



The Illinois Economy:

Current and Future Fiscal Challenges

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Illinois faces a long list of fiscal challenges: a fall 2010 deficit close to \$12.3 billion, rapidly increasing health care costs, and a high unemployment rate. Economists predict that the state's economic recovery will be slow, ensuring economic and fiscal stress will be likely for some time to come.

The Economics team at the University of Illinois Institute of Government and Public Affairs answered questions about the state's fiscal future. What can the University of Illinois community expect in 2011? One thing is for sure: there are no easy solutions to the state's fiscal problems.

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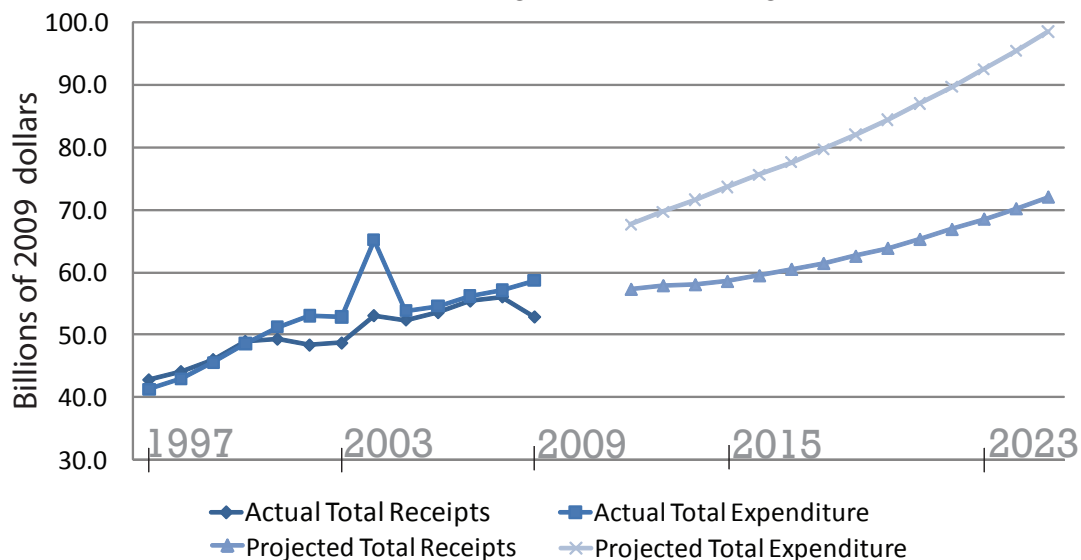
What are the state's biggest fiscal challenges?

A

- The magnitude of the state's fiscal problems is severe. The state has to fund an operating deficit of \$5.8 billion plus \$6.5 billion of unpaid bills from the past two years. The total current deficit is **\$12.3 billion**.
- The biggest challenge will be transitioning to a fiscal system where revenue streams meet spending needs not only this year, but for years to come. In other words: balancing the budget.
- The state's economic woes have burdened social service agencies and organizations that contract with the state. Credit down-grades have also increased the state's borrowing costs (through higher interest rates). This situation has tarnished the state's image and reduced its ability to contract with some suppliers.

The Illinois Structural Deficit

(general and non-general funds)



Q

How will this fiscal situation affect economic recovery?

A

- Fiscal instability limits economic growth.
- Illinois citizens are not confident in the economy. They are uncertain what tax burden they will face in the future. Many are unsure if services they rely upon will be cut. This could cause citizens to forego opening new businesses in Illinois. It could also force current businesses to leave the state entirely.
- Decreases in state spending will also affect suppliers.
- The best available data suggest that Illinois and the Midwest will grow somewhat slower than the rest of the nation.
- Illinois will grow at a 1.7% rate while the rest of the U.S. will grow at a 2.8% rate.

“The magnitude of the state’s fiscal problems is severe. The current deficit is \$12.3 billion. Closing this budget gap will be impossible without tax increases *and* spending cuts.”

Q

How does the economy affect the state budget?

A

- For many years, revenue growth has lagged behind increases in expenditures.
- The recession of 2008 has caused a decrease in major revenue sources (i.e., sales and income tax revenue).
 - An increase in federal funds and borrowing has largely compensated for this decrease.
 - However, federal stimulus funds are being phased out, so the state will be unable to continue spending at its current pace in 2011 and beyond.
- The economic downturn has caused more people to rely on social services. This means spending for these programs (especially Medicaid) has increased.
- Federal rules have also required that Illinois maintain high levels of spending on K-12 education to be eligible for stimulus payments.
- Medicaid constitutes 21% of the state budget. K-12 education constitutes 15% of the state budget.



What can be done to reduce or eliminate the state budget deficit?



Borrow our way out?

- Borrowing can be either direct, like taking on new debt, or indirect, like selling future income streams or not putting aside sufficient funds to cover future payments. Any form of borrowing is **not a real solution**, because even though it temporarily increases the amount of money in the state budget, it will have a negative effect on the budget in the future.

Focus on creating new jobs?

- Increased employment leads to more tax revenue, but economists forecast that Illinois will not reach full employment for several years. Even if we did see full employment and if tax revenues increased to 2008 levels, **state tax revenue would only increase by \$3.5 billion. That's only about half of what will be needed on an annual basis.**

Increase the income tax rate?

- Governor Quinn proposed an increase from 3% to 4%, and others have proposed going as high as 5%. Putting aside the difficulties of raising taxes, each increase by 1 percentage point **would raise \$2.5 to \$3 billion.**

Increase the sales tax base?

- Illinois taxes goods, but very few services. If we were to start taxing every service that other states tax (in the face of intense opposition from a long list of service industries), **state revenue would increase about \$3.6 billion.**

Spending cuts?

- There are countless proposals for cutting spending on the table. The total General Fund is about \$33.5 billion. If we were to cut it by 10%, **the state would save \$3.4 billion.**



All of these options are costly and problematic. It is unlikely that every solution will be implemented. Even in combination these solutions are likely to take several years to eliminate the \$12 billion total deficit



What does this mean for the University of Illinois?

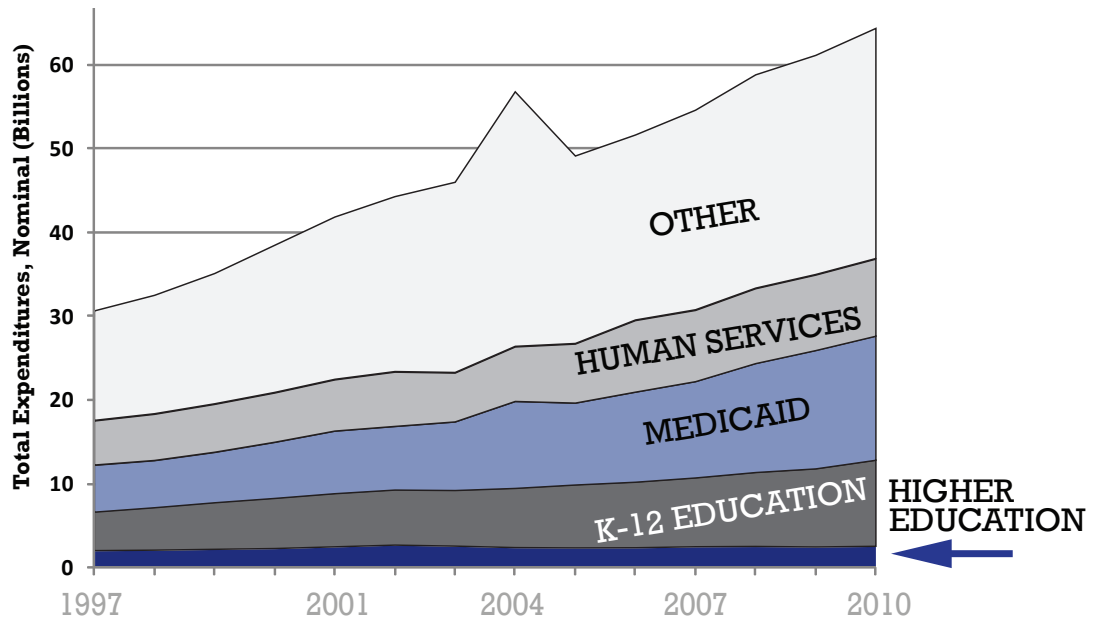


- University of Illinois' share of the state budget is being squeezed as competition for limited state funds becomes increasingly intense.
- State spending on higher education and human services (other than Medicaid) has remained largely steady, while other spending--such as spending to cover future pensions--has soared.
- Although U of I takes a very small share of the budget (1%, or \$750 million), maintaining other social services may take precedence in multiple rounds of budget cuts.
- Tuition and fees at University of Illinois at Chicago (\$12,034) and at Urbana-Champaign (\$12,528) are already higher than every other public university in the state. This makes it difficult to further raise tuition.
- It is likely that the university will have to find other sources of revenue and cut spending to compensate for slashed state funding.

“University of Illinois’ share of the state budget is being squeezed as competition for limited funds becomes increasingly intense. The university will have to find other sources of revenue and cut spending.”

Illinois Expenditures, 1997-2010

(general and non-general funds)





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