($2,676)	($3,112)	($3,576)

Notes:
1) GRF Revenues for FY2000 to FY2008 from CGFA FY2010 Budget Sumary P. 62.
2) Revenue for FY2009 to FY 2011 is projected based on average FY 2000 to FY 2008 revenue growth rate of 3.09%.
3) FY2000 Appropriation is set to equal to FY2000 revenue.
4) FY2001 to FY2008 Appropriations are FY2000 level adjusted for annual ECI and population growth.
5) FY2009 to FY 2011 GRF Appropriations are projections based on average ECI FY2000 to FY 2008 growth of 3.47% from the BLS and annual population growth of 0.65% from IL DCEO.
6) ECI values for FY 2000 are estimated using 2002 over 2001 quarter over quarter ECI growth rates.

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TABLE 4

Illinois Own Source Revenue as a Percent of GDP and Personal Income (millions of current dollars)

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average
GDP	$453,973	$470,328	$481,795	$498,713	$522,363	$543,693	$570,910	$625,553	$625,553				
Personal Income	$391,607	$413,308	$417,941	$428,639	$444,653	$464,099	$487,968	$518,871	$542,500	$540,053	$535,333		
Total Own-Source General Fund Revenue	$19,359	$19,786	$19,121	$18,846	$20,239	$23,257	$22,634	$23,937	$24,844	$22,577	$21,178	$21,262	
Year over Year Own-Source Revenue Growth Rate		2.21%	-3.36%	-1.44%	7.39%	14.91%	-2.68%	5.76%	3.79%	-9.12%	-6.20%	0.40%	0.86%
Own Source Revenue Percent of GDP	4.26%	4.21%	3.97%	3.78%	3.87%	4.28%	3.96%	3.83%	3.97%				4.01%
Own Source Revenue Percent of Personal Income	5.17%	4.99%	4.78%	4.61%	4.87%	4.90%	4.90%	4.88%	4.58%	4.18%			4.79%
Federal Revenue	$3,891	$4,320	$4,258	$3,940	$5,189	$4,691	$4,725	$4,703	$4,815	$6,567	$5,920	$5,850	
Year over Year Federal Revenue Growth Rate		11.03%	-1.44%	-7.47%	31.70%	-9.60%	0.72%	-0.47%	2.38%	36.39%	-9.85%	-1.18%	3.78%

Notes:
1) Fiscal Year Illinois GDP data estimated as average of consecutive calander year BEA Illinois GDP data.
2) Fiscal Year 2000 to 2010 Illinois Personal income data calculated by summing relevant quarterly BEA Illinois Personal Income data.
3) Fiscal Year 2010 Personal income estimated as average of annualized 2009 Q3 to 2010 Q1 data.
4) FY 2000 to FY 2010 Illinois Own Source Revenue (net of Refund Fund) and Federal Revenue from CGFA FY 2011 Budget Summary and March 16, 2010 FY 2011 Revenue Estimate.
5) FY 2011 Illinois Federal Revenue as estimated in "CTBA FY2011 Deficit Fact Sheet".
6) Averge 0wn-Source and Federal Revenue growth rates are geometric averages that take compounded growth into account.

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TABLE 5

Impact of Baseline Revenue Growth on the Current Fund Deficit, Holding Spending Constant in Real Terms

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Federal Sources	$5,850	$6,071	$6,301	$6,539	$6,786	$7,042	$7,309	$7,585	$7,872	$8,169
Total Revenue	$27,112	$27,546	$27,990	$28,445	$28,911	$29,389	$29,879	$30,381	$30,895	$31,423
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,356	$28,019	$28,698	$29,393	$30,105	$30,834
Pension Ramp Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,186	$34,108	$35,060	$36,041	$37,053	$38,105
Current Operating Deficit from Baseline Revenue Growth	($1,890)	($2,488)	($3,079)	($3,682)	($4,275)	($4,719)	($5,182)	($5,660)	($6,158)	($6,682)
Carry Over Accumulated Deficit	($7,581)	($12,471)	($14,959)	($18,038)	($21,721)	($25,997)	($30,717)	($35,900)	($41,562)	($47,722)
Total Deficit	($9,471)	($14,959)	($18,038)	($21,721)	($25,997)	($30,717)	($35,900)	($41,562)	($47,722)	($54,406)

Notes:

1) Current Operating Deficit is Total Revenue from previous figure minus Total Appropriations in this figure. FY 2012 Carry over accumulated deficit is FY 2011 Operating Deficit. See CTBA updated FY 2011 Operating and Total Deficit Fact Sheet.

2) Future ECI growth estimated as FY2010 over FY2009 ECI growth of 1.6% (pro-rating seasonalized 2010Q2/2009Q2 growth as equal to 2010Q1/2009Q1 growth rate). Data is from BLS, this is a very slow rate of ECI growth appropriate to a slowly growing or stagnant economy.

3) Future Illinois population growth from Illiniois DCEO population forecast for 2015 and 2020 averaged to annualized growth rates of 0.70% until 2015 and 0.81% from 2015 to 2020.

4) FY 2012 to Fy 2020 Appropriations are FY 2011 Appropriation adjusted by multiplying estimated future ECI by estimated future population growth rate.

5) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.

6) Pension Debt Service from CGFA, June 30, 2009, "Report on Financial Condition of the State Retirement Systems," Appendix N, p. 100.

7) FY2011 Own Source and Federal Revenue from previous Figure.

8) Own-source revenue assumed to grow at 1% per year.

9) Federal Revenue assumed to grow at FY2000 to FY 2011 average of 3.78% per year.

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TABLE 6

Impact of Optimistic Revenue Growth on the Current Fund Deficit, Holding Spending Constant in Real Terms

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,071	$6,301	$6,539	$6,786	$7,042	$7,309	$7,585	$7,872	$8,169
Total Revenue	$27,112	$27,758	$28,422	$29,102	$29,801	$30,517	$31,253	$32,008	$32,783	$33,579
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,356	$28,019	$28,698	$29,393	$30,105	$30,834
Pension Ramp Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,186	$34,108	$35,060	$36,041	$37,053	$38,105
Current Operating Deficit from Baseline Revenue Growth	($1,890)	($2,275)	($2,647)	($3,025)	($3,386)	($3,590)	($3,807)	($4,033)	($4,270)	($4,526)
Carry Over Accumulated Deficit	($7,581)	($12,471)	($14,747)	($17,394)	($20,420)	($23,807)	($27,398)	($31,207)	($35,241)	($39,513)
Total Deficit	($9,471)	($14,747)	($17,394)	($20,420)	($23,807)	($27,398)	($31,207)	($35,241)	($39,513)	($44,041)

Notes:

1) Current Operating Deficit is Total Revenue from previous figure minus Total Appropriations in this figure. FY 2012 Carry over accumulated deficit is FY 2011 Operating Deficit. See CTBA updated FY 2011 Operating and Total Deficit Fact Sheet.

2) Future ECI growth estimated as FY2010 over FY2009 ECI growth of 1.6% (pro-rating seasonalized 2010Q2/2009Q2 growth as equal to 2010Q1/2009Q1 growth rate). Data is from BLS, this is a very slow rate of ECI growth appropriate to a slowly growing or stagnant economy.

3) Future Illinois population growth from Illiniois DCEO population forecast for 2015 and 2020 averaged to annualized growth rates of 0.70% until 2015 and 0.81% from 2015 to 2020.

4) FY 2012 to Fy 2020 Appropriations are FY 2011 Appropriation adjusted by multiplying estimated future ECI by estimated future population growth rate.

5) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.

6) Pension Debt Service from CGFA, June 30, 2009, "Report on Financial Condition of the State Retirement Systems," Appendix N, p. 100.

7) FY2011 Own Source and Federal Revenue from previous Figure.

8) Own-source revenue assumed to grow at 2% per year.

9) Federal Revenue assumed to grow at FY2000 to FY 2011 average of 3.78% per year.

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TABLE 7

CTBA Plan Baseline Scenario Projected Illinois Budget Deficit

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Federal Sources	$5,850	$6,071	$6,300	$6,538	$6,785	$7,041	$7,307	$7,583	$7,870	$8,167
Total Revenue Without CTBA Plan	$27,112	$27,546	$27,990	$28,444	$28,910	$29,388	$29,877	$30,379	$30,893	$31,421
Additional Non Sales and Non Retirement Tax Revenue from CTBA Plan	$4,510	$4,555	$4,601	$4,647	$4,693	$4,740	$4,787	$4,835	$4,884	$4,933
Sales Tax revenue from CTBA Plan	$2,400	$2,436	$2,473	$2,510	$2,547	$2,585	$2,624	$2,664	$2,704	$2,744
Income from 5% Tax of Retirement income of filers with over $ 50,000 overall AGI	$905	$914	$923	$932	$942	$951	$961	$970	$980	$990
Dedicated increase in P-12 Education Funding		$700	$1,400	$2,100	$2,800	$2,846	$2,893	$2,940	$2,988	$3,037
Dedicated increase in Higher Education Funding		$300	$305	$310	$315	$320	$325	$331	$336	$342
Net increase in Undedicated GF Revenue from CTBA Plan	$7,815	$6,905	$6,291	$5,679	$5,067	$5,111	$5,154	$5,198	$5,243	$5,287
Total Undedicated Revenue With CTBA Plan	$34,927	$34,451	$34,281	$34,123	$33,978	$34,498	$35,032	$35,577	$36,136	$36,708
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$5,925	$4,417	$3,212	$1,996	$779	$366	($66)	($515)	($983)	($1,478)
Carry Over Accumulated Deficit	($9,471)	($4,656)	($239)	$2,973	$4,969	$5,748	$6,114	$6,048	$5,533	$4,550
Total Surplus/Deficit	($1,656)	($239)	$2,973	$4,969	$5,748	$6,114	$6,048	$5,533	$4,550	$3,072

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Income from taxing retirement income for retirees with over $ 50,000 AGI in FY 2008 is estimated by taking the ratio of this value in FY 2008 ($ 1.294 B) to FY 2008 total own own source revenue ($ 24.846 B from FY 2011 State Budget book) times own source revenue in respective fiscal year and multiplying by 0.9 for LGDF and than 0.908 for Refund Fund.
3) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
4) FY 2011 CTBA plan estimate is CTBA estimate based on CGFA FY 2011 revenue estimate in March 16, 2010 briefing.
5) FY2011 Deficit is CTBA estimated FY 2011 defcit minus additional FY 2011 non-dedicated revenue raised by CTBA plan.
6) Fy 2012 Deficit includes $ 3.0 B non-recurring revenure gap from Fy 2011.
7) From FY 2012 to FY 2020 own-source revenue exclusive of SB 750 sales tax revenue is assumed to grow at 1.0% per annum and SB 750 sales tax revenue is assumed to grow at 1.5% per annum.
8) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.
9) Estimates of SB 750 education dedicated funding are from "SB 750 (Meeks): Summary Proposed Senate Amendment #1" at:http://66.100.112.6/Government_affairs/Key_legislation/documents/SenateBill750-Summary-4-10-09.doc

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TABLE 8

CTBA Plan Optimisitc Scenario Projected Illinois Budget Deficit

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,071	$6,300	$6,538	$6,785	$7,041	$7,307	$7,583	$7,870	$8,167
Total Revenue Without CTBA Plan	$27,112	$27,758	$28,421	$29,102	$29,800	$30,516	$31,252	$32,007	$32,781	$33,577
Additional Non Sales and Non Retirement Tax Revenue from CTBA Plan	$4,510	$4,600	$4,692	$4,786	$4,882	$4,979	$5,079	$5,181	$5,284	$5,390
Sales Tax revenue from CTBA Plan	$2,400	$2,472	$2,546	$2,623	$2,701	$2,782	$2,866	$2,952	$3,040	$3,131
Income from 5% Tax of Retirement income of filers with over $ 50,000 overall AGI	$905	$923	$942	$960	$980	$999	$1,019	$1,040	$1,060	$1,082
Dedicated increase in P-12 Education Funding		$700	$1,400	$2,100	$2,800	$2,846	$2,893	$2,940	$2,988	$3,037
Dedicated increase in Higher Education Funding		$300	$305	$310	$315	$320	$325	$331	$336	$342
Net increase in Undedicated GF Revenue from CTBA Plan	$7,815	$6,995	$6,475	$5,959	$5,448	$5,595	$5,746	$5,901	$6,060	$6,224
Total Undedicated Revenue With CTBA Plan	$34,927	$34,753	$34,896	$35,061	$35,247	$36,111	$36,997	$37,907	$38,842	$39,801
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$5,925	$4,720	$3,828	$2,933	$2,049	$1,979	$1,900	$1,815	$1,723	$1,615
Carry Over Accumulated Deficit	($9,471)	($4,656)	$64	$3,891	$6,824	$8,873	$10,852	$12,752	$14,567	$16,290
Total Surplus/Deficit	($1,656)	$64	$3,891	$6,824	$8,873	$10,852	$12,752	$14,567	$16,290	$17,904

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Income from taxing retirement income for retirees with over $ 50,000 AGI in FY 2008 is estimated by taking the ratio of this value in FY 2008 ($ 1.294 B) to FY 2008 total own own source revenue ($ 24.846 B from FY 2011 State Budget book) times own source revenue in respective fiscal year and multiplying by 0.9 for LGDF and than 0.908 for Refund Fund.
3) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
4) FY 2011 CTBA plan estimate is CTBA estimate based on CGFA FY 2011 revenue estimate in March 16, 2010 briefing.
5) FY2011 Deficit is CTBA estimated FY 2011 defcit minus additional FY 2011 non-dedicated revenue raised by CTBA plan.
6) Fy 2012 Deficit includes $ 3.0 B non-recurring revenure gap from Fy 2011.
7) From FY 2012 to FY 2020 own-source revenue exclusive of SB 750 sales tax revenue is assumed to grow at 2.0% per annum and SB 750 sales tax revenue is assumed to grow at 3.0% per annum.
8) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.
9) Estimates of SB 750 education dedicated funding are from "SB 750 (Meeks): Summary Proposed Senate Amendment #1" at:http://66.100.112.6/Government_affairs/Key_legislation/documents/SenateBill750-Summary-4-10-09.doc

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TABLE 9

SB750 Plan Baseline Scenario Projected Illinois Budget Deficit										
Fiscal Year	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Total Own-Source General Fund Revenue	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Federal Sources	$5,850	$6,071	$6,300	$6,538	$6,785	$7,041	$7,307	$7,583	$7,870	$8,167
Total Revenue Without SB750	$27,112	$27,546	$27,990	$28,444	$28,910	$29,388	$29,877	$30,379	$30,893	$31,421
Additional Non Sales and Non Retirement Tax Revenue from SB750	$4,510	$4,555	$4,601	$4,647	$4,693	$4,740	$4,787	$4,835	$4,884	$4,933
Sales Tax revenue from SB750	$2,400	$2,436	$2,473	$2,510	$2,547	$2,585	$2,624	$2,664	$2,704	$2,744
Dedicated increase in P-12 Education Funding		$700	$1,400	$2,100	$2,800	$2,846	$2,893	$2,940	$2,988	$3,037
Dedicated increase in Higher Education Funding		$300	$305	$310	$315	$320	$325	$331	$336	$342
Net Increase in Undedicated GF Revenue from SB750	$6,910	$5,991	$5,368	$4,746	$4,125	$4,159	$4,194	$4,228	$4,263	$4,297
Total Undedicated Revenue With SB750	$34,022	$33,537	$33,358	$33,191	$33,036	$33,547	$34,071	$34,607	$35,156	$35,718
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$5,020	$3,503	$2,289	$1,063	($163)	($585)	($1,027)	($1,485)	($1,963)	($2,468)
Carry Over Accumulated Deficit	($9,471)	($5,561)	($2,058)	$231	$1,294	$1,132	$547	($480)	($1,965)	($3,928)
Total Surplus/Deficit	($2,561)	($2,058)	$231	$1,294	$1,132	$547	($480)	($1,965)	($3,928)	($6,396)

Notes:

1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 SB 750 estimate is CTBA estimate based on CGFA FY 2011 revenue estimate in March 16, 2010 briefing.
4) FY2011 Deficit is CTBA estimated FY 2011 defcit minus additional FY 2011 non-dedicated revenue raised by SB 750.
5) Fy 2012 Deficit includes $ 3.0 B non-recurring revenure gap from Fy 2011.
6) From FY 2012 to FY 2020 own-source revenue exclusive of SB 750 sales tax revenue is assumed to grow at 1.0% per annum and SB 750 sales tax revenue is assumed to grow at 1.5% per annum.
7) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.
8) Estimates of SB 750 education dedicated funding are from "SB 750 (Meeks): Summary Proposed Senate Amendment #1" at:http://66.100.112.6/Government_affairs/Key_legislation/documents/SenateBill750-Summary-4-10-09.doc

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TABLE 10

SB750 Plan Optimistic Scenario Projected Illinois Budget Deficit										
Fiscal Year	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,071	$6,300	$6,538	$6,785	$7,041	$7,307	$7,583	$7,870	$8,167
Total Revenue Without SB750	$27,112	$27,758	$28,421	$29,102	$29,800	$30,516	$31,252	$32,007	$32,781	$33,577
Additional Non Sales and Non Retirement Tax Revenue from SB750	$4,510	$4,600	$4,692	$4,786	$4,882	$4,979	$5,079	$5,181	$5,284	$5,390
Sales Tax revenue from SB750	$2,400	$2,472	$2,546	$2,623	$2,701	$2,782	$2,866	$2,952	$3,040	$3,131
Dedicated increase in P-12 Education Funding		$700	$1,400	$2,100	$2,800	$2,846	$2,893	$2,940	$2,988	$3,037
Dedicated increase in Higher Education Funding		$300	$305	$310	$315	$320	$325	$331	$336	$342
Net Increase in Undedicated GF Revenue from SB750	$6,910	$6,072	$5,533	$4,999	$4,468	$4,596	$4,727	$4,861	$5,000	$5,142
Total Undedicated Revenue With SB750	$34,022	$33,830	$33,955	$34,100	$34,268	$35,112	$35,978	$36,868	$37,781	$38,719
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$5,020	$3,797	$2,886	$1,973	$1,069	$979	$880	$776	$662	$533
Carry Over Accumulated Deficit	($9,471)	($5,561)	($1,764)	$1,122	$3,094	$4,164	$5,143	$6,024	$6,799	$7,462
Total Surplus/Deficit	($2,561)	($1,764)	$1,122	$3,094	$4,164	$5,143	$6,024	$6,799	$7,462	$7,995

Notes:

1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 SB 750 estimate is CTBA estimate based on CGFA FY 2011 revenue estimate in March 16, 2010 briefing.
4) FY2011 Deficit is CTBA estimated FY 2011 defcit minus additional FY 2011 non-dedicated revenue raised by SB 750.
5) Fy 2012 Deficit includes $ 3.0 B non-recurring revenure gap from Fy 2011.
6) From FY 2012 to FY 2020 own-source revenue exclusive of SB 750 sales tax revenue is assumed to grow at 2.0% per annum and SB 750 sales tax revenue is assumed to grow at 3.0% per annum.
7) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.
8) Estimates of SB 750 education dedicated funding are from "SB 750 (Meeks): Summary Proposed Senate Amendment #1" at:http://66.100.112.6/Government_affairs/Key_legislation/documents/SenateBill750-Summary-4-10-09.doc

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TABLE 11

SB750 Plan Baseline Scenario Projected Illinois Budget Deficit

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Federal Sources	$5,850	$6,071	$6,300	$6,538	$6,785	$7,041	$7,307	$7,583	$7,870	$8,167
Total Revenue Without SB750	$27,112	$27,546	$27,990	$28,444	$28,910	$29,388	$29,877	$30,379	$30,893	$31,421
Additional Non Sales and Non Retirement Tax Revenue from SB750	$4,510	$4,555	$4,601	$4,647	$4,693	$4,740	$4,787	$4,835	$4,884	$4,933
Sales Tax revenue from SB750	$2,400	$2,436	$2,473	$2,510	$2,547	$2,585	$2,624	$2,664	$2,704	$2,744
Dedicated increase in P-12 Education Funding		$700	$1,400	$2,100	$2,800	$2,846	$2,893	$2,940	$2,988	$3,037
Dedicated increase in Higher Education Funding		$300	$305	$310	$315	$320	$325	$331	$336	$342
Net Increase in Undedicated GF Revenue from SB750	$6,910	$5,991	$5,368	$4,746	$4,125	$4,159	$4,194	$4,228	$4,263	$4,297
Total Undedicated Revenue With SB750	$34,022	$33,537	$33,358	$33,191	$33,036	$33,547	$34,071	$34,607	$35,156	$35,718
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$5,020	$3,503	$2,289	$1,063	($163)	($585)	($1,027)	($1,485)	($1,963)	($2,468)
Carry Over Accumulated Deficit	($9,471)	($5,561)	($2,058)	$231	$1,294	$1,132	$547	($480)	($1,965)	($3,928)
Total Surplus/Deficit	($2,561)	($2,058)	$231	$1,294	$1,132	$547	($480)	($1,965)	($3,928)	($6,396)

Notes:

1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 SB 750 estimate is CTBA estimate based on CGFA FY 2011 revenue estimate in March 16, 2010 briefing.
4) FY2011 Deficit is CTBA estimated FY 2011 defcit minus additional FY 2011 non-dedicated revenue raised by SB 750.
5) Fy 2012 Deficit includes $ 3.0 B non-recurring revenue gap from Fy 2011.
6) From FY 2012 to FY 2020 own-source revenue exclusive of SB 750 sales tax revenue is assumed to grow at 1.0% per annum and SB 750 sales tax revenue is assumed to grow at 1.5% per annum.
7) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.
8) Estimates of SB 750 education dedicated funding are from "SB 750 (Meeks): Summary Proposed Senate Amendment #1" at:http://66.100.112.6/Government_affairs/Key_legislation/documents/SenateBill750-Summary-4-10-09.doc

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TABLE 12

HB 174 Optimistic Scenario Projected Illinois Budget Deficit										
Fiscal Year	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Total Revenue Without HB 174	$27,112	$27,775	$28,456	$29,156	$29,876	$30,615	$31,375	$32,156	$32,959	$33,784
Additional Revenue from HB 174	$4,339	$4,172	$4,255	$4,340	$4,427	$4,516	$4,606	$4,698	$4,792	$4,888
Dedicated increase in P-12 Education Funding	$0	$1,391	$1,418	$1,447	$1,476	$1,505	$1,535	$1,566	$1,597	$1,629
Dedicated increase in Higher Education Funding	$0	$695	$709	$723	$738	$753	$768	$783	$799	$815
Net Increase in Undedicated GF Revenue from SB750	$4,339	$2,086	$2,128	$2,170	$2,214	$2,258	$2,303	$2,349	$2,396	$2,444
Total Undedicated Revenue With HB 174	$31,451	$29,861	$30,584	$31,327	$32,089	$32,873	$33,678	$34,505	$35,355	$36,228
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$2,449	($173)	($485)	($801)	($1,109)	($1,259)	($1,420)	($1,587)	($1,764)	($1,958)
Accumulated Surplus/Deficit (Including Current and Prior Years)	($9,471)	($8,132)	($8,305)	($8,789)	($9,590)	($10,699)	($11,959)	($13,379)	($14,966)	($16,730)
Total Surplus/Deficit	($5,132)	($8,305)	($8,789)	($9,590)	($10,699)	($11,959)	($13,379)	($14,966)	($16,730)	($18,688)

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 HB 174 estimate is CTBA estimate based on CGFA FY 2011 revenue estimate in March 16, 2010 briefing.
4) FY2011 Deficit is CTBA estimated FY 2011 defcit minus additional FY 2011 non-dedicated revenue raised by HB 174.
5) Fy 2012 Deficit includes $ 3.0 B non-recurring revenue gap from Fy 2011.
6) From FY 2012 to FY 2020 own-source revenue exclusive of HB 174 revenue is assumed to grow at 1.0% per annum and
7) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.

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TABLE 13

Quinn 1% for Education Baseline Scenario Projected Illinois Budget Deficit										
Fiscal Year	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Own-Source General Fund Revenue Before Quinn 1% for Education	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Additional General Revenue from Quinn 1% for Education	$2,877	$2,906	$2,935	$2,964	$2,994	$3,024	$3,054	$3,085	$3,115	$3,147
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Total Revenue after Quinn 1% for Education	$29,989	$30,468	$30,960	$31,463	$31,980	$32,510	$33,054	$33,613	$34,186	$34,775
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$987	$435	($109)	($664)	($1,218)	($1,622)	($2,043)	($2,479)	($2,933)	($3,411)
Accumulated Surplus/Deficit (Including Current and Prior Years)	($9,471)	($9,594)	($9,159)	($9,268)	($9,933)	($11,151)	($12,773)	($14,816)	($17,296)	($20,228)
Total Surplus/Deficit	($6,594)	($9,159)	($9,268)	($9,933)	($11,151)	($12,773)	($14,816)	($17,296)	($20,228)	($23,640)

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 estimate of increased revenue from Quinn 1% for Education based on CTBA estimates from CGFA March 16, 2010 FY 2011 Revenue estimate.
FY 2011 estimate is CTBA FY 2011 deficit minus additional revenue raised by Quinn 1% for Education.
4) FY 2012 to FY 2020 Quinn 1% for Education revenue estimate is the ratio of FY 2011 Quinn 1% estimate divided by FY 2011
Own Source Revenue, times FY 2012 to FY 2020 own source revenues. $ 3.0 B in non-recurring revenue from FY 2011 is added to FY 2012 deficit.
5) From FY 2013 to FY 2020 own-source revenue including HB 174 is assumed to grow at 1.0% per annum. recurring revenue from FY 2011 is added to FY 2012 deficit.
6) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.

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TABLE 14

Quinn 1% for Education Optimistic Scenario Projected Illinois Budget Deficit

Fiscal Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Own-Source General Fund Revenue Before Quinn 1% for Education	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Additional General Revenue from Quinn 1% for Education	$2,877	$2,935	$2,993	$3,053	$3,114	$3,176	$3,240	$3,305	$3,371	$3,438
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Total Revenue after Quinn 1% for Education	$29,989	$30,710	$31,450	$32,210	$32,990	$33,791	$34,615	$35,461	$36,330	$37,222
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$25,526	$26,126	$26,740	$27,368	$28,044	$28,736	$29,444	$30,171	$30,915
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$29,002	$30,034	$31,069	$32,128	$33,198	$34,132	$35,098	$36,092	$37,119	$38,186
Current Operating Surplus/Deficit	$987	$676	$381	$82	($209)	($341)	($483)	($632)	($789)	($963)
Accumulated Surplus/Deficit (Including Current and Prior Years)	($9,471)	($9,594)	($8,918)	($8,537)	($8,455)	($8,664)	($9,004)	($9,488)	($10,119)	($10,908)
Total Surplus/Deficit	($6,594)	($8,918)	($8,537)	($8,455)	($8,664)	($9,004)	($9,488)	($10,119)	($10,908)	($11,872)

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 estimate of increased revenue from Quinn 1% for Education based on CTBA estimates from CGFA March 16, 2010 FY 2011 Revenue estimate.
FY 2011 estimate is CTBA FY 2011 deficit minus additional revenue raised by Quinn 1% for Education.
4) FY 2012 to FY 2020 Quinn 1% for Education revenue estimate is the ratio of FY 2011 Quinn 1% estimate divided by FY 2011
Own Source Revenue, times FY 2012 to FY 2020 own source revenues. $ 3.0 B in non-recurring revenue from FY 2011 is added to FY 2012 deficit.
5) From FY 2013 to FY 2020 own-source revenue including HB 174 is assumed to grow at 2.0% per annum. recurring revenue from FY 2011 is added to FY 2012 deficit.
6) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.

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TABLE 15

Brady Budget Baseline Scenario Projected Illinois Budget Deficit

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue Before Brady Tax Cuts	$21,262	$21,475	$20,478	$20,682	$20,889	$21,098	$21,309	$21,522	$21,737	$21,955
Brady Tax Cuts		($997)								
Total Own-Source General Fund Revenue After Brady Tax Cuts	$21,262	$20,478	$20,478	$20,682	$20,889	$21,098	$21,309	$21,522	$21,737	$21,955
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Total Revenue After Brady Tax Cuts	$27,112	$26,565	$26,813	$27,275	$27,750	$28,238	$28,739	$29,255	$29,784	$30,329
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$22,940	$23,479	$24,031	$24,596	$25,202	$25,824	$26,461	$27,114	$27,783
Brady 10% Cut in Appropriations Excluding Pensions	($2,000)									
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$27,002	$27,448	$28,422	$29,418	$30,426	$31,291	$32,187	$33,109	$34,062	$35,054
Current Operating Surplus/Deficit	$110	($882)	($1,609)	($2,143)	($2,675)	($3,053)	($3,447)	($3,854)	($4,278)	($4,725)
Accumulated Surplus/Deficit (Including Current and Prior Years)	($9,471)	($10,471)	($11,353)	($12,962)	($15,105)	($17,780)	($20,833)	($24,280)	($28,135)	($32,413)
Total Surplus/Deficit	($7,471)	($11,353)	($12,962)	($15,105)	($17,780)	($20,833)	($24,280)	($28,135)	($32,413)	($37,138)

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 estimate of Brady cuts and tax increases based on Brady Campagin statements - see text.
FY 2011 Total Deficit based on CTBA estimate of $ 9.4 B FY 2011 deficit minus CTBA estimate of Brady GF cuts of $ 2.0 B.
FY 2012 Total Deficit includes an additional $ 3.0 B in non-recurring revenue carried over from FY 2011.
4) From FY 2013 to FY 2020 own-source revenue is assumed to grow at 1.0% per annum.
5) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.

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TABLE 16

Brady Budget Optimistc Scenario Projected Illinois Budget Deficit

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue Before Brady Tax Cuts	$21,262	$21,687	$20,690	$21,104	$21,526	$21,957	$22,396	$22,844	$23,301	$23,767
Brady Tax Cuts		($997)								
Total Own-Source General Fund Revenue After Brady Tax Cuts	$21,262	$20,690	$20,690	$21,104	$21,526	$21,957	$22,396	$22,844	$23,301	$23,767
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Total Revenue After Brady Tax Cuts	$27,112	$26,778	$27,026	$27,697	$28,387	$29,097	$29,826	$30,576	$31,347	$32,141
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$22,940	$23,479	$24,031	$24,596	$25,202	$25,824	$26,461	$27,114	$27,783
Brady 10% Cut in Appropriations Excluding Pensions	($2,000)									
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$27,002	$27,448	$28,422	$29,418	$30,426	$31,291	$32,187	$33,109	$34,062	$35,054
Current Operating Surplus/Deficit	$110	($669)	($1,396)	($1,721)	($2,038)	($2,194)	($2,360)	($2,533)	($2,715)	($2,913)
Accumulated Surplus/Deficit (Including Current and Prior Years)	($9,471)	($10,471)	($11,140)	($12,537)	($14,258)	($16,296)	($18,491)	($20,851)	($23,384)	($26,099)
Total Surplus/Deficit	($7,471)	($11,140)	($12,537)	($14,258)	($16,296)	($18,491)	($20,851)	($23,384)	($26,099)	($29,012)

Notes:
1) General Fund Revenue and Appropriations from prior Figure on Baseline Revenue and Appriations projection.
2) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
3) FY 2011 estimate of Brady cuts and tax increases based on Brady Campagin statements - see text.
FY 2011 Total Deficit based on CTBA estimate of $ 9.4 B FY 2011 deficit minus CTBA estimate of Brady GF cuts of $ 2.0 B.
FY 2012 Total Deficit includes an additional $ 3.0 B in non-recurring revenue carried over from FY 2011.
4) From FY 2013 to FY 2020 own-source revenue is assumed to grow at 1.0% per annum.
5) Total Surplus/Deficit assumes all surplus is used for paying down accumulated deficit. FY 2011 defict includes $ 3.52 B pension payment that has not been made.

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TABLE 17

Civic Federation Baseline Scenario Projected Illinois Budget Deficit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,475	$21,689	$21,906	$22,125	$22,347	$22,570	$22,796	$23,024	$23,254
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Civic Federation Personal and Corporate Income Tax Revenue Increase	$5,646	$5,702	$5,759	$5,817	$5,875	$5,934	$5,993	$6,053	$6,114	$6,175
Civic Federation Increase from Taxing Retirement Income	$1,600	$1,616	$1,632	$1,648	$1,665	$1,682	$1,698	$1,715	$1,733	$1,750
Civic Federation Total New Tax Revenue	$7,246	$7,318	$7,392	$7,466	$7,540	$7,616	$7,692	$7,769	$7,846	$7,925
Total Revenue Including Federal Sources	$34,358	$34,881	$35,416	$35,965	$36,527	$37,102	$37,692	$38,297	$38,917	$39,553
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$23,840	$24,400	$24,974	$25,561	$26,191	$26,837	$27,500	$28,178	$28,873
Civic Federation Cut in Appropriations	($1,100)									
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations	$27,902	$28,348	$29,343	$30,361	$31,391	$32,280	$33,200	$34,147	$35,126	$36,144
Current Operating Surplus/Deficit	$6,456	$6,533	$6,074	$5,604	$5,136	$4,822	$4,492	$4,150	$3,791	$3,409
Carry Over Accumulated Deficit	($9,471)	($4,125)	$2,408	$8,482	$14,086	$19,222	$24,044	$28,536	$32,686	$36,477
Total Surplus/Deficit	($1,125)	$2,408	$8,482	$14,086	$19,222	$24,044	$28,536	$32,686	$36,477	$39,886

Notes:
1) Own-source and Federal Sources General Fund Revenue from prior Figures.
2) Future ECI growth estimated as FY2010 over FY2009 ECI growth of 1.6% (pro-rating seasonalized 2010Q2/2009Q2 growth as equal to 2010Q1/2009Q1 growth rate). Data is from BLS, this is slow rate of ECI growth appropriate to a slowly growing or stagnant economy.
3) Future Illinois population growth from Illiniois DCEO population forecast for 2015 and 2020 averaged to annualized growth rates of 0.70% until 2015 and 0.81% from 2015 to 2020.
4) FY2012-FY2020 Appropriations adjusted by multiplying FY2011 Appropriation by estimated future ECI and estimated future population growth rate.
5) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
6) Total Civic Federation revenue increases and spending cuts as detailed in text.
7) FY 2011 Total Deficit is CTBA estimate of $ 9.47 B deficit minus new FY 2011 Civic Federation revenue and spending cuts.
8) FY 2012 Total Deficit is FY 2011 Total Deficit plus $ 3.0 B in non-recurring revenue from FY 2011.
9) From FY 2013 to FY 2020 own-source revenue is assumed to grow at 1% per year.

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TABLE 18

Civic Federation Optimistic Scenario Projected Illinois Budget Deficit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Own-Source General Fund Revenue	$21,262	$21,687	$22,121	$22,563	$23,015	$23,475	$23,944	$24,423	$24,912	$25,410
Federal Sources	$5,850	$6,088	$6,335	$6,593	$6,861	$7,140	$7,430	$7,732	$8,047	$8,374
Civic Federation Personal and Corporate Income Tax Revenue Increase	$5,646	$5,759	$5,874	$5,992	$6,111	$6,234	$6,358	$6,485	$6,615	$6,747
Civic Federation Increase from Taxing Retirement Income	$1,600	$1,632	$1,665	$1,698	$1,732	$1,767	$1,802	$1,838	$1,875	$1,912
Civic Federation Total New Tax Revenue	$7,246	$7,391	$7,539	$7,690	$7,843	$8,000	$8,160	$8,323	$8,490	$8,660
Total Revenue Including Federal Sources	$34,358	$35,166	$35,995	$36,846	$37,719	$38,615	$39,535	$40,479	$41,449	$42,444
FY2011 Appropriation Excluding Pension Funding Adjusted for Estimated Inflation and Population Growth	$24,940	$23,840	$24,400	$24,974	$25,561	$26,191	$26,837	$27,500	$28,178	$28,873
Civic Federation Cut in Appropriations	($1,100)									
Pension Payments	$3,521	$3,918	$4,356	$4,805	$5,251	$5,514	$5,767	$6,033	$6,315	$6,596
Pension Debt Service Payments	$542	$590	$586	$583	$579	$575	$595	$615	$633	$675
Total Appropriations Including Pension Payments	$27,902	$28,348	$29,343	$30,361	$31,391	$32,280	$33,200	$34,147	$35,126	$36,144
Current Operating Surplus/Deficit	$6,456	$6,818	$6,652	$6,485	$6,328	$6,335	$6,335	$6,332	$6,323	$6,300
Carry Over Accumulated Deficit	($9,471)	($4,125)	$2,693	$9,346	$15,830	$22,159	$28,494	$34,829	$41,161	$47,484
Total Surplus/Deficit	($1,125)	$2,693	$9,346	$15,830	$22,159	$28,494	$34,829	$41,161	$47,484	$53,784

Notes:
1) Own-source and Federal Sources General Fund Revenue from prior Figures.
2) Future ECI growth estimated as FY2010 over FY2009 ECI growth of 1.6% (pro-rating seasonalized 2010Q2/2009Q2 growth as equal to 2010Q1/2009Q1 growth rate). Data is from BLS, this is slow rate of ECI growth appropriate to a slowly growing or stagnant economy.
3) Future Illinois population growth from Illiniois DCEO population forecast for 2015 and 2020 averaged to annualized growth rates of 0.70% until 2015 and 0.81% from 2015 to 2020.
4) FY2012-FY2020 Appropriations adjusted by multiplying FY2011 Appropriation by estimated future ECI and estimated future population growth rate.
5) Pension payments from CGFA May 2010 Monthly Briefing p. 10. We assume that the required $ 3.52 B FY2011 pension payment is made in FY 2011.
6) Total Civic Federation revenue increases and spending cuts as detailed in text.
7) FY 2011 Total Deficit is CTBA estimate of $ 9.47 B deficit minus new FY 2011 Civic Federation revenue and spending cuts.
8) FY 2012 Total Deficit is FY 2011 Total Deficit plus $ 3.0 B in non-recurring revenue from FY 2011.
9) From FY 2013 to FY 2020 own-source revenue is assumed to grow at 1% per year.

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