Fiscal Condition Critical: The Budget Crisis in Illinois

Solutions to state’s fiscal trouble will require difficult decisions
Late in 2009, the Pew Center on the States released a national study which found that Illinois ranked among the top 10 states facing the worst fiscal problems, and warned that “some of the same factors driving California toward the brink of insolvency also are hurting an array of states.”

Starting from the basic question, “What went wrong in California?” Pew researchers identified six indicators that had played a significant role either in creating California’s fiscal crisis or preventing it from being fixed. They then scored all states on each of the indicators, finding these same conditions in many places. While Illinois fared better than some states in terms of its ability to weather the housing market meltdown and the collapse of specific industries, the magnitude of its budget shortfall and its unfunded pension liability are among the worst in the nation. The Pew study noted that, “what puts Illinois squarely in the company of California is its lack of fiscal discipline to balance its state budget … the legislature passed a budget significantly out of balance, leaving it to the governor to make the cuts. The state also has a history of deferring its bills, including payments to cover its public-sector pension liabilities; this year, Illinois borrowed money to pay for its annual pension contribution.”

Certainly, the national economy is affected by the degree to which states are able to recover from the “Great Recession,” and many states are not recovering. In the following sections we outline the national situation, describe the current situation in Illinois, and discuss possible long-term solutions. We then present the first results of our economic forecasting model, the Fiscal Futures project, a new Institute of Government and Public Affairs initiative developed in the past year. We conclude that Illinois, like many states, faces some very hard budget choices in the bleak years ahead.

Short-Run and Long-Run Crises in Illinois and Other States

The current recession appears likely to be the worst since the Great Depression. Real gross domestic product fell by about 3.8 percent between the fourth quarter of 2007 and the second quarter of 2009, a full percentage point greater than the decline in the severe 1981-83 recession. Nationally, the unemployment rate peaked at 10.2 percent in October 2009, while Illinois was higher than average at 11.0 percent. Current national unemployment rates are lower than the peak of 10.8 percent during the 1981-83 recession but are otherwise higher than any time since the Great Depression. The Federal Reserve reports that 86 percent of the nation’s industries have cut back on production since the recession began – the largest figure in the 42 yearsthat the statistic has been kept – while every state reported an increase in unemployment since December 2008. Having begun at the end of 2007 and only now showing signs of ending, this recession is turning out to be even worse than the 1981-83 decline.

Illinois is among the states whose budgets were already in poor condition before the recession began. In a case of remarkably bad timing, the state government’s contribution to the state pension system was scheduled to increase markedly in 2010 as a way to partially make up for decades of underfunding. The underfunding of pension obligations is a form of “implicit debt” and a major way that Illinois has been able to meet the letter of its balanced budget requirement in past years. The accumulated implicit
debt from underfunded budgets during the good economic years before the current recession has increased the strain on the current budget situation and contributes to the deficit going forward. The state relies heavily on a sales tax with a relatively narrow base. Much of the gasoline tax is levied on a per-gallon basis, which means revenue can actually fall as the price of gas rises. While recessions never come at a good time, Illinois needed a much longer stretch of growth to offset its underlying deficit.

A National Perspective

Illinois is far from alone in its current budget situation. A National Association of State Budget Officers (NASBO) publication, “Fiscal Survey of the States,” paints a grim picture. During the 2009 fiscal year, 42 states have together been forced to reduce their budgets by a combined $31.6 billion. Though some states have managed to maintain balanced budgets by cutting expenditures, 41 states reported budget gaps during the 2009 fiscal year and 37 states expect to face gaps for 2010. According to the NASBO, more than 40 percent of the states have enacted across-the-board spending cuts. Targeted cuts, rainy day funds, furloughs, layoffs, and reduction in local aid have also been used to reduce spending in response to budget shortages.

The budget declines are large by historical standards, particularly because budgets increase in most years. Figure 1 shows the annual percentage change in the total budgets across all states from 1979 to 2009. Budgets declined only three fiscal years across this 30-year period, in fiscal year 1983 and now during the two most recent fiscal years. The 2.5 percent decline projected for fiscal year 2010 is the largest decline during this 30-year period, with the 2.2 percent for fiscal year 2009 a close second.

These reductions in revenue have led to significant decreases in expenditures. Twenty-six states cut spending on K-12 education in 2009, while 31 states reduced spending for higher education. Expenditures were also cut for public assistance (22 states), Medicaid (25 states), corrections (25 states), transportation (15 states), and personnel (25 states). Illinois is one of only 12 states that did not make major program cuts in fiscal year 2009.

Several states – not Illinois – have managed to set aside rainy day funds or other reserves to help stabilize their budgets during economic downturns. According to NASBO, an informal rule of thumb is that a budget reserve of at least 5 percent of total expenditures is an adequate cushion. Illinois’ budget reserve balance was 1.5 percent of expenditures in fiscal 2008 and 1.4 percent in 2009. In contrast, the national average was 9.1 percent, and is estimated to have declined to 5.5 percent in fiscal 2009. States have been reluctant to draw from their reserves because the recession is only now showing signs of ending, and state fiscal conditions often take a long time to improve after a downturn.

Some states have been helped by the American Recovery and Reinvestment Act
(ARRA), popularly known as the “stimulus plan.” More than $135 billion of the $787 billion in stimulus money was allocated to the states to help reduce budget shortfalls. Most of that money, $87 billion, is for Medicaid. On average, ARRA funds have succeeded in closing 30-40 percent of the budget gaps. However, when this temporary source of federal aid goes away, states like Illinois with structural budget problems on top of cyclical problems will still be in trouble.

**Structural Deficits**

The severity of the current recession has exposed systemic weaknesses in the design of many states’ revenue systems and their spending obligations, which raises concern about structural deficits. 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.” In a structural deficit, crisis conditions become the new normal, and structural deficits are becoming common. A 1998 study found structural deficits in 39 states and a similar study in 2002 found structural deficits in 44 states.5 By not funding the current value of future obligations for pensions and retiree health care, states like Illinois have increased future spending obligations and added to their structural deficits.

Among the causes of structural deficits are: the shift of the economy from goods to services; outdated sales tax systems; erosion of state corporate taxes; over-reliance on and erosion of state income taxes; growth of interstate sales (due to Internet transactions); the aging of the population (more retirees, fewer workers); states’ failure to maintain a mix of taxes that can grow with costs; political adoption of tax and spending limitations and supermajority requirements; federal policies that affect state revenue (federal pre-emption of states’ taxing authority); and interstate tax competition (fears that raising taxes will harm states in competition with their neighbors).6 Dealing with structural deficits requires fundamental reforms of both state revenue systems and spending obligations – with health care costs being the overarching consideration in every budget examination.

**Illinois Budget Problems Are Nothing New**

Illinois has had periodic cyclical deficits, in which a downturn in the economy causes revenue to decline, leading to a scramble to balance the budget, and a long-recognized structural deficit. A 1996 study by J. Fred Giertz, Therese McGuire, and James Nowlan of the Institute of Government and Public Affairs found that expenditures were projected to grow at a rate of 2 percent above inflation for the next decade, while revenue was projected to grow at half that rate. Thirteen years ago, they wrote:

“A look at how Illinois has coped with the structural deficits in the past (such as increased income tax rates, under-funding the state’s pension systems, and delaying payments to health care providers) indicates that the state has been using short-term coping strategies to deal with a long-term, persistent problem. Illinois can continue to increase the efficiency of state government; however, because state operations take up less than one-quarter of general funds spending it is unlikely that future operating reductions alone can erase the projected structural deficit.”7

Unfortunately, the warnings in 1996 did not lead to fiscal reform. In The Illinois Report 2007, Giertz presented estimates of Illinois’ structural deficit growing year after year, showing (again) that revenue is projected to grow at a slower rate than expenses, concluding that, “[s]oon, the state must face the prospect of either making large and painful cuts in major programs or finding additional permanent sources of revenue.”8

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In our contribution to *The Illinois Report 2009*, we wrote that, “the state has taken no…action and may have made things worse.” At that time, we noted that the Commission on Government Forecasting and Accountability (COGFA) had issued an “early warning” of fiscal trouble in November 2008, predicting a $1.3 billion revenue shortfall for fiscal year 2009, and feared that even worse was yet to come. Unfortunately, we were proven correct.

Seven months later, the actual FY 2009 deficit reported in last July’s *Comptroller’s Quarterly* was more than twice as bad: $2.9 billion. Determining the actual amounts of the 2009 and 2010 budget shortfalls is like attempting to pin down a moving target, but concluding that they are large and problematic is easy.

### Two Really Bad Years in a Row: the 2009 and 2010 Budgets

As noted earlier, Illinois and other states faced a severe budget shortfall in fiscal years 2009 and 2010 due to the national recession and the hangover from past budget decisions. Soon after Governor Pat Quinn assumed office from the impeached and removed Rod Blagojevich in late January 2009, numerous budget reports and briefings were issued by government officials, advocates, and experts. While all agreed that there would be a serious budget shortfall, and that Illinois needs to make some drastic fiscal changes, there was no agreement about the actual amount of the current and near-future deficit or the specific solutions proposed.

During the latter half of FY 2009, analysts predicted revenue shortfalls ranging from $1 billion to $4 billion. In February 2009, the *Comptroller’s Transitional Report* estimated that Illinois’ general funds deficit was $8.9 billion, by combining preliminary estimates for 2010 with one for the 2009 shortfall that would be carried into 2010. Just one month later, the Governor’s Office proposal for FY 2010 upped the ante with an estimate of the 2009 carryover plus the 2010 deficit “without reform and cuts” of $11.6 billion. Other estimates from other sources or from these same sources at different times vary considerably, but they are all very large.

Governor Quinn proposed a substantial increase in the personal income tax to help balance the FY 2010 budget, but was unable to get support from the legislature to pass it into law. Instead, on July 15, 2009, the legislature passed and the governor signed a budget without a tax increase that included:

- $3.5 billion in borrowing to cover pension payments to be paid back over five years
- $1.8 billion in federal stimulus money
- $0.4 billion in “fund sweeps,” or transfers from special fund balances
- $2.1 billion in spending cuts
- another $1.1 billion in spending cuts to be made later in the year.

Pension borrowing helps in this year, but makes the next five years worse. The federal stimulus money is a non-recurring revenue source, as are the fund sweeps. It seems at this writing that revenue is coming in at a slower rate than budgeted and that budget year 2010 will have a sizable deficit without future tax increases or spending cuts or both. Moreover, the 2011 budget will start in a deeper hole due to the non-recurring revenue sources and the delay in spending cuts.

### Long-Term Solutions

*Major revenue options:* In *The Illinois Report 2008*, David Merriman outlined Illinois’ fiscal situation and possible revenue solutions:

“[O]ver the long term Illinois will have to make hard choices in order to pay for its normal operating expenses, pension obligations and Medicaid programs. Minor tinkering with the tax system,
user charges and one-time revenue fixes simply will not provide enough money for Illinois to continue business as usual. There is a long list of revenue-raising options, which includes increases in sales, corporate or income tax rates or elimination of exemptions; means testing for tax credits; changing the base of the personal income tax to the federal income tax liability; expanding the sales tax to include consumer services; increasing the gasoline tax; value-added tax; and others.”

Merriman evaluated several major options and expressed his own preference for one that would change the base of the Illinois personal income tax to the federal income tax liability, making Illinois’ personal income tax into a surcharge on the federal income tax. This would be easy for the state to administer and would make the Illinois’ income tax more progressive. It also would broaden Illinois’ tax base by taxing pension and Social Security income. Merriman argued that this change “would allow Illinois’ revenue to grow more rapidly in the future if the current trend toward disproportionate growth of high incomes continues. This change could help stabilize Illinois’ fiscal climate for many years into the future.”

**Sales tax base broadening.** Expanding the sales tax base to cover consumer services has recently been studied by the Commission on Government Forecasting and Accountability (COGFA). They estimate that taxing a broad array of consumer services could raise approximately $3.6 billion in additional state revenue per year. Taxing services may make sense in Illinois because, compared to its Great Lakes neighbors, Illinois’ economy is more heavily concentrated in the services sector due to the predominance of finance, insurance, and professional services. Broadening the sales tax base to include services would “increase economic efficiency and modernize the sales tax system so that revenues would grow more rapidly as the economy expands,” Merriman wrote.17

**Income tax rate increases.** Governor Quinn’s unsuccessful budget proposal for 2010 would have increased the personal income tax rate from its current 3.0 percent to 4.5 percent. To soften the impact on low- and moderate-income families, the proposal would also have tripled the personal exemption from $2,000 to $6,000 per person.

**Multi-part revenue proposals.** In the spring of 2009, a tax reform bill introduced by state Senator James Meeks (SB 750) and revised by State Representative David Miller (HB 174) was proposed as a way to help balance the 2010 budget. The proposal had six components:

- Raise the personal income tax rate from 3 percent to 5 percent
- Increase the per person exemption from $2,000 to $3,000 per person
- Triple the state’s Earned Income Tax Credit
- Double the residential property tax credit from 5 percent to 10 percent
- Increase the corporate income tax rate from 4.8 percent to 5.0 percent
- Expand the sales tax base to cover 39 different consumer services.

The first element would be a very large increase in the personal income tax. The next three would have reduced that increase in ways that are targeted to all taxpayers, low-income families, and homeowners respectively. The fifth component was a modest increase in business taxes. The final plank was a very modest broadening of the sales tax base. The bill passed the Senate but was not called to a vote in the House.

**Spending cuts.** Substantial cuts in state spending will also have to be part of any long-term plan to balance the state’s budget. There are a number of proposals being circulated and available online, some
listing multiple options. Noteworthy are an analysis of the state budget by the Civic Federation\textsuperscript{18} and the report of the Taxpayer Action Board,\textsuperscript{19} a citizen’s commission empanelled by Governor Quinn. Some advocate across the board cuts in all government programs. Some offer long lists of smaller programmatic cuts. The major candidates for reforms that would cut spending are:

- \textit{Medicaid:} Past spending increases in excess of income and revenue growth have been the major source of state budget problems for decades. Nationally, Medicaid has experienced cost inflation as have all health care services, so the biggest chance for “bending the cost curve” on health spending comes from federal actions beyond the control of any one state. Reductions in Illinois’ total Medicaid spending would not entirely be credited to the state’s budget, because federal reimbursements currently cover the majority of the state’s Medicaid bills. In Illinois, the federal match rate has historically been 50 percent, meaning that the federal government would reimburse the state for half its Medicaid costs, but in April 2009 the federal stimulus plan temporarily increased the match rate to 61.88 percent.\textsuperscript{20} So, for example, a $2 billion reduction in the state’s overall Medicaid expenditures would result in less than $1 billion in savings of Illinois’ own dollars. The fact that Illinois’ federal match rate of 50 percent was the lowest possible – states’ reimbursement rates range from 50 percent to 83 percent – has been controversial for many years, and proposals to permanently increase Illinois’ match rate have been advanced since the program’s inception. Some of the cost-saving recommendations for actions by the State of Illinois include continuing to reduce Medicaid patients’ in-patient hospital and emergency-room use by expanding the Illinois Healthy Connect program, which has reported substantial cost savings since its inception in 2007 and provides case-managed and preventative care, often in an outpatient clinic, similar to a HMO. Managed-care-type programs in other states have been cost-effective for Medicaid patients with disabilities or mental illness; the vast majority of these persons in Illinois have no “medical home.”\textsuperscript{21} The Civic Federation notes that “Illinois lags behind other states in developing alternatives to institutional care for the elderly and disabled. Of particular concern are the hundreds of millions of dollars that Illinois spends annually on institutional care that is not eligible for federal reimbursement.”\textsuperscript{22}

- \textit{Pensions and retiree health care:} The biggest problems with both pensions and retiree health care programs are due to the decisions to not fully fund the promises that were made to state workers over the past several decades. Going forward, there are some opportunities for more modest savings in pensions,


which include increasing employee contributions from current state workers, increasing the retirement age, and a two-tier system with lesser benefits for new employees.\textsuperscript{23} Cost savings may also be realized by consolidating the pension systems’ administration and service providers. Recently enacted legislation to reform the management of the state pension programs calls for increased oversight and regulation.\textsuperscript{24} Similar to pensions, retiree health care has become a huge, unfunded liability that the state needs to address. Reforms in this area could include increasing employee contributions and providing less costly benefit packages.

- **Human services:** Recommendations include consolidating services – adopting an integrated service delivery model – and streamlining the Department of Health and Family Services’ approach to service delivery. Illinois human services agencies currently operate more than 300 locations; it may be possible to consolidate these many small offices and provide several services in one place. Currently, the state is implementing a pilot program for streamlining service delivery systems via the Internet; a similar program in Florida is reportedly saving $83 million annually.\textsuperscript{25}

- **K-12 Education:** According to the Taxpayer Action Board, administrative efficiency and cost savings might be attained by consolidating school districts, of which there are 870 in Illinois. About 200 districts have only one school.

- **Public Safety:** The Taxpayer Action Board recommends reviewing the case files of low-risk inmates for early parole and release. Nearly 20 percent of those who are incarcerated committed relatively minor Class 3 and Class 4 felonies and it costs the State of Illinois more than $250 million per year to keep them in prison.

### Illinois’ Fiscal Future Is Bleak

Two clear implications from our examination of fiscal years 2009 and 2010 are that cyclical revenue problems will persist for at least another year and that the hangover from some of the temporizing choices – like the five-year repayment of the borrowing that papered over part of the 2010 deficit – will persist for a number of years. The near-term fiscal future of the state of Illinois is bleak. There is also new evidence on the structural deficit from which we conclude that, absent some major changes, the long-term fiscal future of the state is similarly bleak.

### The Fiscal Futures Project

In *The Illinois Report 2009*, we introduced a new IGPA initiative, the *Fiscal Futures Project*. In this edition, we outline a year’s progress on that project and some of the resulting estimates of future budgets.

*Illinois budget data for prior years.* In order to know where you are going, you first need to understand where you have been, so considerable effort has gone into gathering,
In most reporting and discussion of the Illinois state budget, the concept of General Funds is used. We use a more inclusive concept, which we call Consolidated Funds, because we believe that it better represents the total burdens and benefits of state government to taxpayers and residents. If analysis was limited to the four General Funds, it would largely exclude several important categories of revenue and expenditures:

- Only a small amount of the transportation budget comes from the General Funds, because motor fuel taxes are deposited in the special road fund. We include transportation revenue and expenditures, including the Illinois State Tollway Authority, in the consolidated budget.

- Debt service expenditures do not come directly from the General Fund, but rather from special debt service. Debt service is incorporated in the consolidated budget in a way that avoids double counting.

- Most transfers of revenue back to local governments do not come from the General Funds but are in our consolidated budget. These include: the Personal Property Replacement Tax levied on corporations and utilities; the 1.25 percent of the general sales tax that is passed back to local governments (out of the 6.25 percent total); the one-tenth of the state income tax that is transferred to local governments; and the portion of motor-fuel taxes that goes to local governments. The consolidated budget includes these taxes, because they are levied statewide at a common rate and with a burden on taxpayers throughout the state. Also, the distribution to local governments is by statutory formula, which could be changed. (Note that purely local-option taxes levied by specific local governments with the state just acting as collection agent are not included in our consolidated budget.)

- Health care providers’ taxes and fees are a key component of the total Medicaid budget, but they are typically deposited into specially designated funds, not the General Funds. With care to avoid double counting, this revenue source and associated expenditures are included in our consolidated budget.

- Many federal grants for a designated purpose go into specially designated non-general funds. These are important sources of revenue for transportation, Medicaid, education, and human services, and are accordingly included in our consolidated budget.

Adding those and smaller adjustments increases the total state budget by over two-thirds in fiscal year 2008 – from $35 billion for general funds alone to $60 billion for the consolidated funds.

Figure 3

Revenue Components of Consolidated Budget In FY 2008

| Source: IGPA Fiscal Futures Model 20 October 2009 |

Economic and demographic data: actual for prior years, forecasts for future. The Regional Economics Applications Laboratory (REAL) at the University of Illinois
supplied detailed historical and forecast data from its model of the Illinois economy. Additional economic, fiscal, and demographic data for both the state and the nation has also been obtained. In particular, the model described below makes use of past and forecast data for Illinois personal income, consumption, consumption of services, total population, and population in various age groups as “drivers” of different budget categories.

**Demonstration model.** We have completed a preliminary version of the fiscal futures model. For some of the budget components – pensions and debt service – official schedules of future payments are used. For each of the other designated revenue and expenditure categories we have created a “projection module.” The modules estimate the historical relationship between the budget variable and one or more “driver” variables, such as total income or population, and use forecasts of the driver variables to create projections for the budget component. Most of the attention to date has been given to the largest revenue and spending categories: personal income and general sales taxes, Medicaid, and K-12 education spending.

The default module simply relates past growth in the budget measure to past growth in state personal income; for some components, additional drivers are used, such as growth in: population, school-age population, college-age population, or health-sector output. Two revenue sources, gambling and motor fuel, showed zero growth in recent years so we assumed zero growth in the future.

Figures 4 and 5 (on page 24) show the growth rates for each of the revenue and expenditure components generated from this data and the estimates that lead to the assumed relationships with the driver variables. The growth rates predicted by the model fluctuate somewhat in the initial years, and then converge on a fairly constant rate, so the figures show the annual average for the 2020 to 2030 time period. The first two bars in both figures give, for reference, the rate of growth for personal income and the rate of inflation in the Consumer Price Index.

The growth rates in revenue components are shown in Figure 4. Referring to Figure 3, we see that the three largest revenue sources are the personal income tax, the general sales tax, and federal funds. The growth rate in personal income tax collections is projected to be 4 percent per year, slightly above the growth in statewide income. The general sales tax is projected to grow at only 1.7 percent per year, which is less than the rate of inflation. Projected growth in federal aid of 6.1 percent per year is a statistically educated guess based on the growth rate between 1998 and 2008. Whether or not this actually happens depends upon the future actions of Congress. The projections for all types of revenue indicate total growth of 4.4 percent per year.

The growth rate projections for the spending categories are shown in Figure 5. The largest spending components are elementary and secondary education and Medicaid, both of which have high projected growth rates, 5.2 and 7.8 percent, respectively. Transportation spending also has a high projected growth rate, as does the payment schedule for state contributions to state and local public employee pensions. The growth projections for all types of spending total 5.3 percent per year. This may not seem like much more than the 4.4 percent projection for revenue growth, but note that the difference will be compounded over many, many years.

The demonstration model has two basic purposes. First, the model can be used to project a “baseline” into future years of revenue and spending under current law and current projections of economic and demographic trends. The difference
Figure 4
Projected Growth Rates for Income, Prices and Revenue Components
(Annual Average for 2020 to 2030)

Source: IGPA Fiscal Futures Model 20 October 2009

Figure 5
Projected Growth Rates for Income, Prices, and Spending Components
(Annual Average for 2020 to 2030)

Source: IGPA Fiscal Futures Model 20 October 2009
between total would-be spending and total would-be revenue in a future year can be called an estimate of the “structural deficit.” Second, with the right data, the model can also simulate budgets under alternative policy scenarios or using different economic and demographic variables. These “what if” estimates, or out-year projections of policy alternatives, might be called the “scorekeeping” function of the model. For example, the personal income tax module has been constructed in a way that allows for changes in policy parameters like the tax rate or the amount of the personal exemption.

**Total budget estimates.** Figure 6 shows the actual and projected paths for total state expenditures and total state revenue over time in real (inflation-adjusted) dollars. The first part of the figure shows actual values for the consolidated budget concepts for the historical 1998 to 2008 period. The amount by which spending exceeds revenue is called a deficit, and the amount by which revenue exceeds spending is called a surplus. The surge in revenue in fiscal year 2003 is a cash surplus resulting from a new issue of “pension obligation bonds” and a related jump in pension spending shows up in the next year. The projected values for 2012 to 2030 come from the model described above. As noted, the model compounds any differences between spending growth rates and revenue growth rates over the years, so the higher growth for spending leads to an ever larger deficit projection. The model projects that the deficit will grow to the order of $15 billion (real 2008 dollars) by 2020 and to $29 billion by 2030. This underlying mismatch between the level of revenue that existing rules can sustain and the level of spending that caseload drivers project is sometimes called a “structural deficit.”

For example, we could use the model to compute projected revenue under the Merriman proposal to piggyback on the federal income tax, the Quinn proposal to increase the income tax rate and personal exemption, the COGFA option to expand the sales tax base to include a wide range of consumer services, or a hybrid proposal like Meeks-Miller to make multiple changes.

The important qualitative result from our tax simulations is that there is no perceptible impact on the growth rate of revenue in future years. Except possibly for the expansion of the sales tax base to include services, none of the proposed changes will increase the growth rate of revenue, only the baseline amount. So even if a policy is successful in closing the gap in one year, it will do little or nothing to change the fact that spending will grow faster than revenue, so the structural deficit will soon re-emerge.

**Notes on interpreting the model.** This article is being written in budget year 2010, but the model is based on available data that stops in fiscal year 2008. Even though we know that, due to the severity of the recession, budget years 2009 and 2010 are much worse than the model projects, we base
our later-year projections in Figure 6 starting from the rather “optimistic” 2008 baseline. (This is why we choose not to even show the near-term projections of the model.)

Data lags are not the only thing to note about the model. The fiscal futures model measures underlying, long-run tendencies and makes projections, not predictions or forecasts, so the model is not a substitute for existing short-term budget forecasting techniques. Future policy makers will be forced by balanced-budget requirements or cash-flow constraints to raise revenue, cut spending, or increase the amount of explicit or implicit debt to avoid the would-be deficits. In the words of economist and sage Herb Stein, “If something cannot go on forever, it will stop.” We are continuing to refine our model and are seeking support to expand its capabilities.

**Regrettable Choices in the Past, Tough Choices in the Future**

Illinois has both a cyclical and structural deficit. We have outlined some of the reasons for the current budget crisis. The current recession has contributed significantly
to the state’s problems, but if the recession went away tomorrow the state’s budget problems would not. The current problem and its projection into the future have been exacerbated by the avoidance of tough choices in the past. The most significant choice made repeatedly was to not make current contributions to cover the cost of future pension obligations. These are not just pensions of state employees; the state is also responsible for covering the cost of pension promises made to local government employees. This “implicit debt” has grown and the obligation has been passed to future taxpayers. Eventually, the unfunded promises for pensions and retiree medical costs will become due and payable. Other avoidance mechanisms in the past include: borrowing against or selling future revenue streams and spending the proceeds on current operations; rolling unpaid bills into the next budget year; and committing temporary, cyclical surges in revenue to new or expanded programs. All this temporizing has put Illinois in a very deep hole. Worse, the differential growth rates driving existing revenue streams and program caseloads make for a structural deficit. Even if we restored balance next year, the state would face deficits several years down the road.

It is inescapable that Illinois faces very, very tough choices. There almost certainly will have to be major cuts in spending programs and major increases in revenue.

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