Illinois' Economic and Fiscal Challenges and Responses

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Outline

An update on Illinois' economy, state revenue, and other key themes relating to state's fiscal and budget situation.

- Recent legislative actions (as of Jan. 18, 2011)
- Illinois' Economy
  - Median income: relatively high
  - Unemployment: high but starting to fall
- State Revenue Trend
- Depth of Fiscal Problem
- Adequacy of legislative proposals and implications for higher ed. and the economy

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Recent legislative actions
(As of Jan. 18, 2011)

- Revenue
  - Increase individual income tax rate from 3% to 5% btwn Jan 1, 2011 and Dec. 31, 2014
    - Rate falls to 3.75% Jan. 1, 2015 to Dec. 31, 2024
    - Rate falls to 3.25% starting Jan. 1, 2025
  - Increase the corporate income tax rate (including personal property replacement tax) from 7.3% to 9.5% from Jan 1, 2011 until Dec. 31, 2014
    - Rate falls to 7.75% Jan. 1, 2015 to Dec. 31, 2024
    - Rate falls to 7.3% starting Jan. 1, 2025

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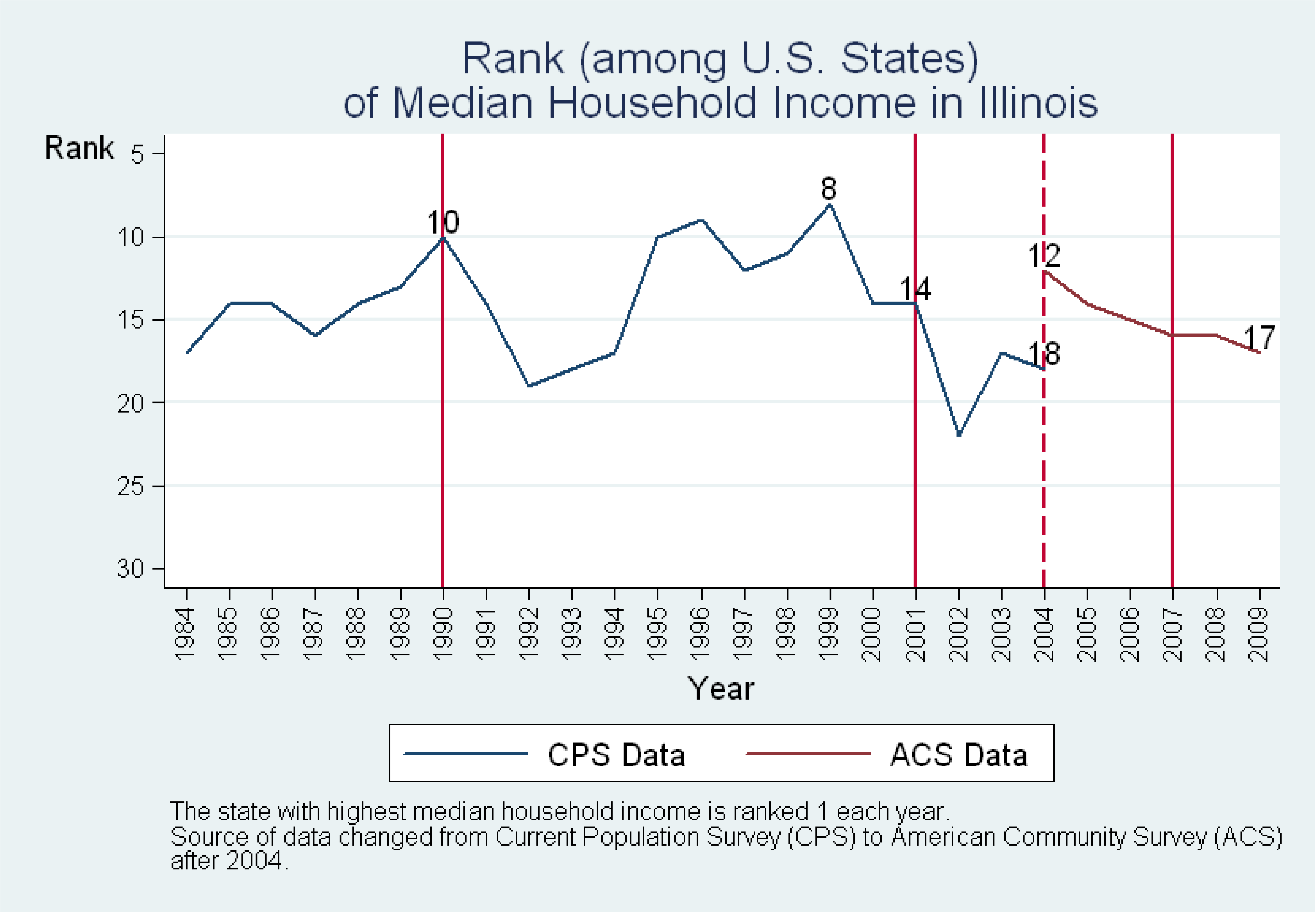
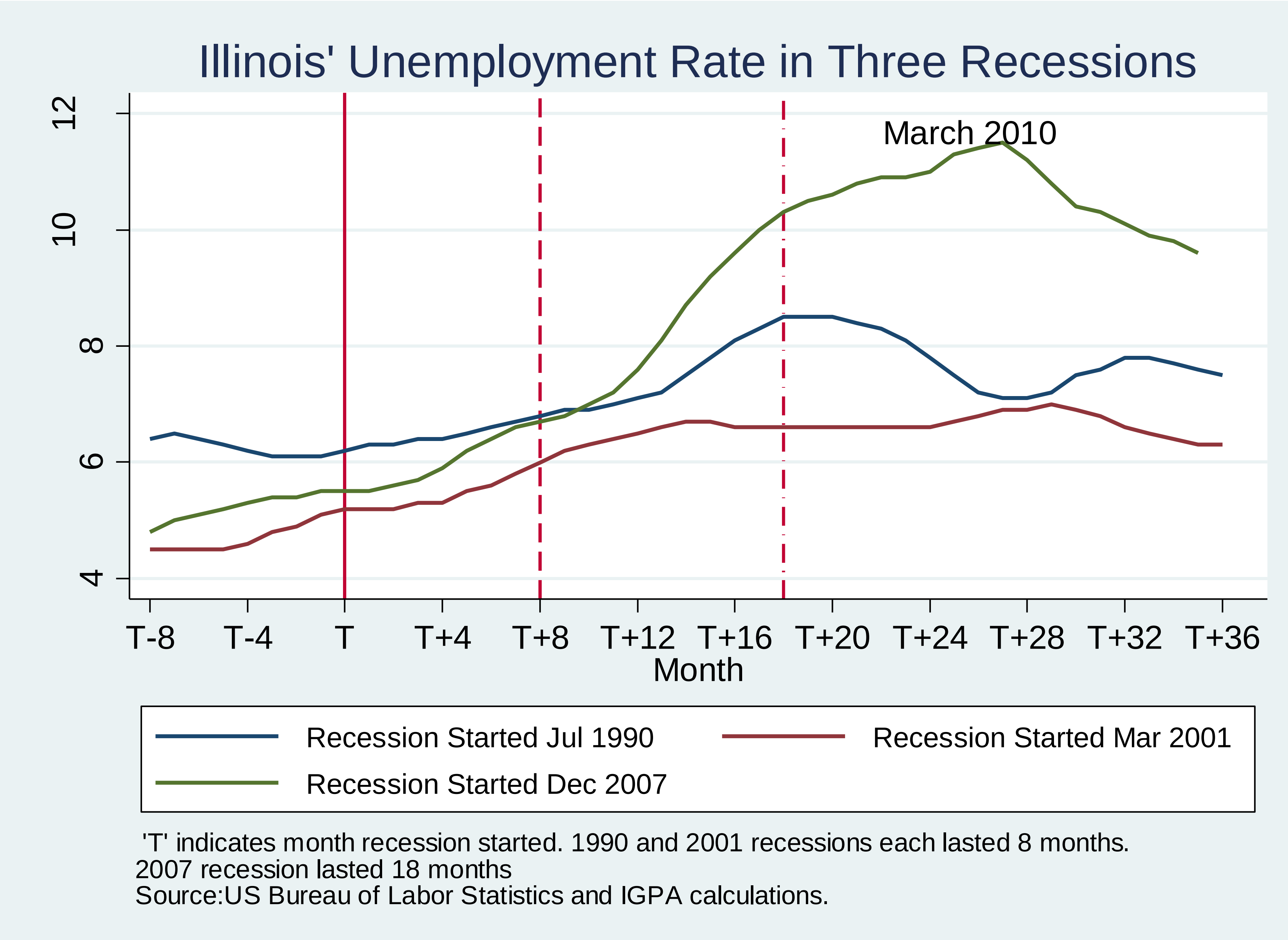
- Net operating loss absorption suspended between Dec. 31, 2010 and Dec. 31, 2014

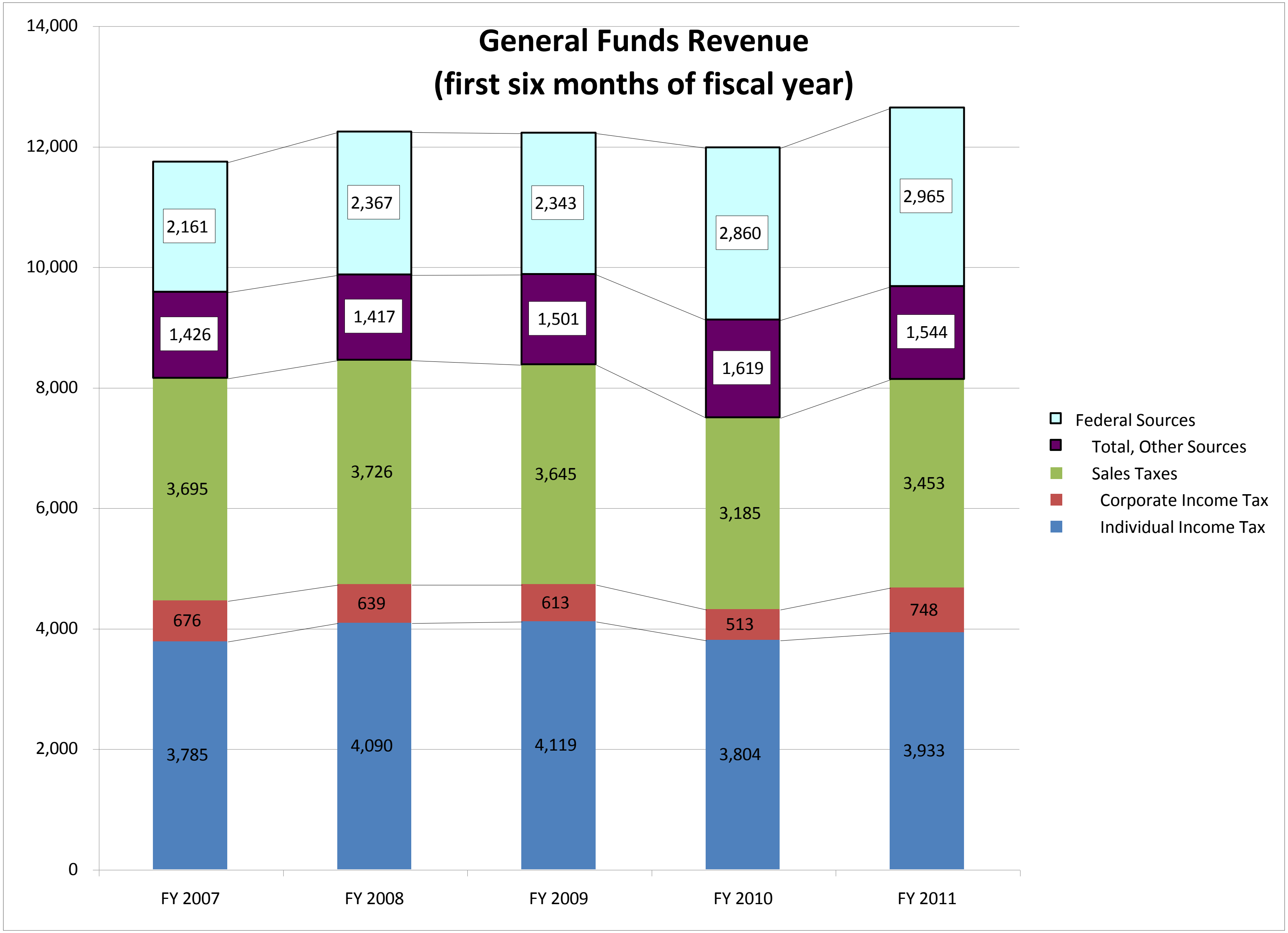
- Revenue Estimates (round numbers)
  - **$6.6 billion** annually from the personal income tax increase
  - **$900 million** annually from the corporate rate increase
  - **$250 million** first year elimination of carry-over losses

- Borrowing
  - **$3.7** billion for pension payments (one time)

- Spending
  - Increase in Medicaid managed care
    - $800 million in savings over a 5-year period.
  - State spending limitation and tax reduction
    - Annual caps on general funds (GF) spending for FY2012 through FY2015 with potentially strong enforcement mechanism.
    - Caps allow total GF spending to grow 2% per year but include pension and debt service which will grow more than 2%.
    - We estimate that state spending other than debt and pension (including higher ed) must decrease by 1% to conform to the law.


Rank (among U.S. States)
of Median Household Income in Illinois
Rank
5
10
15
20
25
30
10
8
12
14
17
18
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
Year
CPS Data
ACS Data
The state with highest median household income is ranked 1 each year.
Source of data changed from Current Population Survey (CPS) to American Community Survey (ACS) after 2004.


Illinois' Unemployment Rate in Three Recessions
March 2010
12
10
8
6
4
T-8
T-4
T
T+4
T+8
T+12
T+16
T+20
T+24
T+28
T+32
T+36
Month
Recession Started Jul 1990
Recession Started Mar 2001
Recession Started Dec 2007
'T' indicates month recession started. 1990 and 2001 recessions each lasted 8 months.
2007 recession lasted 18 months
Source:US Bureau of Labor Statistics and IGPA calculations.



*We use general fund (GF) rather than consolidated fund (CF) data here because partial year data on CF is unavailable prior to FY 2008. Post FY2008 trends similar in GF and CF data

Titanic and Sinking: The Illinois Budget Disaster

It is hard to overstate the depth of the fiscal hole the state is in.

27

IGPA will release
The Illinois Report 2011
in February 2011.

Visit www.igpa.uillinois.edu
for more information.

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Measuring the budget gap

- *Official estimates* of the General Funds budget gap for fiscal year 2011—which include unfunded obligation from prior years' deficits—are more than $12 billion.

- *Comptroller's office*, (October 2010) reported that the deficit could be as high as $15 billion by spring 2011.

- *IGPA estimates* FY2012 consolidated funds deficit of $11.9 billion. The state also is likely to have billions of dollars in unpaid bills at the start of FY2012.

Illinois will face severe future budget pressures.

- Illinois pension under-funding is the worst in the nation.
  - $3.5 billion in bonds to cover Illinois 2010 pension payment must be paid back with interest over five fiscal years (2011-2015).

- The FY11 budget relied on one-time proceeds
  - $1.25 billion tobacco settlement
  - $392 million tax amnesty
  - $354 million in inter-fund borrowing
  - $3.7 billion in pension bonds

- Future federal aid is likely to be lower.

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Inadequacy of one-dimensional policy options

- **Waiting for the economy to improve**
  - If major taxes increased to their peak 2008 level, inflation-adjusted revenue would increase by only $2.8 billion.
- **Continuing to accumulate obligations**
  - By FY2014 there would be a five year payment backlog. Vendors would refuse to contract with Illinois.
- **Borrowing**
  - By about FY2018 every dollar of revenue from the personal income, corporate income, and sales tax would be required simply to service our debt.
- **Raising the income tax**
  - Personal income tax rate of 7.1 percent, corporate rate of 11.3 percent, and new policies to slow spending growth required. (Calculated before Jan. 2011 changes.)

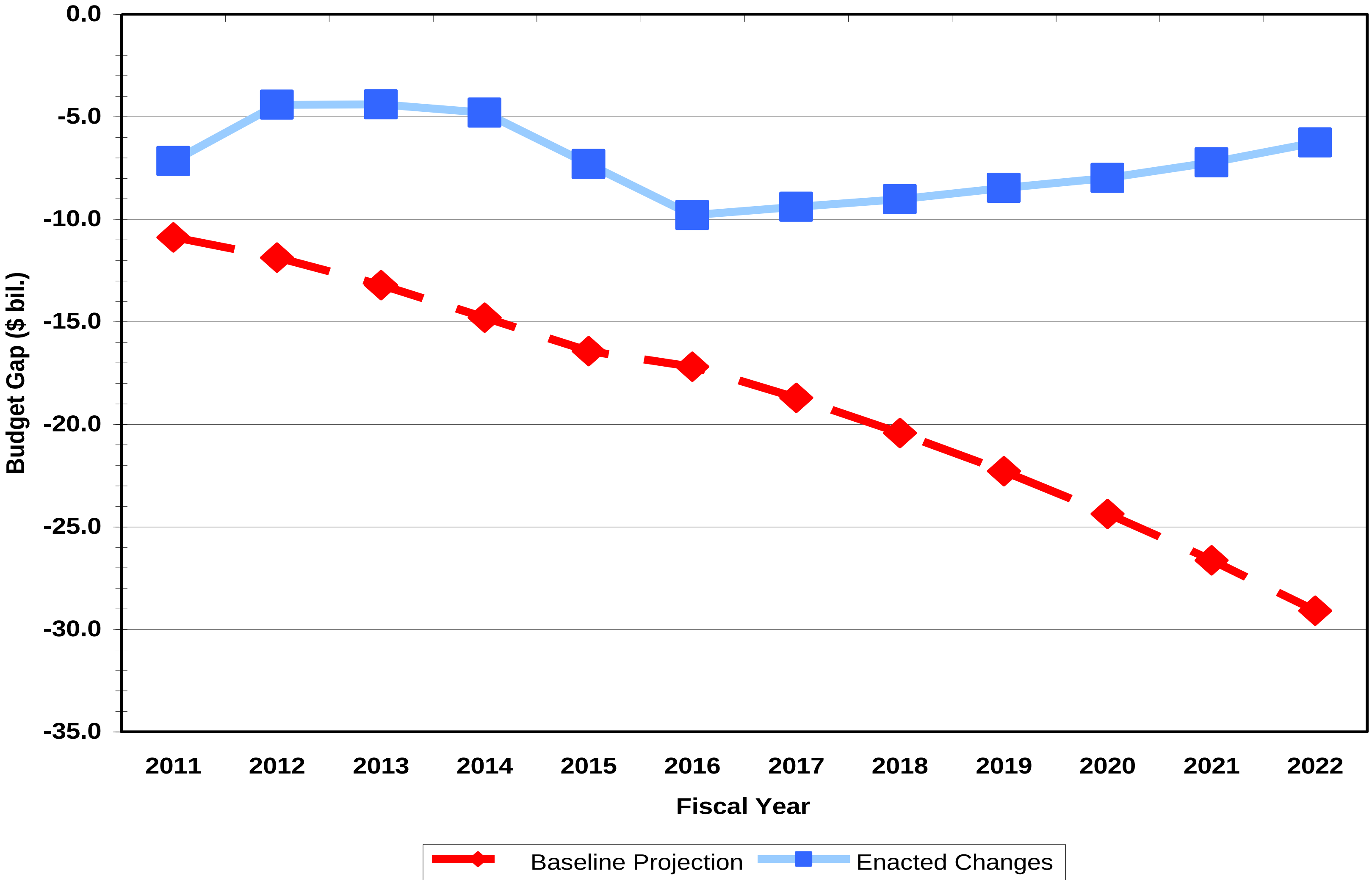
Inadequacy of one-dimensional policy options

- **Raisings the sales tax**
  - State rate of 13.5 percent (by far the highest in the nation) and new policies to slow spending growth would be required. (Calculated before Jan. 2011 changes.)
- **Cutting spending**
  - A 26 percent cut in spending (exclusive of transportation, debt service and pensions) would be required. (Calculated before Jan. 2011 changes.)
- **Broadening existing tax bases**
  - Including retirement income in the income tax will raise about $1.1 billion in FY2012.
  - Including consumer services in the sales tax base could raise as much as $4.5 billion in FY2012.

Projected Illinois deficits in FY2011 and FY2012 with & without changes enacted January 11, 2011

	FY11	FY12	Notes
	($ bill.)	($ bill.)	
Baseline budget gap without new law	-10.9	-11.9	IGPA estimates using Fiscal Futures Model with "consolidated funds budget" data
Continuing revenues			
Income tax increase	3.7	7.7	Estimated additional revenue from both the personal and corporate income tax changes plus estate tax (effective half of FY11)
Spending changes			
Across-the-board		0.3	New law caps general fund growth at 2%, which decreases non-pension non-debt spending by 1%
Service (FY11) pension bonds		-0.6	Assumes eight year payback at 5.0% interest
Operating deficit (subtotal)	-7.2	-4.4	
One time revenues			
Tobacco securitization & interfund borrowing	2.2		Previously legislated for FY11
New pension borrowing	3.7		Required pension payment of $3.5 billion is less than the $3.7 billion borrowed.
Remaining cash deficit	-1.3	-4.4	
Backlog carried in	-6.0	-7.3(?)	

Figure 1: Projected Gap in Consolidated Budget with and without Enacted Changes



Source: IGPA Fiscal Futures Model, January 17, 2011.

Note: Assumes no additional borrowing or debt service other than existing and enacted amounts.

Implications for higher education and the Illinois economy

- Higher education
  - Budget situation may be somewhat improved because of recent legislative changes. Backlog of unpaid bills could be reduced.
  - FY12 budget prospects remain grim even if with significant tax increases. A large structural deficit remains and will become evident almost immediately in FY2012.
- Illinois economy
  - Reduction in unpaid bills should increase state's fiscal credibility.
  - Increased personal income tax rate and high corporate income tax rate may send negative signal.
  - Continued structural deficit could deter economic activity.

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Summary

- Illinois' economy
  - Growing slowly but fundamentally sound
  - Slowly emerging from the severe recession
- Illinois state gov't revenue
  - Fairly stagnant over the last five years
  - Propped up by federal spending
  - Insufficient to support state's current spending commitments
- Current legislative actions
  - Raise substantial additional revenue but not nearly sufficient to right the short-term budget imbalance
  - Do little to balance the budget over the longer term

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