

Why Keeping the Income Tax Rate at 5 Percent is Important to the State's Fiscal Condition.

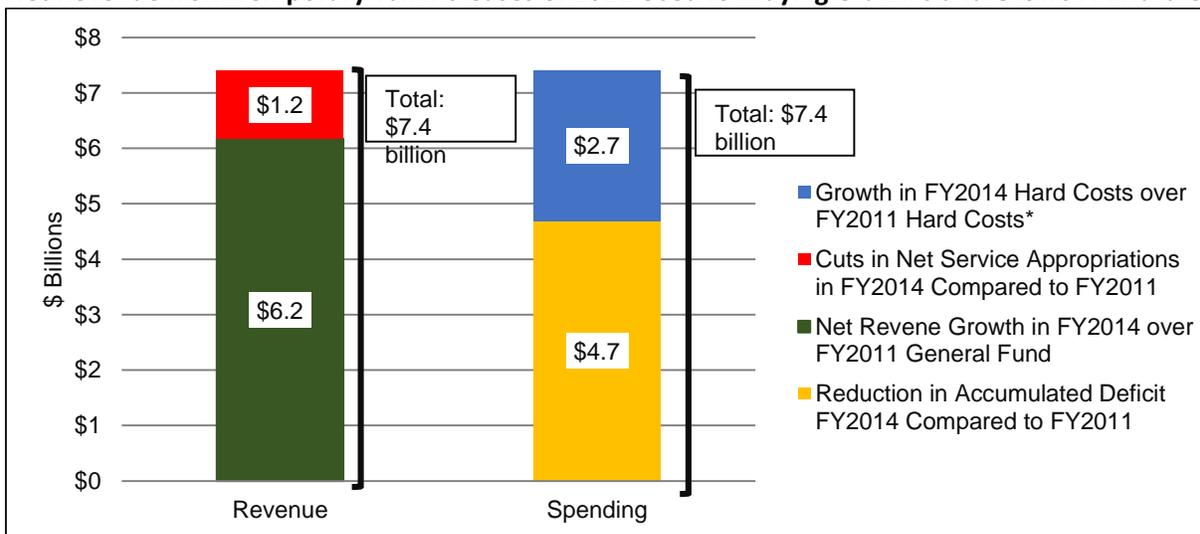
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By the end of May the Illinois General Assembly will be taking a vote to determine what the state's budget will look like for Fiscal Year 2015. This vote will be an important one because both of the temporary state income tax increases that became law under the Taxpayer Accountability and Budget Stabilization Act of 2011 (**TABSA**)¹ are scheduled to begin phasing down during fiscal year 2015. Under TABSA, the personal income tax rate will decline from 5 percent to 3.75 percent, and the corporate income tax rate will drop from 7 percent to 5.25 percent on January 1, 2015, halfway through the fiscal year. Collectively, those rate reductions will cause the state to realize a loss of \$2 billion in revenue from FY2014 levels.²

Given Illinois' already shaky fiscal condition, that loss of revenue will be impossible for the state's General Fund to absorb without significantly reducing FY2015 spending on core services from FY2014 levels. Here is why:

- Before losing the revenue from the phase down of the temporary tax increases, Illinois already had an accumulated deficit of **\$6.8 billion**. That is roughly 27.8 percent of total FY2014 spending on the core services of education, healthcare, human services, and public safety, which collectively account for 90 percent of all FY2014 General Fund spending on services.
- Illinois has that significant accumulated deficit despite the new revenue generated by the temporary tax increases (personal and corporate) that passed under TABSA, and the **\$4.7 billion** in service cuts made over the last five years.³ Indeed, spending on current services was \$1.2 billion less in nominal dollars in FY2014 than in FY2011, when the tax increases under TABSA became effective.

All Net Revenue from Temporary Tax Increases of 2011 Used for Paying Old Bills and Growth in Hard Costs



Sources: accumulated deficit and revenue sources (FY2011 actual spending from GOMB, *Illinois State Budget: Fiscal Year* (Springfield, IL: Feb 22, 2012), CH 2-18; FY2012 actual spending from GOMB, *Illinois State Budget: Fiscal Year 2014* (Springfield, IL: March 6, 2013), CH 2-16; FY2013 actual spending from GOMB, *Illinois State Budget: Fiscal Year 2015* (Springfield, IL: March 26, 2014), CH 2-16; actual revenue for FY2011-FY2013 from COGFA, *State of Illinois Budget Summary: Fiscal Year 2014* (Springfield, IL: August 1, 2013), 50; and estimated FY2014 revenue from COGFA, *Monthly Briefing for the Month Ended: April 2014* (Springfield, IL: April 2014.); appropriations and Hard Costs for 2011 from revised January 2011) GOMB, *Illinois State Budget: Fiscal Year FY2012* (Springfield, IL: Feb 16, 2011), CH 2-13; FY2014 from GOMB, *Illinois State Budget: Fiscal Year 2015* (Springfield, IL: March 26, 2014) and GOMB, "Operating Budget Detail," March 2014, *Excel file*.

- The truth is that contrary to public perception, decision makers have not used any of the new revenue generated by the temporary tax increases under TABSA to fund growth in current services.
- As the chart shows, all net General Fund revenue growth over the FY2011-FY2014 sequence, including the new revenue generated from the temporary tax increases passed under TABSA together with the savings generated by the \$1.2 billion in spending cuts implemented over those fiscal years, was used to reduce the accumulation of back due bills in the state's General Fund by \$4.7 billion while covering the \$2.7 billion growth in "Hard Costs."
 - o "Hard Costs" are expenditures required by law that neither the General Assembly nor the Governor have the discretion to reduce or eliminate, and include three things: "Debt Service," like payments made on general obligation bonds; "Statutory Transfers Out," which are money transfers that state legislation, required be paid from the General Fund to other state funds; and "Pension Contributions" required by law to be made to the state's five retirement systems.
- Over the last five fiscal years (FY2009-FY2014), Hard Costs have more than tripled, increasing from \$3.2 billion to \$11.3 billion, accounting for all increased spending in the General Fund.
- The phase out of the temporary tax increases under TABSA that are scheduled to begin midway through FY2015 will result in the General Fund losing a total of \$2 billion in revenue from FY2014 levels.
- Without dramatic spending cuts to current services, the \$2 billion in lost revenue from the phase out of the temporary tax increases under TABSA would balloon the accumulated deficit to \$8.8 billion—or 36 percent of all spending scheduled for current services last year in FY2014.
- Since \$9 out of every \$10 spent on current services through the General Fund goes to Education (Early Childhood, K-12, and Higher Education-35 percent), Healthcare (29 percent), Human Services (20 percent), and Public Safety (7 percent), spending cuts necessitated by the phase out of the temporary tax increases would have to be made to one or more of those core services. Indeed, since the vast majority of state healthcare spending is for Medicaid services, which Illinois has little discretion to cut under federal law regarding matching grants, spending cuts would have to fall disproportionately on education and human services.
- So if the temporary tax increases are in fact allowed to phase out, the General Assembly will have to implement significant spending cuts which would be devastating to communities across the state.

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¹ Public Act 96-1496.

² Figure based on comparing COGFA's FY2015 revenue estimate in COGFA, *Monthly Briefing for the Month Ended: April 2014* (Springfield, IL: April 2014) and House Joint Resolution 80 of the 98th General Assembly.

³ Comparison of FY2014 General Fund service appropriations to FY2009 service appropriations. FY2009 service appropriations from GOMB, *FY2010 Budget Book* (Springfield, IL: March 18, 2009), CH 2-10. FY2014 appropriations from CTBA analysis of GOMB, "Operating Budget Detail," March 2014, *Excel file*.