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ISSUE BRIEF Facing Reality: Illinois Must Raise Revenue to Balance Its Budget

Painting an Accurate Picture of the Deficit Problem. So many varying estimates of the state's budget deficit have been put forth, that it is truly hard to know which estimates are closest to reality. While projecting future revenue and expenditure changes is always tricky; historically, the Commission on Government Forecasting and Accountability ('COGFA") has generated the most accurate fiscal forecasts. Chart 1 shows COGFA's estimates of the state's deficit for the current Fiscal Year 2009 and coming Fiscal Year 2010 that was issued in March 2009.

Chart 1 View of FY 2009 & FY 2010 Budget Shortfalls \$ in millions				
*Note, this is before accounting for federal, one-time	FY 2009 Base	FY 2010 Base		
revenue under stimulus				
GOMB March-09 Revenue Estimates	\$27,170	\$26,972		
Appropriations	\$28,306	\$31,506		
less unspent approp	(\$500)	(\$500)		
Net Approp Spending	\$27,806	\$31,006		
Statutory Transfer Out				
Approx. Pension Obligation Bond Debt Service	\$469	\$467		
Continuing Pension Approp.	\$381	\$0		
Proposed Reduced Pension Transfer	\$0	\$0		
Legislatively Required Transfers	\$2,804	\$2,788		
Total Transfers Out	\$3,654	\$3,255		
Total Operating Spending and Transfer Out	\$31,460	\$34,261		
Operating Deficit (Surplus)	(\$4,290	(\$7,289)		
Short-Term Borrowing	\$1,400	\$0		
Repay of Short-Term Borrowing	(\$1,427)	\$0		
Budget Deficit (Surplus)	(\$4,317)	(\$7,289)		
SOURCE: COGFA Testimony to Senate Deficit Reduction Committee, March, 24, 2009				

The estimates in Chart 1 do not include Federal stimulus revenue Illinois is scheduled to receive in Fiscal Years 2009 and 2010 under the American Recovery and Reinvestment Act of 2009 ("ARRA").











Chart 2 NET DEFICIT AFTER FEDERAL STIMULUS UNDER AMERICAN RECOVERY AND REINVESTMENT ACT (ARRA)				
FY 2009		FY 2010		
Base Deficit from COGFA	-\$4.317 B	Base Deficit	-\$7.289 B	
		Deficit carry forward from FY2009	-\$2.162 B	
Federal Stimulus	\$2.155 B	Federal Stimulus	\$1.843 B	
NET DEFICIT	-\$2.162 B	CUMULATIVE, TWO-YEAR NET DEFICIT	-\$8.443 B	

Now for the bad news: Based on current, year-to-date receipts, COGFA now estimates that revenues will be \$406 million less than it initially projected for FY 2009. This increases the deficit shortfall to \$2.569 billion in FY 2009, and \$8.85 billion cumulatively in FY 2010.

A Non-Solution. A proposal to address, in part, the state's deficit has been put forth in the Illinois House of Representatives. It would generate "revenue" for FY 2010, through various budgetary maneuvers and the issuance of debt. Chart 3 below summarizes these revenue enhancements:

Chart 3

<u>Initiative</u>	FY 2010 Revenue Impact
Maintain FY 2009 income tax refund percentages	\$387 M
FMAP Increase for Medicaid	\$166 M
 Various Sweeps from Special Funds 	\$600 M
Debt Restructuring	\$600 M
• Issue Pension Notes	\$2,200 M

• NET \$3,710 M

• Loss of Revenue from time issues under ARRA

That would leave a cumulative deficit in FY 2010 of \$5.14 billion, which represents 16.6 percent of the FY 2010 budget.

-(\$243 M)

There are other, significant issues with this House proposal, the most important of which is, each initiative makes revenue available on a one-time, non-recurring basis. Even worse, the vast majority of this "revenue" is not really revenue at all, but debt that must be repaid.

So, the \$2.2 billion in short-term pension notes will have to be repaid out of the General Fund over the next five years. The \$387 million saved by not increasing the income tax refund percentage in FY 2010 will in all likelihood become a liability in FY 2011. Obviously, the \$600 million saved from debt restructuring will not be available in FY 2011, nor will the fund sweeps of \$600 million unless reauthorized. Hence, the state will magically have to find \$3.7 billion in new revenue in FY 2011, just to maintain FY 2010 spending levels—that were already cut by \$5.14 billion!

<u>Illinois Cannot Solve Its Problems Without Increasing Revenue</u>. The time for excuses on tax reform is past. The state simply is not in a position to invest in needed services on a sustainable basis without reforming its tax system and generating new revenue. The commonly raised objections to implementing a revenue increase, that Illinois is high tax and/or high spending, simply are not supported by the data.

Comparative State Income Tax Information.

- There are 41 states with a personal income tax, 42 if you count the District of Columbia.
- Illinois is one of only 6 states with an income tax that has a flat tax rate that applies to all taxpayers. The other five states are: Colorado (4.63%), Indiana (3.4%), Massachusetts (5.3%), Michigan (4.35%), and Pennsylvania (3.07%). Every other state has some progressivity built into its income tax rate structure.
- Illinois, with its 3% rate, has the lowest flat rate of all states with a flat 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 folks, but have a much greater overall rate after taking the progressivity into account.)
- Following are the top income tax rates in certain states:

(A) The Midwest
Ohio - 6.24%
Missouri - 6.0%
Kentucky - 6.0%
Indiana - 3.4%
Wisconsin - 6.75%
Iowa - 8.98%
Michigan - 4.35%
Minnesota - 7.85%

(B) Other Big States

New York - 6.85%

New Jersey - 8.97%

California - 9.3%

Tax Burden Comparison in Context.

- Illinois has the fifth largest population (12,831,970) and fifth largest economy (of approximately \$633 billion)¹ based on state GDP of any state in the nation.
- That said, since 1990, economic growth in Illinois has lagged both the Midwest region and the nation as a whole.²
- High tax burden cannot be blamed for this long-term, poor economic track record. Overall total state and local tax burden as a percentage of income in Illinois ranks 41st in the country.³ This tax burden figure isolates and includes every tax and fee charged by any unit of state or local government in Illinois, versus those charged by every unit of state or local government in every other state. When state taxes as a percentage of income are considered in isolation, Illinois drops to 43rd in tax burden.⁴

Out of Control Spending is not the Problem.

- According to the most recent data available from the Bureau of Economic Analysis (May 27, 2009), in 2007, General Fund spending in the State of Illinois accounted for just 3.4 percent of the Illinois state GDP. That ranked Illinois 45th in the nation in spending, despite having the fifth largest population.
- According to the same BEA data, ten years earlier in 1997, Illinois General Fund spending accounted for 3.35 percent of the Illinois GDP. Hence, General Fund spending as a percentage of GDP increased by just five one-hundredths of one percent during that 10 years period. This, despite the shift of responsibility to cover healthcare costs from the private sector⁵ to the public sector (today, over 40% of Illinois workers do not have employer-provided health insurance and over 27% of the state population is uninsured or on Medicaid), plus the phase-in of the pension ramp, which imposed annual cost increases on state government to cover decades of pension underfunding.

Balancing the Budget by Cutting Spending will hurt the State's Economy and Cause Job Loss.

- If the state were to close its \$8.85 billion budget deficit by cutting spending, it could cause the state's economy to lose 125,875 jobs, thereby worsening the recession and the state's unemployment rate.
- If Illinois state government desires to create jobs and counter the deepening recession, its best option for eliminating the deficit is to raise taxes, preferably progressively, and maintain or enhance total spending.
- If state government chooses the option to maintain or enhance spending, it could maintain and/or create up to 125,875 jobs, potentially shorten the recession in Illinois by over six months, and reduce the state's unemployment rate by almost two percentage points (1.9%), based on multipliers created by Mark Zandi, chief economist at Moody's Economy.com.⁶

<u>Conclusion</u>. Illinois has an antiquated revenue system that cannot fund public services in a modern economy. It in fact has a long-term, structural deficit (for more information, see the Center for Tax and Budget Accountability's special report on the structural deficit, available at <u>www.ctbaonline.org</u>). It has already cut billions in funding for essential human services over the past decade. It is time the state faced reality and raised the revenue needed to invest in services relied upon by millions.

For More Information:

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ENDNOTES

¹ Bureau of Economic Analysis, News Release, June 5, 2008.

² State of Working Illinois 2007, Northern Illinois University and the Center for Tax and Budget Accountability.

³ Federation of Tax Administrators, www.taxadmin.org.

⁵ State of Working Illinois 2007, Northern Illinois University and the Center for Tax and Budget Accountability.

⁶ Center for Tax and Budget Accountability, "Moving Forward: To Counter the Current Recession, Illinois State Government Should Maintain or enhance Spending-Even if it Means Progressive Tax Increases-Rather Than Cut its Budget", March 2009. The rationale for decreasing unemployment by two percent is based upon the potential creation/maintenance of 125,875 jobs. approximately 2 percent (1.88) of Illinois's overall labor force of 6,668,052. From December 2007 – May 2009, Illinois lost 359,592 jobs, a rate of 19.977 jobs per month. Therefore, creating or maintaining 125,875 jobs that would otherwise be lost or not exist, has the potential to shorten the recession by six months. All data taken from the Bureau of Labor Statistics, extracted July 2, 2009.









