The Illinois Report 2012

CHAPTER 4

Through a Dark Glass: Illinois' Budget Picture is Dire and Distorted

By Richard F. Dye, Nancy W. Hudspeth and David F. Merriman

Unfortunately, Illinois' accounting and budgeting practices have not promoted good fiscal behavior and sometimes obscure the nature and extent of its fiscal challenges.

Illinois ended 2011 with a better financial situation than it faced a year earlier. However, the state began the year with a hole so deep that not even a massive tax increase and drastic spending cuts could come close to filling it. In this chapter, we use a carefully constructed model of the Illinois budget and detailed database about past revenue and expenditures to develop projections of future fiscal balance. This analysis delivers what is, perhaps, the headline message from our work: We find that maintaining increased income tax rates after they are scheduled to expire *and* extreme austerity with respect to spending could bring Illinois into fiscal balance by Fiscal Year 2019. We neither endorse nor reject this scenario but believe that it provides a useful baseline against which alternative fiscal plans can be measured.

Unfortunately, Illinois' accounting and budgeting practices have not promoted good fiscal behavior and sometimes obscure the nature and extent of its fiscal challenges. Illinois still has about $4 billion in unpaid General Funds bills, and no financial plan to deal with the backlog.[1] A major tax increase in January 2011 brought increased income tax receipts, but federal aid is down because the national stimulus plan has ended. General Funds spending was capped at 2 percent, but Illinois has more than 600 other funds that have no cap on growth. The state comptroller's website reports the deficits in the General Revenue Fund, but no one officially reports deficits in the non-General Funds.[2]

It took years of avoiding tough fiscal choices and a brutal recession to get Illinois' finances into such a mess. Denial, borrowing, one-time revenue, and other short-term solutions delayed the reckoning, but eventually the severity of the underlying problems restricted the state's cash flow and it became difficult to conduct day-to-day operations. This dire circumstance has penetrated the public and political consciousness. The tax increases and spending growth caps have been huge steps in the right direction, but other recent efforts to deal with the fiscal crisis have not been productive.

A number of proposals to expand revenue or cut spending are on the table, but as of this writing[3] none has passed. Major gambling expansion plans have been fiercely debated, but not yet enacted. Proposals to restructure public-employee pensions, lay off state workers, and close state-run

[1] In October 2011 the Comptroller's Office reported that in July, 2011, the bill backlog was $3.798 billion, and since that time "the Office has received $1.34 billion in FY 2011 bills. That means more than $5.1 billion in FY 2012 revenues will be used to pay off last year's bills." The outstanding liabilities above and beyond the $3.8 billion backlog include "unaddressed Medicaid bills, unpaid state employee health insurance bills and unpaid corporate income tax refunds held by the state agencies. Beyond those challenges, the GRF owes approximately $486 million to other state funds to pay back FY 2011 interfund borrowing, of which approximately $350 million is due to be repaid in FY 2012." Illinois Office of the Comptroller. *Comptroller's Quarterly*. Edition 41, October 2011 (pages 1-2.) http://www.ioc.state.il.us/index.cfm/resources/comptrollers-quarterly/; down from the $6.4 billion in the January 2011 report (Edition 38).

[2] For the General Revenue Fund balance see http://www.ioc.state.il.us/index.cfm/fiscal-condition/fiscal-condition/.

[3] Late November 2011, after the fall veto session of the General Assembly.

facilities have raised numerous legal issues and it could be years before these plans—if implemented—would save the state any money. Governor Pat Quinn, a Democrat, has proposed additional borrowing to pay down the state's overdue bills, arguing that the state has already spent this money, but these plans have been opposed by Republican leaders. Borrowing is becoming increasingly costly as Illinois' bond rating has been repeatedly downgraded, resulting in higher interest rates to sell the state's debt. As a result, social service providers, physicians, pharmacies, schools and other vendors that do business with the state continue to wait for payment.

A lack of clarity in the presentation of the state's finances further complicates the situation. Without an accurate assessment of the problem, it is all but impossible to make progress toward a solution. Although most people can agree that government transparency and accountability are laudable ideals, how do we know when a state's financial reports are transparent? Illinois has a lot of information posted on its websites, which give it high marks from some online transparency advocates, but in a recent 50-state study we found that Illinois is one of the least transparent states because of its practice of moving expenditure items between the General Funds and special funds budgets from one year to the next.

This chapter is divided into four sections. First, we review the events of the past year, beginning with the January tax hike, which—as our analysis shows—does not completely close Illinois' budget gap. Second, we present our latest long-term projections from the *Fiscal Futures Model* for three different policy scenarios. These scenarios demonstrate that achieving fiscal balance in

Richard F. Dye, The Fiscal Futures Project, IGPA

Nancy Hudspeth, The Fiscal Futures Project, IGPA

David F. Merriman, The Fiscal Futures Project, IGPA

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Illinois will require extraordinary willpower and careful fiscal monitoring. We then discuss our recent study of budget transparency that shows Illinois compares unfavorably to other states, and finally we outline some simple policy options that could make the state's financial reports more transparent.

2011 in Review: A Titanic Beginning

In *The Illinois Report 2011*, we described the fiscal situation at the beginning of the year in a chapter titled "Titanic and Sinking: The Illinois Budget Disaster."[4] We used the *Fiscal Futures Model*[5] to quantify a variety of policy scenarios for closing a Fiscal Year 2011 budget gap of about $11 billion. We illustrated that to balance the budget only with revenue increases would have required doubling the Illinois income tax or sales tax; to balance the budget only with borrowing would mean that by 2014 debt service would consume all the receipts from the personal income tax; and to balance the budget only by reducing expenditures would require cuts of 26 percent. We also illustrated the impossibility of doing nothing but wait for the economy to grow. Even if personal income, corporate income, and general sales taxes returned to their 2008 peak levels in inflation-adjusted dollars, state revenue would increase by only about $2.8 billion (net of revenue transfers to local government), far short of the amount needed to close the budget gap. The "Titanic" chapter also showed that if the state continues to spend more than it receives, unpaid bills could amount to nearly $40 billion by the end of FY 2013, with an associated payment delay of more than five years. In 2022, the backlog would be on the order of $230 billion and the payment delay would exceed 30 years. All in all, Illinois had little choice but to raise taxes.

The January 2011 Tax Increase and Spending Cap

Facing a mounting cash flow crisis, in mid-January 2011 the General Assembly took advantage of a short political window—during which lame-duck legislators could vote on unpopular legislation without fear of electoral reprisal—to enact a temporary increase in the state personal and corporate income tax rates. The legislation also included a cap on General Funds expenditures and authorization for new borrowing. Governor Quinn signed these into law shortly after legislative approval:

- **An increase in the personal income tax rate from 3 percent to 5 percent through 2014** (effective January 1, 2011). The rate then falls to 3.75 percent through 2024, and 3.25 percent after that.
- **An increase in the corporate income tax rate from 4.8 percent to 7 percent through 2014** (effective January 1, 2011). The rate then drops to 5.25 percent through 2024, and back down to 4.8 percent after that.[6]
- **A cap on General Funds spending growth of 2 percent per year for fiscal years 2012, 2013, 2014 and 2015**. Because scheduled and non-discretionary increases in pension contributions and debt service are more than 2 percent, the effective cap on non-pension, non-debt spending like Medicaid and school aid is closer to 1 percent per year. (Note also that the cap only applies to General Funds, which represent about half of the total state budget.)

[4] Dye, Hudspeth and Merriman, *The Illinois Report 2011*, Institute of Government and Public Affairs, University of Illinois pp. 28-38.

[5] *The Fiscal Futures Model* starts with past and current amounts for a broad measure of the state budget, broken down into a number of revenue and expenditure categories that are consistently defined over time. The statistical relationship for each budget category and selected economic or demographic "driver" variables is estimated. Those relationships are combined with projections of future values of the driver variables to make projections of the fiscal variables. See: http://igpa.uillinois.edu/fiscalfutures.

[6] Illinois also imposes a personal property tax replacement tax of 2.5 percent on the corporate income tax base. This was unaffected by the new legislation.

- **Authorization to borrow $3.7 billion to make the required payment for FY 2011 pensions** with that debt to be paid off over eight years.

Immediately after the January 2011 policy changes were enacted, the *Fiscal Futures Model* was used to project Illinois' budget gap before and after the changes.[7] The conclusion from these projections was that the January 2011 policy changes significantly reduced—but did not eliminate—the projected budget gaps. Instead of projected gaps growing steadily from $12 billion in FY 2012 to $29 billion in FY 2022, the tax increases and spending caps decreased the projected FY 2012 gap to the range of $4 billion to $10 billion.[8] Even with the new taxes and spending caps, the budget crisis in Illinois was worse than the $4 billion-$10 billion budget gap projection because:

- As of December 31, 2010 the state had $6.5 billion in unpaid bills from the prior 2½ years. The backlog was not addressed by the January 2011 (or any subsequent) legislation.
- Because the 2 percent growth cap is specified in terms of General Funds, it is still possible to increase spending more than 2 percent by shifting expenditures to non-General Funds.
- The January 2011 projections optimistically assumed expenditures will grow only 2 percent even after the cap expires. Historical rates of expenditure growth have generally exceeded 2 percent.
- Fiscal Futures Project calculations do not take account of pension liabilities that will be unfunded even if Illinois makes the statutorily required pension payments.
- The $4 billion-$10 billion gaps will have to be dealt with somehow, causing additional problems.
  - Longer payment backlogs will increase service costs as some vendors stop doing business with the state and others raise prices to compensate for the delay.
  - New borrowing will mean new debt service obligations in future years.
- Worsening underfunding of pension obligations will increase future gaps.
- Revenue from the new tax rates might be lower than projected because businesses or workers could leave the state to avoid the higher burden. Others might decide against moving into Illinois, diminishing the state's future economic growth.

The bottom line is that the fiscal crisis in Illinois is far from over, even after the tax increases.

Subsequent Budgetary Events and Actions

There have been a number of proposals for new revenue and cost savings since the tax increase in January 2011. But compared to the size of the state's budget imbalance, the receipts or savings—if realized—are relatively modest.

1. FY 2011 (July 1, 2010 - June 30, 2011, with an "extended lapse period" until December 31, 2011, during which bills accrued during the fiscal year may be paid):

- In December, 2010 the state securitized its tobacco bonds for $1.5 billion (a one-time revenue source for FY 2011).[9]
- Pension restructuring legislation affecting current employees was proposed in the spring but failed to pass.[10]
- Gambling expansion was proposed, but not approved in FY 2011.
- Just before the end of FY 2011, Illinois issued $4 billion in pension bonds to pay its required contribution. Illinois has not yet made its required FY 2012 contribution.

2. FY 2012 (July 1, 2011 to June 30, 2012):

- In July, a private company began managing the Illinois State Lottery. In its proposal, the company said it will generate an additional $1.1 billion to $1.5 billion more than what the state had originally projected the lottery

7 *Fiscal Futures* analyses use a broad budget concept (which we call the consolidated funds budget) rather than the narrow and more commonly discussed General Funds concept to analyze Illinois' fiscal health. There are very large and important differences between these two budget concepts and, for reasons discussed in more detail later in this chapter, we believe that our broad concept is strongly preferable to General Funds.

8 "Fiscal Fallout #5: The large tax increase just enacted falls short of closing the state's enormous budget gap," Fiscal Futures Project, Institute of Government and Public Affairs, University of Illinois, January 18, 2011, http://igpa.uillinois.edu/system/files/documents/FF-5-18jan11.pdf.

9 http://www.bondbuyer.com/issues/119_480/-1020672-1.html.

10 http://www.suntimes.com/news/metro/5678933-418/pension-reform-put-off-by-illinois-lawmakers.html.

would earn through the next five years.[11]

- In August, after the national debt ceiling crisis and ratings downgrade, Moody's—a major credit rating agency—issued a special statement on the dire state of Illinois finances.
- In early August, Illinois' Republican leaders held a press conference to state their opposition to further borrowing.
- In September, the Illinois State Toll Highway Authority board voted unanimously to pass a $12 billion, 15-year capital plan to expand and modernize the tollway. Tolls will increase 87 percent.[12]
- Also in September, Governor Quinn announced plans to lay off thousands of state workers and close seven mental health and correctional facilities in response to the reduced budget.[13] In October, an arbitrator ruled that the governor's layoffs would violate prior agreements made with the American Federation of State, County, and Municipal Employees (AFSCME). In addition, the plans for facilities closures were being challenged.[14] On November 29, 2011 the governor and legislators reached a last-minute agreement to keep facilities open and prevent layoffs by shifting money from special funds into the General Funds.[15]

As illustrated by these events, after the January legislation very few changes have been made that would help bring Illinois to solvency. Perhaps political leaders and the public believe that the tax increase and spending caps are solving the state's fiscal problems. To determine whether that is the case, we used the *Fiscal Futures Model* to project revenue and expenditures into the future for four possible scenarios. As we demonstrate in the pages ahead, solving Illinois' budgetary imbalance is going to be a very difficult struggle for the coming decade.

New Consolidated Budget Projections from the *Fiscal Futures Model*

We present the latest budget projections from the *Fiscal Futures Model* for four possible scenarios: (a) assuming current law, i.e., the increased tax rates are really temporary, and will be phased out beginning in 2015; (b) assuming that the higher tax rates remain indefinitely; (c) assuming that the spending growth rate can be limited to the inflation rate; (d) maintaining higher tax rates and limiting spending growth to inflation. Each of these scenarios shows that budgetary deficits will continue to be a problem in the years ahead, but the state's finances will be more stable if the higher tax rates remain in place beyond 2015.

Scenario A: Consolidated budget gap projections under current law

The *Fiscal Futures Model* projects growth rates for a number of separate spending and revenue categories of the consolidated funds budget.[16] We use this model and the latest available data to estimate Illinois' current and future fiscal situation. The October 2011 version of the *Fiscal Futures Model* (using the most current data available as this was written) uses revised, but not yet final, data for FY 2011 and updated estimates for FY 2012.[17] In compiling numbers for FY 2012, we have used the most current available estimates from the Commission on Government Forecasting and Accountability (COGFA), the Illinois Office of the

[17] Fiscal Year 2012 does not end until July 2012, so it is not yet known what the final, actual receipts and expenditures will be or what the "lapse period" for final payments will be. FY 2010 and 2011 lapse periods were extended from two months to six months past the end of the fiscal year. The *Comptroller's Detailed Annual Report* for FY 2010 is not available (as of December 1, 2011). FY 2011 data is available on the Comptroller's website drilldown but since the lapse period is not over until December 31, expenditure numbers for FY 2011 are still changing and are often revised.

[11] http://www.huffingtonpost.com/2010/09/03/illinois-lottery-contract_0_n_704944.html.

[12] http://www.suntimes.com/news/transportation/7271678-418/illinois-tollway-board-approves-steep-toll-hike.html.

[13] http://articles.chicagotribune.com/2011-09-06/news/ct-met-pat-quinn-illinois-budget20110906_1_quinn-plans-major-state-employees-union-pat-quinn.

[14] http://www.cnbc.com/id/44758783/Illinois_Can_t_Lay_Off_1_900_State_Workers_Arbitrator also see http://www.pantagraph.com/news/state-and-regional/illinois/ article_33d5792e-00d0-11e1-94b1-001cc4c03286.html.

[15] http://illinoisissuesblog.blogspot.com/2011/11/lawmakers-say-budget-deal-fixed.html

[16] See http://igpa.uillinois.edu/system/files/fiscal_futures_documentation_25may11 percent20 final.pdf for much more detail on data and methods.

Comptroller, and the Governor's Office of Management and Budget (GOMB). However, not all agencies and receipt categories have estimated total budgets from all funds (as opposed to General Funds) available. Therefore, in some cases we have had to estimate based on past trends.

Illinois' four-year, 2 percent cap on spending growth applies to General Funds expenditures. However, debt service and pension fund contributions from General Funds are scheduled to grow by more than 2 percent. So, to remain within the constraints of the spending cap, we estimate that non-debt General Funds spending may grow by a maximum of

- 0.8 percent in FY 2013,
- 1.1 percent in FY 2014, and
- 0.6 percent in FY 2015.[18]

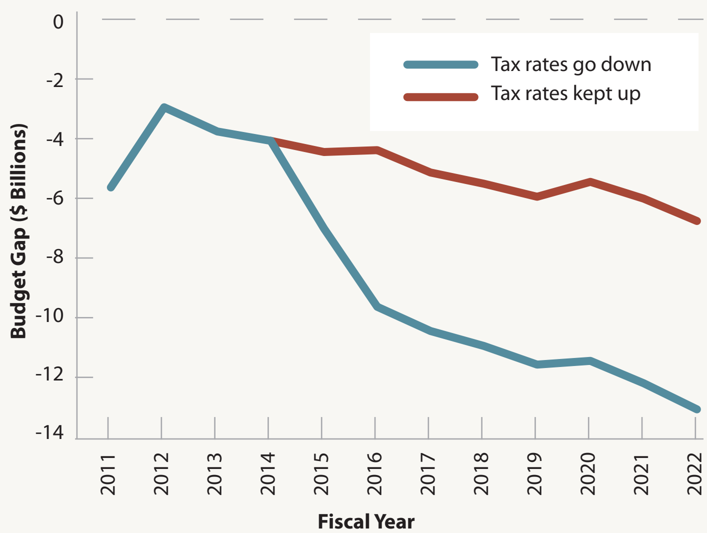
General Funds spending represents less than half of total spending in the 380-fund consolidated Illinois budget used in the *Fiscal Futures Model*. The General Funds share of total spending varies widely across the categories of expenditure—from zero percent for employee health care spending to 95 percent for corrections spending.[19]

Since the spending caps apply only to a fraction of the total budget, it is quite possible that they will not be binding. When spending starts to grow beyond the limits set on the General Funds, parts of the budget could be moved into the non-General Funds. If this happens, spending will continue to grow at the same underlying rate. Instead of this pessimistic (but plausible) possibility, the model projections for FY 2013-15 assume that the General Funds portion of each spending category really grows only by the allowable 0.8 percent, 1.1 percent, or 0.6 percent maximum each year while the non-General Funds portion grows at the rate estimated for that category from historical evidence. After 2015, growth rates estimated from historical data are applied.

The long-term projections of the budget gap from the *Fiscal Futures Model* are shown by the blue line in Figure 1. If the higher tax rates are phased out beginning in 2015, the consolidated-funds budget gap is projected to rise from just under $3 billion in 2012 to almost $13 billion in 2023. Note the big jump in the projected deficit when the personal income tax rate drops to 3.75 percent in 2015 from 5 percent in 2014.[20] Figure 1 illustrates the important point that the fiscal crisis in Illinois is far from over despite large tax increases and tight spending caps.

Figure 1

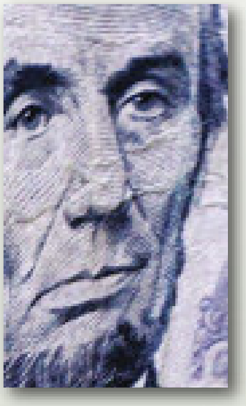
Projected Gap in Consolidated Budget With and Without Phase-out of Income Tax Rate Increases



Source: IGPA Fiscal Futures Model, with information as of November 6, 2011

[18] The corresponding share for FY 2012 was also less than 2 percent, but 2012 spending is estimated directly from budget documents and not projected by the model.

[19] See Figure 9 below and Dye, Hudspeth and Merriman, "Why Ignore Almost Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting." Institute of Government and Public Affairs, University of Illinois, July 2011, http://igpa.uillinois.edu/system/files/Fiscal percent20 Futurespercent20Budgetpercent20Transparency percent20Report.pdf.



Scenario B: Consolidated budget gap projections with no drop in tax rates

The red line in Figure 1 shows the projected budget gap if the higher income tax rates—5 percent personal and 7 percent corporate—are retained past the 2015 expiration date. If the tax rates were to remain at the higher levels, this would substantially reduce, but not eliminate, the projected consolidated budget gap for Illinois. The deficit would be more than $4 billion in FY 2015, would grow each year, and exceed $6.5 billion in FY 2022. The growing budget gap results from the fact that the model projects revenue to grow more slowly than spending—a difference of about 1 percent per year.

Scenarios C & D: Keep the growth rate in spending down to the inflation rate

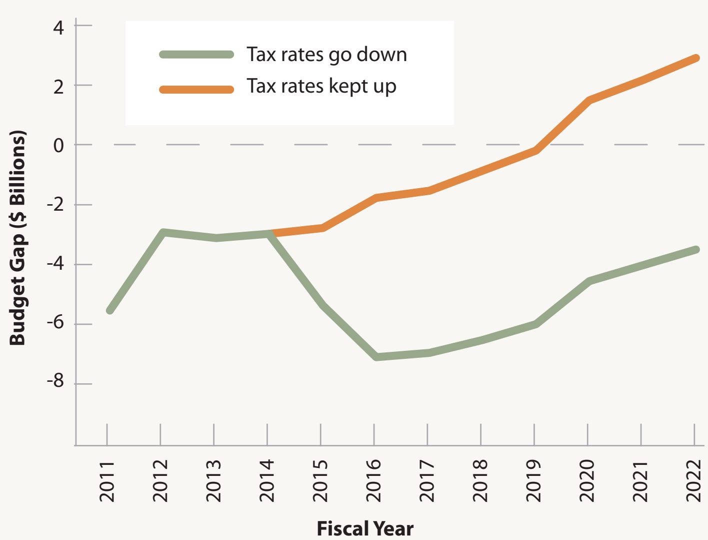
The spending growth cap applies just to General Funds spending and expires after FY 2015. What if spending growth could be constrained across the entire consolidated budget and further into the future? The projected inflation rate in the *Fiscal Futures Model* varies slightly from year to year, but averages about 2.1 percent per year for the next 10 years.

Figure 2 shows *Fiscal Futures Model* projections of the consolidated budget gap assuming: the same impact of the cap on General Funds spending through 2015 that was assumed in preparing the estimates used for Figure 1, scheduled changes in debt service and pension spending, and the same drivers of revenue growth in all years; General Funds spending growth is held to the inflation rate after 2015; and other spending grows at only the inflation rate both before and after 2015.

The green line in Figure 2 illustrates Scenario C. If the higher tax rates are allowed to expire, the projected gap in the consolidated budget would reach $7 billion in FY 2016 and then, because inflation-only growth in spending would be less than revenue growth, the gap would decline each year and reach $3.5 billion in 2022. The orange line represents Scenario D with both higher taxes and spending constraint. If spending growth is held to inflation *and* the higher income tax rates are *not* phased out, the consolidated budget is projected to roughly balance in 2019 and reach a surplus of $3 billion in 2022.

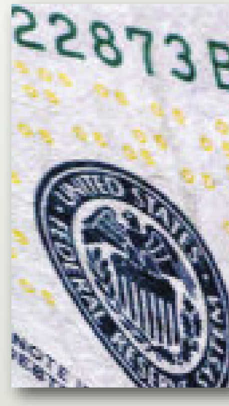
Keeping the growth rate of all spending down to 2.1 percent per year would require severe cuts in state programs. Over the long term, wages tend to grow at a higher rate than inflation, and only by doing so can the real standard of living grow over time. The model assumes that state contributions to pensions grow as currently scheduled by law, but that schedule will result in growing unfunded liabilities unless there are major changes to pension law. Medical costs, which show up in the state budget both as Medicaid and contributions for employee

Figure 2
Projected Gap in Consolidated Budget if Future Growth in All Non-Pension, Non-Debt Spending Can be Held to the Inflation Rate With and Without Phase-out of Income Tax Rate Increases



Source: IGPA Fiscal Futures Model, with information as of November 6, 2011

[20] By stopping the projections in 2022, the detrimental effect on the projected deficit of a further drop in the income tax rate in 2025 to 3.25 percent is not shown.



health care, have grown well in excess of either the price inflation rate or the growth in other government spending and are projected to continue to do so.[21]

As brutal as it would be to hold overall spending growth to the inflation rate and to maintain tax rates at or near current levels, it is reassuring to see projections that suggest Illinois' fiscal problems are potentially manageable over the next 10 years. In *The Illinois Report 2011*, we estimated that the state budget gap was so massive that correcting it with a change in any single policy instrument would be impossible. The big tax increases enacted in January 2011, the spending cuts that have been made so far, and the additional cuts necessary to achieve the General Funds spending caps have whittled the gap from impossibly large to *potentially* manageable. That's progress.

Before FY 2011, the state did very little long-range fiscal planning, but legislation enacted in January 2011 mandated multi-year forecasting and planning for some elements of Illinois' budget. In April, the Commission on Government Forecasting and Accountability (COGFA) issued multi-year budget projections for General Funds revenue and spending for FY 2012 thru FY 2014. It is a very important step forward, but as we discuss in the following sections, General Funds are not the total state budget. This fact is not obvious because looking at Illinois' budget picture is like looking through a dark and distorted glass. The state could do a much better job of presenting budget information in a clear, broad, and consistent way to help Illinois move toward fiscal solvency.

Budget Transparency: Benefits and Measures[22]

We believe that a focus on the seemingly arcane topic of budgetary reporting may be an important facet of fiscal reform and recovery. State budgets in Illinois and other states are massive, complicated documents that use idiosyncratic and sometimes inconsistent accounting conventions. Moreover, budget information is not always presented in a timely manner or an easily accessible form. Worse, confusion follows transactions that can flow through multiple funds or accounting conventions that change from one year to the next.

The General Funds budget represents less than half of state receipts and spending—a fact that is not always well-understood. Presenting clear budget categories—without fund shifts and transfers—increases transparency. As we have explained, the *Fiscal Futures Model* uses a broad and time-consistent budget concept—consolidated expenditures—which prevents distortion by idiosyncratic accounting practices. Without an accurate assessment of the problem, it is more difficult to make progress toward a solution. If voters are to be asked to make difficult choices, elected officials have an obligation to provide clear and transparent information about the actual history and constraints faced by the state.

It is easy to agree that complicated, hidden, and inconsistent budget practices are not desirable and that greater transparency would help create more informed policymaking. But how does one go about measuring budget transparency? A recent report by the IGPA Fiscal Futures Project team, *Transparency in State Budgets: A Search for Best Practices*, examines budget transparency from several perspectives. But before presenting our own indicators of budget transparency, we briefly review past work by others: academic and professional studies of government budget transparency, and public interest organizations' evaluations of public access to state budgetary information.

Academic and professional studies of government budget transparency

In academic literature, there are transparency studies published in political science, public administration, and

[21] The Congressional Budget Office calculates "excess cost growth for spending for health care" as 1.7 percentage points per year for the 1985 to 2007 period and uses that same figure in their long-term projections, http://www.cbo.gov/ftpdocs/122xx/doc12212/06-21-Long-Term_Budget_Outlook.pdf, Table 3-1, p. 42.

[22] This section draws on Dye, Hudspeth, and Merriman, "Transparency in State Budgets: A Search for Best Practices," Institute of Government and Public Affairs, University of Illinois, September 2011, http://igpa.uillinois.edu/content/transparency-state-budgeting.

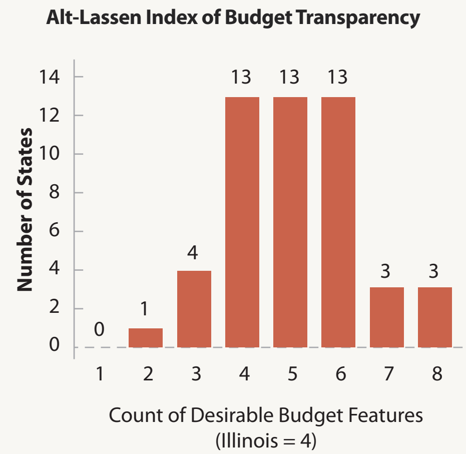
economics journals. Most of these studies: (a) identify desirable characteristics of the timing or content of budget information; (b) find measurable indicators of these; (c) compile an overall score for each government studied; and (d) look for a statistical association between budget ttransparency scores and cross-government differences in outcomes—such as the size of the budget, debt, or how informed the electorate is. Empirical studies generally find that greater transparency is associated with favorable outcomes. Almost all of the academic articles describe transparency differences between nations. Only one group (James Alt and co-authors) has published academic studies on budget transparency among the United States.

Using recent data from the National Association of State Budget Officers (NASBO) we reconstructed an index based on the work of Alt and co-authors with current data.[23] The criteria, number of states with a "yes" and results for Illinois are:

- Budget is reported using generally accepted accounting principles (GAAP); 16 states, including Illinois, "yes";
- Multi-year expenditure forecasts are used; 38 states, including Illinois, "yes";[24]
- Budget cycle is annual; 29 states including Illinois, "yes";
- Revenue forecasts are binding; 32 states "yes," Illinois "no";
- Legislative branch has or shares responsibility for revenue forecasts; 37 states "yes," Illinois "no";
- Appropriation bills are written by non-partisan staff; 31 states "yes," Illinois "no";
- Tax or expenditure limitations; 29 states "yes," Illinois "no";
- Budget requires published performance measures; 42 states, including Illinois, "yes."

Figure 3 shows the distribution of states by the total number of "yes" scores for the above

Figure 3
Tally of State Budget Transparency Indicators Number of States with Each Count



Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

criteria. Illinois' tally of only four "yes" scores is below 32 other states that score a "yes" on from five to eight of the criteria.

Public interest organizations' evaluations of public access to state budgetary information

There are three groups that score states based on the online accessibility of their budget and related information: Good Jobs First, U.S. Public Interest Research Group (PIRG), and Sunshine Review. Figures 4-6 show the number of states given A, B, C, D, and F grades by each of the organizations.

Compared to other states, Illinois is graded fairly highly and earns a "C" from Good Jobs First, a "B" from U.S. PIRG, and a "B" from Sunshine Review.

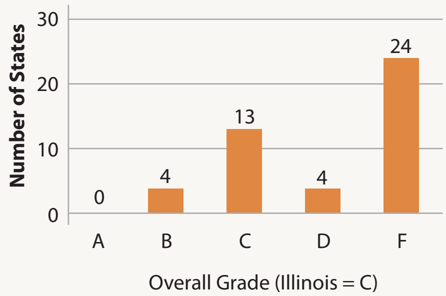
A fourth public interest group, Truth in Accounting, reports the average number of days from fiscal-year end to the release of the important Comprehensive Annual Financial Report (CAFR). As shown in Figure 7, Truth in Accounting groups the states into three categories:

- "timely," up to 179 days;
- "tardy," 180-279 days;
- "worst," 280 or more days, including Illinois at 316 days.

[23] See our *Transparency in State Budgets* for more details and full citations.

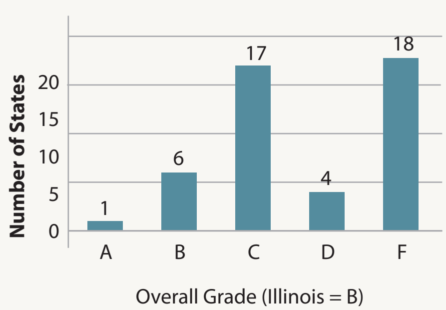
[24] Our on-the-ground experience confirms all of the Illinois-specific NASBO data except for the claim that Illinois uses multi-year expenditure forecasts in compiling its budget. For national consistency, we have used NASBO data for all states but note that NASBO error on this item causes Illinois to appear to have a more transparent budgeting process than it does in reality.

Figure 4
Good Jobs First: Internet Disclosure of Budget and Other Information



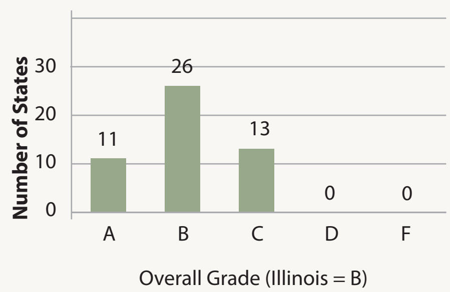
Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

Figure 5
U.S. PIRG: Web-Page Access to Budget Information



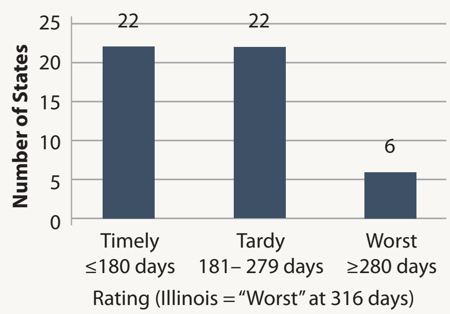
Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

Figure 6
Sunshine Review: Completeness of Online Budget Information



Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

Figure 7
Truth in Accounting: Number of Days to Release of CAFR



Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

General Funds versus special funds shares of total spending

As we have discussed above and elsewhere[25] our study of Illinois has demonstrated that accounting procedures that narrow the focus of budgetary discussions to General Funds can lead to obfuscation and confusion, and can enable the use of unsustainable budgetary practices. Using this insight, we developed four original indicators of fiscal transparency: (a) the share of total spending that comes from special—as opposed to General—funds; (b) year-to-year variation in that share; (c) the magnitude of net transfers between General Funds and special funds; and (d) year-to-year variation in net transfers. Because General Funds are more commonly reported, using special funds or transferring funds back and forth can cloud the budget picture. Year-to-year changes in special funds or in fund transfers may alter the frame of reference and confuse budget watchers.

Table 1 and Figures 8 and 9 show Illinois' scores on these measures. Note that for all four measures, lower scores imply greater

[25] Dye, Richard, Nancy Hudspeth and David Merriman July 2011. "Why Ignore Almost Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting." Institute of Government and Public Affairs, University of Illinois, July 2011, http://igpa.uillinois.edu/content/igpa-report-examines-strategy-transparent-budgeting.

transparency and higher scores imply less budget transparency.

Figure 8 and the first row of Table 1 show that the special-fund share of total spending in Illinois is far below the 50-state average in each year and eighth-lowest among states overall. Illinois' relatively good score on this measure of transparency may be misleading. The other three indicators suggest a lack of transparency. Inspection of the year-to-year changes in Figure 8 and the second row of Table 1 indicate that variation in the special-fund share of the state of Illinois budget is extraordinary. Only three states have more average variability—i.e., less transparency—than Illinois.

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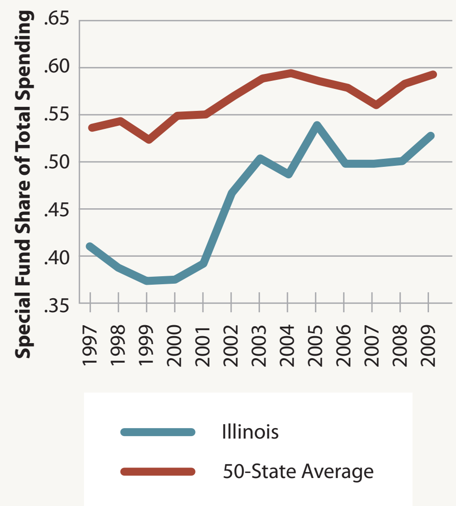
Figure 9 and the third row of Table 1 indicate that Illinois has extremely large within-year transfers from General Funds to special funds (Measure C). While the 50-state average is about 2 percent, Illinois variation ranges from 8 percent to 17 percent and averages around 13 percent. Illinois is ranked 49th among the 50 states on the special-General fund transfer share. The final row of Table 1 summarizes Measure D, the year-to-year variation in the transfer share. Large year-to-year jumps, as seen in Figure 8, result in Illinois being ranked 39th on this measure of non-transparency, among the worst in the nation.

Figure 8
Special Fund Share of Total Spending



Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

The importance of broad and consistent consolidated reporting to promote budget transparency

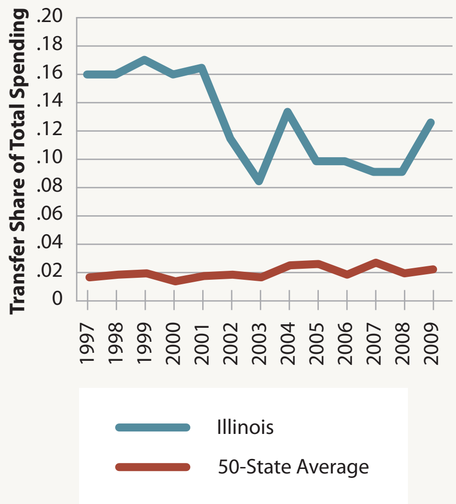
Illinois scores poorly on academic and other measures of budget transparency. This lack

Table 1
Fiscal Future Measures of Fiscal Transparency for Illinois
(Higher scores imply more confusing budgets thus lower transparency)

	Average Illinois Score FY '97-09	**Illinois' Rank**	**Illinois' Transparency**
A. Special Fund Share of Total Spending	.458	8	High
B. Variation in Special Fund Share	.061	47	Very Low
C. Special-General Fund Transfer Share of Total	.127	49	Very Low
D. Variation in Inter-Fund Transfer Share	.032	39	Low

Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

Figure 9
Special-General Fund Transfer Share



Source: Dye, Hudspeth and Merriman, "Transparency in State Budgets," September 2011

of transparency may have contributed to the difficult fiscal situation in which Illinois now finds itself. More importantly, the lack of clear, accessible information about the Illinois budget and fiscal condition may inhibit constructive discussions about potential remedies. The Fiscal Futures Project has developed both conceptual and concrete proposals for reformed reporting of Illinois' budget. We believe that the advantages of transparency support our call for Illinois to adopt a broad-based, time-consistent framework for reporting its revenue and expenditures.

If Illinois is to effectively deal with its fiscal challenges it will need widespread compromise and cooperation. Trust among groups with differing political agendas and constituencies will be required. Clear, accurate and complete budgetary information will enable discussions that can lead to trust and mutually acceptable sacrifice for the good of the state.

Toward consolidation and greater transparency[26]

The state of Illinois has hundreds of separate funds created to monitor the receipt and use of public money. There are four General Funds, seven highway funds, five debt-service funds, nine bond-financed funds, and hundreds of others, including nearly 300 federal and state trust funds. Some important categories of spending, such as transportation, do not come out of the General Funds budget. Other agencies' budgets use a combination of General Funds and special funds. Over time, the use of non-General Funds has increased, and today General Funds represent less than half of the total budget. Still, most discussion of Illinois' budget concentrates only on the four General Funds.

If properly used, fund accounting can help policymakers determine the use of scarce resources and bolster public trust. However, the complexity and multiplicity of funds can also be used to mystify, obscure and even distort true budgetary actions. Reporting only the General Funds budget—while increasingly using non-General Funds—allows important budgetary choices, such as changes in transportation spending, to be made with little scrutiny. It also becomes harder to monitor actual changes in spending from one year to the next. These limitations, in turn, make it more difficult to foresee future budgetary problems.

Adding more funds to budget reporting presents a more accurate and complete picture of the state's fiscal situation. The Fiscal Futures Project team created a consolidated funds budget that tracks 380 funds and uses historically consistent categories of spending and receipts. This view of the budget brings important categories of state spending—transportation, debt service, transfers to local government, and federal grants—into budget analysis and discussion of priorities.

The consolidated budget also provides more consistency over time. Assigning an item to General Funds in one year and to a special fund in the next does not change *total* spending. But if the focus is only on

[26] Ibid.

We believe that the advantages of transparency support our call for Illinois to adopt a broad-based, time-consistent framework for reporting its revenue and expenditures.

the General Funds, it would appear that spending went down. Fiscal Futures Project consolidated budget reporting is not affected by changes in the assignment of spending (or revenue) from General Funds to special funds and vice-versa because it tracks *total* spending, regardless of fund assignment.

Another advantage to consolidation is that inter-fund transfers cancel out. Transfers between General Funds and special funds can obscure the magnitude of actual changes in the state's budget situation. This could be manipulated when there is a political advantage to making the budget look bigger or smaller. Fiscal Futures Project consolidated budget framework is not distorted by transfers because revenue and expenditures are treated comprehensively.[27]

Figure 10 illustrates the difference between the General Funds and consolidated funds budgets with data from Fiscal Year 2010. The General Funds share of final spending ranges from zero for Transfers to Local Government to 10 percent for Environmental and Natural Resources, and is more than 80 percent only for Higher Education and Corrections. Overall, as shown in Figure 11, the General Funds share of final spending is only 41 percent of the consolidated total.

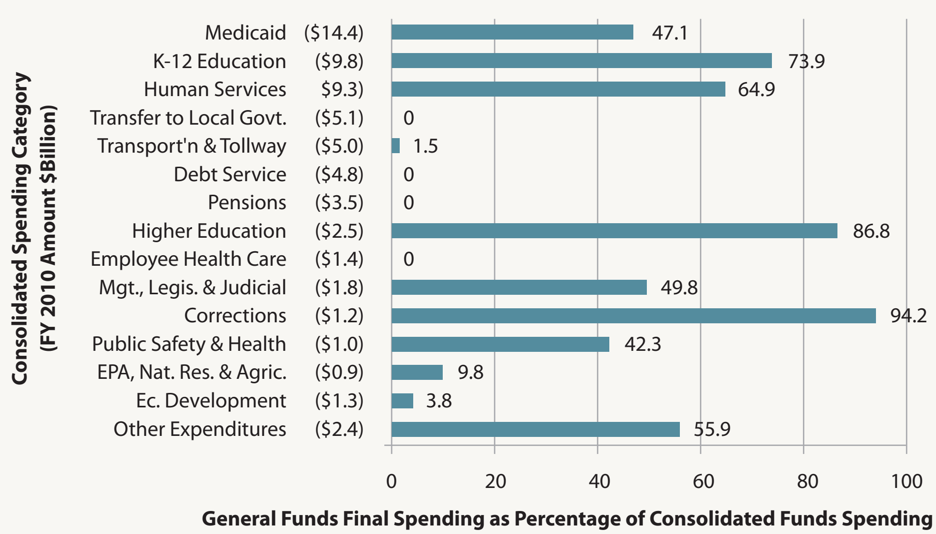
Special funds often hold federal dollars or other earmarked revenue that comes with strings attached. Some argue that for this reason, non-General Funds should be excluded from budget presentations.[28] We believe non-General Funds should be included for two reasons: (a) the legislature could change past decisions to earmark certain revenues and (b) dollars in special funds are important substitutes for, or complements to, General Funds expenditures and should be carefully considered in budgetary discussions. For example, if federal dollars become available for a specific program, such as education, they will be placed in a specially designated fund. The portion of the General Funds budget that is used for education could then be reduced.

[27] Ibid.

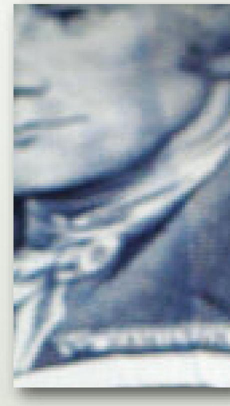
[28] For example, Governor Pat Quinn, FY 2011 State of Illinois Budget Address, March 10, 2010, Transcript Final Draft. http://www2.illinois.gov/budget/Documents/FY percent202011 percent20 Transcript.pdf accessed 4-4-11.

Figure 10

General Funds Expenditures as a Percentage of Consolidated Funds Expenditures



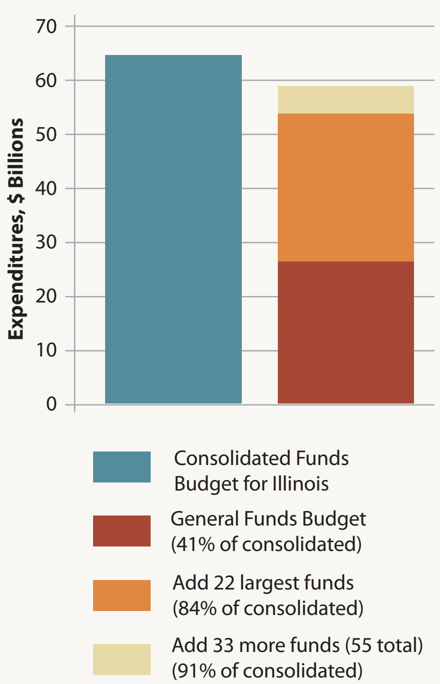
Source: Dye, Hudspeth and Merriman, "Why Ignore Almost Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting," IGPA, July 2011



Which special funds are the most important? Adding the 22 largest non-General Funds into reporting with the General Funds covers more than 80 percent of total consolidated spending. Adding 55 funds into reporting with the General Funds covers more than 90 percent of total consolidated spending. In our full report on budget consolidation, we provide tables that show how the General Funds budget differs from the total budget, as well as lists of key funds.[29]

Another alternative, perhaps easier to implement, would be to expand the number of General Funds to include 10 or 20 of the largest non-transportation funds that are currently designated as special funds.

Figure 11
Comparing Fiscal Futures Consolidated Funds Budget for Illinois to General Funds, General Funds plus 22 Funds, and General Funds plus 55 Funds, Fiscal Year 2010



Dye, Hudspeth and Merriman, "Why Ignore Almost Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting," IGPA, July 2011

A final note: combined or consolidated reporting does not mean that any accountability and control restrictions on the use of particular funds have to be changed. It just means that those funds would be easier to monitor and could be subjected to more scrutiny. It is also important to note that with any form of budget consolidation, annual monitoring is necessary to maintain consistency.

Difficult Choices Ahead

The true extent of Illinois' fiscal problems cannot be seen with the General Funds-only budget, which is less than half of the total. Worse, the scope of the General Funds can change from one year to the next with reassignments or transfers from special funds to General Funds or vice versa. A broadly and consistently defined all-funds measure of the state's budget is needed.

Likewise, more transparent consolidated budget reporting could help policymakers understand the magnitude of the problems and the difficult choices that need to be made going forward. Consolidated budget reporting would also make the gaps and alternative solutions more comprehensible to voters and help avert fiscal crises in the future.

The Fiscal Futures Project has developed a broad measure of the state budget that consolidates reporting of Illinois' four General Funds with about 380 special funds. This is a time-consuming exercise requiring detailed information that is available only after a budget year has been completed, and is not available when the governor is presenting or the General Assembly is voting on a budget for the upcoming year. However, adding 20 to 50 other funds to the General Funds could bring 80-90 percent of the full budget picture into view. This is not complete transparency, but it would be far better than the current 40 percent that the General Funds represent of the consolidated funds total.

[29] Dye, Hudspeth, and Merriman, "Why Ignore Over Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting," Institute of Government and Public Affairs, University of Illinois, July 2011, http://igpa.uillinois.edu/content/igpa-report-examines-strategy-transparent-budgeting.

The sobering news is there are no quick or easy solutions for Illinois.

Using the consolidated funds budget concept, the *Fiscal Futures Model* estimates that the state's budget gap is (a) currently on the order of $4 billion; (b) will jump to $10 billion in FY 2016 after the income tax rates are scheduled to go down; (c) will rise each year after that if spending growth exceeds revenue growth as historically has been the case; and (d) will reach about $13 billion in FY 2023. The actual budget problem is worse because these estimates do not account for the current backlog of unpaid bills, increased borrowing or other consequences of dealing with the large and growing deficit, or an unfunded pension liability that will continue to grow without policy action.

The good news is that policy solutions to address a budget gap on the order of $10 billion are potentially available. We estimate that if the large increases in income tax rates adopted in January 2011 are not phased out and if the growth in total state spending can be kept down to the consumer price inflation rate, the budget gap could be eliminated within 10 years.

The sobering news is there are no quick or easy solutions for Illinois. The changes of the past year mean that Illinois residents and businesses are already paying higher taxes and receiving fewer services. The tax increase was not the instant solution that some people thought it would be: cutbacks and late payments will continue to affect schools, human service providers, and those who rely on state assistance. The prospect of 10 years of additional belt tightening is daunting. If the higher tax rates are phased out when scheduled, Illinois' state of fiscal insolvency will continue for even longer than a decade. Holding spending growth to the inflation rate might sound fairly painless, but higher pension and debt service costs will take a good chunk of that and it is hard to imagine medical costs not growing in excess of the inflation rate, further squeezing other types of spending. Bringing Illinois' budget into balance will impose great political, economic, and human costs for many years to come.

Photograph by Kelsey McCoy