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ANALYSIS OF ENACTED ILLINOIS FY2012 BUDGET

August 2011
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PRELIMINARY ANALYSIS OF ENACTED FY2012 BUDGET

Founded in 2000, the Center for Tax and Budget Accountability is a non-profit, bi-partisan research and advocacy think tank committed to ensuring that tax, spending and economic policies are fair and just, and promote opportunities for everyone, regardless of economic or social status.

CTBA uses a data-focused, bipartisan approach to work in partnership with legislators, community groups and other organizations to help change both public policy and perceptions.

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1. INTRODUCTION

The FY2012 budget enacted by the General Assembly and signed by the Governor on June 30, 2011 with some line item vetoes, came on the heels of one of the most significant tax increases in Illinois history. On January 13, 2011, the General Assembly—on a strictly partisan Democratic vote—passed and the Governor signed into law the “Taxpayer Accountability and Budget Stabilization Act” (P.A. 96-1496), which raised just over \$7 billion in new, annual recurring revenue.

We commend the Governor and General Assembly for their courageous action in passing a tax increase that averted a complete financial disaster in Illinois. The extent of that financial disaster is detailed in Figure 1. Given the hard costs the state has to pay in FY2012 before spending anything on delivery of current services, without the tax increases that passed in January, the state would have been facing a revenue shortfall of almost \$16 billion in FY2012, if it just wanted to hold FY2012 General Funding flat at FY2011 levels.

FIGURE 1
Revenue Shortfall Entering FY2012
Without the January, 2011, Tax Increases

(i) Revenues	Amount*
Projected State Own Source Revenue (pre-tax increase)	\$20.026 B
Projected Federal Revenue	\$ 4.844 B
Other Projected Transfers In	\$ 1.810 B
TOTAL FY2012 PROJECTED REVENUE (without the tax increase)	\$26.680 B
(ii) Hard Costs Entering FY2012	
Carry Forward Unpaid Bills from FY2011	\$6.05 B**
One-Time Revenue Used in FY2011	\$3.00 B
Debt Service FY2012	\$2.137 B
Pension Payment FY2012	\$4.829 B***
Transfers Out FY2012	\$2.317 B
SUBTOTAL HARD COSTS	\$18.333 B
(iii) Cost of Flat Funding Nominal Dollar Amount of FY2011 GF Appropriations for Services in FY2012	\$24.313 B
(iv) TOTAL FY2012 REVENUE NEEDED TO PAY HARD COSTS & MAINTAIN FLAT FUNDING OF SERVICES	\$42.646 B
(v) INITIAL FY2012 REVENUE SHORTFALL (Before 1/13/2011 tax increases)	(-\$15.966 B)
* All data from the FY2012 Budget Book and GOMB 1/20/2011 plan, except as noted in *** below.	
** FY2012 Budget Book, Chap. 2-14, Footnote 3	
*** The pension contribution is from the March 10, 2011, update to the “Supplemental Digest to Retirement Systems’ Audits” issued by the State Auditor General.	

Fortunately, decision makers did pass a tax increase, which not only will generate \$7.25 billion in new revenue for FY2012, but also created \$2.9 billion in revenue to cover some FY2011 costs. This new \$2.9 billion in FY2011 revenue effectively reduced the carry forward hole entering FY2012 from the **(-\$15.966)** billion shown in Figure 1 to **(-\$13.066)** billion.

Though no politician likes to increase taxes, the tax increases Illinois passed in January were necessary, particularly since the primary drivers of Illinois' fiscal problems are long-term and structural, not cyclical. In fact, the data show that the state's dire fiscal condition entering FY2012 was caused by a combination of: (i) flawed tax policy, which created a long-term structural deficit; (ii) irresponsible fiscal practices used over time to paper-over that structural deficit, most typically in the form of using debt proceeds to pay for current services (which primarily involved diverting payments owed to the state's five pension systems to cover current service delivery); and (iii) to a lesser extent, the "Great Recession" of 2009-2010. For more information, see CTBA's "*Funding Our Future*" report, issued in October, 2010, and available online at www.ctbaonline.org (which among other things, recommended that the state's structural fiscal problems be at least in part addressed by increasing the personal income tax rate from three to five percent, as was done in January).

Indeed, the ultimate FY2012 budget enacted by the General Assembly shows just how crucial the tax increase of January, 2011, was. For, despite over \$7 billion in new, recurring revenue, and an FY2012 budget that cuts spending for every major category of public services except public safety and health care (and nominal increases in the later are insufficient to keep up with inflation), the state will end FY2012 with \$ 8 billion in unpaid bills, an increase from the \$6.05 B of unpaid bills carried over from FY2011. CTBA had pointed out that without expanding sales taxes to include services, taxing high-income retirees, and in the long run making the state's tax system more progressive, Illinois would not be able to adequately fund its public services. CTBA also advocated a refundable income tax credit for low income households to build some progressivity into the more immediate tax increases.¹

The sad truth is that even after the tax increase, Illinois needs significantly more revenue just to provide average funding levels relative to other states for critical public services that have received real funding cuts (relative to inflation and population growth) for over a decade. Though legislators are making a show of further starving and eliminating vital public services as "political repentance" for the tax increase (even while offering \$ 600 B in additional wasteful business tax cuts) the state fiscal system (even assuming that the FY2011 income tax increases are made permanent) does not raise sufficient public revenue, and, with its current structure, will be unable to grow revenue at a pace adequate to meet increased public need. And this is assuming that the FY 2011 income tax increase becomes permanent. If this tax increase is gradually repealed or reduced as envisioned in PA 96-1496 there can be no doubt that state finances will immediately implode as would have happened in FY2011 without the tax increases.² Illinois Senate Republic fantasies notwithstanding, there is no way for the state to "cut" its way to financial solvency short of eliminating education, human services, and health care for major portions of Illinois residents and turning Illinois into a third world like impoverished society with an increasingly stagnant and unproductive economy.

The good part is that the state can easily raise adequate revenue, even while reducing or not changing its overall tax burden on the lowest 60% of families, by simply recalibrating existing taxes so that they apply more fairly to families that can most easily afford them. By adjusting the mix of property, sales, and income taxes, and applying these in a progressive as opposed to the current regressive fashion, Illinois state and local governments could raise \$32.5 B in additional revenue while cutting or not changing existing tax loads for the bottom 60 percent of families, and not raising effective tax rates on the top 40% any higher than the rates currently paid by the bottom 40 percent of families.

Illinois can no longer get by with emergency increases in taxes that are barely sufficient (and in the longer term clearly inadequate) to fund universal and high-quality public services. If the state is going to raise adequate public revenue to fund vital public services it must now directly confront the long festering problem of tax equity.

2. FY2012 BUDGET HIGHLIGHTS

Following are some highlights of the FY2012 budget proposal:

- The House FY2012 revenue estimate is \$1.1 billion less than the Senate estimate of \$34.282 billion and \$757 million less than the estimate in the Governor's FY2012 proposed budget.³ The Senate estimate is based on Commission on Government Forecasting and Accountability (COGFA) estimates (reduced by \$600 million because of additional Illinois corporate income tax revenue loss from federal a new bonus depreciation tax break – see below) that have historically been the most accurate of any state agency.⁴ Though economic conditions could change for the worse, it appears that the House chose to low-ball its revenue forecast in order to force legislators to enact larger cuts in appropriations.⁵

- Similarly, in what appears to be part of an effort to force increased budget cuts, the Legislature did not decouple from federal a bonus depreciation business tax break. As a result the state is due to lose, based on COGFA estimates, \$25 million in FY2011 corporate income tax revenue, and if not enacted in FY2012, another \$600 million in corporate income tax revenue in FY2012. State legislators were repeatedly warned about this impending loss of tax revenue by CTBA and many other groups, and were provided with detailed assistance from CTBA in drafting a bonus depreciation decoupling bill, but (as of this writing) Illinois legislators have not enacted bonus depreciation decoupling.
- The FY2012 budget proposal continues to prioritize funding the same four core services of education (36.4% of the budget), healthcare (32.9%), human services (19.4%) and public safety (6.4%) as have historically pertained. Collectively, these four core service areas account for over \$9 out of every \$10 appropriated in the FY2012 enacted General Fund budget.
- Of those four core service areas, appropriations for only two are increased. Public safety is scheduled to receive a nominal funding increase of \$30 million or 1.9% inadequate to increase real service provision after adjusting for inflation and population growth. Health care will get a nominal increase of \$ 899 million, or 12.6% much of which will be consumed by rising health care costs.
- Even after accounting for the \$7.25 billion in tax increases that passed in January, 2011, the state will have an overall General Funds FY 2012 deficit of \$8.0 billion, when unpaid bills left over from FY2011 are considered.
- The human service category—which collectively includes the Department of Aging, Department of Human Services, and Department of Children and Family Services (“**DCFS**”)—is scheduled to receive nominal dollar cuts from FY2011 levels, with aggregate appropriations being \$373 million less in FY2012 than in FY2011.
- The FY2012 human service cuts were not evenly distributed among the three human service agencies. In fact, aggregate appropriations for the Department of Aging will increase by \$109 million or 17.3 percent from FY2011 levels, while the DCFS and the Department of Human Services receive nominal cuts in funding. DCFS receives a 3.3 percent cut of \$28 million from FY2011, and funding for the Department of Human Services is cut by \$454 million or 12.4 percent from FY2011. Since FY2002, cumulative real, inflation and population adjusted, cuts in human services total \$8.5 billion.
- The FY2012 budget proposal also shows that the state continues to fall further behind in funding an adequate education. The nonpartisan Education Funding Advisory Board reviews these costs and then recommends the minimum, per pupil “Foundation Level” of K-12 spending required to provide a basic, adequate education. In FY2003, the state’s actual Foundation Level was \$120 less than the EFAB recommendation. The Foundation Level established in the FY2012 budget, however, is fully \$2,241 less than the EFAB recommendation.
- Despite the one-year upward trend in spending noted above, after adjusting for inflation and population growth, overall General Fund appropriations proposed for FY2012 will be less than they were over a decade ago in FY2000, with total appropriations down 20.6 percent; PreK-12 down 8.3 percent; higher education down 36.7 percent; healthcare down 10.0 percent; human services down 32.7 percent; and public safety down 24.9 percent.
- Though a number of short-term measures would be helpful, including: a) decoupling from federal bonus depreciation, b) making the 2011 tax increases permanent, c) expanding the sales tax to services in line with neighboring states, d) taxing high income retirees like most other states, and e) providing a large low-income family tax credit; in the long run Illinois will not be able to adequately fund critical public services without fundamentally reforming its highly regressive state and local tax system. A progressive tax system could increase state and local revenue by up to 56.2 percent (\$32.5 billion), and reduce the state and local tax burden on the bottom 40 percent of families, leave the burden unchanged for the middle 20 percent, and not increase the burden for the top 40 percent by more than the bottom 40 percent are currently paying. Illinois needs to change its constitution to allow the state to enact a progressive income tax.

3. ILLINOIS HOUSE LOW-BALLS STATE REVENUE ESTIMATE

Note that, under the Taxpayer Accountability and Budget Stabilization Act, General Fund spending on services is one of a number of items (collectively, the “**Capped Spending Items**”) made subject to an annual, overall spending cap. For that reason, the revenue and spending comparisons analyzed for FY2012 do not focus solely on the General Fund, but rather include the total revenue available to cover all the spending items subject to the annual caps.

Figure 2 identifies the total revenue projected for FY2012 to cover all the Capped Spending Items. It delineates: (i) the revenue the state should receive in FY2012 from its own-source tax structure after the FY2011 tax increases; and (ii) the revenue estimated for FY2012 from federal transfers. As Figure 2 shows, total revenue available to cover the Capped Spending Items for FY2012 is anticipated to be \$33.173 billion.

FIGURE 2
House Resolution 110
FY2012 GF Revenue Estimate
(\$ millions)

Personal Income Tax	\$14,955
Corporate Income Tax	\$2,009
Sales Tax	\$6,586
Other Taxes, Fees, and Interest Income	\$2,969
Subtotal	\$26,519
Transfers In	\$1,810
Total State Sources	\$28,329
Federal Sources	\$4,844
Total Federal and State GF Revenue	\$33,173

The House FY2012 revenue estimate is \$1.1 billion less than the Senate estimate of \$34.282 billion and \$757 million less than the estimate in the Governor’s FY2012 proposed budget.⁶ The Senate estimate is based on COGFA estimates (reduced by \$600 million because of additional Illinois corporate income tax revenue loss from federal a new bonus depreciation tax break – see below) that have historically been the most accurate of any state agency.⁷ Though economic conditions could change for the worse, the House chose to low-ball its revenue forecast in order to force legislators to enact larger cuts in appropriations.⁸ It appears that the Legislature refused to decouple from federal bonus depreciation for the same reason (see discussion below).

4. LEGISLATURE DOES NOT ACT TO CLOSE \$ 600 M REVENUE LOSS FROM FEDERAL “BONUS DEPRECIATION” BUSINESS TAX EXPENDITURE

Long standing federal tax law permits corporations and individuals to gradually, *over several years*, “depreciate” or deduct a share of the cost of new capital purchases from taxable income. A new federal law will allow Illinois corporations and individuals to claim a 100 percent federal corporate income tax deduction for capital goods (plant, machinery, and equipment) purchases made between Sept. 8, 2010 and Dec. 31, 2011, and a 50 percent deduction for capital purchases in calendar year 2012. The new law doubles the federal 50 percent “bonus depreciation” tax credit enacted in 2008 that was supposed to expire in 2010.

As Illinois’ Corporate Income Tax (CIT) and Individual Income Tax (IIT) laws are based on federally taxable income, Illinois taxable income will decline if the state does not *decouple* from the new federal bonus depreciation tax deduction. This would require that the new federal law would not apply to taxable income for the purposes of the Illinois CIT or to depreciation deductions from individual income tax (for example from “S” Corporations) for the Illinois IIT. Illinois individual income tax filers and Illinois corporations (2/3rds of which pay no CIT, and another one fourth pay less than \$5,000, according to the latest IDOR data⁹) would still be eligible for the new bonus depreciation deduction for the purposes of federal CIT, just not for state CIT.

Illinois stands to lose between \$520 and \$615 million according to IDOR¹⁰, or up to \$1.009 billion according to the CBPP¹¹, if it does not decouple from a recent “Bonus Depreciation” change that would allow individuals and businesses to increase their CIT and IIT deductions for depreciation. COGFA estimates this loss at \$75 million in FY2011 and \$600 M in FY 2012, and COGFA’s FY 2012 revenue estimates including this \$ 600 M loss are the basis for the Illinois Senate revenue estimates for FY2012.¹² COGFA estimates that not decoupling will result in a \$ 276 million loss of IIT revenue and a \$323 million loss of CIT revenue.

Twenty seven states, including all of our neighboring states except Missouri, will save an estimated \$10.8 billion by decoupling from this legislation.¹³ Historical and current evidence suggests that enhanced bonus depreciation may depress rather than stimulate job growth, and even if corporation did invest part of their bonus depreciation savings in job growth, there is no guarantee that state income tax savings from one state would necessarily be invested in that same state.¹⁴ Since Illinois is surrounded by states that have decoupled it is likely that a large share of any real investment (if it occurs at all) would benefit surrounding states.

State legislators were repeatedly warned about this impending loss of tax revenue by CTBA and many other groups, and were provided with detailed assistance from CTBA in drafting a bonus depreciation decoupling bill, but (as of this writing) Illinois legislators have not enacted bonus depreciation decoupling. As a result the state is due to lose, based on COGFA estimates, \$25 million in FY2011 income tax revenue, and if not enacted in FY2012, another \$600 million in income tax revenue in FY2012.

Apparently avoiding additional state revenue loss conflicted with the Legislative Leadership priority of forcing through more funding cuts.

5. **FY2012 GENERAL FUNDS APPROPRIATIONS ARE CUT FOR EVERY MAJOR CATEGORY OF GENERAL FUNDS SPENDING EXCEPT PUBLIC SAFETY AND HEALTH CARE.**

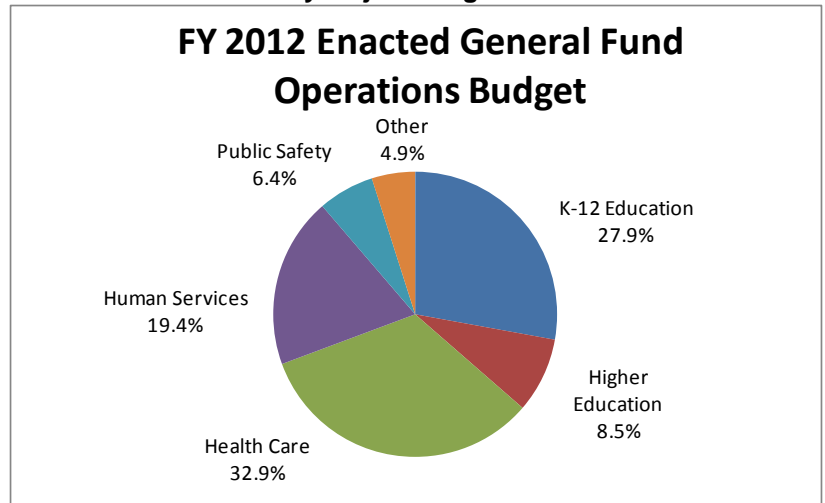
Final FY2012 appropriations are shown in Figure 3 below.

**FIGURE 3
FY2012 Enacted General Fund Appropriations
(\$ Millions)**

Category	Total Appropriations
Total General Fund Appropriations¹	\$33,577
Statutory Transfers Out²	\$4,856
General Fund Including Pensions	\$28,721
Pension³	\$4,230
General Fund Excluding Pensions	\$24,491
K-12⁴	\$6,824
Higher Education⁵	\$2,092
Health Care⁶	\$8,058
Human Services⁷	\$4,754
Public Safety⁸	\$1,558
Other	\$1,203
Sources and Notes:	
1) COGFA FY 2012 Budget Book, p. 29. Excludes "unspent appropriations".	
2) CGFA FY 2012 Budget book, p. 29	
3) CGFA FY 2012 p. 29 .	
4) COGFA FY 2012 Budget Book, p. 50	
5) Op. Cit., p. 51	
6) Op. Cit. Sum of GF approps for CHIP, DHFS, and DPH, p. 52.	
7) Op. Cit. Approps for Aging, DCFS and DHS, p. 51-2.	
8) Op. Cit. Appropriations to Dept. of Corrections, Juvenile Justice, and State Police, p. 52-3.	

FIGURE 4
FY2012 General Fund Appropriation Shares
By Major Categories

The Enacted FY2012 budget proposal continues to prioritize funding the same four core services of education (36.4% of the budget), healthcare (32.9%), human services (19.4%) and public safety (6.4%) as have historically pertained. As can be seen in Figure 4, these four core service areas account for over \$9 out of every \$10 appropriated in the FY2012 enacted General Fund operations budget.



As can be seen in Figure 5 below, of those four core service areas, only two, health care and public safety receive nominal funding increases of 12.6 percent and 1.9 percent respectively. The increase in health care largely reflects increases in health care costs rather than expanded provision. On the other hand K-12 education and human services received large nominal funding cuts of 4 percent and 12.6 percent, respectively. The massive cut in human services funding continues a decade long pattern of cutting funding for human services in Illinois.¹⁵

FIGURE 5
FY2012 Enacted Compared to FY2011
Appropriations by Major Categories

Category	FY 2012 Enacted	FY 2012 Enacted Appropriations		
		FY 2011 Final	Diff FY 2012 Enacted - FY 2011 Final	% Change
General Fund Including Pensions	\$28,721	\$28,233	\$488	1.7%
Pension	\$4,230	\$3,919	\$311	7.9%
General Fund Excluding Pensions	\$24,491	\$24,314	\$177	0.7%
K-12 Education	\$6,824	\$7,110	(\$286)	-4.0%
Higher Education	\$2,092	\$2,124	(\$32)	-1.5%
Health Care¹	\$8,058	\$7,159	\$899	12.6%
Human Services²	\$4,754	\$5,128	(\$373)	-7.3%
Public Safety³	\$1,558	\$1,529	\$30	1.9%

Notes: 1) DPH and DHFS
2) Aging, DCFS and DHS
3) Corrections, Juvenile Justice, and State Police
Sources: See Figure 3.

6. BECAUSE THE TAX INCREASE DID NOT RAISE SUFFICIENT REVENUE THE STATE WILL END FY2012 WITH A \$7.1 B GENERAL FUNDS DEFICIT

As can be seen in Figure 6, even after accounting for the \$7.25 billion in tax increases that passed in January, 2011, the state will have an overall General Funds FY2012 deficit of \$8.0 billion, when unpaid bills left over from FY2011 are considered.

Note that this estimate is based on a COGFA revenue estimate and assumes a \$600 million loss from Federal Bonus Depreciation legislation. The HR 110 revenue estimates in Figure 2 above produce a FY2012 General Fund Operating Budget that results in an increase of the total FY2012 General Fund deficit to \$8.32 billion. Note that this recent Comptroller estimate of the state's end of FY2012 backlog of unpaid bills is \$2.27 billion larger than the \$6.05 billion in unpaid bills at the end of FY2011 (See Figure 1), indicating that in spite of the severe budget cutting Illinois will continue to defer payments forcing non-profit providers and for-profit vendors and contractors to cut services or borrow to meet their expenses in providing services and goods to the state.

FIGURE 6
FY 2012 Minimum Accumulated Deficit Walkdown
Based on COGFA Revenue Estimate

Category	Enacted Amount (\$ billions)	Surplus/Deficit % of Revenue
FY 2012 Appropriations¹	\$33.58	
Total Projected Revenue²	\$33.94	
Initial Operating Surplus	\$0.36	1.06%
Carry forward deficit (unpaid bills and tax refunds)³	-\$8.32	
Total FY 2012 Revenue Shortfall	(\$7.96)	-23.46%
Sources:		
1) See Figure 3		
2) CGFA FY 2012 Budget book, p. 31.		
3) Comptroller estimates for FY 2012, April 27, 2011.		

7. MASSIVE FY2012 DEPARTMENT OF HUMAN SERVICES CUT CONTINUES THE STATE'S DECADE LONG TREND OF SEVERELY UNDERFUNDING HUMAN SERVICES

The human service category—which collectively includes the Department of Aging, Department of Human Services, and Department of Children and Family Services (“DCFS”)—is scheduled to receive nominal dollar cuts from FY2011 levels, with aggregate appropriations being \$373 million less in FY2012 than in FY2011.

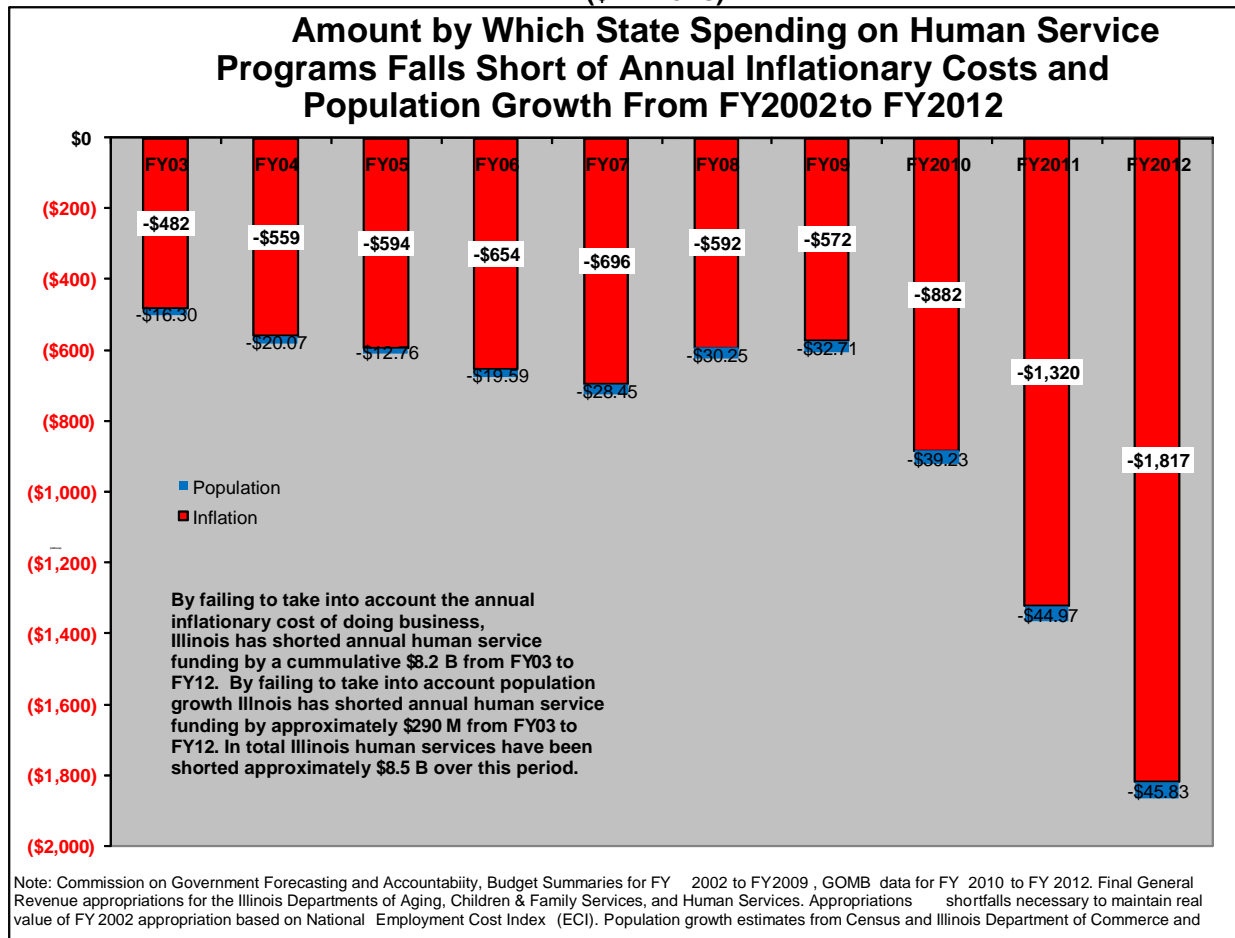
As can be seen in Figure 7 below, almost all of the FY 2012 cut in human services falls on the Department of Human Services (DHS) which will receive a \$454 million (12.4%) cut from FY2011.

FIGURE 7
FY2012 Cuts in Human Service Agencies
(\$ Millions)

Category	FY 2012	FY 2011	Diff FY 2012	
	Enacted	Final	Enacted - FY 2011 Final	% Change
Department of Aging	\$737	\$629	\$109	17.3%
Department of Child and Family Services	\$809	\$836	-\$28	-3.3%
Department of Human Services	\$3,209	\$3,663	-\$454	-12.4%
Total Across Agencies	\$4,754	\$5,128	-\$373	-7.3%

This continues a decade long trend of human service cuts from an already very low level of spending compared to other states in FY2002.¹⁶ As can be seen in Figure 8 below, Illinois has cut real human services provision since FY2002, relative to inflation and population growth, by a cumulative \$8.5 billion.

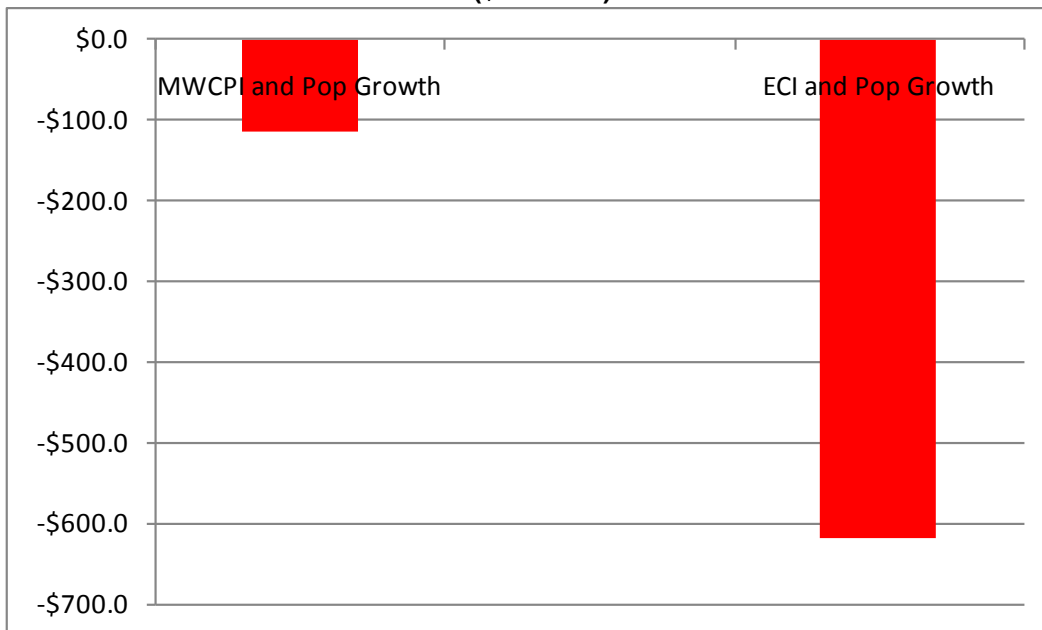
FIGURE 8
Cuts in Illinois Human Service Spending Since FY2002
Adjusted for Inflation and Population Growth
(\$ Millions)



8. FY2012 EDUCATION CUTS FURTHER INCREASE STATE EDUCATION FUNDING SHORTFALL

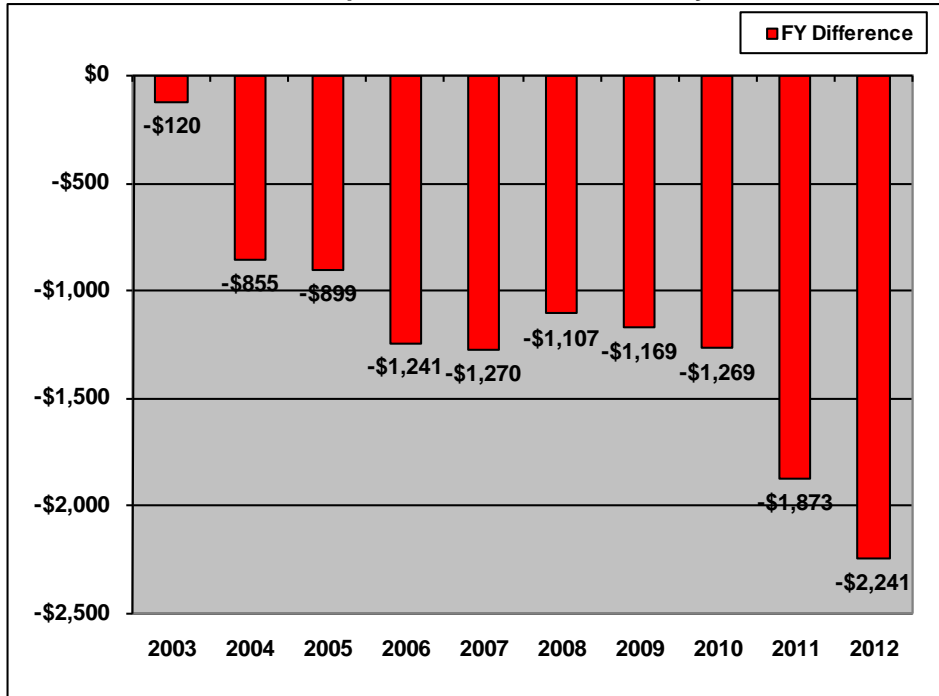
On June 30, 2011, Governor vetoed an additional \$100 million in K-12 education spending from HB 327 including: \$89 million from MCAT- Transportation, \$11.3 million for Regional Superintendent Services and Compensation.¹⁷ As can be seen in Figure 9 below, the state's FY2012 K-12 \$6.82 billion appropriation is \$113 million to \$619 million lower than FY2000 after accounting for inflation and population growth.

FIGURE 9
Illinois State K-12 Education FY 2012 Appropriation Relative to FY2000
Adjusted for Inflation and Population Growth
(\$ Millions)



CTBA has repeatedly pointed out that state General Fund spending on education is woefully inadequate by the state's own standards. Every year the Education Funding Advisory Board (EFAB) is required by law to make a recommendation for Foundation Level per pupil spending that will provide an minimally adequate K-12 education. Figure 10 below shows that the state shortfall in funding to meet this standard has been increasing since 2003 to the point where the FY2012 appropriation is \$2,241 below the EFAB per-pupil Foundation Level. According to National Association of Budget Officer's data, in FY2008 Illinois ranked 40th in education per-capita spending in spite of having the 13th highest per-capita income among the states. In order to just have "average" per-capita spending (a ranking of 25) among the states, state education appropriations in FY2008 would have had to increase by \$2.89 billion.¹⁸ Illinois' repeated abdication of state responsibility for funding adequate public education has led to an over reliance on local property taxes that is a major cause of poor and inequitable educational outcomes in Illinois.¹⁹

FIGURE 10
Shortfall in State Per-Pupil K-12 Education Funding
To Meet EFAB Adequate Education Standard By Fiscal Year



9. ILLINOIS HAS BEEN CUTTING FUNDING FOR EVERY MAJOR CATEGORY OF PUBLIC SERVICES SINCE AT LEAST FY2000.

Generally speaking, in most categories state General Fund spending on the core four services increases from year to year in nominal dollars. That, however, does not provide an accurate barometer of whether spending on services is actually growing, staying flat or declining, because nominal dollar comparisons do not account for inflation or population growth.

Obviously, it costs more to provide the same level of services to more people, so adjusting spending to account for population growth is fundamental. Just as obvious, the cost of providing the same level of services increases year-to-year based on the inflationary growth in the price of labor, energy, rent, etc. So to determine whether public spending on services is truly increasing or not, it also has to be adjusted for inflation. There are two primary inflation metrics that could be used: the "Consumer Price Index" ("CPI") or the Employment Cost Index ("ECI"), both of which are published by the Bureau of Labor Statistics. The CPI is the best inflation metric for economy as a whole, because it adjusts for price changes in all goods and services. But that includes thousands of items that are not relevant to public sector spending (think: pop tarts, toaster ovens, shoe polish and three-piece suits). The ECI on the other hand, tracks comprehensive changes in the cost of labor. Since 80 to 85 percent of all government spending goes to the wages of the workers providing the applicable service, the ECI is the better, more accurate inflation metric to apply to public sector budgets

Figure 11 below shows that after adjusting for inflation and population growth using the ECI, Illinois has cut funding for every major category of public services.

FIGURE 11
Illinois General Fund Spending By Major Public Service Category
FY2012 Enacted Compared to FY 2000 Adjusted for Inflation and Population Growth

Category	FY 2012 Enacted	FY2000 Adj (ECI) ⁴	Diff FY 2012 - FY 2000 (ECI) ⁴	%Change	FY2000 Adj (ECI and Pop Growth) ⁴	Diff FY 2012 - FY 2000 Adj (ECI and Pop Growth) ⁴	%Change
General Fund Including Pensions	\$28,721	NA	NA	NA	NA	NA	NA
Pension	\$4,230	NA	NA	NA	NA	NA	NA
General Fund Excluding Pensions	\$24,491	\$28,484	(\$3,993)	-14.0%	\$30,829	(\$6,338)	-20.6%
K-12 Education	\$6,824	\$6,877	(\$53)	-0.8%	\$7,443	(\$619)	-8.3%
Higher Education	\$2,092	\$3,055	(\$963)	-31.5%	\$3,306	(\$1,214)	-36.7%
Health Care¹	\$8,058	\$8,271	(\$213)	-2.6%	\$8,952	(\$894)	-10.0%
Human Services²	\$4,754	\$6,529	(\$1,775)	-27.2%	\$7,066	(\$2,312)	-32.7%
Public Safety³	\$1,558	\$1,917	(\$359)	-18.7%	\$2,075	(\$517)	-24.9%

Sources: Figure 5 above, FY 2000 data from CGFA FY 2002 Budget Summary.

Notes: 1) DPH and HFS (Public Aid in 2000 and 2001)
2) Aging, DCFS and DHS
3) Corrections, Juvenile Justice, and State Police. No Juvenile Justice in FY 2000.
4) Index value for FY 2000 has been approximated by using 2001 and 2001 ECI.
For Health Care Medical Care Midwest CPI (MCMWCPI) has been used.

Sources: Figure 5 and CGFA Illinois State Budget FY 2001. FY 2000 Teacher and State worker retirement contributions excluded from agency appropriations.

10. ILLINOIS COULD RAISE ADEQUATE REVENUE, WITH LARGE TAX CUTS OR UNCHANGED TAXES FOR THE BOTTOM 60% OF FAMILIES, WITHOUT INCREASING THE TAX BURDEN FOR THE TOP 40% OF FAMILIES BEYOND WHAT THE BOTTOM 40% ARE CURRENTLY PAYING

CTBA has long argued that the state needs more revenue and that the lowest income families need tax relief. Over the short run we have proposed a variety of initiatives that would raise more revenue and make the state fiscal system more stable, responsive, equitable and sustainable. These include: a) decoupling from federal bonus depreciation, b) expanding the state sales tax to services in line with most of our neighboring states, c) taxing high income retirement of earnings, and d) providing a low-income family tax credit to offset the additional burden that these and any other revenue enhancement measures impose on low-income families.²⁰ However, over the long run any serious reform of Illinois' revenue system must: d) recalibrate state and local tax systems to shift the burden of taxes from low and lower-middle income families to high-income families.

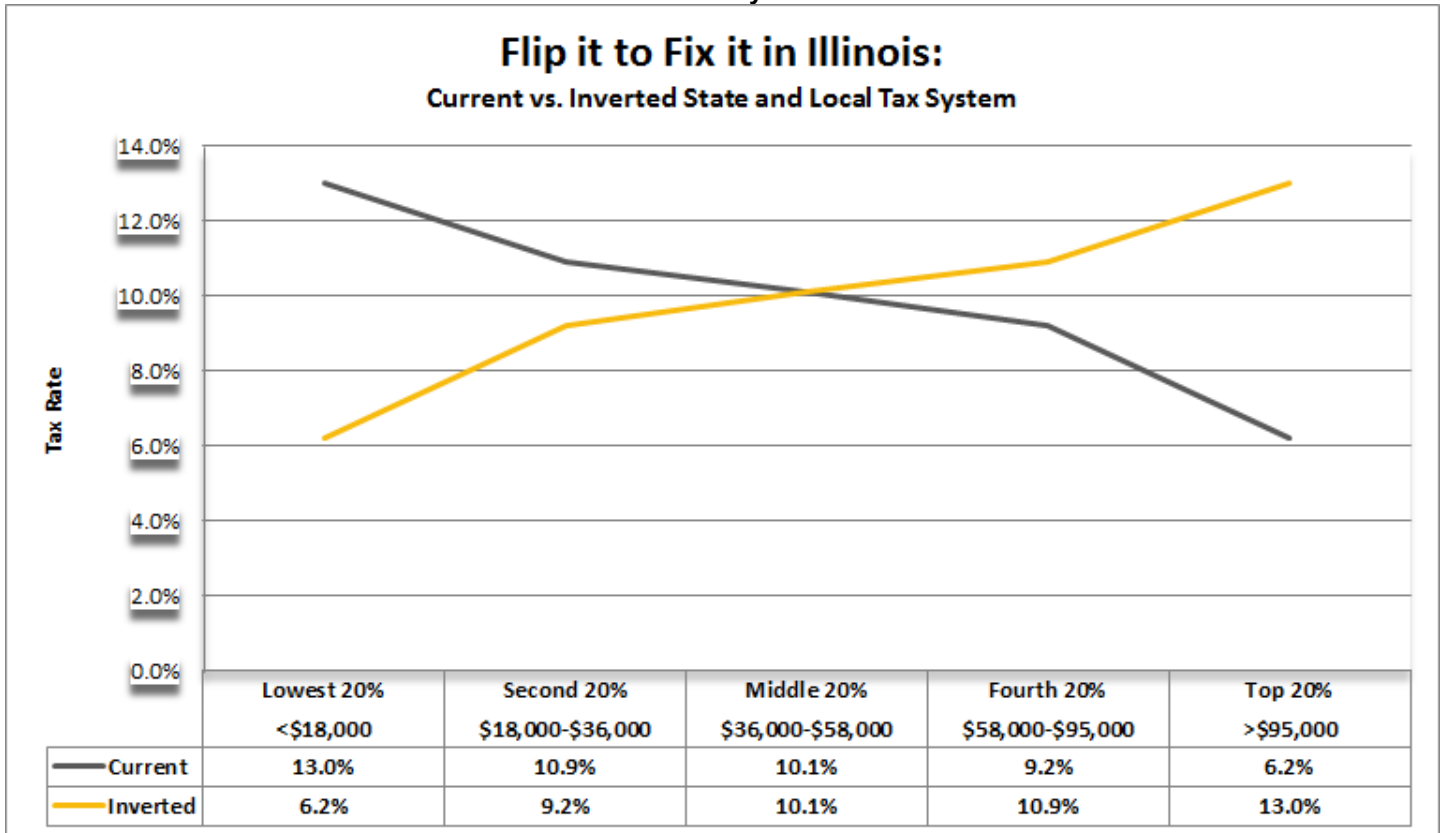
In 2007, the bottom 20 percent of non-elderly families in Illinois paid 13 percent of their income in sales, property, and income taxes, the third highest share of 50 states and the District of Columbia, and more than three times the share paid by the top 1 percent (4.1%).²¹ But though Illinois imposes a high tax burden for the lowest income families, of 41 states with an income tax, even after the 2011 tax increase, Illinois was tied for fourth lowest individual tax rate on households in

the top income bracket.²² These data imply that Illinois' state and local tax burden is among the most regressive of all the states.

Figure 12 below shows the combined state and local (income, sales, and property) tax burden as a share of income for Illinois non-elderly families (black line) and what these tax incidence rates would be if the burdens were "flipped" so that the top two quintiles would pay as a share of their income what the bottom two quintiles currently pay.

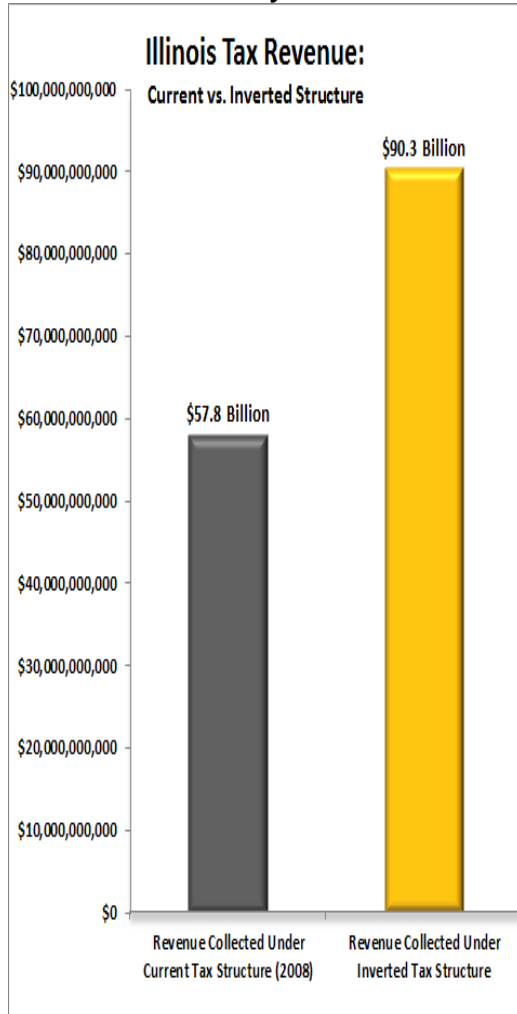
Figure 12 shows that if Illinois' state and local tax burden were "flipped," for example by making the income tax progressive so that top rates approach those of our neighboring states or other large industrial states (IA 8.98 percent, WI 7.75 percent, NY 8.97 percent, CA 9.3 percent) and using the large increases in revenue that even small changes in top rates will provide (see Figure 13 below), to partially off-set the state's over-reliance on highly regressive property and sales taxes, state and local revenue would increase by \$32.5 billion, a 56.2 percent increase in state and local revenue that would be more than enough to adequately fund state and local education, human service, health care, and public safety needs. The point here is not that the state needs \$32.5 billion tax increase but that a more reasonable state and local tax structure whereby the burden for low income families was equal to the current burden for high income families, and vice versa could raise this much more revenue, so any movement toward more basic fairness in tax burden, and greater stability, responsiveness, and sustainability along these lines would dramatically increase available revenue for the state, and lower or not change the proportionate state and local tax burden for a majority of Illinois' families.

FIGURE 12
Illinois State and Local Tax Burden by Family Income Quintile
Current and Inverted Tax Payments as Share of Family Income
Non-Elderly Families



Source: United for a Fair Economy, "Flip It, to Fix It: An Immediate Fair Solution to State Budget Shortfalls," May, 2011.

FIGURE 13
Illinois State and Local Tax Burden by Family Income Quintile
Current and Inverted Tax Payments as Share of Family Income
Non-Elderly Families



Finally, Figure 14 below provides an estimate of 2011 Illinois Personal tax incidence based on Illinois Department of Revenue detailed 2007 disaggregate personal income tax data that has been adjusted to a 5 percent income tax rate. Note that even at a flat 5 percent rate, and after deducting 55 percent of their income so that their effective tax incidence of 2.2 percent is roughly half the 4.0 percent rate of most upper middle income families, 28,999 filers (less than 0.5 percent of all 6,013,310 filers) provided more personal income tax revenue (\$2.9 billion) for the state than the bottom 60 percent of all income tax filers (over 3.5 million filers) combined (\$2.1 billion). Looking at this from a different angle, only 0.49 percent of state personal income tax revenue comes from bottom 20 percent of taxpayers (with incomes of less than \$7,000 per filer), and only 2.92 percent from the next quintile of tax payers (with incomes of \$7,000 to \$19,000), so that the state raises only 3.4 percent of its personal income tax revenue from the bottom 40 percent of tax filers – why does the state bother taxing these very low income tax payers? Conversely, even with a flat 5 percent tax, over two-thirds (68.6 percent) of state personal income tax revenue comes from the upper 20 percent of tax payers. The point here is that because of extreme and ever increasing U.S. (and Illinois) income inequality, even small changes in tax rates for upper income tax filers can raise enormous amounts of increased revenue for the state.²³

FIGURE 14
Illinois Personal Income Tax by Taxpayer Quintile
2011 5% Tax Rate Applied to 2007 Data

	Illinois Base Income Bracket	Average Base Income ¹	Number of Filers	% Deductions	Tax Liability	Total Tax Revenue	%Total Tax Revenue	Cummulative %Total Revenue	Tax Incidence
Bottom 20%	\$0 < \$7,000	\$3,085	1,104,169	60.1%	\$79	\$77,093,057	0.49%	0.49%	1.93%
20% - 40%	\$7,000 < \$19,000	\$12,652	1,095,093	29.5%	\$420	\$460,067,041	2.92%	3.41%	3.26%
40% - 60%	\$19,000 < \$40,000	\$28,745	1,339,766	16.5%	\$1,150	\$1,541,063,604	9.78%	13.20%	3.98%
60% - 80%	\$40,000 < \$75,000	\$56,153	1,219,061	11.3%	\$2,359	\$2,875,331,306	18.26%	31.45%	4.25%
80% - 100%	\$75,000 <	\$179,016	1,255,221	30.1%	\$8,601	\$10,796,496,391	68.55%	100.00%	4.24%
Total		\$72,328	6,013,310	25.2%	\$2,619	\$15,750,051,399	100.00%		3.62%
Approximate Median² (P 49.5)		\$30,000		17.2%	\$1,092				3.98%
Millionaires³ (> P 99.5)		Over \$ 1,000,000	28,999	55.3%	\$99,040	\$2,872,059,605	18.24%		2.23%

Notes:

1) Approximate averages using Figure 1 IDOR income categories conservatively approximating top millionaire bracket with \$1,000,000 average income.

2) P 49.5 rather than true median at P 50 based on Figure 1 IDOR data.

3) P 99.5 and above.

11. CONCLUSION

Though, again, we commend Illinois' public officials for doing the right thing by raising taxes and pulling the state back from the brink of a complete fiscal melt down, more needs to be done to put Illinois' fiscal house in order. The tax increase did not result in an adequate increase in Illinois' ability to raise necessary revenue to fund its most basic public service needs in all four major categories of spending that make up over 90 percent of General Funds spending: education, health care, human services, and public safety. The state's long-term structural imbalance between public revenue need and vital and necessary public services has not been resolved and contrary to the public posturing of some of our Legislative Leaders, it cannot be addressed through spending cuts alone.

The state has been cutting real spending in all four categories of public services for over a decade and is well below the national average in critical education and human service spending both in per-capita and capacity terms. Though efficiency gains in public service provision can always be made and should be wholeheartedly supported, any such gains should not be used to cut state spending but rather to increase the scope and quality of public services. The fact is that Illinois has been starving its public sector for years and needs to dramatically increase its public spending both to enhance the quality of life for current residents and in the interests of its long term economic development. Further cuts in public spending will invariably fall hardest on the poorest and most vulnerable Illinoisans and severely compromise the states' long term economic development. There is no magic way out. Additional revenue loss needs to be stemmed, the tax increase needs to be made permanent, and more revenue needs to be raised.

The good news is that by simply realigning our state and local tax burden we can raise very large amounts of additional revenue while at the same time reducing or not changing the tax burden for the bottom 60 percent of families in Illinois, and without increasing the tax burden on the top 40 percent by more than the bottom 40 percent currently pay.

ENDNOTES

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- ¹ “Funding Our Future: Reforming Illinois Tax Policy,” CTBA, October 2010. Section 8b).
- ² The state’s lack of revenue remains so significant that although the Taxpayer Accountability and Budget Stabilization Act created hard spending caps for the next four fiscal years (2012 through 2015, inclusive), the state will not have enough revenue to spend up to the caps in any of those fiscal years. For more information, see CTBA’s issue brief covering the Taxpayer Accountability and Budget Stabilization Act, available online at www.ctbaonline.org.
- ³ See Senate Joint Resolution 29 (SJ0029) and GOMB FY 2012 Budget Book, Chap. 2 – 35.
- ⁴ From FY 2003 to FY 2010 the average deviation of COGFA revenue forecasts from actual revenues was about half that of GOMB forecasts over the same period (April 2011, COGFA communication).
- ⁵ This was and is (as of this writing in June/July 2011) the source of continued conflict between the House, the Senate, and Governor over their respective revenue forecasts, and subsequent efforts to increase Education and Human Service appropriations via the Capital budget.
- ⁶ See Senate Joint Resolution 29 (SJ0029) and GOMB FY 2012 Budget Book, Chap. 2 – 35.
- ⁷ From FY 2003 to FY 2010 the average deviation of COGFA revenue forecasts from actual revenues was about half that of GOMB forecasts over the same period (April 2011, COGFA communication).
- ⁸ This was and is (as of this writing in June/July 2011) the source of continued conflict between the House, the Senate, and Governor over their respective revenue forecasts, and subsequent efforts to increase Education and Human Service appropriations via the Capital budget.
- ⁹ Table 10, p. 14, of IDOR 2008 and 2009 *Annual Report of Collections and Distributions*.
- ¹⁰ GOMB FY 2012 Budget Book, Chap. 5-15.
- ¹¹ “States Can Avert New Revenue Loss And Protect Their Economies by Decoupling From Federal Expensing Provision,” April 14, 2011, by Ashali Singham and Nicholas Johnson.
- ¹² See COGFA “FY 2012 Economic Forecast and Revenue Estimate and FY 2011 Revenue Update,” p. 25, and Senate Joint Resolution 29, adopted March 17, 2011.
- ¹³ “States Can Avert New Revenue Loss and Protect Their Economies by Decoupling from Federal Expensing Provision, by Ashali Singham and Nicholas Johnson, Center of Budget and Policy Priorities, April 14, 2011.
- ¹⁴ Op. cit. Federal bonus depreciation in effect from September 2001 through December 2005 coincided with the “jobless recovery” of that period and the bonus depreciation enacted in ARRA (extended and expanded in the 2010-2011 federal bonus depreciation legislation) again appears to have bumped up capital spending at the expense of added employment – see “Companies Spend on Equipment not Workers,” Catherine Rampell, *New York Times*, June 9, 2011.
- ¹⁵ See “Illinois State Funding for Human Services in Context,” CTBA, February 2010.
- ¹⁶ Op. Cit.
- ¹⁷ See GOMB June 30, 2011 “Reduction Veto Fact Sheet” at: <http://www2.illinois.gov/gov/Documents/Budget/Reduction%20Veto%20Sheet%20FY2012.pdf>.
- ¹⁸ Funding Our Future, op. cit., p. 10.
- ¹⁹ CTBA, “Money Matters: How the Illinois School Funding System Causes Significant Inequities that Impact Most Students in the State,” Sept. 2008.
- ²⁰ “Funding Our Future, op. cit., Section 9.
- ²¹ Institute on Taxation and Economic Policy 2007 data from: “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” Third Edition, November, 2009.
- ²² Federation of Tax Administrators, February 2011, see: http://www.taxadmin.org/fta/rate/ind_inc.pdf.
- ²³ See for example: “Eisenhower Era Income tax rates on the Upper 10% of Families would Immediately Erase the Federal Deficit”, Chicago Political Economy Group, May 2011: <http://www.cpeonline.org/workingpapers/CEGWP2011-2.pdf>.