The Illinois State Budget: How Bad is the Picture, and What Can You Do About it?

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Introduction: About IGPA

The Institute of Government and Public Affairs (IGPA) is part of the University of Illinois. It was created in 1947 by the State of Illinois.

We have 24 faculty members over 3 campuses (Chicago, Urbana-Champaign, Springfield) and we don't have a political agenda.

Basics of Budgeting in Illinois

State finances work much like your finances at home. The state has income (revenue) and expenses (sometimes called expenditures). It also has a bank account of sorts (called a fund balance).

Each year, the state comes up with a budget for the year, and then tries to stick to that budget throughout the year.

Recently, the State of Illinois budget has been operating in a way that would be much like having a personal budget with massive credit card debt and no money in your checking account, but you kept writing checks anyway and had no plan to deal with the debt.

Revenue: Where does the Money come from?

As shown in Figure 1, the Federal Government is the largest single source of revenue for the State of Illinois, due in large part to programs such as Medicaid that are jointly funded between the state and federal government. Income tax and sales tax are also large parts of the state's revenue stream.

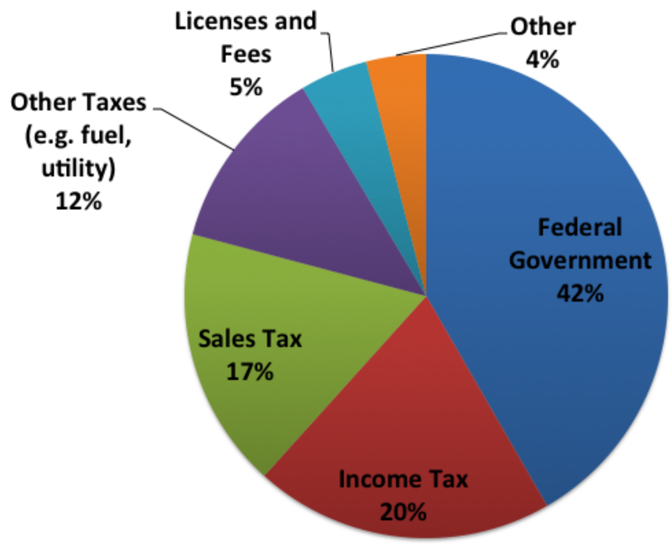

Figure 1: Revenue in Illinois (Source: 2010 CAFR data)

Taxes: How Does Illinois Rank?

As shown below, Illinois ranks relatively high in some tax categories, but low in others. For example, state and local property taxes are relatively high, while sales and use taxes are relatively low. The bottom line is that Illinois is neither a high tax nor a low tax state.

Fiscal Year 2009, per capita rankings

Overall rank: 15th
Lowest: Tennessee
Highest: Alaska

Individual income tax: 33rd
Lowest: Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming;
Highest: New York

Corporate income tax: 11th (2007-08)
Lowest: Nevada, Texas, Washington, Wyoming
Highest: Alaska

State and local property tax: 10th
Lowest: Arkansas
Highest: District of Columbia

Sales and use tax: 30th
Lowest: Delaware, Montana, New Hampshire, Oregon
Highest: Wyoming

Expenditures – Where does the Money Go?

As shown in Figure 2, the two largest spending categories in Illinois are health/social services and education, with these two categories comprising approximately 69 percent of expenditures. Politicians promising to balance the budget by cutting waste, fraud, and abuse are often promising to cut a tiny portion of the budget.

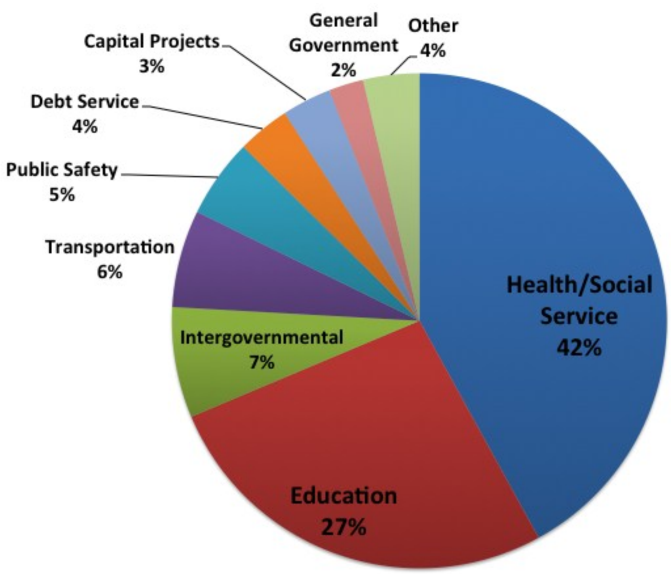

Figure 2: Expenditures in Illinois (Source: 2010 CAFR data)

Budget Issues: How Did We Get Here?

Deficit

Every year since 1999, Illinois has spent more than it has "earned." We do not count borrowing money as actual income when we say this, just as you would not count a bank loan as income in your household budget. In 2010 alone, the state had a nearly $8 billion deficit (it "earned" $50.6 billion and spent $58.2 billion).

To balance its budget over the past several years, Illinois has simply put its bills on its credit cards, so to speak. The credit card bills are coming due, but the state isn't sending in its payments on time.

2011 In Review: A Titanic Beginning

The beginning of 2011 saw Illinois facing a harrowing fiscal situation. The State had billions in unpaid bills, and a 2011 budget gap estimated at $11 billion. If the budget were balanced with only cuts, 26 percent cuts would be required across the board. Beyond cuts, the State had few options to deal with this problem. Among the potential solutions: accumulating bills, issuing debt, and raising revenue. It could also enact a combination of these options.

What do we mean by Unpaid Bills?

Since the state is out of money and politicians do not want to raise taxes, borrow money, cut spending, or a combination of the above, the state has simply delayed paying its bills (just like sending in your credit card bill late). This means vendors are waiting up to several months for payments. Like your credit cards, the state also must pay late fees on these bills.

What are the Potential Solutions?

2011, Solution 1: Accumulate Bills

Simply accumulating bills was not a reasonable option. As shown in Figure 3, if the State pursued this route, by 2022, it would have unpaid bills of $230 billion and payment delays of over 30 years.

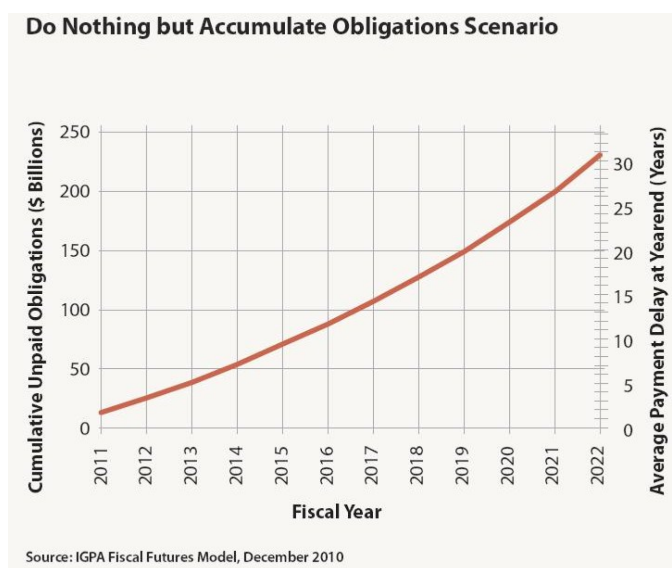

Figure 3: Accumulate Bills Scenario (Source: IGPA, 2010)

2011, Solution 2: Issue Debt

Similar to accumulating bills, issuing only debt to solve the state's fiscal problem was also not a reasonable solution. If the State pursued this route, by 2014, all personal income tax revenue would go to paying debt service, and by 2019, all personal and corporate income tax, as well as sales tax, would go to paying debt service.

Issuing debt to finance the state budget is much like charging your entire household budget to your credit cards: eventually, the bills add up.

The January 2011 Tax Increase and "Spending Cap"

Ultimately, lawmakers chose a third option – a combination of increasing revenues and limiting spending - in January 2011. These changes are illustrated in Figure 4.

Item	Pre-2011	2011 to 2015	2015 to 2025	After 2025
Income Tax	3%	5%	3.75%	3.25%
Corporate Tax	4.8%	7%	5.25%	4.8%
Spending Cap*	No cap	2%	No cap	No cap

Figure 4: January 2011 Tax and Spending Changes
**Applies to General Funds only*

However, the "spending cap" (spending is limited to 2% over the previous year's expenditures) applies to only the State's 4 General Funds – which is only about half of the total budget. The January 2011 "fix" also included authorization to borrow $3.7 billion for the State's contribution to the employee pension systems.

Unfortunately, the above actions still did not get Illinois out of its budget crisis.

State of Illinois total budget

About half of the State budget exists in what is called General Funds, which are essentially the State's main bank account. The remaining portion of the State budget exists in other funds, which one can think of as a number of small accounts that are established for specific purposes (such as transportation). As shown in Figure 5, the State budget involves a considerable amount of moving money around between its main "checking account" (General Funds) and other funds – a practice called "transfers." As such, when the legislature enacted a General Funds spending cap, this did not necessarily mean that TOTAL spending was limited.

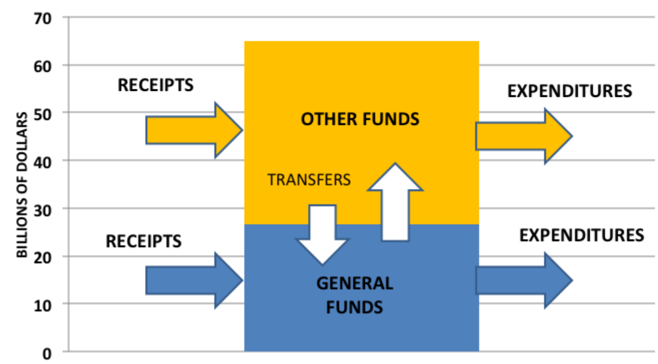

Figure 5: Illinois Total Budget (Source: IGPA, 2012)

As shown in Figure 6, during Fiscal Year 2010, only 3 percent of the State's approximately $7.6 billion deficit existed in General Funds.

Fiscal Year 2010	General Fund "Checking"	Other Funds (Other Accounts)	Total Government
Revenues (Income)	$31.6 billion	$19 billion	$50.6 billion
Expenditures (Expenses)	$31.8 billion	$26.3 billion	$58.2 billion
Surplus/Deficit	-$0.2 billion	-$7.3 billion	-$7.6 billion

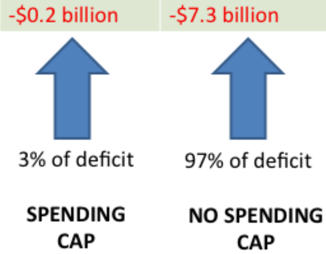

Figure 6: Illinois Revenues and Expenditures, 2010 (Source: 2010 CAFR data)

Another way to look at General Funds as a part of the state budget is by examining the portion of certain categories of spending that exist in General Funds. Figure 7 illustrates that some spending categories, such as transportation and pensions, mostly do not come from the General Funds.

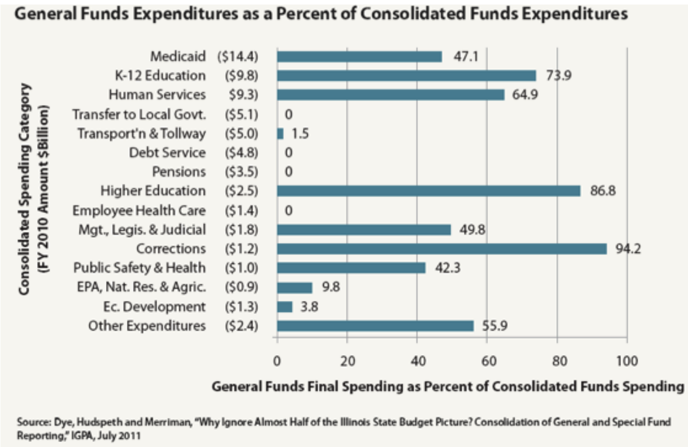

Figure 7: General Funds Expenditures as a Percent of Total Consolidated Governmental Spending (Source: IGPA, 2011)

The January 2011 Tax Increase and "Spending Cap": Problems Remain

As we mentioned earlier, the Jan. 2011 tax increase and "spending cap" still did not get Illinois out of its fiscal problem. The State did have some good news, in that its Fiscal Year 2012 gap is now $4-10 billion, rather than $12 billion. However, $8.5 billion in unpaid bills have not been addressed, and there is no plan to address them. Worse, the $8.5 billion figure does not represent all of Illinois' unmet financial obligations. Pension liabilities continue to be large and growing.

Cuts may be Difficult

Unfortunately, cuts may not be an easy option for the State. Some programs, including Medicaid, are entitlement programs – that is, if someone is eligible, the State has to pay. The State cannot reduce a person's eligibility for Medicaid under the 2010 National Health Care Reform. Other expenditures, such as pensions, may be constitutionally protected.

What Has Happened Since Then?

Subsequent Budgetary Events and Actions: Few Long-Term Solutions

Since the State has again faced a budget crisis, lawmakers have taken what has become a traditional path of temporary budget fixes.

Fiscal Year 2011 saw one-time revenue from tobacco bonds and pension borrowing. Pension reform was proposed but not approved. Similarly, casino gambling expansions were proposed and not approved.

Fiscal Year 2012 continued this trend with a private company managing the State Lottery, and an increase in Tollway rates. A number of politicians have continued to oppose future borrowing, despite the State's unpaid bills. During this time, the State's bond ratings (similar to an individual's credit rating) have continued to be downgraded.

2013 Budget

The 2013 budget maintains education funding, but cuts other areas of spending – Medicaid, state medical assistance, and human services. This is because most state expenditures are in the areas that people care about: education, health, and human services. The budget does contain theoretical General Funds "surpluses." However, note this is only General Funds – not the total budget. Lawmakers are planning to use these "surpluses" to begin addressing the state's ongoing backlog of unpaid bills, reported in June 2012 to be $8.5 billion.

2013 Budget: Medicaid Savings

The centerpiece of the 2013 Illinois State Budget is reducing Medicaid spending by $2.7 billion. The State is seeking this savings because enrollment has grown recently, which has increased spending at the same time that Illinois has faced deficits – and the State cannot control growth in the program. The end of federal stimulus spending also plays a role in the difficulties of funding Medicaid (the federal matching rate was lowered after the stimulus program ended).

Medicaid savings come from a total of 58 cuts, reductions, and efficiencies. These include *(savings amount listed after each item)*:

- Removing people who don't belong on rolls - $120 million
- Reducing services, including:
  - Ending Illinois Cares Rx (seniors) - $72 million
  - Limiting adult prescriptions - $136 million
  - Eliminating adult dental care - $51 million

In addition, cigarette taxes have increased $1 per pack (to $1.98 per pack) – this is projected to generate $337.5 million to go toward Medicaid, which will double to $675 million due to federal matching monies.

2013 Budget: Summary

The 2013 State Budget contains **new ideas**, but continues **old problems**. New ideas include budgeting based on existing revenues (lawmakers cannot budget based on new theoretical revenues) and budgeting using a three-year projection of General Funds spending and revenues. However, the State still has no realistic plan to deal with its unpaid bill backlog, and no solution to the pension problem.

Illinois' Bond Rating

As the State has continued to kick the can down the road with regard to budgeting, its credit rating has suffered. The State's bond rating is like your personal credit rating – it determines whether the State can borrow money, and how much it will cost to borrow.

Illinois' bond rating has been in decline for over a decade as the State has failed to right its fiscal ship. Moody's gives Illinois the worst bond rating in the nation. According to ratings agencies S&P and Fitch, Illinois' rating is second-worst - only better than California. Figure 8 shows the State's rating over time.

ILLINOIS' G.O. BOND RATINGS OVER TIME			
Year	**S&P**	**Moody's**	**Fitch**
1998	AA	Aa2	AA
1999	AA	Aa2	AA
2000	AA	Aa2	AA+
2001	AA	Aa2	AA+
2002	AA	Aa2	AA+
2003	AA	Aa3	AA
2004	AA	Aa3	AA
2005	AA	Aa3	AA
2006	AA	Aa3	AA-
2007	AA	Aa3	AA
2008	AA	Aa3	AA-
2009	A+	A2	A
2010	A+ (neg.)	A1 (stable)	A (neg.)
2011	A+ (neg.)	A1 (neg.)	A (stable)
2012	A+ (neg.)	A2 (stable)*	A (stable)

Figure 8: Illinois Bond Ratings Over Time (Sources: Garcia, 2012; Merriman, 2012; Shields, 2012)

KEY TO RATINGS: Ratings for each agency are in declining order of quality (e.g. AAA/Aaa ratings are highest).
S&P: AAA, AA, A, BBB, BB, B, CCC, CC, C, D* (AA through CCC ratings may be modified with (+) or (-) sign to show standing within category). D* indicates default
Moody's: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C (AA through Caa ratings may be modified with numbers 1, 2, and 3 to show standing within category - 1 is highest, 3 is lowest).
Fitch: AAA, AA, A, BBB, BB, B, CCC, CC, C, D* (AA through B ratings may be modified with (+) or (-) sign to show standing within category).

Looking to the Future: Budget Projections

What about the Tax Increase?

The January 2011 tax increase was a step in the right direction. However, it is scheduled to be phased out beginning in 2015. Additionally, without spending restrictions, future budgets will not balance even if tax increases are kept intact, as shown in Figure 9. This figure shows the gap between revenues and spending for two scenarios: spending is at historical rates of growth, and (1) the tax increase expires in 2015 as scheduled (blue line); or (2) the tax increase does not expire (red line). Even if taxes are kept at current rates, the budget does not balance, although the deficit reaches $14 billion in 2022 if the tax rates expire.

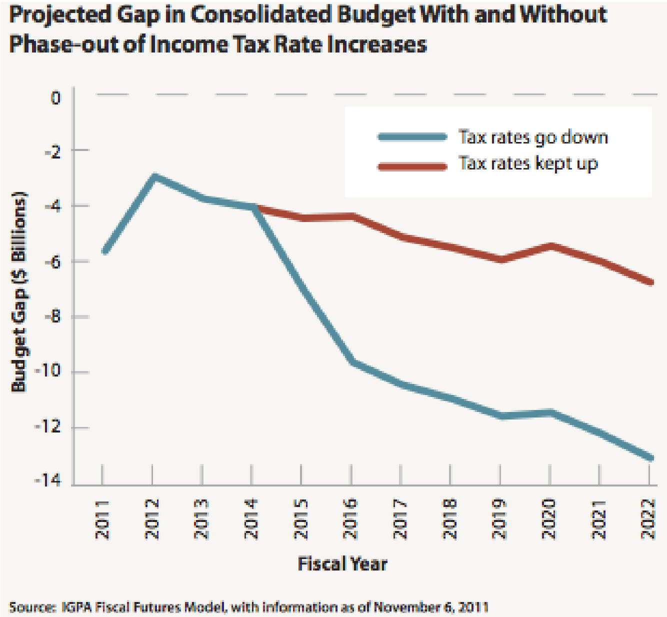

Figure 9: 2011-2022 Budget Projections, with and without phase-out of January 2011 tax increase (Source: IGPA, 2011)

A Light at the end of the Tunnel…

Despite the State's bleak budget picture, IGPA finds that the budget can balance in 2019 if increased tax rates are kept and **total** spending is kept to the rate of inflation, as shown in Figure 10. This would require cuts, as some spending categories are growing at rates greater than inflation.

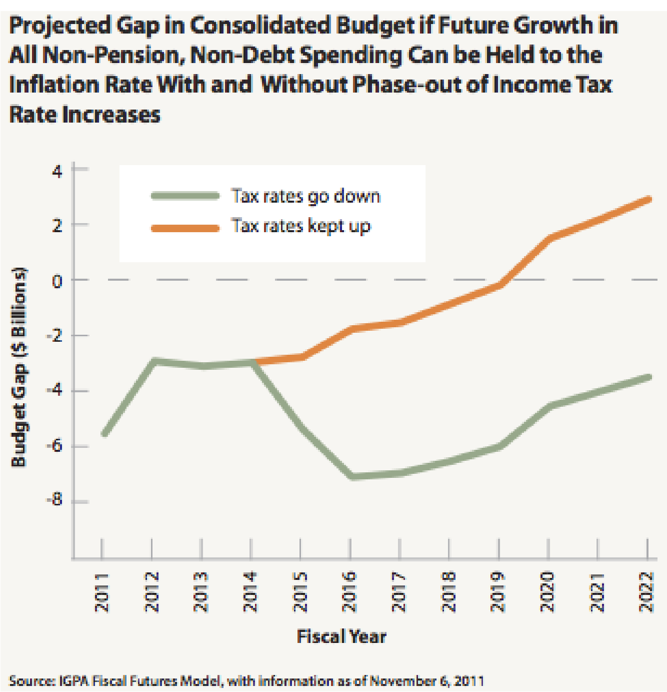

Figure 10: 2011-2022 Budget Projections, with most of total governmental spending held to inflation (Source: IGPA, 2011)

Summary – A Mixed Bag of Clouds and Sunshine

At the beginning of 2011, Illinois had a dire budget outlook. This was averted in part with tax increases, but we are far from the light at the end of the tunnel. Balancing the budget will require both a sustained, increased, revenue stream and spending restraint. Unfortunately, this is difficult for most people to monitor - transparency in Illinois is murky at best; and the often-presented General Funds budget is not an appropriate way to view the budget.

What Can You Do?

We encourage you to be part of the budget process in Illinois. You can do this by **contacting your legislator.** You can search for your legislator at http://elections.illinois.gov.

You can also **contact Governor Quinn.** You may reach the Governor's Office online at http://governor.illinois.gov.

More than anything, you can **vote for honest candidates**. If someone offers a budget solution that sounds too good to be true, it probably is. Quick fixes are likely not real options. Illinois is not likely to be out of its fiscal crisis for at least several years (IGPA projects 2019, even under the most optimistic of scenarios).

IGPA projects that taxes need to remain at their current levels for budget to balance. Cutting certain programs may also be a wise budget move, but some programs cannot be cut or cut quickly.

Ultimately, **doing nothing and waiting for the economy to grow is not an option.** By telling your lawmakers that you understand the complete budget picture and want to see the budget fixed in an honest and responsible manner, you are encouraging them to tackle difficult and unpopular problems.