POLICY SPOTLIGHT | MARCH 15, 2023

Assessing Illinois' Fiscal Future After an Influx of Federal Funds

University of Illinois System
Institute of Government and Public Affairs

INTRODUCTION

As the U.S. continues to cope with the COVID-19 pandemic and its aftermath, state governments are faced with the challenge of prudent fiscal management considering the pandemic's uncertain course into the near future. However, as reported elsewhere, states' revenues have largely fared better than expected at the pandemic's onset.[1] Illinois is no exception.[2]

Unprecedented federal stimulus and other measures have helped boost Illinois' revenues beyond initial projections in 2021. Nominal revenue across all funds rose to $91.4 billion in 2021. Total expenditures rose to $92.3 billion in 2021. The temporary influx of federal funds and the pandemic driven increase in yearly expenditures and revenues makes it difficult to fully capture the change in Illinois' long term fiscal health. Both spending and revenues have increased significantly beyond their long-term trends.

This report summarizes Illinois' fiscal situation at the end of fiscal year 2021, which ran from July 1, 2020, to June 30, 2021. The IGPA Fiscal Futures Project has tracked Illinois' fiscal situation using

Authors

Francis Choi, PhD Student, Department of Public Policy, Management and Analytics, College of Urban Planning and Public Affairs, University of Illinois Chicago

Alea Wilbur-Mujtaba, PhD Student, Department of Public Policy, Management and Analytics, College of Urban Planning and Public Affairs, University of Illinois Chicago

David Merriman, Co-lead, Institute of Government and Public Affairs Fiscal and Economic Policy Working Group; James J. Stukel Presidential Professor of Public Policy, Management and Analytics, at the College of Urban Planning and Public Affairs, University of Illinois Chicago

Contact: Robin Fretwell Wilson, Director, IGPA: (217) 244-1227

detailed revenue and expenditure figures from the Illinois Office of the Comptroller (IOC) since 1998. The data supplied by the Comptroller's office covers essentially all state spending and revenue, appropriated and non-appropriated, within both general and special funds. Using an "all funds" basis of fiscal categories, we aggregate the IOC data into a meaningful and consistent set of revenue and expenditure categories focusing on the function of spending rather than making a distinction between fund names, e.g. general and special funds. Thus, Fiscal Futures expenditure categories (e.g. "Central Management") refer to functions (e.g. central management) rather than departments (e.g. The Department of Central Management Services) that may have similar names. This approach allows us to develop consistent time series even when government functions move between departments.[3] Based on our summary, we provide a basic snapshot of Illinois' current fiscal condition and implications regarding long-term fiscal outlook.

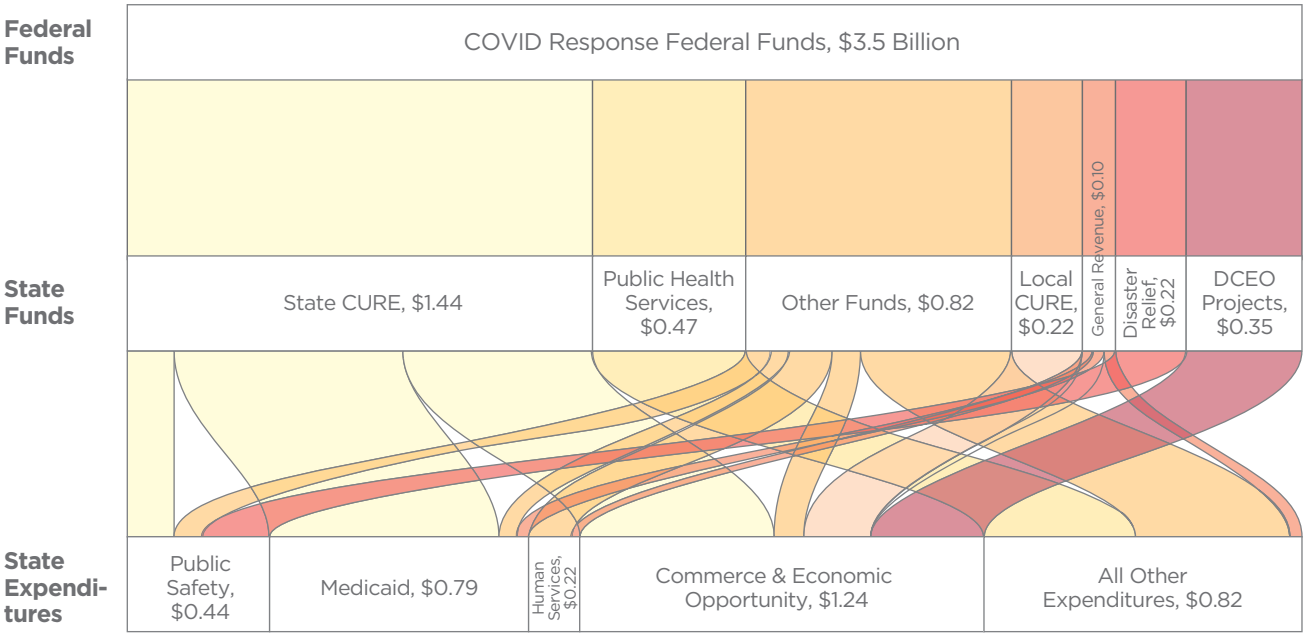
YEARLY EXPENDITURES AND REVENUES

We begin with a summary of yearly expenditures and revenues over time. The big story of the year for state finances was federal relief money. This had major impacts on both revenues and expenditures.

Federal assistance was a significant contributor to Illinois' revenues. The Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law on March 27, 2020, and the Coronavirus Response and Relief Supplemental Appropriations Act (CRRSAA) was signed into law on December 27, 2020. Between these two acts, referred to simply as the CARES Act from here forward, the federal government provided over $3.5 billion to the State of Illinois.[4] Illinois created the State Coronavirus Urgent Remediation Emergency (State CURE) Fund and the Local CURE Fund to accept and disperse the federal transfers. The CARES act funded state agency operational costs, local government grants, grants to small businesses and childcare providers, rental and mortgage assistance programs, and healthcare provider support payments.

Figure 1 illustrates how revenue from the CARES Act flowed through the state budget and its eventual impact on our all-funds expenditure categories. As shown in the figure, in Illinois the $3.5 billion of federal CARES dollars was allocated to more than seven state funds and the money distributed to these funds was then directed to several expenditure categories. The biggest expenditure category was Commerce and Community Affairs which largely used the money to lessen the economic impact of the COVID-induced downturn on business, local governments, and residents.

Figure 1: Illinois Expenditures funded by federal CARES funds, in billions of dollars



Flow of COVID response funds from federal to state funds and state funds to Fiscal Future expenditure categories. COVID response federal funds include funds made available through the CARES Act and the CRRSAA. These funds include the Covid Relief Fund (CRF), Emergency Rental Assistance, ESSER I and ESSER 2.

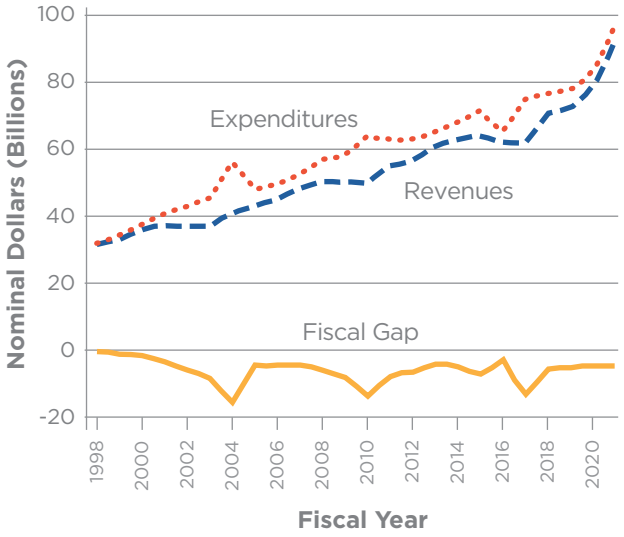
A significant share of the federal money was also spent on healthcare provider support grants, many of whom also provide services under the State's Medicaid program. These significant and temporary infusions of money and spending during the fiscal year make it more difficult to track Illinois' current fiscal health and make long term projections about fiscal stability.

In addition to the CARES Act, the American Rescue Plan Act (ARPA) was signed into law on March 11, 2021 and provided $1.9 trillion in national economic relief. ARPA allocated $8.38 billion to the State of Illinois through the Coronavirus State Fiscal Recovery Fund and the Coronavirus Capital Projects Fund. $4.8 billion of this was appropriated to the 2022 fiscal year budget; this includes $2 billion as "reimbursement for essential services," $1.8 billion in the operating budget, and $1 billion for capital expenditures.[5] Another $2.7 billion will be used for repayment of federal advances to the unemployment trust fund. The remaining funds have been appropriated to multiple agencies involved in the COVID-19 response in fiscal year 2023.

Significant federal relief and a stronger economy were contributors to the bump in state revenues, but as federal relief phases out and Covid-related strains continue, the outlook for 2023 and beyond is uncertain. A key measure of a state's fiscal condition is its ability to achieve a balance between its operating revenues and expenditures. If yearly expenditures are much greater than the revenue collected in a year, then the budget may not be sustainable in the long term. While FY21 shows large increases in many spending and revenue categories, many of these changes were one-time purchases or revenue infusions in response to the COVID-19 pandemic. Unprecedented federal aid buoyed revenues and supported much of the increased spending.

With this background in mind, **Figure 2** shows the trend of Illinois expenditures and revenues from FY98 through FY21. We present more detail about the same data in tabular form in Appendix Table 1. As prices and wages rise naturally expenditures and revenues have steadily increased over time, with only a few instances in which they fell from the previous year. Total expenditures and revenues increased dramatically in FY21. Figure 2 also displays the fiscal gap, which measures the difference between annual revenues and expenditures. This gap has been consistently negative (expenditures have exceeded revenues) for Illinois's history, but in recent years, the gap gradually decreased and shrunk to less than $1 billion in 2021. Much of this imbalance between spending and revenue in the past year appears to be due to costs associated with responding to the pandemic and maintaining services. Avoiding a fiscal imbalance remains a long-term challenge.[6]

Figure 2: Fiscal Balance FY98-FY21



Note: Note: In FY04, Illinois issued $10 billion in pension obligation bonds. The fiscal gap is large in 2004 as we do not count bond proceeds as revenue but do count pension contributions (funded by the bonds) as expenditures.

EXPENDITURES

Table 1 provides a breakdown of Illinois' 13 largest expenditure categories from 1998 to 2021, showing the one-year change (2020 to 2021) in expenditures and the compound annual growth rate since 1998.

Medicaid[7] was Illinois' largest expenditure category at $26.3 billion compared to $22.3 billion in the previous fiscal year. The large increases in Medicaid spending during 2020 and 2021 are primarily due to the Covid-19 pandemic, specifically from more individuals enrolling for Medicaid due to above average levels of unemployment and increased demand for medical insurance. This increased spending is partially funded by federal dollars from Medicaid matching grants; Illinois received $17.6 billion in federal reimbursements compared to the $26.3 billion spent on Medicaid for residents in 2021.

Table 1: Major Expenditures

FY21 Expenditure Category	FY21 Expenditure ($ billions)	Change from 2020 to 2021	Compound Annual Growth, 1998-2021*
Medicaid	26.3	17.9%	7.1
K-12 Education	12.2	7.7%	3.9
State Pension Contribution	9.5	6.5%	10.7
Local Government Revenue Sharing	7.2	11.2%	3.2
Human Services	6.5	9.3%	2.3
Transportation	5.1	32.4%	4.3
State Employee Healthcare	2.5	-6.3%	6.3
Debt Service	2.0	4.1%	6.4
Public Safety	2.0	35.2%	6.9
Tollway	2.0	2.4%	7.6
Commerce & Economic Opportunity	1.9	205.9%	6.3
Central Management	1.4	14.5%	5.2
Capital Improvement	0.5	47.7%	2.5
All Other Expenditures **	13.4	13.9%	2.6
Total Expenditure	**92.3**	**14.5%**	**4.9**

* Note: Compound Annual Growth Rate or CAGR = $\left(\frac{\text{Final Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{23}\right)}$

Note that (1998-2021) is 23 years. See appendix items 3a and 3b for CAGRs calculated over alternate time spans. ** Note: " All Other Expenditures" represents all other categories of expenditures not included in this table.

State spending on K-12 education also experienced a large increase from $11.3 billion in 2020 to $12.2 billion in 2021. Nearly all of these additional costs were covered by the CARES Elementary and Secondary School Emergency Relief Fund (ESSER I) and CRRSSA ESSER II which together provided $959 million for e-learning and other COVID expenses involved with bridging the digital divide and teaching classes online.

Local Government Revenue Sharing experienced an increase in expenditures due to the increased tax revenue collected and distributed by the state back to local governments. An increase in tax revenue, discussed in the following section, resulted in a proportionally larger amount to be transferred to local governments.

Debt service increased slightly in 2021 to $2 billion (from $1.9 billion in 2020). This increase reflects interest rates paid for previously issued debt and other factors largely beyond the control of current government officials. The State addressed revenue shortfalls by borrowing $3.2 billion from the Federal Reserve Municipal Liquidity Fund (MLF); $1.2 billion in June 2020 and $2 billion in December 2020. By June 2021, Illinois had paid back $2.2 billion of the $3.2 billion borrowed and fully paid

off the obligation on January 26, 2022. Paying off the debt earlier than anticipated is estimated to have reduced interest costs by $82 millions.[8]

Since FY98, total expenditures have grown by about 4.9% each year. Spending categories experiencing consistent and relatively large growth include pensions (10.7%), debt service (6.4%), state employee healthcare (6.3%), and Medicaid (7.1%). The State of Illinois' contributions to the pension systems have been increasing over time in attempts to increase the systems' funding levels. Illinois contributed the statutorily required amount of $9.8 billion to state pension funds. The legislative goal is to reach 90% funding of pension obligations by 2045. Currently, Illinois' systems are approximately 40% funded.[9]

The amount spent on state employee healthcare decreased during the pandemic largely due to the suspension of non-essential care at overwhelmed hospitals that prioritized treatment of COVID-19 patients.[10] Postponed or canceled procedures reduced costs for health insurers during FY21, but it is likely that most of these "savings" will become costs pushed into future years. The amount paid in interest has declined in recent fiscal years due to large payments in fiscal years 2018 and 2019 toward past interest on insurance bills. In 2017, a bond sale was issued and bond proceeds were used to pay off nearly $4 billion in group insurance bills.[11]

Spending categories that have particularly large percentage increases from 2020 experienced temporary growth in expenditures due to the pandemic response and the influx of federal funds for that response.

Spending categories that had particularly large percentage increases from 2020 experienced temporary growth in expenditures due to the pandemic response and the influx of federal funds

for that response (See **Figure 1 above**). Commerce and Economic Opportunity experienced a 206% increase equal to $1.9 billion, of which $1.24 billion was paid for with COVID response federal funds. Some examples of expenditures in this spending category include rental and housing assistance, energy assistance programs for low-income families, and other programs that contributed to the COVID pandemic recovery.

Public safety's large increase in spending is due to Illinois' Emergency Management Association, one of the departments included in "Public Safety," receiving $436 million in federal funds in FY21 during the initial pandemic response.[12] This federal transfer was passed through the state's Federal Aid Disaster Fund to local governments responding to the COVID pandemic. Illinois' State CURE and Public Health Services fund was used to support Federally Qualified Health Centers, provide stability payments to medical assistance providers, and purchase COVID testing lab materials. Many of these supplies and services are included in the Fiscal Futures "Medicaid" category. "Other Funds" include 102 additional state funds that received CARES money during FY21. Local CURE funds were distributed to municipalities that did not directly receive CARES funds to be used for reimbursement payments. "All Other

Expenditures" include all remaining expenditure categories included in the Fiscal Futures methodology.

REVENUES

Total revenue was $91.4 billion in FY21, a 17.5% increase from 2020. This was significantly higher than the long run growth rate of 4.8%. **Table 2** provides a more detailed breakdown of Illinois' revenues from FY98 through FY21, showing the one-year change (FY20 to FY21) in revenues by cate- gory and the respective compound annual growth rate since FY98. As reported in an earlier report, during the early stages of the pandemic in 2020, Illinois experienced revenue losses in the Big 3 taxes (individual income tax, corporate income tax and sales tax revenues), but losses were much lower than anticipated as revenues sharply recovered in the latter quarters of 2020.[13] In fact, Illinois' major tax revenue categories each saw a sizable increase in 2021, as shown in **Figure 3**. This deviation from anticipated revenues was due to a mix of factors. One thing to note is that part of the increase in Illinois' individual and corporate income tax revenues is due to the extension of the income tax filing deadline.

The income tax filing deadline was extended from April 15, 2020 to July 15, 2020. Because of this some tax payments were delayed from the previous year and made in FY21 which boosted overall revenues in that year. According to the Commission on Government Forecasting and Accountability, about $1.3 billion of the FY21 increase in General Funds revenue alone is attributable to the changed tax filing deadline.[14, 15] The consequence of that timing adjustment will continue to appear in year- over- year comparisons as FY 22 reverted back to the April 15th filing date. Aside from the

Table 2: Major Revenue Sources

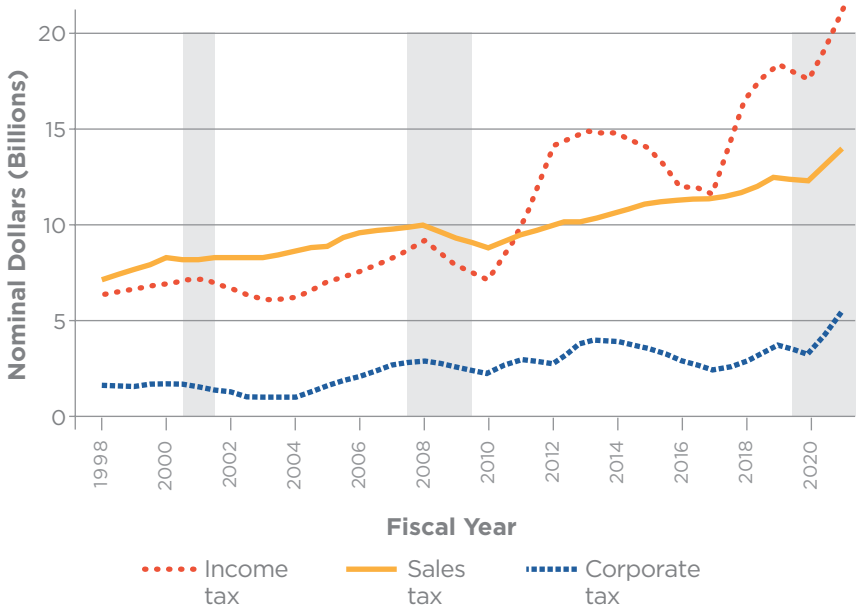
Revenue Category	FY21 Revenue ($ billions)	% Change from 2020 to 2021	Compound Annual Growth, 1998-2021*
Income Tax	21.2	20.2%	5.4%
Federal Medicaid Reimbursements	17.6	26.8%	7.5%
Sales Tax	13.9	13.2%	2.9%
Federal Other	9.2	-5.1%	4.0%
Corporate Income Tax	5.5	69.0%	5.4%
Medical Provider Assessments	3.8	9.7%	8.8%
Federal Transportation	2.4	33.4%	4.7%
Motor Fuel Taxes	2.4	2.60%	2.6%
Receipts from Revenue Producing	2.3	6.6%	5.2%
Licenses, Fees, Registration	2.0	38.9%	8.4%
Other Revenue Sources **	11.3	12.8%	3.4%
Total Revenue	**91.4**	**17.5%**	**4.8%**

*Note: Compound Annual Growth Rate or CAGR = $\left(\frac{\text{Final Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{23}\right)}$

Note that (1998-2021) is 23 years. See appendix items 3a and 3b for CAGRs calculated over alternate time spans.

**Note: "Other Revenue Sources" is made of "All Other Sources," a category that existed in the Fiscal Futures codebook plus all other additional revenue categories that brought in less than $2 billion.

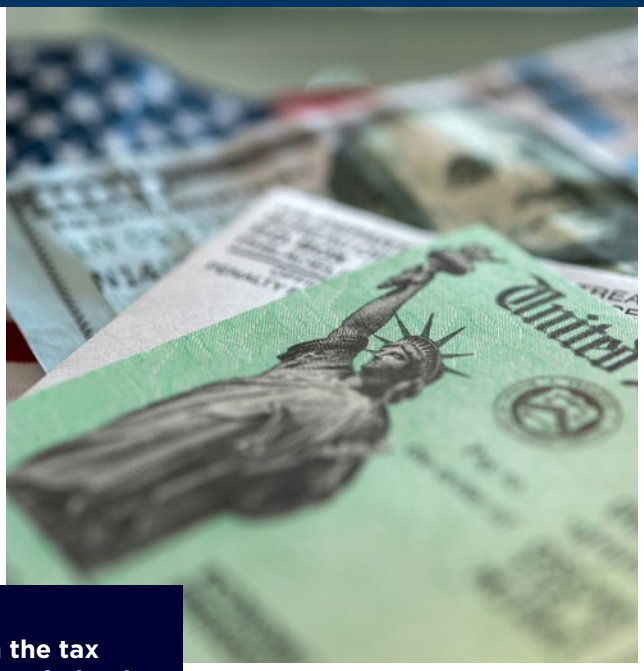
Figure 3. Illinois' three largest revenue sources: Corporate, Income, Sales Tax Revenues FY98-FY21



Note: Individual Income Tax rate change (calendar year): 2011 5% (from 3%); 2015: 3.75%; July 2017: 4.95%. Corporate Income Tax rate change (calendar year): 2011 7% (from 4.8%); 2015: 5.25%; July 2017: 4.95%

tax filing extension, federal stimulus from COVID relief helped boost the state's own-source tax revenues. Consumer spending rebounded sharply with help from federal stimulus checks, unemployment benefits, child tax credits, and other forms of assistance. While unemployment benefits rose, the taxation on these benefits also kept income tax revenues from falling during the recession.

Individual income taxes, Illinois' largest revenue source, grew from $17.6 billion in 2020 to $21.2 billion in 2021, a temporary increase of 20.2% compared to the long-run growth rate of 5.4%. Despite the slight decline early in the pandemic, sales taxes increased from $12.3 billion to $13.9 billion in 2021 partly due to consumer demand increases that had been deferred due to stay-at-home orders early in the pandemic and federal stimulus payments. Illinois also enacted the Leveling the Playing Field for Illinois Retailers Act requiring e-marketplaces to pay state and local sales tax rates.[16] Without this online sales tax, sales tax revenues might have suffered considerably more due to the large transition from in-person shopping to online shopping during the pandemic.



Aside from the tax filing extension, federal stimulus from COVID relief helped boost the state's own-source tax revenues. Consumer spending rebounded sharply with help from federal stimulus checks, unemployment benefits, child tax credits, and other forms of assistance.

Federal Medicaid reimbursements are the second largest source of revenue for Illinois. Like the rest of the states, Illinois receives federal matching funds for Medicaid expenditures based on the Federal Matching Assistance Percentage (FMAP). The FMAP for Illinois in 2021 was 57.16%, reflecting a 6.2 percentage point increase from the CARES Act that was applied to all states and expired on October 15, 2022.[17] Total federal Medicaid revenues for Illinois was over $17 billion in 2021, a 27% increase from $13.8 billion in 2020. The long run growth rate of federal Medicaid reimbursements is 7.5%. The large deviation in revenues from the long run trend reflects the significant impact of the pandemic as more people enrolled in Medicaid and states were required to continue coverage for Medicaid enrollees already in the program in early 2020.[18] Federal aid other than Medicaid ("Federal Other") declined by 5.1% from $9.7 billion in FY20 to $9.2 billion in FY21, but this amount is still considerably above the long term trend due to increased levels of federal aid for the COVID response in FY20 and FY21. Pre-pandemic levels of funding for "Federal Other" would be around $5.9 billion had it followed its historic trend. Federal transfers (Medicaid reimbursements, transportation, and "Federal Other") make up a significant portion of Illinois' revenue totaling $29.1 billion, while own source revenues totaled $62.2 billion.

Licenses, fees, and registrations ($2.0 billion) are another revenue source that increased above trend, up 38.9% for the year. This increase was largely due to increases in fees associated with motor vehicles. Medical Provider Assessments ($3.8 billion), which are earmarked revenues (taxes) from medical providers used for maximizing federal matching grants for state Medicaid expenditures, were similar to 2020 levels with a long-term growth rate of 8.8%. Motor fuel taxes ($2.4 billion) followed the historic trend, while receipts from revenue producing activities ($2.3 billion) were slightly above trend.

LONG TERM FISCAL CHALLENGES

Despite Illinois' relatively strong fiscal performance in FY21 we believe that it faces very significant long term fiscal challenges. We briefly discuss several of these.

Pensions

Public pension benefits are funded by three key sources: government contributions, employee contributions, and investment returns. Investment returns account for most of their revenue. While the stock market fell in March 2020, it increased rapidly during the 2021 fiscal year. During this time of economic growth, pension plans experienced historic gains. The impacts of changing

demographics remain unclear in the long run; pandemic-related deaths may decrease obligations; however early retirement of public employees also will have a financial impact on pension plans. Pension contributions have been increasing in recent years and are reflected as increased yearly expenditures. Funding pensions remains a significant long-term fiscal concern for Illinois and its residents.

Unpaid Bills and Unemployment Trust Fund Debt

At the end of fiscal year 2021, the Illinois Office of the Comptroller estimated that the general funds and Health Insurance Reserve Fund bill backlog totaled $4 billion.[19] Including outstanding borrowing, the state owed $5.9 billion. This is the lowest year-end general funds backlog amount in 10 years, but Illinois is still holding many bills that are accruing interest while vendors wait for payment. The Unemployment Insurance Trust Fund was another large contributor to Illinois' debt. The fund borrowed money to keep unemployment benefits flowing to those that lost jobs during the pandemic.[20] On March 25th, 2022, Illinois legislators signed SB2803 which approved using ARPA money to pay off $2.7 billion of the $4.5 billion owed for unemployment insurance benefit payments.[21]

Even an additional $1 billion is about one percent of Illinois' annual revenue, so it could easily be insufficient to cover lost revenues in a severe recession.

Rainy Day Fund

State and local governments have historically been unable to accommodate budget deficits by borrowing money to fill their budget gap. Most states have created rainy-day or budget stabilization funds to help stabilize their finances during economic downturns when revenues are most likely to decline. If properly designed and funded, budget-stabilization funds can also reduce the perceived default risk on state bond debt and ultimately reduce the borrowing cost for the state. Common measures for assessing how much should be in a rainy day fund use the percentage of reserves compared to a state's total expenditures for a year or the number of days a state could run on the accumulated reserves.

While some states drew on their rainy-day funds during the pandemic to make up for lost revenues, Illinois had to rely on short-term borrowing to assist with its pandemic cash flow. Illinois' rainy-day fund has been, and continues to be, very small. Illinois' Budget Stabilization Fund was created in 2001 to be used as a "rainy-day" fund, but very little was deposited into it; the $275 million that was in the fund was drained during the budget impasse in fiscal year 2017. While the depleted rainy-day fund could not be used during the pandemic's financial crisis, Governor Pritzker allocated $1 billion to the rainy-day fund across fiscal years 2022 and 2023 to better prepare for future financial shocks.[22] Even an additional $1 billion is about one percent of Illinois' annual revenue, so it could easily be insufficient to cover lost revenues in a severe recession.

The combination of paying off backlogged bills, building a rainy-day fund, and better funding future liabilities has improved Illinois' fiscal status. The state has been recognized for its recent progress in paying off its debts and signaling responsible budgeting. Moody's and Standard & Poor's upgraded the Illinois bond rating in June 2021—the first Illinois upgrade in over 20 years—with additional bond rating upgrades since. Despite this accomplishment, Illinois general obligation bond ratings remain among the lowest of all 50 states.

Tax Policy Changes Reducing Revenue

Despite concerns about maintaining revenue levels that can fund current and future spending trends, Governor Pritzker's approved budget for fiscal year 2023 includes $1.83 billion in temporary tax relief on food, gasoline, and property taxes.

While Illinois did improve its financial outlook since the last election, there are still massive pension debts and other long-term fiscal challenges that must be dealt with. While many voters are understandably concerned about inflation, these tax breaks would most likely not provide much assistance to those most in need. In addition, it is politically challenging to restore previous taxation levels after residents become accustomed to the lower taxation levels.

LOOKING FORWARD: POTENTIAL BUDGET SCENARIOS

As some federal funding streams are discontinued post-COVID, Illinois must consider what is next for its budget. Spending and revenues can each remain at their long-term trends or deviate above or below their long-term trends in the coming years. The fiscal gap (the difference between annual revenues and expenditures) may increase or decrease over time as significant spending or revenue categories experience shifts in their growth rates into the future. We describe a few scenarios below. These scenarios are neither exhaustive nor meant to serve as detailed forecasts of Illinois' fiscal condition. They are simply illustrative examples of how potential changes in the growth rates of significant revenue and expenditure categories may impact the overall fiscal gap in the coming years. **Table 3** summarizes the scenarios we examine.

Scenario 1: Back to Trend

In the first scenario, we assume that the growth in total revenues and expenditures falls back to their respective long-term trends after 2021. While the pandemic-era federal aid has boosted Illinois' financial position with an influx of cash, this is not expected to continue in the coming years. Federal aid is expected to diminish along with other temporary relief measures. The extension to the tax filing deadline will not be in effect. With the fading of fiscal stimulus, we expect personal income growth to slow down while consumer spending slowly shifts back from goods to services. On the expenditure side, we expect that Medicaid spending will slow down as enrollment growth is expected to decline with the expiration of the public health emergency and maintenance of eligibility requirements for increased FMAP rates.[23] However, as Medicaid spending decreases, federal Medicaid reimbursements will also decrease. Spending on K-12 education, which saw a boost with pandemic-era federal relief, is assumed to return to its long-term trend. In this scenario, we assume a return to the long-term spending and revenue growth rates of

Table 3. Scenario Summaries

Scenario	Revenue Assumptions	Expenditure Assumptions	Summary	Notes
Base case*	All revenue categories grow at their 1998 to 2021 CAGR after 2021.	All expenditure categories grow at their 1998 to 2021 CAGR after 2021.	Fiscal gap deepens to $8 billion in 2031 without revenue or expenditure restructuring.	The expenditures and revenues lines after 2021 reflect the totals assuming all categories grow at their 1998 to 2021 CAGR.
Fiscal gap is reduced	Income tax revenues grow at 8% after 2021. Remaining revenue categories grow at their 1998 to 2021 CAGR.	All expenditure categories grow at their 1998 to 2021 CAGR.	Fiscal gap turns positive in 2022 and is reduced by over $9 billion in the projected case vs baseline in 2031.	Income tax revenue's 1998 to 2021 CAGR is 5.4%. We assume income tax revenues grow at the 2011 to 2021 CAGR (10 year) of 8% after 2021.
Fiscal gap is increased	Federal Medicaid reimbursements increase by 60.2 cents for each additional dollar of Medicaid spending, as they historically have. Other revenues grow at their CAGR rates.	Medicaid expenditures grow at 10% after 2021. K-12 education expenditures grow at 6% after 2021. Other expenditures grow at their CAGR rates.	Increased Medicaid expenditures: Despite increased federal reimbursements, the fiscal gap deepens to $23 billion by 2031. Increased K-12 expenditures: The fiscal gap deepens to $12 billion by 2031.	Medicaid expenditures' 1998 to 2021 CAGR is 7.1%. K-12 education expenditures' 1998 to 2021 CAGR is 3.88%. The categories' increased growth rates are slightly above their 5-year CAGR.

* In addition to the 23-year CAGR mentioned, growth rates for FY98-FY19 ("Pre-Covid") and FY99-FY20 ("Mid-Covid") were included in Appendix Item 3a and 3b.

5.1% and 4.8%, respectively, from 2021 into the future (**Figure 4**). Given the current trends, spending would continue to outpace revenues with the yearly fiscal gap reaching $4 billion in 2027 and $8 billion in 2032 (see Appendix Item 2 for more detail about our assumptions). Even as a base case, Illinois faces a precarious financial future without significant restructuring of the revenue and expenditure systems. In such a scenario, Illinois' options are to cut spending or raise revenues to address the fiscal gap.

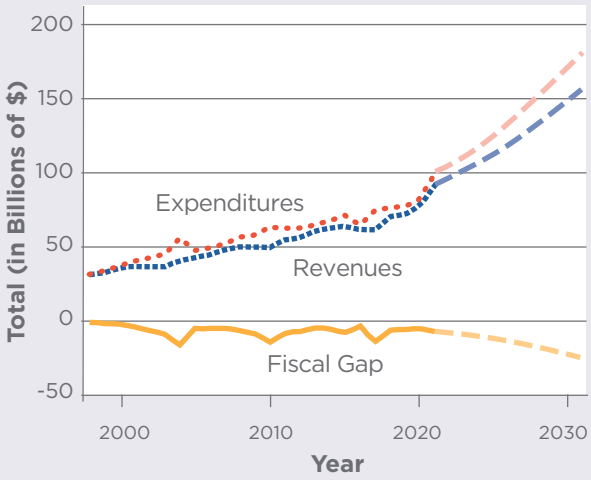
Scenario 2: Revenues Outpace Expenditures

In this relatively optimistic scenario, we project that the growth rate of individual income tax revenues will increase from 5.4% (its long-term trend) to 8% into the future (its most recent 10-year trend). This growth in income tax revenue would shift the total revenue trend line upward above total revenues growing at long-term trend (**Figure 5**). Individual income taxes, Medicaid reimbursements, sales taxes, other federal transfers, and corporate income taxes make up over 70% of all revenue for Illinois, which makes these categories important when predicting changes in revenue. Temporary federal relief may phase out, but personal income growth is expected to remain strong in the short-term with a tight labor market, rising wages, and elevated income tax revenues. Supply-chain disruptions, massive federal stimulus, and global uncertainty have also given rise to inflationary pressures, which have contributed to higher business profits, corporate, and sales tax revenues; however, we assume these remain at their long-term (23-year) trends in this scenario. As noted by forecasters, Illinois' revenues in the short-term remain above their short-term pace.[24] In the long-term, we assume a restructuring of Illinois' revenue system which sustains the elevated growth rate of revenues. If expenditures stay at their respective long-term trends while individual income tax revenues sustain their 10-year growth rate (8%), the fiscal gap would decrease until revenues were greater than expenditures for the first time since 1998. Of course, this is a generous scenario and would require significant raising of revenues due to economic growth, broadening of the tax base, or a rate increase. We display the large difference that would occur when just one of the significant revenue categories (individual income tax) grows at a higher pace over time.

Scenario 3: Expenditures Grow Above Long-term Trend

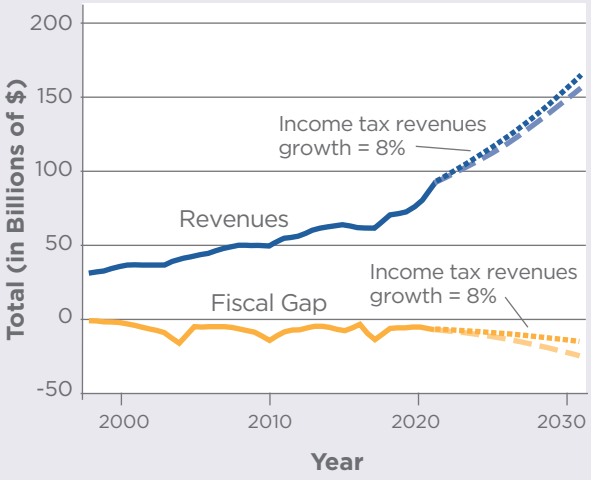
A third scenario has Illinois' expenditures growing faster than their long-term trend while total revenues fall back to the long-term trend as the impact

Figure 4: Baseline Scenario (Expenditures and Revenues after 2021 are projected)

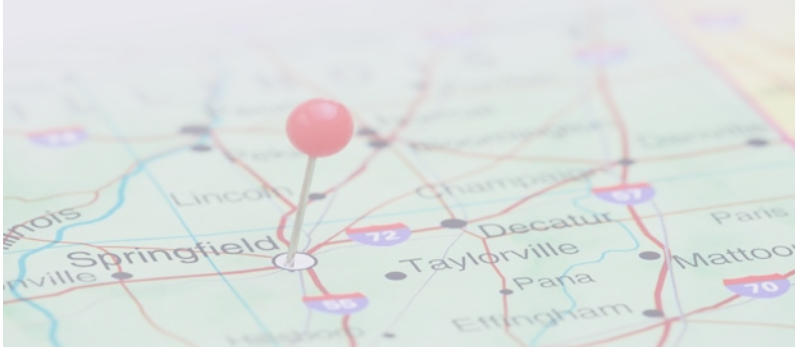


Long dash shows total expenditure and revenue projections assuming all categories grow at 1998 to 2021 compound annual growth rates.

Figure 5: Reduced Fiscal Gap (Figures after 2021 are projected)



Long dash revenue line assumes all revenue categories grow at respective long-term CAGRs. All expenditure categories are assumed to grow at respective long-term CAGRs.



of federal relief phases out. **Figure 6** shows the trend of total expenditures when Medicaid spending, the largest category of spending, experiences a compound annual growth rate of 10% which we consider an upper bound on the likely growth rate. All other categories of spending are assumed to grow at their respective long-term trends. With the projected increase in Medicaid spending, the expenditure trendline shifts above the baseline trend after 2021.

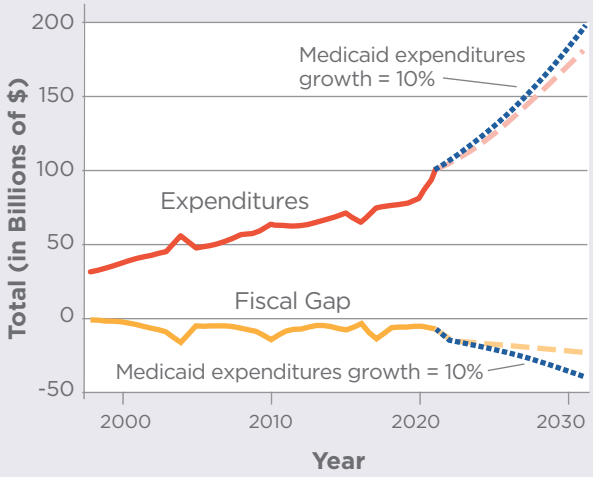
The growth of Medicaid expenditures in this scenario would not happen without an impact on federal revenues because federal reimbursements for Medicaid are directly tied to the level of Medicaid expenditures. The federal government matches Illinois' Medicaid expenditures at the rate of 57.29% for FY22 (the federal matching assistance percentage or FMAP in effect). In response to the COVID-19 pandemic, the FMAP was enhanced by 6.2 percentage points which increased the level of federal reimbursements for Medicaid expenditures. A higher federal match would increase Illinois' financial incentive.[25] However, the FMAP for Illinois has remained close to the federal minimum of 50% during the 23-year period except for years of federally enhanced FMAPs, i.e., during the Great Recession or COVID-19 pandemic. While in this scenario we assume that total Medicaid expenditures grow above the long-term (23-year) trend to 10%, we also assume that the FMAP returns close to the historical minimum of 50% for Illinois after 2021. Federal reimbursements would increase with the higher expenditures as every $1 the state spends on Medicaid would be matched with $1 from the federal government.[26, 27] We do not label this as either a pessimistic or optimistic scenario due to the complexity of the Medicaid program and impacts on the local economy and health outcomes. However, incorporating the increased federal reimbursements after 2021 with the projected rise in Medicaid expenditures would result in a widened fiscal gap over time. Based on our assumptions, **Figure 6** shows a fiscal gap of $23 billion by FY31.

An alternative scenario is the trend of K-12 education spending. In **Figure 7** we project K-12 education spending to grow at a rate of 6% after 2021 (about 2% above its long-term trend and close to its 5-year CAGR) while all other categories grow at their long-term trends. Total spending shifts upward above its long-term trend while the fiscal gap increases over time. Such a situation would cause expenditures to outpace revenues by almost $12 billion in 2031.

CONCLUSION

This report provided a brief summary of Illinois' fiscal situation by examining current revenues and

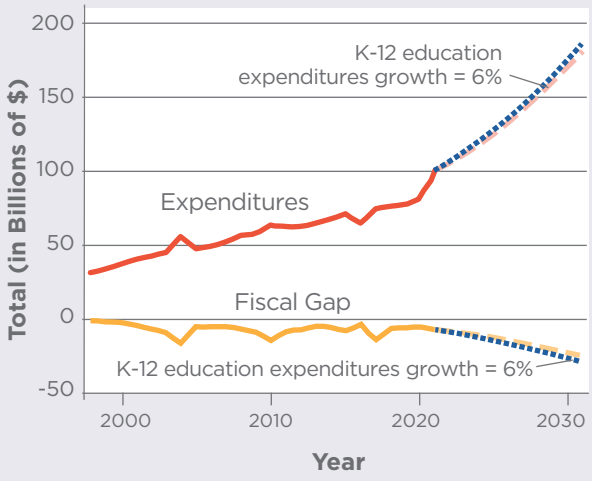
Figure 6: Increased Fiscal Gap with Medicaid Expenditures Growth (Figures after 2021 are projected)



Long dash expenditure line assumes all categories grow at CAGR. Short dash shows projected total with Medicaid expenditures growth of 10%. Federal reimbursements are assumed to be roughly 60% of Medicaid expenditures based on 23-year average.

Note: We assume federal reimbursements are roughly 60% of Medicaid expenditures after 2021 based on the 23-year average ratio of federal reimbursements to Medicaid expenditures. We assume the federal government reimburses 50% of the projected expenditures after 2021 (FMAP of 50%). However, using 50% of expenditures alone may underestimate the federal revenues due to exceptions and enhanced match rates for different types of medical services.

Figure 7: Increased Fiscal Gap with K-12 Expenditures Increase (Figures after 2021 are projected)



Long dashed expenditure line assumes expenditure categories grow at respective long-term CAGRs.

expenditures against their long-term trends. The takeaway from 2021 is that federal relief significantly strengthened Illinois' fiscal position, at least temporarily. The state has emerged from the pandemic with revenues beyond their historical levels, lower unpaid bills, and borrowed funds paid back. Moody's has even upgraded the state's credit rating. This has given the current administration reason to be optimistic and draft a potentially balanced budget in the coming years. Like other stakeholders interested in the state's finances, we are cautiously optimistic but remain uncertain about long-term fiscal sustainability. Between the federal revenue winding down, concerns of increased inflation, and a continuing but struggling recovery from COVID-19 related issues, the outlook for the state remains uncertain but optimistic. While we may not have to cut spending, we should learn from this experience and use the temporary influx of federal funds wisely. Illinois is experiencing less fiscal stress than in the past, but it should take the opportunity to invest in areas that will bring long term benefits for residents.

APPENDIX

Appendix Item 1: Summary Table

Largest Categories within Revenue Sources and Expenditures: Revenues (Own source [Big 3 and All Other] & Federal Transfers [Transportation, Medicaid, Other]): Expenditures (Medicaid, K–12, All Other)

	Revenue										Expenditures			
		Own Source					Federal Transfers							
Year	Total Revenue	Total Own Source	Individual Income Tax	Corporate Tax	Sales Tax	Other	Total Federal Transfers	Other	Transportation	Medicaid Reimbursements	Total Expenditures	Medicaid Expenditures	K-12 Edu	Other
1998	31,144	23,222	6,334	1,631	7,198	8,058	7,922	3,748	835	3,339	31,075	5,248	5,069	20,758
1999	32,902	24,652	6,609	1,577	7,647	8,819	8,250	3,924	726	3,600	33,657	5,587	5,588	22,482
2000	35,714	26,790	6,910	1,698	8,218	9,964	8,924	4,233	927	3,763	37,132	6,217	6,025	24,890
2001	36,998	27,313	7,156	1,550	8,175	10,432	9,685	4,310	1,019	4,356	39,850	6,932	6,390	26,528
2002	36,660	26,601	6,639	1,172	8,279	10,511	10,059	4,579	996	4,484	41,821	7,292	6,630	27,900
2003	36,630	26,098	6,096	936	8,228	10,838	10,532	5,012	846	4,674	42,350	7,901	6,691	27,759
2004	40,667	27,743	6,170	987	8,637	11,949	12,924	5,566	999	6,360	52,708	10,061	7,125	35,521
2005	42,673	30,505	6,936	1,604	8,981	12,984	12,168	5,313	1,002	5,853	45,024	9,530	7,570	27,925
2006	44,499	32,151	7,537	2,061	9,638	12,914	12,348	5,211	1,141	5,997	47,655	10,466	7,874	29,316
2007	47,815	34,711	8,271	2,645	9,785	14,011	13,104	5,524	1,159	6,421	50,665	11,198	8,266	31,201
2008	49,983	36,303	9,105	2,935	9,994	14,269	13,680	5,425	1,367	6,889	53,677	12,699	8,875	32,102
2009	49,623	33,245	7,858	2,540	9,298	13,549	16,377	7,950	1,384	7,043	56,250	13,827	9,371	33,053
2010	49,569	31,305	7,174	2,196	8,789	13,146	18,264	9,052	1,885	7,327	58,741	14,156	9,844	34,740
2011	54,457	36,038	9,694	2,965	9,514	13,865	18,419	8,379	1,916	8,124	59,883	14,161	9,558	36,164
2012	55,975	41,188	14,145	2,708	10,003	14,333	14,787	6,414	1,845	6,528	59,310	12,228	8,948	38,133
2013	60,527	44,268	14,804	3,924	10,236	15,304	16,259	6,269	1,705	8,286	62,745	14,776	8,719	39,250
2014	62,360	45,282	14,715	3,907	10,654	16,006	17,078	6,462	1,738	8,878	66,274	15,190	8,979	42,106
2015	63,729	44,995	13,994	3,538	11,148	16,314	18,735	6,212	2,031	10,491	69,279	16,914	8,903	43,462
2016	61,625	42,629	11,950	2,915	11,307	16,457	18,997	5,904	1,845	11,247	63,302	17,035	9,331	36,936
2017	61,002	42,515	11,738	2,389	11,385	17,003	18,488	5,934	2,105	10,448	71,118	17,853	9,755	43,509
2018	70,127	49,257	16,832	2,862	11,745	17,818	20,870	5,802	1,593	13,475	74,366	18,587	10,456	45,323
2019	71,807	52,436	18,281	3,670	12,454	18,031	19,372	5,942	1,363	12,067	73,760	19,026	10,635	44,099
2020	77,792	52,462	17,610	3,245	12,252	19,355	25,330	9,705	1,784	13,842	80,600	22,289	11,304	47,007
2021	91,392	62,247	21,172	5,482	13,866	21,727	29,145	9,210	2,380	17,556	92,264	26,277	12,177	53,810

Appendix item 2: Fiscal Gap Prediction Assumptions

	Baseline	Increases Fiscal Gap	Decreases Fiscal Gap
All revenue	**4.8%**	**4%**	**6.5%**
Income Tax Revenue	10-year CAGR = 8%, Baseline assumption is 5.4%	23-year CAGR is 5.4%. Would be a reduced level of growth	Policy change: potential income tax increase on high earners; No policy change: 8% similar to 10-year CAGR
Sales Tax	2.9%	2%, below long term trend	4%; Policy Change: Online sales or Services tax increases
Corporate tax	23-year CAGR = 5.4%	6%, Concerns over potential recessions, recovering from COVID shocks	10% - between 5 and 10-year CAGR
Federal Transfers (Transportation + Other)	4.1%	1% Feds try to decrease spending after all the COVID money went out	6% Between 10-year and 5-year CAGR, transportation investment bills
Federal Medicaid Reimbursements	23-year CAGR is 7.5%	10%; FMAP is 50%	If FMAP is 58%.
All expenditures	**23-year CAGRs**		
K-12 expenditures	3.9%	6%	2.45%, 10-year CAGR, unlikely to be able to cut expenditures
Medicaid expenditures	7.1%	10%, Medical expenses continue to rise disproportionately in price compared to other expenses	Expenses are unlikely to decrease without major policy changes at the federal level

Appendix Item 3a: Revenue CAGRs

Revenues	1-year CAGR	3-year CAGR	5-Year CAGR	10-year CAGR	Pre-COVID* 21-year CAGR	Mid-COVID** 22-year CAGR	23-year CAGR
Corporate Income Tax	68.97	24.19	13.47	6.34	3.94	3.18	5.41
Federal Medicaid Reimbursements	26.83	9.22	9.31	8.01	6.31	6.68	7.48
Federal Other	-5.1	16.65	9.3	0.95	2.22	4.42	3.99
Federal Transportation	33.42	14.31	5.22	2.19	2.36	3.51	4.66
Income Tax	20.22	7.95	12.12	8.12	5.18	4.76	5.39
Licenses, Fees, Registration	38.9	17.38	10.08	8.57	6.63	7.22	8.43
Medical Provider Assessments	9.66	20	14.31	8.83	7.28	8.8	8.84
Motor Fuel Taxes	2.63	20.42	11.98	6.13	0.16	2.64	2.64
Receipts from Revenue Producing	6.58	-2.19	1.07	5.75	6.23	5.1	5.16
Sales Tax	13.17	5.69	4.16	3.84	2.64	2.45	2.89
All Other Revenue Sources ***	12.82	2.18	2.95	2.58	3.43	3.02	3.43
Total	**17.48**	**9.23**	**8.2**	**5.31**	**4.06**	**4.25**	**4.79**

Compound Annual Growth Rate or CAGR = $\left(\frac{\text{Final Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{t-1}\right)}$ where t = number of years between first and last value.

* Pre-COVID CAGR represents the 21-year compound annual growth rate for fiscal years 1998 – 2019.
** The mid-COVID CAGR represents the 22-year CAGR for fiscal years 1998-2020 and includes some early COVID response-related expenditures.
*** All Other Revenue Sources includes the remaining revenue categories included in the Fiscal Futures Analysis.

Appendix Item 3b: Expenditure CAGRs

Expenditures	1-year CAGR	3-year CAGR	5-Year CAGR	10-year CAGR	Pre-COVID* 21-year CAGR	Mid-COVID** 22-year CAGR	23-year CAGR
Capital Improvement	47.65	26.68	37.78	2.16	-0.02	0.81	2.50
Central Management	14.48	10.93	13.64	5.90	3.85	4.81	5.21
Commerce & Economic Opportunity	205.88	56.14	29.92	5.06	1.04	1.33	6.32
Debt Service	4.06	0.93	1.23	2.13	7.12	6.53	6.42
Human Services	9.26	6.43	5.29	1.37	1.75	1.96	2.27
K-12 Education	7.73	5.20	5.46	2.45	3.59	3.71	3.88
Local Government Revenue Sharing	11.20	5.11	2.87	2.64	3.04	2.85	3.20
Medicaid	17.89	12.23	9.06	6.38	6.18	6.66	7.12
Public Safety	35.19	30.90	22.39	9.60	4.15	5.81	6.94
State Employee Healthcare	-6.28	-23.51	83.61	4.37	7.55	6.88	6.27
State Pension Contribution	6.52	8.66	6.11	11.72	10.96	10.91	10.71
Tollway	2.38	10.19	-2.66	10.25	7.72	7.80	7.56
Transportation	32.40	14.58	4.23	1.58	2.42	3.12	4.25
All Other Expenditures ***	13.85	5.47	10.40	2.56	2.06	2.16	2.64
Total Expenditure	**14.47**	**7.45**	**7.83**	**4.42**	**4.20**	**4.43**	**4.85**

Compound Annual Growth Rate or CAGR = $\left(\frac{\text{Final Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{t-1}\right)}$ where t = number of years between first and last value.

* Pre-COVID CAGR represents the 21-year compound annual growth rate for fiscal years 1998 – 2019.
** The mid-COVID CAGR represents the 22-year CAGR for fiscal years 1998-2020 and includes some early COVID response-related expenditures.
*** All Other Expenditures includes the remaining expenditure categories included in the Fiscal Futures Analysis.

ENDNOTES

[1] National Association of State Budget Officers, "Summary: Fall 2021 Fiscal Survey of States" (Dec. 2021), https://perma.cc/D4M3-HCD6. Accessed September 7, 2022.

[2] Kenneth Kriz, "Data Indicate COVID-19 Impact on State Revenue Not as Severe as Feared" (2021), https://perma.cc/HJ8X-69UL. Accessed September 7, 2022.

[3] For detailed information on categorization, please see the Fiscal Futures technical documentation, https://perma.cc/P354-M2L5. Accessed September 7, 2022.

[4] U.S. Treasury, https://perma.cc/RV2V-WKCX. Accessed September 7, 2022.

[5] Office of Management and Budget, "American Rescue Plan Act – Fiscal Year 2022" (June 21, 2021), https://perma.cc/US7N-PKWS"; Committee for a Responsible Federal Budget, "Covid Money Tracker," https://perma.cc/GCY8-5ZDD. Accessed September 7, 2022.

[6] David F. Merriman and Xiaoyan Hu, "Illinois' Fiscal challenges: Where are we now and how do we proceed?" April 22, 2021, https://igpa.uillinois.edu/illinois-fiscal-challenges-where-are-we-now-and-how-do-we-proceed/. Accessed January 25, 2023.

[7] Medicaid as an expenditure category includes medical expenditures funded with federal awards and grants. This includes public health services and funding for locations that provide public services. Much of the COVID response went to "Healthcare Provider Relief" which falls under the category of Medicaid in this analysis.

[8] Illinois Office of Management and Budget, https://perma.cc/9BLS-N3GB, 520. Accessed September 7, 2022.

[9] *Ibid*.

[10] Commission on Government Forecasting & Accountability (CGFA), "FY 2022 Liabilities of the State Employees' Group Health Insurance Program" (2021), https://perma.cc/N7L9-HETQ. Accessed September 7, 2022.

[11] *Ibid*.

[12] Data downloaded from the Illinois State Comptroller, "Covid-19 Response and Resources," https://perma.cc/V6ES-4TU7. Accessed September 7, 2022.

[13] Kriz, *supra* n. 2.

[14] CGFA, Revised FY 2022 Economic Forecast and FY2021 Revenue Update (May 2021), https://perma.cc/F839-V564. Accessed September 7, 2022.

[15] Consistent with this FY2020 finding where personal and corporate income tax revenue declined (https://perma.cc/3VLE-8F4D). Accessed September 7, 2022.

[16] *See* "Leveling the Playing Field for Illinois Retail Act" for additional tax information, https://perma.cc/TU82-45ME. Accessed September 7, 2022.

[17] Kaiser Family Foundation, "Federal Medicaid Assistance Percentage for Medicaid and Multiplier" (2022), https://perma.cc/CT7F-6DPQ. Accessed September 7, 2022.

[18] Kaiser Family Foundation, "Analysis of Recent National Trends in Medicaid and CHIP Enrollment," (2021), https://perma.cc/FCS8-BNQE. Accessed September 7, 2022.

[19] Governor's Office of Management and Budget (GOMB), "Illinois Economic and Fiscal Policy Report," (Nov. 9, 2021), https://perma.cc/LB5H-VUJW. Accessed September 7, 2022.

[20] Xiaoyan Hu, Alea Wilbur-Mujtaba, and David Merriman. "Why does Illinois' Unemployment Insurance Trust Fund have a large deficit?" (2022), https://perma.cc/2L5Y-7SMP. Accessed September 7, 2022.

[21] Illinois Comptroller, Debt Transparency Report Summary, Vol. 5, No. 2 (February 2022), https://perma.cc/XLH2-N5P4. Accessed September 7, 2022.

[22] Governor's Office of Management and Budget, "FY23 Budget Press Release," (April 2022), https://perma.cc/K7F5-5MTJ. Accessed September 7, 2022.

[23] Kaiser Family Foundation, "Medicaid Enrollment and Spending Growth (2021), https://perma.cc/27JV-E6AV.

[24] Commission on Government Forecasting and Accountability, "Monthly Briefing for February 2022," https://perma.cc/7EU9-N8CF. Accessed September 7, 2022.

[25] Kaiser Family Foundation, "The Role of Medicaid in State Economies: A Look at the Research" (January 2009), https://www.kff.org/wp-content/uploads/2013/01/7075_02.pdf. Accessed September 7, 2022.

[26] *Ibid*.

[27] *See* Illinois State Comptroller webpage, "About Medicaid Spending," https://perma.cc/TRB2-A5J8. Accessed September 7, 2022.

ACKNOWLEDGMENTS

We thank Amanda Kass and Beverly Bunch for comments on earlier versions of this paper.

Publisher's Notes

Any opinions expressed herein are those of the authors and not necessarily those of the Institute of Government and Public Affairs, the author's employer, including the University of Illinois Chicago, or the University of Illinois System.

Mast Photographs

Chicago cityscape - Elena Sivitskaia, stock.adobe.com
Illinois State Capitol Dome - Frame from video at https://www.youtube.com/watch?v=F2wPy7DfXfQ
Capitol Dome at Dusk - Frame from Adobe Stock video file 187821651, by VIA Films

Photography from istockphoto.com

Pg. 1 - Illinois Capitol, #1319763678 by rruntsch
Pg. 1 - $100 bills, #1151839130 by igorbondarenko
Pg. 3 - Upward arrows, #1317087986 by gesrey
Pg. 4 - Plotting growth, #1361507082 by Khanchit Khirisutchalual
Pg. 5 - Covid testing, #1286737238 by Plyushkin
Pg. 5 - Illinois Coronavirus,#1219701951 by bgblue
Pg. 7 - Stimulus check, #1295543486 by CHUYN
Pg. 8 - Rainy day fund, #648659120 by phive2015
Pg. 9 - Illinois Capitol and reflection, #547428764 by Ron and Patty Thomas
Pg. 10 - Map pin on Springfield, Illinois, #535413139 by dk_photos