

Cook County's Revenue System is Structurally Unable to Support the Public Services it Provides

**Prepared by:
Heather O'Donnell and Ralph Martire**

September 2007



70 East Lake Street
Suite 1700
Chicago, IL • 60601
www.ctbaonline.org

Cook County’s Revenue System is Structurally Unable to Support the Public Services it Provides

Table of Contents

Executive Summary.....1

Key Findings3

The Basic Public Services Cook County Provides and the Revenue Sources that Fund Them4

Cook County Does Not Have the Fiscal Capacity to Fund the Public Services it Provides.....7

The County’s Current Revenue System Cannot Cover Rising Health Care Costs.....9

The County’s Revenue Shortcomings Combined with Escalating Costs.....12

Designing a Tax Structure that Supports the Local Public Services Cook County Provides12

Fees Imposed By Cook County that Fund Specific Public Services14

Conclusion.....15

Cook County's Revenue System is Structurally Unable to Support the Public Services it Provides

Executive Summary

Local governments, such as counties, cities, and townships, provide a number of basic public services that help create safe, clean, healthy, vibrant communities. Cook County, which has over five million residents and is the second largest county in the nation, is no exception.¹ It delivers such essential services as public safety, the operation of the largest court system in the United States, health care for poor and low-income individuals through three public hospitals and 14 community clinics, the operation of the largest jail facility in the nation, and economic and human development programs. The cost of the public services Cook County will provide in fiscal year 2007 is \$2.8 billion.² By comparison, the annual budget for Los Angeles County, which has nearly 10 million residents, is over \$21 billion annually.³

To deliver and sustain quality public services, local government must design and implement a revenue system – that is, a combination of taxes and fees – that adequately funds the services taxpayers desire and consume. Although taxes are often disdained, without them – and therefore, without the financial ability to support public services – our communities would be a far different place.

State and local governments across the country are facing significant fiscal challenges. According to a recent report by the U.S. Government Accountability Office (GAO), the cost of public services provided by local governments is growing at a rate greater than local revenues, resulting in expanding annual deficits.⁴ Annual health care costs, which are increasing faster than three times the general inflation rate,⁵ are the primary driver of this budgetary conundrum.⁶

Cook County is not immune to this trend, suffering through consistent deficits in recent years. In fiscal year 2006 alone, it is estimated that the County's expenditures exceeded revenues by more than \$479 million,⁷ more than double the size of the County's deficit of \$220.2 million in fiscal year 2002.⁸ To address its recurring budget problems, the County Board reduced appropriations for fiscal year 2007 by 11.4 percent, or \$41.1 million.⁹ Nonetheless, the County is expected to have a deficit of \$121 million for its operating budget at the end of the 2007 fiscal year.¹⁰ Moreover, the spending cuts made in 2007 will have negative consequences for County-provided services: fewer criminal prosecutors and public defenders, forcing the criminal justice system to operate at a slower pace and potentially inefficiently. The closing of several health clinics for the indigent will mean less access to health care for the less fortunate. Likewise, the reduction in health care professionals and medical equipment will mean longer waiting lists for medical procedures for low-income, chronically ill patients.

As pointed out by the GAO, on the cost side, local governments are being squeezed by soaring health care costs.¹¹ Cook County, as the largest provider of indigent health care in the state and the third largest provider of such care in the nation, has been significantly strained by rising health care costs. This is compounded by increasing demand for public health care services as the number of uninsured individuals continues to increase annually. According to the most recent report released by the U.S. Census Bureau, the number of uninsured Americans increased by more than two million between 2005 and 2006.¹² Fully 46 percent of all Chicagoans are either uninsured or receive public health care coverage, up from 42 percent just four years

ago.¹³ As employers continue to drop health insurance benefits for workers because of increasing costs – in Illinois, employer-sponsored health care coverage declined by nearly 15 percent between 1979 and 2003, falling from 75 percent of workers receiving employer-provided health insurance in 1979, to only 61 percent in 2003, the latest year for which data is available¹⁴ – public safety-net providers like Cook County are filling in the gap. For example, visits to the network of County hospitals and clinics increased by nearly 200,000 in fiscal year 2005 alone, as the number of prescriptions filled at the County increased by 73 percent between fiscal year 2003 and 2005.¹⁵

Cook County generates revenue to fund local public services from a combination of County-imposed taxes (primarily property, sales, cigarette, and gas taxes) and fees (e.g., federal Medicaid dollars that reimburse the County for medical services provided to Medicaid recipients, court appearance fees and fees for vital records). The majority of Cook County's tax and fee revenues do not grow with the economy, while the costs of the services the County provides do. For instance, the County's property tax levy – the amount of local property taxes it is permitted to collect each year under current law – has remained at the same level – \$720 million – for the past ten years.¹⁶ On an inflation adjusted basis, therefore, using the U.S. Bureau of Labor Statistics' Consumer Price Index, the County's local property tax revenue has lost 23 percent of its value over this ten-year period. The local property tax is the County's main tax revenue source for funding public services.¹⁷

The local sales tax is the second largest tax revenue source for Cook County, accounting for 13 percent of total County operating revenue for fiscal year 2007.¹⁸ However, the local sales tax only partially grows with the economy. The reason for this is that, under Illinois law, the sales tax base generally includes only the sale of goods, while excluding the sale of consumer services. This is problematic from a fiscal policy standpoint because the consumer services sector is the largest and fastest growing sector of the state's economy, while the consumer goods sector of the economy is actually declining.¹⁹ To illustrate, between 1965 and 2004, the sale of consumer services increased from 63 percent of the Illinois state economy to 77 percent.²⁰ Over the same period, the consumer goods sector of the state's economy declined from 32 percent to just 13 percent.²¹ The state's sales tax base is too narrow to track economic growth in the modern economy.

Meanwhile, as health care costs increase annually at rates far greater than regular inflation, federal Medicaid cuts in recent years have resulted in the County losing \$139 million in federal Medicaid funds between fiscal years 2005 and 2007.²² Accordingly, as County cost pressures increase, most of its revenue sources have either remained flat or actually declined in recent years. This ongoing fiscal mismatch between revenues that underperform inflation and service costs that grow at rates above inflation, has resulted in chronic annual budget deficits.

This report analyzes the County's fiscal system to determine whether it has the ability to fund and sustain the level of public services it currently provides. The analysis reveals Cook County has what is called a "structural deficit."²³ A structural deficit exists when a public entity's fiscal system is unable to generate sufficient revenue to support base-level public services from one year to the next, adjusting *solely* for annual inflationary costs. It is important to recognize that the model used in this report assumes service levels will remain constant – that is, when running simulations of the cost of public services into the future, no service expansions are projected from fiscal year 2007 levels. Therefore, the starting point for the analysis in this report is the service levels existing after the cuts made in fiscal year 2007.

Key Findings

Following are the key findings of this report:

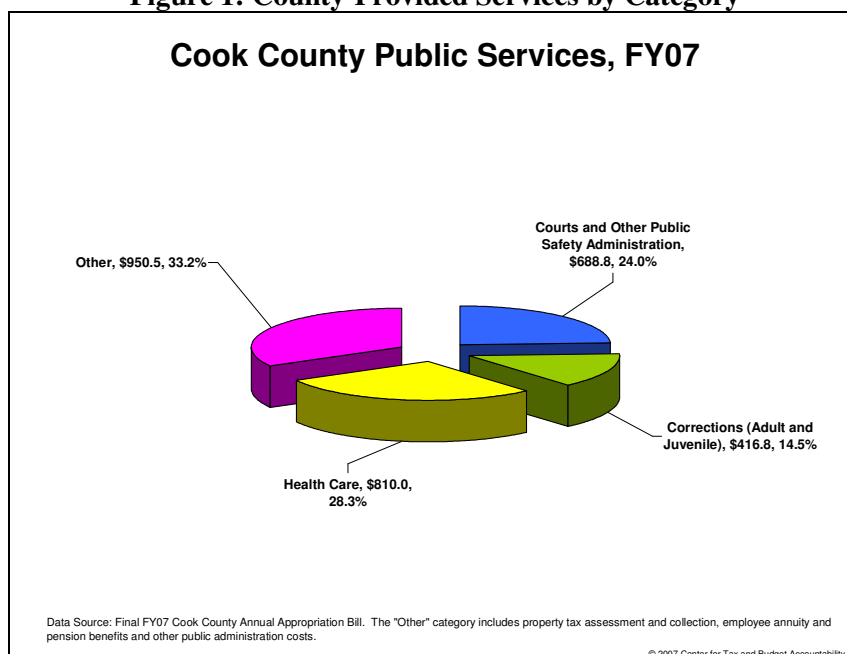
- **Cook County has a structural deficit.** The annual inflationary cost of Cook County continuing to provide current service levels from one fiscal year to the next significantly outpaces its projected annual revenue growth. Moreover, without a significant change in either revenues or expenditures, the County's structural deficit is projected to continue over time, worsening the County's total deficit.
- **The County's structural deficit has contributed substantially to its total deficit for fiscal year 2008, which is estimated to be \$288 million.** As a result of stagnant and declining annual revenues and annually increasing costs based on projections that take into account solely the inflationary cost of maintaining fiscal year 2007 public service levels, the County's structural deficit will cause its total deficit to increase to \$568 million in three years (fiscal year 2010), to \$808 million in five years (fiscal year 2012) and to \$1.5 billion in ten years (fiscal year 2017).
- **The cost of providing public services increases annually with inflation.** Based on historical inflationary trends over the past ten years using the U.S. Bureau of Labor Statistics' Consumer Price Index, the cost for County-provided services other than health care services (primarily public safety and public administration costs), is projected to grow at an average annual rate of 2.6 percent.²⁴ Using U.S. Congressional Budget Office projections, Medicaid costs are expected to grow at an average annual rate of 7.5 percent.²⁵ Cook County's revenue, however, is projected to grow at an average annual rate of only 0.5 percent. Accordingly, Cook County's current revenue system cannot support growing service costs.
- **The principal reason for the County's structural deficit is that the County's revenue system is fundamentally flawed: most of its revenue sources do not grow with the economy while costs do.** This makes it fiscally impossible under the County's current revenue system to fund the level of public services the County currently provides into future years. One primary reason for the disparity between County revenues and costs is that the amount of the County's property tax levy has been held at the same level – \$720 million – over the past ten years. After inflation, this flat revenue source has lost 23 percent of its value since 1997. That decline in value creates a significant fiscal strain for the County since property taxes fund 25 percent of the public services the County provides.
- **As a result of recent federal cuts to the Medicaid program, federal Medicaid dollars, which fund 16 percent of the County's total operating budget, and 51 percent of the County's health care system, declined by \$139 million between fiscal years 2005 and 2007.**²⁶ Under current federal law, it is likely the County will experience more Medicaid cuts in future years.²⁷
- **In fiscal year 2008, it is estimated the County will lose \$68.2 million upon the implementation of new federal Medicaid regulations.**²⁸ These cuts will impact the County every fiscal year thereafter: in 2009 the County's federal Medicaid funds will be cut by \$112.9 million, in 2010, the cuts are expected to amount to \$111.2 million. Over the five fiscal years between 2008 and 2012, the County stands to lose an estimated \$504.9 million in the aggregate.
- **The only revenue source used to fund basic public services in Cook County that grows annually is the sales tax, which funds 13 percent of County-provided services.**²⁹ However, under state law, the County is only permitted to impose a local sales tax on the sale of goods – it does not have the legal authority to tax the sale of consumer services. As a result of leaving a significant portion of the state's economy (consumer services) out of the sales tax base, the County's sales tax does not capture all economic growth.

- **Nearly half – 47 percent – of patients in the Cook County health care system do not qualify or are not enrolled in Medicaid or Medicare, and do not have private health care coverage.** Medicaid is the public federal-state health insurance program for poor and low-income families, while Medicare is the federal public health insurance program for senior citizens. This means that the vast majority of care provided by the County is unreimbursed (*i.e.*, very little revenue is realized for this patient population). The fiscal strain this creates for the County is easy to demonstrate: in fiscal year 2006, only 2.6 percent of patient fee revenue came from patients with private insurance or self-pay patients (*i.e.*, patients who do not have private or public coverage). Data was not available on the amount of patient fee revenue received only from the uninsured, but clearly it is less than 2.6 percent of all patient fee revenue.
- **In addition to changes in federal law, there appear to be flaws in Cook County’s Medicaid and Medicare billing practices that inhibit the County’s ability to receive all federal and state funds to which it is entitled.** The County has a public duty to taxpayers to ensure that it bills and collects all Medicaid and Medicare revenue from the state and federal government to which it is entitled for health care services delivered to program enrollees. This is especially true during fiscally strapped times. Based on very conservative estimates, this could generate an additional \$40 million annually once a billing system is put in place at the Bureau of Health Services, the local agency responsible for running the Cook County health care system.³⁰
- **This report did *not* take into account the increasing demands placed on the public health care system as the number of uninsured low- and moderate-income families continues to rise.** Clearly, if the Cook County health care system is expected to cover families in this population, as it has throughout its history, the additional costs will need to be considered.
- **Unless Cook County undertakes fundamental fiscal reform so that its revenue sources grow with the economy and keep pace with the natural inflationary costs of providing public services from one year to the next, it cannot sustain current public service levels.**
- **In conjunction with fiscal reform, the County must implement a billing system at the Bureau of Health that captures all federal and state health care funds to which the County is entitled for public health services delivered.**

The Basic Public Services Cook County Provides and the Revenue Sources that Fund Them

Cook County’s operating budget for fiscal year 2007 is \$2.8 billion.³¹ As shown in Figure 1 below, the amount appropriated for providing public safety – courts, police, criminal prosecutors, public defenders, public guardians for abused or abandoned children, and detention facilities for juveniles and adults – to County residents accounts for more than one-third (38.5 percent) of County-provided services.³² Nearly another third (28.3 percent) of the fiscal year 2007 County budget – \$810 million – covers health care for poor and low-income uninsured individuals.³³ The remaining third of the County budget is spent to fund public administration functions such as the recording of real estate deeds, computer and information technology, county employee pensions, elections and the assessment and collection of all property taxes collected from Cook County property owners.³⁴ It is important to note that while Cook County government assesses and collects all local property taxes paid throughout the County – and thus, bears the cost of this function – only 17.5 percent of County property taxes paid by homeowners and businesses actually goes to fund County-provided services.³⁵ The overwhelming majority of local property taxes go to the Chicago Board of Education to fund public schools.³⁶

Figure 1: County-Provided Services by Category

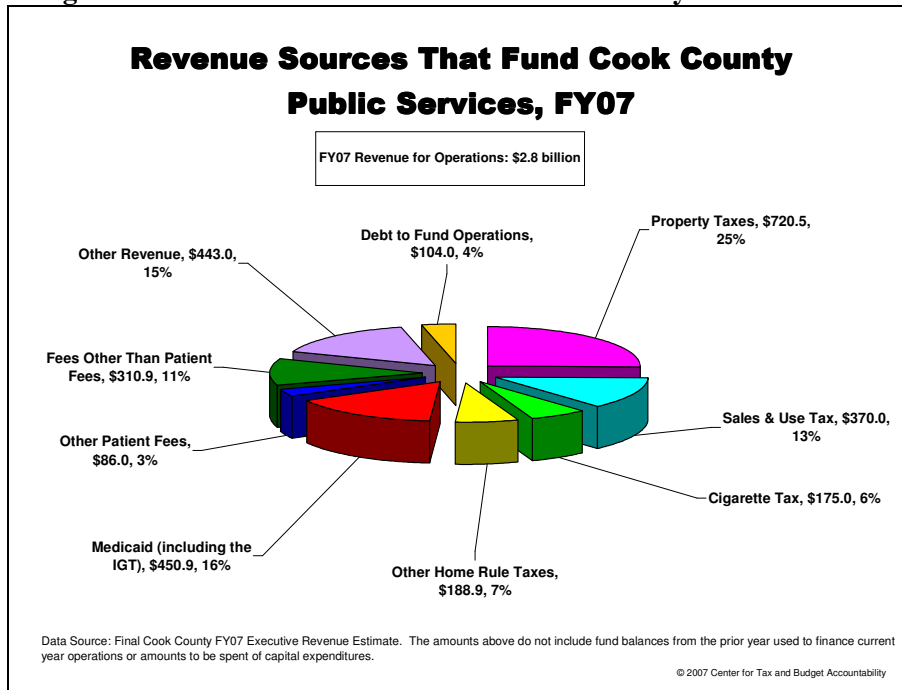


Cook County, like other local governments, uses a mix of several different revenue sources to fund public services: local property taxes, sales taxes, cigarette taxes, and a variety of fees for specific services delivered. Figure 2 below shows the different revenue sources used to fund the County's cost of providing public services. The Figure shows that 51 percent of the County's revenue is generated by taxes, 45 percent by fees and other miscellaneous revenue, including federal Medicaid and Medicare funds, and four percent is financed with debt.³⁷ For fiscal year 2007, local property taxes will account for a quarter of County revenue (\$720.5 million), sales taxes will constitute 13 percent (\$370 million), cigarette taxes will cover six percent (\$175 million) and other home rule taxes (*e.g.*, alcoholic beverage tax, parking lot tax and a tax on the sale of motor vehicles) will total seven percent of total County revenue (\$188.9 million).³⁸

Fees support 30 percent of Cook County government.³⁹ Federal Medicaid and Medicare funds are categorized as fees because the County receives these funds as reimbursement for health care services provided to qualifying patients. Medicaid dollars, which in Cook County's case are all federal dollars, play a fundamental role in funding health care for poor, uninsured individuals treated in the County health care system. Federal Medicaid dollars are estimated to account for 16 percent of total County operating revenue in fiscal year 2007, and fund fully half of the County's health care budget.⁴⁰ Medicare funds play a smaller role in financing County government – Medicare, private insurance and self-pay patient fees will constitute only three percent of total County operating revenue this fiscal year, while other fees such as court filing fees and document fees will make up 11 percent of the County's revenue for 2007.⁴¹

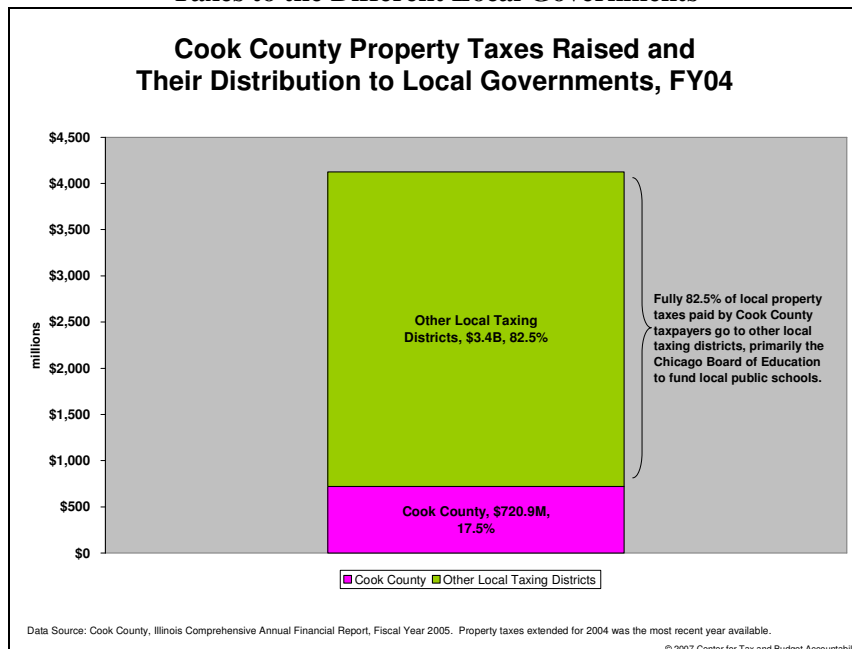
General obligation bond debt totaling \$104 million will finance four percent of County operations in fiscal year 2007.⁴² As a general rule, debt should not be used to fund general government operations. However, without some structural reform, if Cook County government desires to maintain current service levels in coming years, in all likelihood, the County's fiscal problems will result in the more and more reliance on debt to fund basic public services.

Figure 2: Revenue Sources That Fund Cook County Public Services



A common misperception is that a significant portion of local property taxes go to County government. This is simply not the case. Cook County's property tax levy is \$720 million annually.⁴³ This represented only 17.5 percent of all local property taxes paid by homeowners and businesses in 2004, the most recent year for which data is available, as illustrated in Figure 3 below. Most local property taxes paid in Cook County are distributed to the Chicago Board of Education to fund the Chicago public school system. Other local taxing districts that receive a portion of the property tax revenue raised in Cook County are the City of Chicago, the Metropolitan Water Reclamation District, the Cook County Forest Preserve District, the Chicago Park District, the Chicago School Finance Authority and the City Colleges.

Figure 3: The Distribution of Local Property Taxes to the Different Local Governments



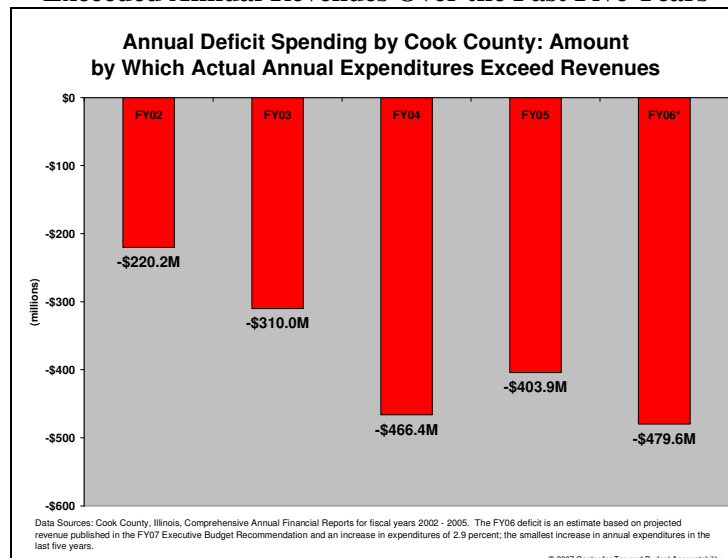
In fact, Cook County’s property tax levy – the amount of property taxes permitted to be paid to Cook County government out of the total amount of such taxes assessed against real property in the County – has been held constant at \$720 million for a decade.⁴⁴ This means that adjusting for inflation, the County’s property tax levy has lost 23 percent of its value since 1997. Net of abatements, the County’s property tax rate was .547 per \$100 of assessed property valuation in 2005, while the rate for the Chicago Board of Education’s was 3.104 and the City of Chicago’s rate was 1.302.⁴⁵

The result of the “freeze” of Cook County’s property tax levy is that it is a declining revenue source for County-provided services. To highlight the impact, in 1997, local property taxes represented 31.7 percent of the County’s revenue while in fiscal year 2007, it is expected to represent only 25 percent of public revenue – a decline of over six percent.⁴⁶

Cook County Does Not Have the Fiscal Capacity to Fund the Public Services it Provides

Technically, Cook County, like the state and all local governments in Illinois, is required by law to balance its budget every year.⁴⁷ Accordingly, the County must prepare reasonable revenue estimates prior to the start of every fiscal year and design appropriations (estimated expenditures for the year) that are expected to stay within projected revenues.⁴⁸ Despite the prohibition against operating at a deficit, the County has experienced years of deficit spending. As Figure 4 below shows, according to the County’s annual audited financial statements, it has run significant deficits over the past several years when taking into account actual annual revenue received and actual annual expenditures. For fiscal year 2005, the most recent audited fiscal year, the County’s expenditures exceeded revenue by \$403.9 million.⁴⁹ This report estimated that for fiscal year 2006, expenditures will have exceeded revenue by more than \$479 million. This estimate was determined by comparing the County’s unaudited revenue as reported in the Fiscal Year 2007 Executive Budget Recommendation, published by the Cook County Comptroller’s Office, to a projected increase in expenditures of 2.9 percent from 2005 levels. The 2.9 percent cost increase was the smallest increase in annual expenditures the County realized in the prior five years. To the extent expenditures increased by more, the actual deficit for fiscal year 2007 will be greater.

Figure 4: Cook County’s Annual Expenditures Have Exceeded Annual Revenues Over the Past Five Years



Cook County’s annual deficits are not just a one-time aberration resulting from unforeseen economic conditions or the actions of one official. Rather, it is the result of a revenue system that does not grow with

the economy while costs do. Figure 5 below shows that Cook County has what is called a “structural deficit.” A structural deficit results when a public entity’s revenue system does not produce enough revenue to continue funding the cost of current public services into the future, adjusting solely for inflation. The structural imbalance is, in essence, a mismatch between revenue capacity and annual inflationary costs that results in a gap between annual revenues and costs. As costs grow every year at a faster pace than revenues, the gap, which is the structural deficit, worsens annually. It is important to emphasize that when determining whether Cook County has a structural deficit, it was assumed that County service levels will be held constant from the initial base-year (fiscal year 2007), meaning that the estimates in this report assume no service expansions in future years. Figure 5 below illustrates Cook County’s structural deficit.

Figure 5: Cook County’s Structural Deficit and its Growth Over Time

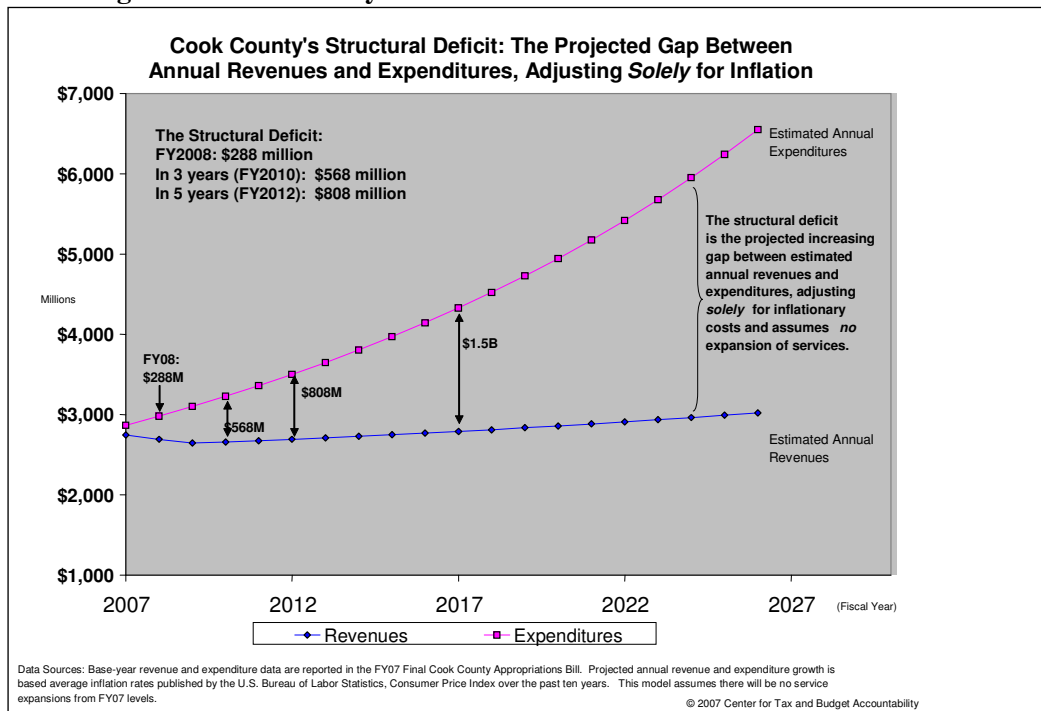


Figure 5 above illustrates the extent to which Cook County’s revenues do not keep pace with the inflationary costs of providing public services over time. In fiscal year 2007, the base year, Cook County’s expenditures are estimated to exceed revenues by \$121 million.⁵⁰ Due solely to the projected inflationary cost of providing the same level of services in 2008 as the County provided in 2007, and historic rates of growth for the County’s revenue sources, the County’s structural deficit is estimated to be \$288 million for fiscal year 2008. Given the County’s historic trends in cost and revenue growth, and federal Medicaid cuts, the County’s total deficit is estimated to grow to \$568 million in three years (FY2010), to \$808 million in five years (FY2012), and to over \$1 billion in ten years (FY2017).

The model used to calculate the County’s structural deficit is based on current and historical spending and revenue patterns. The projection of ongoing revenue shortfalls shown in the Figure is a conservative estimate that assumes economic growth of four percent annually over the next 20 years and no new programs or services are passed (only 2007 service levels are maintained). The graph compares the projected costs of maintaining 2007 service levels over time, adjusting only for inflation based on the U.S. Bureau of Labor Statistics’ Consumer Price Index, to revenue growth. The Consumer Price Index (CPI) measures cost growth in the economy as a whole.

It is important to note that the use of the CPI in estimating the County’s structural deficit understates annual cost growth. This report used CPI because it is the most commonly applied inflationary index. However, a

more appropriate measure of annual inflationary cost increases for Cook County government is the U.S. Bureau of Labor Statistics' Employment Cost Index (ECI), which measures labor costs. Labor costs are the most significant cost in providing County services. Using the ECI, Cook County's total deficit is estimated to be \$311 million in fiscal year 2008; reaching \$639 million in fiscal year 2010; and \$934 million in fiscal year 2012.

Even if Cook County started with a balanced budget in fiscal year 2007, its revenue system still would not create enough revenue to keep up with inflation in future years. The principal reason for this is that the only revenue source the County has that grows with the economy is the sales tax, which accounts for only 13 percent of the County's total operating budget as Figure 6A below illustrates. The property tax, on the other hand, which funds 25 percent of the County budget, is stagnant at \$720 million annually. The Figure 6A also shows that federal Medicaid revenue, which funds 16 percent of County government, will actually decline in the coming years as a result of a change in federal law.⁵¹

Conversely, adjusting just for inflation, County expenses increase, as shown in Figure 6B. The annual inflation rates projected are based on the historical annual average of the CPI over the past ten years (2.6 percent), and using the Congressional Budget Office's projection of the annual increase in Medicaid costs (7.5 percent).⁵² As demonstrated, the delivery of health care to poor and low-income County residents is estimated to grow at 7.5 percent annually, increasing from \$810 million in fiscal year 2007 to \$1.2 billion in just five years (2012). This does not take into account the County's annually increasing role in providing health care to the ever-expanding number of uninsured in the Chicago Metropolitan Area, which could drive costs higher.

At the same time, the costs of the County court system and other public safety administration will increase from \$689 million in fiscal year 2007, to \$783 million in 2012, while the cost of the correctional system will rise from \$417 million to \$474 million over the same period. The County's current revenue system simply cannot cover these costs even though the starting point for this projection follows significant budget cuts (11.4 percent) made in fiscal year 2007.

Figure 6A: Estimated Annual Revenue Growth by Source

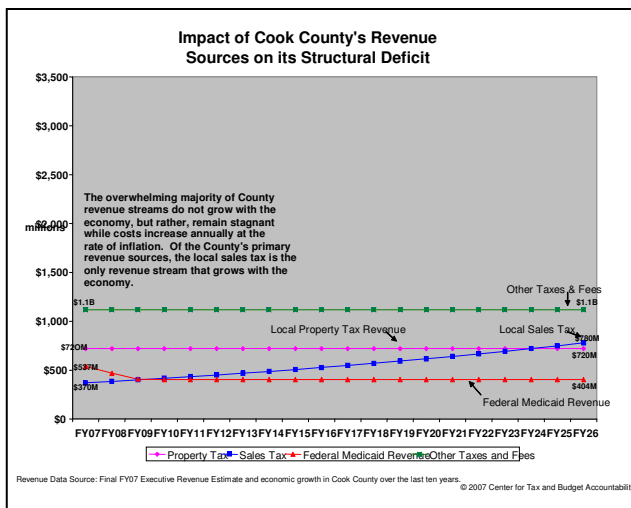
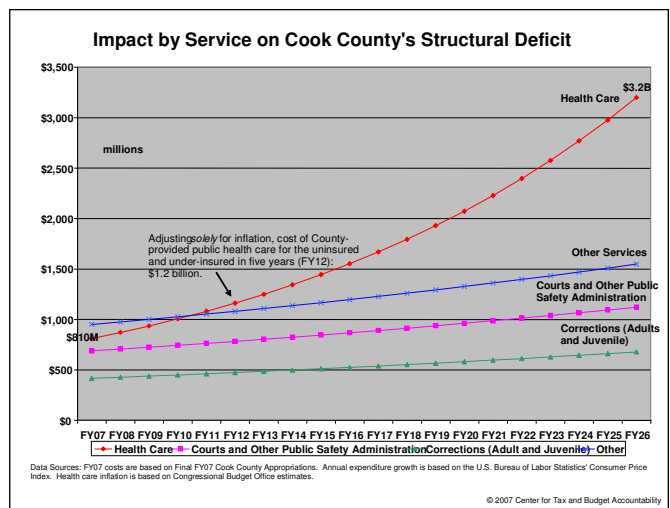


Figure 6B: Estimated Annual Inflationary Cost Growth by Service



The County's Current Revenue System Cannot Cover Rising Health Care Costs

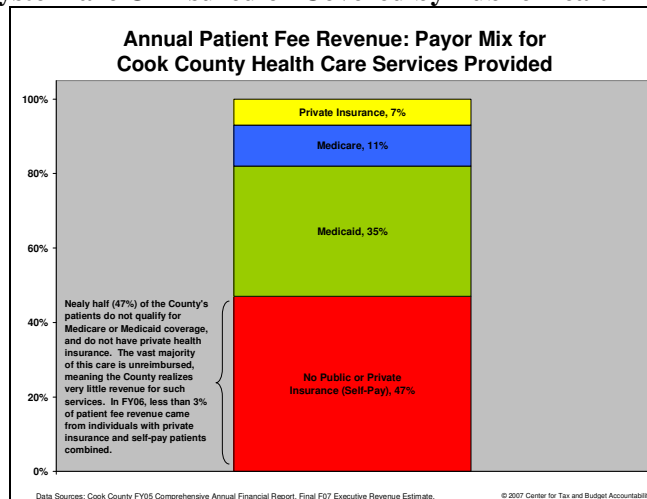
Cook County is instrumental in providing basic health care services to poor and low-income individuals who cannot afford private health care coverage. To highlight the importance of the County health care system, in

fiscal year 2006, Stroger Hospital treated 244,112 individuals in its emergency room, Cook County’s community clinics saw 744,444 patients, and County pharmacies filled over four million prescriptions.⁵³ The County is also one of the largest providers of cancer care in Illinois, treating approximately 2,000 uninsured cancer patients a year, is responsible for treating more than 40,000 cases of diabetes annually, performs more than 500 heart surgeries per year, and cares for approximately 900 (15 – 20 per week) cardiac patients through its clinics annually.⁵⁴ Cook County is by far and away the largest provider of care for the uninsured poor in the state, a role that can be expected to grow as the number of low-wage uninsured individuals continues to climb.⁵⁵ If it were not for the County health care system, it is likely that many of low-wage individuals would go without health care.

Annually increasing service demands are compounded by spiraling health care costs. According to the Congressional Budget Office, Medicaid expenditures are expected to rise by 7.5 percent annually over the next ten years.⁵⁶

Fully 93 percent of patients treated at Cook County are either uninsured or receive public health insurance as shown in Figure 7 below, while only seven percent of those treated at the County are covered by private health insurance.⁵⁷ This means that for the vast majority (93 percent) of care delivered, the County relies either on payment from public insurance programs (Medicare or Medicaid), or patients who can afford to pay for their care out-of-pocket. That said, nearly half of County patients – 47 percent – either do not qualify for Medicare or Medicaid coverage or are not enrolled, and do not have private insurance.⁵⁸ As a consequence, for health care services provided to this group of individuals, the County realizes virtually no revenue because in reality, there is no revenue source. This is demonstrated by the fact that in fiscal year 2006, a mere 2.6 percent of patient fee revenue came from patients with health insurance or uninsured patients who paid for care themselves.⁵⁹ Revenue data is not available on the amount of patient fees received only from the uninsured; however, it is clearly less than 2.6 percent of total patient revenue generated.

Figure 7: Nearly All Patients Treated by the Cook County Health Care System are Uninsured or Covered by Public Health Insurance

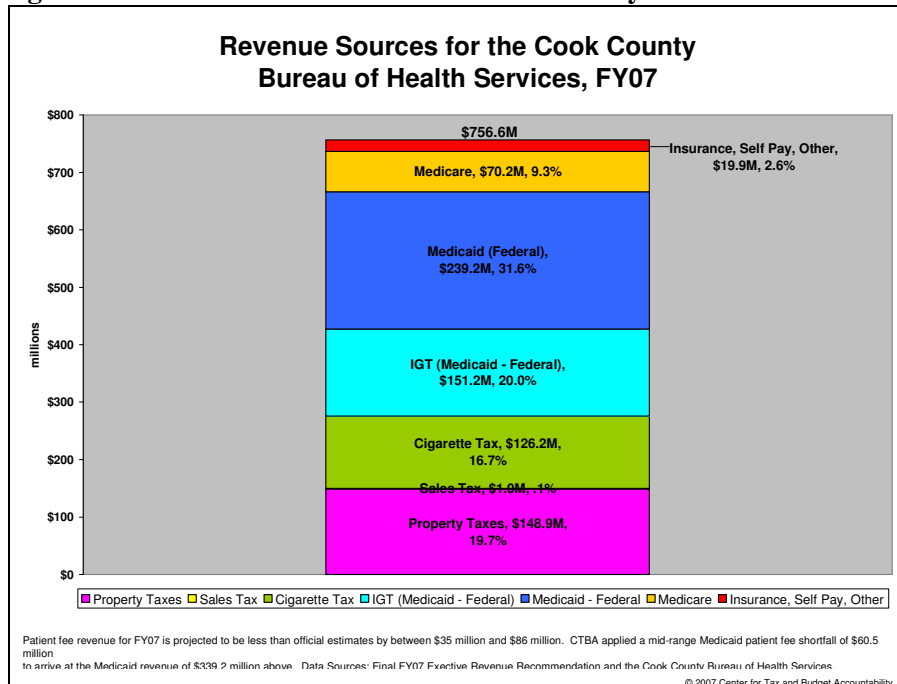


Federal funds play an important role in financing Cook County health care services. Federal Medicaid dollars fund half – 51.6 percent – of County-provided health services, as shown in Figure 8 below.⁶⁰ However, as the federal government comes under increasing pressure to rein in its own costs, especially health care costs, it has cut funding for local safety-net providers in recent years.⁶¹ As a result, Cook County has seen a significant reduction in federal Medicaid dollars. Just three years ago, in fiscal 2004, federal Medicaid dollars funded nearly two-thirds (65 percent) of the Bureau of Health Services’ budget.⁶² The Cook County Bureau of Health Services is the local agency responsible for running the County health care system. In fiscal year 2007, however, federal Medicaid dollars will cover only 51 percent of the County’s health care budget.⁶³ Between fiscal years 2005 and 2007, (fiscal year 2005 was the first year the County

was first impacted by federal regulations that severely cut federal Medicaid funding using what is called the Medicaid upper payment limit),⁶⁴ the County will have lost \$139 million between fiscal years 2005 and 2007.⁶⁵

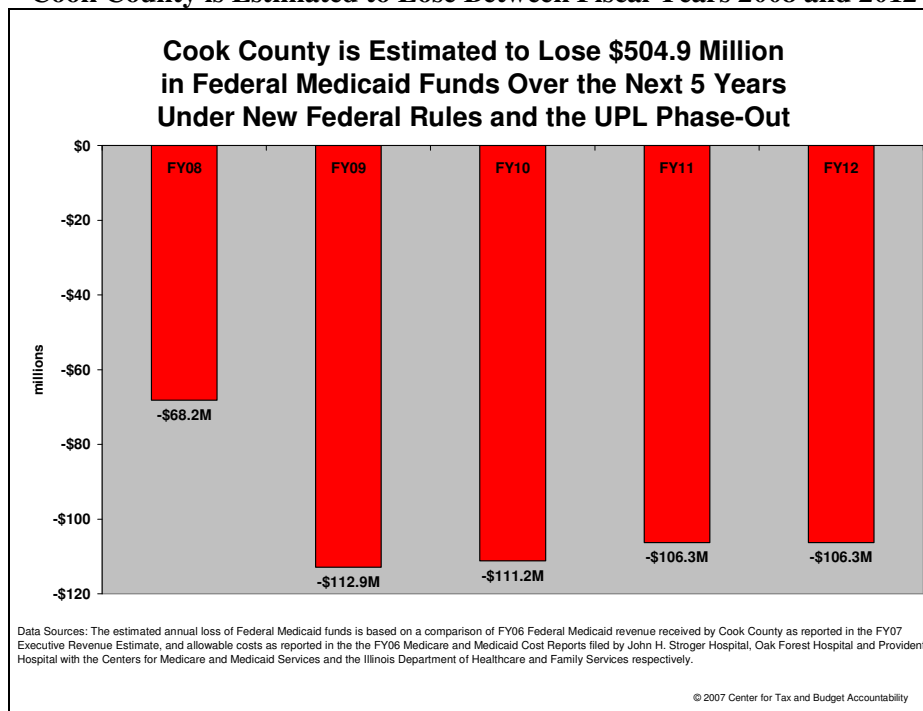
The County has not been able to find a new health care revenue source to replace the lost federal Medicaid funds. For instance, the share of the County’s property tax levy that goes to the Bureau of Health Services has remained unchanged at \$148.9 million since fiscal year 2004. At the same time, the Bureau’s share of local sales tax receipts has actually declined since 2004, from \$17 million to \$1 million in 2005, and each fiscal year thereafter. Accordingly, while the County has received fewer federal dollars to fund indigent health care in recent years, neither local tax dollars nor other fees have filled in the hole.

Figure 8: Revenue Sources that Fund Cook County Health Care Services



More severe federal Medicaid cuts are scheduled take effect in fiscal year 2008.⁶⁶ In mid-fiscal year 2008, new federal Medicaid rules will be implemented that are estimated to reduce the County’s federal Medicaid dollars by \$68.2 million for the year, and by an additional \$112.9 million in FY09. These cuts include the effect of the new regulations as well as the final phase-in of federal regulations put in place in 2001 (significantly phasing out the use of the Medicaid upper payment limit (UPL)). As Figure 9 below illustrates, Cook County is estimated to lose approximately \$504.9 million in federal Medicaid funds that were expected to support its health care system over the next five years (from fiscal year 2008 through 2012). The estimated amount of lost federal funds is based on Medicaid costs for fiscal year 2006, the most recent year for which data was available, as reported in the Medicare and Medicaid Cost Reports filed by the three Cook County hospitals with both federal and state governments, compared to fiscal year 2006 Medicaid revenue as reported by the Cook County Comptroller’s Office in the Fiscal Year 2007 Executive Revenue Estimate, which contains Medicaid revenue received from prior fiscal years.

Figure 9: The Amount of Federal Medicaid Funds Cook County is Estimated to Lose Between Fiscal Years 2008 and 2012



The County’s Revenue Shortcomings Combined with Escalating Costs

No one factor is to blame for the ongoing structural deficit in Cook County. Rather, both revenue shortcomings and public service cost pressures have combined to create the problem. On the revenue side, the tax structure simply fails to track economic growth, resulting in revenue underperformance. On the cost side, the factors range from general inflation, to healthcare costs that outpace general inflation, and the simple fact that the public health care system is stepping in to cover the growing number of families who cannot afford private coverage, resulting in increased demand pressures on the public safety-net system.

Designing a Tax Structure that Supports the Local Public Services Cook County Provides

Design flaws in the County’s fiscal system are primary contributors to its chronic annual budget shortfalls. As discussed in detail above, County services are funded by a combination of taxes and user fees, with taxes funding 51 percent of the County’s budget. The principal taxes that fund basic public services the County provides are the local property tax, which covers 25 percent of the County’s budget, local sales taxes, which fund 13 percent of the budget, and the cigarette tax, which funds six percent of the County’s budget. The remaining seven percent of tax revenue comes from a combination of home rule and other smaller taxes. Fees paid for specific public services rendered, such as health care and court services, fund 30 percent of the County’s total operating budget. Of those fees, federal Medicaid dollars cover 16 percent of the budget, while court fees, and fees for certain documents (the filing of real estate deeds, marriage certificates, etc.) account for 11 percent of the County’s total operating budget.

Local fiscal systems raise revenue primarily in three ways: levying taxes, charging fees and issuing debt in the form of bonds. Generally, tax revenue is intended to fund the day-to-day operations of public services, fees are intended to reimburse the government for specific services it provides (e.g., health care or the

recording of real estate purchases) and bond revenue is used to build public works such as public hospitals and other basic infrastructure. Typically, bond revenue is not available to finance public services. This report will focus primarily on outlining the principles used to design a tax structure that will support general public services provided by Cook County, but will also touch on user fees for specific services, particularly Medicaid, since such fees finance nearly one-third of the County budget.

With respect to the different types of taxes used to fund public services, under fundamental principles of public finance, a sound tax system incorporates four core principles: fairness, responsiveness, stability and efficiency.⁶⁷

First, a fiscal system should be fair. Fairness is determined by how the fiscal system assesses tax burden on various taxpayers. Fairness is achieved if taxpayers with similar incomes have similar tax burdens, and if the tax burden imposed across different income levels is “progressive,” that is, it imposes a greater tax burden on high-income taxpayers than low- and moderate-income taxpayers, when tax burden is measured as a percentage of income.

Property taxes, cigarette taxes and sales taxes are considered to be unfair methods of taxation because they are a fixed cost based on the fair market value of the property owned or purchased and do not take into account a taxpayer’s ability to pay based on income. In essence, the tax liability on the property owned or purchased continues to increase annually, whether or not an individual’s income increases at a similar rate. As a result, low- and middle-income families pay a greater percentage of their incomes in property, sales and excise taxes like those imposed on cigarettes than do upper-income families.

On the other hand, income taxes more closely correspond with an individual’s ability to pay, because income taxes are assessed as a percentage of a taxpayer’s income. A progressive, graduated income tax, which allows for rate increases at higher income brackets, as opposed to a flat tax, is the fairest way to impose an income tax. This allows low-income families to pay a smaller percentage of their income in income taxes than middle- and upper-income families. A flat income tax, while not as fair as a graduated rate structure, is nevertheless a fairer method of taxation than a property or sales tax because it is at least based on family income (*i.e.*, ability to pay).

Because state law generally dictates how local governments are permitted to raise tax revenue, local governments have less flexibility and legal authority in designing their tax systems than do states. Most local governments across the country are financed primarily through local property and sales taxes rather than income taxes.⁶⁸ However, some cities and counties have begun using income taxes as a way to provide property tax relief and fund essential public services.⁶⁹

Cook County, is a home rule unit of government, meaning the state has granted it broad regulatory and taxation powers over local matters.⁷⁰ Theoretically, the County may implement a local income tax with the prior approval of the Illinois General Assembly, provided the County uses one, flat rate across all income classes as required by the Illinois Constitution.⁷¹ The County has not sought state legislative approval to impose a local income tax to date.

Second, a fiscal system should be responsive to how growth is actually realized and distributed in the economy. A responsive tax system captures increased revenue during periods of strong economic growth, which can then be placed in a “rainy day” fund, to help get through economic downturns without slashing services. Generally, implementing a progressive income tax is the best way to ensure a tax system is responsive to growth in the economy.

Cook County’s property tax, its primary source of funding, does not respond to economic growth. Its property tax levy has remained unchanged at \$720 million for the last ten years, while expenses have increased every year at least by inflation. In order to adequately fund the level of public services it provides, Cook County’s tax system must be redesigned to cover the inflationary costs of providing public services.

Third, a fiscal system should be stable. A stable tax system maintains base revenue collection even during poor economic cycles. Property taxes generally provide a more stable and predictable revenue stream than income taxes. This is because property values typically remain steady from one year to the next, whereas income taxes based on wages tend to fluctuate with the economy. Consequently, during economic downturns, income tax revenue is likely to be lower than during periods of strong economic growth, whereas property taxes will continue to generate reliable revenue streams, even during poor economic cycles.

In addition, having a sales tax that is imposed on a broad range of transactions actually occurring in the economy is the best way to have a stable state or local tax system. The sales tax helps bring stability to a revenue system because consumer spending, which accounts for two-thirds of the nation's economy, remains fairly constant even during economic downturns.⁷²

Cook County's local sales tax is based on the type of transactions that are subject to the Illinois state sales tax implemented under state law.⁷³ Currently, the state only permits sales tax to be imposed on the sale of products and excludes most consumer services from taxation.⁷⁴ The principal failing of the state's sales tax is that it does not apply to consumer services, the largest and fastest growing sector of the state's economy.⁷⁵ Of the 168 taxable services that could be included in the sales tax base, Illinois taxes only 17 of them.⁷⁶ Illinois taxes fewer services than all its neighboring states (Iowa, Wisconsin, Missouri, Indiana and Kentucky). Because the state of Illinois has responsibility for collecting the local sales tax imposed by Cook County, administratively, it would be very difficult if not impossible for the County to expand its sales tax base to cover consumer services if the state does not.

While the state's sales tax base, and therefore by default, Cook County's sales tax base, is too narrow, the state's sales tax rate is the seventh highest in the nation and tied with three other states.⁷⁷ Leaving the largest and fastest growing sector of the Illinois economy out of tax base for the state and local government, like Cook County, severely restricts the system's ability to generate revenue over time, and fails to stabilize revenue generation during economic downturns, when demand for public services increases.

Fourth, a fiscal system should be efficient. An efficient tax system is one that has minimal impact on important economic decisions private taxpayers make, such as where to purchase a home or locate a business. Generally, an efficient tax system is more reliant on broad-based income and sales taxes than local property taxes. This is because over-reliance on local property taxes as a revenue source creates significant tax competition between local governments, causing a significant disparity between property tax rates from community to community, proliferation of tax relief incentive programs, and inefficient distortions of private economic decisions.

Cook County's tax system is over-reliant on property taxes as a revenue source with more local property tax revenue collected than from the sales and cigarette taxes combined.⁷⁸ Over-reliance on property taxes is very inefficient – that is, it distorts private marketplace economic decisions. For instance, if property tax burdens are high in comparison to available local services, both businesses and individuals have an incentive to leave the area, and a disincentive to locate in that area. This results in a local community suffering a decrease in its property tax base and values, and forces that community to increase property tax rates even higher, as the services it can afford to provide decline.

Fees Imposed By Cook County that Fund Specific Public Services

A variety of user-fees are employed to fund specific public services in Cook County, such as health care services, court services, and the recording of real estate transactions, to name a few. These fees fund 30 percent of Cook County's operating budget.

Targeted fees imposed on certain types of public services are used as a funding mechanism generally intended to apply only to the consumers of such services. For fiscal year 2007, 37 percent of all fees that help finance the Cook County budget are generally for court services, real estate recording fees, and fees for documents such as marriage or birth certificates. Approximately 60 percent of Cook County fees are paid to the County not by individuals, but by the federal government, for County health care patients covered by public health care coverage under Medicaid or Medicare.⁷⁹

As a result of federal Medicaid cuts that are either in effect or will take effect in fiscal year 2008, Cook County is estimated to lose a substantial amount of its “fee” revenue paid by the federal government under the Medicaid program. As discussed in detail above, Cook County will lose an estimated \$68.2 million in fiscal year 2008 in federal Medicaid dollars, and \$112.9 million in fiscal year 2009. In the five years between fiscal years 2008 and 2012, the County is estimated to lose an aggregate of \$504.9 million in federal Medicaid dollars. These funds play a critical role in financing indigent care provided by the Cook County health care system. In order to continue providing such services, it will be imperative to find a revenue source to replace the lost federal funds.

In addition, the Cook County Bureau of Health Services does not have a sufficient billing system in place to bill and collect from the state and federal governments all Medicaid funds to which the County is entitled for health services delivered. By very conservative estimates, the Bureau could collect an additional \$40 million annually in Medicaid and Medicare revenue – this is revenue from the state and federal government, not individuals or insurance companies – if a billing system were implemented.⁸⁰

Conclusion

The annual inflationary cost of Cook County-provided services far outpaces County revenue growth, creating a structural deficit that will worsen over time. Unless the County undertakes fundamental fiscal reform so that its revenue sources grow with the economy and keep up with the natural inflationary costs of providing public services from one year to the next, it cannot sustain current service levels.

Endnotes

¹ According to U.S. Census Bureau data, Los Angeles County, California is the largest county in the nation, with 9.9 million residents; Cook County is second largest, with over 5 million residents; and Harris County, Texas is the third largest, with 3.6 million residents.

² This amount is the cost of financing the operation of public services for fiscal year 2007, based on the final 2007 Annual Appropriation Bill. It excludes fund balances from the prior year used to fund current year operations, and amounts spent on capital expenditures.

³ Los Angeles County 2007-08 Adopted Budget.

⁴ United States Government Accountability Office, "State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade," July 18, 2007.

⁵ The Kaiser Family Foundation.

⁶ United States Government Accountability Office, "State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade," July 18, 2007.

⁷ The FY06 budget deficit is an estimate based on an analysis of the Cook County, Illinois Comprehensive Annual Financial Reports for fiscal years 2002 through 2005 and the Final FY06 Executive Revenue Estimate. The estimated FY06 deficit is based on revenue projections reported in the final Fiscal Year 2007 Annual Appropriations Bill and an increase in expenditures of 2.9 percent for the fiscal year, the smallest increase in annual expenditures in the prior five years.

⁸ Cook County, Illinois Comprehensive Annual Financial Report for Fiscal Year Ended November 30, 2002.

⁹ Final Fiscal Year 2007 Annual Appropriations Bill, Cook County, Illinois.

¹⁰ *Id.*

¹¹ *Id.*, General Accountability Office.

¹² U. S. Census Bureau, "Income, Poverty, and Health Insurance Coverage in the United States: 2006," August 2007.

¹³ Gilead Outreach and Referral Center, "The Face of the Uninsured, A Detailed Description of Illinois' Uninsured," March 2007 (based on March 2006 U.S. Census data).

¹⁴ Northern Illinois University and the Center for Tax and Budget Accountability, "The State of Working Illinois," 2005.

¹⁵ Cook County Executive Budget Recommendation, Fiscal Year 2006, President's Budget Message.

¹⁶ Cook County, Illinois, FY2007 Executive Budget Briefing.

¹⁷ *Id.* See also, Final Fiscal Year 2007 Annual Appropriations Bill for Cook County (property taxes will fund 25 percent the County's operating budget for fiscal year 2007).

¹⁸ *Id.*

¹⁹ Based on U.S. Census Bureau, 2002 Economic Census data.

²⁰ Based on data from the Bureau of Economic Analysis, U.S. Department of Commerce.

²¹ *Id.*

²² 42 C.F.R. § 447.272(e)(2) (regulations limiting the use of the Medicaid upper payment limit). The estimated loss between fiscal years 2005 and 2007 as a result of the regulations is based on Medicaid revenue reported in the 2007 Executive Revenue Estimate of the 2007 Annual Appropriations Bill.

²³ The Center for Tax and Budget Accountability developed a model to determine a state or local government's structural deficit with the assistance of economics professor, Dr. Fred Giertz, Executive Director of the National Tax Association, University of Illinois Urbana. CTBA has identified the extent of the structural deficit problem in Illinois in its report "Private Sector Job Trends and the Illinois Structural Deficit," January 2007.

²⁴ U.S. Bureau of Labor Statistics' Consumer Price Index, CPI-U data from 1997 - 2006.

²⁵ Congressional Budget Office, "A Budget and Economic Outlook," 2007; CBO Testimony, Statement of Donald B. Marron, Acting Director of the CBO, "Medicaid Spending Growth and Options for Controlling Costs," July 2006.

²⁶ 42 C.F.R. § 447.272(e)(2) (regulations limiting the use of the Medicaid upper payment limit).

²⁷ 42 C.F.R. § 443, 447, and 457 (limiting Medicaid reimbursement to cost). As the federal regulations state in the Preamble, the new Medicaid cost limitations will not apply to payment under Section 701(d) of the Benefits Improvement Protection Act of 2000, which is commonly referred to as BIPA.

²⁸ *Id.* The estimated annual loss of federal Medicaid funds takes into account the phase-out of the Medicaid upper payment limits and the cost of the new regulations limiting Medicaid reimbursement to cost.

²⁹ Final Fiscal Year 2007 Annual Appropriation Bill.

³⁰ The estimate for additional annual patient fee revenue that could be collected if an efficient billing system were implemented in the County's health care system was based on a review of responses by billing contractors to Cook County's Requests for Proposals and related data. Estimates ranged from \$40 million to \$120 million, net to the County, in annual revenue. The most conservative estimate of \$40 million for purposes of this report. These amounts did not include one-time revenues, but rather, annual recurring amounts.

³¹ Final Fiscal Year 2007 Annual Appropriation Bill. This amount includes appropriations for operating expenditures only and excludes amounts to be spent on capital expenditures.

³² See Final Fiscal Year 2007 Annual Appropriation Bill.

³³ *Id.*

³⁴ *Id.*

³⁵ Cook County, Illinois Comprehensive Annual Financial Report for the Fiscal Year Ended, November 30, 2005 (Only 17 percent of property taxes paid by Cook County property taxpayers goes to fund Cook County government. The remainder of the property tax revenue is divided between the City of Chicago, Chicago Board of Education, Chicago School Finance Authority, City of Chicago Library Fund, Metropolitan Water Reclamation District, the City Colleges and the Forest Preserve District); See also, Illinois Department of Revenue, 2004 Comparison of Current Taxes Extended by Class of Property.

³⁶ *Id.*

³⁷ The break-down of operating revenue by source is based on data in the Fiscal Year 2007 Executive Revenue Estimate.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ Cook County, Illinois Comprehensive Annual Financial Report for the Fiscal Year Ended, November 30, 2005.

⁴⁴ Cook County, Illinois, FY2007 Executive Budget Briefing.

⁴⁵ Cook County, Illinois Comprehensive Annual Financial Report for the Fiscal Year Ended, November 30, 2005; Illinois Department of Revenue.

⁴⁶ Cook County, Illinois, FY2007 Executive Budget Briefing.

⁴⁷ Art. VIII, Sec. 2 of the Constitution of the State of Illinois. Forty-nine of the 50 states have balanced budget requirements.

⁴⁸ Code of Ordinances of Cook County, § 2-106.

⁴⁹ Cook County, Illinois, Comprehensive Annual Financial Report for Fiscal Year Ended November 30, 2005.

⁵⁰ Final Fiscal Year 2007 Annual Appropriation Bill (amounts exclude fund balances and capital improvements).

⁵¹ 42 C.F.R. § 447.272(e)(2); 42 C.F.R. § 443, 447, and 457.

⁵² U.S. Bureau of Labor Statistics, Employment Cost Index data from 1995 – 2006; Congressional Budget Office, “A Budget and Economic Outlook,” 2007; CBO Testimony, Statement of Donald B. Marron, Acting Director of the CBO, “Medicaid Spending Growth and Options for Controlling Costs,” July 2006.

⁵³ Cook County Bureau of Health Services, Presentation by Interim Bureau Chief, Dr. Robert Simon, to the Cook County Board of Commissioner, June 2006.

⁵⁴ *Id.*

⁵⁵ The Cook County Bureau of Health Care Services.

⁵⁶ Congressional Budget Office, “A Budget and Economic Outlook,” 2007; CBO Testimony, Statement of Donald B. Marron, Acting Director of the CBO, “Medicaid Spending Growth and Options for Controlling Costs,” July 2006.

⁵⁷ Cook County, Illinois Comprehensive Annual Financial Report for Fiscal Year Ended 2005.

⁵⁸ *Id.*

⁵⁹ 2007 Executive Revenue Estimate.

⁶⁰ *Id.*

⁶¹ 42 C.F.R. § 447.272(e)(2) (regulations limiting the use of the Medicaid upper payment limit), 42 C.F.R. § 443, 447, and 457 (limiting Medicaid reimbursement to cost). As the federal regulations state in the Preamble, the new Medicaid cost limitations will not apply to payment under Section 701(d) of the Benefits Improvement Protection Act of 2000, which is commonly referred to as BIPA.

⁶² 2007 Executive Revenue Estimate.

⁶³ *Id.*

⁶⁴ See Center for Tax and Budget Accountability, “Illinois’ Medicaid Program, Financing Challenges in the Face of Federal Medicaid Cuts and a Flawed State Fiscal System,” September 2006.

⁶⁵ Estimated lost Federal Medicaid funds are based on annual patient fee revenue reported in the Fiscal Year 2007 Appropriations Bill.

⁶⁶ These estimated include lost federal Medicaid under 42 C.F.R. § 447.272(e)(2), and 42 C.F.R. § 443, 447, and 457.

⁶⁷ National Conference of State Legislatures, “Principles of a High-Quality State Revenue System,” June 2001.

⁶⁸ Institute on Taxation and Economic Policy, “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” January 2003.

⁶⁹ The following states allow localities to use local income taxes as a revenue source: Alabama, Delaware, Iowa, Indiana, Kentucky, Maryland, Michigan, Missouri, New York, Ohio and Pennsylvania. The Brookings Institution Metropolitan Policy Program, “Budgeting for Basics: The Changing Landscape of City Finances,” August 2005; Institute on Taxation and Economic Policy, “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” January 2003.

⁷⁰ Art. VII, Sec. 6, Illinois Constitution.

⁷¹ *Id.*

⁷² United State Federal Trade Commission, Prepared Statement for the House Financial Services, Committee, June 4, 2003; Center on Budget and Policy Priorities, Michael Mazerov, “Expanding Sales Taxation of Services,” June 2003.

⁷³ 35 ILCS 5-1006.

⁷⁴ 35 ILCS5-120.

⁷⁵ Based on United States Census Bureau, 2002 Economic Census data.

⁷⁶ As defined by the Federation of Tax Administrators’ Analysis of the North American Industrial Classification System.

⁷⁷ Federation of Tax Administrators.

⁷⁸ Based on data in the Cook County 2007 Annual Appropriation Bill and the Comprehensive Annual Financial Reports for fiscal years between 1995 and 2005.

⁷⁹ The estimate is based on FY07 revenue data in the FY07 Annual Appropriation Bill (Medicaid, Medicare and other patient fee revenue account for 63 percent of County fee revenue). Based on FY05 revenue, it was assumed that for fiscal year 2007, three percent of patient fee revenue will come from patients with private insurance or self-pay patients.

⁸⁰ The estimate for additional annual patient revenue that could be collected if an efficient billing system were implemented in the County’s health care system was based on a review of responses by billing contractors to Cook County’s Requests for Proposals and related data. Estimates ranged from \$40 million to \$120 million, net to the County, in annual revenue. CTBA used the most conservative number of \$40 million for purposes of this report. These amounts did not include one-time revenues, but rather, annual recurring amounts.