

Fiscal Fallout

No. 3: AS FAR AS THE EYE CAN SEE...ILLINOIS' STRUCTURAL DEFICIT

If a state consistently experiences conditions in which costs are projected to increase faster than revenue, even in non-recession years, this is considered a "structural deficit." With a structural deficit, crisis conditions become the new normal.

IGPA's Fiscal Futures model finds strong evidence of a structural deficit in Illinois, due to the projection that spending is growing faster than receipts.

The Fiscal Futures model:

- Creates a "consolidated funds budget" for Illinois with multiple spending and receipts categories that are consistently measured over time;
- Supplements this with data on economic and demographic "driver" variables;
- Estimates statistical relationship between budget components & driver variables;
- Uses forecasts of driver variables to project receipts & spending to future years.

The most recent projections from the model are:

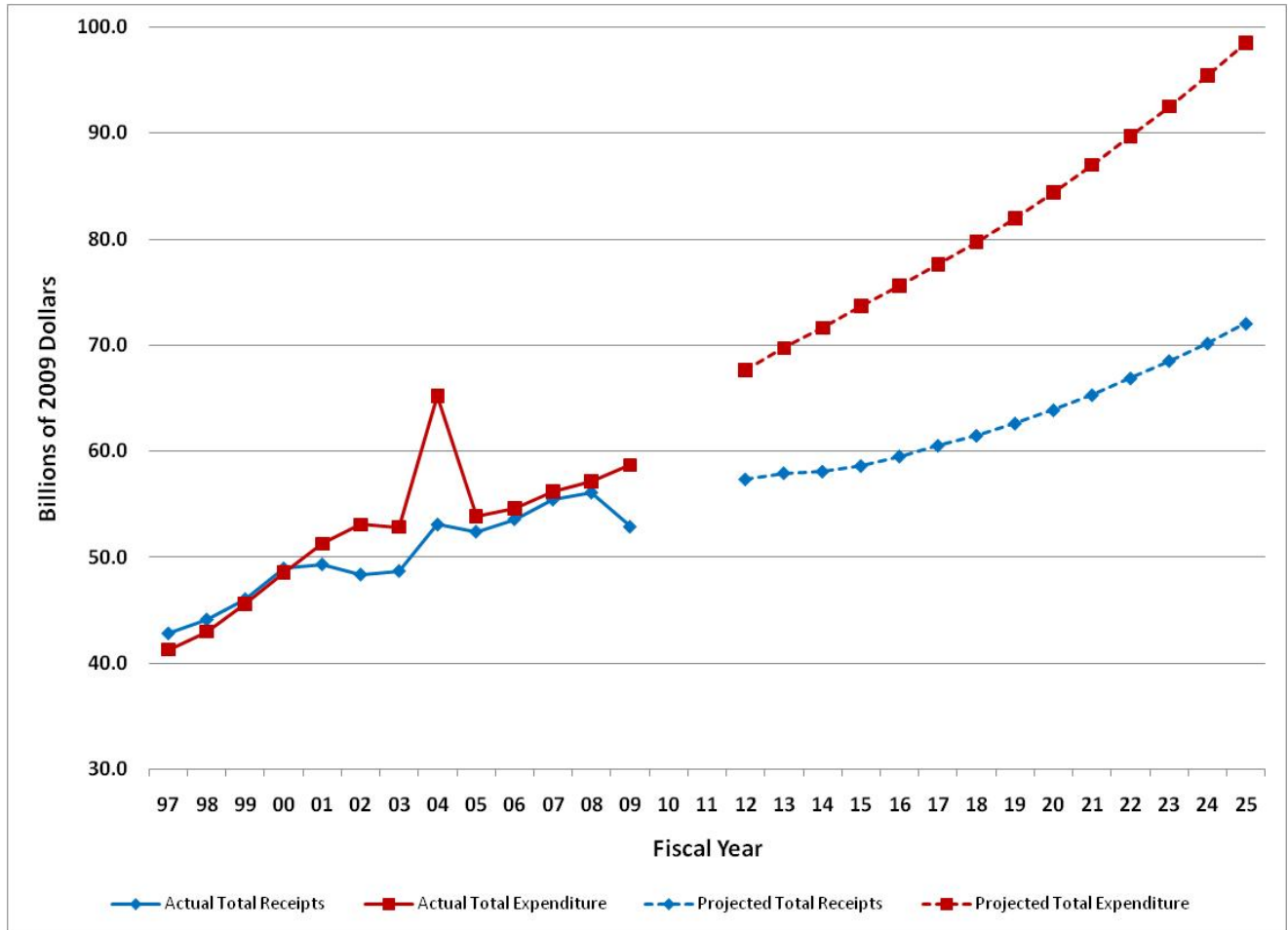
- **Expenditures**
 - High projected growth for Medicaid, K12 education, transportation, and pension obligations
 - Total outflow **projected to grow 4.6 % per year**
- **Receipts**
 - Very low sales tax growth; modest income tax growth; federal aid (based on past experience) projected to be high growth
 - Total inflow **projected to grow 3.5 % per year**

A difference of only one percent per year seems small, but compounded over many years is the source of the structural deficit. The year-by-year projections shown in the **figure** on the next page suggest deficits on the order of \$15 billion in 5 years, \$20 billion in 10 years, and \$25 billion in 15. Please note that these projected deficits, and for comparability the past deficits, **assume no new borrowing** (i.e., budget gap definition "B" explained in *Fiscal Fallout* No. 2).

Past trends in expenditures or receipts may not continue into the future, but the model assumes they will. For example, recent growth in Medicaid spending was partly due to major expansions of eligibility, which might not happen again. Or, the model incorporates past tax rate increases that may not be repeated. Also, the federal government has its own problems and aid to states might not grow as fast as before.

Deficits of the magnitude projected by the model cannot happen because of credit market, cash flow, and constitutional constraints. Future policymakers will be forced to raise revenues, cut spending, or increase the amount of debt to avoid projected deficits.

Actual and Projected Illinois Consolidated Total Receipts and Expenditures (with new borrowing excluded from receipts)



Source: Model described in Dye and Hudspeth, *The Fiscal Futures Project: Progress Report and Initial Results*, May 17, 2010. The June 2010 results presented here incorporate minor data revisions since the May version of the model.