

CENTER FOR TAX AND BUDGET ACCOUNTABILITY

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Revenue Underperformance is the Primary Cause of Illinois' Chronic Budget Deficits

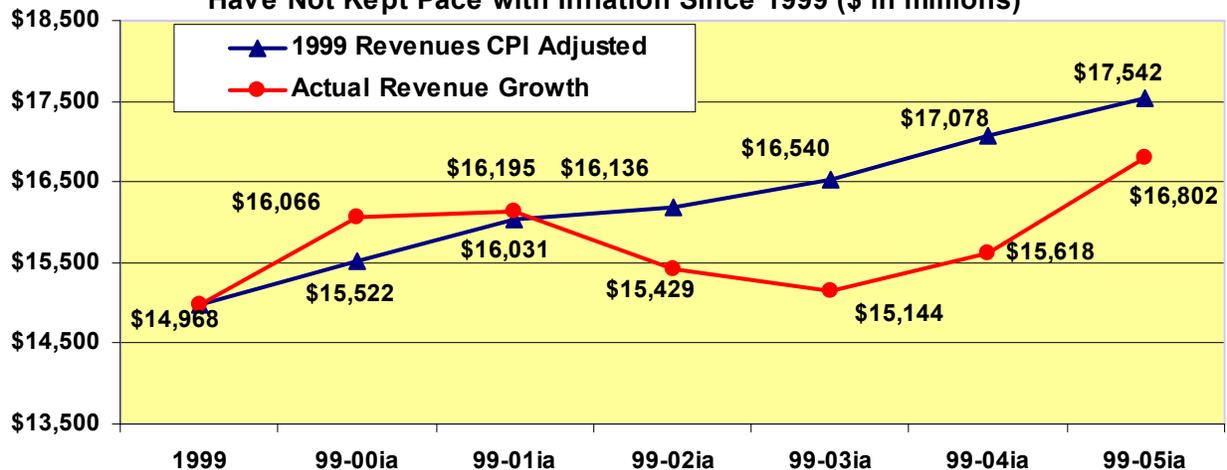
For the past six years, Illinois lawmakers have faced annual budget deficits ranging from \$1.5 billion to \$3.5 billion. Unlike the federal government, Illinois is constitutionally required to balance its books.¹ The Illinois budget deficit, therefore, significantly impairs the state's ability to provide public services. Unless Illinois develops a sustainable solution to its ongoing deficits problems, the state will not have the financial capacity to maintain current services, much less expand or improve effective existing programs like early childhood education.

Chronic deficits, like those in Illinois, usually result from one of two causes, over spending on services or underperformance by state tax revenues. In Illinois, the data strongly indicate the state has a revenue, not a spending problem.

Consider spending first. Compared to other states, Illinois is low spending, ranking only 41st nationally in state spending on public services.² Moreover, in inflation adjusted terms, overall state spending on public services *declined in Fiscal Years (FY) 2004 and 2005 and increased by only 0.2% in FY 2006.*³ So, in spite of being a low spending state compared to the rest of the nation, the trend for Illinois government is to spend less on public services in real terms from year to year, and yet the state's deficits problems persist.

Now consider the revenue side. Illinois tax revenue growth has consistently underperformed inflation over time. Table 1 below illustrates how actual tax revenue growth in Illinois has failed to keep pace with inflation since 1999. It reveals that in the aggregate, state tax revenue has fallen short of inflation by more than \$4 billion in just the last four years. That is almost 20% of the total FY 2006 General Revenue Fund appropriation for all public services, from education to public safety. In FY 2005 alone, state revenue growth fell short of inflation by \$740 million. Even if Illinois revenue growth reaches the FY 2006 forecast of \$17,571 made by the Commission on Government Forecasting and Accountability, state revenues will again fall short of inflation by almost \$400 million.⁴

Table 1
Revenues From the Four Major Illinois Tax Sources
Have Not Kept Pace with Inflation Since 1999 (\$ in millions)



Why are Revenues Failing?

State revenues are failing primarily due to design flaws in the Illinois tax system. Economists have identified four fiscal policy principles needed to fund public services sustainably in a capitalist economy—fairness, responsiveness, stability and efficiency. The Illinois system does not satisfy any of them.

Not surprisingly, that doesn't work. Annually, it is the main reason Illinois' tax revenue growth falls short of the inflation

¹ IL Const. art. VIII, § 2 note: 49 of the 50 states have balanced budget requirements

² U.S. Census Bureau, Bureau of Economic Analysis Regional Economic Accounts – Annual State Personal Income. National Association of State Budget Officers, *State Expenditure Survey, 2002*. Adjusted for income and population.

³ Center for Tax and Budget Accountability (CTBA) Analysis of Illinois final enacted budgets with inflation based on the Consumer Price Index (CPI)

⁴ Illinois Commission on Government Forecasting and Accountability— Update: Economic Outlook and Revenue Estimate, August 2005.

adjusted cost of maintaining the prior year's public services, even when the economy is growing. This is a "structural deficit". It means the Illinois deficit is created primarily because the structure of how the state taxes cannot keep pace with increases in the cost of providing services caused by inflation. Factoring in population growth would make matters worse.

In addition to failing to produce revenue that grows with the economy, the flaws in the Illinois tax system have created one of the most regressive, that is, unfair distributions of tax burden in the nation. Middle and low income taxpayers in Illinois pay a significantly greater percentage of their income in state and local taxes than do affluent taxpayers. This runs counter to the fundamental principle that fairness in capitalist taxation means progressive taxation. The chart above illustrates that the bottom 20% of income earners in Illinois, those making less than \$16,000 per year, pay 8.1% more of their income in state and local taxes than do the most affluent 1% of income earners, who make an average yearly income of \$1.3 million.⁵

Income Bracket	% of Annual Income that goes to IL State and Local Taxes
Lowest 20%	12.7%
Top 1%	4.6%

How Does This Affect Public Services?

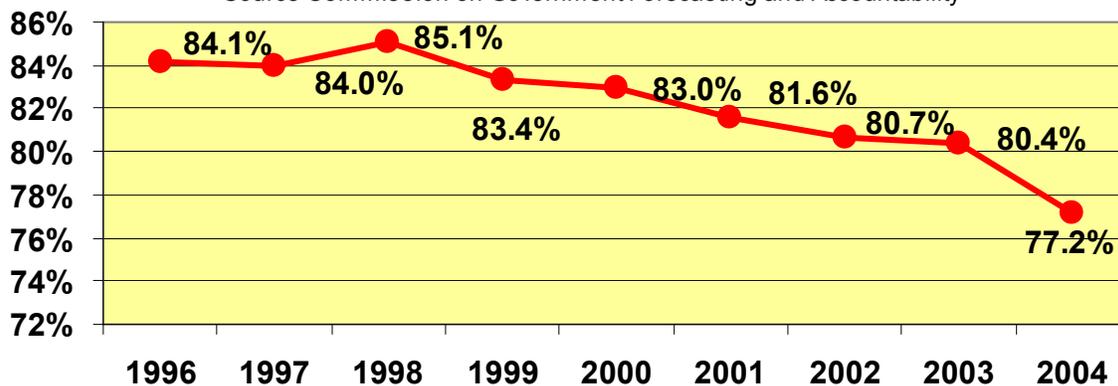
The state's chronic revenue underperformance has forced Illinois to cut spending on all public services other than education and health care since 1995.⁶ It has also forced elected officials to rely on unsound fiscal practices or one-time revenue sources to fashion temporary plugs to the state's ongoing revenue shortfalls. In FY 2006 alone, these tactics included a \$1.17 billion pension holiday (which must be paid back by future generations, with interest), \$160 million in sweeps from state funds dedicated to priorities like environmental protection, and \$1.4 billion in deferred payments owed to private healthcare providers of Medicaid services.

As Table 2 below demonstrates, overtime the state's recurring tax revenues continually fund a lesser percentage of the public services provided. This indicates that the current level of public services may not be sustainable.

Table 2

Reliance on 4 Primary Taxes FY 1996- FY 2004

Includes Personal and Corporate Income, Sales and Public Utility Taxes
 *Source Commission on Government Forecasting and Accountability



The Center for Tax and Budget Accountability is not alone in recognizing the state's revenue shortcomings. According to **The Governor's Office of Management and Budget**, "...the state's revenue base remains insufficient to support the growth of the state's fixed costs, especially pensions, and still allow the state to fund its key priorities."⁷

⁵ Institute on Taxation and Economic Progress. Figures include tax burden net of federal deductions.

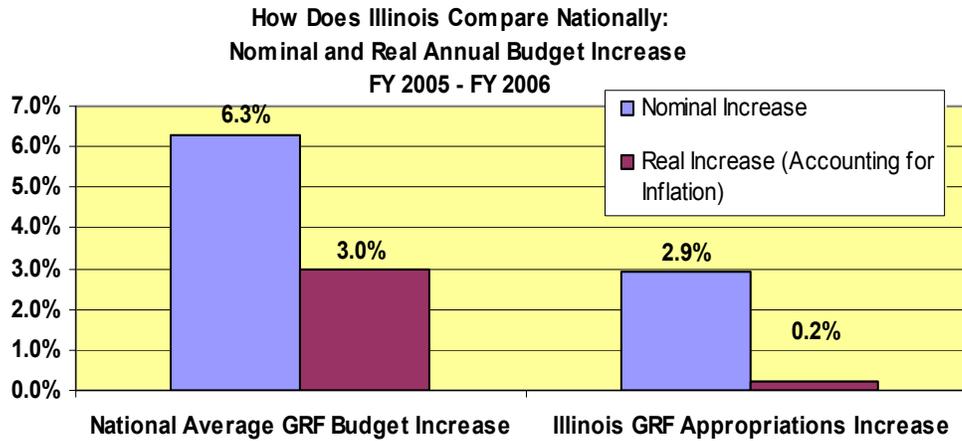
⁶ CTBA Analysis of Illinois final budget expenditure reports since 1995. For more information see CTBA's special report, *Illinois has Cut Real Spending on All Services Except Health Care, Pensions and Education Since 1995* at www.ctbaonline.org

⁷ State of Illinois Governor's Proposed FY 2006 Budget, pg. 1-3.

How Does Illinois Compare Nationally?

Currently, many states are increasing taxes to generate reliable, sustainable revenue to fund public services. A 2005 report by the National Governors Association and the National Association of State Budget Officers (NASBO) found that 25 states enacted tax increases in FY 2006. NASBO also reported that, “For fiscal 2006, state (General Revenue Funds) spending is budgeted to grow by 6.3%.”⁸ At the same time, Illinois General Revenue Funds spending grew by only 2.9% (0.2% after adjusting for inflation) and total spending by only 0.6% (-2.0% after adjusting for inflation).⁸

Table 3



Long Term Consequences

Two negative consequences can be expected to develop if Illinois does not reform its revenue system to at least grow with the economy by keeping pace with inflation. First, Illinois will continually have to reduce the amount of public services it provides from one year to the next. That means less healthcare, transportation, environmental protection, human services and economic development for our communities. Second, Illinois will never have adequate state financial resources to implement school funding reform, which has been sorely needed for over 30 years. Instead, the burden for funding education will continue to shift from state-based revenue to local property taxes. This over reliance on local revenues to fund education ultimately ties school quality to local wealth, and causes the significant inequities in school funding from district to district that caused Illinois to receive the unacceptable grade of “D+” in school funding fairness from Education Week. In addition to school funding inequities, over reliance on property taxes hurts families and senior citizens with stagnant, fixed or moderately increasing incomes.

⁸ National Governors Association and National Association of State Budget Officers, The Fiscal Survey of States, Dec 2005, pgs. 1- 3.

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