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

The Illinois State Budget and Tax Primer

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THE ILLINOIS STATE BUDGET AND TAX PRIMER

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FOR MORE INFORMATION:

Ralph M. Martire
Executive Director
(312) 332-1049
rmartire@ctbaonline.org

Robert Otter
Education and Fiscal Policy Analyst
(312) 332-2151
rotter@ctbaonline.org

Amanda Kass
Policy Research Specialist,
Pensions and Local Government
(312) 332-1103
akass@ctbaonline.org

Jennifer R. Lozano
Research Associate
(312) 332-1348
jlozano@ctbaonline.org

Center for Tax and Budget Accountability
70 E. Lake Street, Suite 1700
Chicago, Illinois60601
Fax: (312) 578-9258
www.ctbaonline.org

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1. Why Care About the Illinois State General Fund Budget?

Why care about something as dry and arcane as the State of Illinois's General Fund Budget? After all, the document itself is typically hundreds of pages long, written in "fiscal-speak" and involves numbers that run into the billions. Worse yet, final implementation of the budget is incorporated into many separate pieces of legislation, and spread across numerous state agencies, making it difficult for even experts to track to specific programs.The answer as it turns out is both simple and compelling: more than anything else, the General Fund Budget is the state's most comprehensive statement of public policy priorities. It defines what programs and services will be funded with the taxes that you pay and at what levels. This in turn determines both the level and quality of services provided, as well as which needs will be met and which will not.

By making appropriate investments in public goods and services, the state can develop needed infrastructure, promote an expanding economy, care for vulnerable members of society, provide a quality public education for children, make available training and educational opportunities for adults and otherwise contribute to safe, clean and vibrant communities. Many of the services state government delivers generally benefit everyone. These include education, public safety, economic development, parks and libraries. Others focus direct benefits on smaller segments of the population while providing indirect benefits statewide by reducing crime, helping individuals stay employed and improving the overall quality of life. These include job training, childcare assistance, affordable housing, healthcare and special services for senior citizens, low-income families and those with physical or mental disabilities. The catch is that good quality public services are possible and sustainable only when the state raises adequate tax revenues to pay for them.

The need for taxes to pay for services is a significant catch indeed. After all, no one really likes paying taxes, and for that reason most elected officials disdain dealing with the subject. Paradoxically, taxes pay for the public services that residents demand and expect. A recent poll by the Paul Simon Public Policy Institute at Southern Illinois University confirms the clear disconnect between the public's expectation that core services be provided and its antipathy towards the taxes needed to fund them. When queried about how the state should resolve its current General Fund deficit, the majority polled supported spending cuts.[1] However, in the very same poll, the majority of respondents also indicated they would not support cuts to education, healthcare, human services, or public safety, which collectively comprise over 90% of the public service expenditures from the state's General Fund.[2]

This inability of the voting public to connect the taxes they pay to the services they demand and consume is one key reason why policy makers have failed to implement the long-term, structural reforms needed to get the state's fiscal house in order. Yet, this failure to construct a sound and fair fiscal system with the sustainable capacity to fund core services demanded by the public is both short-sighted, and has led to some irresponsible fiscal practices—like borrowing against the pensions to pay for current services—that further diminish the state's fiscal capacity to sustain public services over time, while simultaneously pushing a material portion of the obligation to pay for current services down to future generations, making our children pay for the services we consume.

2. The Scope of the Current Problem

Today, Illinois is experiencing the very real consequences of its flawed to fiscal policy. Of particular concern are the ongoing deficits that have plagued the state's General Fund budget for years. These deficits have grown and carried forward over time. For example, the current Fiscal Year—FY2013—will close with a deficit of at least $8.1billion.[3] That is a significant problem indeed, since it represents approximately 34% of the $23.487 billion General Fund Budget for services appropriated for FY2013. This should concern most voters and taxpayers since over $9 out of every $10 of the General Fund is spent on the four core public services of education, healthcare, human services and public safety most people expect, demand and, as indicated previously, least want to see cut.

Running annual budget deficits imperils the state's ability to provide these core public servicesfor one simple reason, unlike the federal government, Illinois is not supposed to deficit spend, at least from a constitutional standpoint.[4] This in turn means that when confronted with a deficit, state decision-makers essentially have three options: cut spending on the core four services that collectively account for over 90% of all service spending; raise tax revenue to continue paying for them; or borrow money, deferring the obligation to pay for current services into the future.

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Over the years, Illinois has increasingly relied on the third option—debt—to cover the cost of funding current services. This is the equivalent of using a credit card to pay for groceries and other essentials and then rolling over that debt to next month and repeating the process. Obviously, a persistent policy of borrowing money to provide current services is not just irresponsible—it is also unsustainable. Whatever is borrowed must be repaid—with interest. Moreover, the debt proceeds used to cover service delivery in a current fiscal year are one-time funds that are not available in following fiscal years. Illinois has so over-relied on debt to fund services that bond rating agencies have recently been downgrading the credit worthiness of Illinois as an issuer of debt, making it more expensive for the state to borrow.

There are times when it makes sense to incur debt to maintain important services. For instance, during recessionary periods, demand for core public services generally increases while revenues decline. This is diametrically opposed to what typically happens in the private sector, when increased demand for the products or services sold by a business are accompanied by increased revenue as that business sells more. Hence, the public sector frequently faces a dilemma that the private sector does. Moreover, in the private sector, businesses, which have the obligation to remain profitable, respond to declining revenues and demand by cutting back on production and workers. During recessions and periods of declining revenues, the public sector cannot choose to stop educating children, turn loose prisoners, or stop patrolling streets and putting out fires. In fact, demand for basic services increases during recessions. The choices outside of service cuts are either to borrow money or raise taxes – the latter being especially problematic given taxpayers are coping with their own financial difficulties. Even when it makes sense to cut some services, the cuts need to be made judiciously. This is because spending cuts may create adverse unintended consequences. This is especially the case if the service cuts are not made up for by other units of government. In that situation, reduced public sector spending usually reinforces economic losses across the state and makes the local effects of the recession even worse. Therefore, incurring limited debt to cover operational expenditures on basics like education, health, human services and public safety could make some sense during poor economic times. That said, this option should be used sparingly, in limited amounts and during very difficult economic situations, because it is simply not sustainable.

The debt Illinois state government has historically incurred to finance current service delivery has come primarily in three forms. First, the state borrows money directly from financial institutions, and then uses the loan proceeds to cover the cost of delivering current services or payment of past-due obligations. This practice not only creates an unsustainable way to fund services, but also misleads the public into believing they can have a greater level of services than what recurring tax revenue can support.

Second, for decades Illinois has borrowed against the five public employee pension systems[5] it is obligated to fund, by diverting a portion of the state's required pension contributions to instead fund current services. In effect, then, for more than 30 years, Illinois used its pension systems much like a credit card, creating a significant unfunded pension liability, primarily to avoid either raising the tax revenue needed to maintain public service levels from one year to the next, or cutting spending on core services too severely.[6]

Third, Illinois state government has delayed payments owed to many businesses that performed services for the state (primarily in the areas of healthcare and human services) from the fiscal year in which they were due to the next fiscal year.This practice has so greatly increased in recent years that Illinois now ranks as the state with the greatest rate of late payments to human service providers in the nation.[7] By delaying payments owed to providers, businesses became involuntary lenders to Illinois government for the amount equal to the dollar value of the services they delivered. This makes it difficult for these businesses to remain solvent as they are denied the cash to meet payroll, cover rent and utilities and pay other operating costs.

3. Key Terms

This Primer is intended to provide a deeper understanding of the services and programs provided by the state, the inter-relationship of tax policy and spending, the state fiscal system, and the deep-seated challenges that force difficult choices in resolving the state's fiscal shortcomings.However, before delving into the budget itself, it will be helpful to define a few key terms that are part of the state's budget process.

"**Appropriation**" – An appropriation is simply the dollar amount of spending targeted to a specific program or service in a given fiscal year. The General Assembly makes annual appropriations subject to the Governor's approval, veto or line-item reduction. The General Assembly may choose to override any of the preceding actions the Governor takes.

"**Balanced Budget Requirement**" – Article VIII Section 2 of the Illinois Constitution requires that the state produce a balanced budget each year. The specific constitutional language provides, "Appropriations for a fiscal year shall not exceed funds estimated by the General Assembly to be available during that year."

- This means the revenue forecast for a fiscal year must at least equal all budget appropriations for that year. Under state law, debt proceeds can be counted as 'revenue' for purposes of determining whether there is a balanced budget in a given fiscal year.
- Actually creating a balanced budget has eluded decision makers for decades. Consider, for instance the accumulated deficit in the General Fund for the most recently completed fiscal year, FY2012, as shown in Figure 1.

FIGURE 1
FY2012 Accumulated Deficit
($ Billions)

Category		Governor's Proposed Budget
(i)	Projected FY2012 Revenue	$33.17
(ii)	FY2012 Hard Costs	$9.09
(iii)	Deficit Carry Forward from FY 2011	$8.600
(iv)	Net FY2012 General Fund Revenue Available for Services	$15.48
(v)	General Fund Service Appropriations in FY2012 (Net of "Unspent Appropriations")	$24.491
(vi)	Accumulated FY2012 General Fund Deficit	(-$9.01)
(vii)	Deficit as a percentage of General Fund Service Appropriations	-36.8%

Source: COGFA FY 2013 Economic Forecast and Revenue Estimateand FY 2012 Revenue Update.

"**Deficit**" – There are two basic types of deficits. The first is an "Operating Deficit." An operating deficit simply means that in a given fiscal year, government has committed to spend more in appropriations than it has in revenue to support that spending. Determining whether there is an operating deficit can be complex. For instance, in addition to revenue generated from taxes and fees, many states—including Illinois—allow debt proceeds obtained from borrowings to count as "revenue" to support current spending. Obviously, if a state is borrowing to cover current spending, it does not have enough recurring revenue from taxes and fees. In reality, this is deficit spending, although it is not counted as deficit spending for budgeting purposes. Moreover, Illinois is entitled—by law— to defer certain payments from one fiscal year into the next (primarily for Medicaid but there are other smaller allowances) that may make it appear as if the budget is balanced when in fact it is not.[8]

The second type of deficit is a "structural deficit." This simply means that, after adjusting for inflation and population growth, and assuming a normal economy, the annual rate of revenue growth from the state's mix of taxes and fees is insufficient to maintain service levels from one fiscal year into the next—even if no new services are added and no existing services are expanded.

"**Revenue Earmark**" – A revenue earmark is the designation of revenue from a specific source to spending on a specific service. An example of earmarking in Illinois involves the net revenue the state collects from the Lottery (after paying winners and administrative/third party vendor costs) which is primarily earmarked to spending on K-12 education.

"**Fiscal Year**" or "**FY**" – Illinois creates its annual budget on a fiscal, rather than calendar year basis, with each fiscal year beginning on July 1 of a calendar year and continuing until June 30 of the next calendar year. So the state's current fiscal year-FY2013-began on July 1, 2012, and will continue through June 30, 2013.

4. How Illinois Stacks Up

It is also helpful to know how Illinois compares to other states in key areas, such as size of the economy, tax burden, spending on services, pension debt, etc. Following are some basic comparisons of how Illinois ranks nationally.

With 12,869,257 citizens, Illinois has the fifth largest population of any state.[9] As shown in Figure 2, Illinois also has the fifth largest economy of any state, with a total state Gross Domestic Product (GDP) of $671 billion in 2011.

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Figure 2
Illinois GDP Compared to Other States

Real GDP by State (millions of chained 2005 dollars)		
All industry total		
Area	2011	Rank
Vermont	22,968	50
Iowa	128,597	30
Wisconsin	221,741	21
Indiana	240,933	17
Michigan	337,427	13
Illinois	582,094	5
California	1,735,360	1

Source: Bureau of Economic Analysis

That said, Illinois' unemployment rate of 8.7% is significantly worse than most other states, as shows in Figure 3.

Figure 3
Unemployment Rate and Rank by State

As of December 2012		
State	Unemployment	Rank
NORTH DAKOTA	3.2%	1
IOWA	4.9%	4
WISCONSIN	6.6%	18
INDIANA	8.2%	37
ILLINOIS	8.7%	45
NEVADA	10.2%	50

Source: Bureau of Labor Statistics

Moreover, as Figure 4 shows, Illinois had the third lowest growth in real, inflation-adjusted GDP of all Midwestern states in 2010, the first full year of recovery following the Great Recession.

Figure 4
Real GDP Growth in 2010

Indiana	5.9%
Iowa	5.1%
Michigan	4.9%
Wisconsin	4.0%
Illinois	3.0%
Ohio	2.7%
Missouri	2.1%

Source: Bureau of Economic Analysis

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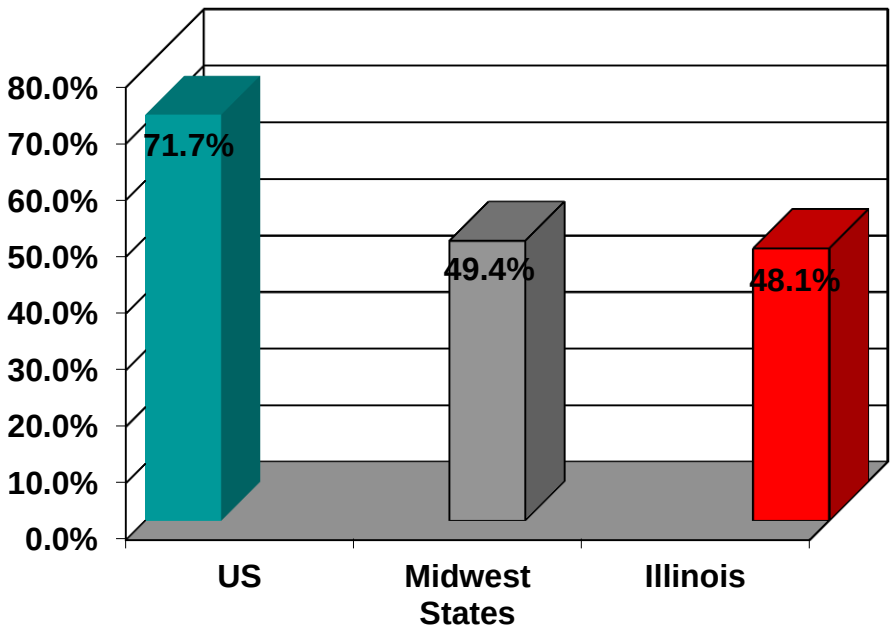
This continues a long-term trend for Illinois. Note that, as Figure 5 shows, Illinois' GDP growth lagged the nation and the Midwest from 1990-2007, the two decades preceding the Great Recession.

Figure 5
GDP Growth 1990-2007



Source: Bureau of Economic Analysis, US Department of Commerce

Illinois is right about in the middle of the nation, with 22% of its children currently living in poverty, as shown in Figure 6.

Figure 6
Percentage of Children under the Age of 18 Living Below the 2011 Federal Poverty Line

Rank	State	Percentage
1	New Hampshire	12%
13	Iowa	17%
16	Wisconsin	18%
26	Illinois	22%
30	Indiana	23%
36	Michigan	25%
50	Mississippi	32%

Source: Annie E. Casey Foundation Kids Count Database.
http://datacenter.kidscount.org/data/acrossstates/Rankings.aspx?by=a&order=a&ind=43&dtm=322&tf=867

Given that Illinois has lagged the nation in economic growth and has had a worse unemployment rate than most other states, growth in personal income in Illinois has also fallen below most other states, as shows in Figure 7.

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Figure 7
State Personal Income Growth and Rank
Third Quarter, 2012

State	Quarter-to-Quarter Change	Rank
North Dakota	1.4%	1
Indiana	0.9%	4
Wisconsin	0.6%	21
Michigan	0.6%	22
New Mexico	0.5%	28
Illinois	0.5%	32
South Dakota	-1.6%	50

Source: US Department of Commerce - Bureau of Economic Analysis

Illinois has historically been a relatively low tax burden state. Indeed, when total state and local tax burden as a percentage of income is compared, in 2010 Illinois was 42nd in tax burden nationally. As Figure 8 shows, this made Illinois the second lowest taxing state in the Midwest in 2010.

Figure 8
Total State and Local Tax Burden asa Percentage of Income in 2010

Midwest States	Percentage	National Rank
Iowa	**17**	**10**
Michigan	**16.9**	**12**
Wisconsin	**16.6**	**16**
Indiana	**16.6**	**17**
Ohio	**16.1**	**26**
Illinois	**14.2**	**42**
Missouri	**13.5**	**47**

Source: Federation of Tax Administrators. Includes all state and local taxes and fees.

For purposes of computing the total state and local tax burdens identified in Figure 8 above, the Federation of Tax Administrators first aggregates all taxes and fees charged by a state as well as any and all local governments or other taxing authorities (think school districts, water reclamation districts and fire districts) within that state, and then divides the aggregate amount by total personal income in the applicable state.This gives a very good picture of total tax burden, because it includes all state and local charges—however categorized—made to support public spending on services, and hence allows for comparisons of 50 states that all have varying tax and fee policies at the state and local levels.

The comparisons in Figure 8 are from 2010 because that is the last year there is complete state and local revenue data available from all 50 states. In January 2011, Illinois did increase, on a temporary basis, its personal income tax rate from three to five percent, thereby increasing the overall tax burden in the state. In Figure 9, the impact of this tax increase is estimated, by allocating it to 2010, adjusting solely for inflation.

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Figure 9
Total State and Local Tax Burden as a Percentage of Income in 2010
(with IL tax Increase)[10]

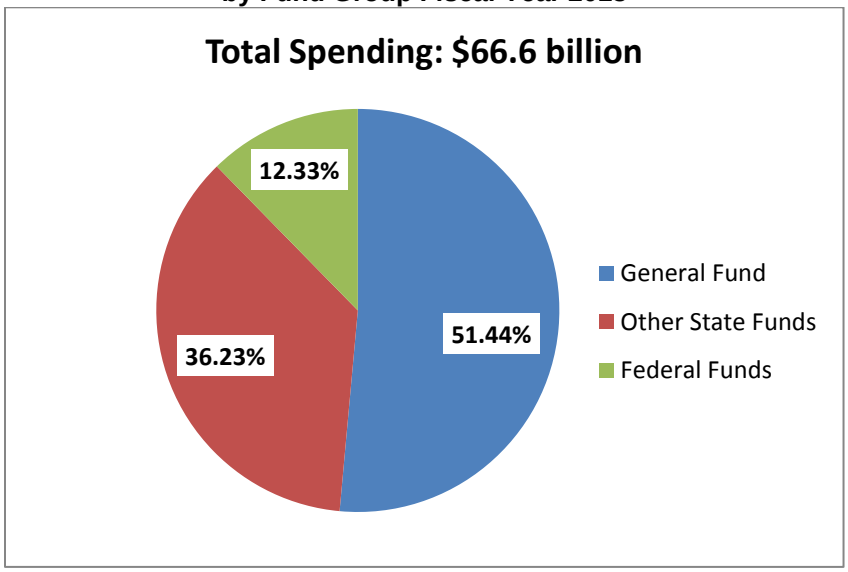
Midwest States	Percentage	National Rank
Iowa	17	10
Michigan	16.9	12
Wisconsin	16.6	16
Indiana	16.6	17
Ohio	16.1	26
Illinois	15.6	32
Missouri	13.5	47

Source: Federation of Tax Administrators. Includes all state and local taxes and fees.

5. The Illinois State Budget at a Glance

This Primer focuses on the Illinois General Fund—not the entire state budget. The reasons for this are fairly simple. First, as shown in Figure 10, the General Fund is the largest of the funds that are reported collectively as the total state budget. In FY2013 for instance, total appropriations for the General Fund are $34.256 billion,while the total state budget is in excess of $66.6 billion.

Figure 10
Total Proposed Operating Appropriations
by Fund Group Fiscal Year 2013



Source: COGFA, *FY2013 Budget Summary* (Springfield, IL: COGFA, August 2012), 25.[11]

Second, not only is the General Fund the largest state fund but it is also where the General Assembly and Governor have the most discretion over services through the appropriation process. Indeed, the vast majority of the balance of the state's overall budget is not discretionary. Instead, as Figure 10 shows, approximately 36.24% of the total state budget is comprised of numerous different dedicated funds, which are limited in how they can be used. Three of the most significantfund categories are the Highway Fund ($7.48 billion in FY2013), Federal Trust Fund ($8.12 billion in FY2013) and the Debt Service Fund ($3.50 billion in FY2013).

In fact, all federal funds that the state receives may be used solely for the purposes identified in the applicable federal statute. Medicaid is an example.

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Following is a short summary of the other major fund categories that together with the General Fund collectively constitute the total state budget:

- **Highway Fund** –receive and distribute special assessments related to transportation, such as the motor fuel tax and fees from vehicle registrations. The Highway Funds support the construction and maintenance of transportation facilities, roads and bridges.
- **Federal Trust Fund** – are established pursuant to grants and contracts between the state and federal governments and are not subject to discretionary appropriation by state decision makers. Instead, these funds must be utilized solely for the specific purposes established by terms of the applicable federal grant. Examples of Federal Trust Funds are Federal DisasterAid and GI Education.
- **Bond Fund** –receive and administer the proceeds of various state bond issues.Bond funds primarily pay for work on capital projects as completed over time (like building construction), but in some instances finance other obligations of the state, such as the authorization for the sale of $7.56 billion in pension obligation bonds made by the state over the FY2010 and FY2011 sequence, the proceeds of which were used to cover the state's pension contributions in those fiscal years.[12]
- **Debt Service Fund** –receive revenue from general taxes and fees and pay the various state debt service obligations due from time to time, including principal and interest, and covering both long and short-term borrowings.
- **Revolving Fund** –pay for the operations of state agencies that render services to other state agencies on a cost reimbursement basis. Appropriation of these funds is dependent upon intra-governmental service requirements and funding from other state agencies. Examples include state printing and facilities management.
- **State Trust Fund** –are established by statute or under statutory authority for a specific purpose. These funds ensure that required payments are made to recipients typically designated by statute or court/administrate order.
- **University Fund** –are revenues such as fees and tuition. These funds are locally held and administered by the state's public universities and are not subject to appropriation by the state.
- **Other Special State Fund** –are various, smaller funds required to be identified and held in the State Treasury as "special funds" under Section 5 of the Finance Act, restricted in use to the specific purpose(s) for which they were created. There are over 700 of these special state funds that support activities as diverse as medical assistance and environmental cleanup. They are, for the most part, designed as segregated accounts, restricted in use and funded from specifically earmarked revenue or fee sources. Examples include the Illinois Affordable Housing Trust Fund, the Youth Drug Abuse Prevention Fund and the Brownfields Redevelopment Fund.

Third, over the past 30 years, the vast majority of the spending on services under the General Fund has gone to just four core service areas: education (35%), human services (21%), healthcare (30%) and public safety (5%). The balance of the General Fund goes to services such as environmental protection, economic development and administrative costs. Since these are the services elected officials have used their discretion to spend your tax dollars to provide, the General Fund represents the most accurate statement of public policy priorities at the state level.

The General Fund itself is comprised of a number of other funds, including the General Revenue Fund, the Common School Fund, the Education Assistance Fund and the General Revenue-Common School Special Account Fund, which are primarily used for accounting purposes to ensure, for instance, that tax revenue earmarked for a specific service provided under the General Fund is in fact used for that purpose.

Most of the proceeds generated from the three largest sources of state tax revenue--the personal income tax, corporate income tax and sales tax--are deposited into the General Fund, and for the most part are used to cover the cost of providing the previously mentioned four core services.

6. The FY2013 General Fund Budget

Figure 11 shows FY2013 General Fund budget appropriations by major service category as enacted (the **FY2013 Enacted Budget**). The FY2013 Enacted Budget closely follows the spending plan initially detailed by the House of Representatives in House Resolution 706 (Enrolled), which passed on March 29, 2012 (the **House Proposal**). Under the House Proposal, a total of $23.458 billion would have been spent on current services in FY2013, while the FY2013 Enacted Budget will spend $23.476 billion, or $18 million more than the House Proposal. Note that when the Governor

first introduced a proposed budget for FY2013 in April of 2012, he proposed spending $703 million more on public services in FY2013 than what ultimately passed in the FY2013 Enacted Budget.

FIGURE 11
FY2013 General Fund Appropriationsby Budgeting for Results Category
($ Millions)

Category		Appropriation Amount
(i)	Total General Fund Appropriations for Capped Items (Gross)	$34,256
(ii)	Total Hard Costs	$9,330
	Debt Service (Pension & Capital Bonds)	$2,168
	Other Statutory Transfers Out (including $151 million for FY2013 Medicaid bill repayment)	$2,052
	Pension Contributions(includes contribution to the Chicago Teachers' Pension and Retirement Fund)	$5,110
(iii)	Repayment of Bills	$800
	Medicaid	$500
	Backlog of Other Unpaid Bills from 2012	$300
(iv)	General Fund Services Appropriations Gross*	$24,126
	PreK-12 Education	$6,918
	Higher Education	$1,980
	Healthcare	$6,743
	Human Services	$4,112
	Public Safety	$2,096
	Government Services	$2,148
	Economic Development	$83
	Quality of Life	$46
(v)	Unspent Appropriations	(-$650)
(vi)	Net General Fund Service Appropriations for FY2013	$23,476

Sources: Governor's Office for Management and Budget; and Commission on Government Forecasting and Accountability, "State of Illinois Budget Summary: Fiscal Year 2013" (Springfield: August 2012).

*These figures are based on the FY2013 utilizingBudgeting for Results criteria as reported by the Governor's Office of Management and Budget. Data from GOMB, however, differs from how the budget has historically been presented. In order to allow for historical comparisons figures for General Fund service sectors used elsewhere in this report are different from those listed above. The appropriations for Human Services and Healthcare shown in Figure 11 differ from the figures reported by GOMB because in that dataset a number of Human Services programs were categorized as "Healthcare" outcomes in the new BFR system. That reporting, however, is inconsistent with prior year budgeting. For the purposes of this report, those programs have been reconciled with their prior year designation as human services to allow for consistent analysis over time.

Also, note that there is a $650 million line item for "Unspent Appropriations" in the FY2013 Enacted Budget. This simply means the General Assembly and Governor have agreed to spend $650 million less on services than what they

appropriated—but they have yet to determine where those cuts will be made. In effect, this means that the specific appropriation amounts identified for services in the FY2013 Enacted Budget are maximum potential appropriations, which collectively will be reduced by $650 million over the course of the Fiscal Year. Since the "Hard Costs" identified in Figure 12 have to be paid by law, all spending cuts associated with the "Unspent Appropriation" line will have to come from the public service categories listed under item (iv) in Figure 11.

7. The Appropriation Process and New Developments in State Budgeting

The appropriation process is the legislative mechanism through which state government expends the revenue it collects. Technically, making appropriations for services is a legislative function. However in Illinois, as in most other states, the initial budget proposal for a fiscal year is usually drafted by the Governor's office, with recommended appropriations by line item, and then submitted to the General Assembly for consideration and ultimately legislative action.

Prior to FY2013, the appropriation process in Illinois was done on a traditional, line item basis. The Governor's Office of Management and the Budget (**GOMB**) would start with the current year's line-item appropriations and suggest changes to each line for the next fiscal year.These changes would be based on a combination of factors such as the Governor's priorities, inflation-based cost growth, and the lobbying efforts of providers. On the plus side, this process created some year-to-year predictability. On the downside, this incremental approach to making spending decisions rarely considered the state's overall fiscal capacity or how delivery of one service was related to another.

All that changed in FY2013 when two recently passed laws went into effect. The first change to the state's historic, one-year-at-a-time, line item approach to budgeting came in the form of the Taxpayer Accountability and Budget Stabilization Act (**TABSA**) that was enacted in January 2011 (P.A. 96-1496). TABSA caps aggregate General Fund spending in FY2013, FY2014 and FY2015. This is the first time in Illinois history that total General Fund spending is subject to, annual maximum limits. Figure 12 shows the amounts of those annual caps, together with the associated projected revenue. Note that in no year over the sequence is it projected that the state will actually have enough General Fund revenue to spend up to the cap.

Figure 12
Annual Amount by Which Revenue Projection Falls Short of Spending Caps, FY2013-FY2015
($ Billions)

	FY2013	FY2014	FY2015
Revenue Projections	$33.719	$35.068	$33.628
Annual Spending Caps under P.A. 96-1496	$37.550	$38.310	$39.070
Shortfall between Revenue and Caps	**(-$3.831)**	**(-$3.242)**	**(-$5.442)**

Sources: FY2013 revenue estimate is from Amendment No. 1 to HR707 adopted March 1, 2012, and Senate Floor Amendment No. 1 to SR 586 adopted March 12, 2012. FY2014 and FY2015 revenue estimates from COGFA, 3-Year Budget Forecast FY2013-FY2014 (Springfield, IL: COGFA, March 2012).

The items of General Fund spending which are subject to the aggregate caps established under TABSA (the **Capped Items**) for each fiscal year in the FY2013-FY2015 sequence are:

(i) The current "operations budget" for all public services covered by the General Fund for the applicable fiscal year—this includes the core services of Education, Healthcare, Human Services and Public Safety, which collectively account for over 90% of all General Fund spending;

(ii) "Statutory Transfers Out" of the General Fund for "hard costs"; that is, spending over which the Legislature and Governor have little to no discretionary authority to change. The most significant transfers out required by statute involve the payments made to local governments under the Local Government Distributive Fund (**LGDF**)[13] and repayments of amounts borrowed from other state special funds, such as the Budget Stabilization Fund, to cover General Fund spending in prior fiscal years;

(iii) Other "hard costs" such as debt service owed to bond holders and financial institutions in the applicable fiscal year; and

(iv) Payment of all amounts owed to the five public pension systems for the applicable fiscal year.[14] This payment to the five pension systems has two distinct components. First is the employer's normal cost contribution needed to fund the future benefits of current workers, which is approximately $1.58 billion of the total $5.099 billion payment in FY2013. Second is the amortized portion of the repayment of the $83 billion in total pension debt that is due in FY2013, which is approximately $3.51 billion. It should be noted that the debt the state owes to the pension systems was built up over decades as lawmakers and governors from both parties chose to divert payments owed for employer pension contributions to instead cover the cost of state services. This practice essentially underfunded the state pension systems to subsidize then current delivery of public services.This benefited taxpayers in the short term by allowing them to consume public services without fully paying for those services. It also benefited elected officials politically by allowing them to avoid both tax increases and the hard choices of picking which services to cut. However, those short-term benefits resulted in significant long-term costs. Indeed, the price of repaying the pension debt incurred to reduce the cost of past services is proving difficult to manage. More information on the state's pension funding issues is contained in Section 11(f) of this Primer.

The second major legislative change to the state's budgeting process that became fully effective in FY2013 came in the form of the Budgeting for Results Act (**BFR**), which was signed into law on July 1, 2010. BFR changes how General Fund appropriations are made and reported.[15] Among other things, BFR requires the Governor to make three-year projections covering both General Fund spending and revenue. BFR also requires GOMB to report proposed appropriations by category of service being rendered, as well as by the traditional method of department and agency. The initial seven service categories established pursuant to BFR by the Governor are:

(i) **Education**—Quality Education and Opportunities for Growth and Learning for all Illinois Students;
(ii) **Healthcare—**Primarily Medicaid, but also Group Health Coverage for State Workers and Public Health Functions;
(iii) **Human Services—**Protection of the Most Vulnerable of our Residents;
(iv) **Public Safety—**Protection of Citizens' Lives and Property;
(v) **Economic Development—**Enhanced Economic Well-Being of Residents;
(vi) **Quality of Life—**Improved Quality of Life of Residents;
(vii) **Government Services—**Improved Efficiency and Stability of State Government.

This new BFR methodology for categorizing public services complicates historical comparisons of service funding trends, because the new service categories do not fully comport with past practices.

From a practical standpoint, the Budgeting for Results Act makes several fundamental changes to the state's appropriation process. The most significant of these changes is the new "results-based" budgeting process. This new process is intended to link data-driven outcome measures with program goals. The aim is to focus state spending the most effective program initiatives funded under each service category.

This is a significant departure from the past, line-item approach to budgeting utilized in Illinois. Under prior practice, the appropriation budgeted to an agency or program in the preceding fiscal year was used as the baseline for incremental funding changes in the current fiscal year. This incremental, line-item approach to budgeting frequently resulted in near automatic continuation of programs from year-to-year. Under BFR, that near automatic funding process ends, and is replaced by setting an aggregate appropriation for the new service categories annually, and then divvying that aggregate appropriation up amongst programs that are best achieving the underlying service objectives, using a data-based analysis.

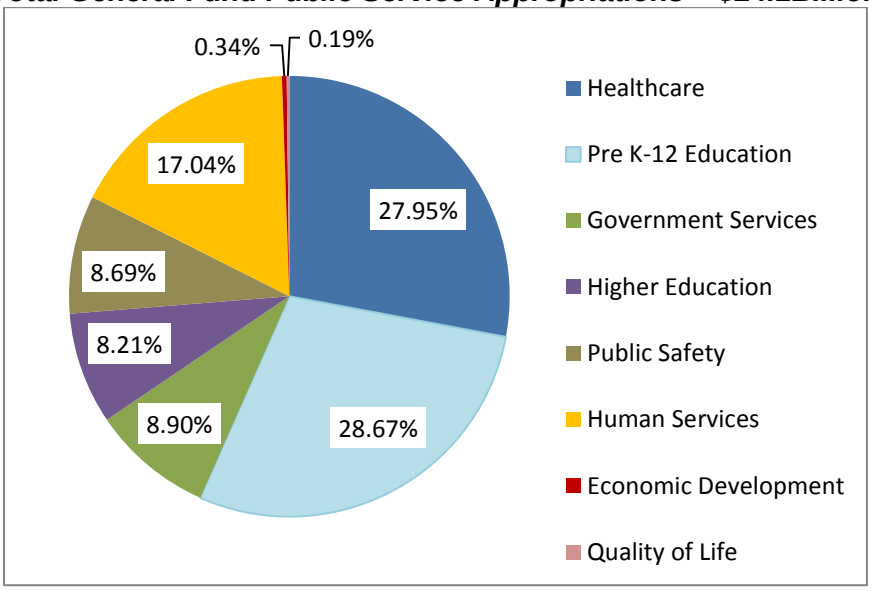
This change in process truly alters how spending decisions are made. Now, instead of starting with specific dollar expenditures targeted to specific programs, decision makers first identify how much they have to spend, and then make the policy decision to allocate portions of that total spending to significant service areas, say $6 billion to education and $4 billion to social services and so on. Once the policy decision is made about how to divvy up spending by major service category, decisions are then made about how much of a service category's funding will be used for specific programs that deliver the outcomes desired within that service category. These program level spending decisions are supposed to be made using data and evidence. Also, by grouping programs along common themes, BFR is expected to help root out redundancies and minimize overlap, leading to better coordination across agencies and more efficient and effective use of state resources.

Better performance metrics are expected to be developed over the course of succeeding budget cycles, and these metricshopefully will inform future appropriations decisions, by measuring program outcomes against the best in the class. That said,it willalso be important that the evaluation metrics address fundamental questions of capacity. For example, a program may not be successful simply because it lacks the resources to accomplish its mandate. Under this circumstance, inadequate results would not be due to programmatic flaws but rather inadequate funding levels. Hence, further funding cuts would be counterproductive.

8. FY2013 Service Appropriations at a Glance

Figure 13 displays General Fund public service appropriations in FY2013 as a percentage of total service appropriations for the year. It does not include hard costs – costs that are not subject to the authority of the General Assembly and Governor—and hence highlights the spending priorities of state decision makers.

Figure 13
FY2013 Appropriations by Budgeting for Resultsas a Percentage of Total General Fund Public Service Appropriations
(Total General Fund Public Service Appropriations = $24.1Billion)



As Figure 13 shows, in the FY2013 proposed budget, 90.6% of General Fund public service appropriations are for education, healthcare, human services, and public safety. Medicaid currently is the biggest single state budget item and is appropriated across several budget categories, including Healthcare and human services.

9. Spending Trends

(a) Impact of Inflation. Frequently, government spending on services is measured solely by annual changes in expenditures expressed in nominal dollars—that is, total dollars expended without adjusting for inflation.Of course, a nominal dollar comparison does not provide an accurate barometer of whether spending on services is actually growing, staying flat or declining. That is because nominal dollar comparisons do not adjust for either inflation or population growth, both of which make it more expensive to provide the same level of services from one fiscal year into the next.

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There are two major inflation metrics published by the Federal Bureau of Labor Statistics (**BLS**) that are used to determine how much the cost of products and services increase over time. The first is the Consumer Price Index or "**CPI**". The CPI is a comprehensive inflation measure that broadly covers the change in price for all goods and services in the economy. The CPI includes changes in the cost of everyday goods and services, like hair care products, toothpaste and bowling. State government, however, does not purchase most of the items covered by CPI. So while the CPI is an excellent metric for evaluating the economy from the point of view of a typical consumer, it is not the best choice for evaluating public sector spending.

The second major inflation metric is the Employment Cost Index – Compensation "**ECI-C**". As the name implies, the ECI-C is narrower than the CPI, and focuses on changes in the cost of total compensation for workers over time. Public services are very labor intensive. More than 80% of public sector expenditures made through the Illinois General Fund cover the compensation paid to the healthcare workers, teachers, police officers, social workers and other civil servants who actually provide the public services consumed in communities across the state. Hence, the ECI-C is the more accurate metric for analyzing the inflationary cost increases that impact public sector expenditures on services.

The way inflation adjustments work over time is easy. Say expenditures on public safety were $100 in year one, and the inflation rate for that year was five percent. In year two, the appropriation for public safety would have to be $105 to purchase the same level of services provided in year one, in what is referred to as "real"—i.e. inflation-adjusted terms. If in year two public safety received an appropriation of $103, then despite the $3 increase in nominal appropriations, in real, inflation-adjusted terms, there is actually a $2 cut in what can be delivered in services.

(b) Spending on Services in the FY2013 General Fund Enacted Budget Compared to FY2000. Figure 14 shows how spending under the General Fund in the FY2013 Enacted Budget compares to FY2000, in both nominal and real, inflation-adjusted terms.

FIGURE 14
Illinois General Fund Spending by Major Public Service Category, FY2013 Enacted Budget Compared to FY2000 Enacted, and FY2000 Adjusted for Inflation and Population Growth ($ Millions)[16]

Category	FY2000 Enacted	FY2013 Enacted	Nominal% Change	FY2000, Enacted Adj for Infl (ECI) & Pop Growth	$ Diff FY2013 – FY2000 Adj (ECI& Pop Growth)	Real% Change
General Fund (excluding Pensions)	$20,064	$23,476	17.3%	$30,288	-$6,812	-22.5%
P-12	$4,844	$6,542	35.1%	$7,312	-$770	-10.5%
Higher Ed	$2,152	$1,980	-8.0%	$3,249	-$1,269	-39.1%
Healthcare (excluding Group Health)	$5,022	$6,852	36.4%	$8,598	-$1,746	-20.3%
Human Services (excluding all Healthcare)	$4,599	$4,749	3.3%	$6,943	-$2,194	-31.6%
Public Safety	$1,350	$1,606	18.9%	$2,038	-$432	-21.2%

Sources: : COGFA Budget Summary FY2000;FY2013 Budget as passed in HR 706, SB2348, SB2413, SB2443, SB 2454, SB2474, SB 2332, SB2378, SB2409, and June 2012 Communications with Legislative staff. FY2000 appropriations adjusted using ECI-C and Midwest CPI-Medical Care from the Bureau of Labor Statistics as of January 2013, and population growth from the Census Bureau as of January 2013.

Figure 15 shows that after adjusting for inflation and population growth using either the CPI or ECI, spending on services under the FY2013 Enacted Budget will be lower in real terms than FY2000 levels.

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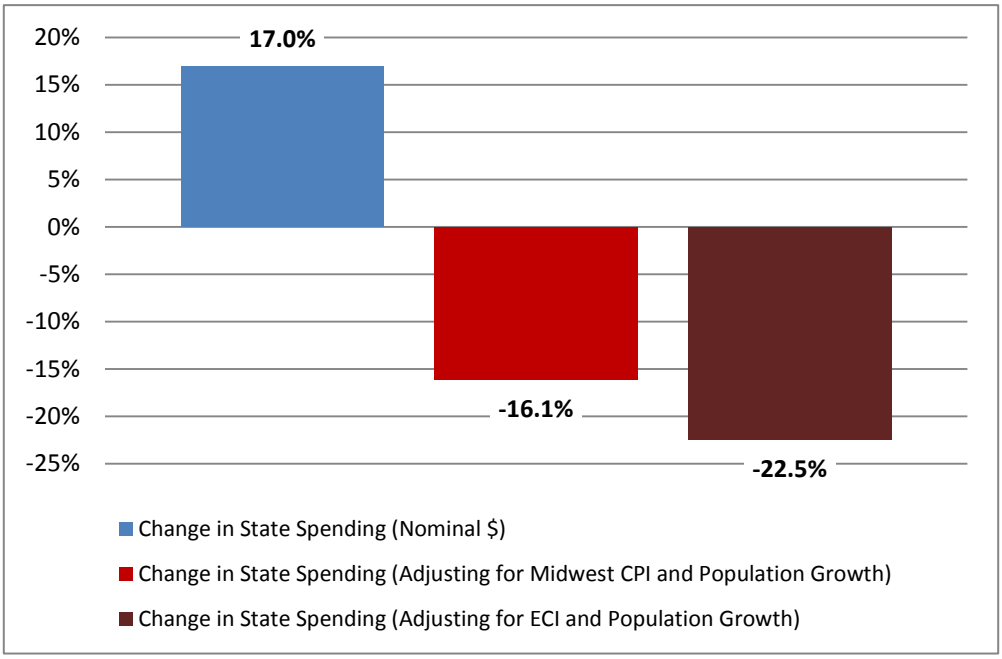
Figure 15
FY2013 Enacted General Fund Services Appropriations (Excluding Group Health and Pensions) Relative to FY2000, in Nominal Dollars and Adjusted for Inflation and Population Growth



Sources:FY2013 Budget as passed in HR706, SB2348, SB2413, SB2443, SB 2454, SB2474, SB 2332, SB2378, SB2409, and June 2012 Communications with Legislative staff; ECI-C and CPI from Bureau of Labor Statistics as of January 2013; and population from Census Bureau as of January 2013.

10. Illinois' FY2013 Operating and Ongoing Structural Deficits

The FY2013 Enacted Budget shows that the state's fiscal health remains in serious doubt. As illustrated in Figure 16, even after accounting for the new revenue from the temporary tax increases that passed in January 2011, and the General Fund spending cuts of approximately $263 million implemented in FY2012,[17] the state will nonetheless have a minimum, accumulated General Fund deficit of about $8.1 billion in FY2013 once the unpaid bills left over from FY2012 are considered. Obviously, Illinois continues to struggle with a material backlog in unpaid bills despite both significant spending cuts and the temporary tax increases that were implemented over the last few fiscal years.

FIGURE 16
FY2013 Accumulated Deficit ($ Billions)

Category		FY 2013 Actual
(i)	Projected FY2013 Revenue	$33.72
(ii)	FY2013 Hard Costs	$9.33
(iii)	Deficit Carry Forward from FY 2012	$9.00
(iv)	Net FY2013 General Fund Revenue Available for Services	$15.39
(v)	General Fund Service Appropriations in Enacted G.F. Budget(Net of "Unspent Appropriations")	$23.48
(vi)	Minimum FY2013 General Fund Deficit	($8.09)
(vii)	Deficit as a Percentage of General Fund Service Appropriations	-34.45%

Sources: FY2013 Budget as passed in HR706, SB2348, SB2413, SB2443, SB2454, SB2474, SB2332, SB2378, SB2409, and June 2012 Communications with Legislative staff; Revenue from Amendment No. 1 to HR707 adopted March 1, 2012, and Senate Floor Amendment No. 1 to SR 586 adopted March 7, 2012; and unpaid bills from April 2012 Quarterly Report from the Comptroller.

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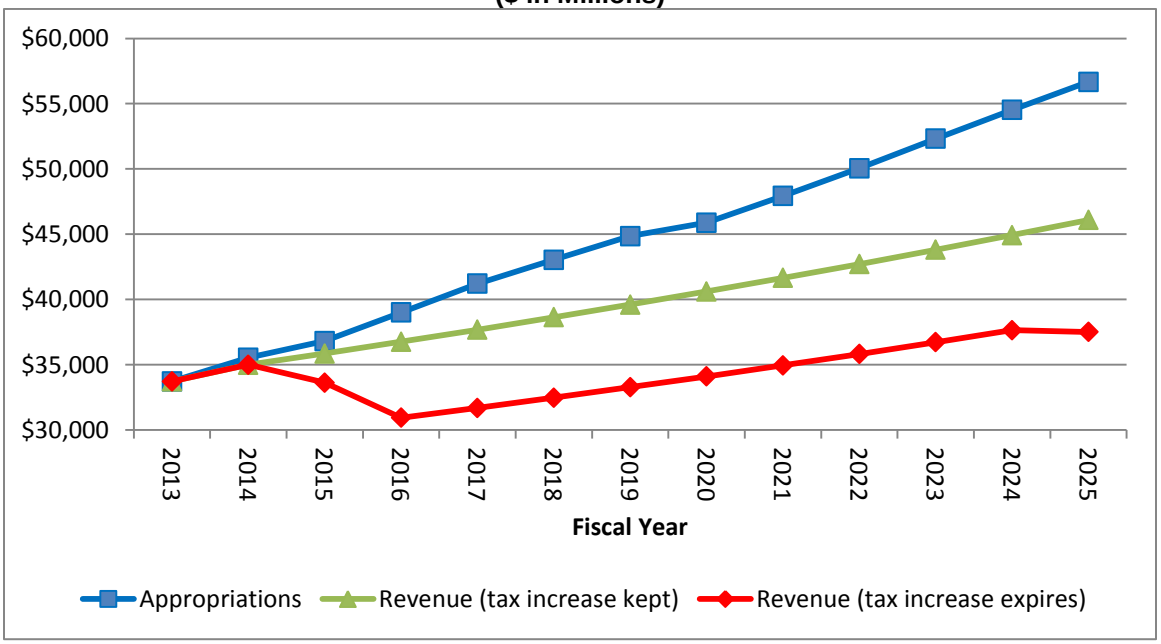
(a) Accumulated Deficit. Figure 16 shows only the minimum, accumulated deficit for FY2013 for two key reasons. First, the FY2013 Enacted Budget assumes that Group Health Insurance costs will be reduced by $260 million from FY2012 levels. This may be difficult to attain, given that the average annual increase in healthcare inflation over the last decade was 4.1%.[18]

Second, Figure 17 assumes that the $1.6 billion in Medicaid service cuts, patient fee increases, and provider reimbursement rate reductions, and $1.1 billion inadditional revenue to pay past due Medicaid bills, are all fully realized. This also may be difficult to attain since Illinois already has some of the lowest Medicaid provider reimbursement rates in the nation, ranking seventh lowest of all 50 states,[19] and must receive federal approval for many of the proposed Medicaid service cuts that the state is counting on for savings. See Section 11(e) of this Primer for a more detailed analysis of Medicaid changes implemented in FY2013.

(b) Illinois' Structural Deficit. A state has a "structural deficit" when the rate of growth for its total revenue stream does not keep pace with the cost of maintaining current levels of public services from one year to the next, adjusting solely for inflation and population growth and assuming a normal economy. Figure 17 is a graphic depiction of the structural deficit in the Illinois General Fund.

FIGURE 17
Illinois State General Fund Structural Deficit
($ in Millions)



The structural deficit depicted in Figure 17: (i) assumes that enacted revenue and appropriations for FY2013 will be fully realized; and (ii) uses the revenue estimates for FY2014 and FY2015 made by the Commission on Government Forecasting and Accountability.[20] Figure 17 also assumes that the state maintains constant spending on services in real terms through FY2025, meaning that no programs are expanded or added, and that revenue will grow at historic annual rates.[21]

The takeaway from Figure 17 is clear—even assuming Illinois can continue making significant, real, inflation-adjusted cuts in spending to all services covered by the General Fund in FY2014 and FY2015, the structural deficit in the General Fund will worsen nonetheless.

(c) Looking Forward. The state's structural deficit as outlined in Figure 17, together with the Governor's three-year spending projection that goes through FY2015, raise a number of concerns about the state's capacity to continue funding core services into the future. Figure 18 highlights how much each of the core public service areas stand to be cut from FY2012 levels in real terms by FY2015.

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FIGURE 18
Projected Real General Fund Spending Cuts to theCore Service Areas under The Governor's Three-Year Projections for the FY2012 – FY2015 Sequence ($ Billions)[22]

Category	FY2012 Enacted	FY2012 Infl& Pop Adj to FY2015	Governor's FY2015 Projected Approp	% Change	$ Diff
PreK-12	$6.75	$7.33	$6.78	-7.5%	-0.55
Higher Education	$2.09	$2.27	$2.16	-4.9%	-0.11
Human Services (Net of all Healthcare)	$5.02	$5.45	$5.06	-7.2%	-0.39
Healthcare Total	$8.34	$9.38	$8.06	-14.1%	-1.32
Medicaid	$6.64	$7.47	$6.64	-11.1%	-0.83
Group Health	$1.44	$1.62	$1.17	-27.7%	-0.45
Other	$1.38	$1.50	$1.25	-16.6%	-0.25
Public Safety	$1.71	$1.85	$1.51	-18.4%	-0.34

Note: Governor's Projected FY2015 is equal to Governor's Proposed FY2013 based on GOMB flat three-year projected budget. Categories based on House Committees.

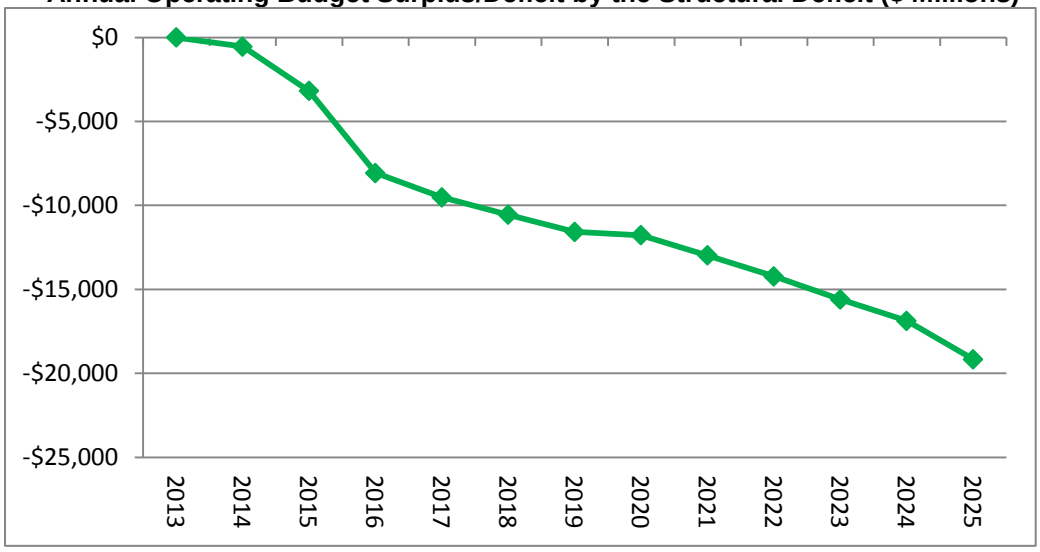
Consider, for instance, the minimum potential impact on human services funding. If average annual inflation (using the ECI-C) and population continue to grow at the same rates as over the last decade (2002-2012), a decade of relatively low growth in inflation, then in real terms FY2015 General Fund spending on Human Services will be at least -7.2% lower than it was just three years previously in FY2012.

In FY2015, Public Safety will fare even worse, facing a -18.4% real cut from FY2012 levels, while real spending on PreK-12 Education would be down by -7.5% from FY2012. Meanwhile, spending on Higher Education stands to be $111 million or -4.9% less in FY2015 than in FY2012. Similarly, based on historic (FY2002 to FY2012) annual growth of 4.1% in the Midwest Medical CPI and Department of Community and Economic Opportunity projected 0.8% annual population growth, real Healthcare spending in FY2015 will be cut by -14.1% from FY2012 levels.

As shown in Figure 19, despite the nominal and real cuts in state spending projected by the Governor through FY2015, and assuming no real increases in spending on any core services, the state will nonetheless have an estimated operating deficit of almost $20 billion by FY2025.

Note that the growth in annual operating deficit depicted in Figure 19 does not take into account the accumulated General Fund deficit of at least $8.09 billion that will exist by the end of FY2013.

FIGURE 19
Annual Operating Budget Surplus/Deficit by the Structural Deficit ($ Millions)



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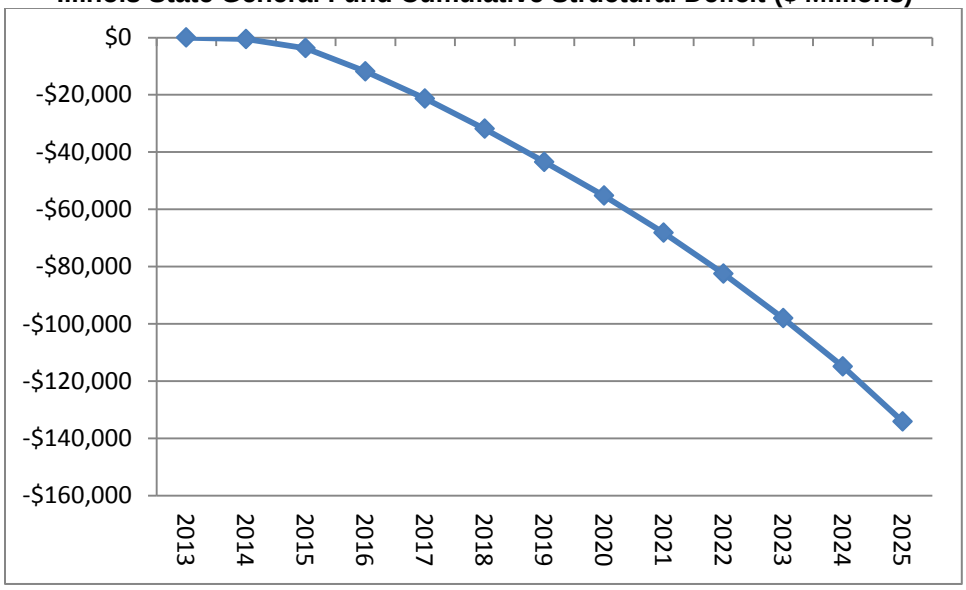
Long term, if decision makers fail to resolve the structural deficit, Figure 20 shows that Illinois could have cumulative unpaid bills of nearly $135 billion by FY2025.

FIGURE 20
Illinois State General Fund Cumulative Structural Deficit ($ Millions)



11. FY2013 Enacted Budget Appropriations by Major Category

(a) Human Services. Human Services – provided primarily through the Department of Aging (**DOA**), Department of Human Services (**DHS**), and Department of Children and Family Services (**DCFS**) – are unique among the primary budget categories (Education, Healthcare, Human Services, and Public Safety). Unlike the other core public services, each of which has a relatively narrow program focus, human services encompass a broad panoply of programs that include everything from aiding adults with developmental disabilities, to assisting homebound seniors, abused and neglected children, and individuals with substance abuse and mental health issues. And while most human services are delivered under the auspices of DOA, DHS and DCFS, many other agencies also administer human services programs. Because of this, it is difficult to analyze human services funding over time with a true "apples-to-apples" comparison. The new categorization of services under the BFR has not helped matters. To try and the most consistent long-term comparisons of human services spending possible, certain BFR spending categories have been reconciled with how they were accounted for prior to BFR.

That said, Figure 21 shows the nominal dollar difference between the FY2013 Enacted General Fund appropriations for the three primary Human Services agencies and the final appropriations for those agencies in the FY2012 budget.

FIGURE 21
Nominal Dollar Comparison of Human Services Appropriations, FY2012 Final vs. FY2013 Enacted ($ Millions)

Category	FY2012 After Veto	FY2013 Enacted	Diff FY2013 Enacted vs.– FY2012 After Veto	% Change
Department of Aging	$737.4	$785.1	$47.7	6.5%
Department of Child and Family Services	$812.5	$707.0	-$105.5	-13.0%
Department of Human Services	$3,460.7	$3,256.5	-$204.3	-5.9%
TOTAL ACROSS AGENCIES	$5,010.7	$4,748.6	-$262.1	-5.2%

Source: COGFA, *FY2013 Budget Summary* (Springfield, IL: August 2012).

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The nominal dollar increase for DOA in FY2013 will help maintain the same service levels provided by that agency in real terms at FY2012 levels. That, however, does little to offset the long-term trend of state government imposing significant, inflation-adjusted cuts to social services relied upon by vulnerable populations. Indeed, real funding for Human Services in Illinois will be substantially less (some $2.2 billion less) under the FY2013 Enacted Budget than a decade ago in FY2002, as shown in Figure 22.

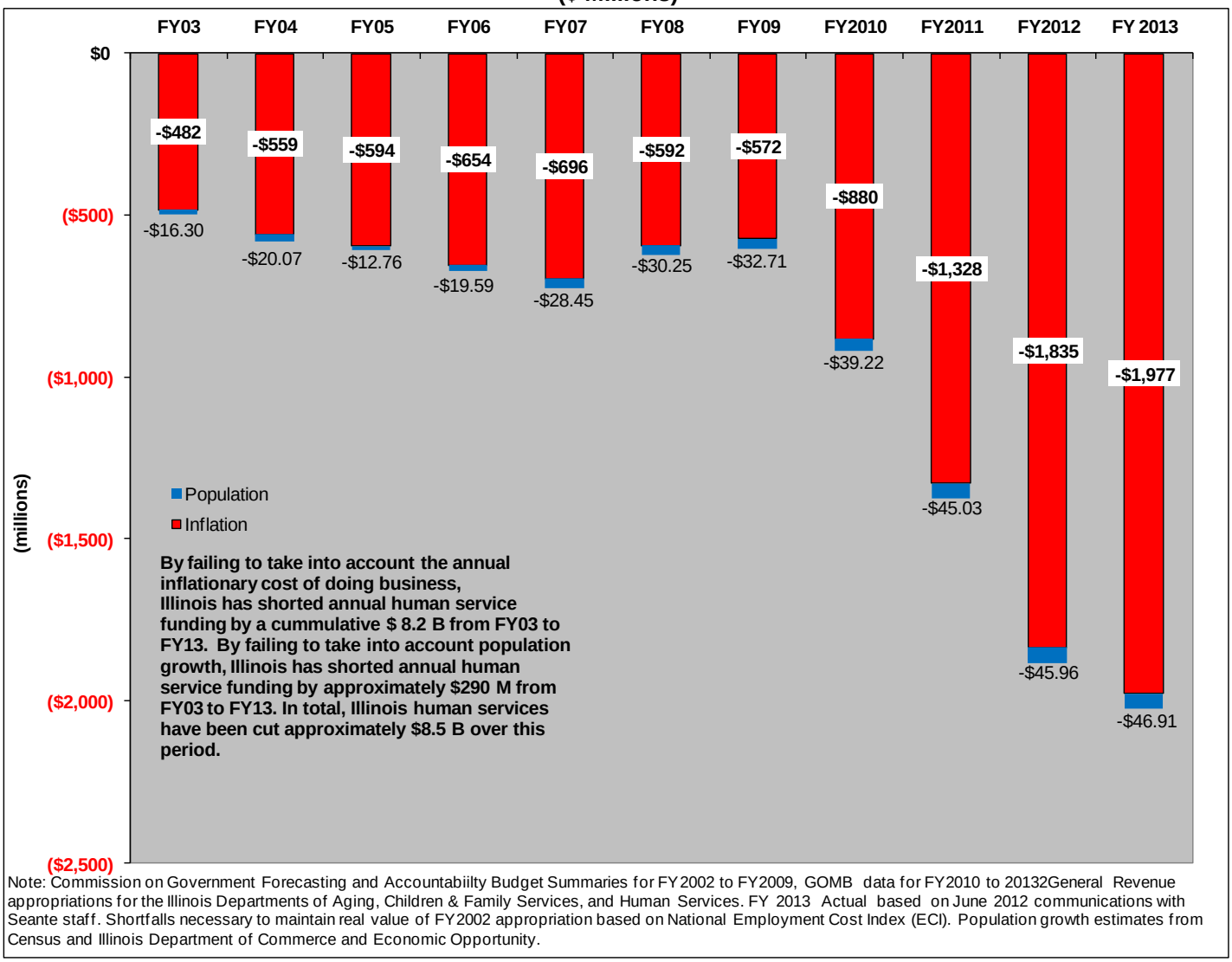
FIGURE 22
Illinois General Fund and Major Service Area Inflation Adjusted Appropriation Comparison FY2002 Enacted vs. FY2013 Enacted ($ Millions)[23]

Category	FY2002 Final	FY2002 Adjusted	FY2013 Enacted	$ Diff FY2013 - FY2002	% Diff FY 2013 - FY2002
General Fund	$23,409.3	$32,559.1	$23,476.4	($9,082.6)	-27.9%
P-12 + Higher Education	$8,894.3	$12,370.7	$8,522.0	($3,848.7)	-31.1%
Healthcare (excluding Group Health)	$5,397.6	$8,329.9	$6,852.2	($1,477.7)	-17.7%
Human Services	**$4,971.2**	**$6,914.2**	**$4,748.6**	($2,165.6)	-31.3%
Public Safety	$1,552.3	$2,159.0	$1,606.0	($553.0)	-25.6%

Sources: COGFA Budget Summary FY2002;FY2013 budget as passed in HR706, SB2348, SB2413, SB2443, SB2454, SB2474, SB2332, SB2378, SB2409 and June 2012 communications with legislative staff. FY2002 appropriations adjusted using ECI-C and Midwest CPI-Medical Care from the Bureau of Labor Statistics as of January 2013, and population growth from the Census Bureau as of January 2013.

Figure 23 highlights the cumulative, real impact of General Fund cuts to Human Services that were implemented over the last decade. Note that despite the nominal year-to-year Human Services funding increases included in the FY2013 Enacted Budget, human service providers will have to make up for, in the aggregate, $8.5 billion in reduced funding from the General Fund since FY2002. Because more than 75% of human services are delivered by private sector providers,[24] this significant loss in state funding has led to a concomitant loss in private sector jobs. Using multipliers developed by Mark Zandi the chief economist at Moodys.com, total Illinois job loss attributable to the $8.5 billion in real Human Service spending cuts over the last decade could have reached around 96,000.[25] Obviously, no economic multiplier can provide an exact accounting of the impact of either spending cuts or tax increases, since there are so many other economic factors—like compensatory behavior and leakage, for instance—that modify the final impact on the economy as a whole. That said, the use of a respected, independent multiplier like Zandi'sat least helps illustrate the fact that fiscal policy decisions do indeed have consequences for the private sector economy, and that reality must be borne in mind when these key policy decisions are made.

FIGURE 23
Cumulative Impact of Cuts in Illinois Human Service Spending Since FY2002 Adjusted for Inflation and Population Growth ($ Millions)



Note: Commission on Government Forecasting and Accountabiilty Budget Summaries for FY2002 to FY2009, GOMB data for FY2010 to 20132General Revenue appropriations for the Illinois Departments of Aging, Children & Family Services, and Human Services. FY 2013 Actual based on June 2012 communications with Seante staff. Shortfalls necessary to maintain real value of FY2002 appropriation based on National Employment Cost Index (ECI). Population growth estimates from Census and Illinois Department of Commerce and Economic Opportunity.

As indicated previously, the Budgeting for Results process requires the Governor's Office of Management and Budget to release a three-year General Fund budget projection listing expenditures by BFR priority area. GOMB's current projections call for Human Services to be flat funded in both FY2014 and FY2015. Because the cost of delivering care increases with inflation and population growth annually, this flat funding will result in a real, inflation-adjusted spending cut to Human Services programs of at least -$390 million over those two years, as shown in Figure 24.

FIGURE 24
Projected Real General Fund Spending Cuts to Human Services under The Governor's Three-Year Projections for the FY2012 – FY2015 Sequence ($ Billions)

Category	FY2012 Enacted	FY2012 Infl& Pop Adj to FY2015	Governor's FY2015 Projected Approp	% Change	$ Diff
Human Services (Net of all Healthcare)	$5.02	$5.45	$5.06	-7.2%	-0.39

Note: Governor's Projected FY2015 is equal to Governor's Proposed FY2013 based on GOMB flat three-year projected budget. Categories based on House Committees.

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(b) FY2013 Education Appropriations. The FY2013 Enacted General Fund Budget appropriation for PreK–12 education is $6.54 billion dollars, which represents a nominal decrease of -$208.6 million or 3.1% compared to the FY2012 appropriation of $6.75 billion, as illustrated in Figure 25. Inflation (using the ECI-C and population) for FY2012 is estimated at nearly three percent (2.76%), which means in the FY2013 Enacted Budget,PreK–12 funding will be cut by just over -$395 million in real terms from FY2012 levels, a year-to-year reduction of almost -6%.

FIGURE 25
FY2013 Enacted Appropriations for P-12 Education Compared to FY2012, Nominal Dollars ($Millions)[26]

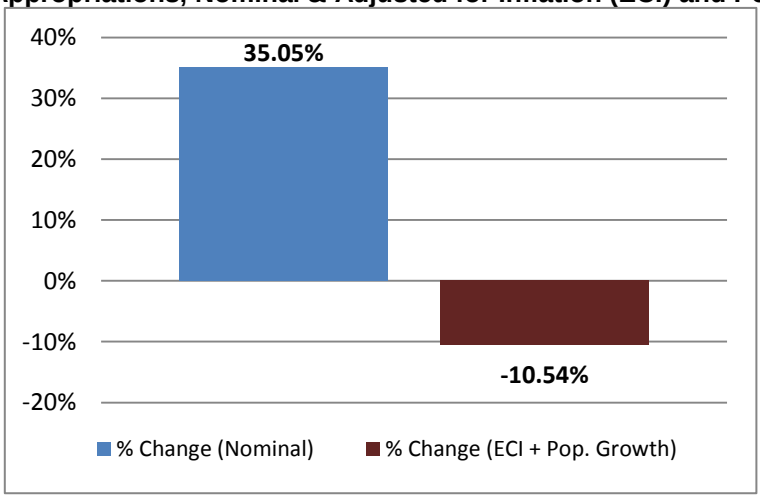
Category	FY2012 Enacted	FY2012 Adjusted	FY2013 Enacted	Nominal % Change FY2012 – FY2013	Nominal $ Change FY2012 – FY2013	Real % Change FY2012 – FY2013	Real $ Change FY2012 – FY2013
PreK-12 Education	$6,750.4	$6,886.5	$6,542.0	-3.1%	-$208.4	-5.0%	-$344.5

Sources: FY 2013 Budget as passed in SB 2413, June 2012 Communications with Legislative staff; Bureau of Labor Statistics, Employment Cost Index as of January 2013; Census Bureau, population growth estimates as of January 2013.

The aggregate appropriation for PreK-12 education in the FY2013 Enacted Budget is $6.54 billion. However, the General State Aid formula-grant portion of the PreK–12 appropriations identified in the FY2013 Enacted Budget—a total of $2.345 billion—will be "prorated" for the year.[27] That means school districts will not receive the full appropriation for General State Aid identified in the FY2013 Enacted Budget, but rather a smaller portion—or "proration"—of that $2.345 billion appropriation. The amount of this proration is currently estimated at around 89%. In any event, the investment in PreK–12 for the FY2012-2013 school year will be less than indicated in the FY2013 Enacted Budget—and school districts statewide will have to compensate for this reduction in state funding from appropriated levels without knowing what the final amount of the reduction will be.

Considered over the long-term, the FY2013 enacted appropriations for PreK–12 continue the trend of cutting the state's funding of public education in real terms. As illustrated in Figure 26, although the enacted appropriation for PreK–12 education is 35% more in nominal dollars in FY2013 than it was in FY2000, once inflation and population changes are accounted for, real PreK–12 education appropriations will be nearly11% less than FY2000 levels.

FIGURE 26
PreK-12 Education Appropriations for FY2013 Compared with FY2000 Appropriations, Nominal & Adjusted for Inflation (ECI) and Population



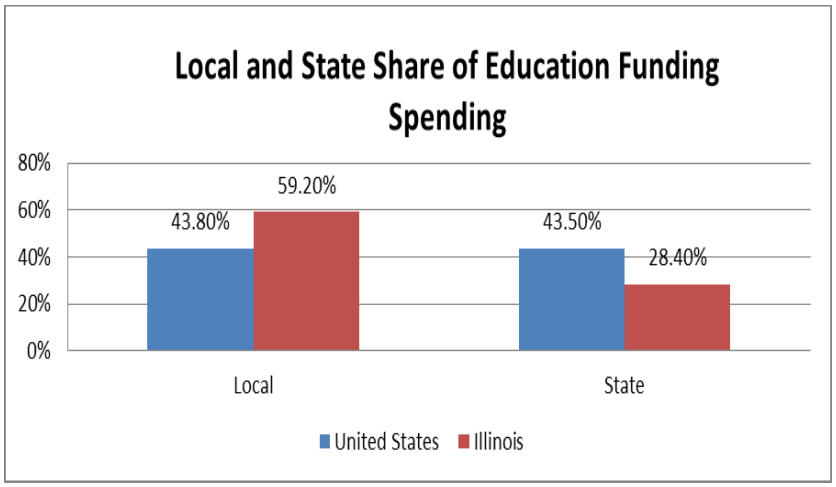
Sources: FY2013 Budget as passed in SB 2413, June 2012 Communications with Legislative staff; Bureau of Labor Statistics: Employment Cost Index as of January 2013; Census Bureau, population growth estimates as of January 2013.

The trend of real cuts to public education funding in Illinois can be expected to continue. As shown previously, the Governor's three-year budget projection calls for flat funding of education in FY2014 and FY2015. Because the cost of delivering education increases each year due to inflation and population growth, this flat funding—if it is attained—will result in real cuts to PreK–12 education.

Given that the data demonstrate that the state's General Fund spending on education in Illinois is inadequate, whether considered under national or by the state's own standards, it can be assumed that future cuts to K-12 funding will have negative consequences for educating children.

Consider national comparisons first. According to the National Center for Education Statistics (NCES), Illinois ranks dead last among the states in the portion of education funding covered by state, rather than local resources. Indeed, as Figure 27 shows, Illinois only covers 28.4% of public education costs, while the national average is 43.5%. Meanwhile, 59% of PreK–12 education costs are covered by local resources in Illinois.

FIGURE 27



Source: National Center on Education Statistics, 2012. "Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2009-2010 (Fiscal Year 2010)."

Figures 28 and 29 show how Illinois stacks up with other large states and the Midwest.

FIGURE 28

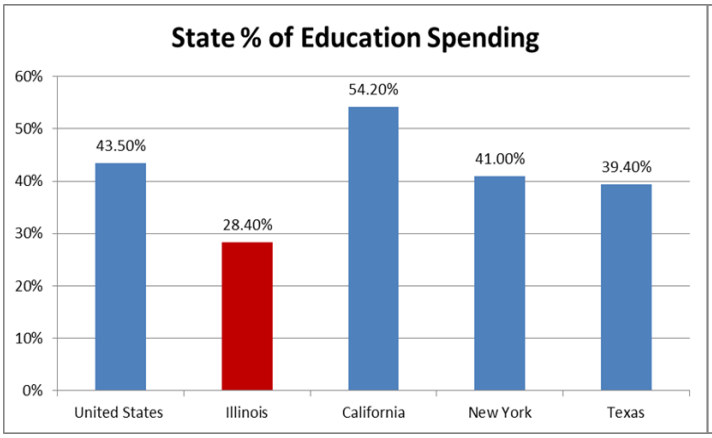
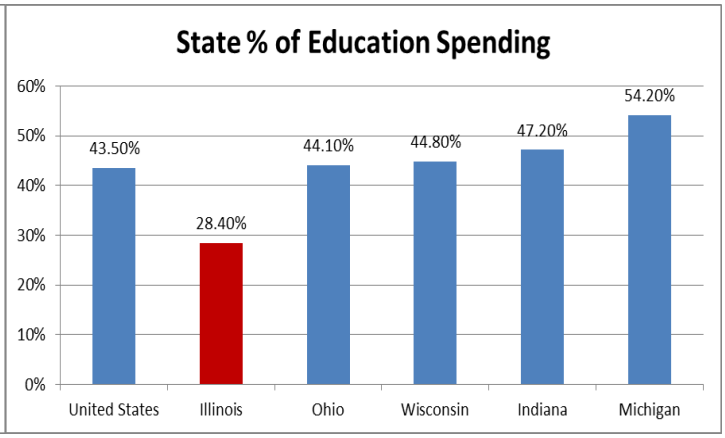


FIGURE 29



Source: National Center on Education Statistics, 2012. "Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2009-2010 (Fiscal Year 2010)."

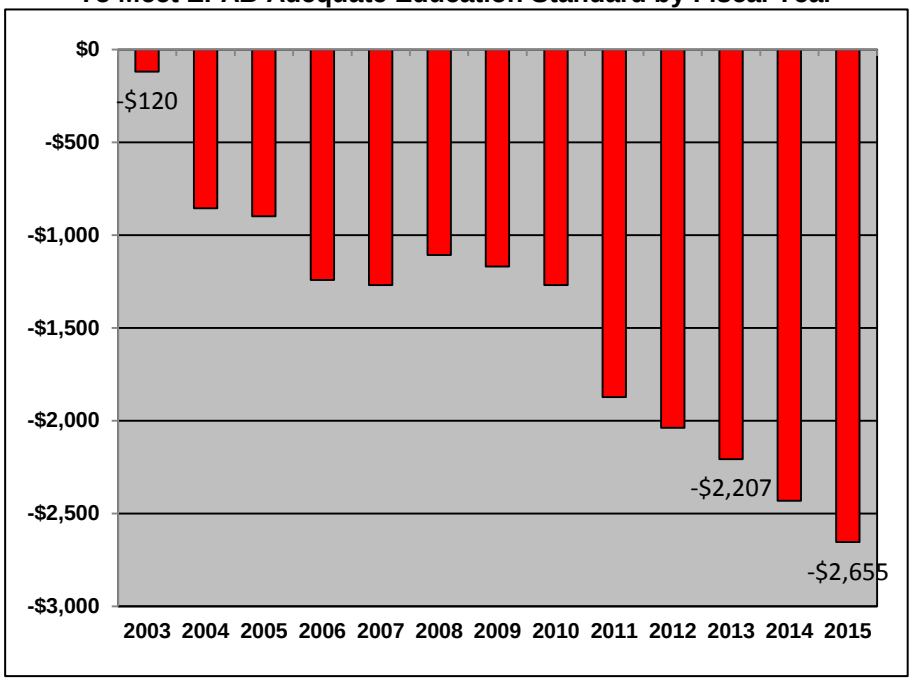
The state's record of underfunding education from state-based resources has forced local property taxes to cover a disproportionately high portion of education funding in Illinois. The data show that Illinois' significant over-reliance on local property taxes is a material cause of both poor and inequitable educational outcomes in the state.[28]

Meanwhile, despite the significant portion of education funding local school districts have assumed, overall education funding levels in Illinois remain low compared to national averages. According to the National Association of State Budget Officers (**NASBO**), **Illinois ranks 40th in percapita education spending**, despite having the 15th highest per capita income among the states.[29] In order for Illinois to move up to being just "average" in per-capita spending (a ranking of 25th) among the states, after adjusting for inflation and population growth, the state appropriation for PreK-12 education in FY2013 would have to be $10.58 billion, or fully $4.04 billion more than the FY2013 Enacted Budget appropriation.[30] So, from a national comparison standpoint, Illinois ranks near or at the bottom in funding public education.

Now consider the state's own standards. Every year the nonpartisan Education Funding Advisory Board (**EFAB**) is required by law to recommend a "Foundation Level" of per pupil spending that is sufficient to cover the cost of an adequate K–12 education. Made up of a combination of both state and local resources, the Foundation Level is supposed to include most of the basic costs of educating a "non-at-risk" child, that is, a child with a reasonable likelihood of academic success, because he or she does not live in poverty, is not an English Language Learner, and does not have special needs. The Foundation Level does not include the cost of significant items, like transportation, special education, and educating children who are English Language Learners or live in poverty.

Figure 30 shows the difference between the dollar amount of the Foundation Level as actually set by the General Assembly and Governor versus what the Foundation Level should have been to cover the basic cost of educating a non-at-risk child as recommended by EFAB over the FY2003 through FY2012 sequence. Projections for FY2014 and FY2015 are based on the Governor's three-year estimates. Last year, in FY2012, the state's actual Foundation Level was over $2,000 less per child than the EFAB recommended Foundation Level. According to the Illinois State Board of Education, the total amount that would have been needed to increase the state's enacted Foundation Level in FY2012 to the EFAB recommendation was over $3.5 billion. Yet, rather than increase the Foundation Level in FY2013, it will technically be held constant with FY2012 levels—but in reality will be cut below FY2012 levels once the 89% proration of General State Aid is accounted for. This means the gap between the EFAB recommended Foundation Level and the state's actual Foundation Level will worsen in FY2013. Note that by FY2015, it is projected that Illinois' enacted Foundation Level will be at least $2,655 less per child than the cost of a basic education.

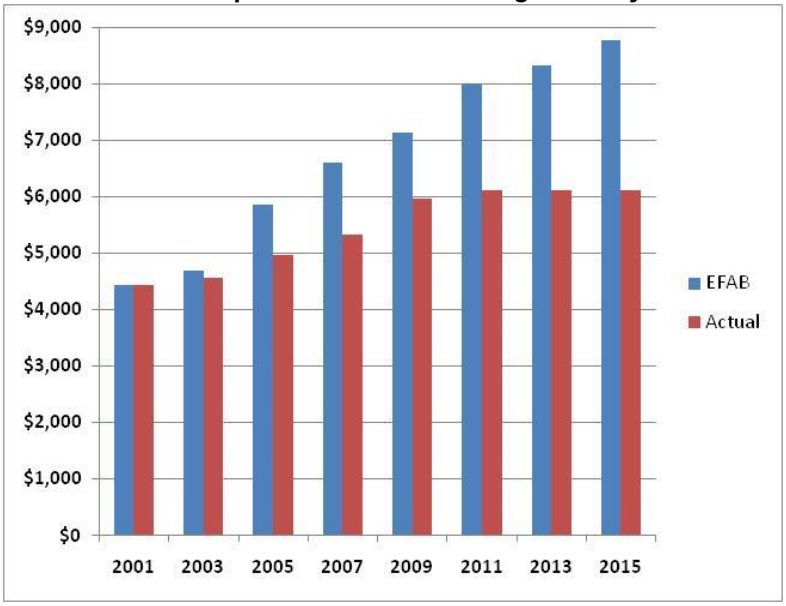
FIGURE 30
Dollar Shortfall in State Per-Pupil K-12 Education Funding
To Meet EFAB Adequate Education Standard by Fiscal Year



Source: CTBA Analysis of January 2011 EFAB data. Inflation projection FY2012-FY2015 based upon ECI-Cinflation.

Figure 31 shows how the difference between the EFAB recommendation and the state's enacted Foundation Level can be expected to grow through FY2015, based on the Governor's projections for FY2014 and FY2015 as contained in his three-year General Fund Budget projections issued in January of 2012.

FIGURE 31
EFAB Per-Pupil Funding Recommendation Compared to the Enacted Per-Pupil Foundation Funding Level by Fiscal Year

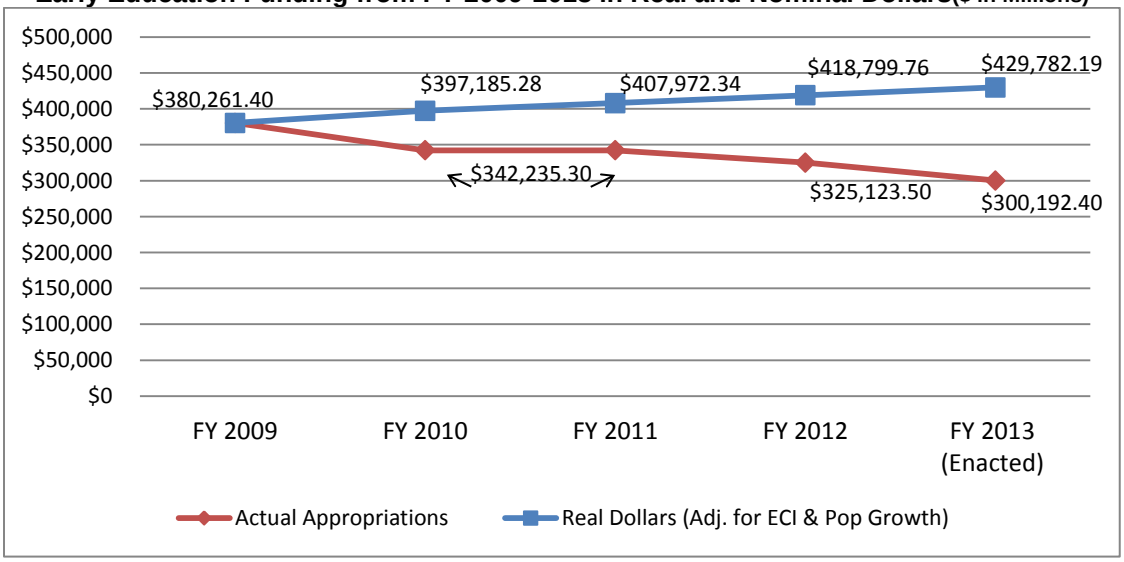


Source: CTBA analysis of EFAB data. Inflation projection FY2012-FY2015 based upon ECI-Cinflation.

In any event, the actual shortfall between the Foundation Level set by the state and the EFAB recommendation will be greater than what is shown in either Figure 30 or Figure 31 for FY2012 and FY2013 (and in all likelihood thereafter) due to the decision to "prorate" General State Aid in FY2012 and FY2013.

Early childhood spending has also been reduced in recent years. As shown in Figures 32 and 33, over the last five years state funding for early childhood declined from $380 million to $300 million.

FIGURE 32
Early Education Funding from FY 2009-2013 in Real and Nominal Dollars($ in Millions)



Sources: ISBE FY2010, FY2012, and FY2013 Budget Book Early Education appropriation

This is questionable public policy, given the evidence-based support for the positive correlation between early childhood programs and academic success.[31]

FIGURE 33
Enacted Appropriations for Early Education
FY2013 Compared to FY2009, Real Dollars ($ Millions)

FY 2009 Enacted	FY 2009 Enacted (Adj. for ECI& Pop Growth)	Diff FY 2013 Enacted- FY 2009 Enacted (Adj. for ECI& Pop Growth)	% Change
$380,261.40	$403,853.75	-$103,661.35	-27.26%

Sources: ISBE FY2010 and FY 2013 Budget Book Early Education appropriation

(c) Higher Education. The FY2013 Enacted Budget appropriation for Higher Education is $1.97 billion dollars, which is a nominal decrease of -$113 million or -5.4% compared to the FY2012 appropriation of $2.09 billion. As enacted, the FY2013 appropriation for Higher Education represents a real, inflation-adjusted decrease of -7.9% compared to FY2012 levels.

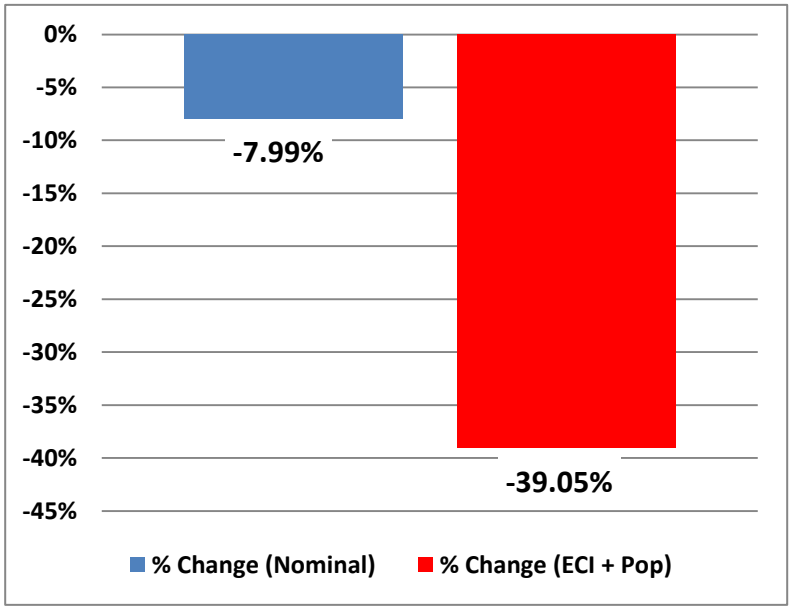
FIGURE 34
Enacted Appropriations for Higher Education
FY2013 Compared With FY2012 ($ Millions)[32]

Category	FY2012 Enacted	FY2012 Adjusted	FY2013 Enacted	Nominal % Change FY2012 – FY2013	Nominal $ Change FY2012 – FY2013	Real % Change FY2012 – FY2013	Real $ Change FY2012 – FY2013
Higher Education	$2,092.4	$2,134.6	$1,979.9	-5.4%	-$112.5	-7.2%	-$154.7

Sources: COGFA,*FY2012 Budget Summary*(Springfield, IL: COGFA, August 2011); and COGFA, *FY2013 Budget Summary* (Springfield, IL: COGFA, August 2012).

The long-term funding trend for Higher Education is not pretty, as highlighted in Figure 35. Indeed, given the FY2013 enacted appropriation, real funding for Higher Education will be significantly less in FY2013 than in FY2000.

FIGURE 35
Percentage Change in Higher Education Funding
Between FY2000 and FY2013, in Nominal and Real Terms



Sources: COGFA, *FY2013 Budget Summary* (Springfield, IL: COGFA, August 2012); June 2012 communications with Senate staff; Bureau of Labor Statistics; and Census Bureau as of January 2013.

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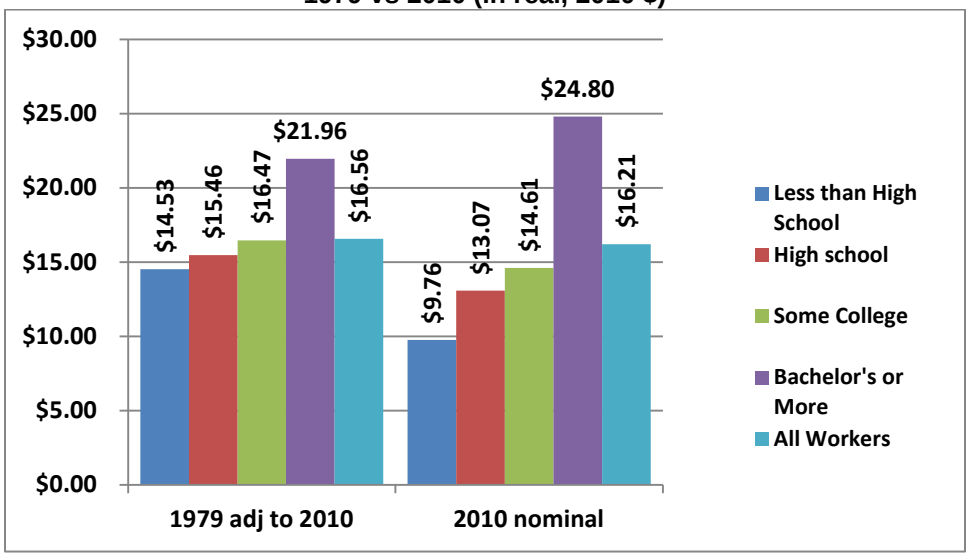
As illustrated in Figure 35, the enacted appropriation for Higher Education in FY2013 represents a nominal dollar cut of 8% below FY2000 levels. Once inflation and population changes are accounted for, however, the enacted Higher Education appropriation for FY2013 is 39% less than FY2000.

Cuts to Higher Education will make it harder for many Illinois students to attend college at a time when a college degree is more important than ever when it comes to success in the labor market. Indeed, as shown in Figure 36, the only cohort of workers in Illinois that realized a real increase in wages from 1979 through 2010 had a college degree. Every other worker saw his or her pay decline in real terms.

FIGURE 36
Hourly Wage Comparison by Education Level, 1979 vs 2010 (in real, 2010 $)



Source:EPI Analysis using Current Population Survey data, inflation adjusted using the CPI-U-RS

This is a real problem in Illinois. Consider that the state's fiscal woes have so hampered its ability to assist low-income students in paying for college that as recently as March 21, 2012, the *Chicago Tribune* reported that funding for Monetary Award Program (MAP) grants, which provide this very crucial support, has been exhausted. The consequences of this are clear: approximately 140,000 Illinois college students will lose up to $4,968 each in state grants that would have helped pay for college.

(d) Healthcare Overall. There have traditionally been three primary categories of Healthcare spending in the state's General Fund: Medicaid for poor, disabled and low-income populations; Group Health Insurance for state workers; and funding for the Department of Public Health. Also historically included in Healthcare funding were the administrative and related costs of child support services delivered by the Department of Health and Family Services (**DHFS**). Under the new Budgeting for Resultsregimen, however, Public Health, Group Health and the administrative costs of child support services delivered by DHFS have been re-categorized as "Human Services" spending—and collectively described below as "Other Healthcare" within the rubric of Human Services.

Given those changes in how funding for these services is categorized, Figure 37 shows the differences between the FY2012 budget and the FY2013 Enacted Budget in nominal dollars.

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FIGURE 37
Comparison of FY2012 and FY2013
Appropriations for Healthcare ($ Millions)

Category	FY2012	FY2013
Medicaid	$6,639	$6,639
Group Health	$1,436	$1,171
Other Healthcare	$ 260	$ 213
TOTAL	**$8,335**	**$8,023**

Source: CTBA,*Illinois FY 2013 General Fund Enacted Budget Analysis*, (Chicago, IL: August 2, 2012). "Other healthcare" includes appropriations to the Department of Public Health and Department of Healthcare and Family Services per SB2454 of the Illinois 97th General Assembly.

There has been much concern expressed recently about Healthcare expenditures generally and Medicaid expenditures specifically. Medicaid will be dealt with at some length in the following Section. However, even after Medicaid expenditures are taken into account, overall inflation-adjusted General Fund spending on Healthcare Services for the public (excluding Group Health Insurance for state workers) in Illinois will be less in FY2013 than it was in FY2000, as shown in Figure 38.

FIGURE 38
Healthcare Appropriations, FY2013 vs. FY2000,
Adjusted for Inflation and Population ($ Millions)

Category	FY2000 Enacted	FY2000 Infl& Pop Adj	FY2013 Enacted	% Diff FY2013 & FY2000 Adj
Healthcare (including Medicaid, DHFS and DPH, but excluding Group Health Insurance)	$5,022	$8,598	$6,852	-20.3%

Sources: Unadjusted historic appropriations from governor's Final Budget Summary for FY2000; FY2013 appropriation from SB2454 and as reported by Senate staff, June 2012. FY2000 appropriation adjusted using the Midwest CPI for Medical Care from the Bureau of Labor Statistics as of January 2013; population growth from the Census Bureau as of January 2013.

The state's General Fund spending on healthcare can best be understood in context of changes driven by the private sector. Consider, for instance that between 1980 and 2005, over 16% of Illinois workers in the private sector lost their employer-provided health insurance.[33] Today, over 46% of full-time workers in Illinois do not have private, employer-provided health insurance.[34]

As the private sector scales back this benefit, the demand for the public sector to assist in providing Healthcare coverage for low and increasingly middle income families will grow. The impact of reduced availability of private health coverage from employers is somewhat reflected in Medicaid data.

In 2008, more than 75% of national Medicaid beneficiaries were not on welfare, while fully 94% of Illinois' Medicaid recipients were not receiving welfare,[35] but were either working or unable to do so due to age or disability.[36]

Illinois' chronic fiscal problems make it increasingly difficult for the state to keep up with both increasing demand forHealthcare and soaring Healthcare costs, which historically grow faster than general inflation.[37]

The scope of the problem this creates for Illinois' fiscal system is illustrated by the gap between the increase in liability for Illinois' Medicaid program, which grew at an average annual rate of 6% between fiscal years 2004 and 2013, and the increase in state tax revenue over that same period, which grew at an average annual rate of only 2.5%.[38] The Congressional Budget Office currently projects that healthcare costs for the public sector will grow by at least 8% annually over the next decade.[39]

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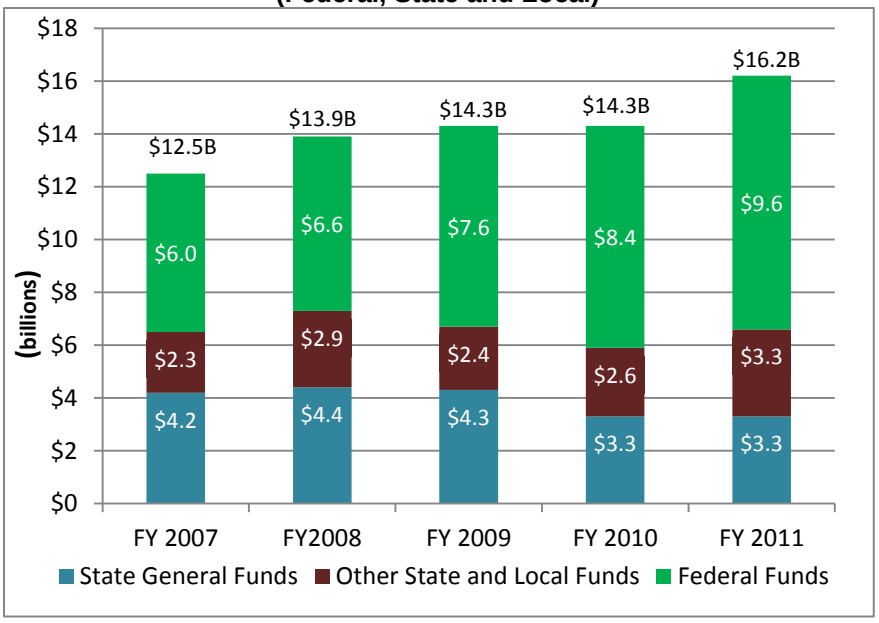
(e) Medicaid. For FY2013, Medicaid spending wasinitially targeted by both the House and Governor for a significant, $2.7 billion cut from FY2012 levels. In the final FY2013 budgetthe actual cut to Medicaid was reduced to $1.6 billion,[40] while the balance was made up with a combination of: (i)$350 million in anticipated new revenue from an increase in the cigarette tax from $.98 to $1.98 per pack, and the $350 million in enhanced federal Medicaid matching revenue that will generate;[41] (ii) $100 million from the new hospital assessment;[42] and (iii) $300 million in additional Medicaid match from allocating more revenue to Medicaid than initially budgeted. Ostensibly, the reason for making this cut to Medicaid is because officials were worried that the growth in overall Medicaid expenditures over time was absorbing so much state revenue that it was crowding out funding for other core services in the General Fund. However, nothing could be further from the truth. Despite the fact that overall Medicaid expenditures have been increasing over the last five years, the portion of Medicaid expenditures actually paid by state, own-source tax revenue has been declining, as shown in Figure 39.

FIGURE 39
Medicaid Spending by Funding Source
(Federal, State and Local)



Source: National Association of State Budget Officers State Expenditure Report, 2010, released December 13, 2011, Pg. 47, Table 28.

Note that FY2011 Medicaid expenditures are estimated, and include enhanced federal matching funds Illinois received due to the significant increase in the federal Medicaid matching rate, from 50% to 61.88%, that was temporarily implemented under the Federal Stimulus program.[43]T hat said, the state own-source General Fund tax revenue used to cover Medicaid expenses in FY2010 and as projected for FY2011 is $3.3 billion, or $900 million less than in FY2007.

As indicated in Figure 39, the data on own-source tax revenue used to fund Medicaid came from the Illinois final report to the National Association of State Budget Officers, which has not been updated through FY2012. DHFS, however, currently estimates that own-source tax revenue used to fund Medicaid will increase from the $3.3 billion used in FY2011 to $3.5 billion in FY2012. Even if this happens, state own-source tax revenue used to fund Medicaid in FY2012 will still be $700 million less than in FY2007. So, rather than crowding out the other core services, Medicaid has actually been subsidizing them.

Despite the decrease in state own-source revenue used to pay for Medicaid, on June 14, 2012, the General Assembly enacted Public Act 97-0689, which is designed to reduce the state's expenditures on Medicaid in FY2013 by $1.6 billion, through 62 different program specific spending reductions, new service utilization limits, and cutting healthcare provider reimbursement rates. Of the 62 spending reductions, $1.36 billion in cuts are attributable to Medicaid programmatic changes and $240 million to provider rate cuts. Many of the Medicaid service cuts will deny preventative, dental and other needed healthcare services to low-income populations.[44] Moreover, further cuts to Illinois' already low provider reimbursement rates—Illinois ranked 41st in value of its provider reimbursement rates before these cuts—will likely discourage some healthcare providers from accepting Medicaid patients.

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The legislature also appropriated enough additional General Fund and other revenue to Medicaid in FY2013 to cover $1.1 billion of past due, unpaid Medicaid bills.[45] This $1.1 billion payment will come from a combination of existing General Fund Revenue, new cigarette and tobacco tax revenue, new Hospital Assessment Revenue, new patient fees and the federal match generated thereby, as shown in Figure 40.

FIGURE 40
Revenue Sources for New, FY2013 Repayment of $1.1 Billion in Medicaid Bills Left Over from FY2012
($ in Millions)

(i)	State Revenue Sources	Amount
	● General Fund Transfers Out ● New Cigarette and Tobacco Tax Revenue ● Enhanced Hospital Assessment Fees ● Subtotal State Revenue	$151 $350 $ 50 $551
(ii)	Federal Match on the Above	$551
(iii)	Total Payment in FY2013 of FY2012 Medicaid Bills	$1,102

Source: HFS, *Final Legislative Package to Save Medicaid* Memo, May 2012

Together, the $1.6 billion in cuts and $1.1 billion in additional bill payments cover the accumulated unpaid Medicaid costs that the Department of Healthcare and Family Services initially projected would go unpaid in FY2013.[46] Figure 41 shows how the state's share of unpaid Medicaid bills was initially projected by the Department of Health and Family Services (DHFS) to increase through FY2017.

FIGURE 41
Illinois Department of Healthcare and Family Services Five-Year Medicaid Budget Outlook General Revenue and Related Funds Only
($ in Millions)

ESTIMATED BILLS ON HAND	FY 12 $313.6	FY 13 $1,860.5	FY 14 $4,545.7	FY 15 $8,127.0	FY 16 $12,318.5	FY 17 $17,161.2
Projected Program Liability						
Practitioners	$1,336.6	$1,394.6	$1,456.5	$1,522.6	$1,593.2	$1,668.8
Hospitals	$3,205.0	$3,297.2	$3,453.3	$3,616.9	$3,788.2	$3,967.6
Prescribed Drugs	$2,166.6	$2,307.8	$2,457.8	$2,617.6	$2,787.7	$2,969.0
Long Term Care	$1,939.3	$2,059.2	$2,074.5	$2,091.1	$2,109.3	$2,129.0
Other Medical Services	$2,221.7	$2,417.5	$2,604.4	$2,808.7	$3,029.6	$3,268.5
Total Program Liability	**$10,869.3**	**$11,476.3**	**$12,046.6**	**$12,656.9**	**$13,308.0**	**$14,002.9**
% change		**5.6%**	**5.0%**	**5.1%**	**5.1%**	**5.2%**
Projected Program Resources						
GRF Appropriation(assumed 0% growth)	*$6,625.6*	*$6,625.6*	*$6,625.6*	*$6,625.6*	*$6,625.6*	*$6,625.6*
Current Year GRF Cash Spend	**$7,090.0**	**$6,660.1**	**$6,625.6**	**$6,625.6**	**$6,625.6**	**$6,625.6**
Estimated State Share	*$3,545.0*	*$3,330.1*	*$3,312.8*	*$3,312.8*	*$3,312.8*	*$3,312.8*
Estimated Federal Share	*$3,545.0*	*$3,330.1*	*$3,312.8*	*$3,312.8*	*$3,312.8*	*$3,312.8*
Other Related Funds Spend	**$2,232.4**	**$2,130.9**	**$1,839.7**	**$1,839.7**	**$1,839.7**	**$1,839.7**
Estimated State Share	*$1,116.2*	*$1,065.4*	*$919.8*	*$919.8*	*$919.8*	*$919.8*
Estimated Federal Share	*$1,116.2*	*$1,065.4*	*$919.8*	*$919.8*	*$919.8*	*$919.8*
Total Program Resources	**$9,322.3**	**$8,791.0**	**$8,465.3**	**$8,465.3**	**$8,465.3**	**$8,465.3**
Estimated State Share	*$4,661.2*	*$4,395.5*	*$4,232.7*	*$4,232.7*	*$4,232.7*	*$4,232.7*
Estimated Federal Share	*$4,661.2*	*$4,395.5*	*$4,232.7*	*$4,232.7*	*$4,232.7*	*$4,232.7*
ESTIMATED ENDING BILLS ON HAND	**$1,860.5**	**$4,545.7**	**$8,127.0**	**$12,318.5**	**$17,161.2**	**$22,698.7**
INCREASE IN ESTIMATED ENDING BILLS ON HAND	**$1,546.9**	**$2,685.3**	**$3,581.2**	**$4,191.5**	**$4,842.7**	**$5,537.5**

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In 2011, Medicaid covered over 2 million Illinois residents or 17% of the state population.[47] Medicaid is an entitlement program for poor and low-income individuals and families who are in need of health coverage. It is jointly funded by both the federal and state government and is the largest source of federal revenue for states. Medicaid is considered a source of revenue for states because of the way it is funded through the Federal Medical Assistance Percentage (FMAP). FMAP is a statutory formula, based on a states' per capita income, which sets the federal match rate each state will receive, with the poorest states receiving the highest federal match rate. Under the Social Security Act, the lowest match rate is set at 50%, and as of 2012, the highest rate is set at 74%. Since Illinois has one of the highest per capita incomes,[48] its match rate is 50%. This means for every $2 Illinois spends on Medicaid services, the state receives $1 back from the federal government. Similarly,in order to save a $1 in state general fund spending on Medicaid, Illinois has to cut at least $2 in Medicaid spending.[49] So, when the state cuts $2.7 billion in Medicaid spending, it is not really saving that total amount because it will lose $1.35 billion in federal matching revenue, leaving net savings at $1.35 billion.

(f) Repayment of Debt Owed to the Pension Systems Strains Existing Fiscal Resources. The Illinois state government has the responsibility to fund five distinct public employee pension systems: Teacher's Retirement System (TRS), State University Retirement System (SURS), State Employee's Retirement System (SERS), General Assembly Retirement System (GARS) and Judge's Retirement System (JRS).[50] Presently, all five state-sponsored retirement systems are significantly underfunded, with a combined unfunded liability of $95 billion and a collective funded ratio of just 40.4%.[51]

This means the retirement systems' assets cover less than 50% of their liabilities. Figure 42 shows the current financial condition of each retirement system. Since public employee pension benefits are constitutionally guaranteed in Illinois,[52] the state must pay the full $95 billion in unfunded liabilities it owes.

FIGURE 42
Summary of State-Sponsored Retirement Systems' Financial Conditions as of FY2012 ($ Millions)

System	Assets[53]	Liabilities	Unfunded Liability	Funded Ratio
JRS	$601.2	$2,021.7	$1,420.5	29.7%
SERS	$11,477.3	$33,091.2	$21,613.9	34.7%
TRS	$37,945.4	$90,024.9	$52,079.5	42.1%
SURS	$13,949.9	$33,170.2	$19,220.3	42.1%
GARS	$56.1	$303.5	$247.4	18.5%

Source: COGFA, *Special Pension Briefing* (Springfield, IL: COGFA, November 2012).

According to GOMB, the state's FY2012 contribution to the five state-sponsored pension systems will be $4.14 billion. That contribution increases to $5.1 billion under the FY2013 Enacted Budget. Figure 43 provides a breakdown of the FY2012 and FY2013 state pension contributions.

FIGURE 43
FY2012 and FY2013
State Pension Contributions ($ Millions)

	FY2012 Enacted Budget[i]	FY 2013 Enacted Budget[ii]
Teachers Retirement System	$2,406	$2,702
State University Retirement System	$980	$1,403
State Employees, Judges & General Assembly Retirement Systems[54]	$978	$1,144
Less: Transfers from State Pension Fund (Unclaimed Property)	(-$230)	(-$150)
Equals: General Fund Pension Contributions (net)	**$4,135**	**$5,099**

Source: (i) GOMB, Illinois Budget: Fiscal Year 2013 (Springfield, IL: GOMB, February 2012), Ch. 2-18; and (ii)Public Act 97-0685

It should be noted that both the FY2012 and FY2013 pension contributions are less than the estimates produced by the retirement systems themselves for those two fiscal years by a combined $107 million. Figure 44 compares the state budgeted pension contributions with the retirement systems' estimates. According to GOMB, this $107 million differential over FY2012 and FY2013 will be made up through use of either transfers from special funds **(as yet undetermined**) or other General Fund appropriations made to the agencies that have members in the respective plans.

FIGURE 44
FY2012 and FY2013 Budgeted Pension Contributions vs.
Retirement Systems Certified Pension Contributions ($ Millions)

	FY2012 Enacted Budget[(i)]	FY2012 Certified Amount[(ii)]	FY2013 Enacted Budget[(iii)]	FY2013 Certified Amount[(vi)]
Teachers Retirement System	$2,406	$2,406	$2,703	$2,702
State University Retirement System	$980	$980	$1,403	$1,403
State Employees, Judges & General Assembly Retirement Systems[55]	$978	$1,032	$1,144	$1,198
Less: Transfers from State Pension Fund (Unclaimed Property)	($230)	($230)	($150)	($150)
Equals: General Fund Pension Contributions (net)	**$4,135**	**$4,188**	**$5,099**	**$5,153**

Sources: (i) GOMB, Illinois State Budget: Fiscal Year 2013 (Springfield, IL: GOMB, February 2012), Ch. 2-18; (ii) Systems' certified letters contained in COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2010"; (iii) Public Act 97-0685; and, (vi) Systems' certified letters contained in COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011."

In either case, the proposed pension contribution for FY2013 will be a little more than 23% greater than in FY2012. This is a significant year-to-year increase that can be expected to continue under current law. But the primary reason why there will be significant, annual growth in the state's pension contribution is poorly understood. It has nothing to do with increasing benefits for workers, nor any other inherent aspect of the pension systems themselves. By far and away the main reason the state's annual contributions to its pension systems are increasing so much annually is the unrealistic, heavily back-loaded schedule the legislature set back in 1995 for repaying the debt the state owes to its pension systems.

It is easy to demonstrate just how much the repayment of debt is driving the increase in annual pension. Of the $4.135 billion contribution to the five pension systems made in FY2012, about $1.613 billion was the employer's normal cost of funding benefits being earned by current workers, whereas more than half, $2.522 billion, was repayment of debt. Of the FY2013 contribution of $5.099 billion to the five pension systems, about $1.578 billion is attributable to the employer's normal cost of the benefits being earned by current workers, while $3.521 billion is debt repayment. That means all of the 23% year-to-year growth in the pension contribution from FY2012 into FY2013 is due to the repayment schedule.

How did we get here? For decades, Illinois has had a structural deficit (as identified previously). To paper over—without resolving—the fact that the cost of delivering public services from year-to-year grew at a greater rate than revenue did—decision makers opted to borrow against what they owed the pension systems and use that borrowed revenue to fund delivery of public services. This meant that for decades the pension systems—against their will—were lending money to the state's General Fund to subsidize the cost of delivering current services. This effectively allowed taxpayers to consume public services for over 40 years without having to pay the full cost of those services.

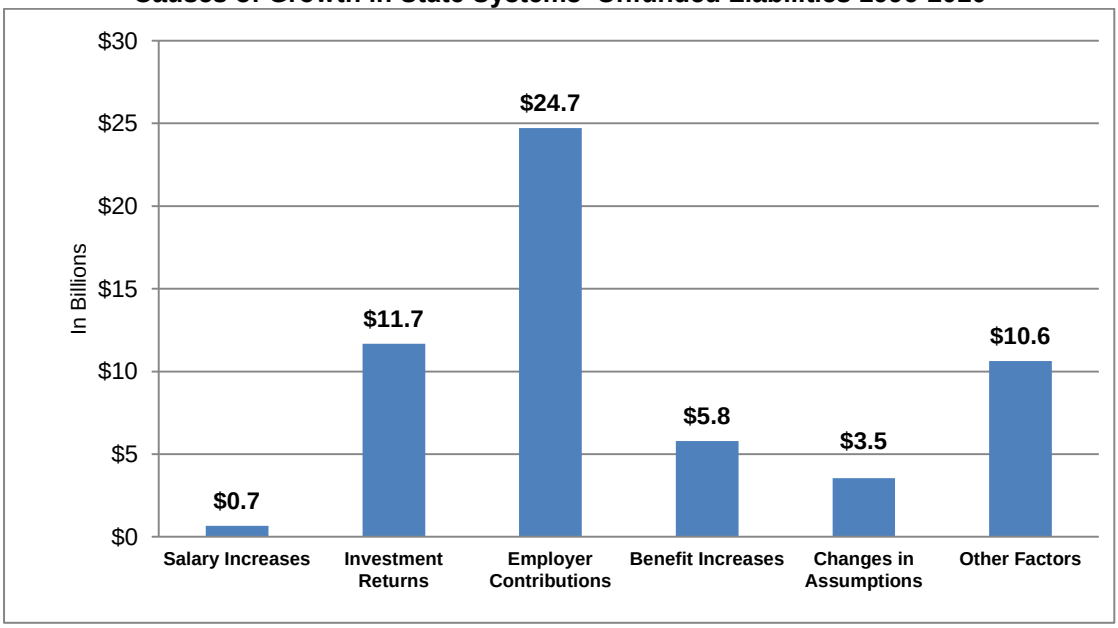
By the end of FY1994, Illinois lawmakers had borrowed so much against the pension systems to fund services that the overall funded ratio of all five systems was just 54.5%, and there was a cumulative unfunded liability of $17 billion.[56] Ostensibly to rectify this situation, in FY1995 the General Assembly passed and Governor Edgar signed P.A. 88-0593, which established what became known as the "Pension Ramp." The Pension Ramp mandated that the state's annual pension contributions be made pursuant to a continuing appropriation, and established a repayment schedule for the debt owed to the pension systems which would result in all five systems having 90% funded ratios by 2045.

Even though P.A. 88-0593 was allegedly designed to repay the debt owed to and resolve the unfunded liability of the pension systems—by law—the legislation continued the practice of borrowing against contributions owed to the pension systems to subsidize the cost of delivering public services for 15 years after passage. P.A. 88-0593 accomplished this boondoggle by creating the following two-phase repayment schedule:

- **Part 1: Fiscal Years 1996-2010**. During this "15-year phase-in period" the state's annual contributions were calculated as a percentage of payroll significantly below the normal cost of funding benefits for current workers each year. This effectively increased the unfunded liabilities of the five pension systems by $24.7 billion. Figure 45 shows how much all factors contributed to the growth in unfunded liabilities during this period.

- **Part 2: Fiscal Years 2011-2045**. During this period, the state is annually required to contribute a percentage of payroll that is sufficient, when added to employee contributions, investment income and other income, to bring the systems to a 90% funded ratio by the end of FY2045.

FIGURE 45
Causes of Growth in State Systems' Unfunded Liabilities 1996-2010



Source: COGFA, "A Report on the Appropriateness of the 90% Funding Target of Public Act 88-593." p. 9.The category 'other factors' covers "miscellaneous actuarial factors such as rates of termination, disability, and pre-and post-retirement mortality" (ibid.).

In what can only be described as piling on, legislation enacted during former Gov. Blagojevich's tenure altered the funding schedule designed by P.A. 88-0593, and resulted in making the already unattainable repayment schedule initially established under the Pension Ramp even worse.

First, the Blagojevich Administration paid a portion of the state's pension contribution for FY2003 and all of its FY2004 contribution with debt proceeds from the sale of $10 billion worth of Pension Obligation Bonds (2003 POB). Under this legislation, P.A. 93-0002, the state's annual contributions to the pension systems were reduced by the annual debt service on the bonds.[57] It would be one thing if the full $10 billion in debt proceeds from the 2003 POB were paid into the pension systems to retire pre-existing pension debt. That would have constituted a refinancing at lower interest rates, something businesses do all the time to save money. In this instance, however, the state incurred debt to pay its current obligations—which had to be repaid over time—ultimately increasing costs to the state, a situation made worse by the reduction in current annual contributions the bill implemented.

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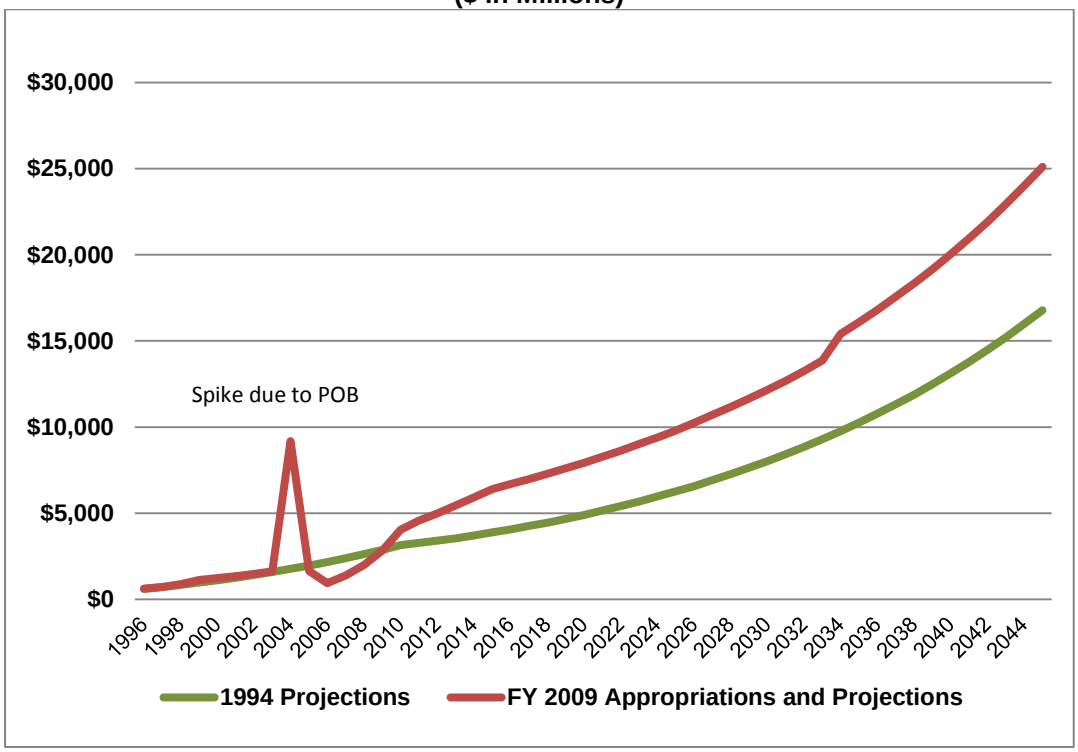
Then in 2005, the General Assembly passed P.A. 94-0004, which was designed to reduce the liability growth in the five pension systems, creating future savings.However, that legislation also reduced the state's contributions to the retirement systems for FY2006 and FY2007 by $2.31 billion. The reduction in the state's pension contributions for those two fiscal years essentially offset the liability savings that were supposed to result from P.A. 94-0004 over the long-term.[58]

Figure 46 shows the state's annual contributions based on the funding schedule for fiscal years 1996-2045 as it was originally established under the Pension Ramp (in green), compared to how those contributions changed due to growth in unfunded liabilities (in red) caused by both the changes in law enacted during the Blagojevich Administration that resulted in insufficient employer contributions, and the investment losses caused by the financial crisis of 2008.

FIGURE 46
Changes in Funding Schedule: 1994 Projections vs. 2009 Projections
($ in Millions)



Sources: (i) COGFA, 2006. "Report on the 90% Funding Target of Public Act 88-0593;" and, (ii) COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2009."

In 2010, legislators took a new approach to reducing the state's obligation to repay its debt to the pension systems. Rather than replace the existing Pension Ramp with a rational, attainable payment schedule, they decided to have future workers pay for state government's past sins by creating a second benefit tier under SB 1946 (P.A. 96-0889). This legislation requires new employees who receive lower pension benefits under Tier II, to make contributions to the pension systems that cover more than the cost of their Tier II benefits. In effect, this means new state employees and teachers are assuming part of the state's obligation to repay pre-existing pension debt—out of their wages. This ultimately reduces the employer contributions required from the state.

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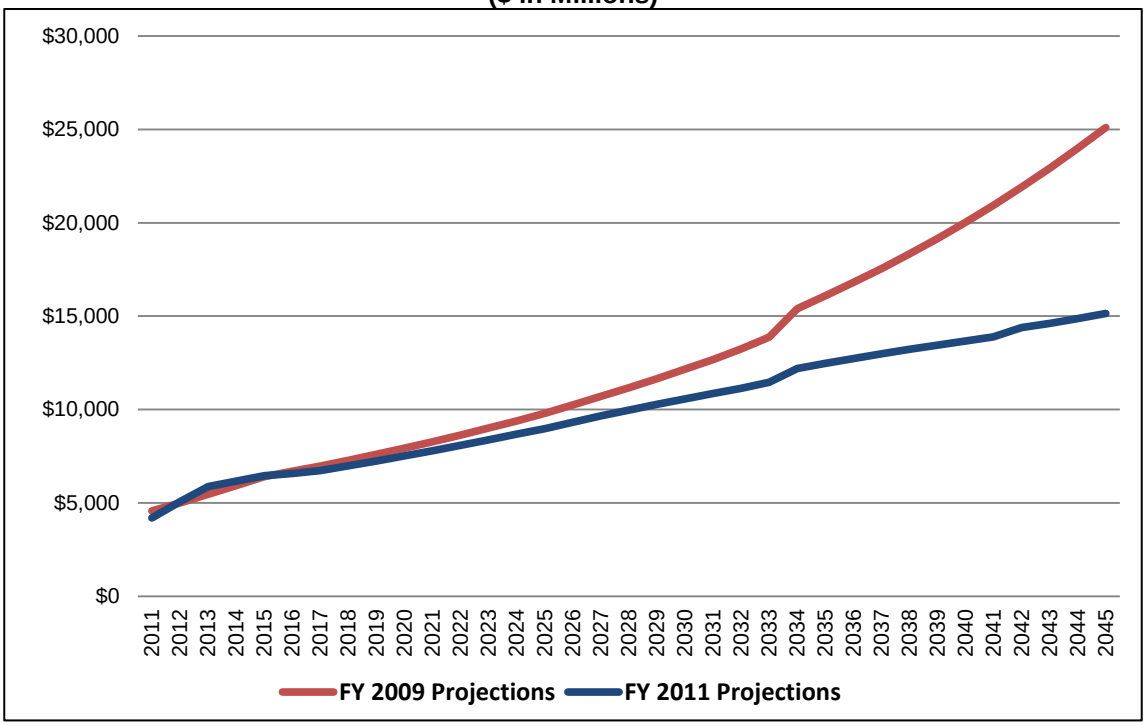
Figure 47 shows how Tier II reduces the state's projected employer contributions (the blue line) compared to pre-existing law (the red line).

FIGURE 47
Required State Pension Contributions Before & After Creation of Tier-II
($ in Millions)



Sources:(i) COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2009," p. 87; and, (ii) COGFA, "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011," p. 95.

Of course, the future savings projected from Tier II assume that the state will adhere to the current funding schedule, an assumption that seems overly optimistic. In FY2011, the state could not pay its pension contribution from General Fund revenue, so instead it authorized the sale of $4.096 billion worth of bonds under P.A. 96-1497 to cover that contribution. Of the authorized amount, the state only sold $3.7 billion in bonds, which it used to pay a portion of its FY2011 pension contributions. The state's use of debt—which has to be repaid—to cover its then current pension contribution is nothing new. The proceeds of bond sales authorized under P.A. 96-0043 were similarly used to pay part of the state's required contributions for FY2010. It is just not possible for the state to continue issuing pension bonds to meet its annual contribution requirements going forward. Which means it is highly unlikely the state will continue to satisfy the pension contribution and debt repayment schedule it is currently required to meet, given the rapid growth in its pension-debt repayment schedule on the one hand, and the structural deficit on the other.

After all the changes in law passed over the prior few years, the remaining payment schedule under the now modified pension ramp is still unattainable. Based on current projections, to meet the 90% funded ratio target by 2045, annual employer contributions will have to grow by an average of 3.5% every year for the remainder of the funding schedule (FY2013 – FY2045).[59]

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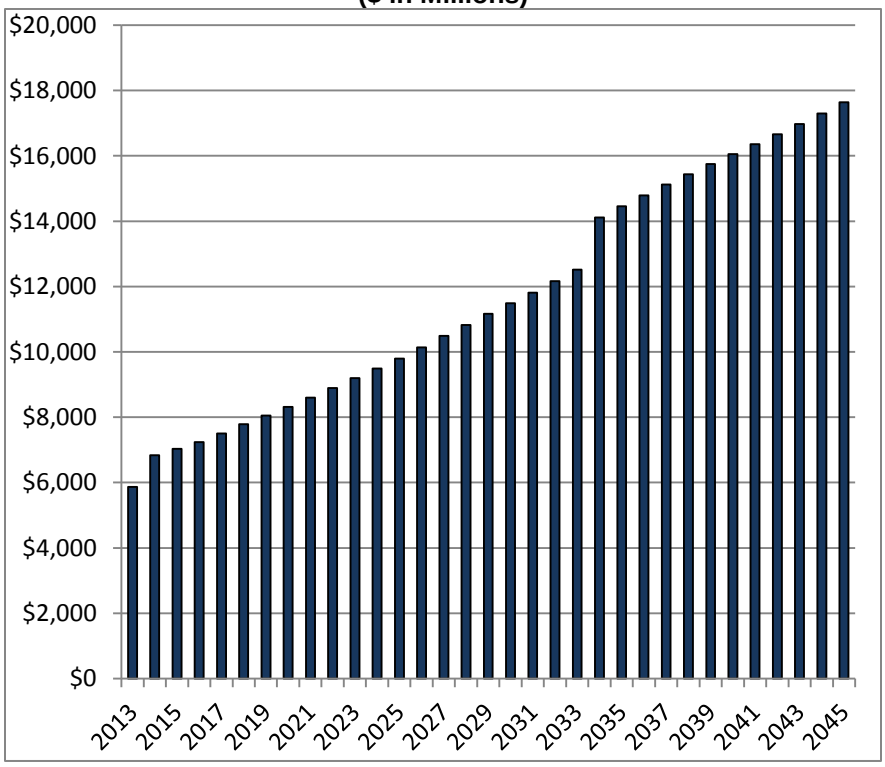
Figure 48 displays projections of the state's pension contributions for FY2013 through FY2045 under the modified Pension Ramp.

FIGURE 48
Required State Pension Contributions FY2013 – FY2045
($ in Millions)



Source: COGFA, *Special Pension Briefing* (Springfield, IL: COGFA, November 2012).

The debt Illinois incurred to these systems over time subsidized the cost of service delivery to taxpayers, allowing taxpayers to consume services for decades at a discount. But now the bill to repay what was borrowed from the pension systems is phasing-in pursuant to an amortization schedule that is so back-loaded it is both unrealistic and a primary cause of the fiscal strain that threatens funding for services.

12. Bonds and Debt

Illinois has incurred relatively more debt than most of the rest of the nation. In fact, Illinois' total debt is exceeded by only four other states: California, New York, New Jersey and Massachusetts. However, the amount of total debt alone is not a particularly useful metric for evaluating whether a state's debt position is appropriate. Debt per capita and debt as a percentage of personal income are more illustrative of whether the amount of debt incurred by a state government is supportable. As of 2011 (the latest year for which comparisons were available), the state of Illinois' $2,383[60] in tax-supported debt per capita ranked 9th highest in the nation.

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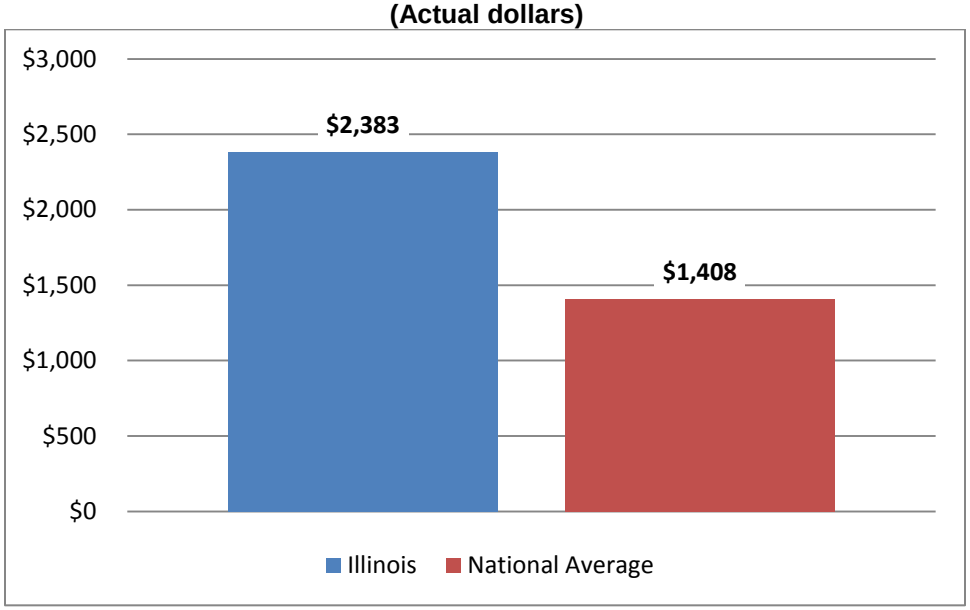
As Figure 49 shows, this is well above the national average of $1,408.[61]

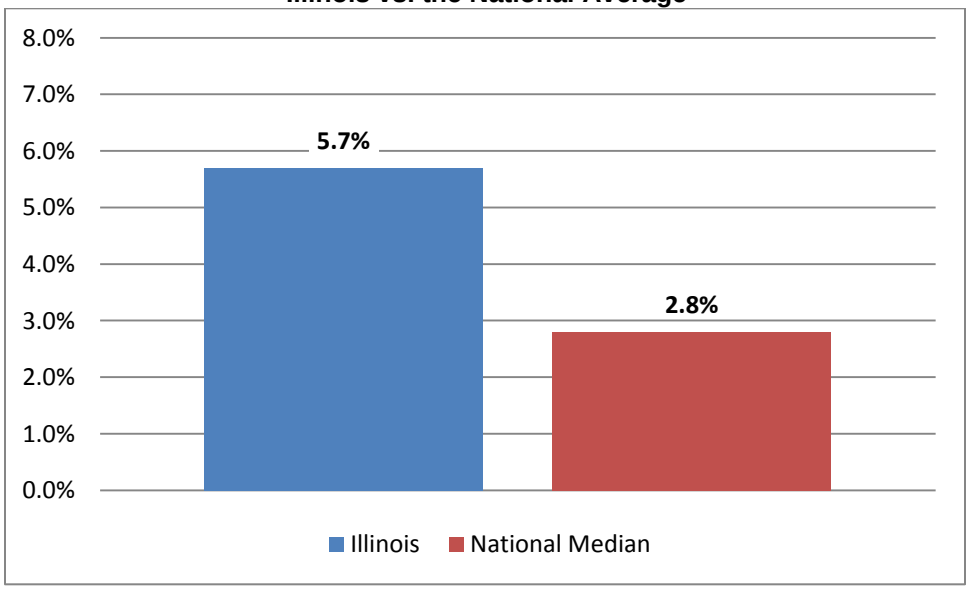
Figure 49
Tax-Supported Debt Per Capita: Illinois vs. the National Average 2011
(Actual dollars)



Source: Moody's Investor Service, 2011 State Debt Medians Report.

Yet another barometer used to evaluate a state's overall debt position compares total state debt to personal income in that state. As shown in Figure 50, using this metric Illinois again appears to be well above the national average in terms of debt burden. Illinois' tax-supported debt as a percentage of personal income (5.7%) is substantially higher than that of the median state (2.8%).

Figure 50
Tax-Supported Debt as a Percentage of Personal Income 2011:
Illinois vs. the National Average



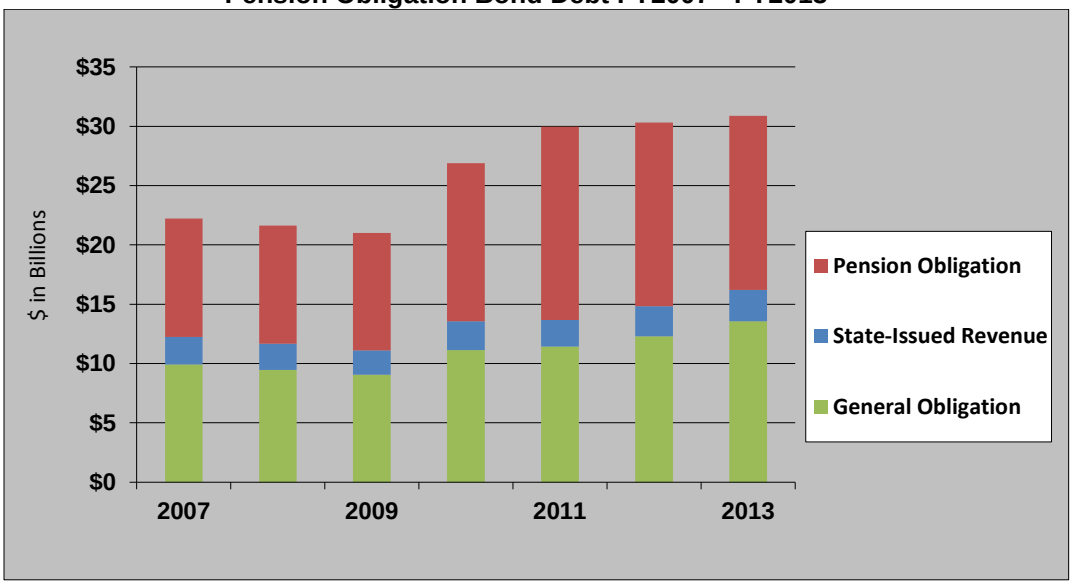
Source: Moody's Investor Service, 2011 State Debt Medians Report.

Debt owed on state-supported general obligation bonds and state-issued revenue bonds in Illinois has increased since 2007, as shown in Figure 51. Note that, the debt service identified in Figure 51 includes solely debt the state owes to private sector, third parties. It therefore does not include the $95.58 billion unfunded liability owed to the five public employee pension systems, but does include the various pension obligation bonds the state issued over this period to cover contributions owed to the pension systems in said years.

Illinois uses the proceeds from many of these bonds to finance large public works projects such as roads, bridges, housing developments and universities. Issuing bonds to build a road is similar to a family purchasing a home. Most families do not have sufficient cash flow to purchase a home outright, so they must take out a mortgage and finance the purchase over a number of years. As a result, in addition to owing the mortgage principal, the homeowner also owes interest to the lender. However, because the house has a long useful life, the long-term debt-related costs associated with the purchase are appropriately matched to the life of the house. Therefore, the costs of ownership are spread across the years in which the owner derives benefit from the house. For similar reasons, issuing bonds is a rational means of spreading the costs of investing in public infrastructure over time.

The growth in the issuance of pension obligation bonds, however, cannot be justified on the same good government grounds as infrastructure improvements. Instead, this debt was incurred by the state as a means of coping with its ongoing deficits while still making contributions to the pension systems, and is not sustainable.

Figure 51
Growth in State-Issued Revenue, General Obligation and Pension Obligation Bond Debt FY2007 - FY2013[62]



Source: COGFA, *Analysis of the FY2013 Capital Infrastructure Plan for the State of Illinois* (Springfield, IL: COGFA), 33.

As the state incurs more debt over time, it has to pay increased debt service (principal and interest) costs annually on that debt. Much of the debt that the state incurs must be repaid from the General Fund. Since debt service is a hard cost the state must pay, debt service payments from the General Fund reduce the revenue available to fund current public services on a dollar-for-dollar basis. Hence, it is important to monitor the state's debt position, to ensure that it does not constrain the state's long-term ability to pay for current public services.

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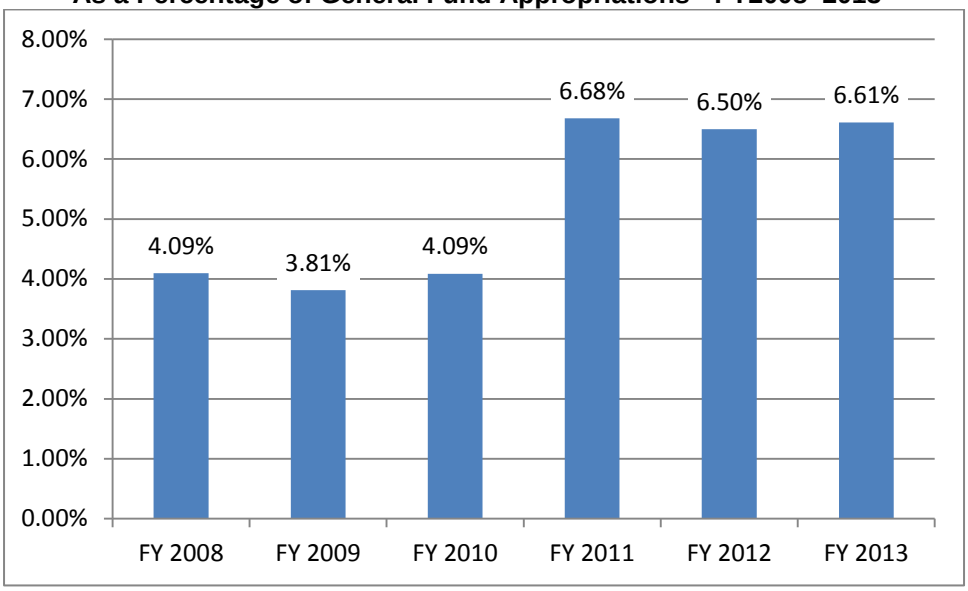
As Figure 52 shows, in FY2013, debt service payments consumed 6.61% of total General Fund appropriations. In dollars, that means $2.17 billion of the General Fund was used to pay debt and interest in FY2013, rather than funding public services.

Figure 52
General Obligation Bond Debt Service
As a Percentage of General Fund Appropriations - FY2008–2013[63]



Source: Calculations done by CTBA using debt service figures as reported by COGFA in their annual *Capital Infrastructure Plan* reports. Appropriation figures for FY2008-FY2012 from GOMB's annual *Budget Book.*

Since December of 2008, the "Big Three" ratings agencies (Fitch, Standard and Poor's, and Moody's) have repeatedly lowered Illinois' general obligation bond ratings, resulting in a slide from ratings of A, A+, and A1 to A Stable, A Negative, and A2 Stable as of August, 2012.[64] These reductions in credit ratings have real-world consequences. When a state's credit rating is lowered, it faces higher interest and issuance costs when it borrows money. As of August 2012, Moody's had assigned Illinois the lowest credit rating of any state in the nation,[65] despite the fact that Illinois' annual gross domestic product of over $671 billion ranks fifth highest in the country.[66] The three aforementioned ratings agencies noted other factors that contributed to Illinois' low bond rating, including poor revenue performance, the state's structural deficit, growing unfunded pension liabilities, and an increase in the state's overall debt burden.[67]

13. Illinois Taxes and Fees

(a) Overview of Primary Revenue Sources Used to Fund State and Local Governments Generally.

Before deciding how Illinois should fix its ongoing deficit problems, a basic description of how state and local governments raise revenue to fund public services is in order. Revenues are typically generated in one of four ways: levying taxes, charging fees, assessing gaming-generated proceeds and issuing debt. Generally speaking, tax revenue is used for funding day-to-day public services (like education, healthcare, public safety and social services), fees are primarily intended to reimburse state or local governments for the cost of the specific services being provided or to build reserves for needed infrastructure development, maintenance and repairs (like the road fund), and bond revenue is used to build or maintain public works (like school buildings, water systems, etc.) that have a long useful life. With limited exceptions, fee and bond revenue is typically not available for funding day-to-day public services.

Revenue from gaming activity is frequently earmarked either for specific public services,such as education, or for paying debt service on capital projects.

The three primary taxes states levy are income, sales and excise. State income taxes are generally assessed against the "taxable income" of either individuals or certain corporations. This "taxable income" is what remains after adjusting for deductions/exclusions of specified amounts or types of income from taxation. Some business entities, e.g. partnerships,

"S"–corporations and limited liability companies, by law are not assessed any income taxes no matter how profitable. Instead, the owners of those businesses pay personal income taxes on the profits of the businesses they own, in accordance with their respective percentage ownership interests in the underlying business. Most states (including Illinois), piggyback to a great extent on federal law in defining what is and what is not included within taxable income, with some notable exceptions. For instance, while most retirement income is subject to the federal income tax, it is not subject to the Illinois state income tax.[68]

Sales taxes are generally based on a percentage of the final purchase price of those goods and services included within the sales tax "base." The "base" of a tax is simply what items the tax is assessed against.

Excise taxes are like sales taxes in that they apply to goods or services sold in the economy. They are unlike sales taxes, however, in one fundamental way. Instead of being based on a percentage of the price of the good or service sold, excise taxes are usually a fixed charge per unit. Examples of an excise tax would be, for instance, the $1.98 Illinois state tax per package of cigarettes. In this case, the $1.98 excise tax per pack remains constant over time, irrespective of any changes in the price of cigarettes.

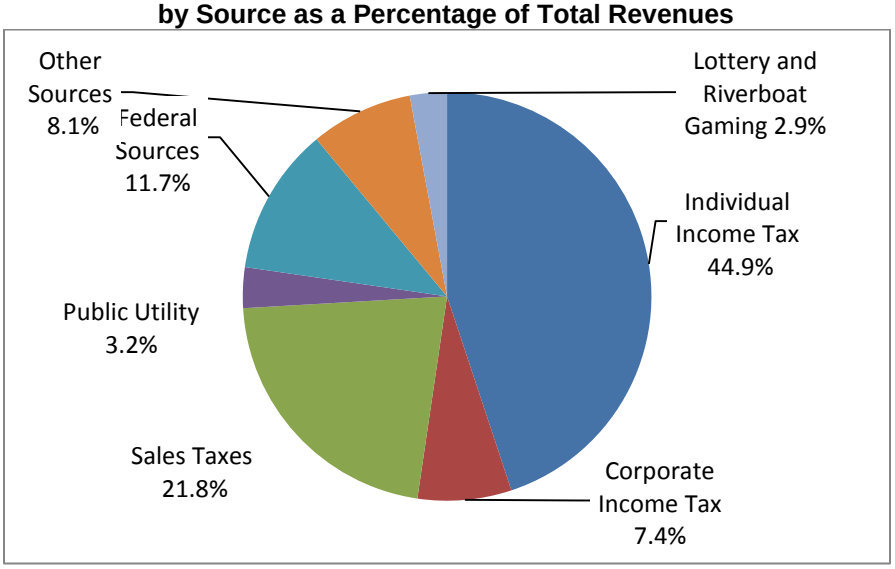
While a few states levy a property tax (e.g. Michigan), in the vast majority of cases property taxes are purely a local revenue source levied by local governments such as counties, municipalities, school districts, park districts and the like. Illinois does not impose a state-level property tax.

Unlike taxes, which generate general revenue states can typically use for spending on any services their General Assemblies deem appropriate, fee-based revenue is usually restricted to reimbursing a government entity for the cost of providing a specific service. Illinois is typical in this regard, in that in most cases the state's constitutionrestricts the value of fees being charged to the amount reasonably necessary to reimburse the state for the cost of providing specific services.[69]

Gaming revenue can come from a variety of sources. For quite some time, Illinois has generated gaming revenue from both the operation of a state lottery and from imposing an assessment against the earnings of the horseracing and riverboat casino industries.[70] Illinois has recently authorized video gaming,[71] which should start generating revenue this fiscal year. In FY2012, state revenue from all gaming sources totaled $1.056 billion.[72] Of that total, 67.0% came from the lottery, 32.2% came from riverboat casinos, and just 0.8% came from horseracing.[73] Finally, there are also transfers of revenue from other governments – like the federal government for instance – and from the many special funds into the General Fund which occur annually.

Roughly, 11.6% of the revenues that make up the General Fund are transfers from the federal government**.** Figure 53 shows the various revenue sources that currently feed the Illinois General Fund.

Figure 53
Estimate of FY2013 Illinois General Fund Revenues
by Source as a Percentage of Total Revenues



Source: House Joint Resolution 68 of the 97th Illinois General Assembly.

(b) The Elements of a Sound, Modern Tax System. Knowing the different sources of revenue is helpful, but not enough to make policy decisions about which should be kept, eliminated, increased or decreased. That is because a sound tax system depends on a number of factors, such aswhether or not it has a proper mix of tax revenue sources, the base of each tax, and how tax burden is distributed among taxpayers. There are basically four principles to use as guideposts for creating a sound tax system.[74]

First, tax policy should be **fair**. "Fairness" for tax policy purposes is measured in two ways: "horizontally", that is comparing the tax burden of different taxpayers with similar income levels, and "vertically", that is comparing the tax burden of taxpayers across different income levels.[75] Tax policy achieves horizontal fairness if taxpayers with similar incomes have similar tax burdens. A tax system will have horizontal fairness when it does not contain numerous tax breaks which favor one taxpayer over another similarly situated taxpayer. Tax policy achieves vertical fairness if the tax burden imposed across different income levels is "progressive", that is, high-income taxpayers have greater tax burdens than low and moderate-income taxpayers, when tax burden is measured as a percentage of income.[76] A graduated income tax rate structure is the favored method of creating vertical fairness in a tax system. Under a graduated income tax rate structure, rather than have one tax rate that applies to all of a taxpayer's taxable income, variousmarginal income tax rates,which increase as taxable income increases, apply to different ranges of taxable income. The Illinois constitution only authorizes a flat-rate income tax; a graduate tax rate is not permitted.

Second, taxes should be assessed to **respond** to how growth is actually realized and distributed in the economy. That means taxes should be imposed where economic activity is significant and where it is increasing over time. A responsive tax system generates revenue growth that keeps pace with the inflationary cost growth of providing services overtime, since it responds to growing economic activity. The plus of a very responsive tax is during times of exceptional economic growth, it generates significantly more revenue that in turn can be placed in a rainy day fund to help get through down cycles. Many states have rainy day funds since the downside of a very responsive tax is that it tends to generate significantly diminished revenue during poor economic cycles. As with creating tax fairness, a graduated income tax rate structure that includes most forms of income is one of the best ways to ensure a tax system is responsive to income distribution in the modern economy.

Third, a tax system should have a **stable** revenue source. A stable tax maintains some decent base revenue generation even during poor economic cycles. Generally, having a sales tax that is imposed on a broad range of the transactions actually occurring in the consumer economy is the best way to bring some stability to a state-level tax system. Illinois' sales tax is imposed primarily on the transfer of tangible goods, which is a narrowing portion of the entire consumer economy. Local property taxes, which are also stable, typically are not levied by a state, but rather by local governments, and therefore provide stability in revenue collection to local, not state governments.

Fourth, tax policy should be **efficient.** An efficient tax system is one that has minimal impact on important private sector economic decisions, such aswhere to purchase a home or locate a business.[77] In other words, for the most part, a tax system should not distort what should be private, market-based decisions. Generally, a tax becomes more efficient as the size of the jurisdiction grows. State-based revenue sources, such asincome and sales taxes, are more efficient than local revenue sources such asproperty taxes, in funding public services. This is because unlike state-based taxes that are assessed at uniform rates throughout a state, local property tax rates vary across that state, resulting in tax competition between and among local governments.

Efficiently assessed property taxes should not unduly influence significant private sector location decisions because the demand for home ownership and/or commercial or industrial facilities is relatively constant over time,[78] so the decision to purchase or sell a tract of property is not greatly influenced by property tax rates, assuming they do not vary significantly from community to community. Moreover, once a taxpayer owns a residence or commercial or industrial facility, that taxpayer is likely to remain at such location for a significant period of time, and usually relocates for reasons that have nothing to do with tax burden, so long as property tax burden remains fair in light of the associated public services (such as education, health, sewer, water, transportation and security) it funds.

Over reliance on property taxes to fund major public services,such aseducation, has the potential to distort economic decisions made by taxpayers and create great differences in the quality and distribution of such services. This is because when property tax rates are high in comparison to the value of available local services, both businesses and individuals have an incentive to leave the area, and a disincentive to locate in that area. This results in a local community suffering a decrease in its property tax base and values, and forces that community to increase property tax rates even higher, as the services it can afford to provide decline. Frequently, the resultant higher tax rate is then assessed against the remaining lower income individuals, which, in addition to being inefficient, contributes to regressivity.

(c) Current Illinois Tax Policy is Inadequateto Satisfy the Principles of Sound, Sustainable Taxation. Current Illinois tax policy substantially fails to satisfy each of the aforesaid four principles of sound tax policy. As a result, it is both unfair and unsound. In simple terms, the very structure of the state's current tax system is unable to generate sufficient, sustainable revenue to continue funding today's level of public services into the future, even at the state's relatively low spending levels. This creates the "structural deficit" discussed previously.Sections 14 and 15 focus on income and sales taxes since they are the two most important revenue sources from a sound tax policy standpoint. Section 16 will provide a short summary of the other revenue sources which feed the state's General Fund, including excise taxes and gaming revenues.

14. Income Taxes in Illinois

(a) Individual Income Tax. As of January 1, 2012, the individual income tax rate in Illinois was temporarily increased from three to five%. Subject to some modifications, this flat rate of five percent is applied to a person's federal adjusted gross income, less exemptions of $2,050 per person.[79] Prior to 2012, the individual income tax rate was three percent and the standard exemption was $2,000 per person. Under current law, the state's five percent individual income tax rate will automatically phase down to 3.75% on January 1, 2015.[80] On January 1, 2025, the rate automatically declines again to 3.25%.[81]

As noted earlier, the Illinois Constitution mandatesthat the state impose only one, flat income tax rate across all income levels. This is contrary to the practice in most other states with an income tax. Indeed, of the 41 states that currently assess an individual income tax, 34 states or 83% have a graduated rate structure.[82] That makes Illinois a tax outlier, joining only six other states in having a flat income tax rate apply to all individuals, regardless of annual earnings.

Figures 54 and 55 show how Illinois' personal income tax rate ranks when compared to the state's Midwest neighbors and other large population states that have an income tax.

Figure 54
Top Income Tax Rates in the Midwest

Iowa	8.98%
Minnesota	7.85%
Wisconsin	7.75%
Missouri	6.00%
Kentucky	6.00%
Ohio	5.925%
Michigan	4.25%
Illinois	5.00%
Indiana	3.40%

Source: State Individual Income Taxes (Tax Rates for 2013 as of Jan. 1, 2013), Federation of Tax Administrators, February 2013

Figure 55
Top Income Tax Rates in Other Populous States

California	12.30%
New Jersey	8.97%
New York	8.82%
Illinois	5.00%

Source: State Individual Income Taxes (Tax Rates for 2013 as of Jan. 1, 2013), Federation of Tax Administrators, February 2013

In addition, Illinois does not include any retirement income in the income tax base. Illinois is one of only three states with an income tax that excludes all retirement income from its base.[83] As the population grays, and more income in both absolute and proportional terms is comprised of retirement income, this exclusion becomes more costly in terms of missed revenues.

Most of the revenue generated from the state's individual income tax goes to the General Fund. However, roughly 6% of the gross revenue generated by the state's individual income tax is distributed to local governments under the Local Government Distributive Fund.[84] Additional revenue generated from the state's individual and corporate income taxes fund the individual and corporate "refund funds," the proceeds of which are used to pay taxpayers entitled to a refund under their Illinois income tax returns.

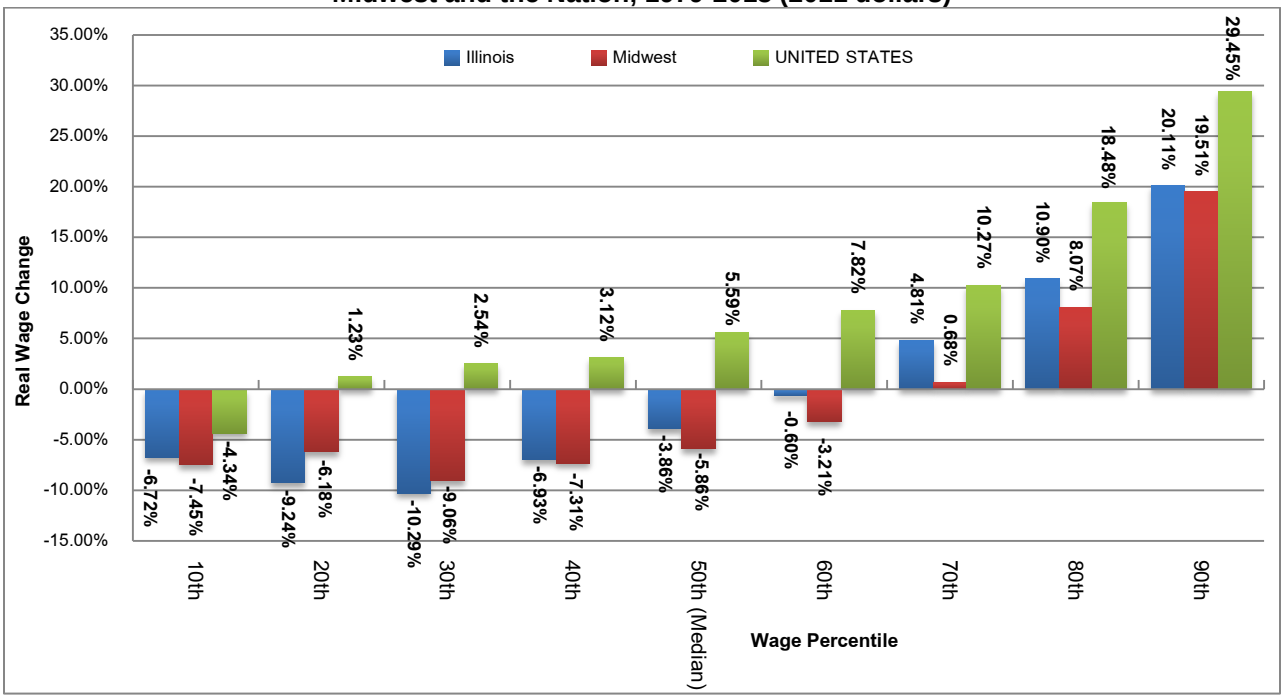
Figure 56
Historic Performance of the Illinois Individual Income Tax

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Personal Income Tax Revenues (Nominal $)	$9,408	$10,320	$9,223	$8,511	$11,225	$15,512	$15,140
FY 2007 Personal Income Tax Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$9,408	$9,797	$9,973	$10,109	$10,340	$10,667	$10,992
Difference Between Actual and Real Personal Income Tax Revenues	$0	$523	($750)	($1,598)	$885	$4,845	$4,148

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. FY2012 is the first fiscal year during which the increase in the personal income tax rate from three to five% was effective. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(b) As Designed, the Personal Income Tax is Neither Fair Nor Responsive From a Tax Policy Standpoint. Recall that two fundamental principles of sound tax policy are that taxes be imposed in a manner that is fair to taxpayers and responsive to the economy.[85] Both of these principles are typically satisfied by using a graduated rate structure for the personal income tax that imposes a greater tax burden on affluent families than on low or middle-income families, when tax burden is measured as a percentage of income. A graduated rate is more proportional to income available for discretionary expenditures. In addition, it is better able to capture the upside of economic change sinceincome growth has disproportionately benefited high-income families over middle and low-income families, in both Illinois and the nation as a whole.[86] In fact, as illustrated in Figure 57, real wages (inflation adjusted) for the bottom 60% of Illinois residents declined from 1979-2013.

Figure 57
Inflation Adjusted Income Growth in Illinois, the Midwest and the Nation, 1979-2013 (2011 dollars)



Source: EPI Analysis using Current Population Survey data, inflation adjusted using the CPI-U-RS

This trend in real wages should not be surprising, given the overall distribution of income growth in America since 1979, as shown in Figure 58. Note that the vast majority of growth in the nation's economy over the last 30 years went to the top 10% of income earners. Since such a significant portion of national income growth went to the top 10% over this time period, after adjusting for inflation, everyone else lost income. Indeed, real family income of the bottom 90% of income earners in America was lower in 2007 than in 1979.[87] From a state fiscal standpoint, it also makes the income tax an

unreliable source of revenues that is not able to maintain pace with even small inflationary increases in the cost of funding basic government operations over time.

Figure 58

Distribution of US Income Growth Over Time

Families	1947 - 1979	1979 - 2007
Top 10%	34.10%	63.70%
Bottom 90%	65.90%	36.30%

Source: PikettyandSaez, "Striking it Richer: The Evolution of Top Incomes in the United States (Update with 2007 estimates),"August 5, 2009, U. C. Berkeley; Calculations from John Schmidt, *Challenge,* September - October 2010.

Interestingly, none other than Adam Smith, the father of capitalism, anticipated that income distribution would skew to the top under capitalism. That is why he opined in his seminal work *The Wealth of Nations*, that "The subjects of every state ought to contribute toward the support of government as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."[88] Smith specifically endorsed the idea that tax policy should "remedy inequality of riches as much as possible, by relieving the poor and burdening the rich."[89]

Unfortunately, the state constitutional mandate that Illinois have only one flat income tax rate that applies to all taxpayers makes it very difficult to use the state's income tax to create tax fairness as described by Adam Smith. Indeed, as Figure 59 illustrates, overall tax burden in Illinois is regressive, does not adjust for ability to pay and is therefore unfair from a tax policy standpoint. Indeed, after adjusting for federal tax offsets, the bottom 20% of income earners in Illinois have state tax burdens that are nearly double the tax burden of high-income earners. That makes Illinois one of the fourth most regressive taxing states in the nation.[90]

Figure 59
Illinois State & Local Taxes Paid as a Share of Family Income for Non-Elderly Taxpayers[91]

					Top 20%		
Income Group	**Lowest 20%**	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income	**Less than $18,000**	**$18,000 – $36,000**	**$36,000 – $57,000**	**$57,000 – $93,000**	**$93,000 – $182,000**	**$182,000– $445,000**	**$445,000 or more**
Average Income in Group	**$10,100**	**$26,900**	**$46,800**	**$73,500**	**$124,100**	**$273,800**	**$1,489,200**
Sales & Excise Taxes	**7.40%**	**5.80%**	**4.60%**	**3.70%**	**2.70%**	**1.80%**	**0.90%**
Property Taxes	**5.20%**	**4.20%**	**4.00%**	**4.30%**	**4.50%**	**3.80%**	**2.10%**
Income Taxes	**1.20%**	**2.20%**	**2.80%**	**2.90%**	**2.90%**	**2.90%**	**3.10%**
TOTAL TAXES	**13.80%**	**12.10%**	**11.30%**	**11.00%**	**10.10%**	**8.50%**	**6.00%**
Federal Deduction Offset	–0.0%	–0.1%	–0.5%	–0.7%	–1.2%	–1.0%	–1.1%
TOTAL AFTER OFFSET	**13.80%**	**12.10%**	**10.90%**	**10.3.%**	**9.00%**	**7.60%**	**4.90%**

Source: Institute on Taxation and Economic Policy, Who Pays? A Distributional Analysis of Tax Systems in All 50 States, p 52, Fourth Edition January 2013.

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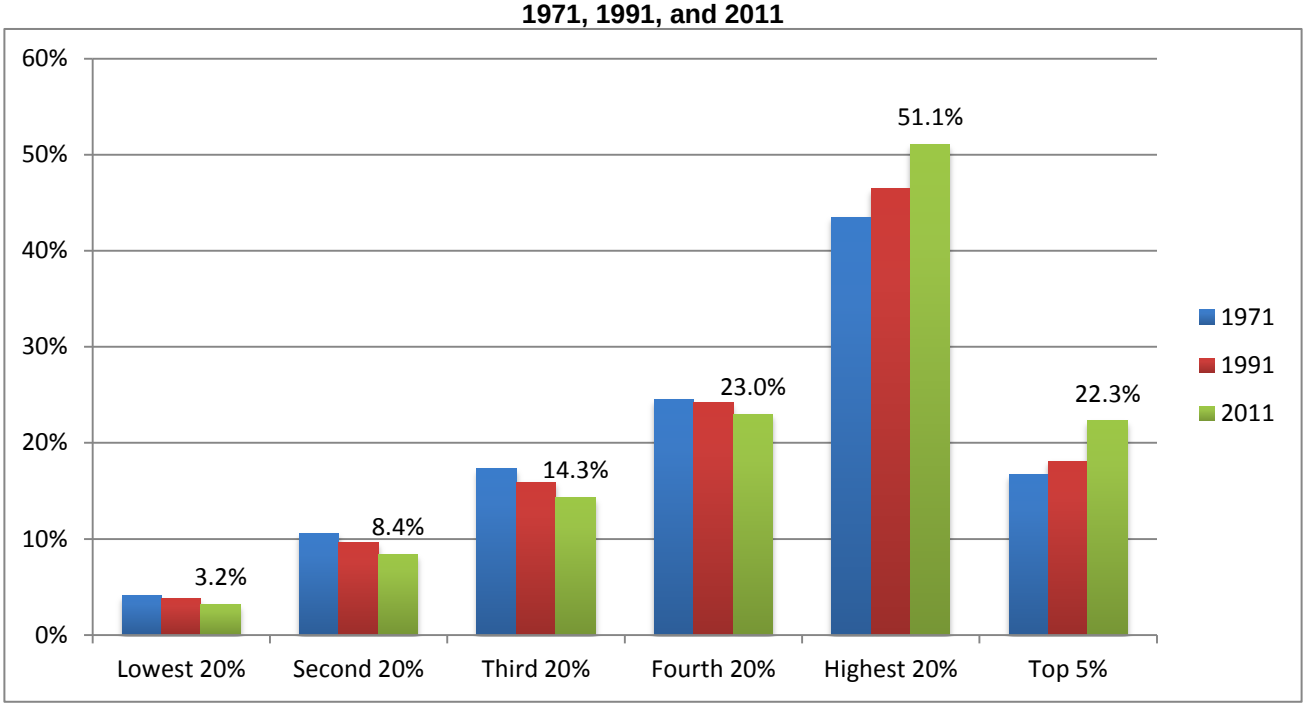
Figure 60 illustrates how income inequality in the nation has actually grown significantly in the past 40 years which, from an economic standpoint, the regressive nature of the Illinois tax system actually worsens.

Figure 60
Shares of Household Income by Quintiles:
1971, 1991, and 2011



Source: U.S. Census Bureau, Current Population Survey.

Because the state'spersonal income tax is set at a flat rate across all income levels, it also fails to "respond" to how economic growth is distributed in the economy over time. Consider the importance of a responsive fiscal system. If the concept is to design a system that keeps up with the modern economy and generates adequate revenue to sustain funding of core services over time, then focusing on low- and middle-income families makes no sense. From a fiscal standpoint, low and middle income taxpayers are a poor revenue source that remains relatively poor over time. Low- and middle-income families not only make less money than their affluent counterparts, historically they also do not gain anywhere near the share in long-term economic growth that more affluent families gain. Put another way, focusing overall tax burden on a demographic that has flat to declining incomes after adjusting for inflation necessarily means annual revenue growth will be constrained over time.

Furthermore, Illinois' tax system hinders economic growth. The reason for this is simple. The biggest driver of the private sector economy is consumer spending, which accounts for over 68% of all economic activity.[92] Low and middle-income families are the state's primary consumers. This is because as they gain more income, they tend to spend most of it quickly, putting the money back into the local economy.[93] The tendency to consume rather than save is for obvious reasons, low and middle income families have more basic needs than affluent taxpayers, and much less income over time to cover those needs. Hence, the wealthy have the earnings capacity to save, while low and middle income families consume. In economic terms, this means low and middle income families have a high "marginal propensity to consume".[94] That is, for every additional dollar they receive in income, they are much more likely to spend it—and primarily in the local economy—than save it. This is why a sales tax affects low and middle income families more than it does higher income families—a significantly greater portion of the total income earned by low and middle income families is spent on consumption.

Nobel Prize winning economist Joseph Stiglitzfound that modestly increasing income taxes on high-income earners, on the other hand, does not materially reduce their spending.[95] This is because affluent families enjoy such a significant portion of all income growth that they have a very low marginal propensity to consume. Additionally, there is clear, data-based evidence which shows that imposing high marginal state income tax rates on the wealthy does not impede state economic growth over the long-term. A study published by the Institute on Taxation and Economic Policy (ITEP), reviewed how the nine states with the highest marginal individual income tax rates compared to the nine states with no

individual income tax in the following three, core economic indicators from 2001 through 2010: real per capita gross state product growth; real median income growth; and average annual unemployment rate.[96] Over the period studied, the high individual income tax states realized greater growth in real, per capita gross state product than their non-tax peers (10.1% to 8.7%), significantly lower loss in real median household income (a decline of -0.7% compared to -3.5%) and an identical average annual unemployment rate of 5.7%.

(c) Corporate Income Tax. As of January 1, 2011, the state's corporate income tax was temporarily set at a flat rate of 7%. Prior to 2011, the corporate income tax rate was 4.8%. The Illinois Constitution forbids the imposition of a corporate income tax rate that is greater than 8/5ths of the individual income tax rate.[97] Since the current individual income tax rate is 5%, the maximum corporate income tax rate that could be assessed is 8%. On January 1, 2015, the corporate income tax rate will automatically decline to 5.25%. On January 1, 2025, the corporate income tax rate will revert to its original level of 4.8%.

Corporations also pay an additional 2.5% of their profits in taxes under the Corporate Personal Property Replacement Tax.[98] However, the Corporate Personal Property Replacement Tax (just like real estate property taxes) provides funds solely to local governments. None of the revenue from the Corporate Personal Property Replacement Tax goes to the state of Illinois. It should be noted that currently 41 other states (including most of our Midwest neighbors like Indiana and Iowa) still have a personal property tax businesses must pay.[99] The corporate personal property tax, which funded local services, was phased out by the Illinois constitution adopted in 1970.

The state's corporate income tax primarily feeds the General Fund, although, like the personal income tax, roughly 6% of the revenues from the corporate income tax are distributed to local governments under the Local Government Distributive Fund. Figure 61 shows the performance of the corporate income tax in Illinois from 2007 through 2013.

Figure 61
Historical Performance of the Illinois Corporate Income Tax

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Corporate Income Tax Revenues (Nominal $)	**$1,750**	**$1,860**	**$1,710**	**$1,360**	**$1,851**	**$2,461**	**$2,504**
FY 2007 Corporate Income Tax Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	**$1,750**	**$1,822**	**$1,855**	**$1,880**	**$1,923**	**$1,984**	**$2,045**
Difference Between Actual and Real Corporate Income Tax Revenues	**$0**	**$38**	**($145)**	**($520)**	**($72)**	**$477**	**$459**

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Note: FY2012 is the first year in which the corporate income tax rate was increased from 4.8% to 7%.Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

15. The Illinois Sales Tax

Illinois is one of 49 states that impose a general state sales tax. The Illinois sales tax is based on the following statutes: (i) the “Retailers Occupation Tax,” which is assessed on the gross receipts retailers collect from the transfer from seller to buyer oftangible property in Illinois; (ii) the “Retailers' Use Tax,” which is assessed on individuals who purchase property outside of Illinois but use it in the state; and (iii) the "Service Occupation and Use Taxes," which interestingly are not imposed on most services, making the title of the Act quite a misnomer. Instead, the Act imposes a sales tax primarily on tangible property acquired incident to purchasing a service. For example, when a car is repaired, the state sales tax applies only to the parts included in the repair, not to the cost of the labor.

The Illinois state sales tax rate is 5%, and the standard local government sales tax rate is an additional one and one 1.25%, making the base combined state and local sales tax rate 6.25%.[100] Certain local governments have increased their sales tax rates, so that, for instance in Chicago, after adding the City’s rate and the Cook County rate, the total sales tax rate is 9.25%.[101] The Illinois state and local combined rate of 6.25% is in the middle of the national range and consistent with our border states.[102] Iowa, Kentucky and Michigan all impose a 6% sales tax rate, while Missouri’s rate is 4.225% and Indiana’s is 7% tax rate.[103]

The state's share of revenue from sales taxes is primarily deposited into the General Fund. Figure 62 shows the performance of the state portion of the sales tax since FY2007.

Figure 62
Historic Performance of the Illinois Sales Tax

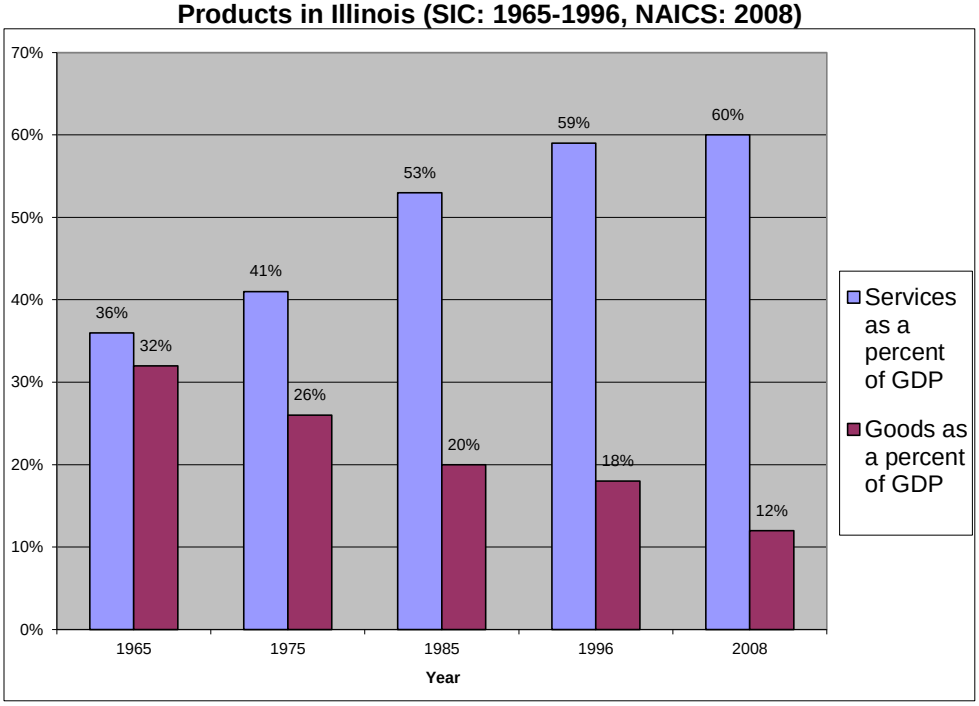
All $ in Millions	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013*
Actual Sales Tax Revenues (Nominal $)	$7,136	$7,215	$6,773	$6,308	$6,833	$7,226	$7,335
FY2007 Sales Tax Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$7,136	$7,431	$7,565	$7,668	$7,843	$8,091	$8,338
Difference Between Actual and Real Sales Tax Revenues	$0	($216)	($792)	($1,360)	($1,010)	($865)	($1,003)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

If properly designed, sales taxes can make a state's fiscal system more stable. That is, sales taxes can ensure revenue generation does not suffer inordinate declines in times of economic hardship. To achieve this stabilizing effect, the base of the sales tax (that is, the items the sale of which are subject to a tax) must be broad enough to include most of the transactions occurring in the consumer economy. The Great Recession demonstrates emphatically how such a broad-based sales tax can bring stability to a fiscal system. Even though the economy overall went into deep recession, consumer spending remained relatively constant, with real personal consumption expenditures declining by less than 1% from the first quarter of 2008 through the second quarter of 2010.[104] Since consumer spending accounts for around68% of all economic activity nationwide,[105] a sales tax that applies broadly to most goods and services purchased in the consumer economy ensures the relative stability of sales tax revenue in good and bad times.

Of the 49 states in America with a sales tax, Illinois has the fourth narrowest base, primarily because it fails to apply to most of the transactions that actually occur in the state's consumer economy.[106] The main problem with the Illinois state sales tax is that it primarily taxes the sale of goods and does not apply to most services. In fact, of the 168categories of taxable services recognized by the Federation of Tax Administrators, Illinois taxes 17, while the national average is 56.[107] Figure 63 shows why focusing on the sale of goods rather than services is fiscally problematic, since services now account for more than 60% of Illinois' state GDP.[108] The next largest sector accounts for less than half that amount.

Figure 63
Sales of Goods and Services as a Percent of State Gross Domestic Products in Illinois (SIC: 1965-1996, NAICS: 2008)



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Services are not only the largest sector of the state's economy, but also the fastest growing. Leaving the largest and fastest growing sector of the Illinois economy out of the state's tax base makes it impossible for the sales tax to track with the real Illinois economy and to bring needed stability to Illinois' fiscal system that can sustain spending on core services over time.

As Figure 64 shows, all of Illinois' neighboring states tax consumer services more than Illinois does.

Figure 64
Sales Taxation of Consumer Services*
"X" indicates current taxation

	U.S.	Illinois	Border State Comparisons				
	# of States Taxing	IL* 5%	WI 5%	IN 6%	KY 6%	MO 4.225%	IA 5%
STORAGE:							
Automotive storage/Fur Storage	19		X				X
Household goods storage	12						X
Marina service (docking, storage, cleaning, repair)	21		X			X	
SERVICES – PERSONAL SERVICES:							
Travel agent services							
Consumer electronics repair & maintenance	23		X				X
Personal & household goods repair & maintenance	23		X				X
Carpet and upholstery cleaning	15		X				X
Dating services	10						X
Hair, nail & skin care	6						X
Health clubs, tanning parlors, reducing salons	20		X			X	X
Laundry and dry cleaning services, non-coined operated	21		X				X
Consumer goods rental	45		X	X	X	X	X
General goods rental	45		X	X	X	X	X
Diet & weight reducing services							
Private investigation (detective) services	13						X
Process server fees (Bail bonding)	6						X
Telephone answering service	19		X				X
Photographic studios, portrait	N/A						
Linen supply	32		X	X	X		X
Industrial launderers	32		X	X	X		X
Interior design services	9						X
Computer systems design & related services	16						
Credit bureaus	14						
Collection agencies	9						
Photocopying/Printing Services	42		X	X	X	X	X
AUTOMOTIVE SERVICES:							
Automotive repair & maintenance	23		X				X
Parking lots and garages	23		X				X
Motor vehicle towing	15		X				X
ARTS, ENTERTAINMENT, RECREATION							
Pari-mutual racing events	28		X		X	X	X
Amusement park admissions and rides	36		X		X	X	X
Bowling alleys	28		X			X	X
Cable TV services	24		X	X			X
Circuses and fairs – admission and games	34		X		X	X	X

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	U.S.	Illinois	Border State Comparisons				
	# of States Taxing	IL* 5%	WI 5%	IN 6%	KY 6%	MO 4.225%	IA 5%
Coin-operated video games/Pinball and other mechanical amusements	19		X			X	X
Golf courses and country clubs	22		X			X	X
Fitness and recreational sports centers	22		X			X	X
Admission to profession sports events	35		X		X	X	X
Performing arts companies	31		X		X	X	X
Miniature golf courses	N/A						
Scenic & sightseeing transportation	N/A						
LEASES AND RENTALS:							
Limousine service (with driver)	13						X
Unscheduled chartered passenger air transportation	10					X	
Motion pictures theaters (expect drive ins)	N/A						
Drive in motion picture theaters	N/A						
N/A = incomplete information							
State tax rates reflect total state/local portions collected by state. Rates do not reflect additional local options sales taxes. Sources: Federation of Tax Administrators and various State Department of Revenue reports.							

*Note, Illinois currently taxes 17 services, giving it the fourth most narrow sales tax base of any state. Those services Illinois taxes, as well as business, professional and utility services taxed by other states, are not covered in Figure 64.

16. Other State Revenue Sources

(a) Overview. In addition to the income and sales taxes, Illinois receives revenue for its General Fund from a number of other sources, like excise taxes and gaming, which are summarized below

(b) Cigarette Tax. The state taxes cigarettes at the rate of $1.98 per pack. Out of the total state tax, $0.98 is used for the General Fund budget.The receipts from cigarette taxes are deposited into the General Fund, the Common School fund, the School Infrastructure Fund and the Long Term Care Provider Fund.[109]

Figure 65
Historic Performance of Cigarette Tax Revenue

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Cigarette Tax Revenues (Nominal $)	$350	$350	$350	$355	$355	$354	$355
FY 2007 Cigarette Tax Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$350	$364	$371	$376	$385	$397	$409
Difference Between Actual and Real Cigarette Tax Revenues	$0	($14)	($21)	($21)	($30)	($43)	($54)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(c) Liquor Taxes and Fees. The state levies excise taxes of 23.1 cents per gallon on beer, $1.39 per gallon on wine and $8.55 per gallon on hard liquor. Out of the total state taxes, 18.5 cents per gallon on beer, 73 cents on wine, and $4.50 per gallon on hard liquor are used for the General Fund budget.[110] Taxes above those rates are deposited into the Capital Projects Fund.[111]

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Figure 66
Historic Performance of the Illinois Liquor Taxes and Fees

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Illinois Liquor Taxes Revenues (Nominal $)	$156	$158	$158	$159	$157	$164	$162
FY 2007 Illinois Liquor Taxes Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$156	$162	$165	$168	$171	$177	$182
Difference Between Actual and Real Illinois Liquor Taxes Revenues	$0	($4)	($7)	($9)	($14)	($13)	($20)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(d) Public Utility Taxes. The state assesses utility taxes on three different types of public utilities: the electricity excise tax, the telecommunications excise tax and the natural gas excise tax. The revenues from the state's public utility taxes are deposited primarily into the General Fund. A small percentage is deposited into both the School Infrastructure Fund the Common School Fund (which is part of the General Fund).[112]

Figure 67
Historic Performance of Illinois' Public Utility Taxes

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Public Utility Taxes Revenues (Nominal $)	$1,131	$1,157	$1,168	$1,089	$1,147	$995	$1,085
FY 2007 Public Utility Taxes Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$1,131	$1,178	$1,199	$1,215	$1,243	$1,282	$1,321
Difference Between Actual and Real Public Utility Taxes Revenues	$0	($21)	($31)	($126)	($96)	($287)	($236)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(e) Lottery Transfers. Annually, approximately 30% of total lottery sales become general state revenue that is earmarked for the Common School Fund, which is part of the General Fund. The remaining lottery proceeds go toward prizes, vendor fees and lottery administration. Historically, a very small portion of the lottery proceeds have funded various causes, such as veterans' affairs programs and HIV/AIDS awareness.[113]

Figure 68
Historic Performance of the Illinois Lottery Transfer

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Lottery Transfers (Nominal $)	$622	$657	$625	$625	$632	$640	$649
FY 2007 Lottery Transfers Adjusted for Inflation (CPI-U) and Population (Real $)	$622	$648	$659	$668	$684	$705	$727
Difference Between Actual and Real Lottery Transfers	$0	$9	($34)	($43)	($52)	($65)	($78)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(f) Riverboat Gambling Transfers. The state imposes a graduated assessment on gross gaming revenues (called "Adjusted Gross Receipts" or "AGR") generated by riverboat casinos. The revenues from this assessment—net of a 5% share that is distributed to the governments of the municipalities in which the casinos are located—flow into the Common School Fund. Adjusted Gross Receipts are currently assessed at the following rates:

*15% of AGR up to and including $25 million
*22.5% of AGR in excess of $25 million but not exceeding $50 million
*27.5% of AGR in excess of $50 million but not exceeding $75 million
*32.5% of AGR in excess of $75 million but not exceeding $100 million
*37.5% of AGR in excess of $100 million but not exceeding $150 million
*45% of AGR in excess of $150 million but not exceeding $200 million
*50% of AGR in excess of $200 million[114]

Additionally, an admission tax is imposed, which is $2 to $3 per admission. One dollar per admission goes to local governments while the remaining $1 to $2 is state revenue.[115]

Figure 69
Historic Performance of Gaming Tax Transfers

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Gaming Tax Transfers (Nominal $)	$685	$564	$430	$431	$324	$413	$340
FY 2007 Gaming Tax Transfers Adjusted for Inflation (CPI-U) and Population (Real $)	$685	$713	$726	$736	$753	$777	$800
Difference Between Actual and Real Gaming Tax Transfers	$0	($149)	($296)	($305)	($429)	($364)	($460)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(g) Inheritance Tax. The state levies a tax on transfers of wealth from a decedent to his or her heirs, equal to the maximum state tax credit allowed against the decedent's federal estate tax liability.

- Revenue from the Inheritance Tax is primarily deposited into the General Fund. Six percent of the revenue from this tax is diverted to the Inheritance Tax Collection Distributive Fund for transfer to the county of residence of the decedent.[116]
- Data show the state's inheritance tax is only paid by the wealthiest 1.7% of all taxpayers, making it the only progressive tax Illinois has.

Figure 70
Historic Performance of the Illinois Inheritance Tax

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Inheritance Tax Revenues (Nominal $)	$264	$373	$288	$243	$122	$235	$230
FY 2007 Inheritance Tax Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$264	$275	$280	$284	$290	$299	$308
Difference Between Actual and Real Inheritance Tax Revenues	$0	$98	$8	($41)	($168)	($64)	($78)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(h) Insurance Taxes and Fees. The most significant component of the insurance tax is the premium tax, which is levied on both foreign and domestic insurance companies. Illinois' health maintenance organizations and health insurance premiums are taxed at a rate of 0.4%, while other types of coverage are taxed at a 0.5% rate. Non-Illinois companies pay an additional tax if their home state taxes insurance companies at a higher rate than Illinois. Revenues from these taxes are deposited into the General Fund.[117]

Figure 71
Historic Performance of Illinois Insurance Taxes and Fees

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Insurance Taxes and Fees Revenues (Nominal $)	$310	$298	$334	$322	$317	$345	$285
FY 2007 Insurance Taxes and Fees Adjusted for Inflation (CPI-U) and Population (Real $)	$310	$323	$329	$333	$341	$351	$362
Difference Between Actual and Real Insurance Taxes and Fees Revenues	$0	($25)	$5	($11)	($24)	($6)	($77)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(i) Corporate Franchise Taxes and Fees. Illinois assesses a variety of nominal service fees and franchise taxes on corporations, in the following amounts: (i) 0.15% of a corporation's reported paid-in capital for its initial year of doing business in the state; (ii) an additional 0.15% of any increase in paid-in capital during the corporation's initial year; and (iii) 0.10% of reported paid-in capital thereafter. Revenue from corporate franchise taxes are primarily deposited into the General Fund. Two percent of the revenues, however, are deposited into the Corporate Franchise Tax Refund Fund.[118]

Figure 72
Historic Performance of Illinois Corporate Franchise Taxes and Fees

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Corporate Franchise Taxes and Fees Revenues (Nominal $)	$193	$225	$201	$208	$207	$192	$195
FY 2007 Corporate Franchise Taxes and Fees Adjusted for Inflation (CPI-U) and Population (Real $)	$193	$201	$205	$207	$212	$219	$226
Difference Between Actual and Real Corporate Franchise Taxes and Fees Revenues	$0	$24	($4)	$1	($5)	($27)	($31)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(j) Investment Income. This is simply the investment return the state earns on its various fund deposits. The General Fund receives the largest share of investment income.

Figure 73
Historic Performance of Illinois Investment Interest Income

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Interest on State Funds and Investments Revenues (Nominal $)	$204	$212	$81	$26	$28	$21	$20
FY 2007 Interest on State Funds and Investments Adjusted for Inflation (CPI-U) and Population (Real $)	$204	$212	$216	$219	$224	$231	$238
Difference Between Actual and Real Interest on State Funds and Investments Revenues	$0	($0)	($135)	($193)	($196)	($210)	($218)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(k) Federal Transfers. The federal government provides grants and reimbursements to the Illinois General Fund for public aid, social services and other programs such as temporary assistance for needy families (TANF), childcare and Medicaid.

Figure 74
Historic Federal Transfers to Illinois

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Federal Transfers Revenues (Nominal $)	$4,703	$4,815	$6,567	$5,920	$5,386	$3,682	$3,935
FY 2007 Federal Transfers Revenues Adjusted for Inflation (CPI-U) and Population (Real $)	$4,703	$4,897	$4,986	$5,054	$5,169	$5,332	$5,495
Difference Between Actual and Real Federal Transfers Revenues	$0	($82)	$1,581	$866	$217	($1,650)	($1,560)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

(l) Cook County Inter-Governmental Transfer (IGT). The state retains a portion of federal Medicaid reimbursements paid to Cook County for rendering healthcare services to low-income patients, through an intergovernmental fund transfer agreement between Cook County and state government. Although IGTs have been ongoing for several years, in FY 2006, federal law changed in a manner that curtails the practice.[119] For a complete review of both how the IGT system works and the impact of this change in federal law, see the following report available on the CTBA website: *Illinois' Medicaid Program: Financing Challenges in the Face of Federal Medicaid Cuts and a Flawed State Fiscal System.*

Figure 75
Historic Performance of the Cook County Inter-Governmental Transfer

All $ in Millions	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013*
Actual Cook County Intergovernmental Transfers (Nominal $)	$307	$302	$253	$244	$244	$244	$244
FY 2007 Cook County Intergovernmental Transfers Adjusted for Inflation (CPI-U) and Population (Real $)	$307	$320	$325	$330	$337	$348	$359
Difference Between Actual and Real Cook County Intergovernmental Transfers	$0	($18)	($72)	($86)	($93)	($104)	($115)

*Figure for FY2013 is a projection per HJR-68 of the 97th General Assembly. Population from the Census Bureau as of January 2013; CPI-U from the Bureau of Labor Statistics as of January 2013.

17. Local Government Revenue Sharing

Local governments care what the state does about revenue collection. Why? Because under the Local Government Distributive Fund (LGDF), the state shares a portion of the revenue it receives from the individual and corporate income taxes with local governments. In FY2013, the total transfer to local governments under the LGDF will be over $1 billion. As discussed previously, one-tenth of the net collections from the first 3% of the 5% state individual tax and first 4.8% of the 7% corporate income taxes (gross collections minus refund funds) are distributed from the state to municipal and county governments, in proportion to the percentage of the total state population that resides in each of those localities. Other state transfers to local governments include:

- *Sales tax revenue*- local governments generally receive 20% of total collections (1.25% of the 6.25% rate), although Home Rule entities may receive more. Local governments also receive 100% of collections from a 1% tax on qualifying food and drug purchases.[120]

- *Corporate Personal Property Replacement Tax* - is imposed on the income of corporations at the rate of 2.5% and the income of partnerships, trusts and S corporations at the rate of 1.5%.[121] This replaces the personal property tax Illinois businesses previously paid to local governments. Currently, 41 states still assess a personal property tax against businesses.

- *Electricity Distribution Tax* - is imposed on electric utilities or alternative retail electric suppliers that distribute electricity for use or consumption (not for resale) and are not electric cooperatives, school districts, or units of local government. The tax is based on the amount of kilowatt-hours distributed per month.[122] Revenue from this tax is deposited into the Personal Property Replacement Tax Fund, and 51.65% is distributed to taxing districts in Cook County and 48.35% is distributed to non-Cook County districts.

- *Invested Capital Tax* – A tax imposed at 0.8% on electric cooperatives that are required to file reports with the Rural Utilities Service, persons engaged in the business of distributing, supplying, furnishing, or selling natural gas who are subject to the Gas Revenue Tax, and water companies subject to taxes imposed by the Illinois Income Tax Act.[123] Revenue from this tax is deposited into the Personal Property Replacement Tax Fund, and 51.65% is distributed to taxing districts in Cook County and 48.35% is distributed to non-Cook County districts.

- *Telecommunications Infrastructure Maintenance Fee (TIMF)*- The state TIMFis imposed at the rate of 0.5% on the gross charges made by persons in the business of transmitting, supplying, or furnishing telecommunications and all associated services in Illinois for compensation (i.e., telecommunications retailers). Net collections from the TIMF are distributed as follows: 51.65% are distributed to Cook County taxing districts, which are then redistributed to various taxing districts within Cook County on the basis of each district's share of corporate personal property tax collection for the 1976 tax year, and 48.35% is distributed to taxing bodies in downstate counties, which is distributed based on each district's share of personal property tax collection for the 1977 tax year.

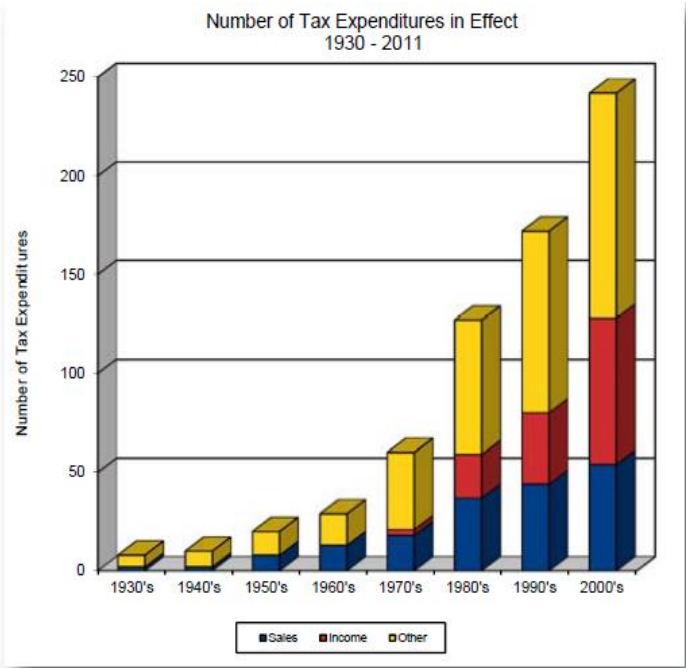
- *Motor fuel taxes* – Municipalities and counties receive 54.4% of the Motor Fuel Tax Fund (net of statutorily mandated transfers to the Grade Crossing Protection Fund).The motor fuel tax revenues shared with local governments must be used for the construction and maintenance of highways. To qualify for this revenue share, municipalities must be incorporated. Allotment is based on population. Counties receive their allotment based on total driver license fees issued in a county, as a percentage of total driver licenses issued in state. Townships must levy a 0.08% road and bridge tax to be eligible to receive revenue sharing under the motor fuel taxes, and then receive an allotment based on total township mileage.[124]

- *Gaming* - Revenues received from the operator license fees and the 3% tax on gross proceeds of charitable games are deposited into the Illinois Gaming Law Enforcement (IGLE) Fund. Two-thirds of the amount deposited into the IGLE Fund is appropriated to the Department of Revenue, the Department of the State Police and the Office of the Attorney General. The remaining one-third is distributed for law enforcement purposes to municipalities and counties annually in proportion to the number of gaming licenses issued in each municipality or county. Revenues received from the operator license fees and the 5% tax on gross proceeds of pull-tabs and jar games are divided equally between the Common School Fund and the Illinois Gaming Law Enforcement (IGLE) Fund.Two-thirds of the amount deposited into the IGLE Fund is appropriated to the Department of Revenue, the Department of the State Police and the Office of the Attorney General. The remaining one-third is distributed for law enforcement purposes to municipalities and counties annually in proportion to the number of gaming licenses issued in each municipality or county.[125]

18. Tax Expenditures

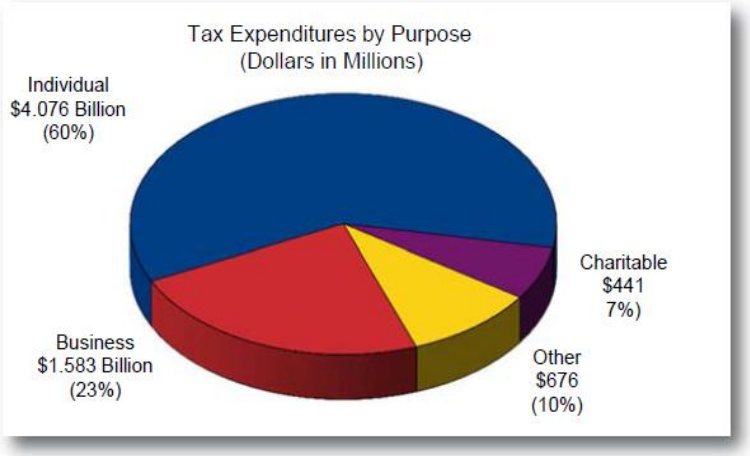
A "tax expenditure" is a tax break given by the state that reduces the amount of taxes a business or individual otherwise would have to pay to state or local government. It is called a “tax expenditure” because it amounts to indirect spending by the government of taxpayer money. Rather than collecting tax revenue from a taxpayer and then directly spending that revenue on a public service, the state lets qualifying taxpayers keep what they otherwise would have to pay in taxes, in exchange for that taxpayer delivering the desired public good. In FY 2011 (the most current year available), the total impact of tax expenditures in Illinois was estimated at $6.8 billion.Approximately 91% of all tax expenditures came from sales (49%), individual income (38%), and corporate income (4%) tax revenue sources.[126]

Figure 77
Number of Tax Expenditures in Effect by Decade



Note: figure excerpted from the Illinois State Comptroller’s *Tax Expenditure Report, FY 2011*.

Figure 78
Tax Expenditures by Purpose
($ in Millions Unless Otherwise Noted)



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[13]State of Illinois Budget Summary, Fiscal Year 2013; Illinois Commission on Forecasting and Accountability.
[14]P.A. 88-593 requires the State to make contributions to the State retirement systems so that total assets of the systems will equal 90% of their total actuarial liabilities by Fiscal Year 2045.
[15]*Budgeting for Results Commission Report*; November 2011.
[16] The FY2013 budget is broken down by major service category in Figure 14 to allow for historical comparisons as organizing the state budget per Budgeting For Results is a recent development. Only the major service categories are shown in Figure 14, which account for 90% of total General Fund spending, and as such the appropriations for service categories do not add up to total General Fund figure.
[17] P.A. 097-636 passed December 16, 2011. Bill Status and Fiscal Note for House Amendment No. 3 (Dept. of Revenue) estimates are $263 million in FY2012 and $325 million in FY2013.
[18]BLS Midwest Urban Medical Care Consumer Price Index average increase from FY2002 to FY2012. Index values for February to June 2012, are estimated as having grown by same rate as index values for February to June 2011 from February to June 2010.
[19]On the Henry J. Kaiser Family Foundation State Health Facts website Illinois is ranked seventh lowest in Medicaid reimbursement rates. Link: http://www.statehealthfacts.org/comparemaptable.jsp?ind=183&cat=4&sub=47.
[20] COGFA, *3-Year Budget Forecast FY2013-FY2015*, (Springfield, IL: COGFA, March 2012).
[21] Public spending on the core services is based on these assumptions: (i) projecting spending on core services using the Congressional Budget Office's projection on employment growth and population growth using the Illinois Department of Commerce and Economic Opportunity's population projections; (ii) pension contributions based on the funding plan put in place by Public Act 88-593; (iii) statutory transfers are projected based on historic CPI-U growth and population growth using the Illinois Department of Commerce and Economic Opportunity's population projections; and (iv) bond debt service is the General Revenue Fund schedule reported by the Comptroller in FY2011 *Bond Indebtedness and Long Term Obligations*.
[22] In Figure 18, the budget is broken down by major service category to allow for historical comparisons as organizing the state budget per Budgeting For Results is a recent development.
[23] The FY2013 budget is broken down by major service category in Figure 22 to allow for historical comparisons as organizing the state budget per Budgeting For Results is a recent development. Only the major service categories are shown in Figure 22, which account for 90% of total General Fund spending, and as such the appropriations for service categories do not add up to total General Fund figure.
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[33]Center for Tax and Budget Accountability analysis of Bureau of Labor Statistics data.
[34]Ibid.
[35] Task Force on Access to Benefits and Services, Illinois Department of Healthcare and Family Services as of May 2008. http://www2.illinois.gov/hfs/agency/Documents/0708_access.pdf
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[51]COGFA, Special Pension Briefing (Springfield, IL: COGFA, November 2012).
[52] Ibid.
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