



## Issue Brief The Pending FY2016 Fiscal Cliff

DECEMBER 22, 2014

Following is an overview of the fiscal challenges facing the next General Assembly and Governor-elect Bruce Rauner in crafting a General Fund budget for Fiscal Year 2016. Assuming no tax policy changes, if spending on services in FY2016 is held constant in nominal, non-inflation adjusted dollars at FY2015 levels, the state's accumulated deficit in its General Fund will almost double, increasing from an estimated **\$6.8 billion** in FY2015, to **\$12.7 billion** by the end of FY2016. This is shown in Figure 1.

**Figure 1  
FY2014, FY2015 and FY2016 General Fund Comparison (\$ Millions)<sup>1</sup>**

	FY2014	FY2015 (Enacted)	FY2016 (Projected)
<b>Revenue</b>			
Total Recurring General Fund Revenue	\$36,718	\$34,702	\$31,710
One-time, Non-recurring Revenue	\$0	\$650	\$0
<b>Total Revenue</b>	<b>\$36,718</b>	<b>\$35,352</b>	<b>\$31,710</b>
<b>Spending</b>			
Net General Fund Spending on Services	\$24,950	\$24,919	\$24,919
Hard Costs (pensions, bonds, statutory transfers)	\$11,910 <sup>2</sup>	\$10,756	\$12,031
Repayment of Inter-Fund Borrowing	\$0	\$0	\$650
<b>Carry Forward Deficit from Prior Fiscal Year</b>			
	(\$6,336)	(\$6,478)	(\$6,800)
<b>Projected Fiscal Year-End Deficit</b>			
	(\$6,478)	(\$6,800)	(\$12,690)

Indeed, after accounting for the \$650 million in one-time, non-recurring revenue that was used to prop up the FY2015 General Fund budget, decision makers will have some **\$3.64 billion** less in total revenue in FY2016 than FY2015.

### 1. FISCAL PRESSURE #1: SIGNIFICANT INCOME TAX REVENUE LOSS

By statute, both of the temporary state income tax increases that became law under the Taxpayer Accountability and Budget Stabilization Act of 2011 (**TABSA**)<sup>3</sup> will begin to phase down on January 1, 2015. This is halfway through the current fiscal year—FY2015—which began on July 1, 2014, and ends on June 30, 2015.

Under TABSA, the personal income tax rate will automatically decline from 5 percent to 3.75 percent, and the corporate income tax rate will automatically drop from 7 percent to 5.25 percent, on January 1, 2015. While those reduced income tax rates resulted in a significant FY2014-FY2015 revenue loss, its impact was somewhat mitigated, because the reduced income tax rates only pertain for six months of FY2015. Things will be worse in FY2016, because those reduced income tax rates will be in effect for the full fiscal year.

Indeed, the recurring revenue loss caused by the phase down of the temporary income tax increases under TABSA will be quite significant. According to the non-partisan Commission on Government Forecasting and Accountability (COGFA), recurring General Fund revenue in FY2015 will be some **\$2 billion** less than it was in the immediately preceding fiscal year, FY2014.<sup>4</sup> In FY2016, however, when the full effect of the reduced income tax rates will be felt, General Fund revenue is projected to be nearly **\$3 billion** less than in FY2015.

**Figure 2**  
**General Fund Recurring Revenue Comparison**  
**FY2014 Actual to FY2016 Projected (\$ Millions)**

	FY2014 (Actual)	FY2016 (Projected)
General Fund Revenue	\$36,718	\$31,710
Difference (\$)	N/A	<b>(\$5,008)</b>
Difference (%)	N/A	<b>-13.6%</b>

Sources: FY2014 from COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014), 25; and FY2016 from COGFA, *3-Year Budget Forecast FY2015-FY2017* (Springfield, IL: March 2014), 12.

As shown in Figure 2, the net result of the phase down in tax rates is clear: the amount of annual recurring revenue available to cover General Fund services will have declined by **\$5 billion** since FY2014.<sup>5</sup> To put this into perspective, that \$5 billion decline in annual General Fund revenue is greater than the sum of all General Fund appropriations for Human Services scheduled for the current fiscal year (FY2015), which total \$4.8 billion.<sup>6</sup>

## **2. FISCAL PRESSURE #2: LOSS OF ONE-TIME REVENUE GENERATED THROUGH INTER-FUND BORROWING**

As shown in Figure 1, when crafting the FY2015 General Fund budget, decision makers opted to mitigate a portion of the projected **\$2 billion** FY2014 to FY2015 revenue loss caused by the phase down of the temporary income tax increases under TABSA, through utilization of \$650 million in one-time, non-recurring revenue. That “revenue” was obtained by borrowing said \$650 million from other state funds.<sup>7</sup> The proceeds from that inter-fund borrowing effectively increased the total amount of General Fund revenue available in FY2015 from \$34.702 billion to \$35.352 billion, as shown in Figure 3.

**Figure 3**  
**FY2015 General Fund Revenue (\$ Millions)**

FY2015	
Recurring General Fund Revenue	\$34,702
One-time, Inter-fund Borrowing	\$650
<b>Total General Fund Revenue</b>	<b>\$35,352</b>

While borrowing that \$650 million from other state funds helped mitigate the scheduled loss in recurring revenue from FY2014 to FY2015, it will worsen the shortfall in General Fund revenue moving from FY2015 to FY2016.

Figure 4 shows how. It compares total General Fund revenue from all sources projected for FY2016, to total General Fund revenue from all sources—including the \$650 million in one-time inter-fund borrowing—projected for FY2015.

**Figure 4**  
**General Fund Revenue, Including Inter-Fund Borrowing (\$ Millions)**

	FY2015 (including \$650 million inter-fund borrowing)	FY2016
Total, General Fund Revenue	\$35,352	\$31,710
Year-to-Year Difference (\$)	N/A	(\$3,642)
Year-to-Year Difference (%)	N/A	-10.3%

Sources: FY2015 from HJR-100 of the 98<sup>th</sup> General Assembly; and FY2016 from COGFA, 3-Year Budget Forecast FY2015-FY2017 (Springfield, IL: March 2014), 12.

As highlighted in Figure 4, the loss of this \$650 million in one-time revenue, together with the projected loss in recurring revenue from the phase down of state income tax rates under TABSA, results in the FY2016 General Fund having **\$3.6 billion** less in total revenue than FY2015. That amounts to a year-to-year revenue loss of just over **10 percent**.

### 3. FISCAL PRESSURE #3: INCREASED HARD COSTS

The term “Hard Costs” refers to General Fund expenditures that are required by law and over which neither the General Assembly nor Governor have discretion to reduce or eliminate. Hard Costs include three things: “Debt Service”, which are payments made on general obligation bonds; “Statutory Transfers Out”, which are expenditures that, pursuant to state legislation, must be paid from the General Fund to other state funds (the largest of which are for Medicaid transfers and the Local Government Distributive Fund); and the “Pension Contributions,” which are required by law to be made to the state’s five retirement systems.<sup>8</sup>

The pension contribution portion of the Hard Costs includes two factors. First, there is the normal cost of funding benefits for current workers. This amount has been relatively stable over the last five years, coming in at roughly \$1.1 - \$1.5 billion annually. Second, there is an amount included to repay the debt borrowed from the pension systems over time. By law, this debt repayment amount has grown significantly over the last few fiscal years, and is now over \$5 billion annually, accounting for around 80 percent of the total pension contribution required by law.

In an effort to reduce the debt owed to the pension systems, the General Assembly passed and Governor Quinn signed into law Public Act (PA) 98-599 in December of 2013. That law implemented sweeping changes to Illinois’ state-funded public retirement systems. At its core, PA 98-599 cut pension benefits for current employees and retirees, and those benefit cuts were meant to reduce the state’s required annual contributions to the pension systems, thereby lessening Hard Costs. FY2016 was supposed to be the first fiscal year during which the state’s total pension contribution would be reduced by PA 98-599. However, on November 21, 2014, Sangamon County Circuit Court Judge John Belz ruled that PA 98-599 was unconstitutional, and put a permanent stay on the law’s implementation.<sup>9</sup> While the state will appeal Judge Belz’s ruling to the Illinois Supreme Court, the benefit cuts designed to reduce the state’s pension contributions cannot be implemented for the duration of the stay. Because of Judge Belz’s ruling, the state’s contributions to the pension systems for FY2016 will have to be calculated in accordance with the pension funding laws and benefit levels that existed *prior* to the passage of PA 98-599.

Moreover, the three largest state pension systems recently reduced their investment rate assumptions.<sup>10</sup> This means the pension systems now project that their assets will generate a lesser return over time than what was previously anticipated. This in turn will cause the annual pension contributions required of the state to increase from what was initially scheduled, to make up for the difference between the higher returns previously projected for the pension systems’ assets, and the new lower growth projection. As a result of the stay on PA 98-599’s implementation and the reduced investment rate assumptions, the state’s FY2016 General Fund contribution to the pension systems will be some \$630 million—or 10 percent—more than in FY2015, rather than declining from year-to-year as previously anticipated.

In addition, the state’s debt service on bonds is projected to increase by 30 percent from FY2015 to FY2016, while statutory transfers are estimated to decrease slightly from year-to-year. Finally, the \$650 million in one-time revenue that will be borrowed in FY2015, has to be paid back within 18 months of that borrowing.<sup>11</sup> Effectively, then, that \$650 million of one-time FY2015 revenue obtained by borrowing from other state funds, creates a new Hard Cost repayment obligation in FY2016. As a result, the FY2016 Hard Costs are estimated to be \$1.9 billion *more* than the FY2015 Hard Costs, as shown in Figure 5.

**Figure 5  
Hard Cost Comparison (\$ Millions)**

	FY2015	FY2016	Year to Year Change (\$)	Year to Year Change (%)
Pension Contributions <sup>12</sup>	\$6,164	\$6,794	\$630	10%
Statutory Transfers	\$2,215	\$2,156	(\$59)	-3%
Debt Service on Bonds	\$2,377	\$3,081	\$704	30%
<b>Sub-total</b>	<b>\$10,756</b>	<b>\$12,031</b>	<b>\$1,276</b>	<b>12%</b>
Repayment of Inter-Fund Borrowing	\$0	\$650	N/A	N/A
<b>GRAND TOTAL</b>	<b>\$10,756</b>	<b>\$12,681</b>	<b>\$1,926</b>	<b>18%</b>

Sources: FY2015 COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014); FY2016 statutory transfers and debt service on bonds from GOMB, *Fiscal Year 2015 5 Year Blueprint Not Recommended* (Springfield, IL: March 2014); FY2016 pension contribution from COGFA, *Special Pension Briefing* (Springfield, IL: November 2014), 7—CTBA increased the amounts in the COGFA report by \$117.6 million to include the cost of retiree healthcare and the state's contribution to the Chicago Teachers' Pension Fund.

#### **4. THE NET RESULT: THE ACCUMULATED GENERAL FUND DEFICIT IN FY2016 WILL ALMOST DOUBLE FROM FY2015 LEVELS**

CTBA estimates that FY2015 will end with an accumulated deficit of **\$6.8 billion**.<sup>13</sup> Looking ahead, the combination of increased Hard Costs and decreased revenue will cause that deficit to grow significantly in FY2016. Indeed, assuming no changes to current law, if decision makers simply want to maintain FY2016 General Fund spending on the four core services of education, healthcare, human services, and public safety in FY2016 level with FY2015 in nominal, non-inflation adjusted dollars, then FY2016 will end with an accumulated deficit of around **\$12.7 billion**. That would mean nearly **51 percent** of service spending in FY2016 will be deficit spending. Figure 6 details how that **\$12.7 billion** deficit is calculated.

**Figure 6  
Projected FY2016 General Fund Deficit (\$ Billions)<sup>14</sup>**

Category	Amount
<b>Projected FY2016 Revenue</b>	<b>\$31.71</b>
<b>Projected FY2016 Hard Costs</b>	\$12.03
<b>Inter-Fund Borrowing Repayment</b>	\$0.65
<b>Projected Deficit Carry Forward from FY2015</b>	(\$6.8)
<b>Net FY2016 General Fund Revenue Projected to be Available for Current Services</b>	<b>\$12.23</b>
<b>FY2016 General Fund Service Appropriations (if kept level in nominal dollars with FY2015)</b>	\$24.92
<b>Estimated Minimum FY2016 General Fund Deficit</b>	<b>(\$12.69)</b>
<b>Estimated Deficit as a Percentage of General Fund Service Appropriations</b>	<b>-50.9%</b>

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## Endnotes

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<sup>1</sup> Note numbers have been rounded. Sources: FY2014 and FY2015 revenue from COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014), 25; FY2016 revenue from COGFA, *3-Year Budget Forecast FY2015-FY2017* (Springfield, IL: March 2014), 12; FY2014 and FY2015 appropriations from COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014).

<sup>2</sup> Hard Costs for FY2014 includes a pre-payment of a \$600 million transfer that would have otherwise taken place in FY2015. This artificially reduces Hard Costs for FY2015 by said \$600 million, which in part explains the significant year-to-year change in Hard Costs of some \$1.275 billion over the FY2015 to FY2016 sequence.

<sup>3</sup> Public Act 96-1496.

<sup>4</sup> FY2014 and FY2015 revenue from COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014), 25. FY2015 revenue adjusted to exclude inter-fund borrowing.

<sup>5</sup> FY2014 from COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014), 25; FY2015 from HJR-100 of the 98<sup>th</sup> General Assembly; and FY2016 from COGFA, *3-Year Budget Forecast FY2015-FY2017* (Springfield, IL: March 2014), 12.

<sup>6</sup> CTBA analysis of appropriations for Department on Aging, Department of Children and Family Services, Department of Human Rights, Department of Human Services, Department of Veteran's Affairs, the Human Rights Commission, and the Illinois Guardianship and Advocacy Commission in COGFA, *State of Illinois Budget Summary Fiscal Year 2015* (Springfield, IL: August 2014, 38-47).

<sup>7</sup> Public Act 98-682; 30 ILCS 105/5k.

<sup>8</sup> Pension Contributions also include funds appropriated for the healthcare benefits for retirees who were employed by a non-Chicago public school (\$105.4 million for FY2015) and the state's required contribution to the Chicago Teachers' Pension Fund (\$12.1 million for FY2015).

<sup>9</sup> Sangamon Co. Ct. R. 1, <http://files.sj-r.com/media/news/11212014pensionruling.pdf>.

<sup>10</sup> COGFA, *Special Pension Briefing* (Springfield, IL: November 2014), 4.

<sup>11</sup> Public Act 98-682; 30 ILCS 105/5k.

<sup>12</sup> Pension Contributions also include funds appropriated for the Teachers Retirement Insurance Program (\$100.98 million), the College Insurance Program (\$4.46 million), and the state's required contribution to the Chicago Teachers' Pension Fund (\$12.145 million). The FY2015 amounts are from PA 98-680. The FY2015 amounts were used for the total Pension Contribution estimated for FY2016.

<sup>13</sup> In July, CTBA initially estimated that FY2015 would end with an accumulated deficit of \$6.5 billion. That estimate was based on CTBA's analysis of the legislative bills authorizing the FY2015 appropriations and the Governor's Office of Management and Budget's estimated unspent appropriations. Since then COGFA has released its FY2015 Budget Summary. Net FY2015 General Fund spending on services is some \$376 million more than CTBA's original estimate. As a result, CTBA increased its estimate of the accumulated deficit for FY2015 to \$6.8 billion to account for the state's projected increase in net General Fund spending.

<sup>14</sup> Numbers do not add up due to rounding.