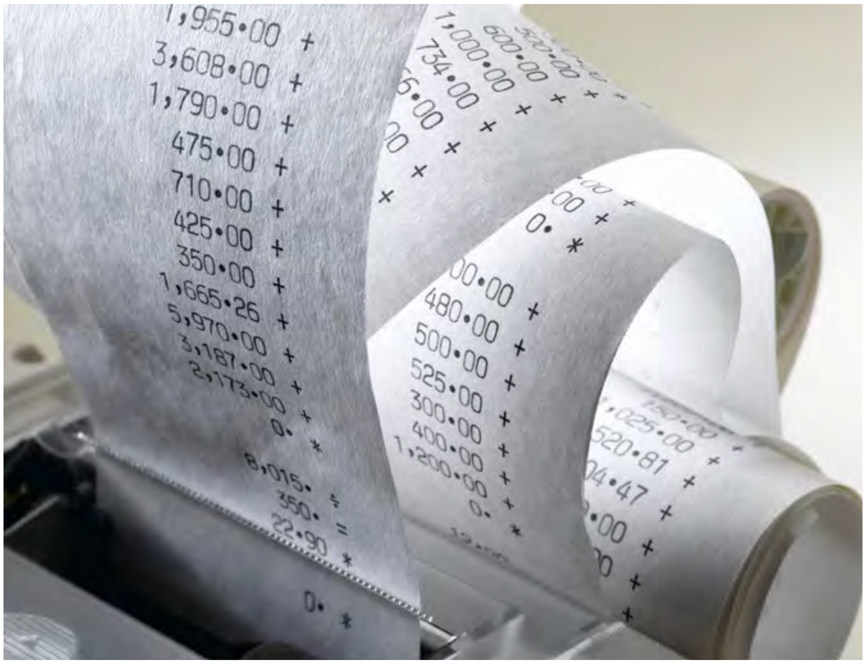
UNIVERSITY OF ILLINOIS SYSTEM
INSTITUTE OF GOVERNMENT AND PUBLIC AFFAIRS

FISCAL FUTURES PROJECT REPORT | APRIL 22, 2021

Illinois' Fiscal Challenges: Where are we now and how do we proceed?



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BY DAVID F. MERRIMAN AND XIAOYAN HU

INTRODUCTION

> Illinois' fiscal challenges have been widely discussed, sometimes under-emphasized and sometimes exaggerated. We believe that dealing with the state's fiscal challenges will require an objective and realistic assessment of the facts and potential paths forward. We provide this analysis in that spirit.

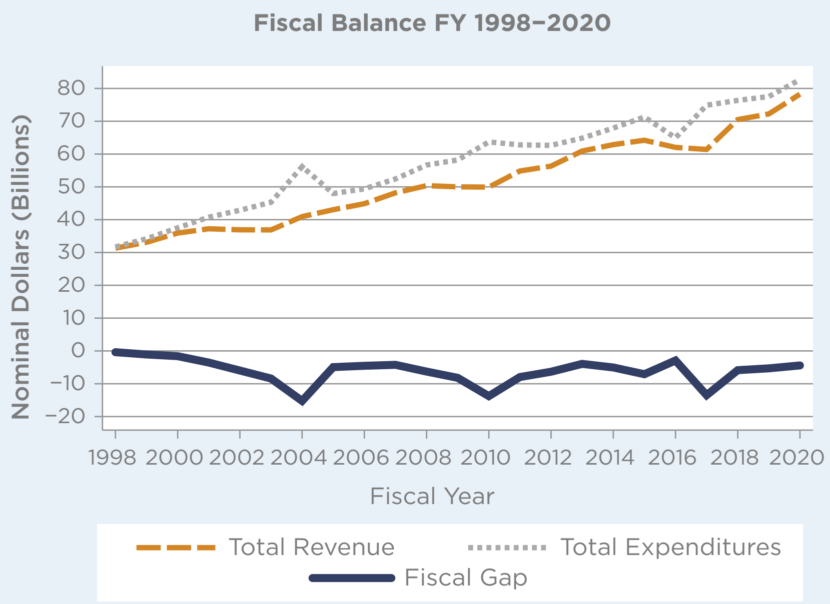
The Institute of Government and Public Affairs (IGPA) Fiscal Futures Project has consistently tracked Illinois' fiscal situation and explored strategies to achieve long-term fiscal balance since 2008. This report continues that tradition. We have obtained detailed data on actual revenue and expenditures of the state from the Office of the Illinois Comptroller for each fiscal year from 1998 through 2020. These data come to us in very disaggregated form, listing more than 9,000 expense items and almost 2,700 revenue items in 2020. We use a well-documented, consistent, and transparent set of procedures to aggregate these line items into roughly two dozen meaningful revenue and expense categories that can be consistently tracked over the

years for which we have data. Our calculations ignore artificial distinctions between Illinois' "general" and "special" accounting funds and instead focus on the government function to which the spending contributes. We call this the "all funds" representation of Illinois' fiscal activities. We use great care to ensure that our calculations are consistent over time, within and across categories. Because of these procedures, our calculations provide a clear, objective, consistent, holistic, and evidence-based picture of the fiscal situation of Illinois.

BASIC FINDINGS

Figure 1 plots Illinois' total expenditures, total revenue, and the "fiscal gap" which is revenue minus expenditures. Since 1998, nominal revenue across all funds has risen from $31.3 billion to $78.2 billion while all funds nominal spending has risen from $31.7 billion to $82.7 billion. Illinois' expenditures were greater than revenue in each year so that there was a "fiscal gap." Such fiscal gaps are problematic because they increase the burden on future budgets in some form—lower fund balances, unpaid bills, higher debt service obligations, higher cost of borrowing in the future, greater default risk, or diminished capacity to respond to new spending needs.

FIGURE 1



Source: Illinois comptroller as processed by the IGPA Fiscal Futures Project

The fiscal gap has not had a consistent trend: expenditures exceeded revenue by $0.38 billion in 1998, by $15.2 billion in 2004 and by $4.4 billion in 2020. On average, over the decade from 2010 to 2020, Illinois' expenditures exceeded revenue by $6.2 billion or roughly 10% of revenue each year.

Table 1 on page 3 provides detail on the components of total expenditures. In 2020, Illinois' single largest expenditure was Medicaid, on which the state spent $22.3 billion or about 27% of total expenditures. Medicaid expenditures in 2020 were $3.3 billion higher than in 2019. This was primarily because of a surge in enrollments due to lost

employment and other factors associated with COVID-19, such as the need for increased medical care in some circumstances. Medicaid spending increased by $5.1 billion in 2020. This more than offset substantial declines in debt service, local government revenue sharing, and several other spending categories. State spending on K-12 education was almost exactly one-half of spending on Medicaid at $11.3 billion and increased a comparatively modest $0.7 billion. State payments to the public pension systems increased $0.8 billion and totaled $9.2 billion. Another notable change in 2020 was the fortunate $2.1 billion decline in debt service costs, which was largely attributable to the timing of repayments for previously issued debt, interest rates, and other factors beyond the control of current government officials.

The right-most column of Table 1 shows the average annual growth rate of each spending category during the period 1998 to 2020. On average, total expenditures have grown by 4.5% each year. State pension payments have been the fastest-growing item, averaging 10.9% each year. Importantly, the rapid growth of pension payment expenditures is essentially unrelated to the growth in pension benefit obligations. Annual pension payments are determined by state laws designed to achieve a 90% funding level for pension obligations by 2045. The increase in pension payments is necessary to reduce unfunded pension liabilities (a form of debt) and does not represent the annual cost of public services.[1] Other rapidly growing spending categories are state employee healthcare, 6.9%, and Medicaid, 6.8%. Because Medicaid is by far the largest expenditure, its very high growth rate is particularly significant.

Table 2 on page 4 provides parallel information about revenue. Overall revenue was $78.3 billion in 2020, a $6 billion increase over 2019. However, the long-run revenue growth rate is only 4.2%, lagging behind the 4.5% growth rate of expenditures.

TABLE 1

Major state government expenditures, annual changes in spending and long-run growth rates

Category	2020 Spending (in billions of dollars)	Change in spending 2019 to 2020 (in billions of dollars)	Average Annual Growth rate 1998 to 2020
Medicaid	22.3	3.3	6.8%
K-12 Education	11.3	0.7	3.7%
State Pension Contribution	9.2	0.8	10.9%
Local Govt Revenue Share	6.1	-0.4	2.6%
Dept of Human Services	5.9	0.4	2.0%
Transportation	4.2	0.9	3.5%
Debt Service	3.6	-2.1	5.1%
State Employee Healthcare	2.6	-0.2	6.9%
Other Expenditures	21.0	-0.4	3.2%
Total Expenditures	82.7	3.0	4.5%

Data source: Illinois comptroller as processed by the IGPA Fiscal Futures Project https://igpa.uillinois.edu/policy-initiatives/fiscal-futures-project.

Individual income taxes are by far the largest revenue source at $17.6 billion. The $0.7 billion decline in individual income tax revenue in 2020 may be an artifact of a complex situation. Because of the COVID-19 pandemic, the federal government delayed the deadline for filing of income tax forms relating to calendar year 2019 from April 15 to July 15, 2020. Like other states, Illinois followed suit and moved the deadline for filing state income tax returns to July 15, 2020. Because Illinois' state fiscal year ended on June 30, 2020, the payments for many tax obligations incurred during calendar year 2019 were recorded in the 2021 state fiscal year. Extending the income tax filing deadline made fiscal year 2020 state personal and corporate income tax receipts artificially low. In July 2020, the first month of Illinois' 2021 fiscal year, income tax receipts were more than 75% ($1.2 billion) above their level in the previous July.[2] Because a large share of Illinois' July 2020 income tax receipts were likely due to obligations incurred with income earned in calendar year 2019, it seems prudent to interpret fiscal year 2020 individual income tax receipts as essentially flat compared to previous years and to assume that the $0.7 billion decrease is capturing a shift in the timing of payments.

The second largest category of revenue is federal funding to reimburse Illinois for a portion of its Medicaid expenditures. As a general rule, Illinois is reimbursed for its Medicaid expenditures at its federal medical assistance percentage rate, which was 50.14% in 2020. This means that Illinois gets about 50 cents back from the federal

TABLE 2

Major state government revenue, annual changes in revenue and long-run growth rates

Category	2020 Revenue (in billions of dollars)	Change in revenue 2019 to 2020 (in billions of dollars)	Average Annual Growth rate 1998 to 2020
Individual Income Taxes, Gross of Local, Net of Refunds	17.6	-0.7	4.8%
Federal Medicaid Reimbursements	13.8	1.8	6.7%
Sales Taxes, Gross of Local Share	12.3	-0.2	2.5%
Federal Other	9.7	3.8	4.4%
Corporate Income Taxes, Net of Refunds	3.2	-0.4	3.2%
Licenses, Fees and Registrations	2.6	1.4	10.2%
Medical Provider Assessments	2.3	-0.1	6.8%
Motor Fuel Taxes, Gross of Local Share, Net of Refunds	2.3	1.0	2.6%
All Other Sources	2.2	0.3	3.7%
Receipts from Revenue Producing	2.2	-0.4	5.1%
Other Revenue	10.0	-0.4	3.0%
Total Revenue	78.3	6.0	4.2%

Data source: Illinois comptroller as processed by the IGPA Fiscal Futures Project https://igpa.uillinois.edu/policy-initiatives/fiscal-futures-project.

government for each dollar it spends on Medicaid. However, there are many exceptions to this general rule. Most notably, Medicaid expenditures for individuals who became eligible under the Medicaid expansion that was part of the Affordable Care Act are reimbursed at 90%.[3] Medical provider assessments ($2.3 billion in 2020) are earmarked revenue from hospitals and other medical providers that pay for Medicaid expenditures. After federal reimbursements ($13.8 billion) and provider taxes ($2.3 billion), the remaining Medicaid expenses of about $6.2 billion (calculated as $22.3 – $13.8 – $2.3) are paid for with other non-federal revenue.

General sales taxes are another important 2020 revenue source at $12.3 billion. Sales tax revenue fell only slightly in 2020 despite the COVID-19 pandemic, which severely truncated the operations of many of the businesses that normally collect sales taxes.

Early indications from the 2021 fiscal year suggest that sales tax revenue suffered, at most, modest declines despite the pandemic. Through the first half of the 2021 state fiscal year, sales tax revenue was up 1.5% compared to the previous year.[4]

By far, the largest increase in revenue in 2020 came from federal sources other than Medicaid reimbursements, which increased by $3.8 billion to $9.7 billion. Nearly all of this increase resulted from provisions of the federal government's Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provided more than $3.5 billion to the state of Illinois. The federal money came with rules about how it could be spent and much of the money was, or will be, spent in the 2021 state fiscal year, which runs from July 1, 2020 to June 30, 2021.[5] Illinois comptroller tabulations[6] show that about $1.1 billion of the $3.5 billion in CARES Act aid was spent during the 2020 fiscal year. Although final figures were not available as of early March 2021, at least $3.1 billion in CARES Act aid had been spent by the end of December of 2020.

The only other major revenue sources to change substantially in 2020 were licenses, fees and registrations, and motor fuel taxes. These increases were due to fee increases and increases in motor fuel tax rates, respectively.

Over the longer term, the only revenue categories that have grown faster than the 4.5% growth rate of spending are the individual income tax; federal Medicaid reimbursements; licenses, fees and registrations; medical provider assessments; and receipts from revenue-producing activity. Individual income tax revenue has increased due to rate increases enacted by state lawmakers. None of the other revenue categories are strictly related to economic activity. Thus, given Illinois' recent pattern of economic growth over the past two decades, revenue has grown, and likely will continue to grow, more slowly than the historic expenditure growth rate.

Illinois' long-term fiscal challenges have led to a significant buildup of unpaid bills. The Illinois comptroller is charged with disbursing payments to vendors that perform services or provide goods to Illinois. Since at least July 2015, Illinois has had a backlog of more than $5 billion of unpaid bills.[7] Under certain conditions, Illinois pays interest on unpaid bills. A 2018 Illinois comptroller's report documented a cumulative total of more than $2 billion in late payment interest penalties over roughly two decades.[8] Unpaid bills reached a high of more than $16 billion in calendar year 2017. Since then, the state has issued bonded debt to reduce the need for late payment interest, with a $6 billion issuance in 2017 and additional borrowing in 2020. While much of the state's outstanding bills have been paid, in early January of 2021, Illinois still had more than $5 billion of general funds unpaid liabilities.

EARLY IMPACT OF COVID-19 ON ILLINOIS' FISCAL CONDITION

On March 11, 2021, President Joseph R. Biden signed the American Rescue Plan Act of 2021 (ARP) into law.[9] It is a complex bill that allocates almost $2 trillion of federal spending, including substantial aid to state and local governments. According to an analysis by the Federal Funds Information for States, Illinois will receive approximately $7.5 billion in aid to the state government while Illinois local governments get $5.9 billion and Illinois public school

districts will get an additional $5 billion. The local and school district monies must be spent by the end of September 2023 while the state monies must be spent by the end of December 2024.[10] As of this writing, it was not possible to determine the myriad impacts the ARP might have on Illinois' fiscal position. The ARP should certainly lessen immediate fiscal strain but is unlikely to have much impact on Illinois' structural imbalance or the long-term fiscal issues discussed below. The ARP will make Illinois' fiscal management easier over the next several years but should not distract from the need to craft longer-term solutions.

COVID-19 is a significant public health event and has had a sizeable impact on the economy of the country and Illinois, but the effects on revenue have not been as great as originally feared. A report from the Institute of Government and Public Affairs in early 2021 found that the revenue impacts of COVID-19 were not "as dire as predicted at the start of the pandemic."[11] Although the state lost a sizable amount of revenue during the early part of the pandemic, the report says "much of that revenue loss has been made up since that time. Therefore, the net revenue loss to the state is much lower than" originally projected.

Less clear is COVID-19's effect on spending. A study last year foresaw large increases in Medicaid spending, which seem to have come to fruition.[12] However, Congress authorized a significant increase of six percentage points in the matching rate for all states and, as is evident from the data above, this has resulted in a very significant increase in federal reimbursements for state Medicaid expenditures. A national-level analysis of COVID-19's effects on the fiscal condition of state and local governments concludes that "in the aggregate, existing federal aid to state and local government appears sufficient, or at least nearly sufficient, to offset expected revenue shortfalls and increases in Medicaid expenditures for the 2021 fiscal year."[13] But the analysis cautions that "there is significant heterogeneity across states and localities… [and that] there are longer-term considerations that should be taken into account."

Currently available data suggest that the fiscal effects of COVID-19 on Illinois state finances have, thus far, been less severe than initially feared because income and sales tax revenue has been more robust than initially expected and because there has been significant federal support through increased Medicaid match rates and various kinds of federal stimulus payments.[14] However, the longer-term impacts of the crisis are still difficult to foresee. We remain cautious but optimistic.

HOW DO WE FIX THE FISCAL IMBALANCE?

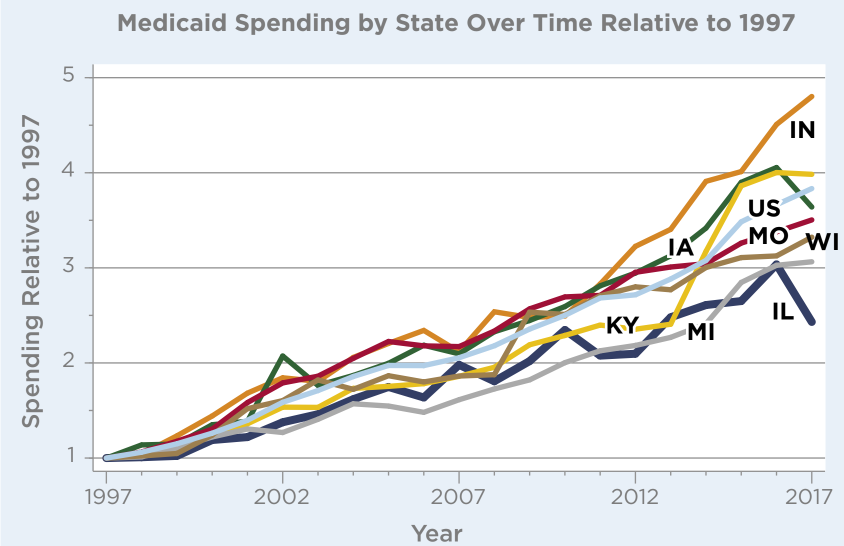
Even if the fiscal impacts of the COVID-19 pandemic are smaller than many initially feared, it is undoubtedly true that Illinois will continue to face significant fiscal challenges in the coming months and years. This raises the question of how Illinois can bring the state budget into long-term fiscal balance.

Fundamentally, there are only two possible solutions to a budget imbalance: cut spending or raise revenue. Further, revenue can be increased through either more economic activity, which raises the tax base, and hence revenue, or through changes in tax policy that extract more tax revenue from the same tax base. We discuss each of these possibilities in turn.

Cutting spending

As shown in Table 1 on page 3, the three major expenditures in the Illinois budget are Medicaid, K-12 education and pension funding. We divide our discussion of spending cuts into these three items and "everything else." We note that our discussion of potential budget cuts does not take into account court rulings, federal rules or other legal constraints that would restrict the state's ability to make budget cuts should elected officials so choose. Because of this, elected officials' discretion to enact budget cuts may be more limited than indicated here.

FIGURE 2



Sources: U.S. Centers for Medicare & Medicaid Services Form CMS−64 and authors' calculations.
Notes: Lines show states' total spending over time on Medicaid as a proportion of their 1997 spending. For example, a value of 2 indicates a state is spending twice as much as it did in 1997.

Medicaid

Illinois' Medicaid program is discussed extensively in a forthcoming report.[15] Here we simply summarize some basic facts. Over time, Illinois' Medicaid spending has actually grown somewhat slower than Medicaid spending in the U.S. as a whole, as well as Medicaid spending by other states in the region (see Figure 2).

According to a 2017 study, Illinois provider reimbursements are lower than average and lower than surrounding states.[16] In a national survey, the researchers found that Illinois' Medicaid Physician Fee Index for all Medicaid services is 0.85, compared to a national average of 1.00. Illinois' index is also below the value in Indiana (1.05), Iowa (1.04), Michigan (0.90), and Kentucky (0.98), but is above the value in Wisconsin (0.80).

Because Illinois' provider reimbursement rates are already low, it will be very hard to cut them further. Moreover, Illinois' Medicare spending growth is already less than that of many other states, so it will be difficult to reduce the rate of growth. In any case, as shown in Tables 1 and 2, although Illinois' Medicaid expenditures are quite high at more than $22 billion, much of the expenditures are funded with federal revenue and special provider taxes. Any reductions in Illinois' Medicaid spending also would lead to reductions in the federal revenue that matches Illinois' Medicaid expenditures. Because of this, even a dramatic reduction in Medicaid spending would do little to close Illinois' fiscal gap.

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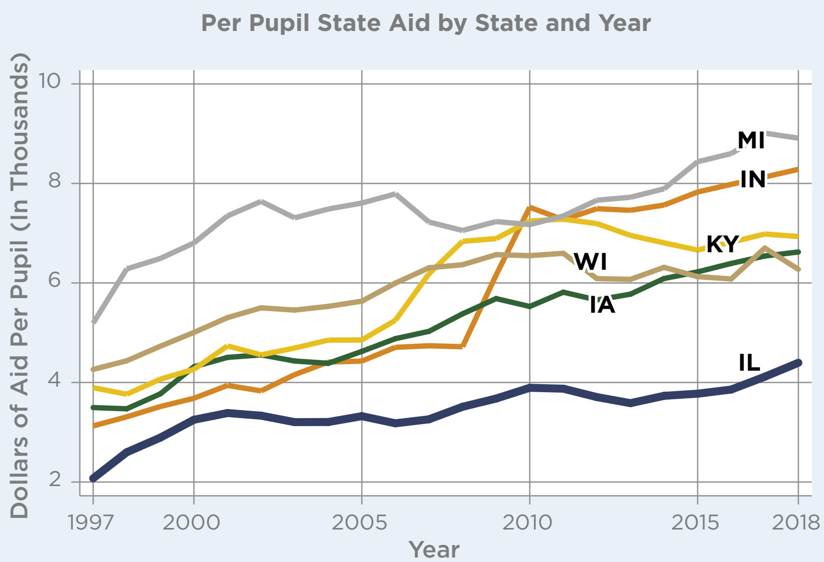
K-12 education

Net of federal aid, state of Illinois spending on K-12 education is greater than any other single category of spending, including Medicaid. Despite this, Figure 3 on page 8 illustrates the fact

that Illinois' per pupil state aid is very low by comparison to other states and has grown little in recent years. The General Assembly substantially revised the state school funding formulas beginning in 2018, using a new evidence-based funding distribution calculation.[17] This did little to change the overall funding level but committed to allocate future spending increases based on school districts' needs. The combination of relatively low per pupil state spending on education and recent commitment to funding formulas based on need make reductions in state spending for K-12 education very challenging to achieve.

FIGURE 3

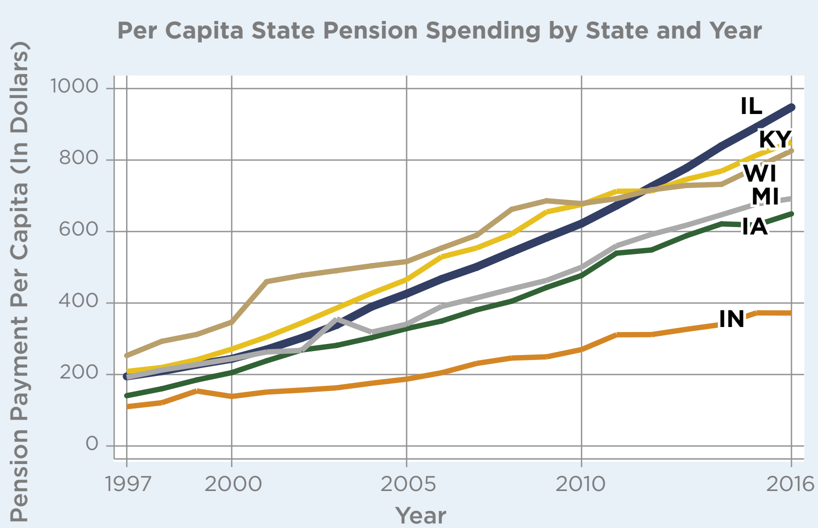


Sources: Pierson K., Michael Hand and Fred Thompson. 2015. "The Government Finance Database: A Common Resource for Quantitative Research in Public Financial Analysis," *PLOS One*, accessed March 25, 2021, https://doi.org/10.1371/journal.pone.0130119; author's calculations.

Pensions

Illinois' spending for state worker pensions has attracted much attention and is often viewed as the key reason for Illinois' current fiscal stress. Illinois' annual payments to the public retirement systems have grown dramatically in recent years, as Table 1 makes clear. Almost $1,000 per capita was spent on pensions in 2016, eclipsing any surrounding state according to U.S. census data shown in Figure 4. This difference should be understood with additional context, however. While Illinois spends 2.5 times as much as Indiana on public pensions on a per capita basis, its per capita pension spending is about 11% above Kentucky and 15% above Wisconsin. Per capita pension spending differs across states for many reasons including: whether public employees are covered by the Social Security system; whether local government employees (like teachers) are covered by the state pension system; and the extent to which

FIGURE 4



Sources: Pierson K., Michael Hand and Fred Thompson. 2015. "The Government Finance Database: A Common Resource for Quantitative Research in Public Financial Analysis," *PLOS One*, accessed March 25, 2021, https://doi.org/10.1371/journal.pone.0130119; author's calculations.

state payments are used to reduce unfunded liabilities. Higher per capita spending does not necessarily indicate that public employees have more generous pension benefits.

The most concerning issue with respect to Illinois' pension spending is the level of unfunded liabilities, rather than the current level of spending. According to the Illinois Commission on Government Forecasting and Accountability's (COGFA) June 2020 report, the five state of Illinois pension funds had a cumulative funded ratio—the ratio of assets to pension liabilities—of only 40.3%, with more than $137 billion of unfunded liabilities. Because of Illinois' large unfunded pension liabilities, total state pension contributions will rise from $9.2 billion in 2020 to an estimated $19.2 billion in 2045, according to actuarial projections shown in the COGFA report. This increase in pension payments will require an average annual (compound) growth rate of about 3%.[18] If Illinois maintains its long-term revenue growth rate of 4.2% shown in Table 2, COGFA figures suggest that the growth rate of pension payments will be less than the growth rate of revenue. As a result, if current trends are maintained, Illinois' pension payments will fall as a share of revenue over time.

The necessity for increased pension payments is solely the result of Illinois' statutory commitment to raise the funded ratio from its current 40.3% to 90% by 2045. Actuarial calculations reported by COGFA[19] project that Illinois' employer normal cost—i.e., the cost of the benefits accumulated by current workers during a given year—will fall from $2.2 billion in 2020 (or 11.1% of payroll) to only $694 million (or 1.8% of payroll) in 2045.[20] This dramatic fall in employer normal cost is the result of the switch to the less generous Tier II pensions for employees hired after 2010. The lower benefit levels in the Tier II pension system represented a significant cut in Illinois' long-term pension spending. Tier II pension benefits probably cannot be significantly reduced because federal law requires that pensions for those who are not enrolled in the Social Security system be at least equivalent to the benefit that would be received from Social Security.

Illinois has committed to reducing its large, unfunded pension liabilities, and the state constitution and court rulings prevent it from cutting pension benefits to current or retired employees. So, it will be very difficult for Illinois to reduce pension spending for the foreseeable future.

Everything else

Medicaid, K-12 education and pension spending totaled $42.8 billion in 2020 or 51.7% of aggregate state spending (see Table 1). The analysis above suggests that it will be extremely difficult to significantly reduce state spending in these categories. What about the rest of the budget?

Because the other categories of spending are relatively small, we do not explore them individually in detail. If Illinois spending is to be significantly reduced without severely compromising the services delivered to residents, it will likely require careful scrutiny of many individual spending programs to determine which ones most effectively provide value to Illinois residents.

It turns out that since July 2010, Illinois has had an initiative to do just that. Signed into law in July 2010,[21] Budgeting for Results (BFR) is a method of budgeting that justifies spending

based on program merit rather than the preceding year's allocation.[22] Illinois has identified seven spending priorities: education, economic development, public safety, human services, healthcare, quality of life,[23] and government services. Within each category, programs are evaluated based on their results or outcomes and money is then allocated based on the evaluation. In this way, BFR aligns the program outcomes with the spending priorities and public money is spent efficiently and effectively.

The BFR framework uses three tools: (1) the Illinois Performance Rating System (IPRS), (2) the Pew-MacArthur Results First Cost-Benefit Model (Results First), and (3) the State Program Assessment Rating Tool (SPART). The IPRS is a web-based database that provides an interactive performance dashboard for more than 400 state agency programs. Each of these programs is recorded according to the agency name and program name. Then at least one measure is assigned to the program, with the numerical value and the fiscal year shown next to the measure. The Results First model provides quantitative assessment to the various state programs. The evidence-based performance data from nine national research clearinghouses are used to identify programs in the IPRS that are matched with similar approaches shown in the clearinghouse database. After that, benefit-cost analysis is conducted to quantify the program returns. SPART adds a qualitative context to the benefit-cost analysis and, together with the IPRS and Results First, provides an overall program rating to the various programs that allows policymakers to compare them both within and across state agencies.

While BFR's IPRS system provides a great deal of data about measures that are relevant to the value of state programs to date, only a small amount of formal evaluation has been done through BFR. As of March 2021, the Results First/SPART website listed only 11 reports and all of them were confined to the rather narrow budget areas of adult and juvenile crime/corrections. Ten of the 11 reports provided estimates of the probability that the benefits of the program exceeded the costs. Four of the reports found the probability that the benefits of the program exceeded the cost of the program was 100%, three reports found a probability of less than 100% but more than 90%, while the other three reports found probabilities of 75%, 64%, and 50% that benefits exceeded costs. The 11th report provided technical details related to one of the other reports. Based on this in-depth rigorous examination of a few programs in the area of adult and juvenile corrections, there is little evidence that cutting spending will significantly improve Illinois' fiscal situation because the benefits of these programs have generally far exceeded costs.[24] While the Results First/SPART approach to evaluating spending is promising, it is currently too limited to provide evidence that could lead to major reductions in spending.

Whatever categories are going to be cut, the question remains as to how to justify the appropriateness of such cuts. A study by C.H. Levine proposed two criteria to evaluate cutback strategies—equity and efficiency.[25] Equity-based cutback means "sharing the pain" equally across all the units within the organization, irrespective of the long-run capacity of the organization as a whole. Efficiency-based cutbacks are allocated to minimize the organization's long-run loss of the total benefits, irrespective of how cuts are distributed across the units. Equity and efficiency are both important criteria that should be considered in assessing cutback strategies.

Increasing revenue

The alternative to cutting spending is to increase revenue. There are fundamentally two ways in which more revenue can be gained: increasing economic growth and changing revenue policies. We consider these two alternatives in turn.

Increasing economic growth

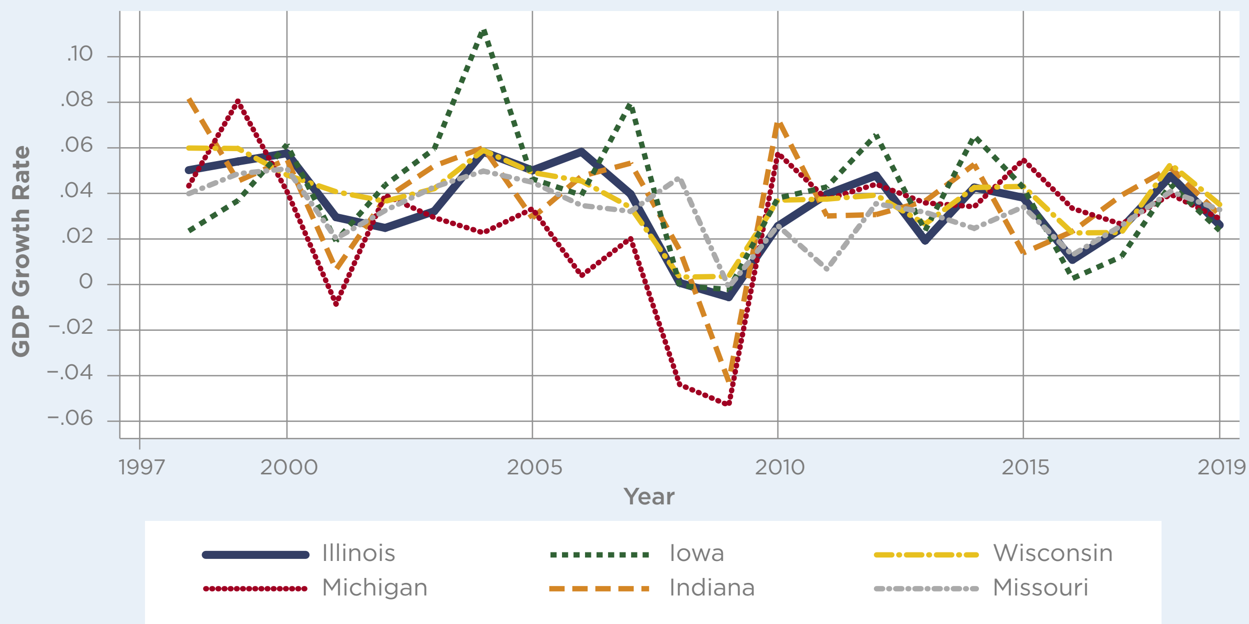
Many of Illinois' most important revenue sources, including individual income taxes, sales taxes, and corporate income taxes, are sensitive to economic conditions. The revenue generated by these sources will generally vary directly with economic output. As a result, an improved economy will often improve Illinois' fiscal condition. Economic growth is the preferred method to achieve fiscal balance because, unlike spending cuts or tax increases, it does not require anyone to sacrifice. Unfortunately, there is little evidence that state policymakers can do much to influence Illinois' short-term economic growth. Consider Figure 5 below, which shows annual growth rates of gross domestic product (GDP) in Illinois and surrounding states over the past two decades.

The six states examined have had varied economic bases and economic policies. They have, at different times, been led by elected officials with various political philosophies, ranging from the politically conservative to relatively liberal. Despite these differences, no state has consistently outperformed the others and there is a great deal of correlation in cross-state economic outcomes. From 2003 to 2006, every state in the group had a growth rate above 2.9% each year. In 2009, every state except Wisconsin had a negative growth rate. In 2018, the states' growth rates varied in the relatively narrow range from 4% to 5.1%. Illinois has generally been in the middle of the pack, with some states having lower growth rates and others having higher growth rates (except in 2006).

This is not meant to suggest that no state economic policy

FIGURE 5

GDP Growth Rate by Calendar Year 1998 to 2019



Source: U.S. Bureau of Economic Analysis

will have any effect on economic growth. There is solid economic evidence that some government policies can have benefits far exceeding their costs.[27] However, no matter what policies Illinois adopts, its economic growth is likely to always be buffeted by national and regional phenomena. Moreover, any policy changes that improve growth are likely to have only a modest impact on the state's short-term fiscal condition.

Changing revenue policies

Another, and perhaps the least appealing, option to reduce Illinois' fiscal gap is to change revenue policies to increase state revenue. Of course, a policy change that increases state revenue must come at a cost to whomever contributes the additional revenue.

Many groups have provided discussion and analyses of various options for increasing revenue, but Illinois' revenue structure has changed little in recent years. We believe there is little to be gained by restating the options. Rather, we refer readers to these past analyses themselves:

1. Center for Tax and Budget Accountability
2. Civic Committee of the Commercial Club of Chicago
3. Civic Federation
4. University of Illinois, Illinois Budget Toolbox.[28]

As revenue policy changes are discussed, the basic issues to be considered are:
- Equity (who pays or how is the tax burden distributed)
- Elasticity of the tax base (how people react when a tax is levied on them)
- Stability of the revenue source (predictions of how a revenue source grows relative to economic needs).

Systemic tax reform might be best formulated under the auspices of a nonpartisan and objective state tax commission comprised of independent experts who operate independently of elected officials.

We emphasize that these issues should be considered with respect to the entire tax system rather than any individual component. This is important because for a large, sweeping tax reform to be successful, efforts should be made all at once.[29] In this way, every change people do not like may be at least partially offset by other changes that people favor. Expansion of the sales tax base to food in grocery stores may have a questionable impact on equity but can still be acceptable if other aspects of the tax system are appropriately modified. For example, the earned income tax credit component of the individual income tax could be increased to offset any negative equity impacts from higher taxes on food. Comprehensive revenue reform should consider each of the three issues above across the entire revenue system. Evaluations of equity in particular should consider not only the entire revenue system but also government expenditures. Governments redistribute economic resources by policies on both the spending and revenue sides.

Systemic tax reform might be best formulated under the auspices of a nonpartisan and objective state tax commission comprised of experts who operate independently of elected officials. Such reviews may work best when elected

officials provide general policy direction (e.g., increase sustainable revenue by 10% without increasing the tax burden on households with less than the median income) but leave independent experts to craft several policy options. Tax commissions are often given six to 12 months to complete their work. Many states have considered, and sometimes adopted (in part or in whole), policy options formulated in this manner.[30]

CONCLUSION

Comprehensive, consistent data show that Illinois has had a significant fiscal gap for two decades. Overall spending has grown faster than revenue and spending growth has been particularly rapid in the very large categories of Medicaid and state pension contributions. Comparative data suggest that Illinois' general experience is much like that of other states in the region except that its recent pension spending has grown faster because of significant underfunding in earlier years. Fixing Illinois' fiscal problems will be challenging. There are no quick or painless fixes.

Solutions will take time and will require fiscal discipline that includes reductions in the rate of spending growth, as well as significant additional revenue. The fledgling Budgeting for Results initiative holds promise for applying objective information to resource allocation. More emphasis on, and resources for, this type of analysis could increase the efficiency of Illinois government.

Many analysts have discussed the best potential tools for acquiring additional state revenue, including broadening of the sales tax base to cover more services and broadening of the individual income tax base to include retirement income. Also, there have been many suggestions for increasing the fairness of Illinois' tax system. A tax study commission that could formulate independent, nonpartisan and objective proposals to comprehensively revise Illinois' revenue system offers promise as a path toward more fiscal stability.

ENDNOTES

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Publisher's Note

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