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

The Impending Fiscal Cliff of FY 2025

November 9, 2021

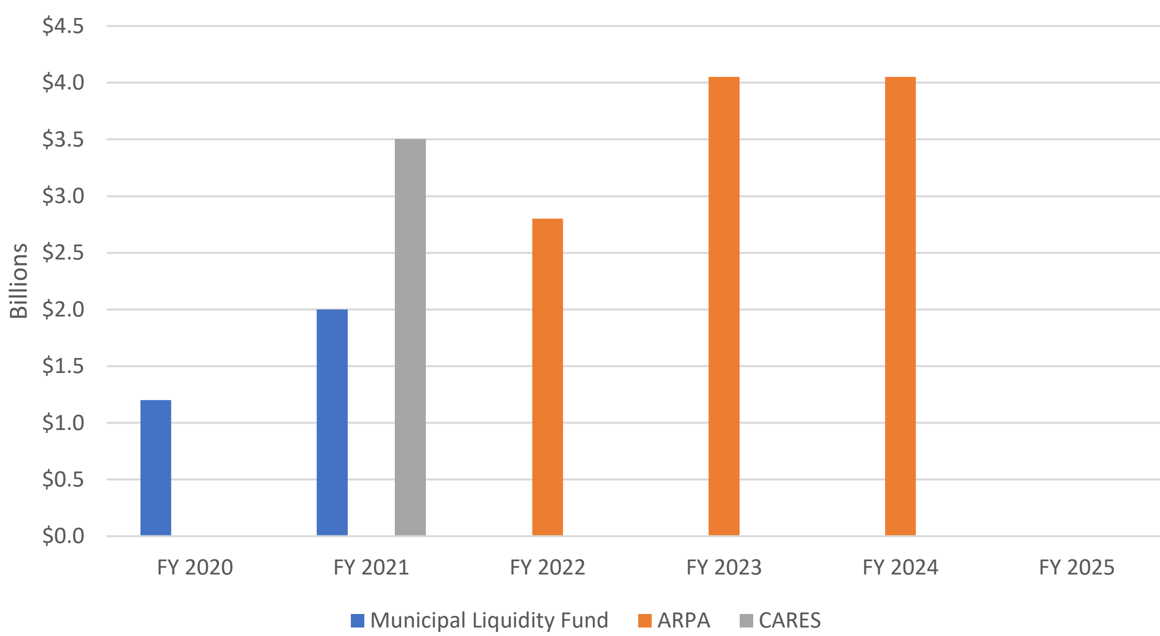
1. Illinois' True Fiscal Challenges Are Being Temporarily Masked By One-Time Federal Pandemic Relief

1.1 Illinois State Government is Receiving Over $17 Billion in Federal Pandemic Relief

This past Spring when the General Assembly and Governor were developing a General Fund budget for FY 2022, there was a significant amount of new revenue on the table. For instance, Illinois state government received around $11 billion in federal aid for General Fund use under the American Rescue Plan Act of 2021 ("**ARPA**").[1] ARPA is a major national relief package that made $1.9 trillion of federal funding available nationwide to help state and local governments cope with fiscal challenges created by the pandemic.[2] Illinois was empowered to utilize its ARPA relief aid to cover many General Fund and other service expenditures over the FY 2022-FY 2024 sequence.[3] *For more information, please see CTBA's report on the* [*American Rescue Plan.*]()

ARPA came on the heels of various other federal relief initiatives that passed in 2020—most notably the Coronavirus Aid, Relief, and Economic Security Act ("**CARES Act**").[4] As shown in **Figure 1**, When considered together with ARPA, over $17 billion in federal relief funding has been designated to cover state-level General Fund spending on core public services in Illinois over fiscal years 2020, 2021, 2022, 2023, and 2024.[5]

FIGURE 1
ONE-TIME FEDERAL PANDEMIC RELIEF FOR ILLINOIS STATE GOVERNMENT



Source: CTBA analysis of the Governor's Office of Management and Budget federal funding reports

Meanwhile, in addition to that unanticipated federal largess, the General Assembly enacted legislation that, beginning in FY 2022, will generate an estimated $655 million in a combination of new, one-time and recurring General Fund revenue, through elimination of various tax expenditures for corporations.[6]

1.2 Due to Long-Term Fiscal Shortcomings, Federal Pandemic Relief Has Not Led to a Spike in General Fund Spending on Current Services in Illinois

Despite both record federal assistance and the aforesaid boost in state-based revenue, Illinois' long-term fiscal challenges are so significant that year-to-year General Fund spending on services in FY 2022 is scheduled to increase by just 1.9 percent in nominal, non-inflation-adjusted dollars, from $27.98 billion in FY 2021, to $28.514 billion in FY 2022.[7]

Of course, a nominal dollar comparison does not provide an accurate picture of the year-to-year change in public sector spending, because it fails to account for inflation. After adjusting for inflation, General Fund spending on services in FY 2022 will actually be only $24 million—or roughly 0.09 percent—more in real terms than in FY 2021.[8] And even though the real, year-to-year spending increase is less than a rounding error, the state's General Fund is none-the-less projected to have a significant, as in $6.3 billion, accumulated deficit at the end of FY 2022.[9]

Which means the biggest takeaway from the FY 2022 General Fund budget is no different from the 20 or so that preceded it: Illinois lacks the fiscal capacity to continue funding the same level of core services it provides today into the future. Indeed, the state's fiscal shortcomings are so significant that even billions of dollars in federal relief barely made a difference.

Unfortunately, in addition to being significant, the state's fiscal shortcomings are also nothing new. According to the Comptroller's Office, Illinois has run a deficit in its General Fund every year for the last 19 consecutive years.[10] These ongoing deficits are a cause for concern, since over $9 out of every $10 of the state's General Fund spending on services goes to the four, core areas of Education, Healthcare, Human Services, and Public Safety.[11]

1.3 Illinois' Long-Term Fiscal Problems are Driven by Flawed Tax Policy, Not Overspending on Services

Many erroneously believe overspending on services is primarily to blame for the state's long-running General Fund deficits. The data, however, is completely at odds with this belief. For instance, Illinois ranks very low in spending on services when compared to the other 49 states. Despite having the sixth largest population[12] and the fifth largest Gross Domestic Product (**"GDP"**) of any state,[13] Illinois was 34th in General Fund spending on services per capita in FY 2019, the last year for which there's comprehensive data available.[14] Illinois also ranked 43rd in spending as a share of GDP in the last year for which data permitting a national comparison using that metric exists.[15]

In fact, as shown in **Figure 2**, after adjusting for changes in inflation and population, General Fund appropriations for current services in FY 2022 are scheduled to be over 20 percent less than they were two decades ago in FY 2000.[16]

FIGURE 2
ILLINOIS GENERAL FUND APPROPRIATIONS FOR CURRENT SERVICES:
FY 2020 ENACTED COMPARED TO FY 2022 ENACTED ($ MILLIONS)

Category	FY 2000 Enacted (Nominal)	FY 2000 Enacted (inf. adj.)	FY 2022 Enacted	$ Change (inf. adj.)	% Change (inf. adj.)
Healthcare	$5,022	$10,038	$7,795	($2,243)	-22.35%
Human Services	$4,599	$8,187	$7,384	($803)	-9.81%
K-12 Education	$4,674	$8,321	$8,696	$375	4.51%
Higher Education	$2,152	$3,831	$1,993	($1,838)	-47.97%
Early Childhood Education	$170	$303	$544	$241	79.67%
Public Safety	$1,350	$2,403	$1,934	($469)	-19.52%
Total Net General Fund Service Appropriations	**$20,064**	**$35,718**	**$27,802**	**($7,204)**	**-20.17%**

Sources: FY 2000 unadjusted appropriations from Governor's final budget summary for FY 2000; and CTBA analysis of P.A. 102-0017; Healthcare appropriations inflation-adjusted using Midwest Medical Care CPI; all other appropriations adjusted using ECI-C from the BLS and population growth from the Census Bureau[17]

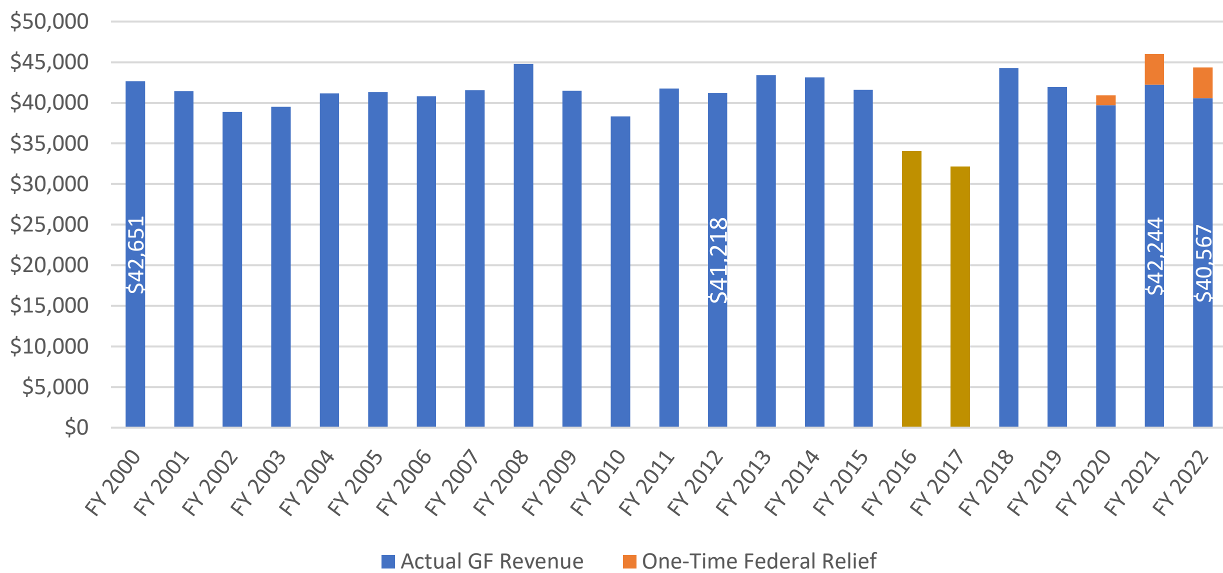
So how is it possible that Illinois continues to run a deficit in its General Fund given that it is a low spending state to begin with, and it has been cutting its real, long-term, spending on core services for decades? Again, the data make the answer clear. The reason Illinois keeps struggling to maintain General Fund spending on core services over time is simple: the state's existing mix of taxes and their respective structures are so flawed, they simply do not work in a modern economy, and instead have created a "structural deficit."[18]

A "**structural deficit**" exists when during a normal, non-pandemic economy, annual revenue growth is not sufficient to cover the cost of providing the exact same level of public services from one fiscal year into the next, adjusting solely for changes in inflation and population. So, even when no public service programs are added or increased, the deficit in the state's General Fund grows annually.

Figure 3 highlights how the state's flawed tax policy has driven the structural deficit in the Illinois General Fund. It shows that, after adjusting for inflation, and eliminating the one-time federal pandemic aid, General Fund revenue in FY 2022 is projected to be over $2 billion less in real terms than it was two decades ago in FY 2000.

That is a particularly eye-opening outcome for one simple reason: the state's income tax rates for both individuals and corporations are greater now than they were in FY 2000. Currently, the individual income tax rate is 4.95 percent, as compared to the three percent rate that pertained in FY 2000, while the corporate income tax rate is seven percent, as compared to the 4.8 percent rate that pertained in FY 2000.[19] Yet despite those rate increases, total General Fund revenue has not grown in real terms for over 20 years.

FIGURE 3
ACTUAL GENERAL FUND REVENUE, FY 2000 – FY 2022 ($ MILLIONS)
INFLATION-ADJUSTED USING 2021 DOLLARS



Source: CTBA Analysis using historical revenue data from COGFA and FY 2022 estimate from GOMB. The revenue shortfalls in FY 2016 and 2017 occurred due the phase out of the 2011 temporary income tax rate increases.

Decision makers then worsened the structural deficit when, on a bi-partisan basis, they enacted the "Pension Ramp" in 1995. The Pension Ramp created an unaffordably backloaded schedule for repaying the significant amount of debt—technically called "unfunded liability"—which the state had incurred to its five public employee pension systems.[20] Illinois incurred this debt—which is currently projected to be over $143 billion[21]—because for generations elected officials in both parties approved the highly irresponsible fiscal practice of underfunding the actuarially required contributions the state owed to its public pension systems, as a way to maintain some of the spending on current services that revenue growth was not covering because of the structural deficit.

Effectively, this meant the state was borrowing to spend, by intentionally underfunding pension contributions to pay for services. And rather than represent a departure from the irresponsible fiscal practices that necessitated its creation, the Pension Ramp—by design—made things worse. For starters, over the first 15 years the Pension Ramp was in place, it required payments that were so low it actually continued to increase the unfunded liability Illinois owed to its five public pension systems by tens of billions of dollars.[22]

Thereafter, the annual increases in debt service payments under the Pension Ramp are scheduled to grow at such unaffordable rates, they annually exceed both inflation and what the state's flawed tax policy can accommodate. Until the repayment of Illinois' pension debt is re-amortized into an affordable and responsible schedule, the Pension Ramp will continue to exacerbate the structural deficit. *For more information on how to create a responsible approach to funding the pensions, see CTBA's report "Update: Addressing Illinois' Pension Debt Crisis with Re-amortization".*

And in a few short years the fiscal condition of the General Fund will get much worse. That is because the over $17 billion in federal relief previously detailed in **Figure 1** constitutes one-time revenue that will not be available to support General Fund—or other—state expenditures after FY 2024. This has two clear consequences. First, it will create a fairly substantial fiscal cliff in FY 2025, when no more federal relief funding is available. Second, it artificially inflates the amount of General Fund revenue the state actually has in FYs 2020 through 2024, thereby distorting long-term revenue comparisons and making the accumulated deficit in the state's General Fund appear to be less than it actually is.

The only effective way to eliminate that distortion and provide an accurate computation of the state's true General Fund deficit at any given time is to isolate the dollar value of the impact all the one-time federal pandemic relief aid is having on the General Fund between now and FY 2025, when that aid will no longer be available.

So, to differentiate between ongoing revenue the state can rely on to fund services over-time, and the one-time federal relief aid that will not be available after FY 2024, this Report will use the following two defined terms:

(i) First, the term "**Total GF Revenue**" will mean all revenue from any source that feeds the General Fund in a given fiscal year, including any one-time federal pandemic relief aid.

(ii) Second, the term "**Actual GF Revenue**" will mean the sum of: (a) all state own-source revenues that feed the General Fund in a given fiscal year; plus (b) all "Historic Recurring Federal Transfers" for such fiscal year; minus (c) all one-time federal pandemic relief aid used to support General Fund spending in a given fiscal year. The term "**Historic Recurring Federal Transfers"** includes solely those ongoing federal transfers the state typically receives in its General Fund in a given fiscal year, exclusive of the one-time relief funding Illinois is getting to address the pandemic.

2. The FY 2022 Accumulated General Fund Deficit

A state's General Fund is its primary budget—the one which both covers most core public services and reveals actual legislative and gubernatorial priorities. Illinois' General Fund budget consists of two main elements: "Hard Costs" and "Current Services."

"**Hard Costs**" are mandatory spending obligations over which decision makers have no discretion. Hard Costs are required to be paid either by existing laws, such as debt service payments owed to bondholders, or contractual obligations, like paying health insurance benefits for state workers. In the FY 2022 enacted General Fund budget, $15.8 billion, or 36 percent, of the $44.27 billion in total, net spending is for Hard Costs.[23]

"**Current Services**" cover spending on public services over which elected officials generally have at least some discretion. Currently, 95 cents out of every $1 of General Fund spending on Current Services goes to the core areas of Education, Healthcare, Human Services, and Public Safety. After accounting for nondiscretionary Hard Costs, the Enacted FY 2022 General Fund Budget contains a net appropriation of $28.51 billion for spending on Current Services.

The "**accumulated deficit**" that is remaining in the state's General Fund at the end of a given fiscal year is that amount which equals the sum of the unpaid bills for current General Fund services which were rendered in said fiscal year that still remain outstanding at the end thereof. The actual revenue short fall that impacts the General Fund in a fiscal year is the sum of: (i) the accumulated deficit carry-forward from the prior fiscal year; plus (ii) the amount of any one-time revenue that was used to support delivery of current General Fund services in the prior fiscal year, for which there is no replacement in the immediately succeeding fiscal year.

The amount of the accumulated deficit that remains outstanding at the end of a fiscal year matters, because it becomes a charge against the Total GF Revenue that is available to fund Current Services in the immediately succeeding fiscal year. It has to be emphasized that the accumulated deficit only impacts spending on Current Services, since Hard Costs must be paid by law.

As things stand now, at the end of FY 2022, CTBA projects that the accumulated deficit in the Illinois General Fund will be $6.3 billion.[24] The walk-down showing how this accumulated deficit is calculated is shown in **Figure 4**.

FIGURE 4

PROJECTED ACCUMULATED DEFICIT AT THE END OF FY 2022 ($ MILLIONS)

Item	Amount	Remaining Revenue
1. Total GF Revenue	$44,367	
2. Subtract the accumulated deficit left over from FY 2021	($6,355)	$38,012
3. Subtract the revenue needed to cover spending on Hard Costs in FY 2022	($15,758)	$22,254
4. Subtract the revenue needed to cover spending on Current Services in FY 2022	($28,514)	($6,260)
5. Projected accumulated General Fund deficit outstanding at the end of FY 2022 in dollars	**($6,260)**	
6. Projected accumulated General Fund deficit outstanding the end of FY 2022 as a percentage of net Current Service Appropriations	**(22%)**	

Source: CTBA analysis of Governor's Office of Management and Budget, FY 2021 "Operating Budget Details (xls)"; P.A. 102-0017

Note, however, that the computation in **Figure 4** was done using the Total GF Revenue available in FY 2022. Which means one-time federal pandemic relief aid is supporting some of the current spending in FY 2022. Specifically, the $44.37 billion in projected Total GF Revenue for FY 2022 includes one-time federal reimbursements of $2 billion received under ARPA, plus $1.8 billion in ARPA operating appropriations.[25]

As shown in **Figure 5**, after removing that one-time federal aid, Actual GF Revenue for FY 2022 will be just $40.568 billion, which is fully $3.8 billion, or almost nine percent less than Total GF Revenue for the year.

FIGURE 5

COMPARISON OF TOTAL AND ACTUAL GF REVENUE: FY 2022 ENACTED ($ MILLIONS)

Revenue Sources	FY 2022 Total GF Revenue (with Federal Relief Aid)	FY 2022 Actual GF Revenue (w/o Federal Relief Aid)	Difference
1. State Own Source Revenues	**$36,468**	**$36,468**	**$0**
2. Other Transfers In (state-based and federally funded)	$3,697	$1,697	($2,000)
3. Other Federal Sources	$4,203	$2,403	($1,800)
3. Total Revenue	**$44,368**	**$40,568**	**($3,800)**

Source: CTBA analysis of Sources: "Revised FY 2022 Economic Forecast and Revenue Estimate and Updated FY 2021 Revenue Update," COGFA, May 2021; and "FY22 Enacted Budget General Funds Walkdown," GOMB, June 2021; additional federal relief derived from FY 2021 $1.774 billion and FY 2022 $1.8 billion in increased federal receipts

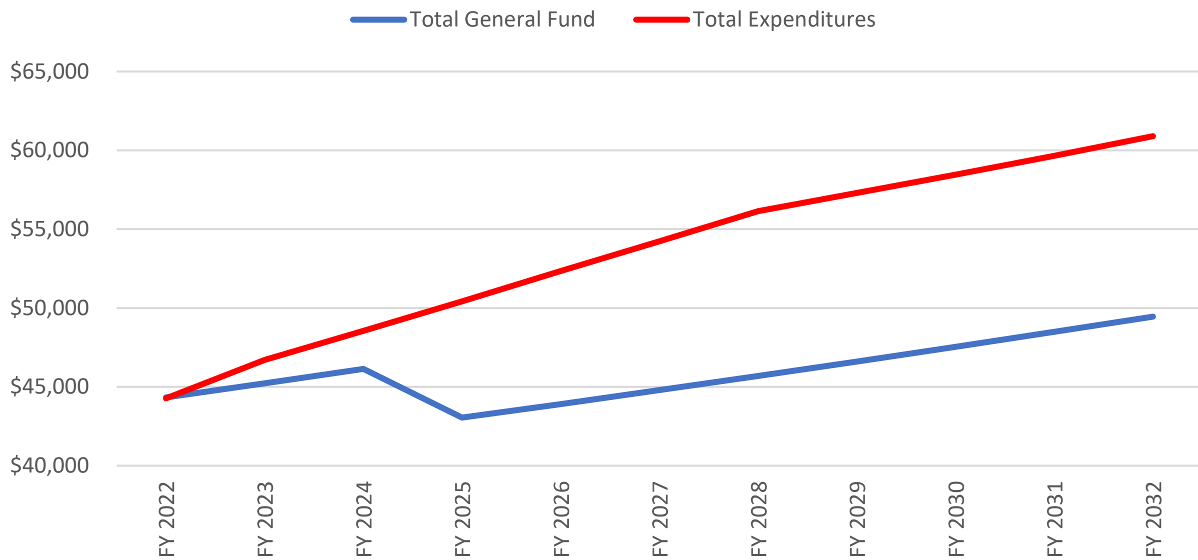
It also means that without the aforesaid $3.8 billion in one-time federal pandemic relief being utilized to support Current Service expenditures in FY 2022, the projected accumulated deficit in FY 2022 would increase from $6.3 billion to $10.1 billion.

3. The Impending FY 2025 Fiscal Cliff

Two factors will combine to create a substantial fiscal cliff for Illinois in FY 2025. The first has been highlighted in detail previously in this Report: Illinois will no longer have federal pandemic relief aid to support its General Fund spending beginning in FY 2025. That means at a minimum, the state would have to find $3.8 billion in new revenue to support maintaining the same level of spending on public services that are scheduled for the current fiscal year—FY 2022.

The revenue shortfall, however, will be more significant than that because of the structural deficit in the state's General Fund. Recall that when a structural deficit exists, annual revenue growth is not sufficient to cover the cost of providing the same level of public services from one fiscal year into the next, adjusting solely for changes in inflation and population, and assuming a normal economy. **Figure 6** is a graphic depiction of the structural deficit in the Illinois General Fund.

FIGURE 6
THE STRUCTURAL DEFICIT IN ILLINOIS' GENERAL FUND



Source: CTBA analysis using historical revenue data from COGFA and FY 2022 estimate from GOMB

Note that, even if the General Fund had a fully balanced budget in FY 2022, after accounting for the loss of one-time federal pandemic relief, by FY 2025 the state is projected to have only $43.051 billion in Total GF Revenue, to support $50.426 billion in projected expenditures—for an initial revenue shortfall of $7.375 billion.

However, the actual shortfall will be significantly greater, given that the state will not end FY 2022 with a balanced budget in its General Fund, as assumed in the structural deficit model. Instead, it is projected to have an accumulated deficit of $6.3 billion at the end of FY 2022. Which means the fiscal cliff facing the state's General Fund in FY 2025 could potentially reach $13.675 billion, or roughly 47 percent of all projected FY 2022 spending on Current Services. Obviously, an operating deficit of almost 50 percent is simply not sustainable.

So, if Illinois' decision makers want to ensure the state will have the fiscal capacity to fund the four core services of Education, Healthcare, Human Services, and Public Safety into the future, it is incumbent upon them to eliminate the structural deficit by both creating a responsible amortization of the state's pension debt, and reforming the state's tax policy so that it works in the modern economy.

For more information, contact the Center for Tax and Budget Accountability:
Ralph Martire, Executive Director, (312) 332-1481 or rmartire@ctbaonline.org
Allison Flanagan, Associate Director, Budget & Policy (312) 332-1348 or aflanagan@ctbaonline.org
Drazzel Feliu, Research Director, (312) 332-2151 or dfeliu@ctbaonline.org

Endnotes

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[16] CTBA, "Analysis of Illinois' FY 2022 Enacted General Fund Budget," July 2021. https://www.ctbaonline.org/reports/analysis-illinois-fy-2022-enacted-general-fund-budget
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