CTBA | Center For Tax and Budget Accountability

430 S. Michigan Avenue, AUD 874
Chicago, IL 60605
www.ctbaonline.org

Foster social and economic justice through advancing fact-based public policy solutions

February 26, 2024

"Focused and Disciplined"

On February 21, 2024, Governor Pritzker delivered his 6th State of the State budget address to the 103rd General Assembly. This address, and the FY 2025 General Fund budget proposal the governor put on the table with it, include a number of notable highlights that feature everything from a recitation of the Pritzker Administration's fiscal successes, to proposed revenue increases, tax relief in the form of an end to the local sales tax imposed on groceries, service investments, and pension funding reform. It also acknowledged that the strong revenue growth of the last couple of fiscal years will be leveling off in the near future, as the historical structural deficit in the General Fund re-emerges in a post federal bailout economy.

Initially, the governor focused on the fiscal accomplishments his administration achieved during his first five years in office. And while elected officials have been known to overstate their successes from time-to-time, Governor Pritzker's efforts to get the state's fiscal house in order are truly deserving of praise. Among other challenges, Pritzker inherited a state General Fund that had a backlog of unpaid bills hovering at around $8 billion back in FY 2019.

That was a real problem, because it meant that roughly 20% of all General Fund spending in FY 2019 was deficit spending. Given that around 94% of all General Fund spending on services goes to the four core areas of Education (Pre-K, K-12, and Higher-Ed), Healthcare, Human Services and Public Safety, a deficit of that magnitude meant that the state's investment in those core services really wasn't sustainable over time. Today, the vast majority of that backlog has been eliminated, with unpaid bills anticipated to be just under $450 million by the end of FY 2025.

Because the state is paying the vast majority of its bills in a timely fashion, late payment interest costs have dropped from nearly $1 billion in FY 2018 under former Governor Rauner, to $23 million in FY 2023. The Pritzker Administration has also saved interest cost on the state's debts by garnering nine credit upgrades from the rating agencies over the last five years. Other fiscal accomplishments of the Pritzker Administration include building the state's "Budget Stabilization Fund"—which is what Illinois calls its rainy day fund, up from zero dollars under Governor Rauner to over $2 billion today. In FY 2025, the governor proposes bumping the rainy day fund by an additional $170 million. Pritzker's Administration also prepaid $700 million into the state's woefully underfunded public pension systems, prepaid various state loans, and deposited $1.4 billion into the state's Unemployment Insurance Fund.

The net result of this responsible fiscal stewardship has been making the General Fund financially healthier than at any prior point over the last four decades. Unfortunately, not all the fiscal news is good.

When explaining why he is not proposing to increase spending in some key service areas as much as is needed or he would like, the governor noted that General Fund revenue growth is not as robust as it has been for the last couple of years. There are a number of reasons for this. For one, there is no more bailout revenue coming from the federal government under relief programs like the American Rescue Plans Act or ("**ARPA**") and the Coronavirus Aid, Relief, and Economic Security Act or ("**CARES**.") That alone takes $4.95 billion in federal aid that subsidized the General Fund over the last few years off the table. The boom in the economy that followed the end of the pandemic has slowed. So even though the economy is still expanding, it is not generating the growth in income and corporate profitability that transpired in the last two years.

The aforesaid factors combined to mask the state's historical, long-term "structural deficit." A "**structural deficit**" exists whenever a tax system fails to generate enough revenue growth over an extended period of time to cover

the cost of both: (i) maintaining delivery of the same level of public services from year-to-year, after adjusting solely for changes in inflation and population, and assuming no changes in law; and (ii) repaying existing debt service. This structural deficit will constrain the General Fund's ongoing capacity to cover the cost of core services into the future.

It is also why the FY 2025 budget proposal includes the following proposed revenue increases:

(i) A projected $200 million in annual revenue from increasing the rate of the sports wagering tax from 15% to 35%;
(ii) A projected $526 million in annual revenue from increasing the annual cap on the amount of the Corporate Net Operating Loss Deduction ("**NOL Cap**") a business can claim on its state income taxes from $100,000 to $500,000; and
(iii) A projected $101 million in annual revenue from placing a cap of $1,000 per month on the amount of the retailers' discount ("**RD Cap**") a business can claim from collecting sales taxes for Illinois.

For various reasons, each of the proposed revenue enhancements constitute sound fiscal policy and should be passed into law. Start with the proposed NOL Cap and RD Cap. These are "tax expenditures" because they effectively work as a vehicle to spend public money indirectly through the tax code, to help fund a public good or service that is being provided by a private business. Extending the NOL Cap (the current NOL Cap is expiring) makes sense because the research shows there is no statistically meaningful correlation between tax policy changes and job or economic growth, hence elimination of this tax expenditure cannot be expected to create any economic harm for the state, while continuing to provide this tax expenditure is highly unlikely to generate any public good in the form of job growth.

Pursuant to the "Retailer's Discount," businesses that charge and collect Illinois' sales and use taxes are allowed to keep 1.75% of what they collect as an administrative fee. Under current law, there is no limit on the amount a retailer may keep. Because it has no cap, Illinois has one of the most generous retailer's discount programs of the 30 states with similar legislation. Given the advent of accounting software, the actual administrative costs associated with collecting the sales tax for the state are minimal, and easily recouped. The FY 2025 proposed budget is proposing to cap the current unlimited Retailer's Discount at $1,000 per month. The new proposed cap is estimated to increase the state's general fund revenue by $101 million and increase local government revenues by $85 million. Hence the RD Cap makes sense.

As for the proposed increase in the sports wagering tax—this recreational activity has grown in leaps and bounds over the last few years, with adjusted gross receipts on sports wagers jumping from $380 million in 2021 to $611 million in 2022.[1]

From a tax relief for people perspective, the governor proposes to repeal the sales tax on groceries, which saved taxpayers roughly $251.6 million according to the FY 2023 Annual Report by the Illinois Department of Revenue.[2] While this will alleviate some of the tax burden faced by families hurt by inflation, some of that tax relief will also benefit wealthy taxpayers who are not likely to have been harmed economically. If decision makers want a more effective way to ensure the full dollar value of the tax relief being provided gets to those who need it most, the tax relief should be targeted to low- and middle-income households.

Moreover, it isn't the state that will lose the revenue associated with the sales tax on groceries—it is local governments. That creates other fiscal issues as it will lessen the capacity of local governments to fund services like police and fire protection, streets and sanitation, and libraries. This in turn may force local governments to raise other taxes and fees to make up the difference or cut those essential services—neither of which is an ideal outcome.

© 2024 Center for Tax and Budget Accountability

Some highlights of the General Fund spending proposed for FY 2025 include some additional investments in education, and healthcare access and outcomes. Among other things, the governor proposes:

(i) A $75 million dollar increase to the Early Childhood Education block grant funding above the FY 2024 appropriation;
(ii) Consolidating all early childhood programs into one state agency called the Department of Early Childhood,
(iii) A $449 million increase to K-12 Education General funds above the FY 2024 appropriation;
(iv) Increasing the year-to-year appropriation for the state Monetary Award Program by $10 million above the FY 2024 appropriation; and
(v) A $4.4 million dollar increase to the Department of Public Health to access the state's maternal mortality rate and $1 million appropriation towards a low-income diaper program.

Higher Education funding is increasing by $12 million on a year-to-year basis. That is significantly less than the $286 million increase in nominal dollars Higher Education received last year and is a sign of the impact the structural deficit has on service funding. Even after receiving that year-to-year bump, after adjusting for inflation funding for Higher Education in FY 2025 will still be 43 percent less than it was over 20 years ago in FY 2000.

The governor also proposes to increase funding for the Monetary Award Program ("**MAP**") by $10 million this year, which is welcome, given that MAP grants, which don't have to be repaid, help low-income students cover the ever-escalating cost of college. That said, even after this increase, MAP grants covered on average 27 percent of the cost of attending a public university in Illinois in FY 2022 compared to 66 percent back in FY 2000.[3]

One of the more interesting proposals the governor makes for FY 2025 involves re-amortizing the debt the state owes to its five public pension systems, with the goal of getting those systems 100% funded by FY 2048. Under current law the goal is set at 90% funded by FY 2045. While it makes all the sense in the world to establish a funded ratio goal of 100%, there are some issues with the approach the governor takes. For one thing, the governor's proposal does not deal with the challenge created by the Tier II benefit structure, which is so inadequate that it does not satisfy the Social Security safe harbor, and hence has to be increased. Any new pension amortization should include the cost of a Tier II fix.

Second—and more importantly, the new amortization schedule is still backloaded, with increasing annual payments from FY 2045—2048. It would be far better to instead front-load repayment now, and go to a level dollar amortization of the balance. CTBA found that Illinois could save taxpayers over $42 billion by simply implementing such a re-amortization strategy now, and still get the pensions 90% funded by FY 2045. In the coming weeks, CTBA will run a revised amortization through FY 2048 using a 100% funded ratio as the target to see what the cost differential would be of going to a level dollar approach.

CTBA will issue a full report highlighting the important revenue and spending trends that are contained in the FY 2025 General Fund Budget proposal made by the Pritzker Administration in the next couple of weeks.

To stay up to date with CTBA this budget season, follow us on Twitter, Facebook, on the BudgetBlog, or at www.ctbaonline.org.

Endnotes

[1] COGFA (2022) "2022 Update Wagering in Illinois". https://cgfa.ilga.gov/Upload/2022_Wagering_in_IL.pdf
[2] IDOR Annual Report for FY 2023, Public Act 102-0700
[3] Illinois Student Assistance Commission, FY 2022 Databook using CPI from BLS

© 2024 Center for Tax and Budget Accountability